



# Price *Points*

**You can shift consumers' perception of an insurance premium from a guaranteed loss to a bargain-priced gain.**

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“**W**hy should I care about life insurance? I’m going to be dead!” Every agent who has heard this utterance knows that if a prospect truly believes this, then there’s probably little point in pursuing a sale. Unless someone cares deeply about someone or something other than himself, there usually isn’t any need for life insurance.

The fact that the decision to purchase life insurance resides so firmly in the emotional realm is good reason to consider some of the findings of behavioral economics. In fact, behavioral economics offers a number of effective responses to the uninterested prospects who claim not to care about anyone.

Where neoclassic economics assumes that all consumers are like Mr. Spock and make rational buying decisions based upon the pristine logic of expected utility theory, behavioral economics introduces the murky musings of psychology and

assumes that consumers make irrational and emotional buying decisions much like Homer Simpson. Or to put it another way, neoclassic consumers spend money—behavioral consumers spend “d’oh”!

The insurance industry has benefited greatly from behavioral economics. In fact, the 2002 Nobel Prize in Economics was awarded to psychologist Daniel Kahneman primarily for developing an effective model for describing how people make decisions regarding risk, particularly as respects insurance and financial decisions.

How often is our industry fortunate enough to benefit directly from the work of a Nobel laureate?

Kahneman found that not only do people relate differently to the risks of losses and gains, but they also hate losses more than they love gains by a margin of 2:1. On the one hand, this would appear to be great news for our industry since we are all about protecting people from losses. The problem is that

behavioral economics has also identified that people lack an understanding of probability and tend to completely dismiss the risk of low probability events ever occurring. As a result, they tend to evaluate risk based upon the frequency rather than the magnitude of loss. Therefore, when people make insurance purchasing decisions, they consider the premiums they have to pay to be equivalent to a definite loss, and the potential gain to be so probabilistically remote as to be inconsequential.

For a comprehensive (and readable) synopsis of behavioral economics and its application to the insurance industry, interested readers should download a 2005 LIMRA report by Dr. James O. Mitchell and Dr. R. James Holzworth titled *Behavioral Economics: Literature Review and Implications for Financial Services*. LIMRA followed this report with another interesting study titled *Increase Sales through Behavioral Economics* that created two distinctly different sales tracks—one based upon classic economic understandings and the other based upon behavioral methods—and compared consumer reactions to each approach to determine which was more effective.

However, for the purposes of this article, rather than repeat what has already been written, I'd like to synergize some of the other insights that behavioral economics has contributed to industries other than insurance.

### What Price?

For evidence of the fact that there is an element of irrational bias in consumers' buying habits, one only has to look at 9-ending pricing. Everyone knows that when they buy a shirt for \$9.99 they're essentially paying \$10, right? Or a new digital camera that costs \$499 is relatively equivalent to \$500? Or a song on iTunes that costs 99 cents is pretty much still a buck? Yet if no one is fooled, then why does 99 pricing not only persist, but prevail?

Rutgers University professor Robert Schindler conducted a compelling experiment in 1996 where a clothing catalog that was mailed to 90,000 customers was distributed according to three distinct pricing strategies: prices ending in .99, .00, and .88. The .99

catalogs resulted in an eight percent increase in sales over the .00 catalogs even though the average price decrease was only three-hundredths of a percent. Surprisingly, the .88 ending prices resulted in the lowest overall sales even though the prices were the lowest.

“[Consumers] tend to evaluate risk based upon the frequency rather than the magnitude of.”

It's interesting to note that for every study that confirms the advantage of 9-ending or just-below pricing, there are also studies that have been inconclusive. This hasn't deterred researchers from postulating theories to help explain the phenomenon, including the “left digit effect” and the “right digit signal”.

The “left digit effect” stems from the fact that we read left to right and therefore tend to assign more importance to the first numbers we see. Cornell University professor Manoj Thomas asked students to compare the differences between prices of \$99.99 and \$150, and also between \$100 and \$150 and the perceived difference between the first two numbers was significantly greater.

