

## Different Channel – Different Price? INVESTIGATING THE PRACTICE OF MULTI-CHANNEL PRICE DIFFERENTIATION

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### Different Prices in Online and Offline Channels: Higher Profits or Irritated Customers?

Price differentiation has long been recognized as a strategy that companies can use to increase profits when consumers' tastes and valuations of a good price vary. Companies engaging in price differentiation have the opportunity to increase profits considerably compared to those which use a uniform pricing strategy. Accordingly, it should be beneficial for companies to exploit the possibility of charging different prices in online and offline channels as they offer different shopping benefits and are differently valued by consumers. Nevertheless, it can be observed that some multi-channel retailers prefer to charge uniform prices in online and offline channels. They argue for consistent prices across distribution channels to maintain a strong brand – and because varying prices may lead to customers' confusion, anger, irritation and perceptions of price unfairness.

#### How Retailers Engage in Channel-Based Price Differentiation – Evidence from Two Studies Conducted in Germany

In two studies (study 1 in 2005, study 2 in 2006), the online and offline prices were monitored for a total of 2,742 products that were sold by 115 retailers in diverse industries and retail stores in a major German city.

Both studies revealed that multi-channel retailers engage in channel-based price differentiation (30 % of the retailers in study 1 and 60 % in study 2). The charged prices varied between the online and offline channels for 20.55 % of the 1,080 products analyzed in study 1 and for 34.40 % of the 1,662 products in study 2. The extent and direction of price differentiation fluctuated according to retailer and product category.

A greater number of retailers consistently charge more in offline than in online contexts than vice versa, but most companies pursue a mixed strategy (75 % in study 1 and 92 % in study 2) – that is, these retailers charged higher prices both online and offline. For the products with price differentiation, the price offline was higher in 73.42 % of the cases in study 1 and in 62.98 % of the cases in study 2. Table 1 gives an overview of the major findings.

	Study 1	Study 2
Percentage of retailers engaging in channel-based price differentiation	29.63 %	29.63 %
Percentage of products with price differentiation	20.55 %	34.30 %
Percentage of products with higher offline prices given price differentiation	73.42 %	62.98 %
Percentage of retailers always charging higher prices offline if engaging in price differentiation	18.75 %	5.41 %
Percentage of retailers always charging higher prices online if engaging in price differentiation	6.25 %	2.70 %
Percentage of retailers following mixed strategy if engaging in price differentiation	75.00 %	91.89 %
Mean absolute extent of price differentiation given price differentiation (%)	12.33 %	16.06 %

In both studies, the highest positive relative price gaps (offline is more expensive than online) can be found for consumer electronics. In contrast, high negative relative price gaps can be observed for products belonging to very different product categories (online is more expensive than offline) in both studies. Examples for such products are eye creams (EUR 19.90 online versus EUR 7.90 offline), sneakers (EUR 159.90 online versus EUR 79.95 offline) and canned food (EUR 1.79 online versus EUR 0.99 offline). On average, online prices in both studies are lower than offline prices.

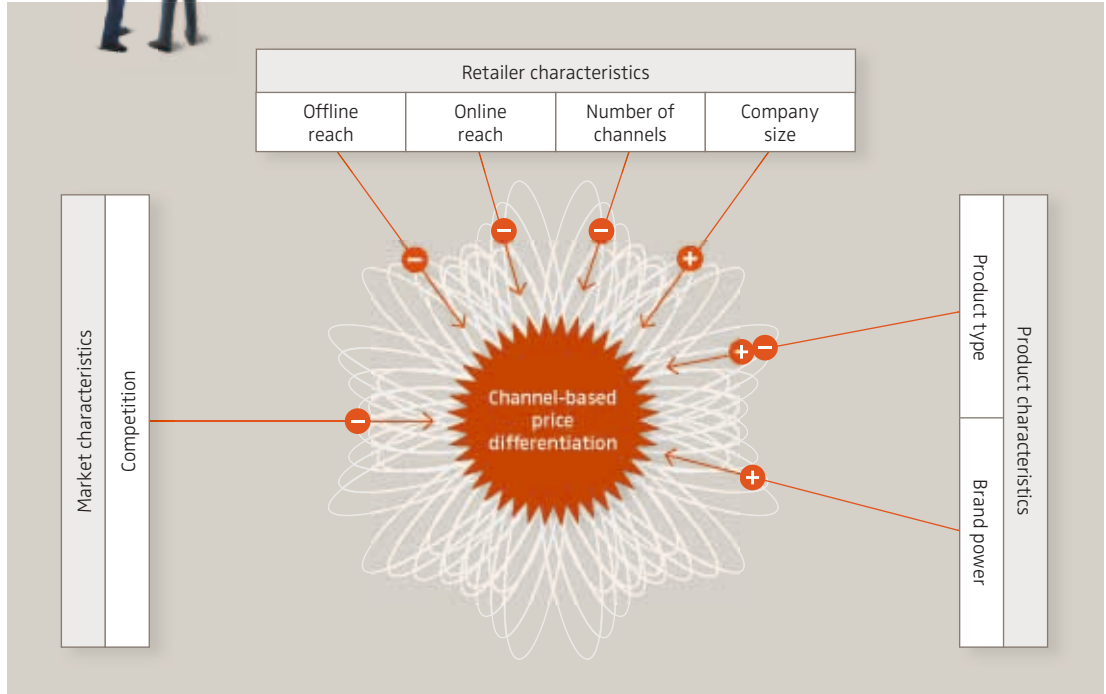
#### What Factors Favor Channel-Based Price Differentiation?

