

## **The Moderation Effect of Legal Environment on RM Strategies and Ethical Values of SMEs' Customer Service Officers.**

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### **Abstract**

It has been suggested that the effectiveness of the relationship marketing (RM) strategy (or the strength of firm-customer relationship) may be dependent on the legal environment in which it is being practised. This paper investigates the role of the legal environment in the association of relationship marketing underpinnings (namely trust, competence, commitment, communication and conflict handling) with ethical values of customer service officers (CSO). Data for the research was collected through a survey of customer service officers of outsourcing SMEs in the Klang Valley, Malaysia. Hierarchical Multiple Regression Analysis (HMRA) was used to estimate the moderation effect of the legal environment in the RM-ethical value relationship. The findings of the study are discussed.

**Key Words:** Relationship marketing underpinnings, Legal environment, Ethical values, SMEs, Malaysia.

### **Introduction**

The business process outsourcing (BPO) industry is a service based industry that relies upon good relationship marketing strategies to enhance relationships with clients and clients' customers. The relationship with the client is based upon contractual principles where the parties are legally bound by the terms of their agreement. The agreement implies that the BPO will act with due care and skill in performing its services towards the clients and its customers. Failure to act in this manner could result not only in financial losses to the client but a loss of goodwill. The client is likely to terminate the contract with the BPO and claim compensation for the loss of reputation. It is imperative that the customer service officers (CSOs) of the BPO act professionally and maintain a good relationship with the client's customers.

Studies have indicated that there is a significant relationship between relationship marketing strategies which are trust, commitment, communication and preemptive conflict handling and ethical values of customer service officers in the outsourcing services industry. These studies have concluded that when customer service officers in that industry have high levels of trust, competence, commitment, communication and conflict handling it results in high ethical values (Ndubisi, Satkunasingam and Ting, 2006). The purpose of this research is to determine if the legal environment has an impact on the link between relationship marketing strategies and ethical values. This paper intends to determine if the ethical values of customer service officers are actually due to the threat of legal sanctions. In this paper we try to address the issue of the role of legal sanctions on the impact of relationship marketing strategies on the ethical values of CSOs in BPO SMEs.

### **Literature Review**

#### **Compliance theories**

There are many theories that attempt to explain why people comply with the law. Legal theories posit that the law and other values will only be adhered to if strictly enforced and backed by legal sanctions. Deterrence theories posit that a person will comply with the law out of fear of legal punishment. These theories are usually applied in relation

to criminal law but have also been linked to other sanctions in civil law (Williams 1993; Schroeder 2002). Deterrence theories state that when breaches of the law go unpunished, the position of the law is weakened as the message sent is that those in the position to enforce the law do not value the law sufficiently to enforce it. (Nadler 2005). This may have an impact on social behaviour. Law-abiding people perceive themselves as having no protection from or recourse to the authorities. They then either resign themselves to their position or try to retaliate. They also lose faith in the authority of the law and their tendency to infringe the law is higher (Nadler 2005). Hasen (1996) states that as breaches of the law increase and wrongdoers go unpunished, the general consensus is weakened and law loses its moral authority. At some point complying with the law while everyone else is breaching it makes one a "chump". He describes this as the "snowball effect". Legal sanctions will not be a deterrent under these circumstances. (Huang & Wu 1994).

There is a general understanding that infringements of the law should be punished. The question is whether punishment ensures compliance? The three justifications for punishment are utilitarian, retributive and denunciation. The utilitarian theory of punishment justifies punishment in the interest of the greater good in the long run. If the punishment benefits society then the evil done to one person is justified. It focuses on the consequences of breaching a law. When a breach occurs, the focus is upon maximizing social welfare to prevent recurrence of the breach and to serve as a deterrent to others not to commit a breach. It focuses on punishment to the extent that it maximizes social welfare (Becker, 1968; Posner 1985). It posits that negative incentives can influence the way in which human beings choose to behave and make them calculate the cost involved before breaching the law. Therefore the higher the cost, the more effective the deterrence will be (Ehrlich 1975). It also posits that people will refrain from breaching the law because they fear the associated risks (van den Haag & Conrad, 1983).

