
ACADEMIC PAPERS

Does service failure influence customer loyalty?

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Abstract

There is a general consensus that customer loyalty to service providers is not solely dependent upon their level of satisfaction or dissatisfaction. However, the identified antecedents of loyalty remain, at best, highly speculative. The aim of this extensive literature review is to give some understanding of the nature of customer loyalty and the antecedent effects of service dissatisfaction.

The research reviewed suggests that customer loyalty is an attitudinal state, reflecting value, trust and commitment within supplier–customer relationships. Satisfaction is one of several antecedents of loyalty. A key influence on loyalty is the offer of unique value-delivering advantages not provided by competitors. Thus firms need to develop positive value-based exit barriers to achieve loyalty. When service failures occur, the recovery process is likely to have a greater impact on loyalty than the original service failure. The key to successful recoveries was found to be the customer's perception of 'fairness'. Recovery programmes must get it right first time. Customers who remain dissatisfied after a complaint has been handled are more dissatisfied than if no recovery attempt had been made. Dissatisfaction and customer satiation are major causes of a customer's exit. The solution to customer satiation is dynamic value creation. Collection and monitoring of customer data is needed for success and two-way communication is vital.

Keywords:

Service failure,
service recovery,
justice perceptions,
customer value,
customer loyalty,
customer exit

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RESEARCH METHOD

Database searches using InfoTrac in conjunction with desk research of existing known papers and media contributions resulted in over 260 relevant academic, practitioner and consultancy papers being identified. Additionally, over 270 market research organisations with customer satisfaction experience were approached in order to request details of any relevant research.

UNDERSTANDING CUSTOMER LOYALTY

Firms aim to cultivate repeat transactions ('exchanges of value', Gummesson 1995, p. 245) with customers. The repetition of these interactions over time leads to the development of relationships between firms and their customers. Customer Relationship Management (CRM) is a cost/profit issue. It is generally believed to cost more to gain a new customer than it does to retain an existing one (Blodgett *et al.*, 1995: five times as much; Gummesson, 1994: five–ten times). The CRM agenda brings a long-term focus to customer management (Grönroos, 1994, p. 12) since it aims at generating enhanced revenue streams from customers over a lifetime of transactions. CRM therefore aims to achieve customer retention/loyalty (Cross, 1999). Many researchers and consultants, including Morris *et al.* (1999), claim that *intimacy, trust* and *commitment* are the cornerstones of customer loyalty. To achieve this, companies must learn continuously about their customers: 'The key to customer retention is measurement . . . and by focusing on understanding customer's needs' (Jamieson, 1994). However, there is no consensus about what exactly the term loyalty means, or, indeed, how to measure it. One point of view is that loyalty is simply another term for customer retention; a customer who continues to buy is a loyal customer. However, Fay (1994) reports the case of one retail organisation which

found that the customers it retained the longest were actually the least profitable because of their strategic bargain-seeking behaviour.

A second point of view is that customer loyalty has an affective or attitudinal component: 'It's about having had experiences of things that you feel are important. Putting it in personal terms, you build loyalty to your friends through personal experiences you've shared. Customer loyalty really is like friendship' Ros Novotny, head of customer relationship division, BRMB (Woolgar, 1998). Researchers holding this point of view point to the fact that many customers continue to do business with a supplier despite being dissatisfied with service performance. Inertia, indifference, high switching costs and the belief that all suppliers are equally good (or bad) all account for high levels of customer retention.

The importance of customer retention is clear. Jamieson (1994) reports that a 2 per cent improvement in customer retention has an impact on profit equal to a 10 per cent reduction in overheads. Bain & Co found that a 5 per cent increase in customer retention raised the value of each customer by 25–95 per cent (Reichheld, 1996). Narayandas (1998) identified six benefits of customer retention when retention is grounded on strong positive attitudes to the service provider/organisation: resistance to (1) counter-persuasion, (2) competitors' offers, (3) adverse expert opinion, willingness to (4) wait for products to become available, (5) pay a premium and (6) recommend. It does seem that repeat-buying behaviour grounded in attitude is more powerful than behavioural loyalty.

