Essentials of Services Marketing

4th Edition

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firm offers the best value for money and therefore reduce price competition. In fact, complexity does make it easy (and perhaps more tempting) for firms to engage in unethical behavior.

For example, cell phone companies have a confusing variety of plans. Plans can be national or regional in scope. Monthly fees vary according to the number of minutes and mobile data capacity selected in advance. Data plans (including features such as being allowed to roll over unused mobile data to the next month), hand set subsidies for new phones, roaming fees, family and bundled plans that can include several cell phones and other mobile devices, landlines, Internet services and cable TV add further to this complexity. In addition, many people find it difficult to forecast their own usage, and this makes it even harder for them to compute comparative prices when evaluating competing suppliers whose fees are based on a variety of usage-related factors (Figure 6.20).

Bernard Schoenbaum/The New Yorker Collection/The Cartoon Bank

Figure 6.20 Many service firms would rather confuse customers than compete on price.

It seems no coincidence that the humorist Scott Adams (creator of Dilbert) exclusively used service examples when he "branded" the future of pricing as "confusiology". Adams remarks:

> You would think this would create a price war and drive prices down to the cost of providing it (that's what I learned between naps in my economics classes), but it isn't happening. The companies are forming efficient confusiologies so customers can't tell who has the lowest prices. Companies have learned to use the complexities of life as an economic tool.[13]

Piling on the Fees

Not all business models are based on generating income from sales. There is a growing trend of imposing fees that have little to do with usage. In the United States, the car rental industry has attracted some notoriety for advertising bargain rental prices and then telling customers on arrival that other fees such as collision insurance and personal insurance are compulsory. In some Florida resort towns, there were so many "hidden extras" for car rentals at one point that people started joking, "The car is free, the keys are extra!"[14]

There has also been a trend of adding (or increasing) fines and penalties. Banks have been heavily criticized for using penalties as an important revenue-generating tool rather than as a means to educate customers and achieve compliance with payment deadlines (Figure 6.21). Chris Keeley, a New York University student, used his debit card to buy $230 worth of Christmas gifts. His holiday mood soured when he received a notice from his bank that he had overdrawn his checking account. Although his bank authorized each of his seven transactions, it charged him a fee of $31 per payment, totaling $217 for only $230 in purchases. Keeley maintained that he had never requested the so-called overdraft protection on his account. He wished his bank had rejected the

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Figure 6.21 Consumers may be unaware of the high penalty fees imposed on overdrafts.

transactions, for he could simply have paid by credit card. He fumed, "I can't help but think they wanted me to keep spending money so that they could collect these fees."[15] Likewise, many credit cards seem to use excessive fees for late payment and turn them into profitable "gotchas."

It is possible to design fees and even penalties in ways that do not seem unfair to customers. Service Insights 6.2 describes what drives customers' fairness perceptions with service fees and penalties.

SERVICE INSIGHTS 6.2

Managing Customer Responses to Fines and Penalties

Many pricing schedules include different kinds of penalties as a core element. Such penalties range from charges for cancelling a flight to fines for late mobile phone payments, but the common objective is to deter customers from negative behavior. However, customers can react quite poorly to penalties, and the service provider could then lose them to another firm or even face a backlash online if the customer takes to social media.

An online study that surveyed people who had faced penalties has provided insights into how negative responses can be mitigated. The participants were asked to think about a specific instance that involved a penalty. They were then asked to describe it, then answer a specific set of questions about their experience and the nature of their response. The results suggest that three factors may have a major impact on the management of customer responses to penalties:

1 **How proportional was the fine to the offense?** Customers are more likely to consider a penalty unfair if they believe that it exceeds the magnitude of the "offense" it is meant to punish, and their reaction will likely be even more negative if the penalty is either unexpected in itself or if is surprisingly large. If a firm takes care to match a fine to the degree of the customer's failure, the latter will not be as motivated to complain than if the fine seemed excessive. Additionally, to avoid the negativity that accompanies the unexpected fine, customers should be made aware beforehand of the fines or fees that would be imposed on specific customer failures. For example, when a customer chooses their mobile subscription plan, the recurring deadline for payment should be clearly communicated, and front-line staff also should explain the potential fines or fees that are associated with various "violations" (such as roaming or exceeding the monthly data limit).

