

# I Earn It, But They Just Get It: Loyalty Program Customer Reactions to Unearned Preferential Treatment in the Social Servicescape

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## Abstract

Hospitality and tourism firms use two different strategies in customer relationship management: rewarding loyalty program customers with earned rewards (earned preferential treatment) and delighting the nonprogram customers with surprise rewards (unearned preferential treatment). However, research overlooks the key impact of how these two customer relationship management strategies may negatively affect the observing loyalty program customers. To address these gaps, Study 1 finds that providing a nonprogram customer with a high-value unearned treatment significantly decreases perceptions of distributive justice, status, and loyalty among the observing loyalty program customers. No significant interaction effects of a firm's explanation were found, suggesting that the practice of unearned preferential treatment cannot be justified simply by presenting a reason for the practice. Study 2 finds that compensating the affected program customers with tangible compensation is the only significant factor that enhances the observing loyalty program customers' perceived trust, suggesting rebuilding customers' trust as the key element in recovery. This research is grounded in social comparison and justice theory and builds upon the loyalty, social servicescape, and customer delight literature to explicitly examine the reward comparison stemming from the social presence of other customers.

## Keywords

unearned preferential treatment, perceived status, justice, loyalty, loyalty program, delight, social comparison theory, explanation, social servicescape

## Introduction

In today's competitive business environment, firms are striving to both reward loyal customers yet also delight new customers with surprise rewards. These conflicting strategies cause confusion for practitioners and researchers. Similarly, as so many customers share the physical environment, how we treat one customer can affect how the other customer feels when they don't get the same perceived treatment. As firms struggle to keep the existing customers (through loyalty programs) yet gain new customers (through surprise rewards), the question of how each strategy affects the other customers is critical in affecting customers' perceptions and represents a critical issue both theoretically and managerially.

Preferential treatment, where extra benefits are offered to some but not all customers, is a common phenomenon in consumption contexts (Jiang, Hoegg, & Dahl, 2013). This frequently occurs in hospitality and tourism settings as many customers are members of loyalty programs, and firms also try to surprise and delight customers with free or upgraded products and services. In general, preferential

treatment is "earned" through a customer's past history of purchase behavior with the firm's loyalty programs; the more you buy, the better treatment you earn (Drèze & Nunes, 2009). Although research investigates earned preferential treatment, unearned preferential treatment has received little attention (Hwang & Mattila, 2018; Zhang & Hanks, 2015).

Unearned preferential treatment is awarded spontaneously or by chance (Jiang et al., 2013) and includes free upgrades in hotels and airlines as well as free food products in restaurants (Zhang & Hanks, 2015). Various firms use unearned preferential treatment as a key business strategy to surprise and delight customers (Park & Jang, 2015) including United Airlines, Caribou Coffee, and Expedia

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(Hwang & Mattila, 2018). These free surprises can lead to significant positive outcomes from the customers who receive them, such as increased satisfaction, delight, and loyalty (Lee & Shea, 2015). However, recent studies indicate that the use of unearned free rewards can create unintended unfairness perceptions (Park & Jang, 2015; Zhang & Hanks, 2015). The role of unearned preferential treatment with regard to a delightful customer's experience remains unclear and thus warrants future research.

According to social comparison theory, humans have a natural urge to compare themselves with others (Festinger, 1954). Firms simultaneously offer both strategies of surprising unearned customers with preferential treatment and earned preferential treatment to reward program members. Thus, a gap exists in examining both earned and unearned reward strategies simultaneously and how it affects loyalty program customer's perceptions. In other words, comparisons are made when rewards are distributed to different consumers in shared social settings (Colliander, Söderlund, & Szugalski, 2016). This is especially critical in hospitality, tourism, and service settings as many hotels and airlines allocate separate counters and service areas and often prioritize customers (e.g., British Airways, Japan Airlines, Hyatt, and IHG hotels). This then creates natural comparisons between customers (Jiang et al., 2013; Steinhoff & Palmatier, 2016) which is why this research is needed. Unlike most previous studies of loyalty programs, where the customer is examined in social isolation (Colliander et al., 2016), this research builds upon the loyalty and social servicescape literature to explicitly examine the reward comparison stemming from the social presence of other customers.

Surprisingly, although customer comparisons take place, they have not received empirical examination as it relates to justice perceptions in the loyalty research (Colliander et al., 2016; Liu & Mattila, 2016). Loyalty programs likely trigger unfairness perceptions, due to cross-customer comparisons based on social comparison theory (Steinhoff & Palmatier, 2016) and equity theory (Adams, 1965). Although some research examines the effects of cross-customer comparisons related to different loyalty status levels in hierarchical programs (Eggert, Steinhoff, & Garnefeld, 2015), research to date has not examined customer delight strategies through unearned preferential treatment. Taking this one step further, this phenomenon would be of particular relevance to examine in the social servicescape, as different customers are likely to have different perceptions based on whether the preferential treatment is earned or unearned through surprise rewards.

Furthermore, while the limited research examining unearned preferential treatment examines power/relationship status (Zhang & Hanks, 2015) and relationship status/envy (Park & Jang, 2015), even less research examines what firms and managers should do to recover from the

negative situation. Such practical relevance would build upon the current gaps by providing actionable behaviors that can mitigate the negative impacts. Imagine that you are a long-term member of a hotel's loyalty program. You have earned several differentiated preferential services in relation to other nonprogram customers such as room upgrades and a complimentary Wi-Fi service. But what if you notice that another, seemingly nonmember customer gets upgraded to the same room and free Wi-Fi service as yours? How fair would you perceive the situation? How might you react based on your perceived status? How would you react to your loyalty program or the firm after this incident? What can the firm do to recover from your negative perceptions?

Based on the gaps surrounding unearned preferential treatment (Hwang & Mattila, 2018; Zhang & Hanks, 2015), cross-customer comparisons in the servicescape (Colliander et al., 2016), fairness perceptions between earned and unearned preferential treatment (Steinhoff & Palmatier, 2016) and firm's actions to minimize the negative effects, this research attempts to fill these important theoretical and managerial gaps by examining whether the conferment of unearned preferential treatment in the shared social servicescape causes negative perceptions and thus damages loyalty behavior among the observing loyalty program customers. More specifically, this research aims to (a) examine the negative impact of unearned preferential treatment on the loyalty program customers' perceived justice, status, and customer loyalty toward both the firm and the firm's loyalty program; (b) identify whether such negative impact may be attenuated by a firm's explanation to the observing program customers; and (c) investigate whether damaged customers' perceptions of justice and trust can be enhanced through firms' compensation strategies. To address these gaps, this research conducts two separate between-subjects experimental design studies using a hotel context.