Robinson and Darley (1997) are of the view that legal sanctions are not deterrents as most people do not know the details of such sanctions and cannot make a rational and informed decision to calculate the cost of infringement. However Posner is of the view that this is the real benefit of deterrence as it has predictive power and since people are uncertain of the actual legal sanction attached to an act, they are usually reluctant to breach the law (Becker 1968; Posner 2003). The conclusion from the utilitarian theory is that if the cost of deterrence is low or removed altogether then people will breach the law as it costs them nothing to do so. This theory has its supporters in Jeremy Bentham and David Hume (Feinberg & Gross 1980) but has been criticized on the grounds that punishing one person to benefit others is morally wrong (Hart 1983).

The second justification for punishment is for the purposes of retribution. Duff defines the retributive theory as insistence on punishment for past wrongdoings (Duff 1996). The idea behind the retributive theory of punishment is that the offender is duty-bound to suffer punishment because his or her actions has caused an imbalance of benefits and burdens in society as a whole (Fletcher 1978) The offender is expected to pay a contractual debt to society (Murphy 1973) Retributive theories have been linked to theories about fair distribution and used in civil remedies where a wrongdoer is expected to repay what has been received and restore the position of those who have suffered at his or her hands (Rawls 1955).

The denunciation theory believes that the reason behind punishment is to reaffirm societal values. It is aimed at those who comply with the law and their reaction to those who infringe the law. When people who infringe the law are made to pay for their actions, it re-affirms the values of those who have complied with the law (Rychlak 1990) The denunciation theory is suited to civil actions as well as criminal actions. In the area of contract, it reaffirms that people who do not abide by their contracts will be made to compensate the innocent party. This reaffirms the social values that support contract law which emphasize that people should be bound by their promises. Kahan points out that the debates over sanctions often refer to the impact that these sanctions have on the law-abiding section of the community and not just the wrongdoer. However this is carefully hidden behind rhetoric which attempts to justify that the reason for certain sanctions is to prevent others from breaching the law. Thus according to Kahan, legal sanctions are very often an expression of society's views which are presented as an exercise in maximizing social welfare to prevent others from breaching the law. (Kahan 1993).

Denunciation theories are also linked to expressive theories which believe that sanctions have a social meaning and are an expression of a community's views and the norms that are acceptable within that community. The role of punishment is to send a message to the community as to how to behave. McAdams believes that social sanctions play a more important role than legal sanctions. Social sanctions such as the simple denial of esteem can generate norms because individuals seek the esteem and respect of others. (McAdams 1997). He posits that people comply

with the law due to social sanctions and not legal sanctions. They fear the disapproval of their peers if they disobey the law. This includes fear that their past commitments will be in jeopardy and they will lose valued relationships (Williams & Hawkins 1986; Lott Jr. (1992). The proponents of these theories believe that one of the reasons for compliance with the law is that people have internalized the values within the law and regardless of the role of legal sanctions, will comply with the law (Tyler 1990; Robinson & Darley, 1997). Sunstein (1996) believes social norms are extremely powerful and can command compliance even when there are no laws supporting it. Most people hold the view that the social norms represent the view of the majority and will align their behaviour accordingly. Lessig (1996) holds similar views and states that there are social discourses that create social norms which if breached will result in social sanctions. One of the preconditions to this type of sanction is a general consensus that a particular type of behaviour is unacceptable. When there is a lack of social sanctions then people are more willing to breach the law (Grasmick & Green 1980). This is usually the case when a law carries a sanction but is widely perceived to be unfair (Robinson & Darley) or where breaches are so widespread that it becomes the norm and there are no social sanctions attached (Lessig 1996).

Cooter (2000) however does not completely agree with this view as he believes that if people internalize a norm, they will not change it easily in the face of widespread breach. He states that people who internalize a norm make a moral commitment to abide by the norm and do what they think is right even if it the cost of doing so increases. Such people eventually reap high benefits because others trust a morally committed person especially where that person is willing to pay a higher price to stand by their commitment. This improves relationships and in the long term creates trust between the parties in the relationship. Cooter states that if people perceive that their commitment to a norm will improve their opportunities of cooperating with others, then they will comply with the norm as the cost of doing so outweighs the cost of breaching it.

