Research Proposal

for

When the Price Isn't Right: A Decision Processes Approach to Ethics in Price Setting

by

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I plan to study the consequences of overcharging in asymmetrical markets where buyers are uncertain of the true quality of the goods. My hypothesis is that overcharging changes consumers' use of prices as a heuristic. I propose an experimental study on this topic with support from the Russell Ackoff Doctoral Student Fellowship. This opportunity will help me contribute to a deeper understanding of decision making in both ethical and effective price-setting.

Philosophical research on price gouging (e.g., Snyder and Zwolinski's discussion in *Business Ethics Quarterly*, 2008-9) raises awareness that overcharging is an important issue in today's economy, and that we do not have empirical analysis of its effects. The proposed study is an attempt to understand one aspect of the effects of overcharging – a resultant change in consumer behavior.

The modern marketplace has evolved as a place where people often rely on prices as a signal for quality (Rao and Monroe, 1989). This reliability is critical to the ease of transactions in the marketplace and consumer satisfaction (Akerlof, 1970). My hypothesis is that overcharging threatens the dependability of prices, and thus increases transaction costs.

To test this hypothesis, I developed an experimental procedure based on Peter Kollock's work (1994). The method uses a classroom or laboratory setting to mimic a marketplace in which sellers attempt to sell goods whose quality is unknown to the buyers. Like in a true marketplace, the buyers make a decision whether or not to purchase the goods, and only after purchasing the item are they told its true quality. A control group has buyers continuing to buy from the same sellers, and a test group has buyers purchasing from different sellers each round. My hypothesis is that buyers who are overcharged early in the game will learn that they cannot trust the price as a heuristic for quality, and will be less likely to buy goods later in the game. A further hypothesis is that the learning will carry over to interactions with other sellers, not just the sellers from whom the overpriced product was bought. If these hypotheses are correct then overcharging changes the way consumers understand the pricing system, and weakens their ability to use prices as an indication of quality.

I ran a pilot of this study in an undergraduate classroom, and the results supported these hypotheses. Further study is needed to confirm these results, as well as to understand the underlying mechanisms driving them. Additional studies involving greater experimental control will also allow me to test models of reinforcement learning in this context, to explore the motivations of buyer and seller market activity.

This empirical study will be combined with an analysis of its normative implications for business executives and consultants responsible for setting prices. The addition of the empirical piece to the contemporary normative debate will help develop a discussion which I intend to share with the wider business ethics community. Finally, I expect that insights from this study will be useful in developing an integrative view of the ethics of setting fair prices.

References

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