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Consumer willingness to pay across retail channels

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ABSTRACT

Published research examining differences in consumer willingness to pay for products at omnichannel and pure-play online retailers is based on non-durable, search products and is equivocal; prices at pure-play online retailers are not always lower. This research examines differences in consumer willingness to pay for online purchases of functional and expressive products that differ in the length of product life, i.e. durable and nondurables at omnichannel versus pure play online retailers. Empirical analysis of consumer-centric, multi-site clickstream data of prices paid show that consumers are willing to pay higher prices for home goods products at omnichannel retailers compared to pure-play online retailers but differ for functional and expressive products. Implications are drawn to assist both omnichannel and PPO retailers in their pricing strategies.

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1. Introduction

The rapid adoption of the Web as a distribution channel has disrupted the retail industry with pure-play online (PPO) retailers dominating many product categories. Many commercial reports and academic research point suggest that lower prices at PPO retailers threaten the financial performance and viability of store-based retailers (Zimmerman, 2012). Store-based retailers have responded by offering consumers the ability to transact across multiple channels – brick-and-mortar stores, catalogs, kiosks, mobile apps, and/or web sites – and face the challenge of exploiting synergies across them. Omnichannel retailers (OC) are firms that are involved in selling merchandise or services to consumers through more than one retail channel (Levy and Weitz, 2009). Most researchers find that online channels offer lower prices than traditional brick-and-mortar stores because of the lower overhead costs associated with an online business compared to the operation of a physical store (Brown and Dant, 2014). However, published research examining prices for products at PPO retailers compared to online stores of OC retailers have been equivocal.

One set of research found that prices for books and CDs were not necessarily lower at online retailers (Bailey, 1998), while Tang and Xing (2001) saw that in the case of DVDs, prices and price dispersion at pure-play online retailers were significantly lower than prices at websites at OC retailers. Another study contends

that OC retailers have the higher prices compared to PPO retailers (Ancarani and Shankar, 2004). A survey conducted by Anthem Marketing Solutions, found that items priced under \$5 are cheaper online (Callard, 2014). Huang and Swaminathan (2009) found that price differences at PPO versus OC retailers are positive for some products and negative for others. A possible reason for these discrepancies in findings is that most empirical research on price comparisons across PPO and OC retailers have used posted prices on websites (Tang and Xing, 2001; Bayliss and Perloff, 2002) which may not reflect prices paid by any consumer since the researchers do not know if the product and price considered in their research sample was actually bought by any customer. PPO retailers change prices often by monitoring prices of other retailers, adding to the limitation of using posted prices as an indicator of the actual price paid by a consumer. To overcome this limitation, in this research, we focus on prices of products actually bought by customers at PPO retailers and websites of OC retailers which reflect the consumer willingness to pay (WTP) and not just advertised prices.

With increasing numbers of brick-and-mortar stores entering the online marketplace (i.e., operating in an omnichannel environment), it is unclear how PPO and the online channel of OC retailers compete in terms of price. Most studies that compared price differences between OC and PPO retailers have utilized a non-durable product (e.g., books and CDs) as the object of comparison, though it is unclear whether these results can be generalized to all product categories. Since consumer behavior toward channel selection and price preference vary depending on the product category, with significant differences between *durable* versus *non-durable goods* and *functional goods* versus *expressive goods* (Ailawadi et al., 2003; Inman et al., 2009; Kamakura and Du, 2012), it is necessary to recognize this critical factor.

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Functional products are defined as essential, utilitarian tools that enable the owner to achieve a goal or complete a practical task (Dhar and Wertenbroch, 2000) and are distinguished by their product characteristics, which can be evaluated prior to purchase (Nelson, 1970) and can be compared online. In contrast, expressive products are more likely to be evaluated in terms of sensory attributes and symbolic features, which are non-alignable and cannot be compared across alternatives; hence, they are more likely to be characterized by preference uncertainty. Expressive products include scarce and differentiated products (Tian et al., 2001) and may be used to express social standing, status, and group membership as well as the owner's unique lifestyle, values, and attitudes (Dittmar et al., 1995). In the case of expressive products, the evaluation and comparison of attributes across alternatives are based on consumers' special tastes and preferences rather than its functional utility (Berger and Heath, 2007). On the other hand, durable goods and non-durable goods are distinguished based on the product life. Products that last over 3 years are classified as durable goods and those with a life less than 3 years are classified as non-durable goods (Sullivan and Sheffrin, 2003).

