

Saimaa University of Applied Sciences
Business Administration, Lappeenranta
Degree Programme in International Business Management
Master of Business Administration

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Profitability Development of Value-Added Services in the Case Company

Thesis 2013

Abstract

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The objective of this thesis was to analyse the current situation of a specific value-added service in terms of profitability in the case company. The specific value-added service cannot be revealed in the thesis. A further goal was to examine the specific value-added service itself, and how the process of the service is executed. The purpose of the research was to gain in-depth understanding of the value-added service and the cost structure as well as the processes used to produce the service.

The research for this case study was carried out by using qualitative methods. The following research methods were used: document analysis, participant observation and semi-structured interviews. These research methods were chosen to examine employers, employees and customers' insights. Data for the document analysis was gathered from the company's income statements and internal reports. Semi-structured interviews were held to employees as development discussions to receive information on profitability and processes used. Customer insight was gathered via six mystery shoppers who participated in the survey conducted. Part of the data concerning the case company was declared confidential.

The results of the study show that there are several actions that can be taken to improve the profitability, the practices used in processes and also in customer satisfaction. The findings of the study will benefit the management and the decision making process in the future. The thesis created a good basis for the continuous development process in the specific value-added service in the case company.

Keywords: profitability, service design, value-added services

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1 Introduction

1.1 Background for the study

Being competitive and profitable is a matter of survival in the markets today. The operations of a company must be efficient, productive and profitable. If one part of the company is weaker, it instantly shows in the profit.

Positive financial development is a challenge for the management of every company. The operations that are profitable are usually developed even further, whereas unprofitable operations are valued and estimated whether they have any strategic value for the company. If the operations are continuously unprofitable, the management has to make decisions about the future of these operations. In the long-run profitability is necessary for the company (Selander & Valli 2007, pp. 104).

This thesis project will concentrate on a specific value-added service of Imatran Kylpylä Spa. The main idea of the thesis is to study the business in terms of profitability. The ultimate goal is to find solutions for turning the loss of the value-added service into profit. The author of the thesis works in Imatran Kylpylä Spa as a Service Manager. Part of the data concerning the case company and the nature of value-added service is confidential and therefore cannot be revealed.

Albert Einstein observed: "We can't solve problems by using the same kind of thinking we used when we created them." Or to put it in another words: Keep doing the same thing as you have always done and you can expect the same results. The value-added services of Imatran Kylpylä Spa have not been renewed and developed in the same pace as the core business of the company. By focusing on the value-added services and seeing them as an opportunity for development and additional revenue, positive changes will occur.

However, as mentioned earlier value-added services are not the core business of the company. The company might be prepared or is willing to accept some

losses in some departments in order to maximize the profits in another. Sometimes value-added services are used as a decoy for customers, and profit is not sought. The strategic value of these services is hard to measure.

White (2008, pp. 128) suggests that core business of a company consists a network of operations within the company. If the parts fit well together and complete the business, the recipe for success is guaranteed. He adds that the business is also about planning and deciding on the future actions that the company wants to be involved in. The business environment must be created and guided by the management of the company and services or products must be carefully chosen.

In the case company all the services the company offers are completing each other. For instance, hotel visitors enjoy a variety of activities and services and probably choose Imatran Kylpylä Spa as a destination due to the wide range of services. Daily visitors instead can have a full and fun day by concentrating mainly on value-added services such as bowling, gym or pampering treatments.

1.2 Case company Imatran Kylpylä Spa

Imatran Kylpylä Spa was founded 1985. The early years functions concentrated on rehabilitation. Rehabilitation served mostly war veterans and work welfare-oriented groups. Over the years the operations have been leaning towards recreation and entertainment. Investments, development of services and products as well as the change of customers from rehabilitation clients to more international tourists have brought new challenges for the future.

Imatran Kylpylä Spa is one of the most versatile leisure centers in Eastern Finland. The main businesses of Imatran Kylpylä Spa are accommodation services, pool area called Spa Taikametsä, rehabilitation services and restaurant services. Additional services such as pampering spa treatments, Fitness-services, bowling, shopping and all kinds of activities are available as well. Imatran Kylpylä Spa is also a refreshing alternative as a conference venue, and a place to enhance staff well-being and occupational health.

Imatran Kylpylä Spa is an employer for 100 permanent workers and subcontractors i.e. in cleaning. The turnover in 2012 was 11,8 million Euros. Facilities are owned by the Etelä-Karjalan Kuntoutumissäätiö foundation and Imatran Kylpylä Ltd is the company behind the business.

1.3 Objective and limitations of the study

The objective of this study is to analyse the current situation of specific value-added service in terms of profitability. A further goal is to examine the specific value-added service itself, and how the process of service is executed. The purpose of the research is to gain in-depth understanding of the value-added service and the cost structure as well as the processes used to produce the service. This information is essential for the management of Imatran Kylpylä Spa when developing the profitability of the value-added service.

Profitability is a rather large subject and there are many factors that influence on the outcome whether the business is profitable or not. Also the value-added services under study have no control of all the costs appraised to departments which falsifies the profitability on some level. After understanding the concept of value-added services, profitability can be evaluated on certain levels.

This study establishes a ground work for a continuous improvement project and multiple actions that will take place further on in the future after the thesis project has been completed.

1.4 Research questions

The main research questions for the project can be defined as follows:

- What is the current profitability of the specific value-added service in Imatran Kylpylä Spa?
- How to increase the profitability?

The purpose of the first question is to find out the current state of the business in one specific value-added service. The current state analysis is done by using

an income statement and translating it into a horizontal and vertical analysis. Products and services are analysed via gross profit margin calculations to find out the profitability of each item.

Furthermore, to receive answers to these questions employees are interviewed and outcomes of the interviews are deconstructed together with the employees in brainstorming sessions in order to produce ideas for the development of profitability. Also a study of customer satisfaction is conducted to receive information influencing on profitability.

The findings of the studies are important for the management of Imatran Kylpylä Spa. The information gathered via interviews and the ideas generated from the brainstorming sessions will be selectively taken into action. Customer feedback is considered carefully when developing future actions. Based on the results of the current state analysis Imatran Kylpylä Spa can plan and execute profitable new processes for the value-added service.

1.5 Research methods

The thesis is a case study where qualitative research methods are used. The method was chosen due to the objective of the study. The purpose is to come up with ideas on how to improve the profitability of value-added services in the case-company. The most prominent data collection methods were document analyses, participant observation and semi-structured interviews.

Qualitative methods are often used to find out what people do, know, think and feel through observing, interviewing and analysing documents. The qualitative method is a mixture of rational, explorative and intuitive qualities. In order to use qualitative approach the researcher must be thinking abstractly, critically analyzing situations, recognizing and avoiding biases, obtaining valid information, having social and theoretical sensitivity and ability to keep analytical distance (Ghauri & Gronhaug 2002, pp. 110).

Qualitative methods	Quantitative methods
<ul style="list-style-type: none"> ● Emphasis on understanding ● Focus on understanding from respondent's/informant's point of view ● Interpretation and rational approach ● Observations and measurements in natural settings ● Subjective 'insider view' and closeness to data ● Explorative orientation 	<ul style="list-style-type: none"> ● Emphasis on testing and verification ● Focus on facts and/or reasons for social events ● Logical and critical approach ● Controlled measurement
<ul style="list-style-type: none"> ● Process oriented ● Holistic perspective ● Generalization by comparison of properties and contexts of individual organism 	<ul style="list-style-type: none"> ● Objective 'outsider view' distant from data ● Hypothetical-deductive; focus on hypothesis testing ● Result oriented ● Particularistic and analytical ● Generalization by population membership

Figure 1. Differences between qualitative and quantitative methods (Ghauri & Gronhaug 2002, pp. 110).

A case study focuses on an existing phenomenon in a real life environment and boundaries between the phenomenon and the environment. It concentrates on the phenomenon analyzing it in detail and not trying to generalize it from the results. Case studies usually try to answer questions like “how” and “why”. The case study has procedural characteristics, which include various elements and features for example a high number of variables, numerous sources of evidence and theoretical propositions to guide the data collection and analysis procedure (Likitalo & Rissanen 1998, pp.57-59).

The advantages of case studies according to Robson (2008, pp. 27) are:

1. Possibility to carry out study in-depth when studying a single case. Complexities, relationships and processes are captured more easily.
2. Use of multiple data collecting methods and sources are strongly recommended.
3. Flexible boundaries and often possibility to tailor them to match the time and resources available.
4. Less artificial and detached than traditional approaches.

5. Suitable for variety of research purposes and variety of different types of cases.

The case study as a method suffers from criticism and its validity has been questioned from time to time. It has been argued that the case studies are arbitrary and subjective. Also the credibility of generalizations is often challenged. However, the case study is as scientific as any other form of study if it is executed properly. It is important that when doing a case study, triangulation, the collection of data is done by using two or more different methods, is used (Robson 2008, pp. 26-28).

The qualitative case study approach was chosen for the study since this study focuses on one problem or phenomenon, improving profitability of the value-added service in a specific environment or to be more precise in the particular company and the results of the study may not be generalized to other environments. The qualitative method is suitable in this case because among other factors the emphasis is on understanding the interviewees' point of views and the study is more process orientated.

Theoretical background supports the empirical part of the study and provides detailed information for calculations and factors influencing the profitability of the company. The theoretical part also has a role in analysing the results of the empirical part.

1.6 Structure of the study

The first chapter provides an introduction of the case and furthermore reasons for conducting the study. The theoretical background in the second chapter contains basic knowledge of profitability and ways to measure and improve it. The theory also consists of ideas of service design and other factors that have an impact on profitability. Value-added services in the theoretical point of view are introduced as well since they are very much related to the aim of this study.

The third chapter concentrates on the empirical part of the study. It focuses on research process, methodology, gathering of data and somewhat on analysis. The fourth chapter comprises an in-depth analysis, outcomes of the study and

the results provided by interviews, survey and document analyses. Also the brainstorming session is described.

The fifth chapter summarizes the work and draws conclusions. The outcomes and experiences of the study are also described and suggestions for further studies are made.

2 Keys to profitable business

What makes businesses profitable? Efficiency, quality, productivity, innovation, employees, timing and marketing and so on, reasons can be found probably as many as there are successful businesses. One answer to this question is provided by Gregory (2010, pp. 3). Figure 2 is presenting the reasons behind success:

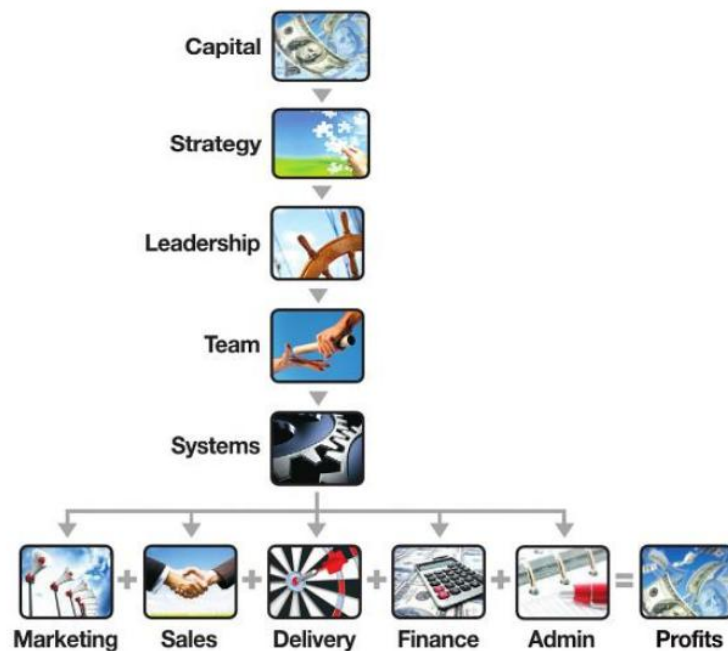


Figure 2. Ten key factors to a profitable business (Gregory, 2010 pp. 3).

