

Service Strategies Marketing, Operations, and Human Resource Practices

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Introduction

Over the last three decades, the principles of service management have become widely accepted. These call for an integrated approach to marketing, operations, and human resource management (HRM). The scholarly and business press routinely point to the importance of customer loyalty and customer relationship management for corporate profitability. Advances in marketing concepts and information systems make it possible to capture more precisely the demand characteristics of customers and to tailor solutions to meet their needs. Why is it, then, that measures of customer satisfaction have declined steadily in the last decade, websites for consumer complaints have proliferated, and media accounts of bad service appear with regularity?

In this chapter, I explore this paradox. I focus particularly on the private sector and on interactive service activities, defined as those that are produced through the interaction of employees and customers (Leidner 1993). Service management is important because the expansion of service activities and contraction of manufacturing in advanced economies means that management in services covers an ever increasing number and range of operations and employment. In addition, competing on the basis of customer service has become central to competitiveness in manufacturing as well as service industries. This is particularly true in supply chain management, where quality and productivity depends importantly on how vendor contracts with major customers are managed. However, it also applies to consumer markets, where after-sales service and service warranties and agreements have become a major source of revenues in goods production, particularly durable goods. Finally, there is growing empirical evidence that companies that compete on the basis of customer quality and customization do generate higher revenues and profits. Customer satisfaction does, in fact, matter; and the evidence is consistent with the widespread rhetoric of the importance of

long-term customer relationships.

I organize this chapter into three parts. In section 21.2, I review the alternative theoretical approaches to human resource management that have been developed in the academic literature and discuss why these need to incorporate conceptual advances from services' marketing and operations management. Here, I also discuss the evidence regarding what strategies lead to better service and sales, under what conditions, and why. In section 21.3, I examine alternative organizational models that rely on outsourcing and supply chain management for customer service and sales and the arguments for and against these approaches. In section 21.4, I review real world trends: what strategies are companies actually pursuing and what are the results for consumers and employees? I close with conclusions about the future direction of service management strategies and the role of HRM in them.

Alternative models of human resource management

The central premise of strategic human resource management theory is that successful organizational performance depends on a close fit or alignment between business strategy and human resource strategy. The 'fit' argument has two dimensions: a 'vertical' one (fit between business and HR strategy) and a 'horizontal' one fit among the components of the HR system). The logic of the vertical fit argument is that effective implementation of strategy depends on having human resource policies to ensure that employees have the appropriate knowledge, skill; and abilities to carry out the strategy. The 'horizontal fit' argument assumes that the ability and motivation of workers to carry out a strategy depends on having a coherent set of policies in place—a system or bundle of complementary policies— that provide incentives for specific actions. Coherence in human resource policies includes classic functionalities: selection, training, job design, and rewards.

A number of scholars developed this line of reasoning in the 1980s (Dyer 1983) later linking it to the resource-based view of the firm (Wright et al. 1994). This approach to conceptualizing human resource management is best viewed as a framework for corporate management, designed to emphasize the importance of the human resource function and to make it an integral part of the top management team. Much of the empirical research using this

framework focused on the corporate level of analysis (e.g. Delery and Doty 1996; Huselid 1995), although it expanded to include establishment-level studies as well (Youndt et al. 1996). Recent work has developed more elaborate models linking strategy and human resource management (Boxall and Purcell 2003). In general, this body of scholarship was more persuasive in demonstrating the benefits of horizontal fit (among the dimensions of human resource systems) than vertical fit (between business strategy and human resource strategy) (Wright and Sherman 1999), although there are exceptions (Arthur 1992).

Industrial Relations Approaches

A complementary approach to strategic human resource management emerged in the related field of industrial relations over a similar period of time. Compared to the SHRM literature, this perspective focused more on the productivity of whole industries and the role of institutions in shaping competitive advantage (Appelbaum and Batt 1994). Drawing on internal labor market theory (Doeringer and Piore 1971; Osterman 1984), this approach focused less on the corporate level or on the 'fit' between business and HR strategy and more on the idea of coherent employment systems at the workplace, which included human resource and labor relations practices (Kochan et al. 1986). It emphasized the need to understand the context-specific nature of technology and production processes and the complementarities between operations management and human resource systems (e.g. MacDuffie 1995).

