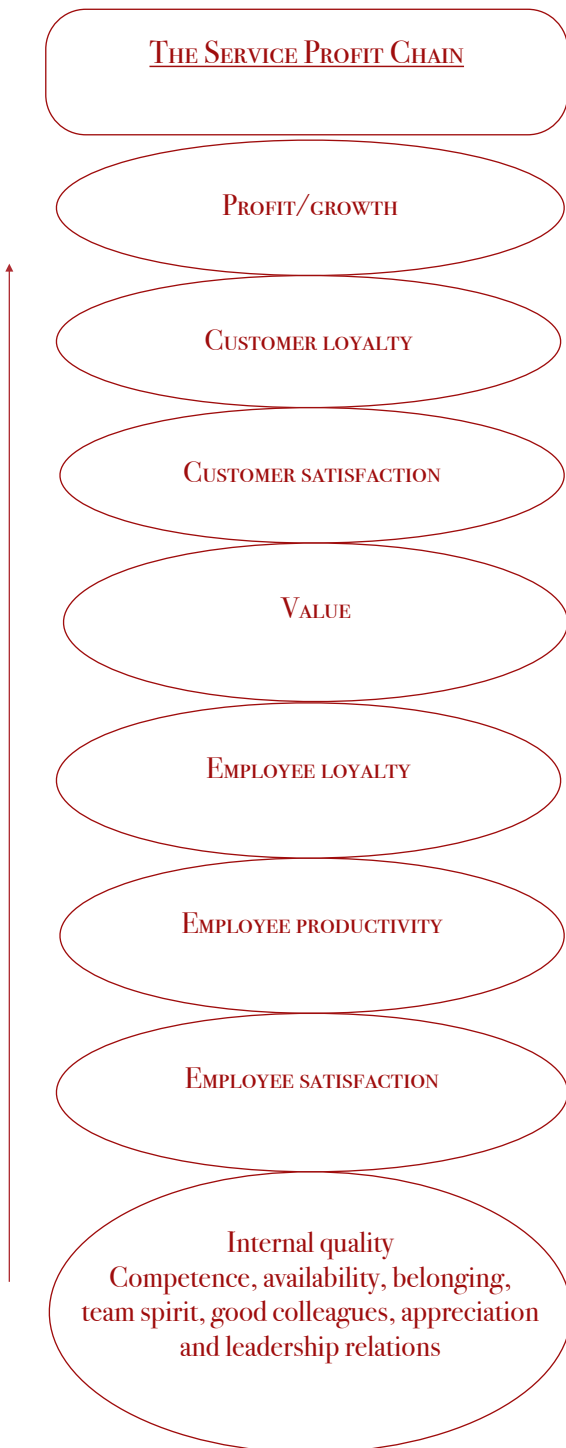How do you know when your cookies in the oven are ready? Is it when the fire alarm goes off in the bedroom upstairs – or do you check the cookies in the oven regularly? When you put it that way the answer is obvious. However, many companies are managed by the principle of firefighting. That is, you use the fire alarm as an indicator of whether everything is the way it's supposed to be or not. In companies the indicators – or fire alarms – can be key ratios, monthly balance and annual accounts. You take the temperature of the last link of the chain. Profit and growth is the last step in a process or chain. If you wish to influence profit you actually have to start at the first link of the chain. This principle is called "The Service Profit Chain". It's a well documented theory and model of the relations that lead to extraordinary results in service companies.

## Introduction to The Service Profit Chain

Researchers from Harvard University evolved The Service Profit Chain theory in the nineties. In short the theory explains that profit and growth depend on the internal quality in the company and value creation for the employees. This is what makes the difference between an average and a fantastic service company. James Heskett and his colleagues have proved that there is a clear chain of causes – a step-by-step process that leads to extraordinary growth and results. In short the whole philosophy can be illustrated as in the model on the following page. To get good results you have to create the best possible internal quality – which is primarily achieved through good leadership.