Most businesses have a chance to become profitable by having a written plan, strategy, which outlines the vision for the business. Components of a profitable business plan include good leadership and a great team of employees. Marketing efforts, sales strategies and the operational management are important fac-

tors as well. Together these components are the key to success (Gregory, 2010).

Drury (2008) mentions a few key success factors for companies: continuous improvement, employee empowerment, total value-chain analysis and factors such as time, innovation, quality and cost efficiency. These all managed in the right way lead to great results. He also emphasizes the importance of customer satisfaction on profitability.

In the following sub-chapters some key factors of profitability and business performances are brought up and discussed to support the empirical part of the study.

2.1 Profit and profitability

Profitability of a company is usually measured by the amount of profit the company annually produces. As mentioned in chapter one, profitability in the long-run is essential for the company. If the company is not profitable, the company fails in the field of business, unless the owner can tie up more and more capital to sustain the business.

Drucker (1955) states that profit is not the main reason why the business is established, but profit is the result of the performance, marketing, innovation and productivity. He believes that maximization of profit is not the main purpose of the company, but avoidance of loss is instead the guiding principle. He also defines three purposes for profit: measuring the net effectiveness, covering the costs of staying in the business and ensuring supplies if the future capital for innovations and expansion.

The environment of business has changed since Drucker wrote his ideas. Many of them still apply in today's business world, but profit has become more and more important for companies, owners and shareholders. Fast moving markets and a competitive environment lead to more brutal actions in businesses and the avoiding losses mentality is not enough anymore for profit seeking owners and shareholders.

Investopedia (2013) defines profit as financial benefit that is realized after the expenses, costs and taxes that sustain the business are deducted of the revenue gained from the business activity.

$$\text{Profit} = \text{Total Revenue} - \text{Total Expenses}$$

Armstrong (2001, p. 336) categorizes profit under four headings:

1. *Gross profit* –the difference between net sales and variable costs (cost of goods sold).
2. *Operating or trading profit* – the difference between gross profit and the fixed costs such as marketing and distribution costs, administrative costs and research and development expenditure.
3. *Profit before taxation* – operating profit plus invested income minus interest payable.
4. *Net profit* – profit before taxation minus corporation tax.

The income statement of a company consists of these different profit classifications. Gross profit indicates the relationship between sales and production. Operating profit instead indicates the profit generated before financing costs and net profit is what is actually left after all the costs. High net profit indicates that the company is profitable; it controls its costs well and is able to keep a solid competitive position in the markets (Baker & Powell 2005, pp. 62).

Profitability is a significant driver of every organization. A company with profitable operations will keep owners satisfied, is able to pay debts and other obligations on time and is more flexible in its operations (Östring 2004, pp. 73).

Armstrong (2001, pp. 335-336) defines profitability as the company's primary aim and the best way to measure efficiency in competitive business. He also states that profitability analysis is made to provide more data to improve the company's business performance.

The overall profitability of the company can be checked after each financial period from the final accounts, but it is lacking information on whether the pricing

is proper or if single events, departments and products are profitable (Selander & Valli, pp. 36).

The role of accounting is essential for any company. Accounting reports provide essential information for controlling current profit performance, and for planning future profit performance. Accounting information should also help managers in their decision-making, controlling and planning processes. One of the purposes of accounting is to identify each source of profit within the department of the business and to accumulate the sales revenue and the expenses for each of these sources of profit (Alhola & Lauslahti 2000, pp. 27).

Profitability can be defined internally for example by gross margins or operating margins. Gross margin informs how much profit the company makes from each sales whereas operating margin measures the relationship between revenue and the business's operating profit. Both of these are usually expressed in percentages. A successful company has both, strong gross margin and strong operating margin. Guidelines for good margins are defined for different industries. (Hettinger & Dolan-Heitlinger 2011, pp. 135-143). Good operating profit margin in the service sector is around 5-15%.

2.2 Measuring profitability

Cost-Volume-Profit (CVP) approach assists the management to evaluate current and future actions regarding sales and costs of the company. With the CVP analysis the company can determine the break-even level of sales revenue, the sales revenue needed to cover the fixed costs and the additional sales needed to cover the variable costs. The analysis also gives answers to questions like what is the effect on operating results if selling prices changes or how much additional sales are needed to cover loss (Jagels 2007, pp. 332).

The CVP analysis assumes that all costs can be divided into variable and fixed costs. Fixed costs must remain relatively stable during the evaluated period. CVP also assumes that variable costs will increase if the sales of the company increase, they are in consistent linear relationship with sales revenue. CVP is limited to a specific situation, product or department. The economic and other

conditions will remain relatively unchanged during the period under study (Jagels 2007, pp. 333).

After understanding the limitations and assumptions of the CVP method, the analysis produces useful information and estimates to assist the management in the decision making process. However, the CVP analysis relies on accounting information and calculations, and does not consider the customer's or employee's point of view nor social neither potential environmental impacts (Jagels 2007, pp. 333).

The CVP analysis produces useful tools such as *gross margin*, *contribution margin*, *break-even point* and *margin of safety*.

Gross margin and contribution margin

The purpose of gross margin is to determine the value of incremental sales, and guide the management in pricing decisions. In the service sector companies can use contribution margin as an indicator instead of gross margin. Companies operating only in the service sector do not have cost of goods sold item in the income statement (Bhimani et al. 2008).

$$\text{Gross margin} = \text{Revenue} - \text{Cost of goods sold}$$

$$\text{Contribution margin} = \text{Revenue} - \text{All variable costs}$$

Gross margin refers to sales minus cost of goods sold. It is not necessarily profit as other expenses such as sales, administrative, and financial must be deducted. Contribution margin is calculating the variable costs, but fixed costs must be considered as well to be able to define the profit. However, the higher the ratio, the better the result.

When evaluating the company's performance in short-term or based on units, the gross and contribution margins are the best measuring tools. In a short period of time, variable costs as well as fixed costs are unlikely to change. The company is profitable if the gross margin is higher than fixed costs (Stenbacka et al. 2003, pp. 61).

Gross profit margin or gross margin percentage is often a more useful indicator for companies. It expresses the results in percentages (Stenbacka et al. 2003, pp. 63).

$$\text{Gross profit margin} = \frac{\text{Gross Margin}}{\text{Revenue}} \times 100$$

Margins represent key indicators of the state of the business and therefore every manager should know their approximate business margins. By analyzing and using these important figures, the company can control them and maintain a certain level of profitability. The company also gains strategic advantage against competitors. The higher the percentage is, the more the company earns on each dollar of sales. Low gross margins make it difficult to drive profitability by maximizing unit sales volume (Smith, 2006).

Break-even point

Another good way to measure the company's profitability is break-even point. It is the point in which the company is not making either a profit or a loss. Costs and revenue of the company are equal (Stenbacka et al. 2003, pp. 63).

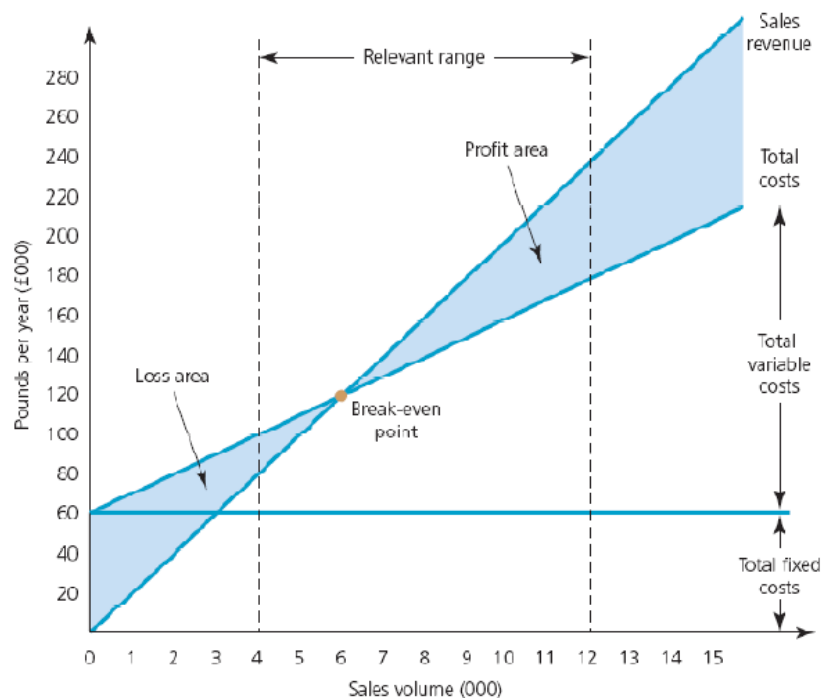


Figure 3. Break-even point in graph (Drury, 2008).

Break-even point can be calculated in Euros or in units. If it is calculated in Euros, the company will find out, how much it has to sell to cover all the costs.

$$\text{Break-even point in Euros} = \frac{\text{Fixed costs}}{\text{Gross Profit Margin}} \times 100$$

Break-even point in units:

$$\text{Break-even point in units} = \frac{\text{Break-even point (€)}}{\text{Price of one unit (€)}}$$

Break-even point provides a dynamic view of the relationships between sales, costs and profits and evaluates the risks. For businesses, reaching the break-even point is the first major step towards profitability (Stenbacka et al. 2003, pp. 63-64).

Margin of Safety

Margin of safety is the difference between actual sales and the sales in break-even point. When the margin is positive, it expresses the amount how much the sales level can fall before a business reaches its break-even point. Negative margin informs how much the sales level has to rise to reach the break-even point (Stenbacka et al. 2003, pp. 65).

$$\text{Margin of safety} = \text{Revenue} - \text{Sales in break-even point}$$

Margin of safety in percentages:

$$\text{Margin of safety percentage} = \frac{\text{Margin of safety}}{\text{Revenue}} \times 100$$

2.3 Improving profitability

Östring (2004, pp. 72) states that it is important to find out the reasons for loss. There might be unprofitable products, excessive operating costs or poor management behind the losses. She advises to analyze the income statement care-

fully from top to bottom and not only check out the net profit/loss to find out the real financial performance of the company.

Östring (2004, pp. 77) also writes that when analysing the financial statements and evaluating profitability of a company it is essential to remember two facts, trend over time and comparison with similar companies. By comparing the similar companies with a certain period of time, valuable information on financial performance of each company is received.

