

Week 4 Consumer Price Perceptions Module Introduction

Consumer Price Perceptions

In this module...

- Mental accounting and price perceptions
- Consumer price perceptions
- Building better deal and discount plans
- Mental shortcuts that impact pricing

By the end of this module you'll be able to...

- Assess the impact of psychology on customer perceptions of price
- Describe likely consumer responses to pricing strategies
- Use knowledge of psychology to create better deal and discount plans

Mental Accounting and Price Perceptions

What is mental accounting?

Draw Together Research From..

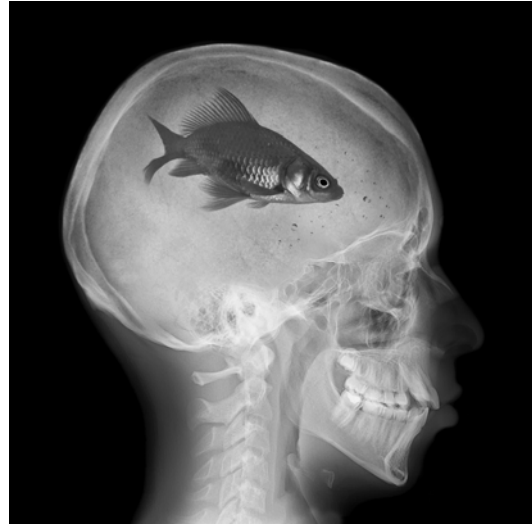
- Daniel Kahneman
- Amos Tversky
- Richard Thaler
- Dan Ariely
- George Lowenstein
- Drazen Pralec
- Terrence Odean
- Brad Barber
- Thomas Gilovich
- Gary Belsky
- Richard Feinberg
- Jason Zweig
- Rahul Guha
- Michael Schill
- Dick Wittink
- Ron Wilcox

The Evolution of Irrationality

- Many thoughts that used to have a survival advantage no longer do (maladaptive)
 - Our fish brains
 - Taste for sugar
 - Pattern confabulation
 - Frugal heuristics

Our Fish Brain

- All human beings tend to see negatives more clearly than positives unless
 - They won the serotonin genetic lottery
 - They are on a serotonin reuptake inhibitor (Prozac)
 - They practice Buddhist meditation

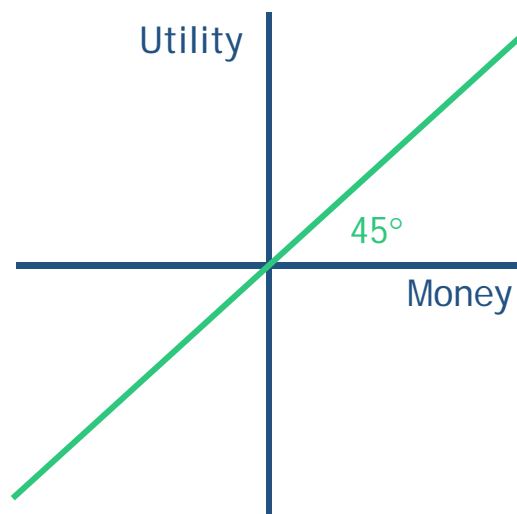


Consumer Price Perceptions

Money Is Not Perfectly Fungible

$$U(A) + U(B) \neq U(A + B)$$

Value Function - Rational



Thaler: Mental Accounting (Situation 1)



Thaler: Mental Accounting (Situation 2)



Thaler: Mental Accounting (Situation 3)



Thaler: Mental Accounting (Situation 4)

