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THE ROLE OF ECONOMIC AND PSYCHOLOGICAL COSTS IN SERVICE ELIMINATION

Service elimination (SE) requires systematic planning and execution to retain customers. However, service providers struggle with finding the best way to minimize customer churn following SE. This paper investigates the impact of economic and psychological costs on consumer reactions following SE with a scenario-based experimental design. The findings suggest that economic cost is positively related to churn and negatively related to satisfaction and commitment. Psychological cost decreases satisfaction and commitment, but does not affect churn. Interactions between costs show that psychological cost refines the impact of economic cost on customer reaction. This research contributes to the understanding of how SE impacts consumer behavior.

Keywords: service elimination, economic cost, psychological cost, customer retention, telecommunication services

Service elimination is a potential tool of portfolio renewal, as it enables to unlock resources of service firms and thus, accelerate the launch of new portfolios. Due to the short life-cycles of services, services might get accumulated in the system of firms very quickly that requires the management of a relatively big service portfolio. In today's fast-paced economy service elimination is seen as a requirement for business competitiveness, because through the simplification of business portfolio, both customer and firm value could be increased.

Service elimination requires systematic planning and execution to retain customers. However, service providers struggle with finding the best way to minimize customer churn following SE, due to both strategic issues and limited information about this process. Understanding customer reactions to service eliminations could contribute to a more efficient implementation of service elimination decisions.

Service elimination is particularly relevant in the telecommunications industry, due to the short life-cycles of services, however most studies tend to focus on financial services (Argouslidis – McLean, 2003; Argouslidis – Baltas, 2007).

This paper aims to contribute to a better understanding of consumer reaction following SE in the telecommunications context.

Section 2 introduces the theoretical background of the study comprising theory of both economic and

psychological costs and service elimination. Section 3 develops the study's hypotheses. Section 4 presents the sampling, level of analysis, and measures. Section 5 describes the results. Section 6 presents the conclusions, including limitations and suggestions for further research.

Theoretical background

In the literature review, the main concepts are introduced in three areas: service elimination, service elimination-related theories and customer reaction to service elimination. Satisfaction and affective commitment are used to describe consumer reactions following SE. Churn is considered as the operative key performance indicator of customer retention.

Service elimination

Based on Gounaris et al. (2006), service elimination (SE) is considered an action by service firms that involves both the closing and the elimination of existing service(s). Elimination requires existing customers to migrate to new packages, which can result in forced migration. In the case of closing, the package remains available for existing customers but is not open to new ones. The importance of SE is underlined from two main aspects:

1. There are gaps in academic research in many subfields: this literature review clearly shows possible research directions, such as the outcome of SE and customer-perspective studies.
2. There is a need for companies to build a proper SE strategy, instead of the currently adopted ad-hoc basis.

SE can be enhanced if brought to strategic level (Harness – Harness, 2012), and from the corporate portfolio management (CPM) perspective there is no adequate method in strategic management research for effectively organizing and managing multi-business portfolios (Nippa – Pidun – Rubner, 2011). SE combined with CPM could be an adequate tool for successful service innovation.

We found a link between service innovation and SE, as service maintenance is part of new service development (Gustafsson – Johnson, 2003). Furthermore, existing frameworks do not support service innovation in on-going customer relationships, where alternative service innovation methods could be a solution (Gremyra – Witell, 2013). SE could be one of these alternative solutions, if managed correctly by the firm.

