Singapore Airlines goes to extraordinary lengths to ensure that every aspect of the passenger experience exceeds expectations.

applies a 40-30-30 rule in its holistic approach to people, processes, and products: 40 percent of resources go to training and invigorating staff, 30 percent to reviewing process and procedures, and 30 percent to creating new product and service ideas. With its innovatively designed Boeing 777-300 ERS and Airbus A380 planes, SIA set new standards of comforts in all classes of service, from eight private minirooms in first class to wider seats, AC power supplies, and USB ports in coach.[26]

A Shifting Customer Relationship

Not all companies, however, have invested in providing superior service, at least not to all customers. In many service industries, such as airlines, banks, stores, and hotels, customer satisfaction in the United States has not significantly improved—or in some cases actually dropped—in recent years.[27] Customers complain about inaccurate information; unresponsive, rude, or poorly trained workers; and long wait times. Even worse, many find their complaints never actually reach a live human being because of slow or faulty phone or online reporting systems.

It doesn't have to be that way. Fifty-five operators handle 100,000 calls a year on Butterball Turkeys' 800 number—10,000 on Thanksgiving Day alone—about how to prepare, cook, and serve turkeys. Trained at Butterball University, the operators have all cooked turkeys dozens of different ways and can handle the myriad queries that come their way, including why customers shouldn't stash turkeys in snow banks or thaw them in bathtubs.[28]

Savvy services marketers are recognizing the new services realities, such as the importance of the newly empowered customer, customer coproduction, and the need to engage employees as well as customers.

Customer service dissatisfaction increasingly goes viral—Canadian singer Dave Carroll's musical frustration with United Airlines was downloaded by millions.

CUSTOMER EMPOWERMENT Customers are becoming more sophisticated about buying product-support services and are pressing for " unbundled services." They may desire separate prices for each service element and the right to select the elements they want. Customers also increasingly dislike having to deal with a multitude of service providers handling different types of equipment. Some third-party service organizations now service a greater range of equipment.

Most importantly, the Internet has empowered customers by letting them vent their rage about bad service—or reward good service—and send their comments around the world with a mouse click. Although a person who has a good customer experience is more likely to talk about it, someone who has a bad experience will talk to more people.[29] Ninety percent of angry customers reported sharing their story with a friend. Now, they can share their stories with strangers too. At PlanetFeedback.com, shoppers can send a complaint, compliment, suggestion, or question directly to a company, with the option to post comments publicly on the site as well.

United Breaks Guitars

When Canadian singer Dave Carroll faced $1,200 in damages to his $3,000 Gibson guitar after a United flight, he put his creative energy to good use. He created a humorous video, *United Breaks Guitars*, and launched it on YouTube with this catchy refrain:

> "United, you broke my Taylor guitar. United, some big help you are. You broke it, you should fix it. You're liable, just admit it. I should have flown with someone else or gone by car 'cuz United breaks guitars."

Viewed over 5 million times, his follow-up video focused on his frustrating efforts to get United to pay for the damage. United got the message. It donated a check for $1,200 to a charity Carroll designated and now uses the incident in training baggage handlers and customer-service representatives.[30]

Most companies respond quickly. Comcast allows contact 24/7 by phone and e-chat but also reaches out to customers and monitors blogs, Web sites, and social media. If employees see a customer report a problem on a blog, they get in touch and offer help. E-mail responses to customers must be implemented properly to be effective. One expert believes companies should (1) send an automated reply to tell customers when a more complete answer will arrive (ideally within 24 hours), (2) ensure the subject line always contains the company name, (3) make the message easy to scan for relevant information, and (4) give customers an easy way to respond with follow-up questions.[31]

More important than simply responding to a disgruntled customer, however, is preventing dissatisfaction from occurring in the future. That may mean simply taking the time to nurture customer relationships and give customers attention from a real person. Columbia Records spent $10 million to improve its call center, and customers who phone the company can now opt out to reach an operator at any point in their call. JetBlue took a service disaster and used it to improve its customer service approach.

JetBlue CEO David Neeleman set the bar high for responding to enraged customers after the company's drastic Valentine's Day failure of 2007. During storms in New York City, JetBlue left hundreds of passengers stranded aboard grounded aircraft—some for longer than 9 hours without amenities—and cancelled more than 1,000 flights. JetBlue had built its reputation on being a more responsive, humane airline in an era of minimal services and maximal delays. Neeleman knew he had to act fast to stem another kind of storm: a whirlwind of customer defections. Within 24 hours, he had placed full-page ads in newspapers nationwide in which he personally responded to JetBlue's debacle. "We are sorry and embarrassed," the ads declared, "But most of all we are deeply sorry." JetBlue gave concrete reparations to passengers. Neeleman announced a new "customer bill of rights" that promised passengers travel credits for excessive waits. For instance, passengers who are unable to disembark from an arriving flight for 3 hours or more would receive vouchers worth the full value of their round-trip ticket. JetBlue will also hand out vouchers for the full amount of passengers' round trips if a flight is cancelled within 12 hours of a scheduled departure. The apology, backed by concrete benefits for the angry and inconvenienced passengers, netted kudos for the company from both the business press and JetBlue's own true blue customers. Neeleman eventually stepped down as new management was brought in to address some of the growth challenges the airline faced.[32]

JetBlue weathered a customer service disaster and continues to receive kudos from its passengers.

CUSTOMER COPRODUCTION The reality is that customers do not merely purchase and use a service; they play an active role in its delivery.[33] Their words and actions affect the quality of their service experiences and those of others, and the productivity of frontline employees.

Customers often feel they derive more value, and feel a stronger connection to the service provider, if they are actively involved in the service process. This coproduction can put stress on employees, however, and reduce their satisfaction, especially if they differ culturally or in other ways from customers.[34] Moreover, one study estimated that one-third of all service problems are caused by the customer.[35] The growing shift to self-service technologies will likely increase this percentage.

Preventing service failures is crucial, since recovery is always challenging. One of the biggest problems is attribution—customers often feel the firm is at fault or, even if not, that it is still responsible for righting any wrongs. Unfortunately, although many firms have well-designed and executed procedures to deal with their own failures, they find managing *customer* failures—when a service problem arises from a customer's lack of understanding or ineptitude—much more difficult. △ Figure 13.3 displays the four broad causes of customer failures. Solutions come in all forms, as these examples show:[36]

1. ***Redesign processes and redefine customer roles to simplify service encounters.*** One of the keys to Netflix's success is that it charges a flat fee and allows customers to return DVDs by mail at their leisure, giving customers greater control and flexibility.
2. ***Incorporate the right technology to aid employees and customers.*** Comcast, the largest cable operator by subscribers in the United States, introduced software to identify network glitches before they affected service and to better inform call-center operators about customer problems. Repeat service calls dropped 30 percent as a result.
3. ***Create high-performance customers by enhancing their role clarity, motivation, and ability.*** USAA reminds enlisted policyholders to suspend their car insurance when they are stationed overseas.
4. ***Encourage "customer citizenship" so customers help customers.*** At golf courses, players can not only follow the rules by playing and behaving appropriately, they can encourage others to do so.

SATISFYING EMPLOYEES AS WELL AS CUSTOMERS Excellent service companies know that positive employee attitudes will promote stronger customer loyalty.[37] Instilling a strong customer orientation in employees can also increase their job satisfaction and commitment, especially if they have high customer contact. Employees thrive in customer-contact positions when they have an internal drive to (1) pamper customers, (2) accurately read customer needs, (3) develop a personal relationship with customers, and (4) deliver quality service to solve customers' problems.[38]

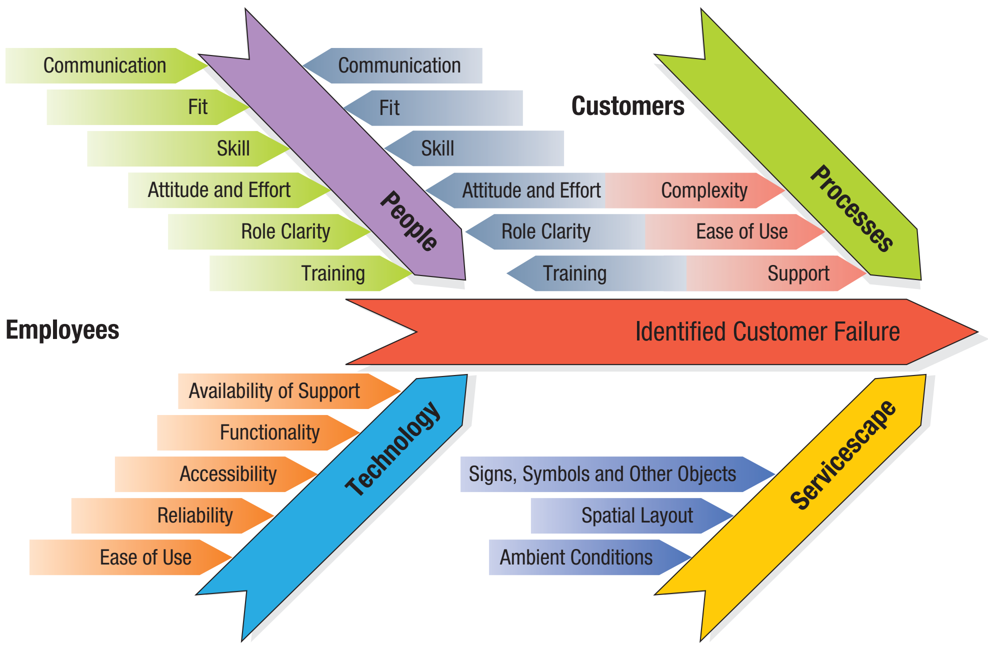
Consistent with this reasoning, Sears found a high correlation between customer satisfaction, employee satisfaction, and store profitability. In companies such as Hallmark, John Deere, and Four Seasons Hotels, employees exhibit real company pride. The downside of not treating employees right is significant. A survey of 10,000 employees from the largest 1,000 companies found that 40 percent of workers cited "lack of recognition" as a key reason for leaving a job.[39]

Given the importance of positive employee attitudes to customer satisfaction, service companies must attract the best employees they can find. They need to market a career rather than just a job. They must design a sound training program and provide support and rewards for good performance. They can use the intranet, internal newsletters, daily reminders, and employee roundtables to reinforce customer-centered attitudes. Finally, they must audit employee job satisfaction regularly.

|Fig. 13.3| △

Root Causes of Customer Failure

Source: Stephen Tax, Mark Colgate, and David Bowen, *MIT Sloan Management Review* (Spring 2006): pp. 30–38. ©2006 by Massachusetts Institute of Technology. All rights reserved. Distributed by Tribune Media Services.



The Panda Express restaurant chain has management turnover that's half the industry average, due in part to a combination of ample bonuses and health benefits with a strong emphasis on worker self-improvement through meditation, education, and hobbies. Special wellness seminars and get-to-know-you events outside work help to create a caring, nurturing atmosphere.[40]

Achieving Excellence in Services Marketing

The increased importance of the service industry has sharpened the focus on what it takes to excel in the marketing of services.[41] Here are some guidelines.

