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Discount reference moderates customers' reactions to discount frames after online service failure

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ABSTRACT

This paper aims at investigating customers' reactions to discounts as service recovery offered in context of an online store. It argues that customers prefer dollar-off discounts to percentage-off discounts. The present research also argues that for discounts on price of one item out of several items, customers evaluate dollar-off discounts more positively (i.e., higher satisfaction and lower anger), while for discounts on the total price, customers react similarly to percentage-off and dollar-off discounts. Two online experiments confirm these arguments. This research discusses the importance of discount reference in online service recovery and represents effective service recovery regarding discount reference and discount frame as its practical implications.

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1. Introduction

The development of the Internet has given rise to the popularity of online shopping (Chen & Cheng, 2009; Lian & Lin, 2008). Oftentimes, shoppers order multiple items together to pay only one shipping fee instead of individual shipping fees on each item and even save time through performing only one transaction (1), which may also lead to less psychological costs due to performing fewer transactions. In such cases, when a problem occurs in delivery, the problem may not be with one item only but with all items that a customer has purchased together. As a common remedy, retailers may offer discounts, hoping to reduce customer dissatisfaction with a delivery failure incident (Harris, Grewal, Mohr, & Bernhardt, 2006). However, the question here is whether a retailer should offer discounts on the price of the single item that has led to delivery failure of all items or they should provide discounts on the total payment (i.e., the price of all items purchased together). How would this change of reference impact customers' reactions to recovery discounts for online service failures? In addition, would customers react more positively to percentage-off or dollar-off discounts? These are the questions that this research addresses.

Research demonstrates that compensation can work as effective recovery, since it increases satisfaction (Chandrashekar, Rotte, Tax, & Grewal, 2007; Roschk & Gelbrich, 2013) and reduces customers'

negative emotions (Smith & Bolton, 2002) such as anger (Bonifield & Cole, 2007). Existing research views discounts as the most common type of recovery compensation (e.g., Blodgett, Hill, & Tax, 1997; Bonifield & Cole, 2008; Gelbrich, Gätthke, & Grégoire, 2015; Smith & Bolton, 2002).

Service providers and retailers can frame their recovery discounts either in percentage or in dollar. In fact, service recovery literature has mostly focused on offering percentage-off discounts (e.g., Blodgett et al., 1997; Gelbrich et al., 2015; Goodwin & Ross, 1992; He, Chen, & Alden, 2012; Mattila, 2001; Mattila & Cranage, 2005; Mattila & Patterson, 2004; Patterson, Cowley, & Prasongsukarn, 2006; Smith & Bolton, 1998; Smith & Bolton, 2002; Smith, Bolton, & Wagner, 1999; Sparks & McColl-Kennedy, 2001; Wirtz & Mattila, 2004), and therefore majority of the existing conclusions on the effectiveness of recovery discounts is drawn from customers' reactions to percentage-off discounts. On the other hand, there are few studies that have investigated customers' reactions to dollar-off discounts (e.g., Bonifield & Cole, 2008; Grewal, Roggeveen, & Tsiros, 2008). However, since the existing research has not contrasted customers' reactions to percentage and dollar frames, existing conclusions on the effectiveness of recovery discounts in either frame may seem to be similar, which may not be true. For example, service recovery research has shown that percentage-off discounts (Blodgett et al., 1997) or dollar-off discounts (Bonifield & Cole, 2008) reduce customers' engagement in retaliatory behavior. This leaves one wondering about the effectiveness of dollar-off discounts versus percentage-off discounts, which requires further investigation to test the effectiveness of discount frames and find out which frame works more effectively and under which condition.

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In response to the above issues, the current research contrasts customers' reactions to percentage-off discounts with dollar-off discounts, based on different reference points. This research proposes that customers react more positively to dollar-off discounts than to percentage-off discounts. In addition, the present research argues that when a retailer offers discounts on price of one item, customers prefer dollar-off discounts to percentage-off discounts; when a retailer offers discounts on the total price, customers react equally to both frames. Across two studies, this research indicates that although service recovery literature has mostly focused on percentage-off discounts, customers react more positively to dollar-off discounts. Importantly, the results indicate that by offering a small proportion of discounts (30%) based on appropriate reference, retailers can effectively recover from online service failures.

2. Background and hypotheses

2.1. Customers' reactions to discount frames after service failure

To better understand customers' reactions to discount frames, this research borrows insights from pricing research, which demonstrates that customers are unwilling to compute percentage-off discounts (DelVecchio, Krishnan, & Smith, 2007; Suri, Monroe, & Koc, 2013) because of additional procedures that customers should do to understand their values (DelVecchio et al., 2007). In particular, for percentage-off discounts, consumers should consider the base price and compute the percentage off the base price. Then, they need to subtract the calculated proportion from the base price. This requires an additional step of processing the proportion of the discount. The multiplication process is a relatively difficult task, making percentage-off discounts more difficult to calculate than dollar-off discounts (DelVecchio et al., 2007). These additional steps can lead to math anxiety associated with computation of percentage-off discounts (Suri et al., 2013) or to a state of uncertainty about the accuracy of computation of these discounts (DelVecchio et al., 2007).