Research on consumers' WTP for functional and self-expressive products is critical for retailer merchandising and product mix decisions, though there is a lack of literature on the topic. This research examines if online consumers are willing to pay more for functional and expressive products at OC versus PPO retailers and if it differs for durables versus non-durable products. To avoid confounding effects of product category-specific characteristics, we need to consider online purchases in a single vertical industry that includes durable (functional and expressive) and nondurable (functional and expressive) products. In developed countries, the purchasing of home goods is not only to satisfy functional needs, but also for expressing one's individuality, lifestyle, and identity. Therefore, in this study, we select home goods as the product category of examination as it encompasses the dimensions of durable, non-durable, expressive, and functional goods. Given the vast differences in product characteristics of durable/non-durable and functional/expressive goods, it becomes an interesting question to examine if there are differences in consumer WTP higher prices across OC and PPO retailers for these goods.

Specifically, this research investigates: (a) if there are significant differences in WTP for functional versus expressive products across online channels of OC and PPO retailers; and (b) if differences in prices paid for similar durable and nondurable products at websites of OC and PPO retailers differ for functional and expressive products. This study examines online purchases of home goods using clickstream transaction and browsing data at websites of OC and PPO retailers, a sample selection method sparingly used in the literature. Consumer-centric panel clickstream data from 50,000 US consumers and manually collected data on retailer channel information was used to examine our proposed objectives.

2. Background and hypotheses –

2.1. Effect of retailer type on WTP

Channel types differ in their abilities to perform various service outputs (Bucklin et al., 1996). Retail stores provide excellent opportunities for pre-purchase trial, instant gratification, personalized salesperson attention, and post-purchase services like return and exchange. Internet sites provide expanded accessibility, product information, and novelty (Grewal et al., 2004). Internet and demand-driven supply chain technologies create opportunities for cross-channel synergies. Since multiple complementary channels provide diverse service outputs than single-channel strategies, an

OC retailer can increase retailer trust and loyalty by increasing customer contact points by expanding both the quantity and possible combinations of service outputs (Miller et al., 1999).

Early research on pricing proposed that online markets have all of the characteristics associated with perfect competition suggesting that mean prices for similar products at PPO retailers would be low or approach the law of one price as in perfect competition (Bakos, 1991). Cost of changing prices on websites is low hence PPO retailers can adjust their prices frequently, sometimes several times during the day. This enables PPO retailers to undercut competitors and ensure that price-rankings for their products on comparison-shopping websites and search engines remain high thereby gaining market share (Bailey, 1998). In contrast, OC retailers can adjust prices on their websites to be competitive but changing prices as frequently as on websites on store shelves and checkout systems is time-consuming, labor-intensive and costly (Soper, 2015). Many OC retailers offer price-matching guarantees in-stores; most offer to match prices at their own online store or to selected competitors (usually Amazon.com) but only for those consumers who ask for it – a price-discrimination tactic to capture purchases of price-sensitive in-store customers. While prices for some products can differ across websites and physical stores of a OC retailer, in general, OC retailers have to maintain consistency in prices across their online and offline channels especially for featured products or products that consumers are likely to comparison-shop prior to purchase. Hence, OC retailers face a challenge in posting the lowest prices online if they cannot match it in-store.

PPO retailers are likely to have lower overhead costs associated with operating retail stores compared to OC retailers because of the lack of fixed costs such as real estate, utilities, insurance, and floor staff payroll (Zhang et al., 2010) and can achieve profitability at lower prices. Prices at OC retailers are likely to be higher due to higher operating costs and they need to maintain parity in prices for same products sold through their online and store channels (Zhang et al., 2010). As discussed earlier, empirical research on posted price differences between PPO retailers and the websites of OC retailers are mixed. One set of evidence show that prices charged by PPO retailers are lower than the online channels of OC retailers (Pan et al., 2004) whereas other studies point out that when adjusted for shipping costs, prices at PPO retailers were higher than the websites of OC retailers (Ancarani and Shankar, 2004).

In this paper we argue that consumers may be willing to pay higher prices at the online channel of a OC retailer for some types of products based on their perceived risk which will be function of product type and product life. For riskier purchases ordering online at OC gives them the ability to evaluate products in-store using sensory information of the chosen product compared to its alternatives in-store while taking delivery as well the optionality of getting warranties, after-sales service and return/exchanges for defective products at the physical stores of the OC retailer.

2.2. Effect of product type, product life, and retailer type on WTP

2.2.1. Product type

Most empirical research on prices at PPO and OC retailers have used search or functional goods like books, DVDs, electronics that are standardized and can be described/compared on objective features and attributes prior to purchase. However, these results cannot be extrapolated to expressive goods that are characterized by subjective, sensory and mostly non-alignable characteristics that are difficult to compare across alternatives. Expressive products are more likely to be evaluated based on non-alignable attributes which are not shared by all alternatives, hence comparisons and evaluations are more subjective and driven by

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