Balancing Giving-Up Vs. Taking-In: Does the Pattern of Payments and Benefits Matter to Customers in a Financing Decision Context?

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ABSTRACT

Despite the relevance of mental accounting as a framework in addressing consumer behavior decision making, very little has been documented about the applicability of mental accounting to financial marketing and behavioral financing. This paper attempts to build and extend the literature on financial decision making by drawing on mental accounting and prospect theory. Specifically, we take the current literature one step further by testing the alignment hypothesis which states that consumers prefer financing schemes that not only match the length of benefits with payments but also the corresponding patterns as well. Through three studies, our paper finds general support for the alignment hypothesis. Implications for financial decision making along with retailing strategies are discussed.

INTRODUCTION

As consumers increasingly use debt and installment payments to finance durable goods, understanding of how financing decisions are made can allow marketers to better design financing schemes that will stimulate purchases. Prior researches have examined consumer financing decisions using mental accounting principles which enable a better understanding of how gains and losses from transactions are processed (Henderson and Peterson 1992; Okada 2001; Thaler 1985). Gains and losses can occur not only at a specific point in time as when purchases are made and consumptions takes place but can also extend over a longer period of time. Such is the case when consumers finance a durable good.

In a typical financing scenario, the consumer makes payments for an agreed upon time period and in exchange uses the product and reaps the benefits that are derived from consumption. The financing period can be either longer or shorter than the useful life of the product depending on the financing term. Research has shown that consumers prefer to match the cost stream associated with the financing payments with the benefit streams that accrue from using the product (Hirst, Joyce, and Schadewald 1994; Prelec and Loewenstein 1998). When unbalance between the two types of stream occur, people are less likely to choose financing as a method of payment. This has been one of the primary reasons for people’s hesitance for financing services such as vacations since the benefits terminate once the trip is over but the payments used for financing the trip continue (Hirst, Joyce, and Schadewald 1994).

Our paper tries to add theoretical and practical knowledge into this important area by addressing inconsistencies in the literature and is distinct in several ways. First, we attempt to capture how consumers prefer to match the length of benefit streams with the length of cost streams (experiment 1). We specifically address this in the context of a widely used and accepted promotion, payment deferrals. Put differently, our research explores how flexibility to make repayments (e.g., when I can start to make repayments) can affect the misalignment between benefit and cost streams created by a special financing promotion, payment deferral programs.

Second, whereas prior research has found a linear pattern for mental depreciation of durable goods, we contest this and suggest a non-linear mental depreciation pattern for high-tech products (experiment 2).

Third, past research has been solely focused on the temporal contiguity of costs and benefits thereby suggesting that as long as the benefit stream coincides and overlaps with the cost stream, consumers will be favorable towards financing (Hirst, Joyce, and Schadewald 1994). We build and extend this argument by asserting that it is not only the length of cost and benefit streams that are relevant but also the pattern of costs and benefits that is of utmost importance in determining consumer’s preference for financing (experiment 3). That is, when benefits display a constant pattern throughout the useful life of the product, consumers should prefer payments that correspond to a constant pattern. However, when the benefit stream is not constant but decreases over time, consumers should prefer decreasing payments. We refer to this, the similarity in pattern of benefit and cost streams, as the alignment hypothesis throughout the paper. We test our above three contributions in three different experiments.

Our paper is organized in the following order. We first discuss the relevant literature in this under developed area of financial marketing by building and extending on mental accounting as our primary analytical framework in developing our argument for the alignment hypothesis. We then report the results of three experiments that test the robustness and validity of our alignment hypothesis.

CONCEPTUAL BACKGROUND AND HYPOTHESES

Compatibility between Length of Gains and Losses over Time

Our previous arguments have underscored the central thesis that consumers prefer to engage in financing when the benefits from using the product are in temporal alignment with the payments. In recent years, payment deferral programs (PDP) have been popular promotional tools among retailers to boost sales. This type of promotion can be conceived as a decoupling strategy as consumptions occur before payments are made (Prelec and Loewenstein 1998). Strictly speaking, a PDP is a special type of financing whereby the retailer gives the consumer a “make up” time to make the payments. This no payment and interest free period typically ranges from 12 to 36 months depending on the details of the promotion. During this interval, the consumer is literally using the product for free. The consumer is not responsible for any payments or interests during this period. This is an attractive promotional tool for consumers who want the product today but don’t have the money to make the payments now.

