THE EFFECTIVENESS OF COMPENSATION GIVEN TO COMPLAINING CONSUMERS: IS MORE BETTER?

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ABSTRACT

Most major consumer products companies offer compensation (e.g., refunds, coupons, replacement products) to their dissatisfied consumers to resolve their complaints. However, it is not clear if greater amounts of compensation have significantly positive effects on complaining consumers. This study evaluated the impact that greater amounts of compensation had on 1,796 consumers who complained to a major consumer products company. The results showed that greater amounts of compensation did *not* significantly increase these complaining consumers' repeat purchase intentions, word-of-mouth communication, or satisfaction with the company's compensation offer.

INTRODUCTION

Most major consumer products companies have instituted complaint management systems in which dissatisfied consumers are encouraged to express their complaints directly to customer service representatives via toll-free telephone complaint "hotlines" (Garrett and Meyers 1996; SOCAP 1992, 1996). During these interactions, customer service representatives typically attempt to minimize consumers' dissatisfaction levels by offering them appropriate compensation, such as refunds, coupons, or product replacements. Companies hope that this compensation will soothe the anger and frustration of complaining consumers so that they will consider buying these products again and will not discourage their friends from purchasing these products.

While most consumer products companies routinely give compensation to dissatisfied consumers, comparatively little research has been devoted to the issue of what is the optimal level of compensation that should be offered to dissatisfied consumers in order to stimulate repeat purchase behavior and positive word-of-mouth communication. As Smith, Bolton and Wagner (1999, p. 356) recently noted, "Although service recovery is recognized by researchers and managers as a critical element of customer service strategy, there are few theoretical or empirical studies of service failure and recovery issues." If too much compensation is offered to complaining consumers, companies are needlessly wasting money that does not significantly increase consumers' repeat purchase intentions and positive word-of-mouth communication. Conversely, if too little compensation is offered, companies are failing to generate the additional benefits that can be reaped from more adequately resolving consumers' complaints.

This study addresses this important research issue by investigating the impact that the amount of compensation given by a company has on complaining consumers' repeat purchase intentions, word-of-mouth communication, and satisfaction with the compensation offer. Relevant literature and the theoretical foundation for this study are reviewed next. Then the research hypotheses addressed in this study are explicated, followed by a description of the study's methods. Finally, the results are presented and discussed.

LITERATURE REVIEW

Recent research clearly demonstrates that there is a positive relationship between customer satisfaction and company profitability (Anderson, Fornell, and Lehmann 1994). When consumers are highly satisfied with a company's products, they engage in repeat purchase behavior and also encourage their friends to buy the company's products through positive word-of-mouth communication. In this favorable situation a company is able to spend less money on promotion and, as a result, profitability is increased. In contrast, when consumers are dissatisfied with a company's products, they switch their future purchases to competitive companies and discourage their friends from buying the offensive company's products through negative word-of-mouth communication. Thus, profitability suffers because a company must spend more money on promotion to overcome the effects of negative word-of-mouth communication

To minimize the adverse effects that dissatisfied consumers can cause, progressive

companies encourage these customers to communicate their complaints directly to customer service representatives (Garrett and Meyers 1996; SOCAP 1992, 1996). By doing so, service representatives can identify problem areas within the company that are generating customer complaints. In addition, service representatives also attempt to resolve dissatisfied consumers' complaints, typically by offering some compensation to consumers for their negative experience. This compensation may take various forms, such as a refund for the consumer's purchase price, coupons for future purchases of company products, or new products given to replace defective merchandise.

During the past two decades a growing body of research has investigated the effectiveness of compensation given by companies to dissatisfied consumers (Baer and Hill 1994; Blodgett and Tax 1993; Clark, Kaminski, and Rink 1992; Gilly 1987; Gilly and Gelb 1982; Gilly and Hansen 1985; Goodwin and Ross 1992; Hoffman, Kelley, and Rotalsky 1995; Lewis 1983; Megehee 1994; Pearson 1976; Resnik and Harmon 1983; Smart and Martin 1992; Smith, Bolton and Wagner 1999). In general, these studies found that dissatisfied consumers are more favorably impressed with a company's response to a complaint when some amount of monetary compensation is included as compared to when the company responds without any compensation offer.

