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What money can't buy: The psychology of financial overcompensation

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ABSTRACT

When a financial damage has been inflicted, perpetrators can satisfy victims' outcome related concerns by providing a financial compensation. Few studies have investigated, however, whether *overcompensation* (i.e., compensation that is greater than the damage suffered) is more beneficial than *equal compensation* (i.e., compensation that covers the exact damage suffered). The results of four studies show that overcompensation offers no effects in addition to the impact of equal compensation, and that it even provokes negative outcomes. More specifically, overcompensation is attributed to occur because of a lower level of moral orientation on the part of the perpetrator (Study 2 through 4), leads to less favorable perceptions of the perpetrator (Study 2 and 4), and lower levels of trust in the perpetrator (Study 3 and 4) than equal compensation. No significant differences between overcompensation and equal compensation appeared for relationship preservation and cooperation (Study 4). These results show that while overcompensation may rebuild cooperation (albeit not more effectively than equal compensation), it does so at a monetary and relational cost that limits its effectiveness as a tool to promote true interpersonal trust. The present studies thus show that a large financial compensation does not provide any surplus value in terms of psychological outcomes and relationship continuation, even though such compensation best satisfies a victim's economic needs.

1. Introduction

After a financial damage has been inflicted, like in case of a damaged property or an unequal division of resources, victims' outcome-related concerns are violated (Bolton & Ockenfels, 2000; Fehr & Schmidt, 1999). Previous studies have shown that a violation of these concerns is often perceived as unfair, and consequently may lead to a host of negative reactions, such as anger and spite (Pillutla & Murnighan, 1996), reduced interpersonal trust (Desmet, De Cremer, & Van Dijk, 2011), lower intentions to preserve the relationship (Haesevoets, Reinders Folmer, De Cremer, & Van Hiel, 2013), and decreased cooperation (Bottom, Daniels, Gibson, & Murnighan, 2002).

One way to settle for the outcome-related violations is to provide a financial compensation, a monetary reimbursement to be paid by the perpetrator as a compensation for the victim's financial loss. Sometimes an *overcompensation* is offered. In

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these cases, victims receive a compensation that is greater than the damage they suffered, which results in a more favorable outcome for the victim than the perpetrator, and thus signals self-sacrifice from this perpetrator (see De Cremer & Van Knippenberg, 2002; De Cremer & Van Knippenberg, 2004). Such overcompensation occurs in real-life, for example in the context of customer service complaints when companies provide additional compensation that goes beyond mere failure restoration (e.g., in the form of a refund, a coupon, or a product replacement that is worth more than the damage suffered), in order to increase post-complaint satisfaction (Boshoff, 1997; Estelami, 2000; Estelami & De Maeyer, 2002; Gilly & Hansen, 1985). Or, in case of hotel overbooking, when a customer is offered the finest suite of the hotel, a voucher, or a cash-based overcompensation (Noone & Lee, 2011).

Although overcompensation occurs in many real-life situations (as illustrated by the above mentioned examples), it is unclear whether overcompensation entails higher satisfaction with the arrangement than *equal compensation* (i.e., compensation that covers the exact damage suffered). Indeed, very few empirical studies have investigated whether overcompensation has positive consequences beyond equal compensation. Because overcompensation is associated with additional costs on top of the expenses of equal compensation, it is costly for the perpetrator, but at the same time profitable for the victim. Moreover, since people attach high value to fairness and equality (see Camerer, 2003; Messick, 1993) – and overcompensation fails to restore equality in outcomes – the critical question that arises is whether such costly overcompensation has beneficial effects, and more specifically, has effects in addition to the impact of equal compensation? To answer this question, we contrast an economic perspective (which focuses on the magnitude of the outcomes per se) and a psychological perspective (focusing on fairness and equality in outcomes, rather than the outcome itself) on overcompensation.

1.1. An economic perspective on overcompensation

According to classic economic theory, which is based upon the concept of "homo economicus" or "economic man", individuals are mainly motivated by money and by the possibility of making profits (Franz, 2004). Hence, such an economic perspective assumes that individuals are self-interested and, above all else, want to maximize their own outcomes (Camerer & Thaler, 1995; Dawes & Thaler, 1988). This implies that, in terms of economic outcomes, after a financial harm has been inflicted, greater compensation should yield better outcomes for the victim. In line with this argument, there is some evidence in consumer behavior that indicates that, after a service failure, overcompensation results in more satisfaction than an equal compensation (Boshoff, 1997; Gilly & Hansen, 1985).

Hence, from an economic perspective, when an overcompensation is granted the recipient can be expected to show a host of positive reactions. More specifically, compared to equal compensation, overcompensation should foster greater satisfaction with the agreement, more favorable perceptions of the perpetrator, higher levels of trust in this perpetrator, and a greater willingness to continue the relationship with this perpetrator (e.g., see Desmet et al., 2011; Lewicki, Wiethoff, & Tomlinson, 2005; also see De Cremer & Van Kleef, 2009; De Cremer & Van Knippenberg, 2002; De Cremer & Van Knippenberg, 2004).

1.2. A psychological perspective on overcompensation

Psychological models have postulated that behavior in interpersonal settings is not only driven by concerns for tangible outcomes, but also by other, non-material concerns (see Curhan, Elfenbein, & Xu, 2006). Specifically, rather than the magnitude of outcomes per se, it is also important whether these outcomes are fair and in proportion to the damages suffered. Indeed, a substantial body of research has shown that people are influenced profoundly by such fairness considerations (for reviews on this matter, see Bazerman, White, & Lowenstein, 1995; Folger, 1984; Törnblom, 1992), and that in many situations people adhere to the fairness norm of equality as a decision heuristic (Messick, 1993). The equality norm (Deutsch, 1975) assumes that people prefer equal outcomes between all members of some specified group (see Camerer & Thaler, 1995; Handgraaf, Van Dijk, & De Cremer, 2003; Lerner, 1975; Pillutla & Murnighan, 2003; Sampson, 1975; Van Dijk, De Cremer, & Handgraaf, 2004). Based on this norm different effects of overcompensation, relative to equal compensation, might be expected.

From one point of view, as soon as the financial compensation undoes the damage suffered by meeting or exceeding the equality norm, a ceiling effect might occur whereby people benefit little from additional financial restitution (see Haesevoets et al., 2013). This implies that overcompensation should yield similar (no better, nor worse) results as equal compensation. Accordingly, research in the area of consumer behavior recently confirmed the idea that overcompensation is of little additional value in a meta-analysis of 17 experimental studies (Gelbrich & Roschk, 2011) by showing that overcompensation does not significantly enhance post-complaint satisfaction beyond the effect of simple compensation (i.e., when the refund given is equivalent to or less than the purchase price).

From another point of view, however, equal compensation and overcompensation differ in the extent to which the compensation reestablishes equality in outcomes between the victim and the perpetrator (Messick, 1993). That is, while equal compensation restores equality, overcompensation fails to restore equality, as it turns the state of disadvantageous inequality on the part of the victim into a state of advantageous inequality. Because of the high value that people attach to equality (Deutsch, 1975; Lerner, 1975; Sampson, 1975), equal compensation should be considered the best possible outcome for a victim. Research on fairness has indeed revealed that people's appreciation of equal and unequal outcomes may not match their objective monetary value (e.g., see Adams & Freedman, 1976). More specifically, although people prefer advantageous