"Should Consumers Request Cost Transparency?" Cost Transparency in Consumer Markets

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Abstract:

Purpose — The purpose of this article is to provide a viewpoint about the role of cost transparency in consumer markets and whether or not consumers should request cost transparency from sellers, in light of the article by Simintiras et al. 2015.

Design/methodology/approach — Research in the area of cost transparency, pricing and related theoretical domains, is synthesised to understand the potential role for buyers and sellers in consumer markets.

Findings — Although there are an increasing number of examples of greater operational transparency in supply chains, cost transparency in consumer markets is not widespread. Increased cost transparency represents an important product attribute for consumers, enhancing fairness perceptions and affective evaluations. For sellers it is a potentially powerful complement to price moves, and, through enhancing trust among consumers, can positively influence brand value(s).

Research limitations/implications — Operational and cost transparency holds much promise as an emerging area in marketing but research into cost transparency in consumer markets is in its early stages and the limited number of field examples reduces the scope for empirical work. However using carefully controlled lab experiments much can be done to understand the generalisability and boundary conditions to its effect.

Originality/value — This article takes a balanced view about value to consumers and the implementation of cost transparency in consumer markets, highlighting key mechanisms through which greater transparency may influence consumer product evaluations, and concluding with some caveats in relation its practice.

Keywords: Cost transparency, Fairness, Pricing, Trust

Article Classification: Viewpoint

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Introduction

Under competitive conditions it is expected that prices charged by sellers will reflect their costs. To this end governments have either tried to liberalise markets through deregulation or have sought to introduce price controls where price increases require justification by cost changes (Rockoff, 2004). With globalisation and the digital economy, the removal of information impediments for consumers has significantly improved markets. Consumers in the new millennium have better price information and improved product quality information in the form of attribute comparisons, product reviews and online forums, and these help them to make better choices. In many cases the balance of power seems to have shifted to consumers within the marketplace. However, brands still proliferate and consumers still seem to rely on a range of heuristics to speed up decision making (e.g., Gilovich, Griffin, and Kahneman, 2002; Kahneman, 2011).

Cost transparency is defined as "…the sharing of information related to cost between suppliers and buyers" (Simintiras et al. 2015), or more specifically as "…the disclosure of the variable costs associated with each component of producing a good" (Mohan *et al.*, 2014, p. 2). Increased cost transparency ought to allow customers to compare costs, as well as prices, in order to more accurately assess a product's value and has been identified as a way to help build trust and relationships (Simintiras et al. 2015). Operational and cost transparency in business-to-business exchanges is a feature of many intermediate markets where collaboration between members of a supply chain is required to research and develop new products and processes (Lamming *et al.*, 2002; Sinha, 2000). But has it a place in business-to-consumer markets? In many ways cost transparency is already here. For example, fairtrade products are sold on the basis that they cost more to supply but that the added cost is socially desirable and a component of value (Reinecke, 2010). Two questions arise: 1. Should *consumers* request cost transparency from sellers? 2. Should *sellers* voluntarily supply cost information because it provides them with an advantage?

This commentary argues that the consumer has the right to *request* whatever information they require to make judgments about the value of the products they purchase and they can request this information by favouring those sellers who are most transparent. However, information itself comes at a cost to suppliers in the form of the loss of confidential and proprietary knowledge. There are also costs for consumers. For example, information accuracy is a perennial problem in the interpretation of costs and even within the accounting profession there is concern about the accuracy of cost information (Johnson and Kaplan, 1987; Otley, 2001). In addition there is an increasing problem of cognitive load as consumers typically struggle to accurately process an ever increasing array of shopping information (e.g., see Fasolo et al., 2007; Lowe et al., 2015; van Ittersum et al., 2010). Even though such information may be conveyed on the basis of a simple unit cost figure, consumers still need to trade this off against an understanding of the price of the product and the value of the attributes to them, and whether the offer is fair and acceptable. Thus, consumers may request greater cost transparency but this greater transparency may come at a cost.