LOYALTY TYPOLOGIES

There have been a number of attempts to develop typologies of loyalty. Dick and Basu (1994) take the position that loyalty has two dimensions: attitude and behaviour. They identify four distinct loyalty conditions: 'true loyalty',

'latent loyalty' (low patronage/positive attitude), 'spurious loyalty' (high patronage/indifferent or antagonistic attitude) and 'no loyalty', each reflecting various mixes of attitude and repeat patronage. True loyalty exists when customers have both a positive attitude to the service provider and exhibit high levels of repeat patronage. Four customer types have been identified by Knox (1998): loyals, habituals (routine buyers, indifferent to their choice, more likely to defect), variety seekers (purchase depending on personal circumstance/situation/event) and switchers (no attachment to service provider, pursue transaction deals/discounts). The first two are high-share, generally high-profit customers purchasing a narrow product range and displaying loyalty. The retail multiple, Boots, has linked loyalty card and promotions data to four types of customer behaviour: 'deal seekers', 'stockpilers', 'loyalists' who buy more of an item when on special offer, and 'new market' who try a special offer and continue to buy after the promotion ends (Hoare, 2000). Finally, Pugh (1991) identifies four desirable characteristics that make up the loyal customer: repeat purchasing, cross-product/service purchasing, referral/word-of-mouth active and immune to competition.

SATISFACTION AND DISSATISFACTION

Ten years ago, customer satisfaction was the key objective for marketers. Oliver (1996, p. 13) offers the following formal definition, which he claims to be consistent with the theoretical and empirical evidence to date: 'Satisfaction is the consumer's fulfilment response. It is a judgement that a product or service feature, or the product or service itself, provided (or is providing) a pleasurable level of consumption-related fulfilment, including levels of under- or over-fulfilment.'

Customer satisfaction is recognised by researchers as a major antecedent of their general attitude towards

organisations, and this, in turn, is an important determinant of future behaviour (Narayandas, 1998; Zeithaml *et al.*, 1996). Oliver (1999) concludes that satisfaction is a 'necessary step in loyalty formation'. Bolton (1998) conducted a very extensive quantitative investigation of relationship duration and satisfaction. In her study of the US cellular telephone industry, she found evidence that:

- supplier–customer relationships are longer for customers having high levels of cumulative satisfaction;
- experienced customers are less sensitive to transaction failures because of high prior satisfaction levels;
- conversely, the positive effects of a satisfying transaction are reduced if the customers' historic experience is of service under-performance or failure; and
- the effect of prior cumulative satisfaction on the duration of the supplier–customer relationship is greater for customers who have more experience with the organisation.

She concludes that there is considerable heterogeneity across customers and that they will have differing utility levels associated with a particular service.

Additionally, there appears to be a clear relationship between customer satisfaction and word of mouth (WOM) (Blodgett *et al.*, 1995). In his review of WOM research, Buttle (1998) identified one of the positive effects of satisfaction as advocacy-based referrals of new customers. Spreng *et al.* (1995, p. 17), state that both satisfaction and dissatisfaction have been found to be antecedents of WOM.

Many researchers, however, have identified a discontinuity between satisfaction and loyalty (Edwards *et al.*, 1994; Fay, 1994; Romano, 1995; the Ogilvy Loyalty Centre, UK, cited in Rosenspan, 1998; Wood, 1998; PA Consulting, 1999; Harte-Hanks Market

Research, 1999). ‘‘Satisfaction is an inherently unstable and temporary mental state’’ and a poor way of predicting customer retention’ (Frederick Reichheld quoted in Cash Jr., 1996).

Romano (1995) suggests that 65–70 per cent of encounters that meet or exceed the expected threshold of customer satisfaction merely involve hygiene factors, having no impact on customer loyalty. In a business-to-business survey, Fay (1994) found that while over 70 per cent of companies ranked price as the first or second least satisfactory issue, interviews with switchers found that no more than 10 per cent had changed suppliers because of price. Satisfaction, therefore, seems a necessary, although insufficient, cause of loyalty. Romano (1995), Cash (1996) and Wood (1998) all claim that customers may be satisfied with the current product/service offering, but that loyalty is dependent upon the supplier offering the best overall customer value proposition (CVP).

