

Price comparisons research

Cover report

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1 EXECUTIVE SUMMARY

- 1.1 OFT and DTI commissioned Nottingham Business School (NBS) to conduct research into misleading price comparison advertising, to identify the characteristics of price comparison advertising that have a significant influence on consumer decisions. This research was conducted in two phases with an extensive literature review being completed prior to conducting new empirical work.
- 1.2 Price comparison advertising takes place when the current selling price (SP) of a product or service is compared with some other advertised reference price (ARP). Comparisons may be made with historical prices (eg: 'was/now'), reference prices (eg: '50% off manufacturer's suggested selling price') or with competitors' prices. The intention of presenting a comparator, in most cases, is to highlight potential savings to consumers and so influence their decision to buy.
- 1.3 This type of advertising is frequently used by retailers across a wide range of products and services and can be seen in newspapers, on posters within stores, on flyers and through other forms of promotional material.
- 1.4 When used legitimately, price comparison advertising can increase competition, helping markets to work well for both consumers and business. This type of advertising can have particular benefit to businesses wishing to highlight competitive discounting and to consumers with high search costs. However, if consumers are misled, then this type of advertising has the potential to distort the behaviour of consumers and hence to distort competition.
- 1.5 The potential for misuse of price comparison advertising has been widely recognised by governments. In the UK there are two key pieces of legislation, the Consumer Protection Act 1987 (the 1987 Act) and the Control of Misleading Advertising Regulations 1988 (CMARs). In most cases, the OFT will only exercise its powers under CMARs if other systems of advertising control, such as the enforcement of the British

Code of Advertising, Sales Promotion and Direct Marketing by the Advertising Standards Authority, or action by trading standards authorities, has failed to resolve a complaint.

1.6 The NBS research identifies a number of characteristics of advertising which can alter consumer perceptions and intentions. Specifically, it found that:

- any changes in the **level of the advertised reference price** had a significant effect on consumer perceptions and intentions. This finding is supported by evidence from both the literature review¹ and the empirical analysis contained in the NBS research
- consumers were observed to react differently to **different forms of wording** describing essentially the same deal, for example, offers presented as 'was/now, with a percentage saving', 'was/now, with an absolute saving' or just 'save'
- advertisements focusing on the **potential costs of missing an offer** had a greater effect than if the benefits were highlighted, and
- finally, despite strong theoretical² support the research found no evidence that **time limited offers** affected consumer buying behaviour. However, given the methodology employed and that the evidence is based on an aggregate level data this does not imply that time constraints can not have a significant effect in specific markets.

¹ Urbany, J E, Bearden, W O and Weilbaker, D C (1988) 'The Effect of Plausible and Exaggerated Reference Prices on Consumer Perceptions and Price Search' *Journal of Consumer Research*, 15, June, pp 95-110.

² Grewal, D and Compeau, L D (1992) 'Comparative Price Advertising: Informative or Deceptive?' *Journal of Public Policy and Marketing*, 11(1), pp52-62.

1.7 The structure of the rest of this summary report is as follows:

- how price comparisons can impact on consumer decisions,
- how alterations in consumer decisions can cause consumer detriment,
- constraints on the use of price comparison advertising (a brief résumé), and
- the evidence collected in the NBS research.

2 HOW PRICE COMPARISONS IMPACT ON CONSUMER DECISIONS

- 2.1 Price comparison advertising is defined as the activity of explicitly, or implicitly, advertising a product with both its current selling price (SP) and some comparison price, referred to here as the advertised reference price (ARP). The aim of presenting an ARP is usually to highlight the potential saving to the consumer of buying from a particular retailer or buying now. Examples of this type of advertising are offers presented as 'was / now', 'save 50%' or 'save £200'.
- 2.2 The theoretical literature surveyed found that the process by which consumers assess the information presented in a price comparison advertisement is characterised by two stages.³ First, the consumer reviews the presented information for **believability**.⁴ The consumer then uses the available information to **value** the offer by the supplier.

