Knowledge for Decision-Makers

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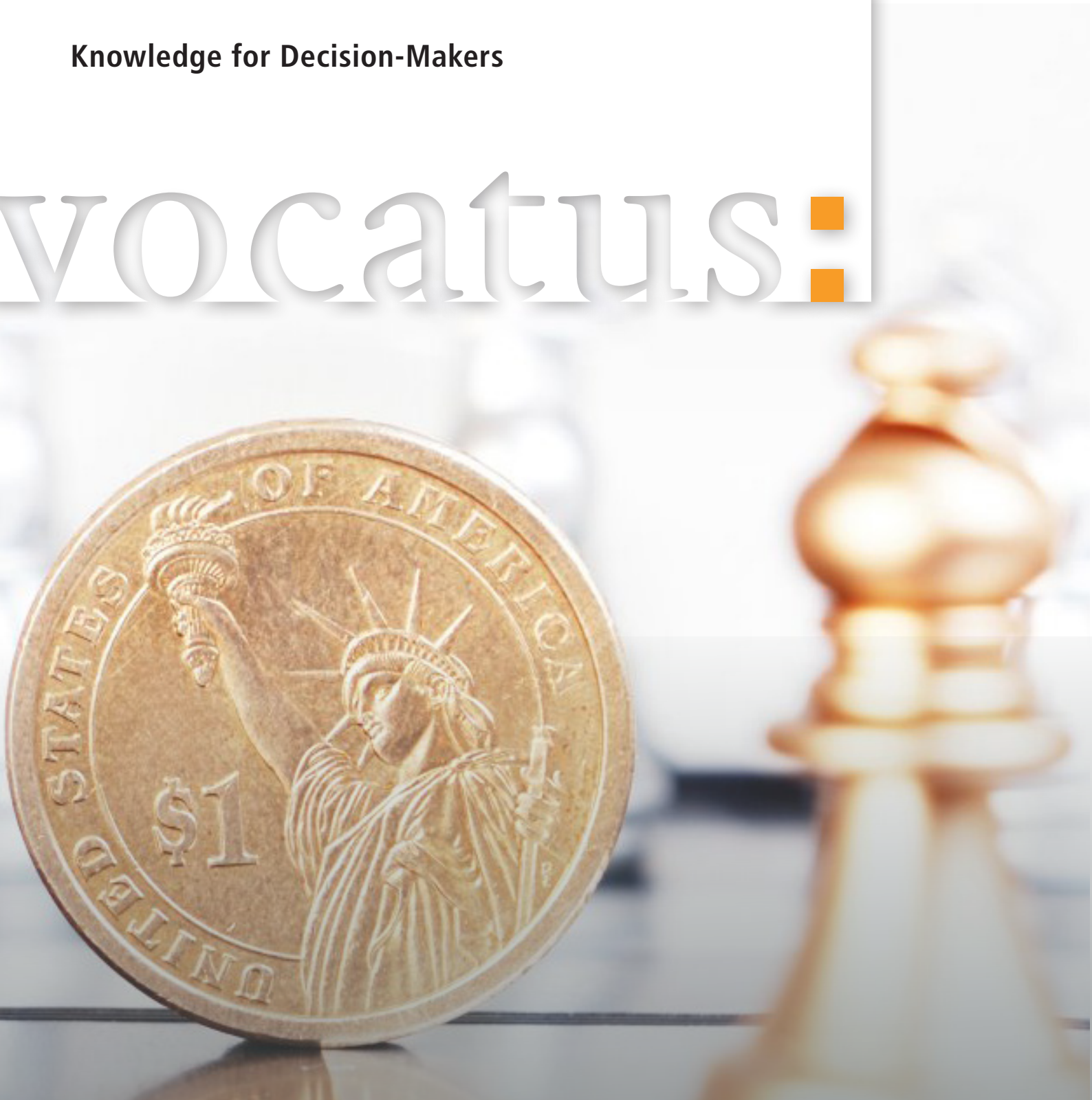

The 5 biggest mistakes in Pricing

- and how to avoid them with Behavioral Economics

Myths and fallacies

People make rational decisions.

Customers are aware of our prices and those of our competitors.

The more features a product includes for the same price, the better.

