Organizing Work in Service Firms

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Since the time of Frederick Taylor and Henry Ford, a cornerstone of manufacturing practice has been to separate complex tasks into a collection of simple ones and exploit the economies of scale. More and more, service industry practice has followed the same path by redesigning jobs—splitting up the high and low customer contact activities within a job in order to cut costs. In this "decoupling" process, low customer contact activities are removed from front office jobs, standardized, and often centralized in some remote back office to achieve scale economies.

In general, academic literature has stressed the wisdom of this process. Here, we take a somewhat opposite view. Though there are certainly occasions in which a technological shift has rendered the old way of organizing work obsolete, and firms must decouple to compete, quite often this is not the case. When management has a range of options, decision-makers must resist being seduced by the highly touted benefits of the decoupled, centralized approach and recognize that potentially significant drawbacks exist. The choice of how to organize back office work carries strategic implications that must be considered at the onset.

Our prescriptive model introduces four approaches that link the way work is organized to different strategies. We illustrate the model using data from a study of retail bank lending operations supplemented by examples from other service industries. Most important, we provide recommendations for managing and implementing each approach.

The Practitioner Press: More Decoupling Is Better

For a number of reasons, there has been an exodus of low-contact tasks from the point of service. In the banking industry literature, for example, it seems to be canonical that the decoupling process is necessary to success. Consider the historical development of processing deposits.

Front office or back office? Different approaches to decoupling tasks can be used with different company strategies.

Some time ago, when one presented a check for deposit, a teller inspected the items, verified the total, and provided a receipt. During downtime or after closing, checks and deposit slips were encoded with dollar amounts by tellers. When the checks had been sent to the bank on which they were drawn, branch clerks sorted them by customer, proofed statements against them, and stuffed and mailed the statements on a monthly basis. The physical processing of other items, such as stop payments, overdrafts, and so on, were also handled at the branch.

Advancing computer technology has gradually replaced the clerks that performed these duties. But the technology only operates efficiently at a large scale, so the check processing operations for many branches have been centralized. The only activities still handled at the branch level for most banks are inspecting items and giving receipts. Even deposit totals are verified centrally.

Other paper-processing industries have had similar migrations of work content away from branch facilities. At the U.S. Postal Service, mail volume rose 114 percent from 1972 to 1996, whereas personnel increased only 3 percent during the same time. This was largely because the task of mail sorting had been transferred from the front office to the back office, centralized and automated. In synch with the decoupling process described in the postal and banking industries, many firms have segregated and centralized their mail and accounts receivable processing functions to reduce costs.

Governmental offices, by nature, must be dispersed throughout the region of governance. Yet back office record-keeping is becoming more centralized. Hospitals have also been active in decoupling back office management. “Shared Service Centers” comprising centralized general corporate functions such as human resources and corporate treasury and finance appear to be in vogue. For example, the accounting, payroll, human resources, and other record-keeping functions for the *New York Times* are conducted in such a shared center located in Virginia.

It is not merely paper processes that are decoupled. The centralization of physical goods in service firms has a far longer history. Examples such as centralized storage of retail goods, spare parts, or centralized food preparation facilities are well known.

It would appear that the ability to move operations from the front office to a segregated back office is constrained merely by a lack of imagination—and a resistant consumer market. Medical diagnoses are now made in centralized telephone call centers by nursing staff. With the aid of technology such as two-way television and electronic stethoscopes, patients in remote locations can be “seen” by physicians in central locations. The so-called “local” and, to customers, supposedly live television weather report for 50 stations across the U.S. is actually performed and taped in Jackson, Mississippi. Although the weather forecaster cannot look out the window to determine accuracy, the broadcasts are convincing as local phenomena, at times even including taped rehearsed banter that appears to the viewing audience to be spontaneous live repartee between a weather forecaster and a news anchor.

