Fairness in Consumer Markets: Price Expectation, Cost Saliency, and Competition

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This research attempts to provide new insights on price fairness. Findings suggest that a price increase due to a decrease (increase) in supply (demand) is fairer than a price increase due to an increase in consumer wealth. Second, perceptions of the fairness of a price change depend on whether the seller of the product is a retailer or an individual. Third, individuals expect to pay more than the price they deem to be fair. Lastly, given a wholesale price increase, a monopolist retailer’s price increase action is deemed fairer than that of a retailer facing competition.

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Consumer perceptions of price fairness have received increasing research attention over the past several decades. Kahneman, Knetsch, and Thaler (1986; hereafter KKT) were among the first to experimentally show that price changes may engender concerns of fairness on the part of consumers. Their basic findings were threefold. First, it is fair for a firm to raise prices when faced with increasing costs. Second, it is fair for a firm to maintain prices as costs decline. Third, it is unfair for a firm to benefit from shifts in demand by raising prices. Their cumulative findings are known as the notion of dual entitlement (DE), as a firm and buyer are both considered “entitled” to certain economic gains or losses given increases or decreases in product supply or demand.

Following KKT, several researchers empirically tested the basic tenets of the DE principle and have suggested conditions which either qualify or counter KKT. Kalapurakal, Dickson, and Urbany (1991) challenged DE by showing that an alternative cost-plus rule and a buffer rule are both observed to be fairer than the rule derived from the DE principle. Bolton, Warlop, and Alba (2003) showed that increases in some firm costs lead to increased perceived fairness, however some costs are considered unfair for price increases. Vaidyanathan and Aggarwal (2003) suggest that even cost-justified price increases can be perceived as less fair when the locus of causality is internal to the seller and/or when the price increase is within the volitional control of the seller. Homburg, Hoey, and Koschatte (2005) reveal that as customer satisfaction increases, the negative impact of the magnitude of a price increase is weakened. Finally, Bolton and Alba (2006) showed that the perceived fairness of the price increase will also depend on the alignability of the cost and price increases, such that alignable increases are perceived as more acceptable than non-alignable increases.

The current research investigates several phenomena that may impact fairness perceptions. First, we consider whether there is a psychological difference between a price deemed “fair” and a price that one expects to pay given a change in economic condition. It has been forwarded that consumers have preconceived ideas about what is a fair price for a given item, and are unwilling to spend more than that amount for the particular item (Kamen and Toman 1970). However, it is not clear how fairness and the price one expects to pay are related in the consumer’s mind. Second, we consider when and under what conditions unfairness perceptions can be attributed to different entities in a distribution channel such as a retailer, wholesaler, or manufacturer. Third, we consider the impact of the nature of competition on perceptions of price fairness. Specifically, we consider whether a price is deemed to be more unfair when the seller is a monopolist versus when the seller has close competitors. Lastly, we note that in most of the hypothetical price or cost change scenarios outlined in KKT, fairness perceptions may be highly sensitive to the explicit reason given for the change. Thus, we attempt to delineate between when the amount of the price change versus the reason given for the change predominate unfairness perceptions.

The results of five scenario-based studies with undergraduate subjects yield several interesting findings. First, a price increase caused by a decrease in supply is found to be fairer than a price increase caused by an increase in consumer ability-to-pay (wealth). In addition, a price increase caused by an increase in demand is found to be fairer than a price increase caused by an increase in consumer wealth. These two findings are not qualified by whether or not the price fluctuation was caused by the actions of the seller (retailer) or the upstream manufacturer.

Second, perceptions of the fairness of a price change may depend on whether the seller of the product (a video game console in our scenario) is a retailer or an individual (the latter becomes relevant in today’s Internet marketplace). Specifically, a price increase is found to be more fair when the seller is an individual rather than when the seller is a retailer. It is less fair for a retailer that one frequently visits to raise prices, given a change of demand or supply, than it is for an individual who may or may not be known to a consumer.

Third, using KKT’s famous snow shovel scenario, we find that on average people expect to pay more than $15 for a snow shovel given an increase in demand, and think it is fair for the firm to increase their price by a “reasonable” amount (about 10% in this instance). Subjects, on average, expect to pay more than the price they deem to be fair. Moreover, both the average ‘expect to pay’ price and the

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