However, payment deferral programs create considerable misalignment or non-overlap between the benefit stream and the payment stream. In other words, if the PDP is for 24 months and assuming that the consumer is planning to take full advantage of this PDP by not making any payments till the very end, for the first 24 months, only the benefits are accumulated without any payment streams to be matched. A crucial pitfall of PDP can occur when the product’s useful life is often shorter than the no payment and interest free interval such as is the case for high technology products. This implies that the consumer will have to make payments when the benefits are starting to decline or have already
declined. This would be an extremely painful experience on the part of consumers as it would be perceived of as paying for something that returns very little in exchange.

Thus, in contrast to the intended objective of PDP, such a promotion can actually hamper sales especially for products that have a shorter useful life than the payment deferral period itself. Therefore, given our argument for people’s preferences to desire temporal alignment between benefits and costs, when PDPs have a longer payment deferral period than the product’s useful life, people will act purposefully to achieve alignment between benefits and costs as much as possible, given the opportunity. On the other hand, when the product’s useful life is longer than the payment deferral interval, people should be relatively insensitive to act upon the opportunity to make temporal alignments between benefits and payments.

The objective of hypothesis 1 is to test our basic contention of consumer’s preferences for temporal alignment between benefits and costs by giving the subjects the opportunity to do so and examine if they will readily accept such opportunities. If we consider the worst scenario in which the consumer decides to take full advantage of the payment deferral period and make no payments, we believe this situation will have a different effect than would the case if a consumer were in a position to make payments before the expiration of the deferral period. In the first case where no payments are expected to be made before expiration of the deferral period (i.e., deferred payment option), a PDP whose no payment period’s length is longer than the useful life of a product would not be very attractive. This is because when the time comes to make your first payment, the financed product will have been essentially obsolete and useless.

In contrast, when the option is given to consumers to make payments anytime before the expiration of the deferral period (i.e., flexible payment option), this sense of being in control should nullify the relationship between the length of the deferral period and the useful life of the financed product. Only when the length of the financing term is greater than the useful life of the financed product will there be an effect of payment option (flexible vs. deferred) on the likelihood of using and attitude towards a PDP. Taken collectively, the above arguments lead us to the following hypotheses:

\[ H_{1a} \] When the length of the payment deferral period is greater than the useful life of the financed product, the likelihood of using and attitude towards a PDP will be greater under a flexible payment option than a deferred payment option.

\[ H_{1b} \] When the length of the payment deferral period is equal to or less than the useful life of the financed product, there will be no difference in the likelihood of using and attitude towards a PDP between a flexible payment option and a deferred payment option.

Mental Depreciation

The notion of mental depreciation (Heath and Fennema 1996) and mental cost allocation (Gourville and Soman 1998) commonly refer to the activity of consumers spreading out the costs involved with a purchase over an extended period of time in order to align the expected benefits with the upfront incurred payment. The tendency to engage in such behaviors stem from the fact that quite often the benefits that accrue with a purchase are obtained over a certain time period, usually over the useful life of the product, while the payments occur at the time of purchase. As an example, when a consumer purchases a notebook computer for $2000, rather than opening up a notebook account and posting the entire $2000 to the account at the time of purchase, consumers may allocate certain sub-amounts to this account as they use the notebook or have gotten their money’s worth from using the notebook over time.

Prior researches have examined the pattern of mental depreciation. Heath and Fennema (1996) report a linear relationship between mental depreciation and different time periods in a product’s useful life. In their study, they used indirect measures to measure mental depreciation. They specifically used a) how much people would sell their products at different time points in the product’s useful life, b) how disappointed they would be if they lost their products at different points in time, and c) the extent to which they were willing to make a replacement decision for a new product. Their results generally supported a linear trend with the exception of disappointment, which followed a quadratic pattern.

We took a more direct approach and asked the subjects how much they got their money’s worth (GMW hereafter) at different time points in the product’s useful life. Greater GMW would be indicative of more mental depreciation because in order to realize a significant amount of GMW, a considerable amount of depreciation has to have occurred. Using the above measure, we posit that consumer’s mental depreciation can take on one of three possible patterns as illustrated in Figure 1.

