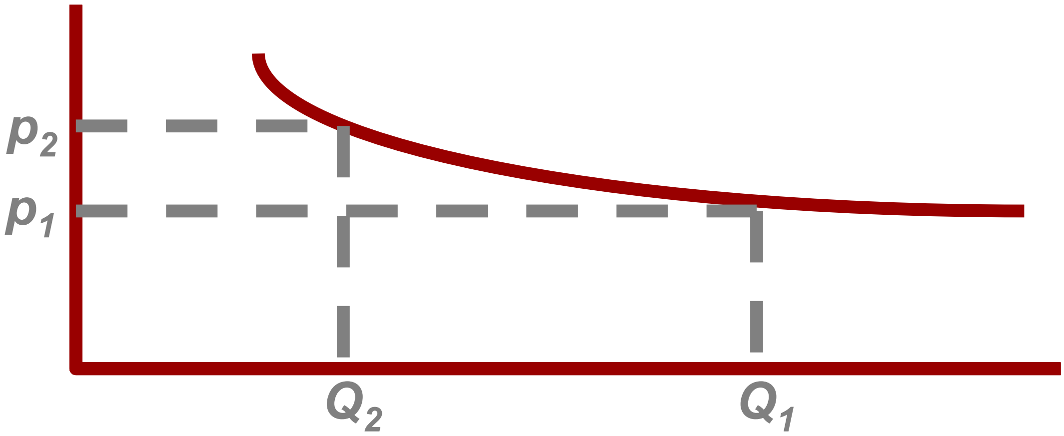
An IASS Subproject

Prices and Contracts for Service Selling

Service Level Agreements, Contracts and Price Models



Jakob Rehme

Industrializing After Sales Services, IASS, is a research and development project equally financed by participating companies and VINNOVA, performed by the Marketing Technology Centre, MTC, Linköping University School of Management, and the Swedish Industrial Design Foundation, SVID.

Participating companies are AGA/Linde Gas, BT Industries, TeliaSonera, ITT Flygt, Metso Minerals, Electrolux Laundry Systems, Volvo Bus Corporation and Saab Technologies.

The aim of the project is to identify how to increase companies' ability to develop and produce after sales services in an industrialized way.

This report summarizes the work within one of four IASS sub projects, aimed at investigating contracts and price models. In particular, price models are presented with the intention to introduce a better understanding of available options in service selling.

CONTENT

Jakob Rehme
Institute of Technology
Linköping Universitet

Contracts in Service Selling

- *Service selling in this report means:*
  - *Financial services, such as Rental Services*
  - *After sales services such as Maintenance, Repair and Operations Services, including the provision of Spare Parts and Reconditioned Units etc.*
- *It is getting more important to handle contracts.*
- *Industrial services are normally handled with contracts between buyer and seller.*
- *Service contracts typically describe:*
  - *repair service,*
  - *specified maintenance service,*
  - *preventive checkups,*
  - *may provide specified consequential damages.*
- *Contracts articulate the offer provided by the seller.*
- *Gives the opportunity to move from spot market prices and/or price lists towards price models reflecting value and contingencies.*

1.1 Defining Service sales

> *In connection with the evolution of the term [service] should be noted one curious qualitative change that has occurred. As first used, the word service denoted something gratuitous which was given in addition to the commodity, such as restroom and telephone accommodations in a department store. Service was regarded as a sort of economic second-mile which the seller furnished out of the goodness of his heart. Within recent years, however, and by the advanced sellers, service has come to be regarded not as an accessory but as a real part of the commodity, indeed, as the commodity itself. -As both seller and buyer have begun to philosophize about the matter they have come to see that after all the latter pays for the service. He therefore has the right to specify what form it shall take.*

This citation could have been written today, but was in fact written by Harry D. Kitson already in 1922. Although the concept of service selling is not new, and solutions and different types of service selling has been around for many years now, the impact and importance of it has not declined. Instead services have grown in importance, particularly since manufacturers have seen prices on their products and commodities being held down by global competition. For services, the business is still local (some exceptions are the banking and IT-sectors in India cf. Gadrey, 2000) and the markets and prices are arranged on a case-by-case basis. In some industries it is valid to speak of a “Service Migration” where companies move into services because 1) margins are relatively high; 2) expansion into services is based on product selling and does not involve major investments (if compared to investments in production units) and 3) when the installed base is greater than the yearly sales.

