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## Compensatory Solution: Can it Save a Company from a Service Failure?

Trang P. Tran, Widyarso Roswinanto, Erlinda Nusron Yunus & Pepey Riawati Kurnia

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## 10 **Compensatory Solution: Can it Save a Company From a Service Failure?**

Trang P. Tran<sup>a</sup>, Widyarso Roswinanto<sup>b</sup>, Erlinda Nusron Yunus<sup>c</sup>,  
and Pepey Riawati Kurnia<sup>b</sup>

<sup>18</sup><sup>a</sup>Department of Management, Marketing, and Information Systems, State University of New York at Oneonta, Oneonta, New York; <sup>b</sup>Department of Marketing, PPM School of Management, Jakarta, Indonesia; <sup>c</sup>Department of Operations, PPM School of Management, Jakarta, Indonesia

### **ABSTRACT**

This article develops a framework incorporating the relationship between service failure and customer behaviors, as well as moderation effects of compensatory mechanism. Based on 321 responses from two cultures (United States = 180, Indonesia = 141), using the partial least squares path modeling approach, we found that service failure severity was negatively associated with customer loyalty and positively associated with customer's need for avoidance and need for revenge. The findings also suggest that the impact of service failure severity on customer loyalty is mediated by the need for avoidance, but not revenge. Theoretical and managerial implications are also discussed.

### 10 **KEYWORDS**

Customer behaviors;  
customer loyalty; Indonesia;  
service failure; United States

## **Introduction**

Imagine after you explain to a service person in Best Buy—your favorite electronics store—that the ASUS VivoBook 13.3 laptop you bought a month ago does not run smoothly so you want to get a refund, yet your request is declined. Instead, the staff offers you an exchange with any other item at an equal price. The staff further explains that you would have received the refund if you had a receipt and had returned the item within 14 days after purchase. Beyond the stipulated date, you could not get the refund although the item was still under 12 month manufacturer's warranty. What would you think when you heard this information? Will you come back to Best Buy again when you need an electronic item? The present article will help readers understand more about the mechanism on which customers make a decision.

Understanding what customers want and need and then providing products or services to fulfill customers' requirements are the top priority in marketing strategies of service providers and retailers. Fulfilling customers' requirements is an

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**CONTACT** Trang P. Tran ✉ [trang.tran@oneonta.edu](mailto:trang.tran@oneonta.edu) 📧 Department of Management, Marketing, and Information Systems, SUNY Oneonta, 108 Ravine Parkway, Oneonta, NY 13820.

<sup>11</sup> Color versions of one or more of the figures in the article can be found online at [www.tandfonline.com/wsmq](http://www.tandfonline.com/wsmq).

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ultimate goal of the majority of the marketers (Dowling & Uncles, 1997; Rigby, Reichheld, & Scheffer, 2002), since there is a strong relationship between customer satisfaction and a firm's profitability. The contribution to profitability of happy customers is represented through positive customer behaviors such as more frequent shopping, higher willingness to pay a premium price, as well as through the company's saving cost in maintaining customers and advertisement (Dowling & Uncles, 1997; Rigby et al., 2002; Wulf, Odekerken-Schröder, & Iacobucci, 2001). Although customer relationship literature has raised a question as to whether investing to build a strong customer relationship is profitable, maintaining a healthy relationship with customers is still a priority in several service firms (Reinartz & Kumar, 2000).

Although the customer relationship has been studied extensively, little research has been conducted to examine how a customer relationship changes when a service provider fails to provide a promised service or product. This has been a call for future marketing research. It is extremely critical for marketers to be aware of how a service failure affects customer perception, because such a failure has a serious negative effect on the firm. Failure can transform loyal customers into disloyal ones, and deteriorate a firm's reputation and profitability. For customers, a service mistake represents an indicator of the firm's failure to keep a promise, or a signal of the firm's betrayal. Therefore, they tend to react negatively against the firm (Grégoire & Fisher, 2006).

This article primarily focuses on investigating (a) the effects of service failure on customer reactions represented by customer loyalty (CUSL), need for avoidance (NFA), and need for revenge (NFR); (b) the mediating effects of need for avoidance, as well as NFR, on the relationship between service failure and CUSL; and (c) the role of compensation procedure in reducing the extent to which customers avoid or revenge a firm (see Figure 1).

