

# Long-Term Contracts in the Cellular Phone Industry

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## INTRODUCTION

A service company's major goal often tries to identify profitable customers and to retain those customers through long-term relationships (e.g., Reinartz & Kumar, 2003). Retention has been shown as a sound strategy for long-term success (e.g., Reichheld & Sasser, 1990). Frequently, companies employ a market orientation strategy to reach their retention goals. Market orientation occurs when organizations base their procedures and structures around the customer (Narver & Slater, 1990), with the intention of garnering customer loyalty through superior customer satisfaction. The importance of the customer and the delivery of quality service has been illustrated in many literature sources, (e.g., Zeithaml, Berry, & Parasuraman, 1996) yet many companies continue to use policies that exploit the customer or service quality in favor of bottom line profits. Long-term contracts may be such a policy.

It is argued here that long-term contracts utilized in the service industry contribute to low satisfaction levels of customers. Major inefficiencies are caused by firms' reliance on long-term contracts as a means to lock customers into relationships. As the market saturates and power shifts to the customer, many of the existing structures used by dominant companies who contribute to this lack of satisfaction may become unacceptable. If this situation is not remedied, firms will be in jeopardy of going through rapid changes in customer loyalty (i.e., switching behavior (Jones & Sasser, 1995)).

To illustrate this problem, the cell phone industry in North America will be analyzed with a contingency theory approach. The cell phone industry was chosen as a viable example of contractual problems because the industry is dominated by firms that base their provider/client relationship on long-term contracts. For example, in North America phone companies such as

Verizon and Cingular initiate most plans beginning at one year, with increased benefits accrued only to those who sign on for longer terms (i.e., free phone). It is assumed that arguments set forth in this article will be applicable to other service firms due to major similarities found across service industries. Currently, customers in the cell phone market are extremely dissatisfied (Navarro, 2005), but find themselves without sufficient secondary options. Contingency theory is used because it assesses the fit of the firm structure with the firm's external environment. We argue that cell phone companies are able to use long-term contracts because of the lack of secondary options for their customers. In other words, cell phone companies use long-term contracts, which do not create customer satisfaction because customers have no other choices.

The intended contribution of this research is to help service firms satisfy their customers. By proactively creating firm structures and procedures that fit the service environment, firms will greatly increase their chances to develop long-term relationships with customers rather than forcing long-term relationships through contracts. In the following sections, we first review the tenets of contingency theory and follow this with a brief review of contracts and their implications in the service relationship. Next, propositions are developed which describe the inefficiencies created by long-term service contracts. Finally, the article concludes with a discussion of practical applications of the propositions and implications for future research.

## BACKGROUND

Contingency theory states "for organizations to be effective, they have to achieve the proper fit between their structure and their environment (Bluedorn, 1993, p. 166). This theory can be traced to Lawrence and

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Lorsch (1967), and has gained increasing sophistication based on three main environmental dimensions, which assist in describing the environment: dynamism, complexity, and munificence (Bluedorn, 1993). Dynamism describes the degree of market instability over time and the turbulence caused by the interconnection between organizations; Complexity describes the degree of heterogeneity and the dispersion of organization activities; Munificence describes the extent to which an environment can support sustained growth” (Starbuck (1976) and Aldrich (1979) stated in McArthur & Nystrom (1991)).

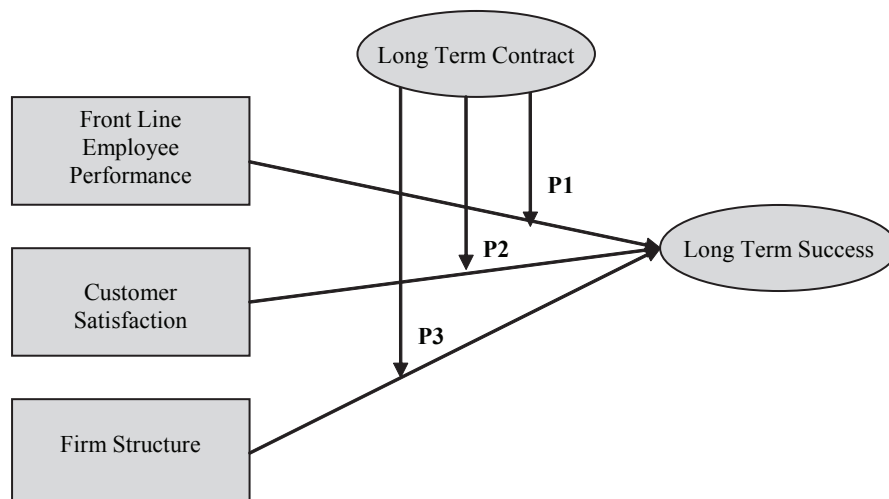
There are several assumptions underlying contingency theory (Weill & Olson, 1989): (1) Fit: Contingency theory assumes that the better the fit among contingency variables, the better the performance of the organization; (2) Rational Actors. The theory assumes that the organizational actors perform in ways that are always in concert with the super ordinate goal of organizational effectiveness; (3) An organization with fit is at equilibrium, and better performance is a result of that equilibrium. Therefore, there is no time lag between the independent variables and their impact on organizational performance; and (4) Deterministic model. Although the methodologies employed do not allow conclusions about causality, clear causal inference is often made.

It is important for firms to take into account the environment in which they are inhabiting for three main reasons: (1) some environmental change is rhythmic

and strategic; (2) some managers can perceive these rhythmic patterns and use them to make accurate predictions; and (3) the predictions can be used to bring the organization into a more favorable alignment with strategic environmental rhythms (Bluedorn, 1993, p. 173). The key thought being that the company with the ability to anticipate patterns and to use these perceptions and predictions in the strategic planning process may have a major source of competitive advantage (Bluedorn, 1993).

With regards to the cell phone industry, it is hypothesized that the current structure of many dominant firms does not match the environment in which they exist. The structures have been developed while the relationship between the firm and the customer is uneven. This has occurred because the cell phone industry resides within a munificent environment. In other words, the market for cell phones has not reached saturation and companies have incorrectly developed procedures and structures without regard to a much needed market orientation. Problems resulting from this lack of fit include: (1) front line employees (FLE’s) with little motivation, ability, or resources to meet problems; and (2) firm policies based on exploiting the environment. It is hypothesized below, that three variables (employee, customer, and the firm) are all negatively moderated by a central structure of the firm (contract). This has led to major inefficiencies, which has left the door open for competitors.

Figure 1. It is hypothesized that a contract has a negative effect on the performance of three main features in a service firm’s long term success. Namely the employee (P1), the customer (P2), and the actions of the firm (P3).



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