Consumers and cost transparency

Cost transparency is not a common feature of markets but has most commonly been seen within utilities under regulatory pressure. Stigler (1971) argues that whilst regulatory intervention might be initiated because of a dominant position in markets, much regulation is a negotiation process in which consumers and producer special interest groups argue their case in various ways. Because producers are better organised than consumers, their voice is often heard most. Part of the persuasive process is demonstrating that prices are not overly in excess of costs in order to understate economic rents and by representing profit as an average rate of return consistent with the operating costs and capital and risk requirements of a business (Sanderson and Winter, 2002). Rail, water, power and telecommunications companies for instance may represent their costs, profits and investment intentions to the public in ways that emphasise their average profitability and forward investment plans.

However, the provision of cost information has not typically been an attribute that marketers provide to *consumers*. This could be for a variety of reasons, including reluctance to publicise profit margins and an inability to provide such information in a practical and effective way. Cost transparency may occur on a continuum from explicit unit cost information at each stage of the supply chain to divulging unit variable costs for producing a good (Mohan *et al.*, 2014), to signals from producers which lead to a perception of lower costs of production (e.g., retailers such as Aldi and Lidl may be perceived as better value because the company has not invested in costly and less important value added features). Alternatively consumers may be told costs are higher but not by how much (e.g., fairtrade products). So it appears that the provision of implicit or more explicit cost information does matter to consumers. A recent survey, for example, shows that 85% of consumers would be prepared to pay more for their milk if it meant helping the farmers who supplied it (Case, 2014). However, provision of explicit unit-cost information is not widespread.

Whilst consumers or regulators might request more cost transparency, another interesting question is 'when is it in a seller's interest to voluntarily disclose and publicise cost information?' Companies may be motivated to become more transparent about costs with consumers for a variety of reasons. These may include:

- *Enhancing the value proposition:* For example, a seller aiming to define value within the market (e.g., "hard" grocery discounters) as a low price-cost difference to enhance perceptions of fairness (Kumar, 2006).

- *Justifying a price increase:* For example, a seller aiming to counteract the adverse effects on customer satisfaction of a price increase (e.g., an energy company) by linking it to supply costs (Campbell, 1999)
- *Justifying the selling price:* For example, a seller aiming to 1) to justify a higher price than competitors when quality is discernible (e.g., Marks & Spencer' "quality worth every penny" campaign), or 2) to deflect issues about dominance in the supply chain (e.g., British retailer, Sainsbury's, advertises the prices retailers pay for milk; White, 2015).
- *Regulatory requirements:* For example, to deflect regulatory interest that could lead to costly investigations.

Using a series of lab and field experiments, recent research (Mohan *et al*., 2014) suggests that explicit provision of unit cost information may lead to an increase in sales of up to 44% for some classes of product. Therefore, firms may have a clear incentive, in some situations, to provide more explicit cost information to their consumer base. The implications of further cost transparency are discussed below, through exploring the mechanism of this effect.

Cost transparency and consumer fairness perceptions

One explanation for the mechanism through which cost transparency affects decision making is that consumers perceive cost transparency as a form of intimate disclosure (Mohan *et al.*, 2014) and that such disclosure has affective consequences for the firm and its products (e.g., likability and attractiveness). However, Mohan *et al.* (2014) point out that the benefits accruing to firms are likely to be lower (through lower willingness to buy and lower brand attraction) if the price to cost ratio is higher and if mark-ups are made more prominent to consumers. Therefore, firms need to be careful about how and what information is communicated to consumers. For example, cost transparency might not be appropriate for luxury products where the high price is less related to cost and more to exclusivity.

