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Is hiding fair? Exploring consumer resistance to unfairness in opaque pricing

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ABSTRACT

The recent emergence of opaque websites and their implications in practice have been studied extensively. However, a less highlighted aspect of this distribution method is that it is a special form of price discrimination. Focusing on this aspect, the current study explores the reactions of potential customers subjected to an unfair situation created by the practice of opaque pricing. By utilizing a variation of the Ultimatum Game, the study found through analysis of variance (ANOVA) that approximately 30% of the respondents were willing to avoid a hotel that may be seen as unfair based on using the opaque method, despite sacrificing transaction value. Additional testing suggests that the results are robust when controlling for gender and familiarity with opaque websites. Implications and suggestions for future research are discussed along with the findings of the study.

1. Introduction

"Opaque" distribution of hotel rooms by online travel agencies (OTAs) is generally characterized by non-disclosure of key attributes of the hotel. In the opaque model (i.e. Priceline or Hotwire), customers choose a hotel based on general information regarding the area and quality (i.e. star rating) without specific details of the room type or brand. In lieu of the unavailable information, these rooms are usually sold at a discounted price.

As an intermediary, opaque websites allow consumers to stay in a hotel at a discounted price and hotels to utilize excess capacity without explicitly discounting the rooms. As illustrated in a series of televised commercials by Hotwire.com, the main argument for opaque websites is that the method allows for a win-win scenario for both primary trading parties. Consumers can gain a higher transaction value, while hotels can prevent brand and price erosion.

So far, the statistics seem to support this argument. The success of such opaque websites as third-party distribution channels has been gaining significant attention, especially in hotel and airline reservations and accordingly the mainstream media (Conlin, 2010). According to TravelClick (2011), opaque websites account for more than 12% of all hotel rooms booked through the Internet. The numbers also seem to indicate consistent growth, from 8.0% in 2006 to 12.2% in 2010 (see Fig. 1). The increasing share of opaque room bookings has led some prominent online travel agencies, such as Travelocity or Expedia, to add opaque features to their services, garnering significant attention in the business press (Elliott, 2010; Fowler, 2011).

This new mechanism, which allows for the potential reduction of hangover inventory, has received considerable attention from academics in terms of profitability (Shapiro and Zillante, 2009), accuracy of quality information (Guillet and Law, 2010), dynamic pricing strategies (Zouaoui and Venkateshwara Rao, 2009), how prices evolve over time (Abrate et al., 2012), mitigation of price competition through differentiation (Shapiro and Shi, 2008), and consumer searches for the lowest available rates (Law et al., 2007). The implications of such 'shady' room distribution through third party websites have also extended to research on the cost of room sales (Toh et al., 2011), room rate variance (Tso and Law, 2005), and price transparency of bundled trip packages (Tanford et al., 2011).

A less highlighted aspect of this new distribution channel, however, is that it is a special case of price discrimination (Shapiro and Shi, 2008). In the opaque model, customer segmentation is achieved on what is otherwise the same room product by websites intentionally 'shading' some key information about the product characteristics (Jiang, 2007). Thus, customers who are sensitive to these characteristics (*and* have a higher willingness-to-pay) will choose to purchase the product with full information (Shapiro and Shi, 2008). Although some believe that the opaque product with limited information may be perceived as a low-quality version of the product (Fay, 2008), the possibility of guests paying different prices to eventually consume an identical product (based on exogenous attributes) closely resembles the definition of third-degree price discrimination (Schwartz, 1990).

By acknowledging that opaque distribution is a special case of price discrimination, customer perceptions of the fairness of said practice come into the picture (Choi and Matilla, 2004; Kimes, 2002; Kahneman et al., 1986a). Customers' perceived fairness of the

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Fig. 1. Hotel booking shares by online channel. Adopted from TravelClick (2011).

transaction will likely influence their satisfaction with the products purchased (Kimes and Wirtz, 2003) or their loyalty to the product (Martin et al., 2009). Even though opaque channels offer viable means for price-sensitive consumers to seek alternative methods of booking, this distribution channel runs the risk of subjecting consumers to indirect price discrimination. As a form of price discrimination, customer perceptions of the fairness of opaque pricing practices have not been explored yet, while the reactions of customers who experience unfairness from opaque methods continue to remain hidden. Furthermore, it has been reported that opaque products and prices are sometimes disclosed, facilitating a direct comparison between the standard and opaque prices (Garrow et al., 2006).

