Online purchase return policy leniency and purchase decision: Mediating role of consumer trust

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ABSTRACT

Recasting prior work on return-policy and purchase intentions literature, through the lens of signaling theory and relational signaling theory, we posit that returns policy, as a market signaling mechanism, is a costly investment that online retailers make to not only support current transaction but also to signal commitment towards customer service. What outcome would such costly signal result into? Based on relational signaling theory, it promotes trust, that in turn, could enhance purchase intentions. With empirical data from 730 online consumers of fast-moving consumer goods in Sweden, the study finds that, after controlling for shoppers' age, education, income, gender, and frequency of online purchases, perceived consumer trust fully mediates the effect of perceived return policy leniency on purchase intention. Building on past research, we apply a different theoretical lens that connects costly signaling that drives relational signaling to foster customer trust to improve purchase intentions.

1. Introduction

In a recent meta-analysis of 21 studies on the leniency of return policy, Janakiraman et al. (2016) found return policies do in fact benefit retailers—at least in terms of encouraging purchase proclivity. Lenient return policy is a costly signal for the current purchase (Spence, 1981, 1973), however, we ask how such signals could impel behavioral mechanisms that influence future purchase proclivity. Based on relational signaling literature, costly signals related to lenient purchase provide a solidarity frame towards the online retailer to foster perceived customer trust in the online retailer (Six et al., 2010; Six and Sorge, 2008; Six, 2007). Connecting the signaling literature on return policy to purchase intentions could through the lens of relational signaling helps further unpack the link between leniency in returns and future purchase intentions. Continuing from prior literature, we draw on signaling theory to interpret the leniency in returns and propose online retailer trust, driven by relational signaling, as a mediator that would help increase purchase intentions.

The proposed research question differs from previous research on the following basis.

As such the proposed framework of returns policy influencing trust that in turn influencing purchase intentions, is undergirded by the intertemporal component in online purchasing – retailer invests in a costly signal of lenient returns, that results in development of trust beyond that in the current transaction or willingness to pay (Rao et al., 2017), that in turn, translates to purchase intentions. The need to understand perceived customer trust in the retailer as an important mediator is rooted in three recent studies. Janakiraman et al. (2016) find in a meta-analysis that return leniency has a direct positive effect on purchase and return behaviors. However, according to their meta-analysis, the mediating mechanisms that explain how returns translate to purchase intentions is less understood. While a recent study by Pei et al. (2014) shows that the depth of a firm's return policy is associated with consumers' perception of leniency of the return policy and purchase intention, it is limited to leniency perception in the present transaction, while we focus on trust in the retailer in general. In a study of 4000 consumers, Lantz and Hjort (2013) find that a free return policy is associated with an increased order frequency, an increase in probability of return, a decrease in average value of orders and a decrease in the average value of purchased item. Their large-scale study could be complemented by understanding the role of a mediator, trust in the retailer.

Second, while studies on returns leniency have focused on customer trust generally specific to the transaction. As in, returns leniency increases trust in online purchase where return policy facilitates a costly signal to assuage risk associated with a current purchase transaction.
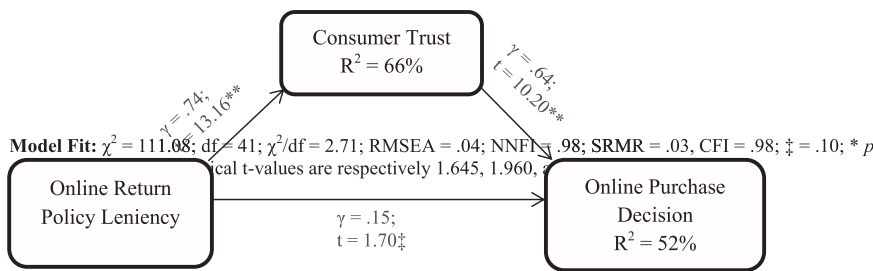
Fig. 1. Results of structural equation modeling. **Model Fit:** $\chi^2 = 111.08$; df $= 41$; χ^2/df $= 2.71$; RMSEA $= .04$; NNFI $= .98$; SRMR $= .03$, CFI $= .98$; ‡ $= .10$; * $p < .05$; ** $p < .01$. α $=$ critical *t*-values are respectively 1.645, 1.960, and 2.326 (two-tailed test).