Services and service marketing has been defined by a number of authors, and by and large these definitions are fairly general. In fact, Judd (1964) meant that it is almost easier to formulate definitions by exclusion, i.e. what service is not. Gadrey (2000) also means that a number of traditional definitions of services (for instance*: 1- The Immateriality of Services and the "Immediate Perishability" of Their Output; 2- the Co-production, Cooperation or Interaction Between Producer and Consumer in Obtaining the Product or Outcome and 3- The Non-storable and Non-transportable Nature of Services),* has become obsolete by the emergence of IT-services and other technologies. Therefore a number of services are not perishable, can be stored and does not necessarily involve a co-production by the customer.

Nonetheless, Judd (1964) defined the provision of services to a customer as:

> *1. the right to possess and use a product (Rented Goods Services) ; or*
> *2. the custom creation of, repair, or improvement of a product (Owned Goods Services); or*
> *3. no product elements but rather an experience or what might be termed experiential possession (Non-Goods Services).*
> *(Judd, 1964)*

In this project, services are regarded in terms of after sales services, and involve issues surrounding physical goods. In this report the emphasis is on 1) and 2) in the definition above, that is 1) the financial arrangements for the provision of the goods as well as the services and 2) after sales services in terms of repair and maintenance etc.

This means service selling in terms of: ***Financial services***, such as Rental Services; and ***After sales services*** such as Maintenance, Repair and Operations Services, including the provision of ***Spare Parts*** and ***Reconditioned Units*** etc.

1.2 Contracts and service selling

Contracts and agreements in service selling are important for a number of reasons.

1) It is getting more important to handle contracts.
   Contracts are becoming more important in international business, fuelled by the globalization of markets and a marked influence from American business.
2) Industrial services are normally handled with contracts between buyer and seller.
   Industrial services are often complex, and therefore need to be handled in contracts. Furthermore, by the nature of services, and the situation that some customers may end up in, to articulate the business dealings in a service contracts is an imperative.

   > *In many types of service transactions, the buyer is a client rather than a customer of the seller; the client, when buying a service, figuratively or literally places himself "in the hands" of the seller of the service. (Rathmall, 1966)*

3) Service contract typically describe repair service, specified maintenance service, preventive checkups, and may provide specified consequential damages. A service contract can be viewed as failure insurance or prepaid maintenance and repair service over a specified length of time called the term of the contract (cf. Bryant and Gerner, 1982)
4) Contracts articulate the offer provided by the seller..
   Many companies can articulate offers that they want to provide to their customers. It is however their customers that define them in the end, which then normally need to be formulated in contracts.
5) Gives the opportunity to move from spot market prices and/or price lists (product catalogues) towards price models reflecting value and contingencies.

2 Price Models

- *Pricing is based on price lists and discounts*
- *Firm's can work much more with prices for service, especially for new services.*
- *To control costs are vital in order to be able to use various price models such as value-based pricing*
- *The process to develop a realistic price plan contain a number of process steps*

The most common way to think about prices in saturated industrial markets is that there are *market prices* that cannot be affected by the individual firm. In this view, the only way to affect the profitability of a firm is to work with the costs of manufacturing and distributing goods and services to the customers (cf. Mason, 1926). However, there are also possibilities to work with various price models, particularly when introducing new services or offers, and in doing so, change the way in which services and offers are priced. Pricing in general (see e.g. Fogg and Kohnken, 1978) and pricing for services in particular is a very important part of firm's marketing strategy but have not been treated as a centerpiece in the studies of marketing strategy (see Avlonitis and Indounas, 2005).

Prices are always important to handle, but even more so for services than for products because they are often more complex to define. Unlike a product, where monetary values are easily stated in terms of a price, services are more likely to be expressed as rates, fees, admissions, charges, tuition, contributions, interest, etc. (cf. Rathmall, 1966). Furthermore, price models are more heterogeneous for services than for commodities:

> *"Price-making" practices vary greatly within the services category. Utility and transportation rates are rigidly controlled by public agencies; interest rates display characteristics of price leadership; and some service charges are established on the basis of what the traffic will bear. (Rathmall, 1966)*

Three groups of price models can be discerned, 1) Cost based Pricing Models, for example Cost Plus Pricing and 2) Competition-based methods:, e.g. Market Pricing (competitive-product-comparison) models and finally 3) Demand-based methods, e.g. Value Based Pricing, i.e. Based on Customer Value [1]). (cf. Avlonitis and Indounas, 2005). Hoewever, prices and costs for services are complex.

> *Economic concepts of supply and demand and costs are difficult to apply to a service because of its intangible nature. Moreover, values of some services are difficult to fix. (Rathmall, 1966)*

According to a study by Avlonitis and Indounas (2005) of the Greece service market the four most commonly used pricing strategies were: 1) Cost-plus method; 2) Pricing according to the market's average prices 3) Target return pricing and 4) Pricing according to the dominant price in the market. This means that is was Cost-based and Competition-based pricing models that companies predominantly used.

