

The Role of Advertised Reference Prices in Consumer Search

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Consumers routinely search online and in-stores to get lower prices for the product they want to purchase. In doing so, consumers trade-off the expected benefit from search with the cost of search to determine whether to perform an additional search, or how many searches to perform. Retailers often post two prices on the price tag of a product – a regular price or an advertised reference price (ARP) and a sale price which the consumer pays if they choose to purchase. Previous research (see for example, Della Bitta and McGinnis 1981, Bearden and Teel 1984, Urbany and Weilbaker 1988) has shown that the presence of these ARPs increases a consumer’s likelihood of purchase and lowers her likelihood of search primarily by giving her additional transaction utility (Huang 2018). In this paper, we study a different mechanism through which ARPs influence consumers decisions to search and its potential implications for market structure. Specifically, we focus on the role of ARPs in influencing price beliefs and explore whether price beliefs mediate the direct effect (through transaction utility) of ARPs on a consumer’s decision to search.

We design an incentive aligned online study where consumers update their price beliefs based on random search outcomes, and trade-off potential savings from search with the associated search costs. The elicited price beliefs can be viewed as a consumer’s internal reference price which is consistent with previous research (e.g., Erdem et al. 2005, Urbany and Weilbaker 1988, Wenner 2015). Eliciting the entire distribution of price beliefs allows us to capture the role of uncertainty and account for the presence of multiple reference prices (Thomas and Menon 2007). In a randomly chosen subset of search tasks, consumers also see the ARP of the product, and we elicit price beliefs immediately after exposure to ARP. This allows us to focus on the role of ARPs in updating price beliefs, independent of the role of search outcomes on price beliefs (Kopalle and Lindsey-Mullikin 2003, Chandrashekar and Grewal 2006).

Preliminary results show that consumers update price beliefs in response to ARPs. Importantly, we find that price beliefs mediate the role of ARPs on search decision such that ARPs influence search decision primarily due to their impact on price beliefs as opposed to providing transaction utility to the consumer, as has been posited in the literature. We explore the implications of ignoring this mechanism on search outcomes and market structure.