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Co-creating service recovery after service failure: The role of brand equity

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ABSTRACT

Co-creating service recovery with customers has recently appeared as a new perspective in service research. Prior research demonstrates the effectiveness of co-created recovery strategies in driving customer outcomes, and outlines when co-creating a service recovery is recommended. This paper complements prior research not only by demonstrating the mediating role of outcome favorability in the relationship between co-created service recovery and customer outcomes, but also by showing whether organizations with different levels of brand equity benefit equally from co-creating service recovery with their customers. The results of two experiments show that co-creating a service recovery makes customers believe they received the most favorable solution for the service failure, which in turn influences satisfaction with service recovery and repurchase intentions. In addition, co-creating a service recovery is recommended for organizations with low levels of brand equity, but not for organizations with high levels of brand equity.

1. Introduction

Many customers experience service failures. For example, the U.S. Department of Transportation (2016) reports that of the 423,889 flights in the U.S. in February 2016, a little <70,000 flights were delayed, and almost 7000 flights were cancelled. As service failures are a major cause of customer defection (Knox & Van Oest, 2014), managers benefit from understanding how to restore customer satisfaction following these events. Researchers propose several service recovery options, such as offering compensation, apologizing, showing empathy, and offering explanations (Gelbrich & Roschk, 2011). More recently, researchers demonstrate the viable benefits of co-creating service recovery with customers. A co-created service recovery refers to customers' "ability to shape or personalize the content of the recovery through joint collaboration with the service provider" (Roggeveen, Tsiros, & Grewal, 2012, p. 772). Several studies show the positive effect of a co-created service recovery on customer satisfaction and repurchase intentions, especially since customers consider a co-created service recovery as more fair (e.g., Cheung & To, 2016). Interestingly, research also reveals that a co-created service recovery makes customers less likely to demand a compensation (Roggeveen et al., 2012).

This paper complements prior research in three ways. First, while researchers have been studying service recovery issues for over 40 years (Van Vaerenbergh & Orsingher, 2016), co-creating a service recovery emerged as a research stream only recently. The increased popularity of co-creation in service recovery calls for additional empirical verifications, particularly considering the increasing emphasis on replications in marketing science (Lynch, Bradlow, Huber, & Lehmann, 2016).

Second, despite the observation that people's evaluations of joint decision-making is driven by both justice and outcome favorability perceptions (Skitka, Winquist, & Hutchinson, 2003), the service recovery literature focuses predominantly on perceived justice as a theoretical mechanism. Researchers, however, question whether other mechanisms underlie the effects of service recovery on customer evaluations (Van Vaerenbergh & Orsingher, 2016). This study provides a better understanding of the co-created recovery—customer outcomes relationships by examining the mediating role of outcome favorability, that is customers' beliefs that the received outcome is the most favorable of all potential outcomes.

Third, prior research mainly examines *when* a co-created service recovery is appropriate (e.g., in case of severe failures or when the employee initiates the co-created recovery; Roggeveen et al., 2012; Xu, Marshall, Edvardsson, & Tronvoll, 2014), but do not disclose whether all organizations benefit equally from doing so. This study examines the moderating role of the service provider's customer-based brand equity (hereafter: brand equity), which refers to the differential effect of brand knowledge on consumer response to the marketing of the brand (Keller, 1993). Customers react differently to service failures caused by high- versus low-equity brands (Brady, Cronin, Fox, & Roehm, 2008). Despite the observation that organizations differ significantly in their brand equity, the literature seems to have taken for

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granted that organizations could apply the same recovery options. This paper therefore examines whether customer reactions to a co-created recovery depend on the service provider's brand equity.

2. Theoretical background

2.1. Service recovery, justice and outcome favorability

Service recovery refers to the actions a service provider takes in response to a service failure (Grönroos, 1988). Prior research has commonly applied justice theory to explain why recovery activities (such as offering compensation, apologizing, etc.) affect customers' evaluations. Customers assess the fairness of the recovery in terms of what is provided to them (distributive justice), how (interactional justice), and why (procedural justice). Justice perceptions, however, explain only between 43 and 63% of the variance in customer satisfaction and behavioral intentions (Gelbrich & Roschk, 2011). Van Vaerenbergh and Orsingher (2016) thus suggest that mediators other than justice might "provide a more comprehensive understanding of the processes underlying service recovery's effects on individual customers" (p. 340).

