



Shopping, gambling or shambling? Penny auctions

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ABSTRACT

On penny auction websites, consumers participate in a game where the winner receives the opportunity to purchase a product for pennies on the dollar and discounts of over 90% are often advertised and recorded. Losers, on the other hand, may easily spend hundreds of dollars and walk away with nothing. For penny auction websites, profit margins over 300% on a single auction are not uncommon. Critics call penny auctions gambling. Proponents call penny auctions entertainment shopping. Either way, this emerging form of ecommerce represents a fascinating area for academic research.

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1. Introduction

“They are a combination of bingo night, the Home Shopping Network and a slot machine addiction (Dubois, 2010).”

Did you know a consumer can buy a new Apple iPad for only \$27 (the product typically sells for \$700) and yet the retailer can still earn \$2000? How is this possible? An emerging type of e-commerce has captured the attention of consumers, investors, and regulators; however, consumer researchers have yet to explore this engaging new consumption phenomenon. Penny auctions, described as entertainment shopping by the industry, and like a drug or addiction by the popular press, sell everything from cash to luxury handbags, and vacations to laptops. If you have not heard of penny auctions, you likely will, as online and television advertising becomes more pervasive and both consumer awareness and participation increase.

Penny auctions differ from traditional online auctions (e.g., eBay) in that consumers pay to bid, with the vast majority of bidders walking away without a product and with a monetary loss. In addition, the item up for bid is sold by the penny auction website itself, as opposed to another consumer, or the manufacturer. While penny auctions have been referred to as discount shopping and games of skill, they have also been compared with slot machines, or other forms of gambling, as the auctions have one winner and many losers (Luscombe, 2010; Pennells, 2008; Thaler, 2009).

First appearing online in 2005, penny auctions have grown from a single auction website to more than 150 penny auction websites attracting millions of users (Pennells, 2008; The Economist, 2009). Some penny auction websites attract millions of dollars in investment capital, but still, barriers to entry are relatively nonexistent (Stone, 2010). Essentially, anyone with a computer can establish a penny auction website, as website building software is readily available, relatively inexpensive and no licensing or credentials are needed (Pennyauctionwatch.com, 2010; The Economist, 2009). The industry has a global reach and has gone largely ungoverned, a point of contention for some consumers and consumer watch groups (Kyodo News, 2010; Pennells, 2008; Pennyauctionwatch.com, 2010; The Economist, 2009).

The primary objectives of this article are to provide the academic research community with an introduction to this new phenomenon, and to begin a discussion regarding areas for fruitful research in this growing and compelling industry. As befits this special issue, this new phenomenon is conceptualized as a combination of shopping and gambling; thus shambling is at an interesting conjunction of two consumer research areas. This work broadly outlines the area, highlighting compelling and perplexing research issues and concludes with an exhortation to fellow researchers to delve into study of this fascinating phenomenon. But first, the phenomenon needs explaining.

2. Background

2.1. How penny auctions work

Penny auction bidders pay to and per bid, and while auctions open with a predetermined end date/time, additional time is added to the

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auction each time a bid is placed. As a result, penny auctions may remain in their final seconds for literally hours and days (Thaler, 2009). For example, a consumer looking to purchase a new purse might decide to try her hand at one of the many penny auction websites online. First, she purchases a bid pack of 100 bids, costing \$100. The purse she opts to bid on retails for \$1200 and the bidding starts at \$.01. She bids on the purse, along with a number of competing bidders, and interestingly enough, every time someone bids on the product the time of the auction is extended, thus prolonging the final auction-end time, allowing more bidders to join the auction and bid on the item.

The consumer uses all of her bids and unfortunately, is not the final bidder. The final price of the purse is \$57.36, which seems like a real bargain for the winning bidder, but the unsuccessful bidder/consumer in this scenario spent \$100 and has nothing, while the penny auction site brought in \$5793, a profit margin of 383% over retail price. This is not an uncommon scenario, and though some variation among penny auctions exists, with some bids costing less than \$1 and some auctions increasing by \$.02 per bid, the process is relatively uniform and profit margins can be sizable.