The consequences of such disclosed information on indirect price discrimination is expected to be adverse. For example, Wu et al. (2012) used scenario-based questionnaires to examine the emotional responses of consumers when they are made aware that they are being subject to price discrimination through coupons. They found that consumers are likely to develop negative emotions, and indirect price discrimination was considered more unfair when the information was revealed post-purchase. In a similar context, Dixit et al. (2005) cites the price discrimination practices of Amazon, which resulted in a consumer backlash due to the heightened availability of price information.

Therefore the current study purports to explore this gap between practice and research, namely between the implementation of opaque product distribution for the hotel industry, which has seen formidable growth, and customers' perceptions of the fairness of such practices. Investigating customers' perceptions of fairness regarding the opaque sale of hotel rooms is important because it is relevant to hotel managers and owners and other hospitality firms who face decisions regarding their pricing strategy. One step further, examining reactions (to the unfair situation) would be more relevant to industry professionals in the short-term to the extent that it creates an economic anomaly (Thaler, 1988) where individuals may not pursue their best interest (or maximize measurable profit or utility), in contrast to the implications of previous studies on the long-term profitability of customer satisfaction and subsequent actions (Choi and Matilla, 2004, 2005). In order to jointly achieve this goal, we utilized a variation of the Ultimatum Game, which is a well-known classic experiment that tests the respondents' willingness to resist unfairness when a sacrifice of monetary value is involved.

2. Literature review

2.1. Ultimatum Game

The first documented experiment with the Ultimatum Game was conducted by Güth et al. (1982). In this rather simple

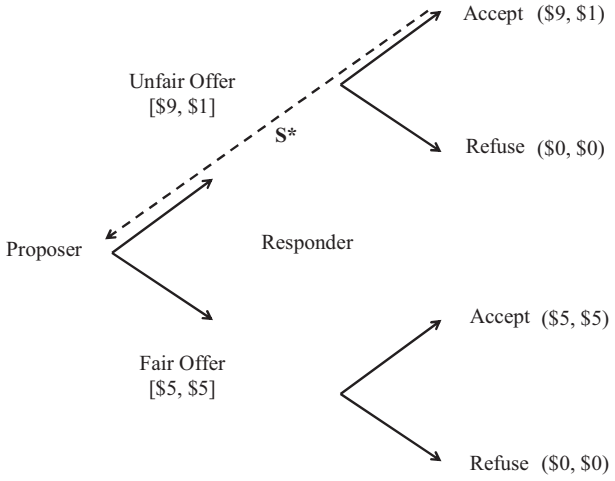

Fig. 2. Ultimatum Game in extensive form.

Ultimatum Game, two players are given the opportunity to split a predetermined sum of money (i.e. usually around $10 USD or similar denominations in other currencies). One player, named the proposer, makes a one-time offer to the other player, who is the responder. The responder has two options: to either accept or to reject the offer. If the responder accepts the offer, the two players split the monetary amount as suggested by the proposer. If the offer is rejected by the responder, then neither player receives anything. In the event of either acceptance or rejection the game is over. A single round of play is an important condition of the Ultimatum Game as players' expectations for future games would influence their strategy (Nowak et al., 2000).

The standard solution offered by game theory for the proposer is obtained by backward induction, illustrated as an extensive form game in Fig. 2 (Dutta, 1999). The initial offer by the proposer is represented on the first decision node and the proposer's strategy set is denoted as [Unfair Offer, Fair Offer]. The second decision node is that of the responder and the responder's strategy set is denoted as [Accept Unfair Offer, Refuse Unfair Offer, Accept Fair Offer, and Refuse Unfair Offer]. The final payoffs to the proposer and the responder are respectively displayed on the right-hand side, after the decision of the responder. Depending on the responder's decision, four possible outcomes can take place: $9 for the proposer and $1 for the responder, $5 each for both the proposer and the responder, and $0 each for both the proposer and the responder.

It is often assumed (and believed to be true) that utility refers strictly to an increase in money (Feenstra, 1986). Under the intuitive assumption that the responder's utility strictly increases with any trivial denomination of money, the responder's best strategy will be to accept any nonzero offer, be it $1 or $5, since by rejecting it the outcome will surely be $0. The proposer, knowing that any nonzero offer should be accepted by a utility-maximizing person, would try to offer the smallest denomination possible, represented as $1 in Fig. 2 (This offer could be $.50, $.10, or even $.01 as well.) The best strategies for the proposer and the responder therefore would be [Unfair Offer] and [Accept Unfair Offer], respectively. This is the standard game-theoretic solution to the Ultimatum Game obtained by backward induction, denoted by S*.

Many experimental economists have been dedicated to seeing whether the rigorous game-theoretic solution indeed holds in reality. In empirical efforts, however, the results have been disappointing. Regardless of the context in which the experiment was held, including culture, income level, and related incentives, about 50% of all respondents reject offers below 30% of the total monetary

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