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Managing Complaints to Improve Customer Profitability☆

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Abstract

In this study, the authors aim to understand whether, to what extent, and under what circumstances, organizational responses to customer complaints improve customer profitability. To do so, they build upon the congruence approach and propose a contingency framework in which the effectiveness of three organizational responses to customer complaints (timeliness, compensation and communications) in improving customer profitability is contingent upon the strength of the relationship and the type of failure. The framework is tested empirically in the financial services industry applying latent class techniques to longitudinal data for a sample of complaining customers. The results reveal that: (1) different complaint-handling initiatives affect customer profitability differently for each of the four segments of complaining customers that are obtained; (2) these heterogeneous responses to complaint handling are explained by differences in the orientation of the relationship and in the failure context; and (3) complaint-handling initiatives are more (less) effective at improving customer profitability when the benefits they offer strongly (poorly) match the benefits sought by customers in each segment to recover from the failure. These results contribute to a better theoretical understanding of customers' heterogeneous responses to complaint handling and offer managerial recommendations to allocate marketing resources across alternative complaint-handling strategies to improve profitability.

Keywords: Customer profitability; Service failure; Complaint handling; Contingency framework; Congruence approach; Latent class modeling

Introduction

"Unless decision makers fully understand customer complaint behavior and can quantify the return on investment (ROI) of complaint handling, they won't see the link between complaint handling and loyalty and profits, and it's unlikely they will ever allocate adequate resources for change" (John Goodman, Vice-Chairman of TARP 2006, p. 28).

Academics and practitioners continuously warn about the damaging consequences of service failures for the development of successful and profitable customer relationships (Keaveney 1995; Surachartkumtonkun, Patterson, and McColl-Kennedy 2013). However, despite recognizing the benefits of limiting the number of unsatisfactory situations, customer complaints as a result of service failures continue to be the norm, rather than the exception, in most businesses (Mittal, Huppertz, and Khare 2008; Zhu et al. 2013). For example, in the European financial services industry, a recent report shows that, in 2012, complaints increased by 5%, with 828,040 new reported financial service failures (Data Monitor 2012). In other industries, the pattern is similar, with the European Consumer Centres Network (ECC-Net) reporting a total of 32,197 complaints in electronic commerce in 2012 and an increase of 20% in the number of complaints in the airlines industry for the same year.

In response to a complaint, firms frequently implement complaint-resolution mechanisms (Brady et al. 2008; Hess, Ganesan, and Klein 2003; Huang and Lin 2011). These strategies imply investing significant financial resources. For instance, at an average cost of handling a customer complaint of $5

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(Goodman 2006), the increase in complaints reported previously in the financial services would lead to a total cost of complaint handling of more than 4 million dollars. However, these investments provide an uncertain return. This is because, as suggested by prior empirical and anecdotal evidence, customers' post-recovery reactions differ significantly (Beverland et al. 2010; Boshoff 1997; Homburg and Fürst 2005; Kaltcheva, Winsor, and Parasuraman 2013; Ringberg, Odekerken-Schröder, and Christensen 2007), ranging from a magnification of the initial negative response to the service failure (DeWitt, Nguyen, and Marshall 2008; Grégoire, Tripp, and Legoux 2009) to improvements in attitudes and perceptions after the failure (Homburg and Fürst 2005; Smith and Bolton 1998). Even the same strategy implemented to compensate customers for a similar failure can be effective for some customers but ineffective for others (Grégoire, Tripp, and Legoux 2009). Thus, as marketing strives for greater accountability, an important – yet unresolved – challenge for managers is to understand how to allocate resources to the alternative complaint-handling initiatives so that, for each individual customer, the impact on performance outcomes is maximized. Several academic and managerially relevant questions remain to be answered. How do alternative complaint-handling initiatives affect financial performance? Are they equally effective for all complaining customers? If not, under what circumstances does each complaint-resolution mechanism become more effective?

