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What goes into a retailer's decision to lower prices?

December 16 2022

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Holiday shoppers are finding that discounts among some of the items on their shopping lists are a little easier to find this year due to higher inventories at retailers and a slowing demand due to inflation and certain recessionary economic conditions. At the same time, consumers may notice that some retailers are slower to reduce prices to generate sales.

This is a result of "price frictions," which make it more difficult and sometimes less cost-effective to lower prices. Price frictions are the focus of a new study that identifies three reasons retailers are reluctant to adjust new product prices.

The study, published in the current issue of *Marketing Science,* is titled "Price Frictions and the Success of New Products" and is authored by Diego Aparicio of IESE Business School in Barcelona, Spain, and Duncan Simester of the Massachusetts Institute of Technology.

"Price frictions are simple obstacles that make it more complicated for retailers to adjust prices. We found that retailers may be reluctant to adjust prices on a new product because there may be no price changes on related products, or state-level pricing laws require price stickers on each package, or the initial prices end in 99 cents. Our research has found that larger price frictions often lead a retailer to discontinue a poor-performing item before changing its price," says Aparicio.

"A popular pricing tactic is 99-cent endings: $2.99, $9.99, etc. We see this everywhere! Surprisingly, 99-cent endings are a price friction that make it harder for new products to succeed. Intuitively, retailers like to retain 99-cent price endings. And if a new product has low initial sales, retailers prefer not to touch a 99-cent price instead of triggering a promotion, and as a result, the product is more likely to be discontinued in the short-term. This is a novel side effect of price endings that managers and scholars might want to input in their models," adds Aparicio.

The researchers focused on two events in which retailers face initial demand uncertainty: new stores and new products. The researchers chose these events on the assumption that uncertainty increases the likelihood that retailers will make price adjustments after observing initial sales. This enabled the researchers to determine when and how retailers decided whether to lower prices or discontinue their sales of underperforming new products altogether.

More information: Diego Aparicio et al, Price Frictions and the Success of New Products, *Marketing Science* (2022). DOI: 10.1287/mksc.2022.1367

Provided by Institute for Operations Research and the Management Sciences