The most used pricing strategies can be listed as:

1. ***Cost-Plus Pricing***
2. ***Target Return Pricing***
3. ***Competitive Strategies***
   a. ***Parity***
   b. ***Above Market***
   c. ***Below Market***
4. ***Life Cycle Pricing***

[1] One definition of Value for Money - ($Value_s$-$Price_s$)>($Value_a$-$Price_a$) (cf. Anderson and Narus, 1995)

a. *Skimming*
b. *Penetration*
5. ***Experience Curve Pricing***
6. ***Economic Value-Based Pricing***
   a. *Contingency Pricing*

2.1 Cost-Plus Pricing

Cost-plus pricing is an approach that adds a standard markup to the cost of the product. This is an easy and cheap way to handle pricing, but requires certainty about costs. Pricing is simplified, and one would assume that price competition is not so high. The method ignores current demand and competition. Ultimately, this type of pricing method rewards inefficiency.

2.2 Target-Return Pricing

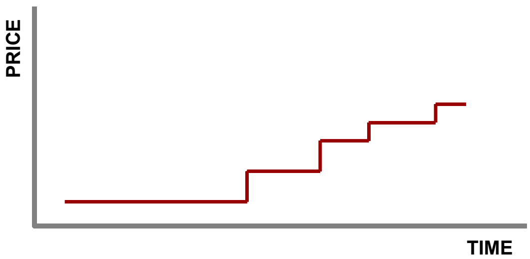
Target-Return Pricing is a pricing strategy whose objective is to achieve a target return on investment over a specified time period. This Breakeven Analysis or Target Profit Pricing is s a way to determine the price at which a firm will break even or make a certain target profit.

2.3 Competitve Pricing

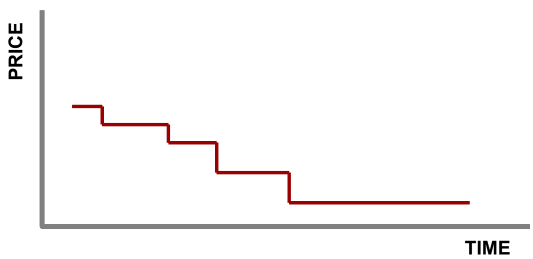
This is probably the most common way to price industrial products. Depending on the market structure there different ways to price the service or product. A company can price at market price, below market or above market. Normally, there are also a number of companies in the different groups, to supply different market segments, with various levels of price sensitivity.

2.4 Life Cycle Pricing

Market-penetration pricing is a prudent methodology when the market is highly price-sensitive, and a low price stimulates market growth. Furthermore, the production and distribution costs should fall within accumulated production experience, and that the low initial price discourages actual and potential competition. In other words a penetration strategy is an initial low price aimed at achieving the broadest overall market coverage, where high volumes compensate for low margins.



Market penetration

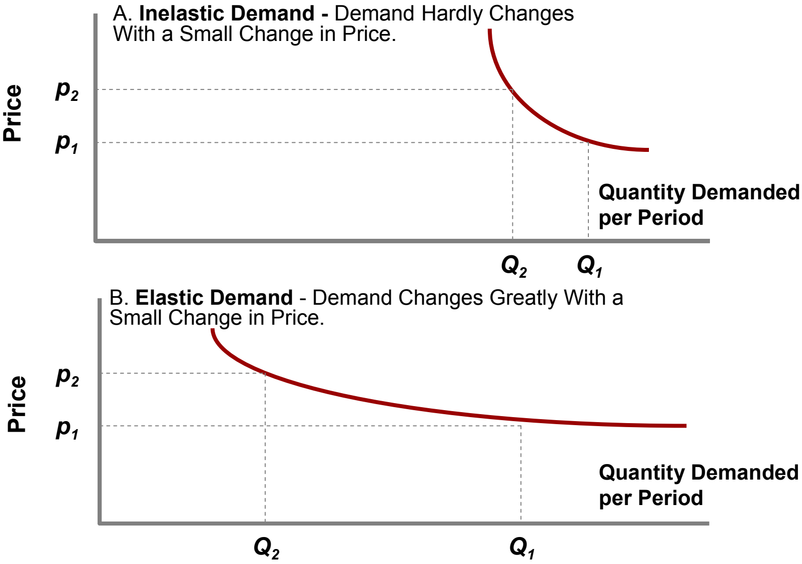


Market skimming

Market-skimming pricing is conversely best when there are a sufficient number of buyers with a high current demand, and the unit costs of producing small quantities are not so high as to cancel charging what the traffic will bear. In addition, the high initial cost does not attract additional competitors to the market, and the high price communicates the image of a superior product

A Skimming strategy (initial high price) will attract a limited market segment, one that places a very high value on the product/service. This is used when introducing the product/service to the market. The price is then gradually lowered to appeal to larger segments of the market. (This may be accomplished with the original product or by offering lower featured product extensions.)

