Pay what you want – a new pricing strategy for wine tastings?

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Abstract

“Pay What You Want” is a pricing strategy where buyers pay any desired amount for a given commodity, sometimes including zero. Giving buyers the freedom to pay what they want can be very successful in some situations, because it eliminates many disadvantages of conventional pricing e.g. the fear of whether a product is worth a given set price and the related risk of disappointment.

In Germany most often wine tastings are free despite of the associated costs. However, often visitors feel obliged to buy some bottles of wine even though they are not in favor of this wine. Hence, dissatisfaction might occur. Hence, other strategies have to be developed in order to cover the costs but reducing the risk of dissatisfaction. In this context we want to discuss the possibility to introduce “Pay-What-You-Want” pricing in the German wine business. We will first provide a literature overview. Afterwards we will combine these findings with existing example.

Key words

Pay what you want, wine tasting

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Introduction

“Pay-What-You-Want” (PWYW) is a recently emerging pricing scheme in which a good is up for sale and the buyer, should he decide to buy, chooses the price to pay for it. A famous example, which illustrates its attractiveness to a seller, is the release of the band Radiohead’s album “In Rainbows” in 2007, which at the time was highly anticipated. Fans were able to download the album from the band’s website for any price they chose, including zero. Standard economic theory predicts that the rational decision for the buyer would be to pay nothing and get the album for free. However, hundreds of thousands of fans chose to pay a positive amount for the album, and the band in fact profited from this pricing format, making more money than from digital downloads of all their other studio albums combined.

Because PWYW is still an innovative pricing instrument, it has not yet been widely used. So far, PWYW has been applied in several varied areas, such as gastronomy (e.g., Sobo Bistro, Sydney; ‘Wiener Deewan’ in Vienna and ‘Lentil as Anything’ in Melbourne), hotels (e.g., IBIS Singapore), and music (e.g., Radiohead, Girl Talk). In practice, PWYW is implemented either as a short-term or long-term pricing tool. Evidence exists that PWYW persists even in the long run (Kim et al. 2010; Rienert and Traxler 2012). Despite these successful examples there are also PWYW ventures which have not been as successful. For example, ‘Terra Bite Lounge’ in Seattle returned to a fixed-price scheme after adopting PWYW for a period of time.

Although formal PWYW situations have only recently emerged and the pricing scheme is not yet widespread, the same principle of choosing what to pay is in fact found in another common phenomenon that is tipping. In many countries, it is a social norm for good restaurant (or other) services to be rewarded with a good tip from the customer. Although in this case the service has already been provided, just like PWYW the customer is under no obligation to pay an amount above zero. Despite this, the level of the tip is often above this minimum. (Kim et al 2013)

Overall, PWYW is a pricing strategy where buyers pay any desired amount for a given commodity, sometimes including zero. In some cases, a minimum price may be set, and/or a suggested price may be indicated as guidance for the buyer. The buyer can also select an amount higher than the standard price for the commodity. Giving buyers the freedom to pay whatever they want can be very successful in some situations, because it eliminates many disadvantages of conventional pricing (Kim et al 2013).

Buyers are attracted by permission to pay whatever they want, for reasons that include eliminating fear of whether a product is worth a given set price and the related risk of disappointment. For sellers it obviates the challenging and sometimes costly task of setting the “right” price. For both, it
changes an adversarial conflict into a friendly exchange, and addresses the fact that value perceptions and price sensitivities can vary widely among buyers (Schons et al. 2014).

In Germany nearly 20% of all wines sales are directly sold. Hence, customers have to be attracted to the wineries. As a result most often wine tastings are for free despite of the associated costs. However, often visitors feel obliged to buy some bottles of wine even though they are not in favor of this wine. Dissatisfaction might occur. Hence, other strategies have to be developed in order to cover the costs but reducing the risk of dissatisfaction. In this context the aim of our paper is to discuss the possibility to introduce “Pay-What-You-Want” pricing in the German wine business.

Literature overview

Pay-what-you-want pricing (PWYW) is the most extreme form of participative pricing where a buyer has full control over the price setting. Sellers must accept any price, even if it is below their costs or zero (Kim et al., 2009). Besides the famous Radiohead example, this relatively new pricing strategy has been implemented in many areas including music, restaurants, accommodation, and soccer clubs (Mantraris, 2008; Isaac et al., 2010; Riemer and Traxler, 2012; Gautier and Klaauw, 2012). To explore the reasons behind the apparent success of these PWYW examples, studies have been done using experimental economics, field experiments as well as empirical data.

