

Is the deal on? Study shows why herd mentality best mode for group buying sites

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We might like to think we're not influenced by other people.

But a new study into group buying mechanisms -- like those used on popular internet websites such as Groupon and LivingSocial -- reveals that telling buyers who come later to the offer how many have already signed up increases the number of purchasers.

Researchers at the University of Toronto's Rotman School of Management wanted to understand why group buying sites that have entered the market recently have enjoyed greater success than those operating a decade ago, such as Mercata and MobShop. Earlier attempts typically left potential buyers waiting for days before confirming whether or not they had got the offer they had signed up for.

"We think one of the reasons group-buying has been successful recently is because of the short time horizon," says Rotman Prof. Ming Hu, who co-wrote the study with Prof. Mengze Shi and PhD student Jiahua Wu. "It allows for a herding effect."

Another reason is the use of an information structure that discloses to later arrivals how many have already signed onto the deal.

Researchers looked at two ways of designing the purchasing mechanism for a group buy: a simultaneous mechanism, where no one knows how many buyers have come before them, and a sequential mechanism, where a second group of buyers has the advantage of knowing the size of

the first group.

The researchers' analytical model shows the most successful mechanism is the sequential one because it eliminates uncertainty for those coming later to the deal, and improves the confidence of those who sign on early, as they're able to track the numbers of those who come after them.

"That boosts confidence," says Prof. Hu, who teaches operations management. Deals for "luxury" services, vs. everyday items, work better in a group buy scenario because they offer consumers a greater benefit.

Group buying sites have become increasingly popular recently, but group buying has appeared in various incarnations for hundreds of years. The website Kickstarter.com links artists with potential buyers who can contribute to the artist's proposed project. If enough buyers commit to financially support the project, the project goes ahead. Musicians such as Beethoven and Mozart used the same mechanism to sell tickets to their concerts.

Group buying has also been used to obtain discounts -- if enough [buyers](#) commit within a certain timeframe, they can obtain a substantial cut on the regular price. Although a hallmark of most [group buying](#) sites is that committed money is refunded if the deal gets called off, purchasers still experience a "psychological loss" when that happens, and may be more willing to sign on to a deal they feel is guaranteed to happen.

Provided by University of Toronto, Rotman School of Management

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