The more we reduce prices, the more sales we will make.

Regular price increases scare away customers.

The greater the choice, the better for our customers.

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About Vocatus

vocatus:

Vocatus is a globally active, innovative consulting focussed company focussed on Behavioral Pricing. We support businesses by conducting empirical research and asking targeted questions before using our findings to draw logical conclusions. Our services are aimed at decision makers who are looking to boost their company's success using valid findings as opposed to common false assumptions. All our projects attach the greatest importance to problem-oriented solutions, specific recommendations and the efficient implementation of findings.

Vocatus was founded in 1999 and currently employing over 70 members of staff. Vocatus has been awarded numerous national and international prizes for its innovative studies and practice-based strategies.

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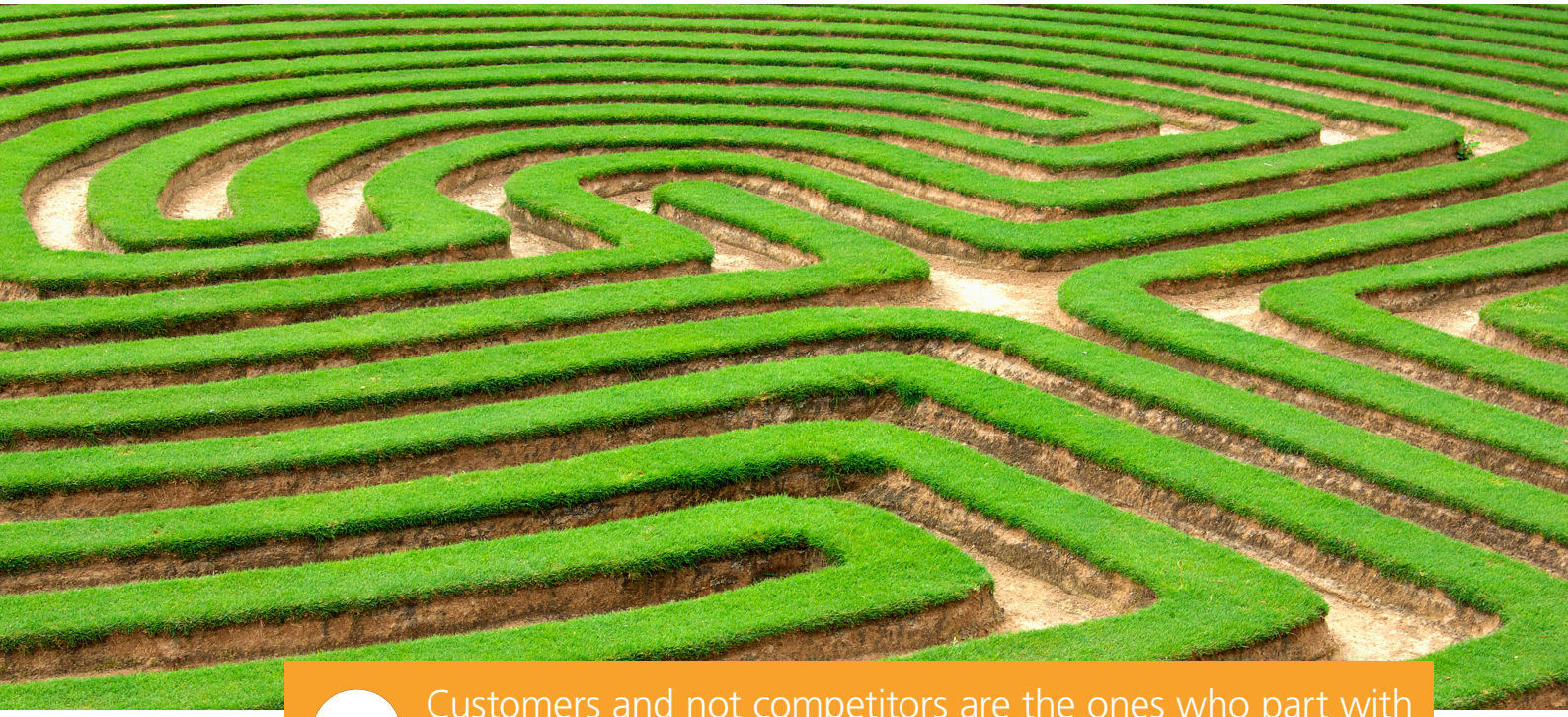
Prices are based on the cost of production



Customers and not competitors are the ones who part with their money to purchase a product – and customers are rarely interested in manufacturing costs.