In Figure 1, line A indicates a constant mental depreciation of products over time. In other words, consumers are getting roughly an equal amount of money every time they use the product. For example, a consumer purchases a brand new sofa that lasts about 10 years. Every year, the consumer uses roughly 1/10 of the value of the sofa. Since the utility consumers get from sitting on the sofa does not change from year to year, he/she mentally depreciates equal amounts of value from the initial purchase price until the sofa is worthless at the end of the 10th year.

On the contrary, line B indicates a mental depreciation pattern in which there is little loss in value initially in the life cycle of the product. After a period of time, there is an increase in loss in value and the line races towards the horizontal axis. This indicates that consumers are more likely to get most of their money’s worth towards the later half of the product’s useful life than the first half. Products, which require a prolonged period of consumer adjustment before full benefits can be enjoyed, may be indicative of this pattern.

Finally, line C illustrates a mental depreciation pattern in which the majority of the value is consumed in the early part of the product’s life than the later part. That is, consumers get most of their money’s worth early on in the product’s useful life. Products with a high “newness” premium typically fall into this category. Having the latest and the newest product often is a source of pride for consumers, and thus having something that’s new in it of itself is often enough to justify a premium price. Much of today’s computing hardware also falls under this pattern of mental depreciation. Initially, new computers are able to process information and perform tasks at a relatively high speed. However, as more and larger softwares are installed, the computer’s hardware resources are taxed and its processing speed starts to decline after some point. Thus, from the perspective of computer users, most of the value of the computer is in the early part of its useful life where hardware technology is ahead of the software as opposed to the later half where hardware struggles to keep up with software updates.

Based on our argument about mental depreciation, we posit that for a high-tech product such as a notebook computer, the mental depreciation curve will follow a pattern consistent with graph C. This implies that consumers will obtain more GMW in the early stages of the product’s useful life compared to later stages. This leads us to the following hypothesis:
H2a: GMW and cost used up will be greater during the first half of the product’s useful life than in the second half for high-tech products.

H2b: GMW and cost used up will be equal between the first half and the second half of the product’s useful life for durable non-high-tech products.

Compatibility between Patterns of Gains and Losses over Time

If we conceptualize utility from product usage as gains (i.e., GMW) and payments as losses, the problem can be framed using prospect theory (Kahneman and Tversky 1979). Two principles in prospect theory warrant further attention, mixed gains and mixed losses. Mixed gains (losses) are defined as outcomes that entail gains (losses) that are larger in absolute size than losses (gains). The notion of financing includes both multiple gains and losses over time. Financing a product corresponds to a mixed gain in that in order for a customer to use such a promotional tool, the multiple gains (i.e., benefits from using the product over its useful life) should equal or outweigh the multiple losses (i.e., costs from paying over the financial term). Over the useful life of a product, the stream of gains and losses can be graphically depicted as in Figure 2.

In Figure 2, benefits from product use is depicted by “+” while payments are represented by “−”. For illustrative purposes, we show the declining benefit stream for a hypothetical technological innovation and two possible payment streams, constant and declining. When the patterns of the benefit stream and the payment stream are matched, each period has a net gain/loss of 0. That is, the financing payments consumers make are just enough to be offset by the benefits consumers reap each time they use the product.

When constant payments are made, however, consumers perceive positive net gain early on in the life of the product because they derive more utility then they are actually paying for while in later periods they are making more payments then what they actually derive from product usage. Thus, consumers experience net gain early on but net loss later on. Despite the different configuration of net gains and losses, when aggregated over the life of the product, both the decreasing and constant financing payments will result in a zero balance.

We argue that such future streams of gains and losses derived from usage benefits and financing payments, respectively are evaluated by consumers at the time of purchase. This implies that consumers are forward looking in their evaluations of benefits and
payments downstream. When a mismatch occurs between the patterns of benefits and payments such that the benefits are received non-linearly but payments occur in a linear pattern over the life of the product, this creates a pattern of misalignment. Under such a case, consumers are expected to perceive an advantage during the early part of a product’s useful life but a disadvantage during the later stages. Prospect theory suggests that in a mixed gain/loss context, losses loom larger than gains and therefore losses towards the end of the financing period should have a greater impact than the gains realized early in the financing period, thus adversely affecting the evaluation of financing decisions and purchase intent.1

Prelec and Loewenstein (1998) provide additional support for making greater payments early on than later in the product’s useful life. They argued that all else equal, people prefer to pay in advance so that when they actually consume the product downstream, it is perceived as if it is free. This is consistent with the idea of eliminating a loss or dread as soon as possible (Loewenstein and Prelec 1993). As a result, consumers are able to savor the good for later and appreciate delayed gratification. Furthermore, preference for improvement over time may be a natural instinct and desire for humans in that we like to make incremental improvements rather than deteriorations over time. Also, the notion of preference for a happy ending is in line with a decreasing payment financing structure (Ross and Simonson 1991).

