Consumer Options

How much is it worth to you to have a seat in the arena as Carolina competes for the NCAA basketball championship? Would you risk buying a Final Four ticket if you didn't know whether Carolina would be one of the teams? Would you pay to keep your options open?

In applying the concept of consumer options to the marketing field, Prof. Sridhar Balasubramanian – along with Preethika Sainam, a former PhD student at UNC who is now a faculty member at Indiana University's Kelley School of Business, and Prof. Barry Bayus, the Roy O. Rodwell Distinguished Professor in UNC Kenan-Flagler's marketing department – constructed a research scenario that tapped into the passions of Tar Heel basketball fans. In a lab setting, they measured fans' willingness to buy a Final Four ticket before they knew whether Carolina would play, after they knew which four teams made it, and who would, before the Final Four teams were known, pay for the option of buying a ticket after the semi-final competitors were set.

"The notion of options has been very popular powerful in the finance literature and in the operations and production literature," said Balasubramanian, the Roy and Alice H. Richards Bicentennial Scholar and associate professor of marketing at UNC Kenan-Flagler. "This is the first time that the concept of consumer options has been formally explored in the marketing literature. We believe it's a big idea."

Options are meant to protect holders from risk. For example, in the financial market, an option could serve as a contract between buyer and seller that gives the option holder the right to buy an asset in the future at an agreed-upon price. The buyer pays the seller a fee for this opportunity. The buyer is not required to buy the asset, but if the agreed-upon price is lower than market value on the agreed-upon transaction date, the buyer would want to purchase the asset and lock in the profit. Options don't control the price of the asset, but they can limit risk, and they can protect the holder from spending money upfront needlessly.

"Interestingly," Balasubramanian said, "in the marketing arena, consumers face this kind of risk all the time. But the corresponding concept of the consumer option has not been formally developed."

Until now.

Here's how the concept would work in Balasubramanian's Final Four tickets scenario. A significant market segment of Carolina basketball fans would want to go to the Final Four only if Carolina were playing. The tickets go on sale long before the brackets are set. So those fans don't buy tickets when they first go on sale. That leaves room for people who don't care about the game but do care about making money – scalpers – to buy the tickets. At the last moment, if UNC does make the playoffs, that segment of Carolina fans has to scramble to buy tickets. They buy from whoever is willing to sell, often at an exorbitant price. The scalper, not the basketball league, profits in this scenario.

If consumer options were in effect, the profits would accrue to the league, and fans would be protected against having to overpay for tickets. Fans would pay a fee for the option of buying a Final Four ticket after the playoff teams became known. The price of the ticket could be the same as the price paid by those who bought tickets from the league when they first went on sale. If UNC did not make the playoffs, those Carolina fans would not have to buy a Final Four ticket before a preset date. The league would be free to sell the tickets to others who do want to go. The Carolina fan is only out the fee paid to hold the option open.

“What option pricing allows you to do is leverage uncertainty in a positive way from the viewpoint of the league,” Balasubramanian said. Option pricing essentially expands the league’s customer base and revenues by collecting a fee from fans who ultimately don’t buy a ticket, and still collecting the full price of the ticket from fans who do decide to go.

“Usually what happens is when the firm benefits, the customers don’t benefit,” Balasubramanian said. “In this case, because it expands the market and enables more people to participate in the marketplace, the league’s profits can go up and the consumers can benefit as well. It can be a win-win on all sides.”

Other industries could benefit from consumer options as well. Balasubramanian can see the concept being used by airline industries. Say a traveler tentatively plans a vacation to Florida during peak season, and so buys an option on an airline ticket. But a few days before the trip, he learns that work deadlines interfere with his planned time off or that bad weather is headed for the Florida coast. By a preset date close to the travel date, he decides not to exercise the option and buy the ticket. The airline can then sell the seat to someone who does want to fly to Florida, and the airline keeps the option fee.

Before consumer options gains widespread acceptance, Balasubramanian said, “someone has to come out and lay down the rules for the concept and popularize it.” At one point, financial options didn’t exist, either, but the concept caught on as investors and businesses realized the advantages.

“If your company has been pricing in a particular way forever, inertia gets in the way,” he said. “You have to think differently about pricing to do this. Experiment in a small market and refine it before you apply it company-wide.”

The research paper on consumer options is due to be published in the *Journal of Marketing Research*.

Balasubramanian and his research team are turning their attention next to the concept of consumer forwards. Using the Final Four scenario, if a consumer buys a forward on Carolina, he is automatically charged for the ticket if Carolina makes the playoffs; if Carolina doesn’t make the playoffs, the ability to purchase a ticket automatically expires. A company would not offer options and forwards at the same time.

“The point is to lay out these new ideas so that firms can pick them up and run with them,” Balasubramanian said, “Doing new and different things is central to keeping the competitive edge in today’s marketplace.”

It’s always better to have options.