In summary, the results of this study suggest both theoretical and managerial implications. First, this research provides an opportunity to reconsider the practice of unearned preferential treatment in the social servicescape by investigating the negative reactions of firms' loyalty program customers. Second, this research provides practical guidelines for developing a more effective compensation strategy to rebuild customer's trust as an initial step to recover from the negative situation.

## Literature Review and Hypotheses Development

### Preferential Treatment

Preferential treatment is defined as giving selected customers elevated social status, recognition, and/or additional or enhanced products and services beyond standard

firm value propositions and customer service practices (Lacey, Suh, & Morgan, 2007). Preferential treatment is bestowed through discounts, free upgrades or services, and offers of recognition and encouragement to continue the relationship (Pez, Butori, & de Kerviler, 2015). Preferential treatment naturally reflects the relationship marketing perspective that focuses on market segmentation and customer selectivity. Preferential treatment is typically aligned with a firm's loyalty program that treats customers differently, often favoring the program customers over the nonprogram customers (Drèze & Nunes, 2009) with both economic and customized benefits (Gwinner, Gremler, & Bitner, 1998). Economic benefits consist primarily of monetary rewards and time savings, which may include complimentary products and expedited check-in service. Customized benefits involve personal recognitions or limited privileges such as membership only services and individually customized communication. Many loyalty programs use a combination of economic and customized benefits. For example, the Marriott Rewards program offers program members economic benefits such as price discounts and free nights and customization benefits such as exclusive access to dedicated elite reservation lines. Similarly, The Wyndham Rewards program awards points that can be redeemed for economic benefits such as complimentary (e.g., free hotel stays at any participating hotel worldwide), discounted products (e.g., discount off the best available rate), or customization benefits such as limited privilege (e.g., customized offers). The selection of who to reward and how to reward customers is an ongoing critical issue in customer relationship management. Failing to reward customers who expect recognition can lead to negative consequences (Pez et al., 2015) yet rewarding customers who do not expect anything can lead to delight, satisfaction, and increased loyalty (Magnini, Crotts, & Zehrer, 2011).

### *Unearned Preferential Treatment*

Many service, hospitality, and tourism organizations use the strategy of unearned preferential treatment in the form of an unexpected upgrade or with free items (Zhang & Hanks, 2015). Unearned preferential treatment, where extra benefits are offered spontaneously or by chance, is not earned through a customer's past history of purchase or loyal behavior, and it is increasingly used by firms (Jiang et al., 2013) in an effort to create delightful experiences (Lee & Shea, 2015; Torres & Ronzoni, 2018). One of the key elements to delight is that surprise is necessary and that delight leads to customer loyalty (Magnini et al., 2011). Surprise rewards are defined as unexpected incentives firms provide, and these are increasingly strategically used to delight customers with surprise rewards (Wu, Mattila, & Hanks, 2015). Therefore, research that investigates the effects of surprise

rewards on customer loyalty (Hwang & Mattila, 2018) would provide value to the hospitality and tourism literature, especially related to how customers compare the earned versus unearned rewards other customers receive.

### *Impact of the Social Servicescape on Cross-Customer Perceptions*

Firms seek to surprise and delight customers by offering elevated service or preferential treatment, yet it remains unclear whether or not this practice positively affects these customers nor takes into consideration the perceptions of bystander customers (Jiang et al., 2013; Mattila, Hanks, & Zhang, 2013). These cross-customer perceptions are grounded in social comparison theory where individuals naturally compare themselves with others (Festinger, 1954). Specifically, loyalty program effectiveness may fail to account for cross-customer comparisons which are critical to investigate as customers make comparisons with one another in the social servicescape (Baker & Magnini, 2016), and this co-presence occurs frequently in service settings such as airlines, restaurants, and hotels (Kim & Baker, 2017). In other words, customers affect each other in the social servicescape and make comparisons based on what they see or hear other customers receiving. According to social comparison theory, customers naturally compare themselves with others, upward, laterally, or downward (Steinboff & Palmatier, 2016). A customer who observes themselves receiving better loyalty rewards or perceived unearned rewards can significantly affect perceptions of status and justice.

Second, a key underlying principle in understanding cross-customer perceptions is rooted in justice theory and equity theory. A customer's sense of justice can be the key psychological mechanism when comparing differences in perceived status (Mattila et al., 2013). Therefore, this research is grounded in justice theory and uses distributive justice perceptions in better understanding how different loyalty rewards affect different customers. Loyalty programs, in particular, trigger unfairness perceptions, due to the cross-customer comparisons (Steinboff & Palmatier, 2016). This is grounded in justice theory where individuals perceive whether what they get is fair, particularly related to distributive justice. In other words, the perceived unfairness of witnessing another customer receiving unearned preferential treatment can cause negative customer perceptions and behaviors from the traditional loyalty program members. In service settings, given that customers share the service environment, it is important to examine the underlying mechanisms such as justice. This study seeks to shed light into how justice mediates the impact of unearned preferential treatment by examining perceptions of justice and status which are critical for unearned versus earned preferential treatment perceptions.

### Perceived Distributive Justice

This study focuses on distributive justice as it refers to an individual's perceptions of justice in terms of the distribution of tangible outputs from exchange activities. The concept of distributive justice is rooted in equity theory (Adams, 1965), which focuses on determining whether the distribution of resources is fair. For example, distributive justice exists when customers are equitably rewarded based on their inputs in comparison with the inputs and outputs of other customers, typically assuming the following formula (Szymanski & Henard, 2001):

$$\frac{O_c}{I_c} = \frac{O_r}{I_r}$$

where  $O$  is outcomes,  $I$  is inputs,  $c$  is the focal customer, and  $r$  is the reference person or group. Inequality occurs when others get the same outputs but with less inputs or others get more than you with the same inputs. This creates perceptions of unfairness. In this regard, unearned preferential treatment in the social servicescape can be problematic because it creates a violation of the equation between the firm's loyalty program customers and nonprogram customers, ignoring individual inputs (Jiang et al., 2013; Park & Jang, 2015). When other customers see preferential treatment that they believe other customers do not earn, it can lead to negative perceptions (Jiang et al., 2013), specifically distributive justice. Customers are likely to find the distributive justice unfair when they view the ratio of their outcomes relative to inputs, compared with the corresponding input-outcome ratio of other customers (Henderson, Beck, & Palmatier, 2011).