According to Stenbacka (et al. 2003, pp. 72) most essential factors to improve the profitability of the company are the following:

1. Increase in selling price
2. Increase in sales volume
3. Decreasing the variable costs
4. Decreasing the fixed costs

In addition to the list Andersson, Ekström and Gabrielsson (2001, pp. 57) suggest more efficient manufacturing. All of these above require special actions and difficult decisions from the management. An increase in selling price might affect consumer demand in a negative way and lead to a decrease in sales volume. An increase in the sales volume might increase for example the marketing costs when acquiring new customers, or decrease the profits if the price is reduced. Decreasing costs might have negative effects on the business, e.g. shorter opening hours or less personnel.

2.3.1 Increase in selling price and sales volume

Sales revenue can be raised either by increasing the sales volume without changing the selling price or changing the selling price without affecting the sales volume. However, the price an end customer pays has to be attempting and reasonable enough to acquire customers to buy the product or service. Competition is defining the prices in many branches and benchmarking must be done within various competitors.

The price and sales volume are generally linked to each other. The price, either up or down, can have a greater impact on sales faster than any other factor. The company must fully understand the implications of price increase or reduction on markets as well as gross margins before any actions are taken (Heikkilä & Saranpää 2008, pp. 62).

If the selling price increases and the sales volume remain on the same level, neither variable nor fixed costs change. In this case effects are positive: gross margin grows higher and operating profit increases, break-even point is smaller and margin of safety will go up (Heikkilä & Saranpää 2008, pp. 62).

	1st month		2nd month	
Sales	400 pieces 300 €/piece	120000	400 pieces 330 €/piece	132000
Variable costs	400 pieces 180 €/piece	<u>72000</u>	400 pieces 180 €/piece	<u>72000</u>
Gross margin	400 pieces 120 €/piece	48000	400 pieces 150 €/piece	60000
Gross profit margin		40 %		45,45 %

Figure 4. Increasing the selling price (Mäkinen et al. 2004, pp. 52).

If the sales volume increases and the selling price remains the same, variable costs will increase by the same proportional amount as sales volume increases. Thus fixed costs do not increase. In this case the company's gross margin, operating profit and margin of safety increase, but there is no effect on either gross profit margin or break-even point (Heikkilä & Saranpää 2008, pp. 63).

	1st month		2nd month	
Sales	400 pieces 300 €/piece	120000	440 pieces 300 €/piece	132000
Variable costs	400 pieces 180 €/piece	<u>72000</u>	440 pieces 180 €/piece	<u>79200</u>
Gross margin	400 pieces 120 €/piece	48000	440 pieces 120 €/piece	52800
Gross profit margin		40 %		40 %

Figure 5. Increasing the sales volume (Mäkinen et al. 2004, pp. 51).

When the selling price increases, the company might experience some decrease in sales volumes. Customers respond better on price reductions, which can lead to an increase in sales volumes according to Shimp (2010, pp. 202). A lower price naturally lowers the gross margin. It would be ideal that lower prices

allure customers to stores and purchase also other products with full price (Tomperi 2000, pp. 58).

2.3.2 Decreasing costs

Decreasing costs is another way to improve the company's profitability. Costs reduce the business's ability to a make profit, but in order to do business, costs are necessary. Costs are divided into fixed and variable costs. Fixed costs include for example rents, salaries, insurances and marketing costs; costs that happen anyway despite of the level of activity. Variable costs are cost that change in line of output for example raw material used in production or cost of goods sold in retail.

In order to decrease the variable costs, the company has to be able to reduce the cost of materials. Negotiating with suppliers and for example purchasing larger quantities at once if the volume of sales allows, the company may be able to reduce the variable costs (Mäkinen et al. 2004, pp. 53).

	1st month		2nd month	
Sales	400 pieces 300 €/piece	120000	400 pieces 300 €/piece	132000
Variable costs	400 pieces 180 €/piece	<u>72000</u>	400 pieces 162 €/piece	<u>64800</u>
Gross margin	400 pieces 120 €/piece	48000	400 pieces 138 €/piece	55200
Gross profit margin		40 %		46 %

Figure 6. Decreasing the variable costs (Mäkinen et al. 2004, pp. 53).

Fixed costs do not have effect on gross margins, but the overall net profit of the company is improved if the fixed costs are reduced. By controlling fluctuating costs like advertising and salaries, questioning methods used in business processes and evaluating the value of service or product sold, it is possible to reduce costs (Heikkilä & Saranpää 2008, pp. 64).

Basically the economies of scale are well-known: When a business gets larger and the volume increases, the average cost per unit of output is expected to drop. Reasons are e.g. creation of an improved transportation system, skilled labor force, sharing technology or increasing production (Lipsey & Harbury 2004, pp. 148).

2.4 Service design

The success of a company is not only measured in gross margins, profits or losses. Processes are a good way to differentiate companies. By paying close attention and fine-tuning the processes the company can achieve above average results, higher profit and competitive advantages. Service design is a tool aiming at profits by improving processes and differentiating services in order to gain satisfied and loyal customers.

Service design uses the methods of traditional design to plan and improve new and already existing services. Service design organizes people, infrastructure and communication to improve the quality of service and interaction between the service provider and customers. The purpose of service design is to consider the overall experience of the customer and concentrate on improving the processes and strategies, so that the service is user-friendly, competitive and relevant to the customers (Moritz 2005, pp. 39-40).

Successful companies satisfy the needs of their customer through the design of high quality services and products. Mondiano and Ni-chionna have studied that the use of service design is a value adding activity for a company. They found out that successful companies were highly customer-orientated and fast and flexible in their customer service. However, Clifford and Cavanagh found out that key success factors for medium-sized enterprises were paying attention to the needs of customers, having market-orientated strategy, focusing on innovative products or services, producing high-quality and value adding products or services and employing motivated staff (Larsen et al. 2006).

According to Moritz (2005, pp. 39-40) service design is a process of four D's: Discover, Define, Develop and Deliver. The service provider needs to understand the need of the customers, create services to meet the demand and sustain on-going development of the services. At the same time the company and employees are under constant development and guidelines and strategies are planned to maximize the customer experience. Service design also concentrates on rational use of resources and effectiveness of processes.

Service design interacts with several fields of expertise inside the company. Different areas of expertise already have the knowledge, tools, experience and resources needed to execute service design successfully within the company. Management, marketing, research and design are integrated and the result is the better understanding of customer needs (Moritz 2005, pp. 48). The following figure explains the integration:

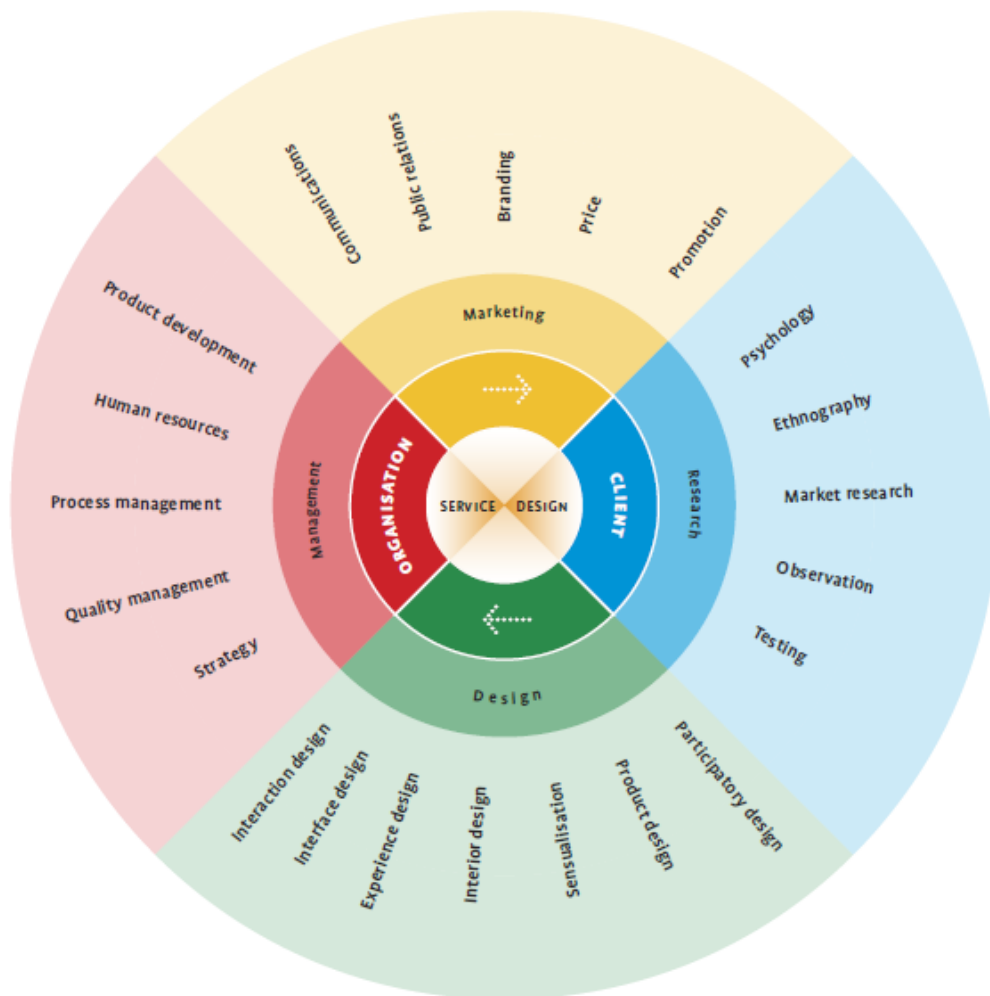


Figure 7. Areas of expertise used in service design (Moritz 2005, pp.48).

Tim Brown (2013) states that companies in the service industry using innovative technology should also use innovations for improving the quality of customer's experience, otherwise the lesson from the industrial age will be re-learned: past innovation is not a guarantee for future performance.

Service design in practice

According to McIntyre et al. (2011, pp.11-12) in order to use the concept of service design, the company must ask two fundamental set of questions:

- *LIMBIC: What emotional (limbic) response are we seeking to elicit in our clients and in our work teams?*
 - a) *How are we going to elicit these limbic responses?*

- *NEOCORTICAL: What service are we seeking to provide? What business are we in? i.e. are we providing after-care product support, rental services, retail services and so on.*
 - a) *How are we going to provide these services?*

By answering these questions and combining the answers with Slack's model of competitive advantage, the company is able to find the key success factors.

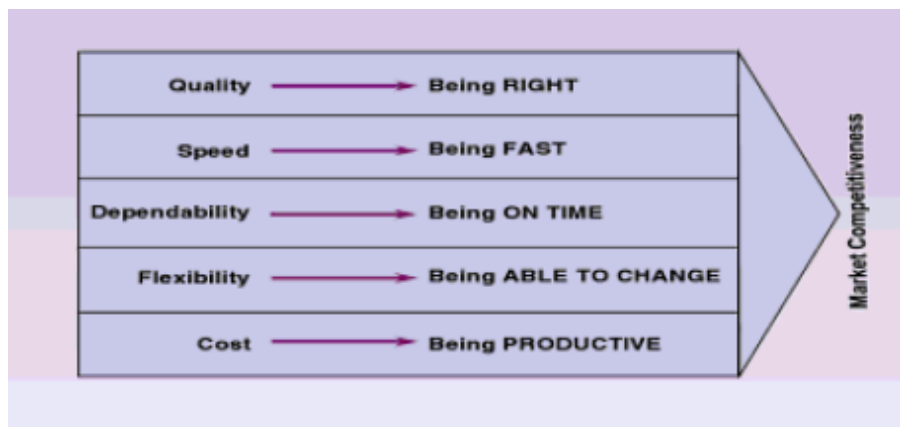


Figure 8. Slack's model of competitive advantage (McIntyre et al. 2011, pp.5).

