When the Supplier's Human Capital Walks Away, Where do the Customer Go?

Work-in-Progress Paper

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Abstract

Professional business service firms play an increasing important role in the modern society. Several aspects differentiate those kinds of organizations from production of standardized services and industrial goods. They are heavily dependent on highly skilled employees to attract and retain clients. Usually there is a wide knowledge asymmetry between the professional agent and its client. The service output is specialized to each client’s unique and varying needs. Hence, both the qualities of the professional service provider and the service output may be difficult to assess correctly. Finally, the production of professional business services often necessitates close buyer-seller interaction with strong social bonds between the individual parties resulting. Those aspects of professional business service production places the individual service provider in a very special situation both vis-a-vis his or her organization and the client. In short, the individual professional controls the customer capital and can easily walk away with the customers to a competing business. What can the professional service provider do to reduce its vulnerability and motivate the customers to stay in case the individual service agent leaves? By drawing upon institutional economics theory we suggest that the service firm can benefit from investing in firm specific structural capital. In spite of evidence from practice, little is known from research about factors motivating clients whether to follow their contact persons to other service organizations or not. In this paper we identify variables and develop research propositions about the client’s decision to follow the contact person or remain with its incumbent service organization in case the contact person leaves for a competitor. Implications for theory and practice are also discussed.

Introduction

A characteristic of the post industrial economy is the proliferation of professional service firms such as advertising agencies, management consultants, law partnerships, and engineering companies (Sharma 1997). One common trait of those organizations is that production of customer value is based on the human capital of the individual members of the organizations through their specialized skills as professionals and their specific knowledge of their clients (Gosh and John 1999; Sharma 1997). Another trait is the social embeddedness of the service provider-client relationship since the solution to the customer problem often is co-produced through interactions between the individual service agent and the client (Sharma 1997; Stabell and Fjeldstad 1998). As a result the quality of the service is individualized, and social bonds in the form of social capital develop between the professional service provider and the client (Coleman 1988; Wilson 1995). Moreover, the professional service provider usually has more knowledge of the problems to be solved than the client (Sharma 1997), as well as several types of professional services have credence characteristics (Darby and Karni 1973) or a high degree of performance ambiguity (Mishra, Heide, and Cort 1998; Williamson 1985). In sum, these characteristics give the individual member of the professional service organization control over both the service organization’s production and customer capital.

From the client’s perspective two problems might arise. First, the client becomes dependent on that specific person to solve new problems, since turning to a new contact person means giving up former investments in specific human and social capital. Second, the high level of performance ambiguity increases the risk of selecting a contact person with the wrong qualifications. This unique position vis-á-vis the client might be exploited by the individual agent, for example by going to a competitor or starting his/her own business taking the clients with him/her.

A question can be raised whether a professional service organization can do anything to prevent such a situation? It can be argued that in the same way financial capital without organization have little value, a firm’s human capital needs to be organized through organization specific structural capital in form of working routines and organizational culture in order to create customer value (Løwendahl 1997; Nahapiet and Goshal 1998). As such, the structural capital will enhance the value of the individual service agent’s human capital within the organization, but reduce it outside the organization for example if the service agent quits[1]. Furthermore, the service organization can invest in client specific routines and working processes that might create switching costs for the client in case of breaking the relationship with the service firm (Wathne, Biong, and Heide 2001). Consequently, the service provider’s investments in structural capital and client specific assets create a disincentive for the client to leave the incumbent service organization by following the contact person to another service firm.

In spite of the emerging literature on relationships between professional service organizations and their clients (e.g., Seabright, Levinthal, and Fichman 1992; Sharma 1997), the question of what the client will do if the service provider’s contact person leaves the organization for a competitor has been given little attention. The purpose of this paper is to identify variables and research propositions with respect to the client’s decision problem of following the contact person or not by drawing on social network theory, transaction cost theory, and agency theory. The paper is organized as follows. The next section presents our conceptual framework, including the research propositions. Based on the model, implications for theory and management will be discussed in the final section.

