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"UTILIZATION OF SERVICE QUALITY IN STRATEGIC MANAGEMENT"

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ABSTRACT
Quality initiatives will be threatened until they can be justified in positive financial returns. This paper uses existing literature to relate service quality to profitability and customer satisfaction and to integrate these considerations into strategic decision making.
"Utilization of Service Quality in Strategic Management"

INTRODUCTION

The future of the Quality Movement is being threatened. The cost cutting trend of the 90's is threatening the continuance of the quality initiatives implemented during the quality revolution of the 80's. For the quality movement to continue it is imperative that organizations understand the importance of investing in quality and specifically investing in service quality. For this to occur methods of measurement and evaluation of the impact of service quality must be developed and included in the strategic planning and decision making of organizations. Following a brief overview of the service quality evolution, this report will compare the similarities and differences of the methods currently being evaluated for assessing the impact of service quality, specifically the trend towards determining the financial impact that service quality initiatives have on the organization. The importance of utilizing the information generated by these methods in planning for the future will also be addressed. The general belief is that the ability to compete in the future will require a shift to assessment of the external environment, particularly customer wants and needs. By determining the relationship between service quality, customer satisfaction, and profitability and including them in the strategic plan, organizations will be able to determine which quality initiatives are necessary for customer satisfaction and thus allow the organization to earn the greatest return and assist in competing for the future.

OVERVIEW

The evolution of service quality over the years has brought about much debate and confusion in the literature. Parasuraman, Zeithaml, and Berry (1988) attribute the
confusion to the fact that unlike goods quality which can be measured objectively, service quality is an "abstract and elusive construct because of three features unique to services: intangibility, heterogeneity, and inseparability of production and consumption." The confusion in the literature expands to include the differentiation between service quality and customer satisfaction. Parasuraman, Zeithaml, and Berry (1988), and Oliver (1981) are in agreement that perceived service quality is an attitude or global judgement relating to the superiority of the service provided, and satisfaction is a transaction specific reaction. These same authors, as well as, Bitner (1990) and Bolton and Drew (1991) agree that incidents of satisfaction over time result in perceptions of service quality. Cronin and Taylor (1992), agree that service quality should be measured as an attitude. Cronin and Taylor differ however, from Parasuraman, Zeithaml, and Berry (1988), and others, in that they have found that service quality is actually an antecedent of customer satisfaction. It is this finding that is imperative for the understanding of the current literature. There is general consensus in the current literature that service quality leads to customer satisfaction and it is customer satisfaction that leads to profitability for organizations through growth in market share and customer retention. For this reason, as Rust (1993) points out, the use of the terms service quality and customer satisfaction are often used interchangeably.
MODELS FOR ASSESSING SERVICE QUALITY

The models developed for assessing service quality have undergone an evolution as well, in that the same model has been developed and modified over the years to accommodate the advances of research in the field. The unfortunate fact is that no one model has been proposed that can assess service quality across all industries because different industries have customers with different needs and wants. The overwhelming consensus is that there is a need for a model to assess service quality as an individual construct to allow for management to utilize the information and monitor the progress of service quality initiatives that are being utilized.

The initial model developed was a multiple-item scale for measuring service quality called SERVQUAL developed by Parasuraman, Zeithaml, and Berry (1988). The model was based on the assumption that perceived service quality is the degree and direction of the discrepancy between customers' perceptions of performance and customers' expectations. The SERVQUAL scale is based on the finding that customers use basically the same general criteria for arriving at an evaluative judgement about service quality. There are five dimensions that are considered in the SERVQUAL scale: tangibles, reliability, responsiveness, assurance, and empathy each separated into performance items, totaling twenty-two items, for defining the service quality domain.

The SERVQUAL scale was assessed and modified by Cronin and Taylor (1992). Cronin and Taylor (1992) agreed that the performance items and dimensions previously identified in the SERVQUAL scale were adequate for defining service quality however, they found that performance measures alone were a more accurate measure of service quality than the inclusion of customers expectations. Their research showed that the
inclusion of customers’ expectations based on the disconfirmation of expectations paradigm made service quality indistinguishable from customer satisfaction. The inability to distinguish between service quality and customer service made the tool useless for managers because they were unable to determine if progress was due to service quality improvements or due to some other influence on customer satisfaction. Cronin and Taylor removed the customer expectation measure from the equation and renamed the new scale the SERVPERF scale. Cronin and Taylor (1992) further suggest that based on their findings, service quality is an antecedent of customer satisfaction and customer satisfaction has a stronger influence on purchase intention; therefore, management should form strategies based on total customer satisfaction rather than solely on service quality.

