

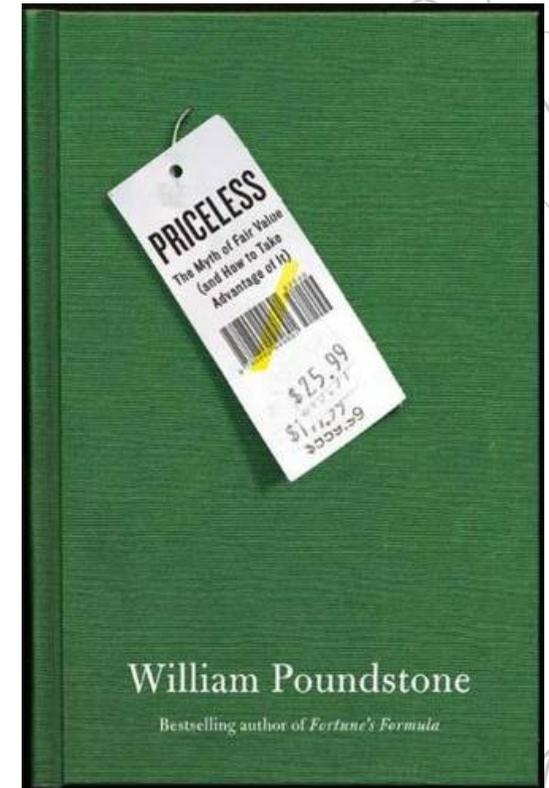
Priceless: The myth of fair value (and how to take advantage of it) - William Poundstone © 2010

Prices ending in 9, shrinking packages and high-priced decoys are just a few of the techniques sophisticated retailers have learned to dramatically increase their margins at your expense.

William Poundstone's book shares the theory behind why consumers have difficulty judging fair value and the ease at which they can be manipulated.

More importantly he provides numerous insights about how prices are set in different industries to help you buy smarter.

“Price consultants tell the goal is to devise price structures that maximise the willingness to pay from each customer. Capitalism takes on a weirdly Marxist twist: every customer pays according to his ability”



Hill and Wang
ISBN 978-0-8090-9469-1

Theoretical underpinnings of pricing

People are acutely sensitive to differences and not absolute values

- **You can easily spot the heavier of two suitcases weighing 32 lbs and weighing 36 lbs, but you would be unsure if either exceeded an airlines 42 lb limit without weighing**
- **Contrasting or “anchoring” and the power of suggestion play an important role**

We are less sensitive to changes to money than other things

- **Need “twice the cash to double the thrill” compared with 1.2x increase in electric charge and 1.6x in weight to perceive a doubling in effect**

Prospect theory says we over-value certainty and are loss averse

A “Rule of fairness” creates a limit on profiteering

- **Price increases need a justification or be hidden**

Industry based insights (I)

Super-marketing

- Are careful to change items on most frequently purchased ~ 500 items (eg. milk, bread, meat) and instead raise prices on infrequently purchased items (eg. sauces)
 - “customers can’t remember what they paid last time and don’t otherwise have a notion of what these items should cost”
- Manufacturers shrink packages frequently to sell more for less (example new concave base jar)
- “Organic” and “green” designations have been a windfall for pricing
- Prices of bulk goods and large sizes aren’t comparable and you may not be getting a good deal
- Decoy products are used to promote both expensive and cheap brands
 - New super cheap beer legitimises bargain beer, high priced decoy pulls consumers upscale
 - “Most consumers favour something in the middle”
- Consultants found shoppers spend more when moving through a store counter-clockwise (at least in the northern hemisphere!) – stores then try to put entrance to the right

Luxury goods retailing

- Obscenely high-priced articles displayed to manipulate customers to overpay on others
- “The art of luxury good pricing lies in quantifying the value to consumer regardless of cost”
- “Trade off contrast” (loss aversion) used to sell items which otherwise look and behave similarly “this one has X feature which is clearly better than that one”

Industry based insights (II)

Restaurant menus

- Putting a \$100 truffle and wagu steak hamburger on a Manhattan restaurant menu is designed to make all other items including a \$50 steak seem inexpensive; it also doesn't hurt when someone comes in and buys the burger either!
- Industry convention divides menu into "stars [high profit popular dishes], puzzles [high profit unpopular], plowhorses [unprofitable but popular] and dog [unprofitable, unpopular]" – goal is to nudge customers away from plowshares, turn puzzles into stars and convince prices are reasonable
- Menu's should allocate prime space to profitable items and minimise price sensitivity by not arranging prices in columns, scrap leader dots, omit dollar signs and decimal places ...
 - Unprofitable staples should be "exiled to menu Siberia" (corner or back page)
- Bundles used to incentivise buying extra and confuse – and changed frequently in case figured out
- Restaurateurs encouraged to exploit opportunity such as "prices are up because of shortage"

