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The Free Market Illusion Psychological Limitations of Consumer Choice

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ABSTRACT

Point of departure for market regulation is that enhancing competition helps maximizing social surplus since consumer discipline stimulates innovativeness, quality improvements, and cost effectiveness. These effects however, can only take place if several conditions are met. One of these conditions is consumer rationality. Such rationality is determined by the interaction of consumer psychological characteristics and environmental conditions under which consumers have to make choices. In this paper we therefore study the potential for consumer rationality in conjunction with market developments. We find that, beyond a certain level of competitiveness, consumers increasingly rely on heuristics instead of relying on rational choice. This ultimately results in fewer incentives for innovativeness. To some degree the market itself will make up for the "rationality defects" by developing long term relations in which consumers and firms benefit from information exchange and invest in customized product offers. The paper concludes by making an inventory of possible implications for government interventions.

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I. INTRODUCTION

A so-called "free market" is associated with advantages and disadvantages for the two principal parties involved: the supply side (manufacturers/ marketers/ distributors) and the demand side (consumers/ buyers/ clients). For the former, a free market ensures the freedom to maneuver strategically, tactically, and operationally in the absence of far-reaching (suffocating?) government regulations. For the latter, a free market guarantees competition that, in turn, stimulates innovation, favorable value-cost ratios, efficient use of resources, market transparency, and flexibility in organizations and markets. Competition reduces organizational slack and bureaucracy. What is more: by its constant focus upon the consumer as the end point of the value chain, a free market is a disciplining phenomenon, as consumers will prefer the most favorable purchase options over the less favorable ones. While the free market advantages are impressive, there are some distinct risks as well. By their incessant emphasis on improvement, adaptation and innovation, most free market products and services have either relatively short life cycles or need to invest considerably and incessantly in supporting marketing activities. Market niches are difficult to find, to fill, and to hold. Frequently, products and services need face lifts as a result of evolving consumer preferences, consumer habituation to existing products and services, new technological possibilities, changes in manufacturing costs, and competition (see, e.g., Ofek and Srinivasan (2002)). Some products have a built-in short life cycle like fashion products; most products change attributes over time in order to either demonstrate or suggest progress. Different technologies, designs, and styles change so frequently, that they almost trip over each other. The market seems to be on the move constantly. As "new" products form the reference point for quality assessments, existing products are subject to continuous downgrading. They become "obsolete" either technologically or psychologically. A (technically) perfect product may be completely outdated when considered from a psychological point of view. The mobile telephone sector provides an interesting example. The drive for progress does not only generate turnover and profits, but also high financial risks, so that the balance between more or less innovation is a delicate one (as is well-known from the discussions over the relation between competition and innovation) See Agarwal (1996) for a discussion on the uncertainty and survival effects of innovation.

The balance between free market advantages and disadvantages is not dependent upon market processes alone, but may also be a governmental or political issue. For example when societal welfare losses due to high product turnover outweigh the financial benefits. In those cases, one would expect governments to be able to control market freedom by a predetermined set of effective instruments. However, there is no such thing as a standard “toolbox for competition management”. A toolbox, if any, should be based upon an understanding of the effect of supplier-consumer interactions on consumer behavior. It is the goal of this paper to contribute to this understanding by discussing market interactions and their consumer implications. The discussion will be based upon the existing psychological literature, observations of contemporary market structures and processes, and expectations regarding near future market developments.

The structure of the paper is as follows: Part II presents an inventory of the conditions required by a free market. Part III assesses to what extent these conditions can be met in contemporary markets. Part IV describes possible implications for consumer and supplier behavior. The description and explanation of a possible future market scenario follows in Part V, and Part VI concludes by discussing implications for government policy.

II. CONDITIONS FOR A FREE MARKET TO EXIST

Markets ultimately (should) serve consumer well-being. This term may be interpreted in several ways, ranging from very general to very specific. Consumer well-being in a general sense refers to the perceived overall quality of market structures, processes and supply. At a more specific level, consumer well-being is the equivalent of satisfaction with individual goods and services. At the most specific level, it is the consumer’s appreciation of isolated product/service attributes and prices. We identify four necessary, hierarchically related conditions for the realization of consumer well-being, satisfaction and surplus value

Condition 1: Freedom of choice

The primary condition for consumer satisfaction is freedom of choice. It allows consumers to select the option that provides the best match with personal requirements and desires. If consumers cannot choose (a.o. because of limited market supply or, because the nature and outcome of their purchases are predetermined), then consumers cannot discipline the market by changing suppliers. Free choice, then, relates to the number of options available in the market, the variety within the set of choice alternatives, and the costs to be incurred for obtaining the alternatives.

Condition 2: Free competition

Without the possibility of acquiring (more) profit and market share, there is no incentive for suppliers to create and offer choice alternatives. Competition stimulates suppliers to find new combinations of products and consumer segments, to offer product and service innovations and improvements, and to limit costs in order to increase the attractiveness of their offer.

Condition 3: Consumer rationality

Suppliers provide products and services in a particular quantity and variety. Consumers have to handle this quantity and variety, both physically and mentally. If there are various qualitatively equal, competing products with differing prices, the consumer should be able to identify and select the cheapest one. Conversely, if there are qualitatively different products with identical prices, the consumer should acquire the one with the higher quality (the one which corresponds most closely with personal preferences). The critical question in this discussion is: Do consumers behave rationally? Here, a distinction can be made between the rationality of the decision outcome, and the rationality associated with the decision making process leading to that outcome. The rational consumer selects the product which best fits personal preferences on the basis of an information handling and trade-off process that incorporates all personally relevant information and criteria.