In order to judge the type of market one is in it is important to understand the level of price sensitivity the customers have.



Demand curves

There are a number of factors associated with lower price sensitivity

1) Buyers are less aware of substitutes
2) Buyers cannot easily compare the quality of substitutes
3) The expenditure is a smaller part of the buyer's total income
4) The expenditure is small compared to the total cost of the end product (also cf. Kraljic 1983)
5) Part of the cost is borne by another party
6) The product/service is used in conjunction with assets previously bought
7) Buyers cannot store the product/service

Normally these factors suits well with the market for services, which is one of the reasons why there has been good margin on this market.

2.5 Experience Curve Pricing

Another way of looking at prices is to understand the *dynamics of costs*, which will give a company the possibility to adjust prices as time goes by. This is known as the experience or learning curve, where buyers and sellers adjust to one another, which can result in cost reductions.

This type of dynamic pricing needs to be associated with the traditional usage of price adjustments based on index. This also means that there need to be possibilities to adjust prices not only on a downward trajectory, but also to adjust them upwards if some factor prices have gone up.

For services, this type of pricing seem to be suitable, since the services develop over time and the buyer/seller interaction is so deep. Although there are many issues that speak in favour of the 'learning curve' there are also a number of issues or question marks about the learning curve:

1. Cost declines don't happen automatically
   It is important to get both parties to work with cost reductions, but without proper incentives, it is difficult to get the parties to do so.
2. All companies (or plants of companies) don't operate on the same experience curve.
   It is difficult to assess the experience curve and the cost reductions that it may result in. Every company has its own contingencies, which means that there are large discrepancies between different companies learning curve.
3. Inflation may mask cost declines (use constant money)
   Accumulation of quantity is demand driven, not cost driven.

Therefore it is important to understand the firm's position on the curve (which "doubling" is the firm currently moving toward; how much progress is it likely to make toward this current planning period). It is also important to calculate costs correctly so that amortization of additional fixed investments is factored in, and that components are disaggregated from products, and reaggregate cost components as well as to compute individual experience curves to calculate the proper expected costs.

This type of pricing requires a fair amount of understanding of the underlying processes and costs. It is also contingency based and there is a great deal of thought that has to go into setting these prices. The complexity of these calculations aside, this type of pricing is fairly suitable for services since the dynamic pricing also reflects the nature of the development of services.

2.6 Value Based Pricing

Value Based Pricing is a system of establishing customer prices based on the value which the customer derives from the use of the product or service. Cost is used only as a consideration of whether or not to offer the service or product for sale. This pricing strategy is especially useful for situations where one is introducing an improved product or going against an established competitor

For value based pricing - contingency pricing is a way of determining service fees from where the client determines the value of the services provided. The principles of contingency pricing includes: 1) an objective measure (in economic terms) of customer value such as cost per unit of output, savings, increased productivity or some similar measure; 2) a product or service that costs less to deliver than the value received by the customer; and 3) a willingness of the manufacturer to assume some of the risk inherent in the sale.

Increasingly companies are trying to define their offers and SLA's in terms of 'customer value'. However, in order to provide such solutions it is important to understand the costs incurred in the service, and particularly how these costs may develop over time.

> *Within recent years there has been developing a noticeable tendency to define selling as a process of rendering service. Thus a manufacturer of automobiles does not sell automobiles; he sells transportation. And he uses as his strongest selling point the argument that the buyer of his car will have uninterrupted transportation. Similarly a manufacturer of tires does not sell tires; he sells mileage. And if one casing does not give satisfactory mileage he will furnish another (Kitson, 1922).*