Avlonitis and Argouslidis (2012) provide an overview of the field, from which we focus on the outcome of SE (Table 1). From the SE literature review, it is clear that the pre-elimination decision-making phase and the product/SE decision-making process are covered; what remains relatively unstudied is the post-elimination

phase. This research is positioned as post-elimination consumer research, a significant gap in the extant literature, as it is seen on Table 1.: the authors list all the areas ever studied within SE based on two perspectives: firm and customer perspective. There are three phases of the SE process itself: 1. the pre-elimination phase deals with the causes; 2. the PEDM process determines the attributes of the elimination process; 3. and the post-elimination phase focuses on the result of the SE. Performance outcomes are only studied in manufacturing sectors and success factors in financial service sector and multi-sector studies. Surprisingly there is no customer perspective analysis in the service area combined with post-elimination phase, especially success-factors. In the literature, product elimination (PE) and service elimination (SE) are often studied together, however there are differences between the two concepts which we explain later.

Service elimination-related theories

In order to understand SE more, we review a few SE-related theories that are relevant in for our research objectives. First, product elimination (PE) is described, because although SE and PE are different concepts, they have some common attributes that can be used in our research. Second, justice theory- a widely used theory in services marketing- is used to assess customer reaction to SE. Third, economic and psychological costs are introduced, which are primarily rooted in social exchange theory.

Table 1.

**Summary of product elimination literature on post-elimination phase
– adapted from Avlonitis – Argouslidis (2012)**

Author(s)	Broad topics investigated	Sample	Key independent variables	Key dependent variables	Main findings
Avlonitis (1987)	Post-elimination phase	166 UK industrial and consumer goods firms	Circumstances triggering PEs, nature of the elimination decision	Outcome indicators for PE decisions	Decisions guided by strategic considerations yielded higher outcomes.
Harness – Marr (2004)	Post-elimination phase	45 UK financial firms	Company type	Relative importance of financial PE success factors	Company type accounted for differences in the relative importance of success factors.
(Gounaris et al., 2006)	Post-elimination phase	164 Greek service firms	Characteristics of service elimination case histories	Indicators of elimination decision's success	Successful service elimination decisions were related to treating elimination as a strategic decision, adopting systematic elimination behavior and forming multi-departmental teams.

Product elimination – removing products that no longer add to an organization's objectives – has long been considered a negative activity (Kotler, 1965; Avlonitis, 1986; Hart, 1991), but it has also the potential to alter the relationship between the organization and its customers. Harness and Harness (2012, p. 56.) consider product elimination as a process that “can generate outcome benefits for the organization in four areas: simplification/concentration of management and sales effort; improved product portfolio performance; customer management related; improved physical and financial resource management.”

Product elimination is a rather neglected area, both in practice and in marketing literature. Companies usually focus on product or service development, tending to neglect elimination. This particularly applies to service elimination (SE) where the company re-directs its clientele to purchase a different product (replacing an existing product or one dropped) (Gounaris et al., 2006).

Justice theory is a relevant service marketing concept in our research, which was mostly applied in the case of service recovery (Andreassen, 2001; Wirtz – Mattila, 2004), which is seen as a tool for customer loyalty. Boshoff et al. (2000) define service recovery as follows: “Efforts made by the firm to return aggrieved customers to a state of satisfaction following a service failure” (2000, p. 63.). Although SE is not a service failure, but very similarly, it can involve a negative customer attitude and complaints that might lead to customer churn, if SE is not handled adequately.

To assess the effect of SE, the three types of fairness in justice theory are relevant: distributive, procedural and interactional fairness. Distributive justice refers to the outcome, while procedural justice is the sum of processes, policies and rules (Smith – Bolton – Wagner, 1999). Interactional fairness includes apology, perceived helpfulness, courtesy and empathy of the service staff (Wirtz – Mattila, 2004).

In the following part we summarize the main findings about the application of justice theory in the field of service failures and then highlight their relevance in terms of SE.

One relevant research issue concerns the combination of service recovery tools. Based on Wirtz and Mattila's results (2004), compensation is not always required due to procedural and interactional justice: in case of service failures an immediate recovery and apology makes the compensation unnecessary, however compensation has no impact, when customer perceives procedural and interactional injustice during the process.

Compensation only had an influence on customer satisfaction, when either an immediate recovery hap-

pened without apology or a delayed reaction with apology. This means that an immediate recovery with an apology without compensation might be the most satisfying and cost effective solution for companies.

