Why Businesses Should Negotiate Prices With Customers

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In most scenarios, B2C companies have more to gain by bargaining than not.

In the world of retail, there is a compelling argument for both businesses and consumers to shun **negotiations** for high-priced items: Transactions based on a fixed price are simply faster and easier. For many customers, not only is researching and negotiating prices a waste of time, they could also fall prey to win-lose tactics such as the **bait and switch**. But new research shows that, under the right conditions, sellers have much more to gain by incorporating negotiation into their pricing strategy than sticking to a fixed price. Customers should also learn when to engage in price negotiation to avoid potential traps.

Sellers open to price negotiation – from car dealers, real estate agents to **leather coat vendors** – already know that negotiating gives them a chance to learn the customer's interests and willingness to pay (WTP), and customise prices and offerings that ultimately increase sales and profits. By how much exactly? A new **study** by Preyas Desai and Pranav Jindal involving

98 million eBay listings shows that, on average, negotiation increases purchase likelihood by 8.5 percentage points relative to fixed pricing. Further, between 21 percent and 39 percent of increased profit gained through negotiation can be attributed to an increase in customers' WTP.

To make customers happy while boosting sales, sellers can negotiate to learn a customer's interests and attempt to add value to increase the customer's willingness to pay by offering customisation, additional products or services, repeat-purchase discounts, loyalty points, and so on.

Another potential negotiation benefit is an improved relationship-building ability that could turn a one-off customer into a loyal long-term one. The improved relationship is not a result of added value or benefits extended, but emerges as customers learn to trust a company whose salesperson negotiates by listening first and understanding what value means to them, attempts to build offerings that are indeed value creating, and tries to help them get the best or fairest deal possible. In sum, negotiating prices with a prospective customer can create value and profitability beyond fixed-price transactions.

Price high, but give a discount

Some research findings that show how sellers can benefit more than buyers from negotiations risk being used in unethical ways. Another **paper** by Jindal shows that sellers profit from win-lose tactics against customers, such as anchoring on a high price plus proactively offering a discount, called an initial perceived discount (IPD). The combination of a high anchor and an IPD influences the buyer to either not negotiate at all or to do so less aggressively than if presented with a fixed price and no IPD. Specifically, researchers found that a $1 increase in IPD lowered the negotiated discount by 5.7 cents.

A practical application of this hybrid strategy is for the seller to list a high yet negotiable price with a proactive yet temporary discount. This combination attracts high-negotiation-cost buyers (e.g. no patience/time, fearful or a dislike of negotiations) to buy at the discounted price and later, after the discount expiration, at the high original price. It also captures low-negotiation-cost buyers hungry for a bargain.

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As is often the case in retail, it can be applied selectively to different product ranges. On the other side, buyers need to insist on negotiating such hybrid prices after research or ignore the original discount to avoid being blindsided by the pricing strategy. Buyers could introduce other value levers (e.g. bundles, add-ons, etc) to turn the potentially manipulative pricing strategy into a true win-win negotiation.

Invite-and-drag may not benefit anyone

There is another win-lose tactic sellers often use: the invite-and-drag. Desai and Jindal found that customers were more willing to buy from sellers who dragged their feet *after* a negotiation started under the hybrid pricing strategy, compared to a fixed-price one. Dragging increases the buyer's bargaining costs and their sunk cost bias, thus making them more inclined to close the deal. This gambit will backfire, however, if applied *before* the negotiation starts, as customers anticipate higher negotiation costs and choose to walk away before getting hooked.

But even if the invite-and-drag seller lands a sale, the customer is likely to suffer buyer's remorse, resent the tactic and avoid the seller in the future. Moreover, sellers’ negotiation costs could become prohibitive if, for example, they need to hire and train extra staff, or come under pricing pressure from competitors.

When not to negotiate

A seller with healthy margins and low negotiation costs should seek to lower buyers' negotiation costs by **proactively offering as much information** as possible on prices, how long they are valid for, whether or not they are negotiable, what products are within a certain price range, which sizes are still available and so on. The price does not need to be fixed, as the seller can continue to negotiate and customise the offering until the customer feels safer with the seller’s transparency and is ready to buy.

Sellers in an intensely competitive market where margins are low should not engage in price negotiations at all since their **negotiation power is low**. In other words, the customer can easily walk away. In the extreme case of a zero-profit margin, such as when the merchant wants to dispose of inventory, the best strategy may be to set the price at cost and keep it there. However, in many other cases, being open to negotiate, especially if win-win, can benefit both sellers and buyers.

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