External equity, loyalty program membership, and service recovery

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Abstract

Purpose – The purpose of this paper is to extend research on customer loyalty status, external equity, and satisfaction with service recovery. Most people accept that firms give special treatment to their "best" customers; but after service failures, will they accept firms' offering better compensation to loyalty program members?

Design/methodology/approach – An experiment was conducted involving mobile telephone service failure scenarios affecting two similar customers; the customer received either identical or one-half the compensation of a referent customer, who was described as either a member or non-member of the firm's loyalty program. Participants were randomly assigned to conditions in a 2 × 2 design, completing questionnaires that measured satisfaction with service recovery.

Findings – The paper finds that when both focal and referent customers received equal service recovery, loyalty program status had no effect. When the referent customer received greater compensation, respondents were very dissatisfied with the outcome, but were significantly less dissatisfied if the referent customer was a loyalty program member.

Research limitations/implications – Although respondents were students, 97 percent used mobile telephones and experienced similar service problems.

Practical implications – As communications among firms' customers increase (blogs, online communities), they can compare one another's complaint outcomes. Some inequity in service recovery may be tolerated because of the beneficiary's loyalty program status.

Originality/value – Consumers consider loyalty of other customers when judging fairness of firms' service recovery. Inequity has a powerful effect on satisfaction with recovery initiatives, but the negative impact is moderated by loyalty program status; this paper makes a contribution by showing how inequity and customer loyalty interact.

Keywords Consumer behaviour, Customer service management, Customer loyalty, Customer satisfaction

Paper type Research paper

An executive summary for managers and executive readers can be found at the end of this article.

Introduction

Service failures represent a threat for firms, creating both customer dissatisfaction and incentives to switch service providers (Hirschman, 1970; Dubé and Maute, 1996; Keaveney, 1995; Fornell and Wernerfelt, 1987). Failures often occur in services because production and consumption of services are inseparable and more variable in quality than goods (Eiglier and Langeard, 1987). But firms can avoid the negative consequences of service failures by implementing effective service recovery, potentially transforming a dissatisfied customer who is ready to defect into a satisfied one because she has forgiven the firm for its service failure (Bell and Zemke, 1987; Bitner *et al.*, 1990; Grönroos, 1988; Hart *et al.*, 1990; McCollough *et al.*, 2000; Crié, 2001; Davidow, 2003).

Just as service delivery is variable, the quality of a firm's service recovery also varies, and both can differ systematically among customer groups (Andreassen, 2001). For example, a loyal customer of an airline who has enrolled in a frequent flyer program usually receives special consideration and benefits not offered to the casual, infrequent traveler – services like expedited check-in, special baggage check queues, and preferred seating upgrades. For the most part, the public accepts these arrangements as fair, recognizing that the frequent flyer represents a different type of customer who deserves the special treatment. However, while "Typical" customers accept that "Preferred" customers receive more benefits as a result of their status, it is not clear whether such acceptance would extend to service recovery. If frequent flyers receive greater compensation for service failures, for instance, will average travelers accept the practice as fair? No study has yet considered how members of different customer loyalty segments compare their service recovery outcomes to those of others, and how these comparisons affect their evaluation of

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the firm's service recovery actions. This topic is particularly important because of the rapid growth of customer relationship management (CRM) strategies, whereby the firm selects its best customers and develops stronger, deeper, and more intimate relationships with them, creating customer equity (Rust *et al.*, 2000, 2004).

Applying CRM to service recovery implies that when resolving customer problems and complaints, the firm will benefit by treating its best customers more generously than others. As a result, variation in service recovery can occur intentionally as well as unintentionally. Unintentional service recovery variability occurs in the same way that variation in service delivery does: attempts to implement service recovery succeed for some customers and fail for others. However, intentional service recovery variability occurs when the firm deliberately invests more resources to create greater satisfaction among one group of complaining customers, while investing less to satisfy other similarly dissatisfied complainants. For example, a bank branch manager may "bend over backwards" to solve a problem for a customer who maintains multiple high-balance accounts and loans at the bank, while delegating problems of ordinary customers to low-level employees or ignoring them altogether. The notion of limiting service recovery effort has received support from some service researchers who have concluded that it is simply not worth it to try to recover from every service failure (Andreassen, 2001).

Ordinarily, customers who experience service failure and recovery know nothing about the treatment received by other customers, unless they happen to be present when another customer experiences a similar service failure. But the spread of new technologies that enable sharing of information and communication among customers can facilitate comparisons of service recovery outcomes among different customers of the same firm. For example, internet "chat forums" and complaint sites (Harrison-Walker, 2001; Hennig-Thurau *et al.*, 2004; Wangeheim, 2005) permit customers to communicate with one another regarding the firm's service recovery policies and its actions. It has become easy for dissatisfied customers to compare their outcomes to those of others who experienced similar problems.