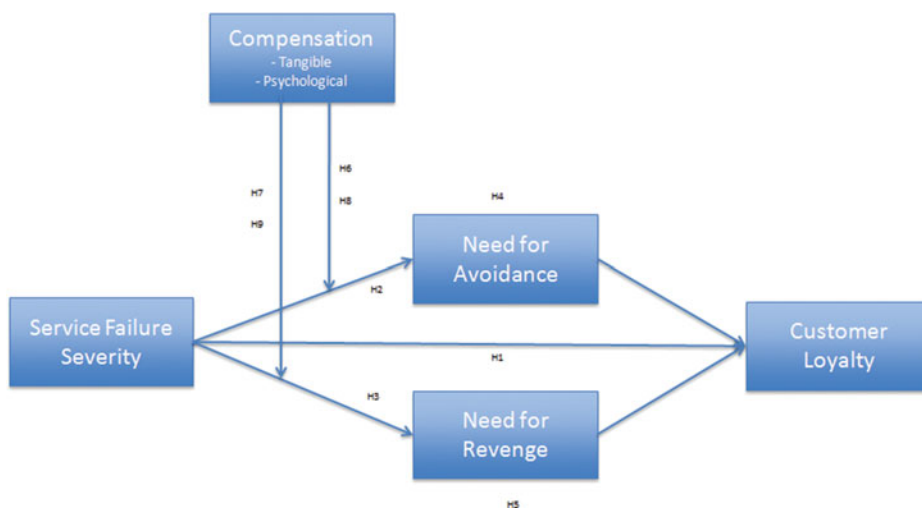


Figure 1. Conceptual model.

The article begins with theoretical perspectives to provide more background of service failure, customer loyalty, need of avoidance, and need of revenge. Methodology then follows in which measure scales, partial least square (PLS) approach, measurement model, and structural model analysis are discussed. The article concludes with general discussions and implications.

## Theoretical background and hypotheses

### *Service failure severity*

A service failure is defined as service performance that falls below a customer's expectation (Hoffman & Bateson, as cited in Hess, Ganeson, & Klein, 2003). Service failure is a key construct that has drawn the attention of both managers and scholars (Kelley & Davis, 1994). Factors affecting customers' perceived magnitude of service failures are divided into individual or situational factors. More specifically, a service failure can be perceived by one person to be more serious than another. In contrast, a service failure that takes place in one situation is considered less severe than the same failure that takes place in a different situation. For instance, while driving you notice that your fuel level is getting low, so it is time to refill the tank. But when you stop at a gas station along the highway, you see a "not in service" sign. What would you think if that incident happened in the morning as opposed to in the evening? Certainly, the effect of "not in service" in the evening is more critical than that in the morning.

For a service organization, it is essential to understand how customers feel after being exposed to a service failure (Hart, Heskett, & Sasser, 1990). A growing body of research in service marketing suggests that if customers view a service failure as serious, it is difficult for a service firm to figure out a solution for the problem (Levesque & McDougall, 2000; Smith & Bolton, 1998; Smith, Bolton, & Wagner, 1999). Service failure and service recovery are two sides of the same coin. When a mistake occurs in a service offering, an action should be done in attempt to recover the problem. By initiating a recovery attempt, a service firm tries to reduce the magnitude of service failure perceived by a customer after experiencing an incident.

The severity of a service failure is defined as the level of intensity of a service problem that a consumer encounters. A higher level of intensity of a service problem results in a higher level of service failure severity (SFS), and therefore the customer experiences a greater loss derived from the failure. Research also shows that the more severe the service failure, the more negative the customer feels about the service provider after the service failure. This connection is further supported by the prospect theory arguing that, in a comparison between a loss a customer experiences as a result of a service failure and a gain that the customer expects to have as a result from the company's recovery efforts, the loss is more heavily weighed than the gain (Kahneman & Tversky, 1979; Smith et al., 1999; Thaler, 1985). Therefore, the customer usually feels more losses than gains after each service failure in spite of the firm's efforts to recover.

## Customer loyalty

CUSL is a key outcome factor that is extremely important for marketers. This construct is an essential driver in motivating customers to maintain a close relationship with a firm (Fornell, 1992; Richins, 1983). The effects of CUSL are well documented in related literature, and include positive word-of-mouth communication, strong commitment and relationship (Morgan & Hunt, 1994), frequent purchases, and willingness to pay premium prices (Zeithaml, Berry, & Parasuraman, 1993).

What are the main factors resulting in CUSL? Among several factors that serve as key drivers of CUSL such as unwillingness to select an alternative, distinct investment, unique personal-based relationship, trust, and commitment (Bendapudi & Berry, 1997; Yi, 1990; Kumar, Hibbard, & Stern, 1994; Buttle & Jamie, 2001), customer satisfaction is viewed as one of the most important (Oliver, 1999). The extent to which customers are loyal to a service provider depends on how satisfied they are with the quality of service provided. If customers are satisfied, they become more loyal to the firm. Otherwise, if they're not satisfied, their behaviors are the opposite (Oliver, 1999). If service failure is taken into account, it is a key driver of customer dissatisfaction, thereby leading to a decrease in CUSL to the firm. As such:

*H1: SFS is negatively associated with CUSL.*

## Need for avoidance and need for revenge

This research employed two focal constructs, NFA and NFR, as behavioral outcome variables in the context of service failure. These constructs are incorporated into the model because they reflect a customer's negative reactions associated with the context of service failure. Both constructs are used to characterize a customer's unwillingness to forgive and the presence of a customer's grudge against the service firm (Aquino, Tripp, & Bies, 2001) when a service failure takes place. Conceptually, NFA is defined as a customer's desire to stop doing business with and avoid interactions with the firm that has caused a damage (Bechwati & Morrin, 2003; Grégoire & Fisher, 2006), while NFR refers to a customer's desire to take a retaliatory action to the firm for the service failure (McCullough et al., 1998). There is a close connection between the two constructs since they represent a customer's unwillingness to "let go" (Finkel, Rusbult, Kumashiro, & Hannon, 2002). When NFA or NFR emerges, a resentment feeling develops in the customer's thought, leading the customer to be less forgiving (McCullough, Fincham, & Tsang, 2003).