If we adopt this view on rationality, for consumers to be rational a variety of conditions is to be met. They should be able to oversee and evaluate all products and services that are being offered, to be capable of fully understanding quality and price differences and to monitor all relevant changes. Also, they should anticipate new market offerings in order to be able to make a trade-off between buying now and buying later. And consumers should comprehend underlying market structures and processes so that they may consider alternative routes to purchase. Similarly, rational consumers should know the costs and benefits associated with the various distribution channels and to select, absorb, and comprehend all relevant product, service, and market information. Rationality implies the distinction, by the consumer, between factual product information and persuasive commercial information. Rational consumers make trade-offs and decisions on the basis of personal preferences, and incorporate long term, social and societal consequences of the choice alternatives. The question to what extent consumer rationality exists can only be answered by referring to the necessary conditions for rationality.

Condition 4: Consumer motivation, capacity, and opportunity

In general, for a particular behavior to take place, three conditions must be met: motivation, capacity or ability, and opportunity (Poiesz (1999); Gatersleben and Vlek (1997); Ölander and Thøgerson (1994); Robben and Poiesz (1992); Batra and Ray (1986)). Poiesz (1999) constructed the so-called Triad model on the basis of these three basic behavior determinants. According to the model, motivation refers to the personal importance of the goal; capacity refers to the set of personal characteristics and the instruments that may be employed; and opportunity refers to the quality of the situation and the available time. The combination of the three conditions determines the likelihood of behavior (such as making a purchase decision). Once it takes place, the combination determines the effectiveness and efficiency of that behavior (for example, the quality of the decision process) once it takes place. So, for rational behavior to occur, consumers must be motivated and have the capacity and opportunity to do so. The three conditions must be met *simultaneously*, not sequentially. If one of these conditions is not met, or only in a very limited way, the likelihood or the quality of the rational behavior reduces considerably.

III. RATIONALITY CONDITIONS IN CONTEMPORARY MARKETS

Now, in this hierarchy of conditions, the key question is whether consumers have sufficient motivation, capacity, and opportunity to be rational decision makers and thereby support the notion of the free market. Before we directly address this question, it is important to have a clear view of the market conditions under which consumers acquire information, make trade-offs, make decisions, and consume the acquired products and services.

These conditions are likely to vary depending on, for example, the nature of the products or services and the stage in the market life cycle. With regard to the former, a continuum may be assumed ranging from high to low perceived risk products. The position of a product on this continuum is a strictly subjective matter. Perceived risk may involve, for example, financial risk ("Is the product too expensive?" – a risk often felt in the case of expensive products like cars, life insurances and houses). It may also involve performance risk ("How durable is this product?" – a risk that may be associated with the purchase of used cars, furniture, and consumer electronics). The stage in the market life cycle is another condition determining market conditions. Upcoming markets may be distinguished from more mature, saturated markets. A market's life cycle starts with the introduction of new (combinations) of marketing instruments. As soon as successes become apparent, new suppliers are attracted and competition develops. In a later stage of the life cycle this will result in price reductions. This notion is similar to that of the "commodity trap" described by Rangan and Bowman (1992) for individual companies. It describes how companies move from a position with a combination of a high surplus value, high consumer price, and low serving costs to a position with a limited surplus value, low consumer price, and high service costs. Companies in the trap risk being forced into a mere price competition and possibly even to bankruptcy if they do not find a strategic way out. At the more aggregate – market – level, the same life cycle process seems to apply. This means that we may distinguish between three market life cycle stages: growth, maturity, and decline. In this sense, the market life cycle may be compared with the product life cycle (see, for example, Agarwal (1996)). In the growth phase, the market is characterized by successful innovations, in the maturity phase by strong competition. To a certain degree this cycle is comparable to the well known product portfolio matrix in which individual products or product groups are categorised by market growth and share: Problem child (cash user development phase with high market growth rate;); star (cash neutral with high market growth rate); cash cow (cash generator but low market growth rate) and dog (cash neutral with low market growth rate). Disciplining choices by consumers lead to acceptable price-quality ratios. In the decline stage (or “dog” phase), high quality is copied by the competition, and price is under strong pressure. The strong price focus reduces surplus value differences between different products, and consumers are increasingly incapable of identifying quality differences. The market eventually becomes more homogeneous. The growth stage and the maturity stage are the stages in which consumers may discipline the market. That is, under conditions of sufficient motivation, capacity, and opportunity to compare purchase options. Then, the critical question concerns the speed by which the decline stage is reached. This seems to depend upon a number of factors including the market potential, the number of suppliers, the level of competition, the rate of innovation, the possibility to imitate, and the level of technological sophistication. Again, from the consumer perspective, once consumers fail to show the motivation, capacity, and/or opportunity to compare market alternatives and to make rational choices, market decline is inevitable. Then, consumers cannot distinguish between quality levels, are more likely to favor lower prices (provided that they still have the motivation, capacity and opportunity to judge these), and there is no longer an incentive for suppliers to present surplus value for premium prices.

Over the past decades, markets have shown an increasing speed by which they progressed through their life cycles. At the level of individual products and services, this implied shorter product life cycles, a reduced opportunity to collect a return on investment, and a reduced incentive to start innovative initiatives. Stated differently, the effort that companies must show in order to present consumers with (perceived) surplus value is increasing over time.

To what extent are consumers’ motivation, capacity, and opportunity to make a rational choice affected by these market characteristics and developments? In relatively stable markets with moderate consumer risk and rather simple products or services, the motivation, capacity and opportunity of consumers do not preclude rational choice. However, in other markets, the levels of motivation, capacity and opportunity to make a rational choice may be reduced by either low risk, high technological sophistication, the number of products, the number of product variants, the number of brands, the number of distribution channels, and intransparant and versatile pricing policies.

Therefore, only in a few markets conditions will exist under which consumers can make rational choices, and when such conditions exists, they tend to be short lived. It seems reasonable to conclude that rational choice, as the basis of free markets, is a rare phenomenon.

