



Archived Newsletter Articles

Analyzing the Psychology of Pricing

Price Changes



Analyzing the Psychology of Pricing

Is your company leaving significant sums of money on the table?

Most likely it is, if you're practicing cost-plus pricing. All too often, companies simply take their costs, add on a markup, and – presto! – that becomes the selling price of their product or service.

But there is a psychological component to consumers' perception of prices, which many organizations – to their detriment – do not consider. By sharpening your price points, you can add a substantial amount to your bottom line.

For example, one educational institution that sells night-school and continuing education courses – some \$25 million worth – had always practiced cost-plus pricing. Consequently, it had many different price points. Some courses were priced at \$57, some at \$65, some at \$74, and so on. However, our research revealed that, when it comes to \$10 increments, people do not tend to distinguish between, say, \$54 and \$59. These are so-called “dead zones,” where consumers don't discriminate between the higher and lower price points. So why charge \$54 when you can charge \$59 with no change in demand? After we had reviewed the institution's price points, we calculated that it had left a whopping \$1.8 million on the table!

In another instance, a brewery had a price point of \$15.85. Our research showed that an increase to \$15.95 would have made no difference to the consumer. Not so for the company. As a result of having had the lower, \$15.85 price point in place for a year, it took a \$4.1-million hit.

How do you know if you are optimizing your price points? If your company is doing cost-plus pricing, it's a sure bet that you are not. If you want to progress to the next level, you must start thinking about price points, and then conduct some price-point testing.

For example, an association that planned to market a book tested various price points first through a direct-mail campaign. Reasoning that the book should be priced somewhere between \$20 and \$30, it distributed four versions of its promotional literature, featuring four different price points – \$23, \$25, \$27, and \$29. The association then analyzed the response rates, and discovered – to its delight



– that the \$29 price point got the highest response! Consumers simply didn't perceive a difference between \$23 and \$29. In fact, studies have shown that prices ending in "9" can be more attractive to prospective buyers than lower numbers within the same range.

Some companies – like IKEA for example – even follow a pricing philosophy called "design to price." They figure out to what price point consumers are willing to go to buy a particular item, and then they build the best product they can to meet that price point and achieve their profit objectives – the exact reverse of cost-based pricing.

But if your company decides to raise its prices beyond a certain threshold, don't hold back! Many companies make the mistake of exceeding consumer price thresholds by only a small amount. Wrong! Once you cross a key price point, keep right on going to the next logical threshold in the consumer's mind. That's what a major confectionery manufacturer learned. It was selling chocolate bars at two for 99 cents – a key threshold price point. When the company decided to bite the bullet and pass that threshold, its volume dropped, not unexpectedly. However, for those consumers who continued to buy the chocolate bars, it didn't matter whether the price was two for \$1.09, two for \$1.19, or even two for \$1.29.

So once you have decided to increase your prices and go for price point, take a deep breath and go the distance – gain the extra profit. You may lose some customers in the process, but those who are going to stay with you will do so whether you exceed the threshold by a little or a lot. As the adage goes, in for a penny, in for a pound!

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