2 **How liable was the customer for the offense?** If the customer feels that they were not responsible for the particular circumstance that resulted in a penalty being imposed on them, they will have a more negative response than if the fault was theirs alone. For example, the mobile service subscriber in our previous example would consider it unfair if their phone line was terminated because of a delay in processing the payment, as opposed to if the customer had just forgotten to make the payment. To promote a sense of fairness, firms could try to account for situations where the customer cannot be considered entirely liable, allowing front-line staff to reduce or waive the penalty.

However, some customers may react negatively even though they are at fault—if they have been diligent and rule-abiding in the past. For such customers, the sudden imposition of a penalty runs counter to their history of good behavior toward the firm. A customer's past behavior can in fact be used as the basis for deciding how to deal with rule violations. If a service firm were in a position to tell a customer that it has waived a penalty on the first instance but that it would be imposed in future incidents, the customer would see that as fairer than if the penalty had been imposed just as a matter of course.

3 **How fair does the customer think the penalty is?** The negativity of a customer's response correlates with how unfair they think the penalty is. For example, one consumer complained that the penalty for a late credit card payment was entirely out of proportion; they not only had to pay a high interest to begin with, but the penalty they had to pay was higher than the original payment it was levied on.

Penalties can also be made more palatable to the customer if they are clearly explained and substantiated, preferably by pointing out the inconvenience caused to other customers (e.g., "The room that you overstayed in had been reserved by another guest" or "Other patrons were unable to use the facilities as a result") rather than any loss of revenue that may have resulted. Finally, the training for front-line employees should include ways to address complaints from customers who think the penalties they have received are unfair (see Chapter 13 for recommendations on how to deal with such situations).

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Source: Young "Sally" K. Kim and Amy K. Smith, "Crime and Punishment: Examining Customers' Responses to Service Organizations' Penalties," *Journal of Service Research* 8(2) (2005): 162–180.

Designing Fairness into Revenue Management

LO 9

Understand how fairness can be designed into revenue management policies.

Like pricing plans and fees, revenue management practices can be perceived as highly unfair. Therefore, a well-implemented revenue management strategy cannot mean blind pursuit of short-term yield maximization. The following approaches can help firms to reconcile revenue management practices with customers' fairness perceptions, satisfaction, trust, and goodwill:[16]

- **Design Price Schedules and Fences That Are Clear, Logical, and Fair.** Firms should proactively spell out all fees and expenses (e.g., no-show or cancellation charges) clearly in advance so that there are no surprises (Figure 6.22). A related approach is to develop a simple fee structure so that customers can easily understand the financial implications of a specific usage situation.

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Figure 6.22 Limousine service providers usually charge for no-shows.

- **Use High Published Prices and Frame Fences as Discounts.** Rate fences framed as customer gains (i.e., discounts) are generally perceived as fairer than those framed as customer losses (i.e., surcharges) even if the situations are economically equivalent. For example, a customer who patronizes her hair salon on Saturdays may perceive the salon as profiteering if she finds herself facing a weekend surcharge. However, she is likely to find the higher weekend price more acceptable if the salon advertises its peak weekend price as the published price and offers a $5 discount for weekday haircuts. Furthermore, a high published price helps to increase the reference price and related quality perceptions.
- **Communicate Consumer Benefits of Revenue Management.** Marketing communications should position revenue management as a win–win practice. By providing different prices and value propositions, firms can enable a broader spectrum of customers to self-segment and enjoy the service. For example, higher prices can be charged for the best seats in a theater because some people are willing and able to pay more for a better location. This also makes it possible to sell other seats at lower prices. When customers become more familiar with certain revenue management practices, unfairness perceptions are likely to decrease over time.
- **"Hide" Discounts through Bundling, Product Design, and Targeting.** Bundling a service into a package effectively obscures the discounted price. When a cruise line includes the price of air travel or ground transportation in the cruise package (Figure 6.23), the customer knows only the total price and not the cost of the individual components. Bundling usually makes price comparisons between the bundles and its components impossible and thereby side-steps potential unfairness perceptions and reductions in reference prices.

Figure 6.23 Cruise packages bundle land tours into their total package price.

