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## Obfuscation in competitive markets

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# **Obfuscation in Competitive Markets**

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# Obfuscation in Competitive Markets

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## ABSTRACT

In many markets, firms make their products complex through add-on features, thus making them difficult to evaluate and compare. Does this product obfuscation lure buyers into buying overpriced products, and if so, why does competition not eliminate this practice? More generally, under which conditions can sellers enforce stable obfuscation levels in a competitive environment such that they can increase their profits at the buyers' expense? We show – based on competitive experimental markets – that add-ons that merely complicate the products render obfuscation quite fragile because buyers display an aversion against complex products. However, if add-ons are surplus-enhancing, sellers can mitigate competition via obfuscation which generates substantial profits and persistent dispersion in headline and add-on prices. Sellers anticipate that obfuscation limits the buyers' depth and breadth of search, and they exploit this by hiding unattractive product features. Therefore, even the best product in the market is priced above marginal cost and buyers persistently fail to find the best product in the market such that inferior products have a good chance of being traded. We also identify the causal impact of obfuscation opportunities on profits and price dispersion because if we remove obfuscation opportunities, overall prices quickly converge to marginal cost. Thus, surplus-enhancing obfuscation opportunities cause persistent price dispersion, facilitate stable profits and reduce buyers' share of the surplus.

# 1 Introduction

Complex products and price schedules are a frequent feature of modern economies. Complexity, however, comes with its own problems because it makes products difficult to evaluate and compare across competing sellers, and firms often appear to deliberately obfuscate the true values and prices of their products. For example, cars, printers, and cameras are often combined with complex bundles of differently priced add-ons and accessories. Electronic products like personal computers and memory modules advertise low prices for a very basic product with limited memory, low capacities, and short warranties, but offer many kinds of complex upgrades separately (Ellison and Ellison, 2009). Similar situations have been proliferating in other industries and marketplaces like markets for transport and tourist services, financial retail markets, insurance markets and educational markets (Muir, Seim and Vitorino 2013; Miravete 2013; Grubb 2015; Greenleaf et al. 2016; Célérrier and Vallée 2017; Bhargava, Loewenstein and Snyder 2017; Seim, Vitorino and Muir 2017; Ellison and Ellison 2018; Richards et al. 2019). The potential harm of complex prices has also attracted attention from regulators in many industries (Greenleaf et al. 2016).

The widespread existence of markets with obfuscated product attributes raises a number of fundamental questions such as under which conditions sellers can use complex product designs and pricing rules to increase their profits at the expense of consumers' welfare? Is, for example, the existence of markets with obfuscation due to a pre-existing lack of competition or can profit-increasing obfuscation persist even in extremely competitive markets that would – in the absence of obfuscation – approach marginal cost pricing? Can profit-increasing obfuscation persist in an environment in which consumers can acquire experience, or do consumers over time see through the veil of obfuscated products, and shy away from them, such that firms with transparent products have a competitive advantage? Can obfuscation opportunities alone cause a persistent violation of the law of one price? And finally, what are the welfare effects of markets with persistent obfuscation, i.e., how do these markets reduce consumers' overall welfare relative to a perfect (Bertrand) competition yardstick?

There is an accumulating body of theoretical papers that examine the mechanisms underlying persistent obfuscation and its consequences in markets (e.g., Ellison, 2005 and 2006; Spiegler, 2006; Gabaix and Laibson, 2006; Carlin, 2009; Wilson, 2010; Ellison and Wolitzky, 2012; Piccione and Spiegler, 2012; Chioveanu and Zhou, 2013; Clippel, Eliaz and Rozen 2014; Spiegler, 2016; Heidhues, Köszegi and Murooka, 2017; Heidhues and Köszegi 2018; Hämäläinen 2018; Shulman and Geng, 2019; Hefti, Liu and Schmutzler, 2020; Heidhues, Johnen, Köszegi 2021). The empirical literature has reported somewhat mixed results. Some papers have found evidence consistent with theories that predict that firms can increase revenues and profits through obfuscation while others find that shrouding products may have negative effects on firms.

For example, Ellison and Ellison (2009) document that charging a low price for a firm's low-quality product attracts many consumers and helps increase sales of medium and high-quality products. Chetty, Looney and Kroft (2009) show that demand elasticities are lower when tax increases are shrouded compared to when they are not shrouded. And Celerier and Vallee (2017) show that financial products with more attractive headline returns are associated with higher complexity and more risk for the customers but generate higher mark-ups for firms. Other literature has, however, provided evidence that consumers value transparency and simplicity (Xia and Monroe 2004; Crosetto and Gaudeul, 2012;

Gaudeul and Sugden, 2012; Repetti, Roe and Gregory 2014; Seim, Vitorino and Muir 2017; Sugden and Zheng, 2018). Chiles (2017), for example, reported that shrouding surcharges decreased sellers' reputation and Hossain and Morgan (2006) and Brown, Hossain and Morgan (2010) find that shrouding surcharges does not improve or even decrease revenues.

In this paper we tackle the above-mentioned fundamental questions with the help of a laboratory experiment that implements a market environment with competing sellers and buyers. We believe that the enhanced controls offered by a laboratory experiment can provide empirical insights that are difficult to obtain with field data. Take, for example, the question whether profit-increasing obfuscation can persist even in competitive markets that would – in the absence of obfuscation – approach marginal cost pricing. With field data, it is typically not possible to observe counterfactual markets, i.e., what would happen in the absence of obfuscation while in our lab experiments, we can exogenously vary obfuscation opportunities such that we can identify their *causal impact* on a wide range of market level phenomena and individual behaviors of both sellers and buyers.

Our experimental design approximates a competitive six-seller online-shopping market in which obfuscation opportunities are implemented by giving sellers the option to add extra features to a basic product. Importantly, the add-on features can be offered by all sellers. Therefore, they do not constitute unique technological innovations that provide sellers with competitive advantages, but just represent the detailed values and surcharges in which the different products may differ. Sellers can stipulate and transparently announce a headline price for their product while the separately listed values and prices of the products' add-on features are only revealed if buyers take the time to learn them. This design captures typical properties of complex products where consumers must invest effort to find and understand the net benefits of the product's features. Sellers and buyers interact for 20 periods in the market so that they can acquire experience, learn, and respond to the behavior of other market participants.

We implemented treatments that varied the available obfuscation opportunities. In the “*surplus-enhancing treatment*”, obfuscation takes the form of surplus-enhancing add-on features that increase the available surplus because consumers value the add-ons above their production cost. Add-on features that enhance surplus but also make the products complex are prevalent in many real-life situations, such as quality upgrades for electronic products, accessories to printers and cameras, extra services like extended warranties or the right to cancel a reserved flight or hotel. In contrast, in the “*surplus-neutral treatment*” all the surplus is already in the base product and generating additional “features” does not change the available surplus but just serves the purpose of partitioning the product's total price into more complicated segments that require buyers to spend extra time to understand. This type of obfuscation reflects, e.g., situations where webpages and product descriptions are deliberately complicated and thus impose extra cost and effort on the buyers. This treatment therefore captures purely exploitative obfuscation opportunities that only serve the purpose of increasing consumers' search cost – a situation that is at the center of many theories of obfuscation. Our design enables us to examine how obfuscation opportunities shape market interactions for both the case of obfuscation via surplus-enhancing add-ons and purely exploitative obfuscation.

To identify the causal impacts of obfuscation opportunities, we also implemented a “*no-obfuscation control treatment*” in the same setting. The key difference between treatments with and without obfuscation opportunities is that in the latter buyers have direct access to transparent information about the *overall* net value of all products. This treatment resembles an ideal form of policy intervention that

summarizes the products in the simplest possible form (e.g., a quality-adjusted price) to enforce competition with one easily accessible price. The no-obfuscation control treatment allows us to identify the extent to which obfuscation opportunities – rather than other factors – are causing persistent positive profits, price dispersion, or a lowering of buyers’ welfare. In addition, we can identify the causal impact of sellers’ obfuscation activities on buyers’ search behavior and the extent to which this leaves buyers uninformed about products and their characteristics, thus mitigating competition.

To what extent do competitive markets with surplus-enhancing obfuscation opportunities enable sellers to increase their profits at the expense of buyers’ welfare? We find that sellers appropriate a substantial share of the total surplus that buyers would have received under marginal cost pricing. Even in the long run, when average prices have settled at a stable level, sellers can appropriate roughly 1/3 of the total surplus. A decomposition of the buyers’ welfare loss shows that 37% of it is due to buyers’ errors in identifying the best product in the market. Importantly, this surplus loss due to errors does not vanish over time and is rather stable, suggesting that buyers cannot easily avoid it through endogenous learning. 58% of buyers’ welfare loss is caused by high prices because even the best available products in the market are priced significantly above marginal cost, and 5% of the buyers’ welfare loss exists because sellers produce their add-ons in a technologically inefficient way. Moreover, obfuscation is associated with substantial dispersion in overall offered prices and overall trading prices throughout the 20 market periods, violating the law of one price.

These findings contrast sharply with the control treatment where obfuscation opportunities are absent. Here, the market quickly converges to marginal-cost pricing after only a few periods. As buyers make almost no buying errors in the control treatment, the best product almost always serves the entire market independent of other products available in the market, indicating strong competitive forces.

Are sellers in markets with purely exploitative obfuscation opportunities also able to persistently increase their profit at the expense of the buyers’ welfare? Our data reveal a clear bi-modal pattern in this case: in half of the markets (that we label “high obfuscation markets”), high and stable obfuscation levels emerge and sellers are able to appropriate consumer welfare to a similar extent as in the surplus-enhancing treatment; but in the other half of the markets (“low obfuscation markets”), obfuscation declines over time to rather low levels and buyers eventually receive almost all of the available trading surplus. An analysis of buyers’ buying behavior in low obfuscation markets suggests that a potential reason for the decline under surplus-neutral obfuscation is that buyers shy away from buying complex products even after controlling for the products’ values and prices. This aversion to complex products in the market with surplus-neutral add-ons thus appears to be a force that mitigates individual sellers’ obfuscation incentives.

But why do buyers display complexity aversion in the markets with purely exploitative obfuscation but not in the market with surplus-enhancing add-ons? A possible reason appears to be that with purely exploitative obfuscation the overall net value of a product’s add-on features is *negatively* related to the complexity of the product. Thus, more obfuscation indicates a worse product for buyers. We also document that buyers notice this pattern, which provides a reason for shying away from complex products. In contrast, this relationship is *reversed* in the market with surplus-enhancing add-ons. Here, a product with a higher number of add-on features is typically a better product for the buyers. Therefore, although obfuscation with surplus-enhancing add-on features also increases the complexity of products and reduces the consumers’ share of the surplus, there is little reason for complexity aversion to arise.

Why are sellers in markets with surplus-enhancing add-ons able to mitigate competition to such an extent that they can persistently earn a relatively high share of the trading surplus? The key reason is that sellers' ample use of obfuscation opportunities has a strong impact on buyers' search behavior. Sellers even made their products more complex than needed to generate the intended value of the add-ons.

The high product complexity in markets with surplus-enhancing add-ons limits the breadth and the depth of buyers' search in heterogeneous ways. The breadth of search is limited because in 40% of the cases the buyers visit only one or fewer products, and in another (roughly) 45% of the cases they visit two or three products<sup>1</sup>. The depth of search is limited because many add-ons of the visited products are never examined by the buyers. Moreover, we find a strong trade-off between the depth and the breadth of the buyers' search, i.e., the more products buyers visit the fewer add-ons they examine per product – a finding that is consistent with the core assumption of Heidhues, Johnen, Köszegi (2021). Thus, buyers who visit more products have a more superficial knowledge of these products compared to buyers who visit fewer products.

The sellers appear to anticipate the very limited depth of search by many buyers. They exploit the buyers' limited attention by strategically placing the best features (i.e., those with the highest net value for the buyers) at the top of their feature lists, where they are first seen, while worse add-on features are placed at the bottom where they are often not examined by the buyers. The limited breadth and depth of buyers' search not only enables sellers to earn a substantial share of the surplus but the strong heterogeneity in buyers' search also makes it possible that sellers persistently charge dispersed prices throughout the 20 market periods. Note that this price dispersion occurs despite the fact that (i) sellers do not have heterogeneous production technologies and (ii) buyers do not have heterogeneous tastes with regard to the available products. Therefore, our results suggest that sellers' strategic obfuscation behavior alone can cause persistent and substantial price dispersion.

Finally, what governs sellers' choices of headline and add-on prices in markets with surplus-enhancing obfuscation opportunities? Could sellers attract buyers by lowering their headline prices or did buyers shy away from low headline prices because they suspect them to be associated with highly priced add-ons (Heidhues, Köszegi and Murooka, 2017; Shulman and Geng, 2019)? We find indications that at least some buyers are suspicious of low headline prices, which may have generated some competition-softening effects. For example, the average headline price of *the first visited* products and the *traded* products is persistently higher than the lowest headline price in the market, implying that a nonnegligible number of buyers do not buy the product with the lowest headline price. Nevertheless, many buyers are attracted by lower headline prices and headline prices significantly impact the sale of products in the market. Sellers respond to this competitive pressure with gradual reductions of headline prices during the first 10 periods until they converge on average to a stable level below the marginal cost of the base products. Overall, we find evidence that competitive pressures eventually force sellers to offer their base products at a loss as predicted by many theories of add-on pricing.

If sellers sell their basic products at a loss, it must be the case that the add-ons are the source of their overall profits. What makes it possible for firms to generate profits from add-ons? Buyers' behavior is again the key. Because sellers strategically exploit the buyers' limited breadth and depth of search, they

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<sup>1</sup> A product is considered as visited if the buyer examines at least one add-on.

can enforce add-on prices that are substantially above marginal cost throughout the entire 20 periods. At the behavioral level, the sellers' power to enforce add-on prices above marginal cost manifests itself in the relatively low price elasticity of add-on features. In other words, although sellers can on average attract additional demand for their product by reducing add-on prices, the demand increase is relatively small, which induces sellers to keep add-on prices relatively high.

Note, however, that sellers in our experiment do not act as monopolists by extracting all the surplus generated from add-ons features and add-on prices turn out to be persistently heterogeneous. This finding differs from several theoretical models that assume (e.g., Gabaix and Laibson, 2006; Heidhues, Kőszegi and Murooka, 2017; Heidhues, Johnen and Kőszegi, 2021) or predict (e.g., Diamond, 1979; Lal and Matutes, 1994; Ellison, 2005) no competition with regard to hidden product features which would enable firms to extract all the surplus from add-ons. As mentioned above, many buyers do visit two or more products in some depth which limits sellers' ability to set arbitrary add-on prices. Therefore, sellers can still lure buyers' away from other sellers by lowering their add-on prices, i.e., competition is still somewhat operative at the add-on level albeit at a lower intensity compared to headline prices. In addition, the heterogeneity of buyers' search behavior allows for the persistent trading of products with heterogeneously priced add-ons.<sup>2</sup>

Our study contributes to the literature in behavioral industrial organization that studies the empirical functioning of markets in which consumers have limited attention or imperfect knowledge about product attributes. We believe that a main contribution of our paper consists in the identification of the causal impact of different types of obfuscation opportunities on a wide range of individual level behaviors and market level outcomes, with a focus on the interaction between buyers and sellers. Our lab experimental approach also enables us to identify obfuscation opportunities as the cause for important phenomena such as (i) sellers' ability to increase their profits at the cost of buyers' surplus share, (ii) substantial and persistent price dispersion despite homogenous seller technologies and buyer preferences, (iii) sellers' deliberate policy of hiding unattractive add-on features, and (iv) the market's eventual convergence towards loss-leader pricing with add-ons as the key source of profits.

Our paper is also related to the literature that suggests or hypothesizes that consumers value transparency and simplicity (Xia and Monroe 2004; Crosetto and Gaudeul, 2012; Gaudeul and Sugden, 2012; Repetti, Roe and Gregory 2014; Seim, Vitorino and Muir 2017; Sugden and Zheng, 2018). We document this desire for transparency (i.e., complexity aversion) by showing that in some of our markets the buyers shy away from more complex products that are otherwise identical, i.e., even after controlling for the products' overall prices and the buyers' valuations of the products. In addition, our findings inform us about whether and under which conditions complexity aversion can undermine the stability of obfuscation at the market level and drive the whole market towards transparency. In this context, the comparison between markets with purely exploitative obfuscation, where obfuscation levels are quite fragile, and markets with surplus-enhancing add-ons is interesting. It suggests that in the latter case,

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<sup>2</sup> The strong heterogeneity in the pricing of add-on features may also have repercussions on competition that operates via headline prices. The existence of dispersed "hidden" prices for add-ons means that headline prices provide only a very incomplete picture of the overall price of a good. Moreover, we find that more attractive headline prices are associated with less attractive add-on features, thus providing a reason for buyers to be suspicious of low headline prices. However, the negative relation between headline prices and the attractiveness of add-on features is quite noisy which may explain why the competitive pressure on headline prices is still relatively strong.



complexity aversion is either absent or insufficiently strong to prevent pervasive obfuscation that allows sellers to mitigate competition and sustain a stable profit share.