In new markets in which consumers can still oversee and judge the options offered, competition in functional. The same applies to mature markets, provided that consumers still have the motivation, capacity and opportunity to make rational choices. In many mature markets, however, competition may prevent or limit rather than stimulate, enhance or facilitate consumer choice for the reasons just mentioned. In declining markets, competition focuses upon (low) price. This seems beneficial to consumers. However, a distinction should be made here between short and long term effects. In the long run, price competition leaves consumers with markets characterized by limited choice options, standard products, and little innovation, if any.

In spite of the enormous variety of choice options available to consumers in many markets, the perceived differences between these options are often small, trivial, or even completely absent. Over time, quality levels have been increasing to a point where quality seems invariably high. Because of the incessant emphasis on innovation (one of the techniques applied by suppliers to outrun the competition), almost all products and services are at a high level of technological sophistication. This does not only apply to cars, personal computers and airplanes, but also to seemingly simple products like margarine and textiles. High innovation rates imply short product life cycles. The amount of information on what is available in the market is overwhelming. New media to reach consumers are introduced frequently. The latest addition is the Internet, which allows consumers to have access to an almost unlimited amount of product, service, and brand information. On top of all this, there are many price levels and payment policies. What is more: the market is highly dynamic; changes are taking place continuously.

These conditions would seem to closely approximate a free market. Consumers can choose and buy what they need and want, and whatever they need and want. However, this seems to apply to rational consumers only. Therefore, let us discuss more elaborately to what extent consumers can meet the conditions of motivation, capacity, and opportunity to make rational decisions

A. *Motivation*

On logical grounds alone, it may be questioned whether consumers are highly motivated to make rational choices. The invariably high quality that characterizes most products and services, and the trivial quality difference that come with it, does not invite the consumer to spend time, energy and/or money on quality assessments. Consumer motivation to carefully judge and compare alternatives is reduced by a.o. the belief that quality is monitored by independent institutions and research organizations. At the same time we must note that these third parties do not guarantee rational consumer choice as they do not assess the particular fit between consumer and product characteristics.

The skepticism with regard to high consumer motivation is reflected in the many publications on low involvement (that is, low motivation) consumer behavior (see, for example Heath (2001); Kujala and Johnson (1993), for reviews). Also the relatively high incidence of impulse buying does not support the notion of a highly motivated consumer (see, for example Huang (2000)). In conclusion, motivation to make a rational choice seems to be a condition that is very difficult to meet in many markets.

(It might be argued that choices, due to the search costs involved, are not necessarily irrational if quality is not scrupulously assessed in the presence of only trivial quality differences. While the argument, in itself, is correct, it is not an issue in a discussion on the disciplining of free markets. If all products are equal, there is no need to discipline the market. Consumer rationality as a disciplining condition is only required in the case of non-trivial product quality differences).

B. *Capacity*

Capacity has different meanings. First, it addresses the consumers' knowledge of the availability of products and services in the market. What products and services does the consumer know to exist? The second meaning of capacity refers to the consumers' understanding of the technology involved. And capacity refers to the consumers' ability to integrate the large amount of product and service information into rational evaluations, trade-offs, and decisions.

With regard to each of these meanings, anecdotal, and empirical evidence suggests serious limitations (see, for example, Olshavsky and Granbois (1979)). Many products and services simply are not understood in terms of their objective inherent qualities. For this reason, Nelson introduced the distinction between search, experience and credence qualities (Nelson (1970)). Search qualities can be ascertained by pre-purchase information. An example of a search quality is the number of Michelin stars for a restaurant. Experience qualities only produce the required information after consumption (such as in an unknown restaurant without search qualities), and credence qualities do not convey quality information at all, neither before, during, nor after consumption. This may be the case with, for example, car maintenance, particular medical treatments, and particular financial services. It may be argued that, over time, the proportion of credence qualities increases relative to that of search and experience qualities. One of the reasons is that the technical sophistication of many products and services has increased to a point where consumers fail to understand what is being offered.

With regard to the amount of information that consumers can oversee and integrate, psychological evidence exists showing that consumer (human) memory capacity is limited (see Dougherty and Hunter (2003)). Slovic (1966) found that people make decisions on the basis of a maximum of three aspects. Here it may be noted that most present-day products and services are characterized by (many) more than three differentiating characteristics only. Research evidence also suggests that peoples' / consumers' decision making is affected by information overload (e.g. Meyer and Gudykunst (1997); Swink and Speier (1999)). In the area of information processing, the vast amount of research on the Elaboration Likelihood Model (Petty and Cacioppo (1986)) has shown that a variety of ability or capacity problems may prevent people from adequately processing product and service information. In the same area, numerous studies have shown that consumers deal with information in a way that is not consistent with rational decision making (see, for example, Peterson and Merino (2003)). Research on the way in which people integrate information from a product-attribute matrix (e.g. Jacoby (1977)) has shown that people have great difficulty in applying so-called compensatory decision rules. Such rules allow negative product attributes to be compensated by positive attributes. Compensatory rules are a prerequisite in rational decision making. So even if consumers would be capable of perceiving and judging product and service information in a rational, unbiased way, they would not be capable of integrating this information into a consistent and well-founded overall decision. Finally, it may be noted, somewhat superfluously, that the quality of consumer knowledge and decision making is likely to suffer from the high level of market dynamics. Consumers cannot be expected to keep track of all the changes that are going on. For consumers, most markets are highly complex, intransparant, and dynamic.

C. *Opportunity*

Finally, for the third condition, opportunity, similar reservations may be expressed, although the amount of empirical evidence is limited here (see, for example Klumb (1999)). This might partly be explained by the fact that hypotheses are often tested under more or less ideal circumstances where opportunity is not limited. This leads to an underestimation of the importance of situational factors in psychological research. There are some exceptions, focusing upon the effects of time pressure on the preference for negative information on choice options (Ben Zur and Breznitz (1981)), reduced decision quality (Meyer and Gudykunst (1997)), the increased reliance upon noncompensatory strategies (Payne et al. (1988); Svenson et al. (1990)), and type of decision making (Kertsholt (1994)). The mere observation of consumer buying in real life at least suggests that the conditions under which complex decisions need to be made are far from ideal. Information acquisition, evaluation, and integration may be seriously disturbed by background noise, talking salespersons, the (noisy) presence of other customers, store music and auditory in-store announcements, in-store displays, and a limited amount of time available for the decision. For services, similar arguments may be presented. The judgment of services is often taking place under conditions that do not facilitate elaborate evaluations and trade-offs.

