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USING AGENCY THEORY IN UNDERSTANDING
SWITCHING BEHAVIOR IN B2B SERVICE
INDUSTRIES "I"

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Abstract

Understanding switching behavior is a cornerstone in sustaining customer led marketing efforts especially in services which depend on long-term relationships with the customers and where the switching process is compound and costly for both the customer and the service provider. The issue of understanding the motives and barriers behind agency-brand switching behavior still needs further conceptual support and empirical investigation in service industries context, where the emphasis placed on investigating the actual switching motives without trying to conceptualize the issue, which if done will result in better understanding for the whole switching process. In this paper, the authors attempt to bridge this gap in the literature by examining the criterion validity of the switching behavior model using the agency theory, as the relation between the business company (principle) and an Advertising agency (the agent) could be described as agency relationship. Furthermore, this approach helps in supporting the efforts for retaining the business-to-business customers, strengthening the relationship with them, developing and adopting globally integrated customer led strategies in different countries, a trend which is expected to dominate the marketing field in the future due to the increasing role of the agency brand selection and switching in today's world markets.

JEL classification

M31; M37; L82

Keywords

Brand Switching; Agency Theory; Business to Business Marketing; Service Marketing; International Advertising Research

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Introduction

Although there is extensive work in both areas of brand switching behavior and agency theory independently (Lam et al 2004; Roy& Lahiri 2004; Shukla 2004; West& Paliwoda 1994), but very little work had been done to use the agency theory in marketing in general and in understanding switching behavior in particular. A number of studies tried to implicitly link the client and agency point of views, without any discussion to the agency theory (Triki et al 2007; Waller 2004; Mortimer 2001).

Since Susan Keaveney (1995) introduced her model on switching behavior in the service industry and this issue has been under intense investigation to validate the model and assure that it could be adopted in different service industries, different market segments, and different cultures (see for example: Colgate, Stewart, and Kinsella,1996; Nielson 1996; Wetzels and Bloemer 1998; Ghosh and Taylor 1999; Gerrad and Cunningham 2000, Keaveney and Parthasarathy 2001, Lee et al 2001; Grace and Cass 2001, Colgate and Hedge 2001; Colgate and Lang 2001; Bansal 2004). These research efforts centered on investigating the applicability of the proposed framework to different markets and overlooked two main issues. Firstly, it overlooked investigating the criterion validity *“the degree of connectedness of focal measure or scale with another measure or scale”* (Bagozzi, 1996, p 19), i.e. investigating the conceptual soundness of this framework with the other sound marketing paradigms and frameworks. Secondly, it limited the scope of the model to the market segments and/or the culture that it was driven from rather than extending it across other service segments and other world cultures in order to overcome the “Emic” (culture uniqueness) nature of this model (Pike 1966; Malhotra et al 1996; Craig and Douglas 2000).

Thus, this research paper and its successive papers will reinforces the call for a broader process of conceptualization for the agency theory model in order to assist in developing a “Derived Etic” (culturally shared) view of the switching behavior phenomenon. Berry (1969; 1989). This broader conceptualization based on service industries and cross-cultural validation should reinforce the main objective on this paper in providing a more global investigation of switching behavior in the business-to-business context of the advertising industry and in testing the applicability of the agency theory model on non-western cultures in order to develop a cross-cultural methodological sound comparison with western cultures..

This paper represents the first phase of an on-going multi phases project that conceptually investigates the criterion validity of the agency brand switching behavior in business-to-business context of the advertising industry (client-advertising and promotional agency relationship) in Egypt. It aims to conceptualize the switching behavior based on the agency theory. The second phase will aim to imperially investigate and validate this developed conceptual framework in the Egyptian advertising agency market. The third phase will aim to investigate the USA market to offer a cross-cultural comparison of the agency brand switching behavior, as the aim is to look for similarities worldwide, which requires investigating culturally-different countries, in order to adopt global advertising

client-based marketing strategies, This paper starts by explaining the rationale of using agency theory in interpretation of switching behavior, reviewing the literature on the switching motives & barriers, followed by the literature on the agency theory sources & costs, introducing the proposed conceptual framework finally the research propositions are presented accompanied by directions for further research, i.e. the second and third phases of this research project.

