

2010 School Seminar Series

Waikato Management School
Te Raupapa



The Impact of Context Effects on Optimal Product Lines

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Abstract:

Product line design involves the optimal selection of a firm's product offerings based on consumer preferences. The literature provides ample evidence that consumer preferences are at least partly driven by the context provided by the set of alternatives. Firms could utilize the context sensitivity of consumers when designing their product lines. This requires a consumer choice model that captures context effects. This paper proposes a discrete-choice model that decomposes a product's utility into a context-free partworth utility and a context-dependent component capturing compromise, attraction, and substitution effects. Model estimation results on choice-based conjoint data concerning digital cameras provide convincing statistical evidence for context effects. The face validity of the context effects is good, even at the individual level. Moreover, accounting for context effects leads to better predictions both in- and out-of-sample. Subsequently, the authors show how the choice model with context effects can be used to design personalized product lines that are based on the heterogeneity in consumers' sensitivity to different context effects.

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