Marketing Excellence

Marketing excellence with services requires excellence in three broad areas: external, internal, and interactive marketing (see △ Figure 13.4).[42]

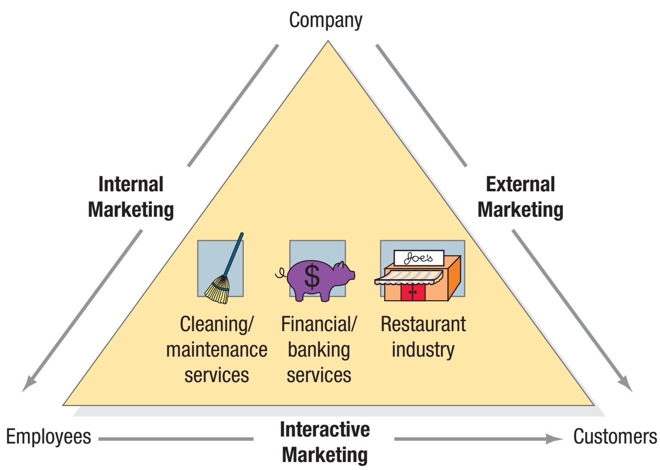
- ***External marketing*** describes the normal work of preparing, pricing, distributing, and promoting the service to customers.
- ***Internal marketing*** describes training and motivating employees to serve customers well. The most important contribution the marketing department can make is arguably to be "exceptionally clever in getting everyone else in the organization to practice marketing."[43]
- ***Interactive marketing*** describes the employees' skill in serving the client. Clients judge service not only by its *technical quality* (Was the surgery successful?), but also by its *functional quality* (Did the surgeon show concern and inspire confidence?).[44]

A good example of a service company achieving marketing excellence is Charles Schwab.

Charles Schwab

Charles Schwab

Charles Schwab, one of the nation's largest discount brokerage houses, uses the telephone, Internet, and wireless devices to create an innovative combination of high-tech and high-touch services. One of the first major brokerage houses to provide online trading, Schwab today services more than 8 million individual and institutional accounts. It offers account information and proprietary research from retail brokers, real-time quotes, an after-hours trading program, the Schwab learning center, live events, online chats with customer service representatives, a global investing service, and market updates delivered by e-mail. Besides the discount brokerage, the firm offers mutual funds, annuities, bond trading, and now mortgages through its Charles Schwab Bank. Schwab's success has been driven by its efforts to lead in three areas: superior service (online, via phone, and in local branch offices), innovative products, and low prices. Daily customer feedback reports are reviewed and acted on the next day. If customers have trouble filling out a form or experience an unexpected delay, a Schwab representative calls to ask about the source of the problem and how it can be solved.[45]



|Fig. 13.4| △

Three Types of Marketing in Service Industries

In interactive marketing, teamwork is often key, and delegating authority to frontline employees can allow for greater service flexibility and adaptability through better problem solving, closer employee cooperation, and more efficient knowledge transfer.[46]

Technology also has great power to make service workers more productive. When US Airways deployed handheld scanners to better track baggage in 2008, mishandled baggage decreased almost 50 percent from the year before. The new technology paid for itself in the first year and helped contribute to a 35 percent drop in complaints.[47]

Sometimes new technology has unanticipated benefits. When BMW introduced Wi-Fi to its dealerships to help customers pass the time more productively while their cars were being serviced, more customers chose to stay rather than use loaner cars, an expensive item for dealers to maintain.[48]

Companies must avoid pushing productivity so hard, however, that they reduce perceived quality. Some methods lead to too much standardization. Service providers must deliver "high touch" as well as "high tech." Amazon.com has some of the most amazing technological innovations in online retailing, but it also keeps customers extremely satisfied when a problem arises even if they don't actually talk to an Amazon.com employee.[49]

The Internet lets firms improve their service offerings and strengthen their relationships with customers by allowing for true interactivity, customer-specific and situational personalization, and real-time adjustments of the firm's offerings.[50] But as companies collect, store, and use more information about customers, they have also raised concerns about security and privacy.[51] Companies must incorporate the proper safeguards and reassure customers about their efforts.

Best Practices of Top Service Companies

In achieving marketing excellence with their customers, well-managed service companies share a strategic concept, a history of top-management commitment to quality, high standards, profit tiers, and systems for monitoring service performance and customer complaints.

STRATEGIC CONCEPT Top service companies are "customer obsessed." They have a clear sense of their target customers and their needs and have developed a distinctive strategy for satisfying these needs. At the Four Seasons luxury hotel chain, employees must pass four interviews before being hired. Each hotel also employs a "guest historian" to track guest preferences. With more branch offices in the United States than Starbucks has, Edward Jones brokerage stays close to customers by assigning a single financial advisor and one administrator to each office. Although costly, maintaining such small teams fosters personal relationships.[52]

TOP-MANAGEMENT COMMITMENT Companies such as Marriott, Disney, and USAA have a thorough commitment to service quality. Their managements look monthly not only at financial performance, but also at service performance. Ray Kroc of McDonald's insisted on continually measuring each McDonald's outlet on its conformance to QSCV: quality, service, cleanliness, and value. Some companies insert a reminder along with employees' paychecks: "Brought to you by the customer." Sam Walton of Walmart required the following employee pledge: "I solemnly swear and declare that every customer that comes within 10 feet of me, I will smile, look them in the eye, and greet them, so help me Sam."

HIGH STANDARDS The best service providers set high quality standards. Citibank aims to answer phone calls within 10 seconds and customer letters within 2 days. The standards must be set *appropriately* high. A 98 percent accuracy standard may sound good, but it would result in 64,000 lost FedEx packages a day; 6 misspelled words on each page of a book; 400,000 incorrectly filled prescriptions daily; 3 million lost USPS mail pieces each day; no phone/Internet/electricity 8 days per year or 29 minutes per day; 1,000 mislabeled or (mispriced) products at a supermarket; and 6 million people unaccounted for in a U.S. census.

PROFIT TIERS Firms have decided to raise fees and lower services to those customers who barely pay their way, and to coddle big spenders to retain their patronage as long as possible. Customers in high-profit tiers get special discounts, promotional offers, and lots of special service; customers in lower-profit tiers may get more fees, stripped-down service, and voice messages to process their inquiries.

When the recent recession hit, Zappos decided to stop offering complimentary overnight shipping to first-time buyers and offer it to repeat buyers only. The money saved was invested in a new VIP service for the company's most loyal customers.[53] Companies that provide differentiated levels of service must be careful about claiming superior service, however—customers who receive lesser treatment will bad-mouth the company and injure its reputation. Delivering services that maximize both customer satisfaction and company profitability can be challenging.

MONITORING SYSTEMS Top firms audit service performance, both their own and competitors', on a regular basis. They collect *voice of the customer (VOC) measurements* to probe customer satisfiers and dissatisfiers. They use comparison shopping, mystery or ghost shopping, customer surveys, suggestion and complaint forms, service-audit teams, and customers' letters to the president.

We can judge services on *customer importance* and *company performance*. *Importance-performance analysis* rates the various elements of the service bundle and identifies required actions. Table 13.2 shows how customers rated 14 service elements or attributes of an automobile dealer's service department on importance and performance. For example, "Job done right the first time" (attribute 1) received a mean importance rating of 3.83 and a mean performance rating of 2.63, indicating that customers felt it was highly important but not performed well. The ratings of the 14 elements are divided into four sections in Figure 13.5.

- Quadrant A in the figure shows important service elements that are not being performed at the desired levels; they include elements 1, 2, and 9. The dealer should concentrate on improving the service department's performance on these elements.

TABLE 13.2 Customer Importance and Performance Ratings for an Auto Dealership

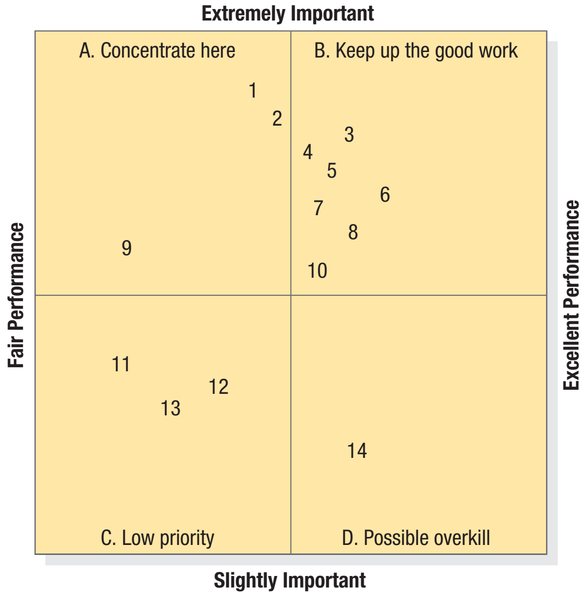
Number Attribute	Attribute Description	Mean Importance Rating[a]	Mean Performance Rating[b]
1	Job done right the first time	3.83	2.63
2	Fast action on complaints	3.63	2.73
3	Prompt warranty work	3.60	3.15
4	Able to do any job needed	3.56	3.00
5	Service available when needed	3.41	3.05
6	Courteous and friendly service	3.41	3.29
7	Car ready when promised	3.38	3.03
8	Perform only necessary work	3.37	3.11
9	Low prices on service	3.29	2.00
10	Clean up after service work	3.27	3.02
11	Convenient to home	2.52	2.25
12	Convenient to work	2.43	2.49
13	Courtesy buses and cars	2.37	2.35
14	Send out maintenance notices	2.05	3.33

[a] Ratings obtained from a four-point scale of "extremely important" (4), "important" (3), "slightly important" (2), and "not important" (1).

[b] Ratings obtained from a four-point scale of "excellent" (4), "good" (3), "fair" (2), and "poor" (1). A "no basis for judgment" category was also provided.

|Fig. 13.5|

Importance-Performance Analysis



- Quadrant B shows important service elements that are being performed well; the company needs to maintain the high performance.
- Quadrant C shows minor service elements that are being delivered in a mediocre way but do not need any attention.
- Quadrant D shows that a minor service element, "Send out maintenance notices," is being performed in an excellent manner.

Perhaps the company should spend less on sending out maintenance notices and use the savings to improve performance on important elements. Management can enhance its analysis by checking on the competitors' performance levels on each element.[54]

SATISFYING CUSTOMER COMPLAINTS On average, 40 percent of customers who suffer through a bad service experience stop doing business with the company.[55] But if those customers are willing to complain first, they actually offer the company a gift if the complaint is handled well.

Companies that encourage disappointed customers to complain—and also empower employees to remedy the situation on the spot—have been shown to achieve higher revenues and greater profits than companies without a systematic approach for addressing service failures.[56] Pizza Hut prints its toll-free number on all pizza boxes. When a customer complains, Pizza Hut sends a voice mail to the store manager, who must call the customer within 48 hours and resolve the complaint.

Getting frontline employees to adopt *extra-role behaviors,* and to advocate the interests and image of the firm to consumers, as well as take initiative and engage in conscientious behavior in dealing with customers, can be a critical asset in handling complaints.[57] Customers evaluate complaint incidents in terms of the outcomes they receive, the procedures used to arrive at those outcomes, and the nature of interpersonal treatment during the process.[58]

Companies also are increasing the quality of their *call centers* and their *customer service representatives* (CSRs). "Marketing Insight: Improving Company Call Centers" illustrates what top companies are doing.

Differentiating Services

Finally, customers who view a service as fairly homogeneous care less about the provider than about the price. Marketing excellence requires service marketers to continually differentiate their brands so they are not seen as a commodity.

PRIMARY AND SECONDARY SERVICE OPTIONS Marketers can differentiate their service offerings in many ways, through people and processes that add value. What the customer

Marketing Insight

Improving Company Call Centers

Many firms have learned the hard way that demanding, empowered customers will no longer put up with poor service when contacting companies.

