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Hidden price hikes at the supermarket

Lack of competition means chains can raise prices without it being noticed

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Many complaints have been voiced in recent years over the way in which supermarket chains set and change their prices. They have been charged with misleading customers by making it hard to compare prices, while concealing price hikes or minimizing them.

As in many other cases, such tactics are not an Israeli invention, having started long ago in the United States. A new study conducted by Daniel Levy from the economics department at Bar-Ilan University shows that American food retailers often engage in what he says are creeping price hikes. By raising prices in small increments over time, the increases tend to go unnoticed.

The study was done in collaboration with researchers from various business schools: Mark Bergen from the University of Minnesota, Haipeng Allan Chen from Texas A&M University and Sourav Ray from McMaster University.

These investigators followed pricing patterns at 93 large supermarkets belonging to the Dominick's chain, founded in 1925 and operating in the Chicago area in Illinois. Their study, carried out between 1989 and 1997, involved more than 98 million weekly recordings of the prices of over 18,000 items, grouped in 27 categories. The categories were very diverse, including cereals, cookies and snacks, soft drinks, dairy products, cleaning materials, frozen foods, non-prescription drugs and more.

The researchers focused on week-by-week price fluctuations. They used their database to measure the frequency of price changes relative to the magnitude of change. In other words, they measured how frequently prices changed by one cent, two cents, etc. They subsequently separated price increases from decreases, relative to the magnitude of the change. The findings indicate that there are more increases of 10 cents or less than decreases.

In searching for an explanation, the researchers examined the patterns of change during periods of low inflation. They reasoned that during inflationary periods more hikes were inevitable. However, if inflation were the only driving force for the asymmetry in price changes, this should be reflected in large price changes as well as in small ones. The results showed that inflation accounted for only half of the asymmetry they discovered.

This finding was borne out by additional tests, including using local market pricing indices, an index of product prices and a specific index based on Dominick's products. These allowed multiple comparisons and accounted for features like delays in supplies.

The other half of the asymmetry was explained by what the researchers termed "rational unawareness." This describes shoppers' behavior in which they knowingly ignore minute price increases. Retailers are aware of this and utilize it to their advantage, raising prices by tiny amounts in a process which continues even in deflationary times.

A further explanation lies in the fact that customers notice big changes and are unhappy when large increases happen more frequently than large decreases. Retailers try to avoid shopper dissatisfaction and employ an asymmetric pricing policy of small incremental hikes that apparently go unnoticed, slipping under customers' radar screens.

Consumers don't always notice price changes. *Ofer Vaknin*

The researchers conclude that customers knowingly ignore these small changes, thus avoiding the mental effort required to register and compare prices. The price they pay for this mental sloth is a creeping price inflation, which is often not justified by increased operational or production costs.

Levy claims that this study is relevant to Israel since supermarket chains in Israel employ the same tactics in setting their prices. "Since the local retail market is less competitive here, compared to the U.S., the policy of creeping price hikes, even when not justified by increased production or operational costs, may be more common in Israel," he says.

"Marketing chains in Israel have much more power in setting prices than the ones in the U.S., where over 1,200 chains compete for shoppers, with much lower profit margins. Competition leads to more efficiency and lower production costs. In Israel, less competition leads to inefficiency, with no incentive to streamline operations. Introducing new players into this arena should be made easier, in order to increase competition."

According to Levy, the chains raise their prices and unhappy customers force retailers to try and hide this. "The most common way of doing this is to disregard the law regulating the price displays and to place different package sizes in different store locations, making it harder for the customer to compare prices. In the U.S., prices are always adequately displayed, but here you hear excuses such as insufficient time to label products."