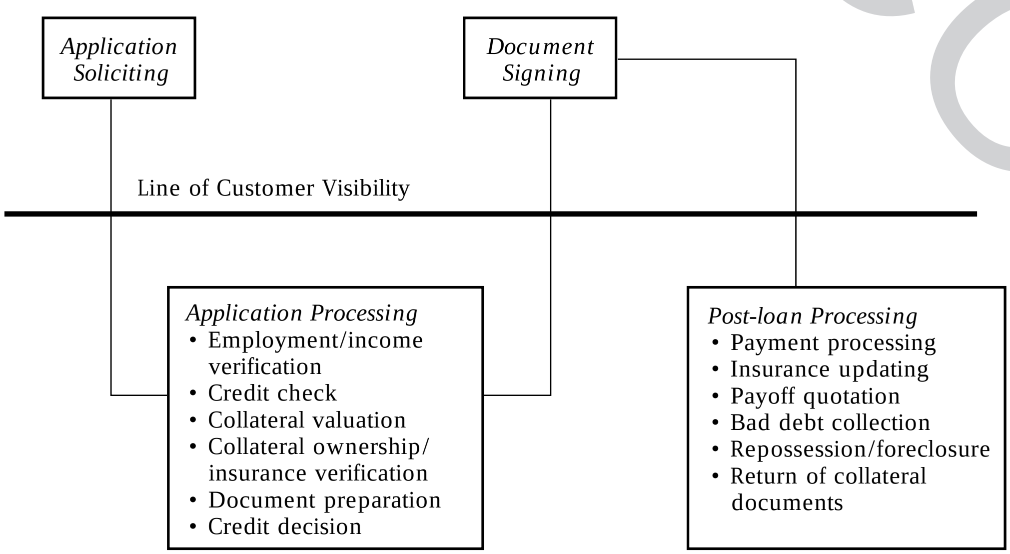
This movement toward service decoupling in practice has had a corresponding push from academics. In two influential articles from the 1970s, Levitt exhorts managers to take a “production-line approach to service,” stating that services can be improved by applying manufacturing wisdom: standardizing processes and replacing employee discretion with technology. Consequently, one should accomplish the “industrialization of service” by separating tasks into multi-task jobs, using division of labor to achieve efficiencies, and centralizing the specialized tasks to achieve scale economies. Levitt argues that such changes will lead to improvements in both conformance quality and cost.

The Retail Banking Environment

There is a general misperception that “bricks” are yielding to “clicks” and that the branch office is a dying breed in the face of such new technology as home banking, ATMs, and Internet banking. However, the reverse has been the case. According to the FDIC (1999), the number of staffed U.S. bank branches has risen 56 percent to 61,957 from 1982 (the start of deregulation) to 1998, with the numbers increasing in 15 of those 16 years. The nature of the branches has changed, though, and the ways they have changed are linked to the competitive approaches presented in the next section. Because of the continued importance of the branch and the changing nature of what it does for a bank, the question of decoupling has become more important for the industry over time.

Although our model can be used by virtually any service firm that has both front and back office work, and examples from several industries will be given, we shall illustrate our prescriptive model by examining retail lending in detail. Rather than study a traditional random sample of firms, we wished to pursue all the potential approaches available in a coherent market. For this purpose, we studied all multi-branch banks competing in the Nashville, Tennessee market.

Figure 1
Activities in Processing a Retail Loan



Before presenting the model in detail, it is helpful to understand the particular process studied.

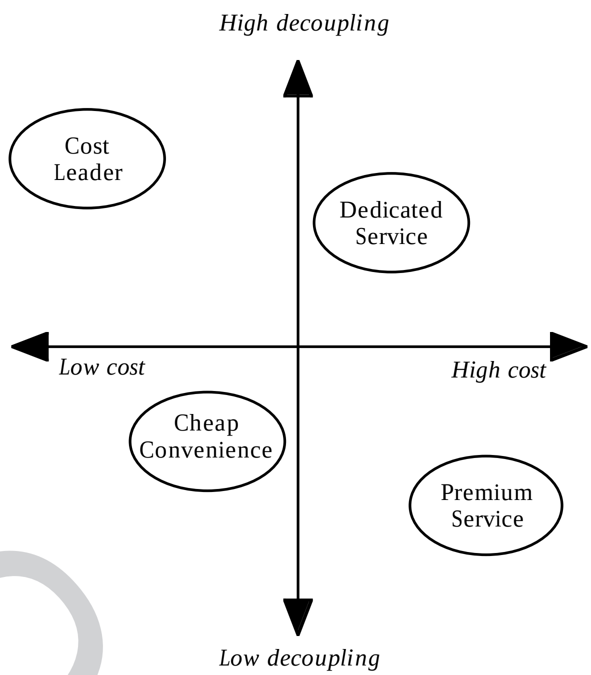
The activities involved in retail lending are described generically in **Figure 1**. Retail lending involves providing monies for personal use rather than for a business. Most of these loans are used to purchase or improve a home, boat, or automobile. Starting the process usually requires some face-to-face customer contact. Extensive personal contact is the reason many customers choose a particular bank. Loan officers are expected to be active members of the community—often leaders in the Rotary, Kiwanis, or local government—who generate business through their personal relationships. Alternatively, customers might select a bank by finding the branch closest to their home or office. They may have minimal face-to-face contact with anyone at the branch.

