

# Developing a Breakthrough Service Model for Profitable Growth

By Philip G. Moscoso and Alejandro Lago



Stronger competition and more demanding customers require companies to deliver exceptional service and ultimately offer differentiated value propositions in an efficient way. To do so successfully, companies need to innovate and continuously improve their service models, but with a holistic view that ensures coherence between strategy and operations, as well as between the clients' and employees' needs.

## The challenge of services

Delivering great service is critical for most companies, yet hard to achieve efficiently and takes time to pay-off. By service we mean the whole 'experience' through which we satisfy customers' needs and create value for them (Moscoso et al., 2011). This experience includes not only the 'product' we offer but also the entire delivery process and experience, in which the customer is an active participant.

First of all, three service delivery factors should be highlighted: (1) delivery is made up of a combination of *tangible* elements (those that are 'objective' and 'measurable' by the customer) and other more *intangible* and *subjective* ones; (2) the customer participates in a di-

rect and interactive way in the service 'production' process; and (3) the 'production' and consumption of the service almost always occur *simultaneously* or *immediately* in time and space<sup>1</sup>.

The characteristics of intangibility, interactivity and immediacy have important implications for service management (summarized in Table 1). They also make growing and managing service companies more complicated, and make it harder for service companies to leverage economies of scale than for companies that produce goods or equipments.

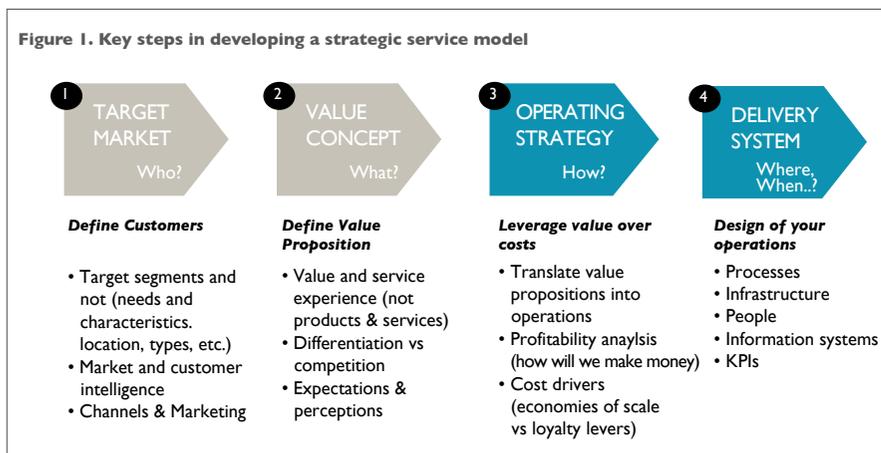
**Table 1. Summary of the characteristics of services and their management challenges**

Characteristic	Challenges for Management
Intangibility	<ul style="list-style-type: none"> <li>• Subjective customer evaluation of the service (experience, trust, etc.)</li> <li>• Difficult to control quality</li> <li>• Difficult to measure customer satisfaction</li> <li>• Difficult to define quality standards</li> </ul>
Client-process interaction	<ul style="list-style-type: none"> <li>• Heterogeneity of service provision (culture, gender, age, personal aspects)</li> <li>• High degree of personalization</li> <li>• Need to design a more human interface</li> <li>• High impact of employee satisfaction on customer perceived value</li> <li>• Danger of inconsistency in provision</li> <li>• Possibility of self-service</li> </ul>
Immediacy	<ul style="list-style-type: none"> <li>• Demand-supply matching (capacity, queue management)</li> <li>• Difficult to centralize production (limited economies of scale)</li> <li>• Difficult to manage growth</li> <li>• Quality control 'after the event'</li> <li>• Importance of waiting times and inefficiencies in the process</li> </ul>

## Service design: developing a sound service model

Figure 1 (adapted from Heskett, 1987) summarizes the four basic steps proposed for developing a sound service model. The first step is to define the target customers of the service to be offered. The second step is to specify a value proposition for these target customers. The third step is then to define how we can leverage value over costs for the stakeholders<sup>2</sup> by selling our value proposition to our target customers. Finally, the fourth step focuses on the design of the delivery system itself<sup>3</sup>.