Kahan offers an alternative view to the reasons why people comply with the law. He supports the role of social sanctions and community morality and states that social sanctions such as methods of shaming when pursued independently or together with legal sanctions send a message to the community to reaffirm societal values (Kahan, 1996). However, shame is only a deterrent when a person is a member of an identifiable group and finds that his or her social standing is being threatened. There must be a threat of exposure to others within that group and the shamed person must fear shunning by the rest of the group. In the absence of these conditions, social sanctions are ineffective (Garvey, 1998; Litowitz 1997; Massaro, 1997; Massaro, 1991; Reske, 1996; Sanders, 1998; Whitman, 1998). Braithwaite (1995) studied the impact of punishment in the corporate sector and discovered that most corporations placed a high value upon goodwill and their relationship with their customers and social sanctions could have a profound impact upon such corporations as they lose enormous goodwill which is usually reflected in their profits. Braithwaite believes that corporations and their employees will refrain from acts which infringe the law if they are certain that they will be publicly shamed as a result.

It is clear that legal sanctions alone may not bring about any compliance with the law unless supported by moral sanctions. Even then there are views to the effect that compliance levels are only high when the law is internalized which will only occur if compliance improves opportunities of cooperating with others. Ndubisi, Satkunasingam and Ting (2006) have argued that ethical values can be achieved through non-punishment oriented strategies or relationship building. The next sections discuss the relationship marketing strategy and ethics.

### **Relationship Marketing Underpinnings**

The concept of relationship marketing has emerged within the field of service marketing and industrial marketing (Berry 1983; Jackson 1985; Christopher et al. 1991; Gummeson 1991). Relationship marketing is to establish, maintain, and enhance relationships with customers and other partners, at a profit, so that the objectives of the parties involved are met (Gronroos 1994). This is achieved by a mutual symbiosis and fulfillment of promises (Ndubisi 2003). Kavali et al. (1999) indicated that relationship marketing is about healthy relationships characterized by trust, equity, and commitment. Other scholars (e.g. Morgan & Hunt 1994; Crosby et al., 1990; Ndubisi 2006) have documented the following constructs namely, trust, competence, commitment, conflict handling and communication or sharing of secrets as key underpinnings of relationship marketing.

Moorman et al. (1993) defined trust as "...a willingness to rely on an exchange partner in whom one has confidence. A betrayal of this trust (by the supplier or service provider) could lead to defection. Other authors have defined trust

in terms of opportunistic behaviour (Dwyer et al. 1987), shared values (Morgan & Hunt 1994), mutual goals (Wilson 1995), making and keeping promises (Bitner 1995), uncertainty (Crosby et al. 1990), and actions with positive outcomes (Anderson & Narus 1984).

Competence is defined as the buyer's perception of the supplier's technological and commercial competence (Anderson & Weitz 1989). Businesses lose approximately 20 percent of their customers each year, most of which arise from issues relating to incompetent service delivery (Rakstis 1996). 65 percent of the average company's business comes from its present customers (Vavra 1992) and small increases in customer retention rates can lead to dramatic increases in profits (Reichheld, 1996).

Commitment is one of the important variables for understanding the strength of a marketing relationship. Moorman et al. (1992) defined commitment as an enduring desire to maintain a valued relationship. This implies a higher level of obligation to make a relationship succeed and to make it mutually satisfying and beneficial (Gundlach et al. 1995; Morgan and Hunt 1994). Since commitment is higher among individuals who believe that they receive more value from a relationship, highly committed customers will be more willing to reciprocate effort on behalf of a firm due to past benefits received (Mowday et al. 1982) and highly committed firms will continue to enjoy the benefits of such reciprocity.

Communication refers to the ability to provide timely and trustworthy information. Sheth (1975), noting the distinction between content and style in communication suggested that the latter recognises the importance of ritualistic behaviour patterns in shaping the outcomes of buyer/seller interactions. Communication is also about mutual disclosure or sharing of secrets. Derlega et al. (1987) remarked that among the behaviours often noted as important in establishing and maintaining interpersonal relationship is mutual disclosure. The authors argued that the perception that another party is engaging in disclosure behaviour toward oneself that is not being reciprocated often is read as a weakness on the other party's part and may lead to an unhealthy relationship. Moreover, the frequency of communication (or contact intensity) is vital.