Neoclassical theory predicts that customers take full advantage of the PWYW offer and pay zero prices. However, particularly experimental economics can show that this is not always the case (Forsythe et al. 1994). Experimental research has shown that behavior is influenced not only by monetary calculations but also by social preferences. Participants in such experimental games frequently choose not to maximize their material payoff when social influences are present. For example, recent experimental research on ultimatum games has found that first movers (the proposers) tend to offer more to their counterparts than non-cooperative game theory would predict (Roth 1995; Fehr and Schmidt 1999; Bolton 1991). Empirical results from ultimatum games show that the modal offer is observed to be half the endowment. Researchers interpret this finding as a behavior that conforms to the fairness norm (Roth 1995; Rabin 1993). It was also found that responders tend to reject offers that are below 20% of the endowment, even though this is somewhat irrational because a small amount is still better than nothing. This is interpreted as a reaction of punishment to the unfair offers.

A variant of the ultimatum game, the dictator game, additionally controls for strategic behavior, as the responders must accept any amount offered by the proposers (Bohnet and Frey 1999b). Although the offers were lower in the dictator game than in the ultimatum game, on average, proposers still allocated money to the responders, a behavior that was interpreted as altruistic and fair (Andreoni and Miller 2002; Forsythe et al. 1994; Bolton et al. 1998). In contrast to dictator game results, applications of PWYW pricing have revealed that free riding is even by far less common when customers receive a product in return: in the studies conducted by Kim et al. (2009), free riding (in terms of paying a zero price) could not be observed in any of the 1,452 observed transactions. This is in line with observations in the context of self-pigging flowers, where free riding is also rare (Münch 2011). The vast majority (over 80%) of people pigging flowers are paying the flowers they took (Wöhler 2009); however some negative examples exist, too (Hansen 2003).

However, as further research suggests, outcomes are not only affected by altruism and fairness but also by varying conditions in the dictator game. Interestingly, several researchers have found that subjects behaved less selfishly as they varied the degree of social distance between the subject and experimenter as well as between the subjects (Andreoni and Bernheim 2009; Hoffman et al. 1994; Hoffman et al. 1996; Bohnet and Frey 1999a; Charness and Gneezy 2008). For instance, Hoffman et al. (1994, 1996) showed that the dictator game was sensitive to whether or not the participants believed that their behavior was being monitored by the experimenter. They found that selfishness increased with anonymity. Bohnet and Frey (1999a) varied the degree of social distance between the dictator and recipient and found a higher allocation when the dictator was provided with more information about the recipient’s identity, leading to a more personal interaction. Another important condition refers to the stake size. Some experimental game studies have also shown that an increase in stakes leads to a less-than-proportionate increase in the money allocation. The evidence in the literature is, however, only partially consistent. Findings in this area are still controversial and require deeper analysis (Kim et al. 2013).

Different theoretical approaches can be used to provide a psychological reasoning behind these surprising results: Heyman and Ariely (2004) for instance derive two categories of human interactions: economic exchange relationships and social exchange relationships. Whereas

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1 This chapter is based on comprehensive literature reviews conducted by Khasay and Samahita (2014); Kim et al. (2013), Schons et al. (2014).

2 In the ultimatum game, two participants interact in allocating an endowment. The proposer suggests that a fixed amount of the endowment be allocated to the responder, with the balance of the endowment retained by the proposer. The responder can then either accept or reject the proposal. If the responder decides to reject, neither of them receives anything.

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economic exchange relationships are guided by market norms, social exchange relationships are guided by social norms of cooperation, reciprocity, and fair distribution. PWYW dissolves the typical market exchange relationship between buyers and sellers and transforms the relationship into a situation where behavior is guided by market as well as social norms. Sellers who implement the PWYW pricing mechanism demonstrate procedural fairness (Xia et al. 2004) by offering the customer the opportunity to determine the price. This operational benevolence signals sellers’ “fiduciary motivation ‘to place the customer’s interest ahead of self-interest’” (Sridharmukh et al. 2002, p. 18), helping to prime customers’ preferences to act fairly (Maxwell et al. 1999). If a customer decides to free ride by not paying for the product she received, this violates social norms of a fair exchange.