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[1] As pointed out by one of the reviewers, many professional service firms rely on teams in their service production. We fully acknowledge this practice. Teams may enhance customer value as they represent organizational memory (Walsh and Ungson 1991). As such teams belong to service firm’s structural capital. Thus team organization might reduce the influence of individual service agents. However, teams are often coordinated by a specific person (e.g. a contact person or key account manager) with main responsibility for the client interaction. Although highly relevant and interesting, we will not include the effect of teams in our structural capital framework.

Theoretical Framework and Research Propositions

In this paper we examine whether a buyer of professional services who has developed a relationship with a specific contact person in a service providing firm will decide to a) follow the contact person or b) stay with the incumbent professional service firm if the contact person leaves and starts working for a competing service provider. More specifically, we explore whether 1) certain aspects of the contact person and buyer interaction serve to preserve the buyer-contact person relationship, and 2) organizational tools employed by the service firm can help keeping the customers with the firm.

In the following section we focus on the nature of professional business-to-business services. Specifically, we examine the effects of the human, social and structural capital on value creation and choice of service provider. All of these effects derive from previous investments in the buyer- supplier relationship. However, the nature of the investments differs. Human capital represents individual investments from the contact person, social capital derives from contact person-buyer relationship investments, while structural capital represents organizational level investments from the incumbent service providing firm. Thus, each dimension exists at a different level, individual, interpersonal and interorganizational respectively.

Professional Services

Basically professional services are services provided by professionals. A professional is a person with special knowledge and techniques acquired by education, training and experience (Sharma 1997). Examples of professions are advertising, accounting, architecture, engineering, law, and management consulting. Services have several features that distinguish them from products. Two characteristics of professional services are inseparability (Erramilli and Rao 1993) and performance ambiguity (Mishra, Heide, and Cort 1998). Inseparability means that the service is produced and consumed simultaneously. As noted by Sharma (1997) the competent delivery of services by service providers such as advertising agencies and consulting firms requires the close physical proximity of providers and receivers and necessitates close buyer-seller interaction. The professional service is produced by the service provider by use of his or her expertise and represents in general a solution to the buyer's unique problem (Stabell and Fjeldstad 1998). Usually, the service provider has more expertise in his field than the buyer and, as noted, a strong impact on the quality and quantity of the service delivered. This knowledge asymmetry combined with the uniqueness of the service outcome makes it difficult for the buyer to know ex ante how much service is actually needed and ex post to monitor the quality of the service received (Sharma 1997; Stabell and Fjeldstad 1998).

The description so far of professional service production may lead to the following conclusions: 1) The service quality is a function of the individual professional's human capital and the interaction with the buyer, 2) the service quality will vary with the quality of the professional's human capital, and 3) the buyer will be more dependent on the individual service provider than on the professional service firm. In other words, the individual professional controls the firm's customer capital, which can be exploited by the individual for example by taking the customer base with him/her to a competing business. What can the professional service firm do to reduce its vulnerability? With a parallel to finance claiming that financial capital needs organization to produce value, the value created by the professional's human capital can be enhanced from the organization's structural capital represented by organizational procedures, methods and culture (Nahapiet and Goshal 1998; Tsai 2000). By implementing specific procedures and methods for solution of customer problems, the value of the human capital of the individual professional will be greater inside the service firm than outside. Moreover, the variance of service quality is reduced and the client will be less dependent on one specific individual. An example are the international management consultants such as Boston Consulting Group and McKinsey that have developed their own analytic tools and procedures, so that the buyer chooses the service firm more than the individual consultant (Løwendahl 1997).

Human capital

Human capital is the individual's investments in education, experience and job training that bring about skills and capabilities to excel at certain tasks (Burt 1992; Coleman 1988). In this context we build on Eramillo and Rao's (1993) conceptualization of idiosyncratic services that can be characterized along the dimensions of professional skills, specialized know how, and customization.

