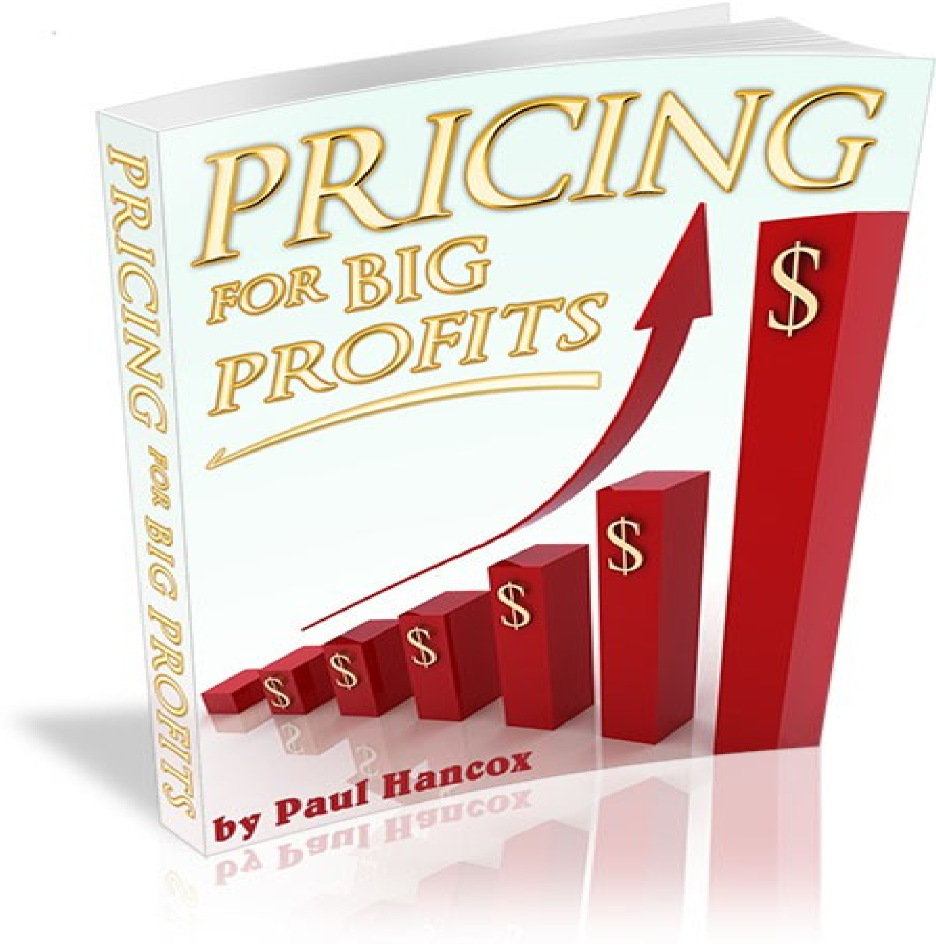

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Chapter 1 – Price Matters!

In this opening chapter I'm going to share with you reasons why your pricing decision is so important, and I'm going to highlight six "myths" that will be challenged or busted later in this report. We'll also look at the strange situation where dropping price by just $1 killed sales and we'll find out why that happened, and I'll explain what's coming up later on.

1.1 The Critical Importance Of Pricing

I'll begin this report with what might be considered a pretty bold statement:

> *Deciding the price of your product is one of the most important business decisions you'll ever make.*

I realize that statement needs a lot of justification, which I intend to deliver throughout this report.

The fact is, the price point you choose for your product or service can determine...

… the volume of sales you make,

… whether you make a profit or loss on that product,

… how your product is perceived by the market,

… whether your product is an impulse buy or a purchase that requires more consideration,

… whether people value your product or not,

… how much you can pay affiliates,

… and much more - so choosing your price point is not a simple decision, by any means. First, let's tackle...

1.2 Six Internet Pricing Myths

In the Internet marketing world, there are quite a few “myths” floating around about pricing, partly because it's easier to just follow or copy what others are doing.

And while there's nothing wrong with that in itself, it also provides fertile ground for poor advice to be spread around, or advice that is only valid in certain limited contexts.

In this report, I'm going to tackle six of the biggest myths, among other things. These are:

Myth #1: “Lowering your prices will increase your sales.”

Reality: While it's certainly possible to have to have too high a price, I'll show you many examples where *increasing* the price also *increased* sales, and we'll explore why this is the case – there are specific circumstances in which this is more likely to happen.

Myth #2: “You can never have too *low* of a price.”

Reality: I'll give you an example shortly where lowering a price by just $1 actually *eliminated* sales altogether! I'd suggest that is precisely the kind of scenario where a price is too low.

Myth #3: “Pricing too far above your competitors will kill sales.”