Hirst, Joyce, and Schadewald (1994) have used the mixed gains argument to show that temporal contiguity matters in a financing context. They posit that since \[ V(\text{gains}) > V(\text{loss}) \] is satisfied in a mixed gains context, due to our third feature of prospect theory (value function is steeper for losses than for gains), it is better to combine and integrate the gains with the losses before evaluation than it is to evaluate them separately followed by combination \( V(\text{gains} + \text{losses}) > V(\text{gains}) + V(\text{losses}) \). This suggests that temporal contiguity is important in that value is greater when the multiple benefits from using the product overlap with the costs associated with the payments as opposed to if they occur in a sequential manner whereby one occurs after the other.

Alternatively, rational economic theory would argue in favor of payment deferral as much as possible as $1 worth today is more than $1 worth tomorrow. In other words, rational economic behavior would suggest postponing payments now by better utilizing the current balance to obtain a higher rate of return elsewhere. Therefor, a rival explanation can be advanced whereby a decreasing payment stream should not be preferred regardless of the pattern of the benefit stream. Taken collectively based on the arguments set forth above, we offer the following alignment hypothesis:

\[ H_3: \text{The evaluation of a financing program will be more positive when a decreasing (constant) benefit stream is matched with a similar decreasing (constant) payment stream than a constant (decreasing) payment stream.} \]

1Support for preference for congruity between the patterns of benefits and costs can be found in the effect of perceived pain or consumption experience patterns over time of an evaluation (Ariely 1998; Loewenstein and Prelec 1993; Ross and Simonson 1991; Varey and Kahneman 1992). The common theme that ties the above research together is the fact that the sequencing, intensity, and pattern of experience or episodes matter in determining one’s overall evaluation of an experience.
similar when product life span=length of the payment deferral program and when product life span=length of the payment deferral program (for attitude index, M’=4.18 vs. 4.34, t(117)=−.702, p>-.40 and for likelihood of use, M’=4.80 vs. 4.48, t(117)=1.16, p>.20). Therefore these two conditions were collapsed for all subsequent analyses.

Hypothesis Testing

As a result of collapsing the financing term variable, the attitude index and likelihood of use were subjected to a 2 (financing term: product life span=length of payment deferral vs. product life span ≥ length of payment deferral) x 2 (repayment option: deferred vs. flexible) between subjects ANCOVA with knowledge in financing as a covariate. We report the results of likelihood of use followed by the attitude index.

When likelihood of use was the dependent variable, significant main effects were supported for both the financing term (M’s=4.64 vs. 3.88, F(1,169)=9.71, p<.005) and repayment options (M’s=4.81 vs. 3.71, F(1,169)=19.74, p<.001). But more importantly, a significant interaction between the financing term and repayment option was supported (F(1,169)=10.41, p<.005).

Further analyses revealed that under the deferred repayment option, likelihood of using such a promotion was significantly greater when the product lifespan was ≥ length of deferred payment vs. when the product lifespan was < length of deferred payment (M’s=4.49 vs. 2.93, simple F=19.54, p<.001). However when the repayment option was flexible, no significant difference was observed in the likelihood of using such a promotion between the two financing terms (M’s=4.79 vs. 4.82, simple F=.008, p>.30).

However, when attitude index was the dependent variable, the interaction between financing term and repayment option did not approach significance (F(1,169)=2.12, p<.15). Albeit not significant, the difference in the attitude index between the two levels of financing term was greater in the deferred repayment option than in the flexible repayment option, which is consistent with our hypothesis. Thus, this provides strong support for H₁a and H₁b when likelihood of use is the dependent variable.

STUDY 2

Method

Design and Procedure

This study used a 2 (GMW vs. cost used up) x 2 (notebook vs. dining table) mixed factorial design. The first factor was between subjects while the second was within subjects. Respondents were randomly assigned to either a GMW cell or a cost used-up (CUP) cell. Within each of these cells respondents rated two product categories, notebooks and dining tables.

