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System Theoretical Approach to the Historical Formation of the Service Sector

17th international conference on Recent Advances in Retailing and Services Science
Organized by the European Institute of Retailing and Service Studies (EIRASS)
Istanbul July 2-5 2010

Content

- 1 History of system theory of differentiation
- 2 Assumptions of system theory of differentiation
- 3 Approach of DDR
- 4 Exemplification
- 5 Conceptualization of formation of service sector

Upon an introduction to the history and main assumptions of system theory of differentiation, my approach of a **general sequence of development** will be deduced and, after exemplification, be applied to explain the rise of services.



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Weber, Max: Grundriß der Sozialökonomik (Outline of socio-economics), in: Johannes Winckelmann, Max Webers hinterlassenes Hauptwerk - Die Wirtschaft und die gesellschaftlichen Ordnungen und Mächte (Max Weber's chief work - Economy and societal orders or powers), Tübingen, 1986.

Parsons, Talcott: Beiträge zur soziologischen Theorie (Contributions to sociological theory), 3rd edition, Darmstadt/Neuwied, 1973.

Bateson, Gregory: Ökologie des Geistes - Anthropologische, psychologische, biologische und epistemologische Perspektiven (Ecology of mind - Anthropological, psychological, biological, and epistemological perspectives), Frankfurt, 1981.

Spencer-Brown, George: Laws of form, London, 1969.

Varela, Francisco J.: Principles of biological autonomy, New York/Oxford, 1979.

Luhmann, Niklas: Soziale Systeme - Grundriß einer allgemeinen Theorie (Social systems - Outline of a general theory), 6th edition, Frankfurt am Main, 1996.

Luhmann, Niklas: Gesellschaft der Gesellschaft (Society of society), Frankfurt am Main, 1997.

The history of origins of theories of differentiation is in works of **Georg Simmel and Emile Durkheim** on social interaction or split of labor. Fundamental to system theory of differentiation, as elaborated by Niklas Luhmann, revisited and refined in my PhD, are works of **Max Weber and Talcott Parsons** on distinct social spheres of rationalities or functions, as well as works of **Gregory Bateson, Francisco Varela and George Spencer-Brown** in logic or mathematics.



- A distinction is not given but drawn.
- To draw a distinction is to construct two sides.
- One side is focused and the other side inevitably neglected.
- Differentiation might later be completed by re-entry of the other side.

From system theory of differentiation abstract statements collected, coherently arranged or advanced in my PhD, are:
 A distinction is not given but drawn. To draw a distinction is to construct two sides. Thereby, to be able to see, select, operate and be productive, **one side is focused and the other side inevitably neglected**. Differentiation might however later be complemented by re-entry of the other side.

Diffusion:

Interrelation
without
differentiation

Differentiation:

Differentiation
without
integration

Re-entry:

Differentiation
and
reintegration

These formal statements of system theory of differentiation are in my PhD for the first time shown by real macro historical developments. Development is conceptualized as **a sequence from diffusion over differentiation to re-entry**. More concretely, the first phase of diffusion means an initial state of interrelation of all dimensions without differentiation, the second phase of differentiation an intermediate state of differentiation of the dimensions but without integration, and the third phase of re-entry a possible final state of reintegration of now **independent** dimensions.

