Tracking Costs of Time and Money

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Consumers usually use mental accounts to keep track of the costs that they incur. These accounts are eventually settled in the black if benefits are received, or in the red if benefits are forfeited. We argue that accounting for time involves a consideration of not only costs and benefits, but also of “accounting periods.” Consequently, costs and benefits are linked when both belong to the same accounting period (vs. different periods). In the case of monetary costs, accounting periods do not have such a moderating influence. A series of studies offer supportive evidence.

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EXTENDED ABSTRACT

People often incur costs first, and receive benefits later, but track both via mental accounts (Thaler 1980, 1985, 1999). For instance, the purchase of a basketball-game ticket could initiate a basketball-game account in the consumer’s mind, which eventually gets closed as a net gain (i.e., pleasure) or a net loss (i.e., pain). That is, the account is settled in the black if the consumer receives the benefit (i.e., attends the game), but in the red if the consumer forfeits the benefit (i.e., misses the game) (Prelec and Loewenstein 1998). Because of several reasons, such as the desire to avoid waste (Arkes and Blumer 1985) and the need to justify prior choices (Staw 1981), people often refuse to close an account in the red even when closing it makes economic sense. For instance, after people have incurred costs on tickets to a game, they are willing to brave a snowstorm to attend the game, even though they would readily miss it if they had received the tickets for free (Soman 2001; Thaler 1980, 1999). Such a tendency has been termed the sunk-cost fallacy (Arkes and Blumer 1985; Thaler 1980) because, from an economic standpoint, the decision of going to the game should be based on future benefits (attending the game) and future costs (traveling in a snowstorm), but not on prior costs (cost of ticket). However, because of the pervasiveness of mental accounts, prior costs do influence the propensity to seek future benefits.

Soman (2001) discusses how the mental-accounting processes described above apply to costs of money, but not time. He argues that individuals lack the ability to account for time because, unlike doctors and lawyers, most people do not routinely keep track of time the way they keep track of money. Consequently, unless interventions (e.g., education about the value of time) are employed to make time seem like money, mental accounting for time breaks down. That is, future benefits are not linked to prior costs, and the sunk-cost effect does not emerge.

In the current research, we demonstrate that people do engage in mental accounting for time, and vice a process that can be seen as more elaborate than that for money. Specifically, accounts for time consider not only costs and benefits, as accounts of money do, but also “accounting periods” (day, vacation, etc.). Consequently, people link temporal costs to benefits when both costs and benefits belong to the same accounting period, but do not link them when they occur in different periods. In the case of monetary costs, this moderating effect of accounting periods is relatively weak.

The current research adds to prior work on mental accounting (Thaler 1980, 1985, 1999) by introducing the concept of accounting period, which aids our understanding of the process by which people track costs and corresponding benefits. It also augments our understanding of time-money differences. For example, Soman (2001) argues that people are not good at keeping track of prior costs of time, because of which the sunk-cost effect (Arkes and Blumer 1985) does not emerge for time as it does for money. We show that, contingent on the accounting period, people do exhibit sensitivity to past costs of time, and the sunk cost effect does emerge. The concept of accounting periods also provides a new perspective of prior findings in time discounting, consumer search, risk preferences, and other areas.

REFERENCES