From the top The Service Profit Chain looks like this:

## The Service Profit Chain

**Profit/growth**

**Customer loyalty**

**Customer satisfaction**

**Value**

**Employee loyalty**

**Employee productivity**

**Employee satisfaction**

**Internal quality**
Competence, availability, belonging, team spirit, good colleagues, appreciation and leadership relations

**Profit and growth**
Most companies are focused on creating profit and growth.

**Customer Loyalty**
Service companies with profit and growth have a large number of loyal customers.

**Customer satisfaction**
Loyal customers are a result of satisfied customers.

**Value**
Satisfaction depends on the company's ability to create value - for the customer.

**Employee loyalty**
Value in a company primarily comes from loyal employees.

**Employee productivity**
Satisfied and loyal customers are clearly more productive.

**Employee satisfaction**
Employee loyalty is a result of employee satisfaction.

**Internal quality**
Satisfaction depends on a number of parameters under the concept 'internal quality'.

## Loyal customers

In a world of abundance there is too much of everything – and this is the reality for companies today. The world does not need a new type of can opener, hoover or dishwasher, nor is there a lack of places to eat, sleep or to be entertained. Because there is too much of most things – except time – we get bombarded with messages from companies telling us that their product is better than all the others. But we have heard that message a million times, so

we close our minds to the noise. The result is that we tend to stay with what we like and what we know works for us. Or if we need to venture out into new experiences we seek the advise of someone we trust and ask: Do you know a great hotel in Barcelona, or what is your favourite restaurant in Paris? It's called word of mouth. When it comes to word of mouth loyal customers are more likely to tell others about their loyalty than just satisfied customers. Excited customers tell other people about their experiences and create ambassadors for the company. They become loyal customers and they keep returning. Attracting new businesses is therefore no longer a question of making more noise than all the others but to get the sweet whisper of word of mouth going. This implies shifting focus from being "noisy" to developing passionate ambassadors.

## Satisfied customers

There are two things about loyalty which are important to notice. A satisfied customer is not automatically a loyal customer. It's only the *super* satisfied customers who become loyal customers. That is why 'satisfied' is not enough in a world of abundance. Add to that the tough reality that what we considered fantastic last year is what we expect this year. The expectations of the customer change all the time. If we want to maintain the loyalty we have to get better and better.



**Loyalty/satisfaction**
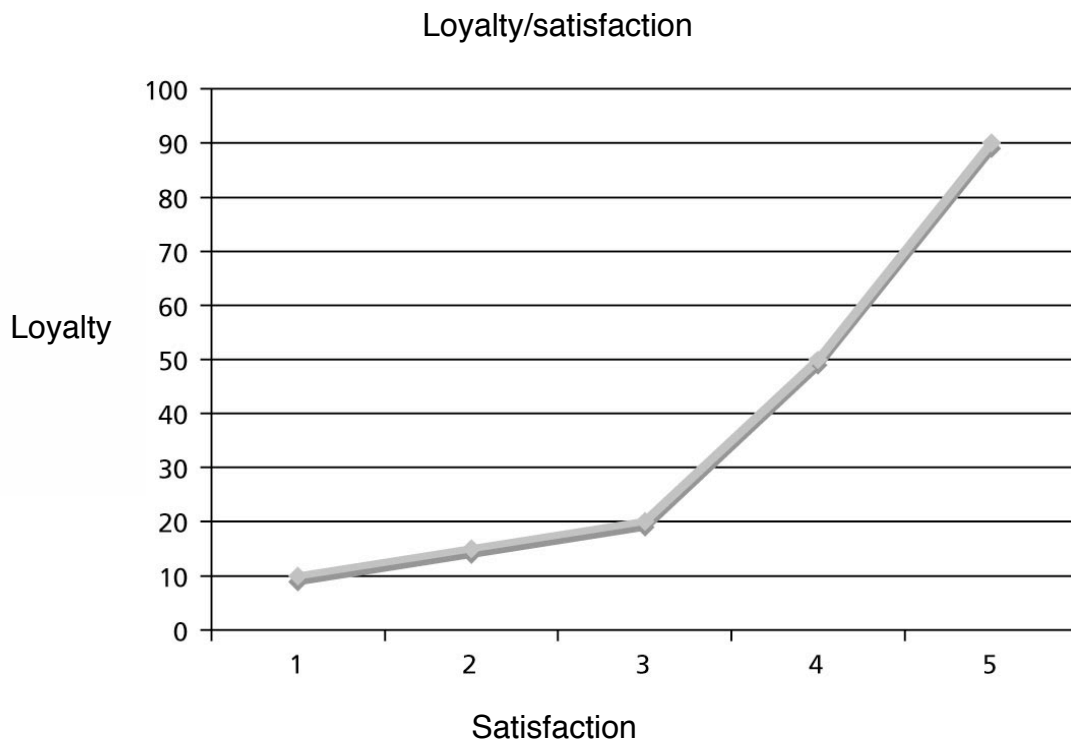
*According to Frederick Reichheld[1] the degree of the loyalty of the customer changes surprisingly little from very unsatisfied to satisfied. First when we move from satisfied to excited, the degree of loyalty of the customer increases.*