The “right digit signal” effect is a more difficult to quantify because it reflects a cultural or psychological response to 99-cent ending prices that just “feel” better because they imply a bargain or a sale price. From this perspective, most consumers would not only be indifferent towards the differences between an item priced at \$99 or \$99.99 but could actually regard the second number as being on sale even though it costs more. In this way, retailers can charge almost an extra dollar per item with the potential for

an increase rather than a reduction in sales.

Upscale retailers have applied this theory in reverse by utilizing big round dollar pricing on their items in order to convey an aura of “quality” rather than “discount”. Some retailers have expanded their just-below pricing methods as a form of code to more readily identify sale items. For example, .99-endings would indicate a standard price, .97-ending would indicate a 40% markdown, and a .93-ending could indicate a 20% sale item. Wal-Mart has exploited this bias further by making .97 ending their standard pricing, conveying the impression that

their every day prices are lower than competitors' sale prices. Foreign retailers have added their own cultural spin by offering 8-ending pricing in Hong Kong, Singapore, Malaysia, China, and Japan because 8's are considered lucky numbers. And no one in China would ever consider using 4-ending pricing because that number phonetically sounds like the word for “to die”.

Now consider the complex pricing process for a small face life product where a specific mortality charge for a given age is multiplied by the desired amount of insurance, a policy fee is then added to the total, and the sum is multiplied by yet another monthly premium factor. Are consumers comforted by the precision that we apply to their insurance pricing? Do they take advantage of the added flexibility of determining their desired death benefit down to the



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nearest dollar? Does “the law of large numbers” lend itself to precisely predicting pre-mature death risk at each age to the nearest penny? And more importantly, could a company’s profitability improve significantly if they were able to charge an additional .99/month on every policy?

Perhaps instead of utilizing traditional pricing, there may be some advantage to offering face amounts rounded to the nearest thousand (to convey quality) and monthly premiums that are all rounded up to the nearest .99 (to convey a discount). Although this approach wouldn’t work with many traditional policies, in a final expense sale where the vast majority of premiums are paid monthly and death benefits are roughly calculated on the back of a napkin, the trade-off in flexibility may be more than offset by the potential increase in sales and profit.

### Simple Life

A good example of the advantages of simplification can be found in auto manufacturers’ routine maintenance intervals. In the past, manufacturers struggled with getting consumers back into the dealership for routine maintenance because of the complexity involved in properly timing ideal maintenance requirements for each of the tens of thousands of parts that make up each car. Honda solved this problem by grouping them together into three different maintenance intervals according to months elapsed or miles driven. As a result, where the other manufacturers struggled to keep their dealership repair bays filled, Honda’s were always busy because consumers could easily understand what was required, when it was needed, and how much it was going to cost. Some of the engineers resisted this approach because it required some compromises—some maintenance would be performed sooner than was absolutely necessary and others might be delayed a tad—but the overall result was improved maintenance on the part of their customers, more revenue to the manufacturer, and improved performance for their products. I would argue that a similar compromise in terms of simplifying small face life pricing could be equally beneficial and effective.

Another example of the benefits of

simplification can be found in a recent study reported by Hyunjin Song and Norbert Schwarz for the University of Michigan titled *If It’s Hard to Read, It’s Hard to Do—Processing Fluency Affects Effort Prediction and Motivation*. In the study, separate groups of students were given instructions on how to implement an exercise routine written in either an easy to read Arial font, or a hard to read Brush font. Another group was given instructions for preparing sushi in either difficult or easy to read fonts. When asked to predict how much time and difficulty would be involved in completing each task, the students given instructions in the easy to read font believed that it would be far easier and take much less time to complete their tasks than the other groups. The differences were significant. The exercise regime was estimated to take 83 percent longer to complete by the people with the difficult to read font, and the sushi preparation was estimated to take 59 percent longer.

The fact that something as insignificant as font style can have such a meaningful impact on people’s expectations is a great reminder for carriers to re-up their commitment to simple language, clean fonts, and lots of white space on their applications, marketing, and training material.