Surprisingly, the service recovery literature has not dealt with the topic of comparison between customers concerning service recovery actions. In an attempt to fill this gap we present an equity theory-based study of interpersonal comparison concerning service recovery.

The article is structured as follows. First, we establish a theoretical foundation for our hypotheses by reviewing research on equity theory (Adams, 1963; Greenberg, 1987), which has been used in diverse settings such as human resources or revenue management pricing (Wirtz and Kimes, 2007). Satisfaction with recovery has been shown to be affected by perceived fairness (Folger and Cropanzano, 1998; Goodwin and Ross, 1992; McColl-Kennedy and Sparks, 2003; Prim-Allaz and Sabbadie, 2003; Smith and Bolton, 1998; Tax *et al.*, 1998, Tissot, 2003). Second, we present the concept of relationship marketing, focusing on the firm's practice of providing preferential treatment for loyal customers. We stress that the application of preferential treatment can cause problems of perceived fairness. Third, we introduce the concept of external equity to explain how consumers react to differential service recovery actions by firms. Fourth, we test our hypothesis in a cell-phone scenario with a student sample. And finally we discuss our results for this quantitative research and outline directions for future research.

Background

Justice theory

Service researchers have turned to theories of organizational justice to explain customers' reactions to service recovery (Folger and Cropanzano, 1998; Goodwin and Ross, 1992; Mattila, 2001; McColl-Kennedy and Sparks, 2003; Prim-Allaz and Sabbadie, 2003; Tax *et al.*, 1998; Tissot, 2003) Organizational justice involves the following three dimensions:

1. Distributive justice – resource allocation and the perceived outcome of exchanges (Adams, 1963; Greenberg, 1987).
2. Procedural justice – the means by which decisions are made and conflicts are resolved (Folger and Greenberg, 1985).
3. Interactional justice – the manner in which information is exchanged and outcomes are communicated (Bies, 1987).

Firms' recovery actions influence each of these dimensions of justice: compensation and apologies influences distributive justice, initiating recovery and empathy influence interactional justice, and the firm's speed of response to complaints influences perceptions of procedural justice (Smith *et al.*, 1999). Every customer who initiates a complaint expects some outcome to result from it – distributive, procedural, and/or interactional – and it is the expectation of positive outcomes that drives consumer complaint decisions (Oliver, 1997). Most often, however, dissatisfied consumers want a refund, replacement, or compensation when they complain, and most studies of post-complaint satisfaction show that distributive justice in the form of compensation has the greatest impact on customer satisfaction with recovery, repurchase intentions, and loyalty (Blodgett and Granbois, 1992; Boshoff, 1997; Conlon and Murray, 1996; Smith *et al.*, 1999; Tax *et al.*, 1998). However, cultural values and norms can influence customers' perceptions of fairness of the service recovery process. Mattila and Patterson (2004) found that compensation was more important to American customers than Asian customers, and that Americans are more assertive and accustomed to asking for redress than consumers in Asia. On the other hand, explanations of the causes for service failures have a more important effect on distributive and interactional justice for Asian customers than for American customers (Mattila and Patterson, 2004).

In this paper, we focus on the distributive dimension of organizational justice, applying equity theory in a service recovery context. We propose to contribute to the service recovery literature by exploring the effects of external equity on customer satisfaction with service recovery actions that differ between customer loyalty segments.

Relationship marketing and service recovery

According to Vargo and Lusch (2004) marketing has evolved from a concept based on the exchange of goods intended for nearly all consumers to the development of offers meeting the specific needs of individual customers, culminating in the concept of CRM. CRM offers many advantages to firms, including reduction in costs of marketing communications,

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decreasing rates of customer attrition, and improving the quality of information available to the company, leading a growing number of companies to adopt CRM (Julien, 2001; Lefébure and Venturi, 2000). CRM makes it possible to identify, attract, and generate loyalty among the best prospects and customers by identifying characteristics predictive of customer profitability, thus making it advantageous to invest in long-term relationships with the best customers, as well as adapting product offerings to the specific needs of the customer.