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[1] Frederick Reichheld is an American writer and business strategist who focuses on loyalty and satisfaction. He has, among others, written these books: Loyalty Rules (2001), The Ultimate Question: Driving Good Profits and True Growth (2006) etc.

*significantly. From this we can also deduce that there's a much bigger effect in making satisfied customers to excited customers than turning very unsatisfied customer into fairly satisfied customers.*

So how do we move from satisfied customers to excited customers? We create value for the customer. Value often has an emotional component that makes the experience particularly memorable for the customer.

## Value

The primary factor of customer satisfaction is value – that the customer has gained more from the product than he thinks it is worth. Satisfaction is a very personal matter and it varies significantly from person to person. This is one of the keys to understand why employee loyalty becomes so important. If two products are almost similar and cost the same, it's the emotional component that makes the difference. If you ask a person to describe a fantastic service experience it's rarely a 48' inches B&O wide screen, gold faucets or designer furniture he or she mentions. Typically it's an emotional experience: The staff did something extra. They came up with a great solution for our child or we got special attention etc. The key to create value – more than just making the customer satisfied – is the ability to connect emotionally with the customer and create *wow* experiences. Therefore, it's stating the obvious that an employee who does not like his or her job, finds it harder to connect emotionally with the customer than the employee that checks in every day with a smile. Value in service companies can be illustrated in a value equation:

$$V = \frac{R + P}{\$ + E}$$

Result — R
Process — P
Value — V
Price — $
Effort — E

Time
Competance
Honesty
Empathy
Visible proof

In what way can we make it easier for them?

In what way can we involve them to make it more exciting?

## Productive employees

Value is a direct result of productive employees. Productivity in service companies is not related to the quantity of the items that you produce per hour. The service employee's productivity has do to with his or her ability to transform the wishes and needs of the customer into good solutions that work within the framework of the company. Productive employees also have a high degree of product knowledge and customer knowledge. This is why employees who have served quite a few years in the company usually are much more productive than new employees.

## Loyal employees

To be able to create excited customers and contribute to memorable experiences you need to be excited as an employee as well. You have to meet the customer at an emotional level. This implies that the employees must be happy with their jobs to have what it takes to meet the customer in this way. If you are unhappy doing your job it can be quite hard to convince the customers about how outstanding the company is. In this case a loyal employee both means an employee who has been in the company for a long time – gaining a great deal of knowledge about customers, processes and the service culture of the company – and an employee who cares for the company, is aware of the costs and gives the customer extra service etc.

This is the kind of loyalty that affects the bottom line (do you for instance turn off the lights before you go home Friday afternoon, or do you just leave it on until Monday and think: "Who cares?"). The opposite of employee loyalty is an employee that answers the guest: "Don't ask me, I just work here..."

## Satisfied employees

Like customer loyalty is driven by excitement rather than just satisfaction, employee loyalty depends on the same principle. Employee satisfaction is rather easy to achieve. To achieve real excitement is far more difficult and much more complex. In The Service Profit Chain the employee satisfaction is a result of 'internal quality' which again relates to a number of elements that have to be present to ensure employee satisfaction.

