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Under the Surface of Drip Pricing

by Coach Rose D. Gases, RFP®

Drip pricing is a pricing tactic where only the baseline price of the item is advertised in the beginning then disclosing a higher final price towards the point of sale. Drip pricing suppresses the mandatory fees that the hooked customer has to pay. Booking fees, baggage fees, internet access, amenities (whether the customer uses it or not), delivery fees, and taxes are just some of those fees being withheld to make it appear that the cost of goods or services is cheaper.

The word "drip" is used to describe this price manipulation as mandatory fees are revealed one by one to the consumer or "dripped" before they checkout.

This practice is prevalent in the hospitality sector. An old aphorism "many a little makes a mickle" means those accumulated little amounts are a sizable amount of money eventually.

Jeffrey Galak, an associate professor of marketing at Carnegie Mellon University's Tepper School of Business said, "Companies do it for a reason (because) it works."

Marketers are conversant of the different behavioral biases in our decision-making. Price is the top criterion in our buying behavior. The initial rate they display on their website or online booking sites is a type of "anchor" for price comparison which in effect will attract consumers and subsequently drive them into paying.

The Australian Competition and Consumer Commission has mandated companies to disclose all mandatory fees, taxes, and other surcharges at the beginning of the transaction because they find this kind of sales practice unfair, deceptive, and unethical.

Regarding the Consumer Act of the Philippines or RA 7394, there is no provision in the chapter on advertising and sales promotion about the effective oversight of drip pricing strategy that obligates companies to publish the necessary fees and surcharges consumers have to settle upfront in acquiring goods and services.

The most commonly used disclaimer in pricing is *base price, denoting that the selling price is preliminary, comparable to the flag down rates of a taxi. You will only know the price you have to pay once you disembark from the taxi.

The behavioral bias sunk cost fallacy comes into play as well. Consumers may be aware of the advertised cost not yet being final, but they still fall prey to this marketing tactic.

Sunk cost fallacy is a human tendency to pursue decisions once an investment in time, money, and effort has been made. On many occasions, a shopper has already made up his mind to buy anyway because he has developed a psychological attachment to the rate. He has pictured himself going on that trip or concert.

Companies know you hate the hassle of abandoning your search and starting again. For that reason, they are counting on your cognitive biases in making the final decision.

Here are some tips to skirt from drip pricing strategy:

Be familiar with the different surcharges you may encounter when shopping online for services, may it be an airline ticket, hotel or resort accommodation, rental, or even a day spa treatment appointment.

Fix in your mind that you will be shelling out more money than the advertised price. It will be beneficial if you continue to shop around with the help of a friend or family member so you can diminish the effects of the behavioral biases on the time you spend for great deals. From there on, you can compare prices rationally with the additional charges included.

Call the service provider before finalizing your purchase. Confirm if the total cost provided is definite and no additional charges are further hidden in the deal before you pay. And lastly, be prepared to walk away and find deals elsewhere.

Marketers will certainly pressure you to spend by using your own physiological and neural signals. Drip pricing is only one of the hundreds of different marketing tactics they employ. Setting goals, knowing your priorities and being mindful of your spending will help you at least reduce these psychological and neural influences on your consumption patterns.

BEWARE OF Drip Pricing

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A Diamond is Forever

by PFA

Treat your household finances like a business.

To sustain a company's future operations and growth, the company will need to generate net income out of its shareholders' capital or equity. And while this net income may be paid out to shareholders in the form of dividends, much of it will be plowed back into capital as retained earnings. Once inside retained earnings, the net income may be used to pare down debt or buy more earning assets.

In essence, what is important is for the company to raise net income out of equity. In finance this is called return on equity. The same is true for a household.

For a household, like in a company, operating costs need to be brought down to the bare minimum to leave a sizeable net income. In fact, in personal finance, there is such a thing called paying yourself first where savings are targeted first and deducted from gross income. What is left will be what the household can allocate for expenses. This means that the household needs to have the propensity to save. The financial ratio that can measure the propensity to save is net income divided by revenues. For easier recall, let us call this "pala save".

A household, like a company, can increase its earning potential by buying more earning assets. And if the household has reached the limit of what its own capital can afford, it can rely on manageable debt. It is important that this debt is used mainly to buy earning assets that can more than offset the cost of the debt, and not be used for wanton spending. So, a household needs to have the propensity to borrow in the right manner. The financial ratio that can measure the propensity to invest is revenues divided by total assets. For easier recall, let us call this "pala invest".

It is by no coincidence that if you multiply the ratios of "pala save", "pala utang nang tama" and "pala invest" to each other that the end result will be net income divided by equity or our earlier mentioned return on equity. And the higher the individual ratios are, the higher will be the return on equity.

One last thing though; to ensure that indeed the household will continue to flourish even if the breadwinners contract critical illness, become disabled or are taken early from this life, such breadwinners need to protect their downside by getting a stable institution to put up the money that they would have otherwise earned. This is where the breadwinners need to get insurance. For easier recall, let us call this "pala seguro".

And to add an image to our ratios for even better recall, imagine the side view of a diamond that has three pointy ends and one flat top. On the left point will sit "pala save". On the opposite point will sit "pala utang nang tama". On the top flat end will sit "pala invest". Finally, on the bottom point will sit "pala seguro". This is what we call the Personal Finance Advisers (PFA) Diamond Model.

As they say, a diamond is forever.

Stay safe and healthy.

Editor's Note

Efren Ll. Cruz, RFP®
Editor-in-Chief

Modern Portfolio Theory

Modern portfolio theory has this hypothesis that no one can earn consistent above normal profits.

Why?

Information, which is critical to investing is immediately reflected in asset prices. This is particularly true in efficient markets because of technology, regulation or both. This hypothesis is called the efficient market hypothesis or EMH. And it is on EMH that index funds were built.

Supporters of index funds say that if no one can consistently earn above normal profits, then why bother trying to actively trade. It would be best to just invest with an allocation like a benchmark index and be compared to that in terms of performance. In other words, it would be very difficult to outperform the broad market index consistently. And in the US, statistics on the performance of actively managed funds bear this out.

But not all markets around the world are efficient. This is not to say that there is insider trading in such markets. It is just that the big and/or experienced investors who have nothing else to do but manage money outperform their respective broad market indexes.

PFA has outperformed the PSEi and PSEi TRI through its in-house model portfolios. How? Watch this space for the answer.

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