Because of the prevalence of over-the-phone loan approvals advertised by banks, one may think there is little back office work required in lending. In reality, quick loan approvals are only "conditional" approvals, and a number of activities must take place prior to writing the check. Applicant credit history must be checked, employment and income must be verified in writing, a host of legal documents must be prepared, and a loan approval decision must be made. For home, boat, or auto loans, or loans in which such collateral as stocks, bonds, or certificates of deposit are involved, the collateral item has to be inspected and appraised, and the collateral ownership and various insurance coverages have to be verified. Customer contact is again required for signing documents. There is also significant post-loan processing. Insurance documentation must be updated, files and collateral documents maintained, payoffs quoted, and, in some cases, delinquent borrowers must be contacted and repossession/foreclosure initiated. Most of this is performed without face-to-face customer contact.

A GUIDE TO THE DECOUPLING DECISION

If a technological shift enables a firm to organize work in such a way that across-the-board improvements in cost and service are the result, then the firm must adopt the new technology. When no such overwhelming technological advantage exists, however, management must carefully consider the method used to organize back office work. As we will show, this decision carries strategic implications that must be properly understood if company strategy is to be supported rather than undermined. As an aid in this decision process, we offer a prescriptive model that pairs four methods for organizing back office work with four different strategies. We refer to these pairings of methods and strategies as "competitive approaches." For each approach, we describe the competitive advantage sought and the way in which back office work should be organized to support that objective. Citing examples from other service industries and our own banking study, we conclude with recommendations regarding the key managerial issues associated with each approach.

Figure 2
The Four Decoupling Approaches



In presenting these four competitive approaches, our goal is to illustrate how the organization of back office work can support a given strategy, rather than to argue for the superiority of one approach over another. Moreover, it may be the case that not all four approaches are viable in all service industries. The ultimate success of a given approach depends not only on how well it is executed, but also on the existence of a supportive market.

Figure 2 arrays the four competitive approaches left to right in order of increasing cost. The vertical dimension indicates the relative level of decoupling of back office activity. For the moment, note that there is no "natural" progression with respect to the level of decoupling as the cost of providing the service increases. The reasons for this will become clearer as each approach is described in detail.

Cost Leadership: Decouple to Minimize Costs

As the name suggests, Cost Leaders pursue the classic strategy of the same name discussed by

Porter (1980)—that of competing on price—and follow the conventional logic of using the decoupling process to reduce costs. The basic methods used to achieve lower costs are as old as the industrial revolution. Just as in a manufacturing firm, the procedure is to separate complex, multi-task jobs into many simpler jobs, standardize the work, and use specialized labor and technology to achieve scale economies.

Centralizing services provides an additional benefit that is often not seen in manufacturing, since many manufacturers have only a few central locations to start with. Scale economies in manufacturing can be achieved merely by spreading overhead over more output, whereas in services the decoupling process also helps cut costs by reducing work variance. If tasks were merely segregated but not centralized in a service environment, the back office activities might still need to be staffed based on the whims of the customer, with some days being busy and others slack for any particular service site. When the back office work is centralized, the slack days of some offices are offset by the busy days of others, allowing for a more predictable work flow and lessening the need to have added workers on the job just in case a randomly busy day occurs.

"Scale economies in manufacturing can be achieved merely by spreading overhead over more output, whereas in services the decoupling process also helps cut costs by reducing work variance."

A cost focus is common across many services. Both the discount stock broker Charles Schwab and the retail insurance firm GEICO focus on cost reduction by eliminating the localized high-contact, commission-oriented personnel that formerly dominated the industries to which they belong. For low-cost corporate legal services, General Counsel Associates employs only experienced lawyers focusing solely on routine legal matters that require little customer contact. In many areas of the United States, Dunkin' Donuts, with over 4,000 locations, cooks doughnuts in centralized facilities that stock all outlets in a given metropolitan area. The fast-food industry follows this advice to an extreme. Certainly no hamburger patties are made or potatoes cut in any local McDonald's restaurants. And Taco Bell centralized virtually all food preparation in the late 1980s. Even the distant "local" weather forecaster mentioned earlier is an example of this process. The reason television stations use such a system for local broadcasts is to cut costs by paying for only a fraction of a weather center's time.

