THROUGH THE LOOKING GLASS: AN AGENCY THEORETIC FOUNDATION FOR THE SATISFACTION MIRROR

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ABSTRACT

We analyze the satisfaction mirror -- the positive but atheoretical correlation between customer satisfaction and staff/job satisfaction -- using agency theory in order to better understand the underlying mechanics of the mirror. We identify the front-line service provider as being the agent in two separate but related principal-agent dyads: the first with the customer, the second with the employing organization. This role in two simultaneous dyads, with one conditional on the other, both provides direction for strengthening the satisfaction mirror and also places upper limits on its potential strength.

INTRODUCTION

Heskett, Sasser and Schlesinger (1997) conceptualized what they called the "satisfaction mirror" (p 99) as a strong positive relationship between customer satisfaction and staff job satisfaction within the service environment. The existence of the mirror has to this point been demonstrated through correlational analysis, with correlations between overall customer satisfaction and overall job satisfaction reported in the range of 0.34-0.53 (Bernhardt, Donthu and Kennett 2000; Tornow and Wiley 1991). While the satisfaction mirror is intuitively appealing – the idea that a customer's satisfaction with a service reinforces the job satisfaction of the front-line service provider, and vice versa – a theoretical analysis of the underlying mechanics of the mirror has not been undertaken.

In this paper, we utilize agency theoretic concepts to understand underlying driving forces that can shape and limit the satisfaction mirror. Additionally, we apply agency theory to develop testable propositions regarding the mirror.

AGENCY THEORY AND THE CUSTOMER-STAFF DYAD

Consider the dyad of a single customer and his or her front-line service provider, with the customer taking the commonly assumed role of the principal, and the service provider as the agent. The customer (principal) requires the service provider (agent) to perform some service on the customer's behalf – the classical principal-agent problem (e.g., Eisenhardt 1989). The customer expects from the service provider a specific outcome to the customer's service requirement, said outcome to be the service resolution: if there is a problem, the customer expects it to be fixed; if there is an opportunity, the customer expects it to be taken.

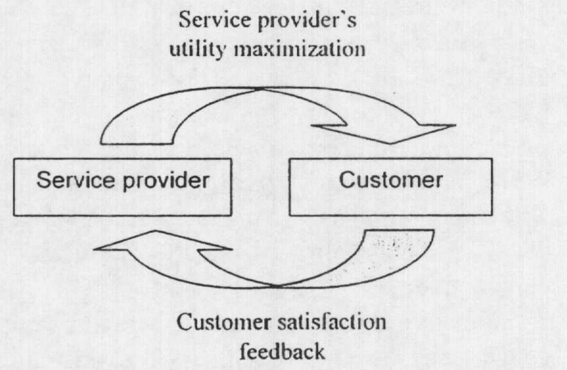
MORAL HAZARD

The problem of moral hazard arises when the customer believes that adequate delivery by the service provider is uncertain because of possible lack of effort and therefore that working with the service provider is risky. In these instances Pareto-optimal risk sharing, a state in which any change to it that would make one party better off would make the other party worse off, is generally precluded as it will not motivate the service provider to take customer-perceived appropriate action. Instead, only a second-best solution, which trades off some of the risk-sharing benefits for motivation, can be accomplished. While optimal levels of satisfaction for both the customer and service provider cannot therefore be simultaneously achieved, the opportunity still exists for efficiency gains – or increases in satisfaction – to be achieved by one or both parties (see Figure 1).

IMPERFECT INFORMATION AND ASYMMETRY

The source of this moral hazard in the customer-staff dyad is information asymmetry that results because each party is unable to observe and thus have an identical understanding of the other's actions. To overcome this obstacle the customer can invest in monitoring the service provider's actions and use this information in the service arrangement. For simple services complete monitoring of service provider activities may be possible, in which case a best solution – entailing optimal risk-sharing – can be achieved by setting up an arrangement that penalizes inadequate service delivery.

Figure 1
The Satisfaction Mirror and Moral Hazard



Generally, however, full observation of actions is either impossible or prohibitively costly. In such situations imperfect aspects or indicators of actions are emphasized. The design of the service arrangement has to ensure that both risk-sharing and motivation assist in acquiring desired service solutions while minimizing any costs related to monitoring the service provider. The service arrangement design will thus determine the overall level of customer satisfaction with the service provider.

