

# **“FREE SHIPPING” OR “DOLLAR OFF”? THE MODERATING EFFECTS OF LIST PRICE AND E-SHOPPING EXPERIENCE ON CONSUMER PREFERENCE FOR ONLINE DISCOUNT**

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## **ABSTRACT**

The use of online shopping has grown exponentially over the last decade. Although traditional and internet shopping behaviors are similar in some ways, there are some significant differences. To this end, this paper investigates the role of different types of pricing discounts in shaping consumer evaluations when shopping online. In particular, we examine the moderating effects of the list price value and online shopping experience on the consumer evaluation of “free shipping” and “dollar off” discounts. Past research suggests that the free shipping offer will be more attractive than the dollar-off offer when they are of the same economic value. This study contributes to our understanding of research by examining the moderating effects of changes in list price and the consumers’ online shopping experience. The results of the quasi-experimental design suggests that the free shipping offer works better than a dollar-off discount for lower-priced goods, but there is no difference between the two for higher-priced goods. Additionally, seasoned online shoppers are more receptive to both types of pricing discounts, no matter the list price, than are novice online shoppers.

**Keywords:** Free Shipping, Dollar Off, E-Shopping Experience

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## **1. INTRODUCTION**

E-commerce has grown exponentially over the last decade in the USA and around the world. Among the items sold online is books, electronics,

furniture, clothing, food, beverages, and healthcare products. Today's marketplace is becoming more internet-oriented as source of information, making comparisons, and purchasing products. Although traditional and internet shopping are similar in some ways, there are several fundamental differences. For example, search cost is low over the internet but consumers often have to pay for shipping costs when purchasing tangible products, something that is not a factor when purchasing these same products at a store. Another example is the timing of a discount offering during a site visit. It has been shown that the timing of a discount offer in the course of a site visit is an important factor in internet shopping<sup>1</sup> but not in in-store shopping. Due to these apparent dissimilarities, it is not always possible to transfer the knowledge of traditional marketing to internet marketing. To this end, this paper investigates the effect of the type of discount offering on potential customers when shopping online.

Research has shown that discounts are a very useful way to boost sales. Consequently, managers must often decide how to offer a discount. Discounts can take the form of price reductions ("dollar off" or "percent off" coupons or rebates), free shipping and handling, or quantity discounts ("buy four, get one free"). So what types of discounts are most likely to attract online shoppers? This paper explores the perceived value associated with the two types of discount framing: "dollar off" coupons and free shipping. We also examine the moderating roles of list price (high versus low) and online shopping experience (novice versus experienced) on consumer evaluations of both types of discounts.

## **2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT**

When shopping for goods online, consumers must consider the additional cost of shipping charges. These charges may be included in the list price (all-inclusive pricing), or added separately as a shipping and handling fee. The strategy of dividing the price into two mandatory charges is called "price partitioning."<sup>1</sup> Price bundling research has compared the effect of all-inclusive to partitioned pricing. Morwitz, Greenleaf and Johnson<sup>1</sup> show that price partitioning makes the transaction appear less expensive than all-inclusive pricing. Xia and Monroe<sup>2</sup> examined price partitioning in an online context. Their research suggests that shipping and handling charges usually discourage purchase intention. When those charges are small, a percentage presentation of the surcharge will not enhance purchase intention to a dollar amount presentation. Schindler, Morrin and Bechwati<sup>3</sup> compared the effect of the consumer's perception of fairness within the price partitioning versus all-inclusive pricing context. They found

that people who are shipping charge skeptic will prefer a bundled price but non-shipping charge skeptics will prefer unbundled formats in the presence of external reference points.

In their study of price partitioning, Bertini and Wathieu<sup>4</sup> found that separating price into two mandatory charges can draw more attention to the secondary (non-focal) part of the transaction. They suggest that when consumers evaluate an all-inclusive price, they pay more attention to the focal point of the transaction (e.g., DVDs, books) and will often overlook secondary attributes. When consumers are faced with a partitioned price, they will pay more attention to these secondary attributes (e.g., shipping and handling, delivery time).

