

**Service Quality and its contribution to Price Premium through Service Loyalty: a B2B
Perspective**

A work in progress paper

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Service Quality and its contribution to market performance outcome: a B2B Perspective

Abstract

Introduction.

A steady stream of sales revenue for a service provider can be achieved through having superior market performance outcomes such as a high price premium. Among the variables underlying customer relationships is the perceptions of quality received. However for relationships to be mutually profitable the customer's willingness to pay must be taken into account (Ravald and Gronroos (1996). This indicator of market performance outcomes is directly related to service loyalty (Aaker 1991, 1996; Chaudhuri and Holbrook 2001). Achieving and maintaining a high price premium through attracting and retaining a loyal customer base is particularly significant in a business-to-business market. Nevertheless, there are opposing viewpoints in that loyal customers are not always seen as profitable despite arguments that loyalty makes customers less price sensitive.

Some authors argue that loyal customers, or presumably experienced customers, are actually more expensive to serve and that they are often demanding (see, for example, Reinartz and Kumar, 2002). Some loyal customers, in particular corporate customers, regularly exchange frequency of purchase in return for lower prices. Thus, Reinartz and Kumar (2002) argue that corporate clients expect and get some tangible benefits for their loyalty. These authors also provide evidence that long term customers consistently paid lower prices than the newer customers (between 5-7% less, depending on the product category). According to Gardener and Trivedi (1998), this is especially true in the retail sector. In other cases, loyal customers may be more willing to attempt to use their purchasing power to gain a discount, a particularly common scenario in business-to-business markets. As a consequence, it may be argued that loyal customers are not always willing to pay a price premium. The main aims of this paper are to empirically examine, within a B2B context, the contribution of perceived service quality to service loyalty and the contribution of service loyalty to price premium-one key indicator of brand equity, though service loyalty and willingness to pay a price premium

Based on a review of literature of perceived service quality, service loyalty, brand equity, business-to-business, relationship marketing and service marketing, a theoretical model examining the antecedents and outcomes of service loyalty in a business-to-business context is developed. This theoretical model explains a) the relationship between service quality and service loyalty b) the relationship between service loyalty, and trust in the service provider and price premium and c) a new composition of the service quality construct with dimensions reflecting a B2B context.

Research Method and research instrument

In order to test our conceptual model, we surveyed a sample of Australian small to medium enterprises (SMEs) on their courier delivery service providers, employing online and paper-and-pencil surveys. A total of 294 small to medium enterprises in Australia participated in this study. Small to medium enterprises comprise an economically important part in the Australian economy, yet they have only received little research attention in the marketing literature in the past. Given that many different definitions and indexes are available to identify small to medium enterprises, we used the Australian Bureau of Statistics (McLennan, 1995-1996) guideline for defining small to medium enterprises based on employee numbers and other characteristics.

Conceptual Background

This study proposes to link three major constructs namely service quality, service loyalty and price premium which is used as an indicator of brand equity. It has been proposed and tested in several previous studies that service quality contributes to loyalty and that loyalty contributes to price premium.

Perceived service quality's contribution to service loyalty

A critical measure understanding B2B markets is relationship quality. In the literature, a number of authors (e.g., Dwyer and Oh, 1987; Moorman et al., 1992) empirically found that relationship quality comprised trust, commitment and satisfaction. While researchers have proposed a great number of relationship quality components, they have most frequently studied the variables of trust, commitment and satisfaction (e.g., Anderson and Narus, 1990; Dwyer et al., 1987; Morgan and Hunt, 1994). In addition, research has only conceptualized but not tested the use of perceived product/service quality as a dimension of relationship quality. Hennig-Thurau and Klee (1997, p. 751) argue that, because the exchange of products and/or services is the fundamental feature of any buyer–seller relationship, including the overall products and/or service-related quality perception as a basic component of relationship quality is necessary; this supports the inclusion of perceived service quality as a dimension of relationship quality in this study.

Perceived service quality is examined in this study as a direct antecedent of service loyalty in the business-to-business service context. Two important service quality models are those of Gronroos (1984) and Parasuraman et al. (1985, 1988). Nevertheless, since most of the empirical research has been limited to the area of retail and consumer services, there is a need to better understand the relationship of perceived quality and customer loyalty in other contexts, such as industrial markets and business-to-business markets. This need is also emphasized by Boulding et al. (1993), who states that research efforts should be expanded to include industrial services and even services within industries in order to test quality models and propositions. Parasuraman (1998) also points out the need for academic research - both conceptual and empirical research - on the quality in business-to-business settings since most of the quality literature is company-to-consumer rather than company-to-company.