However, only a few studies have specifically analyzed the impact that greater amounts of compensation have on complaining consumers (Blodgett and Tax 1993; Gilly 1987; Gilly and Gelb 1982; Gilly and Hansen 1985; Megehee 1994; Smith, Bolton and Wagner 1999). Most of these studies concluded that dissatisfied consumers are more favorably impressed as the amount of compensation given by a company increases (Blodgett and Tax 1993; Gilly 1987; Gilly and Gelb 1982; Gilly and Hansen 1985; Megehee 1994; Smith, Bolton and Wagner 1999). But the results from these studies have not always been consistent. For example, Megehee (1994) found that subjects in her experiment who received $5 of compensation had a greater intention to repurchase than did those subjects who received $7.50, $10, or $12.50. Most notably, Smith, Bolton and Wagner (1999) recently found in their analysis of service failures in the hotel and restaurant industries, that the magnitude of the service failure apparently plays a critical role in this process. They discovered that when the magnitude of failure is low in their hotel scenario, the relative effect of a moderate level of compensation on perceptions of distributive justice was *greater* than the effect of a high level of compensation. In the restaurant scenario, they observed no difference in effects between these levels of compensation. Thus, given this limited number of prior studies and their inconsistent results, there appears to be insufficient empirical data to determine what is the optimal level of compensation that should be offered to complaining consumers.

Two important limitations in these previous studies must also be carefully considered. First, most of these studies did not directly analyze perceptions of dissatisfied consumers who actually received compensation from companies for their complaints. Instead, a number of studies asked subjects recruited for an experiment to evaluate scenarios depicting hypothetical company responses to consumers' complaints (Blodgett and Tax 1993; Gilly and Hansen 1995; Goodwin and Ross 1992; Megehee 1994; Resnik and Harmon 1983; Smart and Martin 1992; Smith, Bolton and Wagner 1999). Other studies asked college students for a class assignment to write complaint letters to companies and then evaluate the company's response (Baer and Hill 1994; Clark, Kaminski, and Rink 1992; Pearson 1976). Thus, because of the artificiality of these situations, the validity of the subjects' evaluations must be questioned. Only a few studies obtained the perceptions of dissatisfied consumers who had actually complained to companies in real life situations (Gilly 1987; Gilly and Gelb 1982; Hoffman, Kelly and Rotalsky 1995; Lewis 1983).

Second, while repeat purchase behavior and word-of-mouth communication are generally considered to be two key variables that companies must positively impact in order to maximize their profitability (Anderson, Fornell, and Lehmann 1994), many of these previous studies did not measure the effect that compensation has on these two variables. Some studies measured repeat purchase intentions or behavior (Baer and Hill 1994; Blodgett and Tax 1993; Gilly 1987; Gilly and Gelb 1982; Gilly and Hansen 1985; Lewis

1983; Megehee 1994), but only a few assessed word-of-mouth communication (Blodgett and Tax 1993; Gilly and Hansen 1985; Lewis 1983).

In sum, the results of this literature consistently indicate that companies should offer some monetary compensation to complaining consumers. However, even though companies are advised to offer "generous" compensation to complaining consumers because these expenditures should theoretically yield attractive returns (Fornell and Wernerfelt 1987, 1988), there is insufficient previous research to demonstrate empirically just how generous this compensation should be. This is obviously an important, unanswered question that has significant financial implications for consumer affairs managers. In the next section, equity theory is presented as an appropriate theoretical framework that may help answer this critical question.