We believe that our empirical findings may also be of interest for the theoretical literature on obfuscation in markets (e.g., Ellison, 2005; Spiegler, 2006; Gabaix and Laibson, 2006; Carlin, 2009; Ellison and Wolitzky, 2012; Piccione and Spiegler, 2012; Chioveanu and Zhou, 2013; Heidhues, Köszegi and Murooka, 2017; Shulman and Geng, 2019). In particular, in view of the paramount importance of the assumptions on buyer behavior in theories of obfuscation, we believe that our detailed empirical results on buyers' search patterns may be useful for future theorizing. We document, for example, a trade-off between in-depth studying and superficial browsing of products, a finding that supports a key assumption in Heidhues, Johnen, Köszegi (2021). However, unlike Heidhues, Johnen, Köszegi (2021) and many others (Ellison, 2005; Gabaix and Laibson, 2006; Heidhues, Köszegi and Murooka, 2017), we find that competition via add-on prices, albeit mitigated, is still present, and result in heterogeneously priced add-ons. Similarly, some theories of search and obfuscation predict that all buyers with positive search cost visit only one product (e.g., Stahl, 1989; Ellison and Wolitzky, 2012) which confers enormous market power to firms. This prediction contradicts our finding that about 45% of buyers visit two or three products which puts tighter limits on sellers' market power. Finally, buyers may directly respond to obfuscation attempts by exhibiting complexity aversion, a potential pro-competition force that has rarely been discussed in the theoretical literature.

These deviations from the assumptions/predictions of theoretical models may help in explaining phenomena like the persistence of substantial dispersions in add-on prices or the fragility of purely exploitative obfuscation. However, at the same time it needs to be stressed that many common predictions of the theoretical models, such as the existence of overpriced add-ons, loss leader pricing to attract consumers or buyers' low sensitivity to "hidden" prices, are confirmed by our results.

Our paper is also related to the literature in marketing that examines how partitioned prices or "drip pricing" affects consumers' perceptions, attitudes and behaviors (e.g., Morwitz, Greenleaf and Johnson 1998; Lee and Han 2002; Xia and Monroe 2004; Bertini and Wathieu 2008; Völckner 2012; Robbert and Roth 2014; Robbert 2015; Greenleaf et al., 2016; Dallas and Morwitz, 2020). Our study differs from this literature by explicitly embedding buyer-seller interactions into a competitive market environment. This makes it possible to study the implications of buyer behaviors for market level phenomena – such as positive profit shares, persistent price dispersion or loss-leader pricing – and to study the mechanisms through which these phenomena are generated because we can explicitly observe the actions of buyers *and* sellers in a competitive environment. This approach also makes it possible to observe competitive forces "in action", such as the gradual decline of headline prices that were initially far above marginal cost but eventually converged to stable levels below marginal cost.

Finally, our paper also contributes to the experimental literature related to obfuscation and bounded rationality in consumer behavior. One part of this literature studies *boundedly rational individual* decision-making in complex situations such as in a complex product space (Crosetto & Gaudeul 2011; Jin, Luca and Martin 2015; Kalayci & Serra-Garcia 2016; Sugden and Zheng 2018; de Clippel and Rozen, 2021). These experiments neither allow for interactions in markets nor is there competition among sellers. The other part of the literature studies obfuscation in market environments but in many of these papers one side of the market in the treatment or the control condition is represented by virtual or robot agents (Kalayci and Potters, 2011; Kalayci, 2015, Gu and Wenzel 2015; Kalayci 2016; Crosetto

and Gaudeul 2017).<sup>3</sup> Our experiment differs in many dimensions from these papers but perhaps the biggest difference is that none of these papers studies the buyers’ endogenous search behaviors. This means that no information exists, for example, on the depth and breadth of buyers’ search, implying that the degree of buyers’ incomplete information, and how sellers respond to it, remains unknown.

More generally, we believe that our set-up constitutes an experimental framework that could be the basis for examining many other interesting questions such as how markets with obfuscation opportunities operate when sellers can acquire a reputation<sup>4</sup>, how flexibly prices and quantities in obfuscated markets respond to supply and demand shocks, or how different regulatory interventions affect the functioning of these markets.

The rest of the paper is organized as follows. In Section 2, we describe the design of the market with obfuscation opportunities and the treatment variations that we implemented. After that, we discuss important design features of the experiment in the context of the current literature and potential outcomes of the experiment. Section 3 reports our detailed empirical findings in the market with surplus-enhancing obfuscation opportunities, in terms of the overall market outcomes and how sellers’ obfuscation strategies and buyers’ search behaviors mutually reinforce each other. After this we contrast our findings in the surplus-enhancing treatment with those of the surplus-neutral treatment in section 4. Section 5 concludes the paper and provides some additional discussions.

## 2 Experimental Design

In this section, we first discuss some key issues in developing an experimental design that mimics an online-shopping market<sup>5</sup> in which buyers have easy access to headline prices but need to find and understand the product’s quality features, add-on services, and potential surcharges. In such markets, although price offers and price dispersion may be empirically observable, the lack of information about potentially confounding factors like sellers’ production opportunities and costs as well as buyers’ heterogeneous tastes across goods make it hard to identify how much market outcomes are affected by obfuscation opportunities. We want to address these issues and characterize the causal consequences of obfuscation opportunities on the endogenous interactions of participants in competitive markets and how these interactions shape the final market outcomes.

To achieve this goal, one needs to compare a competitive market with obfuscation opportunities (“OO Market”) with a control treatment that is identical in every respect except that the sellers can no longer obfuscate their products (market with no obfuscation, denoted as “NO Market”), i.e., the buyers can fully understand the characteristics of the offered products with ease. In principle, products can be complex, and thus difficult to understand, for many reasons. The physical product properties, the

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<sup>3</sup> Another difference concerns the absence of an add-on pricing setting which prevents the examination of loss leadership pricing.

<sup>4</sup> Chiles (2017) reports evidence suggesting that firms that shroud product attributes may suffer reputation losses. These losses in turn may prevent firms from shrouding their products. Our competitive market setting would be an ideal set-up to study the disciplining power of reputation formation on add-on pricing. Whether reputation formation enhances or diminishes competition is, however, not clear (see, e. g., Brown, Falk and Fehr 2004) and is likely to depend on whether reputation is public or bilateralized (i.e., entirely based on bilateral experiences between buyers and sellers).

<sup>5</sup> We believe, however, that many features of the markets we implemented are also relevant in physical markets.

number, the characteristics, and the values of add-ons for the consumers as well as the structure of add-on prices can make it difficult for consumers to assess the product. For example, consumers may be uncertain about their subjective value they derive from a product feature, or some add-ons may be substitutes while others may be complements. All these forms of complexity associated with add-ons require consumers to spend substantial time to assess the overall value and the overall price of the good. Whatever product features and associated subjective valuations that prevail in the OO Market, the control treatment needs to allow for the same features but nevertheless remove obfuscation opportunities.

In our experimental design – described in more detail below – we choose an obfuscation opportunity that enables us to achieve this goal. Sellers are given the opportunity to add extra features to their basic product, but each extra feature has a well-defined objective value for the buyers, and the price of each extra feature is also available for the buyers to observe. But because there are potentially many extra features, the buyers may have to incur some time cost to view them, compute the overall value of a product, and compare the products in the market, which captures a general characteristic of markets with complex products. In contrast, obfuscation is removed in the control treatment by informing the buyers transparently about the *overall* objective value of *each* product in the market, which renders the market very transparent.

Ideally, our design should generate competitive outcomes in the control market without obfuscation, i.e., consumers should appropriate the whole surplus in the control market. The reason for this is that we want to rule out any other competition-mitigation force so that we can cleanly identify the competition-mitigating impact of obfuscation opportunities. By comparing the market with obfuscation opportunities with the control market, we can then study how obfuscation opportunities shape the interactions between buyers and sellers in an (otherwise) highly competitive environment and how this affects sellers' obfuscation activities, their headline prices, add-on prices, profits as well as price dispersion and buyers' search behavior and overall welfare.

An experimental session consisted of three parts. In Part 1, participants interacted in a market with obfuscation opportunities (OO Market). In Part 2, the same participants interacted in a market without obfuscation opportunities (NO Market). In Part 3, we collected additional measures that were designed to help us better understand the mechanisms through which obfuscation works. To examine whether there are spillover effects from the OO Market (Part 1) to the NO Market (Part 2) we also conducted control sessions in which the NO Market took place without a preceding OO Market.<sup>6</sup> During the experiment buyers and sellers can earn money in the form of experimental currency units (ECUs) that are exchanged into real money at the end of the experiment according to a publicly known exchange rate.

## ***2.1 The market with obfuscation opportunities (OO Market)***

In a market, 16 participants interact in a posted-offer institution for 20 trading periods. Among the 16 participants, 6 of them are randomly assigned to be sellers and the other 10 are assigned to be buyers throughout the entire 20 trading periods. The sellers and buyers trade experimental goods that are labelled as phones. Each phone consists of a basic phone and some extra features. Sellers can offer basic

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<sup>6</sup> It turns out that the market outcomes in the NO Market are similar regardless of whether there was a preceding OO Market or not.

phones by incurring the same marginal production cost of 5 Experimental Currency Units (ECU), while buyers' valuations of a basic phone differ. In each period, a buyer's valuation of a *basic* phone is a random value out of five possible values: 0, 5, 10, 15, or 20 ECU; each of the five possible values is randomly assigned to two of the buyers in any given trading period.<sup>7</sup> In each trading period, sellers can set a base price for their basic phone. Each buyer can buy a maximum of 1 unit, but each individual seller can serve the demands of all buyers. As 6 sellers are competing to serve the demands of 10 buyers with no limits in supply, we ensure that the market is very competitive.

On top of the basic phone, sellers can also add extra features to their products. Figure 1 shows an example of how these products are presented in the experiment. Each extra feature has a label, a value, and a price. Each feature provides buyers of this product with the corresponding additional value on top of their own basic values, but generates an additional production cost for the seller. The add-on prices, on the other hand, represent additional charges for the respective add-on feature but they can also be interpreted as representing other negative product attributes. This design maps real-life situations in which firms add and separately list many features to their product, like fancy technical properties, quality upgrades, extra services, additional accessories, express shipping, etc. While these features are often indeed valuable for consumers, they also increase the product's complexity and makes the comparison of products difficult because their characteristics and prices differ in many dimensions.

<u>Phone 1</u>		
<u>Base Price:</u>		
20		
<u>Features:</u>		
<u>Label</u>	<u>Value</u>	<u>Price</u>
shipping:	7	4
display:	9	5
capacity:	3	6
camera:	3	3
warranty:	2	4

**Figure 1**

For simplicity, buyers of any product need to buy all the extra features that come with the product. This design captures many situations in naturally occurring markets. First, in many cases the listed features and add-ons are indeed inseparable components of the product. For example, many “features” in bundle sales and composite products like camera packages or insurance products are indeed parts of the full products. Likewise, printers or phones may be designed in such a way that consumers can later only use the ink or the earphones that are compatible with the original products. Second, buyers often already have a product with certain features in mind that they would like to buy before a purchase. For example, when consumers book flight tickets, they know whether they need to have the right to change their bookings in the future or how many bags they need to check. Therefore, even though these features appear optional, consumers in fact need to find and understand these features. Third, even when add-ons are actually optional, firms often design the descriptions of the products so that the basic product looks significantly worse than the upgraded product with add-ons (Ellison and Ellison, 2019), which entices many consumers to actually buy the add-ons. Finally, note that different firms may indeed offer different add-ons in our experiment. Thus, by deciding from which firm to buy, the buyer has still some discretion about the add-on he or she is buying.

In this setting, we can denote buyers' basic value as  $v_b$ , the base price as  $p_b$ , and sellers' marginal cost of producing a basic phone as  $c_b$ . For a product with  $n$  extra features, suppose the value and price of the  $i^{\text{th}}$  feature is  $v_f^i$  and  $p_f^i$  respectively, then we can denote  $v_f = \sum_{i=1}^n v_f^i$  as the aggregate feature value for

<sup>7</sup> More specifically, each buyer is randomly assigned to one sequence of basic values across the 20 trading periods such that each buyer experiences each basic value for 4 periods. These sequences of basic values also ensure that each of the five possible basic values is assigned to two buyers in each period. Note that a buyer who is randomly assigned a basic value of zero may nevertheless be able to conclude a mutually beneficial trade because the sellers can add value-enhancing features to a basic phone.

a product with  $n$  extra features,  $c_f(v_f)$  as the aggregate cost of producing  $v_f$  and  $p_f = \sum_{i=1}^n p_f^i$  as the aggregate feature price. Then, from the sellers' perspective, their profits per unit sold,  $\pi^S$ , is given by their earnings from both the basic phone  $\pi_b^S$  and the extra features  $\pi_f^S$ , which can be calculated as:

$$\pi^S = \pi_b^S + \pi_f^S = (p_b - c_b) + (p_f - c_f(v_f))$$

From the buyers' perspective, their total earnings from buying a product,  $\pi^B$ , is given by the earnings from both the basic phone  $\pi_b^B$  and the extra features  $\pi_f^B$ , which can be calculated as:

$$\pi^B = \pi_b^B + \pi_f^B = (v_b - p_b) + (v_f - p_f).$$

Thus, all buyers have homogenous preferences with regard to all products in the market and obtain the highest payoff if they pick products with the highest  $\pi^B$ . In addition,  $\pi^S + \pi^B$  provides a measure of the total surplus from a trade.

### The Seller Stage

In the OO markets there are 20 trading periods, and each trading period consists of 3 stages: "Seller Stage", "Buyer Stage", and "Feedback Stage". In the "Seller Stage", sellers decide which product they want to offer. To simplify the sellers' decisions, we do not require them to fix a separate value and a separate price for each extra feature they provide. Rather, in addition to setting a non-negative base price, they only need to determine the number of features  $n$ , the aggregate feature value,  $v_f$ , and the aggregate feature price,  $p_f$ . Given the chosen levels of  $v_f$ ,  $p_f$ , and  $n$ , the computer then randomly assigns a one-digit number to each feature value and feature price so that the two sums,  $v_f$  and  $p_f$ , are exactly met. Sellers can also re-randomize the computer's assignment of numbers as many times as they want until they are satisfied with how their products look.

We intentionally restricted the feature values and feature prices to single-digit numbers. This way, products are not too complex. It would have been easy to introduce additional forms of obfuscation for example by allowing for random components in the feature's values, or making some add-ons complements or substitutes for each other. However, if we find that already our "mild" obfuscation opportunities enable the sellers to appropriate substantial rents, then the more complex forms of naturally-occurring obfuscation opportunities can be expected to cause much worse outcomes for the consumers. In addition, the single digit constraint renders computing the product's net value easy, and a product's overall degree of complexity can be conveniently summarized by its number of extra features. Finally, the single digit constraint can also be interpreted as a technological constraint that puts an upper bound on the value that each extra feature can provide. Such a constraint is quite plausible because it is generally not possible to generate arbitrarily high values without adding more features to a product.

To keep product complexity within limits, we also restricted the maximum number of features to 6. Furthermore, a seller of a product with  $n \geq 1$  features could maximally add an aggregate feature value  $v_f$  of up to  $7n + 2$ . This upper bound on the aggregate feature value ensures that the single-digit constraint for individual extra features can be met. To keep things simple, the sum of extra prices is subject to the same aggregate constraint. Note, that this design gives sellers the opportunity to make their products more complicated than the number of add-ons that are needed to generate the desired

aggregate feature value  $v_f$ . For example, a seller who wants to provide add-on features with an aggregate value of, say  $v_f = 29$ , can do so with 4, 5, or 6 extra features.

Thus, to summarize, each seller determines a base price  $p_b$ , the number of extra features  $n$ , the aggregate feature value  $v_f$ , the aggregate feature price  $p_f$ , and the presentation of the list of individual feature values and feature prices to the buyers. Before a seller commits to an offer, he or she can try out many decisions; for each decision, the computer automatically calculates the overall cost of extra features  $c_f$ , earnings from extra features  $\pi_f^S$ , and profits per unit  $\pi^S$  to help the sellers fully understand the implications of their decisions.

Note that the extra features of the products in this experimental design are not any seller's unique technological innovations that provide *per se* a competitive advantage relative to the other seller's products. Rather, the possibility of adding extra features is a tool that can be used to generate additional value for the buyers, and all sellers have the same opportunities to provide these add-ons. In addition, since all buyers derive exactly the same value from a given extra feature with no uncertainty or noise, no buyer has a pre-determined taste or preference over certain types of products; rather, they just want to find the product that provides the highest monetary payoff  $\pi^B$ . Therefore, if competition is fully at work so that buyers choose only those products that give them the highest overall earnings  $\pi^B$ , the extra features should not enable sellers to earn positive profits.

After all the 6 sellers have determined their products for the current trading period, the "Buyer Stage" starts, in which all the 6 products are displayed to buyers, in an order that is completely randomized across periods. Because sellers and buyers do not have an ID and remain anonymous to each other, our design eliminates any reputation concern. Sellers' reputation may of course play a role in naturally occurring markets with obfuscation opportunities, but reputation formation may interfere with obfuscation in multiple conflicting ways<sup>8</sup>. These confounds may make it hard to draw clean inferences about obfuscation behavior in the field, and most theoretical models of obfuscation also do not yet consider reputation formation. Therefore, here we are – as a first step – interested in how such a market operates in the absence of reputation formation opportunities.<sup>9</sup>

## The Buyer Stage

At the beginning of the "Buyer Stage", buyers are informed of their basic values in the current period, and then they can start shopping. When buyers are shopping, their time is valuable – for every second buyers spend in the market before they make a decision, they incur a cost of 0.1 ECU. The rationale for this is that, in reality, consumers typically have considerable opportunity cost of time from searching the market. In the experiment such time costs of search are absent because the subjects have already committed to participate in the experiment, i.e., they have no alternative use for their time during the experiments. For this reason, we implemented an explicit, yet small, monetary cost of searching the market. On the buyers' screen (see Figure A1 in the Appendix for example screens), they first see only the base prices of the 6 products while the extra features of the various products are not immediately

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<sup>8</sup> For example, if buyers dislike obfuscation, firms may avoid obfuscation for reputational reasons. Or if buyers want to save search costs by displaying brand loyalty and buying from the same firm over time, firms may have additional sources of positive profits because buyers' willingness to switch is low.