Four Nashville banks pursue this approach: AmSouth, First American (recently purchased by AmSouth), First Union, and NationsBank (now part of BankAmerica). AmSouth is typical. A telephone call to the number for all local Nashville branches is automatically routed to a centralized call center more than 100 miles away in Alabama. For loan operations, all 250 branches throughout several states fax loan applications into a single service center in Birmingham, where incoming faxes are picked up by whoever is available. Job duties are highly specialized, with little cross-training. Specific jobs are assigned to those who do data entry, appraisal ordering, disclosure construction, underwriting, and so on. This system is highly efficient for standard customers, but can bog down with special requests. So such requests are not encouraged. There are only a few lines on the form that branch personnel complete to request special considerations.

Cost Leader branch personnel are divided between tellers and "personal bankers," or "customer service representatives." There are no loan officers per se, as occur in the other decoupling approaches; the "personal bankers" perform both loan and deposit account functions. Rather than seek out business, they tend to stay inside the branch and serve customers who walk in. They receive the bulk of their income by straight salary, although each bank has a commission-based system that can augment their pay by a small percentage.

A primary purpose of technology in Cost Leader firms is labor reduction. First American centralizes document preparation, electronically transmitting documents to branch locations for the closing of the loan. The task of loan approval at Cost Leader banks is also geared toward replacing labor with technology. At First Union, the loan application is taken verbally and entered into a computer by a customer service representative in the presence of the customer. The branch is linked by satellite to national headquarters, where a computer statistically assesses the borrower's demographic characteristics and credit history via an electronic link to a credit bureau, then informs the customer service representative whether or not the loan is approved.

The Price of Following Conventional Wisdom. Organizing back and front office activity in this manner brings down costs, but it can also create losses in flexibility, response time, and quality. Consider the mistakes and problems that can result from a computerized assessment of credit quality.

The U.S. Public Interest Research Group found that nearly one-third of credit bureau records are inaccurate in ways that could lead to an unfair loan denial ("Errors…" 1998). Some are obviously wrong, such as a 25-year-old applicant having a 30-year credit history, or a credit record showing simultaneous home loans in several states for an applicant of modest means. Virtually all U.S. banks use so-called statistical “scoring” systems in assessing retail loans, but many do so with scorecards manipulated manually. In a totally automated system, however, the physical credit record is not viewed by a person who could determine accuracy; only the computer generated overall score is seen, which may be far better or worse than the applicant’s actual credit record deserves. This has resulted in such celebrated gaffes as a governor of the Federal Reserve Board, with spotless credit, being denied a Toys ’R’ Us credit card.

Dependability and accuracy of a service provided can be hindered by segregated duties. At Bank of America in the late 1980s, lending for automobiles and repossession of autos for loans in default were separate, centralized activities. As a result of miscommunications, some autos were accidentally repossessed each month from customers who were not in default on their loans. It is difficult to imagine an accidental repossession taking place in an integrated process, with the same individual who solicits the loan and receives the payments also making the collection calls if payments are not received. Further, centralizing segregated activities raises the chances for such problems to occur, since communication is weaker between physically remote areas.

Product line flexibility can also be hurt by such a focus. With the banks in question, the product line is, in effect, truncated. The only collateralized loans handled by the central facilities are generally home, auto, and boat loans. Someone who wanted to use such high-value items as furniture, musical instruments, jewelry, stamps, coins, antiques, or art as loan collateral would have to seek out another bank. Because of the strong music industry in Nashville, some banks give loans based on the prospective stream of royalties from a hit song. Cost Leader banks do not, because reconfiguring their nationwide, centralized loan processing structure to include such a regional product makes no sense.

Another measure of flexibility, adapting to unique customer requests, is also diminished. The Cost Leader approach is at its best when processing standard items. The decoupled structure does not lend itself to accommodating the customer. Only front office personnel come into contact with customers. Special requests for items not currently stocked, or for an exception to procedure that seems reasonable to a front office worker, may fall on deaf ears in the back. Often, back office employees, who are typically rewarded on production volume, never see the customers or their colleagues in the front office. Because they have no personal feeling for either, and because special requests slow down the process, they are less likely to go the extra mile in special circumstances.

Response time to the customer can also be hurt by the Cost Leader approach. Decoupling back office work increases individual task speed through the long-accepted techniques of industrial engineering: task specialization, the learning curve, and automation effects. But the customer cares about process speed, not task speed. The time that is relevant to a customer is the time from service request to service provision, which equals total task time plus the many waiting times and hand-offs between tasks. It is these waiting times and hand-offs that increase with the segregation and segmentation of tasks.