In sum, it seems reasonable to conclude that it is difficult to really meet any one of the three conditions for rational decision making, motivation, capacity, and opportunity, in contemporary markets. By consequence, their *combination*, which is the necessary condition for rational choice to take place, is even more unlikely.

What is more: if we adopt the assumption that all three conditions are necessary and must be present simultaneously for rational behavior to occur, truly rational behavior is extremely unlikely. The notion of consumer rationality seems to apply only in the rare case of a very simple market with a very small number of simple purchase options and a consumer who is interested in making the best buy possible. In real life, such a case rarely exists, if at all. To exemplify this point, let us identify markets on the basis of the degree to which they meet the Triad conditions. For this a – somewhat crude overview – can be made, in which the 8 alternatives are presented that can be constructed by assuming only two levels (+ or –) per condition.

TABLE 1
Rational Choice

Market	Motivation	Capacity	Opportunity
1	+	+	+
2	+	+	–
3	+	–	+
4	+	–	–
5	–	+	+
6	–	+	–
7	–	–	+
8	–	–	–

In only one of these types, all three necessary conditions are met. Of course, this in itself is no indication for the size of these various markets. However, only in market type 1, consumers are motivated to make a rational choice, make use of search qualities, and make the comparison under favorable decision making conditions.

Let us briefly discuss some examples. If competition is introduced in the taxi business, consumer comparisons are seriously hampered by its experience qualities. For example, only after the service, consumers know what the price is. Only if they repeatedly travel by taxi on exactly the same route under exactly the same traffic and weather conditions, comparisons may be made between different companies or drivers. That is, if the trade-off is not complicated by other (quality) elements that differ between the taxi companies, like friendliness of the driver, age of the car, cleanliness of the interior.

Another example is provided by the telecom market. The introduction of competition in this market has initially produced a considerable number of innovations and improvements to the benefit of the consumers. Take mobile telephones, for example. The very competition induced the market to quickly reach the maturity stage. Now the situation has developed to one in which consumers have great difficulty in comparing choice alternatives. For this, the market has become too versatile, too complex, and too in-transparent. Consumers will start making decisions on the basis of heuristics ("I have seen this on tv", "my friend has one too", "this is a well known brand", "I like this design", "is recommended by consumer reports", "is used by a celebrity", "just give me the best price offer", "I want the more expensive one, just to be sure", "which mobile phone do you (salesperson) have yourself?", etc. These heuristics are the best guarantee that the disciplining effects of consumer choice are either small, absent, or even adverse. The objectively best buy may be survived by a poor buy, just because consumers do not know better.

Most of the time, most consumers in most of the situations seem to engage in a process that demonstrates pseudo-rationality.

According to the reasoning presented earlier, implying hierarchically related conditions for a free market to exist, a lack of true rationality implies the absence of competition, freedom of choice, and a free market (except in the rare case of very simple markets with very motivated consumers). Consumers who are incapable of handling market supply side offerings can hardly be considered autonomous. Rational choice exists to the extent that purchase options can reasonably be overseen, judged, compared, and decided upon. The most general conclusion is: they cannot. According to a strict objective and judicial definition, freedom of choice is present but, psychologically, full freedom of choice is absent. (It only exists in the sense that nobody forces anyone to buy anything). It is important to note that free choice is ultimately determined by behavioral and psychological criteria, not by objective and judicial ones. Psychologically, free choice is a *fata morgana*.

D. *Implications for consumer behavior*

This interpretation of contemporary markets implies that, to consumers, the disadvantages of competition might increasingly outweigh its advantages. Of course, this applies more to mature and declining markets than to growth markets. In the former types of markets consumer satisfaction and well-being are structurally and seriously under pressure. What does this mean for actual consumer behavior in the market? We present an inventory of possible implications. And, in order to complete the cycle (consumers react to suppliers and suppliers react to consumers), we also assess the types of reactions shown by suppliers.

If consumers can not really show rational behavior, what alternative behaviors are in effect?

To start with, it is obvious that consumers will continue to make purchases. However, it is not the quantity but the quality of purchases which is at stake here.

Already in 1979 Olshavsky and Granbois noted a variety of deviations from rational consumer decision processes, which they placed in four categories. For each, we will indicate their main findings, emphasizing that the results relate to the U.S. population in U.S. markets in the late seventies. While generalization seems impossible to Western European consumers in Western European markets in 2003, it seems allowed to prudently draw a parallel.

With regard to budget allocation, Olshavsky and Granbois (1979) noted, first of all, that the vast majority of households does not have a financial plan. Budgets for diverse household expenditure categories seem to be established post hoc, that is after the money is spent. (People happen to spend a particular amount of money on household goods. This is called a budget, but is not a planned budget). Regarding generic allocation (allocation to general categories of products and services), the authors found that twenty to fifty percent of the purchases of durable goods involved impulse purchases, while impulse purchases accounted for fifty percent of the supermarket purchases. When preparing for purchases, usually no extended search takes place. Even for the acquisition of durables, consumers often visit a single store only. Before making a brand selection, one third of the consumers only uses one information source, a high percentage only refers to price, and for many supermarket products, no prepurchase information seeking takes place. As this does not only apply to low price and low risk products, but also to their more expensive and risky counterparts. This is a general consumer decision making issue.