<sup>9</sup> However, we consider studying the interaction between reputation formation and obfuscation opportunities an exciting topic for future research, and our experimental design is well-suited for this.

visible. However, the buyers can inform themselves about the values and prices of extra features of each product by “visiting” them.

To “visit” a product, a buyer has to click on the product on the screen. One click makes its first feature appear, the next click makes the next feature appear, and so on. Moreover, any product will only be clickable every 2 seconds. This design mimics typical situations of product search in that consumers always need some time to find the next piece of useful information about a product; moreover, upon seeing a product feature, consumers always need time to understand it and figure out its subjective value. Thus, compared to such time-consuming search in real online markets, the 2-second delay is rather conservative.<sup>10</sup> In fact, the time cost of 0.1 ECU per second is also chosen in such a way that the buyers can acquire full information about all products and still earn a substantial profit<sup>11</sup>.

Overall, our design allows us to obtain a detailed dataset on which products buyers examine, how many add-ons they examine, and the order and overall duration of search. There is no limit on the total time that any buyer can spend in the market. Thus, if buyers are imperfectly informed about the available product properties and add-on prices, they voluntarily forgo additional information.

### The Feedback Stage

After all buyers made their buying decisions, the trading period proceeds to the “Feedback Stage” (see Figure A2 in the Appendix for an example screen). In this stage, the sellers receive feedback on the details of the 6 products that were offered in the current period: their respective base prices, and the values and prices of each extra feature of all products. In addition, they are informed about relevant summary statistics associated with each product: the aggregate feature value  $v_f$ , the aggregate feature price  $p_f$ , the aggregate feature cost  $c_f$ , earnings from extra features  $(p_f - c_f)$ , and profits per unit sold  $\pi^S$ . A seller also privately sees how many units he sold and his realized total earnings in the current period. The feedback for sellers provides them with substantial information about the whole market and thus may enhance competition. Buyers, on the other hand, are shown their realized earnings from trading, total time cost, and total earnings in the current period.

## 2.2 The market without obfuscation opportunities (NO Market)

In this treatment, the participants have the same role assignments and interact with the same group of people under the same conditions as the OO Market except that the computer provides information during the “Buyer Stage” that makes each product’s overall net value immediately visible for each buyer.

Recall that the buyers’ earnings from a trade  $\pi^B$  are given by,

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<sup>10</sup> Moreover, only the features of the currently visited product are visible on the buyer’s screen; that is, when buyers switch the product they visit, the features of the previous product disappear. This design approximates situations in which consumers search sequentially, i.e., where they do not have simultaneous access to all the available information. Our buyers can, however, use paper, pen and blank spaces on the shopping screen to record their findings from searching the add-ons.

<sup>11</sup> To mitigate “psychological liquidity constraints”, we endowed each buyer with 8 ECU in every period. This endowment allows buyers to have enough liquidity to finance their search cost even if all 6 products have the maximal number of add-ons (i.e., 6) and the buyer wants to see them all; in this case the overall time costs are  $6 \times 6 \times 0.1 \times 2 = 7.2$  ECU.

$$\pi^B = \pi_b^B + \pi_f^B = (v_b - p_b) + (v_f - p_f) = v_b + (v_f - p_b - p_f).$$

Note that the buyers' basic values,  $v_b$ , which are randomly assigned and privately communicated to the buyers at the beginning of every period, do not affect the relative attractiveness of the different products because they refer to the value of a basic phone (which is, for any given buyer, identical across products). In contrast, the base price,  $p_b$ , the aggregate feature value,  $v_f$ , and the aggregate feature price,  $p_f$ , all depend on sellers' decisions. They typically vary across products and can be summarized by

$$v_o \equiv v_f - p_b - p_f.$$

Therefore, the buyers only need to know the "overall net value"  $v_o$  to assess the relative attractiveness of the available products, and the computer publicly provides this information to the buyers in the NO Market. Because the NO Market completely eliminates all the complexity and search cost created by add-on features, we conjectured that this market will relatively quickly converge to the competitive equilibrium in which the maximum surplus is produced and appropriated by the buyers. For this reason, the NO Market lasted only 10 periods.

The NO Market mimics an ideal form of policy intervention that requires all the sellers to summarize the useful information of their products in one quality-adjusted price (or in a way as simple as possible). For example, personal loan providers are required to summarize their products by just one Annual Percentage Rate (Ellison and Ellison, 2020). This treatment is virtually similar to the policy intervention proposed in Ellison (2005): sellers are required to advertise one price and provide all the add-ons free of charge<sup>12</sup>. This way, products' overall net values are also transparent to buyers.

### 2.3 *Treatments conditions regarding the economic properties of add-ons*

We implemented several treatments that differ according to the cost function with which sellers could provide value to the buyers with add-ons. In one treatment, which we denote the Half-Cost Treatment (HCT), the cost of producing extra features is always 50% of the features' values. This cost function is represented by the blue line in Figure 2 below. Thus, adding more feature values increases both the available total surplus and complexity (i.e., the number of add-ons). While this type of obfuscation by producing surplus-enhancing add-ons likely approximates a frequently occurring form of obfuscation in naturally occurring environments (e.g., upgrades of products, extra accessories, faster shipping, etc.), we also want to understand how much obfuscation occurs in a competitive market when the marginal surplus from extra feature values can become negative. Therefore, in addition to HCT we implemented a second between-subjects treatment where the cost of producing extra features is a convex function of the values created, so that – beyond a certain level of  $v_f$  – adding additional feature values reduces the total surplus. We call this treatment "Convex Cost Treatment (CCT)"; it is represented in Figure 2 by the red line. In this treatment, the most efficient aggregate feature value is at 30 ECU. Thus, if sellers produce an aggregate feature value of  $v_f > 30$  they need to increase complexity at the cost of producing

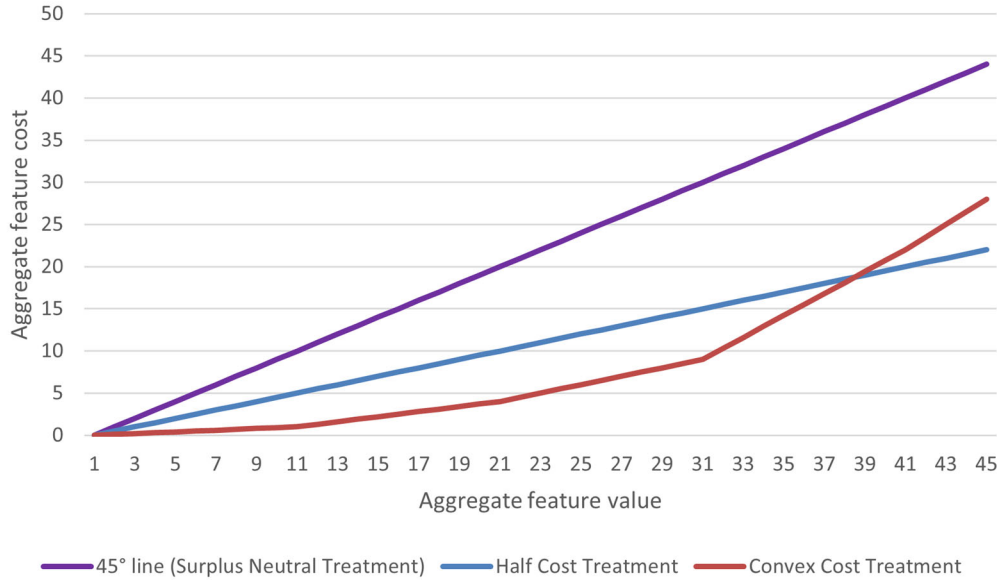
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<sup>12</sup> Ellison (2005) also shows theoretically that even when the add-ons are optional and consumers have heterogeneous preferences over add-ons, this policy intervention benefits both consumers who buy the add-on *and* consumers who do not buy the add-on.



a lower surplus. This treatment enables us to examine whether sellers even offer inefficiently complex products.

**Figure 2: Aggregate feature cost as functions of aggregate feature value in the 3 between-subject treatments**



Finally, we are also interested in the effects of purely “exploitative” obfuscation that only increases complexity, which has been frequently examined in theoretical work. To study this type of obfuscation in the same market setting, we implement a third between-subject treatment called “Surplus-Neutral Treatment (SNT)” in which the production of feature values does not generate any additional surplus, i.e., the cost  $c_f(v_f)$  of producing any given aggregate feature value is equal to  $v_f$ . Therefore, unlike the two previous treatments in which sellers may implement extra features in order to provide extra surplus, all the surplus in this treatment is already in the basic product<sup>13</sup>, and sellers no longer need extra features to increase the surplus of their product. Therefore, a seller who does not want to obfuscate can set  $v_f = 0$ ,  $p_f = 0$  and merely charge the base price without sacrificing any surplus. Adding extra features to the product in this treatment thus makes no sense unless the seller wants to make the product more complex for the sake of obfuscating the true value and price of the product. For example, sellers may design their websites so that it is not straightforward to discover additional charges or they may use lengthy descriptions and difficult language to “hide” a products’ unfavorable attributes. The SNT therefore enables us to explore whether obfuscation is maintained at a similar level compared to the other OO Market treatments and how obfuscation for the mere sake of obfuscation affects the buyers’ behavior.

Note that buyers in all of our treatments only know that sellers incur a cost when they add extra features, but they are never informed about the sellers’ cost levels. Therefore, any differences that may arise in buyer behavior across these treatments occur through endogenous responses to different seller behaviors across treatments because from the buyers’ viewpoint all treatments are otherwise identical. The various treatments with obfuscation opportunities are summarized in the second column of Table 1.

<sup>13</sup> Experimentally, the total available surplus in this treatment is kept roughly identical to the actual surplus in the HCT and CCT by moving all the surplus to buyers’ basic values.

Table 1: Treatment Conditions

	Market with obfuscation opportunities (OO Market)	Market with no obfuscation (NO Market) <sup>14</sup>
Half Cost Treatment (HCT)	6 markets	6 markets
Convex Cost Treatment (CCT)	5 markets	5 markets
Surplus-Neutral Treatment (SNT)	6 markets s	6 markets

## 2.4 Additional tasks, procedures, and subjects

In Part 3 of an experimental session, we collected additional measures that may help us better understand the mechanisms through which obfuscation influences buyers. Specifically, we elicited buyers' beliefs about the aggregate net feature value ( $v_f - p_f$ ) of products with different numbers of add-ons after the end of the 20 trading periods in the OO Market. Buyers were asked to estimate the average aggregate net feature value of products in the market in which they just participated for each possible number of add-ons.<sup>15</sup> These estimates will allow us to understand whether the buyers perceived more obfuscated products on average as more or less valuable.

At the end of Part 3, both buyers and sellers answer a short questionnaire that elicits their demographic characteristics. Afterwards, 10 random trading periods of the OO Market, 5 random trading periods of the NO Market, and earnings from Part 3 are paid out. This payment scheme alleviates House Money Effects – because subjects do not accrue earnings over time – and generates, at the same time, reasonable incentives to motivate subjects to make careful decisions in every period of the market.

The experiment was computerized and programmed with the experimental software z-Tree (Fischbacher, 1999). There are a total of 272 subjects. Each experimental session lasted approximately 2.5 hours and was held in the Econ Lab at the University of Zurich. Each subject earned on average 65 Swiss Francs (CHF 65 ~ USD \$72) with an exchange rate of 7.11 ECU = 1 Swiss Franc (~ US \$1.1). All subjects were recruited from the joint subject pool of the University of Zurich (UZH) and the Swiss Federal Institute of Technology Zurich (ETH). All interactions in the experiment were anonymous.

<sup>14</sup> In each of the three treatment conditions – the Half-Cost Treatment (HCT), the Convex Cost Treatment (CCT) and the Surplus-Neutral Treatment (SNT) – the NO Markets took place after the OO Markets (see Table 1). However, to control for potential spillover effects of the OO Market on the NO Market, we also conducted a few NO Markets (not shown in Table 1) without a preceding OO Market. The market outcomes in the NO Market turned out to be very similar regardless of whether there was a preceding OO Market or not.

<sup>15</sup> They were rewarded 5 ECU for each estimate if it was within  $\pm 2$  ECU of the actual average aggregate net feature value.

## 2.5 *Discussion of potential outcomes*

### **No Obfuscation (NO) Market**

In a market with Bertrand competition prices should converge to marginal cost because as long as the lowest price is above marginal cost, a seller has an incentive to undercut that price and serve the demands of the entire market, while all other sellers earn only zero profits. Experimental studies on Bertrand markets show that the Bertrand outcome will not be realized in the lab when there are only 2 or 3 sellers because of the possibility of implicit collusion. However, the Bertrand outcome is typically quickly reached when there are 4 or more sellers (Dufwenberg and Gneezy, 2000; Huck, Normann and Oechssler, 2004). Buyers in our NO Market do not have different preferences for products with identical overall net values  $v_o$ , and all buyers prefer products with a higher  $v_o$ . In this sense, the NO Market in our experiment is very similar to Bertrand competition. As we have 6 sellers, and each of whom can serve the whole market, we expect fierce competition in the NO Market such that sellers produce the maximum possible surplus, which is appropriated by the buyers. This also means that the overall price that trading buyers pay for a product (i.e., the base price plus the aggregate feature price) is identical, i.e., the law of one price holds.

### **Market with obfuscation opportunities (OO Market)**

In a Bertrand market, consumers can easily access and compare the net values they derive from the different sellers' products. However, subjects may not be able to assess values and prices easily in the presence of complex, obfuscated, products because they need to invest time and effort to understand each of the offered products. If sellers obfuscate, they thus generate endogenous search costs.

Diamond (1971) first formalized a model of markets with exogenous search costs and theoretically showed that monopoly pricing that extracts all the surplus from buyers is an equilibrium in this environment.<sup>16</sup> Monopoly pricing outcomes are also predicted for products' hidden features in many theories of obfuscation and shrouded attributes under various other assumptions that imply limited competition regarding "hidden" add-ons and surcharges (Lal and Matutes, 1994; Ellison, 2005; Gabaix and Laibson, 2006; Heidhues, Köszegi and Murooka, 2017; Heidhues, Johnen and Köszegi, 2021).

However, the monopoly pricing result of Diamond (1971) is also fragile because it can unravel with an arbitrarily small inducement to visit multiple firms (Heidhues, Johnen and Köszegi, 2021). Such situations are likely to occur when consumers have a heterogeneous willingness to search across products' add-on features, and firms may face some incentive to undercut high add-on prices to attract the searching consumers. Thus, heterogeneous buyer search behavior may act as a constraint on the "overpricing" of add-on features, and sellers' who target different buyer types could also generate differentiation and dispersion in the prices of add-on features and lead to the violation of the "law of one price" (Carlin, 2009; Ellison and Wolitzky, 2012; Chioveanu and Zhou, 2013).

In the end, the final price level and price dispersion are likely to depend on how much competitive pressure consumers exert on sellers with their endogenous search activities and purchase behaviors. In our experiment, we are able to explicitly examine the breadth and depth of buyers' search, thus enabling

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<sup>16</sup> Intuitively, this result follows because in equilibrium, all consumers rationally expect all firms to charge monopoly prices and have, therefore, no incentive to search at all and just buy one of the products randomly. This consumer behavior, in turn, gives firms no incentive to lower their prices below the monopoly level.

us to assess how their search patterns differ from those postulated in different theories and what market consequences this may have. Moreover, we can measure the ways in which sellers respond to buyers' search and purchase patterns, thus providing empirical insights into the mechanisms through which obfuscation opportunities mitigate competition and cause a redistribution of the surplus from trade.

Both in reality (e.g., in online shopping markets) and in our experiment, the products' base prices are typically considerably more salient and transparent compared to the prices and values of the add-on features. This then means that base prices may be subject to stronger competition than add-on prices – an assumption or a prediction that almost all theories of add-on pricing make.

However, stronger competition for base/headline prices does not necessarily mean that this competition is unconstrained. In a market with obfuscation opportunities, when buyers have a limited willingness to search, they may try to infer the hidden net values of add-on features from headline prices, especially if they experience heterogeneous add-on features during their search. And if they sometimes have bad experiences with a product that had a low headline price<sup>17</sup>, they may become suspicious of overly low headline prices, a possibility that is, e.g., discussed in Völckner, Rühle and Spann (2012), Heidhues, Köszegi and Murooka (2017) and Shulman and Geng (2019). If buyers are indeed suspicious of low headline prices, then sellers may hesitate to lower their base prices. Because we can directly examine both the characteristics of sellers' offered products and buyers' search behavior in response to different headline prices, our data can shed light on these issues.

