

# What Are Prices to Us?

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# Overview

## The Behavioral View

- What we learn from Behavioral Price Research
- The complexity of price information
- How people process price information

*Has regulation helped or hindered buyers' ability to process price information?*





# Some Myths about Buyers

## Buyers

- Perceive and judge prices accurately
- Always seek to pay the lowest price
- Process price information easily

*None of these is true!*



# Behavioral Price Research

*Prices are physical stimuli!*

- Reference prices
- Absolute price thresholds
- Acceptable price range
- Differential price thresholds
- Anchoring and adjustment
- Framing

# Reference Prices

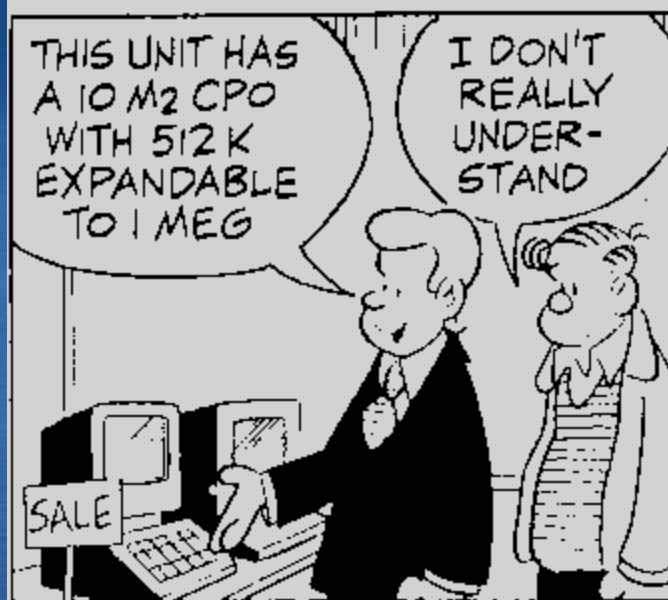
- Prices are compared to a reference price
- Reference prices change and are influenced by:
  - Previous prices paid
  - Frequency of past price changes
  - Expected prices
  - Belief of a fair price to pay
  - Exposure to other prices or numbers



# Price Comparisons

- Prices are not always stored in mind exactly
- Price comparisons solicit approximations
  - We access and manipulate a mental model of approximate quantities
- People do not know how to :
  - Translate features into benefits or
  - Quantify benefits in monetary terms

# HI & LOIS BY DIK BROWNE



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# Absolute Price Thresholds

*Range of  
acceptable  
prices:*

- Consumers have upper and lower price limits for each price market segment.
- Psychological and economic barriers to willingness to pay more than the **upper threshold**.
- Distrust quality if prices are below the **lower threshold**.

# Differential Price Thresholds

*How much of a price difference would change demand?*

- Magnitude of price change
- Price differences of similar offerings



# Price Is Relative

***Price elasticity:  
how buyers perceive a price relative to another price, whether it is:***

- The last price paid
- The price of a competitive offering
- The highest or lowest price in the product line
- The expected price to pay
- Perceived fair price to pay

# Key Insights

- Price elasticity is not constant
- It differs according to
  - A brand's price-quality position
  - The direction of a price change
  - The magnitude of a price change
  - The nature of the product
  - The nature of the market segment



# Anchoring and Adjustment

- Reference price “anchors” judgments and receives more weight in evaluations
  - If selling price  $<$  reference price, then “deal”
  - Or, price + fee + fee = perceived total  $<$  actual
  - If fees are small relative to reference, then they are perceived to be  $<$  actual.
    - Again, perceived total is  $<$  actual

# Framing

- Context in which alternatives are evaluated matters
- What's more attractive?
  - Meat: 90% lean or 10% fat?
  - \$20,000 item: \$1,000 off or 5% off?
  - \$10 item: \$5 off or 50% off?