More specifically, people use heuristics in order to evade decision complexity and ambiguity (Keren and Gerritsen (1999); Tversky and Kahneman (1974) – the certainty effect). Consumer behavior examples of the avoidance of complex decisions are the use of a well-known brandname, the highest price/ the lowest price, the salesperson's advice, the use of frames, anchors or reference points (Tversky and Kahneman (1974); for a review of the effects of decision making reference points see Levin et al. (2002)).

Heuristics may result in the consideration of a limited set of alternative products or services rather than the full set. This has resulted in the proposition of the term "consideration set" in the marketing and consumer behavior literature (e.g. Kardes et al. (2002)).

Purchases may not originate in product needs and desires, but may be by-products of other phenomena such as social exchanges, leisure activities, or fun shopping. The activity of buying may have become an end in itself (see Holbrook and Hirschman (1982)).

Products and services may provide an alibi for going out. This notion, if valid at all, would deviate considerably from the idea of a careful match between market supply and market demand as implied by free market principles.

Consumers may avoid complex decision making by showing habitual behavior. Habits prevent consumers from having to go through the decision process again. It may be assumed that habits are most likely to be formed if the selected product is satisfactory and the purchase related costs are high. Needless to say, in a market where products and services are updated and upgraded on a continuous basis, habitual behavior may deviate considerably from rationality. The same reasoning may equally apply to the purchase of more expensive and less expensive items. For example, consumers may show habitual buying behavior by buying a particular brand or purchasing at a particular retail. According to Fethke et al. (1996), habit goods are most likely to be found in markets with imperfect competition.

Another way to avoid complex decision making is to delegate the decision altogether. One way is to "blindly" follow the advice by consumer associations and independent product tests; another is modeling, by which the consumption behavior of another person (a celebrity) is adopted, or to have another party like a sales person literally make the selection. This does not result in market disciplining by consumer choice if the free market is meant to result in an optimal match between individual consumer needs, demands and wishes on the one hand and product characteristics on the other hand.

Three arguments seem to alleviate deviations from rationality. The first argument is that consumers are increasingly demanding with regard to quality, prices, and after sales. The second one is that there is an abundance of satisfaction research by the market supply side which will prevent products and services to deviate too much from consumers' preferences. Argument three is that consumers can consult the Internet. This new medium helps them to overcome limitations of rationality. We will briefly react to each of these arguments.

E. *Demanding consumers*

Demanding consumers seem to present a paradox: on the one hand consumers are incapable of making the best choice; on the other hand they demand the best. However, it may be argued that the paradox is alleviated by the high probability that these demands refer to relatively simple product and service aspects. Consumers are more likely to discuss a price reduction than to discuss a technical aspect of a new piece of audio equipment. Here a parallel may be drawn with advertising. If consumers do not understand the advertising message, s/he will resort to message aspects that s/he feels are understandable, although these aspects are irrelevant to the actual message content (Petty and Cacioppo (1986)). There does not seem to be an *a priori* reason why the processing of information in advertising is basically different from the processing of information from complex products and services. Thus, when consumers are incapable of judging the actual price-quality relationship of a product or service, they may resort to those product or service aspects that are easy to judge, like speed of delivery, timing, and personnel friendliness

1. Consumer satisfaction

Another puzzling finding is that in market research consumers often react positively when asked to evaluate new product characteristics, new products, or product adaptations. If consumers indicate that they like these, then why don't they act (purchase) accordingly? Dholakia and Morwitz (2002) seem to present one possible explanation. According to them: "For most people, responses to questions in satisfaction surveys are likely to be measurement induced rather than available beforehand or spontaneously formed. This is because explicit directed thoughts regarding the satisfaction level with a particular product are unlikely to occur spontaneously for most respondents in the absence of specific questioning or a striking (…) experience with the product (…) (p.160).

2. Internet

In order to escape information overload, consumers increasingly consult the Internet. This medium allows them to self-select information. However, this does not overcome the limitations in consumer decision making. In the literature, information (over)load is viewed as a combination of information novelty and complexity (Huang (2000)). Both aspects are abundantly present on the Internet. Therefore, it may be questioned whether the Internet, in itself, really supports consumers in making better decisions (Peterson and Merino (2003)).

F. *Suppliers' reactions*

As indicated, consumers react to the behavior of suppliers (aggregated to market supply), and suppliers will react to consumer behavior. The dynamics of the mutual influence may be followed over time.

Suppliers realize that due to deviations from consumer rationality, the self-disciplining function of markets is reduced. The typical reactions by suppliers can best be described with the help of the so-called "marketing spirals" (see Poiesz and Van Raaij (2002)).

The underlying reasoning is that when the effectiveness of conventional marketing practices is reduced, the usual reaction by suppliers is to intensify these same practices. We can take the explosive growth of communication efforts, media, and budgets as an example. At an aggregate level, this produces effects that are the exact opposites of the ones intended by the individual suppliers. These effects will be described for each of the marketing instruments.

1. The innovation spiral

Fierce competition requires suppliers to invest constantly in innovation in order to generate added value of their products and services. New technologies are introduced continuously (Glazer (1995), (1999)). This leads to such an increase of innovations and adaptations that consumers fall behind: they are unable to keep track of all changes. This reduces the perceived added value of these innovations and adaptations. As suppliers are dependent on their relative position in the market, they respond by investing even more in innovations and adaptations in order to guarantee added value. The spiral starts turning, and turns faster and faster.

2. The communication spiral

In order to inform consumers about their products and services, suppliers communicate about them. They communicate even more because of the reduced effectiveness of innovation. This leads to information overload on the part of the consumers, which logically implies a reduction of the effect of the average message (e.g. Jacoby (1977) as consumers will have to divide their attention over all messages or to be selective with regard to messages. Suppliers respond by further increasing their communication attempts (after all, they must reach the consumers), which sets the communication spiral in motion.

3. The distribution spiral

If mass communication proves to be increasingly unsuccessful, the next option is to contact the persons in the target group directly by direct mail, telemarketing, face-to-face contacts, call centers, and the use of more distribution channels simultaneously.

