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Price fairness perceptions and customer loyalty in a retail context

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ABSTRACT

Loyalty and fairness are major research topics in the marketing literature. However, research examining how customer loyalty and fairness perceptions affect each other is lacking. This study examines these two topics in the context of a retailer increasing its prices, develops hypotheses, and tests these hypotheses using an experimental design approach. Results indicate that loyalty has a positive effect on fairness perceptions when price increases are low, though no such effect is found when price increases are high. Also, justifiable reasons for price increases lead to increased fairness perceptions when price increases are low, but any reason offered when price increases are high increases fairness perceptions. Whether distributive or procedural fairness influences post customer loyalty in the presence of price increases is dependent on both the level of the price increase and the reason offered for the price increase. This research provides implications for retailers and directions for future research.

1. Introduction

Retailers and academicians alike exert much effort to understand how to develop loyal customers. A substantial amount of research has focused on the benefits of developing and maintaining a loyal customer base (e.g., Bolton et al., 2002; Reichheld, 1993; Reichheld and Sasser 1990; Rust et al., 2004; Storbacka et al., 1994; Woodruff, 1997). However, comparatively little empirical research is available which examines whether and how retail strategy should account for the existence of loyal customers. Many researchers acknowledge that loyal customers view the firm more favorably than do other customers (Berry, 1995; Bolton et al., 2002; Price et al., 1995). Moreover, loyalty to a firm can result in customers' willingness to endure obstacles in order to maintain certain relational benefits (e.g., confidence, social, and special treatment) that only loyal customers are likely to experience (Gilliland and Bello, 2002; Gwinner et al., 1998).

However, empirical research regarding loyalty suggests that loyal customers may have higher expectations of the retailer than non-loyal customers in some situations. For example, under conditions of high price inequity, customers with high shopping frequency tend to have more negative perceptions of fairness than do customers with low shopping frequency (Huppertz et al., 1978). Also, customers' service quality expectations have been found to be positively related to the duration of their relationship with the firm (Heilman et al., 2000). Despite these findings, research directly investigating the differential effects of customer loyalty on fairness perceptions is lacking from the literature.

As fairness is antecedent to trust (Buttle and Burton, 2002), which is in turn antecedent to loyalty (Morgan and Hunt, 1994), the practices of retailers seeking to develop and maintain loyal customers should be interpreted as fair among their customers. One of the most prominent practices of retailers is their method of deriving prices. Customers' perceptions of the fairness of prices have been identified as a major area of interest due to public concern over the topic (Xia et al., 2004). Price increases are generally seen as unfair by the firm's customers, especially if the reason for the increase is unjustifiable (Xia et al., 2004).

While the fairness literature has identified two major facets of fairness, namely, distributive and procedural fairness (Adams, 1965; Deutsch, 1975; Lind and Tyler, 1988), these facets of justice have not been differentiated in previous research regarding price increases (e.g., Vaidyanathan and Aggarwal, 2003). As these have been identified as distinct constructs (Chebat and Slusarczyk, 2003; Smith and Bolton, 2002), research examining fairness related to prices should discriminate between these types of fairness.

The purpose of this research is twofold. The first is to examine the effects of customer loyalty on customers' fairness perceptions related to price increases. The second is to examine the reciprocal effects of fairness perceptions on post-price increase customer loyalty. In this study, literature regarding fairness and customer loyalty is reviewed, several related hypotheses are presented, and results of empirical research are discussed. Implications for researchers are also provided as well as future research directions.

2. Literature review

2.1. Fairness

Fairness is the belief of the justice of an outcome, process, or interaction (Bolton et al., 2003). Consistent with the fairness

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literature, the terms “fairness” and “justice” are used interchangeably in this study. Perceptions of fairness are necessary if the reputation and credibility of the firm are to be advanced, both of which can translate into competitive advantage (Herbig and Milewicz, 1993; Morgan and Hunt, 1994). For instance, customers' perceived fairness of a retailer's actions can affect customer retention (Chebat and Slusarczyk, 2003). Further, a belief that an outcome, process, or interaction is unjust tends to result in a global perception of unfairness (Bolton et al., 2003; Seiders and Berry, 1998).

Though other means are useful for gauging fairness (e.g., interactional fairness), the most prominent in the literature are distributive fairness and procedural fairness (Chebat and Slusarczyk, 2003; Smith and Bolton, 2002). Distributive fairness relates to an individual's perception of resource allocation or the outcome of an exchange (Adams, 1965; Deutsch, 1975). Three principles underlie distributive fairness: equity, equality, and need (Seiders and Berry, 1998). Equity concerns relate to customers' expectations to receive a certain level of benefits that is commensurate with their costs of acquiring those benefits. For instance, customers who patronize a small clothing store three times a week will expect to receive some level of preferential treatment. The equality principle states that similar customers should be treated alike. Restaurant patrons, for instance, expect that servers will not give unequal amounts of treatment to similar customers. However, the need principle asserts that individuals with greater need should receive greater assistance. For example, individuals waiting in an emergency room with a cold would not normally expect to be treated before another individual who is having a heart attack.