Finally, there is one aspect that has not yet received much attention in the theoretical literature on obfuscation – the possibility that consumers may be averse to product obfuscation. Some literature (Xia and Monroe 2004; Gaudeul and Sugden, 2012; Crosetto and Gaudeul, 2012; Repetti, Roe and Gregory 2014; Chiles, 2017; Seim, Vitorino and Muir, 2017; Seim, Vitorino and Muir 2017; Sugden and Zheng, 2018) has suggested that consumers appear to be averse to complexity and hidden fees, and that they value transparency. Complexity aversion may be the direct consequence of the search cost that complex, obfuscated products impose on consumers (i.e., consumers may resent searching through obfuscated products) or it may result from consumers' experience that more complex products are, on average, more likely to be associated with a “worse deal”. Our experiment offers the opportunity to examine whether complexity aversion (i.e., whether buyers shy away from buying more complex products that are otherwise identical to less complex products) emerges in highly competitive markets and whether this aversion is sufficiently strong to affect aggregate obfuscation levels and potentially other market level outcomes.

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<sup>17</sup> For example, a very cheaply priced flight tickets may be associated with poor experiences and pricy surcharges along the way. Financial investment products with high returns may be associated with high risks and low dividends that were difficult to discover ex-ante. Celerier and Vallee (2017) show, in fact, that financial products with more attractive headline returns are associated with higher complexity and more risks, an empirical regularity that may provide a rational basis for being suspicious of attractive headline returns.

### 3 The impact of surplus-enhancing obfuscation opportunities

In this section, we present the results for the two treatments with surplus-enhancing add-on features (Half Cost Treatment and Convex Cost Treatment)<sup>18</sup>. We start by reporting how the buyers' share of the total surplus and the dispersion of this share evolves over time in the OO Market and the NO Market in section 3.1. Then we decompose the share of the surplus that buyers fail to obtain into (i) efficiency losses due to the fact that sellers fail to choose the surplus maximizing level of feature values, (ii) the component that they lose because even the best available product charges prices above marginal cost, and (iii) mistakes the buyers make because they fail to find the best product in the market. Then we examine the sellers' obfuscation strategies and the underlying intentions in more detail in section 3.2. In section 3.3, we analyze how sellers are able to enforce positive profits by setting their base prices and the aggregate net feature values. We investigate buyers' search and buying behavior and how a product's characteristics attract or repulse buyers in section 3.4.

#### 3.1 Buyer surplus and sellers' profits

Our first primary result concerns how much of the total surplus buyers obtain on average in the market with no obfuscation (NO Market) and in the market with obfuscation opportunities (OO Market), and the extent to which the surplus that individual buyers earn is dispersed across buyers. We summarize the corresponding findings in:

- Result 1:** (a) In the absence of obfuscation opportunities, buyers receive almost all the surplus available in the market. After the first few periods, buyer surplus quickly converges to 97% of the total surplus.
- (b) In contrast, buyers get a much smaller share of total surplus, initially as low as 11%, in the presence of obfuscation opportunities. Buyer surplus converges towards 68% of the total surplus in the long run.
- (c) Dispersion in individual buyers' surplus quickly becomes negligible in the NO Market, whereas large and stable dispersion always prevails in the OO Market, indicating a violation of the law of one price.

We document Result 1 in terms of the share of the traded surplus that buyers obtain on average in the market in percent of the maximally possible total surplus. Recall that buyers' earnings from a product are  $\pi^B = (v_b - p_b) + (v_f - p_f)$ . If we denote the aggregate feature value  $v_f$  that maximizes the total surplus from feature values by  $v_f^{max} \equiv \argmax [v_f - c_f(v_f)]$ , the percentage of the total available surplus a buyer receives from a trade is given by

$$\frac{\pi^B}{\pi^B + \pi^S} = \frac{(v_b - p_b) + (v_f - p_f)}{(v_b - c_b) + (v_f^{max} - c_f(v_f^{max}))}$$

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<sup>18</sup> We pool the data together for results where the two treatments differ only in irrelevant ways.

If at least one seller in the market provides the efficient level of extra features  $v_f^{max}$  and prices his/her product at marginal cost (i.e.,  $p_b + p_f = c_b + c_f(v_f^{max})$ ), then any buyer who buys this product earns the maximum possible surplus.

Figure 3 shows the average buyer surplus per trade in percent of the maximum possible total surplus over the course of the experiment in the NO and the OO Markets.<sup>19</sup> In addition, the figure displays the within-period market-level dispersion in buyer surplus with “deviation bars” that indicate plus/minus one standard deviation of the buyer surplus from the mean. In the NO Market, where all obfuscation is removed by design, the average traded buyer surplus starts off at a very high level (83%), quickly increases to 94% in period 3, and finally reaches on average 97% of the total surplus in periods 6-10.<sup>20</sup> In addition, the dispersion of the buyer surplus very quickly becomes extremely small. Therefore, competition pushes the total surplus to its most efficient level and prices very close to marginal cost in the NO Market such that the law of one (overall) price holds.

In contrast, Figure 3 shows that the buyer surplus in the market with obfuscation opportunities (OO Market) is only 11% of the maximal total surplus at the beginning, implying that sellers appropriate the lion’s share of the total surplus. Competition pushes the buyer surplus slowly up over time, and the buyers’ share stabilizes at roughly 2/3 of the total surplus from period 13 onwards. The buyers’ share of the surplus in the OO Market is thus significantly lower than the buyers’ share in the NO Market ( $p = 0.000$ , t-test with standard errors clustered at the market level)<sup>21</sup>. These facts sharply contrast with the quick convergence of the buyers’ surplus share to nearly 100% in the NO Market, providing a first indication that obfuscation opportunities (i) severely weaken competition in the NO Market but (ii) do not completely remove it.

In addition, there is a large and stable spread in buyers’ surplus from traded products throughout the whole 20 periods of the OO Market: the within-period standard deviation, measured as a share of the maximal total surplus, is 25.3% for offered products and 13.0% among traded product. Moreover, this dispersion does not differ much between the first 15 and the last 5 periods, while in the NO market dispersion quickly vanishes. This result shows again the much weaker competitive forces in the OO Market and the fact that obfuscation opportunities alone can cause large and stable dispersion of buyers’ surplus shares in traded products, although buyers’ homogeneous tastes provide no reason for product or price differentiation.

Why do buyers reap such a low share of the surplus in the market with obfuscation opportunities? Is it because sellers fail to provide the efficient level of extra features, or do sellers implement efficient extra

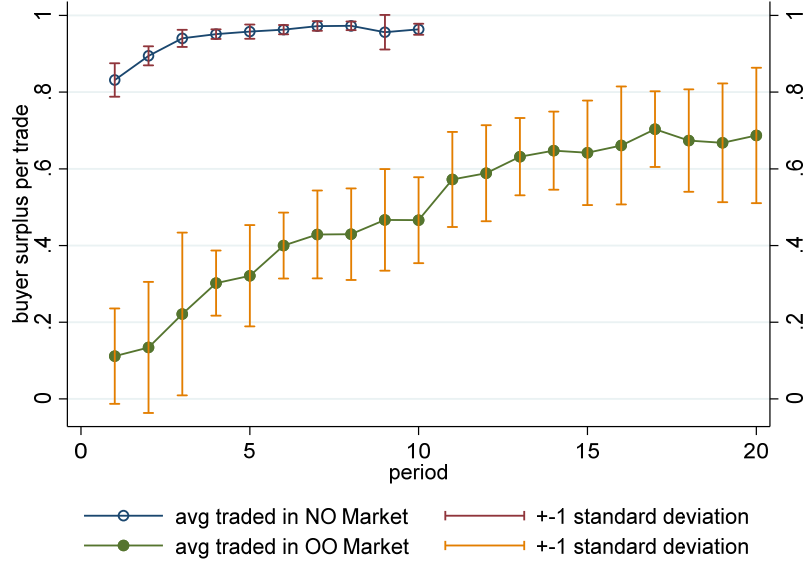
<sup>19</sup> In the OO markets it sometimes happened that not all buyers trade. Because buyers have different values for the basic product, some variations in the actual average surplus per trade may merely reflect which buyers failed to trade. To correct for this variation, we used the average base value (where the average is taken across *all* buyers) to calculate the buyers’ surplus share in Figure 3. This ensures that the reported surplus share in Figure 3 only reflects variations in offered and traded products and is not affected by individual traders’ base values. Note also that this means that Figure 3 does *not* include the buyer surplus that is lost due to non-trades in the OO Market.

<sup>20</sup> It appears that the main reason why the buyer surplus does not reach 100% is that sellers shy away from prices that give them literally zero profits, i.e., sellers want to earn at least one ECU from their trade.

<sup>21</sup> All our statistical results in the paper are based on t-tests that cluster standard errors at the market level unless specified otherwise.

features but charge high prices? Or is it because buyers do not identify the best offered product that is available in the market? The next result answers these questions.

**Figure 3: Average buyer surplus per trade as a share of the maximally possible surplus in NO Markets and OO Markets**



*Notes:* The figure shows the average buyer surplus per trade (plus/minus one standard deviation) as a percentage of the maximum possible total surplus across the 20 periods in the market without obfuscation (NO Market) and the market with obfuscation (OO Market). The figure is based on the pooled data from the Half-Cost Treatment and the Convex Cost Treatment. The traded buyer surplus in the OO Market is significantly lower than the buyer surplus in the NO Market ( $p = 0.000$ ,  $t$  test).

**Result 2:** In the market with obfuscation opportunities, the sellers prevent buyers from appropriating the total surplus mainly by (i) enforcing high prices even for the best available product in the market, and (ii) buyers' persistent failure to purchase the best available product in the market.

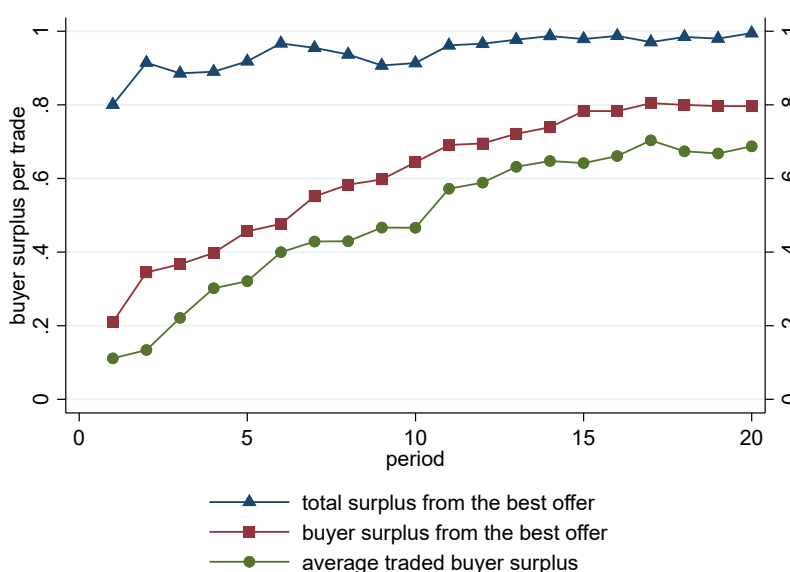
Figure 4 shows the decomposition of the buyers' surplus loss in the OO Market described in Result 2. The figure displays (for each period) the average traded *buyer surplus* (the circle line) as in Figure 3, together with the average *total* surplus from the best offer in the market (the triangle line) and the average *buyer surplus* (the square line) provided by the best offer in the market.<sup>22</sup> The best offer is defined by the product that gives the buyers the highest surplus. Thus, the triangle line shows the extent to which the best offer generates the maximal total surplus by implementing the efficient level of extra features. The difference between the total surplus and the buyer surplus in the best offered product in the market shows the share of the surplus that the sellers of the best offered products could appropriate. The difference between the buyer surplus in the best offered product and the average traded buyer surplus in a period informs us about the extent to which buyers did not identify the best offered product in the market, and instead bought an inferior product.

Figure 4 nicely illustrates the regularities described in Result 2. First, the big gap between the square line and the triangle line indicates that even sellers who make the best offer among the 6 competing products charge a price substantially above marginal cost and earn substantial profits. In Periods 16-20,

<sup>22</sup> All three graphs are normalized by the maximum possible total surplus; therefore, the scale of the vertical axis is the same as Figure 3.

the buyer surplus offered in the best available product stabilizes at only 80%, significantly lower than the maximal buyer surplus ( $p = 0.000$ ). Second, the significant difference ( $p = 0.000$ ) between the average traded buyer surplus (the circle line) and the buyer surplus in the best available product (square line) shows a *stable level* of buyer error in identifying the best offered product across the entire 20 periods of the OO Market. This suggests that it is very hard for buyers to avoid buying mistakes in markets with obfuscation opportunities. Consequently, this failure to identify the best product generates another loss in buyers' surplus of around 12%. Overall, sellers in the OO Market appropriate reductions in buyer surplus from both high prices and buyer mistakes, allowing sellers to earn around 32% of the total surplus in the long run (i.e., periods 16-20).

**Figure 4: Decomposition of buyers' surplus loss in markets with surplus-enhancing obfuscation opportunities**



*Notes:* The figure shows the average buyer surplus in traded products, the surplus buyers could earn if they identify and buy the best offer in the market, and the total surplus generated by the best offer (product). The figure is based on the pooled data from the Half-Cost Treatment and the Convex Cost Treatment, and all graphs are displayed as a percentage of the maximum possible total surplus. The buyer surplus from the best offer is always lower than the total surplus from this offer ( $p = 0.000$ ). Similarly, the average traded buyer surplus is significantly lower ( $p = 0.000$ ) than the buyer surplus from the best offer.

Taken together, while seller earn close to zero profits in the NO Markets, none of the sellers in the OO Markets prices the product at marginal cost when there are obfuscation opportunities, and even inferior products have a fair chance of being sold because many buyers persistently cannot identify the best product in the market. These results also suggest that policy interventions similar to the one we implemented in NO Markets – summarizing products in the simplest form possible or standardizing add-on provision to enforce competition with one easily accessible price – is likely to improve competition and increase buyers' surplus.



### 3.2 Sellers' obfuscation strategies

Why does the existence of obfuscation opportunities enable sellers to reap positive profits and reduce the buyers' share of the total surplus? The answer likely depends on whether and how sellers make use of the obfuscation opportunities. Our next result summarizes our empirical findings in this regard.

**Result 3: (a)** Obfuscation opportunities are widely used in the OO Markets. Sellers add more add-on features on average than needed to generate their desired level of feature values.

**(b)** In addition, sellers intentionally manipulate the order of add-on features in the OO Markets so that those features that first become visible are most attractive for the buyers, while the least attractive add-on features only become visible through deeper search. The intentional manipulation of the order of add-on features is absent in the NO Markets.

We provide support for Result 3 in Figures 5a and 5b. Figure 5a shows the average complexity of both offered and traded products in the Half Cost Treatment (HCT) and the Convex Cost Treatment (CCT), respectively. The average number of offered add-on features per product is 5.9 in HCT and 4.7 in CCT in periods 11-20. The complexity of average traded products is not less than the complexity of the average offered products; if anything, complexity is even slightly higher in the average traded products ( $p = 0.095$  in HCT and  $p = 0.463$  in CCT). That is, buyers buy products with average (or higher) complexity from the set of offered products and do not show an obvious preference for simple products.

Recall that the efficient aggregate feature value in the Half Cost Treatment requires 6 add-ons, while efficiency only requires 4 add-ons in the Convex Cost Treatment. However, the average offered product complexity is at a stable level significantly above 4 ( $p = 0.009$ ) in the Convex Cost Treatment, meaning that many sellers are willing to obfuscate by adding too many features relative to the surplus-maximizing level of feature values.<sup>23</sup>

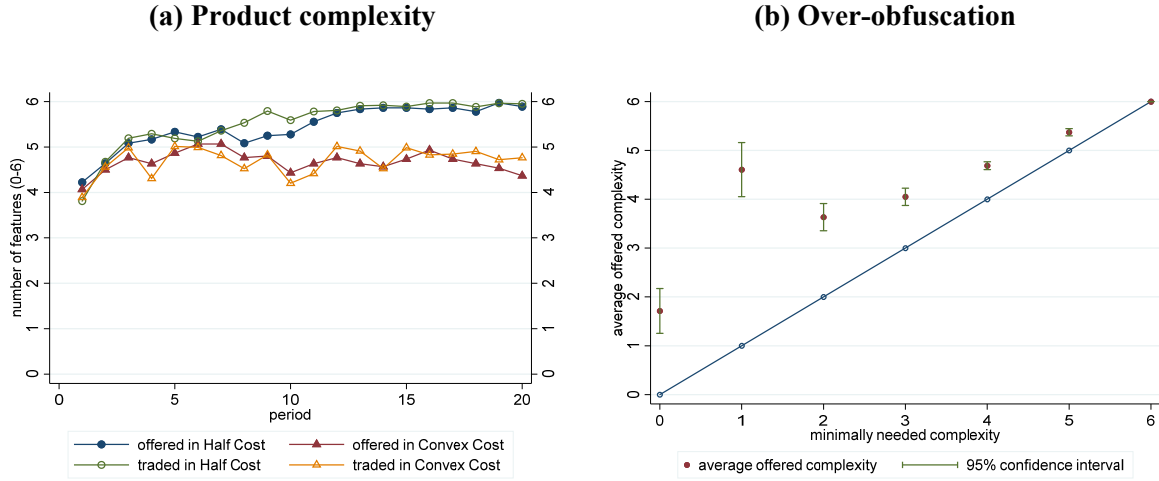
When add-on features enhance the surplus, one may wonder whether the high complexity level in the market is just a consequence of the desire to improve a product's competitive position by increasing its total surplus. There are, however, three pieces of evidence that contradict this view. First, sellers in the Convex Cost Treatment over-obfuscate on average relative to the surplus-maximizing aggregate feature value. Second, sellers also frequently over-obfuscate relative to the minimum number of add-on features required to implement their desired level of aggregate feature values. This is illustrated in Figure 5(b). In this figure, the horizontal axis categorizes all the offered products according to how many features sellers minimally need to produce their desired aggregate feature value, while the vertical axis gives the actual average number of features that these products have. For example, the solid circle at minimally needed complexity = 1 in Figure 5(b) contains all those products that have an aggregate feature value of 9 or less; this means that only 1 add-on feature is needed to produce the aggregate feature value. However, Figure 5(b) shows that the actual number of features for these products is on average 4.6, which is significantly above 1. In fact, all the offered products with a minimally required feature number of 5 or less are significantly more complicated than needed to produce the desired aggregate level of

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<sup>23</sup> Another notable pattern is that offered complexity in the Half Cost Treatment is significantly higher than in Convex Cost Treatment ( $p = 0.006$ ). This suggests that the fact that add-on features enhance the surplus over a wider range in the Half Cost Treatment facilitates obfuscation in that treatment. More implications of surplus-enhancing add-on features will be discussed in the section where we present the results of the Surplus-Neutral Treatment.

feature value. This systematic over-obfuscation points towards motives other than merely increasing surplus via add-on features.

