

The behavioural economics of an A\$1,800 iPhone

Written by The Conversation

The latest iPhone is going on pre-sale today for the eye-watering price of around A\$1,800 for 256GB. But who on earth would pay that, and why is Apple charging so much? The answer comes down to behavioural economics.

By setting prices so high, companies like Apple can extract the most revenue possible. People for whom having the latest technology is important will happily stump up A\$1,800. For the rest of us this price will “anchor” what we think the value of the phone is, and as prices drop later it suddenly doesn’t seem so expensive.

Essentially, once Apple has sold the phone to those willing to pay the most for it, it can then capture the rest of us by reducing the price over time.

Costs and benefits

If you balk at a A\$1,800 price tag for a smartphone, that’s because you are making decisions on the basis of a concept called “[substitutability](#)”. This is drawn from economic psychology and it essentially means you are weighing the costs and benefits of substituting from one smartphone to the next.

In [traditional economic terms](#), if you aren’t willing to stump up A\$1,800, that’s because the “[marginal benefit](#)” (essentially an increased utility or satisfaction) of upgrading doesn’t yet outweigh the marginal benefit of your current phone (or not even having a phone).

Once the price starts dropping this cost-benefit analysis starts to change. Eventually the marginal benefit of upgrading will be greater than that of your current situation and that’s when you switch. You “substitute”, and only then at a lower price does Apple get you to buy their phone.

But this isn’t how the people camping outside the Apple stores are thinking.

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Both [Herbert Simon](#) and [Daniel Kahneman](#) won their Nobel prizes for showing that human beings don't always make decisions by making "rational" comparisons of pros and cons. Peter Earl [built on their ideas](#), recognising that we make decisions by following rules, responding to emotion, satisfying needs, and following the dictates of a particular identity.

We see this whenever a product is released with really strong emotional properties. Remember those [people lining up in the early hours of the morning](#) for the latest Harry Potter? Or those fans [lining up for days](#) to get tickets for the latest Star Wars film? Same thing.

This happens because they *need* the product. There's an emotional connection, it's part of their identity, and they aren't thinking about it in terms of costs and benefits. People even speak of a "[cult of Jobs](#)" (referring to Steve Jobs, Apple's late CEO).

So the people who are camping outside the Apple store, or who dropped A\$1,800 the moment pre-ordering began, aren't particularly responsive to prices. They're not making decisions on the basis of substitutability. Instead they're of a mindset that as long as they can afford the new product, they'll buy it.

Anchoring

So you charge these people as high a price as you can. But once the diehards have the latest iPhone at a very high price, what next? Well, Apple turns attention to the people who *are* making decisions on the basis of substitutability.

This is when Apple allows telcos like Telstra and Optus and Vodafone to offer plans such that the price (usually buried in the bundle of a phone plan) of the actual phone itself begins to decline as we move toward the next product release.

You have to dig around a bit to find the trend, but you can see it in [the price history](#) and the [average selling price](#) in various parts of the world. Eventually, the price will be reduced so much that the last few holdouts deem it a worthwhile trade-off. This is just straightforward economics.

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Except it's not actually that straightforward. Apple and companies like it get a hand from a well-known phenomenon in psychology and behavioural economics known as [anchoring](#).

Essentially, by setting as high a price as possible for the initial release, Apple anchors our thinking about its value and our willingness to pay for it.

While you might be a person who would not have bought a A\$1,500 phone, or a A\$1,300 phone, both of these prices become more attractive when compared to a A\$1,800 phone. Especially so when the A\$1,500 cost isn't paid upfront but buried in a yet smaller monthly fee you pay as part of your phone contract.

An interesting example was provided by Robert Frank in his [textbook](#): have you ever noticed how hardware stores like Bunnings put the ludicrously expensive, "bells and whistles" A\$5,000 barbecue right at the front of the store as you walk in? Nobody really wants to buy that, but it provides an anchor that makes the somewhat cheaper barbecues in the back more attractive.

This is anchoring at work.

Anchoring changes the thinking around the entire iPhone line. A standard iPhone 7 is currently around A\$849 if you buy it straight from Apple, and an iPhone 6s is A\$699. It's even less, or at least appears so, if you get it as part of a plan. So if you're a couple of models behind, maybe you'll just upgrade to the next one, not the latest.

But notice again, your thinking about the iPhone 6 and 7 has been framed by the price of the iPhone 8! Is the iPhone 8 *really* worth that much to you?

This is the way your mind works

In short, the high price of the first batch of new products allows a company to maximise revenue from those whose decision making is not guided by substitution. And by anchoring the thinking of those who are considering costs and benefits about the value of the product it also allows the company to extract more revenue than they probably could have otherwise.

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Simple yet powerful. Cunningly clever. No wonder we see them do it all the time.

Unfortunately, we're starting to discover [we aren't good at avoiding such manipulation](#), even when we're aware of it. We've known for decades that advertising is manipulating us, and we still seem to be buying cars, computers and other consumer items we probably don't need.

But still, your best defence is simply to be aware that this is the way your mind works. Knowing this allows you to question whether you really want to pay that much for a new phone. To use [the terminology of Daniel Kahneman](#), you need to be aware of the way your mind works so that your rational side is ready to put the brakes on your quick and simple, rules-based side.

Brendan Markey-Towler does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond their academic appointment.

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