Despite their connection, a NFA is conceptually differentiated from a NFR (McCullough et al., 1998). NFA represents a passive state in which a customer withdraws from any interactions with firms. Conversely, NFR involves a retaliatory reaction against the firm. Both types of needs are viewed as customers' negative actions that they usually take in response to the firm's service failure. These needs represent the extent to which customers are not willing to let the failure go or to forgive the

firm after a service mistake (Fehr & Gächter, 2000). In this case, they are more likely to avoid or revenge the firm causing the mistake. Therefore:

*H2:* SFS is positively associated with customers' NFR.

*H3:* SFS is positively associated with customers' NFA.

4 After reciprocal reactions, the customer's disappointment derived from the service failure is reduced and the customer feels better. The resulting reactions are considered a catalyst to reduce the tension between the customer and the firm. Although the customer's feeling about the firm is not as positive as before the occurrence of the mistake, the actions (avoiding the firm or taking revenge against the firm) performed to reduce the tension would help the customers regain balance. Therefore, the level of hatred the customer feels about the firm becomes less serious after one reacts. The relationship is formally hypothesized as follows:

*H4:* The impact of SFS on CUSL is mediated by NFA.

*H5:* The impact of SFS on CUSL is mediated by NFR.

As adapted from equity theory, two critical aspects are employed in the context of service recovery: distributive and interactive justices (Goodwin & Ross, 1992; McCollough, Berry, & Yadav, 2000). The former refers to a perception of fairness that one feels when one receives a tangible outcome as a result of service recovery (or service recovery outcome), while the latter relates to the process of a treatment that a firm performs during service recovery (or service recovery process; Blodgett, Hill, & Tax, 1997; Tax, Brown, & Chandrashekar, 1998). Both justices can substantially affect customer behaviors, resulting in an improved customer evaluation of the service recovery or in increased satisfaction (Goodwin & Ross, 1992; McCollough et al., 2000; Smith et al., 1999; Tax et al., 1998).

The level of commitment that a service provider has in service recovery is a main driver that helps the firm regain their reputation and maintain customer relationships. Equity theory suggests that commitment is represented by two different ways: how polite a firm's staff is in dealing with an incident in a recovery process (i.e., interactive justice) or how they compensate a customer (i.e., distributive justice) after the mistake. In the current study, distributive justice is represented by tangible compensation (i.e., refund), while interactive justice is represented by psychological compensation (i.e., apology). Both compensation methods, if used effectively, are key drivers that help subdue customers' negative reactions (i.e., NFA and NFR). Stated formally:

*H6:* The effect of SFS on customers' NFA is less impactful when customers receive tangible compensation than when they do not receive it.

*H7:* The effect of SFS on customers' NFR is less impactful when customers receive tangible compensation than when they do not receive it.

*H8:* The effect of SFS on customers' NFA is less impactful when customers receive psychological compensation than when they do not receive it.

*H9:* The effect of SFS on customers' NFR is less impactful when customers receive psychological compensation than when they do not receive it.

## Methodology

### Measurement scales

After a short introduction, participants were asked to specify, in writing, “a service company or a brand that failed to deliver its promise to you.” Consistent with methods used in prior literature (Vieceli & Shaw, 2010), participants were asked next to visualize the brand or the company and to briefly describe what or in what way the service provider had failed. Participants were asked to provide their responses immediately after listing their focal brand/company. The brand name or the company name was written before the participants continued filling out the survey. Prior knowledge for the brand or the company should be high insofar as respondents themselves pulled from their own service experience.

Statements that collectively captured descriptions of participants’ perception of SFS, NFR, and NFA were adapted from Grégoire, Tripp, and Legoux (2009), while items for CUSL were adapted from Beatty, Homer, and Kahle (1988) and Zeithaml, Berry, and Parasuraman (1996). Participants responded to statements on a 7-point, Likert-type scale (1 = *strongly disagree*, 7 = *strongly agree*), Categorical scale of “yes” or “no” was used to record whether or not the respondents received tangible compensation and psychological compensation (“yes” = receive compensation, “no” = no compensation).

Samples were conveniently gathered from two different countries in which researchers were based: the United States and Indonesia. Translation of the questionnaires from English to Bahasa Indonesia was conducted for Indonesian respondents. The questionnaire was then back-translated into English by four bilingual translators to ensure the translation accuracy (Herk, Poortinga, & Verhallen, 2005).