**Figure 5: Product complexity and over-obfuscation in the Half Cost Treatment (HCT) and the Convex Cost Treatment (CCT) of markets with surplus-enhancing obfuscation opportunities**



*Notes:* Figure 5(a) shows the average number of features in both the offered and traded products in the OO Market. The figure presents data from the Half-Cost Treatment (HCT) and the Convex Cost Treatment (CCT) separately. The average offered product complexity in CCT is at a stable level significantly above 4 ( $p = 0.009$ ), but is significantly below the average offered product complexity in HCT ( $p = 0.006$ ). Figure 5(b) shows the average complexity of offered products (together with the associated 95% confidence interval) compared to the minimal complexity needed to generate the offers' planned feature values. The figure is based on the pooled data from the Half-Cost Treatment and the Convex Cost Treatment.

The third piece of evidence supporting that sellers' intentionally try to mislead buyers is provided in Figure 6. Recall that we simplified the sellers' choices such that they only determine the aggregate feature value and the aggregate feature price of their product, while the computer determines the values and prices of individual features randomly. If sellers are not satisfied with one realization, they can re-randomize until they are satisfied. We find that sellers indeed re-randomize rather frequently.

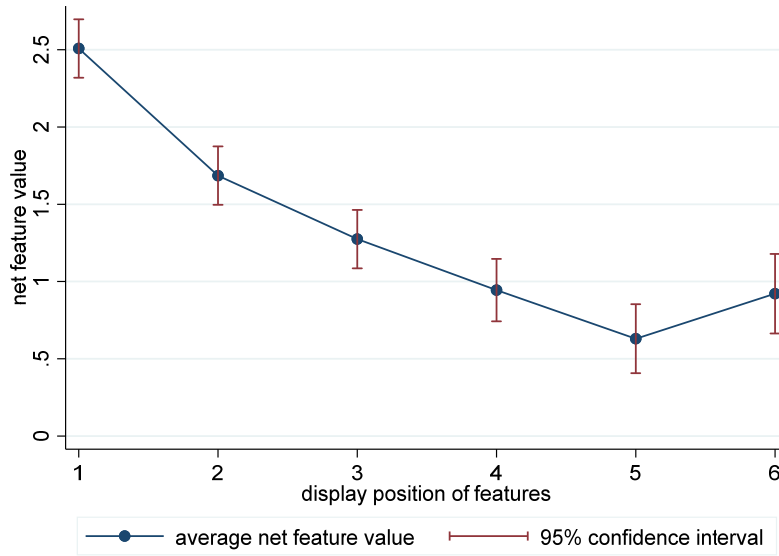
If each of the individual feature values and prices were really randomly determined across the display positions of features, then across all the offered products, there should be on average no difference in the net feature value  $v_f^i - p_f^i$  across the display position  $i$  of individual extra features. That is, the average net value of the features shown at the top of the feature list should be the same as the average net value of the next shown features, and so on.

However, Figure 6 shows that this is not the case. The figure depicts the average net value of features on the y-axis across display positions of features on the x-axis. The figure shows that at any position of the display order, that position's feature is on average significantly more attractive than the next position's feature<sup>24</sup> ( $p = 0.001$  from a joint clustered t test between features in one position and in the next position). This pattern is particularly pronounced among the first three feature positions. Thus, if buyers do not inspect all features of a product, they will only see the first few attractive features and

<sup>24</sup> Only the last 2 features are not significantly different from each other; but this may simply result from the fact that, by design, sellers can determine the display order only by letting the computer re-randomize the whole order so that they do not have full control over the attractiveness of each extra feature.

remain uninformed about the product’s less attractive features. In fact, we will provide direct evidence for such a search pattern among buyers in Result 5. The sellers seem to anticipate the buyer’s search patterns and intentionally distorted the display order in a way that improves the appearance of their product to imperfectly informed buyers.<sup>25</sup> This display manipulation behavior of the sellers therefore supports Result 3b.

**Figure 6: Net feature values across display positions of add-on features**



*Notes:* The figure shows the average net feature value (i.e., feature value – feature price) of individual add-ons in offered products across display positions of individual features within a product. The associated 95% confidence intervals are also presented. The figure is based on the pooled data from the Half-Cost Treatment and the Convex Cost Treatment. A joint t-test for whether the net feature value of each feature is higher than its next feature yields a p-value of 0.001. The first 4 features are also individually significantly (at least at a 10% level) different from each other ( $p = 0.001$  between the first and the second feature,  $p = 0.072$  between the second and the third feature, and  $p = 0.016$  between the third and the fourth feature).

### 3.3 How do sellers compete and earn profit?

As sellers make ample use of the obfuscation opportunity offered in the OO Market, the crucial next question is how obfuscation helps sellers make profits. As a product’s overall price consists of a base price, which is transparent and costless for the buyers to see, and individual feature prices, which are only visible at some small cost, sellers’ profits could come from two sources: (i) base prices higher than marginal costs of basic products and (ii) aggregate feature prices higher than aggregate feature costs. Many models in the theoretical literature (e.g., Ellison 2005; Spiegler, 2016; Choi, Dai and Kim 2017; etc.) have conjectured that headline prices may serve as an attention-grabber in an add-on pricing setting and may, therefore, be set at very low levels in order to attract consumers. Once consumers have been lured to visit a firm’s store or website, they may have a limited willingness to switch to competing firms, meaning that the visited firm can earn profits from its add-on features. However, as the attractiveness

<sup>25</sup> This intentional hiding of unfavorable product features is congruent with field observations. Recall, e.g., the finding of C  lerier and Vall  e (2017) who document that financial firms hide the risks involved in their financial products behind complex product descriptions.

of base prices and “hidden” product features could be negatively correlated (Célérier and Vallée 2017; Shulman and Geng, 2019), buyers may also interpret low base prices as a signal for highly priced “hidden” product features, which may weaken the overall attractiveness of low base prices. Our next result documents how headline prices and add-on prices are used by sellers to generate profits.

**Result 4: (a)** Initially, the average base prices are considerably above marginal cost but they gradually fall over time and eventually they stabilize below the base products’ marginal cost. However, low base prices remain dispersed throughout the 20 market periods.

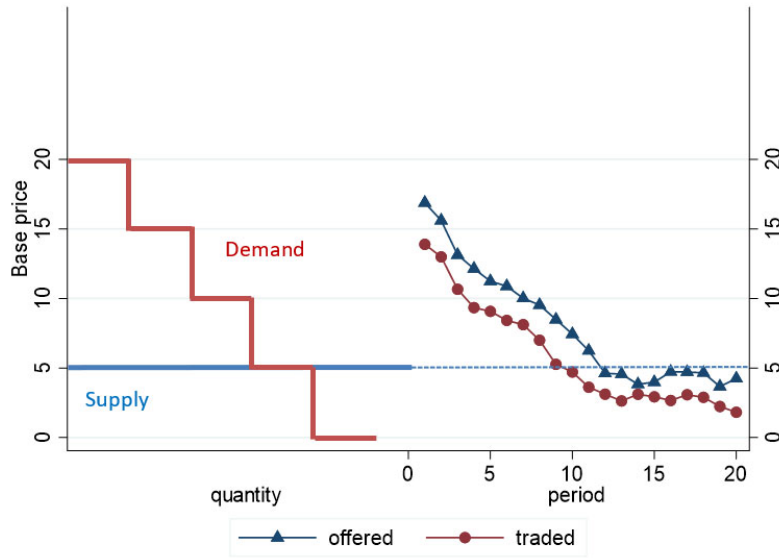
**(b)** Sellers are able to enforce aggregate feature prices substantially above costs, and the average profits sellers earn from add-on features are stable over time. At the same time, sellers do not appropriate all the surplus from add-on features, and net feature values remain dispersed across products.

**(c)** Low headline prices are on average associated with worse add-ons but the association is quite noisy.

Result 4 means that headline prices are initially a source of profits but over time sellers eventually incur losses on their basic products, while the obfuscated extra features become the key source of profits. Result 4 thus supports models of add-on pricing that predict loss-leadership price structures. Support for Result 4a comes from Figure 7, which shows the average base prices in the OO Markets. In addition, the figure shows the flat marginal cost curve and the buyers’ valuations for the basic product. The figure illustrates that base prices are initially far above marginal cost but drop gradually and eventually fall somewhat below marginal costs from period 11 onwards ( $p = 0.616$  and  $p = 0.020$  for offered and traded base prices respectively). In fact, in the long run base prices stabilize at a level slightly below marginal cost. This is indicated by Figure 7 and the fact that neither the offered ( $p = 0.659$ ) nor the traded base prices ( $p = 0.424$ ) differ between periods 11-15 and 16-20. In addition, base prices remain rather dispersed even in periods 16-20. During these periods, the within-period standard deviation, measured as a percentage of the maximal total surplus, is 16.7% for the offered products and 12.1% for the traded products.

If sellers incur losses from their basic products but still earn positive overall profits, then the extra features must be the source of the profits. Figures 8a and 8b illustrate how the average aggregate feature values, prices, and costs evolve over time in offered and traded products respectively. The difference between aggregate feature values and aggregate feature costs reflects the fact that sellers generated a substantial surplus via add-ons. In addition, the figures show that aggregate feature prices turn out to be substantially and significantly higher than the aggregate feature costs ( $p = 0.000$ ). Recall that the same technology to produce add-ons is available to all the sellers. Therefore, the extra features are highly replicable and, if competition is fully at work, they should not allow for prices above their marginal costs. However, sellers are able to obtain a sizable and stable share of profits from their add-ons over the entire 20 periods. Notice that this also means that the increase of the buyer surplus over time in the OO Markets (see Figure 3 and 4) stems almost entirely from declining base prices.

**Figure 7: The development of headline prices over time**

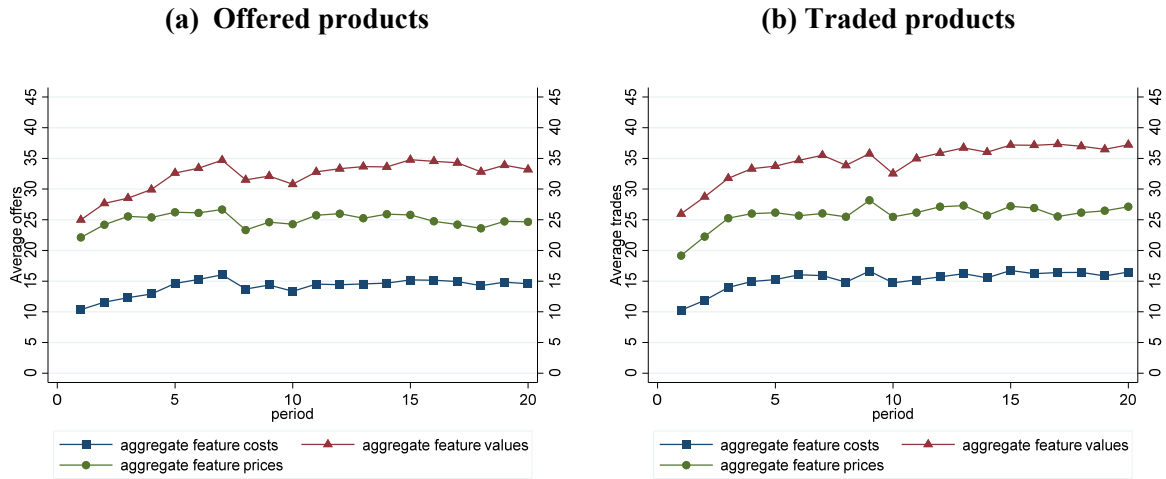


*Notes:* The figure shows the constant marginal cost of the basic product (blue thick line in the left part of the figure), the buyers' valuations of the basic product (red thick line in the left part), and how the prices of the offered and traded basic products evolve over time (in the right part of the figure). The figure is based on the pooled data from the Half-Cost Treatment and the Convex Cost Treatment. From Period 11 onwards, the average traded base prices are significantly lower than the marginal cost ( $p = 0.020$ ).

A comparison of Figures 8a and 8b also reveals that the average buyer surplus from add-ons in traded products (Fig. 8b) is only slightly higher (by 6.1% of the maximal total surplus) than the buyer surplus that sellers offer on average (Fig. 8a). Thus, buyers are on average not able to find products with much better extra features compared to the average in the market. This is in line with the observation in Figure 4 that a significant share of buyers is unable to identify the best available offer in the market and, therefore, inferior products always have a good chance to be traded and to influence market outcomes.

Nevertheless, sellers do not appropriate all the surplus from add-on features, an observation that suggests positive competitive forces among the add-on features. Moreover, the within-period dispersion of aggregate net feature values across products is rather large: even in the long run (in period 16-20), the average standard deviations of the buyers' surplus from the add-on features are 29.5% and 20.0% of the maximal total surplus for offered and traded products, respectively. Both patterns of add-on feature prices differ from theoretical models that rely on the assumption of no competition among shrouded surcharges (e.g., Gabaix and Laibson, 2006; Heidhues, Köszegi and Murooka, 2017; Heidhues, Johnen and Köszegi, 2021) and models that predict non-dispersed add-on prices that extract all the surplus (e.g., Lal and Matutes, 1994; Ellison, 2005). The large and persistent dispersion in aggregate net feature values could have important implications for how markets with add-on features function. First, dispersed net features may reinforce competition among add-on features as buyers may find better products if they search more. Second, dispersed net feature values also may render base prices – which constitute only a small part of the product's overall properties – an imperfect signal for the total price (and value) of products, because the net feature value of the products remains uncertain.

**Figure 8: Aggregate feature values, feature prices and feature costs**



*Notes:* The figure shows the aggregate feature values and the associated aggregate feature costs in offered (a) and traded (b) products. The difference between aggregate feature values and aggregate feature costs is a measure of the surplus the extra features provide. The aggregate feature price (line with circles) shows how this surplus is distributed between buyers and sellers. The figures are based on the pooled data from the Half Cost Treatment and the Convex Cost Treatment. The figure documents that sellers appropriate a stable share of the surplus generated by the products' extra features. The aggregate feature price of offered (traded) products is significantly higher than the aggregate feature cost of offered (traded) products ( $p = 0.000$  for offered and traded products). The aggregate feature value of offered (traded) products is significantly higher than the aggregate feature price of offered (traded) products ( $p = 0.001$  for offered and  $p = 0.000$  for traded products).

Although both base prices and net values of add-on features are quite dispersed in the market, there may still be a relationship between their average levels, based on which buyers may infer the aggregate value of add-on features from the product's base prices. We previously discussed the possibility that low headline prices may indicate that sellers provide overpriced "hidden" add-ons. If this were the case, buyers might become suspicious of products with low headline prices, which would constrain sellers' ability to lure buyers into buying products with overpriced add-ons. Result 4c shows that low headline prices are indeed associated with a lower overall net value of add-ons for the buyers: In a regression of headline prices on products' aggregate net feature values (i.e., aggregate feature values – aggregate feature prices) that controls for period dummies to eliminate the time trend, the regression coefficient is positive and significant ( $p = 0.024$ ). However, the regression coefficient is not very large (0.43) and there is considerable noise in this relationship which may make it difficult for buyers to make strong inferences (see Figure A4 in the appendix). Nevertheless, some buyers may have had bad experiences when buying a product with a low base price that has unattractive add-ons which could well have induced suspicion among them. This suspicion, in turn, may explain why base price stopped falling after period 10. If some buyers were indeed suspicious of low base prices we should observe that the average base prices at which products are traded are higher than the lowest base prices offered. We will examine this in the next section on buyers' search and buying behavior.

### 3.4 Buyers' search and buying behavior

The complexities generated by add-ons and the fact that it takes time to find, understand, and evaluate them imposes “search” burdens on buyers. How buyers' search and buying behavior reacts to obfuscation is key for the functioning of markets. Our next result, therefore, summarizes the buyers' search behavior.

**Result 5: (a)** In 42% of cases, buyers in the OO Market visit<sup>26</sup> only one or fewer products in the market and study these products in depth but, overall, there is substantial heterogeneity in the number of products visited and the percentage of add-ons studied.

**(b)** Buyers' search behavior indicates a strong trade-off between “browsing” (the number products visited) and “studying” (the depth with which individual products are examined). More intense studying is associated with a considerable reduction in browsing.

**(c)** The probability of a product being in the buyer's consideration set declines with higher base prices. However, due to heterogenous search behaviors even the highest base price has still a probability of roughly 25% of being included in buyers' consideration sets.