After Sprint and Nextel merged, they set out to run their call centers as cost centers, rather than a means to enhance customer loyalty. Employee rewards were based on keeping customer calls short, and when management started to monitor even bathroom trips, morale sank. With customer churn spinning out of control, Sprint Nextel began a service improvement plan at the end of 2007 to put more emphasis on service over efficiency. Among other changes that accompanied the appointment of the firm's first chief service officer, call center operators were rewarded for solving problems on a customer's first call, rather than for keeping their calls short. The average customer contacted customer service four times in 2008, a drop from eight times in 2007.

Some firms are getting smarter about the type of calls they send overseas to off-shore call centers. They are investing more in training as well as returning more complex calls to highly trained domestic customer service reps. *Homeshoring* occurs when a customer service rep works from home with a broadband line and computer. These at-home reps often provide higher-quality service at less cost and with lower turnover.

Firms have to manage their number of customer service reps carefully. One study showed that cutting just four reps at a call center of three dozen sent the number of customers put on hold for four minutes or more from zero to eighty. Firms can also try to reasonably get more from each rep. USAA cross-trains its call center reps so that agents who answer investment queries can also respond to insurance-related calls, reducing the number of transfers between agents and increasing productivity as a result. USAA and other firms such as KeyBank and Ace Hardware have also consolidated call center operations into fewer locations, allowing them to maintain their number of reps in the process.

Finally, keeping call center reps happy and motivated is obviously also a key to their ability to offer excellent customer service. American Express lets call center reps choose their own hours and swap shifts without a supervisor's approval.

Sources: Michael Sanserino and Cari Tuna, "Companies Strive Harder to Please Customers," *Wall Street Journal*, July 27, 2009, p. B4; Spencer E. Ante, "Sprint's Wake-Up Call," *BusinessWeek*, March 3, 2008, pp. 54–57; Jena McGregor, "Customer Service Champs," *BusinessWeek*, March 5, 2007; Jena McGregor, "When Service Means Survival," *BusinessWeek*, March 2, 2009, pp. 26–30.

expects is called the *primary service package*. Vanguard, the second-largest no-load mutual fund company, has a unique client ownership structure that lowers costs and permits better fund returns. Strongly differentiated from many competitors, the brand grew through word of mouth, PR, and viral marketing.[59]

The provider can add *secondary service features* to the package. In the hotel industry, various chains have introduced such secondary service features as merchandise for sale, free breakfast buffets, and loyalty programs.

The major challenge is that most service offerings and innovations are easily copied. Still, the company that regularly introduces innovations will gain a succession of temporary advantages over competitors. Schneider National keeps a step ahead of its competitors by never standing still.

Long-haul truckload freight carrier Schneider National goes to great lengths to satisfy its customers and build its brand.

Schneider National

Schneider National is the world's largest long-haul truckload freight carrier, with $3.7 billion in revenues and more than 54,000 bright orange tractors and trailers on the roads. Although its core benefit is to move freight from one location to another, Schneider sees itself in the *customer solutions* business. Its service guarantees are backed by monetary incentives for drivers who meet tight schedules; driver-training programs improve performance. Schneider was the first to introduce in-cab satellite technology and mobile technology to every driver. In 2009, it had its biggest award-winning year, garnering 43 awards for strong customer service, solutions, and commitment to the environment from shippers, government organizations, and industry media. To actively recruit the best drivers, Schneider advertises on television shows such as

Retail health clinics are reinventing patient care for minor illnesses and injuries.

Trick My Truck, on satellite radio, in newspapers, and online; employs Webinars and PR; and partners with AARP, local organizations, and veterans' groups. Even painting the trucks Omaha orange was part of a branding strategy to improve safety and create awareness.[60]

INNOVATION WITH SERVICES Innovation is as vital in services as in any industry. After years of losing customers to its Hilton and Marriott hotel competitors, Starwood decided to invest $1.7 billion in its Sheraton chain of 400 properties worldwide to give them fresher décor and brighter colors, as well as more enticing lobbies, restaurants, and cafés. In explaining the need for the makeover, one hospitality industry expert noted, "There was a time when Sheraton was one of the leading brands. But it lagged in introducing new design and service concepts and developed a level of inconsistency."[61]

On the other hand, consider how these relatively new service categories emerged and how, in some cases, organizations created creative solutions in existing categories.[62]

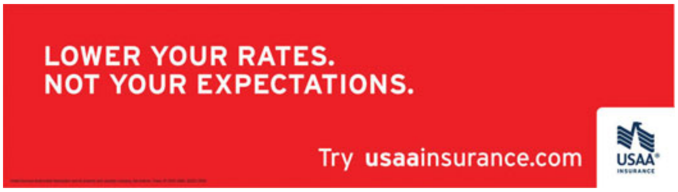
- ***Online Travel.*** Online travel agents such as Expedia and Travelocity offer customers the opportunity to conveniently book travel at discount prices. However, they make money only when visitors go to their Web sites and book travel. Kayak is a newer online travel agency that applies the Google business model of collecting money on a per-click basis. Kayak's marketing emphasis is on building a better search engine by offering more alternatives, flexibility, and airlines.
- ***Retail Health Clinics.*** One of the hardest areas in which to innovate is health care. But whereas the current health care system is designed to treat a small number of complex cases, retail health clinics address a large number of simple cases. Retail health clinics such as Quick Care, RediClinic, and MinuteClinic are often found in drugstores and other retail chain stores such as Target and Walmart. They typically use nurse practitioners to handle minor illnesses and injuries such as colds, flu, and ear infections, offer various health and wellness services such as physicals and exams for high school sports, and perform vaccinations. They seek to offer convenient, predictable service and transparent pricing, without an appointment, seven days a week. Most visits take no more than 15 minutes, and costs vary from $25 to $100.
- ***Private Aviation.*** Initially, private aviation was restricted to owning or chartering a private plane. Fractional ownership pioneered by NetJets allowed customers to pay a percentage of the cost of a private plane plus maintenance and a direct hourly cost. Marquis Jets further innovated with a simple idea of combining prepaid time on the world's largest, best-maintained fleet, offering the consistency and benefits of fractional ownership without the long-term commitment.

Many companies are using the Web to offer primary or secondary service features that were never possible before. Salesforce.com uses cloud computing—centralized computing services delivered over the Internet—to run customer-management databases for companies. Häagen-Dazs estimated it would have had to spend $65,000 for a custom-designed database to stay in contact with the company's retail franchises across the country. Instead, it spent only $20,000 to set up an account with Salesforce.com and pays $125 per month for 20 users to remotely monitor franchises via the Web.[63]

Managing Service Quality

The service quality of a firm is tested at each service encounter. If employees are bored, cannot answer simple questions, or are visiting each other while customers are waiting, customers will think twice about doing business there again. One business that understands how to treat customers right is USAA.

USAA From its beginnings, USAA focused on selling auto insurance, and later other insurance products, to those with military service. It increased its share of each customer's business by launching a consumer bank, issuing credit cards, opening a discount brokerage, and offering a selection of no-load mutual funds. Though it now conducts transactions for more than 150 products and services on the phone or online, USAA boasts one of the highest customer satisfaction ratings of any company in the United States. It was the first bank to allow iPhone deposits for its military customers, to routinely text balances to soldiers in the field, and to heavily discount customers' car insurance when they are deployed overseas. A leader in virtually every customer service award or survey, the company inspired one industry expert to comment: "There is nobody on this earth who understands their customer better than USAA."[64]



By relentlessly focusing on its military customers, USAA has created extraordinary levels of customer satisfaction.

Service outcome and customer loyalty are influenced by a host of variables. One study identified more than 800 critical behaviors that cause customers to switch services.[65] These behaviors fall into eight categories (see Table 13.3).

A more recent study honed in on the service dimensions customers would most like companies to measure. As Table 13.4 shows, knowledgeable frontline workers and the ability to achieve one-call-and-done rose to the top.[66]

Flawless service delivery is the ideal state for any service organization. "Marketing Memo: Recommendations for Improving Service Quality" offers a comprehensive set of guidelines to

TABLE 13.3 Factors Leading to Customer Switching Behavior

Pricing
- High price
- Price increases
- Unfair pricing
- Deceptive pricing

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

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

Service Encounter Failures
- Uncaring
- Impolite
- Unresponsive
- Unknowledgeable

Response to Service Failure
- Negative response
- No response
- Reluctant response

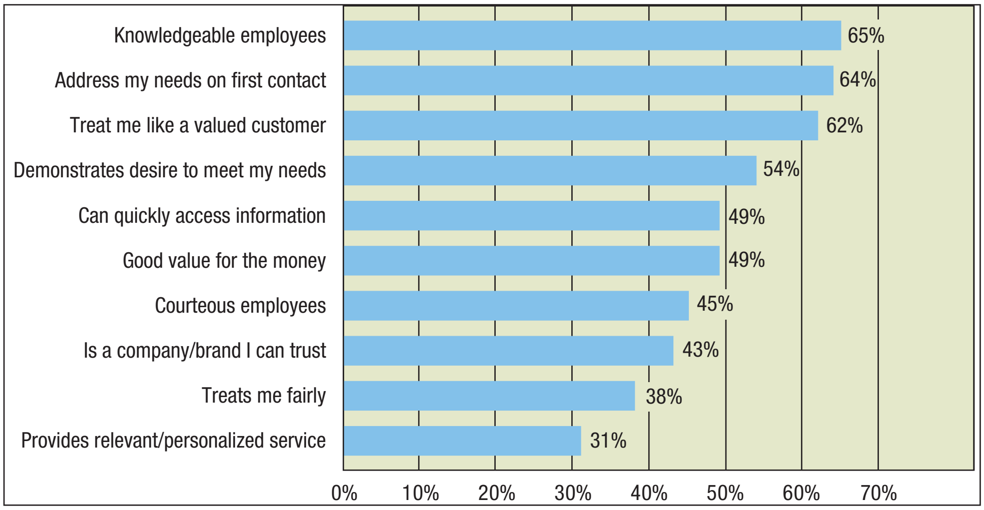
Competition
- Found better service

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

Involuntary Switching
- Customer moved
- Provider closed

Source: Susan M. Keaveney, "Customer Switching Behavior in Service Industries: An Exploratory Study," *Journal of Marketing* (April 1995), pp. 71–82. Reprinted with permission from *Journal of Marketing*, published by the American Marketing Association.

TABLE 13.4 Dimensions of Service Customers Want Companies to Deliver



Source: Convergys 2008 U.S. Customer Scorecard

marketing **Memo**

Recommendations for Improving Service Quality

Pioneers in conducting academic service research, Berry, Parasuraman, and Zeithaml offer 10 lessons they maintain are essential for improving service quality across service industries.

1. *Listening*—Service providers should understand what customers really want through continuous learning about the expectations and perceptions of customers and noncustomers (for instance, by means of a service-quality information system).
2. *Reliability*—Reliability is the single most important dimension of service quality and must be a service priority.
3. *Basic service*—Service companies must deliver the basics and do what they are supposed to do—keep promises, use common sense, listen to customers, keep customers informed, and be determined to deliver value to customers.
4. *Service design*—Service providers should take a holistic view of the service while managing its many details.
5. *Recovery*—To satisfy customers who encounter a service problem, service companies should encourage customers to complain (and make it easy for them to do so), respond quickly and personally, and develop a problem-resolution system.
6. *Surprising customers*—Although reliability is the most important dimension in *meeting* customers' service expectations, process dimensions such as assurance, responsiveness, and empathy are most important in *exceeding* customer expectations, for example, by surprising them with uncommon swiftness, grace, courtesy, competence, commitment, and understanding.
7. *Fair play*—Service companies must make special efforts to *be* fair, and to *demonstrate* fairness, to customers and employees.
8. *Teamwork*—Teamwork is what enables large organizations to deliver service with care and attentiveness by improving employee motivation and capabilities.
9. *Employee research*—Marketers should conduct research with employees to reveal why service problems occur and what companies must do to solve problems.
10. *Servant leadership*—Quality service comes from inspired leadership throughout the organization; from excellent service-system design; from the effective use of information and technology; and from a slow-to-change, invisible, all-powerful, internal force called corporate culture.

