Pricing Prototypical Products

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Abstract

When we think of colas, Coca-Cola first comes to mind. Products such as Cola-Cola, Tide laundry detergent and Chapstick lip balm are the prototypical products in their respective categories. Over three decades, research in consumer psychology has accumulated evidence on how prototypicality influences memory, shapes the composition of consideration set and affects purchase decision. Yet there is no research on how it changes the competitive behavior of firms in a horizontally differentiated market. For example, some prototypical products are lower priced than other products in their category, whereas in certain other categories the prototypical product is higher priced. We propose a novel model of spatial competition, where the prototypicality of a product influences the probability of the product being included in consumers’ consideration sets without affecting the product’s valuation. Using the model, we examine theoretically the impact of prototypicality on the pricing decisions of competing firms. Our analysis shows that when consumer valuations are low, the prototypical product charges a lower price and yet earns more profits compared to other products in the category. However, when consumer valuations are high, the rank order of the prices of the prototypical product and a nonprototypical product is reversed, but not the order of profits. We subject these predictions to an empirical test. The experimental results lend support for the qualitative predictions of the model.

Keywords: Prototypical Product, Pricing, Competition, Experimental Economics, Game Theory.