Ninety-six MBA students from a private business school in the Southeast were used as respondents. Participation was voluntary and the average time for completion was about 10 minutes. The average age of the respondents was 26.53 years old with females comprising 41% and males 59%.

Two key questions were used to measure mental depreciation. The first focused on obtaining one’s money’s worth out of a product. We described a situation where the respondents purchased a notebook (dining table). Then it was explained to the respondents that they would get their money’s worth out of the notebook (dining table) as they used it. Subjects chose from three options that they felt best described the pattern of depreciation in their minds. The first option was getting more GMW from the first half than from the second half. The second option was receiving more GMW from the second half than from the first half. The third option was obtaining equal GMW between the first and second halves.

The second measure of mental depreciation concerned their feelings as they used up the cost of a notebook (dining table) over the useful life of the product. To this end, we asked whether they used up more of the cost of a notebook (dining table) during (a) the first half of the notebook’s (dining table’s) useful life, (b) the second half of the notebook’s (dining table’s) useful life or (c) equal amounts between the first and second halves.

Results

We first tested to see whether GMW and CUP were valid indicators of mental depreciation. We accomplished this by testing to see if any difference existed between GMW and CUP for both notebooks and dining tables. Our results strongly suggested that respondents interpreted GMW and CUP similarly. For notebooks, more respondents agreed with obtaining greater GMW in the first half over the second half than receiving equal GMW between the two halves. The same pattern was observed for CUP in that respondents felt they used up more value during the first half than the second half compared to using up equal amounts between the two halves. The pattern of distribution between GMW and CUP were not statistically different, lending support for the validity of the measures of mental depreciation ($\chi^2=.08, p>.78$). This similarity in distribution pattern was also supported for dining tables ($\chi^2=.009, p>.92$). Therefore, based on the above tests, we obtained greater confidence of GMW and CUP as valid measures of mental depreciation.

Next, we report the results of our hypothesis testing. For notebooks, as hypothesized, respondents felt that they got more of their money’s worth during the first half of the notebook’s useful life time than in the second half (n=36), and this was significantly greater than those who thought that they received equal amounts of money’s worth between the two halves (n=8, $\chi^2=17.82, p<.001$). Also, respondents felt that they used up more of the cost of the notebook during the first half than the second half (n=37), and this number was significantly greater than those who agreed with using up equal amounts between the two halves (n=7, $\chi^2=20.46, p<.001$). Therefore, H₂a was strongly supported.

On the other hand, for dining tables, we expected a linear mental depreciation curve in that the GMW and CUP would be equal between the first and second halves of the dining table’s useful life. Our results were consistent with our predictions. As hypothesized, significantly more respondents felt that they received equal GMW between the two halves (n=37) than receiving more in the first half compared to the second half (n=7, $\chi^2=20.46, p<.001$). Moreover, the results for CUP were also consistent with GMW. A significantly greater number of respondents agreed that they had used up equal amounts between the first and second halves (n=35) compared to using up more in the first half than in the second half (n=7, $\chi^2=18.67, p<.001$). Therefore, we find strong support for H₂b.

STUDY 3

Design and Procedure

H₃ was tested using a 2 (performance pattern: constant vs. decreasing) x 2 (repayment pattern: constant vs. decreasing) between subjects ANCOVA with knowledge in financing as a covariate. The nature of the subjects, procedure of the study, and data collection method for study 3 were identical to that of study 1. A total of one hundred and fourteen (n=114) subjects participated in this study.

Materials

A booklet contained scenarios about financing either a notebook computer or furniture. Subjects were told that they were on the market to purchase either a notebook or furniture and that since they
were short on cash, they had to partially finance their purchase. For subjects in the notebook condition, they were told that notebook computers, in general, lose performance and provide decreasing benefits as they get older and become obsolete. On the other hand, subjects in the furniture condition were told that furniture, in general, provides the same level of performance through their useful life. Thus, for notebooks, the performance was manipulated to be a decreasing pattern over time while for furniture it was manipulated to follow a constant pattern over time.

Furthermore, they were made aware of the fact that currently two types of financing options were available on the market. The first type of financing followed a fixed payment plan in which they were responsible for paying the same amount every month over the duration of the loan (3 years / 36 months). The second plan was a decreasing payment plan in which they would start out by paying a higher amount each month but gradually decrease over the 3 year duration of the loan. In either case, they were informed that the total amount paid in principal and interest was the same between the two plans. The repayment pattern manipulation was followed by stating that the only bank from which they were qualified to borrow $3,000 was only offering the decreasing (constant) payment plan, in which they would be making decreasing (constant) payments every month. In all four conditions, the length of the loan was held constant at 3 years.

