Intern. J. of Research in Marketing 31 (2014) 434–443

Contents lists available at ScienceDirect

Intern. J. of Research in Marketing

journal homepage: www.elsevier.com/locate/ijresmar

Full Length Article

The effects of a "no-haggle" channel on marketing strategies

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ARTICLE INFO

Article history:
First received on July 20, 2012 and was under review for 13 months
Available online 25 June 2014

JEL classification:
M31
L11

Keywords:
Channel relationships
Pricing
Bargaining

ABSTRACT

As sellers increasingly turn to multi-channel retailing, the opportunity to implement different pricing policies has grown. With the advent of the internet, many traditionally bargained products such as automobiles, jewelry, watches, appliances and furniture are now being offered online at a fixed pre-determined price. We explore the strategy of simultaneously offering two pricing formats (fixed and bargained) via two different channels (online and brick and mortar) and find that in a market where there are two types of consumers—those with a high cost of haggling and others with a lower cost—a dual-pricing strategy is optimal only when there are enough high haggling-cost consumers, but not too many, and when the haggling costs between the two types of consumers are sufficiently different. We also find that it is optimal for the seller to specify a higher-than-cost minimum acceptable price as the price floor of bargaining. By doing so, the seller increases the bargained price by complementing the salesperson's bargaining ability, and also softens the internal competition between the two channels. Finally, we find that, surprisingly, the dual-pricing strategy may serve fewer customers while still being more profitable than a single price structure. The implications for consumer surplus are also explored.

1. Introduction

In many markets, bargaining is the norm. In the automobile market, consumers only infrequently pay the sticker price for a car. For products such as electronics, jewelry and furniture, while bargaining is not as overt as in the car market, consumers still expect to be able to haggle with salespeople, either directly on the sales price of the product or on service-related costs: chain retailers such as Best Buy and Sleep Country routinely bargain with in-store customers by offering them in-store discounts as well as additional services such as free delivery and extended warranties.

With the advent of the internet and the growing popularity of online buying, however, many manufacturers and retailers are now offering their products at fixed prices either through their own websites or third party sites, ostensibly addressing some consumers' dissatisfaction with bargaining and time spent visiting the physical store (Business Week, 2007). In the automobile market, third-party websites such as www.CarsDirect.com, www.Autobytel.com and the Canadian website www.unhaggle.com allow consumers to obtain price quotes (typically provided by several competing dealers) for the car of their choice. Consumers simply review the price and, if acceptable, the car is shipped to them directly. Best Buy and other large retailers continue to allow bargaining on the shop floor even though the prices on their websites are fixed.[1] High end stores, such as Cartier and Zales for jewelry and Ethan Allen for furniture, have recently introduced online shopping that, like the online auto-buying websites, allow consumers to avoid haggling and visiting the physical store. In some cultures, such as in Asia, where haggling is traditional even for small-ticket items including clothing, food and home appliances, the growing use of the internet has led to many retailers launching their own web-stores or joining online aggregators such as Taobao (China's leader in e-commerce), where typically prices are fixed and cannot be bargained over.

Despite the growing opportunity for sellers to use multi-channel settings to simultaneously implement different pricing policies, there is significant variation across and within industries in the extent to which this strategy has been adopted, for which the extant literature does not provide a satisfactory explanation. There have been numerous studies examining a seller's choice between a fixed-price format and a bargaining format (e.g., Riley & Zeckhauser, 1983; Wang, 1995; Arnold & Lippman, 1998), all of which focus on a seller's choice of one pricing format over another and do not consider the possibility that the seller may want to offer both simultaneously. In all of these studies, in choosing a fixed, no-bargain price, a seller must weigh the cost of giving up the ability to discriminate through bargaining in favor of the higher prices it is able to charge consumers who can no longer haggle. In these studies, offering a fixed price is an equilibrium strategy under

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[1] According to www.slybaldguys.com, "…managers (of Best Buy) have goals that their teams have to meet and managers that manage the slower times have a harder time of meeting these goals, thus they are more willing to negotiate."

http://dx.doi.org/10.1016/j.ijresmar.2014.06.002
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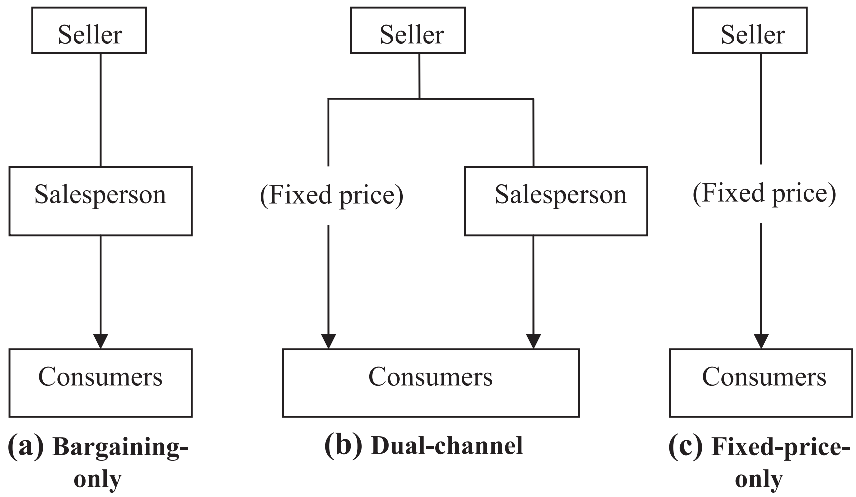