VALUE

‘We have moved from the phrase cheap and nasty, through cheap and cheerful, to cheap and chic as personified by IKEA. Now we are in the age of cheap and clever, best illustrated by the example of EasyJet’ John Brady, Director, McKinsey (Jardine, 1999). The argument has been made that firms should aim for customer delight rather than mere satisfaction, through giving unanticipated rewards. However, meeting or even exceeding customer expectations is not a great predictor of future behaviour. It is suggested that firms should be asking customers not just about their satisfaction perceptions but also about their *value* perceptions. Masciarelli (1998) of Archer Consulting suggests that the creation of value for customers is one of three requirements for long-term customer relationships alongside communication and trust.

SERVICE FAILURE

A customer’s attitude towards a firm depends in part upon this perception of value. The attitude is likely to deteriorate if the cause of customer dissatisfaction is inadequate customer value. Bolton (1998) found that consumer perception of losses experienced during transactions reduce relationship duration and that the effect, in absolute terms, of a recent service failure is greater than a recent service transaction. The aim of ‘zero defects’, strived for in manufacturing, is more difficult to achieve in a services context. Complete standardisation of interactions is hard to achieve, and possibly undesirable. Furthermore, customers acknowledge that in service encounters which they help to co-produce their own work may be the cause of their own dissatisfaction. Many customers will recognise and accept this reasoning. Service failures are thus an important issue, as is how firms remedy them.

THE COMPLAINING PROCESS

Spreng *et al.* (1995) found that in both positive and negative recovery outcomes, recovery can take on greater importance than the original service failure (Berry and Parasuraman, 1993). They state that outcome is the ‘primary driver’ of consumer evaluations of service in initial encounters, but process is more important during service recovery. Blodgett *et al.* (1995) identify two important forms of justice within recovery: ‘distributive justice’ (fair settlement) and ‘interactional justice’ (polite and respectful treatment). Blodgett *et al.* (1993 and 1995) investigated the complaining behaviour process. The 1995 study found that dissatisfaction leads customers to seek redress if they perceive a positive likelihood of success but only if they are the type of person who complains. Stability and controllability of the initial problem were also found to influence dis/satisfaction evaluations. Halstead

et al. (1996) suggest that a single genuine failure can lead to further complaint on other issues: a 'halo effect'.

DISSATISFACTION — THE SILENT MAJORITY

Even if a service firm adopts a policy of recovery not all dissatisfied customers will give them the chance to recover. Many simply take their custom elsewhere (Blodgett *et al.*, 1995). High percentages of dissatisfied customers do not complain: 70 per cent (Jamieson, 1994, p. 12); 96 per cent, of whom 63 per cent defect (Diamond, 1999 and Michelsen, 1999). Studies suggest that only 4 to 10 per cent of customers will give firms the chance to correct a service failure (Zemke, 1994; PA Consulting, 2000). Goodman and Ward (1993) and Cash (1995) report that the majority of complaints fail to reach the attention of senior management. Many consumers will feel that there is no point in complaining as they perceive a low likelihood of complaint success, or cannot be bothered with the effort and cost of complaining. In competitive industries these customers are likely to exit, and engage in negative WOM (Blodgett *et al.*, 1993; Etzel and Silverman, 1981; Fornell and Wernerfelt, 1987; Spreng *et al.*, 1995).

DEFECTION

Goodman and Ward's (1993) study for the US Office of Consumer Affairs suggests that for every five customers who encounter a problem, one will be lost for good. Non-complainers were found to be the least loyal customers — even more disloyal than complaining dissatisfied customers whose problems were not resolved. Keaveney (1995) conducted a study of 500 service customers using a critical incident technique (CIT). She identified over 800 service-firm behaviours that caused customers to switch service providers. These issues were coded into eight general categories: pricing, inconvenience, core service failure,

failed service encounter, response to failed service, competition, ethical problems and involuntary switching. All except competition and involuntary switching are directly controllable by the service provider. Forty-five per cent of switches were due to failure in only one of these eight areas — the most common being core service failures, pricing and service encounter failures. As a consequence of service failure, 75 per cent of customers had told at least one other person, although only 7 per cent told the original service provider, and 85 per cent had switched. Dawe (2000) reveals that the consultancy eLoyalty has identified a 'churn checklist' ranging from the obvious service failures — for example, staff rudeness and product failure — to more relationship-orientated issues including failure to recognise customers as individuals or to adapt services to their specific needs. Keaveney's (1995) study also confirmed that even satisfied customers switch service providers — the main reasons being convenience, competitor actions or price. Reill (1997) suggests that 14–15 per cent of switchers do so because their complaint was not handled satisfactorily.