For example, if the loyalty program customers notice that a nonprogram customer gets the same yet perceived unearned preferential treatment, the discrepancy in the inputs (e.g., loyalty fees paid, past purchases, time spent) of the two parties would negatively affect distributive justice perceptions among the observing loyalty program customers. In other words, the distribution of resources or preferential treatments is perceived to be unfair because all customers receive the same values regardless of individual contributions. Also, the negative impact on perceived distributive justice would differ based on the level of unearned preferential treatment to the nonprogram customer. Based on these rationales, we hypothesize the following:

**Hypothesis 1 (H1):** The observation of unearned preferential treatment to a nonprogram customer will negatively affect perceived distributive justice among the observing loyalty program customers.

### Perceived Status

According to social comparison theory (Festinger, 1954), people often desire to learn about "the self" in comparison

with others around them. Comparisons with others can focus upward, laterally, or downward, allowing people to draw inferences about their own position and rank (Steinboff & Palmatier, 2016). Although social comparisons can involve others who are either better off (upward comparison) or worse off (downward comparison), there is a strong preference for downward comparison when people want to feel better about their self or their situation (Wills, 1981). In general, the feeling of being superior or more capable than others leads to one's enhanced subjective well-being. In a similar vein, the elevated status that firms attempt to bestow on their loyalty program customers by offering preferential treatment can carry the concept of downward comparison (Drèze & Nunes, 2009). Customer status refers to the customer's perception of holding an elevated position or rank within a firm's customer hierarchy or refers to a socially recognized ranking (Pez et al., 2015). Because preferential treatment intentionally entitles the firm's loyalty program customers, but not all customers, it naturally creates varying levels of status among customers.

In addition, the social nature of service encounters often forces customers to see what others receive and make evaluative comparisons that influence their self-perception of status. Therefore, one's perceived status can be deeply affected not only by the preferential treatment they receive but also by what others receive. Research finds the more superior self-perception arises if fewer people receive similar privileges. Brewer's (1991) optimal distinctiveness theory argues that, to maintain one's loyalty, it is critical to satisfy in-group members' belonging and affiliation but also maintain clear boundaries from other out-groups. In other words, customer status is positional that it ranks individuals within a hierarchical structure, representing asymmetries in status conferral where some are high and others low in status (Henderson et al., 2011). The number of hierarchical levels in a hotel loyalty program and the relative size of benefits are found to positively shape perceptions of status, as well as preference for the program (McCall & Voorhees, 2010).

However, prior research overlooks a key aspect related to hospitality and tourism consumption: that customers share the environment and make comparisons in the social servicescape. It is therefore critical that research addresses this gap by examining the social comparisons made when rewards are distributed to different customers in social settings (Colliander et al., 2016). When preferential treatment is unearned and conferred spontaneously in the shared social servicescape, it risks the intended boundary between the firm's loyalty program customers and nonprogram customers, which dilutes the loyalty program member's perceived status. Also, it is predicted that the negative impact on perceived status would differ according to the level of unearned preferential treatment to the nonprogram customer. Hence, we hypothesize the following:



**Hypothesis 2 (H2):** The observation of unearned preferential treatment to another nonprogram customer will negatively affect perceived status among the observing loyalty program customers.

### *Effects on Customer Loyalty*

Very little is known about how behaviors of the firm's loyalty program customers can be influenced when preferential treatment is unearned and conferred to the nonprogram customer. For example, when the loyalty program customers perceive that they are put in an unfair situation caused by inequity in the distribution of unearned preferential treatment, their affected justice perceptions would generate negative loyalty behavior. Similarly, it is expected that decreased status as a result of unearned preferential treatment is likely to lessen their loyalty status. Because feeling special or superior in status compared with others is an important motive for a loyalty program (Arbore & Estes, 2013), any negative impact on the perceived status of the program members would decrease their loyalty to the firm.

Furthermore, research suggests that customers differentiate between loyalty to a company and loyalty to a loyalty program (Evanschitzky et al., 2011), yet most research still examines loyalty as a simple, single construct (Matute, Palau-Saumell, & Viglia, 2018; Yao, Qiu, & Wei, 2019). In other words, loyalty can be toward the firm or the loyalty program (Evanschitzky et al., 2011; Salegna & Fazel, 2011). Stated differently, research has not untangled which portion of overall loyalty reported to a firm may actually be loyalty to specific components of the firm's service such as service employees (Matute, Palau-Saumell, & Viglia, 2018) and store products and location (Jang, Kim, & Lee, 2015). Loyalty to a loyalty program may be more economic in nature based on the benefits of the loyalty program where firm loyalty may be based on the attitude toward the brand (Evanschitzky et al., 2011). Therefore, loyalty is not always a simple, single construct (Jang et al., 2015; Matute et al., 2018; Salegna & Fazel, 2011; Yao et al., 2019), yet service research rarely investigates multiple loyalty constructs within a single model. This gap is critical as a deeper understanding of the objective of customer-firm relationships in services can be the key to improving the effectiveness of customer service management (Mittal, Huppertz, & Khare, 2008). As such, this research specifically examines the impact of negatively affected perceptions of justice and status on the two types of customer loyalty: program loyalty and firm loyalty. While the program loyalty represents a customer's commitment to the firm's loyalty program, firm loyalty represents the loyalty state toward the firm offering the loyalty program. Taken together, this research hypothesizes the following:

**Hypothesis 3 (H3):** Perceived distributive justice is positively related to (a) program loyalty and (b) firm loyalty.

**Hypothesis 4 (H4):** Perceived status is positively related to (a) program loyalty and (b) firm loyalty.

### *The Role of Explanation*

The definition of explanation is described as the act or process of making something clear or understandable (Shaw, Wild, & Colquitt, 2003). In high interaction settings, such as hospitality and tourism, attributes do not exist in isolation (Kim & Baker, 2019), and it is therefore important to examine the interaction effects among key variables. In hospitality and tourism, firms often provide unexpected benefits to randomly selected customers without providing an explicit reason (Park & Jang, 2015). However, other research suggests that managers should explicitly communicate their policies for differential customer treatment to bystanders (Steinhoff & Palmatier, 2016). Therefore, providing an explanation may represent a key moderating tactic that warrants investigation.