Reality: You should definitely keep an eye on your competitor's prices (and just about every online business has competition of some sort), but there are times when pricing much higher than your competitors is an effective pricing strategy, as we'll see. (If you're going to consider this, you need to understand the circumstances in which this works.)

Myth #4: “The best way to determine your price is to ask your customers what they'd be prepared to pay.”

Reality: It might sound surprising, but for reasons we'll discuss later in this report, your customers are probably the last people you should be asking about what price you should charge! I'll explain why this is the case at the end of Chapter 4 – it's a critical piece of understanding that you must know, and surprisingly few marketers know it.

Myth #5: “Customers like choice, and they can never have too much of it.”

Reality: Yes they can, and as I'll demonstrate later, too much choice can actually shrink sales dramatically, and increase the risk of refunds on the sales you make.

On the other hand, there are specific times when adding more choice will increase your sales, which we'll also explore. (And the chances are, you can probably use the techniques you'll discover about choice right now to sell more.)

Myth #6: “Prices that end in 7 work best.”

Reality: Many Internet marketers believe prices ending in 7 have some kind of “magical” property, and that these have been thoroughly tested and found to work best. In this report we'll examine just how valid those assumptions are – I think you're going to be surprised!

1.3 The Counter-Intuitive Nature Of Pricing

Consider the “birthday problem”. If you were to put 365 people in a room, you'd be almost certain to find at least two people with the same birthday.

Now, how many people do you think would need to be in the same room, so that there's a 50% or more probability that two people have the same birthday?

I'd like you to please stop for a moment to consider this problem. What does your common sense or intuition tell you? I'm not expecting you to get it spot on, but I'd like you to at least take a rough guess.

You'll find out whether you were close or not in just a moment, but there's a very important reason I'm asking you this.

You see, when it comes to pricing, many of the results in this report will seem *counter-intuitive* to non-marketers. (That is, the results seem opposite to what the person intuitively thinks should be true.) And even as an Internet marketer, they may raise eyebrows.

For example: to someone *not* in sales and marketing (and even quite a few in these fields), it might sound like common sense that if you lower your prices, you'll get more sales, right?

Well, I'll give you an example in just a moment of where dropping the price by just $1 actually *eliminated* sales altogether – something that wouldn't make “common sense” to a lot of people.

Before I share this example with you, let's get back to the “birthday problem”. If you said 183 or thereabouts, you'd be right as far as “common sense” goes. In other words, that's what most people think the answer is, because their “intuition” tells them so. (After all, it's about half the number of days in the year.)

The actual answer is 23 - you'd only need 23 people to be in the same room, to have a 50% or more probability that two people have the same birthday!

Now, let me say right away that I didn't include this to fool you. In fact, when I first heard of the “birthday problem”, my first thoughts were, “That can't be right!”... and I spent several hours trying to figure out why.

You see, it violated my common sense. In the end, I did a bit of research and found it to be true – that you need just 23 people. Quite honestly I couldn't fully understand the math behind it (despite having a background in math), but I understood the mathematical principle which enabled it to be true.

And I also understand why people without a mathematical background might find it hard to accept that you'd only need 23 people in a room, but that doesn't make it any less true.

Albert Einstein once said: “Common sense is the collection of prejudices acquired by age eighteen.”

The problem with “common sense” (and the same could be said of “intuition”) is that it isn't always right - just as most people's answer to the “birthday problem” is one that *sounds* like common sense, but is completely inaccurate.

It might sound like common sense to say that dropping prices would increase sales, but let's look at an example of where something completely counter-intuitive happened...

1.4 When Dropping Price By $1 Killed Sales

Marlene Jensen of *Pricing Strategy Associates* had stocks of a book for cat lovers which they had acquired in a closeout sale for next to nothing.[1]

They wanted to shift the stock quickly, so they put a low price on the book at around $1.95.

They were getting around 23 orders a week, but were unhappy with the sales volume, so they decided to drop the price by $1, to about $0.95.

Sales dropped to zero. They ran with the lower price (i.e. about $0.95 instead of $1.95) for 4 weeks, with no sales.

I should point out that they made sure the book was thoroughly described to potential customers beforehand, and they included the book cover for them to view.

And yes, they checked that the ads were running, the links were working, and they tested the order process to make sure everything was fine.

The simple fact was: at just $1 less, nobody was buying.

What was Marlene's conclusion? “Where people can't easily ascertain the value of an item themselves... consumers will distrust a price that seems too low.”

- **The “Too Low” Pricing Principle:** It is possible to take a price too low, to the point where the potential customer distrusts the product because of the low price.

Incidentally, throughout this report I'll highlight the key pricing principles. They are not necessarily fixed rules, but should be seen as general “rules of thumb” that can help you in your pricing decisions. I've highlighted them so you can easily find them if you want to refer back to this report at any time.