Natalia Deksbakh \123rf

Service products can be designed to hide discounts. Instead of varying the prices of food (which are difficult to increase once they have been lowered), restaurants can vary the product. For example, restaurants can offer smaller portions for lower-cost set lunches and impose a minimum spending level during peak periods. Thus, menu prices will not be changed, and price perceptions of diners will be unaffected. These two tactics give restaurants flexibility in adjusting effective revenue per seat to demand levels.

- **Take Care of Loyal Customers.** Revenue management systems can be programmed to incorporate "loyalty multipliers" for regular customers so that reservations systems can give them "special treatment" status at peak times, even when they are not paying premium rates.
- **Use Service Recovery to Compensate for Overbooking.** Many service firms overbook to compensate for anticipated cancellations and no-shows. Profits increase, but so too does the incidence of being unable to honor reservations. Being "bumped" by an airline or "walked" by a hotel can lead to a loss of customer loyalty and adversely affect a firm's reputation.[17] It's therefore important to back up overbooking programs with well-designed service recovery procedures, such as

   1. giving customers a choice between retaining their reservation or receiving compensation (e.g., many airlines practice voluntary off-loading at check-in against cash compensation and a later flight)
   2. providing sufficient advance notice so that customers are able to make alternative arrangements (e.g., pre-emptive off-loading and rescheduling to another flight the day before departure, often in combination with cash compensation)
   3. if possible, offering a substitute service that delights customers (e.g., upgrading a passenger to business or first class on the next available flight, often in combination with options 1 and 2 above)

A Westin beach resort has found that it can free up capacity by offering guests who are departing the next day the choice of spending their last night in a luxury hotel near the airport or in the city at no cost. Guest feedback on the free room, upgraded service, and a night in the city after a beach holiday has been very positive. From the hotel's perspective, this practice trades the cost of providing a one-night stay in another hotel against that of turning away a multiple-night guest arriving that same day.

PUTTING SERVICE PRICING INTO PRACTICE

LO 10
Discuss the six questions marketers need to answer to design an effective service-pricing strategy.

The first thing a manager has to realize is that service pricing is multi-faceted. There are other important decisions to be made that have a major impact on the behavior and value perceptions of customers. Table 6.3 summarizes the questions service marketers need to ask themselves to develop a well-thought-out pricing strategy. Let's look at each in turn.

Table 6.3 Issues to consider when developing a service pricing schedule.

1.	**How much should be charged for the service?** • What costs is the organization attempting to recover? Is the organization trying to achieve a specific profit margin or return on investment by selling this service? • How sensitive are customers to various prices? • What prices do competitors charge? • What discount(s) should be offered from basic prices? • Are psychological pricing points (e.g., $4.95 versus $5.00) customarily used? • Should auctions and dynamic pricing be used?
2.	**What should be the basis of pricing?** • Execution of a specific task • Admission to a service facility • Units of time (hour, week, month, year) • Percentage commission on the value of the transaction • Physical resources consumed • Geographic distance covered, weight or size of object serviced • Outcome of service or cost-saving generated for the client • Should each service element be billed separately? • Should a single price be charged for a bundled package? • Should discounting be used for selective segments? • Is a freemium pricing strategy beneficial?
3.	**Who should collect payment and where?** • The organization that provides the service collects payment either at the location of service delivery or at arm's length (e.g., online, by phone, or mail) • A specialist intermediary (travel or ticket agent, bank, retail, etc.) with a convenient retail outlet location or online payment portal • How should the intermediary be compensated for this work—with a flat fee or a percentage commission?
4.	**When should payment be made?** • In advance or after service delivery? • In a lump sum or by installments over time?
5.	**How should payment be made?** • Charge card (credit or debit card) • Mobile payment • Cash (exact change or not?) • Stored value card • Tokens (where can these be purchased?) • Vouchers • Check (how can it be verified?) • Electronic funds transfer • Credit account with service provider • Third-party payment (e.g., insurance company or government agency?)
6.	**How should prices be communicated to the target market?** • Through which communication medium (e.g., advertising, website, app, signage, electronic display, salespeople, customer service personnel)? • What message content (e.g., how much emphasis should be placed on price)? • Can the psychology of pricing presentation and communications be used?