The paradox of the service-profit chain

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The Paradox of the Service-Profit Chain

This paper presents a review and suggests an extension of studies on the service-profit chain (S-PC), focusing on the paradoxical relationships among the key S-PC constructs of employee satisfaction, customer loyalty, and profitability. Our review is broad in that it encompasses prior studies in multi-disciplines. We found that many research issues on the S-PC, such as research design, moderating factors, and linearity of the causal relationships had not been addressed in the extant literature. We propose a research model grounded in social exchange theory and the resource-based view of the firm to examine the propositions of the S-PC. The aims of the proposed model are to investigate the causal ordering of the underlying constructs, examine the moderating effects on their linkages, and explore the characteristics of their relationships. This paper contributes to the literature of operations management and service management by providing important insights and research directions for the S-PC.

(Loyalty; Profitability; Satisfaction; Service-Profit Chain; Service Quality)

1. Introduction

Much of the research in operations management (OM) has been conducted to investigate various operational practices and systems considered conducive to optimizing organizational effectiveness (e.g. Deming 1986, Stank et al. 1999). On the other hand, researchers in human resources management (HRM) have focused on identifying the link between appropriate human resources practices and the effectiveness of a firm (e.g. Youndt et al. 1996, Koys 2001, Batt 2002). However, research to examine the interface between OM and HRM has been scant (Boudreau et al. 2003). A pioneer in this topic, Heskett et al. (1994) proposed a service-profit chain (S-PC) model that integrates OM and HRM for organizational improvement in the context of a service organization. More recently, Boudreau et al. (2003) discussed the potential value of connecting OM and HRM, and identified a set of research challenges that need to be addressed before synergies from integrating the two fields in research and practice can be enjoyed.

The S-PC postulates that operations contribute to the profits of a service firm via the following chain of logical deductions: (1) profit and growth are stimulated primarily by customer loyalty; (2) loyalty is a direct result of customer satisfaction; (3) customer satisfaction is largely influenced by the value of the services provided; (4) value is created by satisfied, loyal, and productive employees; and (5) employee satisfaction, in turn, results primarily from high-quality support services and policies that enable employees to deliver results to customers (Heskett et al. 1994, Heskett et al. 1997: 164 – 165). The S-PC proposition has inspired many researchers from various fields, including operations management, marketing, human resources management, and service management (e.g. Loveman 1998, Silvestro and Cross 2000, Mittal and Kamakura 2001, Batt 2002), to explore the different issues associated with the arguments put forward by Heskett et al. (1994, 1997). These previous studies, while scattered among different disciplines, serve as important sources of information for the consolidation of knowledge and yield insights for future research into the S-PC.
The objectives of this paper are two-fold. First, we present a review of studies relevant to the S-PC, with a focus on identifying existing gaps in the present research. Second, we propose a new research model that is specifically formulated to close the research gaps identified in our review of the literature. This paper comprises the following sections. We examine and discuss the importance of bridging the gap between employee loyalty and customer loyalty in Section 2. Subsequently, we expound the methodological and theoretical issues of prior research into S-PC in Section 3. In Section 4, we propose a new research model grounded in social exchange theory and in the resource-based view of the firm to further explore the S-PC proposition. Finally, we present the conclusion of the paper in Section 5.