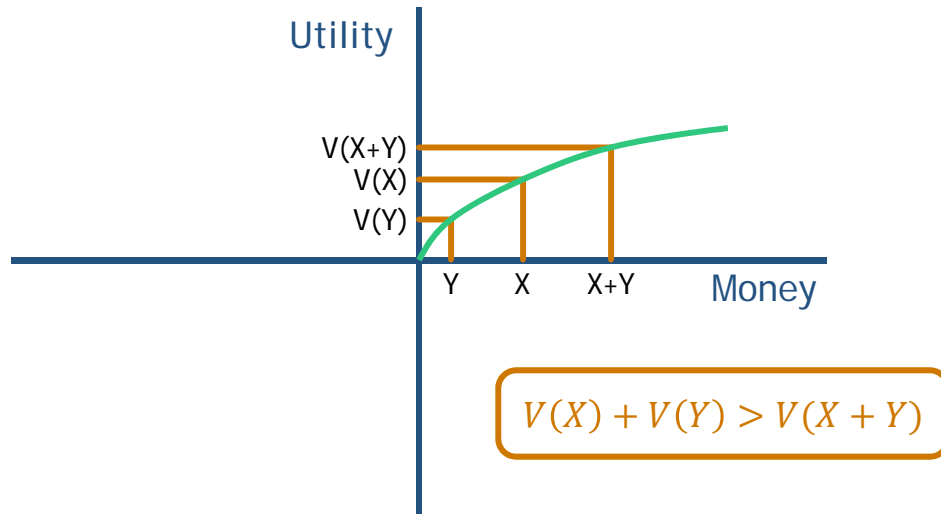


What We Can Learn from Ginsu Knives

Survey Results (Situation 1)



Value Function - Actual



Marketing Implication: Separate Gains

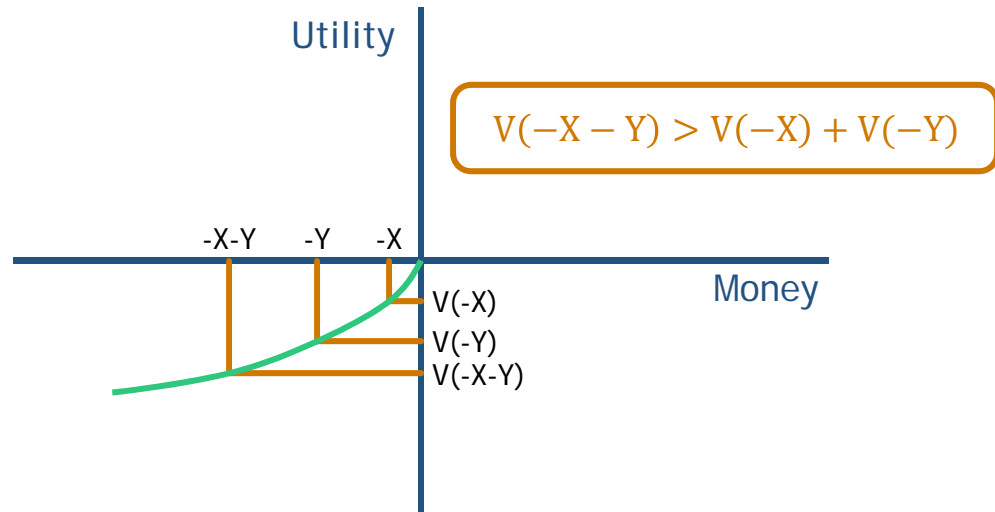
- Need some Ginsu knives?
 - But wait....
- Reference price effects
- Behavioral Regularity → Tax Refunds

Integrating Losses

Survey Results (Situation 2)