During the service experience, customers typically expect an explanation when things go wrong (McColl-Kennedy & Sparks, 2003). Research in service failure demonstrates that explaining what might have caused the failure can alleviate the negative impacts customers experience (Shaw et al., 2003). Mattila and Patterson (2004) find that providing an explanation is particularly effective in restoring customer's perceptions of fairness in service recovery contexts. Extending this logic, providing an explanation in the social servicescape with regard to bestowing rewards may also mitigate negative impacts. Although firms may argue that the provision of unearned preferential treatment to the nonprogram customer is to delight the customer, it can be seen as an unfavorable incident from the perspective of the observing loyalty program customer. Therefore, this study seeks to examine whether a firm's explanation to the program customers can justify the firm's use of unearned preferential treatment and thus mitigate the negative impact on perceptions of the program customers. Hence, the following is hypothesized:

**Hypothesis 5 (H5):** Firms' explanation moderates the impact of unearned preferential treatment on the observing loyalty program customers' perceived (a) distributive justice and (b) status.

### *Effects of Compensation on Trust and Justice*

A violation of the equality policy due to the distributed unearned preferential treatment in the shared servicescape may increase unfairness perceptions and involve damage to the firm's trustworthiness. Customer's firm trust is defined as a consumer's overall evaluation of firm's trustworthiness (e.g., belief) and their corresponding trust intent (Xie & Peng, 2009). Despite its role as a vital relational resource, customer trust is vulnerable to a variety of destructive

threats including dissatisfied service experiences (Kabadayi, 2016), yet this has not been examined with regard to unearned preferential treatment. Unearned preferential treatment may affect the loyalty program customer's perceptions that the firm is dependable and can be relied on to deliver on its promises (e.g., exclusive member benefits; Brashear-Alejandro, Kang, & Groza, 2016). As the ability to keep promises is a key driver of trust, the necessity and ability to restore trust and justice is a crucial issue with significant practical merit (Xie & Peng, 2009).

In addition, compensating dissatisfied customers is known as one of the most effective ways to offset a company's failure and rebuild justice (Roschk & Gelbrich, 2017) and trust to the firm after the negative event (Xie & Peng, 2009). Compensation recompenses customers for a resource they lost due to the organization's failure and distinguishes between tangible and psychological compensation (Gelbrich & Roschk, 2011). While tangible compensation includes a material or economic benefit such as a complimentary voucher or a discount/money back (Wirtz & Mattila, 2004), psychological compensation represents an affective or emotional benefit, which usually comes as an apology (Gelbrich & Roschk, 2011).

Although numerous studies report positive effects of compensation on customer reactions, no research has yet investigated such effects with regard to unearned preferential treatment and the affected loyalty program customers. This gap is critical to investigate as firms should take corrective actions and develop practical strategies to reduce any negative service encounter and consequences. Interestingly, most research focuses on examining negative outcomes of unearned preferential treatment (Jiang et al., 2013; Park & Jang, 2015; Zhang & Hanks, 2015) but neglects firm's actionable strategies. Furthermore, a firm's best customers with a strong relationship are found to react more favorably to a firm's compensation amount compared with weak relationship customers, which suggests the presence of a strong compensation effect for strong relationship customer (Gelbrich, Gäthke, & Grégoire, 2016). Therefore, further examination into how a firm's different compensation strategies affect perceptions of trust and justice among the loyalty program customers is worthy for both theoretical and especially practical reasons. Taken together, we hypothesize the following:

**Hypothesis 6 (H6):** After the observation of unearned preferential treatment, tangible compensation enhances observing loyalty program customers' perceived (a) trust and (b) distributive justice.

**Hypothesis 7 (H7):** After the observation of unearned preferential treatment, psychological compensation enhances observing loyalty program customers' perceived (a) trust and (b) distributive justice

## Method

### Design and Measures

The purpose of the research is to investigate the effects of unearned preferential treatment in the shared servicescape on distributive justice, status, and trust perceived by the observing loyalty program customers and to examine the roles of a firm's explanation and compensation. More specifically, to test the hypotheses, two between-subjects experimental designs were utilized. Study 1 examines a 2 (unearned preferential treatment: high vs. low)  $\times$  2 (firm's explanation: present vs. absent) on observing loyalty program customers' perceived distributive justice, status, firm loyalty, and program loyalty. To increase validity and practical merit, and to explore alternative explanations and outcomes, Study 2 examines a 2 (tangible compensation: present vs. absent)  $\times$  2 (psychological compensation: present vs. absent) on perceived customer trust and distributive justice among the loyalty program customers following the observation of unearned preferential treatment given to the nonprogram customers. A hotel setting was chosen as the research context as the hospitality and tourism servicescapes represent contexts where earned and unearned (surprise rewards) are often conferred among different customers in the presence of other customers (Hwang & Mattila, 2018; Park & Jang, 2015; Zhang & Hanks, 2015).

For data collection, an online marketing research company (MTurk) was recruited to distribute web-based surveys. Prior research demonstrates that MTurk is a useful and valid tool for social science and experimental studies in terms of recruiting more diverse populations compared with traditional college students and other online samples, with the quality of data satisfying the psychometric standards of published research (Buhrmester, Kwang, & Gosling, 2011; Horton, Rand, & Zeckhauser, 2011; Paolacci, Chandler, & Ipeirotis, 2010). Prior hospitality research using experimental design has utilized MTurk to collect data as a reliable sample (Baker & Kim, 2018; Liu & Mattila, 2016; ShinLegendre, Warnick, & Baker, 2017).

In addition, screening questions and attention check questions were embedded throughout the survey (Rouse, 2015). The sample composed adults more than the age of 18 years in the United States. To ensure data were collected from loyalty program customers, respondents were asked to answer a screening question (e.g., "Are you currently a member of any hotel [airline] loyalty program?") and asked their loyalty status membership in additional questions to validate responses. In addition, to ensure quality of the data, workers who participated in the survey needed to have minimum accuracy qualifications (Migacz, Zou, & Petrick, 2018). After eliminating respondents who were not members of loyalty programs or failed quality control checks,

the final samples resulted in 182 and 166 responses of Studies 1 and 2, respectively.