This study selects perceived service quality as the determinant of service loyalty for two reasons. First, customers' perceptions of service quality are considered as one of the critical determinants of loyalty (Lee and Cunningham, 2001). Zahorik and Rust (1992) argue that modeling perceived quality as an influencing factor of customer loyalty will provide significant diagnostic ability to any framework that includes customer loyalty as a dependent construct. Previous research has confirmed that the relationship between perceived quality and customer loyalty exists and is positive (Anderson and Sullivan, 1993; Cronin and Taylor, 1992; Harrison-Walker, 2001). As a critical measure of organizational performance, service quality remains at the forefront of both the marketing literature generally and the service marketing specifically (Jensen and Markland, 1996). Both practitioners and academics are keen on accurately measuring perceived quality in order to better understand its essential antecedents and consequences and, ultimately, methods for improving quality to achieve competitive advantage and build customer loyalty (Palmer and Cole 1995; Zahorik and Rust, 1992). In addition, in discussing the contributions of perceived quality, Aaker (1991) argues that the major advantage of perceived quality is the option of charging a premium price. Dean, Morgan and Tan (2001) found that service quality increases customer's willingness to pay more for travel services. Ruyter and Wetzel (1998) further suggest that it is important to

determine the nature and strength of the relationship between perceived service quality and service loyalty for a firm and/or different industry levels. Firm- and industry-level assessment of the service quality-service loyalty link provides useful information to shareholders on the viability of future performance.

Second, the use of perceived service quality will explain which aspects of service quality and to what degree they affect customers' willingness to pay a price premium for the service provider that they are loyal to.

From the above theoretical support, we can formulate hypothesis 1: Service Quality positively contributes to Service Loyalty.

The contribution of Service Loyalty to Price Premium

There are both theoretical and empirical support to the association between customer loyalty and price premium. Referring to Aaker's (1991) theory of brand equity, it is noted that loyalty is one major dimension of brand equity. Brand equity is believed to have a significant role in generating price premium to the brand owner. As a price premium is an outcome of loyalty, a premium price also reinforces the perceived quality and may also result in higher brand loyalty (Aaker 1991).

The notion that price premium is an outcome of loyalty is also supported by Keller (1993), who states, "consumers with a strong, favorable attitude should be more willing to pay premium prices for the brand". De Chernatony and McDonald (1998) further argue that firms with more loyal customers can ask for higher price premium and have the ability to command higher prices. Their customers are less price sensitive than competitors' customers. In addition, some practitioners, for example, Reichheld and Sasser (1990), proposed that loyal customers might be less sensitive to price increases than transactional customers.

Reichheld (1996) states that loyalty reduces marketing cost because loyal customers are less price sensitive and are often willing to pay a premium for same product and services that are also offered elsewhere. Loyal customers also tend to repurchase the product or re-use the service regardless of any discount or promotion. Loyal customers are also willing to pay more for a product or service if they have positive attitudes towards the providing firm (De Chernatony and McDonald, 1998). In a similar way, Werner et. al (2003) states that business-to-business customers are willing to pay a higher price just to keep the relationship going. Customers place more importance on the relationship than on the price of the product. As a result, these customers are less price sensitive and do not mind paying a price premium.

From above theoretical and empirical support, we formulate hypothesis 2: Service Loyalty positively contributes to price premium.

Hypothesis 2A states the contribution of service loyalty to price premium when price premium is defined as the customers' willingness to pay more for the product/service.

Hypothesis 2B states the contribution of service loyalty to price premium when price premium is defined as the actual extra amount of payment calculated in percentage of original price. (see operationalisation of price premium).

The model that is tested and the nature of the hypothesized relationships are shown in Figure 1.

