



Consider context before objectives



4 types of bias inform pricing

## Driving pricing & profitability through behavioural science

KEY TAKE-OUTS | PEARSON HAM BREAKFAST EVENT | 22ND NOV | FOYLES, LONDON

### The psychological and sociological factors underlying biases in decision-making

Marco Bertini (professor and department head of marketing) - ESADE

People are fundamentally lazy! Considering all factors in decision-making is just too difficult, energy consuming and inefficient.

Our preferences are constructed, not revealed. People don't know what they want till they see it in context. People are affected by the way options are described. People evaluate objects in relative, not absolute, terms.

An economist would say that decisions are based on acquisition utility and transaction utility, but this ignores human psychology. What we do is ask ourselves "is this a good buy?" (perceived quality less perceived price) and "is this a good deal?" (benchmarking, editing, ...). Through conscious and unconscious biases both questions can be influenced through behavioural science.

Value anticipation effect in wines can be remarkable. A £5 bottle of wine tastes better at £45 than at its real price. A £90 bottle of wine tastes worse at £10 than at its real price.

Prospect theory: Pleasure and pain fade but losses loom larger than gains. That's human nature.

### A systematic approach to diagnose biases to improve pricing and revenue solutions

Tim Ham (CEO) and Megan More (Senior Consultant) – Pearson Ham, The Pricing Specialists

Behavioural science has wide ranging applications across strategic and tactical pricing, from price optimisation to commercial models, in both B2C and B2B businesses.

Successful behavioural pricing strategies are derived from careful consideration of context, bias, objectives and mechanisms, where context (purchase situation, how customer thinks and feels) should be looked at first; then the most relevant biases. Combining these with objectives helps create a list of mechanisms, which is the bias and the way in which it can be used.

A sound knowledge of decision biases (>150) will help make pricing strategies more effective. We've simplified these into 4 groups: perceptual (loss aversion, framing effect, etc.), emotional (mood, primary effect, etc.), personal (habits, confirmation bias, etc.), societal (bandwagon effect, group dynamics, etc.).

Understanding context, by which we mean: stage of purchase, product characteristics, purchase nature, and customer considerations, is critical.

Behavioural science affects customer behaviour. Price proposition, structure and communication influence product selection (if they buy), product choice (what they buy) and from whom (you or competition); and influence value to your business (how much, how often and how much they pay).

A well-structured process connecting these biases appropriately to the context and pricing challenges can lead to significant new opportunities and is key to improving commercial success.

## How cognitive biases play out in the commercial world

Richard Shotton author of *The Choice Factory*

People and business can be rather dismissive of behavioural science and cognitive biases and how they influence decision-making.

Through a series of examples, Richard demonstrated that business ignores behavioural science at its peril. They should in fact embrace it, especially in matters of pricing, to improve what products people chose and the revenues they generate. Examples of behavioural science in action include:

A diamond is forever by De Beers. Through anchoring, they told us to spend a month's salary on a ring. Since then they've moved to 2 months. In Japan it's 3 months! They also made diamonds synonymous with engagement. Clever behavioural science!

Charitable sector where simply inverting donation amounts from £5, £10, £25, £50 (left to right) to £50, £25, £10, £5 increases donations by 11%.

Beer menu pricing: ordering list of beers from high to low, rather than the instinctive low to high, generated a 4.2% uplift in revenues.

Nespresso: by reframing the competitive context, its cup servings are typically compared to coffee shop prices at £2.70, rather than supermarket bags of coffee, making their 57p per capsule look rather good value.

Rolls-Royce promoting their cars at international yacht shows. Far cheaper than a gin palace!



## ABOUT PEARSON HAM

Pearson Ham is an award-winning pricing consultancy based in London. We marry the science of analytics with the art of strategy to help our clients improve profitability and create value through

better pricing. We combine our client's market knowledge with our pricing expertise, and typically improve margins by 2 to 5%\* (\*as a percentage of sales).

"Bright, inquisitive, experienced, respectful and collaborative; a pleasure to work with" - CEO

"Using advanced analytics, you helped us make sense of a very complex market situation" – Marketing Director

Our personal approach and robust analytical skills provide work of the highest quality, tailored specifically to each client's needs.

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