**Study 1.** Study 1 uses a 2 (unearned preferential treatment: high vs. low)  $\times$  2 (firm's explanation: present vs. absent) between-subjects experimental design. The subjects were randomly assigned to one of four conditions with a scenario describing their hotel check-in experience in the presence of other customers. This scenario-based approach is consistent with previous studies on unearned preferential treatment (Jiang et al., 2013; Mattila et al., 2013). To ensure the role clarity of a loyalty program customer in the scenario, participants were asked to imagine that they were the hotel loyalty program guests and as a loyalty program member, they passed by nonprogram customers waiting in line and checked in at the priority check-in counter. Many hotels and airlines allot separate counters and offer priority check-in service for their premier customers (e.g., World of Hyatt, IHG Rewards Club, British Airway Executive Club, and Japanese Airline Frequent Flyers). This dedicated service in the shared servicescape creates the social context that allows the customer to compare what he or she receives with what other customers receive (Jiang et al., 2013; Steinhoff & Palmatier, 2016). The hotel setting has been often used as the research context examining bystander effects (e.g., Colliander et al., 2016; Söderlund et al., 2014; Steinhoff & Palmatier, 2016). The scenario then described that the participants received a room upgrade to the deluxe room according to their loyalty status and they observed a nonprogram guest standing at the next normal counter also received the same room upgrade (a high level of unearned preferential treatment) or a complimentary Wi-Fi upgrade (low level). The level of unearned preferential treatment was manipulated based on perceived desirability and value of each type of upgrade, referring to prior research on upgrades (Park & Jang, 2015). In the presence of the explanation condition, the hotel staff explained the reason for the upgrade given to the nonprogram customer, whereas in the absence of explanation condition, there was no explanation about the upgrade toward the nonprogram customer.

All dependent variables and manipulation checks were measured on a 7-point Likert-type scale with multiple items from the literature: four items for perceived status (Drèze & Nunes, 2009), three items for perceived distributive justice (Blader & Tyler, 2003), three items for customer loyalty to the program, and three items for customer loyalty to the firm (Nguyen, Klaus, & Simkin, 2014; Zeithaml, Berry, & Parasuraman, 1996). Reliability tests showed high internal reliability, with Cronbach's alpha values ranging from .85 to .93 for Study 1. The effectiveness of the manipulation of the level of unearned preferential treatment was measured with two items: "Please rate the value of the upgrade given to the other nonprogram customers on a scale from 1 (*low*)

to 7 (*high*)" and "Please rate the desirability of the upgrade given to the other nonprogram customers on a scale from 1 (*low*) to 7 (*high*). The manipulation of explanation was checked using three items (e.g., "In this scenario, the hotel explained a reason for the upgrade given to the nonprogram customers on a scale from 1 (*strongly disagree*) to 7 (*strongly agree*)"). The list of dependent variable measurement items is reported in Table 1.

**Study 2.** To build upon the results from Study 1 and examine managerial actions, Study 2 examines a 2 (tangible compensation: present vs. absent)  $\times$  2 (psychological compensation: present vs. absent) between-subjects experimental design. The participants were randomly assigned to one of four conditions with a scenario describing their hotel check-in experience as a loyalty program customer in the presence of other nonloyalty program customers. Participants were told to assume that they received a room upgrade to the deluxe room according to their loyalty status and observed a nonprogram guest standing at the next normal counter also received the same room upgrade. In the presence of the tangible compensation condition, the hotel offered an additional 20% off discount meal coupon, whereas in the absence of the tangible compensation condition, there was no additional material benefit based on manipulations from previous studies (Roschk & Gelbrich, 2017; Wirtz & Mattila, 2004). Similarly, in the presence of the psychological compensation condition, the receptionist sincerely apologized if the upgrade to the nonprogram customers had caused the loyalty program customer any inconvenience, whereas in the absence of the psychological compensation condition, there was no apology from the hotel staff. All dependent variables and manipulation checks were measured on a 7-point Likert-type scale with multiple items. Customer trust was measured with six items (Xie & Peng, 2009; Cronbach's  $\alpha = .95$ ), and perceived distributive justice was measured with three items used in Study 1 (Cronbach's  $\alpha = .80$ ). The effectiveness of the manipulation of tangible compensation was checked using two items. Similarly, the manipulation of psychological compensation was checked using two items. The manipulation of the level of unearned preferential treatment was measured with two items used in Study 1. The list of dependent variable measurement items is reported in Table 1 (Figures 1 and 2).

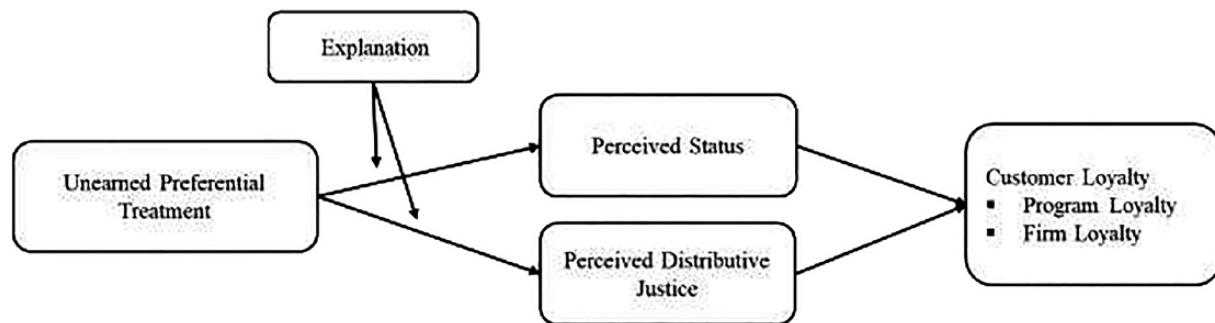
## Results

### Study 1

**Descriptive statistics.** Of the 182 responses, 47.8% of the respondents identified as male and 52.2% identified as female, and their average age was 38.2 years. Almost half of the respondents earned above US\$50,000 annually (46.2%). Seventy-six percent were Caucasian, followed by