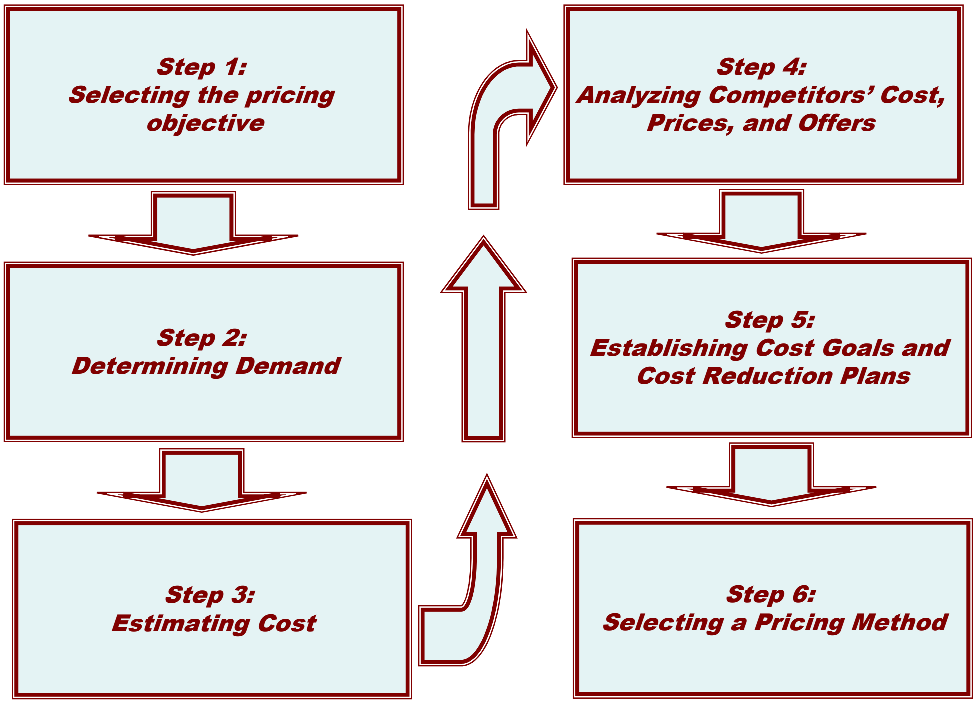
2.7 Process of establishing prices

One of the more important aspects of establishing prices is to understand the costs (Fogg and Kohnken, 1978). For services this can be a bit tricky since they are dynamic and often based on contingencies. Furthermore, to work with prices can sometimes be difficult when there are established market price. In such instances it is difficult for one firm to differ too much from the market price level. However, companies could work more with prices, for instance when they are introducing a new service, or entering a new market. According to Fogg and Kohnken (1978) there are a number of situations when companies should reconsider their pricing policies, such as when a competitor's price structure or offering change considerably or when significant volume is being lost on price, or when quotations are frequently lower than that judged necessary to obtain desirable business.

To define the price-level as well as the pricing strategy it is important to understand the cost structure (Mason, 1926). However, the process to develop a realistic price plan contain a number of steps:

1. Selecting the pricing objective
   Is the pricing objective to survive, maximize current profits or maximize market share.
   Important to define the goals e.g. for market share, based on the firm's competitive situation and the stages of the services' life-cycle.
   Establish the profit goals.
2. Determining Demand
   What is the volume demand on the market, and what is the price sensitivity for the services provided. Use Total Cost of Ownership (TCO), Demand Curves and Price Elasticity of Demand to understand the market demand.

3. Estimating Cost
Understand the types of costs associated to different services and different and levels or amounts of service production, What are the 1) fixed costs (overhead) 2) variable cost, 3) total cost and 4) average cost.
Understand the dynamic development of costs and the accumulated service production, using e.g. the experience curve (Learning curve)
4. Analyzing Competitors' Cost, Prices, and Offers
Take in what the competition is doing and use the best in class as benchmarks to provide better offers.
5. Establish *cost goals* which will achieve targeted profitability. Develop a *cost reduction plan* that will result in targeted costs
6. Selecting a Pricing Method;
E.g. experience curve cost-based pricing or value based pricing. Price levels based on the analysis above.



Suggestion of a process for establishing prices

3 Service Level Agreements

- *Service Level Agreements are seen as company offers*
- *The offers are defined in terms of different standard levels of service*
- *SLA's are offered at variable or fixed price*
- *The SLA - offers are tightly connected to the company's service strategy development*

A lot of the discussion about Service Level Agreements (SLA) is coming from IT-outsourcing, where IT-companies and buyers had to work out the required service levels. An SLA is defined as an agreement: "between a supplier and the end-user which stipulates and commits the supplier to a required level of service."
In terms of this an SLA should contain:

- a specified level of service,
- support options,
- enforcement or
- penalty provisions for services not provided,
- a guaranteed level of "performance" as relates to downtime or uptime,
- a specified level of customer support and
- what additional products and service that will be provided and for what fee.

In other words when one has defined an SLA, the offer is supposed to be quite clear, although it may differ between different customers.

The companies in this investigation have a number of different service levels that they offer (see Table 2).