Figure 1. Key steps in developing a strategic service model



**There are different types of customers, and that good service design requires proper customer segmentation, not only in commercial or marketing terms, but also in terms of the service delivery system.**

### External vision: positioning and value proposition

The first phase of design covers two fundamental steps, focused on the external vision of the service model.

#### Defining the type of customers and the target market

It is important to carefully define the customers to whom we wish to deliver our service. We should understand that there are different types of customers, Good service design requires proper customer segmentation, given that the more broadly defined our target market is the harder it will be for us to provide an excellent service, since customers' needs and assessments will be very disparate, even contradictory. A key point here is to carry out the segmentation not only in commercial or marketing terms, but also in terms of the service delivery system. Consider, for example, a guided tour of an art museum: the more mixed the tour group (in terms of knowledge, interests, age, etc.), the harder it will be for the guide to satisfy everyone. An example related specifically to the delivery system is that most airlines provide baggage claim or lost & found services in the same way to all their customers, independently of the fare paid. It is often useful to also ask who we do not want as a customer, as this forces a first

broad segmentation. Relevant characteristics of the target market segments (e.g. size, psycho-demographics, etc.), as well as the service expectations and experiences offered to each of the chosen segments, should be taken into account when designing the service model.

#### Defining the value proposition

Once the target market has been identified and its characteristics outlined, the next step is to design the value proposition. When managing the various elements that create value for customers, it is important to understand that customers' assessments will be determined by their expectations and their perception of the service actually received. Only if their perception is better than their expectations will their level of satisfaction be positive. In service management research this relationship is known as the First Law of Services. One way of expressing it is as follows:

$$\text{Satisfaction} = \text{Perceived Value} - \text{Expectations}$$

It should be emphasized that both the perception and the expectations are subjective and depend greatly on the individual, as well as competitor propositions. For example, every visitor usually has a prior impression of a Disneyland park. Even without having had

any direct experience of it, an impression will have been gained from comments made by friends and acquaintances, or information in the press or guidebooks. The equation shown above also reflects a common danger: in order to attract customers, organizations tend to generate the highest possible expectations, but then have to meet or exceed those expectations in actual service delivery (similar to the trailer vs. the movie).

Moreover, even where the service provided is the very same, the perceived value will vary depending on the individual customer, since perceptions are always quite personal. The perception may be based on objective aspects, such as the time spent waiting to be served; yet it is not the objective value (say, 10 minutes) that really counts but the subjective one (whether the wait *seemed* long or not). The manager of the service can and should actively manage these subjective factors (perceptions and expectations) and must pay special attention to them when designing and controlling the service interface, as will be explained later.

To schematize the aspects which add and subtract value for the customer and that therefore affect the customer's perception, we can use the following value equation (figure 2, adapted from Huete and Pérez, 2003).

In the numerator is everything the customer 'receives', that is, the things that add value from the customer's perspective. Conceptually, this can be separated into three elements: first, the results the customer hopes to achieve by consuming the service (for example, getting your car repaired). Second, the positive aspects of the *process* of service delivery; in a repair shop this might include the waiting times, the information provided, cleanness, and so on. Finally, in some settings there are emotional aspects associated with the value of the service, for example, when brand or the occasion is important, or health is at risk.

In the denominator are the aspects where the customer believes that he or she 'incurred a cost' in order to enjoy the service: first, obviously, the price; then any inconvenience and personal costs arising from the service process; and third, the customer's uncertainties. Inconveniences are all the things that entail a personal 'cost' to the customer in order to access and enjoy the service (not including the

$$\text{Perceived Value} = \frac{(\text{Results} + \text{Process} + \text{Emotional Value})}{(\text{Price} + \text{Inconveniences} + \text{Uncertainties})}$$

Figure 2. Customer Value Equation

price); examples might include traveling, parking, finding out about the service, waiting, and so on. Uncertainties, on the other hand, are the 'cost' of the customer not knowing whether what he or she is going to receive is what he or she really wants (as in the case of going to the cinema to see a movie, for example). This is why money-back guarantees are attractive to some customers: they reduce uncertainty by offering financial insurance. To sum up, consuming a service typically entails important non-monetary costs for the customer, which should be taken into account in the service design.