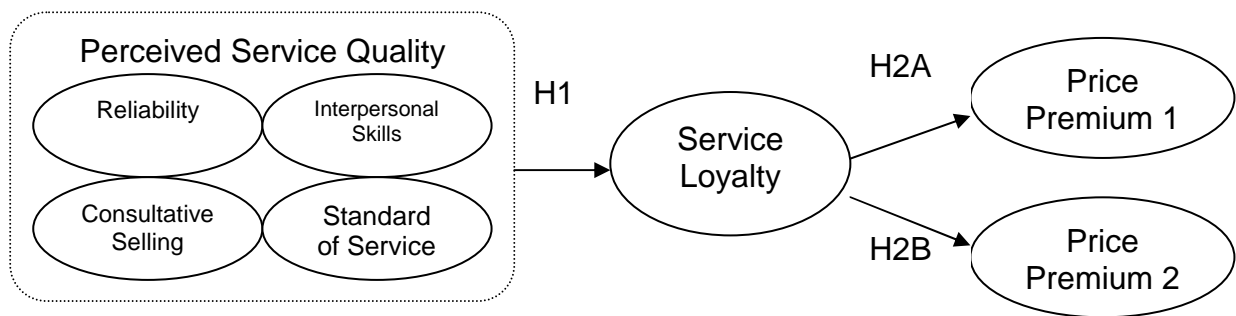


Figure 1: Theoretical relationship between perceived service quality, service loyalty and willingness to pay a price premium.

Operationalisation of constructs

Using a two-step approach of structural equation modelling was, we first tested the measurement models. Findings indicate that all constructs have acceptable levels of reliability and validity. Service loyalty is a composite measure of loyalty comprised of behavioral loyalty and attitudinal loyalty. Price premium was utilized as indicators of brand equity. Perceived service quality is comprised of four dimensions relating to service in the B2B setting: reliability, interpersonal skills, consultative selling, and standards of service. Second, the best fitting, most parsimonious model was identified by means of sequential chi-square difference test.

Perceived service quality

We follow the definitions and conceptualizations of service quality given by Ennew and Bink (1988), Bloemer and Kasper (1995) and Butcher et al. (2001), and conceptualize perceived quality as a customer's perception of the overall quality or superiority of the product and service with respect to its intended purpose, relative to its alternatives.

This study follows Cronin and Taylor's (1992) measurement model, which regarded service quality as a direct evaluation assessment of each of the aspects or facets of service offered by service providers. In addition, the operationalisation of service quality follows Westbrook and Peterson's (1998) dimensions of service quality for the business-to-business context. As a courier and parcel delivery service is chosen as the context of the current research, it is appropriate and necessary to modify and develop service quality items to suit the context.

The research instrument includes 30 items to measure perceived service quality in the business-to-business context. Ten items are dropped due to low factor loadings and cross factor loadings. From the EFA results, four factors are extracted for Service Quality (PSQ).

The four factors extracted for SQ account for 82.24% of total variance explained. Factor 1 (7 items) accounts for 64.05% of total variance explained with an eigenvalue of 12.81; Factor 2 (7 items) accounts for 7.99% of total variance explained with an eigenvalue of 1.595; Factor 3 (4 items) accounts for 5.59% of total variance explained with an eigenvalue of 1.109 and Factor 4 (2 items) accounts for 4.66% of total variance explained with an eigenvalue of 0.934. The extracted factors are labeled according to theory and the reflective meaning of the measurement items. Factor 1 is called "reliability" to capture the reliability of the service process, Factor 2 is called "interpersonal" to capture the interpersonal skills, Factor 3 is called "consultative selling" and Factor 4 is called "standard" to capture the meaning of standard of service.

After EFA, an CFA is produced to confirm service quality as a second-order latent construct. Final CFA results confirm 4 dimensions of service quality in B2B: 4 items of consultative selling, 4 items of process, 3 items of interpersonal skills and 2 items for standard of service. The results of the final model indicate a good fit: CFI (0.995), NFI (0.941), TLI (0.94), standardised RMR (0.0499). GFI (0.891) and AGFI (0.832), however, fell below acceptable levels. The RMSEA (0.099) indicates a marginal fit being slightly smaller than 0.10. The most fundamental level of fit is acceptable for this CFA model of four-factor perceived service quality. As discussed there appears to be no quantitative empirical evidence to support a second-order (four dimensions) latent construct of perceived service quality in the business-to-business context. Final results of Service Quality with four dimensions do not follow the proposed structure of Service Quality in previous research of service quality in a business-to-business context (e.g. Westbrook and Peterson, 1998; Holmlund and Kock, 1995).