Cost reduction, one of the basic purposes of the Cost Leader approach, indirectly and negatively affects delivery speed. One reason for decoupling is to buffer the back office from disruption and allow for smooth work flow. This cuts costs by allowing those personnel to be held at average demand rather than peak demand. To achieve the lowest back office costs, the staff should be used as close to 100 percent as is practical. But the service firm’s back office is not like a manufacturing assembly line, where a worker will take, say, exactly 50 seconds to perform a task. Generally the back office tasks in a service firm have far more variance. So the way to make sure everyone is working fully is to always have a backlog of work in front of each employee. Unfortunately for the customer, the piece of paper with his name on it must wait in several queues before it is completed.

Managerial Issues. Cost Leaders need to stay abreast of technological developments that displace labor in back office operations. They also need to pursue information technology that increases front office productivity by either coopting the customer’s participation in service provision or reducing the need for face-to-face contact. In the retail banking context, some Cost Leaders, including First Union in this study and Mellon Bank, guide walk-in branch customers to interactive television screens to open new accounts, thereby reducing the number of traditional “platform” people required in a branch. Use of the Internet, bank-by-phone, and call centers to settle disputes fits well with this approach.

Cost Leaders must mitigate the marketing and human resource management weaknesses inherent in their approach. One obvious challenge as a consequence of minimizing contact is that without face-to-face interaction with a trusted guide, customers may not realize that they could benefit from additional features and services. Cost Leaders must also plan to take advantage of opportunities for cross-selling. Customers are generated largely through broad-based media marketing or through their own awareness of a firm's low-cost services, rather than through the efforts of high-contact personnel. So compensation for such personnel is not based primarily on commission. Still, it may be useful to have some level of commission structure as an incentive for cross-selling.

Workers in the back office, being responsible for only part of an entire process, may find their work less intrinsically motivating. It is generally believed that internal motivation, job satisfaction, and effectiveness are linked to knowledge of the results of work activities, the degree to which a task seems to be an identifiable unit, and the responsibility individuals feel for the outcome of their work. Being responsible for an entire process aids in seeing one's duties as an identifiable unit and thus has a more intrinsic motivating influence. As Matteis (1979) states, back office workers desire "beginning to end" jobs.

Cheap Convenience: Use Less Decoupling to Keep Costs Lower

Firms using this competitive approach seek to enhance convenience while maintaining reasonably low costs. In what might be called a "kiosk" strategy, these firms populate the landscape with large numbers of service units that offer a limited product line. In terms of Porter's strategies, this would correspond to a geographic "differentiation" strategy. Because of their small size, they are staffed by fewer workers who consequently need to be cross-trained in most or all front office tasks. For Cheap Convenience firms, back office work remains in the front for the same reason Cost Leaders choose to segregate it: cost reduction. The small size of the service units provides the economic logic for using this approach.

In general, service firms cannot staff their high-contact facilities based on average work load. Customers do not arrive in predictable patterns, so such staffing would cause severe customer service problems. Because of the mathematics involved, small "kiosk" facilities are at a severe disadvantage. Comparing the personnel needs of dozens of small facilities located throughout a city versus a single large facility, the need for employees over the number required to serve the average number of customers is substantially larger for the small shops.

The same logic that compels service firms to centralize back office operations also creates incentives for large front offices. Combining several offices into one large one has the effect of pooling the variance of customer arrivals, so fewer overall workers are needed in one large office than in a sea of smaller ones serving the same customer base. This concept, usually called "centralization of waiting lines," is documented in virtually every operations management textbook.

All those extra employees required in a kiosk system means far more idle time, but only in the sense of not having direct contact with customers. If workers have non-contact duties, their idle time can be filled. Of course, these would be the same activities that Cost Leader firms are decoupling and centralizing. Cheap Convenience firms respond to this problem of cost control precisely the opposite way Cost Leader firms do: They opt to keep a large amount of back office work in the front office.

Examples of Cheap Convenience firms include Edward D. Jones, a stock brokerage firm based in St. Louis, which has 3,800 offices in the U.S. that are largely manned by a single broker. The product line is somewhat abbreviated; it does not sell penny stocks, derivatives, or commodities. The law firm of Jacoby & Myers blankets a metropolitan area with numerous small offices that offer convenience and low prices. Relying heavily on television advertising to draw clients, it offers a limited product line. The cost of photo developing at one-hour developers such as Moto Photo is substantially higher than firms pursuing cost leadership (such as mailing film to Kodak), but response time and geographic convenience have created a market for its service. Similarly, Dollar General and 7-11, both with thousands of sites, are competing against the traditional Cost Leaders in their industries by offering more numerous, convenient, small-footprint stores.