Loyal customers expect preferential treatment, which is defined as the practice of giving added value, recognition, or enhanced products and services above and beyond the firm's standard value propositions (Gwinner *et al.*, 1998; Wirtz and Kimes, 2007). Often, firms use customer loyalty programs to deliver added benefits to selected customer groups, and for over two decades firms have turned to customer loyalty programs to help them identify and reward their most loyal customers. These membership-based marketing activities are designed to enhance continued marketing exchanges among pre-identified customers of a sponsoring brand or firm (Lacey and Sneath, 2006). The financial and non-financial rewards of loyalty programs aim to strengthen the long-term competitive position of the firm by strengthening customer retention (Patterson and Smith, 2003). This goal can be achieved in two different ways. First, in some cases loyalty programs encourage true attitudinal loyalty: loyal customers express little interest in competitive offerings (Jacoby and Chestnut, 1978). Second, loyalty programs allow the firms to erect switching barriers by increasing switching costs (financial, psychological and time), which lower the probability of defection (Maute and Forrester, 1993). Consumers have embraced these programs across a wide variety of services including car rentals, banks, hotels, retail stores, and airlines. According to a 2005 AC Nielsen Survey, for example, 97 percent of Canadian consumers participate in at least one loyalty program.

The problem of perceived fairness

Implemented properly, CRM causes little trouble for service providers that differentiate among the customers they serve – potential high net worth customers often receive higher levels of service and products that more closely match their needs than "average" customers do, and prior research suggests that customers expect variation in treatment based on loyalty status (Gwinner *et al.*, 1998; Wirtz and Kimes, 2007). However, it is not known whether such expectations extend into the area of service recovery. Introducing CRM into service recovery practices could create strong dissatisfaction if some customers discover that others receive more favorable treatment following a firm's service failure. For example, in the late 1990s American Airlines introduced a program which offered a higher level of compensation for frequent flyer program members who had undergone multiple delays during the summer, but the airline limited its offer to customers who lived in cities where the company faced stiff competition, while customers residing in other markets did not receive compensation (Lieber, 2001). Thus, the airline excluded certain customers because they did not live in geographic areas that managers defined as "preferred" markets, presumably because these customers represented different economic potentials for the company. But word of the program leaked out because customers started to communicate between themselves on the internet forum "flyertalk" (www.flyertalk.com/), and within a few days' time the customers who had not received the compensation offer clamored for better treatment. Finally, American Airlines was obliged to grant the same compensation to all customers in its frequent flyer program.

Of course, in this example the American Airlines customers were not segmented based on varying degrees of loyalty. However, it illustrates the difficulty firms face as they try to differentially allocate resources to desired customer segments: on the one hand, a firm could generate significant ill will by compensating some customers more than others; on the other hand, customers may accept variations in service recovery outcomes because they perceive that some customers deserve more (Kimes and Wirtz, 2003). This question appears even more relevant today because of new internet technologies that facilitate information exchange between customers. In the past, it was highly unlikely that one customer would know what another received as compensation for a service failure, but now consumers can easily communicate with one another.

External equity

Equity theory (Adams, 1963) posits that an individual can make two different kinds of equity judgments: internal and external. When a customer buys a product, he/she puts something into the exchange with a merchant (inputs), expecting to obtain an outcome proportional to his/her inputs. An internal equity judgment occurs when the consumer makes a comparison between the inputs invested and the outcome obtained, based on prior experience. If the consumer perceives that the result (outcome) is lower than expected based on the inputs he/she invested in the exchange, the internal equity judgment is unfavorable, and perceptions of unfairness and dissatisfaction result (Oliver and Swan, 1989a). An internal equity judgment requires only the interaction between the customer and the service provider, and the customer usually has no information about others' outcomes from their interactions with the service provider (Holbrook and Kulik, 2001). Judgments of internal inequity cause dissatisfaction, but they can be remedied by effective recovery actions in which compensation is offered to the person for the loss incurred (Lapidus and Pinkerton, 1995). If the consumer perceives the compensation as adequate, then he/she will be satisfied with the recovery, but insufficient compensation for perceived damages will result in dissatisfaction with the recovery.

External equity judgments occur when the consumer compares his/her ratio of outcomes to inputs in an exchange with the ratio of a reference person (Adams, 1963; Fisk and Young, 1985; Huppertz *et al.*, 1978; Weick and Nesset, 1968). The reference person may be the seller or another customer (Oliver and Swan 1989a, b; Oliver, 1997). The formula of the external equity judgment is the following:

$$O_c/I_c \cong O_r/I_r$$

where:

O is the outcome;
I is the input;
C is the customer
r is the referent person or group; and
$\cong$ is a proportional operator.

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The customer will be more satisfied with a transaction when he/she feels treated in an equitable manner, that is, when the two ratios are more or less equal (Oliver and Swan, 1989a).

An external equity judgment requires interaction between three actors: the customer, a referent person (another customer) and the service provider. In this process, the referent norm is external (the customer observing what the other participants receive) and posterior (the customer establishes this norm only after having observed what the other customers received).