THEORETICAL FRAMEWORK

Equity theory, which has been applied in a number of consumer satisfaction studies (e.g., Gilly and Hansen 1985; Goodwin and Ross 1992; Oliver and Swan 1989a, 1989b; Swan and Oliver 1989), provides the theoretical framework for this study. In general, equity theory suggests that consumers determine their degree of satisfaction with a product based on the perceived fairness of their exchange relationship with the manufacturer and/or retailer of the product. Previous research has shown that as consumers' perceptions of fairness increase, the content of their word-of-mouth communication becomes more positive (Swan and Oliver 1989). Also, consumers are more satisfied with an exchange relationship as their perceptions of fairness increase (Oliver and Swan 1989a).

Previous research regarding "positive inequity" (i.e., individuals perceive that the outcomes are weighted in their favor) lends insight into the possible effect of compensation on dissatisfied consumers (Brockner and Adsit 1986; Gilly and Hansen 1985; Oliver and Swan 1989a). On the one hand, positive inequity may cause individuals to feel distress or guilt because they believe they are receiving more than they deserve. On the other hand, due to an individual's "egocentric bias", mild amounts of positive inequity may actually lead to increased satisfaction. Supporting the egocentric bias, the results of Brockner and Adsit's (1986) research showed that individuals were more satisfied with a positively inequitable relationship than with an equitable relationship. Similarly, Gilly and Hansen (1985) found that dissatisfied consumers who received an "overbenefiting" response (i.e., positive inequity) from a company were more satisfied than those consumers who received an equitable response. Thus, for the purposes of this study, equity theory indicates that complaining consumers should be more satisfied as the amount of compensation given to them increases.

HYPOTHESES

Based on prior research concerning equity theory, the following hypotheses regarding the impact of compensation on dissatisfied consumers will be addressed in this study:

H1: Complaining consumers' repeat purchase intentions will increase significantly as the amount of compensation given to them increases.

H2: Complaining consumers will be significantly more likely to recommend a company's products to their friends as the amount of compensation given to them increases.

H3: Complaining consumers' degree of satisfaction with a company's compensation offer will increase significantly as the amount of compensation given to them increases.

METHODOLOGY

An experiment was designed to test the effect that the amount of compensation has on complaining consumers. A major consumer products company agreed to cooperate with this project. Like most consumer products companies, this company has a complaint management system in which dissatisfied consumers may call a toll-free telephone number and express their complaints directly to the company's customer service representatives. The vast majority of complaints

received by this company involve cases in which consumers complain that a product did not perform as effectively as expected.

The independent variable in this study is the amount of compensation given to complaining consumers. To be consistent with current company practice, the form of compensation used in this study was coupons that may be used for future purchases of company products. The company's standard compensation policy calls for service representatives to send complaining consumers a coupon approximately equal in value to the average retail price of the product with which they are dissatisfied. Most of the company's products have retail prices in the $2 to $5 range. If a consumer complains about multiple units of the product, then the service representatives send the consumer one coupon for each unit bought. For instance, if a consumer complained about 3 units of a product that retailed for $4 per unit, the service representative would send $12 worth of coupons to the consumer.

To measure the impact that various amounts of compensation have on complaining consumers, three levels of this independent variable were selected. In the "normal" case, service representatives were instructed to follow current company policy and give complaining consumers one coupon equal to the product's average retail value for each unit of product that the consumer bought. In the "double" case, service representatives were instructed to give complaining consumers 2 coupons equal to the product's average retail value for each unit of product bought. Finally, in the "triple" case, complaining consumers received 3 coupons equal to the product's average retail value for each unit of product bought. This manipulation was executed by randomly designating specific days as "normal", "double", or "triple" coupon days. For instance, on "double" coupon days, all service representatives were instructed to give 2 coupons equal to the product's retail price for each unit of the product bought by consumers who called to complain on that day.