The risk of the spiral is evident. By increasing the number of attempts to approach individual consumers, they will experience a reduction of personal freedom, which leads to reactance effects (see, for example Brehm and Wicklund (1997); Edwards, Li and Lee (2002)). This reduces the effectiveness of the instrument, to which suppliers will react by exploiting each new distribution possibility that comes along. The result is a distribution spiral.

4. Finally, the price spiral

If suppliers are incapable of presenting or suggesting differential added value to consumers (even though objective quality differences may continue to exist), the latter will base their decisions increasingly on price only. This is consistent with the reasoning presented earlier: if a consumer does not understand the quality of a product, and does not see the difference in added value with another product, the only understandable difference may be price. Here the residue of rationality comes to the surface, as consumers will favor a lower price over a higher price. A stronger emphasis on price cuts will affect profits. Profits, in turn, will affect the financial room for investments, and the size of the investments determines the possibility of product adaptations, innovation and differentiation. This completes the "spiral of spirals"

In conclusion, the combination of consumer limitations and supplier reactions ultimately results in a homogeneous market. There is no direct empirical evidence to support this as it is a slow, generic process that is likely to expand in the near future. But it seems acceptable to propose that the elaborateness of consumer decisions does not reflect the complexity of products and services. By consequence, surplus value is either absent or remains undetected. Consumers do not pay (extra) for what they do not see. Thus, market differentiation is reduced, which is followed, inevitably, by a reduction of price differentiation. In a homogeneous market, the variety of products and services is very limited, the quality is standard, the innovation rate is very low, and suppliers ultimately compete on the basis of price only. Added value stops being a leading marketing concept. The vast majority of market activities accelerate the marketing spiral. Note that an incidental marketing success in itself does not mean an escape from the spiral: it is copied by the competition in no time. Any activity attempting to differentiate is frustrated and sucked back into homogeneity. This situation reflects the exact opposite of the free market, in which competition boosts quality, variety, innovation, and consumer satisfaction.

V. TOWARD A FUTURE MARKET SCENARIO

Market parties do not only respond passively to these developments. They show some reactions that may be the ingredients of an effective escape strategy. First, we identify the various activities, then describe the general strategy, and finally present the near future market scenario resulting from it. The following reactions are attempts to escape from the marketing spiral. At the same time, it should be noted that successful attempts are likely to be copied by the competition. So, purely in themselves, these conditions may be necessary and not sufficient to guarantee consumer choice.

What marketing activities deviate from the more conventional ones?

1. Brand extensions: the application of a well-known and respected brand name to new products and services (see, for example Swaminathan, Fox and Reddy (2001)). Initially, the brand Nike was exclusively available for sporting shoes. Now, a large variety of other products in sports and clothing carry the name.
2. The introduction of info-mediaries (see, for example Pederson (2000); Degeratu, A.M., Rangwasamy and Wu (2000); O’Keefe and McEachern (1998)). There is an increasing number of Internet-based facilities that allow consumers to compare products and services (“intelligent agents”). There are intelligent agents to support consumers with regard to communication, search, portfolio analysis, purchases, work, news-gathering, product and service comparisons, shopping, auctions, and fun.

3. Policies and systems that place a stronger emphasis on long term customer relationships (Day (2000); Gruen, Summers and Acito (2000); Lemon, White and Winer (2002); Winer (2001)). It is generally assumed that marketing costs associated with individual transactions are much higher than the costs related to building a long-term client relationship.
4. The individualization of products and services, fitting them to the individual consumer's idiosyncratic needs and preferences (see, for example Sheth, Sisodia and Sharma (2000); Wind and Rangaswamy (2001)). Part of this development is mass customization: the production of individually designed products and services through high process flexibility and integration (e.g. Kamali and Loker (2002); DaSilveira et al. (2001)).
5. The formation of product and service packages (see, for example, Poiesz and Van Raaij (2002)). In health care, for example, we see that cure is being combined, increasingly, with prevention and reintegration services. In the area of consumer durables, two Dutch manufacturers have presented an excellent example by combining a coffee maker and coffee pads. Although the businesses (electrical equipment and food products) are completely different, the value of their combination is more than the sum of the values of the individual parts.
6. Commercial activities that allow consumers to delegate their decision to a third party. For example, consumers have the possibility to delegate their wardrobe decisions to a party that pre-selects on taste, size, budget, etc.

Although these activities are rather unconventional and still not common, they are still subject to the disadvantage of rapid adoption by the competition in the case of success. In that sense, they might have no other function than to delay the acceleration of the marketing spiral. For this reason, Poiesz and Van Raaij (2002) argue for a strategy that focuses on a combination of the essence of these aspects. They refer to this combination as "synergy marketing" (to be distinguished from convergence marketing – a combination of the "old" and the "new" Internet marketing – Wind, Mahayan and Gunther (2002)). The central idea is that long(er) term relationships with customers may be used to acquire a deeper insight into individual consumers' needs, *and* that the result, in the form of a package of complementary products and services, will attract consumers to stay in the relationship longer. This combination would provide a self-supporting and enhancing system, by which the marketing spirals may be avoided. Once the relationship involves a more elaborate package, support in the form of information and communication technology is required. This allows the supplier to identify the optimal fit between consumer and product/service characteristics, and it gives the consumer the opportunity to provide feedback on the satisfaction with the provided package. The supplier wants to continue the relationship for reasons of business continuity. And the consumer wants to continue the relationship because of the sunk costs of time and information. Trust (Garbarino and Johnson (1999); Moorman, Deshpande and Zaltman (1993)) develops over different transactions, to the extent that the supplier is better capable of making decisions for the consumer. The consumer provides elaborate feedback, knowing that this will directly affect the quality of the package provided. This will prevent the supplier from offering "useless" products. Under conditions of full trust (as the positive expectation regarding future performance based upon repeated positive experiences in the past), the consumer is likely to delegate, to the supplier, the purchases that are either uninteresting (motivation), too complex (capacity) and/or too time-consuming (opportunity – think of double income families). In turn, the supplier will honor the invested trust, and will select those products and services that are most likely to further increase satisfaction. Consumers will be unable to judge a package's price level. This seems to be a critical point in the argument. However, as the relationship is based upon trust and the intention to continue the relationship, neither party will exploit the situation unfairly.