2.2. Why they work – the attraction

Penny auction advertisements focus on deep discounts and the possibility of getting an incredible deal seemingly appeals to consumers (The Economist, 2009). Commonly, high equity brands with exclusive or limited distribution strategies and prestige pricing policies, are advertised at 90% off retail prices (see Fig. 1). In addition to offering deeply discounted goods, penny auction website operators purport consumers view penny auctions as a leisure activity, a form of entertainment shopping or game (Thaler, 2009). The combination of getting an abnormally good deal may be seen as winning, with the attendant thrill or entertainment value of that win providing the allure needed to attract consumers. One penny auction website has 2.5 million registered members (The Economist, 2009); clearly some value is conveyed by the experience.

Lucrative profit margins and relative ease of entry into the market may explain the allure for penny auction website operators and why the number of penny auction websites increased 15,000% in less than five years. The following depicts the income generated by a high equity product often featured in penny auction advertisements (see Fig. 2 and Table 1). Profit margins of 163% are certainly atypical in traditional retail environments, but are frequently observed in the penny auction industry; indeed, margins are often much greater than this example.

3. A framework for potential research questions

3.1. Is this shopping or gambling?

Whether or not penny auctions are a new form of gambling is debatable (Gimein, 2009; Pennells, 2008). The penny auction model is similar to the dollar auction game invented by game theory pioneer Martin Shubik (Shubik, 1971; Thaler, 2009). This model relies upon

escalation of commitment; people feel invested in the game once they have paid to bid on an item and have a difficult time ending play given their reluctance to walk away from their sunk costs. The concept of escalation, coupled with seemingly amazing bargain prices, such as an Apple iPad that retails for \$699 selling for \$18.07 or being advertised at 90% off, creates an environment that has been called “devilish,” “addictive,” “competitive,” and “reckless” (Gimein, 2009; Luscombe, 2010; Thaler, 2009). While few consumers would likely use such adjectives to describe a typical shopping experience, such words have been used to describe a gambling experience (Cotte, 1997). While industry insiders refer to penny auctions as games of skill, gambling experts disagree, “...bidding on penny auction sites is akin to a gambling-like experience... when people bid again and again and again and don't win the item, that's very much like gambling” (Mark Griffiths, quoted in Pennells, 2008).

The debate as to whether or not penny auctions are simply a form of unregulated gambling rages on. This is perhaps the most fruitful avenue for business researchers to explore. Based upon consumer commentary on penny auction user forums, bidders who have experienced success consider penny auctions to be games of skill, and those who have lost consider them to be games of chance. Many penny auctions bear a striking resemblance to gambling, a contest where few win, many more lose, and the house always seems to profit the most (Thaler, 2009). The resemblance is particularly striking in auctions where participants wager previously purchased bids in an effort to win more bids.

On the other hand, some auctions are incorporating a buy-it-now option. This option allows consumers to apply lost bids towards purchase of the product at the listed retail price and arguably reduces the risk. To the extent that penny auctions are a form of gambling, an equal degree of regulatory oversight should be applied. Alternatively, perhaps regulation should be passed that simply restricts penny auctions to a more benign format. But social science researchers know very little about this phenomenon; regulators will be better informed if researchers begin to study this in earnest.

For gambling researchers, penny auctions present an interesting challenge. They force the question “what is gambling?” Penny auctions in which consumers bid for cash appear to cross the “entertainment shopping” line. On the other hand, auction websites which allow losing bidders to apply the cash value of their spent bids towards an outright product purchase seem much more benign. Perhaps penny auctions represent a missing link in the study of how gaming evolves into gambling.

If penny auctions are indeed gambling, as many commentators insist, then likely some small percentage of consumers encounter problematic and addictive issues with penny auctions. Some evidence of behaviors resembling gambling addiction does exist. On pennyactionwatch.com, a popular thread is titled “You Know You're a Penny Auction Bidder If.” Entries in this thread include: “The only way to eat is having food delivered right to your computer desk,” “You buy a bigger monitor with a gift card you won, so you can split the screen and have more auctions open at the same time,” “You are willing to give up family game night just to win another game for them to play,” “You vow you're going to quit this penny auction thing... as soon as you use up the last of your bids. Then proceed to buy another bid pack the next day... then vow to quit the day after...”



Fig. 1. Image of penny auction advertisements.

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