McIntyre et al. (2011) emphasize emotional motivators in the service sector. The emotional motivators should not be underestimated when business strategy is created. Customers who have had a positive feeling and experience are most likely to use the same service again.

Moritz (2011) has grouped the tasks of service design into six different categories: Service Design (SD) Understanding, SD Thinking, SD Generating,

SD Filtering, SD Explaining and SD Realising. A short description of each step allows a better understanding of the process:

SD Understanding uses different tools and methods such as benchmarking, market segments, context analysis, expert interviews etc. to understand the situation of the company, market needs, customer needs, overall context and the relationships between all the needs.

SD Thinking sets the criteria and objectives for the process. The purpose is to define service strategy by using information given by SD Understanding.

SD Generating's purpose is to produce ideas and concepts. Any ideas are allowed at this point, later on ideas will be cut down by earlier established criteria and strategy. SD Generating requires a good and creative team suitable for the environment. Methods like team discussions or brainstorming can be used.

SD Filtering carefully examines the ideas produced by SD generating and the best and most appropriate and relevant ideas will be chosen. The chosen ideas will be tested and filtered good quality in mind. Also economical, legal and technical issues are important to check at this point.

SD Explaining translates the ideas, concepts and solutions into the more understandable format that is easy to share with the rest of the company. All of the main components of the actual product or service are introduced. Tools like role play, service prototypes, maps or scenarios help in the process of creating the service process smoother and addressing possible problems in advance.

SD Realising uses the basis of SD Explaining in order to finish the product or service. During SD Realising final testing takes place and everything is finished. Training and guidelines for employees are established to ensure that the process will take place as designed. In this stage the product or service is ready to the markets. However, service design is an ongoing process and continuous improvement will take place.

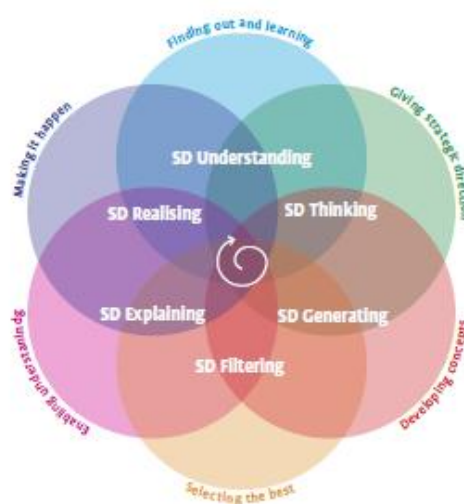


Figure 9. Service design categories (Moritz 2005, pp. 149).

According to Moritz (2011, pp. 149) there is no beginning where to start the service design process or where to end it. Categories are often over-lapping and they inter-link with each other, various tasks can be also done simultaneously.

Tuulaniemi (2011, pp. 126-129) approaches the use of service design through five sectors:

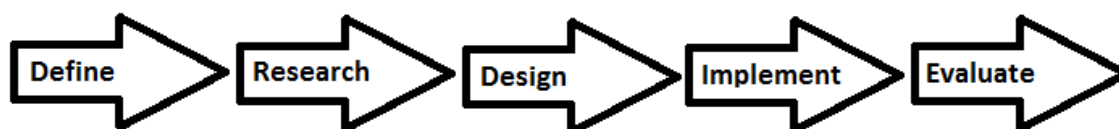


Figure 10. Service design process (Tuulaniemi 2011, pp. 127).

The process starts with *defining* the service. Questions like, “what is the problem the company wants to solve?” and “what is the goal of the process?” help to define the first step.

The second stage is *research*. The purpose of research is to gain full understanding of the development process, environment, resources and the customers’ needs. Research can be done e.g. by interviews, discussions or studies. Also the strategic goals of the company must be established.

The Designing stage produces alternative ideas and concepts. Solutions for problems are planned and ideas are tested briefly whether they are suitable for production. During the designing stage it is important to define the measurement criteria for a successful service.

Implementing starts after the service is ready for the markets. In this phase it is still tested with customers and development continues due to the feedback.

The last stage is *evaluation*. The development process and end product are evaluated. The end product is also measured by the criteria set earlier in the designing stage. The fine-tuning of the service will be an ongoing process for the company.

The service design process is best for a completely new service. If an already existing service is under development, the service design process can be adapted for the particular service for example due to economical limitations or time constraints (Tuulaniemi 2011, pp. 129).

There are also several other methods for service design practices. Companies must find the one that is suitable for their needs, feels comfortable and gives the best results in their business environment.

2.5 Value-added services

Value-added services are not the core product or service of the company. It is usually either an amenity that is intended to create a stronger rapport with customers or a source of additional revenue (Hennig-Thurau & Hansen 2000, pp. 112-115).

Usually customers first purchase the core service and only after that the value-added services are introduced. In some cases, value-added services can be provided to a customer without an extra fee. Yet again in some instances, service is offered to an existing customer with an additional charge (Wisegeek, 2013). For example in the tourism industry parking might be available for customers for free, but room service with additional cost.

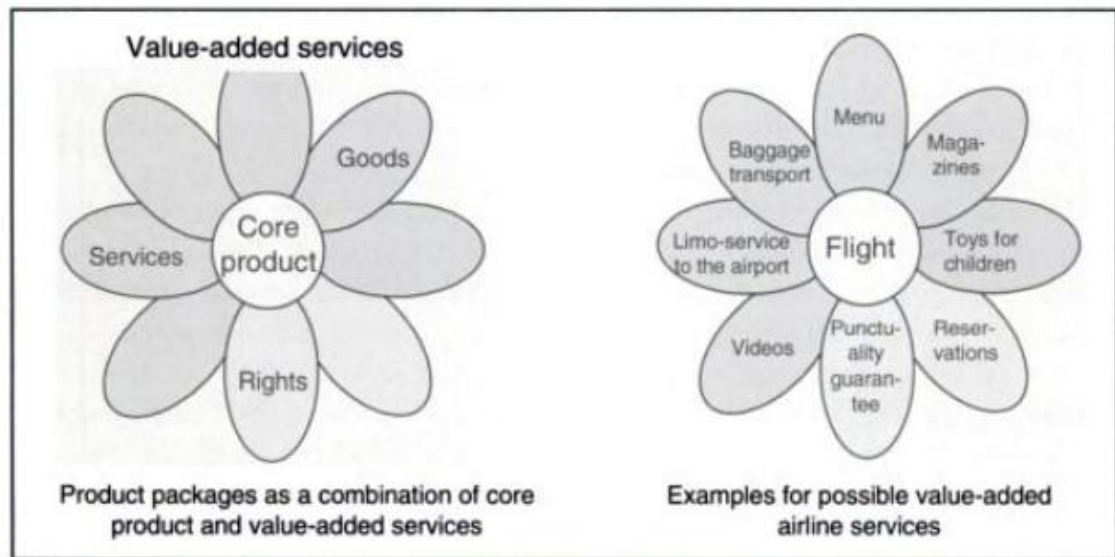


Figure 11. An example of value-added services (Hennig-Thurau & Hansen 2000, pp. 113).

The value-added service is an advantage for both, the customers and the company. Customers can experience the additional service as a great extra they were not looking for and be positively surprised. The company instead strengthens the customer relationship and gains loyal customers, which could be translated into more revenues (Wisegeek 2013).

Value-added services can be also seen as competitive advantages. The customer might choose the company over competitor because of the value-added service (Bruhn & Georgi 2006, pp. 178).

Revenue producing value-added services are advantages for the company. Risk distribution, cost synergies, cross selling potential, switching barriers and loyalty effect are positive side-effects produced by value-added services (Bruhn & Georgi 2006, pp. 165-166). The company can for example compensate losses if one service fails and another one is doing great. The company also gains if the satisfied customer of the company switches another service provider to this particular company's other field of business since good service has been experienced previously in another field.

However, there are downsides as well: higher complexity, negative side effects and image adulteration. For example, if the company offers multiple services,

employees and management have to go through more complex processes maybe weakening the quality of service. Or if one service of the whole company has a certain reputation and standards, it is most likely expected from all of the services within the company, good or bad (Bruhn & Georgi 2006, pp. 167).

Well planned and executed value-added services enhance the reputation of a company and create potential growth. The actual value of the value-added service is hard to measure and can't be directly detected from the income statement.

3 Research process

In this chapter the research methods are introduced more thoroughly to gain understanding of the chosen methods. The chosen research methods are semi-structured interviews, participant observation and document analyses. These methods were chosen due to the objective of the study. The purpose of the study was to find out the current situation of the value-added service in terms of profitability and tools to improve it.

Semi-structured interviews of the employees offer an insight of the processes used, thoughts on profitability and possible suggestions for improvement. Participant observation allows the researcher to see the value-added service through the eyes of the customer and document analyses offers facts about the current financial situation. All together these three methods form a base for the study and all three aspects, employees, customers and employers are covered.

3.1 Semi-structured interviews

A semi-structured interview was chosen for the first data collection method. The aim was to find out the employees' thoughts on profitability and especially on the processes used in the specific value-added services as well as the motivation and sales orientation of the employees.

Semi-structured interviews have flexible balanced structures and the quality of data obtained is detailed. Semi-structured interviews have the same questions for all of those involved, kind and form of questions ensure focus on the topic,

interviewees are encouraged with supplementary questions to ensure the equivalent coverage and equivalent time for the interview is allowed in each case (Gillham 2005, pp.70).

However, interviews should be controlled interaction, where pre-planned agenda is carefully followed. An exact question wording or exact order is not necessary, but all the questions must be covered. If the interview is handled well it sounds almost like a conversation between two people (Robson 2002, pp. 74).

Before the interviews started every employee received a development discussion form. Employees were given time to fill out the forms before the interview and the employees were able to keep the forms during discussions as a reminder. Forms were collected after the interview was held. Development discussions are arranged on an annual basis for the employees, and in this case the author of the thesis has arranged them once before. Development discussions are highly confidential, but very much related to the subject of the study.

Profitability is highly due to the motivation of the employees in this specific value-added service. It is important for the management to know the strengths and development targets of each employee to arrange the work environment, training and tasks according to the characteristics and strengths of the employees. If the resources are allocated well and employees know their tasks, operations are more profitable. This is the reason why development discussions were used as a base for the semi-structured interview.

Interviews were conducted during the working hours in April 2013. All of the employees in the specific value-added service sector were interviewed, all together six interviews were held. Notes were taken during the interviews. As the interviews were semi-structured, the question order varied. The same supplementary questions were asked from everyone, but due to the nature of the conversation, some additional supplementary questions were made. The time used in the interviews varied from 2 hours to 2 hours and 45 minutes. The development discussion form is shown in Appendix 1.

3.2 Participant observation

Participant observation is a method suitable for studying every aspect of human existence. The goal of participant observation is to generate practical and theoretical truths about humans and the realities they are facing (Jorgensen 1989, pp. 12-14).