The use of service recovery tools and the underlying justice theory contribute to the understanding of customers' complaining behaviour, which is also a potential consequence in the case of SE and might affect churn. Overall we can conclude that the understanding of service recovery and justice theory helps us to get a better insight into the way (fairness) SE elimination is implemented and the reasons why it may have a positive or negative attitudes on customers.

Homans defines *social exchange* (1958) as “an exchange of goods, material goods but also non-material ones, such as the symbols of approval or prestige” (Homans, 1958, p. 606.). Blau (1964) adds that it “involves favors that create diffuse future obligations (...) and the nature of the return cannot be bargained” and “only social exchange tends to engender feelings of personal obligations, gratitude, and trust; purely economic exchange as such does not” (Blau, 1964, p. 93-94.).

This means that in social exchange psychological costs are also present besides economic costs, and they affect customer retention. Social exchange might also help to understand, how psychological cost captured by procedural and interactional fairness influences customer reaction (Masterson – Lewis – Goldman – Taylor, 2000). In case of SE social exchange refers to the relationship between the service provider and customer.

According to Homburg et al. (2010, p. 531.), “eliminating a product may result in severe economic and psychological costs to customers, thereby seriously decreasing customer satisfaction and loyalty.” Foa and Foa (1974; 1980) describe the difference between *economic* and *psychological costs* as follows: economic costs and benefits are the ‘hard factors’ of an exchange, psychological costs and benefits represent the ‘soft factors’, such as reliability, flexibility, and cooperativeness. Further, the relationship between product elimination and customer satisfaction also affects customer retention: “psychological costs of the elimination reflect the degree to which the customer becomes uncertain about the eliminating company owing to the product elimination, as the elimination can raise customer doubts about the wisdom of engaging in a business relationship with this company” (Homburg et al., 2010).

Economic and psychological costs are related to the concept of switching costs which include not only those costs that can be measured in monetary terms, but also the psychological effect of becoming a customer of a new firm, and the time and effort involved

in buying a new brand (Klemperer, 1995; Kim et al., 2003).

Switching cost is the sum of economic, psychological, and physical costs (Jackson, 1985). The economic or financial switching cost is a sunk cost which appears when the customer changes their brand, for example the costs of closing an account with an operator and opening another with a competitor (Klemperer, 1987).

Psychological cost is perceived as the cost stemming from social bonds (e.g. staff-customer relations) that appears over the course of time and the uncertainty/risk of the unused brand. The customer perceives high risk regarding a brand they have never used (Sharma – Patterson, 2000). Risk exists especially in services where customers prefer a rival service provider, because service quality cannot be evaluated before purchasing (Sharma et al., 1997).

Customer reaction to service elimination

Customer reaction involves many concepts that primarily affect the outcome of SE and thus are relevant in our research. These concepts include satisfaction and commitment. The importance of those constructs for our study can be underlined by the fact that they have an impact on customer retention. In the following section first we discuss churn as a measurement of customer retention. It is followed by the description of satisfaction and commitment with a special focus on their relation to customer retention.

Churn is an operational measurement of customer retention (Gustafsson et al., 2005). In the wireless telecommunications service industry, *customer churn* is used to denote the customer movement from one provider to another; *churn management* describes an operator's process to retain profitable customers (Berson et al., 2000). Churn studies can be categorized as cause of churn, retention, and type of churn (Braun – Schweidel, 2011). This study focuses on retention. SE can be viewed as a situational factor that impacts customer retention strategy. Thus the models determining normal customer churn rate (Rust et al., 1995; Ho – Zheng, 2003; Kamakura et al., 2005; Prince – Greenstein, 2011; Kumar – Peterson, 2012) need to be modified in order to assess the effect of SE.

