

# Interrelationships between Behavioural Economics and Consumers' Decision-making with emphasis on Pricing Strategies

Author: Kristýna Knorová

Supervisor: Ing. Robin Maialeh, Ph.D.

Czech Technical University in Prague, Masaryk Institute of Advanced Studies



## Introduction

Behavioural economics is a field of economics concerning topics of consumers' decision-making in relationship to rationality, emotions, social and cognitive factors. The goal of behavioural economics is not to replace neo-classic economics theories, but rather to complete them. It is interesting to see how consumers' decision-making is influenced by perceived reality. If we work with an idea that consumers tend to behave irrationally based on bounded perception, behavioural economics can explain seemingly irrational behaviour. It can help us understand how and why consumers' decision-making is influenced on certain occasions and can help us avoid making those mistakes in future or alternatively can help retailers use strategies that profit from human tendencies to misbehave.

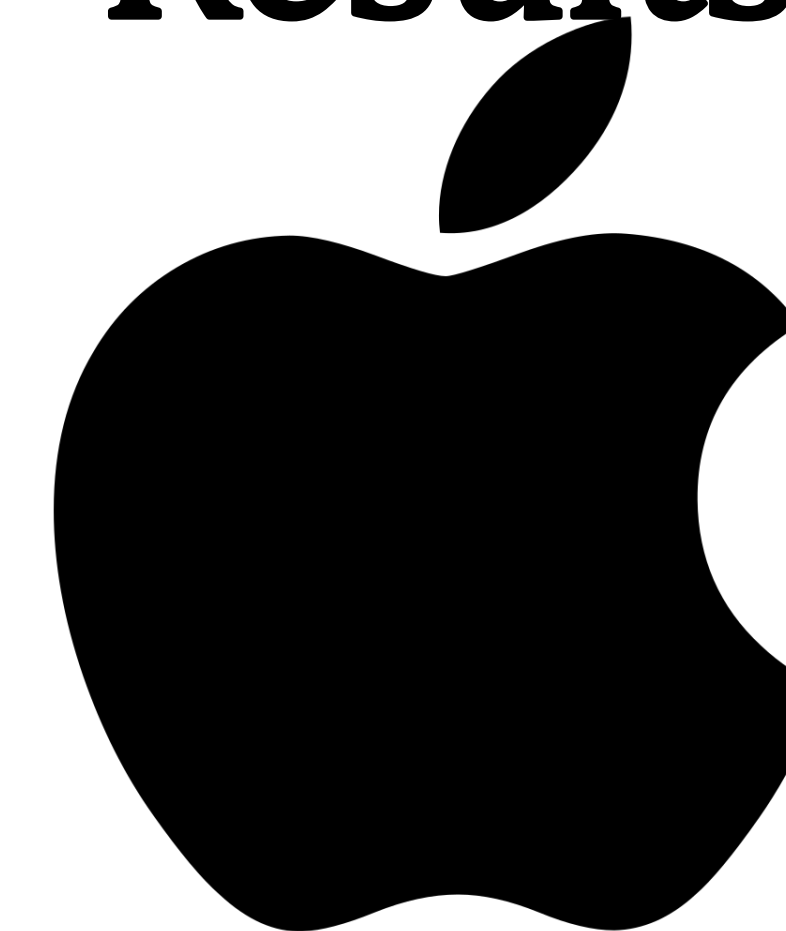
The first goal is to examine new economic trends of behavioural economics in relationship with consumers and their decision-making processes. For that reason, I present behavioural economics and its concept concerning moments when consumers tend to make errors and misbehave. The second goal is to focus on price setting strategies using insights from behavioural economics and how to use them to maximize a company's utility just from price itself. The third goal is to study pricing strategies of the chosen company and examine whether the company is using behavioural pricing strategies and whether they influence consumers' decision-making on purpose.

## Methods

As for my thesis the secondary data was used and quantitative research (the data analysis) was conducted. The secondary data was borrowed from company's quarterly reports and surveys conducted by statistical companies. The purpose of the research was to critically analyse pricing strategy of the particular company – Apple Inc., with focus on iPhone devices and further discuss and propose recommendation towards pricing strategies.

The thesis analyse pricing strategies of Apple Inc., since the company recognize well the power of price and uses many pricing strategies borrowed from behavioural economics. Apple is one of the well-known company which uses behavioural pricing strategies in order to influence consumers' decision-making. It is an example of how behavioural economics' strategies work in real life and how such strategies can at least partially contribute to transforming a small start-up company into billion-dollar business. I am going to analyse pricing strategy especially of iPhone products, since the greatest revenue comes from selling mobile devices.

## Results



- The analysis revealed, that the company uses behavioural pricing strategies such as: Pain of paying, Prestige pricing and Charm pricing
- The company also uses behavioural segmentation such as: Segmentation based on loyalty and Purchase behaviour: confirmation bias and loss aversion
- The usage of decoy effect was not confirmed
- The analysis revealed that Apple policy is focused towards high prices. The revenue growth was confirmed to be the outcome of the Prestige pricing strategy
- The price elasticity was examined and the results states, that demand for iPhone devices is inelastic at early stage of product-life cycle

## Conclusions

The analysis shows that despite the low cost of production, the company choosed to set prices of iPhone devices high and anchored itself as expensive in comparison with competitors. The company reported the highest revenue of all times from iPhone sales, thanks to usage of Prestige Pricing.

Because of the inelasticity of the demand, the company is able to increase its prices and therefore increase the revenue despite lower unites sold. The factors influencing inelasticity and thus possible peak price was further discussed.

Of course, it is not only the behavioural pricing strategy that helped the company to become succesfull, but on top of neo-classical policies, it enriches the marketing portfolio and created a powerful tool for influencing decision-making in the company's favour.

## Bibliography

1. ARIELY, Dan, 2009. Predictably irrational: the hidden forces that shape our decisions. 1st. rev. and expanded ed. New York: Harper Collins Publishers. ISBN 978-0-06-185454-5.
2. KAHNEMAN, Daniel, 2011. Thinking, Fast and Slow. 1st ed. New York: Farrar, Straus and Giroux. ISBN 978-0-374-27563-1.
3. KAHNEMAN, Daniel and Amos TVERSKY, 1979. Prospect Theory: An Analysis of Decision Under Risk: An Analysis of Decision Under Risk [online]. *Econometrica*, 47(2), 263 s. [cit. 2018-04-23]. DOI: 10.2307/1914185. ISSN 1468-0262. : <http://courses.washington.edu/pbafhall/514/514%20Readings/ProspectTheory.pdf>
4. THALER, Richard, 2016. Behavioral Economics: Past, Present, and Future. *American Economic Review* [online]. 106(7), 1577-1600 [cit. 2017-12-05]. DOI: 10.1257/aer.106.7.1577. ISSN 0002-8282. Available from: <http://pubs.aeaweb.org/doi/10.1257/aer.106.7.1577>
5. BAR-GILL, Oren, 2008. The Behavioral Economics of Consumer Contracts [online]. *Minn. L. Rev.*, 92, 749-1966. [cit. 2018-04-10].