

QUALITY UNCERTAINTY AS A BARRIER TO BUSINESS SERVICES DEVELOPMENT

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Abstract

Highly performing innovative business services became important factors of competitiveness in modern economies, but their potential contribution is severely restricted by market dysfunctions, as companies reported during previous studies. There is also a lack of adequate policies partly explained by the fact that the services related knowledge is underdeveloped and poorly disseminated among decision makers. Having found that quality uncertainty limit the size of the market and the access of new companies and SMEs to valuable business services, the authors make a review of existing conceptual models of service quality assessment; discuss the implications of information asymmetry and explore with selected service providers the situation in specific industries, as well as the solutions for overcoming the current shortcomings.

Keywords: services' quality, business services, information asymmetry, knowledge intensive business services

JEL Classification: L84

Introduction

As services became dominant in modern economies, more concern is manifested among economists and business analysts about the particularities of services transactions and services markets. There is still much to do in order to reform the traditional economic theories and business practices, created for an economy based on manufacturing, in order to respond to the changing economic structures (Tachiciu and Popescu, 2007). Service quality evaluation appears to be one of the most challenging topics for the scientific literature, and benefited from a large number of contributors. However, the literature abounds of controversies, studies that invalidate previous assumptions, warnings about omissions, and attempts to provide improved or alternate constructs. Due to services heterogeneity, a significant research effort is dedicated to conceptualizing and measuring quality in specific

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^{*)} This paper was first presented as a communication within the 20th anniversary international conference of RESER, The Resilience of the Global Service Economy, 30 September-2 October, Gothenburg, Sweden.

service industries and categories of service industries, providing in many cases useful insights for market operators. When reviewing the literature a number of characteristics are conspicuous: (1) most of the research focus on consumer services, while the case of business to business (B2B) services is overlooked, not to say avoided; (2) most of the research aims at empowering the service provider in managing quality issues, therefore the accent is put on psychological and behavioral factors that help service companies to attract and maintain the clientele, while the value of the service for the customer is considered only superficially or ignored (Gyimothy, 2000); (3) most of services quality constructs fail to take into consideration the implications of information asymmetry, despite the fact that many researchers have investigated the quality of the relations between the service provider and the customer, due to the co-design and co-production that are specific to services because of their inseparability and simultaneity.

We believe that more efforts should be deployed toward analyzing the case of business services quality and eventually designing an instrumental framework for quality assessment that may contribute at improving market functionality. Various industries depend on services as intermediate inputs, and raise policy concerns especially regarding “structural deficits with respect to industries that typically rely heavily on external inputs from knowledge based services” (Pender, Kaniovski and Dachs, 2000). The authors insist in their background report for The European competitiveness report 2000 upon the need to overcome the problem of asymmetric information by specific institutional arrangements aiming to mitigate the economic effects of uncertain provision of quality, and by a framework where clients’ creative response will be encouraged. In the same spirit, Peter Wood is analyzing the so called “London paradox” suggesting that the contribution of non-science-non-technology based innovation, relying upon the contribution of external knowledge intensive business services, had much higher impact on the success of London based firms as in the case of other major urban locations from United Kingdom (Wood, 2007), which raises once again the problem of uneven benefits of business services from a customer’s perspective. The Commission Communication on business-related services (Commission of the European Communities, 2003) acknowledges that “... serious deficiencies in our understanding of the structure of the services sector and the factors influencing the growth of services enterprises remain”. In the opinion of the commission one important reason of such a situation is the fact that “services are difficult to define and thus to measure”, and we can add that one obvious issue is related to services’ quality evaluation during the transactions with services. This is especially the case of knowledge intensive business services. Leung (2004) noted: “More and more analytical approaches are being developed so that knowledge can be included more directly in production functions. However, incorporating knowledge into standard economic production functions is not an easy task, as this factor defies some fundamental economic principles, such as that of scarcity. Knowledge and information tend to be abundant; what is scarce is the capacity to use them in meaningful ways. Nor is knowledge easily transformed into the object of standard economic transactions”. Following an exploratory research that we carried out during 2009 among business services customers we found out a general dissatisfaction generated first, by the impossibility of the buyer to know in advance what service it will get and to compare the offers available on the market, second, by a perceived poor quality of services and third by excessive tariffs compared with the perceived value of the services (Tachiciu, Dinu and Kerbalek, 2009). All this point to the well-known information

asymmetry specific to service provision relationships coupled with the helplessness to measure service quality.