Dependent Variables

Three questions (agreement about their bank’s plan as a very good repayment plan; agreement with the bank’s plan as making sense; agreement about their bank’s plan as preferable to the other plan that was not available) that tapped into the attitude of the financing plan offered by the subject’s bank were used as the dependent variables. All three were rated on a 1 (strongly disagree) to 7 (strongly agree) scale. Since all three items were highly correlated (alpha=.78), an index as the mean of all three items was used as the dependent variable in subsequent analysis.

Results

Attitude towards the financing plan was subjected to a 2 (performance pattern: constant vs. decreasing) x 2 (repayment pattern: constant vs. decreasing) between subjects ANCOVA with knowledge in financing as a covariate. Results revealed a main effect for performance pattern with subjects in the decreasing performance pattern condition rating attitude towards the financing plan higher than those in the constant performance pattern condition (M’s=4.25 vs. 3.85, F (1,113)=4.42, p<.05) but not for repayment pattern (M’s=4.14 vs. 3.96, F (1,113)=90, p>.30). More importantly though, this was qualified by a significant interaction between performance and repayment pattern (F (1,113)=27.21, p<.001). Further analyses revealed that the constant repayment plan was rated higher than the decreasing repayment plan under constant performance (M’s=4.26 vs. 3.43, simple F=10.45, p<.05). Also, the attitude towards decreasing repayment plan was greater than the constant repayment plan under decreasing performance (M’s=4.85 vs. 3.65, simple F=17.06, p<.001).

We conducted further analyses to confirm our strong interaction effect between repayment pattern and performance pattern on the evaluation of financing plans. We compared the compatible condition (constant performance and constant repayment or decreasing performance and decreasing repayment) to the incompatible condition (constant performance and decreasing repayment or decreasing performance and constant repayment) on the evaluation of financing plans. The results strongly confirmed our previous interaction effect. The financing plan in the compatible condition was rated as better (M’s=4.30 vs. 3.46, F (1,112)=13.31, p<.001), as making more sense (M’s=4.67 vs. 3.63, F(1,112)=21.12, p<.001), and as being preferred over the other unselected plan (M’s=4.77 vs. 3.54, F (1,112)=19.09, p<.001) than the financing plan in the incompatible condition.

IMPLICATIONS

Our first implication is that firms should consider utilizing more payment deferral program as a mean to stimulate purchase, particularly for consumer durables. Recently, firms have increasingly adopted discounting strategies such as manufacturer’s discount of low financing rates to stimulate durable purchases. However, a low interest rate financing scheme may end up costing the firm much more because such incentives may hurt margins while at the same time frequent manufacturer discounts may permanently lower price expectations for products.

For example, when sales for the automaker GM fell in the US, GM announced zero percent financing up to 60 months or up to $4,000 rebate on all its models. However, analyst warned that while such tactics may help GM gain short term market share, such pricing deals may end up costing GM $3,100 per vehicle (Welch 2002). Our findings suggest that instead of low interests or rebate offers, a possible alternative is payment deferral programs. Study 1 showed that when given the option in a payment deferral program, consumers often choose to make payments earlier than called for because they prefer to match their benefit stream with their payment stream. This way, they avoid having to make payments later when the payments outweigh the benefits and end up feeling they are not getting their money’s worth. Consequently, firms are not committed to price discounts, and early payments that consumers make become windfalls for the firm.

A second implication is the possibility of designing an alternative financing scheme for consumers where payments decrease over time. Unlike most financing terms where payments typically remain the same over the duration of the loan, decreasing payments are better aligned with durables that exhibit a decreasing benefit pattern. Since the majority of the payments are made up front decreasing payments may provide creditors a lower default risk toward the end of the financing term.

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EXTENDED ABSTRACT

Charities often request donations while offering a near-worthless token, like a key chain or a pencil, in exchange. Little research has examined whether such ‘exchange’ requests are met with higher compliance rates than simply asking people to donate.

