A Reference Price Effect of Buy-Now Prices in Internet Auctions

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Retailers selling items through Internet auctions frequently use buy-now prices (BNPs), which allow the selling of items immediately to consumers at a fixed price. We propose and estimate a new model of the reference price effects of BNP on bidders’ willingness-to-pay (WTP) in online auctions. We also study under what conditions a BNP can be effectively used as an external reference price (ERP). Results of two experiments clearly indicate that BNPs have a reference price effect. We find, however, that this effect is moderated by (1) the ease of value assessment and (2) product class (i.e. low versus high-end products).

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EXTENDED ABSTRACT

More and more retailers are using Internet auctions as an alternative way of selling their products. Currently, over 750,000 American retailers use the Internet auction website eBay as a major channel of distribution, while another 1.5 million individuals supplement their income by selling on eBay—together these businesses accounted for a majority of eBay’s sales, which was over $52.4 billion in 2006 (eBay annual report, 2006).

Internet auctions have provided a different way of selling items, which has led to the creation of new features; such as proxy bidding machines, feedback mechanisms, and buy-now prices (e.g. Cheema et al. 2005). This paper focuses on buy-now prices (BNPs), an important feature that is widely used in Internet auctions. A BNP or a buy-now option is a fixed price offer by the seller which, when exercised by the bidder, instantly ends an auction and sells the item to the bidder at the fixed price, without them having to wait until the completion of the auction.

Conventional wisdom suggests that a BNP negatively affects an auction’s outcome because it imposes an upper bound on selling prices. Thus, auctioneers who seek to maximize auction outcomes should not provide a BNP option (Budish and Takeyama 2001). In spite of this assertion, BNPs are widely used in Internet auctions. Several researchers in economics and marketing have studied the above paradox focusing on the benefits to the bidders, such as, a risk premium for risk-averse bidders to ensure they win the item; or to reduce waiting or transaction costs (e.g., Budish and Takeyama 2001; Mathews 2004; Wang et al. 2004). Our research adds to this literature by providing an additional rationale for setting BNPs from a seller’s perspective.

The objective of this research is to develop and estimate a new model of the reference price effects of BNP on bidders’ WTP in online auctions. We make several important contributions to the literature. First, we estimate a model, which shows that BNPs may serve as reference prices, favorably influencing bidders’ valuations. Furthermore, we study under what conditions a BNP can be most effectively used as an ERP (external reference price).

We propose that sellers may use BNPs to provide important price information to consumers. Hence, BNPs may serve as a reference price, influencing bidders’ willingness to pay (regardless of whether bidders actually execute the BNP option or not). This is consistent with research has shown that seller-supplied ERP play an important role in the formation of consumers’ valuations and purchase decisions (Briesch et al. 1997; Mayhew and Winer 1992; Mazumdar et al. 2005). Adaption Level theory (Helson 1964) and assimilation-contract theory (Sherif, Sherif and Havlond 1961) predict that consumers exposed to ERPs assimilate this information with previously formed internal reference prices (IRP) and adjust their IRP accordingly.

Research also has found that reserve prices in Internet auctions may serve as reserve prices influencing bidders’ willingness to pay (Ariely and Simonson 2003; Häubl and Popkowski Leszczyc 2003; Kamins, Dreze, and Folkes 2004; Suter and Hardesty 2005). Therefore, we propose that BNPs have a positive reference price effect on bidders’ valuations, leading to higher auction outcomes. In addition, we expect, that this positive effect of a BNP is moderated by the ease of value assessment. Previous research has shown that strategies used to influence customer’s price perceptions tend to be more effective when product values are difficult to assess (Alba et al. 1994; Brint 2003).

Results

We provide the results from two different studies. Study 1 is a controlled field experiment that studies the reference price effect of BNPs on bidders’ valuations in real-life auctions where bidders commit their own money. A 2 (presence of a BNP) × 75 (different products) full factorial design was adopted as the basic design. Each product was sold once with a BNP and once without a BNP. At the completion of the auctions each winner was asked to complete a survey upon collecting the item won in the auction (the response rate was 81%). The results of Study 1 provide support for our hypothesis that retailers in auctions can use BNPs to positively influence the selling prices obtained. In addition, this effect was stronger when bidders perceived the value of an item to be more difficult to assess. Finally, on average, bidders found it easier to assess the value of an item when a BNP was present, indicating that bidders may use BNPs in assessing the value of items.

Study 2 is a computerized laboratory experiment that focuses on the moderating effects of (1) difficulty in assessing a product’s value and (2) of product class (low versus high end products). We conducted a two (ease of assessing value: memory cards vs. diamond earrings) by two (product class: high-end vs. low-end) by two (BNP: presence vs. absence) mixed design with product category as the within-subject factor. A total of 87 subjects participated in this study. Results provided further support for the reference price effect for BNPs. Results find support for two moderating variables, the ease of value assessment and product class, and that the reference price effect of BNPs exists only for high-end products that are difficult to assess.

Most previous research on BNPs has focused solely on the behavior of bidders; in contrast, this paper considers the seller’s decision-making process as well. Different from normative economics theory, we find that BNPs function as external reference prices, and have an impact on bidders’ valuations. A strong reference price effect is observed, resulting in an increase in bidders’ WTPs by 23.05%. This reference price effect is stronger when the value of a product is more difficult to assess and for high-end products. These findings have important implications for seller strategy in online auctions and for consumer welfare.

References