Customer satisfaction is defined as a customer's overall evaluation of the performance of an offer to date (Johnson – Fornell, 1991). It is often researched in relation to customer loyalty across a wide range of product and service categories, including telecommunications services (Fornell, 1992; Fornell et al., 1996). Affective commitment is forward looking, while satisfaction is a retrospective evaluation (Verhoef, 2003).

Commitment is usually defined as the extent to which an exchange partner wants to continue a valued

relationship (Morgan – Hunt, 1994). Gustafsson et al. (2005) define the main factors of retention: overall customer satisfaction and affective commitment. *Affective commitment* is created through personal interaction, reciprocity, and trust.

Hypotheses development

The objective of this study is to get a better understanding of consumer reaction following SE in a telecommunications context. It investigates the impact of economic and psychological costs on consumer reaction. As existing literature has not yet linked economic and psychological costs with SE in a business-to-consumer context, this study fills a significant gap in the literature.

The economic costs of elimination reflect the financial loss or expenditure the customer faces following SE (Homburg et al., 2010). With the increased financial burden, the customer is more likely to churn, be less satisfied with the service provider, and find less value in maintaining a relationship with them.

On the theoretical bases of economic cost, customer retention, satisfaction, and commitment literature, the following is expected:

H1: Economic cost increases churn and decreases satisfaction and commitment.

Psychological cost refers to the reliability, flexibility, and cooperativeness of the company during SE (Foa – Foa, 1974; Foa – Foa, 1980) and reflects the degree to which the customer becomes uncertain about the eliminating company and has doubts about the wisdom of staying with them (Homburg et al., 2010). Psychological costs represent an unpleasant inner state, which in turn may lead to a decrease in trust. Thus psychological cost is expected to increase intention to churn, and decrease satisfaction and commitment.

On the theoretical bases of psychological cost, customer retention, satisfaction, and commitment literature, the following is expected:

H2: Psychological cost increases churn and decreases satisfaction and commitment.

Customer perception of economic cost could also be altered by psychological costs. "Hard factors" could be modified by the service provider with the use of appropriate "soft factors" (Foa – Foa, 1974; Foa – Foa, 1980), through psychological cost effects.

In order to explain the interactions between economic and psychological costs, we rely on the concepts of cognition and affect, which are the focus of several research studies (Oliver, 1980; LaBarbera – Mazursky, 1983; Oliver – DeSarbo, 1988; Westbrook – Oliver,

1991; Mano – Oliver, 1993; Homburg – Koschate – Hoyer, 2006).

Kempf (1999) suggests that for functional (vs. hedonic) products, cognitions are more important drivers of product evaluations than affect. We consider telecommunication as a functional service. We also assume that economic costs correspond to the cognitive approach, while psychological costs are rather related to affect. When economic cost is involved, cognition is likely to dominate affect, while in the absence of economic cost, affect will have a stronger impact.

It is therefore expected that:

H3: There will be interaction effects for economic and psychological costs. In the absence of economic costs, the impact of psychological costs on customer reaction will be stronger than in the presence of economic costs.

Methodology

Experimental design

Based on the literature review and the exploratory research results, a 2x2 between-subject experiment design based on scenarios was carried out. The choice regarding experimental design instead of a consumer survey is due to limited access to customer data. Only a small number of customers involved in service package simplification agree to be contacted for marketing purposes, which results in a small sample size. Further, SE is usually not organized systematically and there are limited numbers of such projects available.

SE researchers usually combine telecommunications with financial services to obtain a higher number of cases required for quantitative analysis.

The following variables and scenarios are used in this experiment:

- *independent variables*: economic cost and psychological cost,
- *dependent variables*: churn, satisfaction, affective commitment.

Economic and psychological costs are used to measure the effect of SE on customers. *Psychological cost* refers to whether the customer had received prior notice and was contacted by phone before elimination, that is, the SE was not unexpected, thus representing a lower level of psychological cost.