Sources: Leonard L. Berry, A. Parasuraman, and Valarie A. Zeithaml, "Ten Lessons for Improving Service Quality," *MSI Reports Working Paper Series, No.03-001* (Cambridge, MA: Marketing Science Institute, 2003), pp. 61–82. See also, Leonard L. Berry's books, *On Great Service: A Framework for Action* (New York: Free Press, 2006) and *Discovering the Soul of Service* (New York: Free Press, 1999), as well as his articles; Leonard L. Berry, Venkatesh Shankar, Janet Parish, Susan Cadwallader, and Thomas Dotzel, "Creating New Markets through Service Innovation," *Sloan Management Review* (Winter 2006): 56–63; Leonard L. Berry, Stephan H. Haeckel, and Lewis P. Carbone, "How to Lead the Customer Experience," *Marketing Management* (January–February 2003), pp. 18–23; and Leonard L. Berry, Kathleen Seiders, and Dhruv Grewal, "Understanding Service Convenience," *Journal of Marketing* (July 2002), pp. 1–17.

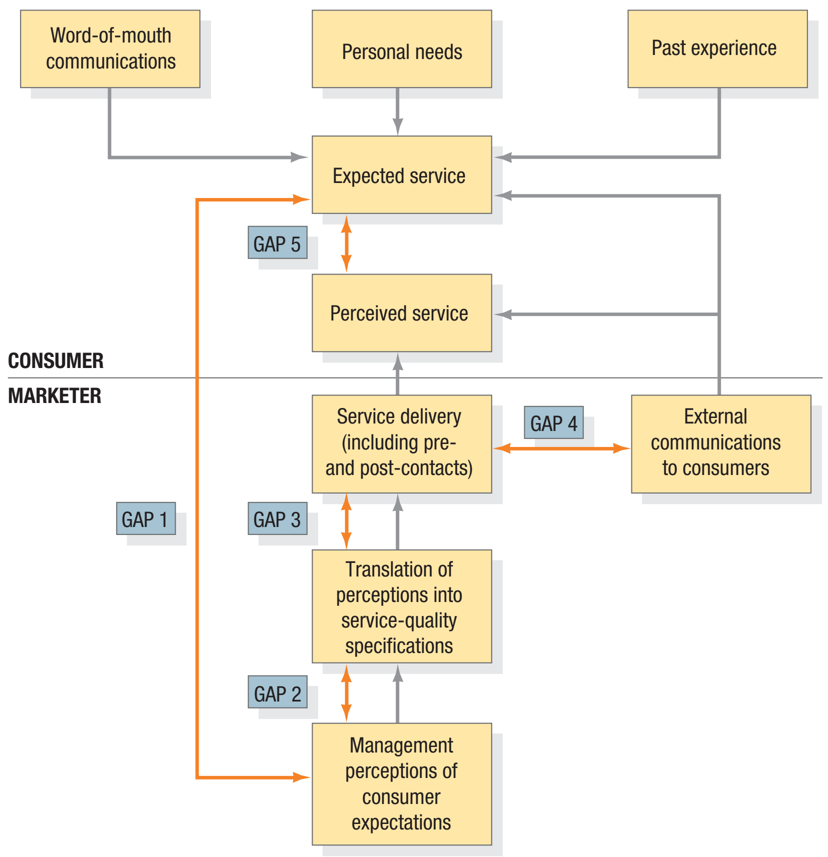
which top service marketing organizations can adhere. Two important considerations in service delivery are managing customer expectations and incorporating self-service technologies.

Managing Customer Expectations

Customers form service expectations from many sources, such as past experiences, word of mouth, and advertising. In general, customers compare the *perceived service* with the *expected service*.[67] If the perceived service falls below the expected service, customers are disappointed. Successful companies add benefits to their offering that not only *satisfy* customers but surprise and *delight* them. Delighting customers is a matter of exceeding expectations.[68]

The service-quality model in Figure 13.6 highlights the main requirements for delivering high service quality.[69] It identifies five gaps that cause unsuccessful delivery:

1. ***Gap between consumer expectation and management perception***—Management does not always correctly perceive what customers want. Hospital administrators may think patients want better food, but patients may be more concerned with nurse responsiveness.
2. ***Gap between management perception and service-quality specification***—Management might correctly perceive customers' wants but not set a performance standard. Hospital administrators may tell the nurses to give "fast" service without specifying it in minutes.
3. ***Gap between service-quality specifications and service delivery***—Employees might be poorly trained, or incapable of or unwilling to meet the standard; they may be held to conflicting standards, such as taking time to listen to customers and serving them fast.
4. ***Gap between service delivery and external communications***—Consumer expectations are affected by statements made by company representatives and ads. If a hospital brochure shows a beautiful room but the patient finds it to be cheap and tacky looking, external communications have distorted the customer's expectations.



|Fig. 13.6|

Service-Quality Model

Sources: A. Parasuraman, Valarie A. Zeithaml, and Leonard L. Berry, "A Conceptual Model of Service Quality and Its Implications for Future Research," *Journal of Marketing* (Fall 1985), p. 44. Reprinted with permission of the American Marketing Association. The model is more fully discussed or elaborated in Valarie Zeithaml, Mary Jo Bitner, and Dwayne D. Gremler, *Services Marketing: Integrating Customer Focus across the Firm*, 4th ed. (New York: McGraw-Hill, 2006).

5. ***Gap between perceived service and expected service***—This gap occurs when the consumer misperceives the service quality. The physician may keep visiting the patient to show care, but the patient may interpret this as an indication that something really is wrong.

Based on this service-quality model, researchers identified five determinants of service quality, in this order of importance:[70]

1. ***Reliability***—The ability to perform the promised service dependably and accurately.
2. ***Responsiveness***—Willingness to help customers and provide prompt service.
3. ***Assurance***—The knowledge and courtesy of employees and their ability to convey trust and confidence.
4. ***Empathy***—The provision of caring, individualized attention to customers.
5. ***Tangibles***—The appearance of physical facilities, equipment, personnel, and communication materials.

Based on these five factors, the researchers developed the 21-item SERVQUAL scale (see Table 13.5).[71] They also note there is a *zone of tolerance,* or a range where a service dimension would be deemed satisfactory, anchored by the minimum level consumers are willing to accept and the level they believe can and should be delivered.

The service-quality model in Figure 13.6 highlights some of the gaps that cause unsuccessful service delivery. Subsequent research has extended the model. One *dynamic process model* of service quality was based on the premise that customer perceptions and expectations of service quality change over time, but at any one point they are a function of prior expectations about what *will* and what *should* happen during the service encounter, as well as the *actual* service delivered during the last contact.[72] Tests of the dynamic process model reveal that the two different types of expectations have opposite effects on perceptions of service quality.

1. *Increasing* customer expectations of what the firm *will* deliver can lead to improved perceptions of overall service quality.
2. *Decreasing* customer expectations of what the firm *should* deliver can also lead to improved perceptions of overall service quality.

TABLE 13.5 SERVQUAL Attributes

Reliability • Providing service as promised • Dependability in handling customers' service problems • Performing services right the first time • Providing services at the promised time • Maintaining error-free records • Employees who have the knowledge to answer customer questions	**Empathy** • Giving customers individual attention • Employees who deal with customers in a caring fashion • Having the customer's best interests at heart • Employees who understand the needs of their customers • Convenient business hours
Responsiveness • Keeping customer informed as to when services will be performed • Prompt service to customers • Willingness to help customers • Readiness to respond to customers' requests	**Tangibles** • Modern equipment • Visually appealing facilities • Employees who have a neat, professional appearance • Visually appealing materials associated with the service
Assurance • Employees who instill confidence in customers • Making customers feel safe in their transactions • Employees who are consistently courteous	

Source: A. Parasuraman, Valarie A. Zeithaml, and Leonard L. Berry, "A Conceptual Model of Service Quality and Its Implications for Future Research," *Journal of Marketing* (Fall 1985), pp. 41–50. Reprinted by permission of the American Marketing Association.

Much work has validated the role of expectations in consumers' interpretations and evaluations of the service encounter and the relationship they adopt with a firm over time.[73] Consumers are often forward-looking with respect to their decision to keep or switch from a service relationship. Any marketing activity that affects current or expected future usage can help to solidify a service relationship.

With continuously provided services, such as public utilities, health care, financial and computing services, insurance, and other professional, membership, or subscription services, customers have been observed to mentally calculate their *payment equity*—the perceived economic benefits in relationship to the economic costs. In other words, customers ask themselves, "Am I using this service enough, given what I pay for it?"

Long-term service relationships can have a dark side. An ad agency client may feel that over time the agency is losing objectivity, becoming stale in its thinking, or beginning to take advantage of the relationship.[74]

Incorporating Self-Service Technologies (SSTs)

Consumers value convenience in services.[75] Many person-to-person service interactions are being replaced by self-service technologies (SSTs). To the traditional vending machines we can add automated teller machines (ATMs), self-pumping at gas stations, self-checkout at hotels, and a variety of activities on the Internet, such as ticket purchasing, investment trading, and customization of products.

Not all SSTs improve service quality, but they can make service transactions more accurate, convenient, and faster. Obviously, they can also reduce costs. One technology firm, Comverse, estimates the cost to answer a query through a call center at $7, but only 10 cents online. One of its clients was able to direct 200,000 calls a week through online self-service support, saving $52 million a year.[76] Every company needs to think about improving its service using SSTs.

Marketing academics and consultants Jeffrey Rayport and Bernie Jaworski define a *customer-service interface* as any place at which a company seeks to manage a relationship with a customer, whether through people, technology, or some combination of the two.[77] They feel that although many companies serve customers through a broad array of interfaces, from retail sales clerks to Web sites to voice-response telephone systems, the whole often does not add up to the sum of its parts, increasing complexity, costs, and customer dissatisfaction as a result. Successfully integrating technology into the workforce thus requires a comprehensive reengineering of the front office to identify what people do best, what machines do best, and how to deploy them separately and together.

Some companies have found that the biggest obstacle is not the technology itself, but convincing customers to use it, especially for the first time. Customers must have a clear sense of their roles in the SST process, must see a clear benefit, and must feel they can actually use it.[78] SST is not for everyone. Although some automated voices are actually popular with customers—the unfailingly polite and chipper voice of Amtrak's "Julie" consistently wins kudos from callers—many can incite frustration and even rage.

Managing Product-Support Services

No less important than service industries are product-based industries that must provide a service bundle. Manufacturers of equipment—small appliances, office machines, tractors, mainframes, airplanes—all must provide *product-support services.* Product-support service is becoming a major battleground for competitive advantage.

Chapter 12 described how products could be augmented with key service differentiators—ordering ease, delivery, installation, customer training, customer consulting, maintenance, and repair. Some equipment companies, such as Caterpillar Tractor and John Deere, make a significant percentage of their profits from these services.[79] In the global marketplace, companies that make a good product but provide poor local service support are seriously disadvantaged.

