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Vulnerability to Low-Price Signals: An Experimental Study of the Effectiveness of Genuine and Deceptive Signals

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Abstract

Low-price guarantees help buyers make inferences about retailers' prices. However, researchers are concerned that consumers might be vulnerable to relying on guarantees associated with high market prices. Furthermore, truly low-priced retailers that issue low-price guarantees might be vulnerable to consumers' discounting of such guarantees. This article experimentally assesses these concerns and finds that the effects of adding a low-price guarantee to a low or high offer price on consumers' pre-purchase perceptions depend on consumers' confidence in their product category price knowledge and their decision involvement. The article explores the implications of the findings and provides directions for further research.

Keywords: Low-price guarantee; Consumer confidence; Low-price signal; Signaling theory; Internal reference price; Decision involvement; Knowledge calibration

Many retailers issue low-price guarantees in which they promise to match or beat competitors' lower prices before purchase or to refund money to consumers who find lower prices after purchase (Arbatskaya, Hviid, and Shaffer 2004). Typically, such guarantees are accompanied by a statement reflecting the retailer's price claim, followed by a statement promising refund. For example, on its website, Office Depot claims "Our prices won't be beat . . . Guaranteed!" and promises to pay the price difference to consumers who find a lower price within 14 days of purchasing a product from the retailer.[1] However, the terms low-price guarantee also apply to retail messages that simply promise a refund, without a statement about the retailers' prices (Arbatskaya et al. 2004; Biswas, Dutta, and Pullig 2006).

Behavioral research on low-price guarantees has viewed them as signals from which consumers infer the position of a retailer's prices in the market array of prices (e.g., Biswas et al. 2002, 2006; Jain and Srivastava 2000; Srivastava and Lurie 2004). Because low-price guarantees signal low prices, they can reduce consumers' perceptions of risk, limit their search intentions, and raise their purchase intentions, if signal credibility is not an issue (Biswas et al. 2002, 2006; Jain and Srivastava 2000; Kukar-Kinney and Walters 2003; Srivastava and Lurie 2001).[2] However, researchers have expressed concern that consumers might be vulnerable to relying on signals from retailers that are not truly low priced (Biswas et al. 2006; Chatterjee, Heath, and Basuroy 2003; Edlin 1997; Srivastava and Lurie 2004). This concern appears to have some validity. Recently, a New York district judge ordered Best Buy to issue refunds to hundreds of consumers who were refused refunds when they showed evidence of lower market prices than Best Buy's (http://consumeraffairs.com/news04/2009/03/bestbuy_scam.html).[3]

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[1] See http://www.officedepot.com/renderStaticPage.do?file=/customerservice/lowPrice.jsp&template=customerService.

[2] Two recent papers indicate that findings of past research related to consumers' pre-purchase search intention in response to low-price signals might not be predictive of actual search. Thus, although past research suggests that a credible low-price signal reduces pre-purchase search intention, a recent paper (Ho et al. 2011) indicates that signal credibility is inversely related to actual search. In a simulated shopping task, these authors find that consumers truncate search earlier in case of a less credible signal, perhaps because seeking refund from the LPG-issuing store is financially superior to continuing search or because they intend to buy from the lower-priced store in the first place, instead of continuing to search. Further, past research suggests that presence of a low-price signal leads to lower search intention but a recent paper finds that buyers in PMG (Price-Matching Guarantee) markets on average search more compared to No-PMG markets (Yuan and Krishna 2011).

[3] Best Buy offers a low-price guarantee on its products. The cited website reports the filing of the lawsuit. The ruling appears in case#1:08-civ-00214-CM-DCF in the records of the Southern District of New York. A copy of the ruling is also available on request.

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This case indicates that low-price signals accompanied by high offer prices exist and consumers fall for them. Also, we scanned the market prices for product models in several product categories and found that low-price guarantees frequently accompany prices that are considerably higher than the lowest available price. Some researchers have also expressed concern that truly low-priced retailers that issue low-price guarantees might be disparaged if consumers, whose lowest price estimates for a product are distinctly below the product's true market lowest price, erroneously discount such guarantees (Biswas et al. 2006). This research tests the validity of these concerns by experimentally investigating the role played by consumers' confidence in their price knowledge in determining the effectiveness of low-price signals associated with low or high market prices.[4]

Three experiments examine the effects of consumers' confidence in their price knowledge of a product category on their evaluations of retail offers with or without low-price guarantees accompanying offer prices that exceed consumers' lowest price estimates by different magnitudes. We find that when consumers' confidence is low, low-price guarantees favorably affect their pre-purchase perceptions regardless of the offer price level. In contrast, when confidence is high, a guarantee associated with a low offer price is ineffective, while one associated with a high market price is effective. However, highly confident consumers are more likely to discount a guarantee accompanying a high price when decision involvement is higher.