**(d)** The average base price of the first visited products as well as the average base price of the traded products is significantly higher than the lowest base price in the market, indicating that a non-negligible number of buyers are not attracted by the lowest base price.

Support for Result 5a is provided in Figure 9a and 9b. Figure 9a shows the distribution of the number of products visited in the OO Market; it indicates that in 42% of the cases only 1 or fewer products are visited. However, in roughly 45% of the cases, the buyers visit between 2 and 3 products, and in the remaining (roughly) 13% of the cases they visit between 4 and 6 products, which indicates substantial heterogeneity in search behavior. This result is thus in line with the fundamental idea in many theories (e.g., Ellison, 2005; Heidhues, Johnen and Köszegi, 2021) that assume or predict very limited search by the buyers (i.e., one or fewer visits<sup>27</sup>) in response to obfuscation. But our results also differ because many buyers make more than one visit, and their search behavior is very heterogenous. These search patterns provide a reason for sellers to differentiate themselves from each other by catering their products to different search types, resulting in dispersion in product features that allows for substantial profits, yet does not extract all the surplus from buyers.

In addition to heterogeneous breadths of search, buyers may also differ in the extent to which they “study” the visited products in depth. Figure 9b illustrates that in 50% of the cases in which a product is visited, buyers study between 80% and 100% of the add-on features. Thus, in-depth study of a limited number of products is a frequent behavior. However, like for the breadth of search, there is substantial heterogeneity in buyers' in-depth study of products as in roughly 50% of the cases, buyers study less than 80% of the add-ons (see Figure 9b), i.e., they obtain only a partial understanding of the product's extra features. Both search patterns shown in Figure 9a and 9b do not change much across the 20 periods.

Support for Result 5b is provided by Figures 9c. This figure displays the cumulative distribution of add-on features that are examined, conditional on visiting 1, 2, 3, etc. products. It documents the existence of a strong tradeoff between the depth of search (studying) and the breadth of search (browsing). For

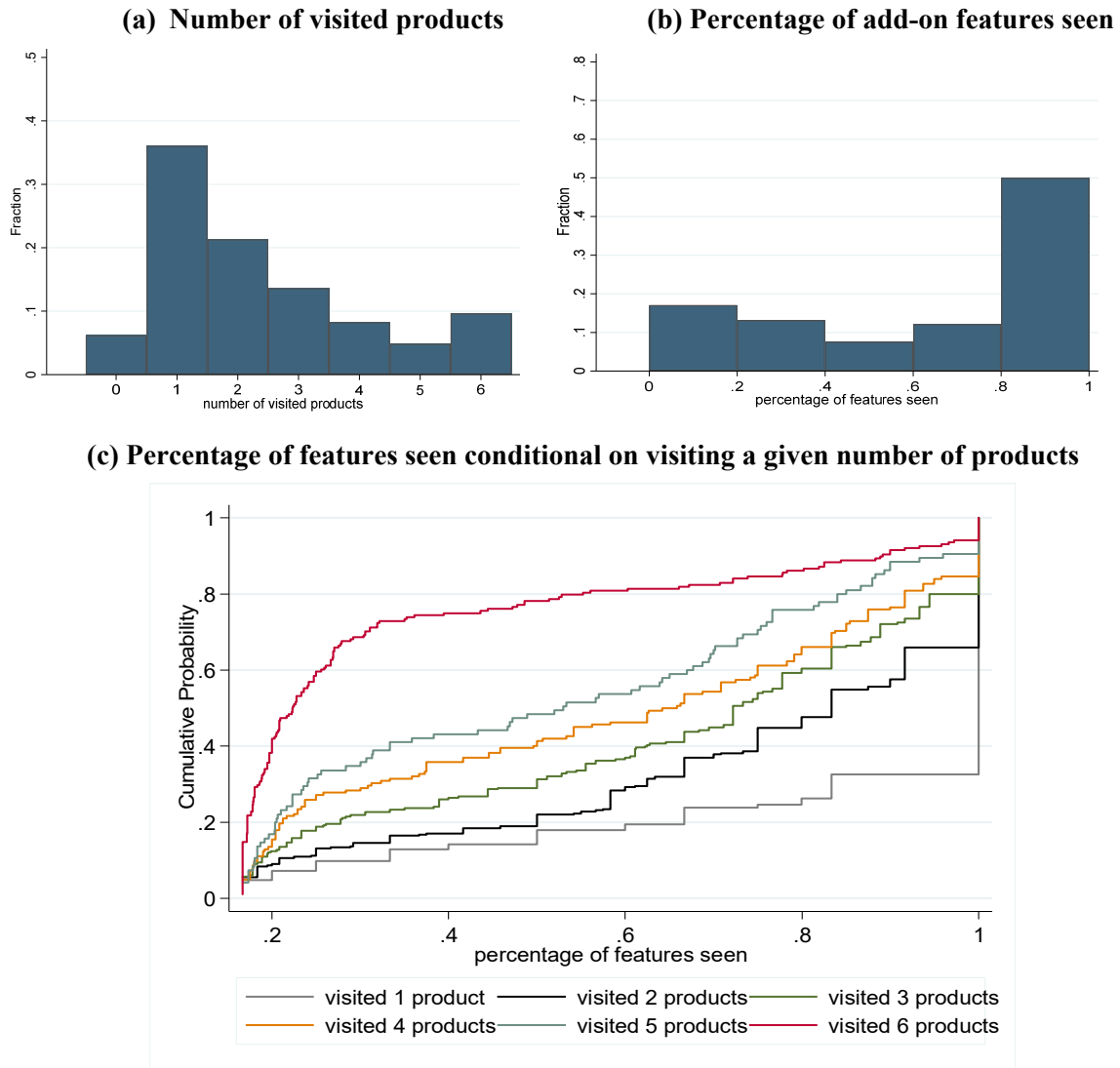
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<sup>26</sup> A product is visited if the buyer examines at least one of the product's add-ons.

<sup>27</sup> Or sometimes twice under certain assumptions in Ellison and Wolitzky (2012).

example, conditional on visiting only one product the depth of search is very high (defined as looking at 80-100% of the add-ons) in roughly 70% of the cases. In contrast, if buyers visited all 6 products their depth of search is very low because in roughly 75% of the cases, they examined less than 40% of the add-ons. More generally, Figure 9c shows that the cumulative probability of examining only a small percentage of add-on features is monotonically increasing in the number of products visited.

**Figure 9: Buyers' search Behavior**



*Notes:* The figure shows the distributions of (a) the numbers of products that buyers visit, (b) the average percentage of features that buyers see for the products that they visit, and (c) the percentages of features that buyers see for those products that they visit conditional on the numbers of products that they visit.

The existence of a tradeoff between studying and browsing rationalizes an important assumption in the model by Heidhues, Johnen and Köszegi (2021) in which the lack of browsing in equilibrium is an important competition-limiting force.<sup>28</sup> In addition, Figure 9c also rationalizes Result 3, which shows that sellers spend effort to intentionally manipulate the display order of the add-on features by positioning the more attractive features higher up on the feature list. Although buyers predominantly

<sup>28</sup> Our experimental results may be viewed as empirical support for the importance of the distinction between browsing and studying, which arises endogenously in our set-up.



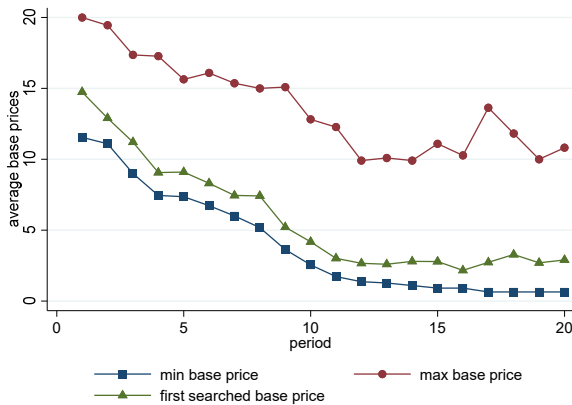
studied a limited number of products in more depth there is still a considerable percentage of cases (58%) in which they studied 2 or more products only in a more superficial way. This search pattern generates an incentive for the buyers to present the most attractive add-on features first.

This trade-off between studying and browsing naturally emerges from the fact that – except for the first few periods – individual buyers tend to spend a similar amount of time in the OO Market *across the periods*. Note, however that this does not mean that there is no *individual heterogeneity* in total time spent examining products in the market: across individuals the per period standard deviation of time spent in the market is rather high – 80% of the mean time spent in the market<sup>29</sup>. This contrasts with search in the NO Market where *all* buyers search close to zero seconds.

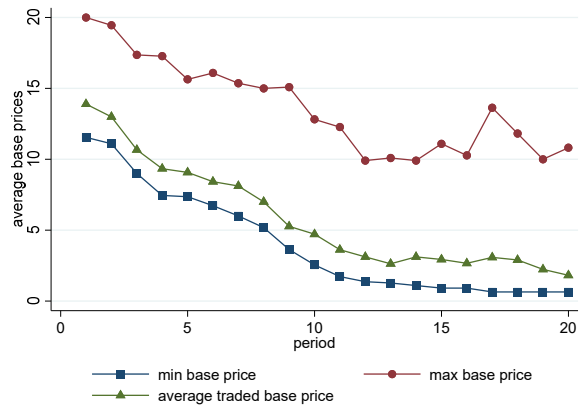
Taken together, the limited breadth and depth of search documented in Result 5a and 5b suggest that obfuscation opportunities cause severe constraints on buyers’ knowledge about the prevailing products and their characteristics. These constraints, in turn, considerably mitigate the competition sellers face in the market, and enable them to make positive profits.

**Figure 10: Base prices and buyers’ search behavior in the OO Market**

**(a) Base price of the first visited product**



**(b) Average base price in traded products**



Note: The figure shows how buyers’ search behavior responded to sellers’ base prices. **(a)** The average base price of buyers’ first visited products together with the range of base prices across different periods. The average base price of the first visited products is higher than the lowest base prices in the market with  $p = 0.000$ . **(b)** The average base price of traded products together with the range of base prices across different periods. The average base price of traded products is higher than the lowest base prices in the market with  $p = 0.000$  for the entire 20 periods and with  $p = 0.006$  for period 16-20.

As many buyers visit only a limited number of products in the market, it becomes particularly important to attract buyers’ attention as soon as possible. We examine the influence of base prices on buyers’ *first* visited products and on the traded products in Figure 10a and 10b while the relation between base prices and buyers’ consideration sets<sup>30</sup> is shown in Figure A5. These figures provide support for Results 5c and 5d. Figure 10a depicts the average base prices of buyers’ first visited products, along with the minimum and the maximum base price in every period. We see that the buyers first visit products with

<sup>29</sup> The mean time spent on examining products in the market was 25.7 seconds.

<sup>30</sup> A sellers’ product is in a buyers’ consideration set if the buyer has visited the product, i.e., if at least one add-on feature has been studied.

relatively low base prices. However, this figure also shows that there is a significant difference ( $p = 0.000$ ) between the lowest base price and the average base price that is visited first. This observation is compatible with the view that some buyers indeed seem to have a suspicion about the products with the lowest base prices. Moreover, Figure 10b illustrates that the average base price in traded products is higher than the lowest base price in the market throughout the 20 periods. Even in the long run (periods 16 – 20) the lowest base price is significantly lower compared to the base prices in the traded products ( $p = 0.006$ ). Thus, apparently a nonnegligible number of buyers shy away from buying the product with the lowest base price which further indicates some constraints on competition via base prices.

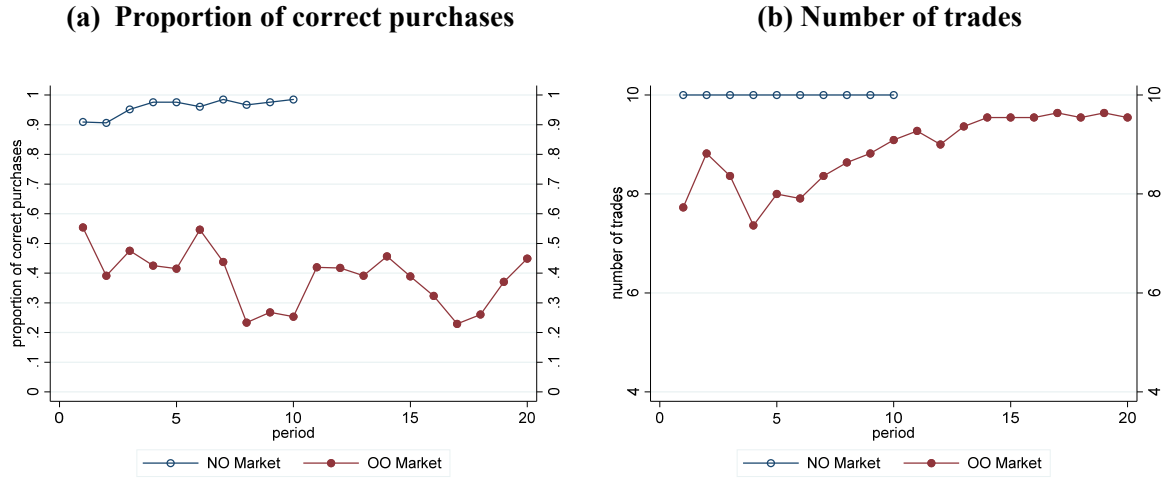
Figure A5 indicates that the proportion of buyers who included a product in their consideration set declines with the rank of that product's base price. The product with the lowest base price is in the consideration set of 83% of the buyers but even the product with the highest base price has still a chance of 24% of being included in buyers' consideration sets. Taken together, Figures 10a, 10b and A5 constitute direct evidence of the attention-grabbing effect of low base prices. At the same time, however, the figures also illustrate that even the products with the highest base prices had a chance of being included in the consideration set, and the average base price of the first visited product as well as the average base price of the traded products is significantly higher than the lowest base price, suggesting nonnegligible suspicion against very low base prices.

The incomplete buyer search documented in Result 5 almost inevitably implies mistakes in buying behavior. Buyers may fail to find and buy the best available product in the market, and they may sometimes even fail to trade. Our next result summarizes the evidence with regard to buyers' mistakes.

**Result 6:** In the market with obfuscation opportunities, more than half of the buyers typically fail to buy the best available product in the market. Buyers sometimes even do not trade and thus completely forgo the available gains from trade. This contrasts sharply with the NO Market where all buyers trade, and almost always buy the best available product.

Figures 11a and 11b support this result. Figure 11a shows the proportion of buyers who end up buying the best product in the market, and Figure 11b displays the number of trades that take place in every period. While buyers in the NO Market almost always buy the best product in the market and everybody trades, more than half of the buyers in OO Market usually end up with strictly dominated products ( $p = 0.000$ ). Moreover, consistent with the evidence shown in Figure 4, buyers do not get better at identifying the best product over time when the market is obfuscated via complex product features. On the other hand, Figure 11b shows that failure to trade is around 20% during the first 6 periods. Although the percentage of non-trades diminishes to less than 5% during the final periods, it is still non-negligible for about 12-13 periods, and significantly positive across the entire 20 periods ( $p = 0.000$ ). These buyer mistakes are an important reason why sellers only faced limited competitive pressure; sellers who offered inferior products were still able to sell them and influence the average market outcomes, and sellers with the best product in the market may sometimes not even have been able to trade at all or traded less than what would have maximized buyers' welfare and total efficiency.

**Figure 11: Buyers' trading mistakes and failures to trade**



*Notes:* Figure (a) shows the proportion of buyers who managed to buy the best available product in the market. Figure (b) shows the number of buyers who traded among the 10 buyers in the market. Both Figures (a) and (b) are based on the pooled data from the Half-Cost Treatment and the Convex Cost Treatment. The proportion of buyers who are able to buy the best product is much higher in the NO Market than in the OO Market with  $p = 0.000$ . The number of trades that occur in the NO Market is also higher than in the OO Market with  $p = 0.000$ .

Our previous results show that sellers compete mainly with their salient headline prices while appropriating a large share of the surplus through add-on features. This seller behavior makes sense if buyers, *ceteris paribus*, respond very elastically to a sellers' and his competitors' headline prices but relatively inelastically to the seller's and his competitors' aggregate feature prices. Our next result summarizes our findings in this regard:

**Result 7:** (a) Sellers can substantially increase their sales by decreasing their base prices. Likewise, the base price of the best product in the market also has a sizeable impact on other sellers' sales.  
(b) The aggregate values and prices of a product's extra features exert a considerably smaller effect on the product's sales. Likewise, the impact of the aggregate value and aggregate price of the market's best product's extra features on other products' sales is relatively small.

Table 2 reports two OLS regressions of product units sold on the characteristics of the product itself and the characteristics of the best available competing product in the market. The regressions also control for market complexity (i.e., the average number of extra features) and time trend; standard errors are clustered on the market level. It turns out that base price variations exert the largest impact on a product's sales: lowering the base price by 10 ECUs significantly increases sales by around 1.6-1.8 units. Similarly, both the base price of the best available product in the market (column 1) and the lowest base price among the competing products in the market (column 2) play a similar (although slightly smaller) role: a reduction in the best competitor's base price (or a reduction in the lowest base price among the competitors) significantly lowers a seller's sales. This large buyer response to base prices helps us understand why competition forced sellers to gradually lower their headline prices over time.

