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Determinants of consumers' response to pay-what-you-want pricing strategy on the Internet

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ABSTRACT

Previous pay-what-you-want pricing research has focused primarily on services in brick-and-mortar settings wherein buyers decide on a price to pay after experiencing the service. Research on this pricing approach in on-line settings is rare and limited to products, such as digital music. This paper explores the effects of pay-what-you-want pricing on the Internet and extends the scope of investigation to tangible products purchased before consumption. Building on theories in communications and pricing, the authors identify and empirically test two factors that interact with brand familiarity to positively influence online shoppers' responses to pay-what-you-want pricing: a virtual product experience and a seller-supplied anchor price. The results further indicate that consumers' online purchase intentions are influenced primarily by their perceived product knowledge, while perceived quality influences their pay-what-you-want prices.

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1. Introduction

Pay-what-you-want (PWYW) pricing is a new form of participative pricing mechanism where buyers can set the final price paid for goods or services at any amount, including zero (Kim, Natter, & Spann, 2009). This approach has attracted much attention and has been used by restaurants (e.g., Wrigley Mansion; City Café Bakery), hotels (e.g., Ibis Singapore; Hotel Tour d'Auvergne France), and museums (e.g., American Museum of Natural History; Brooklyn Museum) (Schons et al., 2014). A London restaurant owner has used this pricing method since 1984 (Monroe, 2003). In another venue, the English band, Radiohead, offered a PWYW option for an album, attracting more than 2 million downloads. The format was profitable and the album became one of its biggest hits (Raju & Zhang, 2009).

Research indicates that consumers usually pay positive amounts and that PWYW pricing can increase firms' turnover and profits. For example, it yielded higher promotional revenues than free sampling or price discounts, and generated a higher repeat purchase rate of new customers and an increased word-of-mouth behavior (Kim, Natter, & Spann, 2014). Factors, such as social norms, perceived fairness, service and customer satisfaction, product value, seller-supplied anchor prices,

level of reputation, length of PWYW policy implementation, and income may influence consumers' decisions to pay positive amounts (Kim, Kaufmann, & Stegemann, 2014; Kim et al., 2009; Kunter, 2015).

Several gaps in research on consumers' response to this pricing strategy remain. First, in a traditional service setting, positive pay-what-you-want payments are a result of a positive consumer *experience* of the service via direct interaction with service providers. Consumers satisfied with the service are more likely to pay more. Such an experience is difficult to generate in an online platform, where direct seller–buyer interaction is absent. Research on PWYW pricing on the Internet is scarce and has been limited to music content (El Harbi, Grolleau, & Bekir, 2014; Regner & Barria, 2009). Whether PWYW can be extended to online products, which cannot be experienced before the purchase, has yet to be studied. An online shopping environment limits the product and service experiential information consumers can obtain. Not being able to utilize all their senses to examine a product increases consumers' online purchase uncertainty and risk (Park, Lennon, & Stoel, 2005). To minimize the financial risk of buying a potentially lesser quality product, consumers may be reluctant to pay what the product might be worth. Hence, finding tactical ways to reduce consumers' uncertainty when evaluating products online is important for this pricing mechanism to be successful on the Internet.

Second, the novel and entertaining aspect of self-determination of prices in the PWYW pricing format attracts new customers and yields high repeat purchase rates (Kim, Kaufmann and Stegemann, 2014; Kim, Natter and Spann, 2014). This pricing strategy can be useful for

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new brands or businesses interested in adopting it as a promotion tool to spread awareness and attract first time customers. While well-known brands, such as Radiohead, have benefitted from the PWYW pricing approach, for other businesses, the strategy could lead to unprofitable outcomes, indicating that it may not be successful in all contexts (Schons et al., 2014). The question of whether, and if so, under what circumstances, a new or lesser-known brand or business can successfully adopt PWYW pricing, is understudied. Thus, it is important to examine the effect of brand familiarity on consumers' PWYW perceptions and purchase decisions across different conditions.

The goals of this research are to address the identified gaps by (1) investigating viable ways to reduce shoppers' uncertainty about online product evaluation and quality so as to facilitate their PWYW purchase decision; (2) examining the effect of brand familiarity on purchase intentions and PWYW price paid; and (3) developing a theoretical explanation for consumers' PWYW purchase decisions, given their inability to experience and evaluate the product and its quality on the Internet prior to purchase.

This research contributes to the PWYW pricing literature by identifying ways e-tailers can enhance consumers' ability to evaluate product quality online, especially when they are unfamiliar with the brand. The identified elements include providing consumers with a virtual product experience and including or excluding external anchor price information for the product. Enhancing consumers' ability to evaluate a product online should positively influence both their online purchase intentions and the price they are willing to pay.