DEFECTION MODEL

Stewart (1998) identifies three dyadic descriptors of customer exit — revocable or irrevocable, complete termination or reduction of patronage, and mutual or unilateral exit. Her review of research into exit behaviour suggested that exit is a process whose nature is best captured by CIT and is dependent upon a trigger activating the exit process. Stewart (1998) cites Andreason's (1988) claim that consumers only take action over a third of their problems and that 60 per cent of this action would be voice as opposed to exit. She lists a number of possible explanations: exit may only occur where dissatisfaction is extreme, customers may see exit as a last resort, and, if a relationship is of sufficient quality,

customers may put up with some dissatisfaction associated with discreet incidents. Stewart (1998) suggests that boredom and satiation may be possible triggers to exit, but conversely habitual behaviour can reduce exit risk. She highlights the key determinants of switching: a perceived decline in service and thus satisfaction, the availability of alternatives, the cost of switching (barriers) and potential for, and potential of, alternative behaviour.

CUSTOMER LOYALTY SCHEMES

It is questionable whether retailer 'loyalty' schemes influence purchasing behaviour and/or loyalty (Rowell, 1998):

'The reward should be the brand: what it is, how it is relevant to the customer . . . customer loyalty is a by-product of a robust and dynamic brand relationship, which is built by rewarding customers with what they want most: relevant marketing offers, a satisfying purchase experience and products or services of high perceived value. That is better than cashing in points' Rob Smith, Herndon Customer Relationship Management (Loro, 1998).

Tesco relies heavily on price promotions as well as their loyalty scheme to generate repeat patronage (Jardine, 1999). Customers may become loyal to points systems rather than the service provider (Woolgar, 1998) and senior marketers' confidence in such schemes is falling (Gofton, 1999).

BUILDING CUSTOMER EXIT BARRIERS

One way of promoting customer retention is to erect relationship exit barriers. Aldisert (1999) calls for companies to build exit barriers so that it 'costs' a lot for customers to leave. Firms are advised to develop the customers' sense of commitment to the organisation and the belief that something is at risk if they switch allegiance (Fisher, 1998). Unpublished research conducted by one of the authors suggests that companies can develop three forms of attachment which transcend mere satisfaction and promote long-term relationships.

Instrumental attachment occurs when customers believe that the organisation excels at meeting their needs; relational attachment occurs when customers form emotional bonds with employees; and values-based attachment occurs when customers endorse the values of the organisation. Exit barriers such as these are based on positive customer attachment.

SERVICE RECOVERY

A firm's approach to dealing with consumer dissatisfaction can be described as 'defensive marketing' — the protection of the existing customer base (Fornell and Wernerfelt, 1987). Service recovery methods include any action necessary to return a customer who has experienced service failure to a state of satisfaction. Technology may be a useful tool (Hart *et al.*, 1990; Berkley and Gupta, 1994).

RESPONSES TO FAILURE

It should be recognised that customers are not always right (Bitner *et al.*, 1994). Customers cause 30 per cent of service or product problems (Zemke and Bell, 1990). Etzel and Silverman (1981) suggest four possible courses of action for dealing with complaints (see Table 1). Spreng *et al.* (1995) highlight the importance of adequate service recovery techniques. 'Token' responses can be seen as unjust. Two studies they cite reveal that only 30–53 per cent and 50–67 per cent of customers questioned were happy with experienced service recovery.