In the majority of companies, prices are set on the basis of discussions between the purchasing, production, marketing and sales teams. The final price is determined by the manufacturing costs and leaves room for a specific margin as well as generally taking competitors' prices into account. In most companies, nobody ever stops to consider the one actual relevant person in the entire purchasing process, namely the customer.

In many cases, manufacturing costs are of course useful to help companies determine the lowest possible price. However, basing price formation on the costs of production and then adding on a margin happens to be one of the likeliest ways of losing out on making a profit. This is because a customer's willingness to spend money has nothing to do with the manufacturing costs and, instead, follows the rules of behavioral pricing.

Pricing structures often hold the key to greater margins

As part of a baseline study conducted in 2008, we showed that pricing structures often have a fundamental influence on how customers evaluate the price of a product. As illustrated by the following example, customers perceive an identically equipped car as significantly less expensive if the base price is high and the cost of additional features is comparatively low than if the car is priced the other way around.

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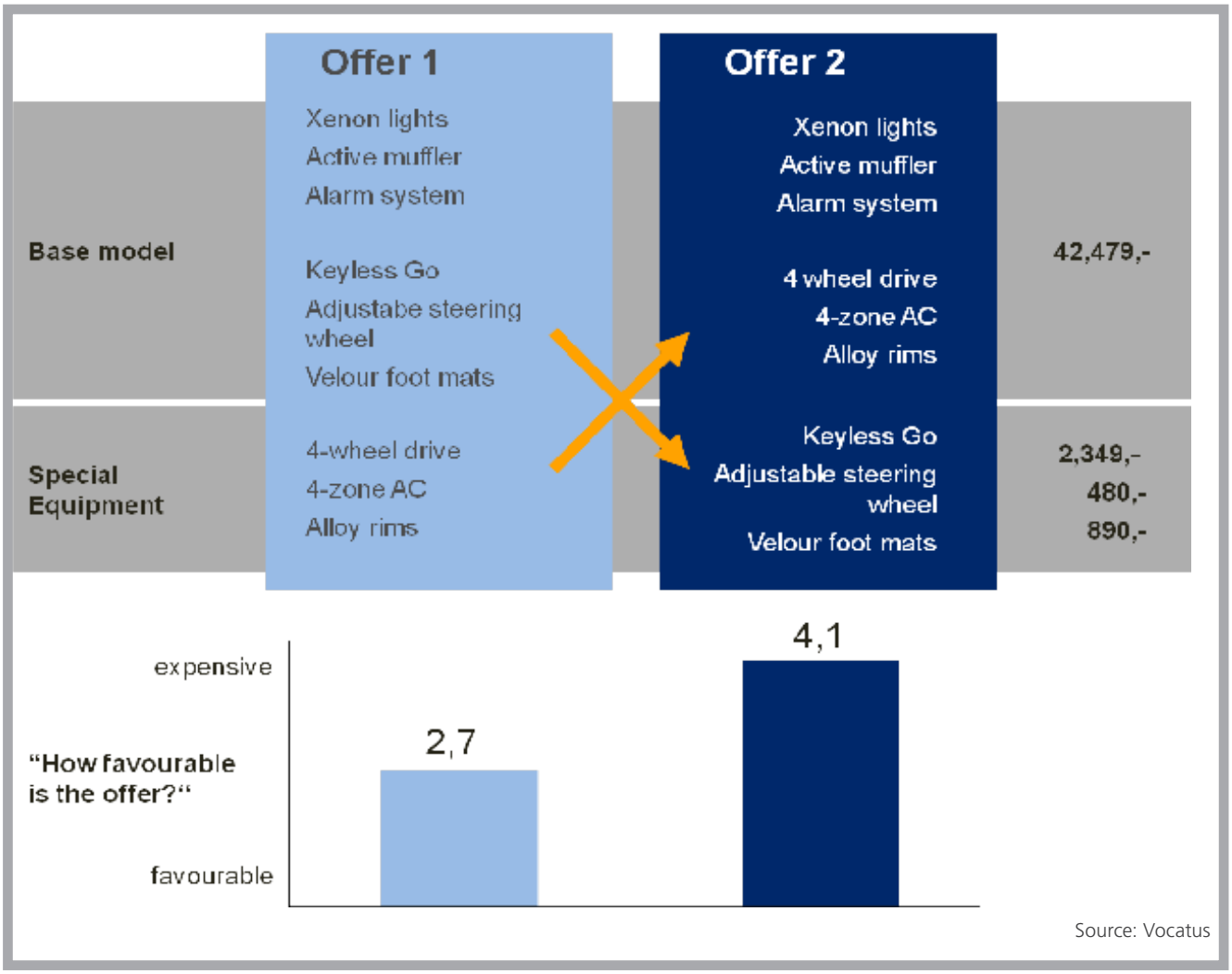