Based on the theory of exchange relationships (Heyman and Ariely 2004) and zero pricing (Shampanier et al. 2007; Nicolau 2012; Palmeira 2011), Kim et al. (2009) and Regner and Barria (2009) showed that paying nothing may result in distress and social disapproval by other people as the relationship between buyer and seller is less governed by market exchange norms and more by social norms, such as norms of distribution or norms of reciprocity. Kim et al. (2009) further showed that social preferences such as fairness and reference prices play a significant role under PWYW conditions. In the context of customers’ “price decisions in PWYW for the first purchase customers set as price equivalent to the Dictator Game endowment, which Schones (2013) calls the “range of fair prices.” This range assumes that customers set prices paid in relation to subjective upper (not paying too much) and lower (not paying too little) limits of fair prices (Carter and Curry 2010).

Pricing research has widely recognized that customers evaluate the adequacy of so-called seller-supplied prices on the basis of mental references (Monroe 1990). These so called internal reference prices (IRPs) are memory-based and provide price information that customers apply as benchmarks in subsequent price encounters (Kalupurakal 1994). IRPs also serve as anchors when determining prices in participative pricing (Kim et al. 2009). As IRPs are strongly related to customers’ willingness to pay (Northcraft and Neale 1987), Schons (2013) posits that IRPs mark the upper limit of customers PWYW price range. Turning to the lower limit of prices to pay, the PWYW rules would allow customers to pay zero prices. In line with the past literature on the dictator game as well as on PWYW applications, Schons et al. (2014) argues that most customers refrain from exploiting PWYW to the full extent. Further, customers are aware that paying zero prices induces a loss for the seller, which makes it impossible to sustain the PWYW offer. A lasting PWYW offer, however, allows customers to regularly pay below conventional market price. Consequently, frequent shoppers in particular should be interested in a sustained PWYW offer and actually consider sellers outcomes when determining the price to pay. Concerning the precise value that marks customers lower price limit, past research shows that customers derive ideas of fair prices on the basis of cost estimates

(Sinha and Batra 1999). The principle of dual entitlement (Kahneman et al. 1986) suggests that customers accept sellers to use cost-related arguments to justify prices (Dickson and Kalupurakal 1994). Further, Kim et al. (2010) argue that the intention to return to the focal seller is another incentive to pay a price that exceeds the estimated costs: by paying a price below the estimated costs, the buyer might fear that the PWYW offer will not be sustained in the long run. Thus, cost estimates constitute the lower limit of the range of fair prices.

In summary, a PWYW pricing scheme does attract nonzero payments. While as expected some PWYW consumers under-pay, there are also situations in which the average price is in fact higher compared to other fixed-price schemes, and the purchase rate lower. In some cases PWYW results in an increase in the seller’s revenues. Kahsay and Samahita (2014) conducted a comprehensive literature review. Their findings are reported in the top half of Table 1. In the second part of Table 1 they attempted to explain the success of PWYW in terms of the market conditions which allow this pricing scheme to succeed.
### Results of PWYW Studies

<table>
<thead>
<tr>
<th>Paper</th>
<th>Method</th>
<th>Results of PWYW Studies</th>
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<tbody>
<tr>
<td>Goutier and Klaasen (2012)</td>
<td>Field experiment</td>
<td>NYOP scheme attracts individuals with low-pro-social-reputational concerns and results in lower average price. Charity component increases demand under PWYW relative to a high fixed price. PWYW results in lower demand than a low fixed price, explained using identity and self-image concerns. PWYW prices are significantly greater than zero; PWYW can increase seller's revenues. Tipping is motivated by reciprocity and reputation concerns. Customer's tipping history determines researcher's effort level. Consumers pay more than minimum and even higher than suggested price, explained in terms of reciprocity. Payments are positive, but decline with time. Increased demand results in higher revenues. Explained in terms of social norms.</td>
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<td>Gneezy et al. (2010)</td>
<td>Field experiment</td>
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<tr>
<td>Kim et al. (2009)</td>
<td>Field experiment</td>
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<tr>
<td>Regner (2009)</td>
<td>Empirical (Google Answers)</td>
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<tr>
<td>Regner and Barita (2009)</td>
<td>Empirical (Magazine)</td>
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### Suggested Explanations