**Table 1.**  
Factor Loading of Items for Studies 1 and 2.

Construct	Items	Cronbach's $\alpha$	
		Study 1	Study 2
Perceived status	The hotel loyalty program made me feel special. The hotel loyalty program gave me a feeling of high status. It would be difficult for others to earn similar status as yours. Relative to the nonprogram customers, I receive better services.	.85	N/A
Perceived distributive status	The hotel allocated free upgrades fairly between the program customers and the nonprogram customers. When considering the upgrade that the nonprogram customers received, the upgrade I received was fair. As the loyalty program customer, would you agree that there was an emphasis on distributing the upgrade fairly at this hotel?	.88	.80
Perceived customer trust	I trust this hotel. This hotel is reliable. This hotel is dependable. I will buy this hotel's products when I need. I am willing to recommend this hotel to my relatives and friends. I am willing to try new products introduced by this hotel.	N/A	.95
Program loyalty	I intend to use this hotel's loyalty program in the future. As long as the present standard of service continues, I would use this hotel's loyalty program again.	.92	N/A
Firm loyalty	I intend to use this hotel's loyalty program less in the future (R). I intend to use this hotel in the future. As long as the present standard of service continues, I would use this hotel again. I intend to use this hotel less in the future (R).	.93	N/A



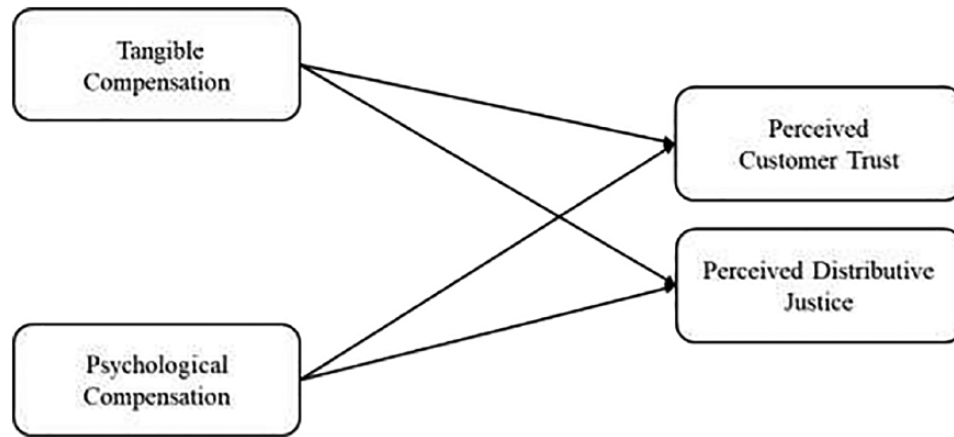
**Figure 1.**  
Conceptual Model for Study 1.

the Asian or Pacific Islander group (9.3%). Almost 60% of the respondents had two or three and more loyalty program memberships, revealing that they are experienced loyalty program customers and suitable for participants in the current experimental design study examining effects of unearned preferential treatment.

**Manipulation checks.** A series of independent-sample *t* tests show that participants found a significant statistical

difference for the level of unearned preferential treatment between the high-valued preferential treatment and the low-valued treatment (*M* guest room upgrade = 5.87 vs. *M* Wi-Fi upgrade = 4.57, *t* = 7.168, *p* < .001) although the magnitude was small. The participants also found a significant difference for unearned preferential treatment (*M* presence of explanation = 6.30 vs. *M* absence of explanation = 1.63, *t* = 24.338, *p* < .001). The scenario was rated as highly realistic (*M* = 5.63, *SD* = 1.46)





**Figure 2.**  
Conceptual Model for Study 2.

with no significant differences across the four conditions ( $F = 2.114, p > .05$ ). In addition, participants perceived they are the hotel's loyalty program customer ( $M = 6.46, SD = 1.14, p > .05$ ) and that there were the loyalty program customers and the nonloyalty program customers together at the crowded reception area of the hotel ( $M = 6.01, SD = 1.49, p > .05$ ). These results indicate successful manipulations.

**Hypothesis testing.** To test the hypotheses empirically, a multivariate analysis of variance (MANOVA) was performed to test the main effect of unearned preferential treatment (high/low) on perceived distributive justice and perceived status and the moderating effect of the explanation for unearned preferential treatment (present/absent). Age, gender, ethnicity, education, income, and loyalty program membership tiers (high/middle/low) were tested as covariates to rule them out as possible alternative explanations, and all these variables were found insignificant. The multivariate and univariate follow-up results reveal a significant main effect for unearned preferential treatment on perceived distributive justice,  $F(1, 178) = 30.325, p < .001$ , and perceived status,  $F(1, 178) = 44.314, p < .001$ . As expected, the observation of a high level of unearned preferential treatment (compared with a low-level treatment) had a greater negative impact on both justice and status perceptions of the observing loyalty program customers. Thus, these results support both H1 and H2. However, no significant interaction effects of explanation for unearned preferential treatment were found on both perceived distributive justice,  $F(1, 178) = 0.573, p > .05$ , and perceived status,  $F(1, 178) = 0.052, p > .05$ . This result implies that even though explanation is related to justice perceptions,  $F(1, 178) = 7.035, p < .05$ , it does not significantly mitigate the negative impact

of unearned preferential treatment on the perceptions of respondents. Therefore, H5 was rejected. The multivariate and univariate results are reported in Table 2.

To examine the effects of customer distributive justice perceptions and status on loyalty, Preacher and Hayes's mediation testing was employed. The results support the mediation effects of perceived distributive justice between unearned preferential treatment and both customer loyalty indicators (program loyalty: 95% confidence interval [CI] =  $[-1.19, -0.49]$ ; firm loyalty: 95% CI =  $[-1.16, -0.53]$ , the number of bootstrap = 5,000). Perceived status as a mediator between unearned preferential treatment and both customer loyalty indicators was also found significant (program loyalty: 95% CI =  $[-1.19, -0.50]$ ; firm loyalty: 95% CI =  $[-1.08, -0.45]$ , the number of bootstrap = 5,000). The application of bootstrapping, which is a computationally intensive method that involves repeatedly sampling from the data, allowed us to test the mediation hypotheses (Hayes, Preacher, & Myers, 2011). Following Preacher and Hayes's (2008) procedure, this study's 5,000 resamples generated 95% CIs (percentile) for the mediators. Because the CIs for indirect effects do not include the zero, the results supported both H3 and H4.