2. Does Bridging Employee Loyalty And Customer Loyalty Matter?

Researchers in organizational behavior have expended considerable effort investigating the relationship between employee satisfaction and loyalty and their impact on a firm’s performance (e.g. Lau 2000, Koys 2001, Batt 2002). On the other hand, the bulk of research in marketing is concerned with studying the links between customer satisfaction and loyalty and business performance (e.g. Stank et al. 1999, Yeung and Ennew 2000, Yeung et al. 2002). Recently, researchers have been paying increasing attention to the issue of bridging the gap between employee loyalty and customer loyalty. A growing stream of research suggests that employee loyalty is a prerequisite to reaping the benefits of customer loyalty and firm performance (e.g. Heskett et al. 1997, Reichheld 2001a). The postulation is that loyal employees are motivated to work hard, improve the overall performance of operations, and serve customers well. This may be particularly the case in the service context, where employees have direct and close interactions with their customers in the process of delivering services. Employee loyalty reflects the status of highly satisfied employees who are faithful, steadfast, and devoted to their employing organization. These employees envision a long tenure of employment, are willing to make discretionary effort to contribute, and are eager to take extra care of their customers for their employing organization. These actions not only improve the efficiency and effectiveness of the delivery of their services, but also enhance perception of the quality of the company’s services, the satisfaction felt by customers, and customer loyalty. The latter, in turn, improves the profitability of the organization. Heskett et al. (1994) asserted that service organizations nowadays must calibrate the impact of employee satisfaction and loyalty on the value of the products or services they offer. This will enable managers to manipulate their staff to build customer loyalty and allow managers to assess the corresponding impact on the organization’s profitability.

Schlesinger and Heskett (1991) have taken another perspective in viewing the relationship between employee loyalty and customer loyalty. They have introduced the concept of “cycle of failure” to explain how employee dissatisfaction and turnover can lead to poor organizational performance in service environments. According to the notion of “cycle of failure”, if an employer invests little in human resources and pays employees low wages, the rate of turnover and level of dissatisfaction among employees will increase, customer satisfaction and retention will plunge, and the organization’s performance deteriorate. Therefore, Schlesinger and Heskett (1991) argued that satisfied employees will equate to highly loyal employees, leading to increased customer loyalty, and eventually improved business performance. Building on this argument, Heskett et al. (1997) introduced the
concept of the “satisfaction mirror” which suggests that business success derived from employee satisfaction is “reflected” in the perception that customers have of the services provided by an organization.

Much previous research on the S-PC has been confined to examining the impact of either employee or customer satisfaction and loyalty on business performance. Only a few studies have looked into the impact of employee satisfaction and loyalty on customer perception of the quality of an organization’s services, customer satisfaction and loyalty, as well as on a firm’s performance (Ryan et al. 1996, Loveman 1988, Rucci et al. 1998, Spinelli and Canavos 2000). Loveman (1988) examined the workings of the S-PC in retail banking. Rucci et al. (1998) studied the links between employee attitudes and customer satisfaction and financial performance at Sears. Spinelli and Canavos (2000) investigated the relationship between employee satisfaction and customer satisfaction in the hotel industry. They found that positive correlations existed among employee loyalty, customer loyalty, and firm performance. Since their study was restricted to a single service organization or industry, it is questionable whether their findings are valid in other service settings. In addition, the studies cited above provide very limited evidence of the recursive effects of customer satisfaction and loyalty, as well as business performance, on employee satisfaction and loyalty. Despite the assumption of Heskett et al. (1994) that recursive effects are embedded among the constructs of the S-PC, only Ryan et al. (1996) empirically demonstrated the recursive effect of customer satisfaction on employee attitudes. Clearly, further work needs to be done on linkages in the S-PC and the recursive effects embedded in those linkages in different service industries. The findings of such a study will advance the frontier of knowledge on the S-PC proposition.

To conclude, the importance of closing the gap between employee loyalty and customer loyalty has been highlighted. For a service organization to be profitable and successful, it must enhance employee satisfaction and loyalty or reduce employee dissatisfaction and turnover in order to improve customer perception of the service and build up customer satisfaction and loyalty. An increasing amount of research has been devoted to examining the impact of employee loyalty on customer loyalty and business performance. However, the previous studies have been limited to a particular service organization or industry. Hence, it seems necessary to validate the relationships in the S-PC in various service settings. Moreover, little has been done to study the recursive effects of customer loyalty and business performance on employee loyalty. While, conceptually, customer loyalty and firm performance are likely to affect employee loyalty, verifying these recursive effects empirically is a challenge.