The author of the thesis is working in the case company and has been able to study the value-added service and employees, first from a distance for years and later on for five months as the manager of the department. To get an objective view and more depth to the observation together with the customers' point of view six mystery shoppers were hired to evaluate the value-added service.

Mystery shopping is used by companies to measure the quality of services and products, and the overall experience of the customer. Basically the company hires a customer to collect information on the products or services. These mystery shoppers perform specific tasks such as purchasing a product, using a service, asking questions, registering complaints or behaving in a certain way, without exposing their special identity to the staff. After gathering information, they fill in a report on the experiences (PamInCa 2009).

Mystery shopping provides objective data and allows the company to identify the specific areas that need improvement, or rewarding. Also training of employees, improving the location of products and maximizing the standards of service might be reasons for using mystery shoppers. The mystery shoppers can be used as well to monitor a certain service point, compare rivalries, and assess the sales skills of employees or to motivate employees (PamInCa 2009).

Questions and things that are under observing must be carefully planned before the mystery shoppers enter the target under study. The sample size might also have a great impact on the results, so research must be well-planned to achieve the reliability and validity (Ritchie et al. 2005).

In this type of study it would be ideal that more than one group of mystery shoppers visits the company during a period of one year to get an overview of the possible fluctuation in different seasons. Due to the schedule of the thesis

and time limitations, only one group visited and evaluated the value-added service in March and April 2013.

Survey

A survey is typically used for seeking answers to a number of standard questions from a carefully selected group of people. A good survey has demonstrable links between the survey questions and research questions. The answers received must be relevant and provide information to the research questions. The researcher must also keep in mind that the questions are not too long, complicated or leading towards particular answers (Robson 2002, pp. 41-42).

A questionnaire was put together to find out the experiences of the customers using the specific value-added service. The purpose of the questionnaires is to describe the process used by the customer and walk along with the customer through the whole process step by step making notes.

The questionnaire consists of 28 statements and seven open questions. Statements and questions were categorized under seven main events: preconceptions, choosing the value-added service, making a reservation, reception, value-added service, general information about value-added service and feedback. Statements and questions were framed to get a good picture of the customer experience and to find out what the things that should be improved and redesigned are.

The mystery shoppers were asked to rate the degree of importance of each statement on a six-point Likert-type scale in the German style (1 = totally agree, 6 = totally disagree) due to the material the researcher studied when creating the questionnaire. An even-point Likert scaling was used to remove the "Neither agree nor disagree" option from the respondents. Mystery shoppers were allowed and recommended to add information on their experience for the each statement for clarification purposes.

In addition to statements, seven open questions were answered. The mystery shoppers were also asked to fill in demographic information such as age, nationality and gender. Some background information was asked as well to find

out their knowledge and previous experiences on this specific type of value-added service.

The mystery shoppers for this study were chosen carefully. In a good survey, the sample represents all of the customer segments under study (Robson 2002, pp. 41). For this thesis analytical and observant nature was the key factor when choosing the mystery shoppers. Also the nationality and age of the mystery shoppers were selected carefully to get as diverse a sample as possible since real life situations vary a lot according to the age and nationality because of the language barriers or different needs of the customers. The mystery shoppers included one male +40 years old, three Finnish females, +30, +40 and +50 and two Russian females +30 and +50.

The mystery shoppers were debriefed before using the value-added service about the general ideas of mystery shopping. The questionnaire was also given beforehand so they had time to read the statements and questions and prepare themselves for observations. Mystery shoppers received a gift certificate for payment.

The questionnaire was conducted first in Finnish and then translated into English by the author of the thesis because of the Russian mystery shoppers. The questionnaire in English is shown in Appendix 2, but it has been slightly altered not to reveal the true nature of the specific value-added service.

3.3 Document analyses

A document analysis is a form of qualitative research in which documents are interpreted by the researcher to gain better understanding on the subject studied. Generally, in all the fields of studies, there are existing documents that can be studied and analyzed as data sources. This secondary data should be checked in case of authenticity, credibility, representativeness and meaning. The advantage of the document analysis is that with a little effort relevant documents can be analysed and important information for the research provided (Robson 2002, pp. 88).

Existing documentation is a good tool to analyze the existing key functions, business rules and business entities. The document analysis also supports the insight of existing business processes or systems. In this particular case, the researcher has good knowledge of the business environment and it is a natural choice to analyze the income statements to find relevant information to improve the profitability of the value-added service.

The secondary data of Imatran Kylpylä Spa consist of the income statements of the value-added service from years 2012, 2011 and 2010 as well as specific documents of purchases, inventory and other costs to calculate the gross profit margins of products and services sold.

In the thesis the researcher used the income statements to create a vertical and horizontal analyses of the value-added service. The vertical analysis expresses all the amounts as a percentage of the total amount. It compares different items to a single item in the same accounting period. This is why it allows the researcher compare the relative annual changes easily. The horizontal analysis allows the assessment of relative changes in different items over time. For example the behaviour of revenues, expenses and other items of financial statements over certain period of time are easily indicated by the horizontal analysis (Investopedia 2013).

Some difficulties occurred while analyses were made. Comparing the annual income statements, years 2011 and 2012, was impossible since all the service departments were combined under the same management at the beginning of the year 2012. After separating costs and recalculating them as they were in 2011 and 2010, the income statements are comparable and reliable results from the analyses were received.

The vertical and horizontal analyses provided interesting information on changes over time and the cost structure as well as the development of sales. The content of the analyses is partly confidential, but parts of the analyses are shown in Appendix 3.

Secondary data was also used to calculate the gross profit margins. Margins represent the key indicators of the state of the business and by calculating and

analyzing them the company maintains a certain level of profitability. The margins for the specific value-added service were calculated together with a member of the staff and based on her professionalism on the use of materials. Gross profit margins are confidential, so they are not included in the appendices.

4 Research analyses and findings

In this chapter the data collected with the previously presented research methods is analysed and findings of each method are presented separately. Then later on results are drawn together and presented in the employees brainstorming session. In the brainstorming session strategy and future goals are created together with the employees based on the results of the study.

4.1 Semi-structured interviews

For analyzing the semi-structured interview a thematic analysis was used. The thematic analysis identifies, analyzes and reports patterns or themes within the data collected. In the thematic analysis the purpose is to capture important details and facts about the data in relation to the research question. The data is studied several times, themes are coded and then reported.

In succeeding in the analysis it is crucial that the researcher reports and documents her processes and procedures fully and truthfully, so that the credibility of the research is possible to evaluate.

In this thesis the researcher started the analysis by reading through several times the notes on the interviews and the development discussion forms filled in by employees. From each interview certain themes came up. The purpose of the analysis was to draw together employees' thoughts on profitability and draft personal development plans for each employee for the future.

The researcher used a schematic drawing to facilitate the findings for the results. A mind map on the factors influencing profitability according to employees is presented in Appendix 4. It shows that factors influencing profitability can be

categorized under four headings: positives, negatives, opportunities and obstacles.

The employees feel that the selection of products and services is good. Although there are opportunities in this field as well, e.g. more sales are possible to conduct if training increases, gross profit margins should be checked and the renewal of services is needed on regular bases. Obstacles in this area concerned the standardized service, whether the value-added service is similar enough to every customer or if there is a lack of training or orientation for new employees. Also the availability of products is seen as an obstacle, which occurs because of lack of routines and resources. Flexibility of employees, cost efficiency and good customer service have a positive impact on profitability according to the employees.

Employees also feel that they would benefit from regular meetings where customer feedback is reviewed and the manager would have an opportunity to give feedback on the current situation. A rewarding system would push the employees for better sales.

Working processes suffer from lack of organization. Invoicing, inventories, orders and maintenance of equipment vary among employees and a coherent system is needed to unify the praxis. Lack of resources is shown especially in the high seasons, during vacations and sick leaves. Lack of resources puts too much pressure and work load to those working.

Premises are generally good and some renovations have been made in the past few years. With small updates the premises and machinery will stay in good condition. There is a need for certain new premises and remodelling, so that parts of the services could be executed more properly.

The most challenging and critical part that needs to be organized better according to the employees is the changes in reception staff. The employees were hoping that in the future reservations would be made by the staff that consists of only full-timers with clear objectives and tasks and with professional attitude.

Marketing is seen as an opportunity. Marketing actions for locals as well as for hotel customers in the low seasons would stabilize the fluctuations between low and high seasons.

In general, it can be said that valuable information on working conditions and relations of employees was gathered. The development plans on the personal level were updated and some new ideas for training were received. The employees also had good ideas on developing the profitability and on new arrangements and processes.

As development discussions are confidential, the personal development plans will not be presented as results.

4.2 Participant observation

Mystery shopping was chosen as a research method to experience the value-added service from customers' perspective. Understanding customers is a key to giving them good service. Good service and exceeding customers' expectations lead to loyal and satisfied customers. This again increases the additional revenues and business is more profitable.

The mystery shoppers answered the questionnaire that consists of 28 statements and seven open questions. Each mystery shopper also commented the statements to clarify the answers.

The first category was preconceptions with two open questions, expectations for the value-added service and overall image of the company. The purpose of the questions was to try to understand what mystery shoppers were looking for and wanted for the upcoming value-added service as well as what kind of image they have on the company itself. Only two of the respondents understood the question as it was presented. Both of the respondents had positive image of the company. Comments were:

- I expect relaxation from the value-added service.
- A few friends have used the value-added services and I have only heard positive comments from them.

- Nice and small holiday destination where everything is close enough to enjoy the services.
- Positive image on the company. In recent years company has invested on the services in a good way.

Four respondents commented on the experience they had on the value-added service and the visit itself.

The second category was choosing the value-added service. The purpose of this category was to see if the information on the value-added services is easily available for customers and is there need for improvements in the pricelist or websites. Two statements and two open questions were answered. The open questions revealed the chosen value-added service and why this particular service was chosen. The statements and answers are shown in table 1. The degree of importance of each statement was asked to rate on a six-point Likert-type scale (1 = totally agree, 6 = totally disagree).

Table 1. Choosing the value-added service

Choosing the value added service	Female/FIN	Female/RUS	Male	Average
It was easy to find information about value-added service from the website	1,3	2,5	1	1,6
The pricelist of Imatran Kylpylä Spa was easy to read and information was found easily	1,7	3	3	2,6

Finnish females were mainly happy about the information found. The duration of the service is information that was missed. This also came up with male answers. Comments from Russian females:

- Big plus that information is found in Russian language.
- There should be more information about the services itself.

- Pricelist in website is only possible to read with Acrobat Reader, big minus. Also pictures and more information would be nice.

Category number three concentrated on making a reservation. One open question was asked in addition to four statements. The open question was to clarify the way reservation was made i.e. phone, e-mail or reception. Two of the mystery shoppers made the reservation directly at the reception and four by telephone.

Table 2. Making a reservation

Making a reservation	Female/FIN	Female/RUS	Male	Average
It was easy to make a reservation	1,3	2,5	1	1,6
Available and suitable time was found easily	1	3	1	1,7
Service was professional	1,3	4,5	1	2,3
Service was friendly	2	2,5	1	1,8

All of the Finnish respondents felt that service was professional and friendly and the reservation was easy to make. Suitable and available appointments were found easily for these four respondents even though two of them wanted the reservation at the same time relatively close to the actual appointment time.