Little is known about the effects of external equity on perceptions of satisfaction with service recovery. External equity requires the customer to engage in comparison processes with similar others: did the consumer who suffered service failure – considering his/her inputs for the service – experience recovery comparable to other customers of the firm who experienced the same failure? Tax *et al.* (1998) and Prim-Allaz and Sabbadie (2003) have suggested that such comparisons influence both perceived justice and recovery evaluations, but neither study tested this relationship.

The concept of external equity has been used in studies of consumer purchases of goods and services (Fisk and Young, 1985; Oliver and Swan, 1989a, b). Equity theory predicts that when two individual consumers compare their outcome/input ratios, they will form judgments about the fairness of the service provider. As Tax *et al.* (1998) and Prim-Allaz and Sabbadie (2003) have suggested, following a service failure, a negative inequitable resolution should affect the consumer's perception of justice, and thus influence his/her satisfaction with recovery. We postulate that the consumers will be less satisfied if they receive compensation lower than that given to the referent customer than when they received the same compensation as the referent customer:

H1. The consumer will be more satisfied with recovery in the condition of perceived external equity than in the condition of unfavorable external inequity.

The loyalty effect

The variability among customers in purchasing volume, frequency, and share of wallet has been recognized by firms through their loyalty programs, which confer privileges and status to the best customers (Cooil *et al.*, 2007). When "typical" customers compare their service recovery outcomes to those of "loyal" customers, do they feel differently than they would if they compared their outcomes to those of other typical customers?

Smith and Bolton (2002) found that dissatisfied customers who respond emotionally to service failures tend to process service recovery information more extensively. When a consumer receives compensation equal to that of a referent customer, we expect that the consumer will be in a positive or neutral emotional state and thus will process the information more superficially, and thus the referent customer's loyalty will not be considered when making judgments about the fairness of the service recovery. However, if a consumer receives less than the referent customer after both experienced the same service failure, we expect that the consumer will process information more extensively, considering information about the referent customer's loyalty status when making judgments about satisfaction and fairness (Smith and Bolton, 2002). Therefore we hypothesize that loyalty program membership will moderate the impact of external inequity and satisfaction on service recovery:

H2a. In a recovery situation of perceived external equity, the consumer will have the same level of satisfaction with recovery regardless of whether the referent customer is a member of the firm's loyalty program.

H2b. In a recovery situation of perceived unfavorable external inequity, the consumer will be more satisfied with recovery when the referent customer is a member of the loyalty program than when the referent customer is not a member of the loyalty program.

Study

Experimental design and sample

An experiment was formed by creating four scenarios in a 2 (external equity vs external inequity) × 2 (referent customer as member vs non-member) design. The scenarios involved a cell-phone service failure, which was chosen because consumer dissatisfaction due to technical incidents has increased, according to public agencies, and qualitative interviews with a sample of users suggest that mobile phone service failures are increasingly common and no allowance is made on the bill. The scenario described a situation in which the phone frequently went out of service, yet the service provider billed for the service and expected the customer to pay (see Appendix). External equity was manipulated by altering the scenario such that the focal customer was compensated by the merchant at a level equivalent to the referent customer (external equity) or at half the compensation received by the referent customer (external inequity). In the Loyal program status condition, the referent customer was described as a member of the "preferred customer" loyalty program; in the non-member condition, no mention of a loyalty program was made.

A questionnaire was administered to a sample of 808 students in business courses (from the first to the fourth year) in a large university in France. Almost all (97.5 percent) owned a mobile phone. Respondents completed written questionnaires individually.

Scenario manipulation

In order to identify a service failure scenario, we conducted six qualitative interviews among mobile phone users (Lavorata *et al.*, 2005). Through these interviews we identified several common types of problems that consumers have experienced: billing problems, being forced to pay for service when it was unavailable, failing to honor a service guarantee, and problems of ending the contract with the provider. We devised a scenario that described a situation in which the phone was temporarily out of service, yet the mobile phone provider billed for it and expected the customer to pay, even though service was unavailable. In this kind of situation the consumer can feel "victimized" (Johnston, 1995; Johnston and Fern, 1996). We then described a post-complaint recovery scenario in which the firm's employee apologizes and offers compensation: a credit on the bill for the next month. In the external equity scenario, both the respondent and the referent customer (a friend named Mark) received the same compensation, six euros off the next bill. In the external inequity condition, the compensation of the respondent was half the compensation received by the

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referent customer: Mark received 12 euros, while the respondent received six euros.