2. Conceptual background

2.1. Pay-what-you-want perceptions and brand familiarity

Product knowledge can be defined as the amount of accurate information held in memory about product alternatives (i.e., objective knowledge) or as consumers' self-perceptions of their product knowledge (i.e., subjective or perceived knowledge). In assessing product knowledge, perceived (rather than objective) product knowledge has been used more widely, since it tends to drive information search and the types of decision heuristics consumers use (Smith & Park, 1992). An enhancement in consumers' product knowledge leads to more accurate product quality evaluations, consequently positively influencing their price perceptions (Grewal, Monroe, & Krishnan, 1998; Rao & Monroe, 1988; Rao & Sieben, 1992). Consumers with high degree of perceived product knowledge are also more confident in their price estimates and exhibit higher purchase intentions than those with low product knowledge (Biswas & Sherrell, 1993). Thus, in conditions of uncertainty, enhancing consumers' experiential product knowledge and quality perceptions should improve their ability and confidence to evaluate products. This enhancement in evaluation capability should increase online PWYW payments.

Consumers' product knowledge is strongly related with their familiarity with the product and brand. While experts collect extensive product information and focus only on the most relevant pieces in their decision-making, consumers tend to rely on brand names and prices in their product evaluations (Alba & Hutchinson, 1987). Research indicates brand familiarity and product knowledge reduce consumers' perceived risk (Nepomuceno, Laroche, & Richard, 2014). Typically, well-known brands are evaluated more favorably than unknown brands (Hardesty, Carlson, & Bearden, 2002). Previous studies on PWYW pricing also indicate consumers paid more in a higher reputable restaurant than a lower reputable one (Kim, Kaufmann and Stegemann, 2014; Kim, Natter and Spann, 2014). In an online pay-what-you-want setting, feelings of uncertainty may arise due to the lack of product sensory cues and undetermined quality prior to using the product. In such situations,

brand familiarity should be an important factor when deciding how much to pay.

2.2. Effect of virtual product experience

Research suggests that consumers' final pay-what-you-want payments are driven by their satisfaction with quality and/or service after experiencing the service (Kim et al., 2009). On the Internet, purchases are often made prior to consumption. To reduce uncertainty and enhance PWYW outcomes, it is essential to establish a sense of online product experience. Experience refers to customers' overall impressions and feelings formed by their encounters with products, brands, services, and the atmospheric aspects of the encounters. Customer experience directly affects their perceptions of product knowledge and value, and consequently, willingness to pay. Experiences occur in a variety of settings, directly when customers shop, buy, search, and use products, or indirectly when they are exposed to communications, including websites (Brakus, Schmitt, & Zarantonello, 2009).

The presentation of product information on merchants' websites provides consumers with an indirect experience and can influence their satisfaction with online shopping (Szymanski & Hise, 2000). To present product information, most commercial websites only provide visual information in the form of text and static product pictures. However, merely presenting on-screen text and static pictures is insufficient to convey important product experience attributes (Jiang & Benbasat, 2007). Research on working memory indicates a combination of audio and visual delivery of information is more effective in enhancing consumers' knowledge than visual presentation only. Working memory is comprised of multiple stores, each with limited capacity to process incoming information (Baddeley, 2000). While learning will decrease when one's working memory is overloaded (e.g., visually processing both text and pictorial information simultaneously), it can be improved significantly if both visual and auditory systems are deployed. When textual information is presented as verbal narration, an individual can process it via the auditory system, effectively freeing the visual system to process pictorial information more extensively (Mayer & Moreno, 1998).

Efficient use of virtual visual presentation has been shown to enhance online shoppers' product knowledge and purchase behavior (Jiang & Benbasat, 2007). In comparison to a 2-D product experience (i.e., static product picture), a 3-D product experience (i.e., zoom in/out and rotate) increases consumers' perceived product knowledge, induces more favorable brand attitudes, and higher purchase intentions (Li, Daugherty, & Biocca, 2002). In addition, consumers exposed to websites with products in motion (i.e., product videos) show higher perceived information gain, more positive mood, lower perceived risk, and higher purchase intentions than when exposed to a static product picture (Park et al., 2005). These effects should be especially relevant for *unfamiliar* brands that are associated with higher perceived risk and lower prior knowledge relative to familiar brands. When buying an unfamiliar brand, a presence of a virtual product experience (e.g., product video), compared to its absence, would enhance online consumers' perceived product knowledge and PWYW price. On the other hand, since consumers' prior knowledge about a *familiar* brand is relatively high, their level of uncertainty will be low. The virtual product experience should not have a significant effect. Therefore,

H1. There will be a significant interaction between brand familiarity and virtual product experience, such that:

- a) for an *unfamiliar* brand, a presence (versus absence) of a virtual product experience will *increase* online consumers' perceived knowledge, perceived quality, purchase intentions, and pay-what-you-want price;

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