Some additional observations were made by the Finnish respondents:

- No questions, like have you visited here prior to this appointment or is this type of value-added service familiar to you from before, were asked.
- No welcoming.
- No information where to come.
- Very friendly and nice service.

However, the Russian respondents instead found the making of reservation inconvenient. There should have been more information about the value-added

services, discounts and promotions available. Also suitable times were not easily found. Russian respondents got a feeling that there is no service, just reservation making. Additional questions like age and preferences should be taken into notion already at this point of the service process.

The fourth category describes the customer's arrival to the value-added service. The purpose of this was to find out if the reception was easy to find and how the mystery shoppers experienced the service at this point. Five statements were introduced to understand this part of the service process.

Table 3. Reception

Reception	Female/FIN	Female/RUS	Male	Average
Reception was easy to find	2	5	3	3,3
Outlook of the reception was visually pleasant	2,3	5	2	3,1
Receptionist noticed you right away and greeted you properly	2	4	1	2,3
Receptionist gave you directions what to do and made you feel comfortable	2,5	4,5	2	3
Waiting area was comfortable	3	6	1	3,3

The Finnish respondents were mainly happy with the reception, a few comments were written:

- Receptionist didn't notice me at all since she was with another client. Though she could've said hi or nodded or somehow notify my existence.
- Waiting area was not comfortable, no privacy, magazines, water etc.
- Reception was behind a lot of stuff, brochures etc.

- Receptionist just said: have a seat, someone will come and get you. Not very polite way to put it.
- I didn't have to wait at all since the employee was waiting for me already.
- The outlook of the reception is usual, nothing special. Works for me.

The Russian respondents instead criticized all of the statements. Comments were similar to those of the Finnish respondents. The most criticism was given to the reception and waiting area. The waiting area was uncomfortable and refreshments like tea, fruits, and water as well as relaxing atmosphere were missed. The reception again was hidden and did not really seem like a reception but more like a shop.

The fifth category concentrated on the value-added service itself. The purpose of this was mainly to find out how active employees are in additional sales processes and how the customers experience the value-added service.

Table 4. Value-added service

Value-added service	Female/FIN	Female/RUS	Male	Average
You were welcomed by the employee	1	2	4	2,3
Premises were pleasant	1,7	2	1	1,6
Employee was considerate and kind	1,3	1,5	1	1,3
Employee was professional	2	2	2	2
Employee showed interest to your wishes and on possible request	4,5	5	4	4,5
Employee introduced the products used in value-added service	5,6	5,5	6	5,7
Employee introduced the best products for home usage	5,6	6	6	5,9
Employee gave you an offer or a discount of the products	6	6	6	6
Value-added service was what you expected	2,7	3	4	3,2
Employee welcomed you back to use the value-added service again	5,7	6	6	5,9
"Check-out"/paying was easy	1	1	1	1

The basic elements of value-added service based on these statements are in order but the statements concerning additional sales were surprising. All of the respondent felt that there was no introduction of products used in the value-added service neither best products for home usage nor offers were made.

The following comments were given:

- Candles could've been lightened, otherwise premises were clean and nice. Music was nice.
- Premises were nice. Lighting is something that could be considered in the future. It could be less bright in the end of the service.
- Employee was extremely friendly and nice. Thank you!
- Very professional, but I missed little bit more consideration of the customer during the service.
- There was no conversation, but this was probably due to the language barrier. I don't know if the employee spoke very good English.
- I was hoping for a little introduction of the service since I had never experienced it before, but I didn't ask and the employee didn't tell me anything.
- I didn't get any recommendations or offers, looks like employee wasn't interested in selling me anything.
- I didn't get any information on products used, what a shame, I could have bought something for home.
- Value-added service was good, but really short. I thought it would've been longer.
- I was ignored after the value-added service, and wasn't welcomed back.
- Employee was kind and even though she didn't welcome me back, she wished for a good journey back home.
- I was given a pricelist and telephone number so I can make a reservation for another time, but employee didn't actually say the words welcome again.

In the sixth category general information about the value-added service was gathered.

Table 5. General information about the value-added service

General information about the value-added service	Female/FIN	Female/RUS	Male	Average
Opening hours are suitable	1,6	3,5	2	2,4
The selection of value-added services is good and diverse	1	2	1	1,3
The quality-price ratio is good	3	4	5	4
The products are placed appealingly in the shop	2,3	2,5	3	2,6
The shop has a good selection of products and different brands	2,3	2	4	2,8
Value-added services plays a big part when choosing a Spa destination for a holiday	1,3	4,5	5	3,6

Table 5 illustrates that the selection of value-added services is good. Opening hours are suitable for Finnish customers. The shop has a good selection of products and products are placed normally. The following comments were given:

- Value-added service should be available every day.
- Opening hours should be extended at least on Fridays and Saturdays.
- Value-added service is a bit expensive.
- The selection of services should be checked and some of the services could be combined.

- The service I got didn't have a good quality-price ratio. Service was too short.
- Selection of products is good, but work is needed in the presentation.
- I totally missed the selection of products since the employee was too busy to introduce me anything.

The seventh category included two open questions whether the service provided met the customers' expectations and positive/negative feedback of the visit. The mystery shoppers gave mainly positive feedback and some notes how to improve the service in the future. The following comments were given:

- More positive feedback, but please pay a little bit more attention to the customer.
- Thank you for the employee. Work was done well and I will definitely use the services in the future as well. Though, presentation of products used and what is suitable for me is something I really missed. Also notifying the customer and good customer service rules are good to go through again with the staff.
- Employee was extremely friendly and professional but I still felt something is missing. Maybe it was the shortness of service or products that weren't introduced or the hurry in the end of the value-added service. It would've been nice to sit down after the service, take a breath and drink a glass of water.
- As a Spa-hotel customer my expectations are very high. I'm looking for luxury and unfortunately this time my expectations were not exceeded or even met. Very good and professional service, but so very short and "busy" All the elements for exceeding expectations exist: premises are nice, professional staff, just a little bit of effort and you have a great service.
- Positive things: Selection of products and services is good and staff is professional. TV screen on the reception is nice and modern. Negative

things: Location of reception and customer service of reception, the image of value-added service suffers from the flaws of reception. Russian speaking staff would be good. Promotions and offers should be available, the staff should introduce and sell the products more enthusiastically. Interior needs improvement.

- Nice and friendly staff. Clean premises and good selection of services.

Overall the information gathered from the mystery shoppers is indispensable. Objective data was gathered and the main areas that need improvement were specified. Guidelines and direction for changes needed are understood. However, the feedback must first be studied together with the employees and the best solutions for this particular value-added service should be found to create profitable business.

4.3 Document analyses

The purpose of the document analyses is to answer to the first research question and find out the current state of the value-added service in terms of profitability. The current state analysis was done by using information from the income statement and translating it into horizontal and vertical analyses. In this chapter vertical and horizontal analyses are interpreted by the researcher. The content of the document analyses is partly confidential, so all of the findings and reasons for changes may not be presented. Analyses are shown in Appendix 3.

Net sales have decreased in 2012 14.2% from 2011 which was a good year with an increase of net sales by 5.2%. The reason for this are probably changes in personnel. The nature of the value-added service is that loyal customers usually prefer the one and only person from the personnel and losing a great employee effects immediately on sales.

Products has been sold 8.8% more in 2012 than in 2011 and 25% from the annual revenue of 2012 is products. This is probably due to the new arrangement in the sales desk and longer opening hours. Apparently also discounts have been given more and promotions and campaigns have been effective.

Gross margin in 2012 has decreased by 28.5% from 2011. This is not completely true since there are changes in inventory models and also a new product line was taken into selection. New products tie up capital and it takes a while before the personnel is comfortable selling new products. This is shown in the purchases which have risen 51.5% from the previous year.

The horizontal analysis reveals that there has been a continuous decrease in the development of the costs of salaries. In 2012 two new employees were hired. The training of new employees has taken time and resources, which again leads to momentary increase in salaries. The salary costs are 2012 daring 82.5% of the sales revenue. Desirable salary costs in this particular value-added service would be around 40 - 45%.

Fixed costs remain relatively stable. There are some peaks found due to some actions taken by the management. For example some repairing work was done in the premises of the value-added service in 2012 and the costs have risen 173.6% compared to the previous year. The case company has also taken part in some larger marketing actions that increased the marketing budget of value-added service annually 2-3% over a certain period of time.

In 2012 operating profit margin was -38.1% when 2011 it was -5.5%, which means that short term profitability has remarkably decreased. There are various reasons explained above that influences the change.

There is a great challenge to turn the loss of the value-added service into profit, but it is not impossible. Improvement can be done by increasing the sales, organizing the department better and going through all the costs. Costs should have a consistent linear relationship with sales revenue. The development work must be consistent and persistent.

4.4 Brainstorming session

Brainstorming session for the employees was held on Tuesday 14th of May. All employees of the specific value-added service and reception took part on the four hour session. The session started with the presentation of the final thesis and the reasons why the study was conducted. The PowerPoint presentation is

included in appendix 5. The theory part was introduced quickly by explaining the basic concepts of profitability, service design and value-added services. The empirical part again was studied more thoroughly by explaining the chosen research methods and goals that the researcher wanted to achieve.

First the financial situation was explained by showing the income statement and the analysis made. The income statement was analysed cost by cost and by explaining what each cost includes. The vertical and horizontal analyses were shown and examples were made to create understanding among employees. Also the main points and changes in income statements as well as reasons for the changes were explained. Good discussion occurred between the researcher and the employees about costs and how to reduce them as well as the effect on increasing the sales.

Secondly the researcher presented the reasons why development discussions were chosen as a research method. The results were shown in a form of a mind map to the employees. Results were discussed carefully and by explaining each point. After the presentation and a brief discussion employees received a task of choosing at least two important points influencing profitability. The points could be taken either from the mind map or if anything else that occurred to their mind. The employees were given approximately five minutes to think about the task alone and write down some ideas to improve the presented points in action. After five minutes the employees were divided into three groups and fifteen minutes was given to work on the ideas together. The employees presented their ideas and good discussion was held. Several new ideas were taken into action e.g. orders have now persons in charge, routines were established to ensure the correct invoicing and inventory methods were improved. A lot of ideas, e.g. to ensure resources in the future, for providing standardized service and regular meetings came up.

After a coffee break the results of the survey were presented. After each category of statements a free discussion of ideas and emotions aroused was held. The employees had good comments and opinions as well as assessments on the subjects. Again improvement targets were found and new rules were established to improve the service and the customer experience. Also a decision was

made that the selection of services will be examined carefully and partly renewed for the next pricelist to meet the customers' expectations.

Lastly the general guidelines and the rules for the work environment were established to avoid conflicts and to ensure a good work environment for every employee.

In general the day was good. The employees understood the current situation in terms of profitability and became committed on improving it. New processes were established to ensure the fluidity in actions and many of the obstacles met by employees were solved. The basis for understanding and need for new actions was created.

5 Summary and conclusions

The objective of the study was to find out the current situation of the specific value-added service in terms of profitability in the case company. A further goal was to examine the specific value-added service itself, and how the process of service is executed. The purpose of the research was to gain in-depth understanding of the value-added service and the cost structure as well as the processes used to produce the service.

