

The Application of the Anchoring Effect in Pricing, Consumer Purchases and Auctions

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Abstract. As an important theory in behavioral economics, the anchoring effect has been widely used in the analysis of economic market behavior in recent years. And scholars' research on this effect also involves all aspects of the economic field, which shows how anchoring has a significant impact. It greatly influences how people behave and has repercussions for all types of decision-making processes. Using the method of case study, this paper discusses and analyzes the definition, types, mechanisms, importance and especially the applications of anchoring. It initially reviews previous anchoring applications in pricing, consumer purchases and auctions. Based on the former research, more modified applications are introduced. First of all, when sellers are pricing, their subtle utilization of stereotypes, namely, reference pricing, is demonstrated. It is a stable and adaptable strategy that would be effective in helping firms earn more profits. Then, based on an experiment focusing on consumer purchases and decision-making bias, potential factors leading to and influencing anchoring are discussed, which may enable consumers to be clearly aware of current conditions and therefore come up with methods protecting themselves from being affected. Lastly, the anchoring effect can also explain the major mechanisms of auctions in today's world. Based on that, the reason why classic auctions often begin with unimpressive initial reference prices but end with higher prices when deals are made is figured out. The conclusions drawn from this analysis can help consumers and investors avoid being affected by invalid information and behave more efficiently when they are making decisions.

Keywords: The Anchoring Effect, Consumer Purchases, Pricing, Auctions.

1. Introduction

When individuals are making decisions, anchoring operates unintentionally and unconsciously to make people affected by the initial value. And this power is unimaginably great. On account of this, plenty of researchers appear to be enthusiastic about exploring the practical applications of the anchoring effect to make a contribution to various fields in the society as well as helping address social and economic issues.

This study is written out of a motive of alleviating the real problem of today's world. It is extensively acknowledged that a period of economic unrest has followed the pandemic of COVID-19. In particular, severe lockdown has taken place in China, which is accompanied by recession in business sales, consumer purchases and individual incomes. On the whole, businesses all over the world were negatively affected with worldwide supply chains impeded. The unemployment rate has been increasing in recent years. Furthermore, concerning news is reported each day regarding more corporations closing down operations or declaring job cuts. The consumption patterns of consumers have also been altered within this period, culminating in scarce market supplies along with declines of earnings across the globe (Fernandes, 2020) [1].

In such a context, the anchoring effect can change people's mind and behavior by osmosis. If it is properly and effectively applied to the current society, the problems would be alleviated with every camp's willingness, hence little conflict. In an effort to make sure that anchoring works well in the multiple contexts of recession, it is worthwhile to deeply explore the mechanisms and the applications of anchoring in real economic activities. And to this extent, this paper is of practical importance. On top of that, this essay is also of theoretical significance for it has fully discussed the mechanisms and further applications of the anchoring effect on a solid basis of previous research. Thus, it would make great contributions to the current academic world. Based on detailed analysis and discussion in this

paper, the author draws a conclusion in the end that anchoring effect swarm's people's everyday lives and has an enormous influence on how people behave and make decisions.

The rest of this paper is divided into four parts. The following section reviews some former literature about the anchoring effect and articulates the principles of anchoring behind that research. Then, the third part of the essay defines anchoring and discusses its types, mechanisms and importance. Based on the previous research reviewed, more modified applications respectively in pricing, consumer purchases and auction occasions are displayed in the fourth section. The fifth part concludes the former research and proposed applications of the essay.

2. Literature Review

2.1. The Anchoring Effect in Pricing

Researchers from multiple fields have confirmed the effectiveness of anchoring in decision-making. First of all, the anchoring effect can be applied to pricing effectively. Chang and Ren (2013) stated that the price of the first-issued share undoubtedly acts as a reference for pricing subsequent issues of shares for a company cross-listed in diverse marketplaces [2]. They contended that this reference role has an informational as well as an anchoring component. They investigated a group of Chinese firms that had initially issued foreign stocks and then domestic A-shares, based on the research hypothesis. Aside from its informational role in this sample, the foreign stock value was postulated to anchor down the A-share offer price, implying that the difference in capital costs between two markets contributed to the under-pricing of A-shares. The empirical findings backed up this dual-role hypothesis. These researchers focus on the specific example of share under-pricing. In this paper, a more general application of anchoring in terms of pricing is introduced and the concept of reference pricing is involved.