³ The research explains this process in more detail, distinguishing between two types of process called central processing and peripheral processing. The key distinction is that in central processing believability is considered, while in peripheral processing it is not. These two processes are combined here by using peripheral processing as a special case of central processing, where the consumer always believes the ARP.

⁴ Believability is defined here as the customer's assessment of the plausibility of the ARP and offer being made.

- 2.3 To assess how **believable** an ARP is, consumers may make use of an internal reference price (IRP). The IRP can be thought of as the price the consumer expects to pay for the good or service. There is substantial theoretical debate about the existence, form (as a single price or range), and creation (via experience, future benefits or some idea of cost of production) of IRPs. This debate is not covered here but can be found in the NBS research.⁵
- 2.4 Having decided whether they believe the presented information, the consumer must then **value** the offer at the given SP. Although many ways have been suggested as to how consumers reach such a valuation, there is no conclusive evidence supporting any of the proposed methods. However, experimental research suggests that the value a consumer places on a product can be measured in a number of ways, including:
- the perceived benefits of the product to the consumer compared to its price (known as acquisition value), which appears to be closely related to the economic concept of consumer surplus, and
 - the difference between the selling price of the product and the price that the consumer expected to have to pay for that product (this difference is known as the transaction value).
- 2.5 The literature review identified a number of specific factors that may influence both believability and offer valuation. This report focuses on the characteristics of the price comparison advertisement, although a full discussion of factors can be seen in the NBS research.⁶

⁵ This debate can be found in the full text of the NBS research on pages 8 and 9.

⁶ The additional factors that are omitted from this report can be grouped into characteristics of the product and characteristics of the consumer.

2.6 The five relevant characteristics of price comparison advertisements identified by the NBS research were:

- the **type of ARP used**. The three types of ARP used are historical reference prices such as 'was £199.95 now £99.95', competitor reference prices such as 'half the price of ...'; or recommended retail prices such as 'only £99.95, rrp £199.95'. The type of ARP used may impact on consumers' decisions if consumers have differing perceptions of reliability or understanding
- the **level of the ARP**, which may be considered in relation to any benchmark such as the offered SP and/or the IRP. An inflated ARP may reduce believability but increase consumer valuation of savings
- the **focus of the advertising**, for example if it was framed in a positive way (stressing the benefits) or negative way (stressing the potential costs). One example would be where bodies highlight the price as a comparison rather than the previous price
- the **wording of the advertisement**, for example '50% discount', '1/2 Price' or 'Half Price'. The wording can alter the consumer's understanding of the offer, and
- the **presence of a time constraint on the offer**, such as 'only available until', or 'must end soon'. Such offers may be perceived to be more believable or valuable owing to their limited nature.

2.7 Having explored how price comparison advertising may influence consumer behaviour, the next section defines the potential detriment that may be associated with misleading price comparison advertising.

3 CONSUMER DETRIMENT FROM MISLEADING COMPARISONS

3.1 Legitimate price comparison advertising can create benefits for both businesses and consumers. Businesses may for example benefit by using this type of advertising to draw attention to competitive discounting,⁷ or as part of an entry strategy to new markets. Consumers may also benefit from price comparison advertising as it may reduce their search costs and promote strong price competition between suppliers.

3.2 However, misleading price comparison advertising can cause detriment to both consumers and honest retailers. The three broad causes of detriment are:

- consumers believing misleading advertisements and **making inappropriate decisions**
- consumers **rejecting honest advertisements**, reducing the effectiveness of honest price comparison advertising and, as a consequence
- **a fall in the intensity of competition.**

3.3 **Inappropriate decisions** mean that consumers may have been induced not to search for a cheaper product and hence paid more than necessary, or have been induced to overvalue the product and buy more or buy a different product than they would otherwise desire. This creates both a cost to those consumers who chooses the wrong option and to those competing retailers who lose a sale as a result.

⁷ The pervasiveness of price comparison advertising observed within the research suggests that this type of advertising is highly valued by business.

