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When giving money does not work: The differential effects of monetary versus in-kind rewards in referral reward programs

Liyin Jin *, Yunhui Huang

School of Management, Fudan University, No. 670, Guoshun Road, Shanghai 200433, China

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ABSTRACT

Customer referral reward programs have recently gained popularity as beneficial customer acquisition tools. This research aims to explore the impact of reward type, specifically with regard to the differential effects of monetary versus in-kind rewards, on referral success. We find that although consumers prefer monetary rewards to in-kind rewards because of the greater economic value of monetary rewards, the higher social costs associated with money offset this benefit and even render money an inferior incentive when the recommendation is not well justified. Through four experiments, we demonstrate that monetary rewards (vs. in-kind rewards) lead to less referral generation and acceptance, especially when the recommended brands are weak (Studies 1 and 4), and that perceived social costs mediate the interactive effect of reward type and brand strength (Studies 1 and 3). Moreover, by increasing the economic benefit or decreasing the social costs associated with monetary rewards, we restore the effectiveness of monetary rewards as incentives. Compared with in-kind rewards, monetary rewards perform equally well when the reward is sufficiently large (Study 2), and they perform even better when both the recommender and the receiver are rewarded (Study 3). This research extends the literature on the psychological consequences of money and provides novel insights into the customer referral process.

1. Introduction

The long-term profitability and prospects of a firm depend on whether it is capable of acquiring the "right" customers and maximizing customer lifetime value (Kumar, Petersen, & Lenoe, 2010). Traditionally, word of mouth (WOM), which is recognized as an important customer acquisition tool, has attracted interest among practitioners and researchers (e.g., Godes & Mayzlin, 2009; Iyengar, Van den Bulte, & Valente, 2011). Numerous academic studies corroborate the effectiveness of WOM for gaining new customers (Godes et al., 2005; Wangenheim & Bayón, 2007).

Pioneering firms have recently introduced referral reward programs (RRPs), which purposefully incentivize existing customers to make recommendations through WOM. Unlike organic WOM, WOM generated by RRPs is deliberately stimulated and actively monitored by firms (Schmitt, Skiera, & Van den Bulte, 2011). Generally regarded as an attractive customer acquisition tool, rewarded referral practices are widespread, appearing in industries ranging from financial services (i.e., ABNARMO Bank) to the automobile (i.e., BMW) and electronic device industries (i.e., Canon). A recent empirical study (Schmitt et al., 2011) confirms the benefits of the use of RRPs in marketing practices by demonstrating that the value of referred customers is 16% higher than that of non-referred customers with a similar profile.

Given the advantages of this stimulated WOM, a natural extension of existing research involves investigating how to design RRPs that are both effective and efficient. Although a few studies have taken steps in this direction (Kim, Shi, & Srinivasan, 2001; Kornish & Li, 2010; Ryu & Feick, 2007), to our knowledge, no study empirically examines how the effectiveness of RRPs may vary as a function of reward type, such that certain reward types may be more effective in encouraging referrals than others. However, firms vary substantially in terms of their chosen reward type (i.e., cash, coupons, gifts, free products). The present study addresses this managerial issue and specifically contrasts the efficacy of monetary rewards with the efficacy of in-kind rewards of equivalent value in driving referrals for either strong or weak brands.

Conventional wisdom suggests that monetary rewards, because of their higher economic benefits, should be equally or more effective in motivating customer referrals than other types of rewards, as prior research (i.e., Biyalogorsky, Gerstner, & Libai, 2001; Ryu & Feick, 2007) on RRPs has unanimously assumed. However, we question this assumption and propose that the disadvantage of monetary rewards, namely the higher social costs associated with monetary rewards, may offset this monetary benefit and may even render monetary rewards as inferior incentives. Drawing on theories that investigate the psychological consequences of money as an incentive, we argue that monetary (vs. in-kind) rewards invoke market exchange norms rather than social relationship norms (Heyman & Ariely, 2004). Thus, monetary rewards increase consumers' perceived social costs by casting doubt on

* Corresponding author. Tel.: +86 21 25011202; fax: +86 21 65103463.
E-mail addresses: jinliyin@fudan.edu.cn (L. Jin), 10210690008@fudan.edu.cn (Y. Huang).

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Table 1
Prior studies on referral reward programs and the incremental contributions of the current research.