2.2. The Anchoring Effect in Consumer Purchases

Meanwhile, the anchoring effect can be applied in consumer judgement and purchases. According to Wolk and Spann's (2008) study of prevalent purchasing behavior among modern consumers, the huge influences reference selling prices have on consumers' bid values and purchase willingness ought to be reckoned with [3]. As a result, additional research is required to further explore the factors that could help lower the susceptibility to original values. In this way, decision makers will be more likely to be protected from the pervasive psychological gimmick utilized in decision-making in the light of the fact that they are more familiar with the mechanisms behind the anchoring effect (Furnham and Boo, 2011) [4]. Based on an experimental study conducted by Zong and Guo, potential factors leading to anchoring and some methods to mitigate its impact will be illustrated in this work (2022) [5].

2.3. The Anchoring Effect in Auctions

Moreover, numerous researchers have examined the adoption of anchoring in auctions. For instance, Wolk and Spann (2008) have pointed out in their research that auction results may also be affected by reference selling prices to a large extent [3]. By way of illustration, in online auctions, the final prices of the products when deals are made actually have their anchoring points, which are the prices for instant purchases. This paper will go over the mechanisms behind this in greater detail.

2.4. Limits of the Anchoring Effect

Although anchoring is useful and widely applied, it is not effective at all times. As a matter of fact, the ideal effect of the anchoring effect occurs only on the occasion when people make their judgment based on preference exactly with the anchoring point is proposed in advance. In addition, the judgement and the anchor ought to be consistent. There is no anchoring bias when anchors and response modes are incompatible (Chapman and Johnson, 1994) [6].

Therefore, in practical terms, the compatibility of anchoring points should be tested or assumed to make the anchoring effect operate effectively and properly. In this essay, the author will propose more modified applications of the anchoring effect showing how the anchor and the preference judgment can be exactly expressed on the same scale when they are properly tested in advance.

3. The Anchoring Effect

While Slovic (1967) was investigating descriptions of preference reversals, the concept of the anchoring effect in decision-making was initially mentioned by him [7]. Nonetheless, this notion is not the same as the primary anchoring effect discussed in the current studies. In fact, the latter one is linked to what Tversky and Kahneman (1974) have proposed in their research regarding human judgment in the multiple environments of uncertainty, the heuristics of anchoring-and-adjustment [8]. The heuristic contends that it is inadequate adjustment that causes anchoring bias since final decisions are considered when determining a judge's starting point for discussions. In the daily life, decision makers are often swayed by spontaneous or uninformative numbers or particular reference points, and at those times, the anchoring-and-adjustment heuristics is unconsciously adopted. These phenomena are so prevalent that they make the heuristics of anchoring a ubiquitous cognitive bias (Chapman and Johnson, 1994) [6]. Also, obviously, both numeric and non-numeric ineffective information is subtly and skillfully used as anchors in the anchoring-and-adjustment heuristics.

Out of the limit of word count, the numeric anchoring is mainly discussed in this essay. In this type of anchoring, once the anchor's value has been determined, there is a huge difference between a person's further arguments, estimates, or other statements and those they would have otherwise made without the anchor. For instance, if a more expensive model which acts as an anchoring point is displayed next to an automobile, consumers will be much more encouraged to buy the automobile. Even when the prices mentioned during negotiations are lower than the anchor, the buyers could still believe that the prices are reasonable or even feel like they are taking the advantage. However, as a matter of fact, these prices are substantially above the car's fair market value.

In order to interpret how anchoring operates in people's brains, scholars these days usually resort to two kinds of mechanisms, which are specifically two disparate thinking patterns. In the first pattern, the human thinking processes are impacted by the affiliations the anchoring point has elicited. This pattern is adopted when individuals think instantly and instinctively, putting people under the illusion that the anchoring point is the final and real value. This pattern is used in an interesting way in the following example: If people are asked whether the last figure of their ID card number (N) is greater or smaller than 4 and then they are asked to write a number in addition to N, they are more likely to write figures larger than 4 if N is larger than 4. Similarly, numbers that are smaller than 4 would be the majority of options from participants whose values of N are smaller than 4.