This research incorporated insights from socio-technical systems (STS) (Trist 1981) and operations management research on quality (Deming 1984). STS theory contributes the idea of jointly maximizing the social and technical system, with employees playing a central role in work design and collaborative problem-solving. The quality literature similarly measures outcomes at the level of the production process and emphasizes employee involvement in ongoing group problem-solving to reduce variances in the production process, thereby improving first-time quality while reducing defects. Both of these approaches are in contrast to the principles of scientific management as developed by Taylor, in which the individual task is the unit of analysis and a

heavy emphasis on cost reduction typically leads to a focus on improving individual efficiency at the cost of first-time quality.

The concept of high-performance work systems emerged in this line of work, which married the insights on work organization found in STS and quality management research, the insights on employee motivation from HRM and organizational behavior, and industrial relations' focus on coherent employment systems. A general proposition emerged that in current markets which demand quality and innovation, better organizational performance hinges on the adoption of coherent human resource systems that provide employees with the skills, opportunity structure, and incentives to use their discretionary effort (Appelbaum et al. 2000). Evidence to support this proposition came from a series of industry-specific studies, including automobile assembly (MacDuffie 1995), apparel and medical electronics (Appelbaum et al. 2000), computers (Bresnahan et al. 2002), semiconductors (Appleyard and Brown 2001), and steel (Appelbaum et al. 2000; Arthur 1992; Ichniowski et al. 1997).

Services Management

However, the human resource and industrial relations frameworks discussed above are insufficient for conceptualizing the management of service activities because of the important role that consumers play in the production process and, in turn, the importance of marketing in shaping interactive services. While scholars in human resource and industrial relations studies were developing a systems approach to HR strategy and employment relations, their counterparts in marketing, operations management, and organizational behavior were elaborating an integrated theory of service management. The marketing literature demonstrated how and why service marketing differs substantially from product marketing (Gronroos 1990; Lovelock 2005; Zeithaml et al. 1990). Operations management examined solutions to the problems of uncertainty and unpredictability introduced by customers in service production (Chase 1978; Mills et al. 1983), and demonstrated the extent of managerial choice in the design of service operations (Chase and Tansik 1983). Research in organizational behavior developed the implications for human resource management (Bowen 1986; Bowen and Schneider 1988).

At the same time, these scholars noted the blurring of boundaries between goods and service production as technological innovations have turned some services into commodities and as competitive advantage in manufacturing has come to depend increasingly on customization in product features and after-sales service. Thus, the service management model has evolved to cover interactive services across a wide range of public and private sector settings with a mix of tangible and intangible products.

The classic assumption in the service management literature is that goods and services production differ along several dimensions. A simple classification distinguishes between the consumption of output versus the consumption of a process (Gronroos 1990). While typologies vary in degree of complexity and detail, most agree on four core differences: intangibility, heterogeneity (or variability), perishability of output (no inventory), and simultaneity of production and consumption (Lovelock 2005). Because service activities are more intangible than not, quality and productivity are difficult to measure. Because they involve co-production between a customer and provider, the heterogeneous preferences of customers make it difficult to standardize production without jeopardizing quality and customer satisfaction. Perishability of output and simultaneity of production and consumption make demand management through inventory systems more difficult and put a premium on first-time quality. These dimensions of customer contact work translate into relatively high levels of uncertainty and unpredictability.

For human resource management, the intangibility of service activities and the lack of clear measures of quality and productivity make it difficult to set specific goals for employees and evaluate and reward their performance based on those goals. The simultaneity of production and consumption implies that demand forecasting is unpredictable, and in turn, determining appropriate staffing levels is a challenge. It also suggests that first-time quality is particularly important— poor health care cannot be returned for repair— thereby putting a premium on investments in training, effective work design, and rewards to motivate responsiveness on the part of employees (Bowen and Schneider 1988). The co-production function means customers may be viewed and managed as ‘human resources’ (Bowen 1986). Thus, management needs to evaluate the effect of HR policies on customer behavior as well as on

employee behavior and motivation. All of these characteristics imply that human resource management is particularly important in service activities and that simple command and control approaches are relatively ineffective. For example, several studies of call center workers have found that high levels of electronic monitoring and routinization are associated with anxiety, stress, emotional exhaustion, and burn-out (Carayon 1993; Deery et al. 2002; Holman et al. 2002; Singh 2000); and these, in turn, lead to absenteeism (Deery et al. 2002) and lower self-reported quality (Singh 2000). Arguably more effective are indirect methods of control—strategies that create behavioral norms and inculcate cultural values so that employees deliver the desired level of service to customers (see, for example, Peccei and Rosenthal 2000).