Literature Review

Rationale

Agency theory is viewed as an arguably innovative and promising framework with a creative potential for improving academic understanding of switching behavior due to a number of reasons. First, the use of agency theory will emphasize switching costs and introduce a new categorization of such costs which is an integral part of any useful theorization of switching behavior. A part of this switching cost conceptualization will include investigating and providing evidence on new sources of these costs. A second motivation for aiming to build this conceptual link between agency theory and switching behavior is that this link should be expected to explicitly address the relationship between switching behavior and untapped issues in this context; namely; information utilities, risk attitudes of buyers and marketers, and moral hazard. A third reason for this research pursuit is that an agency theory analysis of switching behavior ought to highlight important aspects of buyer behavior in switching situations comprising information search and processing, negotiations and bargaining, monitoring and exchange of values in the form of incentives and customer utilities. Finally, the proposed agency-based framework should be expected to allow for broader cross-cultural, cross-context (Service vs. Manufacturing) and cross-industry empirical testing and verification of several controversies of switching behavior.

Understanding Brand Switching: Motives & Barriers

The issue of brand switching is of crucial importance to marketing research and practice, as the benefits related to customer retention in comparison with attracting new customers is very well explained in the literature (Shukla 2004; Berry and Parasuraman 1991), particularly in advertisers-agencies relationship, as agencies are often have a limited number of major accounts (Doyle et al, 1980). Understanding this “agency-brand” switching behavior should work as filtering processes to retain the customers, hence extending the length of the relationship with the customers, trying to learn about their behavior to strengthen the relationship* (Buerger and Ulrich1986; Chan and Ma 1990). The initial starting point for preventing such switching or reducing its occurrence probability is to understand the motives and barriers behind this switching.

The literature identified two main types of the problems customers might experience in their relationships with the service provider, these are manifest and judgmental problems (Andreasen and Best, 1977). Manifest problems are perceived by the customers as issues

* The marketing literature offer huge number of research studies on relationship marketing and management in the service industry (see for example: Bendapudi and Berry 1997; Crosby and Stephens 1987)

that might be solved if reported to the management. Judgmental problems, on the other hand, perceived as issues, which both the customer and the service provider will have different opinions about it, i.e. most probably it will not be resolved even if the customer complain about it to the management. The complaints, which customers will raise to the management, are of the first type where they are expecting resolutions, while for the second type they probably will not report it and might work as a hidden motive in pushing customers in the switching direction (Colgate and Hedge, 2001).

The study of switching behavior literature points out to three main trends, firstly studying features that strengthen the relationship, i.e. discourage switching (White and Yanamandram 2007, Colgate and Lang, 2001; Bendapudi and Berry, 1997; West and Paliwoda 1996). Secondly the impact of switching costs on retention and satisfaction (Lam et al 2004; Gronhaug and Gilly, 1991; Guiltinan, 1989). Thirdly identification of the switching motives (Kelley et al 1993; Keaveney 1995; Levesque and McDougall, 1996).

When Keaveney (1995) introduced her model of service switching, she explained that there are eight main factors dominating such decision (subdivided into twenty-four different item). These are:

- Pricing, (high prices, price increase, unfair prices and deceptive pricing)
- Inconvenience, (location, hours, wait for appointment and wait for services)
- Core service failure, (service mistake, billing error, and service catastrophe)
- Service encounter failure, (uncaring, impolite, unresponsive and unknowledgeable)
- Response to service failure, (negative response, no response and reluctant response)
- Competition, (found better service)
- Ethical problem, (cheat, hard sell, unsafe and conflict of interest)
- Involuntary switching, (customer moved and provider closed).

Keaveney (1995) qualitative and quantitative work was based on researching more than one type of customers-service industries in USA, which raise the importance of studying this behavior in business-to-business context and in other countries. Additionally, Keaveney in her framework overlooked a very important and mounting motive for switching, especially in international marketing context, which is boycotting participation against companies or countries (micro or macro) (for example the boycotting campaign against USA and UK products/ service providers in Arab countries due to and after the Iraq war [war on terrorism]) (Abou Aish et al, 2005). It should be noted that Keaveney's model triggers a new research trend in the switching literature (Bansal and Taylor, 1999). The switching motives literature covered a lot of services industries and indicated different significance for switching motives such as:

- Retail industry: service encounter failure (Kelley et al, 1993)
- Banking industry: core service failure and pricing (Colgate and Hedge, 2001; Gerrard and Cunningham, 2000)
- Insurance industry: overall dissatisfaction (Crosby and Stephens, 1987)
- Child care service industry: core service failure and response to service failure (Grace and O'Cass, 2001)

- Advertising industry: core service failure and voluntary switching (Ghosh and Taylor, 1999)
- Financial auditing industry: core service failure and service encounter failure (Addams and Allred, 2002)
- B2B markets: (Yanamandram and White 2006, Lam et al 2004, Ping 2003)

