Deal or no deal? How discounts for unhappy subscribers can backfire on businesses

July 1 2019, by Shannon Roddel

Vamsi Kanuri, assistant professor of marketing in Notre Dame's Mendoza College of Business. Credit: University of Notre Dame

Subscription-based service providers including newspapers, cable and internet providers and utility companies often issue price-based incentives including discounts in response to complaints about service failures. It's been shown to satisfy angry customers—at least momentarily.

But new research from the University of Notre Dame demonstrates the tactic may not be successful in retaining customers in the long term.

"The Unintended Consequence of Price-Based Service Recovery Incentives," forthcoming in the *Journal of Marketing* from lead author Vamsi Kanuri, assistant professor of marketing in Notre Dame's Mendoza College of Business, and Michelle Andrews from Emory University, shows that in subscription-based service settings, discounts to make up for service failures could backfire by reducing the likelihood of subscription renewals.

"The economic theory of reference prices (amount a purchaser thinks is appropriate to pay for a good or service) leads us to believe that discounts to make up for service failures will provide a new price point for customers to anchor on," Kanuri said. "In turn, this will lead them to compare the price of the service renewal with their reduced service price following the service failure. A higher discount results in consumers forming a lower reference price, which in turn increases the difference between the full renewal price and the reference price. This difference then translates into a perceived loss, which ultimately results in lower renewal probabilities."

In other words, consumers may end up feeling cheated rather than rewarded by the discount—the exact opposite of what the provider hoped to accomplish.

The researchers used econometric techniques to examine 6,919 renewal decisions of subscribers who threatened to cancel their subscriptions following service delivery failures at a large U.S. newspaper firm. The data covered 10 delivery failures frequently experienced by customers, including late delivery, wrong newspaper delivered, missed delivery, newspaper delivered to the wrong location and property damage during delivery.

"Firms do not understand the paradox of service failure," Kanuri said. "It has been shown that if a firm is able to delight a customer at the point of service failure, the customer is likely to be more satisfied than under normal conditions when there is no service failure and is likely to remain a customer longer. Everyone knows that firms are imperfect, just as human beings, and that there will be a service letdown at some point. How the firm chooses to delight its customers can make all the difference."

The study also offers ways to mitigate the negative effect of recovery discounts and can help any subscription-based service provider currently using discounts as a recovery tactic.

"After all, discounts may be necessary to alleviate customer dissatisfaction immediately after a service failure and firms may not have another option," Kanuri said. "In such circumstances, we demonstrate that firms can alleviate the long-term negative consequences by lowering the renewal price at the end of the contract, increasing the time between recovery and contract renewal (offer additional service usage time) and using touchpoints with customers such as emails, bill reminders and follow-up phone calls to remind customers of the initial subscription price."

More information: Vamsi K. Kanuri et al, The Unintended Consequence of Price-Based Service Recovery Incentives, *Journal of Marketing* (2019). DOI: 10.1177/0022242919859325

Provided by University of Notre Dame