Chapter 3
A Model of Profitable Service Recovery

Kristen DeTienne
Brigham Young University, USA

Aaron Brough
Pepperdine University, USA

David Blen Nance
Brigham Young University, USA

ABSTRACT

This chapter presents a model of service recovery designed to improve profitability by differentiating the recovery efforts offered to different customer segments. To predict customer responsiveness to recovery efforts, the model advocates the use of both (1) company knowledge and databases to classify customers by past profitability and (2) the severity of the service failure they have experienced. The chapter makes recommendations related to the level of recovery quality and the type of recovery effort that should be extended to customers in each segment of the classification scheme. Using this strategic model of service recovery, executives can avoid wasting costly resources on unprofitable recovery efforts and instead direct those resources to the customers most likely to respond favorably to recovery efforts. By focusing recovery efforts on these customers, the probability of generating a profit through recovery efforts is increased.

INTRODUCTION

Disappointed customers are less likely to continue doing business with a firm and are more likely to drive other customers away. Obviously, such actions can be costly for companies. Service recovery may be defined as the actions a company undertakes in order to mitigate the damaging effects of service failure. Indeed, strategic recovery of customers is an integral component of relationship marketing (Bruhn, 2003). Successful service recovery restores, and occasionally elevates, pre-failure levels of customer satisfaction and loyalty. Research by Johnson & Michel (2008) shows that service recovery has a positive impact on employees and process improvements as well as on customer recovery.

DOI: 10.4018/978-1-4666-0077-5.ch003

Regardless of a company's experience and effort, some service failures are inevitable. However, research shows that in many cases it is considerably more profitable for a company to work to keep customers who have been disappointed than to try to find new customers. For example, one empirical study found that firm profits doubled after increasing customer retention by only five percent. Additional evidence from these same authors suggests that by cutting customer defections in half, a firm can double its growth rate (Reichheld & Sasser, 1990). Thus, retaining customers can significantly contribute to a company's profitability.

When customers experience a service failure, customer retention is affected by the service recovery effort companies make. Studies in several industries show that return on investment for service recovery can reach 150 percent (Tax & Brown, 1998). Thus, effective service recovery can have a beneficial effect on profitability.

Service Recovery Impacts Profits

Competitive pricing alone does not create customer loyalty; companies must nurture customer relationships and mend broken ones (Scott, 2001). Inevitable accidental service failures necessarily represent visible opportunities to pursue or ignore such nurturing; therefore, the quality of service recovery efforts that companies offer to customers is critical when the relationship has been damaged or endangered by a service failure. High-quality service delivery, and recovery when needed, strengthens customer satisfaction and loyalty and thereby increases profits (Zeithaml, Berry, & Parasuraman, 1996). When customers perceive high-quality service, customer satisfaction is increased (Mohr & Bitner, 1995). Increased customer satisfaction significantly impacts profits; when the management of a credit card company focused on increasing customer satisfaction, profits increased sixteen-fold over a period of eight years (Reichheld & Sasser, 1990). In addition to directly contributing to profits, a high level of customer satisfaction generally promotes customer loyalty; which also leads to increased profits (Jones & Sasser, 1995). By raising levels of customer satisfaction and loyalty, high-quality service recovery reduces costs and improves revenues (Howell, 1996).

Cost Savings

Effective service recovery allows companies to avoid many of the costs associated with service failures. One of the biggest costs associated with service failure is customer defection because finding a new customer is much more expensive than retaining one. For example, one study found that it costs nine times more to attract a new symphony subscriber than to sell a third-year extension to a current subscriber (Zemke, 2000; Fornell & Wernerfelt, 1987). The finding that customer retention is less costly than customer acquisition may be explained in terms of the status quo bias. That is, even in the absence of financial incentives, existing customers may continue to do business with a firm simply because switching to a competitor is inconvenient. In contrast, potential customers must be convinced to change their current behavior, and this may require a high level of investment from the firm. Indeed, in many markets, firms' fiercest (and costliest) advertising efforts focus on poaching each others' dissatisfied customers, such that traditional marketing often serves as a 'revolving door' that brings in new customers even as existing customers are induced to defect (Fornell & Wernerfelt, 1987). As the Internet places firms into ever more direct competition, the costs of advertising and defection are exacerbated (Jain & Singh, 2002). By satisfying current customers and reducing customer turnover, service recovery can reduce these costs and help firms profit from long-term customer relationships.

Negative word-of-mouth is another large cost of service failures. Studies have shown that dissatisfied customers are likely to share their negative