SERVICE RECOVERY: FROM POTENTIAL DEFECTOR TO LOYALIST

'More than half of all efforts to respond to customer complaints actually reinforce negative reactions to service' Hart *et al.* (1990) cited in Spreng *et al.* (1995, p. 16). Complaint handling, when done properly, offers an opportunity for developing customer loyalty. According to various studies, the retention rate of customers whose problems have been resolved is 50 per cent (Goodman and

Table 1 Complaint handling (Etzel and Silverman, 1981)

Action	Scenario
Ignore them Discourage complaints	Low cost, possible for transient clientele. Communicate that service/goods are non-refundable. Possible for low-priced goods.
Appraise each complaint on its own merit	Possible where customer-supplier interaction discreet. Could be used to target only profitable customers or significant service failures.
Encourage complaining behaviour	Satisfy all customers who complain. High-cost approach to encourage long-term loyalty among all customers.

Ward, 1993), 95 per cent (Diamond, 1999), 70 per cent in Canada rising to 95 per cent for swift resolution (Hepworth and Mateus, 1994).

Smith *et al.* (1999) concluded that customers prefer to be recovered in ways that 'match' the failure they experienced, both in the value and the form of recovery. They investigated four attributes of perceived justice — compensation, response speed, apology and recovery initiation — for the influence they exerted on customer perceptions of 'distributive', 'procedural' and 'interactional' justice. Zeithaml *et al.* (1996) tested the conclusion of Bolton and Drew (1992) that service failure can weaken customer–marketer relationships even if the problem is resolved satisfactorily. Their multi-company study of customer intention revealed that customers who had experienced no service problems had the strongest loyalty intention, lowest switch and external response intentions. Customers whose problems

had been resolved satisfactorily expressed greater loyalty intention, willingness to pay more and lower switching intentions than those with unresolved problems, but these intentions were not as great as those of customers who had experienced no service problems. Similarly, Brown *et al.* (1996) discovered that service consistency had a greater impact on customer satisfaction than service recovery. Kelley *et al.* (1993) investigated the effectiveness of various service recovery techniques for customers of US retailers in the light of identified service failure issues (see Table 2). Customer preferences were assessed on a ten-point scale and retention rates were computed for each type of recovery. The bottom five recoveries have ratings below the mid-point of the recovery scale suggesting their inferiority.

ACHIEVING CUSTOMER LOYALTY

How is customer loyalty, based on positive attitude, achieved? '82 per cent

Table 2 Recovery strategies and their success

Recovery category	Recovery rating	Standard deviation	Retention (%)
Discount	8.86	1.70	86.4
Correction	8.81	1.70	96.3
Manager/employee intervention	8.42	1.44	75.0
Correction plus ²	8.24	2.63	90.5
Replacement	7.91	2.76	87.8
Apology	6.75	2.99	77.4
Refund	6.48	3.43	81.5
Customer-initiated correction	3.83	2.48	50.0
Store credit	3.36	1.50	36.4
Unsatisfactory correction	2.57	1.50	62.2
Failure escalation	2.36	1.66	42.0
Nothing	1.55	0.94	31.0

Source: Kelley, Hoffman and Davis, 1993, p. 429

²'Correction plus' implies failure correction plus additional customer compensation. The lower rating for this compared with 'correction' only recovery arises because these incidents tended to be more severe in nature.

of customers whose problems are solved buy again' (KPMG, 2000). 'Only 4% of dissatisfied customers typically complain. Yet, by being able to solve problems effectively, 80% of customers will stay, and by solving problems fast and effectively, 95% will stay, sometimes becoming more loyal' (PA Consulting, 1999). Geller (1997) identifies 14 elements important in achieving customer loyalty. The most significant of which are the quality/value of the product and service, the impression or image portrayed, the dynamism of the organisation, communication and achieving the unexpected for customers. Fredericks and Salter (1995) simplify these issues further, suggesting that customer loyalty is determined by the *perception of value* offered by the marketer. They identified five main components of the CVP: price, product quality, service quality, innovation and image. Their model suggests that customer perceived value is influenced both by individual customer requirements and characteristics, and by the nature of the business environment. Loyalty is thus not directly controllable by the marketer. To their list might be added other elements of the CVP: process, people, physical evidence, customer communication, brand and reputation. Kandampully (1998) cites Zeithaml and Bitner's (1996) claim that customers will remain loyal if the perceived value they receive is relatively greater than that of competitors' offerings. Loyalty is a reward given to firms that consistently identify and act upon latent, unexpressed, customer needs. Firms that ensure they have accurate two-way communication with customers will be better positioned to adapt their offers (Schneider, 1997). 'Companies will never encourage a relationship with a customer by consistently getting addresses wrong or opening their communication with Dear Homeowner/Occupier' (Rowell, 1998).