By means of a regression analysis, the study 2 data was used to analyze factors that influence a company's decision to engage in channel-based price differentiation and its extent. Figure 1 summarizes the main factors and their influence.

**TABLE 1:**  
Summary of the Descriptive  
Results of the Two Studies



**FIGURE 1:**  
Factors Influencing Occurrence  
and Extent of Channel-Based  
Price Differentiation



- > High levels of **online competition** decrease the probability that a multi-channel retailer will engage in channel-based price differentiation and decrease the price disparity between channels. This suggests that retailers do not decrease their online profit margins, due to higher competition online. In contrast, it seems that retailers instead benefit from a higher number of similar websites, maybe because it increases consumers' familiarity with online purchasing using the given retailer format.
  - > Greater offline **reach decreases** online prices relative to offline prices. A high number of offline branches allow consumers to switch easily from online to offline channels. Therefore, a multi-channel retailer with many offline branches is not able to successfully charge higher prices in his online channel.
  - > **Online reach** has a significant negative effect on the probability of observing differential prices and the size of the price gap. As consumers become more familiar with the online environment and the costs associated with their switching to the online channel decrease, the likelihood of the existence of price differentiation between the two channels also decreases.
  - > The **number of distribution channels** of a multi-channel retailer has been shown to have a negative influence on the probability and extent of channel-based price differentiation, implying that with a higher number of distribution channels, price differentiation across channels becomes less likely due to the complexity of channel coordination. This might also be due to the fact that most other channels (e.g., catalog or telephone sales) share more characteristics
- » A greater number of retailers consistently charge more in offline than in online contexts than vice versa, but most companies pursue a mixed strategy. «

with the online than with the offline channel, thus making the latter subject to more channel switching and thereby reducing the retailer's ability to successfully charge higher prices in the online channel.

- > Both *company size* and *brand power* have positive influences on the relative size of the price gap. It is likely that larger companies have a higher incentive to migrate their consumers to the online channel, as they are better able to exploit the cost advantages associated with that channel. As a result, they may be more motivated to charge higher prices offline. Further, companies may have an incentive to charge lower prices online for brands with a high brand visibility (measured as the number of Google hits for the brand name), because those brands' prices can be more easily compared to competitors' prices online and may in addition serve as visible signals of the retailer's overall price positioning.
- > Further, *product type* impacts the extent of price differentiation. Channel-based price differentiation is highest in the case of services, which are less subject to the jeopardy of reselling. Within goods, non-durables (food) exhibit a higher degree of channel-based price differentiation than durables (housewares), again indicating that retailers engage less in price differentiation for products that are appropriate for resale. Interestingly, a lower level of price differentiation was found for clothing than for entertainment (e.g., books, DVDs). Given that clothes, in particular, need to be physically examined before purchase and are thus not equally suitable for online and offline sales, this is surprising. At the same time, there are higher levels of price differentiation for electronics than for cosmetics, even though one would expect the former product category to be equally appropriate for online and offline buying.

### Key Findings and Their Implications

The results indicate that channel-based price differentiation exists, but it seems that it still has a rather limited practical relevance for retailers. The observed price gap of 12 – 16 % reflects, in general, the differences in consumer channel valuation, but this gap is rather low compared to other types of self-selection price differentiation such as quantity-based price differentiation or quality-based price differentiation.

However the two studies were conducted during different time periods and seem to point out that retailers increasingly engage in channel-based price differentiation. At the same time, those retailers offering differentiated prices seem to move from a unifying price differentiation strategy towards a mixed price differentiation strategy, where they make the price differentiation decision on a product-by-product basis.

Besides using the internet as an additional distribution channel, there is potential for companies to further explore this channel by engaging in channel-based price differentiation.

However, because a low online reach helps to separate markets and foster channel-based price differentiation, the increasing popularity of the internet as a marketplace for retailers leads to fewer opportunities to use this channel for price differentiation. Nevertheless, the possibility exists that with the increasing popularity of the online channel, companies may decrease the number of offline branches and thus preserve their ability to engage in channel-based price differentiation due to a lower offline reach.

The findings further indicate that a higher level of online competition online does not necessarily lead to lower prices in the online channel. In contrast, it seems that retailers benefit from a higher number of similar websites, which supports the notion that multi-channel retailers are not necessarily price takers, but do have the power to influence their prices. Therefore, retailers do not necessarily suffer margin losses when they open an online channel. •

#### KEYWORDS:

Price Differentiation,  
Multi-Channel Pricing

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