Dwyer *et al.* (1987) defined conflict handling as the supplier's ability to minimize the negative consequences of manifest and potential conflicts. Conflicts handling reflects the supplier's ability to avoid potential conflicts, solve manifest conflicts before they create problems and the ability to discuss openly, solutions when problems arise. How conflicts are handled will ensure loyalty, exit or voice. Rusbult et al. (1988) concluded that the likelihood that an individual will engage in these behaviours depends on the degree of prior satisfaction with the relationship, the magnitude of the person's investment in the relationship and an evaluation of the alternatives one has. Conflict handling requires cooperative behaviour from exchange partners. Cooperative versus competitive behaviour has been linked to perceptions of trust and satisfaction in negotiation contexts (Pruitt 1981).

## **Ethics**

According to Svensson and Wood (2003), the concept of ethics is "a complex one that is predicated on an interchange of views about the individual belief systems among the citizens of any culture". De George (1999, p. 20) describes ethics as "a systematic attempt to make sense of our individual and social moral experience, in such a way as to determine the rules that ought to govern human conduct, the values worth pursuing, and the character traits deserving development in life". While Velasquez (1998, p. 11) defines ethics as "the activity of examining one's moral standards or the moral standards of a society, and asking how these standards apply to our lives and whether these standards are reasonable or unreasonable".

Although it has been suggested that it is not possible to have a universally recognized definition of ethics, there are various philosophical opinions about those elements that constitute ethics. Various schools of thought exist that approach the topic of ethics from different points of view (Svensson & Wood, 2003). One philosophical perspective is no more acceptable than the others, but each contributes in its own way to possible understandings of the many nuances of the concept of ethics (Svensson & Wood, 2003).

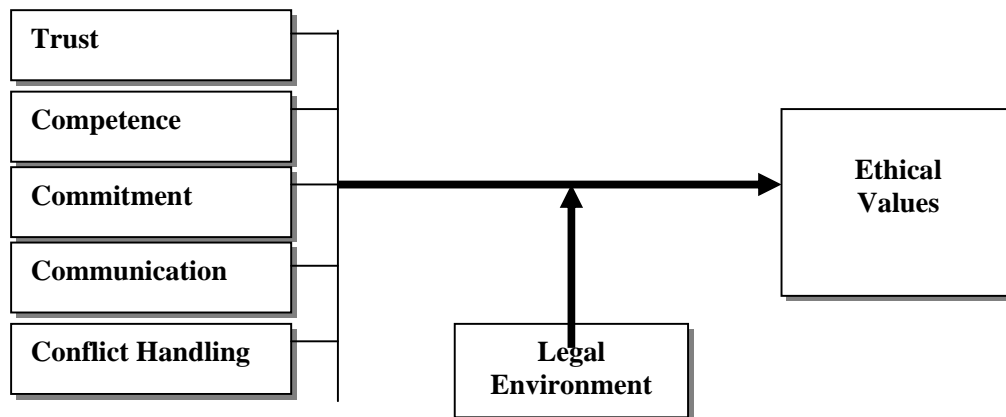
In the field of marketing, practitioners are required to examine from the ethical viewpoint on how they should deal with consumers, challengers, suppliers, and the government due to the social pressures (Takala & Uusitalo, 1996). In contemporary business life, it is increasingly necessary for marketers to examine their ethical responsibilities (Norris

and Gifford, 1988). High ethical values in the principal-agent relationship such as in outsourcing situation would ensure that the agent represents the principal well by providing satisfactory services.

### Methodology

Customer service officers of outsourcing SMEs in the Klang valley were surveyed. The list of outsourcing customer service officers were obtained from a key outsourcing firm in Kuala Lumpur. Participation by respondents was voluntary. A total of 180 officers (45%) supplied usable responses used in this study out of the 400 customer service officers approached to participate in the survey. Some of the questionnaire items were adapted from prior sources and the rest were developed for the present study. Communication, commitment and conflict handling items were adapted from Morgan and Hunt (1994). Competence and trust items were adapted from Ndubisi and Chan (2005) and Churchill and Surprenant (1982) respectively. Ethics and legal environment items were developed for the study as there were no suitable existing items. Factor analysis and reliability analyses were conducted to ascertain the validity and internal consistency of the measures. The Hierarchical Multiple Regression Model was employed to predict the constructs' relationships. Figure 1 below is the schema of the research model.