Data were collected from 321 respondents, primarily between the ages of 19 and 25, in a large public American university (180 respondents) and in an Indonesian private university (141 respondents). From the U.S. sample, 61% of the respondents were male and 85% were between the ages of 18 and 25. Indonesian respondents had a similar composition, with 55% of the respondents male and 93% between the ages of 18 and 25.

### 5 Partial least squares approach

PLS path modeling analysis was employed in the current research. PLS approach is a statistical technique designed to assess and evaluate estimated parameters in a complex, multivariate relationship between observed and latent (unobserved) variables (Ringle, Wende, & Will, 2005). PLS approach is preferred to covariance-based approach (i.e., LISREL or AMOS) in path analysis because it is not strictly bound by a large sample size or an assumption of normal data distribution. Additionally, PLS is preferred because of its ability to estimate the mediation effect in the model, which is considered relatively complicated in covariance-based counterparts (Chin & Newsted, 1999; Haenlein & Kaplan, 2004).



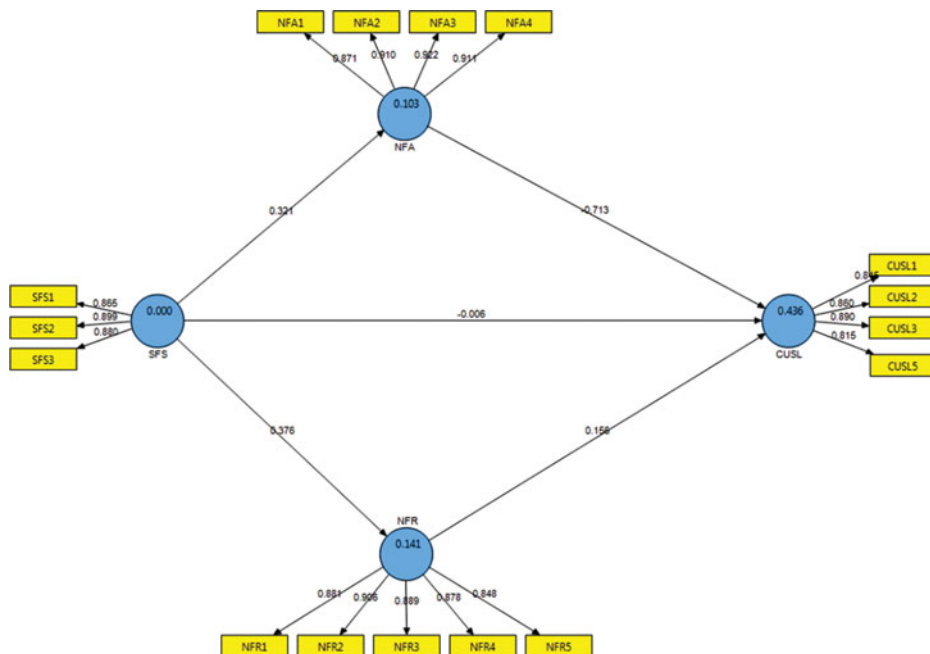
The model was assessed through two sequential steps: (a) the analysis of measurement model and (b) structural model analysis. In the first step, the reliability and validity of latent constructs were evaluated. After it was confirmed, the second step was performed where structural paths between exogenous and endogenous variables were estimated.

### Measurement model

The measurement model refers to the relationship between observed indicators and underlying (latent) constructs. The measurement model, consisting of reflective constructs, is analyzed through assessment of two key criteria: reliability and validity (Chin, 1998; Hulland, 1999).

Reliability is evaluated at two levels: at the indicator level and at the construct level. At the indicator level, factor loadings were used for assessment. Thresholds of factor loadings are 0.4 or 0.5 are accepted depending on the research subject and discipline (Chin, 1998; Hulland, 1999). All items had acceptable factor loadings, greater than 0.5, except one item of CUSL (CUSL4; "I will not buy product from other firm/brand if this firm/brand is available somewhere else") with a factor loading 0.226. Therefore, this item was removed before next steps of analysis were performed. Figure 2 shows factor loadings of latent variables after CUSL4 was deleted.

Other key criteria were employed to assess reliability at the construct level; that included Cronbach's alpha reliability coefficient and composite reliability (Nunnally



**Figure 2.** Results of model testing.

Note. SFS = service failure severity; NFA = need for avoidance; NFR = need for revenge; CUSL = customer loyalty.

**Table 1.** Convergent and discriminant validity.

	CUSL	NFA	NFR	SFS	AVE	Square root AVE	Composite reliability	Cronbach's alpha
CUSL	1				0.73	0.85	0.91	0.88
NFA	-0.65**	1			0.82	0.90	0.95	0.93
NFR	-0.16**	0.46**	1		0.78	0.88	0.95	0.93
SFS	-0.18**	0.32**	0.38**	1	0.78	0.88	0.91	0.86

Note. SFS = service failure severity; NFA = need for avoidance; NFR = need for revenge; CUSL = customer loyalty; AVE = average variance extracted.

\*\*Correlation is significant at the .01 level (two-tailed).