The characteristics of interactive services also create particular challenges for the marketing function and create incentives for it to be involved in setting human resource policies. The task of marketing is to manage customer behavior by building an understanding of the customer's characteristics and buying habits and developing a relationship that yields repeated purchases and long-term loyalty to the product or brand. The fact that customers are part of the production process opens up new avenues for marketing and decentralizes that function so that each service interaction is an opportunity to sell. Thus, marketing is not just interested in a narrowly defined 'sales force' but in any employee who comes into contact with customers. The concept of interactive marketing—the notion that service interactions provide a 'bridge to sales'—became widely accepted in the 1980s; it is viewed as the mechanism through which perceived service quality, customer satisfaction, and customer retention are achieved (Gronroos 1990). Said differently, employees are 'part of the product;' they 'enact the brand.' Every service encounter may be a 'moment of truth' that particularly satisfies or dissatisfies customers, and, in turn, shapes their future buying behavior. The fact that a negative interaction between a customer and employee has far more impact on customer behavior than a positive interaction enhances the incentives for marketing to expand its influence into human resource policies that ensure a skilled workforce capable of providing first-time quality and customizing services to fit consumer demand.

Increasingly, operations management also has influenced human resource

systems in services because of heightened competition and the need to reduce costs and improve efficiencies. Historically, operations management played a limited role because of the labor-intensive nature of service work, the lack of technical solutions, and the role of the customer in the production process. Because customers introduce variability and uncertainty into the process through their heterogeneous preferences, the challenge of improving productivity is more difficult to accomplish in interactive services. This has led operations management to conceptualize customers as 'partial employees' (Mills et al. 1983), developing strategies to control customer as well as employee behavior. While many service activities involve high levels of customer contact that are difficult to standardize (such as hotels or hospitals), for many others, employers can choose a high- or low- contact approach to organizational design (Chase and Tansik 1983).

Operations management has played a critical role in transforming high-contact services into low-contact, technology-mediated ones—turning personalized interactions into impersonal 'service encounters' (Gutek 1995). While investments in computer technology were slow to yield productivity gains in the 1980s (Roach 1991), subsequent applications have helped to automate processes and reduce the labor content of transactions (Hammer and Champy 1992), improve labor productivity (Brynjolfsson and Yang 1996), and increase the speed and reliability of transaction processing by eliminating human error (Stewart and Chase 1999). Banks and insurance companies, for example, have been able to reduce the labor content of jobs by turning face- to-face interactions with bank tellers and agents into technology-mediated transactions in remote call centers.

These changes have had important implications for human resource management. On the one hand, by automating routine tasks, the remaining jobs tend to be more complex and require higher-order skills (Levy and Murnane 2002). The skill requirements of interactive service work involve three dimensions: product or substantive knowledge, knowledge of technical systems, and social interaction skills (Batt 2002). Substantive knowledge tends to be more complex than in the past because of the proliferation of product features, customization options, and product innovation; and ongoing changes in information systems require regular upgrades in computer information-

processing skills and database management. Social interaction skills include not only information-gathering and processing, but negotiation skills and emotional dimensions that have been undervalued (companies have yet to figure out how to compensate emotional labor) and understudied in the research literature (see Korczynski 2005 for an excellent review of this issue).

On the other hand, advances in information systems create opportunities for increased standardization while cost pressures create incentives to compete on labor efficiency. This sets up incentives to simplify jobs by fragmenting tasks, thereby reducing the skill content of jobs and the need for training and investment in human resource systems. This standardization not only affects employee morale, absenteeism, and turnover, but irritates customers as well. For example, the widespread dissatisfaction with call centers is due in part to customer frustration with voice recognition units, elaborate menus, punching in numbers, and valuable time wasted until a service representative comes on-line. The customer's frustration spills over to the employee, whose job becomes even more difficult. Hence, operations strategies to improve efficiencies can backfire into lower service quality, customer dissatisfaction, and built-in conflict between employees and customers.

Other alternatives to improving efficiency include staff reductions, on the one hand, or shifting labor costs to consumers through self-service options, on the other. Staff reductions, however, are likely to result in poor service unless accompanied by major re-engineering of process flows. Similarly, too much reliance on self-service may create resentment among consumers or the risk of losing one's customer base. Research in marketing identifies a number of hidden costs of consumption, including not only the price in dollar terms, but in terms of search time, physical effort, psychological burdens, and follow-up or subsequent problem-solving (Lovelock 2005). In sum, while there are parallels in the effectiveness of engineering solutions in manufacturing and service activities, there are also limits to these strategies in the service arena due to the role of the customer in the process.