This research focuses on this question when the secondary attribute (i.e. shipping) is thought to be free. We also investigate the effect of perceived gain in focal attribute (price off in dollars) and perceived gain in non-focal attribute (free shipping). Chandran and Morwitz<sup>5</sup> suggest that discounts are more closely related to the original price of the product than free promotions are. This difference makes the “free promotions” offer more salient and thus less susceptible to negative contextual information or quality.

The “free” phenomenon was also investigated by Shampanier, Mazar and Ariely<sup>6</sup>. They propose that consumers process the word “free” differently than any other perceived gain condition. A series of experiments showed that people reject even a better monetary option (which they “should” choose according to the rational cost-benefit model) in favor of the free option. This suggests that zero prices are a special condition that cannot be explained by the traditional cost-benefit model. Although the authors examined this phenomenon from a pricing perspective, (zero price of a lower quality good verses low price for a high quality good), this can presumably be extended to discounts. The authors claim that when Amazon offered free worldwide shipping, sales soared. Sales did not increase in France, however, where there was still a fee for shipping. This implies that the amount of the free offer does not matter as much as the word “free.” From this, it follows that “free shipping” would be perceived more positively than an equivalent discount on the list price. Shampanier et al.<sup>6</sup> attributed the cause of this “free” phenomenon to “affect” which says that the free option does not have any downside (there is no cost) and thus is always positively evaluated. In the internet shopping context, when a consumer is offered “free shipping,” the product itself still needs to be purchased. So, it is not exactly the same as a “free” product. Huang and Han<sup>7</sup> have also suggested that free shipping is still a preferred type of discount and can stimulate e-economy in less developed areas of e-business.

There has been limited research on the effectiveness of free shipping promotions on online purchases. However, one stream of research focuses on the retailer's side and the other on consumers' side. Shao<sup>8</sup> looked at the shipping policies from the retailer's and supplier's perspectives and found that free shipping is almost always better than calculated shipping. Moreover, customers prefer free shipping. Meng, Zhang, Li and Rong<sup>9</sup> focus on how free shipping schedule affects ordering strategies when demand for commodities is uncertain. Hua, Hou and Bian's<sup>10</sup> proposed model relates optimal shipping strategy to return service charge (RSC) and concluded that when decisions about these two are taken simultaneously, retailers are better off. Therefore, free shipping is often accompanied by higher RSC and vice versa.

The other stream of research on free shipping focuses on customers. A major concern for online retailers is consumer abandonment of online shopping carts, in large part because of high shipping costs<sup>11</sup>. Therefore, the consumers' perspective must be addressed. The authors<sup>11</sup> developed an optimization model that integrated a conditional free shipping promotion (customers were given free shipping if they exceeded a threshold value) with inventory policies to maximize profitability. Other researchers have examined the effects of different types of shipping discounts and promotions on consumers' online purchasing behavior. Lewis<sup>12</sup> examined the impact of shipping fees on order incidence and order size. His study suggests that higher shipping fees reduce online store traffic and that order size incentives (i.e. shipping fees are waived once a specific order size is reached) increase order sizes. Tan, Ho and Tan<sup>13</sup> compared membership free shipping (MFS) and contingent free shipping (CFS). They concluded that MFS lead to higher profit than CFS when expedited shipping is offered. Lantz and Hjort<sup>14</sup> explored the impact of free delivery and free returns on the purchasing and return behavior of actual e-customers. Their findings suggest that delivery policies are positively associated with order frequency. Chatterjee and McGinnis<sup>15</sup> found that free shipping offers increased the consumer's perception of price fairness more than dollar-off promotions did, particularly for online promotions that were customized to only a segment of the market. Chatterjee<sup>16</sup>, however, did not consider free shipping per se, but rather explored the role of different types of online sales promotions (dollar-off and shipping discounts) in perceived surcharge inflation among skeptical and non-skeptical consumers. The results suggest that shipping charge skepticism is an important segmentation variable for determining the effectiveness of different types of online promotions.