& Bernstein, 1994). The values of 0.7 or higher in both indexes showed high reliability for a construct. Table 1 portrays high reliability in all latent constructs of the model as both Cronbach's alpha and composite reliability values were well above the thresholds of 0.7.

In PLS path analysis, both convergent and discriminant validity are used to evaluate validity of a construct. Average variance explained (AVE) is used to be indicative of convergent validity. AVE of a construct represents the amount of variance that indicators of that constructs explain relative to the total amount of variance including the variance accounted for by measurement errors (Bagozzi, Yi, & Phillips, 1991). A construct that has AVE of greater than 0.5 shows a high level of convergent validity. Accordingly, all latent constructs, SFS, NFA, NFR, and CUSL exceeded the minimum threshold of 0.5. Additionally, composite reliability (with the range from 0.91 to 0.95) and Cronbach's alphas (from 0.86 to 0.93) of these constructs provide further support for convergent validity (see Table 1).

In addition to convergent validity, discriminant validity is employed to measure validity of an underlying construct. If a construct shows evidence of discriminant validity, the variance shared between that construct with the block of its indicators is greater than the variance shared by that construct with other constructs with each characterizing another block of different indicators (Hulland, 1999). That is obtained by comparing between the square root of the AVE and correlation coefficients between that construct with others. If the square root of the AVE is greater than the Pearson's correlation coefficients, the evidence of discriminant validity of a construct is confirmed. Results, shown in Table 1, illustrated that all constructs had acceptable levels of convergent validity. As all criteria designed to evaluate reliability and validity were fulfilled, the results in the measurement model showed a good fit between the model and the data.

### **Structural model**

The relationships between exogenous latent variables and endogenous latent variables are tested in the structural model. Unlike the covariance-based approach (i.e., LISREL), PLS path analysis is a technique that is preferred in the predictive modeling and is not restricted by statistical model fit indices as a result of the assumption of distribution free variance approach (Hulland, 1999). The quality of the structural

**Table 2.** Results of  $f^2$  and  $q^2$ .

Variable	CUSL		
	Path coefficients	$f^2$	$q^2$
NFA	− 0.714	0.690	0.410
NFR	0.156	0.030	0.020
SFS	− 0.176	0.000	0.000

Note. SFS = service failure severity; NFA = need for avoidance; NFR = need for revenge; CUSL = customer loyalty.

12 Model is assessed through a series of nonparametric tests. The results of these tests provided the following statistical figures.

1 First, the range of values of the determination coefficients ( $R^2$ ) is from 0 to 1. The higher the  $R$ -squared value is, the higher percentage of variance in an endogenous variable by the exogenous variables pointing to it. The  $R$ -squared values, shown in Figure 2, were 0.44, 0.10, and 0.14 for CUSL, NFA, and NFR, respectively. CUSL is of importance since it's the final outcome variable. The results showed that 44% of variance in CUSL was explained by three exogenous variables: service failure, NFA, and NFR. Despite the shortage of explanations of what the adequate threshold values for  $R$ -squared are (Pituch, Whittaker, and Stevens, 2015), implications from the results are the conceptual model fits the data reasonably.

5 Second, direction and significance levels of path coefficients estimated in the PLS analysis are tested using a bootstrapping resampling procedure. Means of asymptotic  $t$  statistics generated through this procedure are used to evaluate the goodness of path coefficients. The number of bootstrapping samples was set to 500 and standard error estimates were assessed through  $t$  tests (Chin, 1998; Sellin & Keeves, 1997; (Hulland, 1999). The results pertaining to direction and significance levels of path coefficients were reported in the Hypotheses Testing section.

16 Third, the effect size is a critical criterion to examine whether the impact of an independent latent variable on a dependent latent variable is substantive or not. The current research applied the method developed by relevant literature (Cohen, 1992; Schroer & Hertel, 2009) to test the effect size  $f^2$  in the PLS approach. As Cohen (1992) suggested, if  $f^2$  values are 0.02, 0.15, and 0.35, effect sizes are small, medium, and large, respectively. Table 2 shows that the effect of NFA on CUSL was large ( $f^2 = 0.69$ ), while NFR and SFS on CUSL were small ( $f^2 = 0.03$  and 0.00, respectively).

Fourth, the Stone-Geisser statistic, or  $Q^2$ , (Geisser, 1975) is an indicator of the model's predictive relevance through a blindfold procedure. This value is used to calculate the effect size  $q^2$ . Like the case of  $f^2$ , the  $q^2$  values showed that predictive relevance of NFA on CUSL was large ( $q^2 = 0.41$ ), while predictive relevance of NFR and SFS on CUSL was small ( $q^2 = 0.02$ , and 0.00, respectively) (see Table 2).

Finally, the goodness-of-fit (GoF) criterion is the global measure of the overall prediction performance of the model, since it takes into account both the measurement and structural model (Tenenhaus, Vinzi, Chatelin, & Lauro, 2005). The current study has a GoF value of 0.42, representing a high level of global prediction performance.