Several studies have pointed to the tensions between quality and cost in interactive service settings (Frenkel et al. 1999; Korczynski 2002). In their boundary-spanning role, front-line employees are caught between the

demands of customers and the demands of management, leading to role ambiguity, conflict, and stress (Bowen and Schneider 1985). Several recent empirical studies have demonstrated this problem. For example, in a study of restaurant workers, Babin and Boles (1998) found that role stress negatively affected customer-server interactions and increased workers' intentions to quit. Hartline and Ferrell (1996) surveyed several hundred managers, workers, and customers at 279 hotels and found that role conflict contributed significantly to employees' frustration in their attempt to fulfill their jobs. And in a major meta-analysis of research on role ambiguity and role conflict, Tubre and Collins (2000) found a significant negative relationship between role ambiguity and performance.

However, at a more fundamental level, the tension grows out of different definitions of quality, and human resource management is caught between the competing claims of marketing (focused on customers) and operations management (focused on operations efficiency and reliability). Marketing defines quality as meeting customer demands, whatever this takes (Zeithaml et al. 1990). Achieving service quality entails higher labor costs because it suggests that employees take more time with customers to meet their heterogeneous needs. Operations management, by contrast, focuses more on a manufacturing definition of quality, as conformance to specifications: reducing variances in transactions-processing is central, which can be achieved through process automation (Garvin 1984). By this definition, quality and efficiency can be achieved simultaneously— reminiscent of the quality management arguments found in the manufacturing studies discussed above.

Empirical research on quality in services shows that customers value several dimensions of quality. The most widely used definition (SERVQUAL) lists five dimensions: tangibles, reliability (consistency), assurance (how confident the customer is about the service being provided), responsiveness (to the customer's demands), and empathy (for the customer) (Zeithaml et al. 1990). While operations management solutions can improve the quality of tangibles and the reliability of products, the remaining dimensions of service quality depend primarily on the capabilities of employees. The latter three dimensions, which account for almost 60 percent of customer satisfaction

scores, are related to the ability of employees to respond effectively to customers. Moreover, research in marketing has also shown that customer experience of actual service quality (rather than customer expectations) is the strongest predictor of customer satisfaction (Appiah- Adu 1999; Cronin et al. 2000; Kane et al. 1997). Hence, strategies to improve service quality and customer satisfaction depend importantly on investment in human resource systems, including selection, training, work designed to allow discretion for employees, and rewards to induce discretionary effort.

This line of argument is central to the service climate literature (Bowen and Schneider 1988; Schneider and Bowen 1985) and the service- profit-chain argument (Heskett et al. 1997). The central insight here is that in customer contact settings, customers experience what employees experience, and negative reactions on the part of employees spill over to customers, undermining their confidence in the company and their willingness to purchase services in the future. Employee motivation or attitudes are the underlying causal theory; and human resource practices of training, discretionary work design, and appropriate rewards are thought to induce employee satisfaction and loyalty, which in turn inspire customer satisfaction and loyalty, ultimately resulting in higher profits.

Most evidence for these arguments comes from individual case studies, but some quantitative studies in the banking and retail sectors report a significant positive correlation between employee perceptions of service climate and employee commitment to service (Peccei and Rosenthal 2000), customer reports of satisfaction (Borucki and Burke 1999; Johnson 1996; Schmit and Allscheid 1995; Rogg et al. 2001), and financial performance (Borucki and Burke 1999). Gittell (2002) examined hospital management and found that stronger relationships among providers and between providers and customers produced higher levels of customer satisfaction. However, the causal story is probably more reciprocal than linear, as in Schneider et al.'s (1998) study of the reciprocal relationship between service climate and customer perceptions of quality. Moreover, to date there is little evidence of employee attitudes or satisfaction as mediating the relationship between human resource practices and customer satisfaction (see Korczynski 2002: 29-34).

Another line of argument links human resource investments to better performance, not via employee attitudes but via their effects on worker skills, knowledge, and problem-solving capabilities. For example, Batt (1999) found that sales representatives in self-directed work groups generated significantly higher sales revenues (net of labor costs), than did traditionally supervised groups, and accomplished this in part through better use of technology.

In sum, there is some growing evidence that human resource management plays an important role in the performance of service organizations, although it is less clear whether or under what conditions employee attitudes or capabilities are important as causal mechanisms. More research in this area is needed, particularly with respect to organizational and institutional contingencies. In addition, research has shown that there are unique challenges to managing service activities and that effective performance depends importantly on the coordination of marketing, operations, and human resource management in order to create a coherent approach to customers. In particular, human resource management is often caught between the marketing goal of developing customer relationships through high-contact organizational design and the operations management goal of improving reliability and efficiency through lower-contact approaches. As a result, leading experts in all three fields have called for a functionally integrated approach to service management that focuses on customer satisfaction and loyalty (Bowen et al. 1990; Lovelock 2005).