**Table 2: Buyers' responses to a product's own and the competing products' characteristics**

Dependent Variable	Units sold	Units sold
Base price	-0.18*** (0.01)	-0.16*** (0.01)
Aggregate feature value	0.07*** (0.01)	0.06*** (0.01)
Aggregate feature price	-0.06** (0.01)	-0.04** (0.01)
Best competitor's base price	0.12*** (0.01)	-
Best competitor's aggregate feature value	-0.08*** (0.01)	-
Best competitor's aggregate feature price	0.07*** (0.01)	-
Best base price among competitors	-	0.10*** (0.02)
Best aggregate feature value among competitors	-	-0.01 (0.01)
Best aggregate feature price among competitors	-	-0.00 (0.01)
Number of features	-0.05 (0.07)	-0.10 (0.08)
Average number of features among competitors	-0.12 (0.09)	-0.25** (0.09)
Period	-0.03** (0.01)	-0.04** (0.01)
Constant	3.70*** (0.33)	3.73*** (0.78)
No. of observations	1320	1320
R-square	0.23	0.21

Notes: Standard errors are clustered on the market level. \*\*\* indicates significance at the 0.01 level, \*\* at the 0.05 level, and \* at the 0.10 level.

The high elasticity of buyers' behavior to headline prices contrasts with their much lower elasticity to the aggregate feature values and aggregate feature prices: an increase in aggregate feature prices by 10 ECUs reduces a product's sales only between 0.4 – 0.6 units. Likewise, an increase in aggregate feature values by 10 ECUs increases a product's sales only between 0.6 – 0.7 units.<sup>31</sup> The difference in buyers' responsiveness to headline prices versus their responsiveness to aggregate features values and prices is highly significant ( $p = 0.000$ <sup>32</sup>). Furthermore, the aggregate feature values and prices of the best competing product in the market have also small impacts on the seller's own sales; and the best aggregate feature value or the best aggregate feature price among the competitors basically does not matter at all. It is worthwhile to contrast these sluggish buyer responses to the products and the competitors' aggregate feature values and prices with our findings in the NO Market. The best available product in that market attracts almost all the buyers, practically eliminating the sales of competing sellers,

<sup>31</sup> Notice that unlike in Chetty et al. (2009), in our set-up this low responsiveness of buyers to aggregate feature values and prices cannot be due to their unawareness of the *existence* of "hidden" values and surcharges. Instead, this low responsiveness prevails even though buyers know from the experimental instructions that add-ons may exist. The low responsiveness is therefore a result of buyers' limited breadth and depth of search.

<sup>32</sup> In both regression specifications,  $p = 0.000$  for the hypothesis that the (absolute value of the) coefficient of the product's base price equals the coefficient of product's aggregate feature value and for the hypothesis that the coefficient of the product's base price equals the coefficient of the product's aggregate feature price.

while competition is strongly reduced and inferior products have a good chance of being sold in markets with obfuscation opportunities.

## 4 The impact of surplus-neutral obfuscation opportunities

In the Surplus-Neutral Treatment (SNT), the experiment approximates a situation typically modelled in the theoretical literature on obfuscation. In this case, obfuscation via add-on features only increases complexity but does not come with enhanced surplus. While the data of our treatments with surplus-enhancing extra features already showed many implications of an obfuscated market and supported many qualitative predictions of these theories, we now examine whether our key results on obfuscation remain robust when obfuscation does not add surplus and only serves the purpose to redistribute surplus. We summarize our main findings in the following.

**Result 8:** (a) Obfuscation levels are significantly lower with surplus-neutral extra features compared to markets with surplus-enhancing extra features. In addition, obfuscation is more fragile in the Surplus-Neutral Treatment in the sense that it deteriorates over time in some markets to low levels, and eventually leads to competitive market outcomes.

(b) In these low obfuscation markets, buyers display an aversion against buying complex products even after controlling for the products' values and prices, which appears to induce sellers to offer products with less complexity.

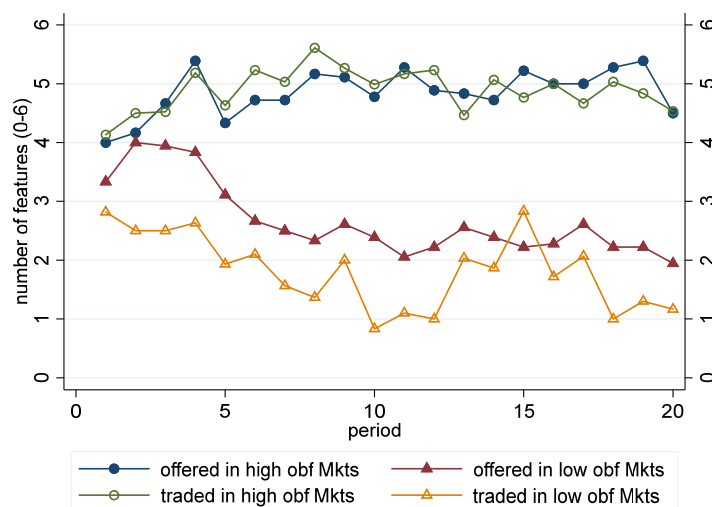
(c) From the buyers' viewpoint, a higher number of extra features is associated and believed to be associated with *better* products in markets with surplus-enhancing add-ons. In contrast, in markets with surplus-neutral add-ons, a higher number of add-ons is associated and believed to be associated with *worse* products. This treatment difference may explain why obfuscation is more fragile in markets with surplus-neutral add-ons.

Support for this result comes from Figure 12 below displaying the obfuscation levels and the fact that we observe a bi-modal obfuscation pattern across the 6 SNT markets: in 3 of the 6 markets (henceforth labelled "high obfuscation markets"), the average number of extra features across the entire 20 periods is 5.21, 4.63, and 4.73, respectively, while the average obfuscation levels in the other 3 markets (henceforth labelled "low obfuscation markets"), are only 3.18, 2.79, and 2.05, respectively. Moreover, the obfuscation level in the high obfuscation markets increases slightly over time (see Figure 12), while it declines in the low obfuscation market, although the initially offered obfuscation levels in the first three periods do not differ significantly in the two types of markets ( $p = 0.114$ ). Consequently, the average number of extra features in offered and traded products is higher in the high obfuscation compared to the low obfuscation markets ( $p = 0.001$  for offered products,  $p = 0.006$  for traded products). Due to the existence of the low obfuscation markets in the Surplus-Neutral treatment, the overall average number of features in offered and traded products in the SNT is lower than in the treatments with surplus-enhancing extra features ( $p = 0.020$  for offered and  $p = 0.025$  for traded products).

Several notable patterns arise in the SNT. First, in high obfuscation markets, the average obfuscation level is very similar to that in the treatments with surplus-enhancing extra features ( $p = 0.304$ ). Consequently, sellers in these high obfuscation markets are able to appropriate similar levels of buyers' surplus as in HCT and CCT (see Figure A7 in the appendix). Second, Figure 12 also shows that the obfuscation levels in offered products and actually traded products are quite similar in high obfuscation

markets of the SNT, a pattern that is also present in HCT and CCT. In contrast, in the low obfuscation markets buyers on average buy products that are considerably less complex than the average offered product, a discrepancy that persists across the 20 periods (see Figure 12). In the long run (periods 16-20), the average complexity of offered products converges to only 2.3 extra features and the buyers buy products with only 1.4 extra features in the low obfuscation markets. Due to the high transparency in these low obfuscation markets, market outcomes eventually become quite competitive and buyers appropriate almost all the surplus in the market (see Figure A7 in the appendix). Taken together, Figure 12 and Figure A7, along with the associated statistical tests, provide support for Result 8a.

**Figure 12: Obfuscation levels in the market with surplus-neutral obfuscation opportunities**



*Notes:* The figure shows the average number of features in both the offered and traded products in the OO Markets of the Surplus-Neutral Treatment. The average number of extra features in offered and traded products is higher in the high obfuscation compared to the low obfuscation markets ( $p = 0.001$  for offered products,  $p = 0.000$  for traded products).

Why are sellers unable to sustain a high level of obfuscation in the low obfuscation markets? Figure 12 shows that they tried to increase product complexity during the first few periods as in the high obfuscation markets. Moreover, the sellers in the low obfuscation markets – like those in the high obfuscation markets – also show clear intentions to manipulate the buyers’ perception of the value of add-on features by strategically placing the best add-on features on the top of the add-on list while the bad add-on features are “hidden” by placing them on the bottom of the list.<sup>33</sup> These findings suggest that sellers in both markets attempted to fool the buyers with the help of complex products.

However, Figure 12 hints at a potential explanation for the unraveling of obfuscation levels in the low obfuscation markets. The figure shows that buyers in the low obfuscation markets tend to buy products with lower complexity than those offered, a pattern that is absent in all other OO Markets. To explore more carefully why buyers behave this way, we examine the determinants of buying behavior econometrically analogously to Table 2. To characterize the extent to which buyers in the low obfuscation markets behave differently than buyers in the high obfuscation markets, we interact the

<sup>33</sup> Specifically, the buyer’s net value from add-on features declines on average by 0.52 ECU for each consecutively displayed feature in the low obfuscation markets. In the high obfuscation markets this number is 0.39 ECU.

determinants of buying behavior studied in Table 2 with a dummy variable that takes on the value of 1 if the observation comes from the low obfuscation markets. Our results are displayed in Table 3.

Table 3 replicates important insights we already observed in Table 2 (which reports the same regressions with the pooled data from HCT and CCT). In particular, the products' own base price, the base price of the best competing product, and the best base price among competitors are three highly influential and significant determinants of sellers' sales in both the high and the low obfuscation markets of the SNT. However, the table also highlights key differences between the high obfuscation and the low obfuscation markets. Most importantly, while the coefficient on the product's "number of features" is insignificant (and even positive) in the high obfuscation markets, the number of features has a large negative effect on a product's sales in the low obfuscation markets. Controlling for all other characteristics of a product (such as base price, aggregate feature price, aggregate feature value) and for the characteristics of the best competitor's products, the addition of two more extra features to a product reduces the number of sold units by 1.2 on average. We interpret this fact as an indication of buyers' aversion against complex products because it shows up even though we control for all other characteristics of a product and the characteristics of the best competing product. Moreover, if it is indeed the case that buyers' in the low obfuscation market dislike complex goods, then we should also observe that the average number of features among the competitors raises the sales of a seller's own product, which is exactly what we observe: the coefficient on the interaction term between the average number of features in competitors' products and the "low obfuscation market" dummy is positive, large, and significant. Finally, complexity aversion already seems to be present in the low obfuscation markets from the very beginning because Figure 12 indicates that the complexity of the traded products is already lower than the complexity of the average product in the market during the first few periods. Taken together, these patterns support Result 8b.

One further noteworthy aspect in Table 3 is the following: Recall that in the markets with surplus-enhancing extra features (i.e., in the HCT and the CCT), a rise (decline) in the products' own aggregate feature value (aggregate feature price) by 10 units increases a product's sales by 0.7 (0.6) units. The corresponding increase in the product's sales is very similar at 0.5 (0.7) units in the high obfuscation markets.<sup>34</sup> This confirms that the elasticity of sales with regard to add-on characteristics is relatively low in markets with high obfuscation levels (like the HCT, the CCT and the high obfuscation markets of the SNT). In contrast, the market quickly becomes much more transparent in the low obfuscation markets of the SNT because of the lower obfuscation level, and this higher transparency may render a product's sales more elastic to the product characteristics. The remarkably large interaction terms between the "low obfuscation dummy" and the products aggregate feature values or aggregate feature prices is in line with this conjecture. For example, while a rise in the products aggregate feature value by 10 units increases the units sold by 0.5 units in the high obfuscation markets, the corresponding increase is 2.1 units in the low obfuscation markets.

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<sup>34</sup> These coefficients are not significant in the high obfuscation market of the SNT, but this is likely to be due to the fact that we only have three of these markets and we cluster standard errors on the market level, while we have six markets in both the HCT and the CCT.

**Table 3: Buyers' responses to a product's own and the competing products' characteristics in SNT**

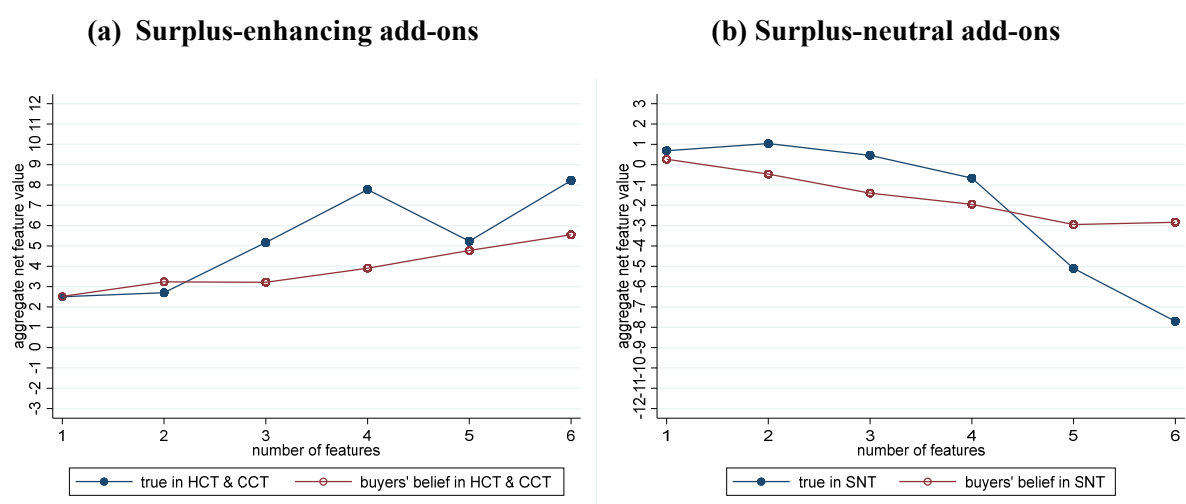
Dependent Variable	Units sold	Units sold
Base price	-0.12** (0.04)	-0.12** (0.05)
Base price $\times$ low obf mkts	-0.14** (0.05)	-0.14** (0.05)
Aggregate feature value	0.05 (0.07)	0.05 (0.07)
Aggregate feature value $\times$ low obf mkts	0.16* (0.07)	0.17* (0.07)
Aggregate feature price	-0.07 (0.04)	-0.07 (0.04)
Aggregate feature price $\times$ low obf mkts	-0.10* (0.05)	-0.10* (0.05)
Best competitor's base price	0.11** (0.03)	-
Best competitor's base price $\times$ low obf mkts	-0.03 (0.07)	-
Best competitor's aggregate feature value	-0.07* (0.04)	-
Best competitor's aggregate feature value $\times$ low obf mkts	0.04 (0.07)	-
Best competitor's aggregate feature price	0.08 (0.04)	-
Best competitor's aggregate feature price $\times$ low obf mkts	-0.06 (0.08)	-
Best base price among competitors	-	0.09*** (0.02)
Best base price among competitors $\times$ low obf mkts	-	-0.07** (0.02)
Best aggregate feature value among competitors	-	0.02 (0.02)
Best aggregate feature value among competitors $\times$ low obf mkts	-	-0.05* (0.02)
Best aggregate feature price among competitors	-	0.00 (0.00)
Best aggregate feature price among competitors $\times$ low obf mkts	-	-0.03 (0.02)
Number of features	0.13 (0.15)	0.11 (0.15)
Number of features $\times$ low obf mkts	-0.58** (0.21)	-0.61** (0.20)
Average number of features among competitors	-0.15 (0.13)	-0.19 (0.15)
Average number of features among competitors $\times$ low obf mkts	0.46** (0.16)	0.68** (0.22)
Period and Period $\times$ low obf mkts	$\sqrt{\phantom{x}}$	$\sqrt{\phantom{x}}$
Constant and Constant $\times$ low obf mkts	$\sqrt{\phantom{x}}$	$\sqrt{\phantom{x}}$
No. of observations	720	720
R-square	0.29	0.30

Notes: The standard errors in the regressions are clustered on the market level. \*\*\* indicates significance at the 0.01 level, \*\* at the 0.05 level, and \* at the 0.10 level.



The previous analyses suggest that buyers' complexity aversion is likely to be a reason for the fragility of obfuscation in the Surplus-Neutral Treatment (SNT). But why are buyers averse to complex products in the SNT, but not in the treatments with surplus-enhancing add-ons? Figure 13 below provides a potential answer to this question. Buyers in the treatments with surplus-enhancing add-ons experience and believe that there is a positive relationship between the products' aggregate net feature values and the number of add-ons (Figure 13a). In contrast, buyers in the SNT experience and believe on average that this relationship is negative (Figure 13b). Thus, a higher number of features is associated and believed to be associated with worse products in the Surplus-Neutral Treatment with purely exploitative obfuscation<sup>35</sup>, while the opposite is the case in the treatment with surplus-enhancing features. In other words, while buyers have good reason to be averse to complex products in the SNT markets, they have no reason to be suspicious of or averse to products with many add-ons in the markets with surplus-enhancing add-ons. We believe that this explains why complexity aversion, and the associated fragility of obfuscation, shows up only in markets with purely exploitative obfuscation but not in markets with surplus-enhancing product features.

**Figure 13: The relationship between products' aggregate net feature values and the number of features in the OO Markets with surplus-enhancing and with surplus-neutral features.**



*Notes:* The figures show the buyers' beliefs about the relationship between products' aggregate net feature values and the number of features and the actual relationship. Figure (a) illustrates the actual and believed relationship in the treatments with surplus-enhancing add-ons (HCT and CCT) while Figure (b) shows the corresponding believed and actual relationships in the treatment with surplus-neutral add-ons (SNT).