## Hypotheses testing

### Main effects

H1 postulates a significant, negative relationship between SFS and CUSL. To test this direct relationship, a model was created including only one exogenous construct (SFS) and one endogenous construct (CUSL). This model excluded NFA and NFR. The results showed that SFS affects CUSL significantly and negatively ( $\beta = -0.19$ ,  $p = .00$ ). That means the more severe a service failure is, the less a customer is loyal to the firm. Therefore, H1 was supported (see Table 6).

To test H2, and H3, two constructs were added to the model. The results showed that all relationships between exogenous and endogenous variables were statistically significant except for SFS and CUSL relationship ( $\beta = -0.006$ ;  $p = .89$ ). The lack of significance in this relationship might be indicative of mediation effects of NFA and NFR (that is discussed in detail in the Mediation Effects section). The results showed that SFS positively predicted NFA and NFR ( $\beta = 0.321$ ;  $p = 0$  and  $\beta = 0.376$ ;  $p = 0$ , respectively), therefore, H2 and H3 were supported.

### Mediation effects

A step-by-step procedure to test mediation effect was adapted from Baron and Kenny (1986). NFA was evaluated first for mediation effect. When the PLS model was estimated without NFA, the results showed path coefficients' significance that was found via bootstrapping procedure (i.e., with 321 observations per subsample and 500 subsamples). The relationship between SFS and CUSL was significant (path  $c = -0.133$ ,  $p = 0.026$ ). Next, when NFA was included, the indirect effects of SFS on NFA and NFA on CUSL were both significant (path  $a = 0.321$  and path  $b = -0.714$ , respectively). So the indirect effect's size was  $(0.321) \times (-0.714) = -0.229$ . Following Hair, Hult, and Sarstedt's (2013) procedure, the indirect effect of SFS on CUSL via NFA was significant ( $p = .000$ ). The final step involved calculating the strength of this mediation. Total effect, that was the sum of indirect effect and direct effect, was  $-0.362$  ( $-0.133$ ,  $-0.229$ ). The VAF was therefore 63% (or  $-0.133/-0.362$ ). Since  $20\% < \text{VAF} < 80\%$ , it was concluded that NFA had partial mediation effect. Therefore H4 was supported.

Similarly, the same approach was applied to NFR to test the mediation effect. However, when NFR was not included in the model, the relationship between SFS and CUSL was not significant (path  $c = 0.034$ ,  $p = 0.442$ ). Therefore it was concluded that NFR had no mediation effect. Hence H5 was not supported.

### Moderation effects

A moderating variable (or moderator) is one that changes the direction and/or significance of the effect of an independent variable on a dependent variable (Baron & Kenny, 1986). The moderator can be quantitative (i.e., age, or income) or qualitative or categorical (i.e., gender, education). In this study, two moderators (tangible and

**Table 3.** Tangible compensation moderation.

Variable	Yes (n = 49)		No (n = 260)		Yes vs. No			
	$p^{(1)}$	SE (p[1])	p(2)	SE (p[2])	p(1) - p(2)	t value	Sig.	p value
SFS → NFA	0.288	0.162	0.810	0.213	0.522	1.959	*	0.051
SFS → NFR	0.161	0.201	0.097	0.159	0.064	0.251	ns	0.802

Note. SFS = service failure severity; NFA = need for avoidance; NFR = need for revenge;  $p^{(1)}$  and  $p^{(2)}$  are path coefficients of corresponding groups; SE (p[1]) and SE (p[2]) are the standard error of  $p^{(1)}$  and  $p^{(2)}$ , respectively. \* $p < .10$ .

**Table 4.** Psychological compensation moderation.

Variable	Yes (n = 111)		No (n = 198)		Yes vs. No			
	$p^{(1)}$	SE (p[1])	p(2)	SE (p[2])	p(1) - p(2)	t value	Sig.	p value
SFS → NFA	0.202	0.098	0.822	0.183	0.620	2.994	**	0.003
SFS → NFR	0.304	0.087	0.097	0.155	0.207	1.165	ns	0.245

Note. SFS = service failure severity; NFA = need for avoidance; NFR = need for revenge;  $p^{(1)}$  and  $p^{(2)}$  are path coefficients of corresponding groups; SE (p[1]) and SE (p[2]) are the standard error of  $p^{(1)}$  and  $p^{(2)}$ , respectively. \*\* $p < .05$ .

psychological compensation) are categorical. The method used to test the moderation effects was adapted from Hair et al. (2013), which was based on a comparison of path coefficients across two groups of data. To do so, there are three steps required to specify relevant parameters: (a) the number of observations in each group; (b) the path coefficients of each group; and (c) the standard errors of the parameter estimates of each group. The results of testing moderation effects of tangible compensation were presented in Tables 3 and 4, which included details of comparison between two scenarios: one with tangible compensation and the other without it. The findings showed that the effect of SFS on customers' NFA was statistically smaller ( $p = 0.051$ ) when customers receive tangible compensation,  $p^{(1)} = .288$ , than when they do not receive it,  $p^{(2)} = .810$ , therefore H6 was supported. However, the effect of SFS on customers' NFR was not statistically different when customers receive tangible compensation than when they do not receive it ( $p = .802$ ), therefore H7 was not supported.