Loyalty membership status was manipulated by describing the referent customer as a member of the firm's customer loyalty program. In the non-membership condition, no mention was made of the program. The referent customer was a customer of the same mobile phone service provider as the respondent, and he had experienced a similar problem as the focal customer. Note that in all four scenarios, the focal customer did not participate in the firm's loyalty program.

After reading about the failure scenario and the recovery compensation given to the respondent and to the referent customer, the participants completed questionnaires that measured satisfaction with recovery on multiple-item, six-point Likert type measurement scales.

Manipulation check

A six-item measure of respondents' perceptions of equity (alpha = 0.86) showed that the manipulation of external equity had been successfully achieved. Respondents in the external equity condition perceived the exchange as significantly fairer than respondents in the external inequity condition ($t = 20.83$, df = 806, $p < 0.0001$).

Results

Analysis of variance showed that the main effect of external equity was statistically significant ($F(1{,}806) = 19.115$, $p < 0.0001$). Respondents were more satisfied with recovery in a situation of external equity than in a situation of external inequity, thus supporting *H1*.

In *H2b*, we posited that respondents who experienced external inequity in service recovery would be less dissatisfied if the referent customer was a member of the firm's loyalty program than if the referent customer was not a member of the loyalty program. This hypothesis was supported. There was a significant interaction between external equity and loyalty program membership status, $F(1{,}804) = 6.21$, $p < 0.012$. Tests of simple main effects confirmed that when external inequity occurred, the difference in the mean satisfaction with recovery between the conditions "referent customer member" and "referent customer not member" was significant: when focal customer receives a recovery lower than that of the referent customer, he/she is more satisfied with recovery when the referent customer participates in the loyalty program than when the referent customer does not participate in the loyalty program ($t = 3.65$, df = 372, $p < 0001$). However, when the respondent experienced external equity (i.e., he/she received the same compensation as the referent customer), no significant differences were found, supporting *H2a*. These findings are illustrated in Figure 1 and Tables I-IV.

Discussion

This study demonstrated that external equity (inequity) has a strong, significant effect on satisfaction with service recovery following service failure. When a person who experienced service failure discovers that other customers suffered similar service failures, he/she expects to receive the same recovery. The customer is dissatisfied when other consumers receive better treatment.

Figure 1 Satisfaction with service recovery as a function of external equity and loyalty program membership

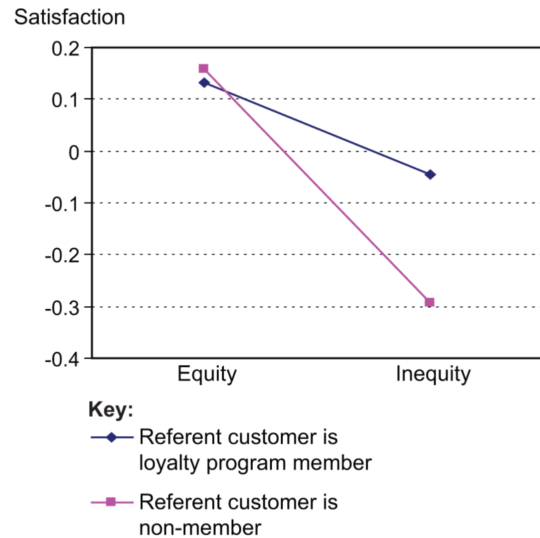

Table I Cell means for satisfaction with service recovery

	Loyalty membership status of the referent customer			
	Referent customer is loyalty program member		Referent customer is non-member	
	Mean	SD	Mean	SD
External equity	0.131	1.048	0.157	1.115
External inequity (unfavorable)	−0.045	0.900	−0.293	0.831

Table II Cell means for perception of external equity

	Loyalty membership status of the referent customer			
	Referent customer is loyalty program member		Referent customer is non-member	
	Mean	SD	Mean	SD
External equity	0.676	0.748	0.390	1.003
External inequity (unfavorable)	−0.526	0.695	−0.754	0.710

However, the results of this study also show that the effects of external inequity on satisfaction with service recovery can be moderated by the status of the referent customer. An occasional customer is less dissatisfied with being undercompensated in comparison with another if the latter is a loyal customer. This result is interesting because it implies that consumers tolerate differences in service recovery and complaint handling if these inequalities are based on criteria that they consider legitimate – for example, membership in a firm's customer loyalty program.