Marker elements should be reasonably priced

In the cell phone market, for example, the price of a cell phone is seen as a marker element, while the cost of the monthly price plan has a much lower bearing on the purchase decision.

Successful pricing often depends on identifying the correct marker elements, i.e. the items on which customers base their decisions as a result of being able to identify whether or not they are expensive. This means that cell phone operators should consider subsidizing the cost of end devices (the marker elements), and even think about offering them below the manufacturing cost. In return, they should increase the monthly price plan instead, as this is something customers generally find more difficult to evaluate.

Customers are fully aware of product prices

Do you know how much your last cappuccino cost? Or what you pay for your electricity? Companies generally overestimate their customers' awareness of prices.

Many businesses naturally assume that their customers are at least equally aware of the prices and features of their products (and those offered by the competition) as their employees who work exclusively with these products day in, day out.

However, our empirical studies have frequently found that the majority of consumers have no idea how much many of the products that they buy or intend to buy actually cost. This even applies to products that customers buy regularly. This means that the lion's share of customers do not know what they pay for their personal liability insurance, checking accounts, painkillers, cell phone calls, newspaper subscriptions, or electricity.

For example, when asked whether they would be willing to pay a certain amount for a checking account, the majority of respondents say "no", despite the fact that they have already been paying a much higher sum for their own checking account for years. Although they are generally assumed to make more rational decisions, those responsible for B2B purchases are no better informed.

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Purchase decisions are often made with minimal information

Company decision makers believe that customers share their levels of expertise and are equally as knowledgeable as they themselves. However, when talking to these very decision makers about their own purchasing behavior in other industries, they readily admit how poorly informed they are, and how they often make extremely illogical purchases themselves.
Despite this, they fail to recognize that their customers are just as irrational. This is problematic because behind these unwise but predictable purchase decisions lies an untapped, hidden potential for margin that remains unexploited by most companies.

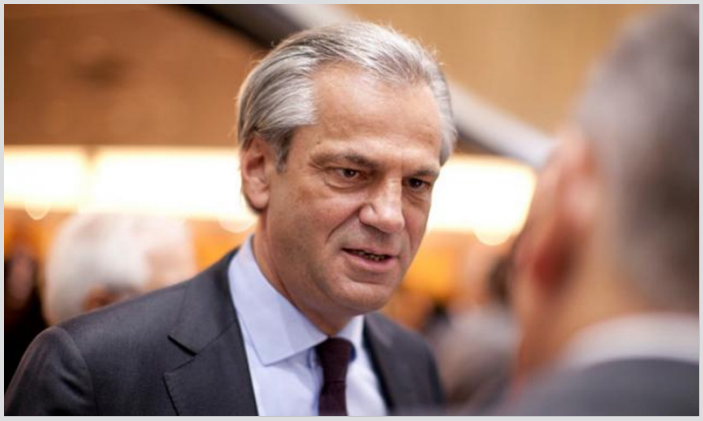
Customers often fail to notice even sharp increases in price

Since prices frequently remain a mystery to customers in certain industries, companies are often able to increase their prices by a double-digit percentage without their customers being any the wiser. This is possible for a variety of products, ranging from newspaper subscriptions to over-the-counter drugs sold at pharmacies.

"Vocatus helped us to get the most out of our pricing potential."