Similarly, the same approach was applied for psychological compensation. The results (see Table 4) indicated that the effect of SFS on customers' NFA was statistically smaller ( $p = 0.003$ ) when customers receive psychological compensation,  $p^{(1)} = 0.202$ , than when they do not receive it,  $p^{(2)} = .822$ , therefore H8 was supported. However, the effect of SFS on customers' NFR was not statistically different when customers receive psychological compensation than when they do not receive it ( $p = .245$ ), therefore H9 was not supported.

### Cross-cultural comparison

The impact of culture in the context of service failure could be interpreted through different levels of uncertainty avoidance associated with the corresponding cultures. Stated differently, the extent to which SFS affects NFA, NFR, and CUSL varies with cultures, each of which is represented by a level of uncertainty avoidance.

**Table 5.** Cross-cultural comparison.

Variable	Indonesia (n = 141)		United States (n = 180)		Indonesia vs. United States			
	$p^{(1)}$	SE ( $p^{(1)}$ )	$p^{(2)}$	SE ( $p^{(2)}$ )	$ p^{(1)} - p^{(2)} $	t value	Sig.	p value
SFS → CUSL	-0.081	0.068	0.056	0.064	0.137	1.449	ns	0.148
SFS → NFA	0.253	0.084	0.409	0.061	0.156	1.514	ns	0.131
SFS → NFR	0.312	0.074	0.413	0.063	0.101	1.050	ns	0.295

Note. SFS = service failure severity; NFA = need for avoidance; NFR = need for revenge; CUSL = customer loyalty;  $p^{(1)}$  and  $p^{(2)}$  are path coefficients of corresponding groups;  $p^{(1)}$  and SE ( $p^{(1)}$ ) and SE ( $p^{(2)}$ ) are the standard error of  $p^{(1)}$  and  $p^{(2)}$ , respectively.

According to Hofstede (2001), one dimension used to differentiate cultures is uncertainty avoidance. In high uncertainty avoidance cultures, people are not likely to take challenges. Conversely, in low uncertainty avoidance cultures, people have propensity to take challenges. Customer behaviors toward uncertain things are different across two cultures where the scores of uncertainty avoidance index (UAI) differ. Hence, in two cultures where the scores of uncertainty avoidance index are not different, customer behaviors are presumably similar. For this purpose, two countries are selected for this study: Indonesia and United States. The UAI score is 48 for Indonesia and 46 for the United States (Hofstede, 2001).

Although no official hypotheses are developed with respect to the cultural dimension, it is proposed that the impact of SFS on customers' behavioral reactions (i.e., NFA, NFR, and CUSL) are similar across the two cultures (Indonesia vs. United States). Procedures applied to test this proposition were the same as those used previously to test moderation effects of compensation. Table 5 shows that the effects of culture were not significant in all relationships between SFS and customer behaviors. Particularly, the impact of SFS on customers' NFA was not statistically different between Indonesia and the United States ( $p = .148$ ); so were the impact of SFS on customers' NFR ( $p = .131$ ) and the impact of SFS on CUSL ( $p = .295$ ). Therefore, the proposition that reactions of customers in cultures with similar UAI are not different was confirmed.

## General discussion

Drawing on the law of reciprocity and the equity theory as theoretical background, the present article develops an integrated model tapping the relationship between SFS and customer reactions (i.e., NFA, NFR, and loyalty), as well as the moderation effects of compensatory mechanism in recovering the weakened relationship between the customer and the firm after an occurrence of a service error. The list of hypotheses were tested using data collected from two cultures (Indonesia and United States) through a survey where all respondents were first primed to think about a company or a brand that failed to deliver a promised service to them, and were then asked to answer questions related to this failure.

In general, the findings of the present article shed light on the crucial relationship between the severity of service failures on customers' reactions including their NFA, NFR, and loyalty, as well as moderation effects of compensatory mechanism. The article also provides further evidence of mediation effects of NFA and NFR on

**Table 6.** Summary of hypotheses testing.

Hypothesis	Finding
Main effects	
H1: SFS is negatively associated with CUSL.	Supported
H2: SFS is positively associated with customers' NFA.	Supported
H3: SFS is positively associated with customers' NFR.	Supported
Mediation effects	
H4: The impact of SFS on CUSL is mediated by NFA.	Partially supported
H5: The impact of SFS on CUSL is mediated by NFR.	Not supported
Tangible compensation moderation effects	
H6: The effect of SFS on customers' NFA is less impactful when customers receive tangible compensation than when they don't receive it.	Supported
H7: The effect of SFS on customers' NFR is less impactful when customers receive tangible compensation than when they don't receive it.	Not supported
Psychological compensation moderation effects	
H8: The effect of SFS on customers' NFA is less impactful when customers receive psychological compensation than when they don't receive it.	Supported
H9: The effect of SFS on customers' NFR is less impactful when customers receive psychological compensation than when they don't receive it.	Not supported

Note. SFS = service failure severity; NFA = need for avoidance; NFR = need for revenge; CUSL = customer loyalty.

the relationship between SFS and CUSL. The results of testing hypotheses are summarized in Table 6.