According to Holmes, Miller, and Lerner (2002), construing the donation as a commercial exchange will allow people to show their genuine compassion, while avoiding the negative feelings associated with violating the norm of self-interest. They argue that the assumption of self-interest has become a collectively shared cultural ideology: people think that other people are mainly driven by self-interest. As a consequence, people prefer self-interested behavior to avoid being exploited by self-interested others, or to avoid social disapproval for being ‘irrational’ (Miller & Ratner, 1998; Miller, 1999). Framing the donation as a commercial exchange may therefore provide potential donors a ‘psychological cover’ that enables them to act altruistically.

In three studies we examine whether and why consumers react positively to donation requests that are framed as the sale of a product. We think that one of the reasons why a priced exchange may increase compliance is that it signals an anchor or a reference price to which potential donors can compare candidate contributions. Just like consumers may have difficulties in estimating the price of a service due to a lack of a salient cost of goods sold (Bolton, Warlop, & Alba, 2003), in a simple donation setting potential donors may also experience difficulties determining what would be an appropriate donation amount. For economic reasons they may want to avoid too large a contribution, while too small a contribution may be perceived as inappropriate. Therefore, the option to ‘buy something’ instead of just donating may make it easier for potential donors to access the minimally socially acceptable donation amount (cf. Fraser, Hite, & Sauer, 1988).

Clearly, if the token that is offered signals too high a donation amount, people will not donate, not even in exchange for a token. In particular, donation requests coupled with ‘overpriced’ exchanges may not help or may even decrease compliance rates compared to simple donation settings. On the other hand, low-priced tokens may signal a donation amount that people consider being ‘fair’. First, a low priced token may signal a donation price that is lower than the perceived donation price in simple donation settings. Moreover, low-priced exchanges may legitimize small contributions and, therefore, render most excuses for noncompliance (e.g. “We can’t afford to help.”) inappropriate. Finally, if the presence of an anchor or reference price is an important factor in triggering donations, the association of simple donations and fixed prices should cause similar effects as the bundling of donation requests and priced tokens.

In the first (scenario) study, participants were asked to donate to a charity without a product being offered (mere donation) or to donate in exchange of staples (exchange condition). To explore our prediction that an exchange might signal an anchor or reference price that may induce people to donate, we asked participants to estimate the value of the offered product either before or after the donation decision. We found that people in the exchange conditions donated more easily when their attention was drawn to the ‘low’ estimated product value. In the mere donation setting, however, people lacked a ‘fair’ reference price; they apparently overestimated the cost of ‘giving’ and hence decided not to donate.

In study 2 we tested directly whether the ‘exchange’ effect is moderated by the token’s value. This time, participants had to make a real donation decision. They were invited to just donate, to donate in exchange of paperclips without a shop value mentioned, to donate in exchange of paperclips with a mentioned shop value of €0.50, or to donate in exchange of paperclips with a mentioned shop value of €0.50. In line with study 1, the €0.50-token presented a comfortable reference price, a socially acceptable anchor that urged people to donate. On the other hand, €0.3 was perceived as a too large amount, a too large anchor that did not induce and even inhibited people to donate. In other words, we found evidence for the moderating role of priced tokens to increase compliance rates.

As the value of an exchange can ‘help or hurt’ depending on its price, we hypothesized in study 3 that the bundling of mere donations and fixed prices would generate similar results as the bundling of donation requests and priced tokens. In a scenario study we found data to support this prediction: the presence of a small (€0.50) or large (€3) reference price in a mere donation setting fulfilled the same, or an even better, ‘anchoring’ function as a small (€0.50) or large (€3) priced exchange. We interpret these findings in the context of the ‘donation deal transparency’: in a mere donation setting the net donation value is explicitly present, whereas the product cost in an exchange context not always is.

In sum, our studies suggest that in simple donation settings people may have difficulties in estimating a socially acceptable donation amount and therefore prefer opportunities that provide them with an anchor price. The value of a material good in a donation setting can play this anchoring role and signal a reference price. To the extent that the suggested reference price is low enough, exchange requests lead to more compliance than simple donation requests. A ‘high’ socially unacceptable or too large an anchor, on the contrary, may inhibit people from donating. It should be noted that our studies were not designed to rule out the exchange fiction theory of Holmes et al. (2002). In fact, our first two studies are still in line with the theory of the norm of self-interest (Miller, 1999). Still, our anchoring explanation gives an additional account for why people react positively to the sale of tokens in a donation request. Moreover, study 3 shows that, as expected by our anchoring explanation, a donation request that explicitly asks for a low amount generates more compliance than a simple donation request.

REFERENCES