The service representatives were briefed prior to the start of the study regarding the general purpose of this project. The coupon status of each work day (i.e., normal, double, or triple coupon day) was prominently posted in the customer service center. The author and the customer service center manager stressed the importance of this study and encouraged all representatives to conscientiously follow the couponing schedule. While the study was being conducted, the service center manager randomly checked call reports to confirm that the service representatives understood the study's directions and were adhering to the couponing schedule.

Approximately one week after their call to the company's customer service center, complaining consumers received through the mail a package containing their coupon compensation and a satisfaction survey that they were asked to complete and return to the company in an enclosed postage-paid envelope. Included in this survey were questions designed to measure these consumers' repeat purchase intentions, word-of-mouth communication, and satisfaction with the company's compensation offer (the specific questions are listed in the results section).

Completed satisfaction surveys were received from 1,766 consumers (515 consumers who contacted the company during normal coupon compensation days, 657 consumers from double coupon days, and 594 consumers from triple coupon days). Because these surveys were coded with the company's customer contact number, each respondent's survey results were then linked directly back to the amount of compensation actually given to each specific consumer. This analysis revealed that dissatisfied consumers who contacted the company on normal coupon days and returned their satisfaction surveys received an average of $3.80 in coupons for each unit of product that they bought. Consumers on the double coupon days received an average of $7.73 for each unit of product with which they were dissatisfied. Consumers on the triple coupon days received an average of $11.06 for each unit of product. This analysis verified that the dissatisfied consumers in these three treatment groups did, in fact, receive significantly different levels of coupon compensation.

RESULTS

Repeat purchase intentions

The first hypothesis asserted that as the

amount of compensation given to complaining consumers increases, their repeat purchase intentions will increase. This hypothesis was tested first by including the following item on the satisfaction survey:

A. How likely is it that you will purchase this product regularly in the future? (1 = definitely will not; 10 = definitely will)

Contrary to the first hypothesis, the average responses to this item for dissatisfied consumers in each of the three treatment groups were *not* significantly different:

Normal compensation group = 6.84
Double compensation group = 6.86
Triple compensation group = 6.83
(F ratio = .007; F prob. = .993)

This first hypothesis was also tested by including the following two items in the satisfaction survey:

B. How many individual units of this product did you buy during the *past* 12 months?

C. How many individual units of this product do you think you will probably buy during the *next* 12 months?

The difference between each respondent's planned future unit consumption and past unit consumption was calculated. As shown by the negative numbers below, each group indicated that they would buy fewer units of this product in the future than they did in the past. However, using a significance level of .01, there is not a significant difference among these three groups.

Normal compensation group = -.40
Double compensation group = -.58
Triple compensation group = -.61
(F ratio = 2.890; F prob. = .056)

Contrary to the first hypothesis, these results reveal that complaining consumers' repeat purchase intentions do *not* increase significantly as the amount of compensation given to them increases.

Word-of-mouth communication

The second hypothesis stated that complaining consumers will be significantly more likely to recommend a company's products to their friends as the amount of compensation given to them increases. The following two items were included on the satisfaction survey to test this hypothesis:

D. Would you recommend to your friends that they buy this product? (1 = definitely no; 10 = definitely yes)

Normal compensation group = 6.74
Double compensation group = 6.74
Triple compensation group = 6.74
(F ratio = .0002; F prob. = .9998)

E. If a friend asked your opinion about this product, would you say that this product is: (1 = terrible; 10 = excellent)

Normal compensation group = 6.85
Double compensation group = 6.92
Triple compensation group = 6.85
(F ratio = .086; F prob. = .917)

Responses to both of these items indicate that there is not a significant difference in word-of-mouth communication among these three groups of complaining consumers. Therefore, contrary to the second hypothesis, complaining consumers are *not* significantly more likely to recommend products to their friends if they receive increased levels of compensation.