Economic cost is incorporated into the scenarios as the cost of the service package for the customer, which is defined as a dummy variable that takes the value of 1 if the cost of the offered service package is high (worse offer), and 0 if the cost is low (better offer).

Bearing in mind that sending a letter notifying the customer of the change in service package is a legal requirement, the four scenarios are as follows:

1. Better service package after elimination; customer receives notification by phone before elimination.
2. Worse service package after elimination; customer receives notification by phone before elimination.

Table 2.

Description of scenarios

Scenario	Description of scenario
1	Your telecommunications service provider eliminates your service package. Before the elimination, they call to inform you about this and to help you to choose a new subscription. You tell the call center operator that you don't want a new subscription, as the current one is perfect for you. The operator can offer you a new service package with lower monthly fee, more internet and lower PPM. One week after the call you receive a letter notification as well about the change.
2	Your telecommunications service provider eliminates your service package. Before the elimination, they call to inform you about this and to help you to choose a new subscription. You tell the call center operator that you don't want a new subscription, as the current one is perfect for you. The operator can offer you a new service package with higher monthly fee, less internet and higher PPM. One week after the call you receive a letter notification as well about the change.
3	Your telecommunications service provider eliminates your service package. Before the elimination, they call to inform you about this and to help you to choose a new subscription. You tell the call center operator that you don't want a new subscription, as the current one is perfect for you. The operator can offer you a new service package with lower monthly fee, more internet and lower PPM.
4	Your telecommunications service provider eliminates your service package. Before the elimination, they call to inform you about this and to help you to choose a new subscription. You tell the call center operator that you don't want a new subscription, as the current one is perfect for you. The operator can offer you a new service package with higher monthly fee, less internet and higher PPM.

3. Better service package after elimination; customer does not receive notification by phone before elimination.
4. Worse service package after elimination; customer does not receive notification by phone before elimination.

Detailed descriptions of the scenarios are presented in Table 2.

Sample

Data were collected through an online questionnaire between November 2014 and January 2015. Participants for the experiment were recruited using social media, including LinkedIn and university student mailing lists. There was no screening for participation.

Scenarios described a telecommunications SE situation, where respondents had to answer questions about the process and evaluate the whole experience.

The sample contains 163 respondents (a 16% response rate). The male-female ratio is quite balanced (59% and 41%, respectively) and the average age of respondents is 31. Respondents were randomly assigned scenarios. The number of subjects for the different conditions varied between 37 and 44.

Measures

The following scales are used in the experiment:

- Churn is measured by the following items: “I would accept the operator’s offer” and “I would leave my current operator after this case” (based on Aksoy et al., 2013). Both items were averaged with a reversed second item to create the final churn intention scale.
- Satisfaction and commitment: Gustafsson’s scales for measuring satisfaction and commitment are used (Gustafsson et al., 2005). Affective commitment was measured by the following statements: “I take pleasure in being a customer of the company” and “I have feelings of trust toward the company.” Satisfaction was measured with four items: “I am satisfied with the operator’s offer,” “The operator exceeds my expectations,” “In my opinion the operator is close to the best operator.” In addition to these three items, which were based on the work by Gustafsson (2005), the authors added a fourth “I consider the operator’s reaction appropriate.”

For the measurement scales, Cronbach’s alphas vary between 0.794 and 0.934 (SAT: 0,794, CHURN: 0,934, AFFCOMM: 0,834).

Manipulation checks

Four expert judges (faculty members in services marketing) reviewed and commented on the scenarios and the questionnaire. Slight modifications in wording were made to improve ecological validity. Next, in accordance with the recommendations of Perdue and Summers (1986), manipulations were checked in a quantitative pilot study, independent of the main experiment indicating that the manipulations were effective, with a significant difference between test and control groups for all conditions.

