Research Report

Is Laissez-Faire Regulation Sufficient to Protect Consumers?

UNDER LAISSEZ-FAIRE REGULATION, REGULATORS CHOOSE NOT TO INTERFERE BECAUSE THEY SEEK TO STIMULATE INNOVATION AND PROTECT ENTERPRISES FROM THE COSTS IMPOSED BY REGULATORY COMPLIANCE. YET, EMPIRICAL EVIDENCE REGARDING THE ABILITY OF LAISSEZ-FAIRE REGULATION TO ENSURE CONSUMER PROTECTION IS LACKING. THIS ARTICLE TESTS EMPIRICALLY WHETHER THE CURRENT LAISSEZ-FAIRE REGULATION OF PRICE ADVERTISING CLAIMS ON THE MOST POPULAR REWARD-BASED CROWDFUNDING PLATFORM, KICKSTARTER, IS SUFFICIENT TO PROTECT CONSUMERS.

Daniel Blaseg

Christian Schulze

Bernd Skiera

Introduction

Consumer protection is the primary goal of regulation. Regulators seek to prevent avoidable reductions in consumer welfare, which could stem, for example, from a lack of competition or result from inaccurate information in the marketplace. Ultimately, regulation can stifle or choke innovation. As such, regulation can be particularly harmful to young and innovative enterprises by creating barriers to entry. These enterprises often lack the necessary resources to bear the costs of regulatory compliance. Also, they find themselves at a disadvantage over incumbents, when regulation negatively affects the innovations upon which their business model depends.

In response to this apparent trade-off between consumer protection and innovation, academics, policy makers, and enterprises have proposed a laissez-faire approach to regulation. Under laissez-faire regulation, regulators choose not to interfere, which means that they neither apply existing regulation nor create new regulation. The motivation for doing so is that regulators suspect a lack of economic injury to consumers in these contexts (i.e., regulation is not needed), or favor self-regulation as a means of ensuring consumer protection.

Self-regulation has been proposed as a faster, cheaper, and more effective approach to regulation more than 45 years ago (Stern, 1971), but has recently gained again in popularity, as regulators have favored a laissez-faire approach to regulation for the FinTech sector, ride-hailing services, and short-term rentals (Haslehurst and Lewis, 2016). Despite the relevance of self-regulation in policy making, there is no consensus on its merits and limitations in the literature. Proponents argue that regulation by the authorities is superfluous, if not detrimental, as enterprises themselves have sufficiently strong incentives to protect consumers in many cases. Others claim that prioritizing their profits over consumer protection severely limits enterprises' potential to self-regulate and protect consumers effectively.

Despite the popularity of laissez-faire regulation and its advantages for fostering innovation, empirical evidence on its ability to ensure consumer protection is still lacking. The aim of this article is to investigate whether laissez-faire regulation is sufficient to ensure consumer protection. For this to be true, at least one of the following four criteria must be met as laid out in Figure 1.

Price Advertising Claims on Kickstarter

To investigate these four criteria empirically, we study a type of regulation that is relevant in the market and permits for investigating economic injury experienced by consumers. One such type of regulation are price advertising claims (PACs). PACs are a form of advertising used in the sale of products whereby current prices are compared with a suggested reference price. PACs are widely regulated around the world and regulators, such as the Federal Trade Commission, have promulgated specific guidelines to determine the conditions under which a PAC is deceptive. For example, if a seller makes a PAC such as "Sold for USD 25 only today, 50% off the regular retail price", regulation requires an immediate price increase after the end of the promotion, an actual price increase to the stated amount, and maintenance of the stated amount for a reasonable time.

Such PACs are widely used in pre-orderings of products, such as video games and technology hardware, to induce consumers to purchase the new product and to advance an amount of money for the enterprise to finance the production.

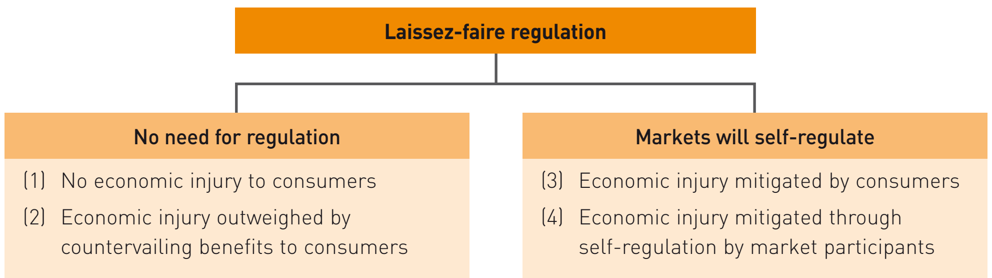

Figure 1: Criteria to Evaluate Whether Laissez-Faire Regulation Ensures Consumer Protection

The regulation of such PACs is widely applied, including online retailers and platforms, such as Amazon.