3. Methodological and Theoretical Issues

Although there has been a fair amount of research on the S-PC, a number of critical research issues have remained unaddressed. First, past research has not empirically established the causal relationships between the key constructs of the S-PC. Second, researchers have moved from documenting the existence of the putative relationships in the S-PC to uncovering the moderating effects of environmental factors, such as market competitiveness, employee-customer contact, and rewards, on the direction and strength of these relationships. Third, the nature of the linkages between the pertinent constructs in the S-PC needs further study. These shortcomings in the extant literature have important implications for the
methodological and theoretical issues that need to be addressed in further research on the S-PC. We discuss these issues in detail in the following sections.

3.1 Research Design

The first research issue is concerned with a lack of clear causal specifications of the links between the key S-PC constructs. This is due to the cross-sectional design employed by the vast majority of prior studies on the S-PC (e.g. Loveman 1988, Silvestro and Cross 2000, Spinnelli and Canavos 2000). In order to give a comprehensive review of the relevant empirical work, we present two summaries in Tables 1 and 2. Table 1 summarizes empirical evidence of the S-PC in the literature. Table 2 summarizes empirical evidence for the links postulated in the S-PC, obtained from different fields of management research.

Heskett et al. (1994) have suggested that there is a causal order in the links between employee satisfaction and loyalty, service quality, customer satisfaction and loyalty, and firm performance. However, Silvestro and Cross (2000) have criticized the study of Heskett et al. as lacking in empirical validation, which requires that data on all of the postulated linkages in the chain be collected and analyzed. For this reason, the validity of the causal specifications proposed in Heskett et al. (1994) has remained unverified. Despite this, researchers have continued to build on Heskett et al.’s (1994) proposition to justify the presumed causal linkages of the S-PC in a single service organization or industry. For instance, the empirical study of Spinelli and Canavos (2000) in the hotel industry indicated that an organization with happier employees also has happier customers. Nevertheless, based on a cross-sectional study, researchers have been unable to distinguish whether employee satisfaction leads to customer satisfaction, or vice versa, or whether they are mutually reinforcing. It is evident that these studies have made no claim on the causality of the S-PC. Clearly, longitudinal empirical assessments aimed at examining the causal sequence of the key constructs in the S-PC are called for.

Further, considerable empirical work has been conducted on performance outcomes (e.g. Hallowell 1996, Loveman 1988, Silvestro and Cross 2000, Silvestro 2002). However, only Silvestro and Cross (2000) have highlighted the existence of a time-lag between improvements in employee satisfaction and loyalty and expected improvements in customer satisfaction and loyalty and business performance. Nevertheless, they did not consider the effect of time-lag on the performance outcomes in their study. It seems justifiable to examine the influence of time-lag on performance outcomes by conducting longitudinal studies.

To summarize, prior research work has revealed no causal ordering of the constructs of the S-PC. On the other hand, previous studies have highlighted the existence of a time delay between the improvements in employee satisfaction and loyalty and expected improvements in customer satisfaction and loyalty and business performance. All these point to the need for longitudinal empirical studies to verify the causal ordering associated with the constructs in the S-PC, so that enough observations can be made on the changes in performance outcomes over time, and so that proper statistical techniques for data analysis can be employed.
3.2 Moderating Factors

The second research issue is on detecting the effects of pertinent moderating factors on the linkages of the constructs of the S-PC. Researchers have only recently recognized the need to examine these moderating factors (Anderson and Mittal 2000, Silvestro and Cross 2000). The recognition of the existence of moderating factors has emerged from the common knowledge that business performance is normally contingent upon environmental variables, which have not been fully captured in the S-PC model (Silverstro and Cross 2000).