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Table III Mean satisfaction with service recovery, three-items

		Loyalty membership status of the referent customer			
		Referent customer is loyalty program member		Referent customer is non-member	
Item	Experimental condition	Mean	SD	Mean	SD
I'm satisfied with the level of compensation	Equity	1.79	1.234	1.80	1.187
	Inequity (unfavorable)	1.64	1.003	1.34	0.745
The compensation given by this phone provider is not satisfactory (r)	Equity	5.16	1.226	5.14	1.309
	Inequity (unfavorable)	5.42	0.968	5.46	1.187
I am not satisfied with the way the phone provider responded to my complaint about this problem (r)	Equity	5.17	1.230	5.12	1.277
	Inequity (unfavorable)	5.24	1.201	5.58	0.930

Note: (r) = reverse scored

Table IV Mean satisfaction with service recovery, three-items

		Loyalty membership status of the referent customer			
		Referent customer is loyalty program member		Referent customer is non-member	
Item	Experimental condition	Mean	SD	Mean	SD
With the solution offered by this provider, other customers obtained more than me	Equity	2.22	1.463	2.91	1.003
	Inequity (unfavorable)	4.90	1.443	5.31	1.444
If I take into account the compensation which was offered to other customers, I did not receive the compensation I deserved	Equity	3.22	1.776	3.48	1.974
	Inequity (unfavorable)	4.97	1.395	5.43	1.297
I think that in my particular situation, other customers received better compensation than me	Equity	2.54	1.628	3.13	1.985
	Inequity (unfavorable)	4.58	1.567	4.92	1.760

Our research contributes to the service recovery literature by formulating a new application of equity theory. Social psychologists who first articulated the equity theory concept (Deutsch, 1975; Adams, 1963) theorized that judgments of equity are not solely based on monetary resources (for instance the prices paid for services received) but also on intangible aspects of the relationship between two parties. In the present study, we show that it is important to take into account a non-monetary variable – the consumer's loyalty status – in consumer assessments of firms' attempts to recover from service failures.

From a managerial perspective our research has several implications. Certainly, external equity directly affects satisfaction with recovery, and the beneficial effects of service recovery on satisfaction are stronger when service providers treat all customers in an equitable manner. Thus, it stands to reason that when service providers handle complaints, they should try to handle their customers in an equitable manner. However, when service providers' resources are constrained and service recovery is difficult to achieve for every customer, this study suggests that allocating service recovery to the best customers can be accomplished. Equity judgments are based on comparisons between contributions and results. Service providers should understand the elements that that consumers perceive as pertinent contributions to the exchange. In this study we show that the consumer's status – being a member or a non-member of the loyalty program – represents a pertinent contribution for the exchange: a non-member customer will show some acceptance for being undercompensated if he/she evaluates the service recovery in comparison to a member of the loyalty program.

This result is particularly interesting for the service industries that rely heavily on CRM and loyalty programs for competitive advantage. For example, the transportation and the hospitality sectors routinely give better service to their customers who participate in loyalty programs. This study shows that consumers can accept differences in recovery handling as well, provided that they know the criteria chosen for the recovery differential, and provided that these criteria seem legitimate. Customers will evaluate a firm more favorably if the firm communicates its recovery procedures and explains on which principles the recovery procedures are based (Folger and Cropanzano, 1998).

Nevertheless, the study findings also suggest that the customer's satisfaction with recovery is highest when external equity is maintained – that is, everyone gets compensated equally and they know it. Customers will be more satisfied if they are treated equitably in comparison with the other customers. As our results show, the positive effects of service recovery on satisfaction are lower when customers perceive they were treated in an inequitable manner in comparison with other consumers.

Another question that emerges from the present study involves the appropriateness and profitability of using compensation for service failures, topics that have not been widely researched. Studies in the service recovery literature have analyzed the effects of satisfaction with service recovery

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on repurchase intentions, presuming a system of causal links between successful service recovery, repeat purchase behavior, increased customer loyalty, and therefore profit. There is a significant relationship between compensation, satisfaction with recovery, and repurchase intentions, but their effect on profitability has not yet been established. Rust and colleagues (Rust *et al.* (2000); 2004, Rust and Chung, 2006) have established that customer equity results from investments in service quality, and part of service quality involves complaint handling and service recovery. Of course, profitability can also result from choosing less expensive means of service recovery than cash compensation (the reviewer suggests vouchers for future service), and perhaps understanding the needs of various segments of customers would guide managers to make the right decisions. Some service researchers have suggested that front-line managers can learn to satisfy complaining customers by understanding and applying exactly the kind of remedy that will result in a positive outcome (e.g., Chebat and Kollias, 2000), and this is another area for future investigations.

Since service failures and recoveries occur relatively infrequently compared to service delivery and consumption experiences, it raises the question whether one dissatisfied customer would know how others who experienced similar service failures had been treated. There is evidence that communication among customers has been growing, especially in services, and that consumers are quite interested in sharing their stories with one another. Hennig-Thurau *et al.* (2004) have shown that consumers engage in word-of-mouth online for a variety of motives, including desire for social interaction and desire for economic incentives. Similarly, Harris and Baron (2004) suggest that service consumers meet two interrelated needs through communication with other customers: reducing risk (including obtaining practical information about buying or using the service) and making social contact. Inter-customer communications about the firm's service failure, complaint handling, and compensation policy meet both of these needs.

