PRICE MATCHING REFUNDS AS SIGNALS OF LOW PRICES? EFFECT ON STORE CHOICE AND PRICE SEARCH BEHAVIOR

Joydeep Srivastava and Nicholas Lurie*

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*Joydeep Srivastava is Assistant Professor and Nicholas Lurie is a doctoral candidate at the Haas School of Business, University of California, Berkeley, CA 94720-1900.
Introduction

Marketing researchers have expended considerable effort in studying the behavioral and psychological aspects of price (e.g., Monroe 1973). Research suggests that there is no simple explanation of how price and price-related strategies influence consumer price perceptions (Monroe 1990). However, much of this research is concerned with either the price-quality relationship (e.g., Erickson and Johansson 1985) or the effects of reference price on consumer perceptions (e.g., Winer 1988). Further, these studies typically focus on consumer price perceptions for individual products or brands (Arnold, Oum, and Tigert 1983).

In contrast, consumer perceptions of overall store prices has received relatively less attention in the literature. Perceptions of store prices are not only an important aspect of overall store image but are also critical determinants of store choice (Buyukkurt 1986). Recognizing that the overall price image is a critical factor in store choice, retailers employ a variety of nonprice- and price-related strategies in an effort to influence consumer store choice and limit their price search.

One such strategy that retailers use is to advertise that they will not be undersold. Often these advertisements are accompanied by a price-matching offer which typically takes the form of a refund. For example:

“Our price-matching policy guarantees you the lowest price. In the unlikely event that you find an identical item that you purchased here for a lower price at another store, we will gladly refund the difference.”

or,

“We promise to refund the difference if you find that you could have bought the same product cheaper locally at the time of purchase and call within 90 days.”

Such price-matching refund policies are common in undifferentiated and homogeneous retail environments. In such environments, price is the primary basis of competition and retailers may try to position themselves as the low price leader. Despite their prevalence in both industrial and consumer markets, price-matching policies have received relatively little attention in the literature.

The few studies which examine price-matching refunds have focused on two explanations: oligopoly coordination and price discrimination. The oligopoly coordination explanation of price-matching refunds is that such policies reduce firms’ incentives to lower prices unilaterally thus circumventing the prisoner’s dilemma problem and decreasing price competition (e.g., Kalai and Satterthwaite 1986). Salop (1986) suggests that firms may view price-matching policies as a means to collude and raise prices to monopoly levels. In this
conceptualization, price-matching policies lead to higher overall prices with adverse consequences for consumer welfare.

The price discrimination rationale, on the other hand, argues that price-matching refunds are used to screen consumers based on their cost of information (Png and Hirshleifer 1987). This explanation assumes that consumers differ in terms of search costs (opportunity cost of time). Since refunds can be claimed only by consumers who can show that a lower price is available elsewhere (i.e., those consumers who have low search costs and are well-informed), consumers with high search costs (i.e., the ill-informed) are charged higher prices.

While the oligopoly coordination and price discrimination arguments offer firm-based explanations for the existence of price-matching refunds, they ignore the effect of such pricing policies on consumer decision making. The purpose of this study is to explore this significant gap in the literature and focus on price-matching policies as a retail strategy from the perspective of the consumer. This research thus extends existing literature by examining how consumers view and interpret price-matching refund policies. Specifically, we examine the effect of price-matching policies on consumers’ store choice and price search behavior.

**Conceptual Background**

Many consumer purchases are made in conditions in which buyers are uncertain of the specific price of a particular product (Grewal and Marmorstein 1994). This is particularly true of infrequently purchased durables. Given the uncertainty over product price, there is always a risk that consumers may purchase a product only to later find it being sold for a lower price. A retailer’s offer to match prices allays this perceived risk by providing redress if, in the near future, consumers find the same product for a lower price either on sale at the same store or at a different store.

Retailers may also use a price-matching policy as an indicator of overall low store prices or as a means of gaining market share from competitors. Articles in the trade often postulate that firms offer price-matching refunds to initiate price competition. It is important to note that retailers can offer price-matching refunds regardless of whether their prices are actually lower than those of competitors. For the consumer, the presence of a price-matching refund policy may lead to inferences that overall store prices are low. One rationale for such an inference could be consumers’ “schemer schema” (their intuitive theories about retailers’ influence tactics, see Wright 1985). The fact that a retailer is willing to match prices and thus undertake a potential liability may convince consumers that the retailer offers low prices. However, price-matching policies, like other pricing strategies that affect price perceptions, are likely to be most effective in influencing price perceptions when consumers are not motivated or are unable to make precise and comprehensive price comparisons (Alba et al. 1994).

To the extent consumers use price-matching refunds as signals of low prices, such pricing strategies affect store choice and price search behavior. Consider a consumer who is uncertain about the specific price level for a durable she wishes to buy. While her objective may be to purchase the item for the lowest price available in the market, there is a tradeoff between the
expected gain from finding a lower price and the cost of searching additional stores. In such a scenario, how will a price-matching refund policy advertised by a store affect initial store choice and subsequent price search behavior?

**Price-matching Refund.** The extent to which price-matching refunds are viewed as signals of low prices should be manifested in at least two ways. First, when confronted with initial store choice, the likelihood of visiting a particular store which offers a price-matching refund should be greater than when no store offers a refund. Second, given that consumers associate price-matching refunds with low prices, it is likely that the presence of a refund may discourage them from searching for a better price. Alternatively, it is also possible that price-matching policies encourage consumers to intensify their search for lower prices. The effect of price-matching refunds -- whether it increases or decreases consumers’ price search behavior -- may depend on their search costs and price uncertainty (price dispersion).

**Search Costs.** While research clearly suggests that price search decreases as a function of search cost, it is not clear how the interaction between search cost and price-matching refund will affect search behavior. A possible outcome is that price-matching refunds will have a greater influence on search behavior when the cost is high than when it is low. Another possibility is that price-matching refunds may decrease search behavior when search costs are high but may increase search behavior when search costs are low.

**Uncertainty (Price Dispersion).** Research also suggests that price search increases as a function of price dispersion because of the increase in expected gains from additional search. It is however more interesting to examine the effect of price dispersion in conjunction with price-matching refund and search costs. It is likely that the presence of refund will decrease price search the most when both search costs and price dispersion are high. Alternatively, it is also possible that a refund will increase price search when search cost is low and price dispersion is high and decrease price search when search cost is high and price dispersion is low.

**Empirical Work**

The competing predictions regarding the effect of price-matching refunds, search costs, and uncertainty were tested in a 2 (refund: present and absent) x 2 (search costs: high and low) x 2 (uncertainty: high and low) between-subjects experiment. 160 undergraduate subjects participated in the experiment for course credit. The experiment involved a computer shopping simulation specifically developed for this research. Subjects’ initial store choice, order to store visits, number of stores visited, amount of time spent shopping, and actual as well as perceived payoffs were observed to examine the effects of price-matching refunds on initial store choice and price search behavior.