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Executive Summary

Customer Cognitive Appraisals of Differential and Dynamic Pricing

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Dynamic pricing is commonly used in service industries such as travel and hospitality, and is currently a growing phenomenon in the retail, particularly for electronic goods. Dynamic pricing algorithms enable companies to extract additional customer surplus by targeting customer-specific willingness-to-pay. In contrast to simpler forms of differential pricing, where prices differ based on one or two criteria, such as the day of the week or demographic segmentation, dynamic pricing uses many criteria and leads to constant price fluctuation. Thus, to the customer, the prices may seem individualized. When customers are price disadvantaged, meaning they have received a price higher than the price other consumers have paid, they might experience feelings of being exploited by the company. Customers may also have difficulties understanding the mechanisms behind the price fluctuations, in other words they perceive price complexity. Feelings of being exploited or perceptions of high price complexity could lead the customer to partake in negative behaviors such as negative electronic word-of-mouth, which can lead to widespread reputational damage. This paper presents the results of a customer focus group and quantitative study and provides evidence that customers perceive dynamic pricing in a more negative light than differential pricing. Furthermore, intentions to spread word-of-mouth online are driven by different mechanisms depending on the product category. For goods, the feeling of being exploited by the company compels online word-of-mouth, whereas, for services, price complexity perceptions are the driving force. Customers are not yet accustomed to dynamic pricing in the context of goods and therefore feel exploited when prices fluctuate in their disfavour, which leads them to spread negative word-of-mouth. In contrast, customers are more familiar with fluctuating prices in many service industries, including travel and hospitality. Therefore they spread online word-of-mouth to attempt to understand how algorithms work and learn to use the pricing criteria to their advantage. Consequently, a suggestion for managers, particularly for the sales of goods, would be to implement differential pricing using one to two criteria in favour of dynamic pricing. Differential pricing

still extracts customer surplus but is more transparent and straightforward, making it more understandable to the customer and lowering feelings of being exploited. If the implementation of dynamic pricing is to be pursued, managers should at least consider mitigating strategies.