Apart from that, the second sort of pattern can be seen when people adopt the intentional mode of thinking. With the influence of this pattern, masses tend to make unidirectional adjustment based on the anchoring value they are initially exposed to. They normally start this off by giving instant predictions and then gradually make slight changes. As a matter of fact, their confidence interval is virtually at its upper limit at this time. There is a corresponding illustration that can be provided: It is widely known the atmospheric pressure when the altitude is 0 meter is 1013.25hpa, but people also understand that Mt. Qomolangma is plainly not at an elevation of 0 meter. Therefore, if inquired about the atmospheric pressure at the peak of the mount, they would attempt to make decreasing modifications to predict the result taking 1013.25 hPa as an anchoring point. However, the second pattern is not functioning properly when individuals are lacking in and even running out of mental resources. This is due to the fact that they can merely make insufficient adjustment based on the anchor by this time.

There are two major reasons why anchoring is of great significance, value and practical utility. To start with, in an abundance of contexts, the anchoring effect can be applied, including areas displayed in this essay: pricing, consumer purchases and auction occasions. Under substantial circumstances,

policymakers, sellers and individuals can resort to the anchoring effect for help. A further benefit of anchoring is that it is straightforward and quick to be implemented. In most cases, other than establishing anchoring points and ensuring that the opposing camps will make insufficient modifications, there are frequently no complicated procedures along the lines of other kinds of heuristics.

4. Modified Applications of Anchoring

4.1. The Anchoring Effect in Pricing

Pricing plays a key role in shaping consumers' perceived value of a product or service in general. And since marketers knowing quite well about the anchoring effect always provide reference prices, it is peculiarly prone to a greater effect on consumer perception. Furnham and Boo (2011) have claimed that merchants have widely utilized a type of price policy, or more precisely reference pricing, as a marketing tactic to influence consumers' purchasing decisions utilizing the mechanism of anchoring [4]. Here, the anchors used by customers when they are evaluating the offers are what the reference prices refer to.

There are multiple methods for marketers to adopt in which they can utilize reference prices to gain positive perceived values on their promoted products. For instance, sellers can enhance the perception of a product through effective promotional communication for it to be compared to more expensive products. That way, they can sell it at a higher price since its reference point is similarly expensive. Another common strategy that influences reference prices is suggesting other potential reference points. An example of this would be stating a higher previous charge by the manufacturers. The order in which consumers view different prices also affects the formation of their reference points in pricing. More specifically, buyers tend to pay more attention to the prices come to their sight first.

A powerful and well-known example of reference pricing is the Apple company's experience of selling the iPad. Steve Jobs used a reference price of 999 dollars at the product launch conference but finally announced that the price of each iPad is 499 dollars. Here, the reference price served as an anchor. And due to the fact that there was no time for people to make sufficient adjustment based on the initial anchoring value, Apple successfully put people under the illusion that the product was twice as cheap and made them gain the feeling of taking the advantage. In consequence, the company made a striking profit.

As the illustration above shows, reference pricing based on anchoring is an effective strategy widely utilized to enhance sales. After all, no one who has not ever experienced the real sales process can imagine such disruptive prices. The pricing strategy provides sellers with the opportunity to adopting anchoring in pricing to earn more profits.

4.2. The Anchoring Effect in Consumer Purchases

Besides pricing, correspondingly, the anchoring effect can also largely affect consumers' behavior when they are purchasing goods. This represents consumers' typical trait of easily being affected by random and unrelated information. According to Zong and Guo (2022), out of all kinds of potential inducements in the experience process and real-life occasions, consumers tend to have cognitive biases in decision-making [5].