<table>
<tr><th></th><th>BT Europe</th><th>Electrolux Laundry Systems</th><th>ITT Flygt</th><th>Saab Aerosystems</th></tr>
<tr><td rowspan="3">Variable (or variable and fixed) price contracts</td><td>Safety inspection</td><td rowspan="3">Country and business specific</td><td>Bronze contract: Basic preventive maintenance</td><td rowspan="3">Spare parts and apparatus</td></tr>
<tr><td>Preventive maintenance</td><td>Silver contract: High-end preventive maintenance</td></tr>
<tr><td>Full service</td><td>Gold contract: Trouble-free operations</td></tr>
<tr><td rowspan="2">Fixed price contracts</td><td>Short-term rental</td><td>Capacity / availability</td><td rowspan="2">Platinum contract: Total offer</td><td rowspan="2">Aircraft availability (not yet offered)</td></tr>
<tr><td>Long-term rental (four different plans)</td><td>Rental (current pilot)</td></tr>
</table>

Service level agreements and solutions offered.

3.1 Saab Aerosystems/Technologies

With the phasing out of the production of Gripen fighter planes to the Swedish Airforce Saab Aerosystems is revamping their business, where one particularly important part will be service selling. It is generally believed that Saab Aerosystems will take an increased service responsibility after the first Gripen fighters are operational in 2006. Service contracts guaranteeing aircraft availability or airtime may be an important part of the company's business in a few years time.

The company has designed an after-sales "product portfolio" defined as the products offered to the customer after the delivery of a system. It consists of follow-on support – services enabling the customer to make use of the system in the most efficient way within the functionality given – and add-on sales – services adding new functionality to the system if the customer has new or changed demands. By bundling single services such as spare parts, repair, overhaul, aircraft modifications, technical publications, and pilot training broader offerings can be presented on the market.

3.2 ITT Flygt

In spite of increased competition from interchangeable parts providers, the main revenue source for ITT Flygt services is spare parts. Many contracts are poorly designed with rebates on products and services, which have led to Flygt trying to standardize the contract forms.

There are four levels of SLAs, from bronze contracts with basic preventive maintenance to platinum contracts with a complete bundling of services and fixed prices. Even though the majority of contracts are bronze or silver, the share differs between different European markets. There are often situations where the customer has its own maintenance personnel and competence that Flygt might have to take over (or compete with). There may also be risks associated with some application areas, making it difficult to make profits from these contracts. Notwithstanding, most service contracts are profitable today. Furthermore, the contracts fill the workshops and give increased possibilities to plan repairs.

3.3 Electrolux Laundry Systems

ELS have signed contracts connected to capacity and availability with some customers, and in these contracts the design and choice of equipment is critical for the profitability; instead of one large washer, two smaller ones can reduce the life cycle cost. In connection to this, ELS has developed CMIS, an online information system connected to the laundry equipment allowing e.g. remote optimization of laundry programs and trouble-shooting without having service technicians at the customer's site. Furthermore, a rental pilot where the customer pays in advance per washing is being launched at a European national market. Examples of new industrial services can be consultancy services connected to profit sharing contracts; if ELS manages to decrease customer costs it will obtain a percentage of this reduction. There are consultancy services today optimizing the laundry process, but these services are only available in connection to product sales.

3.4 BT Europe

BT Europe offers three levels of SLAs: Full service, Preventive maintenance, and Safety inspection. Other services are resident engineer, when a BT technician works full time on the customer's site; night care, which is service outside office hours; and BT Fleet Management. The business area also offers single services, including preventive maintenance and emergency repairs, spare parts supply and driver training. All services are available at the twelve sales companies but they are not always standardized. An example of this is that different national demands on safety inspections can occur. Many services are therefore adapted to local demand, while the international services are standardized. There is a trend towards more Key Account deals and these have to be standardized in order for the customer to perceive that BT's service personnel has the same knowledge at the different markets. All sales companies have to offer the three levels of service agreements but in addition, it is possible for a single sales company to offer local agreements, e.g. full service exclusive of forks.

During the first three quarters of 2004, 40% of all sales in BT Europe were rental contracts, with a higher figure in Northern Europe exclusive of Germany. The ambition is to increase the number of rental contracts and developed relationships with customers are crucial in order to achieve this. Very often contracts with customers are gradually becoming increasingly advanced as the relationships develop and communication and mutual knowledge improve. Customers are also used in the service development process and relationships are necessary for BT Europe when proactively experimenting with new projects and services. The mobile PDA (personal digital assistant) solutions used by service technicians are an example of a service tested in the field before being implemented.

3.5 The SLA and strategy

It is fairly clear that the service level described by the companies in this report also constitutes the offer that the companies want to make. The SLA's are basically in this a description of the firm's service strategy, and are therefore very important to formulate. With reference to the next section, the connection to the service and the customer value, pricing method and dynamics is important to handle.