Many product companies have a stronger Web presence than they had before. They must ensure that they offer adequate—if not superior—service online as well. "Marketing Memo: Assessing E-Service Quality" reviews two models of online service quality.

Identifying and Satisfying Customer Needs

Traditionally, customers have had three specific worries about product service:[80]

- They worry about reliability and *failure frequency.* A farmer may tolerate a combine that will break down once a year, but not two or three times a year.
- They worry about *downtime.* The longer the downtime, the higher the cost. The customer counts on the seller's *service dependability*—the seller's ability to fix the machine quickly or at least provide a loaner.[81]
- They worry about *out-of-pocket costs.* How much does the customer have to spend on regular maintenance and repair costs?

A buyer takes all these factors into consideration and tries to estimate the **life-cycle cost**, which is the product's purchase cost plus the discounted cost of maintenance and repair less the discounted salvage value. A one-computer office will need higher product reliability and faster repair service than an office where other computers are available if one breaks down. An airline needs 100 percent reliability in the air. Where reliability is important, manufacturers or service providers can offer guarantees to promote sales.

marketing Memo: Assessing E-Service Quality

Academic researchers Zeithaml, Parasuraman, and Malhotra define online service quality as the extent to which a Web site facilitates efficient and effective shopping, purchasing, and delivery. They identified 11 dimensions of perceived e-service quality: access, ease of navigation, efficiency, flexibility, reliability, personalization, security/privacy, responsiveness, assurance/trust, site aesthetics, and price knowledge. Some of these service-quality dimensions were the same online as offline, but some specific underlying attributes were different. Different dimensions emerged with e-service quality too. Empathy didn't seem to be as important online, unless there were service problems. Core dimensions of regular service quality were efficiency, fulfillment, reliability, and privacy; core dimensions of service recovery were responsiveness, compensation, and real-time access to help.

Another set of academic researchers, Wolfinbarger and Gilly, developed a reduced scale of online service quality with four key dimensions: reliability/fulfillment, Web site design, security/privacy, and customer service. The researchers interpret their study findings to suggest that the most basic building blocks of a "compelling online experience" are reliability and functionality to provide time savings, easy transactions, good selection, in-depth information, and the "right" level of personalization. Their 14-item scale looks like this:

Reliability/Fulfillment

The product that came was represented accurately by the Web site.

You get what you ordered from this Web site.

The product is delivered by the time promised by the company.

Web Site Design

This Web site provides in-depth information.

The site doesn't waste my time.

It is quick and easy to complete a transaction at this Web site.

The level of personalization at this site is about right, not too much or too little.

This Web site has good selection.

Security/Privacy

I feel that my privacy is protected at this site.

I feel safe in my transactions with this Web site.

This Web site has adequate security transactions.

Customer Service

The company is willing and ready to respond to customer needs.

When you have a problem, the Web site shows a sincere interest in solving it.

Inquiries are answered promptly.

Sources: Mary Wolfinbarger and Mary C. Gilly, "E-TailQ: Dimensionalizing, Measuring, and Predicting E-Tail Quality," *Journal of Retailing* 79 (Fall 2003), pp. 183–98; Valarie A. Zeithaml, A. Parasuraman, and Arvind Malhotra, "A Conceptual Framework for Understanding E-Service Quality: Implications for Future Research and Managerial Practice," *Marketing Science Institute Working Paper,* Report No. 00-115, 2000.

To provide the best support, a manufacturer must identify the services customers value most and their relative importance. For expensive equipment, manufacturers offer *facilitating services* such as installation, staff training, maintenance and repair services, and financing. They may also add *value-augmenting services* that extend beyond the functioning and performance of the product itself. Johnson Controls reached beyond its climate control equipment and components business to manage integrated facilities by offering products and services that optimize energy use and improve comfort and security.

A manufacturer can offer, and charge for, product-support services in different ways. One specialty organic-chemical company provides a standard offering plus a basic level of services. If the customer wants additional services, it can pay extra or increase its annual purchases to a higher level, in which case additional services are included. Many companies offer *service contracts* (also called *extended warranties*), in which sellers agree to provide free maintenance and repair services for a specified period of time at a specified contract price.

Product companies must understand their strategic intent and competitive advantage in developing services. Are service units supposed to support or protect existing product businesses or to grow as an independent platform? Are the sources of competitive advantage based on economies of scale or economies of skill?[82] See Figure 13.7 strategies of different service companies.

Postsale Service Strategy

The quality of customer service departments varies greatly. At one extreme are departments that simply transfer customer calls to the appropriate person or department for action with little follow-up. At the other extreme are departments eager to receive customer requests, suggestions, and even complaints and handle them expeditiously. Some firms even proactively contact customers to provide service after the sale is complete.[83]

CUSTOMER-SERVICE EVOLUTION Manufacturers usually start by running their own parts-and-service departments. They want to stay close to the equipment and know its problems. They also find it expensive and time consuming to train others and discover they can make good money from parts and service if they are the only supplier and can charge a premium price. In fact, many equipment manufacturers price their equipment low and compensate by charging high prices for parts and service.

|Fig. 13.7|

Service Strategies for Product Companies

		Strategic Intent	
		Protect or Enhance Product	**Expand Independent Service**
Source of Competitive Advantage	**Economies of scale**	• Apple's iPod music download and transaction management service (iTunes) • Otis Elevator's remote monitoring and diagnostics services • General Motors' OnStar auto remote diagnostics service • Symantec's virus protection and data security services	• Cardinal Healthcare's hospital inventory-management services • Cincinnati Bell's billing services (now part of Convergys) • IBM's data-center-outsourcing services • Johnson Controls' integrated facilities-management services
	Economies of skill	• Cisco's network integration and maintenance services • EMC's storage-management and maintenance services • SAP Systems' integration services • UTC's utilities field support services	• Cincinnati Bell's call-center-management services (now part of Convergys) • General Electric's aircraft-engine-maintenance services • GE Healthcare's hospital equipment—support and diagnostics services for hospital equipment • IBM's systems integration services

Source: Byron G. Auguste, Eric P. Harmon, and Vivek Pandit, "The Right Service Strategies for Product Companies," The McKinsey Quarterly, no. 1 (2006), pp. 41–51.

Over time, manufacturers switch more maintenance and repair service to authorized distributors and dealers. These intermediaries are closer to customers, operate in more locations, and can offer quicker service. Still later, independent service firms emerge and offer a lower price or faster service. A significant percentage of auto-service work is now done outside franchised automobile dealerships by independent garages and chains such as Midas Muffler, and Sears. Independent service organizations handle mainframes, telecommunications equipment, and a variety of other equipment lines.

THE CUSTOMER-SERVICE IMPERATIVE Customer-service choices are increasing rapidly, however, and equipment manufacturers increasingly must figure out how to make money on their equipment, independent of service contracts. Some new-car warranties now cover 100,000 miles before servicing. The increase in disposable or never-fail equipment makes customers less inclined to pay 2 percent to 10 percent of the purchase price every year for a service. A company with several hundred laptops, printers, and related equipment might find it cheaper to have its own service people on-site.

Summary

1. A service is any act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything. It may or may not be tied to a physical product.
2. Services are intangible, inseparable, variable, and perishable. Each characteristic poses challenges and requires certain strategies. Marketers must find ways to give tangibility to intangibles, to increase the productivity of service providers, to increase and standardize the quality of the service provided, and to match the supply of services with market demand.
3. Marketing of services faces new realities in the 21st century due to customer empowerment, customer coproduction, and the need to satisfy employees as well as customers.
4. In the past, service industries lagged behind manufacturing firms in adopting and using marketing concepts and tools, but this situation has changed. Achieving excellence in service marketing calls not only for external marketing but also for internal marketing to motivate employees, as well as interactive marketing to emphasize the importance of both "high tech" and "high touch."
5. Top service companies excel at the following practices: a strategic concept, a history of top-management commitment to quality, high standards, profit tiers, and systems for monitoring service performance and customer complaints. They also differentiate their brands through primary and secondary service features and continual innovation.
6. Superior service delivery requires managing customer expectations and incorporating self-service technologies. Customers' expectations play a critical role in their service experiences and evaluations. Companies must manage service quality by understanding the effects of each service encounter.
7. Even product-based companies must provide postpurchase service. To offer the best support, a manufacturer must identify the services customers value most and their relative importance. The service mix includes both presale services (facilitating and value-augmenting services) and postsale services (customer service departments, repair and maintenance services).

Applications

Marketing Debate

Is Service Marketing Different from Product Marketing?

Some service marketers maintain that service marketing is fundamentally different from product marketing and relies on different skills. Some traditional product marketers disagree, saying "good marketing is good marketing."

Take a position: **Product and service marketing are fundamentally different *versus* Product and service marketing are highly related.**

Marketing Discussion

Educational Institutions

Colleges, universities, and other educational institutions can be classified as service organizations. How can you apply the marketing principles developed in this chapter to your school? Do you have any advice as to how it could become a better service marketer?

Marketing Excellence

>>The Ritz-Carlton

Few brands attain such a high standard of customer service as the luxury hotel, The Ritz-Carlton. The Ritz-Carlton dates back to the early 20th century and the original Ritz-Carlton Boston, which revolutionized the way U.S. travelers viewed and experienced customer service and luxury in a hotel. The Ritz-Carlton Boston was the first of its kind to provide guests with a private bath in each guest room, fresh flowers throughout the hotel, and an entire staff dressed in formal white tie, black tie, or morning coat attire.

In 1983, hotelier Horst Schulze and a four-person development team acquired the rights to the Ritz-Carlton name and created the Ritz-Carlton concept as it is known today: a company-wide concentration on both the personal and the functional side of service. The five-star hotel provides impeccable facilities but also takes customer service extremely seriously. Its credo is, "We are Ladies and Gentlemen serving Ladies and Gentlemen." According to the company's Web site, The Ritz-Carlton "pledge(s) to provide the finest personal service and facilities for our guests who will always enjoy a warm, relaxed, yet refined ambience."

The Ritz-Carlton fulfills this promise by providing impeccable training for its employees and executing its Three Steps of Service and 12 Service Values. The Three Steps of Service state that employees must use a warm and sincere greeting always using the guest's name, anticipate and fulfill each guest's needs, and give a warm good-bye again using the guest's name. Every manager carries a laminated card with the 12 Service Values, which include bullets such as number 3: "I am empowered to create unique, memorable and personal experiences for our guests," and number 10: "I am proud of my professional appearance, language and behavior." Simon Cooper, the company president and chief operating officer, explained, "It's all about people. Nobody has an emotional experience with a thing. We're appealing to emotions." The Ritz-Carlton's 38,000 employees at 70 hotels in 24 countries go out of their way to create unique and memorable experiences for their guests.

While The Ritz-Carlton is known for training its employees on exceptional customer service, the hotel also reinforces its mission and values to its employees on a daily basis. Each day, managers gather their employees for a 15-minute "line up." During this time, managers touch base with their employees, resolve any impending problems, and spend the remaining time reading and discussing what The Ritz-Carlton calls "wow stories."

The same "wow story" of the day is read to every single employee around the world. These true stories recognize an individual employee for his or her outstanding customer service and also highlight one of the 12 Service Values. For example, one family staying at the Ritz-Carlton, Bali, needed a particular type of egg and milk for their son who suffered from food allergies. Employees could not find the appropriate items in town, but the executive chef at the hotel remembered a store in Singapore that sold them. He contacted his mother-in-law, who purchased the items and personally flew them over 1,000 miles to Bali for the family. This example showcased Service Value 6: "I own and immediately resolve guests' problems."