<sup>35</sup> This correlation is also predicted by, e.g., Carlin (2009), Ellison and Wolitzky (2012), and also Chioveanu and Zhou (2013).

## 5 Summary and Conclusions

While traditional economic models of competitive markets assumed that consumers are able to understand and compare all the products in the market, consumers' attention and information is costly and their cognitive capacities are limited. These constraints appear particularly important in modern economies characterized by a flood of products with a large number of different add-on features.

To understand the consequences of obfuscation via add-ons on market prices, competition, and consumer welfare, we designed an experiment with obfuscation opportunities for the sellers and endogenous search opportunities for buyers. To identify the causal impact of obfuscation opportunities, we contrast the market with obfuscation opportunities with an otherwise identical control market without obfuscation opportunities. We find that while price levels converge very quickly to marginal cost in the control market, in markets with surplus-enhancing obfuscation opportunities the sellers appropriate about 32% of the total surplus that buyers would have received if the prices were at marginal costs. Sellers can appropriate this share of the total market surplus even in the long run, i.e., even during the final periods of the market.

However, we also find that obfuscation is considerably more fragile when add-ons are not surplus-enhancing and obfuscation is thus purely exploitative. We find, in particular, that buyers are reluctant to buy more complex products in some of the markets with surplus-neutral add-ons, and this reluctance prevails even if we control for all other aspects of the good, thus reducing individual sellers' incentive to obfuscate. In these markets, obfuscation therefore unravels over time and the market approaches competitive conditions. A plausible reason for buyers' reluctance to buy complex products is that higher product complexity is associated with less valuable goods for the buyers in these markets – a fact the buyers realize. On the other hand, complexity aversion is absent when add-on features are surplus enhancing. A potential reason for this is that when add-ons generate, on average, additional surplus, sellers can earn profits while not extracting all the surplus from the add-ons. In this case, products with more add-ons are associated are more valuable for the buyers – which is indeed the case in the OO Markets with surplus-enhancing add-ons. We show that buyers perceive this fact and, therefore, they have little reason to resist buying more complex products.

We believe that these findings may provide a deeper understanding of the forces that sustain obfuscation in markets and may inform theory construction. In addition, our experimental design may also be useful as a workhorse for studying other important questions such as (i) how markets with obfuscation opportunities operate when sellers can acquire a reputation, (ii) how flexibly headline and add-on prices as well as traded quantities in obfuscated markets respond to supply and demand shocks, or (iii) how different regulatory interventions affect the functioning of these markets.

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# Appendix

Figure A1: example screens in the buyer stage in market with obfuscation opportunity

(a) Buyer screen before buyer searched though add-ons

**Buyer Stage**

<u>Phone 1</u>	<u>Phone 2</u>	<u>Phone 3</u>	<u>Phone 4</u>	<u>Phone 5</u>	<u>Phone 6</u>
<u>Base Price:</u> 11	<u>Base Price:</u> 13	<u>Base Price:</u> 16	<u>Base Price:</u> 22	<u>Base Price:</u> 17	<u>Base Price:</u> 13
<u>Features:</u>	<u>Features:</u>	<u>Features:</u>	<u>Features:</u>	<u>Features:</u>	<u>Features:</u>

You may use the blue boxes below to keep a record for the **net additional values** of different products

buy	buy	buy	buy	buy	buy

**Your value from the basic features: 10**

Exit

(b) Buyer Screen after searching the first add-on of Phone 1

**Buyer Stage**

<u>Phone 1</u>	<u>Phone 2</u>	<u>Phone 3</u>	<u>Phone 4</u>	<u>Phone 5</u>	<u>Phone 6</u>
<u>Base Price:</u> 11	<u>Base Price:</u> 13	<u>Base Price:</u> 16	<u>Base Price:</u> 22	<u>Base Price:</u> 17	<u>Base Price:</u> 13
<u>Features:</u>	<u>Features:</u>	<u>Features:</u>	<u>Features:</u>	<u>Features:</u>	<u>Features:</u>

<u>Label</u>	<u>Value</u>	<u>Price</u>
headphone:	3	1

You may use the blue boxes below to keep a record for the **net additional values** of different products

buy	buy	buy	buy	buy	buy

**Your value from the basic features: 10**

Exit

(c) Buyer Screen after searching the second add-on of Phone 1

**Buyer Stage**

<u>Phone 1</u>	<u>Phone 2</u>	<u>Phone 3</u>	<u>Phone 4</u>	<u>Phone 5</u>	<u>Phone 6</u>
<u>Base Price:</u> 11	<u>Base Price:</u> 13	<u>Base Price:</u> 16	<u>Base Price:</u> 22	<u>Base Price:</u> 17	<u>Base Price:</u> 13
<u>Features:</u>	<u>Features:</u>	<u>Features:</u>	<u>Features:</u>	<u>Features:</u>	<u>Features:</u>

<u>Label</u>	<u>Value</u>	<u>Price</u>
headphone:	3	1
battery:	7	6

You may use the blue boxes below to keep a record for the **net additional values** of different products

buy	buy	buy	buy	buy	buy

Your value from the basic features: 10

Exit

*Notes:* In the buyer stage, buyers first immediately only see (a). With each click on, e.g., Phone 1, buyers can see one more feature of that product like in (b) and (c). If buyers click on another product, then the features of this other product are also shown one by one as buyers click.

Figure A2: example screens of the feedback stage

(a) Feedback screen for seller of phone 5

Feedback Stage

Phone 1

Base Price:

11

Features:

Label	Value	Price
headphone:	3	1
battery:	7	6
warranty:	6	3
capacity:	1	8

Sum of feature prices: 18  
Sum of feature values: 17  
Sum of feature costs: 8.5  
Earnings from extra features: 9.5  
Total earnings from a trade: 15.5

Phone 2

Base Price:

13

Features:

Label	Value	Price
weight:	9	7
shipping:	5	9
warranty:	8	3

Sum of feature prices: 19  
Sum of feature values: 22  
Sum of feature costs: 11.0  
Earnings from extra features: 8.0  
Total earnings from a trade: 16.0

Phone 3

Base Price:

16

Features:

Label	Value	Price
battery:	5	9
packaging:	8	3
headphone:	2	3
weight:	7	2
camera:	3	1

Sum of feature prices: 18  
Sum of feature values: 25  
Sum of feature costs: 12.5  
Earnings from extra features: 5.5  
Total earnings from a trade: 16.5

Phone 4

Base Price:

22

Features:

Label	Value	Price
None		

Sum of feature prices: 0  
Sum of feature values: 0  
Sum of feature costs: 0.0  
Earnings from extra features: 0.0  
Total earnings from a trade: 17.0

Phone 5

Base Price:

17

Features:

Label	Value	Price
capacity:	2	3
weight:	7	2
camera:	3	1
display:	6	6

Sum of feature prices: 12  
Sum of feature values: 18  
Sum of feature costs: 9.0  
Earnings from extra features: 3.0  
Total earnings from a trade: 15.0  
Units sold: 2  
Total earnings in this period: 33.0

Phone 6

Base Price:

13

Features:

Label	Value	Price
capacity:	2	3
battery:	4	7

Sum of feature prices: 10  
Sum of feature values: 6  
Sum of feature costs: 3.0  
Earnings from extra features: 7.0  
Total earnings from a trade: 15.0

OK

(b) Feedback screen for a buyer

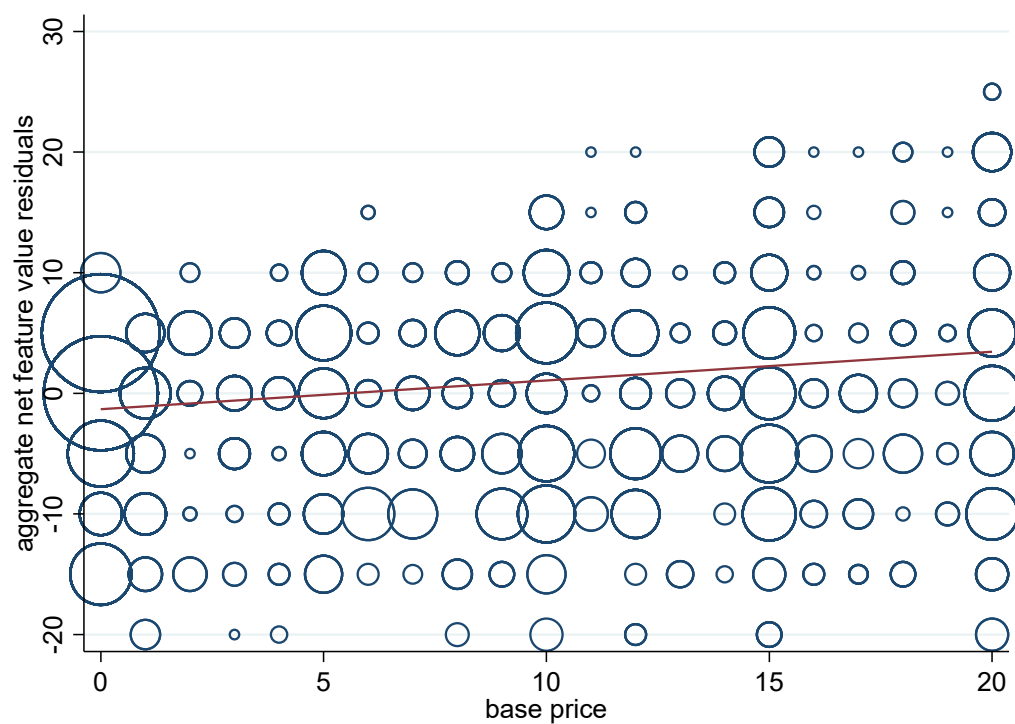
Feedback Stage
Your endowment: 8.0
Your total earnings from trading: 11.0
Your time cost: 6.2
Your total earnings in this period: 12.8
OK



[illegible]

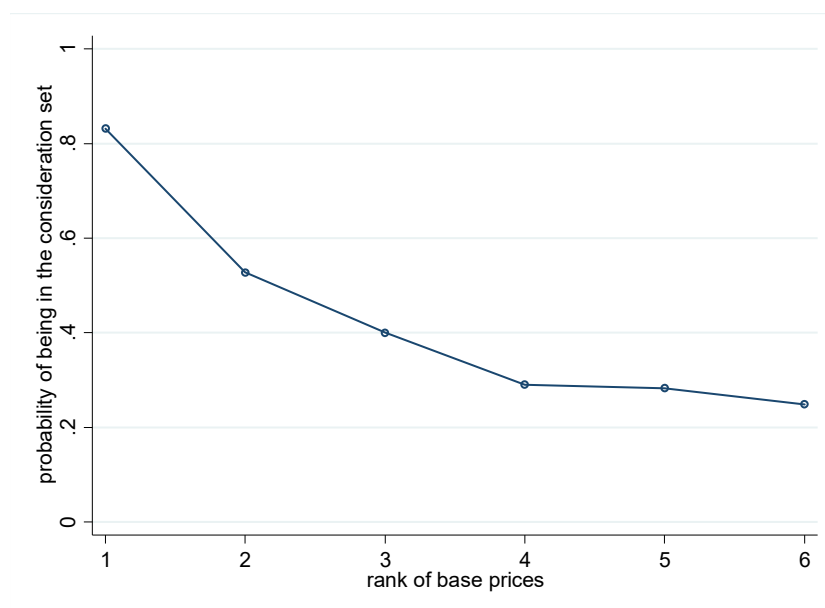
46

Figure A4: The relation between products' aggregate net feature values and their base prices



*Notes.* The figure shows the scatter plot of the residual aggregate net feature values as a function of base prices after controlling for period dummies. The fitted line represents the regression coefficient, and the bubbles represent the smoothed frequency at each data point. The figure is based on the pooled data from the Half-Cost Treatment and the Convex Cost Treatment.

Figure A5: Base prices and buyers' consideration sets



Note: The figure shows the relationship between the rank of sellers' base prices and the probability of being in the buyers' consideration sets. Low ranked base prices ensure a much higher probability of being in buyers' consideration sets. The figures are based on the pooled data from the Half-Cost Treatment and the Convex Cost Treatment.

## Appendix A6 - Buyers' overall welfare cost of obfuscation

In this appendix, we calculate buyers' overall welfare losses in the market with surplus-enhancing obfuscation opportunities relative to a situation in which buyers appropriate the whole surplus in the market – a situation that the NO Market closely approximates. We consider the following categories of buyer welfare losses in this exercise:

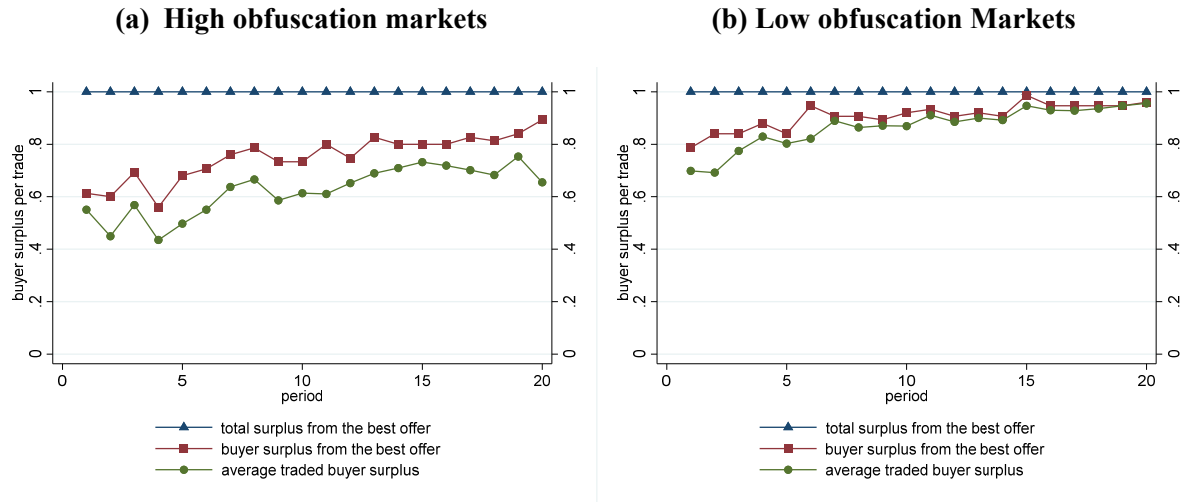
- (i) Losses due to a transfer of buyer surplus to the sellers via high prices even for the best available product in the market (illustrated in Figure 4).
- (ii) Losses due to mistakes in failing to buy the best available product (again illustrated in Figure 4).
- (iii) Time wasted in searching an obfuscated market.
- (iv) Losses due to failures to trade.
- (v) Losses due to the fact that sellers failed to implement the surplus-maximizing level of add-on features (illustrated in Figure 4).

We make this welfare calculation for the entire 20 periods and again for the final 5 periods (16-20) because it is interesting to know how large the welfare losses are overall and also when the market has settled to a stable situation as in periods 16-20. Our calculations indicate the following:

**(a)** Across all the periods, buyer welfare is 68.7% lower compared to a benchmark in which sellers provide the surplus-maximizing add-on levels and buyers appropriate the whole surplus at no search cost. Sellers appropriate 66% of this overall loss for buyers via high prices (48%) and buyers' mistakes from failing to buy the best product (18%). 34% of the overall buyer welfare loss is due to time wasted searching in the market (14%), a failure to trade (11%), and sellers' inefficient choice of add-on levels (8%).

**(b)** In periods 16-20, buyer welfare is 42.9% lower compared to a benchmark in which sellers provide the surplus-maximizing add-on levels and buyers appropriate the whole surplus at no search cost. Sellers appropriate 71% of this overall loss via high prices (44%) and buyer mistakes by failing to buy the best product (27%). 31% of the overall buyer welfare loss is due to time wasted searching in the market (18%), a failure to trade (7%), and sellers' inefficient choice of add-on levels (4%).

Figure A7: Buyer surplus in OO Markets in the Surplus-Neutral Treatment



*Notes:* These figures show the average buyer surplus in traded products, the buyer surplus associated with the best available offer in the market, and the total surplus associated with the best offer in the OO Market. The figures are based on the data from the Surplus-Neutral Treatment. In this treatment, the total surplus from any (i.e., also the best) offer in the market is always 100% by construction because the number of chosen extra features has no surplus consequences.

Figure A7a indicates that the buyer surplus converges to a very high level (94% of maximal total surplus) during periods 16-20 in low obfuscation markets. In contrast, Figure A7a shows that sellers in high obfuscation markets appropriate average profits of 30% of the maximal total surplus even in the long run (Period 16-20), which is only slightly lower than the sellers' surplus share of 32% in the treatments with surplus-enhancing extra features. Figure A7a also shows that there is a persistent gap in the buyers' surplus between the average traded and the best available product in the high obfuscation markets – a gap that is also significant during periods 16-20 (average gap is 12.8% with  $p = 0.042$ ). In contrast, Figure A7b indicates that this gap completely vanishes over time in the low obfuscation markets, i.e., after period 10 buyers almost always are able to identify and buy the best available product in this market.

Table A1: Regression of net aggregate feature values on base prices in OO markets

Dependent Variable	Net aggregate feature values
Base price	0.43** (0.16)
Period dummies for period 2-20	√
Constant	√
No. of observations	1320
R-square	0.11

*Notes:* Standard errors are clustered on the market level. \*\*\* indicates significance at the 0.01 level, \*\* at the 0.05 level, and \* at the 0.10 level.