4 Contracts

- *The service contracts are written as static short-term contracts.*
  - *Focus on defining the operations*
    - *Technical and operational issues*
  - *Legal issues in all contracts – prerequisite*
    - *Liabilities etc.*
    - *Penalties*
- *Dynamic pricing and dynamic long-term discussions are rare*
  - *Price is not 'important' in the contracts*
    - *Prices in price lists*
    - *One example of a price strategy discussion.*
    - *Development opportunity for dynamic pricing – development over time - and Value based pricing*
- *Dynamic contracts could be used both externally towards the market but also internally to clarify offers and to standardise them*

There are several different reasons for developing and formulating different types of contracts. There are also different levels of contracts where one type can be very comprehensive to cover all contingencies. Such contracts are often fairly static. Other contracts have more been formulated to accommodate an agreement between businessmen and are a bit vague in their formulation. These contracts can therefore be more dynamic in their formulation

1) If something goes wrong – but not used in daily operations
   this is the traditional Swedish way, where businessmen agree on a contract, and need something if the relationship turns foul. (see Anderson 1998)
2) Used as *project/process plan* – also to prevent things from going wrong.
   Is an American way of writing contracts, where lawyers define all contingencies

Another aspect that is important with contracts is that they articulate the offers and in other words specify them (e.g. ABB Service ca 1995). This is important in order for the *seller* (sic) to understand the nature of the offer, and gives room for different variants to different customers. However, it is important to standardise these contracts in order to have common offers to the market. This is also a way to market the offers internally.

> *Because services cannot be mass-produced, standards cannot be precise. Although service procedures may be standardized, their actual implementation will vary from buyer to buyer. Perhaps there will be a standardization of services through the increasing use of service technology at the expense of personalized service, […]; and this would mean that services will follow goods from custom to mass production and standardization. (Rathmall, 1966)*

Generally speaking there are a number of things that seem to be included in the wservice contracts: which can be divided into:

1) Service levels/Operation
   technical and operational issues are handled in the contracts. It defines the service levels that the seller will provide under the contract. It does not include how the services will develop.
2) Commercial Issues/Prices and Terms:
   Commercial issues, such as terms of payment, discounts etc., and price lists are naturally enough handled in the contracts. The development is included in one of the contracts,

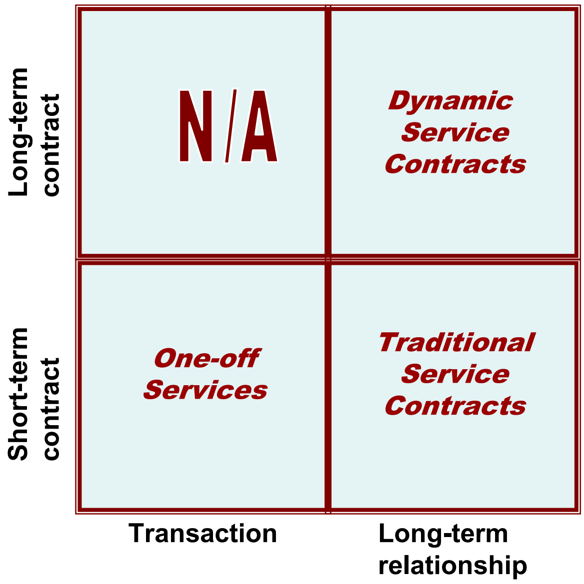
whereas the other contracts handle prices as, price lists. They are fairly silent in terms of e.g. value based pricing.

3) Legal issues
The normal legal issues such as enforcements, penalties, roles and risks are handled in the documents.
4) Time - planning
Time and the when the deliveries take place is included in the contracts. They are fairly silent how this will develop in the future.

	Service Levels/ Operation	Commercial Issues – Prices and Terms	Legal Issues – Roles and Responsibilities	Time Plan
Company 1	Defining different offers – service levels	Not much 'commercial' discussion, Prices in appendix	Roles and responsibilities defined	Time plan outline
Company 2	Technical/operational definitions	Not much 'commercial' discussion, Price terms	Roles and responsibilities defined	Time plan outline
Company 3	Prerequisites for operations/technical issues	Prices in appendix	Focus on roles and responsibilities	Time plan outline
Company 4	Definition of operational/technical	Defining what is included in price, Price in appendix	Defining responsibilities for each party	Time plan outline
Company 5	What is included in the contract – technical/operational	Definition of price strategies – discussion, Dynamic pricing, Experience curve	Roles and responsibilities, guarantee	Time plan outline
Company 6	Comprehensive – total contract Defining some processes	Detailed prices – no price strategy discussion	Roles and responsibilities different parties	Time plan outline

Describing the different companies' contracts

One issue that is handled in one of the contracts is the dynamics of the services, and the development of technology, processes and prices etc. In general terms all contracts are designed to be renegotiated every year or so, although the customer relationships are much longer than that. This means that the contracts are designed as short-term contracts, although the desire is to handle the customer in a long-term relationship (cf. Crawford, 1988). These are the ***'Traditional Service Contracts'*** that are written to satisfy a legal requirement rather than as a tool to develop the customer relationship. The second variant is the services that are conducted with a loose contract or even without contract as a ***'One-off Service'*** (like drivers-by that uses a garage to handle a break-down). Contracts are not so interesting for these situations.



