

The economics of Negative Option Marketing



Behavioural economics includes theories that try to explain why people sometimes make irrational decisions — those that do not maximise their own long-run happiness. Examples include loss aversion, decision weighting and time inconsistency.

Jon Guest considers how these conditions are manipulated by companies in their marketing and advertising

Can companies design effective marketing strategies to exploit these systematic mistakes and so increase their profits? Possible examples are offers that contain the following feature: 'a term or condition that allows a seller to interpret a customer's silence, or failure to take an affirmative action, as an acceptance of an offer.' The Federal Trade Commission in the USA calls these types of contracts Negative Option Marketing.

One rationale for companies to make these types of offers is that they take advantage of consumers who overestimate their ability to remember and cancel these deals. For example, a consumer may pay a monthly subscription fee to stream films and television series from businesses such as Netflix, Disney+, Apple TV+ and Amazon Prime Video. If these subscription contracts include an automatic renewal clause, then they roll over indefinitely unless the customer takes a prespecified action to terminate the deal. An inattentive consumer could end up paying

fees for months after they have effectively stopped using the service.

The autorenewal problem

How big is the problem in the UK? Recent research by the Department for Business and Trade (DBT) estimates that consumers spend £1.6 billion per year on subscriptions they do not want. This includes £573 million on subscriptions they have forgotten about and £602 million where a free or reduced-price trial has been rolled over to the full price.

In addition to the potential problems caused by autorenewal, some companies have been accused of deliberately making the cancellation process more complicated than it needs to be. For example, in June 2023, the Federal Trade Commission in the USA accused Amazon of knowingly making it more difficult to cancel their subscriptions to Prime. The study by the DBT found that UK consumers spent £382 million on subscriptions they did not want because the cancellation process was too complex to follow.

In response to these findings, the government introduced the Digital Markets, Competition and Consumers Bill into Parliament in April 2023. Provisions in this bill standardise the information that businesses must provide in subscription contracts and give consumers greater rights to opt out of autorenewal deals. For example, consumers will be able to cancel a subscription up to 14 days after it has renewed.

However, is it always in the interests of a business to offer autorenewal subscription contracts? If some

consumers are aware of their tendency to forget about their subscriptions it might deter them from taking out autorenewal contracts in the first place. Therefore, by trying to make more money from consumers who underestimate their inattentiveness, the company may lose money by deterring consumers who are more self-aware.

A European case study

In an interesting recent piece of research some economists carried out a field experiment with a leading European newspaper to investigate this issue in more detail. This newspaper ran a promotion where access to its online content was free for the first month before reverting to its usual subscription price. There were two different versions of this promotional offer. In one, the subscription automatically rolled over to the regular price at the end of the promotion period — the autorenewal version of the contract. In the other version, the subscription was automatically cancelled unless readers clicked to enrol onto the paid subscription — the autocancel version of the contract.

As part of the experiment, the offer that over 2 million readers received was determined randomly and then their behaviour was monitored over a 2-year period.

The following are some of the key findings from this study:

- The number of readers who accepted the promotional offer when offered the autorenewal contract was 24% lower than those offered the autocancel contract.
- Among all the readers who accepted the offer, those offered the autorenewal contract were seven times more likely to start paying the full-price subscription than those offered the autocancel contract. However, 4 months after the promotion period ended the difference between these subscription rates started to decline. After a year, the subscription rate among the autocancel group was higher than the autorenewal group.
- The readers who were offered the autorenewal contract were 10% less likely to become paid

subscribers at any point in the 2 years following the promotion compared to those offered the autocancel contract.

Therefore, although the newspaper might be able to make more money in the short-run by using autorenewal subscriptions to take advantage of their inattentive customers, in the long-run it would be more profitable to use autocancel subscriptions.

Questions

- 1 Using a simple example, explain the meaning of time inconsistency.
- 2 Outline the four different types of Negative Option Marketing.
- 3 What are the benefits of Negative Option Marketing for the consumer?
- 4 What are the characteristics of a field experiment in economics? How does a field experiment differ from a laboratory experiment?
- 5 Using behavioural economic theory, explain why the readers who were offered the autorenewal contracts were 10% less likely to become paid subscribers than those who were offered the autocancel contracts.

Weblinks

BBC report on Amazon Prime subscriptions:

www.tinyurl.com/yn7a65kp

FTA account of the decision to take legal action to tackle the autorenewal problem:

www.tinyurl.com/3jx95yp4

UK government policy summary for enhancing consumer rights online:

www.tinyurl.com/mutrctrt

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