Is That Bargain Worth My Time?

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Prior research on relative thinking suggests that the willingness to seek a bargain depends not only on the absolute value of the bargain, but also on the price of the product. For example, a discount of $10 seems more appealing if the price is $20 rather than $60. We invoke the interactive role of consumers’ reference prices to delineate the conditions in which relative thinking holds and in which it gets reversed. Our novel predictions arise from an analytical model and are supported in a series of laboratory experiments.

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EXTENDED ABSTRACT

Consumers love bargains. The possibility of cheaper products urges people to drive to far-flung outlet malls; the prospect of getting a discount makes them clip and save coupons; and the promise of instant savings at the time of purchase is reason enough to sign up for the store-specific credit card. But how far are consumers willing to go in order to get such bargains? Consider an example of two stores: Store A sells a shirt for $20 but Store B sells the same shirt for $10. Would a consumer, who is already in Store A, be willing to take a five-minute drive to Store B in order to save $10? Furthermore, would the consumer be willing to drive to save $10 if the price at Store A were $60?

Traditional economic theories suggest that consumers should base this decision simply on how much they value the benefit of $10 versus the cost of a five-minute drive (Stigler 1987). However, research on relative thinking suggests that a discount of $10 seems less appealing if the price is $60 rather than $20. In other words, people demonstrate relative thinking (Azar 2007; Thaler 1980; Tversky and Kahneman 1981). This notion is significant for marketers because it implies that, given a fixed sales—promotion budget aimed at increasing store traffic, a manager ought to make discounts more attractive by applying them on products that are priced low rather than high. We delineate the conditions under which this strategy would make sense, but also other conditions in which managers ought to do the opposite. We show that a $10 discount can sometimes seem more appealing on a price of $60 rather than $20.

Relying on the strength of multidisciplinary research, we rely on a mathematical model to derive new predictions that we then test in behavioral studies. Our theorizing involves a consideration of referent thinking, which involves the reference price that one expects to pay (Kalyanaram and Winer 1995; Winer 1986). We employ an analytical model to study how two behavioral tendencies—relative and referent thinking—interact when they are jointly incorporated into the prospect theory value function. This leads to three novel predictions: (1) A relative-thinking effect will emerge when the actual price turns out to be the same as expected. That is, consumers will be more willing to seek a bargain on a product that is priced low rather than high. (2) A referent-thinking effect, which is opposite to the relative-thinking effect, will emerge when the actual price deviates from the expected price. That is, consumers will be more willing to seek a bargain on a product that is priced high rather than low. (3) A relative-thinking effect will emerge yet again when actual prices become extremely discrepant from the reference price.

The above predictions are supported in three laboratory experiments that employ an infrequently-purchased product category (blankets) and a frequently-purchased product category (gasoline). An additional study attests to the counter-intuitiveness of our results and provides evidence that these effects might be occurring without people being aware of them. Specifically, when a group of participants were given details about one of our experiments and asked to predict what the results would have been, they suggested a pattern that was consistent with relative thinking, but opposite to the referent-thinking results that we actually found.

From a theoretical standpoint, we help better understand the factors that determine the effectiveness of bargains such as price promotions. We also help provide a more nuanced view of prior research on relative thinking (Tversky and Kahneman 1981). To research on internal reference prices (Kalyanaram and Winer 1995), we add the notion that the influence of reference prices stretches beyond perceptions of actual prices; they also change perceptions of promotions that are offered on those prices. Finally, we present a framework that affords wide applicability. For instance, our framework can be extended to incorporate time-money differences (Okada and Hoch 2004; Saini and Monga 2008) in order to examine how bargain-seeking behavior varies with whether the cost of seeking a bargain is in terms of time or money. Similarly, it can help understand the effect of other consumer benefits, beyond the monetary promotions that we studied.

From a managerial standpoint, our results offer direct suggestions regarding enhancing the effectiveness of a fixed sales promotion budget by considering not only product prices, but also the deviations of those prices from expected prices. Depending on the situation, a fixed sales—promotion budget should sometimes be allocated to cheap products (loss leaders) but to more expensive products (big-ticket items) at other times. Finally, recommendations arise in terms of when promotions ought to be framed in absolute terms ($X off), and when in relative terms (Y% off).

REFERENCES

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