In this study, we attempt to answer these questions and provide managers with new insights to make customer-specific complaint-handling decisions on the basis of an assessment of their potential contribution to customer profitability. To do so, we build on the congruence approach and develop a contingency framework in which the effectiveness of three key organizational responses to customer complaints (timeliness, compensation and communications) in improving profitability is contingent on two critical variables: relationship strength and failure type. Specifically, we propose that achieving a high level of congruence between the benefits offered by firms through complaint handling (economic vs. social benefits) and the benefits sought by customers (economic vs. social benefits) based on the joint consideration of the two contingency variables enhances performance outcome levels. Using data from a financial services company and applying latent class modeling techniques, our proposed framework receives significant support.

This study contributes to existing marketing research in three critical ways. First, prior studies have provided valuable insights into the consequences of complaint handling on customer perceptions and attitudes (Beverland et al. 2010; Kaltcheva, Winsor, and Parasuraman 2013; Valenzuela and Cooskey 2012). We extend this knowledge by providing an understanding of the financial consequences of complaint handling. To do so, we build a link between complaint handling and profitability that can help practitioners to make more adequate resource allocation decisions on the basis of a financial assessment of alternative complaint-handling initiatives. Second, prior studies have offered preliminary evidence about the heterogeneous nature of customer responses to alternative complaint-resolution mechanisms (Hess, Ganesan, and Klein 2003; Homburg, Fürst, and Koschate 2010; Roschk and Gelbrich 2014). In this study, we not only consider customer heterogeneity explicitly by developing a latent class modeling approach but also offer a theoretical understanding of why different complaint-handling initiatives are differently effective at improving profitability. We conceptually propose and empirically show that the nature of the relationship (i.e., relationship strength) and the failure context (i.e., type of failure), by dictating the types of losses experienced by customers, jointly explain their heterogeneous responses to complaint handling. Third, we provide new insights into the circumstances under which recovery efforts are most effective at improving profitability. Building upon the congruence approach (Chandon, Wansink, and Laurent 2000; Mahajan and Churchill 1988), we demonstrate that when the types of benefits offered through complaint handling (economic vs. social) match the types of benefits sought by customers to recover from the loss (economic vs. social), customer profitability is enhanced. Based on these contributions, our study provides a practical basis to help marketers manage complaints to improve customer profitability.

Conceptual Framework and Hypotheses Development

In this section, we present a model and a set of testable research hypotheses that describe the effects of organizational responses to customer complaints on customer profitability. The model provides a contingency framework for understanding how relevant contingency variables related to the customer–firm relationship (i.e., relationship strength) and the failure context (i.e., failure type) influence customer responses to complaint-handling activities after a service failure. Drawing upon the congruence approach, the conceptual model proposes that the effectiveness of complaint handling depends on the match (or mismatch) between the nature of the benefits provided by the firm and the nature of the benefits sought by the customer in the complaint-handling process. The framework is presented in Fig. 1.

When a service failure occurs, the customer experiences a loss due to the failure and the relationship becomes unbalanced. Because customers are motivated to seek balance (a foundational schema, as denoted by Ringberg, Odekerken-Schröder, and Christensen 2007), they frequently file complaints and companies, in response to them, can initiate a service-recovery strategy aimed at providing a gain to the customer to counteract the loss caused and restore the equality in the exchange relationship. To provide a gain to the customer, the firm can engage in a variety of recovery efforts (Davidow 2003; Estelami 2000; Grewal, Roggeveen, and Tsiros 2008). In this study, we focus on three key complaint-handling activities: timeliness, compensation, and communications. These three activities fall into the three categories of organizational responses identified by Gelbrich and Roschk (2011) and by Estelami (2000). Importantly, as we will discuss later in more detail, these initiatives provide different types of benefits to customers to restore the balance in the relationship: economic versus social benefits (Berry 1995). Also, as noted by Smith, Bolton, and Wagner (1999, p. 358), these three activities "are particularly salient to customers,