Can raising prices increase sales? By Justin Jackson, Director at Digital Remit

We take it for granted that lower prices generate more sales. Indeed, it's covered in the first few weeks of any economics course.

Yet we tend to forget the assumptions on which it relies: that we're knowledgeable and we're smart. These are what economists call conditions of 'perfect information' and 'perfect rationality'.

In the real world, of course, we don't know everything and we're not so smart. We face conditions of *imperfect information* and *bounded rationality*.

This changes everything.

First, if prospective customers don't know much about you or your products then they'll make inferences based on what they do know. In fact, that's a reasonable strategy. The point is that, in some cases, the only thing they know is how much you charge – and, typically, the lower the price, the lower the quality. Price is thus an ***indicator*** of value.

As a result, cutting prices might actually result in fewer sales. This effect is reinforced by what psychologists call *confirmation bias*. This is where we do our best – without realising it – to fit new information into our existing view of the world.

Much of the time, the first thing someone learns is the price of our products, which will frame anything that we later add – whether that's a sales call or glowing review.

Even if they are revealed later, prices are such influential data – they somehow seem unbiased, inarguable, objective – that they can create *cognitive dissonance* if they don't track our understanding of the brand.

When they don't match, it's far easier to revise judgments of the brand – after all, aren't these opinionated, debateable, and subjective?

Second, there are cases where price actually determines, or at least influences, the enjoyment that someone gets from our good or service.

This happens when part of its value is down to ***prestige***. For once, economists chose a simple name for this: the 'snob effect'.

It's easy to think of examples in the luxury sector – Bulgari, Hermès, Leica – but it's also quite easy to find mass market case studies.

Would Apple, Nike, Waitrose be as popular if they cut their prices and thereby lost some of the exclusivity and aspiration?

There are lots of reasons why firms carefully pick distribution channels, but one is that it has a direct impact on price.

Third, studies have shown that price can also directly affect the ***efficacy*** of a product.

Consumers get more enjoyment from a bottle of wine with a higher price tag.

Students are more alert if they spend extra on an energy drink.

Patients suffer less if they take painkillers that cost a little more.

In each experiment, the product – and even the packaging – was identical. All that had changed was the price.

Moreover, this isn’t confined to food, drink, or medication.

Clients tend to benefit less from consultancy if it’s offered at a low price. For that affects perceptions of value – and consequently their level of input, degree of engagement, and extent of implementation.

So price matters.

It’s time that we realised that – in the words of Richard Thaler, who won the Nobel Prize in Economics last year – our customers are ‘humans, not econs’.

Customers often don’t know that much about our brand, so they infer a great deal from price. Colleagues, friends, and family make similar inferences, when they judge us on what we spend.

Even our minds and bodies do it, which is why we get more out of expensive goods and services.

However, the clinching argument is surely this: if we don’t value ourselves very highly, how do we expect our customers, our distributors, or our staff to do so?