The Best Way to Price Your Products

Small business CEOs that have a product centered business are always scratching their heads on how to best “price” their products. As a SCORE mentor, I certainly struggle with this question in trying to assist a client. So, I usually emphasize things like doing research on your competitor’s pricing so you know what your customers are seeing out there and also certainly know your costs of production or accessing so you know what your base price is before you build in your cost of doing business.

But so often, the question is really getting at the “magic” of pricing and what will the customer “pay”. I have done a lot of digging on this topic and only concluded that it is very complex.

For example, according to one source, Amazon is slowly phasing out “list prices” because they’re arbitrarily high. In most cases, the "discount" price is the real price, so why bother pretending otherwise?

It's hard to believe that Amazon would take such a radical step unless they were fairly certain that across-the-board discounting was no longer driving higher sales. Which may mean they've got some research behind the strategy.

Amazon aside, the past few years have seen a sharp increase in scientific research into pricing strategies. Some scientists are even using brain scans to track how people make buying decisions!

I respect the contributions of Geoffrey James, a regular contributing writer for INC Magazine. He has summed these pieces up like this, “given all the renewed attention to the study of prices, it's likely that a number of time-honored pricing strategies will gradually fall by the wayside.” However, he added that “there is one pricing strategy that's turning out to be amazingly resilient, even though it's both painfully obvious and faintly annoying: ending your price with the numeral "9."

The classic study of this phenomenon, was published in the journal Quantitative Marketing and Economics, encompassed three field studies where different price-points were offered. According to the researchers, the data yielded these conclusions.

- First, the use of a $9 price ending increased demand in all three experiments.
- Second, the increase in demand was stronger for new items than for items that the retailer had sold in previous years.
There is also some evidence that $9 price endings are less effective when retailers use "Sale" cues. Together, these results suggest that $9-endings may be more effective when customers have limited information, which may in turn help to explain why retailers do not use $9 price endings on every item.

Thus, though the difference is negligible, a product priced at $1,999 will tend to sell better than the same product priced at $2,000.

Surprisingly, the research also showed that a product priced at $1,999 will tend to sell better than the same product priced at $1,995.

So it's not about the savings. Apparently there's just something about ending the price in a "9" that nudges people to buy. In James’ words “Force of habit, maybe? Nobody seems to know for sure.”

So it appears that customers make buying decisions based upon their emotions and how the price is presented.

Entrepreneurs (and novice business CEOs and marketers) often assume that customers are always looking for the best value and make decisions to buy based upon finding the best possible price. Neither of those assumptions are true.

According to James, “Customers are deeply irrational and make decisions based upon emotions rather than logical thought. Fortunately, numerous studies have shown these emotional reactions to be highly predictable.” Here are some:

1. **Similar prices prevent sales.** More customers will buy at least one of two products if they have slightly different prices than if they have identical prices. Example: two T-shirts priced at $9.50 and $9.60 will sell better than if they're both priced at $9.55.

2. **High-priced alternatives increase sales.** Customers are more likely to buy a product after being exposed to an expensive alternative. For example, the Tesla Model 3 (at $35,000) became the most pre-ordered automobile of all time in part because would-be buyers compared it to Tesla's existing high-priced models.

3. **Buyers do not notice price hikes <10%.** As a general rule, customers don't really care that much about price increases until the increase exceeds 10% of the original price. A good example of this is the $.35 that fast food restaurants charge for a piece of cheese (cost: approx. $.01) added to a $3.75 burger.

4. **Customers buy more with installments.** Customers are more likely to buy a product
if the price is broken into multiple payments (like 3 payments of $50) rather than a
single price ($150). Partly this is due to a desire to control cash-flow but it's mostly
because customers don't do the math in their heads.

5. **Price can be re-framed to seem smaller.** Customers will consider a price more
attractive if you compare it to something else that seems trivial. A common example: "it
costs less than your daily cup of Starbucks coffee" makes $766.50 seem more palatable.

6. **Too much choice prevents buying.** Customers are more likely to buy if they're
presented with fewer choices. As *Scientific American* recently put it: "Logic suggests
that having options allows people to select precisely what makes them happiest. But, as
studies show, abundant choice often makes for misery."

7. **Bundling options increases add-on buying.** Customers confronted with add-on
options are less likely to buy when buying requires separate decisions and more likely to
buy when the options are bundled into a package. Apple's bundle-rich website is a
perfect example.

8. **Yes, $999 sells better than $1,000.00.** Also $999 sells much better than $999.99
because the decimal makes the number seem larger.

9. **Customers will pay more in fancy places.** Weirdly, customers are perfectly willing
to pay two or three times as much for the same product when that product is purchased
in posh surroundings. This is why upscale hotels can continue to charge (for instance)
$10.00 for a $.50 glass of milk.

10. **Customers will buy anything that's scarce.** Customers pull out their wallets when
told something won't be available in the future. The archetypal example of this is the
Pontiac, a car that pretty much nobody wanted until GM retired the brand in 2010, at
which point every car left on the lots sold within a couple of weeks.

___________________
Dean L. Swanson
Southeast Minnesota SCORE c/o Rochester Area Chamber of Commerce
220 South Broadway, Suite 100 Rochester, MN 55904
www.seminnesota.score.org/
*Dean is a volunteer SCORE Mentor and Regional Vice President for the North West Region*