In summary, a supplier-customer relationship will support the formation of individualized packages, and the concept of individualized packages will support the development of longer term relationships. Where possible, this combination will be based upon ICT-facilities.

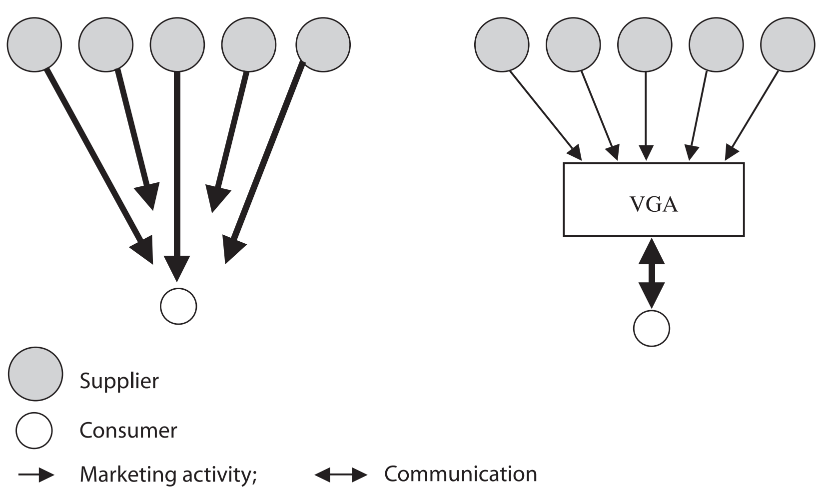
Poiesz and Van Raaij (2002) refer to this new marketing system as a "VGA": an ICT-based "Virtual Guardian Angel". The authors expect that the market will crystallize around a number of such VGAs. They expect them to form with regard to major domains such as education, work, housing, health care, and leisure activities. It is anticipated that the number of VGAs is considerably smaller than the number of brands available in present-day markets, as the VGAs will adopt the function of meta-brands. This new notion of markets may be viewed as a logical extension of the intelligent agent supporting the consumer in his/her purchase decisions. The VGA will serve as an intermediary between the consumer and a variety of suppliers, and will select the suppliers that are best capable of providing added value to the individualized package already formed. The market structure will change considerably (see Figure 1).

As direct communication in the conventional market structure (left hand side) is predominantly top-down, no reverse communication lines are indicated here.

The structure depicted on the left side of Figure 1 shows how each individual supplier confronts the consumer. The figure is a simplification as the number of suppliers per consumer is in fact extremely large, and the thin lines representing marketing activities do not adequately represent the fierce intensity of these activities. The structure on the right side shows how the VGA serves as an intermediary between the suppliers and the consumer. Over time, the VGA receives input from the individual consumer and translates this into the nature of the individualized package. By continuous package improvements, the consumer's satisfaction and trust increase. The consumer notices that feedback on his/her satisfaction/dissatisfaction leads to a further improvement of the fit with personal needs and desires. For this reason, s/he is eager to provide information on any changes in consumption needs, desires, and experiences.

FIGURE 1

The conventional and VGA-based market structures (resp. left and right)



If the market would indeed develop according to this scenario (earlier we mentioned several initiatives showing that it does) it would have important implications for consumer behavior:

- The number of marketing activities directed at individual consumers will decrease dramatically.
- Consumers will delegate those decisions to the VGA for which they do not have sufficient motivation, capacity, and opportunity. At the same time, the disadvantages inherent in the marketing spirals are strongly reduced.

It is important to note here that the consumer will have complete freedom to decide whether, and if so, to what extent, s/he would join and be associated with (be a member of?) the VGA.

Participation is not obligatory. The system would allow for large individual differences and changes in individual consumer preferences.

In a highly saturated fluid, it is not clear where crystals will start to form. Similarly, it is not clear which party or parties will become a VGA in a saturated market domain. It may be an individual supplier, a combination of suppliers, or an independent organization. Privacy issues will need to be considered. But as VGAs are unlikely to trade private consumer information (this would jeopardize their own existence), consumer trust will develop over a sequence of purchases.

Once a consumer is very satisfied and does not question the trust in the VGA, price is no issue, as long as consumers experience added value within their budget constraints. Consumers have no problem paying for added value if spending stays within the constraints set by their own budgets.

The delegation of purchases to a VGA may seem like a reduction of consumer freedom and autonomy. However, the consumer decides which purchases to delegate and which not.

Thus, the future scenario depicted here has the advantages of the free market and lacks the disadvantages of conventional marketing. It meets all conditions for consumer satisfaction and wellbeing. Of course, the scenario has a number of uncertain elements. The speed of development is not known. It is not clear when and where VGAs will form. And it is not clear if supplier-consumer relationships will form in the way described. However, three points are important when judging the likelihood of the scenario. The first one is that the present marketing is reaching its limits. This is agreed upon by the vast majority of marketing managers. The second point is that each of the ingredients of the new scenario is already developing in the market. They only need to be combined in space and time in order to make the synergy work. The third point is that the first initiatives in the direction of VGA-like scenarios may be detected. In the health care sector, for example, there are initiatives in which prevention, cure, and medical guidance and monitoring are organized in relation to a medical passport. Similar initiatives are taken in the area of financial products and services. Given the more or less desperate attempts of contemporary marketing to find a way out of the spiral, the new scenario may burst into existence, once the start is made.