- 3.4 Although no single study evaluates the total cost of inappropriate decisions by consumers caused by misleading price advertising, existing research into individual sales channels suggest a significant level of distortion may exist.
- 3.5 For example the OFT Doorstep Selling market study⁸ (OFT 2004), indicated very wide ranges on the prices of certain products offered to consumers in their own homes.⁹ The sales strategies used and the range of prices offered strongly suggest that the consumers were not well informed about the available prices. The survey found that around a third of doorstep salespeople had quoted a high initial price followed by offering a discount to make a sale. The study also found that more than three in ten attempted to create pressure by offering a discount on condition that the sale was concluded that day.
- 3.6 The second cause of detriment arises if **consumers reject honest advertisements** and incur excessive search costs, or miss opportunities. This would reduce the realised benefits to businesses from price comparison advertising.
- 3.7 Empirical evidence shows that a significant group of consumers tend to be sceptical about price comparison advertising. One study found that a quarter of consumers claimed to consistently ignore the ARP.¹⁰ This is consistent with the findings of the focus groups consulted in the NBS research, which showed that over half of the presented advertisements

⁸ Doorstep Selling: A Report of the Market Study: OFT716, 2004.

⁹ These were all products which consumers purchase infrequently. The research involved test purchasing and did not ask consumers the prices they expected to pay. The full text of this market study can be downloaded from the OFT website, at www.of.gov.uk.

¹⁰ Blair, E. A. and Landon, E. L. (1981) 'The effects of Reference Prices in Retail Advertisements', *Journal of Marketing*, 45, 61-69.

were not trusted. Notwithstanding this, the evidence suggests that the use of an inflated reference price, whether or not it is plausible, affects consumers' perceptions of the quality and value of the advertised product and increases propensity to buy.¹¹

- 3.8 Finally, the **intensity of competition** may be stifled by misleading price comparison advertising. Any such reduction is likely to have a negative impact on consumers, as retailers will be under less competitive pressure, potentially resulting in higher prices. The NBS research highlighted two such ways in which the intensity of price competition might be reduced: through the interdependence of consumers; and reputation effects.
- 3.9 The 'interdependence of consumers' relates to the fact that the behaviour of one consumer may impact on other consumers within the market. If, for example, misleading price comparison advertising were to reduce the number of consumers actively searching, then competitive pressure would be reduced and this might allow prices to rise. In this way, misleading price comparisons may impose a cost on all consumers not just those who are directly influenced by the advertising.

¹¹ The literature review even found evidence that an ARP that was not believed had a material impact on consumer behaviour.

- 3.10 'Reputation effects' reflect the fact that some retailers depend either upon repeated interactions with individual consumers or word of mouth recommendations. In such markets reputation is a substantial asset to an existing retailer and may stop retailers from entering another market where their reputation may be put at risk. For example, if consumers strongly associated the supply of a particular product with dishonest practices (including misleading price advertising), then legitimate suppliers may be unwilling to provide that product, for fear of the damage it may have on their reputation. This could thereby lead to a reduction in consumer choice.
- 3.11 Having considered the ways that misleading price comparison advertising may harm consumers and businesses, the next section sets out how this risk is currently addressed.

4 EXISTING CONTROLS ON MISLEADING ADVERTISING

- 4.1 The potential for misuse of price comparison advertising has been widely recognised by governments, and in response legislation has been passed to limit any such behaviour. There are two key pieces of legislation in the UK are, the **Consumer Protection Act 1987 (the 1987 Act)** and the **Control of Misleading Advertising Regulations 1988 (CMARs)**.
- 4.2 Part III, Sections 20-25 of **the 1987 Act** deal with misleading price indications. Section 20 of the 1987 Act makes it an offence to give consumers an indication which is misleading as to the price of any goods, services, accommodations, or facilities, by any means. Section 25 of the 1987 Act provides that the DTI may, after consulting the OFT, approve a code of practice for the purpose of giving practical guidance on the requirements of section 20, and promoting desirable practices to follow in giving price indications. Under this section, the DTI has given approval to the Code of Practice for Traders on Price Indications 1988 (the Price Indications Code).¹² Compliance with, or a contravention of, the Price Indications Code is strongly probative of whether an offence under section 20 of the 1987 Act has been committed, but is not determinative of such criminal proceedings. The Price Indications Code does not provide an exhaustive list of activities which may be considered to be misleading.