# Recent Behavioral Price Research

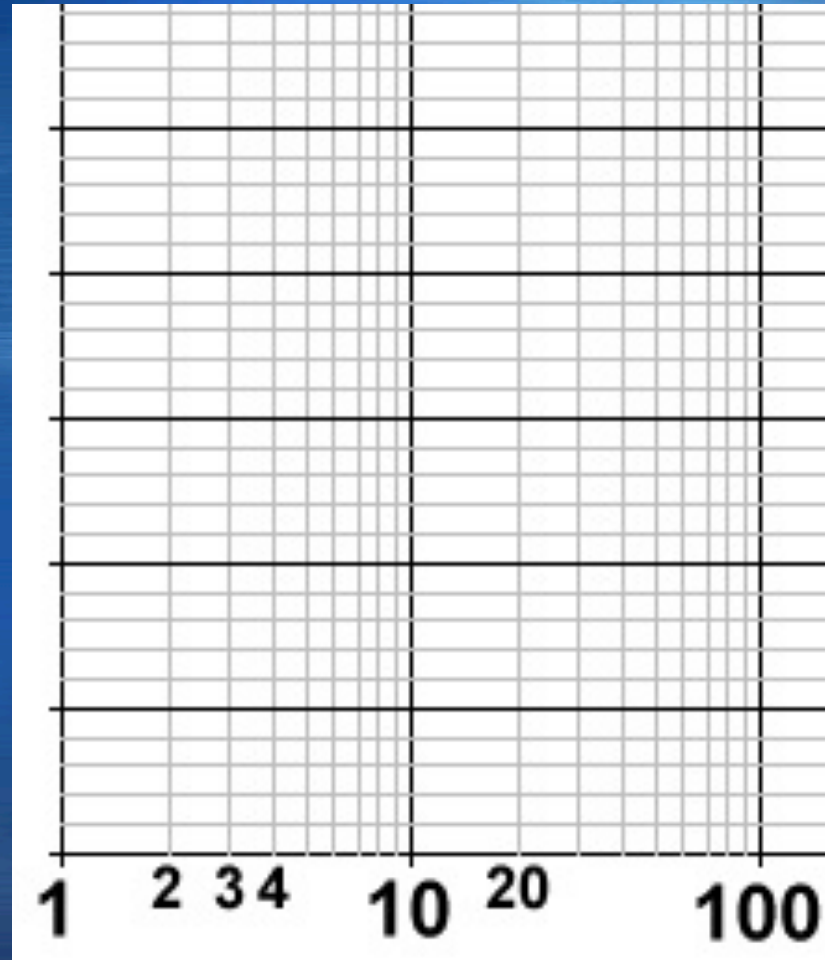
- Buyers calculate incorrect:
  - Net prices for price discounts
  - Total price for partitioned prices (additional fees)
- Buyers have poor memory for recent prices paid
- Buyers have a reference price for a product even if they are consciously aware of it
- Math anxiety interferes with number processing leading to sub-optimal choices