Two banks take a Cheap Convenience approach in the Nashville market: the Nashville Bank of Commerce, and SouthTrust. For the former, 85 of the 101 branches in its system as of year end 1997 were small two- or three-employee branches located in supermarkets. Cross-training levels are high. Aside from part-timers, any branch employee can take a loan application or cash a check. To achieve further convenience, branches are open for business 51 hours per week—nearly 30 percent longer than most banks in the area. Only retail products, however, are available at the vast majority of branches. Corporate customers are seen in only a few locations, so cross-training is confined to retail products.

Although some portions of the lending process are centralized, preprocessing and loan approval for auto and personal loans are performed there in the branch. For home equity loans, portions of the work, such as arranging for an appraisal, are performed centrally. For all loan types, problem loan collection, insurance updating, and repossession/foreclosure are handled in a centralized facility in Memphis, Tennessee, 180 miles away. For SouthTrust, the only decoupled activity is collecting on "unrecoverable" loans—those in default for longer than three months.

Employees of the Nashville Bank of Commerce are basically salaried, with a small amount available in incentives for loans booked. They are not expected to become prominent members of the community, because customers are drawn by the convenient location of the branch, rather than by the force of workers' personalities.

Managerial Issues. Maintaining conformance quality is an important challenge here since many different people are performing the same tasks company-wide. Firms should focus on standardizing tasks and managing job complexity. Developing easy-to-use software and tightly scripted service encounters can be helpful. A related marketing problem is posed in maintaining the product line. Though it is always tempting to add products, especially in response to competitors who initiate new ones, Cheap Convenience firms must maintain a narrow product line. Workers already have to perform the tasks of a number of different workers in other firms. Product proliferation would further complicate an already complex environment and lead to eventual service failure for high-contact employees.

Dedicated Service: Decouple to Support Front Office Personnel

Dedicated Service firms offer more variety and flexibility than their Cost Leader counterparts. Decoupling is done principally to enhance these capabilities; cost considerations are secondary. Employee tasks are segregated by personality type and abilities. This is in accord with Chase's (1978) worker suitability arguments, which are based on the premise that individual worker personalities are generally better suited to either front office, people-oriented work or back office, task-oriented work. Specializing tasks according to orientation, with high-contact workers having interpersonal and public relations skills, presumably enhances the personal charisma, courtesy, and helpfulness of the service staff.

To maintain a consistent face for the internal customer, back office tasks are centralized by region, or a subset of back office workers are designated as contacts for specific branches or front office personnel. This fosters long-term relationships and even strong personal ties between both kinds of workers. One front office employee remarked that he sent birthday flowers and Christmas candy to his designated back office colleague.

With these relationships, back office staff no longer just process paper for customers they may never meet. Instead, they are meeting a reciprocal obligation for a real colleague. Such an approach helps reduce the amount of overlap work resulting from varied personal styles and gives back office workers more personal responsibility. The relationships mitigate the tendency to fall into the over-the-transom syndrome, whereby front office personnel, in their rush to pursue sales, collect information haphazardly and create unnecessary work for the back office. In both cases, needless work is eliminated, effectively freeing up back office capacity to respond to front office requests with no additional expense.

The benefits of decoupling these activities by region, however, come at a cost. Because dedicated back office personnel are needed, the problems with varied demand discussed earlier may crop up. Having such people dedicated to individual front office workers means having more employees and hence higher costs.

Traditional stock brokerages, real estate offices, insurance companies, and law firms are all examples of Dedicated Service firms. Traditional hospitals can also be thought of as being structured this way, with surgeons generally free to perform their special skills, supported by a host of nurses and other staff. In the Nashville retail bank market, Union Planters Bank provides an example of such a firm. Loan officers are compensated largely by the amount of successful loan applications they generate, and they are expected to spend 25 percent of their time outside the branch soliciting customers. All back office work, however, is performed at regional loan operation centers, with 20 to 30 branches supporting 20 to 30 full-timers each. At the regional office, preprocessors are designated as contacts for a subset of the branches served. Groups are also organized by function to serve as input, underwriting, and document-processing teams. All employees are cross-trained to permit Union Planters to mitigate any back office bottlenecks.

"With these relationships, back office staff no longer just process paper for customers they may never meet. Instead, they are meeting a reciprocal obligation for a real colleague."