VI. IMPLICATIONS FOR GOVERNMENT POLICY

What is the possible role of the government with regard to these various developments and with regard to the possible future scenario?

Basically, there are two generic policy options (apart from doing nothing).

A. *Option 1*

This first option assumes that the market will gradually or suddenly progress towards a system of VGA's. Then, notions like consumer choice, competition, and the notion of the free market should be placed at a more aggregate level. Consumers do not choose anymore between different brands or different products, but different multi-product systems. Consumer disciplining of markets can only take place at this level, but is seriously limited by long term relationships. In this sense, competition at the consumer level is strongly reduced. Competition will continue to exist between manufacturers supplying the VGAs.

Government recommendations

- The government may play a rule in setting rules for such VGAs to perform. It is very unlikely that the available anti-trust rules apply in the expected new market situation. The government is advised to monitor market changes closely and to be ready for new VGA-like structures and processes in markets to develop.
- Closely monitor the development toward VGA-like structures. Do not misinterpret the formation of groups of suppliers under one heading or brand name. This may be a logical and acceptable

response to marketing spirals, not a move to limit competition or to reduce consumer autonomy.

- The privacy issue is an important one but should not be taken too rigidly. It may be in the consumers' own interest if personal data can be accumulated in a database. It is not in the interest of consumers if VGA-like developments would be stopped prematurely by legal constraints. The government has an important role in allowing consumers to provide personal data to optimize consumption packages. It may set the legal conditions for an agreement between a suppliers or a group of suppliers and individual consumers.
- The government should stimulate a discussion as to the boundaries within which VGAs or similar structures may develop. These boundaries may refer to the types of products or services (health insurance? Charity?), the types of organizations (can the government be part of such a system), the types of consumers (what is the starting age; what are special requirements for the elderly?), the type of relationships (members; participants, subscribers?), and the type of exchanges taking place (per transaction; monthly payment; automatic deduction from salary?).
- Needless to say, the government should stimulate research in the various areas. On a global scale, many initiatives are on their way. It is not very efficient to reinvent the wheel or to be forced to passively follow initiatives developed in other countries. The rule that innovations require investments is not limited to commercial markets.

B. *Option 2*

A second possibility for the government is to support and stimulate consumers in the present market conditions to evaluate and compare choice alternatives. Thereby, it may stimulate competition and market disciplining by consumers. For these, a number of measures may be recommended that may improve the quality of consumer decision making.

Government recommendations

- Markets do not function properly if consumers lack the motivation, capacity, and opportunity to make rational decisions. The government should be aware of market non-functioning (that is, consumer exploitation?) if either one or a combination of these conditions is lacking. Particular attention should be paid to the so-called low involvement products, technologically complex products, or products that need to be decided upon within a very short time period or under sub-optimal circumstances (an example of the latter is a commercial offer that is “valid for three days only”). To the extent that there is a problem with either consumer motivation, capacity and or opportunity to evaluate and compare purchase options, the government may stimulate these conditions.

- In the case of capacity limitations, consumer information is important. The behavior of information processing is subject, again, to the consumers’ motivation and capacity and opportunity (e.g. Poiesz (1999)). This means that the information provided to the consumer is often too complex to be functional. For example, manuals that come with the product often discourage rather than stimulate its consumption.
- If the purchase of products and services is complex, their consumption is likely to be complex as well. The support of consumers during consumption should be stimulated. One way would be to extend the notion of money back guarantees. Suppliers need to be held responsible for the product or service beyond the point of the actual purchase or payment. Consumers acquire the product or service not for the mere act of the purchase, but for the consumption experience. This, then, should have a higher position on the supplier’s priority list.
- Help consumers with general information on the market. Consumers are unlikely to know the range of quality levels and prices. They are unlikely to have clear reference points. They do not know what may go wrong in the purchase or during consumption. What should quality and price levels be compared with?
- Governments should identify so-called outliers in imperfectly functioning markets. Outliers are suppliers that present products and services with very unfavorable price-quality ratios.
- One of the most important sources of information to consumers is feedback from other consumers. The exchange of purchase and consumption related information should be stimulated.
- The government may stimulate the innovation of decision support systems for consumers. The present paper shows that the mere provision of (more) information is insufficient and possibly even counterproductive The provision of more information may reduce rather than improve the quality of the decision. Even if consumers

understand what information is presented, they may not be capable of combining it into a decision. Consumer decision support systems may be located on the Internet or in stores. This is not the place to discuss the characteristics of such systems, but their major function would be to reduce the number of personally relevant choice alternatives to a number that consumers can oversee, and to carry out the trade-offs between these alternatives on the basis of personal preferences.

- The government may stimulate the Internet as a tool to enhance market performance. Prevent some social groups from becoming Internet have-nots. This would not only affect their general position in society, but also their power as a consumer.

Some of these functions may, in principle, be fulfilled by consumer organizations or other societal institutions. However, if the developments take place as expected here, they will probably outgrow the capacity of such organizations.

VII. CONCLUDING REMARK

The goal of the present paper was to assess consumer freedom of choice and to discuss the relevance and nature of government interventions aimed at securing freedom of choice. It was concluded that freedom of choice is not a virtue of present-day markets anymore. Objectively speaking, freedom of choice is present. But, subjectively speaking, freedom of choice is becoming a consumer burden that holds no guarantees for optimal purchases. The quality of consumer decisions is under pressure. Before recommendations on possible government interventions could be presented, an analysis had to be presented of the meaning of contemporary markets for consumers. Also, it was necessary to anticipate market developments that may take place spontaneously, that is, without government intervention. General recommendations were provided, distinguishing between activities that can be undertaken now and activities that prepare for a possible near future scenario. The present paper takes consumers and consumer behavior as a starting point. It shows how consumers are not only affected by market changes, but play a major role in their future development. The overall conclusion is that the notion of disciplining of markets by consumers needs reconsideration, whether assessed in contemporary or near future market situations.

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