Professional skills

According to Erramilli and Rao (1993, p. 23) professional skills are professional expertise and skills acquired only through several years of education and training. As such, services requiring professional skills represent significant human investments. Although professional skills discriminate professional service providers from others, they are the basic requirement to the professional to create customer value. In TCA language professional skills represent general technology for producing the service. However, the effect on the provider-client relationship may be unclear. On the one hand possession of professional skills may be a necessary requirement to be in business, but may not be sufficient to distinguish one professional from another. On the other hand a contact person with excellent professional skills may be more able to create customer value than a person whose professional skills are inferior. Hence we propose:

> P1: The better the professional skills of the contact person a) the greater the likelihood that the client will follow the contact person and b) the lesser the likelihood for staying with the incumbent professional service firm.

Specialized Know-how and Customization

Specialized know-how is knowledge that is useful in only a narrow range of applications and cannot be easily put to use elsewhere, while customization is the degree to which the service is customized to one or a few users (Erramilli and Rao 1993). Taken together specialized know-how and customization represent investments in human specific assets (Williamson 1985). Such investments are made by the individual service agent in order to produce value for one specific client. Basic TCA-logic argues that the party who makes a specific investment also has to safeguard it against opportunism from the other party for example through long-term commitment from the client. However, certain kinds of specific investments have great value to the other party, so when one party makes the investments the other party will lose by acting opportunistically for example by terminating the relationship (Lohtia, Brooks, and Krapfel 1994; Williamson 1985). We will argue this will be the case for investments in client specific human assets. Thus the client will lose value by breaking the relationship with the contact person and receive less value by employing a professional without such client-specific knowledge. Hence, by following the contact person the client will be able to maximize its value from the contact persons client specific investments. Stated formally:

> P2: The more specialized and customized knowledge the contact person has, a) the more the likelihood of following the contact person, and b) the less the likelihood of staying with the incumbent professional service firm.

Social Capital

Many professional services, for example advertising and management consulting, are produced through interactions between the buyer and the service provider’s contact person. We can see at least two reasons for this practice. First, the client’s problem to be solved may not be clear, neither to the client nor to the service provider. Through interactions the parties reveal various aspects of the client’s situation and identify the real problem more correctly (Stabell and Fjeldstad 1998; Wittreich 1966) and the solution will be better adapted to the client’s needs. Second, the buyer-seller interactions serve as a learning and monitoring device. By frequent and repeated contacts the buyer will be more able to observe the qualities of the service provider as well as be more able to monitor the quality of the service provided. During the social interactions interpersonal relationships evolve between the buyer and account manager (Wilson 1995). According to the economic sociology literature these interpersonal relationships are the social capital of the buyer-seller relationship (Burt 1992; Coleman 1988). Social capital produces value due to its capacity to provide information (Burt 1992; Rindfleisch and Moorman 2001) and enhance human capital (Coleman 1988). It is important to note how social capital is distinct from human capital. While human capital is a property of the individual contact person, social capital exists in the relations among persons and is owned jointly by the two parties in the buyer-seller relationship (Burt 1992; Coleman 1988). As such the social capital disappears if the relationship between the account manager and client is broken. Thus following the contact person to a competitor will keep the value of the social capital intact. Hence we propose:

> P3: The closer the personal relationship between the contact person and the client a) the greater the likelihood that the client will follow the contact person, and b) the less the likelihood of staying with the incumbent professional service firm.