In another instance, a waiter overheard a man telling his wife, who used a wheelchair, that it was too bad he couldn't get her down to the beach. The waiter told the maintenance crew, and by the next day they had constructed a wooden walkway down to the beach and pitched a tent at the far end where the couple had dinner. According to Cooper, the daily wow story is "the best way to communicate what we expect from our ladies and gentlemen around the world. Every story reinforces the actions we are looking for and demonstrates how each and every person in our organization contributes to our service values." As part of company policy, each employee is entitled to spend up to $2,000 on a guest to help deliver an anticipated need or desire.

The hotel measures the success of its customer service efforts through Gallup phone interviews, which ask both functional and emotional questions. Functional questions ask "How was the meal? Was your bedroom clean?" while emotional questions uncover a sense of the customer's well-being. The Ritz-Carlton uses these findings as well as day-to-day experiences to continually enhance and improve the experience for its guests.

In less than three decades, The Ritz-Carlton has grown from 4 locations to over 70 and earned two Malcolm Baldrige Quality Awards—the only company ever to win the prestigious award twice.

Questions

1. How does The Ritz-Carlton match up to competitive hotels? What are the key differences?
2. Discuss the importance of the "wow stories" in customer service for a luxury hotel like The Ritz-Carlton.

Sources: Robert Reiss, "How Ritz-Carlton Stays at Top," *Forbes,* October 30, 2009; Carmine Gallo, "Employee Motivation the Ritz-Carlton Way," *BusinessWeek,* February 29, 2008; Carmine Gallo, "How Ritz-Carlton Maintains Its Mystique," *BusinessWeek,* February 13, 2007; Jennifer Robison, "How The Ritz-Carlton Manages the Mystique," *Gallup Management Journal,* December 11, 2008; *The Ritz Carlton*, www.RitzCarlton.com.

Marketing Excellence

>>Mayo Clinic

Mayo Clinic is the first and largest integrated not-for-profit medical group practice in the world. William and Charles Mayo founded the clinic over 100 years ago as a small outpatient facility and pioneered the concept of a medical group practice—a model that is widely used today.

Mayo Clinic provides exceptional medical care and leads the nation in many specialties such as cancer, heart disease, respiratory disorders, and urology. It consistently ranks at the top of *U.S. News & World Report's* Best Hospitals list and enjoys 85 percent brand recognition among U.S. adults. It has reached this level of success by taking a different approach from most clinics and hospitals and putting a relentless focus on the patient's experience. The clinic's two interrelated core values trace back to its founders and are at the heart of all the organization does: placing the patient's interests above all others and practicing teamwork.

Every aspect of the patient's experience is considered at Mayo Clinic's three campuses in Rochester (MN), Scottsdale (AZ), and Jacksonville (FL). The moment a patient walks into one of Mayo Clinic's facilities, he or she feels the difference. New patients are welcomed by professional greeters who walk them through the administrative processes. Returning patients are greeted by name and with a warm smile. The buildings have been designed so that, in the words of the architect of one, "patients feel a little better before they see their doctors." The 21-story Gonda Building in Rochester has spectacular wide-open spaces with the capability of adding 10 more floors. Fine art hangs on the walls, and doctor's offices are designed to feel cozy and comforting rather than sterile and impersonal.

The lobby of the Mayo Clinic hospital in Scottsdale has an indoor waterfall and a wall of windows overlooking mountains. In pediatric exam rooms, resuscitation equipment is hidden behind a large cheery picture. Hospital rooms feature microwave ovens and chairs that really do convert to beds because, as one staff member explained, "People don't come to the hospital alone." The newest emergency medical helicopter was customized to incorporate high-tech medical equipment and is one of the most advanced aircraft in the world.

The other significant difference in serving patients is Mayo Clinic's concept of teamwork. A patient can come to Mayo Clinic with or without a physician's referral. At that time, the patient's team is assembled, which can include the primary physician, surgeons, radiation oncologists, radiologists, nurses, residents, or other specialists with the appropriate skill, experience, and knowledge.

Teams of medical professionals work together to diagnose patients' medical problems, including debating test results for hours to determine the most accurate diagnosis and best treatments. Once a team consensus has been reached, the leader meets with the patient and discusses his or her options. Throughout the process, patients are encouraged to take part in the discussion. If surgery is necessary, the procedure is often scheduled to take place within 24 hours, a dramatic difference from the long wait patients experience at many hospitals. Mayo Clinic's doctors understand that those who seek their care want action as soon as possible.

Mayo's doctors are put on salary instead of being paid by the number of patients seen or tests ordered. As a result, patients receive more individualized attention and care, and physicians work together instead of against each other. As one pediatrician at Mayo explained, "We're very comfortable with calling colleagues for what I call 'curbside consulting.' I don't have to make a decision about splitting a fee or owing someone something. It's never a case of quid pro quo."

Mayo Clinic is a not-for-profit, so all its operating income is invested back into the clinic's research and education programs. Breakthrough research is quickly implemented into the quality care of the patients. Mayo Clinic offers educational programs through its five schools, and many of its physicians come up through these programs with Mayo's philosophies engrained in their heads, including Mayo's motto: "The best interest of the patient is the only interest to be considered."

President Obama often cites Mayo Clinic as a key example in health care reform. Mayo Clinic has been recognized by third parties for decades for its independent thinking, outstanding service and performance, and core focus on patient care and satisfaction.

Questions

1. Explain why Mayo Clinic is so good at customer service. Why has it been so successful practicing medicine differently from other hospitals?
2. Do conflicts of interest exist between wanting to make your patient happy and providing the best medical care possible? Why or why not?

Sources: Avery Comarow, "America's Best Hospitals," *U.S. News & World Report*, July 15, 2009; Chen May Yee, "Mayo Clinic Reports 2007 Revenue Grew 10%," *Star Tribune,* March 17, 2008; Leonard L. Berry and Kent D. Seltman, *Management Lessons from Mayo Clinic* (New York: McGraw-Hill, 2008); Leonard L. Berry, "Leadership Lessons from Mayo Clinic," *Organizational Dynamics* 33 (August 2004), pp. 228–42; Leonard L. Berry and Neeli Bendapudi, "Clueing in Customers," *Harvard Business Review,* February 2003, pp. 100–106; John La Forgia, Kent Seltman, and Scott Swanson, "Mayo Clinic: Sustaining a Legacy Brand and Leveraging Its Equity in the 21st-Century Market," Presentation at the Marketing Science Institute's Conference on Brand Orchestration, Orlando, FL, December 4–5, 2003; Paul Roberts, "The Agenda—Total Teamwork," *Fast Company,* March 31, 1999.

Chapter 14

As a high-end luxury goods provider, Tiffany & Co. knows the importance of preserving the integrity of its prices.

In This Chapter, We Will Address the Following Questions

1. How do consumers process and evaluate prices?
2. How should a company set prices initially for products or services?
3. How should a company adapt prices to meet varying circumstances and opportunities?
4. When should a company initiate a price change?
5. How should a company respond to a competitor's price change?

Developing Pricing Strategies and Programs

Price is the one element of the marketing mix that produces revenue; the other elements produce costs. Prices are perhaps the easiest element of the marketing program to adjust; product features, channels, and even communications take more time. Price also communicates to the market the company's intended value positioning of its product or brand. A well-designed and marketed product can command a price premium and reap big profits. But new economic realities have caused many consumers to pinch pennies, and many companies have had to carefully review their pricing strategies as a result.

For its entire century-and-a-half history, Tiffany's name has connoted diamonds and luxury. Tiffany designed a pitcher for Abraham Lincoln's inaugural, made swords for the Civil War, introduced sterling silver to the United States, and designed the "E Pluribus Unum" insignia that adorns $1 bills as well as the Super Bowl and NASCAR trophies. A cultural icon—its Tiffany Blue color is even trademarked—Tiffany has survived the economy's numerous ups and downs through the years. With the emergence in the late 1990s of the notion of "affordable luxuries," Tiffany seized the moment by creating a line of cheaper silver jewelry. Its "Return to Tiffany" silver bracelet became a must-have item for teens of a certain set. Earnings skyrocketed for the next five years, but the affordable jewelry brought both an image and a pricing crisis for the company: What if all those teens who bought Tiffany charm bracelets grew up to think of Tiffany only as a place where they got the jewelry of their girlhood? Starting in 2002, the company began hiking prices again. At the same time, it launched higher-end collections, renovated stores to feature expensive items appealing to mature buyers, and expanded aggressively into new cities and shopping malls. When the recession began in 2008, the firm knew it had to be careful not to dilute its high-end appeal. Tiffany offset softer sales largely with cost-cutting and inventory management, and—very quietly—it lowered prices on its best-selling engagement rings only, by roughly 10 percent.[1]

Pricing decisions are clearly complex and difficult, and many marketers neglect their pricing strategies.[2] Holistic marketers must take into account many factors in making pricing decisions—the company, the customers, the competition, and the marketing environment. Pricing decisions must be consistent with the firm's marketing strategy and its target markets and brand positionings.

In this chapter, we provide concepts and tools to facilitate the setting of initial prices and adjusting prices over time and markets.

Understanding Pricing

Price is not just a number on a tag. It comes in many forms and performs many functions. Rent, tuition, fares, fees, rates, tolls, retainers, wages, and commissions are all the price you pay for some good or service. Price also has many components. If you buy a new car, the sticker price may be adjusted by rebates and dealer incentives. Some firms allow for payment through multiple forms, such as $150 plus 25,000 frequent flier miles for a flight.[3]

Throughout most of history, prices were set by negotiation between buyers and sellers. Bargaining is still a sport in some areas. Setting one price for all buyers is a relatively modern idea that arose with the development of large-scale retailing at the end of the nineteenth century. F. W. Woolworth, Tiffany & Co., John Wanamaker, and others advertised a "strictly one-price policy," because they carried so many items and supervised so many employees.

Traditionally, price has operated as a major determinant of buyer choice. Consumers and purchasing agents who have access to price information and price discounters put pressure on retailers to lower their prices. Retailers in turn put pressure on manufacturers to lower their prices. The result can be a marketplace characterized by heavy discounting and sales promotion.

A Changing Pricing Environment

Pricing practices have changed significantly. At the turn of the 21st century, consumers had easy access to credit, so by combining unique product formulations with enticing marketing campaigns, many firms successfully traded consumers up to more expensive products and services. The onset of the Great Recession—a recession more severe than previous recessions, which resulted in many jobs lost and many businesses and consumers unable to receive loans due to their poorly leveraged situations—changed things though.

A combination of environmentalism, renewed frugality, and concern about jobs and home values forced many U.S. consumers to rethink how they spent their money. They replaced luxury purchases with basics. They bought fewer accessories like jewelry, watches, and bags. They ate at home more often and purchased espresso machines to make lattes in their kitchens instead of buying them at expensive cafés. If they bought a new car at all, they downsized to smaller, more fuel-efficient models. They even cut back spending on hobbies and sports activities.[4]

Downward price pressure from a changing economic environment coincided with some longer-term trends in the technological environment. For some years now, the Internet has been changing how buyers and sellers interact. Here is a short list of how the Internet allows sellers to discriminate between buyers, and buyers to discriminate between sellers.[5]

Buyers can:

- ***Get instant price comparisons from thousands of vendors.*** Customers can compare the prices offered by multiple bookstores by just clicking mySimon.com. PriceSCAN.com lures thousands of visitors a day, most of them corporate buyers. Intelligent shopping agents ("bots") take price comparison a step further and seek out products, prices, and reviews from hundreds if not thousands of merchants.
- ***Name their price and have it met.*** On Priceline.com, the customer states the price he or she wants to pay for an airline ticket, hotel, or rental car, and Priceline looks for any seller willing to meet that price.[6] Volume-aggregating sites combine the orders of many customers and press the supplier for a deeper discount.
- ***Get products free.*** Open Source, the free software movement that started with Linux, will erode margins for just about any company creating software. The biggest challenge confronting Microsoft, Oracle, IBM, and virtually every other major software producer is: How do you compete with programs that can be had for free? "Marketing Insight: Giving It All Away" describes how different firms have been successful with essentially free offerings.