1. Limits of business service quality evaluation

In the field of service quality assessment one should easily identify the coexistence of several paradigms. A paradigm is a theoretical construct of any kind which enjoys the adherence of a significant number of scholars. The expression theoretical construct could mean concept, model, theory, or any other kind of intellectualization of an object or a notion (Verstraete and Fayolle, 2005). A paradigm may suffer transformation and may be replaced by another; “the successive transition from one paradigm to another via revolution is the usual developmental pattern of mature science” as Kuhn (1970) said. As long as the scientific debate follows several conceptual models, the service quality does not follow the pattern of a mature science, but that of a science being in an on-going clarification process. Working along existing paradigms, represent “an attempt to force nature to the preformed and relatively inflexible box that the paradigm supplies. No part of the aim of normal science is to call forth new sorts of phenomena; indeed those that will not fit the box are often not seen at all” (Kuhn, 1970).

There are few attempts to classify in a comprehensive manner the conceptual models used in service quality. Susan Proctor and Gillian Wright (Proctor and Wright, 1998) identify several such constructs:

- Importance-performance models (Fishbein, 1967; Martilla and James, 1977; Cronin and Taylor, 1994 - SERVPERF model) that are based on the measurement of customers' perception of the performance of items significant to quality weighted by the importance given by the customer to each item.
- The perceived quality model (Gronroos 1982, 1984, 1993), also known as the disconfirmation model, defines the service quality as a measure of how well the service level delivered matches customer expectations. This model has the merit of considering that the customer's perspective is dominant, rather than that of the provider. Nonetheless, to a deeper analysis the model serves at informing the provider better than the customer
- Service processes models, initially proposed by Smith and Houston (1983), later derived in a number of applications based on the measurement of the quality of the relationships between the service provider and the customer (i.e. Hsieh and Chaing, 2003)
- The gap analysis model (Parasuraman, Zeithaml and Berry, 1985) also known by the name of the subsequent quality measurement scale SERVQUAL, according to which service quality result from a comparison of consumer expectations with actual service performance, while the evaluation is made on both the process and the outcome of the service delivery.
- Haywood-Farmer model
- The gap analysis in professional services model

When reviewing the literature a number of characteristics are conspicuous:

- Most of the research focus on consumer services, while the case of B2B services is overlooked, not to say avoided. Possibly, one reason is the higher complexity of the relationships between the two parties, as figure no. 1 suggests. The number and complexity of interaction between persons is a very significant difficulty in addressing quality issues in services as almost all the authors have revealed. Each interaction is subject of a series of biases related to communication, compliance, knowledge, collaboration, flexibility, perception, etc. More than this, in business to business relationships there is an institutional interaction superposed to interpersonal relationships, the nature, significance and influence of which is difficult to capture, despite the fact that in some cases its presence is obvious, as in the case of the preference that multinationals' subsidiaries have for the local subsidiaries of their mother company service providers. Another issue is that customer's satisfaction used by most conceptual models to measure service quality is itself affected by organizational aspects, as governance, for instance.

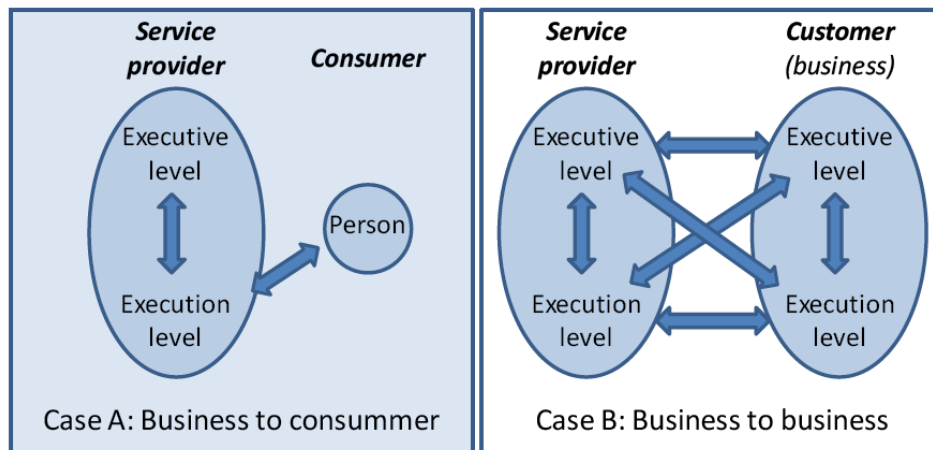


Figure no. 1: Complexity of relationships in business to business service provision as compared with the case of business to consumer