Chosen research methods were semi-structured interviews, participant observation and document analyses. The semi-structured interviews of the employees offered an insight of the processes used, thoughts on profitability and possible suggestions for improvement. Participant observation allowed the researcher to see the value-added service through the eyes of the customer and document analyses offered facts about the current financial situation. All together these three methods formed a basis for the study and all three aspects, employees, customers and employers were covered.

The current state analysis was done by using income statement and translating it into horizontal and vertical analyses. The researcher had an idea of the loss of the specific value-added service, but the amount was higher than expected. There were various reasons for the loss. However, the researcher believes that

the loss can be turned into profit with consistent work. Improvement can be done by increasing the sales, organizing the department better and going carefully through all the costs.

The semi-structured interviews with the employees revealed completely new information and confirmed the researcher's own thoughts on profitability in the specific value-added service. The employees' knowledge of practices used and ideas of improvement are taken selectively, and some have already been taken, into action to create a more efficient and motivated work environment.

The mystery shoppers' insights and comments were valuable. Objective data was gathered and main areas that need improvement were specified. Even though this was a small sample, also the employees identified and recognized the same areas and processes that need development.

The brainstorming session, where all of the material received from the studies was presented to employees, is a great base for the future activities. Awareness of the employees, new processes and motivational factors already effect on the atmosphere and work environment positively. Continuous development work and regular feedback will keep the employees motivated and updated in the future.

As mentioned earlier this study establishes a ground work for a continuous improvement project and multiple actions that will take place further on in the future after the thesis project is completed. Analyses on the quarterly performance in 2013 in terms of profitability will be made in September 2013 to get the most recent figures and guide the management in the decisions to be made.

Suggestions for further research from the management point of view could be to study the improvement process more carefully, to see if the changes and new processes have been effective and what kind of impact they have had on profitability. Also a similar, but a larger study about customer satisfaction after changes would be interesting to conduct. The impact of several similar services in the markets in the Imatra area could be attached to the customer satisfaction study and benchmarking about these companies could be made.

This study and the process of working with the final thesis have been educational for the researcher. The theory read and written has given the researcher new perspectives and tools to work with. The research process expanded the awareness and the competence of the author. The findings received from the study were rather interesting and the purpose of the study was met.

The brainstorming session was an excellent finish for the thesis. The researcher combined successfully the theory of service design and the information received during the thesis process. All the findings from the studies were drawn together, employees took part in the developing process enthusiastically and ideas were generated. The improvement process is already starting among the value-added service.

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Appendix 1.

KEHITYSKESKUSTELU

Nimi:

Osasto:

Työtehtävän kuvaus (tehtävän vastuu ja vaikutukset, osaaminen, ajan käyttö ja työn määrä).

Mitkä ovat mielestäsi tärkeimmät asiat työssäsi?

Mikä on työssäsi mielekkäintä ja palkitsevinta?

Mitkä asiat ovat edistäneet/haitanneet työtehtäviesi hoitamista? Koetko joitakin asioita työtehtävien hoitamisessa, omassa roolissasi tai työyhteisössäsi hankalina/ongelmallisina?

Mitkä ovat tavoitteet työssäsi?

Miten olet onnistunut tavoitteittesi saavuttamisessa?

Mitä osaamisalueita sinun tulisi kehittää?

Minkälaista uutta osaamista tarvitset nykyisessä työssäsi tulevaisuudessa? Mihin suuntaan haluat työsi kehittyvän tulevaisuudessa?

Millaisia tavoitteita sinulla on seuraavalle vuodelle/vuosille?

Miten arvioit omaa työssä jaksamistasi tällä hetkellä?

Miten aiot huolehtia hyvinvoinnistasi ja jaksamisestasi työssä lähivuosina?

Mitä odotuksia sinulla on esimieheltäsi?

Haluatko vielä tuoda esille jonkin muun asian mukaan kehityskeskusteluun?

Aika ja paikka

Allekirjoitukset

Appendix 2.

Thank you for taking part on the survey. This survey consist 7 open questions and 28 statements. Please, when aswering the statements, choose and rate the degree of importance of each statement on a six-point scale. Empty lines are for additional information and observations, feel free to write anything you experienced.

Background information:

Age:_____ Gender:_____ Nationality:_____

Have you visited Imatran Kylpylä Spa prior to this survey? Which services you have used?

.....?

Expectations prior the visit:

1. Expectations you have for the value-added service for example based on previous experiences or hearsays

2. Image you have on Imatran Kylpylä Spa and expectations for service

Choosing the value-added service:

3. It was easy to find information about value-added service from the website imatrankylpyla.fi

Totally agree 1 2 3 4 5 6 Totally disagree

4. The pricelist of Imatran Kylpylä Spa was easy to read and information was found easily

Totally agree 1 2 3 4 5 6 Totally disagree

5. The value-added service you chose: _____

6. Why did you choose this particular value-added service?

Making reservation:

7. How did you make the reservation (for example via phone, e-mail, in the reception etc.)?

8. It was easy to make the reservation

Totally agree 1 2 3 4 5 6 Totally disagree

9. Available and suitable time was easily found

Totally agree 1 2 3 4 5 6 Totally disagree

10. Service was professional when making the reservation

Totally agree 1 2 3 4 5 6 Totally disagree

11. Service was friendly when making the reservation

Totally agree 1 2 3 4 5 6 Totally disagree

Reception:

12. Reception was easy to find

Totally agree 1 2 3 4 5 6 Totally disagree

13. Outlook of the reception was visually pleasant

Totally agree 1 2 3 4 5 6 Totally disagree

14. Receptionist noticed you right away and greeted you properly

Totally agree 1 2 3 4 5 6 Totally disagree

15. Receptionist gave you directions what to do and made you feel comfortable

Totally agree 1 2 3 4 5 6 Totally disagree

16. Waiting area was comfortable

Totally agree 1 2 3 4 5 6 Totally disagree

Value-added service:

17. You were welcomed by the employee of value-added service

Totally agree 1 2 3 4 5 6 Totally disagree

18. Premises were pleasant

Totally agree 1 2 3 4 5 6 Totally disagree

19. Employee was considerate and kind

Totally agree 1 2 3 4 5 6 Totally disagree

20. Employee was professional

Totally agree 1 2 3 4 5 6 Totally disagree

21. Employee showed interest to your wishes and on possible requests

Totally agree 1 2 3 4 5 6 Totally disagree

22. Employee introduced the products used in the value-added service

Totally agree 1 2 3 4 5 6 Totally disagree

23. Employee introduced the best products for you for home usage

Totally agree 1 2 3 4 5 6 Totally disagree

24. Employee gave you an offer or a discount of the products

Totally agree 1 2 3 4 5 6 Totally disagree

25. Value-added service was what you expected

Totally agree 1 2 3 4 5 6 Totally disagree

26. Employee welcomed you back to use the value-added service again

Totally agree 1 2 3 4 5 6 Totally disagree

27. "Check out"/paying the value-added service was easy

Totally agree 1 2 3 4 5 6 Totally disagree

General information about value-added service:

28. Opening hours are suitable

Totally agree 1 2 3 4 5 6 Totally disagree

29. The selection of value-added services is good and diverse

Totally agree 1 2 3 4 5 6 Totally disagree

30. The quality-price ratio of the value-added services is good

Totally agree 1 2 3 4 5 6 Totally disagree

31. The products are placed appealingly in the shop

Totally agree 1 2 3 4 5 6 Totally disagree

32. The shop has a good selection of products and different brands

Totally agree 1 2 3 4 5 6 Totally disagree

33. Value-added services play a big part when choosing a Spa destination for a holiday

Totally agree 1 2 3 4 5 6 Totally disagree

Feedback post your visit:

34. Did the company succeed providing the service according to your expectations?

35. Positive/negative feedback of the company after your visit.

Appendix 3. Horizontal Analyses

TULOSLASKELMA

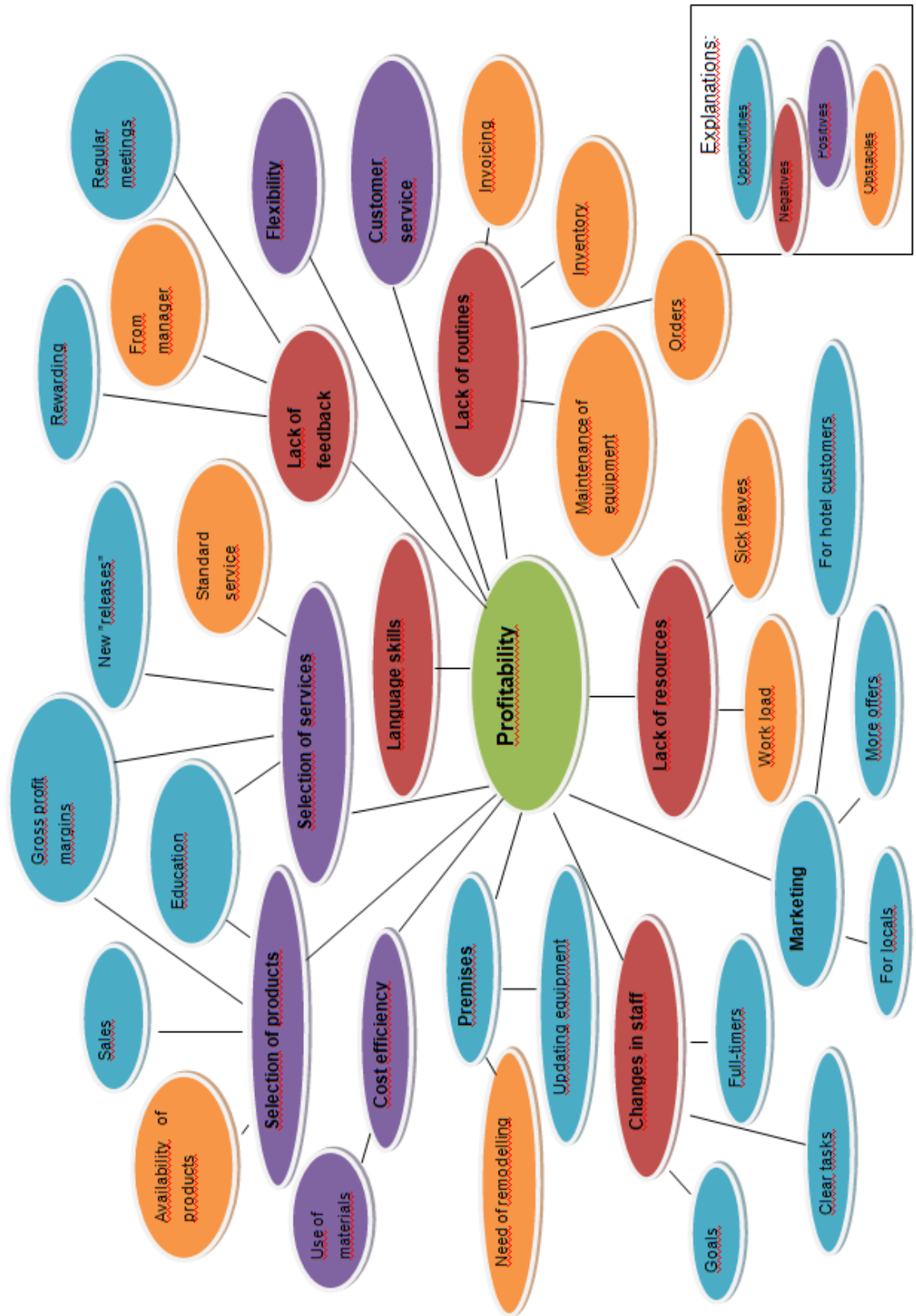
	2012	2011	2010	2012	%	2011	%
LIKEVAIHTO					-19,8		5,6
Muu myynti							-100,0
Hyvinvointipalvelumyynti					-14,2		5,2
Palvelumyynti 0%					-46,2		-9,5
Palvelumyynti W 23 %					-16,7		7,0
Palvelumyynti V 23 %					-20,6		7,0
Myyntituotteet					8,8		-1,3
Myyntin oikaisuerät					335,3		-15,3
Ostot tilikauden aikana					51,5		-27,3
Myyntitavaraostot					19,0		16,4
Ruokaostot					-100,0		5,3
Ostojen oikaisuerät							-100,0
Varastojen lisäys/vähennys					-100,0		-211,3
MYYNTIKATE					-28,5		11,8
Työvoimakulut					-4,1		-5,4
Työajanpalkat					22,8		-11,3
Muut kuin työajan palkat					-100,0		9,1
Henkilösivukulut(lakisääteiset)					-3,0		-8,7
Henkilösivukulut(vapaaehtoiset)					177,5		39,5
Työvoiman vuokraus					-42,9		17,1
PALKKAKATE					-112,0		195,6
Muut toimintakulut					9,7		3,9
Puhtaanapitokulut					6,6		-9,9
Käyttötarvikekulut					-28,5		-6,3
Musiikki- ja viihdekulut					-100,0		122,1
Markkinointi					-24,3		69,6
Korjaus- ja kunnossapito					173,6		-27,2
Koneiden- ja kalustonleasing					35,1		-31,0
Hallinto- ja muut liiketoimintakulut					44,8		53,4
VASTUUKATE/TOIMINTAKATE					452,0		-69,1

