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To influence or not to influence: External reference price strategies in pay-what-you-want pricing☆

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ABSTRACT

Pay-what-you-want pricing mechanisms increasingly are popular among practitioners and interesting to marketing researchers. Prior research only examines strategies in which consumers choose any price without guidance from the firm. Firms currently use several external reference price strategies to influence consumers' chosen prices in pay-what-you-want pricing, including minimum, maximum, and suggested prices. This research examines these strategies' effectiveness to determine which one provides the highest yield and the most benefit to the firm. Four studies show these external reference prices act as anchors, biasing consumers' chosen prices in the direction of the external reference price. Surprisingly, study results find not using external reference prices may be the most beneficial strategy for the firm. Both minimum and maximum prices exhibit a negative influence on consumers' chosen prices in comparison to not offering an external reference price. However, a suggested price strategy appears to be an effective means of maximizing the firm's yield while giving consumers the freedom to choose their own price, especially when the suggested price is close to the consumer's internal reference price.

1. Introduction

Kim, Natter, and Spann (2009) define pay-what-you-want pricing as, "a participative pricing mechanism that delegates the whole price determination to the buyer." Unlike name-your-own-price strategies, in which the seller has the option to reject a buyer's bid, in pay-what-you-want pricing the buyer has complete control over the price paid (Kim et al., 2009). Pay-what-you-want pricing mechanisms are increasing in popularity. Musicians such as Radiohead, Nine Inch Nails, and Moby made headlines for releasing their albums with a pay-what-you-want pricing strategy (Binelli, 2008; Devin, 2008). Restaurants like Panera Cafe give customers the opportunity to choose their own prices for their meals (Leonard, 2010), while the magazine Inc. allows subscribers to pay-what-they-want for their subscriptions (Schindelheim, 2008).

Some firms attempt to influence consumers' chosen prices by suggesting prices or placing limits on the prices consumers can choose. The Metropolitan Museum of Art (Metropolitan Museum of Art, 2011) suggests a donation of $25 per adult visitor, and the Salvage Vanguard Theater allows audiences to pay between $12 and $35 for a ticket (Neulander, 2006). Kim et al. (2009) suggest that consumers process these attempts to influence chosen prices as external reference prices.

External references price strategies appear to reflect different goals. Mandating a minimum price prevents consumers from abusing their bargaining power by offering a low price that would hurt the firm's profitability. Suggesting a price implies a normative or appropriate price to pay. A maximum price may communicate the true worth of the product or the standard retail price. For example, Borck, Frank, and Robledo's (2006) field study allows online newsletter readers the opportunity to pay "up to the regular price" for their subscription.

While firms use external reference prices, research on pay-what-you-want pricing focuses on strategies with no external reference prices (e.g., Kim et al., 2009; Lynn, 1990), providing limited evidence as to their effectiveness or relative value to the firm. This research examines the effectiveness of three common external reference price strategies for pay-what-you-want pricing – a minimum price, a maximum price, and a suggested price – to determine how they influence consumers' chosen prices and which strategy provides the most benefit to the firm.

2. Theoretical foundation

Prior studies provide evidence that reference prices influence consumers' willingness to pay for a product (see Mazumdar, Raj, &

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Sinha, 2005). Consumers rely on internal reference prices to determine whether a price is fair or acceptable (Winer, 1986). Firms present external reference prices to make the firm's prices seem more appealing (Lichtenstein & Bearden, 1989) or to create perceptions of a discounted or sale price (Chandrashekaran & Grewal, 2006). Consumers perceive a potential opportunity for consumer surplus when presented with external reference prices, particularly when consumers are highly price-conscious or sale prone (Alford & Biswas, 2002). Consumers often use external reference prices as anchors and adjust their willingness to pay to a price they perceive to be fair or acceptable (Mazumdar et al., 2005). Consumers sometimes adjust their internal reference prices to be closer to the anchor as well, influencing both their willingness to pay for the product and their perceived savings (Chandrashekaran & Grewal, 2006; Lichtenstein & Bearden, 1989).

External reference prices also have a social influence. Kim et al. (2009) suggest that consumers in a pay-what-you-want setting are motivated by social exchange norms as well as economic gain. Consumers may fear social disapproval or sanctions if they pay zero when others pay more, or if they give the impression of unequal distribution (Kim et al., 2009). They also may feel pressure to pay a socially acceptable price to avoid appearing poor or cheap (Lynn, 1990). Thus, consumers may perceive external reference prices as socially acceptable or normative prices, influencing consumers to choose a price close to the external reference price.

