The pains and pleasures of pricing

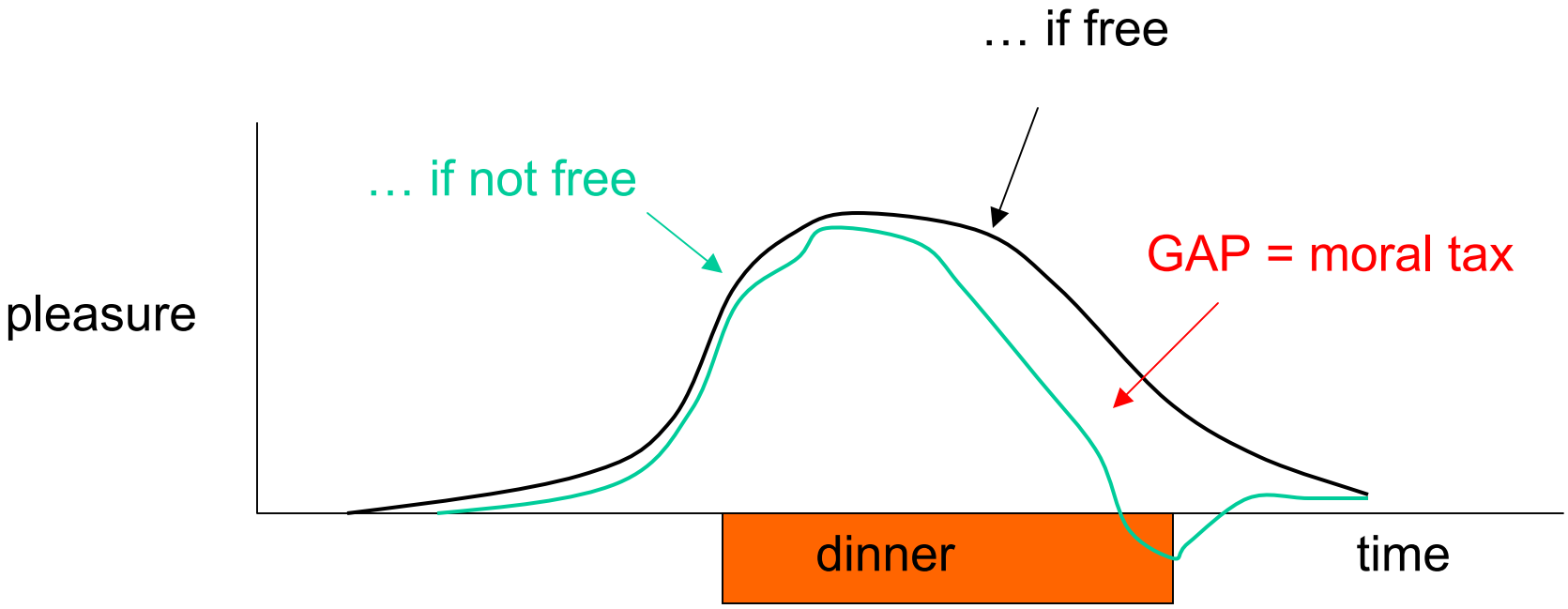
Consider two dinner scenarios

A … excellent food, wonderful company,..

... but you have never in your life paid so much for a dinner

B … like A, but dinner is ‘free’ (expense account)

The Moral Tax on Consumption



Research Agenda

1. Understand how payments diminish the enjoyment of products and services

2. Adjust economic model to incorporate (1)

3. Interpret some existing practices in light of (1)

4. Establish pricing principles that can recover lost satisfaction, without endangering accountability and consumer self-control

Preference for prepayment

- Imagine that you are planning a one week vacation to the Caribbean, 6 months from now. The vacation will cost $1,200.

  You have two options for financing the vacation:

  – *Six monthly payments of $200 before the vacation* 63%
  – *Six monthly payments of $200 after you return* 37%

- Same problem, but now you are buying a washer-dryer:

  – *Six monthly payments of $200 before the WD arri* 24%
  – *Six monthly payments of $200 after the WD arrives* 76%

Ease the pain with 'buffer currencies'

- Token payment mechanisms

  $$$ ==> tokens, coupons, beads, miles, chips.. ==> consumption

- Two stage mental budgeting

  $$$ ==> budget for entertainment ==> entertainment choices
  $$$ ==> prix fixe menu ==> menu choices

Flat, one-time prices eliminate marginal costs

- Fixed-fee, “all you can eat” arrangements

  $$$ ===> fixed fee for health club ==> ‘free’ usage

- Owning rather than renting

  $$$ ===> your tuxedo ==> ‘free’ usage

What, then, do we want from payment arrangements?

- to enjoy products and services as if they were free
- to justify all payments with salient benefits
- to preserve accountability and self-control

Always leave home without it
(Prelec and Simester, 2001)

- Second price sealed-bid auction
- Prize = one pair of Celtics tickets
- Sloan School Masters' Students

  1/2 think payment is in **cash** (within 24hrs)

  1/2 think payment is by **credit card**

Results...

Average bid = $29 for cash, $61 for Credit Card

($p<.01$, by t-test or MWU-test)

Top 20% bids average $53 for cash, $142 for Credit Card

Is this "irrational?"

- Can the same person have a $53 in cash-value and $142 credit card value?
- Would such a person buy $53 cash for a $142 charge?

Prize = dinner for 4 at Legal's (up to $160)

	Identification method	
Payment method	**Any 4 characters**	**Credit card digits**
Cash mean	$77.08 (N=43, st. err=5.9)	$52.80 (N=45, st. err=4.8)
Credit card mean	$67.12 (N=46, st. err=5.7)	$71.78 (N=34, st. err=5.6)
Credit card premium *t-test*	- 13% t=1.21, ns	+ 36% t=2.58, p<.05
Cash median *Credit card median* *Wilcoxson rank-sum*	$80.00 $62.5 z=1.42, ns	$50.00 $69.00 z=2.45, p<.05