From above, this research argues that offering percentage-off recovery discounts requires customers to deal with the additional steps of calculating a percentage off the base price and then subtracting it from the base price. This is contrary to the procedural aspect of service recovery, which can, in turn, impact the recovery outcome (Smith et al., 1999; Tax, Brown, & Chandrashekar, 1998). Procedural justice is concerned with customers' overall perceived fairness of the way a company handles its recovery process (Gustafsson, 2009; Smith et al., 1999). A company can provide fair outcome (high discounts or full refund), but the customer might still think the recovery process has been unfair (Maxham & Netemeyer, 2003). This can explain why every fair outcome does not necessarily lead to overall fair evaluations because the recovery process may not seem fair (Hoffman & Kelley, 2000; Kelley, Hoffman, & Davis, 1994). On the other hand, when people perceive procedures as more fair, they have better evaluations of their outcome (Schroth & Pradhan, 2000).

Accessibility of recovery efforts is an important dimension of procedural justice (Blodgett et al., 1997; Tax et al., 1998). This suggests that the ease of the recovery process can determine customers' evaluations of the recovery outcome. In particular, Tax et al. (1998) argue that procedural-distributive aspect of recovery emphasizes that customers should be able to redeem compensations offered to them without any additional/unnecessary efforts (e.g., receiving discount at the first recourse to a store not the third one).

The conclusion from the above discussions is that because percentage-off discounts require customers to do some additional steps to find out the real values, they are less reflective of recovery fairness compared to dollar-off discounts. This effect is even more pronounced in context of the current pricing strategies that instead of round prices, tend to have prices ending in 9 (e.g., Stiving & Winer, 1997) or decimals (e.g., Aalto-Setälä & Halonen, 2004). This can add to

the degree of the above complexity and make the process even more difficult. Therefore, this research proposes that dollar-off discounts are much easier for customers to understand since they do not require any additional steps of calculation, compared to percentage-off discounts. Formally,

H1. Customers will have higher recovery satisfaction with dollar-off discounts than with percentage-off discounts.

In addition, research indicates that anger is the most prevalent emotional reaction to service failure (Kalamas, Laroche, & Makdessian, 2008; McColl-Kennedy & Smith, 2006). However, effective recovery can reduce customers' anger and increase acceptance of service recovery (Bonifield & Cole, 2007). This research argues that percentage-off and dollar-off discounts can have different impacts on customers' anger, due to customers' fairness perceptions of each of these frames.

Research indicates that fairness perceptions can reduce customers' negative emotions after service failure (del Río-Lanza, Vázquez-Casielles, & Díaz-Martín, 2009). Fairness theory predicts that when individuals think the procedures could have been more fair, they experience states of anger (Cropanzano, Weiss, Suckow, & Grandey, 2000). In particular, Krehbiel and Cropanzano (2000) find that when unfavorable outcomes coincide with unfavorable procedures, individuals engage in high states of anger. Similarly, Mark (1985) conclude that procedural injustice (i.e., low procedural fairness) elicits more anger. On the other hand, Hegtvedt and Killian (1999) conclude that people who perceive a process as fair are less involved in negative emotions. In addition, states of anger can determine customers' evaluations of service recovery (Bonifield & Cole, 2007). Following the discussion on customers' fairness perceptions of discount frames, this research argues that since offering dollar-off discounts is more in line with fair recovery procedures than percentage-off discounts, dollar frame may lead to lower anger and have a better impact on customer satisfaction. Therefore,

H2. Customers will have lower anger with dollar-off discounts than with percentage-off discounts.

H3. Anger will mediate the effect of discount frame on satisfaction.

2.2. The impact of discount reference

Existing service recovery research has addressed different sizes of discounts (Bonifield & Cole, 2008; Gelbrich et al., 2015; Smith et al., 1999). For example, Smith et al. (1999) test customers' reactions to 20% and 50% discounts and conclude that bigger discounts lead to better evaluations. Bonifield and Cole (2008) investigate customers' evaluation of different levels of discounts (zero, \$40, \$100, and \$400) and find that bigger discounts lead to better evaluations of the recovery outcome and lower retaliatory intentions. Gelbrich et al. (2015) study customers' evaluations of 11 levels of discounts (ranging from 0% to 200%) and find that customers' intentions to accept or reject recovery efforts determines minimum and maximum discount necessary to keep them satisfied. Nevertheless, big discounts (50% and above) may elicit negative reactions in customers (Sparks & McColl-Kennedy, 2001), since these discounts may imply that the intensity of service failure has been bigger than customers' perceptions. This casts doubt on the effectiveness of big discounts. Therefore, what can be a solution to this problem?

In many cases, service failure due to problem in one product/aspect out of several products/aspects leads to a failure in the whole experience. For example, in research by Smith and colleagues (Smith & Bolton, 2002; Smith et al., 1999), failure experiences at a restaurant setting include "the restaurant is out of entrée you selected", "the restaurant is also out of your second choice of entrée", and "He (the waiter) doesn't fill your beverages while you're eating". In such cases, failure in one aspect of service is generally described as service failure, and one can say that "I had a bad experience." Now the question is that

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