One vision of the Dedicated Service approach is the "future bank" being implemented by First Union. As Greising (1998) reports, lenders will be paid on 100 percent commission and will be based more out of their automobiles than out of a bank branch.

Managerial Issues. It is important for management to design a reward system for the back office based on how well it supports the front office, rather than just on cost. Expenses are far easier to measure, so it is tempting to reward back office managers based on coming in under budget on spending. Such a reward system, however, would be detrimental to a Dedicated Service firm, because it would be easy to cut expenses by providing inferior service to the front office.

When back office activity includes evaluating the financial risk associated with doing business with a customer, as in retail banking or insurance, the feedback and reward system for front office workers can be critical for enhancing personnel development and profitability. Consider the role of loan officers in a Dedicated Service bank. Their principal job is to solicit loan applications. They do not collect on delinquent accounts, nor are they responsible for loans that result in losses to the bank. The only side of the loan equation they see is the customer who wants the money. So they never develop the ability to judge good risks.

> *"As a foil to Dunkin' Donuts (a Cost Leader), Krispy Kreme makes fresh doughnuts at each location and lights up a neon sign extolling 'hot doughnuts' whenever a new batch is made."*

Although this hinders their ability to market the bank's products in the most profitable way, the situation could be worse. If their compensation were based largely on the volume of loans accepted, both their underdeveloped judgment and this personal financial incentive would reinforce the tendency for them to become strong advocates for most loan applications. Discussions with lenders indicate it is not uncommon to polish applications to a high gloss before sending them to the underwriting department, and to plead their customers' cases regardless of applicant quality if the underwriters are reluctant.

A similar problem exists in the life insurance industry. In a practice called "white sheeting," unscrupulous agents purposely exclude negative information about an applicant's health so that the back office will approve a policy.

Premium Service: Use Less Decoupling to Maximize Customization and Responsiveness

Providing an exceptional level of personalized service while commanding a premium price corresponds to Porter's "differentiation" strategy. Maximizing customization and responsiveness are the key operations. The competitive goal is to move beyond a transaction orientation with customers and into a relationship orientation. At the extreme, customers may be familiar enough that their needs and wants are anticipated. At minimum, prior customer preferences are adhered to in future encounters. Marketing relies more on word-of-mouth and community outreach than mass mailings with discount offers or television advertising.

Back office operations are decoupled only when overwhelming advantages are provided by scale economies. Task segregation is minimized. High-contact workers have fewer layers of management above and fewer workers to coordinate below. They seek to develop a deep professional relationship with customers that can last for years. A broad, complex product line is needed to accommodate the range of customer needs. Workers are primarily dedicated to customers, not products, so they need a broad range of skills. The general approach is to allow local decision-making to react to local conditions.

Such an approach can take various forms, depending on the industry. As a foil to Dunkin' Donuts (a Cost Leader), Krispy Kreme makes fresh doughnuts at each location and lights up a neon sign extolling "hot doughnuts" whenever a new batch is made. In the medical field, a facility such as The Tennessee Birth Place, a birthing center, provides more continuity of care and premium surroundings than a traditional hospital.

Three of the ten multi-branch banks serving the Nashville market pursue this approach: the Bank of Green Hills, RegionsBank, and SunTrust. At the Bank of Green Hills, named after the section of Nashville in which the bank is located, each branch is like a bank unto itself. The holding company owns several legally independent banks, each with its own local name. For retail lending, the branch loan officers personally handle virtually all aspects of Figure 1, from soliciting applicants to collecting bad debts. Real estate appraisal is outsourced to a local appraiser, but the lender chooses and contacts the appraiser. Loan approval authority resides in the same person who solicited the application—the person who must also initiate foreclosure or repossession if payments are not made.

This personal touch at the Bank of Green Hills leads to approval for home equity loans in four days—a marked contrast to the approach at Nashville's Cost Leader banks, which average two to four weeks. High-contact service personnel are expected to know their customers' names and preferences. Community involvement plays an important role in attracting new customers. Pay for loan officers is largely salary-based, but significant bonuses can be awarded based on overall branch performance. The Bank of Green Hills pays for officer memberships in local community organizations. Branches tend to be well staffed and most of them can perform commercial and retail activities, while their more decoupled competitors are often dedicated units to either commercial or retail activities. Back office activities for these branches include payment processing and, for two of them, holding collateral documents such as auto titles.