READER'S REPORT

“Too low pricing - so true. I want to share something that happened to me. When I was managing a Meat Department I accidentally ordered too many frozen Veal patties. It was a big error and I had boxes of the stuff. Fearing I would be stuck with them I decided to drop the price and blow them out. It didn't work, they didn't sell.

In an irrational moment I raised the price to normal, then put out a sign 'Limit 3'. Something magical happened. I sold out quickly.

When the price was too low people thought something was wrong with the product. When the price was normal, but had a limit, people thought that somehow it was a great deal. Go figure.

I had the same experience when the store put boneless hams on sale at an incredible price. These were top quality and fresh. They hardly sold. People figured the price was too low and that something was wrong with them. Once the price was raised, they sold just fine.”

(Scott Ames)

1.5 What You're About To Discover In This Report

If you're familiar with my previous reports, such as *Small Changes: Big Profits* and *The Secrets Of A 10% Conversion Rate*, you'll know that I'm a strong advocate (a.k.a. fanatic) of split testing to find out which price works best for your product.

So in Chapter 2, I'll briefly show you why you need to test, and how to do it. However, price testing can be risky. I'll show you how even big companies like Amazon and Netflix got caught out, and how to avoid what happened to them.

However, testing is not the end of the story when it comes to pricing. In Chapter 3, we'll explore all of the important factors you'll need to consider before determining your price. It's important to get this right early on, because it might be harder to adjust your prices later, once you've started to build your customer base.

Incidentally, right in the heart of this chapter I'll share with you one simple yet little known psychological principle that - if you implement in your business - could easily pay for the cost of this report multiple times over. You will not want to miss that! You'll find it in section 3.9, although you'll see it applied later on in other contexts as well.

Now, you might choose to run a test to see if your product sells better at $27, $37 or $47 - but is there a way you could actually influence people to *want* to pay more?

In Chapter 4, I'll discuss all of the psychological aspects that go into pricing. For instance, I'll share with you the *real* secret behind prices ending in 7 and 9, and it's *not* what a lot of marketers think it is.

I'll explain and give examples of some fascinating pricing principles, such as: under what circumstances people use price as a guide to value, the “compromise” principle, the “decoy” effect and many other intriguing principles.

And in this same chapter I'll explain why asking your potential customers how much they'd be prepared to pay may be a very *bad* idea! (Be careful you don't make this very costly mistake – because many marketers suggest this as a method of determining your price.)

In Chapter 5 we'll look at the “bigger picture”, and how pricing can be an integral part of a larger marketing model. I'll share with you four contrasting examples (ranging from a $7 report to a $1,997 “make money” system) of where a digital product's price was determined by a larger marketing model.

We'll examine the marketing models being used in each example, and we'll see how their pricing fits in with their overall strategy. You can even use these models yourself.

Lastly in Chapter 6 we'll bring it all together. I'll explicitly lay out the eight questions you need to ask yourself before determining your product's price.

So now let's continue our exploration, with price testing – and we'll see if we can avoid the embarrassing mistakes of Amazon and Netflix. First we'll start off with a walkie-talkie that seemed to defy the normal rules of pricing. When we understand the reasons behind this, we'll unlock one of the psychological secrets of pricing.

Chapter 2 – Price Testing

In this chapter, I'm going to show you the results of a fascinating price experiment, which gives us an insight into how people view price. It will show why you should test your prices when you have the opportunity. I'll also show you how to do that, while avoiding the mistakes that Amazon and Netflix made.

2.1 The Walkie-Talkie That Broke The Rules

People don't always react to prices in ways that we'd expect. For instance, “common sense” tells us that lowering our prices would result in more sales... but as we've already discussed, common sense doesn't always apply in marketing and sales – especially when little known psychological principles are at work, which we'll examine in much more detail later.

Consider the surprising results of a pricing experiment conducted by Marshall Fisher and Vishal Gaur.[2]

They wanted to test people's response to prices for three different products: a family center board game, a Phonics traveler and a headset walkie-talkie.

They selected 18 stores belonging to the Zany Brainy retail toy chain to conduct their test, and they chose the three items above because they were not carried by the store's competitors, minimizing the chance of potential customers being able to comparison shop.

They tested three different price points for each of the three products:

For the board game, they tested $19.99, $24.99 and $29.99.

For the Phonics traveler, they tested $24.99, $29.99 and $34.99.

For the headset walkie-talkie, they tested $14.99, $19.99 and $24.99.

After six weeks of testing, sales of the board game and Phonics traveler were not particularly surprising – sales went *up* as price went *down*.

However, the sales figures for the walkie-talkie were intriguing. Sales at the mid-point price ($19.99) were highest at 74 sales, with the lower $14.99 price point getting 47 sales, and the highest priced point ($24.99) selling 36 units.