Koukova, Srivastavam, and Steul-Fischer<sup>17</sup> examined consumer responses to flat rate and threshold-based free shipping. In the latter,

retailers charge a fixed fee but waive the shipping fee once an order has exceeded a specific dollar amount. Order value and justification for the shipping fee structure were included as moderators of the effect of shipping fee structure on consumer response. More recently, Huang and Cheng<sup>18</sup> examined the appeal of piece-based over dollar-based thresholds for free shipping. The appeal of piece-based thresholds over dollar-based thresholds was moderated by the presence or absence of shipping charge information and by the use of time restrictions (short- or long-time restrictions). Li and Dinlersoz<sup>19</sup> looked at the use of shipping menus by different e-retailers. Shipping menus provide consumers with shipping options that are based on delivery time and cost. Essentially, faster shipping options are more costly, and designed for customers who value faster delivery. Their study suggests that larger, better-known internet retailers are more in line with quality-based price discrimination theory; whereas smaller retailers offer fewer shipping options and tends to provide slower shipping services. Frischmann, Hinz and Skiera<sup>20</sup> suggest that online retailers' use of partitioned pricing involves two strategies that lead to higher gross prices. Their findings suggest that online retailers take advantage of consumers' biases by offering either free shipping for more expensive products or by charging higher fees for shipping.

Researchers have investigated the influence of price discounts in a price bundling context. Multiproduct bundling is the selling of two or more products or services at a price that is equal to, or lower than, the combined prices of each product<sup>21</sup>.

For most bundled offers, two or more products are sold together. One is usually the focal product and the other is a tie-in (less valued) product. The utility of the tie-in usually depends on the focal product. For example, game consoles are often packaged with a bundle of games or an extra controller, which could be purchased separately to use the game console. In our context, the tie-in service (shipping and handling) means nothing without the focal product, yet it is necessary to deliver the product to the customer.

Yadav and Monroe<sup>22</sup> concluded that it is better to give discounts on the more important product in a bundle to increase the perceive value of the offering. This result was based on a weighted additive model. Zaniszewasky and Cunha<sup>23</sup>, however, suggest that consumers tend to use a reference-dependent model when evaluating the offer. Therefore the discount should be given to the product in the less-valued portion in the value function. In a series of three experiments the authors<sup>23</sup> showed that consumers preferred an offer with a discount on the less-valued product to a similar offer with a discount on the valued product.

In this paper, the “free shipping” option should always be preferable, because shipping would be considered of lesser value than the product or service itself. At the same time, unlike the product bundles, the shipping service does not provide anything of value to the customer if purchased separately from the focal product, since it is just a way to use the focal product. It means that the utility of this service depends entirely on the focal product. Because of the large associated differential weight, it is possible that consumers see these prices holistically, meaning they think of the total price to get the product. Moreover, shipping is always viewed as a loss. The magnitude of the loss is greater when shipping is a substantial portion of the whole price. For example, if a consumer spends \$15 for a DVD and \$5 for shipping, he will perceive a greater loss than if he spends \$30 for a set of DVDs and \$5 for shipping. In the first case, he is spending 33.33% of his money on the shipping and in the latter case he is spending 16.67%. So, we would expect that offering “free shipping” in the first case will bring a more positive evaluation of the offer. Moreover, if a price discount of the same amount is offered for a \$15 DVD, a consumer will evaluate the offer by combining the two parts of the total cost. First, there is a perceived gain if there is \$5 off but there is also a \$5 loss to pay for shipping. The seminal paper by Kahneman and Tversky<sup>24</sup> explains that losses loom larger than gains. Therefore, we would expect this offer to be evaluated less positively than a “free shipping” offer. In the case of a \$15 DVD, free shipping worth \$5 will be perceived as a big gain. The same happens when the DVD is priced at \$30 with a \$5 discount. A small gain for the dollar off and a small loss for free shipping (with respect to base price) are perceived.



**Figure 1.** Research Framework: The moderating effects of product price and online shopping experience on the consumer’s evaluation of discount offers.

From this discussion, we expect the list price of the product to be a moderating factor in determining the effectiveness of the discount format (Figure 1). We expect consumers to evaluate free shipping offers more positively than the dollar-off discount for lower-priced products compared to higher-priced products when the two types of discounts are of equal monetary value. Thus,

H1: Given an equal monetary value between the two types of discounts, the “free shipping” offer will be viewed as more appealing than the “price discount” for low-priced goods compared to high-priced goods.