### Additional testing

To examine whether tangible and psychological compensations have different effects, another test was conducted between two scenarios: one with tangible compensation and the other with psychological compensation. The results show that no significant difference exists across the two types of compensations in both relationships: SFS and NFA, and SFS and NFR (see Table 7). This implies that tangible solution and psychological solution can be employed interchangeably when a company attempts to recover from its mistake. Customers do not feel any differences between the two solutions.

To compare two cultures, a test similar to moderation test was used. The analysis on the sample data collected from Indonesia and the United States reflected that both cultures, which possess an equivalent level of uncertainty avoidance, are homogeneous in the way customers react against a firm's inability to provide promised

**Table 7.** Tangible and psychological compensation.

Variable	Tangible (n = 49)		Psychological (n = 111)		Tangible vs. psychological			
	$p^{(1)}$	SE (p[1])	p(2)	SE (p[2])	p(1) - p(2)	t value	Sig.	p value
SFS → NFA	0.288	0.162	0.202	0.098	0.086	0.474	ns	0.636
SFS → NFR	0.161	0.201	0.304	0.087	0.143	0.660	ns	0.512

Note. SFS = service failure severity; NFA = need for avoidance; NFR = need for revenge;  $p^{(1)}$  and  $p^{(2)}$  are path coefficients of corresponding group;  $p^{(1)}$  and  $p^{(2)}$  are the standard error of  $p^{(1)}$  and  $p^{(2)}$ , respectively.

services. Customers in both cultures have a similar propensity to avoid (measured by NFA), take revenge upon (measured by NFR), or become less loyal to the firm (presented by CUSL) when they perceive service failure from the firm.

### **Implications**

The current study has provided substantial evidence of the importance of a compensatory solution to be applied in service firms. Managers should take into consideration how to provide an appropriate solution to recover from a service failure. The results pertaining to mediation effects have a number of practical implications. Different from what is anticipated, where customers become less loyal to the firm after a service error, the results suggest that the relationship between SFS and CUSL is mediated by NFA but not by NFR. In other words, customers feel disloyal to the firm when they receive a service with the quality lower than expected. Decreased CUSL is an ultimate outcome variable that is measured in this study, but there would have been other factors serving as antecedents of this construct such as customer satisfaction or trust (those constructs are not included in this study). However, the severe impact of service failure is reduced substantially after the customers take an action to avoid business interactions with the firm. “Flight” approach (where customers are motivated to reduce patronage to the firm) represents an effective way to reduce the feeling of resentment that the customer has against the service firm. Nonetheless, a different effect is observed when the customer takes a “fight” approach (where customers take revenge on the firm). After a retaliatory action is taken, the severity of the service failure seems not to be lessened. In this case, taking revenge does not constitute an effective strategy to reduce the intense level of hatred a customer has against the firm.

The testing of moderating effects indicated that a similar tendency is seen in both tangible and psychological compensation. Receiving any kind of compensation (tangible or psychological) would help tranquil the severe effect of a service failure on a customer’s NFA. In other words, the customer is likely to maintain interactions (or do not avoid interactions) with the firm if the firm comes up with a recovery solution. In this way, a compensatory solution plays a role in calming down the customer’s feeling of resentment toward the firm. Nevertheless, it is not the case for NFR, and the effect is not evident in the fight approach. A customer still has the same tendency to take a retaliatory action against the firm regardless of the fact that the company compensates, either tangibly or psychologically.

Supplementary results provide marketers with profound evidence that compensatory solutions have the comparable effects. Either tangible or psychological compensation would have an equal effect on customer perception of the service failure. Additionally, the results pertaining to cross-cultural comparison showed that customers have similar behaviors toward a service failure no matter where they live. Put differently, customers are more likely to become less loyal, have a desire to avoid, or to take revenge after a service failure occurs as long as they have a similar tendency of uncertainty avoidance.



## Limitations

Although the present article has theoretical and practical implications, it is not without limitations. First, the present study collected data from a student population pertaining to their behavioral responses to service failures. Despite the fact that students could also be a proxy of customers, there might be different behavioral reactions between students and real customers who may have varying levels of sensitivity to the service failure experience. Second, this research employed simple measures to tap into the compensatory domain, which is not necessarily representative of compensation procedures utilized in the actual business. The simplified use of categorical variables for compensation in this study (yes/no) might lead to questionable results when more complicated procedures are applied in the real world. Finally, this study prompted customers to think about a service failure experience that they had encountered; however, customer perception is service sensitive. In reality, the extent to which a firm compensates customers for the firm's mistake varies with the nature of the business, the value of item purchased, or whether the item is bought online or offline. A possible avenue for future research would be to link customer experience of a service failure with a particular service in a clearly defined context.

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