Hemmasi, Strong, and Taylor (1994) agree with the findings of Cronin and Taylor (1992) that the SERVQUAL scale is in essence measuring customer satisfaction and thus an inappropriate measure for the service quality construct. Hemmasi, Strong, and Taylor (1994) also agree that the data collected using the SERVQUAL methodology is not the problem it is the measurement analysis that is the problem. They question the measurement validity of the SERVPERF scale and agree with other researchers such as Babakus and Boller (1992) and Brown, Churchill, and Peter (1993) that the SERVQUAL and SERVPERF scales should be treated as unidimensional scales. Hemmasi, Strong, and Taylor (1994) propose a use for the data collected using the SERVQUAL scale to assist in strategic management. They propose that the SERVQUAL scale items be placed on an importance-performance grid, which would identify areas for concentration to improve service quality. Their evaluation is based on the assumption that like
SERVQUAL quality is a function of customer perceptions of performance and the importance of the attribute. However, unlike Parasuraman, Zeithaml, and Berry (1988) the customers’ expectations are not included because according to Brown, Churchill, and Peter (1993) customers “expect” uniformly high levels of service. The performance dimension in the importance-performance analysis is simply the customer’s perception of the firm’s service performance, as demonstrated with the SERVPERF scale proposed by Cronin and Taylor (1992). The Importance-Performance mapping results in a four-quadrant grid with the X-axis representing the average importance weights for the twenty-two items of the SERVQUAL scale, and the Y-axis representing the performance scores obtained using the SERVPERF scale. Quadrant I represents the areas customers view as particularly important, yet the firm is only providing adequate service quality. The authors refer to this as the “concentrate here” quadrant. Quadrant II, called “low priority” refers to those areas where the firm is performing adequately on issues customers’ view as less important relative to the other dimensions of quality. Quadrant III, called “possible overkill”, identifies areas where the firm is performing quite well but the customer does not consider important. Quadrant IV, called “keep up the good work”, represents the areas in which the customer perceives as very important and the firm is excelling in performance. Hemmasi, Strong, and Taylor (1994) suggest that decision-makers can benefit from the information implicit in the four quadrants to influence the allocation of resources and extend the analysis to make comparisons with the competition within the industry. The authors recognize that their research is limited to a single service setting as opposed to assessing the method across multiple service industries. The authors also warn about the current literature, specifically Bitner and Hubbert (1994) and
DeSarbo et al (1994), suggesting that models of customer decision making often vary across settings and evolve over time.

**TYING QUALITY TO THE BOTTOM LINE**

A 1994 article by Bristol Voss entitled “Quality’s Second Coming”, effectively describes the next major trend in the quality movement as the shift from quality for quality’s sake to using quality strategically. For this to occur quality initiatives must be tied not only to the bottom-line but also to the companies strategies. Y.S. Chang states in the same article, “the way to make customer-defined quality work, without going bankrupt, is to link customer quality with company strategy, or strategically significant business goals- such as greater customer loyalty, better employee relations, lower operating costs, higher productivity, and increased market share and profits- not quality per se.” The analysis that follows describes the attempts by researchers to develop methods and models to evaluate service quality and its impacts in a financial manner so as to be able to assess the investment in quality relative to the other investments that organizations must consider.

Bruce Fanjoy (1994) describes a method of annuitized valuation that organizations can utilize to measure its assets, particularly the asset value of customers. The annuitized valuation represents the potential net cash flow of customers, over time. To be effective the valuation must consider several assumptions: 1) the realistic length of a successful customer relationship; 2) the predictability of future cash flows; 3) the relationship between fixed and variable expenses; 4) the relationship between fixed expenses and sales volume; and 5) the firm’s tax rate. The annuitized value of a customer is determined by dividing the gross profit (net of tax) generated by the
customer, by the appropriate discount rate. Take for example a customer that generates $700 per month, variable costs average 10% of revenue, the company employs a 10% annual discount rate, and the marginal corporate tax is 40%. The gross profit of $630 becomes $378 in after tax profit. By dividing $378 by the 10% discount rate divided by 12 to correspond with the monthly gross profit figure the asset value of the customer is equal to $45,360. The company can now assume that loss of this customer will cost them $45,360 a year. This can be a useful tool in determining the financial opportunities of delivering the service quality that makes customers loyal, and the financial risk of not doing so. Fanjoy concedes that this may be a conservative estimate of the value of the customer because annuitized valuation does not consider non-financial elements such as the loss or gain associated with word-of-mouth.