### Internal vision: operational strategy and delivery system

Once we have defined the target market for our service and have specified the elements of the value proposition, the next two steps in the scheme shown in Figure 1 focus on the internal view of the service model, defining the operational strategy and designing the delivery system itself.

#### Defining the operational strategy

Simplifying somewhat, operational strategy focuses on how we make money selling our value proposition to our target customers, i.e. how we leverage value over costs. This question is obviously closely related to how we plan to compete against other value propositions in the market, since the value generated by an organization will always be in some way influenced by the alternatives available to customers.

In the case of a restaurant, for example, we can compete by having an excellent location, or a great cook, but we can also opt for lower prices or healthier food. In general, however, in economic terms all the options can be summed up in two main lines of action: (1) increase the value generated for customers (their perception and willingness to pay), through personalized service, higher quality, better opening hours, more employees to serve customers, etc.; and (2) reduce the costs of providing the service, by making operations more efficient, reducing the supply of services, reducing capacity, etc. Yet these the cost savings must always outweigh the decrease in perceived value for customers.

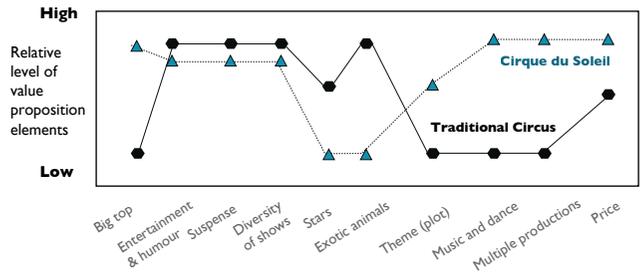
**Operational strategy focuses on how we make money selling our value proposition to our target customers, i.e. how we leverage value over costs.**

#### Value curves: translating the value proposition into the service model design

Given the trade-off between quality of service, costs, and customer perceived value, we will have to appropriately 'translate' the fundamental elements of the value proposition into the design of the ele-

ments of the service delivery system. We will illustrate this through a practical example that is a benchmark for value innovation: Cirque du Soleil. We will use what Kim and Mauborgne (2005) call value curves. Figure 3 illustrates how the value proposition of Cirque du Soleil is positioned compared to that of traditional circuses. Instead of offering yet another circus that tried to be a little more attractive on all fronts (but also more expensive as a result), Cirque du Soleil opted to develop the elements of its value proposition very differently to those of its competitors.

Figure 3. Value proposition of Cirque du Soleil



When translating the value proposition into an organization's operating model, the following four types of decisions can be made:

- Raise certain value attributes above the standards set by competitors (in Cirque du Soleil, the big top, for example).
- Add new elements to the value proposition that are not offered by other competitors (in Cirque du Soleil, dance or a storyline for each production).
- Reduce attributes of the traditional offering that the target audience does not value sufficiently to justify the associated costs (for example, well-known stars).
- Completely eliminate certain elements that do not fit with the proposition for the target audience or that are not valued highly enough to justify their costs (for example, animal numbers).

The first two options are focused more on increasing the value perceived by the customer, while the latter two are focused on reducing the costs of providing the service. Well applied, this approach can resolve the tension between costs and good service, always accepting that there is no 'best service' for all audiences, but rather that an attractive model can only be designed for certain segments (hence again the importance of Step 1 of our scheme, appropriately defining the target market).

#### Operational strategy paradigms in services

Once the value proposition has been decided upon, the next step in defining the operational strategy is to decide on the strategic approach to the design of service operations. In line with the aforementioned trade-off between costs and service quality, here we will merely present four basic approaches that can guide the strategy for designing the service delivery system:

- The first approach centers on the *industrialization of services*, emphasizing the role of processes and standardization. It is therefore

highly focused on the efficiency (cost) of the service. Its key elements are: the *displacement of activities to an area that is 'invisible' to the customer* (the back office) and the *application of process standardization methods* (both are often combined with the *use of technology*, the fourth approach below).