The researchers wanted to understand why consumers behaved differently in response to the walkie-talkie price compared to the other two items, so they talked to the merchandise managers at the stores, and at other retailing firms.

The main reason suggested by these managers was this: because the walkie-talkie was a complex electronic item, consumers found it difficult to judge its quality – so they relied on *price as an indicator of quality*.

However, the board game was easier to understand, so price was less likely to be used in this manner.

Also, the Phonics traveler was a branded item, made by a recognized manufacturer, so consumers could call on their knowledge of that brand. “You might buy a $10 walkie-talkie from Sony because you know and trust the brand,” said Fisher, one of the researchers. “But a consumer might worry that a $10 walkie-talkie with an unknown brand would be a piece of junk.”

The walkie-talkie was not branded, leaving the customer only with *price* as the indicator of quality.

- **The “Branding” Pricing Principle:** Branding is often used to steer customers away from using price solely as an indicator of quality. Potential customers trust more familiar brands.

This idea of “price as an indicator of quality” is an important one, and later on we'll see how one Internet marketer used this concept to make a small fortune.

One of the important lessons we can learn from this experiment is that we need to test our prices whenever possible, which is what this chapter will be about.

However, I think it's also important to get a handle on specifically *why* certain prices work better than others. When we understand what's going on underneath the surface, we can actually design our tests and much more accurately predict which which one is likely to do better! Or if we're unable to conduct a price test (perhaps because we haven't yet got enough sales), we can still make good pricing decisions.

Another thing we can take from this experiment is that they deliberately chose items that people would find difficult to comparison shop. Had they been able to do so, the results might have been quite different. It's likely customers would have been more price conscious if they knew they could get the walkie-talkie for half the price in the store across the street!

2.2 Price Testing On The Internet

The testers at *Marketing Experiments Journal* worked with a leading psychiatrist and author to determine how to maximize online sales of his newly published book.[3]

They set up an online experiment and tested three price points for his book: $7.95, $14.00 and $24.95.

They focused their campaign on drawing traffic from five Google AdWords keywords, and they ran an A/B/C split test on the traffic, evenly distributing the traffic between three different pages, each displaying the different price.

At $7.95, they got 390 orders.
At $14.00 they got **480** orders.
At $24.95 they got 300 orders.

So in terms of *volume* of orders, the $14.00 price point won out, once again demonstrating that a lower price does not automatically equate to more sales.

However, let's look at the revenue earned at each price point:

$7.95 x 390 = $3,100.50
$14.00 x 480 = $6,720.00
$24.95 x 300 = **$7,485.00**

So although the $14.00 price point generated more sales (480 of them), the higher $24.95 price generated more *revenue*. And because this was a physical product, it also created a much higher profit margin, resulting in greater *profit* generated on less physical units sold.

- **The "Profit" Pricing Principle**: The price that sells best isn't necessarily the price that generates the most profit.

On the Internet, price testing is relatively easy – you simply perform a split test. Since you may already be familiar with split testing from my previous reports, I've put how to do a pricing split test in Appendix A. (If you're not familiar with split testing, I'd urge you to read this appendix.)

2.3 Price Testing "Discovery" - Caught Red Handed!

One of the drawbacks of price testing is the risk of being "discovered".

What that means is, if some of your potential customers realize that you're price testing, there's a risk of upsetting other customers. Plus, they may try and "foil" the test by discovering and buying only the lowest price, which may significantly skew the testing results.

For instance, Netflix.com offer an online DVD rental and delivery service. However, in a 2006 blog post entitled "Win The Netflix

Lottery”[4], one potential customer noticed that, while visiting Netflix.com on his laptop he'd been presented with a splash screen offering “plans starting at $4.99”, but when he went downstairs to look at the deal on his desktop computer, the splash screen was identical, but had “plans starting at $9.99” and slightly higher price points!

He had other people try it on their computers, and they found splash screens with the “plans starting at...” bubble ranging from $4.99 to $9.99.

Of course, it's likely he'd stumbled unwittingly upon a price test. The problem was, other bloggers started to pick up on this initial blog post, and mentioned getting in on the lowest price point. After all, they reasoned, why pay $9.99 when they'd found a way of getting in for just $4.99?

Now, because these people were still talking about becoming customers, this may have actually been good publicity for Netflix.

However, it's also possible that, because the price testing was “discovered” and assuming they *were* price testing after all, their testing results may have been skewed by people who knew about the different offers and wanted to get in at the lowest price point in the test.

Price testing may be more of a challenge for higher visibility companies such as Netflix.

Back in September 2000, CNET News reported that some Amazon.com customers were “fuming over random discounts on some of the e-tailer's most popular DVDs.”[5]

According to the report, Amazon spokesperson Patty Smith said the

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