

A Reference-Dependent Preferences Model of Extended Warranty Purchase Decision

Hyeong-Tak Lee

University of Iowa

Sriram Venkataraman

University of North Carolina at Chapel Hill

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Abstract

Durable goods often come bundled with the base warranties. Yet a sizable number of durable goods customers purchase extended warranties that they rarely make claims against. This study offers reference-dependent-preferences-based theoretical explanations of why consumers purchase extended warranties even if their purchased good is already covered by a base warranty. Consistent with the proposed theory, we show that the base warranty on a durable product serves as a reference point, thereby creating qualitative differences in the valuation of an extended warranty on the product slightly above and below the reference point. With the automobile industry as the empirical context and using a quasi-experimental design, we validate the predictions from our model of RDP. Furthermore, we use our calibrated econometric model to quantify price discrimination opportunities (if any) for auto dealers who sell extended warranties to the auto buyers. These findings have important implications for marketing managers, as they provide valuable guidance on the behavioral motivations that drive consumers to purchase extended warranties and who should be targeted.

Keywords: *Warranty; Reference-dependent preferences; Regression discontinuity*

Track: Marketing Strategy & Theory