When is service management a core competency?

This brief overview of alternative human resource models developed in different disciplines in the 1980s and early 1990s shows that there were parallel arguments for a coherent systems approach to management in each case. The terminology was different, but the thrust of the arguments was similar: ‘strategic fit’ in human resource studies, employment systems in industrial relations, and functional integration in service management. There was also a heavy emphasis on quality and building long-term customer relations, as scholars incorporated the insights of quality management into their theories of organizational performance.

Over the last decade, however, the strategy literature has paid particular attention to the argument that firms should focus on their 'core competencies,' as articulated by Prahalad and Hamel (1990), Quinn (1992), and others. That argument posits that firms should retain functions that they consider to be their core competency while outsourcing those that are non-core. Core capabilities are defined as those that contribute value to customer benefits and end products, that provide access to a wide variety of markets, and that are difficult for competitors to imitate (Prahalad and Hamel 1990). When applied to human resource management, the theory suggests that firms should retain human capital that creates value for the firm and that is rare or unique and difficult to imitate (Barney 1991). For example, firms are likely to choose internal employment systems for operations that involve firm-specific knowledge and skills, team-based systems, or work processes that involve 'social complexity,' 'causal ambiguity,' or 'idiosyncratic learning' (Lepak and Snell 1999: 35). They are likely to externalize or subcontract work that is more generic, involves lower-order skills, or is transactional in nature.

This line of argument challenges the integrated models of human resource management discussed above and raises the question of whether, or under what conditions, service management should be considered a core competency. In the classic service management literature, the assumption was that firms should retain this function in-house because front-line employees are the marketing face to the customer and because there is need for close coordination between sales and marketing, operations, and human resource management. The argument implied that customer management should be viewed as a core competency. In the meantime, however, modularization of production emerged as a viable alternative to vertical integration across a wide range of what had been considered core activities in major industries.

Modularization allows companies to separate more complex or knowledge-intensive functions from less-intensive ones, and subcontract the latter to lower-cost producers. This process depends on the degree of separability of tasks, and it is enabled by advanced information systems that allow the coordination and management of production flows across organizational boundaries. If modular production chains can solve the problems of coordination across globally dispersed suppliers in manufacturing, then

arguably the model should apply equally well to service activities. Much corporate thinking has moved in this direction in recent years.

Many service interactions are, in fact, quite separable. While place-based, high-contact services are not (hotels and hospitals), many back-office operations and low-contact services are—services that process information or goods as opposed to people. They may be separated by level of complexity, using a number of categorization strategies: by function (sales versus service; type of service enquiry (billing, repair, collections); by type of product (health insurance, home insurance, auto insurance, credit cards); by type of customer (large business, small business, high-end retail, low-end retail). Once service interactions are separated into distinct categories—by level of complexity, tacit knowledge, or asset specificity—they may be designated as core or non-core, retained in-house or outsourced to subcontractors. With the ongoing restructuring of service and sales channels into remote call centers or web-based transactions, we might expect the majority of these operations to be handled by subcontractors.

Defining what level of complexity or asset specificity should be viewed as core and ‘non-core,’ however, may be more problematic than it first appears. Clearly, at one extreme, customized services for corporate clients entail high levels of tacit knowledge of products and processes and deep relationships of trust with clients. At the other extreme, ad campaigns for credit card sales are generic in nature and require no personal relationships to complete. Beyond these clear *dichotomies*, however, decisions about what *is core and non-core become more* problematic. Are service and sales channels for insurance, telecommunications, and financial services simple and codifiable? Are they core or non-core for these businesses?

In addition, some competitive strategies argue against separation of tasks. Strategies based on service differentiation or branding depend on customer contact employees representing the marketing function and presenting a unique face to the customer. If customer service and sales are outsourced to a vendor who also handles the client’s competitor, how will the vendor’s employees provide a unique approach for one client’s customers but not the competitors?

Another strategy, customer relationship management, relies on the ability of providers to create customer loyalty and long-term relations by satisfying a wide and ever-changing range of customer demands. If companies pursue this strategy, then how work is organized should revolve around the characteristics of the customer or customer segment rather than by a particular task or function. In the 1990s, many companies re-engineered service delivery channels so that business units would be organized by customer segment, with sales and marketing and customer service all reporting to one vice president. This provided a strategy of integration, with sales and marketing and customer service providing a consistent face to the customer. Once companies choose this route, their need for firm-specific knowledge of the customer and investment in human resource systems increases considerably. Employees need to manage a range of firm-specific information and knowledge in terms of substantive products, technical processes, and relationships with customers.