Similar to Fanjoy (1994), Rust, Zahorik, and Keiningham (1995) recognize the need for a model to provide financial accountability for quality. However, unlike Fanjoy’s use of annuitized valuation for measuring the asset value of customers, Rust, Zahorik, and Keiningham attempt to provide an operational method for measuring the link that exists between quality and financial returns. Rust, Zahorik, and Keiningham (1995) propose a model for assessing the financial accountability of service quality called the Return on Quality (ROQ). The ROQ approach is based on the following assumptions: 1) Quality is an investment; 2) Quality efforts must be financially accountable; 3) It is possible to spend too much on quality; and, 4) Not all quality expenditures are equally valid. The model of the relationship between service quality and profitability is described as a chain of effects. “The improvement effort, if successful, results in an improvement in service quality. Improved service quality results in
increased perceived quality and customer satisfaction and perhaps reduced costs. Increased customer satisfaction in turn leads to higher levels of customer retention, and also positive word-of-mouth. Revenues and market share go up, driven by higher customer retention levels and new customers attracted by the positive word-of-mouth. The increased revenues, combined with the decreased costs lead to greater profitability.”

The effect of word-of-mouth is difficult to measure so it is not formally modeled. Similar to Fanjoy’s annuitized valuation, ROQ provides conservative results due to the lack of word-of-mouth valuation. The chain of effects modeled by the ROQ approach can be converted into general equations, which allow for the valuation of each modeled process. The authors suggest that the ROQ approach can quantify the market share implications, net present value of the resulting profit stream, and ROQ of a proposed quality expenditure. ROQ is calculated by first determining the net present value of the profit streams for the quality improvement (NPV), the net present value of the profit streams at status quo (NPV0), and the net present value of additional spending (NPVAS). The ROQ is equal to the NPV minus NPV0 divided by the NPVAS. For in-depth calculations please see Rust, Zahorik, and Keiningham (1995). The ROQ approach uses customer satisfaction survey data, internal company data, competitive market data, test market data, and managerial judgments to form its estimates. The approach requires that the customer satisfaction survey data consist of overall satisfaction questions for the services overall and the processes overall. It is also necessary to make sure each satisfaction question relates to a particular managerial process to ensure ‘ownership’ of the results by specific managers to make the survey results more actionable. For strategic planning, the ROQ approach holds a great deal of promise. The approach allows organizations to
determine where and how much to spend on quality improvement efforts and the impact that these efforts will have on market share, revenues, profits, and return on investment. By knowing the return on investment, organizations can compare service quality improvements to other investments that might be under consideration.

Zeithaml, Berry, and Parasuraman (1996) agree with Fanjoy (1994) and Rust, Zahorik, and Keiningham (1995) that the issue of highest priority in the service quality field involves understanding the impact of service quality on profit and other financial outcomes of the organization. There is agreement among these authors that a link exists between service quality and profits; however, the current authors acknowledge the fact that the link is neither simple nor straightforward. There are several variables effecting profits, service quality being one of them, and a series of intermediate links. Zeithaml, Berry, and Parasuraman (1996) do not create a mathematical model using financial tools as suggested by Fanjoy (1994) and Rust, Zahorik, and Keiningham (1995), they instead attempt to model the link by determining the behavioral intentions resulting from service quality. They employ the previously published relationship between customer retention, a behavioral response, and profits identified by several researchers and generally agreed upon in the present literature. Customer retention is considered a defensive impact of service quality, which is measurable and thus can assist organizations in gauging the financial impact of service quality. Zeithaml, Berry, and Parasuraman (1996) like Cronin and Taylor (1992) attempt to model the link between service quality and behavioral response. Unlike Cronin and Taylor (1992) in which they use purchase intentions as the only behavior to determine the effect of service quality, the current authors use thirteen different behavioral intentions. The model proposed by Zeithaml, Berry, and
Parasuraman (1996) suggests that superior perceptions of service quality result in favorable behavioral intentions, which influence customers to remain, resulting in increases in income generated from the ongoing revenue, increased spending (by customers), willingness to pay price premium, and referred customers. On the other hand, inferior perceptions of service quality result in unfavorable behavioral intentions, which influence the customers to defect, resulting in a loss in income due to decreased spending, lost customers, and the costs that must be incurred to attract new customers. The authors test the model and further hypothesize that there exists a zone of tolerance for customers between the adequate level of service and desired level of service. Organizations operating at or above the zone of tolerance should be hesitant to invest too much on service improvement because the authors find that the slope is nearly flat above the zone of tolerance. This indicates that the return on investment would not be as great above the zone as it would be when investing between adequate and desired levels of service quality. The implications for managers offered by this model include the importance of implementing strategies that will guide behavioral intentions in the right direction, and a basis for determining whether service quality improvements would provide sufficient return on investment. The weakness with regard to strategic management is that unlike Fanjoy (1994), and Rust, Zahorik, and Keiningham (1995), the current authors do not determine an actual dollar amount that can be utilized to compare investment opportunities.