Value Function - Actual



Marketing Implication: Integrate Losses

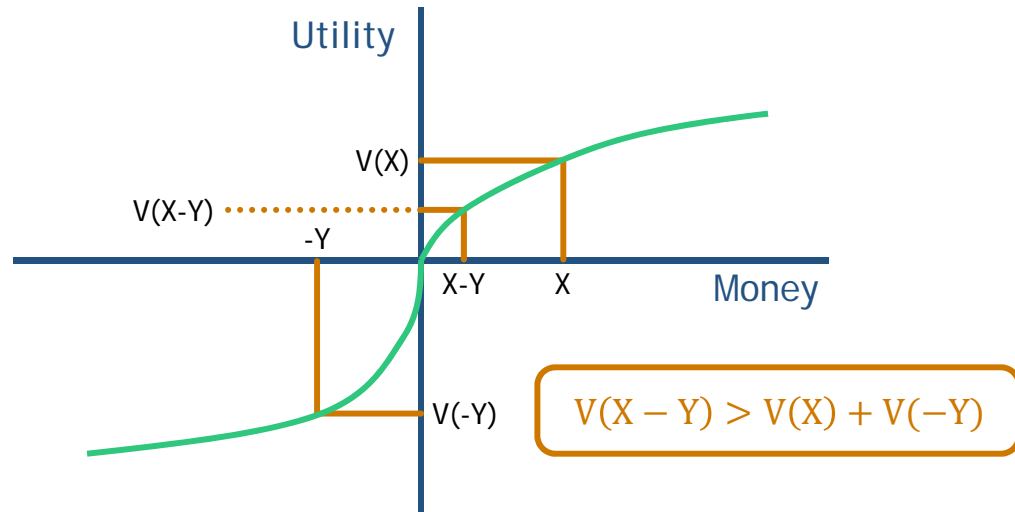
- Smaller add-ons during the purchase of a larger item
 - Fabric protector for your new car's seats
 - Extended warranties
 - Real estate agent fees
- Hedonic laddering
 - Upsell purchases step-by-step instead of all at once
- Pair fees with a larger gain
 - Mutual funds
 - Any investment management situation

Minimizing Losses and Give a Win with a Loss

Survey Results (Situation 3)



Value Function - Actual



Our Fish Brain

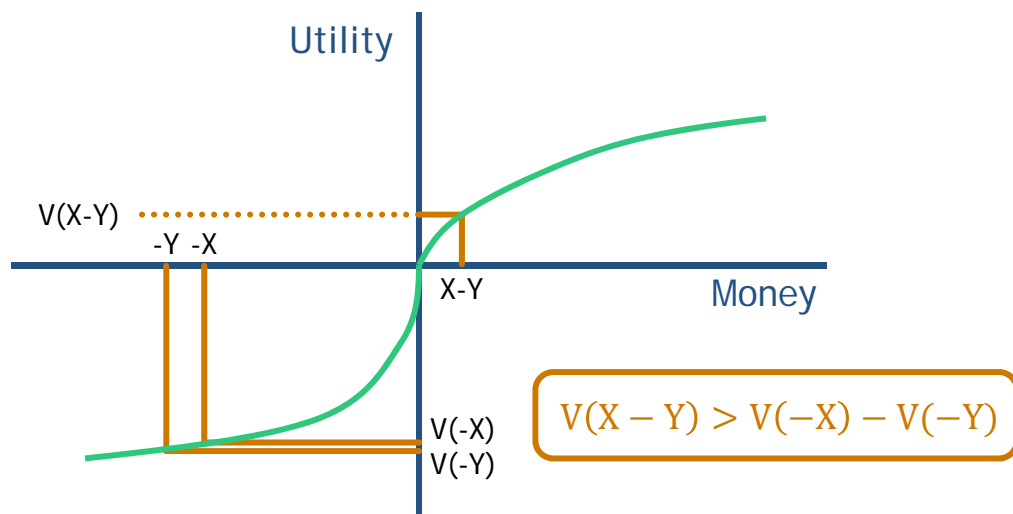
- All human beings tend to see negatives more clearly than positives unless
 - They won the serotonin genetic lottery
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 - They practice Buddhist meditation



Survey Results (Situation 4)



Value Function - Actual



Find the Silver Lining

- Rebates
 - \$30,000 will be greeted with less cheer than \$30,500 + a \$500 rebate
- Reference Prices
 - Compare-at labels induce the feeling of a bonus
 - We are very sensitive to any information about what we “should” be paying for something, and code gains and losses accordingly.