When developing the manipulation checks, the study relied on the definitions provided by Homburg et al. (2010: p. 533.) who described economic costs as perceived economic burden and expenditures, while psychological costs were conceptualized as a feeling of uncertainty, doubt, an unpleasant inner state of tension, and dissonant cognitions.

The manipulation check for the two independent variable was as follows: based on Cannon and Homburg (2001) and Montgomery et al. (2005), economic cost used: “I will have to face financial losses,” where M (economic cost)=4.48 vs. M (no economic cost)=1.56, $F(1.51)=118,73$, $p<0.000$. A one-item measure was used for psychological cost (Dwyer et al., 1987; Noordweier et al., 1990; Arend, 2006): “Following the event I will have doubts about the reliability of the company,” M (psychological cost) =3.73 vs. M (no psychological cost) =3.13, $F(1.50)=3.117$, $p<0.01$. Scenarios for realism were also checked: a telecommunications company manager commented on the scenarios and judged them to be realistic and fitting with their everyday practice. Then, a further qualitative research was conducted in order to validate the scenarios with consumers, one consumer for each scenario.

The results show that all interviewees found the scenarios realistic; they could imagine that their operator would call them informing about a situation like this. Further, two interviewees added that they already were involved in a service elimination, and the process was quite similar as described in the scenarios.

Results

A General Linear Model (GLM) was used to assess the effect of economic and psychological costs on churn, satisfaction, and commitment (Table 3).

In case of the economic cost, all dependent variables behave as expected based on the hypothesis: economic cost decreases satisfaction and affective commitment, and increases churn. Psychological cost leads to a lower degree of satisfaction and affective commitment but does not affect churn. These results provide support for $H1$ and partial support for $H2$.

These main effects, however, are qualified by significant two-way interactions. The interaction effects are visualized in Figure 1.

The plots show that economic cost leads to a lower level of satisfaction and commitment independent of psychological cost. But if there is no economic cost involved, psychological cost leads to a lower level of satisfaction and affective commitment. The plot for churn displays a different pattern. In the case of economic cost, the presence of psychological cost decreases churn while if no economic cost is involved, psychological cost increases churn.

but the customer did not receive a phone call before elimination, they might leave the company. In a worse offer scenario, the call might worsen the situation and result in higher churn rates. Following the operator's explanation, the customer might realize that they are facing economic loss or gain.

The results indicate that the offers themselves are probably not clear for customers; direct contact with the operator before elimination is more crucial. This might change the focus on "hard factors" in terms of customer retention, and emphasize the role of "soft factors."

Table 3.

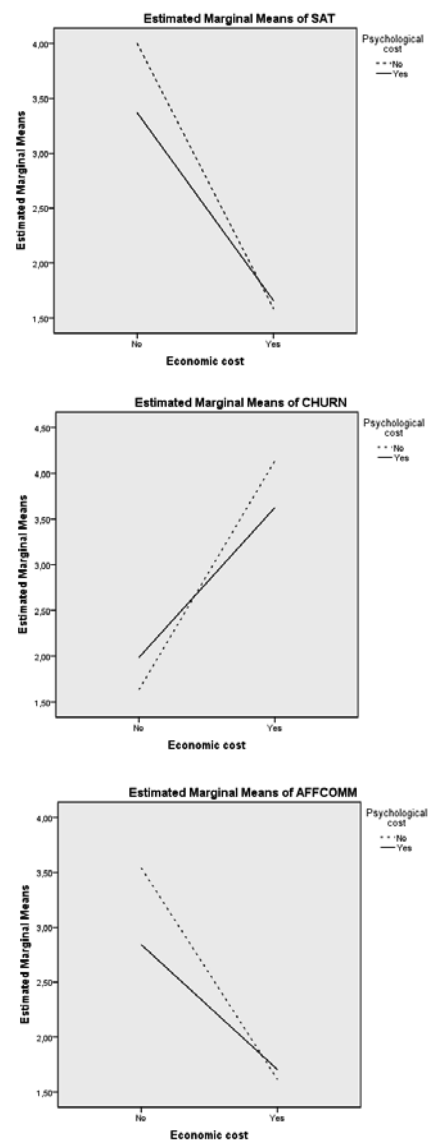
Descriptive statistics and analysis of variance results