- Most of the research aims at empowering the service provider in managing quality issues, therefore the accent is put on psychological and behavioral factors that help service companies to attract and maintain the clientele, while the value of the service for the customer is considered only superficially or ignored (Gyimothy, 2000);
- Most of services quality constructs fail to take into consideration the implications of information asymmetry, despite the fact that many researchers have investigated the quality of the relations between the service provider and the customer, due to the co-design and co-production that are specific to services because of their inseparability and simultaneity.

2. The issue of information asymmetry

There is a large academic literature on the information asymmetry, but its practical implications are still very superficially addressed, exception being made of some so-

phisticated industries as the financial services one. The indifference or ignorance exposed by economic actors and policy makers in relation with the information asymmetry is bizarre, even more as its market implications are insistently revealed by various scholars. In his notorious article, "The Market for Lemons: Quality Uncertainty and the Market Mechanism", George Akerlof (1970) clearly revealed these implications: in markets characterized by information asymmetry, where sellers tend to have more information than the buyers, "there is incentive for sellers to market poor quality merchandise, since the returns for good quality accrue mainly to the entire group whose statistic is affected rather than to the individual seller". In this way, bad products drive out of the market the good ones, and the prices tend to be exaggerated compared to the value the buyer gets. According to Akerlof this process naturally shrinks the market down to the level of its non-existence. We, instead, accept the more general statement that information asymmetry severely inhibit the development of an industry.

It is largely accepted the fact the service industries face more asymmetric information than tangible goods industries (Clark, 1993; Nayyar, 1993; Skaggs and Snow, 2004) and also it is more difficult to overcome. "Since services are consumed as they are delivered, they are neither reversible nor returnable. Therefore, warranties covering services are often difficult to administer. Certification is no performance guarantee. Further-more, when certification is widespread, it provides no distinct performance signal. Monitoring is often inadequate because there is information asymmetry between the monitor and the person or facility being monitored" (Nayyar, 1993). Justifiable, scholars distinguish between service industries in relation to the grade of information asymmetry. Three categories of services were theorized: "search" services, when the quality of service can be known before experiencing it, "experience", when the buyer can assess the quality only after experiencing the service, and "credence" services which quality cannot be assessed properly even after they have been delivered (Hsieh and Chaing, 2004). As useful as it may be this classification has been rarely used in the field of business services, in our opinion, because of the complexity of the relationships between the service provider and the customer when both are organizations. Nonetheless, the problems raised by information asymmetries for the business services market should be addressed, especially in the context of the contemporary wave of services externalization.

Last year we did a survey among 180 executives of business services client firms from Romania. We found a general dissatisfaction about the current situation. The main concern of respondents was the impossibility of the buyer to know in advance what service it will get and/or to assess the correspondence of what it is likely to get with the real needs of his company. Many declared that the services they get are of low value but high priced. Obviously, the main source of concern was the information asymmetry specific to service provision relationships, coupled with the lack of transparency of the market for services and its insufficient institutional development and legal coverage. But the most striking aspect - indirectly revealed during our research - was the almost general incapacity of the client companies to measure, even ex-post, the value-for-money they got from a business service transaction.

Recently Rubalcaba, Gallego and Hertog (2010) published an article on market and system failures in services innovation and they found that information asymmetry is a core issue from both perspectives. They discuss deeply the implications of information asymmetry in the context of the European Union economy, mentioning as principal effects - in our

reading - a limitation in demand for services and the lack of incentive for service providers to raise their capabilities and improve the quality of services. Their position show that the dysfunctions which can be observed on the business services market in transition economies, many of which are attributed to the weaknesses of such systems by the authors of a study on small business service firms in Ukraine (Smallbone et al., 2010) are in fact of a more general nature. Without underestimating the role of soft institutional failures, we believe that addressing information asymmetry is a priority in exploiting the potential contribution of business services in raising the overall economic performance.