The competitive environment of the service sector has been identified as a factor that influences the link between customer satisfaction and loyalty (Jones and Sasser 1995). In a highly competitive market where there are many alternative products and services for customers to select from and the cost of switching is low, customers are not loyal unless they are fully satisfied. Conversely, in a monopolistic market, customer satisfaction seems to have very little impact on loyalty. Jones and Sasser’s (1995) study inspired Lee et al. (2001) to examine how switching cost affects the link between customer satisfaction and loyalty in the cell phone market. Lee et al. (2001) postulated that the impact of switching cost on the relationship between customer satisfaction and loyalty is affected by market structure. They have classified mobile users into three groups: economy users, standard users, and mobile-lovers, according to the amount of calling time that the user chooses at the time he signs the service contract. Their findings have shown that switching cost plays a significant role in moderating the relationship between customer satisfaction and loyalty. The link between customer satisfaction and loyalty is strong for economy and standard user groups who are price-sensitive. But the cost of switching does not affect customer loyalty in the group of mobile lovers. On the basis of Jones and Sasser’s (1995) and Lee et al.’s (2001) studies, one can infer that market competitiveness, as reflected by the switching cost, affects the relationship between customer satisfaction and loyalty. However, these studies are only limited to a particular industry or based on a small sample, so their findings may not be generalizable to other service environments.

Loyal employees are presumed to be positively correlated with high service quality in the S-PC (Heskett et al. 1994). Nonetheless, Silvestro and Cross (2000) have identified an inverse relationship between employee loyalty and organizational performance in the industry they surveyed, where the interaction between employees and customers is not seen as a key driver of service value. Their findings disagree with the satisfaction mirror effect postulated by Heskett et al. (1997), which states that a firm’s success resulting from employee satisfaction is reflected in customers’ perception of the services rendered. This suggests that the level of contact between employees and customers may account for variations in the relationship between employee loyalty and business performance. Chase (1981) considered the degree of customer contact to be a key dimension in classifying service settings. This concept can help a service provider take appropriate measures to react and customize the services it offers to its customers. Soteriou and Chase (1998) have investigated the influence of customer contact, in terms of communication time and intimacy between employees and customers, on customers’ perception of the quality of the services that were delivered. Strictly speaking, Soteriou and Chase’s (1998) study did not focus on investigating the moderating effects of customer contact on perception of the quality of services. However, their study has highlighted the significant impact of customer contact on customer perception of the quality of an organization’s services. Based on the suggestion of Silvestro and Cross
(2000), we believe the contact between employees and customers may have a moderating effect on the link between employee loyalty and customer perception of service quality.

In sum, previous studies have identified market competitiveness and employee-customer contact as pertinent moderators that influence the direction and strength of the different linkages in the S-PC. Nevertheless, very few empirical studies have so far assessed the moderating effects of these factors. A more thorough investigation of the moderating effects on the relationships in the S-PC is necessary to build a solid theoretical foundation for S-PC.

3.3 Linearity
The third research issue pertains to the nature of the relationships previously studied. Most research studies have endeavored to confirm the existence of the constructs of the S-PC. However, the nature of the relationships between the constructs has not been studied in detail. Many researchers have assumed that the linkage between customer satisfaction and loyalty is simply linear (e.g. Ralston 1996). Nevertheless, Ngobo (1999) has argued that there are two thresholds in the relationship between customer satisfaction and loyalty. The loyalty curve is relatively flat after the first threshold of customer satisfaction is passed, then rises rapidly after the second threshold of customer satisfaction is passed. This is supported by Jones and Sasser’s (1995) findings showing that customer loyalty will increase marginally at high levels on the customer satisfaction continuum and rise considerably at higher levels of customer satisfaction. Further, Anderson and Mittal (2000) have asserted that the links among service performance, customer satisfaction and retention, and profit are asymmetric and non-linear in nature. But the validity of the non-linear nature has not yet been clearly established in current research (Singh and Sirdeshmukh 2000). Hence, it is reasonable to expect that further studies based on the perspective of non-linearity may add significant value to the understanding of the relationship between customer satisfaction and loyalty. Following this line of research, it is also worth adopting the perspective of non-linearity to investigate the nature of other links in the S-PC. Such investigation will certainly help to bring a fresh perspective to understanding the nature of the relationships among the constructs of the S-PC.