<table>
<thead>
<tr>
<th>Paper</th>
<th>Method</th>
<th>Suggested Explanations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chen et al. (2009)</td>
<td>Theory</td>
<td>Existence of fair-minded consumers with sufficient generosity, the good has low marginal cost, high concentration of low WTP consumers, and a competitive marketplace. Positive valuation of the good and a social-cost for free riding. Social norm for minimum contribution. Social norm for minimum contribution.</td>
</tr>
<tr>
<td>Fernandez and Nahata (2009)</td>
<td>Theory</td>
<td>Forward looking consumers with low prices demanding to switch to fixed-price schemes. Reciprocity and guilt, social norm for those paying around the recommended price. Outcome-based social preferences, strategic considerations to keep seller in the market. PWYW seller at isolation.</td>
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<tr>
<td>Isaac et al. (2010)</td>
<td>Theory</td>
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<td>McAle (2010)</td>
<td>Theory</td>
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<td>McHale et al. (2010)</td>
<td>Lab experiment</td>
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<tr>
<td>Schmidt et al. (2012)</td>
<td>Lab experiment</td>
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Source: Kalsay and Samanha (2014)
wineries either transmit confusing messages to the public about their services, or regions offer inconsistency in their product. If a winery is attempting to attract visitors to their cellar door for marketing and public relations purposes, then charging a fee to someone they have encouraged to visit may seem incongruous. Similarly, if some wineries charge and others do not, visiting tourists may be confused about whether they are a welcome visitor at wineries who do not charge, or an inconvenience, since they are not paying for services at one winery while payment is expected at others. Some wineries take the attitude that as their wine is a quality product people should expect to pay for it. In contrast, other wineries believe that wine tasting also serves as a means to educate the market, as well as get feedback on their wines, and are therefore happy not to charge. While the debate may be confusing for business decision-making, the issue of whether or not they will be charged is also often confusing to the customer. Travers (1999) points out that tasting fees offer many benefits, including weeding out ‘free loaders’, covering the cost of tasting, and removing some of the pressure on visitors to actually purchase after tasting. In addition, he concludes that it is reasonable for tourism operations to charge for their services. Nevertheless, as noted by King and Morris (1997), there is no way for a winery to determine who the truly interested visitors and potential purchasers are, and therefore wineries charging for entry and/or tasting may be ‘scaring off’ legitimate buyers in both the short and long-term. Beaverland (1999) found that a tasting fee certainly discouraged people from visiting, although their disinterest was reduced by offering a “redeemable on purchase” fee structure. Furthermore, his research at wineries in New Zealand also found that the tasting fee was as much of a deterrent to those who did not spend at the winery, as it was to those who spent over $100. King and Morris (1997), conducting an investigation into winery visitors in Western Australia, also found that a $2 tasting fee could deter up to 36 percent of visitors, 83 percent of whom are regular purchasers of wine. Therefore, this suggests that the winery is effectively turning away a large amount of potential short and long-term revenue.

Excursus: Case study ‘Pick-Your-Own-Cut-Flowers’

Since a long time PWYW has been (unknowingly) introduced to the agriculture sector. “Classical examples” are the small potato and cabbage stalls which one can find in rural areas in Germany. Farmers display different vegetables at an unattended stall at a street and buyers just take a product and pay what is named (as a reference price). Further examples are ‘Pick-Your-Own-Cut-Flowers’. People go straight to the flower nurseries pick their own flowers. Afterwards go to the unattended cashier and pay a certain amount; either there is a notice board displaying prices per flower or people just pay the amount they want. As the following case study shows this marketing channel is quite successful.

At the beginning of the 1990s, blumen bär GmbH started its first pick-your-own cut flower field (gladioli and sunflowers) near Bad Krozingen, Germany based on the idea from Hansruedi Brunner in Switzerland, who was the first person to start up a cut flower field. Initially blumen bär GmbH started with just one flower nursery, but today cultivate about 30 fields covering a total of about 20 hectares. Additionally, blumen bär GmbH set up a professional cultivation advice service for interested farmers more than 10 years ago, convinced that pick-your-own cut flowers are an important niche market in the agricultural sector. Today, blumen bär GmbH works together with around 100 farmers in Germany, Austria, France, Denmark and Belgium. (blumen bär 2013; Mentz 2005)

Discussion and conclusion

Our literature review on Pay-What-You-Want has shown that several factors have a strong impact on this price setting mechanism. These are:

- **Personal factors** such as social background, education income, self-perception as well as price sensitiveness.
- **Attitude and values** such as sense of fairness and on justice, altruism, reciprocity, loyalty as well as social norms and pressure.
- **Product related factors** such as brand/reputation, information asymmetries, reference prices, moment/situation of payment, and anonymity at moment of the payment as well as satisfaction with the product/service.