A unique approach for assessing the financial aspects of service quality is proposed by Praveen Nayyar (1995). Nayyar suggests that because improving customer service should result in improved competitive performance, the stock market should react
positively to these changes. Similarly he suggests a negative market reaction when customer services are reduced. Nayyar (1995) assesses the stock market reaction to press releases based on four customer service objectives: 1) Risk of purchase; 2) Purchasing Cost; 3) Ease, convenience, and cost of use; and 4) Personalization. Through evaluation of the average cumulative abnormal return (CAR) associated with each of the customer service objectives, Nayyar finds that attempts to reduce risk of purchase and purchasing cost are more highly valued by the market than attempts to increase customer service through ease, convenience, and cost of use or the personalization of products. These results imply that actions that increase customer service before purchase are more valuable actions than actions that increase customer service after purchase. The results have strategic implications for managers particularly that positive stock market reactions have positive impact on shareholder wealth thus profits increase. Nayyar’s findings could be useful for managers in determining which services to concentrate their investments. The results also provide warning to managers to be cautious when considering reduction of customer services.

**DETERMINATION OF CUSTOMER “VALUE”**

Tying quality to the bottom line is critical for providing methods of evaluation and for insuring the survival of the quality movement; however, the assessment and understanding of customers needs and wants is also a necessity for organization’s strategy. Thus far it has been determined that service quality is an antecedent to customer satisfaction, and that customer satisfaction is directly related to profits; however the need exists to go to the next step to determine what it is that customers’ “value” in products and services. Managers have been asked to consider their customers when determining
which improvements are needed. Customer Satisfaction Measurement (CSM) was developed to bring the “voice of the customer” into the quality effort; however, it has not been effective due in part to the fact that CSM does not monitor the changing wants and needs of customers (Woodruff, 1997.) Robert Woodruff suggests, in his 1997 article, that it is “customer-value based competition that represents the next major shift in managerial practice, complementing but at the same time moving beyond the quality management focus of the last two decades.” Woodruff (1997) proposes a framework for thinking about customer value, customer value learning, and the related skills required by managers to create and implement superior customer value strategies. Woodruff (1997) shows that to compete for customer satisfaction, organizations must know what customer’s value and how this value is changing over time. He defines customer value as “a customer’s perceived preference for and evaluation of those product attributes, attribute performances, and consequences arising from use that facilitate (or block) achieving the customer’s goals and purposes in use situations” thus suggesting a hierarchy of value judgements. The hierarchy suggests that satisfaction occurs at each step- attribute, consequence, and goal. The CSM measures satisfaction at only the attribute level. For this reason, Woodruff proposes the development of an alternative model, called Customer Value Determination (CVD), which would allow for measurement of satisfaction at the higher levels as well. Woodruff also proposes the creation of a Customer Value Oriented Marketing Information System (CVOMIS) to integrate the various information pertaining to customer service and satisfaction collected by the different departments within an organization. The CVOMIS should integrate data such as CVD research data, macroenvironmental data, customer complaint data, customer
targeting data; salesperson call reports data, competitors offer data, and customer visits data. This could be a vital tool in assessing changes in customer value over time. Woodruff (1997) also offers a proposed model for translating customer value learning into action, which can be a tool for ensuring that organizational strategies reflect the current and changing customer value delivery. The proposed model suggests a circular process beginning with implementation of customer value delivery followed by tracking of the performance of customer value delivery, followed by customer value learning, followed by creation of a customer value delivery strategy, followed by translation of the strategy into internal processes and their requirements, followed again by implementation of the customer value delivery, and so on. Woodruff suggests that as customer retention and customer relationship building and maintenance take on more priority, customer learning and translation processes will become a core competency issue. The system that Woodruff suggests, is based in concept on past theory however it is a new concept and unfortunately does not allow for much similarity and difference assessment. The system proposed if nothing else has opened the door for research into the field of customer value delivery and should help to stimulate the creation of formal theories and tools for measurement because this does appear to be the direction that competition is heading in the future. Although this is a new idea there is one article that critiques Woodruff’s proposed theory and makes it even more useful for strategic managers. Parasuraman (1997) suggests that Woodruff’s evaluation although timely is unclear. According to Parasuraman, Woodruff’s definition of “value” although broader, may be too complex to be translated into an effective operational definition for creation of a general scale for measuring customer value. Parasuraman also questions whether the measure of
satisfaction is really different from measuring the value from a practical perspective? Although not in full agreement with Woodruff’s ideas, Parasuraman proposes a framework for monitoring customer value and how information obtained about customer value can be used to design and implement customer-value based strategies. Parasuraman suggests differentiating customers into four groups: first time, short-term, long-term, and lost. Assessment of first-time customers and lost customers can provide customer value information pertaining to the attribute level, which is useful for strategies aimed at attracting new customers. Assessment of short-term customers and lost customers provides information pertaining to the consequence level and can be useful in strategies aimed at enhancing the customers’ experience. Assessment of long-term customers and lost customers can provide information from the goal level, which is useful for strategies aimed at strengthening customer relationships. Assessment of lost customers can provide useful information for strategies aimed at reducing customer defections. Performing cohort analyses, both longitudinal and cross-sectional, can provide information about the changes in customer value which can be extremely useful for strategies aimed at competing effectively in the future. This model is based on a theory that is neither developed nor accepted at this time. Further research is necessary to determine its effectiveness. The results should be very interesting.
IMPLICATIONS FOR STRATEGIC MANAGEMENT