Performance ambiguity

Performance ambiguity means the difficulties associated with assessing the true level of service performance (Stump and Heide 1996). As noted previously the service provider usually has a stronger expertise than the buyer and has a strong impact on the quantity and quality of the service provided (Mishra, Heide, and Cort 1998). Due to lack of expertise the client will have difficulties in assessing the true quality of the service provided. The inability to assess quality presents two kinds of problems to the client. The first is an adverse selection problem as the client will have difficulties in selecting professionals with the appropriate competence to solve its unique problems. The second is the client's moral hazard problem. With respect to professional services the service provider has the capability to prescribe inappropriate solutions or inappropriate amounts of the service needed. However, by repeated transactions with the service provider, we assume that the client will be more able to detect the quality of the professional and select professionals with the desired competence. By changing contact person, the client will occur costs in detecting the true qualities of the new contact person, as well as risking potential opportunity cost by selecting a contact person with inappropriate qualifications. These costs will be avoided by following the contact person to another service organization. Hence we propose:

> P4: The greater the performance ambiguity of the service provided by the contact person a) the greater the likelihood that the client will follow the contact person, and b) the less the likelihood of staying with the incumbent professional service firm.

Structural capital

Conceptually, structural capital means organization level investments in client specific knowledge and working processes (Williamson 1985), firm specific routines, methods, and technology (Løwendahl 1997), and organizational culture (Ouchi 1979) aimed at creating customer value. From the previous section, it seems that production of professional services is highly individual and that professional service firms in best case could be characterized as loose coalitions of individuals sharing office and common expenses. However professional service firms exist, for example advertising agencies, law partnerships, and management and engineering consultants. Why? According to standard TCE logic the reason for organizing firms is economizing on transaction costs due to high asset specificity and uncertainty. However, as noted the services are often produced between a single professional or a small team of professionals and the client on a project basis (Løwendahl 1997). Hence, service firms could be organized in a network fashion rather than integrated firms (Powell 1990). However, as Nahapiet and Goshal (1998, p. 242) argue, organizations have some particular capabilities for creating and sharing knowledge that give them their distinctive advantage over other institutional arrangements. Thus the capabilities of creating customer value depend partly of the internal structure of the professional service firm. We focus on three structural dimensions of professional service firms: firm skills, organizational culture, and client specific investments.

Firm Skills

According to Løwendahl (1997) professional service firms possess skills at an organizational level in the form of special routines, methods, and procedures. In this respect firm skills serve at least three purposes: 1) they enhance the value of human capital in solving customer problems, 2) by standardization they reduce the individual variability of the service output and thus performance ambiguity, and 3) they reduce the dependence on the individual professional. In information economical terms firm skills bring observability and search properties into the service production (Darby and Karny 1973; Nelson 1970). In sum organizational routines, methods, and procedures create loyalty to the service organization rather then to the individual professional agent. In practice professional service organizations such as Boston Consulting Group and

McKinsey demonstrate the effective implementation of specific firm skills as a means to attract and retain customers. We sum up this argument by proposing:

> P5: The more the incumbent professional service organization has implemented firm specific routines, methods, and procedures in its service production, a) the less the likelihood that the client will follow the contact person, and b) the greater the likelihood of staying with the incumbent professional service firm.

Organizational culture

Organizational culture can be defined as the way the members of the organization has been taught to perceive, think and feel about problems (Walsh and Ungson 1991). Different from firm skills that intend to secure service quality by "external" means, organizational culture makes the employees internalize a customer oriented service attitude in the first place (Ouchi 1979). The effect of culture as a mechanism for enhancing service quality is to eliminate incongruencies between the individual professional service provider and the firm with respect to service quality standards. However, culture may be a two-edged sword. By definition culture is both an individual and an organizational property. The internalized standards of producing high quality services will follow the professional aagent to other organizations as well as the culture will remain with the incumbent service firm. Hence we propose:

> P6: The more the incumbent service firm rely on a customer oriented service culture a) the greater the likelihood that the client will follow the contact person, and b) the greater the likelihood of staying with the incumbent professional service firm.