4. Development of a Research Model
Although the S-PC proposition has not been fully validated using empirical data (Heskett et al. 1997), it does suggest a few viable directions for further research. In this section we present a new research model that is based on the postulations of the S-PC and the insights gained from the review of previous research discussed above.

4.1 Overview of the Research Model
Based on the S-PC framework, we propose a research model shown in Figure 1. The proposed model is not a direct replication of the S-PC, but is guided by, and bears a resemblance to it. As such, it captures most of the elements contained in the S-PC. It subsumes the effects of variations in employee satisfaction and loyalty on perceived service quality, customer satisfaction and loyalty, and organizational profitability. In essence, it
comprises three components in the following sequence: (1) the service delivery component that includes employee satisfaction and loyalty; (2) the service perception component that contains perceived service quality, customer satisfaction and loyalty; and (3) the profitability component that consists of sales profitability and organizational profitability. We adopt social exchange theory and the resource-based view of the firm as the theoretical foundation for the formulation of the model. The premise of the model is that employee satisfaction and loyalty influence perceived service quality, customer satisfaction and loyalty, and ultimately sales profitability and organizational profitability. Apart from proposing the components and their constituent elements, we also encapsulate in our model the investigation into the potential effects of the pertinent moderating factors, namely, employee-customer contact, market competitiveness, and reward. In the following subsections, we present our model in more detail with justifications.

4.2 Service Delivery Component
Employee satisfaction is defined as the pleasurable emotional response of the employee resulting from an appraisal of his perceived working conditions on the job. Employees who are satisfied with the perceived working conditions of pay, promotion opportunity, relationships with fellow workers, supervision, and work assignments will be in a favorable emotional state. Employee loyalty is referred to as an employee’s feeling of attachment to his employing organization. Loyal employees have strong feelings of belonging to and of wanting to contribute to their employing organization. These feelings can be manifested in different behavioral ways, for example, continuing to work for the organization and making extra effort to serve in the employing firm.

Employee satisfaction may influence employee loyalty (Heskett et al. 1994). Empirical studies have shown that there is a significant, negative correlation between employee satisfaction and absenteeism (e.g., Gordon and Denisi 1995) or the rate at which employees quit their jobs (e.g. Drago and Wooden 1992). Loveman’s (1998) empirical study has shown that employee satisfaction is positively correlated with employee loyalty.

Service quality is concerned with the overall perception that customers have of the performance of the services offered by the service provider. Employee loyalty may affect customer perception of service quality (Heskett et al. 1994). Loyal employees would be more committed to serving customers and more willing to make discretionary effort to deliver better services that would be favorably perceived by customers.

The resource-based view of the firm suggests that firms deploy valuable resources to generate above-normal rates of return and to gain a substantial competitive advantage (Amit and Schoemaker 1993, Oliver 1997). From this perspective, employee loyalty is viewed as a valuable, rare, and difficult-to-imitate resource of the firm. It may have value for the firm through the effect it has on the delivery of better services to customers, which will ultimately generate economic returns. The gain in employee loyalty by improving working conditions for employees is valuable to firms. This is particularly the case given the fragile state of contemporary employment relations, in which the lack of job satisfaction is likely to lead to diminished level of employee loyalty which, in turn, will lead to customer perception of reduced level of service quality. Investments in employee loyalty are critical to bringing
about high levels of service quality, and therefore have the potential to enhance the performance of a firm.

Social exchange theory can also be applied to account for the relationships between employee satisfaction and loyalty, and customer perception of service quality. Social exchange theory states that social exchange engenders feelings of personal obligation and gratitude (Blau 1964). In the context of social exchange theory, the employer is devoted to building a relationship of long-term employment with his employees by fulfilling their needs through offering them favorable working conditions; in return, employees will be loyal to their employer. Such a willingness to build a relationship between the employer and employees is one of the key characteristics of a social exchange. The willingness of the employer is demonstrated by the employer’s effort to satisfy the needs of his employees by providing them with a good working environment. The loyal employees are keen on delivering high-quality services to their customers. Loyal employees tend to be committed to making an extra effort to offer services of a high level of quality. This, in turn, enhances customer perception of service quality.