On the other hand, a scarce of research efforts could be easily recognized on the switching barriers literature (Colgate and Lang, 2001). Four main barriers from switching had been acknowledged:

- Relationship investment, as consumers might develop relationship with service providers that provide superior valued benefits, this relationship might prevent them from switching even though the core service is perceived as less than optimal because of the relationship they managed to develop (Gwinner et al 1998; Colgate and Lang 2001).
- Switching costs, are the costs (time, monetary and psychological) emerge from either the termination costs of the current service provider or the joining costs with the alternative service provider, i.e. dissatisfied customers might retain with their customers because of high switching costs (White and Yanamandram 2007, Lam et al 2004, Morgan and Hunt 1994; Gronhaug and Gilly 1991).
- Service recovery, the efforts of the service provider to rectify, amend and restore the losses experienced by the customer following a service failure. The service recovery paradox indicate that successful service recovery might result in customers being more satisfied than prior to the problem (Smith and Bolton 1998; Tax et al 1998)
- Alternatives availability, perceived appropriateness of alternatives is identified as a key factor in sustaining the relationship with the service provider, i.e. prevent switching (Szmigin and Bourne 1998; Bejou and Palmer 1998).

The previous discussion indicates diversity of the switching motives and barriers in different industries. Although the issue of switching was investigated mainly by marketing researchers, most of the research on the motives behind switching emphasized the negative actions from the current service provider and ignored the positive marketing actions from the competitors, which implicitly mean that marketing researchers in service industries assume that marketing is mainly reactive rather than proactive. This assumption could be strongly challenged depending on a critical analysis for the service organizations practices in the markets in different nations, but on the other hand, this trend in the research could be justified based on the difficulties and costs related to the decision of service provider switching, i.e. the difficulties and expenses expected when trying to attract customers retained with other service providers (Colgate and Lang, 2001; Ghosh and Taylor, 1999).

Agency Theory

Agency theory articulates that an agency relationship exists when one or more individuals (called principals) hire others (called agents) in order to delegate responsibilities to them. This empowerment is undertaken in the belief that those agents are able to perform those duties and responsibilities competently because of their professional expertise in a particular area of specialization. The rights and responsibilities of the principals and agents are specified in their mutually agreed-upon employment relationship. Within the term employment relationship, the chosen compensation arrangement for agents, information systems for monitoring purposes, allocation of duties and allocation of ownership rights are delineated and explicitly included (Baiman 1990).

In all agency models, individuals are assumed to be rational and motivated solely by self-interest. An agency problem arises (and subsequently an agency cost) if the cooperative (or first best) behavior, which maximizes the principals' welfare is not consistent with each agent's self interest. Agency cost also stems from the monitoring and incentive systems established by principals to ensure the consistency of the agents' behavior with the principals' best interest. Thus there is wide support among agency researchers on the three main post-contractual constituents of agency cost as proposed by Jensen and Meckling (1976) which are:

- 1- Monitoring cost which is the cost incurred by the agents to establish and operate control systems to ensure that the agents are making decisions that are in conformance with the best interest of the principals (fees of independent auditors).
- 2- Incentive cost which consists of all forms of reinforcements and cues that are used to encourage the agents to direct their behavior in the direction that is most optimizing to principals' objectives through aiming to bridge any gap between the self-interest rationales of principals and agents(e.g., executive share options).
- 3- Residual agency cost which results from the assumption that despite the economizing impact of monitoring and incentive systems on agency cost, there might still be some room for the agents to pursue the agenda of adverse selection but on a more limited scale which implies that agency cost can never be nullified as long as there is delegation of responsibilities but can rather be efficiently managed and minimized. The agency theory literature cites three main sources for all kinds of agency cost (Minkler 1993 and Armstrong 1991):

- 1- Information asymmetry; which is the tendency of agents, in pursuit of self-interest to take advantage of their exclusive access to insiders' information that is due to their professional expertise and operational management of the firm to mislead the principles on what represents their "first-best" or to what extent it has been complied with as embedded by the agents' behavior. This opportunistic behavior of agents relies on the assumption that it is neither economical nor practical for principals to obtain the same information possessed by agents. Additionally may rely on information asymmetry to make extraordinary and undisclosed gains. The examples cited by the literature for such source are in the areas of capital structure decisions, accounting choice and insiders' trading. Information asymmetry is expected to cause incentive agency costs in order to motivate agents to use their information to achieve the best-interest of principals.

Monitoring cost are not expected to be incurred because of information asymmetry due to the irrationality of aiming to effectively watch over expert behavior at a reasonable

cost. As with all sources of agency cost, residual agency costs might still occur if the agents envisage the implicit benefits to exceed the explicit incentives they receive from the firm as authorized by principals.