3. Service quality and market from the perspective of service providers

During our previous investigation, mentioned above, business service customers were asked to anticipate how will evolve their companies' purchases of services. The majority of respondents estimate that during the next five years their purchases of services will record a moderate increase or a relative stagnation. This result confirm to a certain grade the constraint exercised by information asymmetry on the development of business services' market in Romania. Clark (1993) believe that each market has a number of in-built mechanisms which remedy the harmful effects associated with information-related problems, the institutional arrangements which predominate in particular markets being dependent upon the trust-producing mechanisms within those markets. Nayyar (1993), however - as we have shown above -, maintains that information asymmetry between the buyers and sellers of services remains even after firms take action to reduce it.

In order to understand to what extent service providers are concerned with the need of a more competitive environment, quality improvement, market conditions and market perspectives we carried on a number of in depth interviews with managers of local business services providers from Bucharest and Buzau (a medium size town 200 km north from Bucharest). We took account of the diversity of services industries being particularly interested in more knowledge intensive services; so, we choose service providers in the following fields: accounting, computer related services, logistics (third party logistics) and management consulting.

The interviews were conducted around several common topics:

- How well do they know their industry and its dynamics?
- What are they doing in order to acquire new clients and how potential customers select the service provider?
- What kind of interaction takes place between service providers and their customers in the pre-contractual phase when defining the object of the contact according to the needs of the customer?
- How important is the price in business services transactions, compared with other criteria?
- What kind of frictions they face more frequently during the execution of the contract?
- What is their behavior aiming at improving quality and raising customers' business performance?

- How often and how easily an unsatisfied customer terminates the contract before end to find another contractor, or switch from a contractor to another for subsequent contracts?
- What happens in the post-contractual phase? Are there cases of litigious claims, or does the service provider maintain a certain kind of relationships with its former customers, for instance in order to assess ex-post the results (improvements) achieved by the customer as result of their collaboration?

While detailed analysis of the information gathered from interviewees is done in order to prepare the hypothesis that will be tested in a new phase by a more comprehensive survey, a number of aspects could be already of interest at this stage:

- In none of the industries considered by our investigation there is no market information system in place. Nevertheless, some efforts are done, especially by professional bodies. For instance, the authorized accountants body provide a classification of accounting firms in relation with certain professional criteria in classes from A to F (the interviewed companies were classified A and B), the management consultants body publish an annual report regarding the industry, the logistics professional body publish industry analyses, and provide information about events in the industry. On another hand business organizations like the chambers of commerce or third parties publish rankings of companies by sector, based on their turnover. Discussions revealed that all this information is mostly addressed and used by the firms in the industry and not by potential customers who either are not aware about the information or are not interested in it.

- Price does not play a significant role in the choice of the service provider. The only industry where some interest of the customers for price in relation with perceived quality was reported is accounting. Instead, personal relationships and social networks of either firms' executives or staff are usually the main instrument in acquiring new clients. The recommendation by former clients is also frequently a mean to initiate new transactions. Distinctively, management consultants - in principal - and sometimes computer relegated services providers have to win competitions to get public contracts or contracts with large and very large companies that organize procurement procedures. Somehow annoying, interviewee commented that even in the case of procurement procedures, personal relationships, or the history of former collaboration can weight very much in obtaining the contract. Apart from occasional participation in competitive tendering procedures, there is no observable rivalry between the components of selected industries for market share, or confrontation for acquiring new customers

- The structure of the industries is quite different:

- Accounting has the largest market as most SMEs preferred to outsource this activity because of professional responsibility and the difficulty to comply with a very ambiguous and ever changing legal and fiscal environment. The industry itself consists of a large number of small firms many of which are owned by a single person or a family. The service is provided mainly in the same locality. We found no indication of any consolidation trend. Medium and large enterprises organize the accounting in-house or outsource it to their spin-offs or specialized companies in the group, so they are not active demand bearers.

- The computer related services industry is split between large and powerful companies (including their local (national) subsidiaries, dealers, agents or representative offices that share a market of large and very large contracts, having among their clients the

government, banks and other financial institutions, multinationals and other large companies, and a large number of small enterprises that serve the SMEs market with customized, less expensive and less demanding solutions. The two strategic groups of enterprises do not interfere, apart from occasional collaborations, mainly in the form of subcontracting.