We then examine the differences in individual experience in the evaluation of the offer. One of the main differences between a novice and an experienced online shopper is that novice shoppers are less used to the idea for paying shipping for light, small articles. Thus, it is a greater loss for them than for the more experienced shopper who is accustomed to this shipping charge and is more likely to accept it as a normal part of online shopping. This being the case, when free shipping is offered to a more experienced shopper, he is more likely to notice the discount offer. However, when the free shipping discount is offered to a novice shopper, it will matter less since the consumer was not expecting to pay for shipping in the first place. Thus, we expect the “free shipping” offer to be more attractive to experienced shoppers than novice shoppers.

In terms of the “dollar off” scenario for the focal product offer, the more experienced shopper will evaluate the discount positively and will not be caught off guard by being charged for shipping fees when checking out. The novice online buyer, however, will at first evaluate the discount positively but will perceive more of a loss when the shipping fee is added. We therefore expect the experienced shopper to have a more positive impression of the “dollar off” offer than a novice shopper would. Hence,

H2: Given an equal monetary value between the two types of discounts, experienced online shoppers will perceive discounts more favorably than novice online shoppers.

### 3. RESEARCH METHODOLOGY

The purpose of this study was to examine the moderating roles of list price and online shopping expertise on the consumer’s evaluation of discount framing. Participants were undergraduate students ( $n=93$ ) from a large urban Canadian university. Students were from the engineering faculty; 23% were female and 77% were male. Participants were randomly assigned to one of four conditions in a 2 (high versus low list price) x 2 (free

shipping versus dollar-off discount framing) experimental design. They were then asked to imagine that they were shopping online for a DVD of a show that they were interested in. They were shown a web-based shopping cart listing the product's price along with the discount information (Figure 2). The participants were then asked to complete a survey to evaluate the offer. The high price product condition was \$35 for a three-DVD box set, whereas the low price product condition was \$15 for a single DVD. Participants were offered either \$4.99 worth of free shipping or were offered a discount of \$4.99 off the listed price.



**Figure 2.** Example of online shopping pricing scenario (Low price/Free shipping)

**Dependent measure:** Participants were asked to evaluate the offer using three 7-point scale items (1 = very unattractive, 7 = very attractive), to indicate how much would they agree with the statement "It was a good deal" (1 = not at all, 7 = very much), and to indicate whether they believed the offer represented a "good buy" (1 = strongly disagree, 7 = strongly agree).

**Independent measure:** Online buying experience was measured using three 7-point scale items. They were asked the frequency of their online purchases (1 = never, 4 = once every 4 months, 7 = once every 15 days), the number of products they had bought online in the last year (1 = none, 4 = 3 products, 7 = more than 10 products), and the number of online transactions



(including paying for downloaded content) they had made over the last year (1 = none, 4 = 5 transactions, 7 = more than 15 transactions).

Table 1 presents an overview of the descriptive statistics for the independent and dependent variables.

**Table 1.** Descriptive statistics

Variables	Mean	SD	Cronbach's Alpha
Evaluation of Offer	3.91	1.32	0.87
Online Buying Experience	4.34	1.74	0.92

## 4. RESULT

### 4.1 The Discount Frame Effect

The first hypothesis proposes that the participants will evaluate the free shipping offer more positively than the dollar-off discount for the \$15 product than for the \$35 product. An ANOVA was run to test this hypothesis. An examination of the main effects for price and discount type on the evaluation of the offer indicates that both were statistically non-significant ( $p > 0.05$ ). This also suggests that the two treatment price conditions were similarly attractive to the participants. The effect of two price levels (high and low) is ( $F(1, 89) = 2.814, p = 0.09$ ). The effect of discount (free shipping and dollar off) is ( $F(1, 89) = 1.9, p = 0.17$ ). However, the result found a significant interaction effect of price and discount type ( $F(1, 89) = 5.882, p < 0.01$ ). Therefore, hypothesis 1 is supported. At the low price, participants found free shipping ( $M = 4.67, SD = 0.294$ ) to be more attractive than dollar off ( $M = 3.67, SD = 0.262$ ). However at the high price, the evaluation of free shipping ( $M = 3.58, SD = 0.256$ ) did not differ much from dollar off ( $M = 3.86, SD = 0.256$ ). This result is shown in Figure 3.