¹² (SI 1988 No. 2078).

4.3 The Price Indicators Code provides that price comparisons should be accurate and valid. It sets out specific guidance on some of the characteristics of price comparison advertising identified in the literature review. Among other things, it:

- **addresses any manipulation of the ARP.** This is constrained by a number of conditions placed on the use of historical reference prices and recommended reference prices. For example:
 - when a comparison is drawn with a trader's own previous price, the product should have been available at the reference price for at least 28 consecutive days in the previous six months, in the same shop where the discount is offered. The reference price should also be the last price at which the product was available to consumers in the previous six months.¹³ If these conditions are not met, the price comparison should **still** be fair and meaningful'
 - a comparison with a recommended retail price should only be used if it has been recommended by a manufacturer or supplier with whom the trader deals on normal commercial terms and it is not significantly higher than prices at which the product is generally sold.
- the **environment** of the advertising is also constrained by controlling the use of sales or special events. Individual labels on items should state the previous price as well as the discounted price. General notices saying, for example, 'up to 50% off' should only be used where a 50 per cent reduction applies to at least 10 per cent, by quantity, of the products on sale.

¹³ Quoting a future, after-promotion, price is constrained in a similar way, as the trader should be certain, subject to circumstances beyond his control, that he will continue to offer identical products at that price for at least 28 days in the three months after the end of the promotion.

- 4.4 CMARs are based on the principle that, ordinarily, 'established means' should be given an opportunity to resolve a complaint that an advertisement is misleading. The appropriate 'established means' may be the self-regulatory system administered by the ASA¹⁴ or possible action by trading standards authorities under, eg: the 1987 Act or the Trade Descriptions Act 1968. However, on some occasions, immediate action by the OFT may be merited. In these circumstances, or where there is no alternative method of dealing with a complaint (eg: the British Code of Advertising, Sales Promotion and Direct Marketing is inapplicable) or 'established means' have failed to remedy the mischief, CMARs give power to the OFT to bring court proceedings to prevent the publication of misleading advertisements.
- 4.5 Responsibility for enforcing CMARs is split between broadcast and non-broadcast advertising. Radio and television advertisements are the sole responsibility of the Office of Communications (Ofcom). Responsibility for non-broadcast advertising falls on the OFT.
- 4.6 Further, the OFT and trading standards departments, among others, can apply to the court for an enforcement order under Part 8 of the Enterprise Act 2002 (EA 2002) to prevent a trader from publishing advertisements which contravene CMARs, or are contrary to section 20 of the 1987 Act, and harm the collective interests of consumers.
- 4.7 In recent court proceedings brought by the OFT under CMARs and EA 2002, it was found that an advertisement which promoted a percentage discount by reference to a trader's own previous prices carried the implication that that the previous price was a genuine price, as distinct

¹⁴ Advertising Standards Authority: The ASA administers The British Code of Advertising, Sales Promotion and Direct Marketing. CMARs provide that, in exercising its powers, the OFT must have regard to the desirability of encouraging the control, by self-regulatory bodies, of advertisements.

from an artificial price. In order for a historical reference price to be genuine, the goods must be offered for sale at that price in significant quantities and for a sufficient length of time, for potential customers to be aware that the goods are for sale, to consider whether to purchase them and for such transactions to have taken place, in the honest belief that they could be sold at that price.¹⁵

4.8 Overall, the legal framework is not unduly prescriptive about the rules that price comparisons must follow. The legislative regime is intentionally flexible so to leave 'the regulatory authorities with sufficient flexibility to curtail and prevent misleading price indications irrespective of strict compliance with the letter of the practical guidance.'¹⁶ Both the 1987 Act and CMARs are based on the broad requirement not to make a 'misleading' statement, whether expressly or impliedly.

