Retailer Pricing Strategy and Consumer Choice Under Price Uncertainty

Liat Hadar, Arison School of Business, The Interdisciplinary Center (IDC) Herzliya, Israel
Shai Danziger, Recanati Business School, Tel-Aviv University, Israel
Vicki Morwitz, Stern School of Business, New York University, USA

We examine consumers’ retailer choice under price uncertainty. Simulating everyday choice participants made many retailer choices where they chose a retailer and only then learned prices. Results of six studies demonstrated a choice advantage for a retailer that offered frequent small discounts over a retailer that offered infrequent large discounts.

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Liat Hadar, The Interdisciplinary Center (IDC) Herzliya, Israel
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EXTENDED ABSTRACT
Assuming consumers’ average price perceptions guide their choice of retailer, previous research has examined how various retailer pricing strategies influence consumers’ average price perceptions. In these studies, participants viewed competing retailers’ product prices over many trials (simulating multiple shopping trips) and then retrospectively judged each retailer’s average price. We challenge the notion that consumers rely on average price perceptions in repeated retailer choice under price uncertainty, that is, in realistic situations where consumers choose among retailers without knowing current prices. Building on experience-based choice and descriptive choice literatures we predict a choice advantage for a retailer that offers many small discounts or a consistently low regular price (EDLP retailer) over a retailer that offers infrequent deep discounts (depth retailer). We propose the following four reasons for our predictions: (1) Under-sampling and/or underweighting of the depth retailer’s infrequent discounts. Research on experience-based choice indicates that small probability events may be under-sampled (when only partial feedback is provided) and/or underweighted. In the retailer choice context, a consumer should be less likely to choose the depth retailer if they experience the discounts it offers less frequently than it actually appears, and/or if they assign them less weight in choice than normatively warranted. (2) Loss aversion. We propose that when consumers choose a retailer they assess the chosen retailer’s price against that of the competing retailer (whether it is revealed or inferred based on previously experienced trials). Choosing the retailer that offered a lower price than the forgone retailer is perceived as a “gain” whereas choosing the retailer that offered a higher price than the forgone retailer is perceived as a “loss”. Therefore, consumers will deem a depth retailer less attractive than a frequency/EDLP retailer because it is associated with more “losses” (it is usually more expensive than the frequency/EDLP retailer) and fewer “gains” (it is rarely cheaper). (3) Diminishing sensitivity to outcomes. Due to the concavity of the value function for gains, and convexity for losses (payments), consumers gain more positive value from experiencing multiple small gains than from experiencing fewer yet larger gains, and should receive less negative value from experiencing fewer yet larger losses than from experiencing multiple small losses. In the context of repeated retailer choice, choosing the EDLP/ frequency retailer yields many smaller gains (frequent lower prices compared to the depth retailer) and fewer larger losses (missing out a large discount price offered by the depth retailer), while choosing the depth retailer yields few larger gains and many smaller losses. Building on the logic of segregating gains and integrating losses, the EDLP/ frequency retailers should be valued more positively than the depth retailer, and (4) Peoples’ tendency to predict future outcomes based on previously encountered outcomes. Humans tend to perceive patterns and correlations everywhere even if these lead to erroneous inferences (i.e., are not actually present). If people assume that past sequences are representative of future sequences they will be likely to look for patterns in previously experienced outcomes (whether such patterns exist or not), and to predict future outcomes based on these patterns. In the retailer choice context that we study, use of a prediction strategy should produce a choice pattern whereby a retailer’s choice share is proportional to the number of times the retailer provides the best outcome (probability matching), leading to a larger choice share for the frequency retailer.

In seven studies participants made 100 successive choices between frequency or EDLP retailers and depth retailers that offered the same average prices, under price uncertainty. Participants were asked to minimize overall spending and to estimate each retailer’s average price retrospectively.

Participants were more likely to choose the retailer that was cheaper more often, even when they judged this retailer to be more expensive on average, and when it actually was more expensive on average than the competing retailer. The majority of participants indicated using either a prediction strategy, where they chose the retailer they believed would be cheaper on each shopping occasion, or a frequency strategy, where they predominantly chose the retailer they believed was cheaper more often.

A tendency to choose the retailer that was cheaper more often was observed under conditions of dichotomous price distributions (a regular price and a single discounted price) with complete feedback (study 1), persisted when a prior indicated the frequency retailer was cheaper on average, but was attenuated when the prior indicated the depth retailer was cheaper on average (study 2), and was found for low and high discount discriminability conditions for more complex non-dichotomous distributions (study 3). Studies 4a and 4b illuminate why consumers prefer the frequency retailer. Contrasting depth and frequency retailers with a retailer that offered a constant price, these studies show that being cheaper more often, and not offering frequent discounts, drives choice. Study 5 demonstrated that the frequency retailer’s choice share advantage is influenced more by its frequency than by its discount magnitude, and that the frequency effect persists even when the depth retailer offers more savings overall. Study 6 extended our findings from a setting in which participants made multiple successive choices to a more realistic environment where they made one choice per day, over a 15 day period, and replicated the earlier findings. Finally, study 7 demonstrated that participants’ expectations of future prices but not their judgments of retailer’s past average prices predicted their subsequent retailer choice.

The superiority of offering frequently lower prices was demonstrated with different price distributions, product categories, different time lags between choices, across different participant populations (Americans adults and Israeli undergraduate students) and surveying methods (laboratory experiments and an online survey). The managerial implications are clear. Under price uncertainty, when consumers goal is to maximize savings, they will tend to choose the retailer they believe is cheaper more often.

REFERENCES