Marketing Insight

Giving It All Away

Giving away products for free via sampling has been a successful marketing tactic for years. Estée Lauder gave free samples of cosmetics to celebrities, and organizers at awards shows lavish winners with plentiful free items or gifts known as "swag." Other manufacturers, such as Gillette and HP, have built their business model around selling the host product essentially at cost and making money on the sale of necessary supplies, such as razor blades and printer ink.

With the advent of the Internet, software companies began to adopt similar practices. Adobe gave away its PDF Reader for free in 1994, as did Macromedia with its Shockwave player in 1995. Their software became the industry standard, but the firms really made their money selling their authoring software. More recently, Internet start-ups such as Blogger Weblog publishing tool, MySpace online community, and Skype Internet phone calls have all achieved some success with a "freemium" strategy—free online services with a premium component.

Chris Anderson, editor-in-chief of *Wired*, strongly believes that in a digital marketplace, companies can make money with "free" products. As evidence, he offers revenue models involving cross-subsidies (giving away a DVR to sell cable service) and freemiums (offering the Flickr online photo management and sharing application for free to everyone while selling the superior FlickrPro to more highly involved users).

Some online firms have successfully moved "from free to fee" and begun charging for services. Under a new participative pricing mechanism that lets consumers decide the price they feel is warranted, buyers often choose to pay more than zero and even enough that the seller's revenues increase over what a fixed price would have yielded.

Offline, profits for discount air carrier Ryanair have been sky-high thanks to its revolutionary business model. The secret? Founder Michael O'Leary thinks like a retailer, charging for almost everything but the seat itself:

1. A quarter of Ryanair's seats are free. O'Leary wants to double that within five years, with the ultimate goal of making all seats free. Passengers currently pay only taxes and fees of about $10 to $24, with an average one-way fare of roughly $52.
2. Passengers pay extra for everything else: for checked luggage ($9.50 per bag), snacks ($5.50 for a hot dog, $4.50 for chicken soup, $3.50 for water), and bus or train transportation into town from the far-flung airports Ryanair uses ($24).
3. Flight attendants sell a variety of merchandise, including digital cameras ($137.50) and iPocket MP3 players ($165). Onboard gambling and cell phone service are projected new revenue sources.

Other strategies cut costs or generate outside revenue:

4. Seats don't recline, window shades and seat-back pockets have been removed, and there is no entertainment. Seat-back trays now carry ads, and the exteriors of the planes are giant revenue-producing billboards for Vodafone Group, Jaguar, Hertz, and others.
5. More than 99 percent of tickets are sold online. The Web site also offers travel insurance, hotels, ski packages, and car rentals.
6. Only Boeing 737–800 jets are flown to reduce maintenance, and flight crews buy their own uniforms.

The formula works for Ryanair's customers; the airline flies 58 million of them to over 150 airports each year. All the extras add up to 20 percent of revenue. Ryanair enjoys net margins of 25 percent, more than three times Southwest's 7 percent. Some industry pundits even refer to Ryanair as "Walmart with wings!" European discount carrier easyJet has adopted many of the same practices.

Sources: Chris Anderson, *Free: The Future of a Radical Price* (New York: Hyperion, 2009); Peter J. Howe, "The Next Pinch: Fees to Check Bags," *Boston Globe,* March 8, 2007; Katherine Heires, "Why It Pays to Give Away the Store," *Business 2.0* (October 2006): 36–37; Kerry Capel, "'Wal-Mart with Wings,'" *BusinessWeek,* November 27, 2006, pp. 44–45; Matthew Maier, "A Radical Fix for Airlines: Make Flying Free," *Business 2.0* (April 2006): 32–34; Ju-Young Kim, Martin Natter, and Martin Spann, "Pay What You Want: A New Participative Pricing Mechanism," *Journal of Marketing* 73 (January 2009), pp. 44–58; Koen Pauwels and Allen Weiss, "Moving from Free to Fee: How Online Firms Market to Change Their Business Model Successfully," *Journal of Marketing* 72 (May 2008), pp. 14–31; Bruce Myerson, "Skype Takes Its Show on the Road," *BusinessWeek*, October 29, 2007, p. 38.

Sellers can:

- ***Monitor customer behavior and tailor offers to individuals.*** GE Lighting, which gets 55,000 pricing requests a year, has Web programs that evaluate 300 factors that go into a pricing quote, such as past sales data and discounts, so it can reduce processing time from up to 30 days to 6 hours.

Discount airline Ryanair's revolutionary business model is to charge next to nothing for a seat on a flight, but something for virtually everything else.

- ***Give certain customers access to special prices.*** Ruelala is a members-only Web site that sells upscale women's fashion, accessories, and footwear through limited-time sales, usually two-day events. Other business marketers are already using extranets to get a precise handle on inventory, costs, and demand at any given moment in order to adjust prices instantly.

Both buyers and sellers can:

- ***Negotiate prices in online auctions and exchanges or even in person.*** Want to sell hundreds of excess and slightly worn widgets? Post a sale on eBay. Want to purchase vintage baseball cards at a bargain price? Go to www.baseballplanet.com. With the advent of the recession, many consumers began to take the practice of haggling over price honed at car dealers and flea markets into other realms like real estate, jewelry, or virtually any retail durable purchase. Almost three-quarters of U.S. consumers reported negotiating for lower prices in recent years, up a third from the five years before the recession hit.[7]

How Companies Price

Companies do their pricing in a variety of ways. In small companies, the boss often sets prices. In large companies, division and product line managers do. Even here, top management sets general pricing objectives and policies and often approves lower management's proposals.

Where pricing is a key factor (aerospace, railroads, oil companies), companies often establish a pricing department to set or assist others in setting appropriate prices. This department reports to the marketing department, finance department, or top management. Others who influence pricing include sales managers, production managers, finance managers, and accountants.

Executives complain that pricing is a big headache—and getting worse by the day. Many companies do not handle pricing well and fall back on "strategies" such as: "We determine our costs and take our industry's traditional margins." Other common mistakes are not revising price often enough to capitalize on market changes; setting price independently of the rest of the marketing program rather than as an intrinsic element of market-positioning strategy; and not varying price enough for different product items, market segments, distribution channels, and purchase occasions.

For any organization, effectively designing and implementing pricing strategies requires a thorough understanding of consumer pricing psychology and a systematic approach to setting, adapting, and changing prices.

Consumer Psychology and Pricing

Many economists traditionally assumed that consumers were "price takers" and accepted prices at "face value" or as given. Marketers, however, recognize that consumers often actively process price information, interpreting it from the context of prior purchasing experience, formal communications (advertising, sales calls, and brochures), informal communications (friends, colleagues, or family members), point-of-purchase or online resources, and other factors.[8]

Purchase decisions are based on how consumers perceive prices and what they consider the current actual price to be—*not* on the marketer's stated price. Customers may have a lower price threshold below which prices signal inferior or unacceptable quality, as well as an upper price threshold above which prices are prohibitive and the product appears not worth the money. The following example helps illustrate the large part consumer psychology plays in determining three different prices for essentially the same item: a black T-shirt.

A Black T-Shirt The black T-shirt for women looks pretty ordinary. In fact, it's not that different from the black T-shirt sold by Gap and by Swedish discount clothing chain H&M. Yet, the Armani T-shirt costs $275.00, whereas the Gap item costs $14.90 and the H&M one $7.90. Customers who purchase the Armani T-shirt are paying for a T-shirt made of 70 percent nylon, 25 percent polyester, and 5 percent elastane, whereas the Gap and H&M shirts are made mainly of cotton. True, the Armani T is a bit more stylishly cut than the other two and sports a "Made in Italy" label, but how does it command a $275.00 price tag? A luxury brand, Armani is primarily known for suits, handbags, and evening gowns that sell for thousands of dollars. In that context, it can sell its T-shirts for more. But because there aren't many takers for $275.00 T-shirts, Armani doesn't make many, thus further enhancing the appeal for status seekers who like the idea of having a "limited edition" T-shirt. "Value is not only quality, function, utility, channel of distribution," says Arnold Aronson, managing director of retail strategies for Kurt Salmon Associates and former CEO of Saks Fifth Avenue; it's also a customer's perception of a brand's luxury connotations.[9]

The perceived value of a product as simple as a black T-shirt depends in part on where it is sold.

Consumer attitudes about pricing took a dramatic shift in the recent economic downturn as many found themselves unable to sustain their lifestyles.[10] Consumers began to buy more for need than desire and to trade down more frequently in price. They shunned conspicuous consumption, and sales of luxury goods suffered. Even purchases that had never been challenged before were scrutinized. Almost 1 million U.S. patients became "medical tourists" in 2010 and traveled overseas for medical procedures at lower costs, sometimes at the urging of U.S. health insurance companies.[11]

Even in a recession, however, some companies can command a price premium if their offerings are unique and relevant enough to a large enough market segment. Pangea Organics expanded distribution of its pricey $8 soaps and $50 oils, thanks to environmentally friendly organic formulations and clever, seed-infused packaging.[12]

Understanding how consumers arrive at their perceptions of prices is an important marketing priority. Here we consider three key topics—reference prices, price–quality inferences, and price endings.

REFERENCE PRICES Although consumers may have fairly good knowledge of price ranges, surprisingly few can accurately recall specific prices.[13] When examining products, however, they often employ **reference prices**, comparing an observed price to an internal reference price they remember or an external frame of reference such as a posted "regular retail price."[14]

All types of reference prices are possible (see Table 14.1), and sellers often attempt to manipulate them. For example, a seller can situate its product among expensive competitors to imply that it belongs in the same class. Department stores will display women's apparel in separate departments differentiated by price; dresses in the more expensive department are assumed to be of better quality.[15] Marketers also encourage reference-price thinking by stating a high manufacturer's suggested price, indicating that the price was much higher originally, or pointing to a competitor's high price.[16]

When consumers evoke one or more of these frames of reference, their perceived price can vary from the stated price.[17] Research has found that unpleasant surprises—when perceived price is lower than the stated price—can have a greater impact on purchase likelihood than pleasant surprises.[18] Consumer expectations can also play a key role in price response. On Internet auction sites such as eBay, when consumers know similar goods will be available in future auctions, they will bid less in the current auction.[19]

TABLE 14.1 Possible Consumer Reference Prices
• "Fair Price" (what consumers feel the product should cost)
• Typical Price
• Last Price Paid
• Upper-Bound Price (reservation price or the maximum most consumers would pay)
• Lower-Bound Price (lower threshold price or the minimum most consumers would pay)
• Historical Competitor Prices
• Expected Future Price
• Usual Discounted Price

Source: Adapted from Russell S. Winer, *Pricing*, MSI Relevant Knowledge Series (Cambridge, MA: Marketing Science Institute, 2006).