Transactional Marketing	Relationship Marketing
Straight profit orientation Differentiation of factual/social/temporal/spatial by primacy on factual which is profit in the function system of economy and in-between neglect of social, temporal, and spatial	Investments in building a relationship with the customer Reintegration of the second sides "social", "temporal", and "spatial" on the continuing primary side "factual": A twofold rise in sales potential is achieved by reduction to the distinction 'able/not able to pay at a certain price' (factual) and thereupon instrumental reconsideration of the exchange partner's characteristics, previous exchanges, and interaction (social, temporal, and spatial).
Anonymous transaction Differentiation of personal/impersonal by primacy on impersonal for exchange communication on markets and in-between neglect of personal	Personalized communication to consumers Reintegration of the second side "personal" on the continuing primary side "impersonal": Communication on markets remains nonpersonal and indifferent. To raise consumer awareness and response, information content and communication channel are personalized artificially by new technologies of data collection and data mining (database marketing).
Unidirectional mass communication Differentiation of conversational/disseminating by primacy on disseminating and in-between neglect of conversational	Direct communication to consumers and customer dialog Reintegration of the second side "conversational" on the continuing primary side "disseminating": ICT inventions, as printing machine, ousted conversation for homogenous, simultaneous, and cost effective mass market communication. Instancing direct mail and hotline, direct addressing and reply of consumers exist again by maintaining mass communication on markets.
One-off transaction Differentiation of same/different by primacy on different in terms of more and new and in-between neglect of same	Customer retention Reintegration of the second side "same" on the continuing primary side "different": A firm aims still at expanding its customer base and customers keep their exit-option. As customer acquisition, customer retention is to increase sales by repurchase, cross selling, up selling, and recommendation.
Economization of interaction Differentiation of presence/absence by primacy on absence and in-between neglect of presence	Interaction with the customer as most valuable sales communication Reintegration of the second side "presence" on the continuing primary side "absence": Along with value-oriented custom management, in the last decades key account and personal liaison management were implemented to provide special care for the firm's most valuable customers by maintaining independence of communication on markets from interaction.
No control of communication among customers Differentiation of related/unrelated by primacy on unrelated and in-between neglect of related	Referral management Reintegration of the second side "related" on the continuing primary side "unrelated": Although contemporary overload and disapproval of commercial communication (e.g. advertisement) raises the relevance of personal recommendations among customers, substantially, markets remain independent from transfer of information by interpersonal network.
Production orientation Differentiation of client/renderer by primacy on renderer and in-between neglect of client	Customer orientation Reintegration of the second side "client" on the continuing primary side "renderer": Apart from rationalization of production, firms are now also concerned to develop products, business structures and processes (e.g. complaint management) that meet customer expectations.
Exploitation of labor Differentiation of labor/capital by primacy on capital and in-between neglect of labor	Employee orientation Reintegration of the second side "labor" on the continuing primary side "capital": Whereas entrepreneurs of 19 th century industrialization did not attend to working and living conditions, education, health, and family life, the contemporary concept of corporate social responsibility reconciles for corporate purposes personnel, public, and other concerns.
Mass production Differentiation of unique/standardized by primacy on standardized for production procedures and techniques and in-between neglect of unique	Individualization of consumer benefit Reintegration of the second side "unique" on the continuing primary side "standardized": Although services and high-value goods are adjusted on demand to the respective customer's lifestyle, whenever possible the firm will endeavor to realize economies of scale and scope.
Central control of formal organization Differentiation of subordinate/chief by primacy on chief and in-between neglect of subordinate	Decentralization of formal organization Reintegration of the second side "subordinate" on the continuing primary side "chief": To allow for flexible and faster market adjustments, to release local intelligence and innovation, the concept of empowerment followed Taylor's managerial model of central vertical command by maintaining hierarchy as basic structure of formal organization.
Adoption of the rules Differentiation of contextual/generalized by primacy on generalized and in-between neglect of contextual	Legitimization (as on the level of formal organization as on the level of markets) Reintegration of the second side "contextual" on the continuing primary side "generalized": Independence from context by generalization of means and procedure enabled global market exchange. Were compliance and conformity approved up to the last generation, semantics and practices have changed to sovereign handling of rules by maintaining its principals.
Internalization of business units Differentiation of organization/network by primacy on formal organization and in-between neglect of network	Externalization of business units Reintegration of the outer side "society (consisting of other organizations)" on the continuing primary side "organization": Before about 1970, firms were concerned to set up and control business departments. Internalization was followed by outsourcing, co-operation, and resource pooling among firms for enhanced performance due to joint investment, large-scale action, and synergy effect.
Low sub- and multi-reference Functional differentiation by primacy on the system's own specific function and in-between neglect of other functions	Value chain integration and close relations to non-economic organizations Reintegration of the outer side on the continuing primary (sub)function system's inner side on the levels of organization and network: Whereas a function system is based upon differentiation and tends towards progressive sub-differentiation, in the economic function system since some decades firms show a distinct intra- and inter-functionally integrated network approach to markets.

I found this three-phase sequence from diffusion over differentiation to re-entry by [although in marketing controversially discussed but nevertheless on the levels of semantics, social technique and structure taking place](#) paradigm shift from transactional to relational marketing, with [relationship marketing indicating re-entry](#). Reintegration of the second side is illustrated in my PhD at about fifteen distinctions and constructs of relationship marketing respectively.