## Internal quality

Internal quality ensures the employee's motivation. It's important to underline that motivation has to do with both job context and job content. The job context is the external conditions such as fringe benefits, wages and physical conditions. However, this is not the most important aspect of motivation. The context merely prevents demotivation. It's obvious that if you have unsatisfactory physical conditions you don't exactly invite the employees to stay long in the company. The determining factor for motivation and employee satisfaction is the job content. The moment we contribute with something meaningful it gives us a high degree of motivation. Independent decision making, acknowledgement from colleagues and leaders, responsibility, trust and the opportunity for developing yourself as an employee are the most important top scores when it comes to ensure satisfied and motivated employees.[2]

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[2] http://www.arbejdsmiljoeportalen.dk/graphics/Miljo-Nyt/PSYK-pakken-2005/psyk3.pdf

Employees can easily get frustrated when the limitations of their work keep them from serving the customers in the best possible way.

## The Dream Team Process

A quick way of checking your own company's internal quality is to have an open minded discussion with your leader team using the following checklist – we call it the Dream Team process:

| The Dream Team Process | Questions we need to ask ourselves |
|---|---|
| Careful selection of employees | Do we emphasize values and personal opinions in the employment? |
| High quality training | Do we support education and training regarding the job as well as the personal development? Is training and development an important quality in the job? |
| Well designed support systems, information and facilities | Do our support systems reflect the needs of the customers?<br>Do our support systems give us the opportunity to develop the relations to the customers? |
| Latitude to meet customer needs | Is freedom a reality in our company or is it just words?<br>Do we have the freedom to provide the results our customers ask for? |
| Clear limits on and expectations of employees | Is there a clear connection to our service objectives?<br>Is there a balance between "money" and other rewards? |
| Satisfied employees | Do we measure employee satisfaction at regular intervals?<br>Do we do it often enough?<br>Do we provide enough response to these measures?<br>Do the employees feel that the measures contribute to positive changes? |
| Appropriate rewards and frequent recognition | Are we good enough to give positive feedback?<br>Do we celebrate our successes?<br>Do we focus on what works (or do we search for mistakes)? |
| Employees recommend new employees | Do we encourage our employees to recommend new job candidates?<br>Do we give first priority to the candidates recommended by our best employees? |

## The service profit chain put into practice

Some companies have understood the Service Profit Chain intuitively for many years, for example Southwest Airlines. They haven't experienced an economic decrease since they started out as a company 34 years ago. It's a world record and no other airline company has reached a similar success.

The theory of The Service Profit Chain is easy to understand and to put into practice. A good example is Monicals' Pizza, USA, a smaller chain of pizzerias that consists of 53 entities and about 1.000 employees. The chain has existed since 1959. A few years ago the founder and owner felt that the company was in a stage of stagnation. He went to a summer course on Harvard University for personal inspiration, and this is where he was introduced to the philosophy of the Service Profit Chain and decided to fully embrace the thoughts behind the theory.

## Four focus areas/divisions

First he reorganised the whole company. He discarded the classical structure with a big operational department responsible for the operation of all the different units. Instead he established four equal divisions in the organisation:

- Customer satisfaction
- Customer loyalty
- Growth
- Profit

Every division was appointed a team leader (vice president) who reported directly to the chain's holder and CEO. Every division had a separate area of responsibility – employee satisfaction became a first priority. It was an aspect that suddenly required a 100 percent focus in the same way as growth and profit. Another radical consequence of the implementation of The Service Profit Chain was the decision to discard 80 percent of their former media budget (PR) and transfer this amount to improvements of the internal quality in the company. There was a clear shift of focus from profit to the first step of the process - internal quality.

## The result was a significant growth

What benefits did Monicals then achieve from this shift in focus and management style? The two most significant results was partly a dramatic decrease in the turnover of staff and partly an increase of 15 percent in annual turnover. The growth was primarily due to an increased customer loyalty in the current business with an 11 percent increase of sales (the rest of the growth is from new businesses).