On the basis of the resource-based view and social exchange theory, we argue that employees who perceive that working conditions are better will feel more satisfied with their job and so be more loyal to their employing organization. Furthermore, if employees are more loyal to their organization, they are prone to delivering services of a higher level of quality that would be well received by customers. We theorize that employee satisfaction has a positive impact on employee loyalty (link L1). We also believe that employee loyalty has a positive effect on customer perception of service quality (link L2).

4.3 Service Perception Component
Customer satisfaction is defined as the pleasurable emotional response of a customer from an appraisal of his perception of the quality of the services he has received when making his purchase. Customers who are satisfied with the perceived service quality, in terms of value for money, after-sales service, customer service, and complaints-handling service, will have a favorable emotional reaction. A perception that the services are of a high level of quality will lead to customer satisfaction, and provide customers with the incentive to make a repeat purchase from the service provider.

Customer loyalty refers to the feeling of attachment that customers have to the service provider. Loyal customers have a strong intention to make repeat purchases, which overcomes the influence of switching in the market. Their intention can be manifested in multiple ways, for instance, recommending the service provider to others and continuing to purchase the same or different products from the service provider. A customer’s satisfaction with the quality of the services may influence his loyalty to the service provider (Heskett et al. 1994). Customer loyalty in the form of repeat purchases may affect sales performance. Empirical studies have shown the existence of significant and positive relationships between customer satisfaction and loyalty and between customer loyalty and sales performance (Jones and Sasser 1995, Hallowell 1996, Heskett et al. 1997, Stank et al. 1999, Gronholdt et al. 2000). Customers who are satisfied with the quality of the services they have received are likely to have the intention to make repeat purchases, which would translate into actual repeat
purchases. Satisfied customers will make more frequent purchases, in greater volumes, and of a wider variety of products. Moreover, they are less price-sensitive, providing the service provider with the potential to earn large profit margins and decrease the risk of defections arising from the competitive undercutting of prices (Stank et al. 1999). They also engage in positive word-of-mouth recommends of the service provider to other customers (Reichheld and Sasser 1990, Reichheld 2001, Gronholdt et al. 2000). These responses have been shown to be positively correlated with short-term financial performance (Anderson et al. 1994).

In short, high service quality delivered from the service provider can satisfy customers. Satisfied customers who perceive the quality of the services to be high are likely to be loyal to the service provider. Loyal customers are more likely to make repeat purchases from the service provider, thereby enabling the firm to achieve greater profitability from sales.

These arguments are consistent with the resource-based view of the firm: customer loyalty can be considered a valuable, rare, and difficult-to-imitate resource of the firm (Amit and Schoemaker 1993, Oliver 1997). We believe that service firms face more dynamic competition (Roth and Jackson III 1995) than firms in industries where product quality is the main concern in purchases. The loyalty that customers feel toward a firm can differentiate a firm from its competitors, thus allowing it to preserve its superior position in the market. By building customer loyalty through providing customers with services of a high level of quality that fully satisfy their needs, a service firm will be able to generate above-normal rates of economic return, thereby sustaining its competitive advantage (Oliver 1997).

Social exchange theory also lends support to the prediction of the existence of relationships between perceived service quality, customer satisfaction and loyalty, sales profitability, as well as employee satisfaction. In a relationship of social exchange, the customer would be more loyal to the service provider when the latter is committed to developing a long-term relationship with the former by offering services of a high level of quality to fulfill the customer’s needs. The willingness of the service provider to develop such a long-term relationship with the customer is demonstrated by the service provider’s efforts to provide high-quality services to the customer. Loyalty is generated in the customer, which encourages him to form the intention to make a repeat purchase. This intention is manifested in actual making of repeat purchases. This, in turn, increases the firm’s profits from sales.