Clever marketers try to frame the price to signal the best value possible. For example, a relatively expensive item can look less expensive if the price is broken into smaller units, such as a $500 annual membership for "under $50 a month," even if the totals are the same.[20]

PRICE-QUALITY INFERENCES Many consumers use price as an indicator of quality. Image pricing is especially effective with ego-sensitive products such as perfumes, expensive cars, and designer clothing. A $100 bottle of perfume might contain $10 worth of scent, but gift givers pay $100 to communicate their high regard for the receiver.

Price and quality perceptions of cars interact.[21] Higher-priced cars are perceived to possess high quality. Higher-quality cars are likewise perceived to be higher priced than they actually are. When information about true quality is available, price becomes a less significant indicator of quality. When this information is not available, price acts as a signal of quality.

Some brands adopt exclusivity and scarcity to signify uniqueness and justify premium pricing. Luxury-goods makers of watches, jewelry, perfume, and other products often emphasize exclusivity in their communication messages and channel strategies. For luxury-goods customers who desire uniqueness, demand may actually increase price, because they then believe fewer other customers can afford the product.[22]

PRICE ENDINGS Many sellers believe prices should end in an odd number. Customers see an item priced at $299 as being in the $200 rather than the $300 range; they tend to process prices "left-to-right" rather than by rounding.[23] Price encoding in this fashion is important if there is a mental price break at the higher, rounded price.

Another explanation for the popularity of "9" endings is that they suggest a discount or bargain, so if a company wants a high-price image, it should probably avoid the odd-ending tactic.[24] One study showed that demand actually increased one-third when the price of a dress *rose* from $34 to $39 but was unchanged when it rose from $34 to $44.[25]

Prices that end with 0 and 5 are also popular and are thought to be easier for consumers to process and retrieve from memory.[26] "Sale" signs next to prices spur demand, but only if not overused: Total category sales are highest when some, but not all, items in a category have sale signs; past a certain point, sale signs may cause total category sales to fall.[27]

Pricing cues such as sale signs and prices that end in 9 are more influential when consumers' price knowledge is poor, when they purchase the item infrequently or are new to the category, and when product designs vary over time, prices vary seasonally, or quality or sizes vary across stores.[28] They are less effective the more they are used. Limited availability (for example, "three days only") also can spur sales among consumers actively shopping for a product.[29]

A product priced at $2.99 can be perceived as distinctly less expensive than one priced at $3.00.

Setting the Price

A firm must set a price for the first time when it develops a new product, when it introduces its regular product into a new distribution channel or geographical area, and when it enters bids on new contract work. The firm must decide where to position its product on quality and price.

Most markets have three to five price points or tiers. Marriott Hotels is good at developing different brands or variations of brands for different price points: Marriott Vacation Club—Vacation Villas (highest price), Marriott Marquis (high price), Marriott (high-medium price), Renaissance (medium-high price), Courtyard (medium price), TownePlace Suites (medium-low price), and Fairfield Inn (low price). Firms devise their branding strategies to help convey the price-quality tiers of their products or services to consumers.[30]

The firm must consider many factors in setting its pricing policy.[31] Table 14.2 summarizes the six steps in the process.

Marriott's hotel brands differ in price points and the levels of service they offer.

Step 1: Selecting the Pricing Objective

The company first decides where it wants to position its market offering. The clearer a firm's objectives, the easier it is to set price. Five major objectives are: survival, maximum current profit, maximum market share, maximum market skimming, and product-quality leadership.

SURVIVAL Companies pursue *survival* as their major objective if they are plagued with overcapacity, intense competition, or changing consumer wants. As long as prices cover variable costs and some fixed costs, the company stays in business. Survival is a short-run objective; in the long run, the firm must learn how to add value or face extinction.

MAXIMUM CURRENT PROFIT Many companies try to set a price that will *maximize current profits.* They estimate the demand and costs associated with alternative prices and choose the price that produces maximum current profit, cash flow, or rate of return on investment. This strategy assumes the firm knows its demand and cost functions; in reality, these are difficult to estimate. In emphasizing current performance, the company may sacrifice long-run performance by ignoring the effects of other marketing variables, competitors' reactions, and legal restraints on price.

MAXIMUM MARKET SHARE Some companies want to *maximize their market share.* They believe a higher sales volume will lead to lower unit costs and higher long-run profit. They set the lowest price, assuming the market is price sensitive. Texas Instruments (TI) famously practiced this **market-penetration pricing** for years. TI would build a large plant, set its price as low as possible, win a large market share, experience falling costs, and cut its price further as costs fell.

The following conditions favor adopting a market-penetration pricing strategy: (1) The market is highly price sensitive and a low price stimulates market growth; (2) production and distribution

TABLE 14.2 Steps in Setting a Pricing Policy

1.	Selecting the Pricing Objective
2.	Determining Demand
3.	Estimating Costs
4.	Analyzing Competitors' Costs, Prices, and Offers
5.	Selecting a Pricing Method
6.	Selecting the Final Price

Apple created an uproar among its early-adopter customers when it significantly lowered the price of its iPhone after only two months.

costs fall with accumulated production experience; and (3) a low price discourages actual and potential competition.

MAXIMUM MARKET SKIMMING Companies unveiling a new technology favor setting high prices to *maximize market skimming.* Sony is a frequent practitioner of **market-skimming pricing**, in which prices start high and slowly drop over time. When Sony introduced the world's first high-definition television (HDTV) to the Japanese market in 1990, it was priced at $43,000. So that Sony could "skim" the maximum amount of revenue from the various segments of the market, the price dropped steadily through the years—a 28-inch Sony HDTV cost just over $6,000 in 1993, but a 40-inch Sony HDTV cost only $600 in 2010.

This strategy can be fatal, however, if a worthy competitor decides to price low. When Philips, the Dutch electronics manufacturer, priced its videodisc players to make a profit on each, Japanese competitors priced low and rapidly built their market share, which in turn pushed down their costs substantially.

Moreover, consumers who buy early at the highest prices may be dissatisfied if they compare themselves to those who buy later at a lower price. When Apple dropped the iPhone's price from $600 to $400 only two months after its introduction, public outcry caused the firm to give initial buyers a $100 credit toward future Apple purchases.[32]

Market skimming makes sense under the following conditions: (1) A sufficient number of buyers have a high current demand; (2) the unit costs of producing a small volume are high enough to cancel the advantage of charging what the traffic will bear; (3) the high initial price does not attract more competitors to the market; (4) the high price communicates the image of a superior product.

PRODUCT-QUALITY LEADERSHIP A company might aim to be the *product-quality leader* in the market. Many brands strive to be "affordable luxuries"—products or services characterized by high levels of perceived quality, taste, and status with a price just high enough not to be out of consumers' reach. Brands such as Starbucks, Aveda, Victoria's Secret, BMW, and Viking have positioned themselves as quality leaders in their categories, combining quality, luxury, and premium prices with an intensely loyal customer base.[33] Grey Goose and Absolut carved out a superpremium niche in the essentially odorless, colorless, and tasteless vodka category through clever on-premise and off-premise marketing that made the brands seem hip and exclusive.[34]

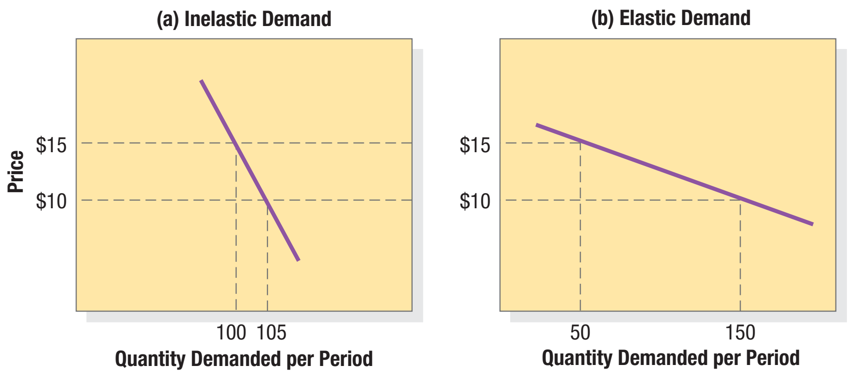
OTHER OBJECTIVES Nonprofit and public organizations may have other pricing objectives. A university aims for *partial cost recovery,* knowing that it must rely on private gifts and public grants to cover its remaining costs. A nonprofit hospital may aim for full cost recovery in its pricing. A nonprofit theater company may price its productions to fill the maximum number of seats. A social service agency may set a service price geared to client income.

Whatever the specific objective, businesses that use price as a strategic tool will profit more than those that simply let costs or the market determine their pricing. For art museums, which earn an average of only 5 percent of their revenues from admission charges, pricing can send a message that affects their public image and the amount of donations and sponsorships they receive.

Step 2: Determining Demand

Each price will lead to a different level of demand and have a different impact on a company's marketing objectives. The normally inverse relationship between price and demand is captured in a demand curve (see Figure 14.1): The higher the price, the lower the demand. For prestige goods, the demand curve sometimes slopes upward. One perfume company raised its price and sold more rather than less! Some consumers take the higher price to signify a better product. However, if the price is too high, demand may fall.

PRICE SENSITIVITY The demand curve shows the market's probable purchase quantity at alternative prices. It sums the reactions of many individuals with different price sensitivities. The first step in estimating demand is to understand what affects price sensitivity. Generally speaking, customers are less price sensitive to low-cost items or items they buy infrequently. They are also less price sensitive when (1) there are few or no substitutes or competitors; (2) they do not readily



|Fig. 14.1|

Inelastic and Elastic Demand

notice the higher price; (3) they are slow to change their buying habits; (4) they think the higher prices are justified; and (5) price is only a small part of the total cost of obtaining, operating, and servicing the product over its lifetime.

A seller can successfully charge a higher price than competitors if it can convince customers that it offers the lowest *total cost of ownership* (TCO). Marketers often treat the service elements in a product offering as sales incentives rather than as value-enhancing augmentations for which they can charge. In fact, pricing expert Tom Nagle believes the most common mistake manufacturers have made in recent years is to offer all sorts of services to differentiate their products without charging for them.[35]

Of course, companies prefer customers who are less price-sensitive. Table 14.3 lists some characteristics associated with decreased price sensitivity. On the other hand, the Internet has the potential to *increase* price sensitivity. In some established, fairly big-ticket categories, such as auto retailing and term insurance, consumers pay lower prices as a result of the Internet. Car buyers use the Internet to gather information and borrow the negotiating clout of an online buying service.[36] But customers may have to visit multiple sites to realize these savings, and they don't always do so. Targeting only price-sensitive consumers may in fact be "leaving money on the table."

ESTIMATING DEMAND CURVES Most companies attempt to measure their demand curves using several different methods.

- ***Surveys*** can explore how many units consumers would buy at different proposed prices. Although consumers might understate their purchase intentions at higher prices to discourage the company from pricing high, they also tend to actually exaggerate their willingness to pay for new products or services.[37]

TABLE 14.3 Factors Leading to Less Price Sensitivity
• The product is more distinctive.
• Buyers are less aware of substitutes.
• Buyers cannot easily compare the quality of substitutes.
• The expenditure is a smaller part of the buyer's total income.
• The expenditure is small compared to the total cost of the end product.
• Part of the cost is borne by another party.
• The product is used in conjunction with assets previously bought.
• The product is assumed to have more quality, prestige, or exclusiveness.
• Buyers cannot store the product.

Source: Based on information from Thomas T. Nagle, John E. Hogan, and Joseph Zale, *The Strategy and Tactics of Pricing,* 5th ed. (Upper Saddle River, NJ: Prentice Hall, 2011). Printed and electronically reproduced by permission of Pearson Education, Inc., Upper Saddle River, New Jersey.