- The second approach, *empowerment* or delegation of authority to employees, concentrates on making the best possible use of employees in providing the service. This approach is therefore centered more on increasing the value perceived by the customer, focusing on the moments of employee-customer interaction and giving employees more power to decide (within limits) how best to serve each customer in each service interaction. The success of this approach requires three fundamental operational pillars: all employees must clearly understand the service *priorities*; be sufficiently *trained* to make decisions correctly; and an appropriate learning and feedback system needs to be in place.
- The third approach is *self-service*. The basic idea is to directly involve the customer in service delivery activities previously undertaken by employees. Well implemented, this approach can help both to enhance perceived value and to reduce service costs<sup>4</sup> (for more information see Moscoso et al., 2011).
- The fourth and final approach, the *use of technology*, cuts across the other three, as, depending on how it is applied, it can be a tool for improving the way the other three are implemented. Technology very often is a powerful service enabler, but it should not become an end in itself. Its use should be technically possible, economically attractive, but most important, in line with the chosen customer strategy.

**The design of the service system is centered on what we call the 'customer corridor', that is, the service delivery process as the chain of activities and events through which the customer passes.**

#### Designing the service delivery system

Any service proposal must be backed by the necessary operating system, in which there are three key elements: the service *processes*, the non-human *resources* (equipment, infrastructure, etc.), and the operational contribution of *employees*.

As a guide, we recommend that the design of the service system be centered on what we call the 'customer corridor': the service delivery process as the chain of activities and events through which the customer passes. The reason for this is that every process has an (external or internal) customer, and it is the customer who decides what is required and what adds value.

In the customer corridor there will be moments of direct interaction between the customer and the company's service system (often employees), which are called *Moments of Truth*. This term highlights the fact that everything the employees have prepared, and all the resources the company has deployed must 'work' correctly at precisely



that moment, as that is when the level of customer satisfaction is determined. In each moment of truth there are always several factors to be considered, which makes managing such moments a challenge: (1) personal interactions; (2) waiting times; and, as already mentioned, (3) customer expectations and perceptions.

### Typical root causes of problems in service design and provision

The difference between customers' expectations and perceptions, in practice, is the result of a whole sequence of potentially inappropriate actions throughout the service design and provision. Figure 4 (adapted from Parasuraman et al., 1985) shows the key gaps that can lead to service quality problems. These gaps must be dealt with separately because they have different causes and can therefore be handled in different ways (and typically by different people).

#### Managing perceptions and expectations: the external view

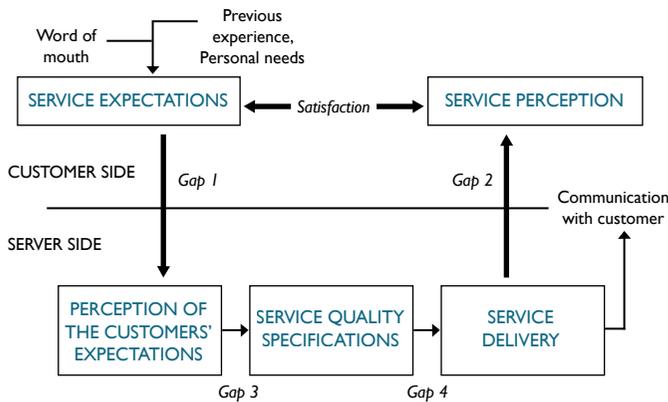
Understanding and managing customer expectations (*Gap 1*) is perhaps where most mistakes of service models are rooted. Many organizations are unaware of what their customers really expect of the service they provide, or mistakenly assume that customers prefer or value certain attributes above others. These errors have to be overcome by listening to customers' needs and suggestions, and intelligently managing expectations and adjusting them to what the institution can realistically deliver.

