

# Winner's curse and parallel sales channels—Online auctions linked within e-tail websites

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## Abstract

A sample of 416 online auctions was examined to determine the extent of overpayment (winner's curse) where online auctions and e-tail websites were linked together to form a parallel sales channel. The results indicated that 8.7% of the highest winning online auction bidders exceeded e-tail posted reference prices of identical retail merchandise found at the same website. Significantly, such bids exceeded the reference prices by a mean percentage dollar amount of 14.1% thus suggesting the existence of a winner's curse. The results also indicated that (1) there was a significant negative association between reference price and mean percentage dollar amount overbid; (2) there was a significant negative association between auction lot size and mean percentage dollar amount overbid; and (3) there was no significant association between overtime auctions and mean percentage dollar amount overbid. While manipulation of reference price and auction lot size might minimize winner's curse, erratic or irrational behavior (by online auction and/or e-tail websites) may lead to disinformation.

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## 1. Introduction

Winner's curse, the phenomenon of buyers paying too much to win a bidding competition and experiencing buyer's regret, has plagued bidders in conventional auctions for years. Similarly, it persists among bidders who participate in online auctions. Given the relative proximity of posted reference price information, the existence of winner's curse among bidders participating in online auctions becomes particularly interesting when the online auction is associated with an electronic

retailer (e-tailer), that is, when the online auction is a component of a parallel sales channel.

Initially thought to be competitors, online auctions are increasingly becoming website partners with e-tailers; indeed, such a link appears to be a win-win situation for both seller and buyer (bidder). Online auctions attract attention and bring additional customers to the e-tail site while consumers are provided with an opportunity to obtain a bargain if they choose to participate in the auction. However, such is not always the case. Therefore, we decided to investigate the winner's curse when an online auction is a component of a parallel sales channel.

## 2. Winner's curse and online auctions

Winner's curse is well documented among participants in conventional auctions [2,4,7,29]. In essence, it

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occurs when an individual in a competitive scenario overestimates the worth of an item, then makes a bid and wins, yet in a sense actually loses by having paid more than the market value.

Value creation for customers is a core concept that successful organizations must embrace when marketing their products and services [22]. Yet when an individual experiences winner's curse, he or she does not have a value added experience but receives a value deficient experience. Such experiences promote customer dissatisfaction and the customers will not repeat the experience to become loyal customers; they may even damage the organization's reputation through negative "word of mouth" electronic communication. For example, Lightfoot [25] reported that "One disgruntled customer ... set up a Web site called Eggheadsucks.com to voice his opinion about what he saw as bad business practices. And other customers used online bulletin boards to complain loudly about Egghead.com's poor service."

When there is uncertainty about an item's value, the chance of experiencing the winner's curse increases [21]. However, because increased availability of information promotes decreased uncertainty, easy access to relevant information is critical in avoiding winner's curse. Because the Internet provides opportunity for buyers to collect pre-purchase comparative information, such as posted prices, it becomes an interesting place to test for the occurrence of the winner's curse phenomenon.

Mehta and Lee [28] found evidence of winner's curse in their study of Ubid, an online auction. Significantly, at the time of the study, it was not a component of a parallel sales channel, that is, it was not associated with an e-tail site. Thus Ubid auction participants had to search the web for reference prices. While their study did not address the winner's curse phenomenon specifically, Vakrat and Seidman [32] reported that "that there are few cases where probably uninformed shoppers bid for more than the catalog price"—that is, they noted that a few SurplusAuction participants had bid more than the posted reference price provided by Egghead, an e-tailer, via an external hyperlink. Thus SurplusAuction participants were specifically directed to the posted reference prices provided by Egghead.

Egghead subsequently merged with SurplusAuction and, thereafter, it became the primary operating entity. Thus, at the time of our study, Egghead was both an e-tailer and an online auction where both were internally hyperlinked together within a common website (Table 1). Stated otherwise, Egghead had posted reference prices for e-tail items internally hyperlinked

Table 1

Comparison of relationships between online auctions and e-tailers

Hyperlink between online auction and e-tailer	Accessibility of e-tail reference prices
None (no direct linkage)	Low (found by searching the web)
External (hyperlink between different websites)	Moderate (found at a different website)
Internal (hyperlink within same website)	High (found within same website)

with their online auction thus forming a parallel sales channel. Such convenient access of posted reference prices has benefits to both buyers and sellers. The e-tail price information gives bidders additional reference price information, which reduces uncertainty about the value of the auction merchandise.

Thus as bidder uncertainty decreased, we expected that confidence in the bidders' ability to avoid winner's curse increased. Providing access to posted reference price information was also an advantage to sellers. Bajari and Hortagsu [1] found empirical evidence that reducing uncertainty about the value of auction merchandise increased overall seller profits. Thus convenient access to posted reference price information was critical to efficient and effective website design [9,23,31,33,34].

### 3. Theoretical development

If posted reference prices reduce uncertainty about the value of merchandise, then the bidder is better able to avoid the winner's curse; in turn, the bidder will have no reason to be disloyal to the seller. Admittedly, erratic and irrational pricing behavior may create disinformation. The consequences of this are discussed in Appendix A.

To explain how bidders' may be influenced by posted reference price information, we consider Adaptation Level Theory [17]. This suggests that a stimulus is evaluated against the norm (what the customer finds usual). Thus, when bidders use the e-tail posted reference price information, their pre-existing memory-based reference price may be adapted by the e-tail posted reference price. Lichtenstein and Bearden [24] showed that this occurred. Specifically, merchant supplied reference prices may be assimilated into the buyer's perceived normal price range if the merchant's price is close to the highest perceived normal price. Thus, Egghead could easily adjust bidders' pre-existing internal reference prices and, in turn, reduce the uncertainty of the value for their merchandise (reducing

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