Managerial Issues. Hiring, training, and employee retention are pressing issues for Premium Service firms. Because of the complex nature of the work, training takes longer and is costlier than for firms that segregate more work. Moreover, customers are drawn to a Premium Service firm because of its personnel, rather than the lure of cheap prices or media advertising. Thus, sizable marketing benefits stem from a stable employee base, and turnover that would be acceptable at other firms can present quite a problem.

Like the Dedicated Service firm, care must be taken not to manage Premium Service back office tasks based solely on cost reduction. Even in the banks discussed here, some of these tasks are outsourced. Given the higher wage rate differentials for clerical workers versus the high-contact workers in Premium Service firms, it is an even greater temptation to outsource or migrate tasks to lower-paid employees. Besides potential impacts on flexibility and responsiveness, Premium Service firms must recognize that high-contact workers often gain important knowledge and insight about customers when performing back office tasks. So an intangible level of marketing losses must be considered in any outsourcing or task segregation decision.

A less obvious managerial challenge is the potential for problems with conformance quality and brand image. The decisions made by each branch may be markedly different. In retail lending, it is possible for a customer to be turned down at one branch only to obtain the loan at another. Maintaining consistency is difficult when geographically dispersed units make their own decisions on how to implement policy.

Premium Service firms have higher costs than Dedicated Service firms, but they can command a higher price based on the level of flexibility and customization they provide. The extent of the price premium that will be paid by customers must be closely monitored.

CHANGING APPROACHES TO ORGANIZING WORK

In a static sense, then, each approach to organizing work supports different competitive advantages. The marketplace, however, is not static. Firms often seek to change their strategy and, consequently, their approach to organizing back office service work. Several issues confront those firms in transition: the speed of implementation, straddling multiple positions, and the difficulties in achieving the transition.

Whether a firm desires to move toward or away from decoupling, two opposing forces dictate the speed with which either occurs. From both a financial perspective and to maintain a consistent face for the customer, it is best to move quickly and completely throughout a network. Having a positive financial return on such a project may depend on the timing of personnel reduction.

But there is also an argument for gradual implementation. One of the benefits of dividing front and back office work is that workers tend to be intrinsically better suited to one or the other. It is reasonable to assume that many workers who are currently employed in the front office are there because they favor interpersonal skills over technical ones. Decoupling means shifting staff from the front to the back. This can be accomplished either by moving current workers with mismatched skills or by wholesale layoffs and new hires—neither of which is an attractive prospect.

In 1983, Crocker Bank, then the thirteenth largest bank in the U.S., began decoupling many branch loan and deposit functions in an attempt to switch from being a Premium Service bank to being a Dedicated Service bank. At the time, there were more than 100 trainees (including one of the authors) in an 18-month program designed to prepare them to become branch operations managers—essentially a back office position, but one physically located in the branch. However, due to the decoupling process taking place, it was clear that no new operations managers were needed, so the trainees were redirected into a training program for front office retail lending—regardless of their fit with the new career track. Had planning for this strategic decoupling change allowed a longer lead time, HRM could have made more appropriate decisions.

Each approach presented here appeals to a different customer base. To gain market share, it is tempting to try to occupy more than one position in the same firm. The typical way to manage this is to create separate internal units for each. In the case of retail lending, Cost Leader banks focus their operations to cut costs, creating highly segregated jobs and heavily centralizing their retail lending. All of them, however, have separate internal units that cater to wealthy individuals, forming a “bank within a bank” that would correspond to the Premium Service approach. Typically, this unit will not share facilities or workers with the regular retail lending process.

Market decisions become more difficult, however, in other circumstances. Noting the success of some Cheap Convenience banks, so many banks have opened small branches in supermarkets that those branches represented 7.7 percent of all U.S. branches in 1996—up from virtually none in the early 1980s. For some banks, small branches are part of a coherent set of decisions, and their back office operations are constructed to support them. Other banks, however, have a small portion of their overall network in supermarkets, and those branches must make use of the same back office structure all branches use.

Depending on the nature of the approach taken by the dominant part of the bank, this can mean higher costs due to an insufficient amount of back office work being performed in the small branches, or a product line that is too complex for the small branches to service adequately.

The choice of how to organize back office service activity is not merely a tactical decision made in the interest of efficiency. As our prescriptive model points out, it must be made in accordance with the strategy of the firm. From the typical textbook viewpoint, the basic advantages of decoupling are lower costs, greater speed, and higher conformance quality. In contrast, we have shown that, depending on the strategy, decoupling can be eschewed to decrease costs or embraced to enhance responsiveness in the front office—in full awareness that this increases the cost of service provision. In choosing and implementing a competitive approach, firms can follow the recommendations presented here. ❐

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