**Figure 1: The Schema of the Research Model**



### Results

The demographic information of the respondents based on gender is male (42%) and female (58%). The racial composition of the respondents is as follows: Malays (35%), Chinese (23%), Indians (35%) and others including (Eurasians) make up the remaining 7%. In terms of educational qualification, those with degree and post graduate qualifications are 30%, high school or diploma (47%) and secondary school or less (23%). Most of the respondents (77%) fall within the 18-28 age brackets (popularly known as the generation Y), followed by 29-42 age group (22%) and then 43-60 years (1%). Income-wise, all the respondents fall within a monthly income of RM 10,000.

### Factor Analysis

The results of the factor analysis are shown in Table 1 below. We accepted factor loadings of 0.50 and above – this level is considered practically significant (Hair et al 1998). The results of the factor analysis show that 23 items loaded well on seven dimensions namely, trust, competence, commitment, communication, preemptive conflict handling, ethical value and legal environment with total variance of 68 percent. Reliability estimates (Cronbach's Alpha) for the construct's dimensions suggest a high degree of reliability as the results exceed .60 (Hair et al. 1998) lower limit of acceptability, except for the communication items which has a slightly problematic scale.

**Table 1: Factor and Reliability Analyses**

Key Dimensions and Items	Loadings	Reliability Estimates
F1		0.79

CSOs should be concerned with the privacy of the customers' transactions. CSOs should ensure that their promises to customers are reliable under all circumstances. CSOs should act consistently to provide quality service. CSOs should fulfill their obligations to customers under all circumstances. CSOs should maintain customers' confidence under all circumstances. (Eigenvalue = 7.01; Variance = 30.47%)	0.69 0.78 0.64 0.64 0.52	
<b>F2</b> CSOs should constantly be in touch with market trends that affect their customers. CSOs should use best practices processes to support customers. CSOs should constantly gather feedback on how to improve current business solutions. CSOs should obtain information about new product development in their customers' business. (Eigenvalue = 2.28; Variance = 9.93%)	0.71 0.70 0.79 0.74	0.79
<b>F3</b> CSOs should provide personalized services to customers whenever necessary. CSOs should be flexible when serving their customers. CSOs should be flexible when their customers' needs change. (Eigenvalue = 1.66; Variance = 7.21%)	0.75 0.89 0.82	0.80
<b>F4</b> CSOs should provide their customers with accurate information. CSOs should keep customers informed about the status of their transactions. CSOs should openly discuss solutions when problems arise. (Eigenvalue = 1.55; Variance = 6.75%)	0.50 0.50 0.75	0.50
<b>F5</b> CSOs should avoid potential conflict with their customers. CSOs should identify potential areas of conflict and resolve them before problems arise. (Eigenvalue = 1.38; Variance = 6.01%)	0.75 0.60	0.65
<b>F6</b> CSOs should remain trustworthy although the customer may not seem to be very reliable. CSOs should ensure that they remain competent as far as possible although the customer does not disclose sufficient information. CSOs should remain fully committed to customer service and the relationship with customer although the customer is not fully committed. (Eigenvalue = 1.01; Variance = 4.37%)	0.63 0.80 0.72	0.80
<b>F7</b> It is permissible for a CSO to breach the contract if the CSO is sure that the customer will be reluctant to take legal action. A CSO need not provide any service which is not stipulated in the contract with the client. It is foolish for a CSO not to breach the contract if other CSOs are breaching it and customers are reluctant to take legal action. (Eigenvalue = 1.00; Variance = 3.96%)	0.89 0.52 0.86	0.70
<b>Total Variance = 68.70% MKO = 0.840</b> Notes: F1 – Trust F2 – Competence F3 – Commitment F4 – Communication F5 – Preemptive Conflict Handling F6 – Ethical Values F7 – Legal Environment		

### Relationship Test Using Hierarchical Regression Model

Hierarchical Regression analysis was used in testing for associations. The moderation effects of gender and the control for confounding effects were carried out following the style of Jaccard et al. (1990). Three-tier multiple regression was employed as follows:

(a) Stage 1 introduces the independent dimensions (relationship marketing underpinnings) into the regression model.

