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Wine Online: Search Costs Affect Competition on Price, Quality, and Distribution

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Abstract

A fundamental dilemma confronts retailers with stand-alone sites on the World Wide Web and those attempting to build electronic malls for delivery via the Internet, online services, or interactive television (Alba et al. 1997). For consumers, the main potential advantage of electronic shopping over other channels is a reduction in search costs for products and product-related information. Retailers, however, fear that such lowering of consumers' search costs will intensify competition and lower margins by expanding the scope of competition from local to national and international. Some retailers' electronic offerings have been constructed to thwart comparison shopping and to ward off price competition, dimming the appeal of many initial electronic shopping services. *Ceteris paribus*, if electronic shopping lowers the cost of acquiring price information, it should increase price sensitivity, just as is the case for price advertising. In a similar vein, though, electronic shopping can lower the cost of search for quality information. Most analyses ignore the offsetting potential of the latter effect to lower price sensitivity in the current period. They also ignore the potential of maximally transparent shopping systems to produce welfare gains that give consumers a long-term reason to give repeat business to electronic merchants (cf. Alba et al. 1997, Bakos 1997).

We test conditions under which lowered search costs should increase or decrease price sensitivity. We conducted an experiment in which we varied independently three different search costs via electronic shopping: search cost for price information, search cost for quality information within

a given store, and search cost for comparing across two competing electronic wine stores. Consumers spent their own money purchasing wines from two competing electronic merchants selling some overlapping and some unique wines.

We show four primary empirical results. First, for differentiated products like wines, lowering the cost of search for quality information reduced price sensitivity. Second, price sensitivity for wines common to both stores increased when cross-store comparison was made easy, as many analysts have assumed. However, easy cross-store comparison had no effect on price sensitivity for unique wines. Third, making information environments more transparent by lowering all three search costs produced welfare gains for consumers. They liked the shopping experience more, selected wines they liked more in subsequent tasting, and their retention probability was higher when they were contacted two months later and invited to continue using the electronic shopping service from home. Fourth, we examined the implications of these results for manufacturers and examined how market shares of wines sold by two stores or one were affected by search costs. When store comparison was difficult, results showed that the market share of common wines was proportional to share of distribution; but when store comparison was made easy, the market share returns to distribution decreased significantly. All these results suggest incentives for retailers carrying differentiated goods to make information environments maximally transparent, but to avoid price competition by carrying more unique merchandise.

(Buyer Behavior; Competitive Strategy; Internet Marketing; Price Sensitivity; Retailing)