Empirical research supports the idea that firm-specific human capital positively affects service performance. In a study of a department store chain, for example, Sharma et al. (2000) found a significant positive relationship between sales experience and performance, and they attributed this finding to the knowledge structures of workers with greater expertise. In a meta-analysis of twenty-two studies of job experience, Quinones et al. (1995) found a .27 correlation between experience and performance. Long-term employees have the tacit firm-specific skills and knowledge—and often personal relationships with customers—to be more effective. Thus, if firms choose to compete on quality or customer service, an in-house, professional approach to human resource management appears to be the most effective route.

‘Service bundling,’ another strategy that is customer centric, takes advantage of economies of scope to package a number of standardized products or services. As soon as employees are responsible for packaging a number of types of products or services, the complexity of their jobs increases and the opportunities for modularization and outsourcing decline.

Even separating sales and after-sales service may be problematic. While from a human resource management perspective, it is well established that sales and service activities require quite different skills, separating service and sales is often inconvenient from the customer's perspective. Moreover, this type of separation reduces opportunities for inbound service enquiries to generate sales. Thus, separating service and sales interactions typically generates trade-offs. In sum, while at first blush low-contact service interactions appear to be easily separated and outsourced, strategic considerations suggest that many companies would choose to treat service management as a core function and retain it in-house.

Real-World Trends: Why 'Service Stinks'

How have customers responded to corporate service management strategies in the real world? Not very well, according to the popular media. In October 2000, *Business Week* devoted a special issue of the magazine to 'Why Service Stinks' (Brady 2000). In it, the editors provided an overwhelming series of examples of customer dissatisfaction with the *process* of service—not product *quality* or *features or price*. Much of the issue was devoted to the negative effects of customer relationship management. While high-value-added customers benefit from personalized attention, the flip side of the relationship coin is the poor quality of service delivered to consumers with a low profitability profile.

The importance of 'service fairness' is an idea that is catching on. Drawing on the concept of organizational justice as applied to employees in organizations, some management theorists (Seiders and Berry 1998) argue that customers expect to be treated with fairness: distributive justice (equity in treatment and outcomes), procedural justice (consistency, transparency, accuracy, freedom from bias), and interactional justice (respect, honesty, and courtesy).

Customers perceive these principles to be violated in airline or hotel programs that allow frequent customers to bump other customers or in practices such as 'weblining' (Stepanek 2000)—the cyberspace equivalent of 'redlining,' in which consumers are profiled on the basis of their personal characteristics. The ability to purchase a good or service on-line depends increasingly on supplying a host of personal information that is not relevant to the transaction at hand.

Consumers feel that their privacy is violated and that they are judged by their

predicted, not actual behavior. Higher-value-added customers often get better discounts or treatment, while the least profitable customers may be ignored at best.

In addition to media accounts, websites such as planetfeedback.com and complaints.com have emerged as popular vehicles for customers to vent frustration at companies. Similar to the popular press articles cited above, a perusal of these sites suggests that consumers are more irritated about the service process itself than about the quality or price of goods or services. Typical complaints focus on frustration with automated response units that don't provide answers to questions, the lack of human interaction, the inability to get access to companies to resolve complaints, the failure of companies to follow through on promises, or the lack of courtesy, training, and competency of front-line staff. In sum, the source of complaints appears to reside in failures of coordination between functional departments or major deficiencies in human resource systems.

Is there any evidence that these anecdotes constitute a more general phenomenon? One of the most reliable sources is a quarterly survey of American consumers conducted by the University of Michigan (the American Customer Satisfaction Index, ASCI), which now has over ten years of trend data (Fornell et al. 1996). That survey shows two consistent trends. First, customer satisfaction with manufactured goods is consistently higher than satisfaction with service industries—averaging to percentage points in many cases. Second, satisfaction with manufactured goods has generally stayed the same or increased, while there has been a consistent downward trend in satisfaction with service industries. Satisfaction ratings for durable goods have hovered at 79 percent over the last ten years: for electronics, between 79 and 83 percent; automobiles, 79-80 percent; and appliances have fallen from 85 percent to 80 percent in the same period. Satisfaction with non-durable goods is also steady at about 79 to 81 percent; and personal care and cleaning products 83 to 84 percent in the same period. However, satisfaction with utilities fell from 75 percent to 72 percent; airlines from 74 percent to 66 percent; hotels from 75 to 72 percent; hospitals from 74 to 71 percent; fixed line telephones, from 80 percent to 71 percent; and wireless telephone service and cable TV hover at 65 percent and 61 percent approval, respectively. While the ASCI does not include

call centers in its ratings, other surveys put satisfaction with call centers at 54 percent (Purdue University 1999).