(b) In stage 2, the moderator (legal environment) was introduced.

(c) In stage 3 the interaction term (i.e. the product of the independent and moderation variables) was introduced.

Generically, the regression has the following equation:

$$Y = b_0 + b_1X_1 \quad (1)$$

$$Y = b_0 + b_1X_1 + b_2X_2 + E \quad (2)$$

$$Y = b_0 + b_1X_1 + b_2X_2 + b_3X_1X_2 + E \quad (3)$$

Where  $Y$  represents Ethical values

$b_0$  represents the constant

$b_1$  represents the strength of RM underpinnings

$X_1$  represents the RM underpinnings

$b_2$  represents the strength of the moderator

$X_2$  represents the moderator

$b_3$  represents the strength of the interaction terms

$X_1X_2$  represents the interaction terms

$E$  is the error term

**Table 2: The Moderation Effects of Legal Environment**

Variables	Step 1		Step 2		Step 3	
	B	Sig.	B	Sig.	B	Sig.
Trust	.154	.022	.153	.043	.164	.468
Competence	.119	.096	.118	.099	.662	.003
Commitment	.147	.029	.143	.035	.143	.428
Communication	.169	.034	.165	.039	.519	.028
Pre-emptive Conflict Handling	.254	.001	.259	.001	.305	.204
Legal Environment (LE)			.035	.565	.496	.001
Trust*LE					.133	.843
Competence*LE					-.589	.013
Commitment*LE					-.016	.960
Communication*LE					-.150	.089
Conflict Handling*LE					-.095	.854
R <sup>2</sup> Changes	.399		.001		.057	
Significant F Change	.000		.565		.005	

The results in step 1 of Table 2 show that there is a significant direct relationship (at 5 percent significance level) between trust, commitment, communication and preemptive conflict handling and ethical values of customer service officers. However, there is no significance relationship between competence and ethical values.

In step 3, we observe the role of the interaction terms. From the results in this column, it can be concluded that legal environment does not moderate the impact of the relationship marketing underpinnings namely, trust, commitment,

communication and conflict handling on ethical values. This means the impact of the four factors on ethical values of customer service officers does not depend on legal requirements. Thus, the more CSOs see the need for trustworthiness, commitment, communication and conflict handling, the higher their ethical values; and these relationships is independent of the legal environment in which they operate. It can therefore be concluded that internal motivation rather than legal requirements is a driving force for high ethical values in a relational marketing environment.

There is no direct significant relationship between competence and ethical values. However, there is a negative moderation effect of legal requirements in this relationship. This means that when there is strict legal requirement, even incompetent customer service officers will behave more ethically. Although the competence level of CSOs do not directly improve ethical values, in a normal or non-strict legal environment, both competent and incompetent CSOs will behave ethically when the legal requirement is strict.

## **Conclusions**

The following conclusions can be drawn from this study. First, trust, commitment, communication and conflict handling have a significant impact on ethical values of customer service officers of outsourcing SMEs in Malaysia. Second, the impact of these relationship marketing underpinnings on ethical values is not moderated by the presence or absence of sanctions. CSOs who value trust, commitment, communication and conflict-handling are more likely to behave ethically even when the legal environment is not strict. The drive for ethical behaviours of these CSOs is internally motivated. The CSOs portray trustworthiness, commitment, communication and conflict handling even when there are no legal or social sanctions attached to their behaviour. This may be due to the fact that they have calculated the costs and found that it is more beneficial to them to remain committed to relationship marketing strategies. Third, competence is not a significant driver of ethical values. Lastly, strict legal requirements, will lead incompetent customer service officers to behave more ethically. These findings add significant value to the present knowledge in the area as there is no known literature on the moderation effect of the legal environment in the relationship between the relationship marketing underpinnings and ethical values of customer service officers of outsourcing SMEs in Malaysia and elsewhere.

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