### Study 2

**Descriptive statistics.** Of the 166 responses, approximately 47.6% of the respondents identified as male and 52.4% as female. The average age was 40.9 years, and more than half of the respondents earned above US\$50,000 annually (55.4%). Furthermore, 75.9% of the respondents were Caucasian and 65% of the respondents had graduated from a 4-year college or above. Nearly half of the respondents were members of more than two loyalty programs, and 51% reported that they belong to middle or above loyalty program tier.

**Table 2.**  
Multivariate and Univariate Follow-Up Results for Study 1.

	Multivariate		Univariate			
	Wilks's Lambda	<i>p</i> Value	DV	<i>F</i>	<i>df</i>	<i>p</i> Value
UPT	.798	.000	PDJ	30.325	1, 178	.000
			PS	44.314	1, 178	.000
Explanation	.961	.030	PDJ	7.035	1, 178	.009
			PS	3.019	1, 178	.084
UPT × Explanation	.995	.662	PDJ	.573	1, 178	.450
			PS	.052	1, 178	.820

Note. DV = dependent variable; UPT = unearned preferential treatment; PDJ = perceived distributive justice; PS = perceived status.

**Table 3.**  
Multivariate and Univariate Follow-Up Results for Study 2.

	Multivariate		Univariate			
	Wilks's Lambda	<i>p</i> Value	DV	<i>F</i>	<i>df</i>	<i>p</i> Value
Tangible compensation	.942	.008	PCT	9.330	1, 162	.003
			PDJ	0.853	1, 162	.357
Psychological compensation	.989	.424	PCT	0.349	1, 162	.555
			PDJ	0.482	1, 162	.489
Tangible compensation × Psychological compensation	.989	.397	PCT	0.679	1, 162	.411
			PDJ	0.248	1, 162	.619

Note. DV = dependent variable; PCT = perceived customer trust; PDJ = perceived distributive justice.

**Manipulation checks.** A series of independent-sample *t* tests reveal significant differences that for the presence of tangible compensation (*M* presence of tangible compensation = 5.87 vs. *M* absence of tangible compensation = 1.24, *t* = 19.239, *p* < .001) and psychological compensation (*M* presence of psychological compensation = 5.06 vs. *M* absence of psychological compensation = 2.00, *t* = 11.137, *p* < .001), the scenario is rated as highly realistic with no significant difference across the four conditions (*M* = 5.45, *SD* = 1.47, *p* > .05). In all the scenarios, participants perceived that they were hotel's loyalty program customer (*M* = 6.40, *SD* = 1.25, *p* > .05) and there were the loyalty program customers and the nonloyalty program customers together at the hotel reception area (*M* = 5.80, *SD* = 1.76, *p* > .05). These results support successful manipulations.

**Hypothesis testing.** The MANOVA and univariate results (see Table 3) reveal that tangible compensation significantly affects perceived customer trust, *F*(1, 162) = 9.330, *p* < .05, but there is no effect on perceived distributive justice. However, no significant effects of psychological compensation were found on any perception of trust and justice. This result indicates that both tangible and psychological compensation do not influence the observing loyalty program customers' justice perceptions, yet the level of trust to the firm increases when additional tangible compensation is

given to them after the observation of unearned preferential treatment, while simply apologizing to the affected loyalty program customers fails to influence both trust and justice. A possible explanation is that observing unearned preferential treatment of the nonprogram customers may be seen as a highly severe event, where justice is hard to recover, yet a trust-recovering opportunity still exists through the firm's tangible compensation strategy. Taken together, H6a was supported, whereas H6b, H7a, and H7b were not supported.

## Discussion

Providing unexpected upgrades is a prevalent practice in the hospitality and tourism industry. Prior research notes that such preferential treatment creates customer delight and thus encourages positive behavioral outcomes such as positive word-of-mouth, purchase intention, and loyalty behavior (Drèze & Nunes, 2009; Lacey et al., 2007). However, when preferential treatment is unearned and conferred in the shared social servicescape, it can lead to unintended negative consequences, such as increased unfairness perceptions from the firm's loyalty program customers.

The findings of the Study 1 indicate that the firm's loyalty program customers experience decreased perceptions of distributive justice and status following the observation of unearned preferential treatment given to the nonprogram

customers. Furthermore, the results find that negatively affected justice perceptions significantly affect loyalty behavior. When unearned preferential treatment is observed and is especially served with a high-value treatment, the observing loyalty program customers perceive the situation as unjust, which ultimately decreases levels of customer program loyalty as well as their firm loyalty. Moreover, perceived status of loyalty program customers also mediates the negative impact of unearned preferential treatment on both customers' loyalty. However, the results of this research show that when customers' perception of status is negatively affected by the observation of unearned preferential treatment, it decreases both firm loyalty and program loyalty.

The second main goal of the research is to examine firm's actions that moderate the negative consequences. Study 1 examines whether providing an explanation to customers moderates the negative impact. The results find that there is no significant interaction effect of explanation with unearned preferential treatment on the loyalty program customer's perceived distributive justice and status. A possible explanation for this finding is that although customers have a normative expectation for some sort of explanation when things go wrong (Sparks & Fredline, 2007), the practice of unearned preferential treatment in the presence of the loyalty program customers cannot be justified simply by presenting a set of reasons for the action, thus failing to attenuate the negative consequences of unearned preferential treatment.

To build upon the practical implications and tangible actions firms can take, Study 2 examines whether tangible and psychological compensation affect customers' justice perceptions. Results find that providing an additional material benefit or/and an apology does not significantly affect perceived distributive justice suggesting that negative justice perceptions caused by unearned preferential treatment cannot be recovered by presenting the firm's explanation and providing any of the firm's tangible and psychological compensation strategies. Stated differently, observing unearned preferential treatment to the nonprogram customers can be seen as a highly severe failure event, where customers' justice perception is greatly affected and thus it is difficult to recover. The results also suggest that the firm's loyalty program customers experience increased perceptions of trust to the firm when they receive an additional tangible compensation from the firm. Specifically, the level of trust to the firm increases when additional discount meal coupon is given to the hotel loyalty program guests who observed unearned preferential treatment toward the nonprogram customers, while simply apologizing to the affected loyalty program customers does not increase trust perception. That is, firms' compensation strategy through tangible benefits is still effective in managing customer's trust. This finding is especially noteworthy as rebuilding a trustworthy image and earning

customer's trust are initial steps to recover from a negative event (Xie & Peng, 2009).