*People don't completely process price information.*



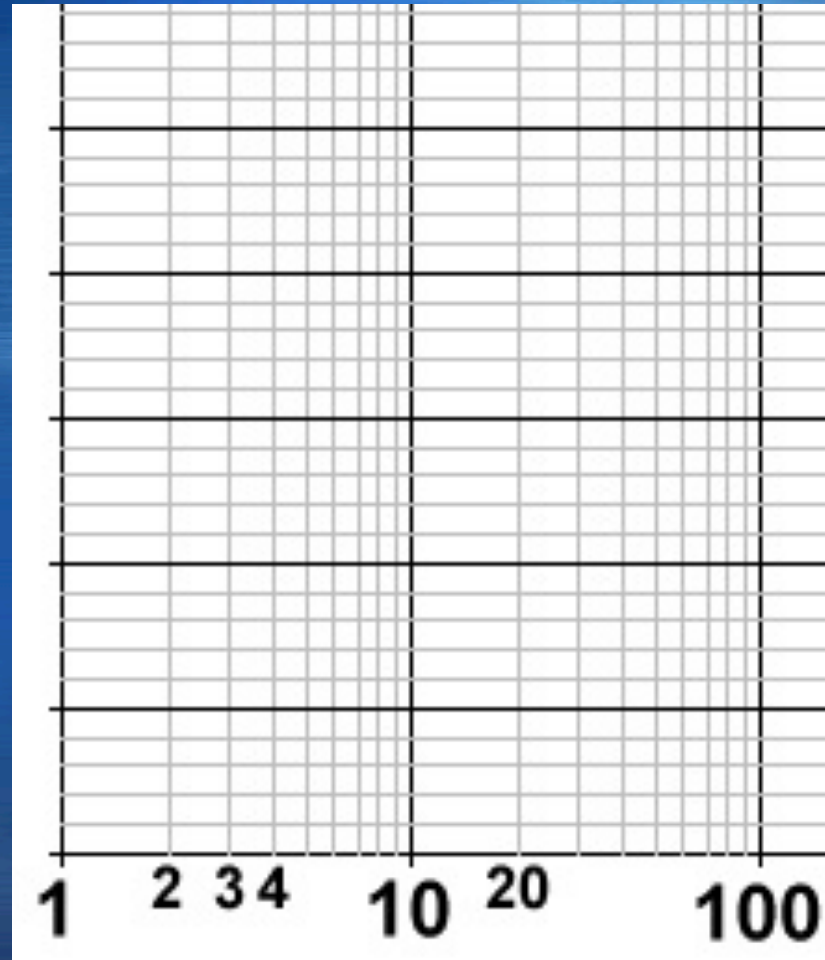
# How We Perceive Numbers

- Hard wired with mental logarithmic number line:
- Small numbers are more easily distinguished than large numbers
- 2 compared to 3 or 7 compared to 8



# How We Perceive Numbers

- More difficult to encode and process correctly large numbers
- 1,683 compared to 1,697
- \$1,683.49 compared to \$1,697.67



# Price Interpretation

- Combinations of selling price and savings, or selling price, shipping charges and fees
- Monthly and/or number of payments
  - \$200 down and 36 months to pay the remainder
- Multiple discounts
  - 30% off but now take an additional 15% off
- Price partitioning (drip pricing)
  - Dividing a price into several elements:
  - Hotel room charge + taxes + fees + parking + breakfast + location + newspaper + pool towel



# Airline Example

<b>Airfare</b>	<b>340.46</b>
US Transportation Tax	25.54
US Flight Segment Tax	7.60
September 11 <sup>th</sup> Security Fee	5.00
US Passenger Facility Charge	9.00
Total	387.60
Seat Charge (outbound)	58.00
1 Checked bag (outbound)	25.00
Seat Charge (inbound)	58.00
1 Checked bag (inbound)	25.00
<b>Total Fare</b>	<b>553.60</b>

*A 63% increase with the fees!!!*







# Price Information Processing

- Arabic numbers are only symbols
- Buyers must encode them into semantic or magnitude representations:
  - To give meaning within the context reflecting magnitude (high, low, expensive, cheap)
  - Compare, evaluate, calculate differences among prices
  - Relate to reference price: “more, less, above or below” the reference price/brand
  - Determine unit prices as well as total price



# Price Information Processing

*Processing of some prices may be more automatic or easier than other prices:*

- Prices that end in even, whole numbers
- Price comparisons in the lower-price range (i.e., smaller numbers with fewer digits)
- Interpreting a price is easier when
  - Price is **lower** than the reference price, and presented **after** the reference price
    - Regular Price \$49                      Sale Price \$30
    - Sale Price \$30                      Regular Price \$49

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# Prices Requiring Computations

- Place demands on buyers' limited working memory
- Influence ability to evaluate and compare prices
- Some effects:
  - People spend more when menu prices exclude tips
  - A precise initial price (\$393,755) induces less negotiation and higher final selling price than a higher initial rounded price (\$395,000).
  - Buyers unlikely to calculate net prices correctly for price promotions

*Only 13% of adults are able to compute numbers correctly in real-life situations.*

*U.S. Dept. of Education*



Take an extra 25% this rack

Entire store 30% off



# CATHY





# Conclusions

- How do people actually make choices in the marketplace? *We know very little.*
- Most consumers use heuristics and simplifying strategies: *they decide and then rationalize.*
- Increasing the complexity (details) of price and quality information exacerbates the problem.

*Efforts to bring price clarity to benefit consumers have had the negative effect of making prices more complex and therefore very difficult for most people to process.*



# *Thank You*

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