Integrating the resource-based view and social exchange theory, we consider it likely that customers who perceive a higher level of quality in the services they received are likely to feel more satisfied with the services. Moreover, satisfied customers tend to be loyal to the service provider. Further, if customers are loyal to the service provider, their loyalty will be demonstrated in such ways as the making of repeat purchases from the service provider in greater volumes and of a wider variety of products, as well as by recommending the service provider to other customers. These actions would ultimately boost profitability from sales. Based on this theoretical ground, we theorize that customer perception of service quality has a positive influence on customer satisfaction, which in turn, has a positive effect on customer loyalty (links L3 and L4). Moreover, we believe that customer loyalty has a positive influence on sales profitability as represented by links L5.
4.4 Profitability Component

As mentioned previously, customer loyalty can enhance the short-term sales performance of a firm when customers make repeat purchases. It is also considered by many to be a key driver of long-term financial performance (e.g. Reichheld and Sasser 1990) and a revenue-producing asset of a firm (Anderson et al. 1994, Anderson and Mittal 2000). Efforts to increase the loyalty of current customers primarily affect their future, rather than immediate, purchasing behavior. For this reason, the increase in economic returns from customer loyalty will be realized in the future. This implies that a long-term perspective is necessary when evaluating the impact of customer loyalty on firm profitability. Empirical studies have also shown that customer loyalty has a positive impact in the long run on various aspects of business performance, such as profitability, market share, and revenue growth (e.g. Heskett et al. 1994, Hallowell 1996).

In sum, sales profitability induced by customer repurchases may affect organizational profitability. Thus, we theorize that sales profitability has positive influence on organizational profitability (link L6).

4.5 Moderating Effects

Employee-customer contact

To this point, we have considered the service context to be a relatively fixed phenomenon in organizations. However, Chase (1981) has attempted to classify service organizations into forms that are pure services, mixed services, or quasi-manufacturing. A more realistic portrayal would represent these service environments according to the degree of interaction between employees and customers in the service delivery process. Employees are responsible for serving customers, so their attitudes and behavior when delivering the service influence the quality of the service as perceived by customers. When there is closer and more interaction between the customer-contact employee and the customer, the service context is most potent, and thus most capable of having a profound influence on the customer’s perception of service quality. The more closely and more often the customer-contact employee interacts with the customer, the easier it will be for the customer to express his needs to the employee, and the more often he will do so. This will enhance the ability of the employee to react to the customer and customize the service offerings. This will certainly enhance the quality of the services as perceived by the customer (Soteriou and Chase 1998). We expect that the degree of employee-customer contact in service work will moderate the extent to which employee loyalty will affect customer perception of service quality, as represented by link L7 in our proposed model.

Market competitiveness

The theories that provide the foundation for link L4 in our research model are useful for determining how customer satisfaction influences loyalty. Nevertheless, given the potential negative repercussion of switching intention and behavior encouraged by competitors who offer a greater variety of products and services, service providers typically have a strong interest in preventing such an intention and action, even if switching is explicitly or implicitly encouraged in the current competitive market. For example, a service organization may
prevent its customers from forming the intention to switch and acting on this intention by delivering services of a higher level of quality to the customers and introducing loyalty programs to retain them. But competitors in the market are eager to encourage switching. This contrast presents an interesting dilemma: if the market encourages switching, but a service firm discourages this, will the customer respond by switching?

We expect that a service firm’s ability to retain customers will depend on how it encourages its customers to make repeat purchases. Conditions that enhance the switching intent and action of customers would certainly lessen the firm’s influence on the decisions of customers to make repeat purchases. A competitive market often strengthens the switching intention and behavior of customers by making available to them a wider variety of products and better services. This, in turn, affects the intention and behavior of customers to make repeat purchases, and ultimately has an impact on their loyalty towards the service provider. We consider that a firm’s influence is limited by market competitiveness. We therefore theorize that market competitiveness moderates the effect of customer satisfaction on customer loyalty in such a way that the relationship is stronger for customers in a less competitive market, as represented by link L8 in our research model.