It might be puzzling that investments in service culture may not seemingly pay off by preventing the clients from following the contact person. As argued above, service culture investments might increase the service quality standards of the individual agent, a property that the agent can transfer to other service firms. To the best of our knowledge there is no literature that a priori can support which of the main effects a) or b) to be strongest. However, it can be reasonable to expect an interaction effect between firm specific methods and organizational culture. In other words, the effects of a service-oriented culture will be affected by the presence of firm specific skills. These firm specific skills will benefit the individual agent as long as he or she stay with the firm, but will loose their effect in case the agent leaves. Stated differently, effect b) will be stronger than effect a) when the incumbent service firm has implemented specific routines, methods and routines for its service production. Hence we offer the following contingency propositions:

> P7: Higher levels of firm specific skills of the incumbent service provider will a) *decrease* the positive effect of organizational culture on the likelihood of following the contact person, and b) *increase* the positive effect of organizational culture on the likelihood of staying with the incumbent professional service firm.

Client Specific Investments

Parallel to the contact person's investments in client specific knowledge, the service firm can make client specific investments at the organizational level. For example suppliers may develop client specific databases (Løwendahl 1997) and organizational procedures.

These databases and procedures can be viewed as dimensions of the client specific organizational memory intended to create customer value. By switching to another service supplier, the client has to be served by standard technology and procedures with less efficiency and effectiveness (Mudambi and Mudambi 1995). Thus, the supplier's client specific investments serve as deterrents to switching. Notice the difference between client specific investments made by the contact person, investments in supplier firm skills and client specific investments made by the service firm. Investments made by the contact person are made at an individual level. The value of the investments will be lost unless the client follows the contact person. Firm skills are general technology intended to produce value for all customers. However, such skills will differentiate the service firm from service providers without such general skills. Client-specific investments from the service firm exist at the organizational level independent of the contact person and their value will be lost by following the contact person to a competitor. Hence we propose:

> P8: The more the incumbent service organization has invested in client specific assets a) the less the likelihood of following the contact person, and b) the greater the likelihood of staying with the incumbent service firm.

Discussion

This paper focuses on professional business services. Production of quality professional services is highly dependent on the skills of the individual service provider. The individualization of the service production places the individual service provider in a powerful situation both vis-a-vis his or her clients and employer. If the individual service agent, the contact person, goes to a competitor the client is placed in a dilemma; whether to follow the contact person or to stay with the incumbent service firm. By drawing on interorganizational theoretical frameworks we have developed a model with research propositions with the aim at examining in more the detail the antecedents to the client's decision problem of which service provider to choose.

Implications for theory

The discussion in the paper shows that investments at different levels in the buyer-seller relationship may have different effects on the client's decision problem. While investments in human specific assets may encourage the client to follow its contact person, investments in client specific assets at the professional service firm level may encourage the client to stay with its incumbent service organization. Furthermore, the decision to follow the contact person might be influenced by a combination of human capital, that is general professional skills and client specific competence, and social capital. Human capital is attributes owned and controlled by the individual service provider, whereas social capital is an interpersonal investment owned jointly by the client and individual service provider. However, client value can also be created at firm level by investments in organizational procedures, organizational culture, and client specific knowledge and processes. Since these variables exist independent of the individual professional, they act as means to withhold the clients with the firm. Finally, the discussion throughout the paper indicates interaction effects among the variables. However, possible interaction effects beyond the ones discussed are not elaborated further.

Implications for management

Managers may also draw some conclusions from the paper. First, highly skilled professionals are assets for the service firm and a necessity to attract clients. However, through their control of the client interaction they represent a possible threat since valuable clients can be easily lost together with competent employees. Managers may improve service outputs by investing in structural capital, that is firm specific routines, methods and procedures, as well as in client specific databases and working processes. Two effects might be achieved. First, by presence of firm specific structural capital, the individual's human capital might produce greater value for the customer within the professional service organization than in another organizational context. Second, the dependence on the single individuals will be reduced. As a result, structural capital investments might encourage clients to remain in the relationship with the incumbent service organization.

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