These findings suggest that consumers who are given external reference prices in a pay-what-you-want setting will incorporate them into the price decision as anchors, shifting their chosen prices away from their internal reference prices and toward the external reference price. If the external reference price is higher than the consumer's internal reference price, this situation creates upward pressure, increasing the consumer's chosen price; the opposite occurs if the external reference price is lower than the consumer's internal reference price. The average impact on consumers' chosen prices depends on whether most consumers experience upward pressure or downward pressure from the external reference price. This pressure varies depending on the firm's external reference price strategy.

For a minimum price, the external reference price likely is lower than most consumers' internal reference prices. The minimum price creates downward pressure for most consumers, leading them to choose prices that are closer to the minimum price than they would without an external reference price. At the same time, the minority of consumers whose internal reference prices are lower than the minimum price experience upward pressure because they do not have the option of choosing a price below the minimum price. Conversely, a maximum price likely creates upward pressure for most consumers whose internal reference prices are below the maximum price and downward pressure on those consumers whose internal reference prices are greater than the maximum price.

Consumers perceive external reference prices that are higher than their internal reference price as a loss. They must adjust their willingness to pay upward, implying a greater cost to the consumer (Mazumdar et al., 2005). In contrast, external reference prices lower than the consumer's internal reference price represent a gain, increasing consumer surplus or savings over the amount he or she initially expected to pay. Many studies confirm that consumers exhibit loss aversion, a greater desire to avoid losses than to approach gains (Kahneman & Tversky, 1979; Thaler, 1985). External reference prices framed as consumer losses have a stronger influence on consumer perceptions than those that are framed as consumer gains (Bearden, Carlson, & Hardesty, 2003). Essentially, consumers are more motivated to avoid overpaying for the product than underpaying for the product.

Although a minimum price intends to preclude low prices, the downward pressure for those consumers whose internal reference prices are above the minimum price provides an opportunity for consumers to gain a surplus. Therefore, a minimum price likely lowers the average price chosen relative to not using an external reference price. In contrast, a maximum price eliminates the high end of the distribution of chosen prices. However, the upward pressure exerted on consumers whose internal reference prices are below the maximum price represents a loss, and is therefore likely to have a weaker effect on consumers' chosen prices. A maximum price's net effect on the average chosen price is therefore also likely to be negative relative to not using an external reference price, and the anchoring effect of the maximum price likely is weaker than the minimum price's anchoring effect.

A suggested price does not preclude any price from being chosen by a consumer, including a price of zero. However, a suggested price still acts as an anchor, creating downward pressure for consumers whose internal reference prices are greater than the suggested price and upward pressure for consumers whose internal reference prices are less than the suggested price. The suggested price's influence on the average chosen price likely varies depending on whether or not most consumers have an internal reference price that is above or below the suggested price. However, price should affect consistently the distribution of chosen prices, reducing the variance and clustering the chosen prices more closely around the suggested price.

Thus, compared to offering no external reference prices, the following effects are predicted:

H1. A minimum price a) decreases the mean chosen price and b) changes the distribution of the chosen prices causing the chosen prices to cluster closer to the minimum price.

H2. A maximum price a) decreases the mean chosen price and b) changes the distribution of the chosen prices causing the chosen prices to cluster closer to the maximum price.

H3. A suggested price changes the distribution of the chosen prices causing the chosen prices to cluster closer to the suggested price.

H4. A minimum price exhibits a stronger anchoring effect than a maximum price.

3. Studies

3.1. Research context, procedure, and sample

These hypotheses were tested in the context of purchasing concert tickets. This context was selected because the choice process for purchasing concert tickets is well known and relatively consistent across venues and performers, and participants could be given different external reference prices without changing the context. A hypothetical purchase scenario and a sample of undergraduate students were chosen for several reasons. First, while a field test using a real product would have stronger external validity, the hypotheses predict negative effects on chosen prices. Conducting a study resulting in lower revenue for a real firm would be ethically questionable. Second, hypothetical purchases allow participants the freedom to imagine any performer they wish to see in concert, reducing the effects of the desirability of the concert on participants' chosen prices. Finally, college students represent the typical concert-going audience and frequently purchase concert tickets. Therefore, students are an appropriate sample for this particular purchase context.

The same procedure was used for all four studies. Participants first read a description of a new concert venue said to be opening in their area soon. The venue was described as a small, intimate space where all seats provide an excellent view of the stage, ensuring a special “up close and personal” experience. Participants were told to imagine that the venue just announced the first season's schedule and a band or singer they like very much would be performing on a day when the participant could attend. Participants were asked to name the performer they were imagining to increase the salience of the performer and to ensure that participants were considering a single performer