Slow-growth economies and industries, more demanding customers, and global competition are the driving factors behind the search by many organizations to find new ways to gain competitive advantage. The increasing service sector of the U.S. economy is forcing organizations to reassess their traditional approach to strategic management. In addition to utilizing service in strategies, organizations must also consider quality assessments and enhancements in their strategic development. Thus service quality must be included in strategies for organizations wishing to compete. The difficulty in tying service quality to strategies has been the inability to assess service quality in a manner that would allow for comparison of service quality investments to investments within the organization and to the competition within the industry. The current research offers tools which managers can and should utilize to incorporate service quality into their strategies. It is imperative for managers to understand the conceptualizations and operationalization of the tools available prior to utilizing them. It is for this reason that this report has illustrated the evolution of the tools offered. Based on assessment of the current literature, the most promising tool created for managers to tie service quality to the bottom line is the ROQ approach by Rust, Zahorik, and Keiningham (1995). They provide a generic and modifiable approach for assessing the financial impact of service quality. Organizations traditionally view quality expenditures as beneficial although expendable in difficult economic times. It is imperative that organizations “see” the return on quality investment. This information is extremely useful for determining which service quality initiatives to invest in and how much to invest before experiencing diminishing returns. Coupling the ROQ approach with Fanjoy’s annuitized valuation of
customers as assets would present an even clearer picture of how much an organization should invest in service quality in order to retain current customers and how much will be lost if these investments in service quality are not initiated.

The key to the success of these strategies is not necessarily quality it is the quality initiative that customers deem add "value" to them. The insightful finding of Woodruff (1997) for the shift of attention from quality to customer value delivery has opened up a new door for researchers to explore. There is much belief that it is the customers that will determine the direction of organizations in the future. To compete in this type of competitive environment, organizations must know what customers want and need and have the ability to monitor these wants and needs continuously to accommodate the needs and wants as they change over time. Woodruff suggests that the ability to learn about customers and translate this learning into processes will become a core competency issue in the future. Parasuraman(1997) utilizes Woodruff's findings to develop a model for obtaining information about customers that will enable strategic managers to utilize in developing their organizations strategies. If the theory manifests, the result would be a very useful tool for strategic managers.

The final issue, which was not covered in the body of the report, is global competition. To compete in the future organizations must be able to compete on a global scale. This implies the requirement of understanding the needs and wants of a variety of customers in a variety of cultures. The idea that all customers in all countries will have similar needs is not realistic. Tools must be created that will allow strategic managers to measure, evaluate, and monitor customers on a more global scale. This may mean developing a different construct for each culture or the creation of a universal construct.
for assessment of customers. The review of the literature, specifically Anderson, Fornell, and Lehmann (1994), and Fornell, Johnson, Anderson, Cha, and Bryant (1996), has stimulated an idea that organizations may be able to utilize the national customer satisfaction indices that are available for countries such as Sweden, America, Germany, New Zealand, and Taiwan. These national indices could be used for comparisons and analyses of what customers require in other countries and what is available to them within their countries, a type of “global benchmarking.” The indices can also be useful for monitoring the changes taking place in customer satisfaction from year to year to determine what changes an organization should implement for continuously seeking the competitive advantage.
REFERENCES