However, PAC regulation has not been applied to Kickstarter – a popular, reward-based crowdfunding platform. Founded in 2009, the platform has attracted more than 13 million consumers that have spent more than USD 2.8 billion on the platform. Consumers fund the final development and production of a new product and in return receive the product a few weeks or months later. Despite similarities to the online shopping experience at retailers such as Amazon, the crowdfunding platform follows a different model. On Kickstarter, consumers fund unfinished and unproven products and hence risk receiving a product of poor quality, experiencing substantial delays, or even getting nothing at all. At retailers such as Amazon consumers could simply ask for a refund in such cases. On Kickstarter, however, regulators' laissez-faire approach currently leaves consumers without such protection.

We use the specific example of non-regulation of PACs on Kickstarter to investigate whether regulators' laissez-faire approach is sufficient to ensure consumer protection.

To investigate whether consumers get the price advantage that was promised, we analyze Kickstarter campaigns started between April 2009 and September 2016. To analyze the four criteria laid out above, we must augment the detailed data available on Kickstarter with information from various outside sources: overall, we combine data from twelve different sources via extensive matching of information with Kickstarter campaigns. In total, we analyzed 34,745 Kickstarter campaigns, 4,279,494 consumer comments, 233,701 campaign updates, 1,705 blog articles from Kickstarter, 18,488 news articles regarding Kickstarter from 500 publishers, 94,569 consumer reviews, and 4,432 pages of consumer complaints filed with official authorities.

Empirical Results

Our analyses provide the following main results:

1) We establish the existence of greater economic injury to consumers from Kickstarter campaigns that use (vs. do not use) PACs. All else equal, consumers funding campaigns that use PACs on Kickstarter do not receive the promised discounts. Products from PAC campaigns that are later offered on the retail platforms Amazon and Steam on average command a lower retail price upon product launch than promised by the Kickstarter campaign. More strikingly, the retail price is even lower than what these consumers paid on Kickstarter. Different from what campaigns promise, backers of PAC campaigns pay more, not less than the retail price. In addition to not receiving the promised discount, consumers funding campaigns that use (vs. do not use) PACs also have lower likelihood of ever receiving the product, experience longer delivery delays, and receive products of lower quality.

2) We show that the economic injury experienced by consumers of campaigns using PACs is not outweighed by countervailing benefits. All else equal, consumers funding campaigns that use (vs. do not use) PACs on Kickstarter have a greater probability of filing consumer complaints. Also, these consumers are unhappier, as indicated by lower sentiment in backers' comments on the Kickstarter platform.

3) We do not find evidence of successful self-regulation through consumer learning. All else equal, campaigns that use (vs. do not use) PACs on Kickstarter do not experience a relative decrease in funding likelihood over time.

4) We do not find evidence of self-regulation by the campaign managers. Only 34 out of 34,745 Kickstarter campaigns engage in self-regulatory activities. We also do not find evidence of successful self-regulation by the platform. Our analysis reveals no positive effect of a major policy change on savings over the retail price, delivery likelihood, delivery delay, or product quality for PAC (vs. NoPAC) campaigns.

Conclusion

In summary, we do not find evidence that current laissez-faire regulation regarding price advertising claims is sufficient to ensure consumer protection on reward-based crowdfunding platform Kickstarter. We arrive at this conclusion after (1) establishing the existence of economic injury among backers of PAC (vs. NoPAC) campaigns, (2) finding no evidence that other countervailing benefits for backers of PAC (vs. NoPAC) campaigns exist, (3) finding no evidence of consumers learning about the economic injury associated with PAC (vs.NoPAC) campaigns and adjusting their expectations and behaviors, and (4) finding no evidence of effective self-regulation mitigating economic injury associated with PACs, neither by campaign managers nor by the Kickstarter platform.

Our study provides first empirical evidence to the primarily theoretical and conceptual literature on self-regulation. It adds to the ongoing high-profile discussion among policy makers about the merits of laissez-faire regulation in solving the innovation vs. consumer protection trade-off. We show that laissez-faire regulation can lead to substantial economic injury experienced by consumers and that regulators cannot count on consumer learning or self-regulation to mitigate this economic injury. Thus, regulators must carefully weigh this injury experienced by consumers against the (societal) benefits of laissez-faire regulation.

References

Stern, L.:
Consumer Protection Via Self-Regulation.
In: Journal of Marketing, 35 (1971) 3, pp. 47–53.

Haslehurst, R.; Lewis, A.:
We Don't Need a Whole New Regulatory Regime for Platforms Like Uber and Airbnb.
Harvard Business Review, 2016,
https://hbr.org/2016/04/we-dont-need-a-whole-new-regulatory-regime-for-platforms-like-uber-and-airbnb (retrieved July 15th, 2017).