"The newspaper industry is in upheaval. The business is changing. The search for new sources of revenue is keeping the publishers busy, however, uncertainty is growing. What has endured for many years is now being questioned. In this stage, when experience is no longer helpful, we need new instruments to make the right choices.
Vocatus helped us to get the most out of our pricing potetial and to utilize it without taking unnecessary risks. The significant increase in retail sales has made a significant contribution to the fact that the F.A.Z. was soon able to put the consequences of the financial crisis behind. Today we are able to concentrate on future-related questions again."

Tobias Trevisan
CEO
Frankfurter Allgemeine Zeitung



Customers make their purchasing decisions on the basis of price

When booking a holiday, do you base your decision on the price? Or does price sometimes not come into it?

Most companies assume that a customer's decision is always influenced by price. Implicitly, it is therefore also believed that products and services are interchangeable, and that the only difference between them is price. Today, however, this is rarely the case, and companies would be well advised to shine the spotlight on the special features of their products or services instead of simply advertising their low cost. To do so, they must understand how customers make their decisions and the role played by price.

Openly inform your customers of the cheaper prices offered by the competition

L'TUR is the market leader in last-minute vacations, a sector in which price is a major factor due to the identical services being offered. Thanks to its prominent position in the market, L'TUR is the first port of call for most customers, who use its website to view the price of selected hotels and flights, before visiting a competing site to compare the price. Since the prices are often very similar, customers then book with the competition simply because they happen to be on their website.

After understanding this decision-making process, Vocatus worked with L'TUR to develop a search engine that, in addition to showing customers L'TUR's prices, enables them to see the prices offered by the competition without having to leave the L'TUR website. When L'TUR is cheaper or similar in

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price, the decision-making process generally comes to an end.

Fairness is often more important than price

However, even when L'TUR is more expensive than the competition, it has been found that many customers still book with L'TUR. After all, a vacation is often the most important event of the year, and it is essential that nothing goes wrong. This is why customers feel happier choosing a travel company with a booking process so fair that it makes consumers aware of cheaper offers provided by competitors. Should the customers encounter any problems on arrival, with the hotel for example, they can also expect to be treated fairly.

It may seem paradoxical at first to show customers rival prices, especially when the competition is cheaper. But this is how L'TUR increased the conversion rate on their site by 70%. This is an unbelievably high figure given the fiercely competitive market, where even a rise in conversion rate of 0.5% is considered a resounding success.

Result: 70% more bookings at L'TUR

"... the approach, which combines analytical and pragmatic thinking, works splendidly."

Markus Orth
CEO
L'TUR Tourismus AG

Customers want to get as much for their money as possible

"The more we offer our customers, the more likely they are to buy our product." This approach actually significantly reduces the likelihood of a purchase being made.

Many companies assume that their customers want to obtain as much for their money as possible. This theory is once again based on the hypothesis that customers act rationally and would rather have more than less for the same price.

Less is often more

Our studies consistently show that instead of favoring the offer with the most features, consumers actually choose the option with features tailored precisely to their requirements. In such cases, less is often more.

Above all customers want offers that meet their needs

For example, in a study conducted for a cell phone operator, we found empirical evidence to suggest that certain groups of customers find a cell phone plan offered at a specific price more attractive when it does not include a set number of free minutes for making calls abroad.
Here, it is important to note that customers who know that they generally won't need to call any foreign numbers see a cell phone tariff with inclusive minutes for making calls abroad in a less favorable light than the same offer without this feature.

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Ultimately, most people implicitly assume that they end up paying in one form or another for all the features they receive, regardless of whether they actually use them. And the vast majority of customers do not like the feeling of implicitly paying for something that they cannot use.

It all boils down to the price/usage ratio and not the price/performance ratio

We have identified a comparable effect in numerous studies conducted on behalf of daily newspapers. After increasing their subscription fee, newspapers frequently print a special supplement for the next few weeks to compensate customers for the increased price.

What may sound plausible at first backfires once customers reflect on the change and cancel their subscription. The main reason for readers ending their newspaper subscription is not the increased price, but the fact that they can no longer manage to peruse the entire paper over breakfast.

Offering too much decreases a product's appeal

At the end of the day, customers are not paying for particular services or products, but for the use and benefit that they can derive from them. In the case of newspapers, the thicker the paper, the larger the unused part. And the greater the likelihood of customers cancelling their subscriptions.

