



# Determining adequate tangible compensation in service recovery processes for developed and developing countries: The role of severity and responsibility



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## ABSTRACT

This study examines effects of different compensation types on satisfaction with the service recovery in different failure severity and responsibility conditions. We additionally integrate cultural and economic developmental differences by studying two completely different countries (Madagascar and Switzerland). We propose a framework based on social exchange, regulatory focus, and attribution theories to explore differences in satisfaction with service recovery across these countries. The empirical results indicate that satisfaction with service recovery as a consequence of using different types of tangible compensation varies considerably depending on cultural and person-specific factors.

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## 1. Introduction

As services are variable, intangible, and dependent on service providers and customers as well as produced and consumed simultaneously (Boshoff, 1997; Zeithaml et al., 1985), it is difficult to generate or even increase customer satisfaction and retention. Moreover, these service characteristics imply a high risk of service failures. Thus, effective service recovery plays an important role in (re-)establishing customer satisfaction. Service recovery refers to corrective actions taken by service providers such as offering (in) tangible compensation in order to generate positive customer responses (Zemke and Bell, 1990). Tangible compensation consists of offering economic benefits to customers such as a refund of money, discounts or coupons for future purchases (Del Río-Lanza et al., 2009), and has been shown to have persistent effects on customer satisfaction over time (Fang et al., 2012). Intangible or psychological compensation consists of simple and inexpensive social actions that aim to recover service failures, for example showing concern, apologizing, providing an explanation, or a manager intervention (Mattila, 2006; Simon, 2013; Sparks and McColl-Kennedy, 2001; Tsai and Su, 2009).

The purpose of the study presented here was to examine the appropriateness of the four most common types of tangible compensation in economically developing compared to developed countries. The target variable analyzed here is customer satisfaction with the service recovery (SSR), which can be defined as the customer's favorable evaluation toward the service recovery effort (Webster and Sundaram, 1998). This variable is appropriate in the context considered here because it directly captures customers' reactions to service recovery efforts and has important effects on overall satisfaction, repurchase intent, and positive word-of-mouth (Cambra-Fierro et al., 2013; Orsingher et al., 2010; Roschk et al., 2013; Sabharwal et al., 2010; Spreng et al., 1995).

As service providers in developing countries usually have less financial service recovery means than service providers in developed countries, the formers might be interested in knowing whether and under which conditions less expensive types of compensation such as a gift or a discount are sufficient. The countries under study are Switzerland as representing a developed country [1] and Madagascar as representing a developing country [2] because these countries were not covered by previous studies. Previous cross-national studies on service recovery focused on comparisons of American, Asian and European countries (e.g., Chan and Wan, 2008; Gruber et al., 2011; Mattila, 1999a; Mattila and Patterson, 2004; Sizoo et al., 2011). Furthermore, it is interesting to study consumers' reactions to different service recovery attempts in these two countries because, on the one hand, they differ with regard to the level of development, but the other hand,

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in both countries, the service sector generates over 50 percent of the gross domestic product.

In order to create realistic situations, the respective types of tangible compensation (small gift, 25% discount, credit for future purchase/consumption, refund) were systematically combined with typical types of intangible compensation, but the study focus was on the effects of tangible compensation because tangible compensation is associated with costs. The types of compensation examined here are the ones that are most often described in service recovery literature. These four types of compensation were chosen because they were expected to be perceived differently by the customers and thus have different effects. Customers might interpret a small gift in terms of a nice gesture of the service provider intended to signal the service provider's concern about the service failure. A discount represents a partial refund and thus a modest type of compensation (Wirtz and Mattila, 2004) that partly compensates for the failure experienced (Kelley et al., 1993). A refund, which consists in the full reimbursement of the price paid, is a generous type of compensation and can generate positive customer reactions, but according to Folkes (1984) customers who get this type of compensation might not come back again. If a credit for future consumption of the same value is offered instead, this assures that a customer will come back to this service provider (Kelley et al., 1993), which is more beneficial from the service provider's perspective.

A further differentiation was made for failure severity (FS). Failure severity in terms of the intensity of the failure perceived by customers (Weun et al., 2004) and thus the loss that consumers associate with a failure (Hess et al., 2003) was included here because previous research did not systematically examine effects of different types of tangible compensation under different FS conditions although existing studies provide the notion that FS determines the appropriateness of service recovery measures (Smith et al., 1999; Weun et al., 2004) and that customers' service recovery expectations depend on FS (Craighead et al., 2004).