Service Loyalty

In an empirical study, Chaudhuri and Holbrook (2001) find that the attitudinal loyalty of customers can result in a higher relative price paid compared to competitors. These results confirm the conclusions of Aaker (1991), Keller (1993) and De Chernatony and McDonald's (1998), evidence that attitudinal loyal contributes to price premium rather than behavioral loyalty. Based on the literature search, it is sufficient to assume that firms with a large loyal customer base will be able to charge a higher price for their products and services. We, therefore, conceptualise service loyalty here as attitudinal loyalty. Service loyalty as attitudinal loyalty is defined for this study as "*the level of customer's psychological attachments and attitudinal advocacy towards the service provider/supplier*". Because the definition of attitudinal loyalty mentioned includes customers becoming attitudinally advocates for the service of the service provider, the measurements of attitudinal loyalty incorporates Zeithaml et al. (1996), which includes positive word of mouth, willingness to recommend and encouraging others to use the product/service.

Price premium

Price premium is proposed as an indicator of extra revenue for a firm, which in turn leads to greater profit. In this study, price premium is conceptualized and measured in two ways a) as the extra amount customers are willing to pay for products and services, b) the willingness of customers to pay more for the product/service. This study operationalised price premium using a modification of De Chernatony and McDonald's (1998), Netemeyer et al. (2003) and Sethuraman and Cole (1999). Price premium₁ was measured on a five point Likert scale. High scores indicate higher willingness to pay more and being less price-sensitive. Low scores indicate lower willingness to pay more and being more price-sensitive. Price Premium 2 was operationalised to measure the actual amount (as a percentage) of price increase that business customers are willing to pay. Price premium 2 is a one item measure asking respondents to indicate the extra price that they would pay on a scale ranging from 0% to 100%. The proposed model is currently being tested and analyzed.

Contribution

The main aims of this paper are to empirically examine, within a B2B context, the contribution of perceived service quality to service loyalty and the contribution of service loyalty to price premium-one key indicator of brand equity, though service loyalty and willingness to pay a price premium. Specifically, we investigate the chain of effects of service quality as an antecedent of service loyalty in predicting only attitudinal aspects of service loyalty and their subsequent impact on willingness to pay a price premium, and actual extra amount of premium. We predict that results will generally support our theoretical model, with all of our

hypothesized paths confirmed by the structural equation modeling analysis, and provide evidence for the importance of B2B service quality as important predictors attitudinal loyalty then price premium. The results of this study will have several practical implications for managers of service organizations, specifically in the context of business-to-business. Most importantly, perceptions of service quality as an important role in influencing attitudinal service loyalty then in turn influencing price premium in B2B context. These results would suggest that service providers would benefit from putting their efforts into building and enhancing their perceived level of service with customers in order to increase their liking in the provider. We would like to draw attention to building customers perceptions of the quality of serviced delivered and build service infrastructures in order for customers to be willing in paying more and seeing that paying more is worth for an excellence service. And the importance of portraying a good and reliable international standard of service of an organization as a whole. Creative pricing structures can be developed whereby loyal customers can be allowed to pay a price premium in exchange for high perceived levels of service. This then leads to mutually profitable B2B customer relationships.

The conceptualisation and scale development of perceived service quality in business-to-business offers a theoretical contribution to the business-to-business and service literature. The development of the measure of B2B service quality used in this research follows guidelines from Parasuraman et al's (1988) SERVQUAL and the qualitative findings of Westbrook and Peterson (1998). The items generated from the literature review are developed and confirmed using in-depth interviews and questionnaire testing. CFA results show that perceived service quality in the business-to-business setting is a multidimensional construct with four major components: consultative skills, interpersonal skills, process and standard of service. Each component is a unidimensional construct on its own. This research suggests that this conceptualization of service quality may be useful for future research in business-to-business settings.

Furthermore, results will provide evidence concerning the role that service loyalty plays in forming brand equity perceptions, The most interesting finding of the study suggests that the commonly held belief that service quality leads to brand equity outcomes needs to be qualified. The research findings on the overall also reinforce the importance of the relationship of different levels of service quality and attitudinal loyalty and price premium in the B2B environment. This would provide an significant insight on shaping and developing different aspects of service in order to lock in attitudinal loyalty with the aim to ultimately increase brand equity. Research is continuing to firmly place this contribution into an IMP context.

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