The rest of the article is organized as follows: Study 1A investigates the role of consumer confidence in evaluation of low-price signals where confidence is measured. Study 1B manipulates respondents' confidence and assesses their skepticism toward low-price signals. Study 2 investigates the effect of decision involvement on highly confident respondents' evaluation of guarantees accompanying high offer prices. The article concludes with a discussion of the theoretical and practical implications of the findings, limitations of the approach, and directions for further research.

Conceptual framework and hypotheses

Genuine versus deceptive signals

Market exchanges are often characterized by information asymmetry in which sellers possess information that buyers do not. When such asymmetry inhibits exchanges, sellers send signals to buyers to convey the required piece of information (e.g., Wernerfelt 1988). For example, sellers might provide warranties to signal product quality (Boulding and Kirmani 1993). Similarly, sellers might offer low-price guarantees to inform buyers that their offer prices are nearly or actually the lowest available in the market (Biswas et al. 2006; Srivastava and Lurie 2001). A signal is typically associated with a self-imposed penalty in which the seller promises to compensate buyers in some fashion if the information conveyed by the signal turns out to be erroneous. For example, low-price guarantees come with a promise of monetary refund should buyers discover lower prices in the market.

Inasmuch as consumers rely on the information inherent in a signal, one providing accurate information is a genuine signal, and one associated with inaccurate information is a potentially deceptive signal (Kirmani and Rao 2000). Research indicates that consumers typically expect a retailer that issues a low-price guarantee to have lower prices than other retailers in the market (e.g., Biswas et al. 2002; Srivastava and Lurie 2001). From this perspective, a low-price guarantee associated with the lowest market price for a product is technically a genuine signal, and one that is associated with a distinctly higher price is a deceptive signal. However, consumers evaluate signals under conditions of partial information and thus do not *know* whether a particular signal is genuine or deceptive; that is, based on personal or contextual characteristics, they *infer* whether a signal is reliable (Biswas et al. 2006; Boulding and Kirmani 1993; Srivastava and Lurie 2001, 2004). In this research, we investigate the role that consumers' confidence in their price knowledge of a product category plays in their evaluation of low-price signals that are actually genuine or deceptive, although consumers have no knowledge of signal genuineness and hence have to infer it. We do this by explicitly incorporating consumers' internal reference prices, that is, the price estimates they bring to a purchase decision, in our conceptualization of the problem and our empirical designs. In order to predict the probable role of confidence in evaluation of genuine and deceptive signals, it is important to understand how consumers' price estimates might be related to the offer prices associated with these signals. For instance, imagine that consumers' estimates of the lowest market price for a product are typically higher than the true lowest market price. Then regardless of their confidence level, an offer price that is equal to the true lowest market price and accompanied by a low-price guarantee, that is, a genuine signal, might not result in different perceptions compared to an offer without a guarantee. On the other hand, if consumers typically underestimate lowest market prices, then a genuine signal might favorably affect the perceptions of the less confident consumers whereas the more confident ones might not be affected by the signal.

Consumers evaluate offer prices based on how much and in what direction their internal reference prices, that is, their estimates of expected prices, deviate from those offer prices (e.g., Kalyanaram and Winer 1995; Mazumdar, Raj, and Sinha 2005; Monroe 2003). When consumers evaluate offers with low-price guarantees, the most relevant internal reference price is their estimate of the lowest market price for the product concerned. Three broad situations are possible: (1) a consumer's lowest price estimate is in the vicinity of the offer price, (2) the estimate is distinctly higher than the offer price, and (3) the estimate is distinctly lower than the offer price. We conducted a pilot study to explore the general pattern of alignment of consumers' lowest

[4] Signal effectiveness refers to the signal's differential effect on relevant consumer perceptions or behavior compared with its absence. Typically, researchers would compare two offers or scenarios, one in which the signal is absent and in which it is present (e.g., Srivastava and Lurie 2001). If the presence of the signal leads to more favorable outcomes, the signal is deemed effective. In this sense, a signal whose presence does not lead to different levels of outcome and one whose presence leads to less favorable outcomes are both ineffective.