Does A Low-Price Guarantee Induce Lower Prices and Benefit Consumers? Evidence from the Retail Gasoline Market

Yifang Guo *

For the most recent version, please visit https://sites.duke.edu/yifangguo/

Abstract

This paper revisits the traditional view that a low-price guarantee results in higher prices and facilitates collusion. I acquired accurate data on matching stores and their competitors to address the common criticism of the scant existing empirical literature that their results are highly dependent on getting the market definitions right. Using station level data in the retail gasoline industry, I find that, contrary to the traditional view, the stores that offered the guarantee significantly decreased their prices, increased their sales and attracted more consumer visits. Although I find that the matching stores suffered a decrease in profits from gasoline sales, I argue that the incentive for them to adopt the low-price guarantee is to attract more consumers to visit the store and turn the increased traffic into profits from on-site services or purchases at the attached convenience stores. Therefore, firms have strong incentives to adopt a low-price guarantee on the product that their consumers are most price-sensitive about, while earning a profit from the products that are not covered in the guarantee. My counterfactual analysis shows that low-price guarantees can increase consumer surplus by 0.3%. I also build a model to look into how low-price guarantees would change consumer search behavior and whether consumer search plays an important role in estimating consumer surplus accurately.

*Email: yifang.guo@duke.edu. The author is especially grateful for advice and guidance from my advisers: Daniel Yi Xu, Chris Timmins, Andrew Sweeting. All remaining errors are my own.