Discounts always increase sales

Over time, discounts ruin the value of your products. Make reductions a habit, and soon all you will attract is bargain hunters.

Given at the correct level and at opportune moments during the sales process, discounts can significantly increase sales in some cases, particularly if they are offered for well-founded reasons and cannot be predicted by customers. Unfortunately, however, there are countless examples of companies that have driven themselves to ruin by taking an unconsidered, scattergun approach to their discount policy. After all, prices are always indicative of product quality, and this is something that should never be carelessly compromised.

Hardware store chain digs its own grave with its arbitrary discounts

For years, the German hardware store chain Praktiker offered regular, high, predictable and totally arbitrary monthly discount offers, which systematically undermined its own price image. Shortly before declaring bankruptcy, it had been offering "20% off everything (except pet food)" for half of the year. As a result of this policy, the discounted prices had become the customers' new reference prices, and the standard price outside of sales periods was seen as too expensive.

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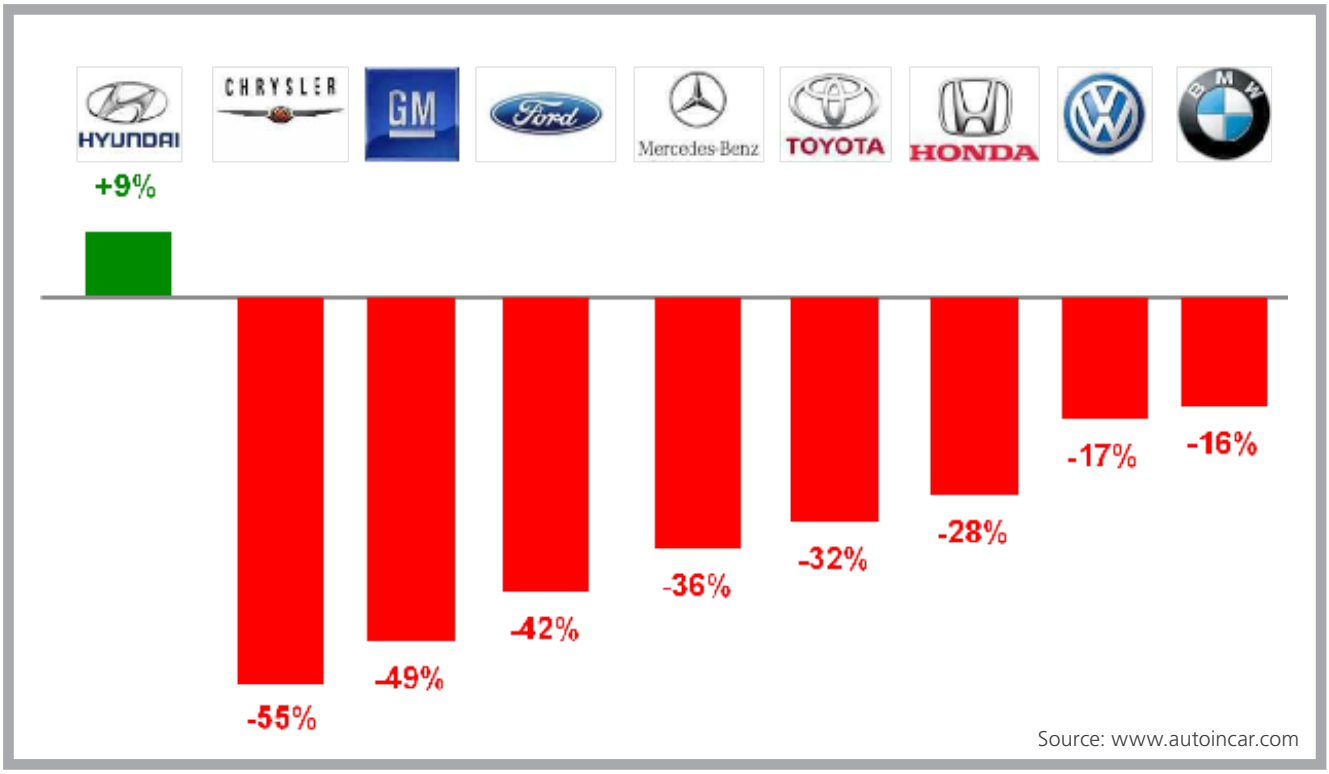
Car manufacturer increases sales during financial crisis without resorting to discounts

