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Perceived fairness of pricing on the Internet

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Abstract

The perceived fairness of price changes has been a subject of much inquiry in economic and marketing literature. This paper examines consumers' perceptions of the fairness of pricing on the Internet. Fair prices on the Internet, pricing mechanisms, methods of price discrimination and yield management are investigated from a consumer's perspective. Results obtained from 276 questionnaires collected in Taiwan indicate that the Internet prices that equal those in the traditional channels are perceived to be unfair. Respondents considered various pricing mechanisms on the Internet to be fair while many practices of price discrimination and yield management were perceived to be unfair.

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1. Introduction

Applying the principles of economics to setting prices on the Internet can be precarious to the reputation of a firm. Amazon.com, the cyberspace retailer, encountered

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problems when some customers who had bought DVD movies began to compare prices on online discussion boards. News media picked up on the disparity and consumer outcry erupted. Amazon.com finally refunded 6,896 customers an average of $3 (Kong, 2000).

Amazon.com claimed that it had been performing random pricing tests, randomly offering the same DVDs at various prices. An Amazon.com spokesman claimed that the tests were useful in determining a price point – the right balance between how much Amazon.com could charge while maintaining a good sales volume. However, Amazon.com faced allegations that the various prices were based on customer data it obtained when the customers visited its site. Such data might include a person's mailing address and how much he or she might have previously spent at Amazon.com. Amazon.com was accused of charging their loyal customers higher prices than new customers.

Setting prices based on shoppers' incomes or buying habits is known as "dynamic pricing" (Kannan & Kopalle, 2001). Dynamic pricing is not new. Retailers frequently charge more for goods in stores in better neighborhoods, or more in areas of less competition. For example, Wal-Mart's prices in remote locations with no direct competition from a large discounter were 6% higher than that at locations where it was next to a Kmart (Foley, Mahmood, Bradley, & Ghemawat, 1996). The price of a can of Coke varies with the type of outlet, from DM 2.20 in newsstand in a train station, to DM 0.64 in a large supermarket (Dolan & Simon, 1996, p116). Airlines are also known to change prices frequently according to demand and the timing of a reservation. Very few people seem to complain about such pricing practices.

On the Internet, opportunities for dynamic pricing are greater for at least two reasons – customer information can be more easily collected and list prices can be more easily changed (Dolan & Moon, 2000). Furthermore, it is easier to check competitors' prices and availability of products. With such information, the dynamics of demand and supply can be better understood and prices adjusted accordingly.

The Internet supports not only the mechanism whereby sellers set prices, while consumers "take it or leave it," but also other mechanisms of transaction, such as group-discounting, negotiation, auction and reverse auction. Each type of transaction has its pros and cons from economic perspectives. For example, Wang (1993) compared posted-price selling with auctions in a traditional retail setting and found that auctions were optimal in most situations. Auctions would be even more attractive on the Internet since the associated costs would be much lower than those of auctions in the real world.

Most mutually satisfying exchange relationships require fairness. The perception of fairness is more critical on the Internet than in traditional channels, since feasible practices in brick-and-mortar stores, such as that adopted by Wal-Mart Stores, Inc., may not be tolerated on the Internet. As Kahneman, Knetsch, and Thaler (1986b, p. S299) stated, "The rules of fairness cannot be inferred either from conventional economic principles or from intuition and introspection," but should be empirically tested.

The perceived fairness of pricing has been extensively studied in economic and marketing literature (Campbell, 1999; Dickson & Kalapurakal, 1994; Kahneman,