ABSTRACT

A MULTIDIMENSIONAL APPROACH TO MEASURE EFFICIENCY OF A SERVICE FIRM AND THE IMPACT OF QUALITY ON FIRM PERFORMANCE

1. Rationale for the Study

Service quality and its impact on firm profitability has been a major area of research for quite a long time. Researchers and managers have tried to identify the linkage between the level of service delivery offered by a firm and the profitability it can fetch for the firm. Issues like impact of improvement on service quality on incremental profit has intrigued the academicians as well as the practitioners. However, linkage between investment in service quality and its impact on profitability is neither simple nor straightforward. There are a variety of reasons for such difficulty associated with identification of the linkage. Benefits associated in providing a better service for example is not a one-shot affair but accrues over a period of time. Further, it is difficult to isolate the impact of service from the other marketing variables like pricing, advertising, distribution in influencing the overall firm profitability. Popular readings suggest a direct linkage between quality and bottomline performance either through attracting new customers or retaining the existing clientele. Marketing literature on the other hand, have empirically demonstrated both positive and negative associations between quality and financial performance.

Banking institutions throughout the world are facing a fast paced dynamic environment where efficiency and competitiveness hold the key to survival. With intense competition from both domestic sector and international players, rapid innovation and introduction of new financial instruments, changing consumer needs and explosive growth in information technology, the way in which the commercial banks conducts business and reaches out to its customers has changed considerably. In order to survive and adapt to the changing environment, the banks are putting more stress on understanding the drivers of success, such as better utilization of resources, process of delivering quality service to its customers and transforming the superior service to generate better financial performance. Banks are looking at concepts like service-profit chain and operational capability-service quality-performance triad in order to retain competitive edge. There are two major areas of banking activities: engaging in financial intermediation and managing of risk, and providing products and services to their clients. In this dissertation, we have specifically focused on the role of the bank as the service provider satisfying the expectations of its clients.

As the Indian banking system is still dominated by the public sector banks, the issues of performance, efficiency and customer service have emerged to be the touchstone for the success of such banks. There is an emerging need to develop a comprehensive framework for measuring their efficiency in transforming their resources to better performance by providing superior service. The public sector banks also need to identify their ability to satisfy the service quality requirements as per their customers' expectations. Due to different business policies pursued by individual banks, they choose their own customer groups whom they want to serve. Segmenting the industry into different strategic groups, positioning themselves in the consumers' mindset can help the banks to restructure their policy choices to compete in this dynamic business environment. Thus, such type of performance benchmarking has become extremely relevant for their success. Incidentally, Marketing Science Institute, USA also considers "Metrics for measuring marketing performance" as an area of highest research priority for the year 2000-2002.

2. Objective of the Study

Extant literature has identified several key issues unanswered on the linkage between service quality and firm profitability. Like the methodologies needed to capture the impact of service quality on financial performance; linkage between expenditures on resources and improvement in the service delivery level; and the transformation of improved service leading to better financial performance. The transformation of resource utilized to service quality and then to better performance or even what should be the optimal level of spending on service quality improvement to have better profitability like calculation of the opportunity cost of not providing adequate level of service as expected by the customers are the questions that need to be delved further. Understanding the relationship between overall service quality and profitability is important, but for a manager it is more important to identify the drivers of service quality, which affect the overall performance. It helps the firm to understand what aspect of service quality needs to be changed and by how much, in order to influence the performance and where to invest resources. In short, identifying the key resources and measuring their impact on individual service quality dimensions can help the managers in their resource investment decisions. In this dissertation, we tried to pursue these unanswered issues in the context of Indian public sector banks.

Methodology proposed here to analyze the issues is a combination of measurement of service quality using a modified version of SERVQUAL along with an operational research method of Data Envelopment Analysis (DEA). A bank is said to be technically efficient if it produces more outputs like better service for its customers and superior financial performance using less input resources like infrastructure, technology, employee, and marketing resources. DEA is a technique to assess the efficiency of production units (in our case the banks) relative to a set of similar units operating in the same business environment (here the banking industry). It can identify the benchmark units in comparison to the peers to determine the best practices.

3. Implications of the Study

Results from the proposed study can have specific significance for both marketing practitioners and researchers. Identification of the service quality drivers and their relative importance can help the policy makers of Indian public sector banks to identify the customer group that matches best to their ability to serve. Such grouping can help in better resource utilization. Identification of loyal customer group can be an important outcome of such an effort, which in turn helps the manager to segment the market according to the lifetime value of the customers. Increased loyalty would lower customer defection rate. Segmenting the industry into different strategic groups depending on the performance along the service quality dimensions can help the banks to position themselves and take long-term strategic decisions for overhauling their service delivery design process. The opportunity cost of not providing adequate service as expected by the customers can provide direction to the inefficient banks in identification of priority areas to be focused for service improvement. The improvement levels along the service dimensions and their impact on the overall performance can help the individual banks to benchmark themselves with respect to the better performers in the industry. Our framework can provide the necessary measurement to how the inefficient banks are overspending their infrastructural resources but leading towards underproduction of service quality standards for their customers when compared to the benchmarked banks.

On the methodological front, we propose to develop a theoretical framework of the resource-service quality-performance triad. We attempt to establish a cascaded framework for transformation of integrated resources to the operational capabilities required for better service delivery. We empirically validate how superior service delivery is leading towards improvement in financial performance for the Indian public sector banks. Measurement of opportunity cost for not delivering adequate level of service as desired by the customers is proposed through the Return on Quality approach. Interbank comparison using the figures for potential performance improvement can provide guidelines to the inefficient banks to benchmark themselves against superior performers operating under similar business environment. Methodologies to capture the impact of service quality on firm financial performance have been an intriguing issue among researchers. In this study, the impact of service quality on performance is empirically verified using the efficiency matrix. Banks delivering better service are shown to have greater ability to transform resource to performance using superior service delivery as the medium. This resource – service quality – performance framework can be used by any service sector firm to monitor the impact of service on the overall profitability of their business.

The dissertation extends the way in which performance of a firm in the services sector is measured including the objective measures of resources utilized and financial parameters along with the subjective, intangible measures of service quality. Identifying the best performer in the Indian public sector banking industry and analyzing the gap of an inefficient bank with respect to the best performer will provide a new vista to the decision makers in developing a long term strategic plan for better performance.