Procedural fairness relates to the processes, methods, and rules used to derive outcomes (Leventhal, 1980; Lind and Tyler, 1988). Six principles underlie procedural fairness: consistency, bias-suppression, representativeness, accuracy, correctability, and ethicality (Seiders and Berry, 1998). Consistency of retailer practices relates to whether the processes used to derive outcomes are unchanging. Bias-suppression and representativeness ensure that customer discrimination based on non-relevant attributes (e.g., gender, race, or ethnicity) does not occur, or else is prevented when reasonably possible (e.g., handicap accessibility). Accuracy is concerned with providing accurate and reliable information. Correctability minimizes the effort customers must expend to correct mistakes, particularly those of the retailer. Likely to be the most important of these principles, customers expect retailers to act ethically in all situations.

While no one facet of justice is entirely responsible for customers' price fairness perceptions, research regarding pricing indicates that procedural fairness may be more important to individuals than distributive fairness. For instance, perceived firm motives in determining prices have been found to be very influential in determining customers' fairness perceptions (Campbell, 1999; Dickson and Kalapurakal, 1994; Kahneman et al., 1986; Kalapurakal et al., 1991; Vaidyanathan and Aggarwal, 2003). If the retailer adheres to a pricing policy considered by its customers to have a negative motive, customers are likely to perceive a violation of the procedural justice principle. Consequently, these customers' fairness perceptions are likely to be adversely affected, even though the resulting price, in and of itself, may be considered equitable (Campbell, 1999; Kahneman et al., 1986).

2.2. Customer loyalty

Defining loyalty has been problematic for many researchers, mainly due to imprecise and varying conceptualizations of the construct. Historically, loyalty has been characterized and measured strictly as a behavior, typically the degree to which or propensity of the customer to engage in repeat purchasing (e.g., Brown, 1952; Day, 1969). However, the link between behavioral loyalty and profitability has been found to be much weaker using this definition (Dowling and Uncles, 1997; Reinartz and Kumar, 2000, 2002). Further, defining loyalty as a behavior does not take into consideration that customers may engage in repurchasing merely out of convenience or due to a lack of reasonable alternatives (Jones et al., 2002). Loyalty which is only behavioral in nature has been defined as “spurious loyalty” (Dick and Basu, 1994).

Some researchers view loyalty from an attitudinal perspective with the argument made that loyalty is a desire or intention to repurchase (Czepiel and Gilmore, 1987). Nevertheless, consumers may have a high relative attitude toward a brand that they have no intention of purchasing. For instance, a college student may believe that Ferrari makes the best automobiles in the world, though the student may believe that he or she will never have the funds to purchase one. Thus, relative attitude alone may indicate that only “latent loyalty” is present among customers (Dick and Basu, 1994).

Recent research redefines loyalty as both a behavioral and attitudinal construct (Kumar and Shah, 2004). In keeping with this two-dimensional conceptualization, customer loyalty is defined here as an attitudinal preference for the retailer accompanied with strong repeat purchase behavior (Dick and Basu, 1994; Kumar and Shah, 2004; Oliver, 1999).

Loyal customers are more likely to concentrate on long-term benefits from the relationship and are more willing to work with the retailer to develop mutual benefits than non-loyal customers are (Bazerman et al., 1995; Doney and Cannon, 1997; Ganesan, 1994; Morgan and Hunt, 1994). Loyal customers are willing to maintain these benefits even if they incur costs in doing so. Thus, customer loyalty involves a willingness of customers to forego their own interests, to a certain extent, in the interests of maintaining their relationship with the retailer (Crosby and Taylor, 1983; Gilliland and Bello, 2002).

3. Development of hypotheses

3.1. Polarization of fairness beliefs

Substantial conflict is present in current research examining loyal customers' perceptions of negative firm actions, such as price increases or service failures. Loyal customers are willing, on some level, to put aside their own needs in an effort to maintain their relationship with the retailer (Crosby and Taylor, 1983; Gilliland and Bello, 2002). For instance, loyal customers tend to respond more favorably to service failure recovery efforts (Hess et al., 2003). However, research regarding customer loyalty is unclear as to whether loyal customers always respond more positively to hardships than non-loyal customers. For instance, under conditions of high price inequity, customers with high shopping frequency perceive price increases to be less fair than do customers with low shopping frequency (Huppertz et al., 1978). In addition, customers' service quality expectations are positively related to the customer–firm relationship duration (Heilman et al., 2000). Though shopping frequency and customer duration are not precise proxies for loyalty, these findings do raise the question as to whether customer loyalty leads to greater expectations of the firm. Following are hypotheses posited with the intention of resolving this apparent conflict in the loyalty literature.

Since loyal customers have a desire to maintain their relationship with the retailer, they are more tolerant of the retailer's relatively minor negative actions (e.g., small price increases) than are non-loyal customers (Hess et al., 2003). Hence, loyal customers are more likely to view minor price increases as normal and fair than non-loyal customers.

Nevertheless, loyal customers do expect retailers to reciprocate their desire to maintain their relationship and believe that they deserve special treatment. Long-term customer–firm relationships have been compared to the marriage of husbands and wives (Levitt, 1983). Similar to a marriage, loyal customers presume that their opportunity costs (e.g., reduced options) will be offset by certain