Vertical Analyses

TUOSLASKELMA

	2012	%	2011	%	2010	%
LIKEVAIHTO		100		100		100
Muu myynti		0,0		0,0		0,02
Hyvinvointipalvelumyynti		108,7		101,6		102,0
Palvelumyynti 0%		0,5		0,8		0,9
Palvelumyynti W 23 %		34,3		33,0		32,6
Palvelumyynti V 23 %		48,8		49,3		48,7
Myyntituotteet		25,0		18,4		19,7
Myyntin oikaisuerät		8,7		1,6		2,0
Ostot tilikauden aikana		20,5		10,9		15,8
Myyntitavaraostot		20,5		13,8		12,6
Ruokaostot		0,0		0,2		0,2
Ostojen oikaisuerät		0,0		0,0		0,0
Varastojen lisäys/vähennys		0,0		-3,2		3,0
MYYNTIKATE		79,5		89,1		84,2
Työvoimakulut		82,5		69,0		77,0
Työajanpalkat		61,0		39,8		47,5
Muut kuin työajan palkat		0,0		9,4		9,1
Henkilösivukulut(lakisääteiset)		12,9		10,7		12,4
Henkilösivukulut(vapaaehtoiset)		2,6		0,8		0,6
Työvoiman vuokraus		5,9		8,3		7,5
PALKKAKATE		-3,0		20,1		7,2
Muut toimintakulut		35,1		25,7		26,1
Puhtaanapitokulut		8,0		6,1		7,1
Käyttötarvikekulut		5,0		5,6		6,3
Musiikki- ja viihdekulut		0,0		0,2		0,1
Markkinointi		7,2		7,7		4,8
Korjaus- ja kunnossapito		8,3		2,4		3,5
Koneiden- ja kalustonleasing		3,5		2,1		3,2
Hallinto- ja muut liiketoimintakulut		3,1		1,7		1,2
VASTUUKATE/TOIMINTAKATE		-38,1		-5,5		-18,9

Appendix 4.



Appendix 5.



PROFITABILITY DEVELOPMENT OF VALUE-ADDED SERVICES IN THE CASE COMPANY

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THEORETICAL PART:

- Profitability
- Service Design
- Value-added services

EMPIRICAL PART:

- Document analysis
- Semi-structured interviews
- Participant observation

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DOCUMENT ANALYSIS

VERTICAL: expresses all the amounts as a percentage of the revenue

HORIZONTAL: allows the assessment of relative changes in different items over time

GROSS PROFIT MARGIN CALCULATIONS: sales – costs

SUMMARY:

- Net sales have decreased 2012 14,2 %
- Products has been sold 8,8 % more in 2012 than 2011.
- 2012 25 % from all the sales is products.
- Purchases 51,5 % higher in 2012
- The salary costs are 2012 82,5 %
- Fixed costs 10 % increase in 2012

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LOSS 2012

- 38,1 %

WHAT CAN WE DO TO REACH THE
BREAK-EVEN LEVEL?

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SEMI-STRUCTURED INTERVIEWS

- Development discussions
- In April 2012
- Confidential
- Mind map of things influencing on profitability

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TASK 1.

How can we develop our actions?

Choose at least 2 things from the mind map or your own ideas and think of ways to make them work.

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PARTICIPANT OBSERVATION (MYSTERY SHOPPING)

- 6 mystery shoppers during spring 2013
- Mystery shoppers:
 - 1 Finnish male, +40
 - 2 Russian females, +30 ja +50
 - 3 Finnish females, +30, +40 and +50
- 28 statements and 7 open questions
- Provided objective data
- Allowed the company to identify the specific areas that need improvement or rewarding.

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1. CHOOSING THE VALUE-ADDED SERVICE

Choosing the value added service	Female/FIN	Female/RUS	Male	Average
It was easy to find information about value-added service from the website	1,3	2,5	1	1,6
The pricelist of Imatran Kylpylä Spa was easy to read and information was found easily	1,7	3	3	2,6

- Big plus that information is found in Russian language.
- There should be more information about the services itself.
- Pricelist in website is only possible to read with Acrobat Reader, big minus. Also pictures and more information would be nice.

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2. MAKING A RESERVATION

Making a reservation	Female/FIN	Female/RUS	Male	Average
It was easy to make a reservation	1,3	2,5	1	1,6
Available and suitable time was found easily	1	3	1	1,7
Service was professional	1,3	4,5	1	2,3
Service was friendly	2	2,5	1	1,8

•No questions, like have you visited here prior to this appointment or is this type of value-added service familiar to you from before, were asked.

•No welcoming.

•No information where to come.

•Very friendly and nice service.

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3. RECEPTION

Reception	Female/FIN	Female/RUS	Male	Average
Reception was easy to find	2	5	3	3,3
Outlook of the reception was visually pleasant	2,3	5	2	3,1
Receptionist noticed you right away and greeted you properly	2	4	1	2,3
Receptionist gave you directions what to do and made you feel comfortable	2,5	4,5	2	3
Waiting area was comfortable	3	6	1	3,3

•Receptionist didn't notice me at all since she was with another client. Though she could've said hi or nodded or somehow notify my existence.

•Waiting area was not comfortable, no privacy, magazines, water etc.

•Reception was behind a lot of stuff, brochures etc.

•Receptionist just said: have a seat, someone will come and get you. Not very polite way to put it.

•I didn't have to wait at all since the employee was waiting for me already.

•The outlook of the reception is usual, nothing special. Works for me.

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4. VALUE-ADDED SERVICE

Value-added service	Female/FIN	Female/RUS	Male	Average
You were welcomed by the employee	1	2	4	2,3
Premises were pleasant	1,7	2	1	1,6
Employee was considerate and kind	1,3	1,5	1	1,3
Employee was professional	2	2	2	2
Employee showed interest to your wishes and on possible request	4,5	5	4	4,5
Employee introduced the products used in value-added service	5,6	5,5	6	5,7
Employee introduced the best products for home usage	5,6	6	6	5,9
Employee gave you an offer or a discount of the products	6	6	6	6
Value-added service was what you expected	2,7	3	4	3,2
Employee welcomed you back to use the value-added service again	5,7	6	6	5,9
"Check-out"/paying was easy	1	1	1	1

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- Candles could've been lightened, otherwise premises were clean and nice. Music was nice.
- Premises were nice. Lighting is something that could be considered in the future. It could be less bright in the end of the service.
- Employee was extremely friendly and nice. Thank you!
- Very professional, but I missed little bit more consideration of the customer during the service.
- There was no conversation, but this was probably due to the language barrier. I don't know if the employee spoke very good English.
- I was hoping for a little introduction of the service since I had never experienced it before, but I didn't ask and the employee didn't tell me anything.

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- I didn't get any recommendations or offers, looks like employee wasn't interested in selling me anything.
- I didn't get any information on products used, what a shame, I could have bought something for home.
- Value-added service was good, but really short. I thought it would've been longer.
- I was ignored after the value-added service, and wasn't welcomed back.
- Employee was kind and even though she didn't welcome me back, she wished for a good journey back home.
- I was given a pricelist and telephone number so I can make a reservation for another time, but employee didn't actually say the words welcome again.

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5. GENERAL INFORMATION ABOUT VALUE-ADDED SERVICE

General information	Female/FIN	Female/RUS	Male	Average
Opening hours are suitable	1,6	3,5	2	2,4
The selection of value-added services is good and diverse	1	2	1	1,3
The quality-price ratio is good	3	4	5	4
The products are placed appealingly in the shop	2,3	2,5	3	2,6
The shop has a good selection of products and different brands	2,3	2	4	2,8
Value-added services plays a big part when choosing a Spa destination for a holiday	1,3	4,5	5	3,6

- Value-added service should be available every day.
- Opening hours should be extended at least on Fridays and Saturdays.
- Value-added service is a bit expensive.
- The selection of services should be checked and some of the services could be combined.
- The service I got didn't have a good quality-price ratio. Service was too short.
- Selection of products is good, but work is needed in the presentation.
- I totally missed the selection of products since the employee was too busy to introduce me anything.

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FEEDBACK:

•More positive feedback, but please pay a little bit more attention to the customer.

•Thank you for the employee. Work was done well and I will definitely use the services in the future as well. Though, presentation of products used and what is suitable for me is something I really missed. Also notifying the customer and good customer service rules are good to go through again with the staff.

•Employee was extremely friendly and professional but I still felt something is missing. Maybe it was the shortness of service or products that weren't introduced or the hurry in the end of the treatment. It would've been nice to sit down after the service, take a breath and drink a glass of water.



•As a Spa-hotel customer my expectations are very high. I'm looking for luxury and unfortunately this time my expectations were not exceeded or even met. Very good and professional service, but so very short and "busy" All the elements for exceeding expectations exist: premises are nice, professional staff, just a little bit of effort and you have a great service.

•Positive things: Selection of products and services is good and staff is professional. TV screen on the reception is nice and modern. Negative things: Location of reception and customer service of reception, the image of value-added service suffers from the flaws of reception. Russian speaking staff would be good. Promotions and offers should be available, the staff should introduce and sell the products more enthusiastically. Interior needs improvement.

•Nice and friendly staff. Clean premises and good selection of services.





COMMON GUIDELINES

What is important for us and what are the guidelines we all commit to?



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