Regarding the personal factors that are connected with wine tasting we argue that in general wine consumers dispose over an above average education and income. Often wine consumers are situated in the upper-middle or upper class having good jobs. Often these persons have a high self perception and want to be perceived as well-educated and generous. In line with this argument we also think that even though the majority of wine is bought in discount or supermarket outlets in Germany (s. appendix), persons who are intentionally driving to a wine tasting at a wine estate are generally not that price sensitive. Hence dispose at that moment over a quite high willingness to pay. Overall, we argue that the mentioned personal factors are suitable for trying PWYW.

Regarding the attitude and values of persons who are participating in wine tastings we argue that they visit often estates they know for a long time. Hence certain loyalty can be assumed. In general wine tastings (at least in Germany) are conducted in such a way that a person from the estate (often the owner or someone from his family) is offering his guest some wines and explains those to his guests. Hence, even during first time experiences a feeling of personal closeness emerges and loyal behavior might result. Additionally, the setting has also positive influence on the perceived reciprocity as well as fairness and justice. Additionally most often wine tastings are conducted as a part of a family excursion/journey or a trip with friends. Thus, wine tastings are seldom conducted by
single persons rather in larger groups. Due to this setting we argue that while tasting wines people perceive rather high social pressure. As a result today people often feel obliged to buy at least a bottle of wine; whether the like it or not. Overall, we conclude that the attitudes and values connected to wine tasting affect PWYW positively.

Regarding the product related factors we argue that particularly persons who are willing to drive to a wine estate are consider themselves as wine lovers or enthusiasts. Hence often they dispose over a good wine knowledge and hence, information asymmetries are rather low. Further these persons have a good knowledge about the reputation of the wine estate and in general about wine prices. Because of the emerging closeness, the ‘event’ character of the wine tasting as well as the overall positive basic mood most people have most often people are rather satisfied with the wines they taste. However, as in most countries wine tastings are free of charge knowledge of specific reference prices is most often not given. However, as shown in wine regions such as Nappa Valley where fees are normal reference price would exist. Overall, we conclude that again the discussed factors are rather in favor of PWYW. Regarding the moment of payment we recommend that at the end of the tasting a basket should be displayed in which the persons can put the amount they want.

### Factors influencing PWYW

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<tr>
<th>Factors influencing PWYW</th>
<th>Detailed estimation</th>
<th>Aggregated estimation</th>
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<td><strong>Personal factors:</strong></td>
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<tr>
<td>social background</td>
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<tr>
<td>education</td>
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<td>family</td>
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<tr>
<td>wealth and income</td>
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<tr>
<td><strong>Attitude and values:</strong></td>
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<tr>
<td>taste experience and or satisfaction</td>
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<tr>
<td>reputation</td>
<td><strong>++</strong></td>
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<td>trust</td>
<td><strong>++</strong></td>
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<tr>
<td><strong>Product related factors</strong></td>
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<tr>
<td>price of the wine</td>
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<tr>
<td>price of the wine estate</td>
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<td><strong>Source:</strong> own preparation</td>
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In conclusion we think that PWYW is feasible. To our understanding PWYW is quite attractive to wine estates as it could help to overcome cognitive dissonances of persons who do not like the wine but feel obliged to buy at least a bottle. Hence, overall it might lower the barrier to try a new wine estate and hence new customers might be attracted. Further, it might provide the opportunity to cover the cost for wine tastings.

### Literature


Appendix

The German Wine Market 2019

Wine Consumption
- Direct Sales
- Retail

Distribution
- Supermarket
- Specialized Retail

Wine Consumption in Germany
- Per Capita Consumption of Wine (Average Annual Rate): 24 L
- Share of White Wine: 59%, Red Wine: 33%, Sparkling Wine: 7%
- Average Retail Price for German Wines: 3.06 €/L; Average Retail Price for Imported Wines: 2.27 €/L
- Average Price per Glass for German Wines: 1.05 €; Average Price per Glass for Imported Wines: 2.97 €

Source: Hanfl et al. (2012)