4.9 There is no formal link between the 1987 Act and the Price Indications Code, on the one hand, and CMARs on the other. The Court recently clarified that it is possible for an advertisement to be misleading under CMARs, even if it complies with the provisions of the Price Indications Code.¹⁷

¹⁵ *OFT v The Officers Club* [2005] EWHC 1080 (Ch).

¹⁶ *Ibid.*

¹⁷ *Ibid.*

5 RESULTS OF THE NBS RESEARCH

- 5.1 To evaluate the impact of the characteristics identified NBS undertook a comprehensive review of the existing psychological and economic empirical literature in this area and conducted additional experimental research. The results of both these sources of evidence are summarised here. For a fuller description of the results and methodology please refer to the full NBS research text.
- 5.2 The NBS experimental research was undertaken in three main phases. The first two phases were essentially exploratory, involving content analysis that would set the parameters for the third phase.¹⁸ The third phase then used experiments to provide empirical evidence.
- 5.3 There is strong evidence that the level of the ARP may alter the behaviour of consumers. This evidence can be seen in both the existing literature and the empirical research undertaken in the NBS research. The literature review even found evidence that an ARP that was not believed had a material impact on consumer behaviour.¹⁹
- 5.4 Further support for the importance of the level of the ARP was also found in the empirical research. This work found that alterations in the level of the ARP had a direct effect not only on consumers' intentions to purchase the advertised item, but also on how highly they valued the item (in terms of transaction and acquisition value).²⁰

¹⁸ These phases were included both hall tests and focus groups.

¹⁹ Op cite 1.

²⁰ A summary definition of acquisition and transaction values can be found in paragraph 2.4 of this report. For a fuller explanation please refer to the full NBS research text.

- 5.5 There is some evidence that **using different types of ARP** has been seen to influence consumer behaviour. In one experiment conducted by Ahmed and Gulas (1982) it was shown that consumers' intentions to search for and compare other products fell when comparisons to 'manufacturer's suggested list price' (the equivalent of RRP in the UK) were presented relative to other types of ARP.
- 5.6 The **focus of the advertisement** has also been seen to have a significant impact on consumer behaviour. In a paper by Tversky and Kahneman, (1986) it was found that consumers' responses to potential losses are more extreme than gains due to loss aversion. This suggests that consumers are more likely to react to advertisements focused on the potential loss from missing the offer (such as 'don't lose out, buy today' or 'this offer can't last') than advertisements which focus on the benefits of the offer (examples include 'great value' or 'bargain').
- 5.7 The experimental research considered the importance of **wording** (semantic cues). The key finding was that choice of such semantic cues between 'was/now, with a percentage saving', 'was/now, with an absolute saving' and 'save' had a significant direct impact on consumers' perceptions of quality and the perceived benefits of the product relative to its price (transaction value). Generally, the 'save' cue was found to have the most positive effect on consumer perceptions.
- 5.8 The importance of wording was, however, not a simple relationship, and altered depending on the product being advertised and the level of the discount offered.

5.9 Finally, this research found no evidence that the presence **time constraint** would have a direct impact on consumers' behaviour. Contrary to the theory, the introduction of a time limit to the offer had no apparent impact on consumer intentions to search and buy, or consumer perceptions of quality, the acquisition value and the transaction value.²¹ It should however be noted that because of the methodology used, where little time pressure may be created, and the type of data used, being based on aggregate data, this does not mean that time constraints would not have an impact in specific markets.

²¹ Some evidence was found that time constraints had an impact on consumer behaviour. However, they were only significant when considered in conjunction with changes in both the level of discount and across locations. The research did not consider the most finite of all offers, the closing down sale.

6 CONCLUSION

- 6.1 The NBS research has reviewed the existing literature, both theoretical and empirical, on the impact of price comparison advertising. The new experimental work confirms past results suggesting that consumers can be misled depending on the way price comparison advertising is undertaken and that consumer perceptions and intentions can be altered. Inevitably, the research only covered a few of a wide range of potential price comparison situations. It would be possible to use the research methods developed by NBS to test a wider range of situations.