Lenient returns policy as an antecedent to trust in online retailer is less explored. Previous studies have examined the role of company characteristics, website design (Cyr, 2013), culture (Carlson et al., 2015), information quality (Daliri et al., 2014), design features (Huang and Benyoucef, 2013), social presence cues (Shrivastava et al., 2016), personalization (Aguirre et al., 2015), privacy level (Mukherjee and Nath, 2007), and third-party guarantees (Clemons et al., 2016). Studies involving consumer trust have shown that system trust (seals, guarantees, and ratings) influences consumer perceived trust in an online vendor, which in turn increases the consumers' intention to purchase from such an online vendor (Badrinarayanan et al., 2014; Dabholkar and Sheng, 2012). Moreover, consumers' trust in their pre-purchase decision making positively affects the consumers' intention to purchase (Bock et al., 2012; Kim, 2012).

Considering the two about points, we aim to develop theoretical explanations to assess how signaling influences trust that in turn influences purchase decisions. The connection between lenient returns and future purchase intentions as a critical 'bridge' component that is absent–development of perceived trust in the retailer.

The theoretical basis of our paper in signaling theory and relational signaling theory. In online purchase transactions a seller and a buyer have access to different information, resulting in information asymmetry. Because the information a seller sends out to targeted consumers about its abilities to undertake a particular task may be viewed as a signal (Connelly et al., 2011). Typically, sellers choose how they signal information, and the consumer chooses how to interpret and act on the signal received (Connelly et al., 2011). A signaling theory helps this study further explain how information asymmetry can be reduced through lenient returns policy, a visible and a costly to imitate signal (Spence, 1981, 1973).

The other theoretical basis is relational signaling framework, a bridge to explain how trust may be realized by costly signal of lenient returns. Relational signaling theory "based on the assumptions that rationality is bounded through framing, that preferences are partially determined by altruism (through a distinction between foreground and background goals), and that an individual's action is influenced by the normative context in which he or she operates," is central to trust building (Six, 2007: page 285). Through the relational signaling theory lens, signaling through lenient returns policies help foster trust through limited " opportunistic behavior, [creating] positive relational signals, avoiding negative relational signals, [and] the stimulation of frame resonance, or the introduction of trust-enhancing … policies" (Six, 2007: page 285). Overall, we explain the link between lenient returns → trust → purchase intentions through the relational signaling theory lens. We make the following contributions.

First, we reason that the return policy would lower risk from current purchase, but also provide a relational signaling approach to understand how future purchase intentions emerge. Retailers who are willing to make a costly commitment through lenient return policy induce necessary trust among customers through relational signaling.

The willingness to accept vulnerability through more lenient returns policy allows customers to perceive greater reliability (Chang et al., 2013; Janakiraman et al., 2016) as they trust the online retailer more for willingness to be vulnerable through more lenient return policies. Lenient return policy provides a solidarity frame to the customer towards future transactions, thereby strengthening future purchase intentions. Second, while studies have examined the direct effect of consumer trust for a brand on purchase decisions, we advance the idea that online shoppers' trust for an online store is a critical link in translating return policy leniency into future purchase decision. The logic backing this contention is anchored in relational signaling theory, which suggests that consumers evaluate stores' return policies in committing themselves to future exchange relationships – purchase intentions. Thus, online purchase return policy leniency can influence online shoppers' purchase decision making via online shoppers' trust for an online vendor. Through the data presented in Fig. 1, this study argues that the effect of perceived online return policy on consumer purchase decision is manifest through online shoppers' trust in an online store.

The structure of the paper is as follows. We begin by reviewing the current literature regarding signaling theory and relational signaling in the context of online retailing literature, providing our hypotheses as well as relevant support from the existing literature. In the next section, we detail the research method utilized, followed by our analyses and findings of the study. Finally, we provide a discussion of our findings, their implications, the limitations of our study, as well as areas for potential future research.

2. Theoretical background and hypotheses

Online retailing environment considerably increases challenges to fully assessing the quality and feel of the product. The spatial gap between the actual product and the purchase location add significantly to perceptions of risk in making purchase decision and time lapse between making the decision and receiving the product add to several challenges to the purchase process. While seller descriptions do provide necessary product details, and many online portals are using virtual reality as a mode to improve the purchase experience, and customer also rely on product reviews and word of mouth to assuage risks in online purchases, a significant amount of uncertainty remains in online sales experience. Seller, with a considerably more information about the product, has information asymmetry with the buyer. Consistent the solution for adverse selection, the seller must invest in costly signals to communicate unobservable quality and the willingness to incur costs to make up for frictions in asymmetric information based online purchases (Basuroy et al., 2006).

Lenient returns policy is a signal of formalized reverse logistics operations and the online retailer's commitment to service recovery (Autry, 2005). Lenient returns policy is a service recovery process necessary to lower customer turnover and increase revenue (Jung and