**Figure 3.** The interaction of price and discount type on evaluation of product offer

## 4.2 The E-Shopping Experience Effect

The second hypothesis states that online shopping experience has a positive moderating effect on the evaluation of both free shipping and dollar-off discounts. To test this hypothesis, a tertiary split of the “online buying experience” variable was performed. Thirty-four participants were categorized as novice online shoppers (below 33 percentile) and 30 were categorized as experienced online shoppers (above 66 percentile). As there was no significant effect of price (from previous analysis), we ran the analysis by merging the two groups with different price levels and same discount format. The result shows a statistically significant difference in evaluation between experienced ( $M = 4.40$ ,  $SD = 1.26$ ) and novice users ( $M = 3.46$ ,  $SD = 1.25$ ) in the “dollar-off” condition ( $F(1, 28) = 4.566$ ;  $p < 0.05$ ). Despite directional support, the difference between the Novice ( $M = 3.59$ ,  $SD = 1.02$ ) and Experienced ( $M = 4.22$ ,  $SD = 1.28$ ) groups in the “free shipping” condition was not statistically significant ( $p = 0.159$ ). Overall, there was directional support and some statistical support for hypothesis 2. This result is shown in Figure 4.



**Figure 4.** The interaction of online shopping experience and discount type on evaluation of product offer

## 5. DISCUSSION

This study has examined the moderating roles of list price and online shopping experience on the evaluation of free shipping versus dollar-off discounts. The results provide general support for the model and the two hypotheses. As expected in hypothesis 1, the value of the list price has a moderating effect on the consumer's evaluation of the type of discount being offered. There was a stronger preference for the free shipping option for the lower-priced product, but no preference between the two types of discounts for the more expensive product. In both cases, the monetary value of both discounts was the same. The familiarity of consumers with online shopping also affected their evaluation of the discount. Our results suggest that experienced consumers evaluated the dollar-off discount more favorably than novice users did. This may be because experienced consumers expect to pay shipping charges and thus they do not perceive it as bigger loss, unlike novice online shoppers who do not expect to pay for shipping. For novice consumers, however, the perceived loss of a shipping cost weighs against the perceived gain of the dollar-off discount on the list price, tempering their favorable evaluation of the online offer. In the free shipping condition, experienced online shoppers expected to pay but did not have to pay (perceived gain). On the other hand, novice online shoppers did

not expect to pay and did not pay (no loss or gain). Whereas the data did not provide statistical support for this part of the hypothesis, there was directional support.

## 5.1 Managerial Implications

The current study has important and direct managerial implications. Many factors affect the online shopping experience and ultimately the purchase decision. The direct impact of this study is that managers' manipulation of shipping fees for different list prices to make evaluations of the offer more favorable. They can also manipulate the types of discount (free shipping vs. dollar off) to increase their return on the same investment. When, giving a discount, managers should provide free shipping for product with a low list price and dollar-off discount for products with a high list price. Managers may manipulate this offer even more by segmenting customers according to their familiarity with online shopping (customized promotion offer). This will directly optimize the sales of the products. Therefore, this study contributes to the better understanding of retail application.

## 5.2 Limitations and Future Research

There are several limitations to this study. One is that only two list prices were used, and it is unclear whether the moderating effect would occur for different price points. In addition, the study was done with a sample of students, so caution should be used in terms of generalizing the results to a larger consumer base. Future research should repeat the study with different list prices in a broader population.

Future research should also investigate the offer of a discount offered in the form of a "free gift." It would be interesting to compare shoppers' reactions to "free gift" and to "free shipping." Another possibility is to examine the effect of speed of the shipping on the evaluation. Future research may also focus on variations (if any) of the perceived quality of the products when the product is tied to different discount frameworks.

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