How to protect consumers from deceptive comparison pricing

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Researchers from Duke University, University of Notre Dame, and Microsoft published a new *Journal of Marketing* article that examines

using "true normal prices" during a sale as a way to reduce deceptive pricing tricks.

The study is authored by Richard Staelin, Joel E. Urbany, and Donald Ngwe.

Does competition make firms more honest? Over 50 years ago, the Federal Trade Commission (FTC) assumed the answer was yes when it stopped enforcing its deceptive pricing regulations. Since that time, competition has increased significantly, particularly in the crowded U.S. retail trade. However, contrary to the FTC's hypothesis, deceptive pricing has proliferated during the same period.

This new article explains why competition is more likely to encourage rather than discourage deception. The researchers propose a possible solution: require firms using reference prices during a sale to also provide information on the true normal price of the on-sale item.

The study starts by critically evaluating two assumptions that underlie the FTC's "competition discourages deception" theory:

1) The first assumption is that inflated reference prices are largely ignored by consumers, who focus primarily on evaluating the actual selling price in a promoted deal. As such, price competition pushes selling prices lower and renders reference prices harmless.

However, empirical research gives a different picture. A robust finding in the marketing literature is that the addition of a high regular price stated in a price promotion increases consumer willingness to pay. The research illustrates how much consumers value "getting a good deal," leading to greater sales for the retailer when comparative prices are used.

2) The FTC's second assumption is that competition drives out economic

incentives to cheat. The theory is that, as competition heats up, firms have an economic incentive to be truthful and that any temptation to stray will be constrained by natural market forces.

However, a number of recent economic models show the opposite; that is, the greater the competition, the more likely the firm will offer "noisy" information in an attempt to shield itself from this competition and in the process increase its profits.

Three recent empirical examples provide consistent support for model development, each finding:

- consistent seller use of high reference prices at which products are never or rarely sold,
- consumer choice being altered by these often fictitious reference prices, and
- firms experiencing financial gains from posting inflated reference prices.

All this leads to the conclusion that there is a substantial negative impact of fictitious reference pricing on consumer welfare.

The value of firms telling the truth

"After evaluating several regulatory options, we conclude the best way to create real change in firms' behavior is to require them to tell the truth. Our proposal is to require firms to disclose an item's true normal price (TNP) whenever comparative prices are used in price communications," says Staelin.

To illustrate, say that a furniture retailer puts a sofa on sale as follows:

Regular Price $1399

Sale Price $599

Also assume, as is common, that in the past three months the retailer has offered the sofa for sale at a price of $1399 for just two weeks. For the other 10 weeks, the sofa was offered at $599. So, $599 is actually the price usually charged for the product.

This "most regular" price would be posted alongside the other two prices as a legally required disclosure when a firm wishes to have a comparative price promotion.

That is:

Regular Price $1399

Sale Price $599

True Normal Price $599*

*Legal Disclosure. True Normal Price = the price most often charged by this retailer in the past three months.

The leads to a question: Does providing TNP moderate the effect of a promoted Advertised Regular Price (ARP)? Urbany says, "We examine this question through a controlled experiment with 900 participants, where the participants' choices in the study determined their total expected compensation. We find that the presence of an ARP with a sale price significantly raises the chance that a consumer will buy. However, adding TNP information drives out this effect of ARP."

"Our results support the premise that TNP provision would reduce or eliminate firms' incentives to give anything but honest information to consumers in their price promotions and it would have an impact on

average market prices, promotions, frequencies, and firm profits. We hope this study leads to a lively debate on the topic," concludes Ngwe.

More information: Richard Staelin et al, EXPRESS: Competition and the Regulation of Fictitious Pricing, *Journal of Marketing* (2023). DOI: 10.1177/00222429231164640

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