There are plenty of potential factors leading to and influencing anchoring. For instance, gender is one of them. According to Zou et al. (2007), females are usually oriented by society, which makes them frequently impacted by emotional and facial expressions in contrast to task-oriented men [9]. As a result, when evaluating a product's pricing, they are more likely to be influenced by subjective emotional elements, and their subsequent opinion of the experience has an impact on their assessment of the product's cost-effectiveness. Besides, expert knowledge and skills also matter. Consumers make their assessments of product prices according to the what they have learned and accumulated before. While consumers with background knowledge are more likely to produce more sensible price estimates when making purchase decisions, those without contextual information are more inclined

to be swayed by information such as prices, neurocognitive levels and sentiments (Epley and Gilovich, 2006; Reitsma-van Rooijen and Daamen, 2006) [10, 11]. Moreover, the various amounts of time pressure that customers experience also have an impact on their sensitivity to anchors. Mussweiler and Englich (2005) have found that an anchoring value will be considered and discerned more carefully if the relevant decision maker is not under time restrictions. However, an individual restricted by time tends to adopt a heuristic approach [12].

When an anchoring value is formed in consumers' minds, the factors mentioned above along with others collectively cause consumers' insufficient adjustment, hence the occurrence of all types of anchoring. Therefore, to mitigate the negative effect of anchoring from the perspective of buyers, it is of great use to remember when bargaining happens in the market, consumers and companies are in opposing camps. Additionally, when they are in negotiation and companies are the first to price the products, they should focus on their own desires and goals or the bottom-lines of the companies to avoid unnecessary temptations.

4.3. The Anchoring Effect in Auctions

The anchoring effect is adaptable in auctions and this is mainly because in real auction occasions, reference pricing can be extensively seen as well. This time, these reference points are ingeniously used to increase bid values and that drawing in more bidders may not always be in the auctioneers' best interests; rather, it may be more important to set the best, lower reference prices. Lowering the minimum bid provides a fixed, minimal reference price. According to Kristensen and Garling (1997), this opening in a negotiating process acts as a value signal, impacting successive offers and counteroffers [13]. The bid at its minimal limit would be gradually surpassed by the bid price when an auction is on-going. Besides, a much lower reference price allows in multiple results and there is a larger possibility of higher prices in the end.

It is worth discussing more particularly how and why in the current social environment, auctions normally begin with lower initial reference prices but end with higher prices when bargains are ultimately made. This effect is the result of three processes. First, reduced entry costs remove obstacles to start bidding, which boosts attempts and results in higher ultimate costs. What's more, bidders would put forth more effort and time (generating sunk costs) when they are opposed to lower prices at the very beginning. And this leads to increased commitments. Lastly, the increased traffic brought about by lower beginning costs may cause bidders to assume that the item is valuable, which would explain earlier observations that increased traffic leads to more remarkably increased traffic (Ku and Murnighan, 2006) [14].

As described above, the current study shows a methodical inversion of the classic anchor integration effect, demonstrating that low starting prices serving as anchoring points reduce hurdles for bidding. In fact, this in reverse enhances bidding attempts and early participants are offered more sunk costs with insufficient adjustment. That is exactly how the ending prices are increased. A variety of auctions taking place every day have benefited from the ramifications the above-mentioned findings have (Ku and Murnighan, 2006) [14].

5. Conclusion

This paper reviews previous relevant literature and proposes more modified and meaningful applications through case study. As a result, a conclusion is drawn that the anchoring effect directly influences people's behaviour and decision-making processes. More precisely, anchoring skillfully utilizes the stereotype of initial values, leading people to make insufficient adjustment. It can be applied in multiple fields.

In this paper, the author firstly mentions that anchoring works well in pricing and is often used by firms to earn a larger profit when they are making marketing strategies. From this application, the readers are well informed of the power of reference pricing. Moreover, anchoring has its application in consumer purchases. Consumers would be better protected from the abuse of the prevalent

psychological ploy in decision-making, known as anchoring, by researching elements that can lower the receptivity towards initial values. Last but not least, in auction occasions, it is a common situation where the lower prices when people start bidding are frequently substituted with much higher ones in the end. This not only provides a way for auctioneers to sell their products, but it also helps consumers be alert to the auction strategies. Overall, all these applications prove to be a boon to investigating more about human's decision-making processes, thereby having positive implications for economy and society.

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