Level / Phase	Diffusion	Differentiation	Re-entry
Semantics	Diffusion of spatial, factual, social, and temporal by dominance of spatial: natural, spatially supported perception; no distinction betw. personal and impersonal: personal, multi topic communication among exchange partners; no difference betw. past and future state: obtainment in the future is like in the past.	Differentiation factual/social/temporal by primacy on factual (binary code, here profitable/non profitable) and neglect of social and temporal; no differentiation of spatial as discrete dimension of meaning: cognition independent from space; change from normative to factual reasoning; differentiation personal/impersonal by primacy on impersonal: nonpersonal, anonymous communication on markets; differentiation past/future by primacy on future: cognition towards expansion and customer acquisition.	Re-entry of social and temporal by continuing primacy on factual (here profit); discrete economic (factual) value attached to space: exchange communication under persons present (here interaction marketing); equal consideration and balancing out of all dimensions of communication; re-entry of personal: to communicate impersonally in a personalized way (here dialog marketing); re-entry of past: consolidation and to raise customer loyalty (here retention marketing by bonus points and other measures).
Communication Medium	Oral communication; exchange depends on individual haves and needs of the exchange partner: exchange product for product; exchange depends on context; exchange depends on negotiation and thereby personality, rhetoric skills, and continuous communication.	Development of letters; differentiation of symbolic generalized communication medium (here money) that consists of two differentiations individual/symbolic and contextual/general by primacy on symbolic and general means of communication: exchange product for money; exchange independent from individual motives and circumstances; implementation of price; exchange independent from negotiation: faceless one-off exchange; implementation of contract; implementation of global rights and regulations; standardization of making and offer: mass production.	Re-entry of individual purposes, contextual adjustments, and negotiation by continuing primacy on the symbolic generalized communication medium (here money and price); individualization of consumer benefit, local self-regulation, personalization of information content and disclosure as well as systematic development of social system history as universal communication media which increase the probability of a communication offered to be accepted.
Types of Social systems	Interaction, society, and maybe interpersonal network as the origin of social system; communication depends on interaction; what one produces, is consumed by oneself, what one creates, is owned by oneself, equal relations among human beings.	Differentiation of formal organization that consists of four differentiations interaction/organization/network/society, client/renderer, subordinate/chief, and labor/capital by primacy on organization, renderer, chief, and capital: internalization of business units, production orientation, central hierarchical control, and exploitation of labor; market observation and communication independent from interaction (due to money, price, technology, and organization); loose, unconnected market exchange.	Re-entry of interaction (here interaction marketing and event marketing) and interpersonal network (here peer-to-peer marketing and referral management); re-entry of other organizations, client, subordinate, and labor by continuing primacy on formal organization, renderer, chief, and capital: externalization of business units (here network marketing), customer orientation, decentralization as well as employee orientation and corporate social responsibility.
Societal Structure	Contextuality and locality of communication; functional diffusion and hierarchy among societal functions expressed at the macro structural level by segmentation and later social stratification of society and at the meso structural level by multiple diffuse functions of midsize social units (here guild).	Parallel process of functional differentiation (formation of modern society) and global interrelation (formation of world society) driven by the factual dimension by non-separation of factual and spatial and carried by symbolic generalized communication medium, formal organization, and network: progressive functional sub-differentiation; formal organization in the most and relevant cases as mono-functional by necessarily concurrent multi-reference; low multi-reference of formal organization.	Re-entry of subdivided societal functions (post modern society) by sustainment of functional differentiation; intra- and inter-functional re-entry as a third and cross macro structure achieved by sub- and multi-reference of formal organization and network at the meso structural level; discrete economic value attached to and extension of structures of sub- and multi-reference (here value chain integration and relationship marketing towards non-economic organizations); beyond nation-state and distance new stabilized boundaries for reestablishing communication space of medium size (post global society) attained by network.
Technology	Direct one-to-one communication and conversation; functional hierarchy of utilization of new technological innovations, e.g. post and automobile are at first reserved for military goals of the political function system.	Development of machinery for production; development of media for dissemination of news and data, such as printing machine, telegraph, telephone, television, and computer; simultaneous mass communication (here advertisement via radio, television etc.); release of technology for universal usage; dominance of production technology over technology for information and communication.	Direct and targeted communication (here direct marketing); discrete economic value attached to technologies for information and communication (here database marketing, IT marketing, e-marketing).

Personal
diversified
communication

Anonymous
mass
communication

Personalized
marketing

To exemplify, one distinction constituting, according to system theory, modern society and productivity, is **personal/impersonal communication**. This distinction is not a given. In ancient times was diffusion. Exchange of goods depended on personal and topically diversified communication. Over the course of societal transition to the modern era to increase productivity in the first instance differentiation of personal/impersonal with focus on impersonal and neglect of personal has been implemented on product markets. Since then on exchange is primarily on **utility or price**, different from former times, independent of the exchange partner's all other characteristics. Impersonal communication **accelerates** exchange. At the end of the 20th century anonymous mass communication is to increase productivity in the second instance supplemented by direct, interactive and one-to-one marketing. In system theoretical terms personalized marketing is re-entry of the neglected side of personal.

Fixed
exchange
relations

Acquisition
marketing

Retention
marketing

Another distinction constituting modernity and productivity, is **recurrence/replacement**. In preindustrial times exchange relations were permanent or exclusive. Over the course of the industrial revolution orientation changed to **expansion**. By then on acquisition only a second changeover in orientation to retention marketing, customer care and loyalty programs at the end of the 20th century show an overall twofold shift: differentiation, and, on the basis and continuity of differentiation, re-entry.

Concurrence of
goods and services

Mass production
of physical goods

Services as tertiary
sector of the economy

This developmental line from diffusion over differentiation to re-entry may as well be applied for a conceptualization of the historical formation of the service sector. Initially a supplier of goods was always also supplier of related services, such as providing support or credit. In the course of the industrial revolution differentiation of **goods/services** was implemented by primacy on mass production of physical goods, automobile as prime example, but no provision of services, car insurance or car wash center. At the end of the 20th century the neglected second side is reintegrated which is the rise of services.

Thanks for listening.

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Bielefeld, July 2010