It should be noted that in the scenarios presented to respondents, the focal customer learned about differential treatment by the firm through face-to-face communication with a friend. Such communications do not always occur in this manner, and with the growth of the internet, more and more communication takes place online and not directly. Owing to the internet, consumers have more options for gathering information from other consumers without firms' involvement. Because the internet presents markedly different communication opportunities between participants compared to face-to-face communication (e.g., everybody can access the forum, the opinions are available to other customers, the opinions are anonymous, etc.) "online" word-of-mouth deserves greater attention of future service recovery research.

Limitations

Of course, there are several limitations of this study that must be considered. First, we studied satisfaction with recovery using scenario manipulations in a laboratory setting. Field research in marketplace settings with actual customers would lend more external validity to the findings. However, it should be noted that almost all the respondents in our sample (over 97 percent) used mobile telephones, and they were extremely familiar with the service; furthermore, in debriefing questions after the experiment, respondents reported that they found the scenario descriptions very realistic. Yet, the scenario method is limited in that respondents may be unable to project their behaviors and their feelings as they actually would in a real situation.

Second, in this research we studied only the case of negative external inequity (the respondent receives a lower compensation than the referent customer), and we did not explore a situation where a focal customer received a higher level of compensation than the referent customer (the case of positive inequity). In workplace settings favorable inequity can lead to feelings of guilt for the advantaged worker (Roussel, 1992). However, Adams (1963) notes that the threshold for positive inequity is much higher than in the case of unfavorable inequity, and in most service recovery contexts, favorable inequity may not be noticed unless it is rather extreme. For example, Tax *et al.* (1998) recalled that Domino Pizza's money back guarantee – which was too generous – generated customer embarrassment, prompting the firm to reduce the level of compensation offered to the customer after a service failure.

Third we conducted this experiment among French student respondents, who may react differently from consumers in other cultures. For example, Hofstede (1991) noted that American consumers are more individualistic than the French, which suggests that American customers may be more likely to maximize their personal interests than French customers. Hence, in our study, the moderating effect of loyalty program on satisfaction would be weaker with American respondents than with French respondents. Future research should attempt to replicate this experiment cross-culturally.

And finally we tested our model in only one service sector – the mobile phone – which has a high frequency of use among the respondents. The mobile telephone industry has several characteristics that help the internal validity of the study but limit the generalizability of the results. In particular, mobile telephone service in France and other countries contain significant switching barriers, including the length of contract between customers and service providers, barriers to transferring one's personal phone number from one service provider to another, and complexity of the pricing of telephone service. The mobile telephone industry has more switching barriers than other service industries (travel, restaurants, hairdressing . . .), and they impact repurchase intentions. It would be interesting to confirm the results of this research in another service industry that has a lower usage frequency and where switching barriers are not as high.

More research is needed to understand the relations between equity/inequity and satisfaction. It would be interesting to know from which threshold – either in terms of percentage, or in terms of absolute value – the customer starts to perceive external inequity. In this study we presume that a linear relationship exists between equity and satisfaction. But it would be interesting to test this relationship between these two concepts with a non-linear model (for instance, using a logarithm model or an artificial neural network).

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Further reading

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Appendix

Scenario describing the service incident and recovery
You received a cell phone with a two-year subscription to Gammatéléphone (fictitious name). At the end of the first month your phone does not work properly anymore: you have breaks in service so frequently that you can no longer use your phone. You contact your closest Gammatéléphone retailer to alert him to this technical problem. Finally, after two months, your phone starts to function normally again, but still you have paid your 30-euro subscription fee for which you did not use. You have paid 30 euros twice (total of 60 euros) for nothing.

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You complain to your Gammatéléphone retailer, who says that he is sorry but this problem is not his responsibility. Finally, Gammatéléphone offers you a 10 percent discount for the following two months: on your next bill you will pay 6 euros less.

You complain to your Gammatéléphone merchant, who says that is too bad for you but this problem is not the company's responsibility. Finally, Gammatéléphone offers you a refund of 10 percent for the two months: on your next bill you will pay 6 euro less.

External equity condition – scenario
On your way back (from the store), you meet your friend Mark who purchased the same fixed rate plan from Gammatéléphone. (Unlike you, Mark subscribed to the preferred customer program "PRIVILEGE" Gammatéléphone, which is only offered to loyal customers.) He had the same troubles with his mobile phone as you did. Mark tells you that he accepted a 6-euro compensation for the two-month period when his mobile phone was faulty.