Fig. 1. Three channel structures.

such conditions as the seller being able to make a credible commitment to a fixed price strategy (Riley & Zeckhauser, 1983), or the buyers' bargaining abilities being, on average, sufficiently high (Arnold & Lippman, 1998), or the operating cost of implementing a bargaining strategy being too high (Wang, 1995). While these findings give us some insights into the benefits of fixed pricing over bargaining, this is different from a situation where consumers have the option to *choose* between the two different pricing formats. As a result, we do not have a clear understanding of why and when a strategy of simultaneously offering bargained and fixed prices is optimal.

Our objective is therefore to answer the following questions. When is it optimal for a seller to bargain, offer a fixed price, or to use a mix of the two via two different channels and given the optimal choice, what prices should the seller set in each channel? To answer these questions, we develop a model where we diverge from the existing literature to allow both pricing formats (bargained and fixed prices) to be offered simultaneously via a dual distribution system so that consumers can self-select into a channel that maximizes their utility. We model the interaction of three parties: (1) a seller that can sell via bargaining in a brick and mortar store, or at a fixed-price online, or both, (2) a salesperson who bargains over price in the physical, brick and mortar channel on behalf of the seller, and (3) the consumer who incurs a "haggling cost" if she decides to bargain. Thus, we consider three potential channel structures: the conventional bargaining channel that allows for face-to-face haggling with the consumer (Fig. 1(a)), a "dual channel" that offers consumers a choice between a fixed price and a bargained one (Fig. 1(b)), and a fixed-price-only channel (Fig. 1(c)).

One distinct feature of our model is that it allows the salesperson's commission to be based on the difference between the sales price and a seller determined "minimum acceptable price".[2] This is in contrast to the existing literature (Basu, Lal, Srinivasan, & Staelin, 1985; Misra, Coughlan, & Narasimhan, 2005) where the commission is based on the difference between the sales price and the marginal cost of the product. Thus, rather than imposing the constraint that the marginal cost of the product represent the lowest price the seller is willing to accept, we treat the bottom line of bargaining as a strategic variable that may be equal to or higher than marginal cost. This flexibility that the seller now has in setting the lowest bargaining point for the salesperson serves two purposes: first, it raises the salesperson's threat point and allows the sales representative to commit to a higher price during bargaining (Cai & Cont, 2004; Gatehouse, 2007), and second, it controls the cost information on which the bargaining is based and helps the seller reach a more favorable bargaining outcome (Wilken, Cornelißen, Backhaus, & Schmitz, 2010).

Our model yields several interesting findings. First, a dual channel is optimal if there are (i) two types of consumers in the market – those with a high cost of haggling and those with a lower cost – and (ii) a high enough proportion of high haggling cost consumers whose cost of haggling is sufficiently different from the low haggling cost customers. Second, we find that it is optimal for the seller to specify a higher-than-cost minimum acceptable price above which it pays the salesperson a commission. While a higher price floor means that the salesperson fails to reach agreements with more buyers (e.g., those with valuations above marginal cost but below minimum acceptable price), the seller still finds it optimal to do so. The lower the salesperson's bargaining ability, the greater the seller's incentive to set a higher minimum acceptable price. The minimum acceptable price also serves to soften the internal competition between the two channels. Third, surprisingly, under certain conditions a dual-channel seller may serve fewer customers while still making a higher profit than under a single-channel structure, i.e., either a bargaining-only or fixed-price-only channel. This is because the minimum acceptable price set in a dual channel is higher, allowing the seller to charge a higher fixed price, which in turn helps the salesperson achieve a higher price in the bargaining channel. Finally, we find that no one channel structure is ideal for every customer: the bargaining-only channel generates the greatest surplus for low haggling-cost and low-valuation consumers, while the fixed-price-only channel generates the greatest surplus for high haggling-cost consumers. Overall, the fixed-price-only channel generates the highest surplus, the bargaining-only channel the lowest, while the dual channel stands between the two.

The contribution of our study lies in two domains. First, we contribute to the channels literature by identifying the conditions under which we would observe a dual channel structure in a market where bargaining is the norm. This is distinct from the existing dual-distribution literature where the addition of a channel does not involve implementing a different pricing format from the original channel (e.g., Moriarty & Moran, 1990; Chiang, Chhajed, & Hess, 2003; Kumar & Ruan, 2006).

A second contribution of our research is to the pricing and bargaining literature, where we explore a means by which the seller

[2] Empirical evidence of a minimum acceptable price can be found in the automobile industry, where the invoice price for vehicles effectively plays the role of a minimum acceptable price because consumers typically observe a vehicle's invoice price through websites such as www.edmunds.com, www.autobytel.com and the Kelly Blue Book, and they view this as the dealer's true cost. In reality, the invoice price is different from the actual cost the dealer incurs. This is because of hidden incentives offered to the dealer by the manufacturer that are not reflected in the invoice price. This includes incentives such as special allowances, dealer cash, dealer holdback and discounts, all of which the dealer may choose not to pass on to the consumer (Besanko et al., 2005).