Bargain or waste of money? Consumers don't always agree

October 23 2006

Once consumers buy an item, it is often difficult for them to get rid of it, even if it makes rational sense to do so. This is even the case if those purchases might include shoes that cause blisters or clothes that no longer fit, said Erica Okada, an assistant professor of marketing at the University of Washington Business School. In their minds, she said, it would be a "waste" of good money to throw a purchased item away, even if the money has already been spent and further use of the item isn't going to bring the money back.

In a study published in this month's *Journal of Marketing*, Okada found that in markets where there are frequent, successive introductions of new and enhanced products, consumers who have bought an older model have a similarly difficult time upgrading to a new version.

"Consumers don't always seek value in a consistent or rational way as economists assume they do," she said. "For example, in upgrading from a portable MP3 player purchased a few years ago to a newer one with more enhanced capabilities, the consumer wouldn't necessarily have to get rid of the old one, but the old one would presumably no longer be used once a new model is purchased. In effect, the old one would become redundant and be taken out of commission, which would again, be a 'waste' of good money."

According to Okada, it's the psychological cost of upgrading that hinders the purchase of newer models by consumers who have an older model. But for consumers who are first-time buyers, she found there are no psychological barriers preventing them from buying the newest model.

"People keep a mental account of the costs and benefits over time," she said. "As the cumulative enjoyment from consumption increases, the consumer gets his or her money's worth from the purchase. The account is closed once the consumer finishes using the product. If an upgrader purchases an enhanced product, he or she will no longer use the existing product, which triggers the closing of that mental account. There is a psychological cost associated with closing the existing account before consumers have gotten their money's worth out of the existing product."

For the paper, Okada did a number of studies to test her theory, including what consumers would be willing to pay for new cell phones in different situations. She asked 179 cell phone users how much they would pay for a new phone, either as an upgraded model or as a replacement purchase. On average, the users perceived the new phones to be superior to the phones they already owned. In the replacement scenario, participants were asked to imagine they had lost their existing phones. This created a situation in which there would be no existing phone to become obsolete as a result of the new purchase, and would resemble a new purchase because there would be no mental cost. Ninety people were assigned the replacement condition; 89 to the upgrade condition.

People in the replacement purchase group were willing to pay considerably more for the phone than were people who would purchase the phone as an upgrade. That makes sense, said Okada, since people in the replacement condition effectively had no working phone and the new phone's marginal benefit would presumably be greater. Replacement buyers were also willing to pay more for the new phone when they thought the features of their existing phones were made better. However, in the upgrade group people were willing to pay more for a phone with new features than they were for phones offering improved features. For example, a new cell phone with a camera feature would be more appealing than one with improved sound quality to a consumer who already has a phone without a camera.

These findings demonstrate how the decision-making process is different when there is a mental cost vs. when there is not, and they apply to the comparative preferences of upgraders vs. first-time buyers, she said. First-time buyers do not incur any mental cost in purchasing a new model, and upgraders do.

Okada theorizes that marketers can introduce an enhanced product to consumers by adding new features or improving existing features, and because the decision-making is different for those who upgrade vs. first-time buyers there is a difference in the relative preference for the two types of product enhancements. Adding new features would be more attractive to upgraders, and improving existing features would be more attractive to first-time buyers.

"There are intrinsic differences between a consumer who already has a product and is considering an upgrade, and a consumer who is purchasing for the first time," she said. "The existing assumption is that they would be the same, but in actuality the first-time buyer may have more to gain marginally because he or she starts out with nothing and may be less knowledgeable about the product category."

Source: University of Washington