



Food for Thought on Pricing Ori Heffetz offers a new perspective on price, perception, and purchase decisions

When it comes to pricing, consumers can behave in puzzling ways. Tell them one wine is more expensive than another, and not only will they think the higher-priced wine is superior, they'll claim it tastes better, too. Offer someone a medication that costs more per pill than another, and that person may well say that it provides more pain relief than the cheaper one.

This might lead companies to believe raising prices will increase sales. Past marketing studies support this theory. But, based on his recent research, Ori Heffetz, assistant professor of economics at the Johnson Graduate School of Management, advises caution: A positive perception of a product based on its higher price doesn't automatically translate into a decision to buy it.

Heffetz and Moses Shayo of the Hebrew University of Jerusalem examined the extent to which price influences someone's perception of a food product and willingness to purchase it. In a lab experiment, they asked university students to choose from differently priced, unfamiliar candies both before and after tasting the products. In the second phase of their research, they looked at how changing the price associated with a main course on a fixed-price menu influences restaurant patrons' selections. They kept the total price constant to ensure that budget constraints didn't dictate choices.

They expected people to clearly favor the higher-priced candies and entrees, just as those in earlier studies had responded positively to the more expensive wine and pills. But price didn't have this expected effect on demand. Instead, Heffetz says, "Once you measure the effects, you realize they exist, but they are too small to matter."

Heffetz and Shayo report this finding in the paper "How Large are Non-Budget-Constraint Effects of Prices on Demand?" to be published in the *American Economic Journal: Applied Economics*. Heffetz says, "When you make something more expensive, the psychological effect may make it more attractive, but that's forgetting good old economics—when something is more expensive, you can afford less of it."

The research doesn't dismiss psychological effects completely, however. Heffetz and Shayo found that once a consumer has a positive impression of an unfamiliar product—even if it's based on price alone—that favorable view persists. Heffetz says, "What we found, at least in the lab experiment, is that experience with a product doesn't make this effect go away. The effect is not very large, but it does not disappear."