2- Moral hazard; which refers to the tendency among agents to abuse the resource allocation authorities delegated to them to them through the agency contract to maximize their own welfare and establish their positions within the firm (e.g., acquisition decisions and luxury spending) even if these actions lead to de-optimizing the best interests of principals.

Monitoring cost is expected to exist due to this source of agency problems through enacting external parties to monitor and control the moral behavior of agents. On the other hand, Incentive costs should not be devised in moral hazard situations since the gains made by agents in such situation can not be anticipated relying on any objective means. Since moral hazard can not be totally transparent for monitoring purposes, a residual agency cost should always be expected to materialize.

3- Discrepancy in risk attitudes; which results from the different regret matrices of agents and principals, i.e., both groups exhibit variances in their abilities to withstand the devaluation and/or demise of the firm. These variances provide different possibilities for risk diversification among agents and principals which is argued to lead agents taking actions to optimize their utility functions even if these actions are inconsistent with optimizing the utility functions of principals.

No monitoring or incentive costs are expected to result from such source of agency cost, because risk-attitude-driven behavior is argued to be difficult to observe, monitor and to compensate. Consequently, the only kind of agency cost that can be expected and traced to such situations is the pure agency cost representing the difference between the optimal risk-return relationship of the principals and that maintained by the agents (Atkinson 1979).

One of the apparent contributions of the basic themes of agency theory is their universality, i.e., their applicability across a large number of management contexts and situations as argued explicitly by its early pioneers; Jensen and Meckling (1976) in their classical paper that the application of agency propositions could extend to any kind of organization, management situations and contractual settings.

However, a theoretical bias is observed by numerous agency researchers on the methodological treatment of agency theory , as it now exists, into the study of organizations which represents little more than a minor, and theoretically unsophisticated addition to the myriad body of organizational theory and research. Furthermore, those researchers have expressed concern at the inclination of agency theorists to protect “ clean and highly abstract agency models” by declining to engage too closely with empirical data and rigorous field investigations (Armstrong 1991, Perrow 1986, Hirsch et al 1987 and Mitnick 1987). Even the considerable tests of agency theory in areas like corporate governance are verifications of whether an agency setting exists or not without addressing the issues of viability and universality of the theory itself (Freeling 1994; Hunt and Hogler 1990).

It is argued by some marketing scholars that agency relationships are pervasive in marketing situations and that devising agency theory to examine and explain marketing

phenomena should be expected to revolutionize our understanding of marketing through enriching it with unprecedented insights of existing and foreseeable marketing contexts. In their review and agenda-setting article Bergen, Dutta and Walker (1992) pointed out to the fact that in recent years, researchers in marketing and other related disciplines have aimed to adopt agency theory to investigate several marketing issues with most of the research attention paid to three areas namely: 1) sales force management, 2) distribution channel coordination and control and 3) promotion and other market signaling decisions. They also highlighted three untapped agency applications in marketing, namely: 1) international marketing, 2) industrial buying and reciprocity, and 3) advertising agency- client relationships.

Bergen, Dutta and Walker (1992) have also made a clear hint to the agency nature of the marketing research patronage situation when they were indicating the possible occurrence of a pre-contractual cost in various marketing situations including the choice of a market research supplier. However the main focus of this research is on pre-contractual as well as post-contractual costs for two reasons. First, the pre-contractual costs involved in switching to a new brand are an economizing factor to other post -contractual costs such as monitoring and residual costs, thus implicitly incorporated in such costs as will be evident by empirical findings.

Consequently, it is possible for this paper to argue that it will aim to help with bridging two important analytical gaps in agency research in marketing. First, proposing a methodology for empirical examination of agency relationships in that is argued to be valid and reliable in several marketing situations. Second, investigating an agency relationship in marketing that has received far from adequate research attention and which is analogous to the second unexplored area proposed by Bergen, Dutta and Walker (1992), i.e. the industrial buying and reciprocity relationship. Finally, endeavoring to bridge these two gaps with special reference to switching behavior which is becoming of immense importance to the discipline of marketing and evolving as a full fledging research area makes it more worthwhile research pursuit that is promising not only improved theoretical understanding but also useful policy implications for the broader context of consumer behavior.

Conceptual Framework

Although the relationship between a brand and its clients (whether present or potential) was not explicitly cited by Bergen, Dutta and Walker (1992) as a potential agency situation, this paper suggests that there is an adequate case for arguing in favor of the existence of an agency configuration of such a relationship (however the focus of this research is confined to switching behavior motives and barriers). Furthermore, such an agency configuration could be grounded on both the essence and propositions of agency theory and the peculiar features of the switching behavior context.