Practical Implication of Mental Accounting

- Separate gains
- Integrate losses
- Pair large losses with small gains

Consumer Price Perceptions

Yi Zhang



Learning Objectives

- Understand the key factors influencing consumer price perception
 - Framing
 - Pain of paying
- Design optimal pricing and promotion strategies that are most likely to be accepted by consumers

Price Perception

- How consumers react and feel about any given price
- Subjective value of the price vs. the absolute value represented by price

\$2,000

\$2,000



Framing Effect

- Consumers react to any given option depending on whether it is presented as a gain or as a loss



Gain Frame



Loss Frame

Imagine you have just been given \$100

Card A

100% chance
of winning
\$50

Card B

50% chance
of winning
\$100

Which card would you choose?

Imagine you have just been given \$200

Card A

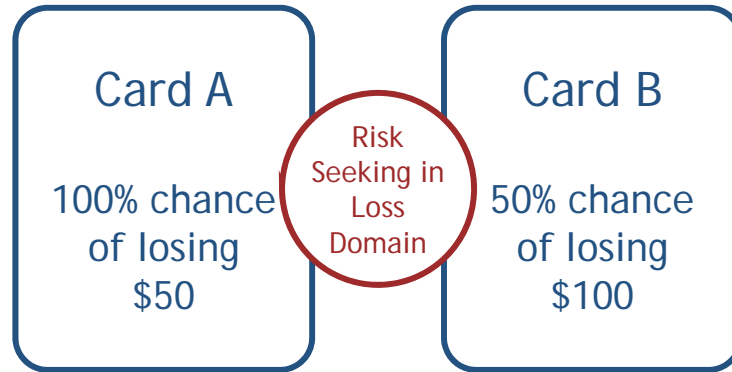
100% chance
of losing
\$50

Card B

50% chance
of losing
\$100

Which card would you choose?

Imagine you have just been given \$200



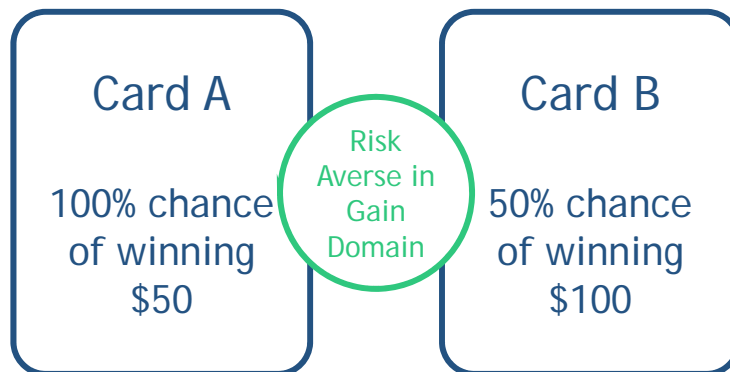
Which card would you choose?

Imagine you have just been given \$100



Which card would you choose?

Imagine you have just been given \$100



Which card would you choose?

Gain and loss frames in pricing

Gain and Loss Frames in Pricing

- Discounts are perceived as gains
- Surcharges are perceived as losses
- The impact of loss is much greater than the impact of gain of the same magnitude.

Example: Pricing a Jacket



Framing Effect Takeaway

- Consumers rarely base their decision solely on the economic outcome.
- They base decisions on the psychological reaction at the moment of transaction.

Building Better Deals and Discount Plans

Yi Zhang



Common Examples of Pain of Paying



Running Taxi Meters



Pay Per Call Phones



Pay Per Usage Charges (Fitness Gym)



Cash Payment (vs. Credit Card Payment)

Pain of Paying

- Purchase Decision =
Costs (price) vs. Benefits analysis
- Consumption Experience =
Costs (price) vs. Benefits analysis



Pain of paying



Photo by Lheld1023 (Wikimedia Commons)

Separate the Pain of Paying from Consumption

- Would you rather pay before or after your next vacation?