> **"...optimally exploiting potential revenue in the reader market – and not only in the short term, but with an eye to the future."**
>
> **Süddeutsche Zeitung**

Companies often offer discounts as a knee-jerk reaction to falling sales. For example, in the USA during the economic crisis of 2008, car manufacturers offered increasingly ridiculous reductions in the struggle to survive. However, during this period the majority of Americans were predominantly concerned about one thing – keeping their jobs. As a result, nobody was thinking about buying a new car, no matter how high the discount in case they lost their job.

Only one car manufacturer had the courage to understand their customers' purchasing process and to adapt their offer accordingly. In 2008, Hyundai offered its cars without a discount at the regular list price, but with a guarantee that the car could be returned if the buyer became unemployed. Customers were even allowed to continue driving the car free of charge for three months while they looked for a new job.

The initiative saw Hyundai increase its sales figures by 9% in spite of the collapsing car market. In comparison, during the same period all other manufacturers lost up to 55% of their sales despite applying heavy discounts, and were still finding it difficult to return to their original prices years later.



Cars sold in the USA in 2008 – Hyundai came out on top by targeting its sales approach to buyers' decision-making behavior.

How to do better

Apply the findings of Behavioral Economics

Behavioral economics hold the key to success. It is essential to understand what makes your customers tick.

The overwhelming majority of findings from behavioral economics show that people largely fail to make decisions as rationally as we believe they do, and as we would like them to. We also generally overestimate the frequency with which we ourselves make rational decisions.

Behavioral economics have also revealed that irrational decisions follow clear patterns, are predictable and can be influenced. Companies need to take advantage of these characteristics if they are to optimize their pricing structures in a targeted manner. It is time to cast common assumptions aside and focus on your customers' true purchase decisions and processes.

Understanding your customers' actual purchasing decisions

The key to a truly successful price strategy lies in understanding your customers' precise decision-making process for the product in question and influencing it accordingly.

Empirical pricing research is a highly challenging field. This is why customers are so infrequently questioned about prices, and why companies make rational and plausible, yet incorrect assumptions as opposed to examining actual consumer behavior. Ultimately, these types of investigation are not as simple as asking customers how much they would like to pay.

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Studies conducted by Vocatus therefore always draw on the theoretical framework of behavioral economics as well as our empirically based typology of decision makers. This was compiled by a 2008 baseline study consisting of more than 150,000 interviews in 26 countries, and for which we have since won several awards.

Choose Vocatus to help you set your price strategies

If you've been left excited by our price strategy work but aren't really sure where to begin, just give us a call. We've been working with businesses to conduct pricing research and implement empirical findings since 1990.

We regularly demonstrate our ability to move companies forward by leaps and bounds, and would be delighted if you conducted your next pricing project with us.

Dr. Florian Bauer

Dr. Florian Bauer studied psychology and economics at TU Darmstadt, MIT and Harvard, and has been researching decision-making behavior and applying behavioral economics for companies for more than 25 years. He is one of the founders and executive board members of Vocatus.

In addition to lecturing at a number of German universities, he is a renowned author and one of the world's leading experts in behavioral pricing. He is also a board member of the Professional Association of German Market and Social Researchers (BVM).

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Hardy Koth

Hardy Koth studied business administration at the University of Washington and the University of Chicago. He has been advising companies on how to use behavioral economics to boost profits for more than 25 years, and before co-founding Vocatus and joining its executive board, he was on the executive board of strategy consultancy Booz & Company.

In addition to having already published several international business bestsellers about novel customer strategies, he is president of IRIS (International Research Institutes) and advances the development of methodologies by conducting global studies.