External inequity condition – scenario
On your way back (from the store), you meet your friend Mark who purchased the same fixed rate plan from Gammatéléphone. (Unlike you, Mark subscribed to the preferred customer program "PRIVILEGE" Gammatéléphone, which is only offered to loyal customers.) He had the same troubles with his mobile phone as you did. Mark tells you that he accepted a 12-euro compensation for the two-month period when his mobile phone was faulty.

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Executive summary and implications for managers and executives

This summary has been provided to allow managers and executives a rapid appreciation of the content of the article. Those with a particular interest in the topic covered may then read the article in toto *to take advantage of the more comprehensive description of the research undertaken and its results to get the full benefit of the material present.*

But it isn't fair! Parents, especially those with more than one child, will be familiar with the cry. Sibling rivalry often manifests itself in such protestations if it is thought that a brother or sister has been treated more favorably or perhaps punished less for a similar transgression.

It seems we never grow out of it. Being treated fairly is just as important to adults and, like children, adults can be ever watchful in comparing themselves with people who might be getting better treatment than they are. It seems that, to slightly misquote George Orwell, all of us are indeed equal but some of us more equal than others.

That is certainly the basis of organizations' CRM strategies whereby a firm selects its best customers and develops stronger relationships with them – the justification being that loyal and potentially more profitable customers can expect and get preferential treatment. For instance, loyalty programs can deliver added benefits to selected customer groups. Other customers tend to accept this and, far from crying "unfair", tend to regard it as a good way to do business.

But what happens when this "we do not treat all our customers equally for very good reasons" attitude is extended to attempts at service recovery when things go wrong? Will customers not in the favored group be prepared to accept a poorer response? Introducing CRM into service recovery could create dissatisfaction if some customers discover that others receive more favorable treatment following a firm's service failure. If firms try to differentially allocate resources to desired customer segments, they could generate significant ill will – that is if the customers who were not the favored ones ever found out.

For example, American Airlines introduced a program that offered a higher level of compensation for frequent flyer program members who had undergone multiple delays, but the airline limited its offer to customers who lived in cities where the company faced stiff competition. In effect they excluded certain customers because they did not live in geographic areas that managers defined as "preferred" markets, presumably because they represented different economic potentials for the company. But word leaked out because customers started to communicate on an internet forum and within a few days' time the customers who had not received the compensation offer clamored for better treatment.

In "External equity, loyalty program membership, and service recovery" Olivier Morrisson and John W. Huppertz study the problem, concluding that consumers can accept differences in recovery handling provided that they know the criteria chosen for the recovery differential, and provided that these criteria seem legitimate. Customers will evaluate a firm more favorably if the firm communicates its recovery procedures and explains on which principles the recovery procedures are based.

It seems obvious that when service providers handle complaints, they should try to handle their customers in an equitable manner. However, when resources are constrained and service recovery is difficult to achieve for every customer, this study suggests that allocating service recovery to the best customers can be accomplished.

The study demonstrated that when a person who experienced service failure discovers that other customers suffered similar service failures, he/she expects to receive the same recovery. The customer is dissatisfied when other consumers receive better treatment. However, the results also show that the situation can be moderated by the status of the referent customer. An occasional customer is less dissatisfied with being under-compensated in comparison with another if the latter is a loyal customer. This result is interesting because it implies that consumers tolerate differences in service recovery and complaint handling if these inequalities are based on criteria that they consider legitimate – for example membership in a firm's customer loyalty program.

Nevertheless, the study findings also suggest that the customer's satisfaction with recovery is highest when everyone gets compensated equally and they know it. Customers will be more satisfied if they are treated equitably in comparison with the other customers. The positive effects of service recovery on satisfaction are lower when customers perceive they were treated in an inequitable manner in comparison with other consumers.

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Since service failures and recoveries occur relatively infrequently compared to service delivery and consumption experiences, it raises the question whether one dissatisfied customer would know how others who experienced similar service failures had been treated. There is evidence that communication among customers has been growing, especially in services, and that consumers are quite interested in sharing their stories with one another – take the popularity of internet forums. Consumers have more options for gathering information from other consumers without the firms' involvement. Because the internet presents markedly different communication opportunities between participants compared to face-to-face communication (e.g. everybody can access the forum, the opinions are available to other customers, the opinions are anonymous, etc) "online" word-of-mouth deserves greater attention of future service recovery research.

(A précis of the article "External equity, loyalty program membership, and service recovery". Supplied by Marketing Consultants for Emerald.)

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