The study presented below additionally differentiates for the responsibility for the service failure (RSF), thus for whether the customer or the service provider is responsible for the failure. Attribution of responsibility refers to consumers' judgments about who caused a negative event and can have effects on consumers' subsequent emotions, attitudes, and behaviors (Folkes, 1984; Weiner, 1985). In the context of service failures, responsibility attribution is believed to have effects on the type of compensation expected by customers. This variable is considered here because, on the one hand, previous studies suggest that consumers think about who is responsible for a service failure, and, dependently on their responsibility perceptions, react differently to service recovery measures (Grewal et al., 2008; Hocutt et al., 1997), but on the other hand, previous research did not examine the appropriateness of different types of tangible compensation in the alternative responsibility conditions.

We also included several control variables such as cultural differences, service involvement, and attitude toward complaining (ATC) in the study because these variables might also affect customer satisfaction (De Matos et al., 2009; Webster and Sundaram, 1998). Culture can be referred to as collective mind sets shared by consumers, which make the distinction between people belonging to one group from those belonging to another (Hofstede, 2001). Service involvement refers to the perceived personal relevance a consumer ascribes to a service (Celsi and Olson, 1988). ATC is an individual's tendency to claim compensation from the firm when s/he is dissatisfied with a product (Richins, 1987).

The study presented here contributes to the existing body of service recovery research by systematically showing in which conditions which types of compensation lead to high SSR. Taking into account important factors such as the state of economic

development of the consumers' country, cultural variables, responsibility for the failure, and failure severity, the study provides interesting new insights. The results of the study presented here contribute to previous research by showing which types of compensation are most appropriate in situations that are characterized by different levels of failure severity and different responsibilities for the failure for countries that are characterized by different levels of economic development. In addition, we show how possibly biasing variables can be controlled for in the data analysis in such a context.

Furthermore, the findings presented here enable managers to develop country-specific service recovery strategies that are appropriate to address service failures in an efficient and cost-effective manner.

## 2. Literature review

As no previous study covered the research objective described above, several studies that examined more basic effects of the variables that are of interest here will be presented and discussed in the following.

### 2.1. Effects of (in)tangible compensation

Goodwin and Ross (1992) found that apologizing and expressing feelings enhance satisfaction and that these effects are stronger if the measures are accompanied by a 10% discount. Kelley et al. (1993) used the critical incident technique and discovered that offering discounts and correcting the failure lead to high levels of customer retention whereas a manager or employee intervention, product replacement, apologies, refunds, and store credits are less effective. Conlon and Murray (1996) found that offering a coupon in response to a customer complaint leads to a higher likelihood of doing future business with the company than offering no coupon. The results of Webster and Sundaram (1998) provide the notion that, in highly (less) important situations, an offer to re-perform the service (offering a 50% discount) leads to the highest levels of satisfaction. An apology triggers the least positive reactions across low and high importance. Miller et al. (2000) found that offering intangible and tangible compensation leads to higher loyalty, satisfaction with the recovery process, and better retention than providing only intangible compensation. The results of Sparks and McColl-Kennedy (2001) show that, under specific conditions, showing concern can lead to high satisfaction. Wirtz and Mattila (2004) found that, if an immediate solution is offered, an apology without compensation leads to the same level of satisfaction as offering the compensation in combination with an apology. The results of Del Río-Lanza et al. (2009) show that the methods and policies used to deal with complaints have the strongest impact on SSR, while tangible compensation and relationship perceptions have less strong effects.

Only the study of Kelley et al. (1993) dealt with more than two types of tangible compensation. However, they only identified several types of compensation using the critical incident technique. This technique leads to the reporting of different service recovery situations across respondents, which can bias the results and limit the range of interpretation. Kelley et al. (1993) found that most service providers prefer to offer store credits for future purchase rather than refunds, but that customers do not value this strategy. Thus, it is necessary to systematically examine the impact of several types of tangible compensation on SSR in a new empirical study where all customers are faced with the same service recovery situation. The analysis presented here goes beyond what was done in previous studies by considering all

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