Photo by Lheld1023 (Wikimedia Commons)

Separate the Pain of Paying from Consumption

- Timing matters
 - Pay before your vacation
 - *Pain of paying is being separated from the consumption experience*
 - Pay after your vacation
 - *Pain of paying interferes with the consumption experience*



Photo by Lheld1023 (Wikimedia Commons)

Separate the Pain of Paying from Consumption

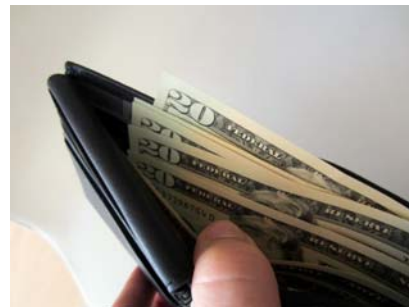
- Manage “sticker shock” at the moment of consideration
 - Use “pennies-a-day” strategy prior to purchase
 - More manageable price perception
 - Easier to justify



\$2,000 vs. \$5/day use

Separate the Pain of Paying from Consumption

- Aggregate payments
 - Credit card statement aggregates pain of paying associated with each single transaction into one statement
 - Multiples losses are mentally coded as one single loss



401(K) 2012 (Flickr)

Separate the Pain of Paying from Consumption

- Freemium: free product boosts consumption experience



Price Hike: When the pain of paying becomes salient

- Consumers typically are agonized and become angry due to the perception of unfairness
 - Uber's surge pricing
 - 2-10 x regular fare

Fairer Ways of Raising Price



- Providing extra service to justify cost



- Obscure price comparison

Mental Shortcuts that Impact Price Perception

Yi Zhang
Senior Lecturer

Mental Shortcuts on Price Perception

- Anchoring
- Price primacy
- Visual tricks to sale prices
- Free as a special price
- Price decoy

Anchoring

- Initial piece of (unrelated) information has a lasting effect on the processing of subsequent information

Anchoring

- Moving from Hong Kong to Mumbai
 - Likely to use the housing prices in Hong Kong to anchor your evaluation of houses in Mumbai



Anchoring

VACATION OPTION A

- Top travelers rating
- Anniversary suite
- Mixed review for onsite restaurant
- Crowded travel destination
- \$1,999

PREFERRED



VACATION OPTION B

- Crowded travel destination
- Mixed review for onsite restaurant
- Top travelers rating
- Anniversary suite
- \$1,999



Photo by Lheld1023
(Wikimedia Commons)

Anchoring

- Suggested price
- Comparable price
- Price of previous model
- Purchase quantity
- Preferable attributes

Mental Shortcuts on Price Perception

- Anchoring
- Price primacy
- Visual tricks to sale prices
- Free as a special price
- Price decoy

Price Primacy

VACATION OPTION A

\$1,999

Top travelers rating

Anniversary suite

Mixed review for onsite
restaurant

Crowded travel destination



Photo by Lheld1023
(Wikimedia Commons)

VACATION OPTION B

Top travelers rating

Anniversary suite

Mixed review for onsite
restaurant

Crowded travel destination



\$1,999

Price Primacy

- When price is revealed before product attribute, consumers evaluate the product based on its worth
- When price is revealed after product attribute, consumers evaluate the product based on how much they like the product
- Application
 - Reveal price first for low-price or need-based products
 - Reveal product attribute first for premium-price products

Mental Shortcuts on Price Perception

- Anchoring
- Price primacy effect
- Visual tricks to price information
- Free as a special price
- Price decoy

Visual Tricks to Sale Prices

- Visual contrast highlights the salience of a price promotion
 - Retail price \$199.99 -> Sale price \$199.99
- Position sale price on the right side to facilitate mental computation
 - Retail price \$199.99 -> Sale price \$129.99
 - Sale price \$129.99 <- Retail price \$199.99

Visual Tricks to Sale Prices

- Left digit suggests the perceived magnitude of price
 - \$129.99 vs. \$130.00
- Smaller font suggests smaller numerical magnitude
 - Retail price \$199.99 -> sale price \$129.99
 - Retail price \$199.99 -> sale price \$129.⁹⁹

Visual Tricks to Sale Prices

- Use percentage discounts for products under \$100
- Use absolute discounts for products over \$100



Mental Shortcuts on Price Perception

- Anchoring
- Price primacy
- Visual tricks to sale prices
- Free as a special price
- Price decoy