Simultaneously, this dyadic service relationship also entails reversed information asymmetry in which the service provider has imperfect information about the service context and/or the specific services solution needed by the customer. For this context-specific information, the customer becomes in effect the agent of the front-line service provider. Such a dual role (i.e., the customer as both principal and agent) is not unknown in agency theoretic situations (e.g., Devinney and Dowling 1999).

Context-specific imperfect information results because the customer alone has intimate knowledge of the environment in which the need for service was originally identified as well as the symptoms that are necessary for service task diagnosis, and yet it is the service provider who requires that information. The service provider as the principal thus contracts with the customer as agent to provide the necessary information. As with all principal-agent relationships, information asymmetry exists to the advantage of the agent (in this case, the customer), and the service provider must expend agency costs (specifically, time spent, which is a monitoring cost) in order to minimize the asymmetry and be able to perform the needed service. The extent to which the service provider is unable or unwilling to expend the necessary agency costs puts an upper limits on the level of satisfaction the customer can ultimately receive and can even prevent satisfaction from occurring at all. Coase (1937) refers to this type of monitoring cost as marketing cost.

This reversed principal-agent situation requires the design of an arrangement which addresses the moral hazard issue in which it is the service provider who now has to ensure that both risk-sharing and motivation assist in delivering an appropriate service solution while minimizing costs related to monitoring the customer's information provision. Here, the design of the implicit or explicit arrangement will determine the overall level of front-line service provider satisfaction with the customer relationship.

A SECOND DYAD

The service provider is also involved in a second dyad, this one with the organization that employs the individual. As with the staff-customer dyad, the two parties in the staff-organization dyad are presumed to be efficiency maximizers.

Parallel logic similar to that previously stated regarding the customer can be applied to the organization, with the result that the organization's effort to maximize its efficiency results in its satisfaction with the service provider as a member of staff. Similarly, the service provider's attempt to maximize efficiency in this relationship yields its satisfaction with its relationship with the employer/employer, such satisfaction more commonly known as job satisfaction.

Because of the two potentially competing dyads in which the service provider operates, he/she is thus in a situation of dual moral hazard. [Note that here we use the term differently to "double moral hazard," in which principal and agent in a single dyad are both involved in production and thus may both exhibit shirking behavior; see Cooper and Ross (1985) for an early use of that term.] Dual moral hazard creates for the service provider a utility function that includes variables relating both to the service provider's relationship with the customer and his/her relationship with the employing organization. The service provider must simultaneously solve the two efficiency maximization problems. It is reasonable to assume that the two are not of equal weight and that the efficiency maximization equation resulting from the relationship with the customer is conditional on that from the organization. Thus, it is the existence of the second relationship, that between the organization and the service provider, which prevents the satisfaction mirror from having a higher positive correlation over time than is currently reported in the literature.

PROPOSITIONS

Is the satisfaction mirror desirable? Is it an advantage to the employing organization for the service provider's job satisfaction to be positively correlated with customer satisfaction? If so, is it to the organization's advantage to attempt to maximize the strength of the satisfaction mirror?

Anecdotal evidence suggests that practitioner managers find the satisfaction mirror appealing (Heskett, Sasser and Schlesinger 1997) and would like to strengthen the mirror, using it as a path to both increased profitability through heightened customer satisfaction and also to reduced staff turnover through increased job satisfaction. To do so, however, dual moral hazard must be reduced.

The greater the disparity between the solution for maximizing efficiency of the service provider's explicit/implicit contract with the organization and the solution for maximizing efficiency of the implicit contract with the customer, the weaker the satisfaction mirror will be. A more customer-satisfaction-focused implicit agreement in the customer-staff dyad will yield less moral hazard and greater efficiency (at least from the customer's perspective), thus increasing customer satisfaction. At the same time, a more outcome-focused contract between the staff member and the employing organization will lessen moral hazard in that dyad and create a more efficient contract from the organization's perspective.