## Theoretical and Managerial Implications

The results from this research suggest both important theoretical and managerial implications in several ways. First, the systematic study of unintended and potentially negative effects of different customer relationship management initiatives represents a critical area for advancing the hospitality, tourism, and relationship management literature. There is scant research that investigates surprise rewards (Hwang & Mattila, 2018), from a cross-customer perspective (Colliander et al., 2016) in the social servicescape with justice perceptions (Liu & Mattila, 2016). Taken together, these relationships have previously been untested but are of critical importance as firms use free upgrade strategies to delight customers (Hwang & Mattila, 2018), customers affect one another in the social servicescape (Baker & Kim, 2018), and customers make social comparisons with one another when in a shared environment (Steinhoff & Palmatier, 2016). Specifically, this study examines the cross-customer comparisons of two distinct customer relationship management initiatives, loyalty program rewards, and customer delight strategies, which have previously not been compared in the academic literature and therefore contributes theoretically to the loyalty, delight, and social servicescape literature.

Second, results find that customers do observe the treatment of others in the social servicescape and compare their treatment with others, which can cause unintended negative damage to these customers in terms of program and firm loyalty. Previous studies of loyalty programs examine the customer as socially isolated (Colliander et al., 2016). More specifically, results find that customers make comparisons to what others receive in terms of psychological mechanisms including perceived status and perceived distributive justice. Comparisons represent a unifying theoretical underpinning for customer responses to loyalty programs that has previously not been investigated and thus builds upon the customer loyalty literature.

Third, this research was the first attempt to measure the negative impact of the hospitality firm's practice of unearned preferential treatment in the form of a free upgrade on the firm's loyalty program customers. The results find that because preferential treatment is generally earned and aligned with the firm's loyalty programs, when preferential treatment is unearned and conferred in the shared social servicescape, it can cause negative effects on the firm's loyalty program customers, especially their perceptions of justice, status, and trust to the firm. Furthermore, this research extends the understanding of the role of perceptions of unearned preferential treatment in determining customer loyalty by demonstrating that

loyalty program customers become less loyal to the program and the firm when their perceived justice and status are damaged from the unearned upgrades given to the non-program customers. This finding is especially noteworthy because up to now, firms' efforts in delighting the customer are emphasized mostly regarding its positive effects on customer loyalty (Finn, 2005). However, the findings of this study reveal the possible unintended negative impacts of such efforts on customer loyalty if there is lack of consideration about the social influence of service encounters. The customer relationship strategy of delight and surprise with preferential treatment may come at the expense of decreased justice, status, and program and firm loyalty from existing loyalty members.

Interestingly, the results of this research also find that providing an explanation for why other customers receive preferential treatment does not moderate the relationship between preferential treatment and perceived status and distributive justice. Previous research suggests that managers should explicitly communicate the reasoning for differential customer treatment to bystanders (Steinhoff & Palmatier, 2016). Prior research in service failure also finds that giving an explanation can moderate the negative effects of service failure. Therefore, the results from this research are unique in that customers evaluate what a company does, and how it is viewed comparatively to what other customers get. The rationale for why is less important than the social comparison outcome. As such, this research builds upon social comparison theory and the loyalty literature.

The results of this study also provide important implications to practitioners. For preferential treatment to successfully result in intended customer outcomes, managers of service firms should be aware of interpersonal influences of other customers in service encounters and thus consider how to effectively manage the negative impact of unearned preferential treatment in public on the observing customers. Because the firm's loyalty program customers have earned preferential treatment, witnessing another, seemingly unequal, nonprogram customer receive same treatments could endanger their perceptions of justice and status. In other words, hospitality operators should be cautious about offering unearned upgrades in the presence of the loyalty program customers.

Although the firm's use of a free upgrade seems to be an easy way to delight a few ordinary customers with seemingly little costs, the findings of this study warns practitioners that, when it is inconsistently practiced in the presence of the firm's loyalty customers, regardless of the presence of explanation for the practice, the firm could not justify the situation and thus risk the relationship with the firm's loyalty program customers—undoubtedly the firm's most valued, important customers.

From a managerial perspective, this research is critical as it highlights firms' need to actively respond to the

affected loyalty program customers rather than simply understanding the negative impact of the practice of unearned preferential treatment. Although earlier research focuses mainly on the negative consequences surrounding the practice of unearned preferential treatment (Jiang et al., 2013; Park & Jang, 2015; Zhang & Hanks, 2015), this research is the first attempt to investigate what firms and managers should do to recover from the negative situation. This contribution is worthy as the necessity and ability to restore customers' perceptions and behaviors from a negative event is a crucial issue with much practical merit. Specifically, this research gives practitioners guidelines to develop and implement a more effective compensation strategy to rebuild customer trust as an initial step to recover the negative service encounter based on the understanding of the role of tangible compensation on perceived trust of the loyalty program customers.

Finally, this research is important as it addresses firms' efforts to account for bystander effects. This represents a current gap in loyalty program measurement and may help managers better identify program effectiveness and ineffectiveness. Second, loyalty program and customer delight strategies may be effective individually, but may cause negative effects when examined simultaneously. Service experiences do not exist in a vacuum, and it is therefore critical to examine how different strategies interact with one another.

## Limitations

Although this research provides important implications, it is not free from limitations. The research considered only two levels of unearned preferential treatment according to the perceived value of each treatment—high and low valued. Other types of unearned preferential treatment such as social and economic treatment and their differential effects on customers can be further tested. In addition, this study used a hypothetical experiment in one service category (e.g., hospitality), thus suggesting future studies in other service categories such as retails through actual service consumption studies. Even though this study shows no interaction effect of firm's explanation (present or absent), more research is needed to investigate other different types of explanations as excuse, referral, or justification or how other situational and relational factors of the service encounters, such as the criticality of purchase occasion, social companion, and reward visibility may affect earned loyalty program customers. Future research should also examine the differential effects of different customer relationship management strategies simultaneously, such as loyalty programs and delight strategies or various membership types and tiers, tenure, and individual attachment to the firm or brand. Although this research is the first attempt to provide a solution to recover from the negative service encounter



surrounding unearned preferential treatment, further research is needed to provide additional solutions to manage the damaged customer justice perceptions beyond restoring trust.

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