Compensation satisfaction

The final hypothesis asserted that complaining consumers' degree of satisfaction with a company's compensation offer will increase significantly as the amount of compensation given to them increases. To test this hypothesis, the following item was included in the survey sent to complaining consumers:

F. Given your experience with this product, how satisfied are you with the amount of compensation you received?

(1 = not at all satisfied; 10 = completely satisfied)

Normal compensation group = 8.62
Double compensation group = 8.75
Triple compensation group = 8.87
(F ratio = 1.418; F prob. = .243)

Because there were no significant differences among these three groups regarding their satisfaction with the amount of compensation that they received from the company, the third hypothesis must also be rejected.

DISCUSSION

Discussion will focus first on the theoretical implications of these results, and then the practical implications of this study will be explored.

Theoretical Implications

The results in this study show that the amount of compensation offered to complaining consumers does *not* significantly impact their repeat purchase intentions, word-of-mouth communication, or their satisfaction with the company's compensation offer. These findings are somewhat surprising because, even though only a few studies have addressed this question previously, they have generally concluded that complaining consumers are more positively impressed as the amount of compensation given to them increases (Blodgett and Tax 1993; Gilly 1987; Gilly and Gelb 1982; Gilly and Hansen 1985; Megehee 1994; Smith, Bolton and Wagner 1999).

There may be two possible explanations for the disparity between the findings in this study and previous research. First, this inconsistency may be related to the range of the independent variable (i.e., amount of compensation) that was evaluated. In this study the amount of compensation offered to complaining consumers ranged from an amount equal to the retail price of the product, at the low end, to an amount equal to three times the retail price, at the high end. In contrast, in several of the studies previously conducted in this area, it appears that the highest amount of compensation offered did not exceed an amount roughly equivalent to the purchase price of the unsatisfactory product or service. For instance, in the Blodgett and Tax (1993) study subjects were given either a 40% discount on a future purchase, at the low end, or a full exchange or store credit, at the high end. The Gilly (1987) and Gilly and Gelb (1982) studies used "percentage of monetary loss reimbursed" as their independent variable. They do not explicitly report the range of this variable, but it appears that most respondents in their studies received compensation that was less than 100% of their loss. And in the recent Smith, Bolton and Wagner (1999) study, their levels of compensation ranged from no compensation at the low end to 100% of the dissatisfied consumer's bill at the high end.

The two studies that did include greater amounts of compensation report inconsistent results. Gilly and Hansen (1985) evaluated three levels of compensation in a scenario in which a hotel cannot honor a consumer's reservation:

> underbenefit: no room is available and nothing is done.
>
> equity: arrangements are made for comparable facilities at another location.
>
> overbenefit: arrangements are made for comparable facilities at another location and, in addition, a complimentary dinner and a free weekend at the hotel chain are offered.

They found that those subjects who received the overbenefiting option were significantly more likely to be satisfied, to stay at the hotel again, and to recommend the hotel to their friends.

Megehee (1994), also using a hypothetical scenario, evaluated how subjects responded to compensation offers ranging from $2.50 to $15.00 for a dry cleaning problem costing the consumer $5.00. While she found that subjects who received greater amounts of compensation were more satisfied with the company's offer, her results also showed that subjects who received $5.00 in compensation were more likely to use the service again than those who received greater amounts of compensation.

Thus, it could be that the impact of compensation on complaining consumers has different effects in specific zones along the

continuum of possible compensation values. That is, complaining consumers may become progressively more satisfied with companies' compensation offers up until the "price paid" point (i.e., reimbursement equal to 100% of the price paid by the consumer). Then, after this point, increased amounts of compensation may not significantly impact complaining consumers. If this relationship is true, this runs counter to the "egocentric bias" which argues that consumers prefer situations in which inequity is weighted in their favor (Brockner and Adsit 1986).