Thus we have a situation in which potential goal incongruence across the two dyads can be reduced. This is a necessary but not sufficient condition for reducing the dual moral hazard that characterizes the staff member's situation: the staff member must balance his or her effort toward satisfying the customer against effort toward accomplishing the organization's objectives.

Reducing this dual moral hazard requires the alignment of the customer's and the organization's objectives from the perspective of the service-providing staff member. This leads to our first proposition.

Proposition 1: A greater customer satisfaction focus in the contract the organization has with each service-providing *staff member will strengthen the satisfaction mirror.*

Dual moral hazard involves the potential incongruence between the organization's objectives and the customer's objectives each with the staff member's objectives. The reduction of dual moral hazard will require a simultaneous lessening of both sets of incongruence, which means aligning the objectives from the staff member's perspective.

Taking a pure agency theory perspective, a sufficient condition for strengthening the satisfaction mirror is to put in place a more customer-satisfaction-focused contract for the staff-organization dyad. Alignment of the customer's and the organization's objectives – from the employing organization's perspective – is not a necessary condition for strengthening the satisfaction mirror, because it is only the organization's actual contractual arrangement with the staff member that impacts job satisfaction and thus affects the mirror.

However, the implementation of a customer-satisfaction-focused contract between organization and staff member without a parallel alignment of the organization's objectives toward customer satisfaction would not completely eliminate dual moral hazard, and its strengthening of the satisfaction mirror would be a nonsustainable solution for the employing organization. Given alignment of the customer's and the organization's objectives, the more customer-satisfaction-focused the staff-organization dyad's contract is, the less dual moral hazard there will be (i.e., the more sustainable and efficient the contract and arrangement from both the customer's and the organization's perspective).

Risk Aversion. Agency theory assumes that the agent is risk averse (e.g., Basu, Lal, Srinivasan and Staelin 1985) or at least no more of a risk-taker than the principal (Coughlan and Sen 1989). In the staff-organization dyad, the service provider as agent is presumed more risk averse than the organization and so will be inclined to resist an outcome-based contract. A contract between the organization and staff member focusing on customer satisfaction, which is the outcome of service provision, thus increases the risk to the service provider. The imposition of an undesired contract structure (the agent preferring a behavior-based contract; see Jensen and Meckling 1976) in a situation of heightened risk will yield lower job satisfaction (i.e., satisfaction with the relationship with the organization) and thus weaken the satisfaction mirror. This leads to our second proposition.

Proposition 2: The more risk-averse a front-line service staff member, the weaker the positive effect on the satisfaction mirror of a customer-satisfaction-focused [i.e., outcome-based] contract between staff member and organization.

Contract Structure. A more palatable alternative to a customer-satisfaction-focused outcome-based contract for the risk-averse staff member is a behavior-based customer-service-focused contract that emphasizes the service delivery process and activities. Given a customer-satisfaction-focused implicit agreement already existing in the customer-staff dyad, the risk-averse staff member's conflict between trying to maximize efficiency in the customer dyad and simultaneously in the organization dyad will now be limited.

Proposition 3: A greater customer service focus [i.e., behavior basis] in the contract the organization has with each risk-averse service-providing staff member will strengthen the satisfaction mirror.

As the number of desired behaviors/outcomes increases, a behavior-based customer-service-focused contract between organization and staff member is more efficient and therefore more acceptable to both parties (Holmstrom and Milgrom 1991). The structure of the contract will thus increase the service-providing staff member's job satisfaction. However, the greater number of targeted outcomes is also likely to water down the importance of any customer-focused outcome, since both the explicit/implicit customer-service-focused contract with the employing organization and the implicit contract with the customer will be increasingly incomplete the more complex the service consumption experience. This has the potential to decrease both the caliber of service provided and the resultant level of customer satisfaction which, in turn, can weaken the satisfaction mirror.

> *Proposition 4. Given a behavior-based customer-service-focused contract between organization and staff member, the greater the number of outcomes the organization desires from the staff member, the weaker the satisfaction mirror will be.*

IMPLICATIONS

We have examined the satisfaction mirror as a principal-agent problem and used this framework to develop four propositions concerning various issues associated with the contract between the organization and the service-providing staff member. The next step is to empirically examine these propositions in a variety of contexts. This is the focus of our continuing work.

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