Kandampully (1998) concurs that being one step ahead of customer needs

and competitors is the key to loyalty. Loyal relationships, where firms are efficiently monitoring and collecting information about customers, give firms the ability to anticipate consumers' future needs, allowing them to surprise and delight customers. Delight reinforces loyalty, thus the key is the dynamic momentum involved in remaining ahead of customers' needs (Oliva *et al.*, 1992).

REACTIVATING CUSTOMERS

Geller (1997) suggests that customer databases should be explored and scrutinised to determine whether customers might be considering defection. Johnson (1994) stresses the importance of knowing a customer's repeat sales ratio (the average interval between purchase occasions). He claims that customers have a 'reverse horizon' just past the repeat sales ratio, beyond which they will be lost to competition if they are not re-activated. KPMG (1999) see the development of tools to identify at-risk customers as one of the critical defensive marketing issues for successful businesses of the future.

CONCLUSIONS

It is widely believed that achieving excellent service performance is vital for the survival of service organisations. Difficulties in achieving consistent service quality, even where relationships with customers have been successfully developed, mean that organisations may need to use service recovery strategies. The firm must create a powerful belief that, if customers complain, they will receive justice. There is scope for research into how service recovery techniques affect dissatisfaction and subsequent behaviour/attitude.

In conclusion, customer loyalty is thought to be dependent upon customer perception of value. This will depend in part upon customers' level of satisfaction with current service but also how well the supplier is innovating and anticipating their next need. Customers

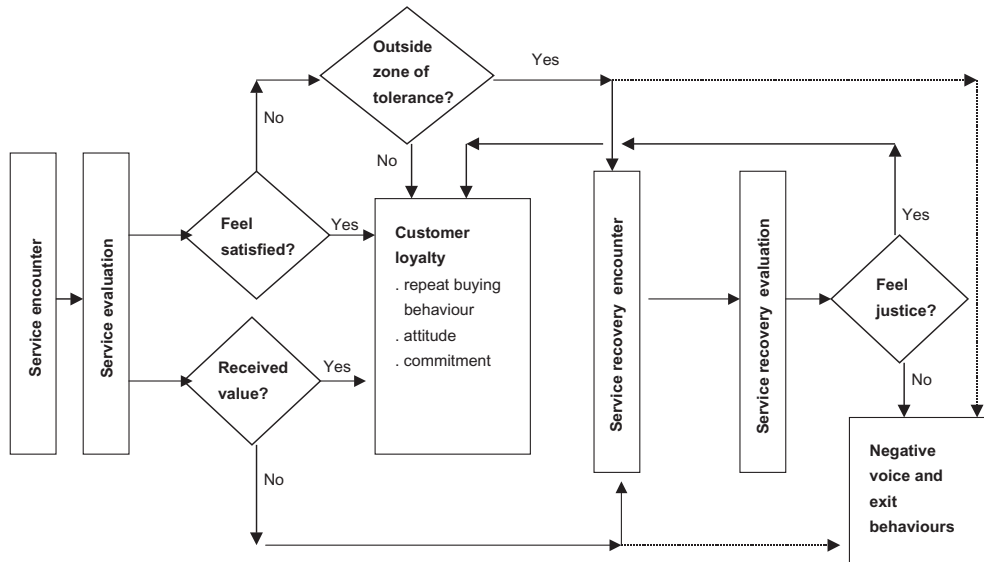


Figure 1: The Buttle-Burton service dissatisfaction model v4

will evaluate dissatisfaction with particular incidents with their suppliers against their overall impression of the value offered by that supplier, when compared with competitors and the cost to them of switching suppliers. Repeated failures will contribute to a reduction in value perception. They may also become the triggers that focus customers' attention on evaluating service levels and value more closely. Dissatisfaction alone, however, is not the only antecedent of customer exit. Loyalty has been found to depend upon consumers' perceptions of value dependent in part upon communications leading to increased trust. These relationships are summarised in the service dissatisfaction model shown in Figure 1.

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