Prior psychological research identifies fairness and favorability as two goals in decision-making (e.g., Skitka et al., 2003; Johnson & Rips, 2015). In line with Skitka et al. (2003), we define outcome favorability as customers' beliefs that the outcome is strictly better than alternatives, given their self-interests, to offset the dissatisfaction caused by the service failure. Social psychologists debated heavily about whether outcome fairness and outcome favorability are distinct, yet Skitka et al.'s (2003) meta-analysis reached the conclusion that "outcome fairness is empirically distinguishable from outcome favorability" (p. 309). Both concepts are naturally related, yet they refer to different aspects of the decision-making process. While the outcome of a service recovery process might be perceived as fair, this outcome might still not represent the most favorable outcome for a complaining customer. Drawing upon this literature, this study proposes outcome favorability as an alternative mechanism underlying the co-created recovery-customer outcomes relationships.

2.2. Co-creation in service recovery

Researchers recently started to explore the effectiveness of co-creating service recoveries with complaining customers. Co-creation is rooted in the Service-Dominant Logic (SDL), which proposes essentially that customers need to integrate their own resources (tools, skills, knowledge, …) with the resources provided by the organization (tools, skills, knowledge, …) in order to create and maximize value (Vargo & Lusch, 2004). Researchers and practitioners increasingly embrace value co-creation, as adopting these principles creates a more customer-centric organization and increases competitive advantage (Payne, Storbacka, & Frow, 2008).

Against this backdrop, several researchers examine the effectiveness of co-creating a service recovery (see Table 1). Co-creating service recovery generally increases customer evaluations of the service recovery, particularly in case of severe service failures, when the employee initiated the recovery, and if the level of co-creation during service recovery matches the level of co-creation during the initial service encounter. This study aims to broaden the scope of this research by examining the mediating role of outcome favorability and the moderating role of brand equity. Fig. 1 provides an overview of the conceptual framework guiding this study.

2.3. Hypotheses development

Prior research offers several explanations for the effectiveness of a co-created service recovery. First, customers appreciate the ability to discuss jointly a certain issue, as it allows them to exert more personal control and increase the probability of attaining the optimal outcome (Thibaut & Walker, 1975). For instance, Guo et al. (2016) show that co-creating a recovery increases perceived control over both the process and the recovery solution. Second, Park and Ha (2016) show that co-creating a service recovery leads customers to perceive the service provider as devoting more efforts to finding the most favorable outcome, which ultimately influences their post-recovery evaluations. Third, offering people the opportunity to express their views before the final decision is made signals the flexibility of the organization (Karande, Magnini, & Tam, 2007), which increases customer outcomes. Fourth, the self-serving bias induces people to take more credit for their own work (Bendapudi & Leone, 2003), leading to perceive the outcome of a co-created recovery as the most favorable. Common to these studies is the observation that customers who co-create a recovery have a higher probability of attaining an outcome that is tailored to their needs, which in turn creates more favorable perceptions of the recovery encounter. Hence, co-creating service recovery might influence customer perceptions of outcome favorability, which in turn affects their post-recovery evaluations. This study hypothesizes:

H1. Co-creating a service recovery affects customer (a) satisfaction with service recovery, and (b) repurchase intentions.

H2. Outcome favorability mediates the relationship between a co-created service recovery and post-recovery evaluations.

2.4. The moderating role of brand equity

Brand equity refers to the 'strength' of a brand in customers' minds, and is based upon brand awareness, perceived quality, brand associations, and other brand assets (Aaker, 1991). Brand equity is commonly considered as a signaling phenomenon (Erdem & Swait, 1998); high equity brands convey quality signals that can reduce customers' uncertainty. Keller and Lehmann (2006) further argue that brand equity plays an important role in reducing risks, especially during failure episodes. For instance, Brady et al. (2008) show that customers are more likely to forgive service failures caused by high equity brands than service failures caused by low equity brands. A high equity brand helps service providers to offset the potential negative consequences resulting from a service failure.

This paper posits that brand equity influences customer reactions to a co-created service recovery. The higher levels of risk and lower quality perceptions associated with low equity brands might make customers more uncertain about getting a favorable outcome during service recovery. Customers experiencing high levels of uncertainty tend to maximize control over the service delivery process (e.g., Grewal, Gopalkrishnan, Gotlieb, & Levy, 2007). Customers of low equity brands prefer to stay as close to the service provider as possible in order to maintain control and to ensure the service provider finds the best solution for their needs. In contrast, customers of high equity brands may feel less the need to closely monitor the service provider's actions as they are more likely to believe that the service provider is acting in their best interest. In support of this rationale, Pitta, Franzak, and Fowler (2006) argue that brand equity fosters trust and serves as a crucial performance guarantee. Customers of low equity brands would thus be less likely to have confidence into firms' recovery efforts, compared with customers of high equity brands. This lack of confidence leads them to value more the opportunity to co-create the recovery in order to ensure a favorable solution is found. This rationale leads to the following hypothesis:

H3a. For low equity brands, co-creating a service recovery has a positive effect on outcome favorability and subsequent customer outcomes.

H3b. For high equity brands, co-creating a service recovery does not have an effect on outcome favorability and subsequent customer outcomes.