The nature of the service contracts

The third variant is *'**Dynamic Service Contracts'*** that are written with a long-term view (where certain parts of the contracts can be renegotiated more often) with dynamic dimensions described in the contract. They contain dynamic pricing discussions, such as learning curves, and/or value-based pricing models. They also include discussions how services, processes and technology can and will develop.

Overall, contract writing is not an area which have received so much attention for service selling. This is somewhat surprising since the contracts can be used as a part of the service **sales toolbox**. This mean that the contracts can promote service selling internally, and provide sellers with a better tool to define service offers. Furthermore, it provides an opportunity to **standardise** offers within the firms, instead of ending up with many locally constructed contracts (that define offers). It is also a possibility to be very **concrete** and clear about the various services in the service portfolio, and is therefore tightly linked to the decided service strategy. Another aspect about the contracts is that they are handling **risks** that can be incurred in the buyer/seller interaction. However, in terms of relationship development and the **dynamics** of the service relation, they are silent. The connection between **SLA's** and the material contracts are also important to understand. In particular, it is also important to decide the **pricing** method or methods used, and dynamic contracts can handle this.

5 Concluding Remarks

There are a number of issues that are important to understand in relation to service level agreements, price models and contracts. First, when speaking about service level agreements, they are seen as the “service offer” that is provided on the market. Second. Prices are more often than not seen as set by the market, and price lists and discounts are used in the sales effort. Contracts are fairly static in their formulation.

In summary, to work with contracts in service selling is important:

1. To describe the **SLA’s** in proposed contracts
2. To be more **concrete** in the service offers
3. To work with price models for new services and bundled service offers, and/or in connection to the SLA’s
4. **Dynamic** contracts handle more of the desired development in service relation, instead of treating the development as unmanageable.
5. Contracts can be used as part of the **sales tool-box**
6. **Standardised** contracts prevents local developments of service offers

Judging by the fivefold increase in the use of "service" during the past twelve years, we may reasonably infer that sellers have found it a profitable idea to exploit, and that the seller who wishes to be successful will probably profit by using the idea in distributing his wares. He may weave his sales arguments and appeals around it; or in a more subtle manner he may coin a new term that will make his commodity stand for some particular form of service. What is still more to the point, he must saturate himself with the idea, concentrating earnestly upon the needs of the buyer and seeking honestly to fulfil them. In other words, he must make service not a matter of rote acquiescence but a matter of hearty anticipation. (Kitson, 1922)

REFERENCES

Anderson, Christian (1998) *Anläggningsprojekt och organisatoriskt lärande* Dissertations from the International Graduate School of Management and Industrial Engineering, 1402-0793 ; 10 Linköping : Univ.,

Avlonitis, George J. and Indounas, Kostis A. (2005) 'Pricing objectives and pricing methods in the services sector' *Journal of Services Marketing* 19/1 pp. 47–57

Bryant, W. Keith and Gerner, Jennifer L. (1982) 'The Demand for Service Contracts' *The Journal of Business*, Vol. 55, No. 3 (Jul.), pp. 345-366.

Crawford, Vincent P.(1988) 'Long-Term Relationships Governed by Short-Term Contracts' *The American Economic Review*, Vol. 78, No. 3 (Jun.), pp. 485-499.

Fogg, C. Davis; Kohnken, Kent H. (1978), 'Price-Cost Planning' *Journal of Marketing*, Vol. 42, No. 2 (Apr.), pp. 97-106.

Gadrey, Jean (2000) The Characterization of Goods and Services: An Alternative Approach, *Review of Income and Wealth*; Series 46, Number 3, September, pp 369-387

Judd, Robert C. (1964) Robert C. 'The Case for Redefining Services' *Journal of Marketing*, Vol. 28 (January). pp. 58-59.

Kitson, Harry D. (1922) 'The Growth of the "Service Idea" in Selling' *The Journal of Political Economy*, Vol. 30, No. 3 (Jun.), pp. 417-419.

Mason, Perry (1926). 'The Use of Cost in Setting Selling Prices' *The Accounting Review*, Vol. 1, No 2. pp. 72-76.

Rathmell, John M. (1966) 'What Is Meant by Services?' *Journal of Marketing*, Vol. 30 (October). pp. 32-36.