Telecommunications

- Complexity is part of an elaborate philosophy to overcharge for a commodity utility service
- "Prices have been replaced with algorithms" making it impossible to comparison shop
- "If you can get a simple price, it will cost you" – purposefully offered to customers who will pay more to avoid multiple loss aversion events and who grossly overestimate their usage
- "Possibly the greatest con job of American capitalism is text messages. The so-called market price of a message has nothing to do with bandwidth or any technological reality. It is determined by how much consumers (or their parents) can be persuaded to pay" [*their true cost is 1/1,000 cent and sometimes nil*] . 3 .

Industry based insights (III)

Real estate

- Studies show agents value a home more if the listing price is higher (anchoring); similar effect means after bubbles collapse it can take years for sellers to readjust to new realities

Airfare price sensitivity has led airlines to unbundle to improve margins and to make comparison hard

- “Three or four years ago airlines got fed up with their tickets being priced like bushels of wheat on a commodity exchange, so they set out a strategy to make prices less transparent”

Car sales

- Dealers admit the reason for bargaining is it is a “search for suckers” (those who don’t negotiate enough, while say 10% in number, account for 50% of profits); also those who said they had already taken a test drive saved on average \$319 in one study vs. those who didn’t

Event ticket sellers uniquely must comply with rule of fairness and leave scalpers to extract obscene premiums on sought after or sold out events

Opposite effect occurs where perceived value is less than price and “the perception of a sweet deal causes consumers to buy completely useless junk” [*Infomercials, factory outlet, riot racks, going out of business sales, duty-free shops*]

- Infomercials exploit a hedonistic rush by selling multiple features and items such that “willingness to pay surges with every bullet point until the price, seems just about right”

Studies show most batteries are similar, but a temporarily discounted premium band looks a bargain

Art pricing can be manipulated and even sometimes “the price tag is the art” (eg. \$100m Hirst skull)

Jurors shouldn’t decide the quantum of a legal award as they are too susceptible to anchoring/demand

Other pricing insights

Charm prices (eg. 99c not \$1) work because people round down and it conveys an image that the item has been discounted – studies say they boost sales 24% compared to nearby pricing

Sale prices are an even more powerful motivator (eg. \$40 down from \$48 better than \$39, “sale \$39” is best !)

While rebates make no sense (you should just pay less), they profitably combine premium with discount

- **Consumers feel like they are saving but after having to provide a store receipt, a UPC code cut from then an unreturnable box, fill out correctly and post a form, wait for an unmarked envelope to arrive and then cash a cheque, causes 60% to give up (and give back profit to suppliers)**

Imagery (priming) often used to nudge customers from “price matters” to “quality matters” thinking

- **“When there aren’t a lot of explicit cues to help define a situation, we are more likely to act based on cues we pick up implicitly”**

Salaries depend mainly on anchoring and adjustment – not supply and demand; workers care more that they are making more than someone else than what value they are delivering (eg. increases after CEO salary disclosures)

Men are susceptible to sex based advertising including thinking a woman is a weak bargainer. It is harder to drive a bargain with someone the higher is their testosterone level

- **For a better deal, look for a man with a wedding ring or a ring finger short relative to his index finger**

“The way people react to chocolate is much like the way they react to money”

If given the choice between two fine chocolates, one small and heart shaped, the other big and shaped like a cockroach, people often choose the cockroach.

However they admit they would enjoy more the hear shaped chocolate.

About Professional Wealth and these summaries

About Professional Wealth

An independently owned, personal wealth advisory and money management firm serving clients in Sydney and Melbourne

We strive to set a new level of professionalism by

- Providing high quality advice free of conflicts
- Considering a broad range of investment and insurance solutions
- Being remunerated only by our clients not by commissions and rebates
- Making education an important part of our offer

About our Executive Summaries

Review important writing about wealth

Summarise authors' views; and we encourage you to read their work to learn more

Should not be considered personal advice as your needs and circumstances will vary

Please contact us or your personal advisor to explore further how you can *Make Work Optional™*

If you have received this from a friend and would like to receive future summaries directly, please send us your email address