- The management consulting industry is heavily dependent on government contracts or transactions in the context of the preparation of projects founded with EU funds. Another component of the demand side of the market is represented by local branches of multinationals and very large (state owned) enterprises, but is apparently reserved to well reputed brand names, as the “big four”, for instance. When the brand is not the decisive criterion in selecting the service provider, personal relationships will be the most important instrument in obtaining a contract. When the object of the contract involves the preparation of an application for funds, having the right relationship within the founding institution can be an advantage. Occasionally, the history of collaborations between the customer and the consultant can also be an important criterion. “They know they have no problem with me in doing this job, so they will select me every time for it” said one interlocutor. The genuine demand for management consulting services from domestic medium and large enterprises, mainly related to mergers and acquisitions, is not significant. Actually, among selected industries, management consulting firms face the highest pressures. First because their market lack a natural dynamics; second, because firms that started in other industries (accounting, auditing, computer related or legal services) tend to diversify by providing management consulting services and third, because of business support services provided to SMEs by noncommercial actors (NGOs, universities etc.).

- The third party logistics industry is in an infant stage in Romania, driven by foreign direct investment. There are very few companies serving mainly large distributors.

• From interviews we understood that quality is not a day by day preoccupation for business service firms, but merely is treated more as a formal issue. For instance all the interlocutors declared that they comply with industry standards, either formal or informal. In some cases they have to comply with professional standards as required for practicing the business; this is especially the case of accounting. Some others are seeking a certification as a sign of capability, despite the fact they are skeptical about the market sensitivity to it. It is the case of management consultants and logistics experts who can individual get a professional certification issued by their professional bodies, or the computer related service providers (for example Microsoft Certified Company). Significantly, consultants are working to create a “standard for selecting management consultants” in order to stimulate the demand to discriminate between consultants on more objective criteria. All the interviewee are familiar with quality management systems standards ISO 9000 series, but none of them is aware about services quality assessment models as SERVQUAL or SERVPERF.

• Very interestingly, the cases experienced by service providers when a client will switches to another provider are accidental and quite exceptional. In the case of accounting and computer related services, most of their clients were acquired at the beginning of their activity, 10 to 16 years ago, and only very few new clients are added each year in their portfolio. They see this situation as an indication that the clients are satisfied with the quality of the service. In reality, as many of their customers did not have any experience with another provider, and have no market information readily available, or capacity to

assess the service quality in relation with its price, we understand that the switching cost is very high, as a sign of a dysfunctional market.

- The information asymmetry is influencing the relationships of service providers with their customers in various ways. Interviewees believe that it is a source of unjustified and unrealistic expectations from their clients. For instance, many clients expect that their accounting firm provide them financial management and fiscal advice which is not part of the contracted service, but it is unclear if the client understands it before, or after agreeing the price and signing the contract. In the case of computer related services frequently the client expect advice in operations management issue while the provider often considers that this exceed his obligations. From management consultants customers also expect advice in legal matters. By another hand, such situations incited service providers to diversify their activities in order to better exploit the customer portfolio, instead of developing collaboration with specialized firms. We may assume that in many cases this diversification is realized - at least at beginning- at the expense of the quality and implicitly at the expense of the customer. A very important and somehow counterintuitive finding from interviews is that the learning process during contract establishment and execution is usually very limited in practice on both parties This raises a very serious concern about the prospects of the markets under scrutiny. We were expecting that better informed customers will become more exigent making better decisions and service providers will become more innovative trying to cope with the evolving needs of their customers. We found no signs that this really happens.

- Service providers consider that they have no responsibility for the results in terms of value for the client company. Even third party logistics companies that are proud to declare that their services contribute at reducing the cost of their customers do not seem to be preoccupied of whether or not the result is slightly better or the best. We found only one example of performance based pricing, in the case of consultants. Smaller consultancy firms were obliged by market pressures to accept performance pricing for their assistance in preparing funding applications, and this practice tend to be generalized for this kind of job. In our assessment this kind of arrangement still does not solve the issue of equitable distribution of the risk between the service provider and the client company. Because the client is unable to assess the quality of the service, the service provider has the possibility to limit its effort close to the value of the retainer, thus taking no risk for the case in which the application is not successful.