Free as a Special Price

- Consumers over-value a free promotion versus the equivalent discount

1 lb. ground coffee

Buy One Get One Free

PREFERRED

\$7.99



Photo by theimpulsivebuy
(Wikimedia Commons)

1 lb. ground coffee

Buy Two Get Both 50% Off

\$7.99

Consumers Prefer Bonus Offers

TOOTHPASTE A



10 oz
33% off \$2.99
\$2.00
20c/oz

TOOTHPASTE B



15 oz
50% more for free
\$2.99
20c/oz

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Photo by William Warby (Flickr)

Discount is more attractive for indulgent products



20% off regular price

PREFERRED

~~\$3.99~~ \$3.19

Guilt Free



20% more for free

\$3.99

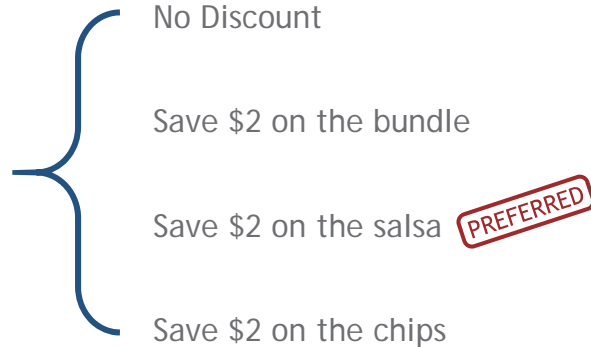
Photo by theimpulsivebuy (Flickr)

Hedonic Bundling

- Price discount on the indulgent item within a bundle is most effective



\$5.99



Mental Shortcuts on Price Perception

- Anchoring
- Price primacy
- Visual tricks to sale prices
- Free as a special price
- Price decoy

Price Decoy

Scenario A

Bread Machine A

\$59

Bread Machine B

\$129

Decoy

Scenario B

Bread Machine A

\$59

Bread Machine B

\$129

Bread Machine C

\$199

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Price Decoy

Scenario A

Bread Machine A

No timer
1.5lb capacity
\$59

Bread Machine B

Automatic timer
2lb capacity
\$129

Dominated Option

Scenario B

Bread Machine A

No timer
1.5lb capacity
\$59

Bread Machine B

Automatic timer
2lb capacity
\$129

Bread Machine C

No timer
1.5lb capacity
\$199

PREFERRED

Mental Shortcuts on Price Perception

- Anchoring
- Price primacy
- Visual tricks to sale prices
- Free as a special price
- Price decoy

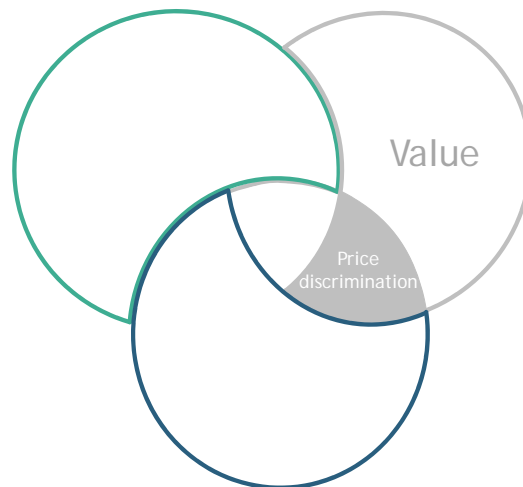
Consumer Price Perceptions Takeaways

Consumer Price Perceptions

- Access the impact of psychology on customer perceptions of price
- Use knowledge of psychology to create deal and discount plans

Three Lenses of Pricing

Economics



Customers
Course #2

Competitors

Value-based Pricing for Customers

- Consumer decision processes and purchase pathways
- The relationship between willingness to pay and demand curves
- Value-based pricing and value drivers
- Measuring customer preferences (rational utility model)
- The human nature of customers (consumer price perceptions)

Next Up

Economics



Customers

Competitors
Course #3