A second explanation for the results found in this study can be found in the results recently reported by Smith, Bolton and Wagner (1999). They discovered that the magnitude of the failure event plays a significant role in consumers' responses to differential levels of compensation. Most germane to this study, they found that when the magnitude of the failure event is low, the relative effect of a moderate level of compensation on perceptions of distributive justice is actually greater than the effect of a higher level of compensation in their hotel scenarios. In their restaurant scenarios, they found that when the magnitude of the failure is low, there is no difference in impact due to the level of compensation. Because the magnitude of the failure event in this study of dissatisfaction with consumer products was quite low (i.e., most consumers were calling to complain about products that retailed in the $2 to $5 range), this might help to explain why higher levels of compensation had no significant impact.

These findings indicate that the magnitude of the failure event (at least in financial terms) may be a significant variable that affects consumers' reactions to compensation that is offered to them. Based on the results from this study and the Smith, Bolton and Wagner (1999) study, it appears that higher levels of compensation have little significant impact of consumers' evaluations and future intentions, at least when the failure event magnitude is relatively low. However, because of a dearth of prior research, it remains to be seen how these relationships hold true when the magnitude of the failure event is much higher, for example when the consumer's financial loss is in the hundreds or even thousands of dollars.

Practical Implications

Obviously, because comparatively little research has analyzed the effect that the amount of compensation has on complaining consumers, considerable caution should be used in drawing definitive conclusions for consumer affairs managers. However, with this caveat, the results from this study do suggest that consumer affairs managers may be wasting money by offering excessive amounts of compensation to their complaining consumers. This study showed that those dissatisfied consumers in the "triple" compensation category who received an average of $11.03 in coupons were no more favorably impressed than those dissatisfied consumers in the "normal" compensation category who received an average of $3.80 in coupons. At least for this company, these results show that increasing the amount of compensation given to complaining consumers past the "price paid" point (i.e., equal to the retail price of the product) does not yield significant improvements in repeat purchase intentions, word-of-mouth communication, or satisfaction with the company's compensation offer.

Of course, consumer affairs managers in other companies and industries would be wise to consider that this study analyzed dissatisfied consumers in a consumer products company which primarily sells products in the $2-$5 dollar range. As noted earlier, It is very possible that consumer affairs managers in industries in which purchase prices are dramatically higher (e.g., automobiles, appliances, computers) may find that dissatisfied consumers react quite differently to compensation offers from companies when the magnitude of the failure event for consumers is much higher.

DIRECTIONS FOR FUTURE RESEARCH

There are two important issues that should be addressed in the future in this research area. First, given the contradictory results between this study and some of the previous research in this area, future research could analyze complaining consumers' evaluations of company compensation offers encompassing a broader range of monetary values. In the present study company managers were unwilling to include a category in the

research design in which complaining consumers received compensation less than the currently established company policy (i.e., equal to a product's retail price). Therefore, future research should specifically test the effectiveness of compensation that is below this "price paid" mark to determine at which point dissatisfied consumers perceive that a company's offer of compensation is too low.

Second, future research could investigate the comparative effects of compensation and service representative quality on complaining consumers. This study focused solely on the impact of various amounts of compensation on complaining consumers. But, as amply noted in the literature (TARP 1985, 1986; SOCAP 1992, 1996), the quality of service representatives who communicate with dissatisfied consumers can also have a major impact on consumers' repeat purchase intentions and word-of-mouth communication. Therefore, future research could determine which of these factors, compensation or service representative quality, has a more significant impact on complaining consumers. This research could help consumer affairs managers to determine if they should devote more financial resources to training and rewarding service representatives or to compensating complaining consumers for their losses.

CONCLUSION

This study revealed that complaining consumers are *not* significantly more impressed when they receive greater amounts of coupon compensation from a company in response to their complaints. Indeed, when the amount of compensation is doubled and even tripled, complaining consumers' repeat purchase intentions and word-of-mouth communication do not significantly improve. This indicates that while consumer affairs managers should probably offer dissatisfied consumers some compensation for their unsatisfactory experiences, compensation beyond a certain amount may not be an effective use of company resources.

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