Overall, from interviews we got confirmation of market dysfunctions generated by information asymmetries in several business services industries. The degree of information asymmetry vary from an industry to another, management consultancy having the characteristics of a credence good while the other service correspond better to the definition of experience goods. Quality in general and quality evaluation does not seem to be a major concern for service providers. Only among management consultants - that face the highest market pressures - we found a certain understanding of the need of a more functional market, in which customers will be able to choose providers based on proven capabilities and results against price.

4. The challenge of creating a sound business services market

In particular in the field of knowledge intensive business services, better informed public policies and public intervention are justified in order to correct market and system failures that lead to under-exploitation of their potential contribution at raising the economic performance (Rubalcaba, Gallego and Hertog, 2010). As the case of management consulting industry demonstrates, increasing rivalry among suppliers by adequate regulatory and institutional measures may determine the industries to undertake voluntarily a significant part of the effort toward a more open and competitive market. The academic world should be encouraged to intensify its efforts in producing robust knowledge conceptual means and analytic tools to address sector specific needs, as well as in disseminating knowledge in society.

The development of a sound business services market is in the interest of the economy, and therefore deliberate actions should be taken to put in place a framework that will increase market transparency, will stimulate an authentic competition between service providers and will reduce the risk of adverse selection and moral hazard.

In our view, the envisaged framework should combine regulatory and self regulatory instruments, public and private initiatives and institutional capacities, horizontal and sector specific actors and mechanisms. It will also encompass the pre-contractual, contractual and post contractual phases of the transaction, or, in other words, the provider selection, the contractual terms, the service provision, and the clearance of duties and rights between the provider and the client.

When developing such a framework, several desiderates must be considered with priority:

- **Market information availability.** Market information helps market actors in making informed choices, and in measuring ex-post their results against what would be expectable in specific conditions, or against the best performances. Market information is a public good (difficult to exclude some users, little profitable for private sector to invest in its supply), therefore it is legitimate for the Government to undertake its provision. As Akerlof (1970) noted “It should also be perceived that in these markets social and private returns differ, and therefore, in some cases, governmental intervention may increase the welfare of all parties”
- **Standardization.** Standardization permits actors to compare offers starting from a common minimum level of service quality and increase market transparency. Especially in the field of business services standardization is far less developed as in the case of tangible goods.
- **Certification and rating.** Independent certification bodies and rating agencies could bridge the information gap
- **Transparency of service providers' cost structure** should represent an effective barrier against moral hazard. One way to increase transparency of the cost structure is to improve the invoicing mechanism.
- **Performance based pricing.** Enlarging the utilization of performance based pricing (for instance, a combination of fixed price and success fee) should be an incentive for service providers to make the best efforts in the interest of their clients. It will also be an

incentive for service providers to provide relevant knowledge to their clients, as in the case of services the final performance depends on co-design and coproduction.

- Effective market supervision and redress instruments. Public bodies and sector professional associations should cooperate in ensuring trustful and in time enforcement of the established market rules, as well as equitable remedies when a party experiences a loss because of the other party's fault.

Concluding remarks

As the modern economies are dominated by services, the well-functioning and development of services' markets is crucial for the socio-economic progress. Not only services have a major contribution to GDP and employment, but also they decisively contribute to the competitiveness of the other sectors. In this context, business services, and in particular the knowledge intensive ones deserve much more attention from the business community and policy makers. The economics and business literature has drawn the attention to the problems encountered in the development of the business services industries due to quality uncertainty and information asymmetry, but a practical reaction from public authorities and market players keep expected still.

The present paper shows that the existing conceptual frameworks of service quality assessment are led by the interest of the supplier and partly inadequate for business services, thus being unable to play a role in market signaling. They also fail to properly address the issue of information asymmetry. The information asymmetry favors adverse selection and moral hazard, diminishes the market confidence and severely restricts the market development, which otherwise could bring higher benefits for everybody. We argue that policy makers and the business community should undertake coordinated and deliberate actions in order to improve the business services market framework and we enumerate six priority desiderates in building such a framework.

Rather than providing a solution, our primary goal is to animate the debate on a subject that we consider to be of a major importance for the nowadays economies.

Acknowledgement

This work was supported by CNCSIS – UEFISCDI, Project number PNII – IDEI 1858/2008 “Management Control in the Sustainable Development of the Human Resources”

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