Consumer psychology has also found its way to the restaurant business where “menu-engineers” promise—and deliver—increased profitability solely by subtly massaging the placement, pricing, fonts, and descriptions of menu items. In many instances, restaurant profitability has been found to increase by more than 10 percent merely by tweaking the menu design in order to influence consumer buying decisions. One tactic dictates tucking prices discretely on the end of item descriptions rather than aligning them all in a row to deter people from readily identifying the cheapest items. Some advisors even recommend eliminating dollar signs, since it reminds diners of their hard earned cash. Placement within the menu is also critical with the most profitable items placed in the upper-right corner where the eye naturally gravitates. The upper left corner and center of the middle page are also prime placements for the most profitable products.

Another key feature of menu design with which we’re all familiar is the descriptions of the items. Everyone knows that “grilled chicken” just doesn’t taste as good as “succulent poultry flame-broiled to perfection”, and that a “medley of berry preserves and puree pindas” is significantly more expensive (and better tasting) than plain old peanut butter and jelly.

By comparison, is it any wonder that consumers are confused about the differences between whole life, universal life, and term insurance? One can’t help but wonder how a “menu engineer” would react to the typical insurance company’s point of sale brochure. Does a product named “Golden Protector Advantage Preferred Whole Life” really evoke an emotional sense of security or does it fall into the same realm as “berry preserves and puree pindas”? Are our product descriptions phrased in a way that is as appealing as they are easy to understand? Does your company take pains to position the most important messages where consumers are most likely to notice?

Offering a few particularly high-priced “decoy” items on a menu also has proven to be very effective in raising the average amount that each diner will spend—not because they gravitate toward the highest priced items, but because they make the second highest priced items appear more affordable by comparison.

Providing a context for comparison has been proven to be an effective sales motivator in a number of different industries. In his book *Predictably Irrational*, Dan Ariely describes an experiment he conducted with MIT Sloan School of Management students that expanded upon an on-line promotion by *The Economist*. In this experiment, students were offered a choice between three different subscription offers. The same students were later offered only two of the same choices in order to determine if their preferences would change—and change they did:

- First Offer: On-line only for \$59 (16 percent); print only for \$125 (0 percent); both print and on-line for \$125 (84 percent).
- Second Offer: On-line only for \$59 (68 percent); both print and on-line for \$125 (32 percent).

Note that the first offer priced the “print only” and “both print and on-line” offers identically. This made the pricing for “both” appear to be a much better value and therefore the vast majority of students selected this offer. However, when the print only pricing wasn’t available for comparison purposes, the majority of the students perceived the on-line offer to be the most attractive.

Williams-Sonoma had a similar experience when they first came out with a bread maker for \$275 and consumers were decidedly uninterested. Rather than abandoning the product, they launched a high end model that was priced 50 percent higher and suddenly the demand for the original version began to boom.

How many insurers have considered offering a high cash value contract primarily as a decoy to provide a more attractive context for their preferred product?

Returning to the statement at the beginning of this article, when someone asks rhetorically why they should

care about life insurance, a behavioral economist might nod in agreement—people shouldn’t care about life insurance. But a well trained agent needn’t walk away from a sale because there are plenty of other things people care about very deeply, many of which they’re not even aware. We make buying decisions based upon motivations and influences that are so deeply ingrained that we don’t even know how irrationally we’re behaving. A smart agent—and smart companies—will continue to test the effectiveness of different sales tactics, promotional material, and product design in order to shift consumers’ perception of an insurance premium from a guaranteed loss to a bargain-priced gain.

For a detailed exploration of the more tangible—and less psychological— aspects of fine tuning our business, the LIC is sponsoring a one-day workshop at LIMRA in Windsor, Conn. on February 3, 2009 titled Excellence in Execution— Actively Managing Your Small Face Life Products for Maximum Profitability. This workshop will explore in detail

how to proactively manage the primary pressure points of profitability for a small face life product—mortality persistency, expenses, and field management. For more information, please visit the LIC Web site at: <http://loma.org/licevents.asp> After all, it’s one thing for our prospects to say they don’t care about life insurance, but it’s quite another for an agent to ask rhetorically why they should care about their company’s profitability! ■



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