Are these good scores or bad? Most marketing experts would argue that a 70 percent rating means that a company stands to lose 30 percent of its customer base, which suggests that both manufacturing and service industries are in trouble, but the latter more than the former. The potential loss of customers is viewed as a major problem because it is far more expensive to win new customers than maintain existing ones. Moreover, loyal customers are more profitable because over time, they buy more products and more value-added products (Reichheld 1996), and they are ‘human resources’ for the marketing function, through word of mouth advertising.

What accounts for these trends? Some argue that consumers’ expectations are rising, and so they are demanding more. However, the ASCI data shows that company ratings vary considerably within a given product market. For example, between 2000 and 2005, satisfaction with BellSouth wireline services fell from 75 percent to 70 percent, while satisfaction with Qwest Communications rose from 64 to 69 percent. In the same time period, Continental Airlines saw its approval rating jump from 62 percent to 70 percent while that of US Airways dropped from 62 percent to 57 percent.

An alternative explanation is that service providers have shifted strategies in response to pressures associated with industry deregulation, and more recently, globalization. This holds true in sectors such as transportation (airlines, trucking), banking, utilities, telecommunications, health care, and insurance. Companies have developed differentiated strategies for serving customers according to the value of their accounts. More costly strategies based on customization, relationship management, and a professional approach to human resource management are reserved for high-value-added customers, particularly business clients, who are served through business-to-business channels. This approach is consistent with the ideas of strategic human resource management and an integrated approach to service management, and the service-profit-chain model. For the majority of customers in the mass market, however, companies have adopted more cost-

driven strategies that emphasize technology solutions, de-emphasize investment in employees, outsource to low-cost providers, shift labor to consumers, and often sacrifice quality. Some management theorists even advocate segmentation strategies designed specifically to eliminate the least profitable customers (Reinartz and Kumar 2002), in essence ‘firing partial employees’ who do not bring in enough profits.

Customer Segmentation and Human Resource Management

Customer segmentation strategies have grown across many industries—from hotels and financial services to telecommunications and airlines. The strategies are well developed in the USA, where the national market is large. They are growing in other parts of the world as well (Boxall 2003). In the USA, a 2003 national survey of call centers found that 50 percent said they competed on the basis of service differentiation and used a targeted customer approach to organizing service. Companies were much more likely to take a professional approach to serving business customers, but a cost-driven approach to serving the mass market. In the professional model, the typical service agent had a college degree, substantial levels of discretion and involvement in problem-solving groups, and annual pay equal to \$45,075. By contrast, the typical service agent in a mass market center had one year of college beyond high school, little discretion to serve customers, and earned \$28,068 annually. In mass markets, where the overwhelming bulk of service transactions occur, the assumption is that competitiveness depends more on price than on quality; and hence, companies are skeptical about investing in the capabilities of front-line employees (Batt and Kwon 2005).

Customer segmentation produces differentiated outcomes for employees as well, contributing to growing wage inequality. A study of service and sales channels in telecommunications found that customer segmentation strategies coupled with variation in human resource practices lead to greater wage inequality, with workers serving large business customers enjoying a 17.5 percent wage premium over those who provided ‘universal service’ to consumers in any market (mixed market centers), even after controlling for human capital characteristics and human resource practices (Batt 2001). These

findings held true in a replication study of a nationally random sample of call center workers across all industries in the USA (Batt and Kwon 2005).

Segmentation strategies also facilitate outsourcing and offshoring of low-skilled service work, undermining fragile job security in these settings. Once tasks are separated into distinct categories by level of complexity or value added, then simpler tasks or services for less valued customers may be outsourced at lower cost. Subcontractors, competing on costs, devise strategies to simplify tasks and further drive down skill requirements of jobs and wages, creating high turnover models of employment for employees, which often translate into low service quality as well. For example, in a comparative international study of call centers, Batt et al. (2005) found substantial differences in management practices between US in-house centers, US subcontractors, and Indian offshore subcontractors. While the in-house centers adopted a more professional approach to service, with high relative levels of skills and training, discretion, and pay, US subcontractors offered the opposite: low levels of skills, discretion, and pay. Indian subcontractors had particularly contradictory systems, hiring relatively highly educated workers with high relative pay by Indian standards, but offering the lowest levels of opportunity for discretion and problem-solving for customer service. These differences translated into significantly higher levels of turnover in the US and Indian subcontractors, compared to the in-house operations.