Criteria	Wirtz et al. (2013)	Schmitt et al. (2011)	Kumar et al. (2010)	Kornish and Li (2010)	Ryu and Feick (2007)	Shi and Wojnicki (2007)	The current research
Nature of research	Empirical	Empirical	Empirical	Analytical	Empirical	Empirical	Empirical
Key objectives	Understand how an incentivized recommendation affects recommendation behavior through meta-perception	Determine whether referred customers are more valuable than customers acquired through other channels.	Optimum customer targeting for referral marketing campaigns	Optimum design of bonus programs and pricing schemes when accounting for customer concerns with regard to recipient outcomes.	Determine the effectiveness of extrinsic motivations (rewards) in affecting customer referral behavior	Investigate the impact of various motivational tactics—tangible or intangible and selfish or altruistic—on the referral rates of different demographic segments.	Examine the impact of reward type on referral likelihood for either strong or weak brands.
Key findings	Referrals are driven by the givers' perception of how they will be viewed by the receivers (meta-perception), which is negatively affected by the presence of an incentive and positively affected by the tie strength between the giver and the receiver.	Referred customers have higher retention rates, higher contribution margins and greater overall value.	Several behavioral drivers of referral value that can help to target customers for referral marketing campaigns have been identified	If the price is not a greater lever, the greater the concern for others' outcomes is, the higher the bonus should be.	It is effective to offer incentives, especially for weaker brands and among individuals with weaker ties. However, the reward size does not make a difference.	Referral rates are higher when tangible rewards are conferred. However, among segments with higher educational levels, when intangible or benefits are emphasized, more altruistic tactics are more effective.	Monetary rewards underperform in-kind rewards in motivating consumer behavior by increasing consumers' perceived social costs. This effect is especially pronounced for weaker brands.
Methodology/ approach	Qualitative interviews and two experiments	Tracking 10,000 customers of a leading German Bank for 3 years	A series of field experiments with a financial firm and a driver-based field experiment with a retailing firm.	Analytical modeling	4 laboratory experiments	A unique dataset matching a large-scale survey with an online field experiment.	3 laboratory experiments and 1 field study

the altruistic nature of a referral. Moreover, monetary (vs. in-kind) rewards exacerbate this situation when the recommendation is difficult to justify. Hard money deters people from ill-justified or unethical actions because it leaves little room to interpret such behavior in a manner that neither threatens their self-concept nor amplifies the perceived social costs of appearing greedy to others (Mazar, Amir, & Ariely, 2008). In summary, the relative effectiveness of monetary and in-kind rewards depends on how the advantage of monetary rewards (with regard to economic benefits) compares with their disadvantage in terms of social costs.

We conducted four studies to examine the impact of reward type in RRPs. Study 1 tests our main hypothesis that the underperformance of monetary rewards relative to in-kind rewards is more pronounced when the recommendation is ill justified (i.e., for weak brands) and examines the role of perceived social costs as a mediator. Study 2 confirms the results obtained in Study 1 in a field setting and identifies reward size as a boundary condition. Study 3 further tests the proposed underlying mechanism by directly manipulating the recommenders' perceived social costs. In Study 4, we adopt the perspective of referred customers and analyze how reward type influences their referral receptivity. Next, we review the related literature and report our empirical studies.

2. Theoretical background

2.1. Costs and benefits of transmitting WOM

Prior literature identifies several psychological and social benefits of and motivations for WOM. For example, market mavens actively engage in WOM transmission because they feel obligated to make good use of their professional expertise (Feick & Price, 1987) or because they find helping others to be intrinsically satisfying (Sundaram, Mitra, & Webster, 1998). Consumers also provide WOM to justify their purchase decisions and reduce post-purchase dissonance (Gatignon & Robertson, 1986). Furthermore, WOM can be a means of achieving social status (Gatignon & Robertson, 1986).

Naturally, providing WOM also entails costs. The most obvious costs of providing WOM relate to the time and effort spent in communicating. Moreover, engagement in WOM transmission may incur opportunity costs (Sundaram et al., 1998). In addition, people with certain personal traits, such as those with a high need for uniqueness, may find the generation of positive WOM particularly costly (Cheema & Kaikati, 2010). Because of the interactive nature of a WOM communication, researchers have identified various types of social costs related to WOM, including the acquisition of social obligations and the risk of providing inappropriate advice (Gatignon & Robertson, 1986). These social costs relate to how the image of the information transmitter changes in the information receiver's opinion and how the relationship between the transmitter and receiver may be affected as a consequence of this WOM exchange (Wirtz, Orsingher, Chew, & Tambyah, 2013).

RRPs increase the complexity of WOM transmission by introducing rewards into an otherwise voluntary exchange. Unlike “organic” WOM, RRPs incentivize customer referrals with extrinsic rewards, generating a form of “stimulated WOM” that is extrinsically motivated and actively controlled. In the current research, we argue that the *benefits* that firms offer to stimulate WOM may increase consumers' perceived *costs* of a referral depending on the type of reward that is provided. In the following sections, we review the literature on RRP design and discuss the relative benefits and costs associated with monetary (vs. in-kind) incentives in motivating referral behavior and discuss how a cost–benefit comparison determines the relative effectiveness of the two types of rewards.

2.2. Relative benefits and costs of monetary versus in-kind rewards in RRPs

Given the profitability of RRPs (Kumar et al., 2010; Schmitt et al., 2011), research has focused on the design of effective RRPs (see Table 1). For example, Kornish and Li (2010) demonstrate that