As above mentioned, the generic nature and universal rationale of agency theory renders it applicable to many marketing settings as argued by Bergen, Dutta and Walker (1992) and as highlighted since its early genesis (Jensen & Meckling 1976). Apart from that, the switching behavior decision situation phases through a logical proceeding that can be used to justify its possible consideration as an agency situation and consequently can

serve as axioms on which the hypotheses of this research can be based. These axioms can be described as follows:

- The processes of switching behavior including need recognition, information search and processing, evaluation of motives for/barriers to switching, the switching action and post-switching evaluation are mainly the genuine responsibility of the brand switcher.
- The brand switcher is the accountable principal as far as the full spectrum of making switching decisions is concerned.
- When a brand switcher (principal) have embarked to contemplate a potential switching action, he/she counts on his/her present/potential brand owner (agent) to motivate/discourage the switching decision and at the least ask them to intervene to augment their switching decisions through reliable information and customer-value-driven- persuasiveness . In other words, an agency situation has evolved.
- This agency situation can be expected to involve all three sources of agency costs and thus exhibits all three kinds of agency costs acting in each case as possible barrier to and/or motive for switching as follows:
 - 1- The switching behavior situation viewed within an agency theory setting includes one principal which is the customer and two agents competing to introduce their agency services to the principal where one of them is the present brand (actual agent) aiming to retain the principal and the other is the new brand (potential agent) aiming to attract the principal.
 - 2- Information asymmetry can be a barrier to switching due to principal's lack of prior knowledge, past experience and deep involvement with the new brand thus leading to greater monitoring costs.
 - 3- Information asymmetry can be a motive for switching if the new brand offers greater information utilities through greater transparency than that offered by the present brand thus reducing monitoring costs of present brand.
 - 4- Moral hazard can be a barrier to switching behavior due to existence of established trust in present brand based on recurring positive reinforcements and experience-based involvement leading to greater sense of security, thus increasing extra incentive costs , i.e., extra costs paid for the new brand to maintain the same level of trust and involvement.
 - 5- Moral hazard can be a motive for switching behavior in the case of poor trust in present brand and/or focus of the new brand on creating and providing different concepts and higher levels of customer well-being and delight-driven values thus reducing incentive costs associated with present brand through introducing lower incentive costs attributed the new brand's lower level of moral hazard.
 - 6- Discrepancy in risk attitudes can be a barrier to switching behavior if the new brand proved to be less risk-averse than the present brand without demonstrating tangible and desirable returns resulting from the extra risk imposed by switching to the new brand, thus conceived by the customer as unnecessary risk leading to higher residual cost.
 - 7- Discrepancy in risk attitudes can be a motive for switching if the new brand is perceived by the customer as more risk averse than the present brand thus

associating the new brand with less risk for the same or even higher return thus reducing residual cost.

Research Propositions

Accordingly, there is enough conceptual and exploratory ground for deducing three propositions to be empirically tested by future research., thus;

- 1- Information asymmetry can be a barrier to or motive for switching behavior depending on the present and promised levels of transparency leading to changes in monitoring costs for advertising and promotion agencies.
- 2- Moral hazard can be a barrier to or motive for switching behavior depending on the present level of positive-reinforcements-based trust and promised sources and levels of trust incurring varying levels of incentive costs for advertising and promotion agencies.
- 3- Diverse risk attitudes can be a barrier to or motive for switching behavior depending on the perceived risk/return relationship of the present brand versus the new brand creating differential residual costs for advertising and promotion agencies.

Conclusions and Research Frontiers Agenda

This paper endeavored to devise the agency theory paradigm to offer a more insightful understanding to the switching behavior phenomenon in the “agent-represented” service sector. The authors argue that the relationship, with special emphasis on switching behavior, between the client (principals) and Advertising agency (agent) could be comprehended within an agency context relying on available literature on agency theory. Literature on both subject areas switching (Motives and Barriers) and Agency theory (Costs and Sources) had been used in introducing a conceptual framework that proposes a synergy between the two concepts. The paper ends with three research propositions of the agency costs’ sources and its proposed impact on the switching behavior (Motives and Barriers).

This paper will be followed by a second one to investigate these research propositions empirically in the Egyptian Advertising industry. A third planned phase for this research will be include the USA evidence to offer a cross-cultural analysis validation and perspective for such a phenomenon, with a view toward assessing the possibility to adopting global marketing strategies that can discourage or encourage switching behavior in a global marketing environment.

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