Organizations must also manage the final perception (*Gap 2*). Where the services offered are intangible, customers very often cannot fully assess the quality of the service they have received and tend to attach more importance to the attributes they have been able to observe and understand. In a hospital, for example, it is easier for the average patient to judge how crowded it was, than the quality of the doctors.

#### Quality control and customer recovery: internal vision

Apart from the management of the more external related aspects, there may be gaps in the physical service provision because the service has not been designed with customers' needs in mind (*Gap 3*).

**Figure 4. Gaps in service design and provision**



This potential error is typically associated with strategic decisions. A manager may deliberately decide to offer a 'one size fits all' service to a very diverse group of customers, with the result that the service meets nobody's expectations.

Even when the process has been well designed, the level of service may vary and a customer may not receive the service as intended or as expected (*Gap 4*). In services, as production and consumption are simultaneous, customers perceive any variation in the level of service directly; and the company has no opportunity to anticipate this. In conclusion, a good quality control system in services should be preventive rather than reactive. In fact, there is a Second Law of Services, complementary to the first:

*It is much more difficult to restore a bad perception than it is to maintain a good perception in the first place.*

Good news is, however, that a good recovery after a negative incident can sometimes result in a very high degree of customer satisfaction (and loyalty). As customers, we understand that companies make mistakes; the important thing is whether we feel they are trying hard enough to fix them.

**It is much more difficult to restore a bad perception than it is to maintain a good perception in the first place.**

## Some final remarks for managers

Following the described design methodology is by no means a final guarantee for a successful service model. But we hope it can provide guidance to managers, as an analysis of the design options and principles and a reflection on design decisions. Specifically, it may help with keeping n strategic and operational issues, and customer and employee needs aligned; as not doing so is almost certainly a guarantee of failure.

*This article is a substantially revised and shortened version of a previously published book chapter titled "A Service Perspective of Cultural Entities and Their*

*Customers", in: Muñoz-Seca, B. and Riverola, J. (eds), When Business Meets Culture, Palgrave, 2011.*

## About the authors

**Philip G. Moscoso** is a professor in the department of Operations & Technology Management at IESE Business School, University of Navarra. Professor Moscoso teaches courses for executives and master students. His primary area of interest is the development of strategies and systems that help service firms achieve service excellence, and ultimately profitable growth. Over the years he has had the opportunity to develop his area of interest through teaching, research and consulting work.

**Alejandro Lago** is a professor in the department of Operations & Technology Management at IESE Business School, University of Navarra. Professor Lago teaches among other courses the required first-year MBA operations course, as well as an elective on service operations. His primary area of interest is the management of service operations, especially in self-service contexts. His work has been published in leading academic and practitioner journals as well as conference proceedings.

## Notes

1. We call these characteristics the three I's of services: intangibility, interactivity and immediacy.
2. By 'stakeholders' we mean all those groups to which the institution wishes to provide value, whether economically, financially or otherwise, including customers, employees, society, public authorities, etc.
3. In parallel, we can use the same scheme to help us understand the employee dimension. We have to decide what kind of employees we want, what value proposition we will offer them, and how they are going to carry out their work in the service delivery system.
4. Consider, for example, something as simple as a breakfast buffet at a hotel. The hotel requires fewer members of staff waiting tables, and customers may also reap benefits, such as faster service, the opportunity to inspect the food first, make their coffee the way they like it, and so on.

## References

- HESKETT, J.L. (1987), Lessons in the Service Sector, *Harvard Business Review*, March.
- HUETE, L. and PÉREZ, A. (2003), "Clienting: marketing y servicios para rentabilizar la lealtad", Ediciones Deusto, Bilbao, 2003
- KIM, W.C. and MAUBORGNE, R. (2005), "Blue Ocean Strategy: How to Create Uncontested Market Spaces and Make Competition Irrelevant", Harvard Business School Press.
- MOSCOSO, P.G., LAGO, A., and AMORIM, M. (2011). Putting your client to work, *The European Business Review*, March - April.
- PARASURAMAN, A. ZEITHAML, V. A., and BERRY, L.B. (1985), A conceptual model of service quality and its implications for future research, *Journal of Marketing*, 4/49.