Segmentation strategies make two important assumptions: that there are necessary trade-offs between cost and quality and that demand in the mass market is driven primarily by price, and hence, investing in human resource systems doesn't pay off. But what evidence exists that quality strategies that invest in the workforce don't pay off in price-conscious markets? Marketing experts argue that there are ample opportunities to compete on quality and customization in mass markets— that mass customization characterizes the majority of consumer markets in advanced economies (Pine 1993). A series of case studies of low-wage service work in hospitals, hotels, banking, and telecommunications showed that investing in human resource practices could pay off in these markets (Appelbaum et al. 2003). A national study of US call centers showed that quit rates were lower and sales growth higher in centers that adopted a more professional approach to service, and that these effects

were *largest* for centers serving the mass market (Batt 2002). High quit rates not only increased the costs of recruitment and selection, but negatively affected performance because new employees face a learning curve. A follow-up study of sixty-four call centers in one company, all of which served the mass market, found that centers with higher rates of training, discretion, and incentives for sales had significantly higher customer satisfaction ratings, which in turn translated into higher net revenues (net of all labor and other operating costs) (Batt and Moynihan 2005).

In sum, there is evidence that competing on quality and investing in human resource systems can pay off in price-conscious markets, but in the absence of countervailing institutional pressures such as unions or consumer organizations, companies have little incentive to make the effort.

Conclusion

In this chapter, I have argued that the unique nature of service activities poses substantial challenges for human resource management. At the level of the corporation, effective delivery of services requires a careful integration and coordination of strategies across marketing, operations, and human resource functions. At the level of the workplace, the role of human resource management is particularly important because of the powerful role that employees play in shaping consumer buying patterns, but marketing and operations management often create conflicting strategies for human resource management, leading to workplace tensions and contradictory incentives for employees.

Many companies have, indeed, created integrated systems of service delivery by targeting distinct customer segments and organizing their marketing, operations, and human resource systems around these targets. Strategies that compete on quality, customization, and innovation target high-value-added segments, typically in business-to-business channels. Strategies that compete primarily on cost are targeted towards the mass market. Hence, the alternative service management models discussed in the first two sections of this chapter are in full play, but utilized for very different market segments in the economy.

In the drive for strategic fit between business and human resource strategies in mass markets, however, it appears that companies may have put too much emphasis on cost reduction—despite the fact that there is growing evidence that strategies of mass customization do, in fact, pay off. There is also growing evidence of dissatisfaction among consumers as they put up with standardized menus and poorly trained employees or absorb the labor costs of service themselves. And managers, themselves, admit that they are uncertain about how to strike a balance between cost and quality. In sum, too much focus on cost may be the wrong business model for this market.

Consumer backlash appears to be on the rise. Consumers are not only concerned about the quality of service, but also the privacy and security of their financial information. Their jitters are exacerbated by news accounts of security leaks. The Internet has become a powerful tool for consumer voice—a major source of negative word-of-mouth marketing—or ‘viral marketing,’ as consumers broadcast their venom about particular experiences with companies to millions of people around the globe. And in some cases, consumer and labor organizations are working together, for example, in the recent backlash against offshoring of white-collar jobs in the USA. Legislative initiatives in over twenty states seek to limit offshoring *or jobs, and most target consumers’ ‘right to know’ where a service is originating* and the right to have service provided onshore.

In sum, while there is much talk about building quality service and relationships with customers, the reality is that the construction of bad jobs and bad service is quite pervasive. The question for the future is how much consumers will complain or organize, whether consumer-labor coalitions develop around ‘good jobs-good service strategies,’ and how companies will respond. On the one hand, there are many opportunities to compete on quality in mass markets—through innovative uses of information technology or more sophisticated marketing research to identify opportunities for customization. Moreover, the availability of Internet databases of company-specific complaints provides opportunities for companies to identify areas that particularly need improvement. On the other hand, financial pressures push companies to continually take costs out of the business. Outsourcing, offshoring, and shifting labor to consumers are attractive quick fixes to remedy

short-term profits.

In either case, it is clear that the dynamics between consumers, employees, and firms in the service economy have changed in important ways over the past few decades. Research in human resource management must be reconceptualized to take into account the influence of consumers in this process.

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