Consumer fairness perceptions are likely to play a role here too (Lowe, Lowe and Lynch, 2013) and existing frameworks incorporating fairness perceptions might provide some insight in assessing consumer reactions to cost transparency (Xia, Monroe and Cox, 2004). A consumer's perception of costs plays an important role in the determination of perceived fairness and subsequent behaviour (Bearden, Carlson, and Hardesty, 2003; Campbell, 1999; Taylor, 1985) through the principle of Dual Entitlement (Kahneman, Knetsch, and Thaler, 1986) and transparency can lead to reciprocated behaviour (Lowe, Lynch and Lowe, 2015). Consumers typically have inaccurate perceptions about a firm's costs and cueing consumers to develop a more accurate awareness of a firm's costs increases fairness perceptions. However, cost cues should be based around making the "right" types of costs more salient (e.g., costs which contribute to product quality) rather than other costs (e.g., promotional costs), which do not appear to link to fairness perceptions (Bolton, Warlop and Alba, 2003). Cost transparency is also likely to be more effective in situations when direct and alignable costs (i.e., labour and material costs) have been made more salient to consumers rather than nonalignable costs (Bolton and Alba, 2006). Therefore, the effectiveness of cost transparency is likely to be moderated by numerous different conditions, but primarily consumers will be concerned about the proportion attributed to different types of costs, and changes in particular costs; thus, all costs are not equal in the eyes of consumers.

Caveats to consumer cost transparency

Further to the moderating conditions noted above, although there is strong evidence that cost transparency has the potential to influence consumer evaluations, a number of caveats should be noted. Firstly, it is clear that the nature of the cost information provided to consumers has a strong bearing upon how they interpret that information within a fairness framework. However, operationally, another issue arises based upon the information that is provided to consumers. Accounting standards and practices vary (Otley, 2001) and in a competitive marketplace the nature of the cost information may need to adhere to some form of industry standard in order to ensure consistency of the information provided to consumers. Otherwise this information is likely to vary dramatically and be presented in a manner that is aligned with a marketing message rather than a true reflection of cost. If the nature of the information provided to consumers can vary too widely as a consequence of different accounting practices then consumers will be vulnerable to confusion and deception. Examples of this potential for confusion may be found in relation to different vendors who provide an apparently simple piece of information to buyers (in this case price) in a number of different formats (e.g., from £99, with or without taxes, further costs for credit card payments etc.).

Secondly, consumers are typically concerned with evaluating a product's benefits and comparing these to the product's cost to them as consumers. Adding another dimension, such as a product's unit cost of production and distribution, may lead to a further cognitive burden for consumers. Though cost transparency led to a number of positive effects for the seller of the products in the field experiment by Mohan *et al.* (2014) it did not take account of the increased complexity this would lead to in the market place if other firms started to do the same. Consequently, many consumers may find the enhanced cost information as an unwelcome distraction and burden and sellers might find its effects nullified by competitors.

Third, if cost transparency becomes prevalent in consumer markets and firms' prices are primarily based on costs, this might inhibit costly long term innovation in industries like pharmaceuticals where there are high and difficult to measure R&D costs (DiMasi *et al.*, 1991). In innovative product categories a common decision often revolves around whether or not to use an initial high price to skim the market or an initial low price to penetrate the market. Skimming strategies would be likely to highlight a large margin initially, which could be interpreted as being less fair (Lowe and Alpert, 2010). Consequently, firms producing innovative products with high margins would be more reluctant to publicly reveal their costs and cost transparency is less likely to be appropriate in the early stages of a high margin product's introduction.

Conclusion

Perceived fairness is important to consumers and is a strong influence on consumer behaviour. Consumers can, and should, request such information from firms, and rather than closely guarding that information firms can provide it to enhance consumer perceptions of fairness and trust. Consequently, some firms may wish to pursue such a strategy to differentiate their offering in a way that reflects their brand value(s). To answer the question posed, cost transparency is not "necessary" and there are many situations where it might not influence consumer choice but it is an attribute of the product that consumers may request and is a way for competitors to communicate their value proposition more clearly. As noted by one veteran in the grocery industry "The consumer has the power of choice ... The price is greater openness and transparency. The reward: a loyal and trusting customer." (Esom, 2008).

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