Independent variables		Dependent variables		
		Satisfaction	Churn	Affective commitment
Economic cost		F=335.97 sig. 0.000	F=241.85 sig. 0.000	F=136.98 sig. 0.000
	Yes	1.62	3.88	1.66
	No	3.68	1.81	3.19
Psychological cost		F=6.14 sig. 0.014	F=0.39 sig. 0.533	F=5.38 sig. 0.022
	Yes	2.45	2.87	2.23
	No	2.69	2.99	2.49
Economic cost	Psychological cost	F=9.83 sig. 0.002	F=11.38 sig. 0.001	F=9.09 sig. 0.003
Yes	Yes	1.66	3.63	1.70
	No	1.59	4.14	1.61
No	Yes	3.37	1.99	2.84
	No	4.00	1.64	3.54

Conclusion

The study sheds light on how SE shapes customer retention. Experimental design is used to determine the effects between SE and its main success factors, churn, and other variables related to customer reaction (satisfaction and commitment). All hypotheses relating to satisfaction and commitment are supported; only interactions between economic and psychological costs gave surprising results. Regardless of economic cost, psychological cost seems to have an attention-raising role for customers. The missing contact from the operator determines the level of satisfaction, loyalty, commitment, and churn. Even if the offer was better,

Figure 1. Interaction effects between economic cost and psychological cost



Contribution

The expected contribution of the research consists of three main parts. First, the focus on telecommunications extends the area of SE research from financial services to a broader sample. Second, SE gives a special circumstance to the normal churn modeling that might help to increase the understanding of churn. Third, SE is a key element both in academic theory and in practice in terms of service portfolio management. The research gives insights for practitioners as well, on how to incorporate this knowledge of customer reactions when formulating an SE strategy.

Managerial implications

Practitioners need to be aware that psychological cost might have a more significant role than expected: the form of contact with the customer has a stronger effect on retention than the quality of the offer itself. Perhaps offers only in written form are not clear for the customer, and as such, verbal notification raises their attention. As a result, the customer is more likely to switch operators.

The role of psychological cost is emphasized here: with worse offers it might lead to lower customer churn, and with better offers to higher customer churn. It is not just the quality of the offer that determines customer retention.

Further research and limitations

Several limitations exist regarding this research. First, partly students served as the sample pool for this investigation. Although the choice of including students somewhat limits the generalizability of the results, the behavior of students and other market segments are expected to be rather similar in a telecommunications context. Second, the scenarios employed were constructed by the researchers and do not describe real situations. With a short description of an imagined situation, it is not possible to capture all important customer details, particularly the emotional content of operator/customer interaction.

There are three possible areas for future research. First, psychological cost measures could be refined. Second, compensation is a churn-reducing technique in practice that could be incorporated into the scenarios. Third, future studies may investigate whether the relationship between the service provider and the customer determines the success of SE,

Although the results may be generalized to other fields, mobile telecom services represent a specific field within SE. Future trends of business models might influence customer reaction to SE, as new types of services emerge. For example, the elimination of contractless services with no subsidy conditions would require an entirely different approach to SE.

Further, both voice and data services are becoming unlimited, which on one hand reduces the power of operators, and on the other fosters customer co-creation (Pralhad – Ramaswamy, 2004).

SE is likely to become increasingly important in the near future, as service trends, and more specifically, telecommunications trends, have started to change dramatically. New types of services, service bundles across industries (e.g. fixed line and wireless services combined with mobile television), and the evolving role of contractless mobile service packages require the reshaping of current portfolios. As a preliminary requirement, a well-structured SE might accelerate this process, while maintaining customer value.

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