5. Conclusion
In this paper we have observed the current research trend that attempts to bridge the gap between employee loyalty and customer loyalty in order to improve an organization’s performance. With increased competition in the market, service firms strive for success by improving their performance through enhancing the satisfaction and loyalty of their employees and customers. Further, we have examined the methodological and theoretical issues, with a specific interest in identifying the gaps in the current research. We have urged that longitudinal studies be conducted to better understand the causal ordering of the links in the S-PC, the exploration of the moderating effects on the direction and strength of such links, and the adoption of the non-linearity perspective to investigating the nature of these links. To provide more insights into the existing literature, we propose a research model grounded in social exchange theory and the resource-based view. The proposed model aims to investigate the causal ordering of its underlying constructs, examine the moderating effects on its linkages, and explore the nature of its relationships. We believe that this model will help business executives formulate effective strategies for business success. We also believe that it can advance the methodological and theoretical foundations of the literature on the S-PC in particular, and on operations management in general.

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References


### Table 1: Summary of Empirical Evidence of the Service-Profit Chain in the Literature

<table>
<thead>
<tr>
<th>Year</th>
<th>Study</th>
<th>Description</th>
<th>Sample source</th>
<th>Sample size</th>
<th>Main findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>Heskett et al.</td>
<td>An empirical study on the relationships among employee satisfaction and loyalty, value of service, customer satisfaction and loyalty, and profit and growth across large service organizations.</td>
<td>Service organizations</td>
<td>20</td>
<td>A service-profit chain model is proposed.</td>
</tr>
<tr>
<td>1995</td>
<td>Jones and Sasser</td>
<td>A cross-sectional study of the relationship between customer satisfaction and loyalty across five service industries.</td>
<td>Companies from the following sectors: automobiles, personal computers, hospitals, airlines, and local telephone services</td>
<td>30</td>
<td>Customer satisfaction is positively correlated with customer loyalty.</td>
</tr>
<tr>
<td>2000</td>
<td>Lau</td>
<td>An ad hoc investigation of the relationship between the quality of internal services and performance in growth and profitability.</td>
<td>Service organizations that provide quality-of-life programs</td>
<td>29</td>
<td>On the employee side, there is a positive significance between employee satisfaction and stated loyalty, not employment tenure.</td>
</tr>
<tr>
<td>2000</td>
<td>Silvestro and Cross</td>
<td>An exploratory study of the application of the service-profit chain in a leading grocery retailer.</td>
<td>Stores of a grocery retailer in the United Kingdom</td>
<td>6</td>
<td>Service organizations that focus on the quality of internal services for their employees tend to have better growth in sales, assets, and returns on assets.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>No significant correlation exists between service value and either employee satisfaction, employee loyalty, or internal capability.</td>
</tr>
<tr>
<td>Year</td>
<td>Author</td>
<td>Study Title</td>
<td>Sample Size</td>
<td>Findings</td>
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<td>2002</td>
<td>Silvestro</td>
<td>A cross-sectional study of the relationships among employee satisfaction, loyalty, productivity, and profit in a single, multi-site supermarket.</td>
<td>15</td>
<td>A strong negative correlation exists between internal quality and service value. No relationship is identified between employee satisfaction and customer satisfaction. Due to the impact of store size, employee satisfaction is negatively and significantly correlated with the store’s profit margin. Employee satisfaction is negatively correlated with profits. Employee loyalty is negatively correlated with profits.</td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>Study</td>
<td>Description</td>
<td>Sample source</td>
<td>Sample size</td>
<td>Main findings</td>
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<tr>
<td>2000</td>
<td>Gronholdt et al.</td>
<td>A cross-sectional empirical study of the relationship between customer satisfaction and loyalty across service industries.</td>
<td>Companies from the following sectors: telecommunications industries, retail banks, supermarkets, the soft drinks industry, and fast food restaurants in Denmark</td>
<td>30</td>
<td>Customer satisfaction has a positive correlation with customer loyalty. The positive effect of customer satisfaction on customer loyalty increases with the degree of competition in the market.</td>
</tr>
</tbody>
</table>
Figure 1: Research Model