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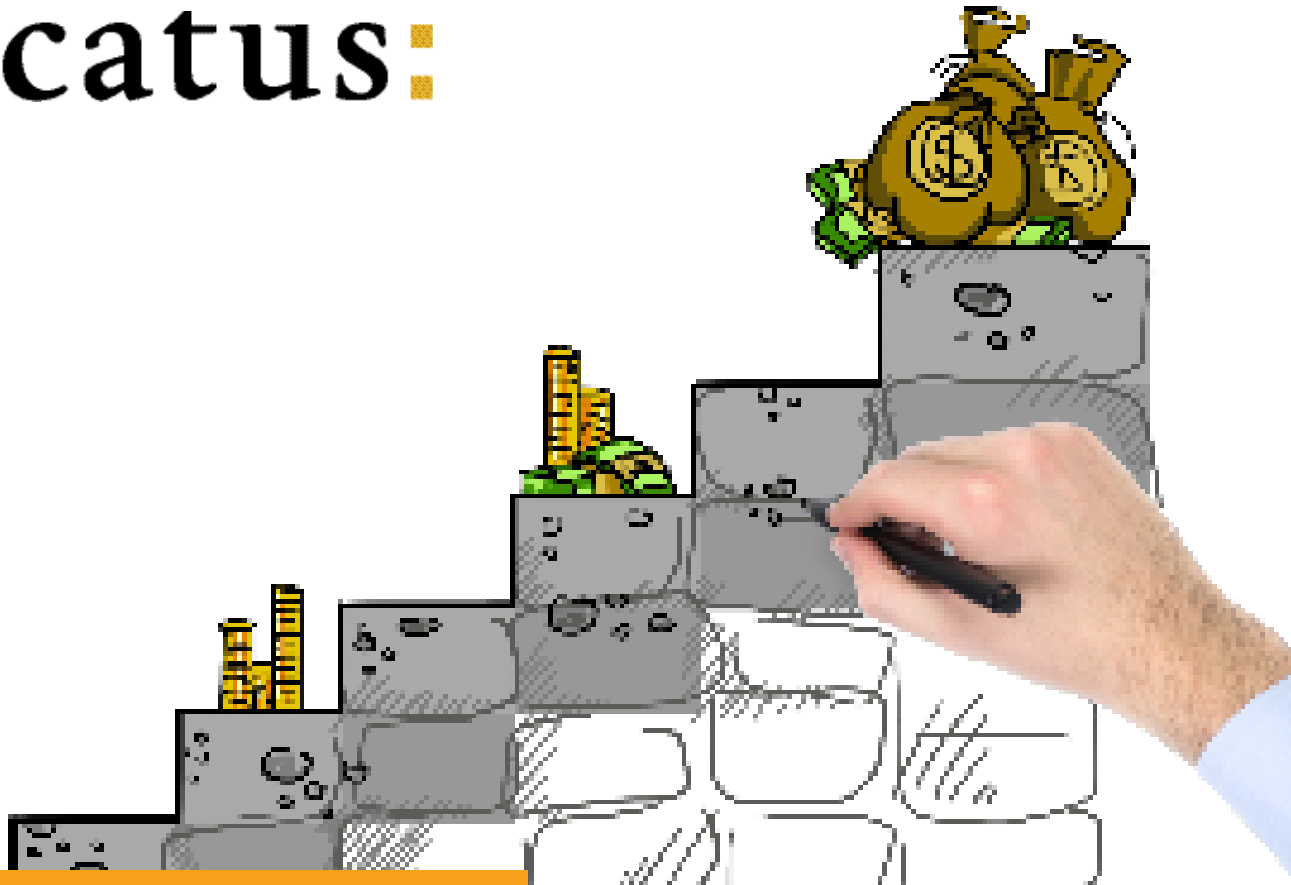

For many years, we have repeatedly been awarded prizes and international awards for our projects.

2015 Image study: Gold for "Innovation", Silver for "Consulting Competence"
2014 GRIT Report – Among the 20 most innovative market research agencies worldwide
2013 ESOMAR – Winner "Research Effectiveness Award"
2012 ESOMAR – Winner "Research Effectiveness Award"
2012 Image study: Gold for "Innovation"
2010 ESOMAR – Winner "Award for the Best Methodological Paper"
2010 German Market Research Prize – Winner "Best Study"

Contact us now!

If you are looking for a reliable and innovative partner for your price strategies or would like to discover the hidden price potential of your products, please don't hesitate to contact us by emailing florian-bauer@vocatus.de or calling +49 8142 5069-742.