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When price precision pays in negotiations

Michael SCHAERER

Singapore Management University, schaerer@smu.edu.sg

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When Price Precision Pays in Negotiations

Michael Schaerer, INSEAD PhD Candidate in Organisational Behaviour | January 13, 2017

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Depending on who you are negotiating with, your offers should be more or less precise.

When negotiating, is an offer of 99.95 euros better than 100 euros? Our recent study shows that there is no universally true answer to the question of price precision and that the right strategy depends on with whom you are negotiating.

The current convention is that the more precise your offer, the better your negotiation outcome will be. This strategy is based on the idea that more precise offers (e.g., 98.75 euros) tend to anchor offer recipients more strongly than “vague” offers (e.g., 100 euros). For example, offering a price of 98.75 euros for a coffee machine will likely lead to a better deal than 100 euros because more precise numbers make it more difficult for people on the opposite side of the offer to adjust away from that number.

Existing research has offered two different explanations for why more precise numbers tend to anchor people more strongly. The first explanation suggests that people mentally operate (and negotiate) on a more fine-grained scale when they are first exposed to a more precise value. A number of 98.75 euros, for example, may encourage people to think in increments of 25 cents, leading to a counteroffer such as 102.50 euros. In contrast, a round number like 100 euros causes people to operate on a coarser scale with bigger increments, subsequently leading to much more aggressive counteroffers such as 110 euros or 130 euros. And the more aggressive the counteroffer from the opponent, the less value the first mover in a negotiation is able to claim.

The second explanation for why more precise offers have a stronger anchoring potency is related to attributions of competence. When someone makes a precise offer, the recipient of the offer assumes that the other person is an expert, or just knows more about the subject, and is thus able to come up with a more detailed and precise number. As a consequence of such competence attributions, an offer recipient is more likely to go along with a precise offer and make a counteroffer that is close to the precise first offer.

What struck us is that these two explanations offer seemingly different advice for negotiating with a novice versus an expert opponent. If more precise numbers indeed cause people to operate on a more fine-grained mental scale, then both novices and experts are likely to be affected in the same way. However, if precise offers signal competence, then such a strategy may not work when one

faces an expert negotiator. After all, negotiation experts are likely familiar with the types of offers that are usually made in a given market and not easily derailed by very precise offers. As a consequence, experts may discount offers that are too precise.

Thus, if the mental-scale explanation is true, then more precise offers should always lead to better outcomes – irrespective of how experienced one’s negotiation counterpart is. But if the attribution of competence explanation holds, making offers that are too precise may backfire when one is facing an expert opponent. To find out, we put these two explanations to the test.

Different reactions to precise offers

In our recent paper, [**The Too-Much-Precision Effect: When and Why Precise Anchors Backfire With Experts**](#), published in *Psychological Science*, David Loschelder, Malte Frieze, Adam Galinsky and I asked both novices and experts in different fields – such as real estate agents, jewellers, car dealers– to respond to varying levels of price precision.

In one experiment with participants from the real estate industry, we asked individuals who had professional negotiation experience (experts) and those without (novices) to make counteroffers for a real estate offering after having been randomly exposed to an initial offer of varying precision. These initial offers ranged from €980,000 (low precision), to €981,200 (moderate precision), and finally to €981,218.37 (high precision). For amateurs, we found a linear effect; the more precise an offer, the more amateurs were willing to pay (see left figure below). For experts, however, we found a curvilinear effect. Experts’ willingness-to-pay (WTP) increased with precision but only up to a point. When offers were too precise, experts strongly discounted the initial offer and the anchoring benefit was lost (see right figure below).

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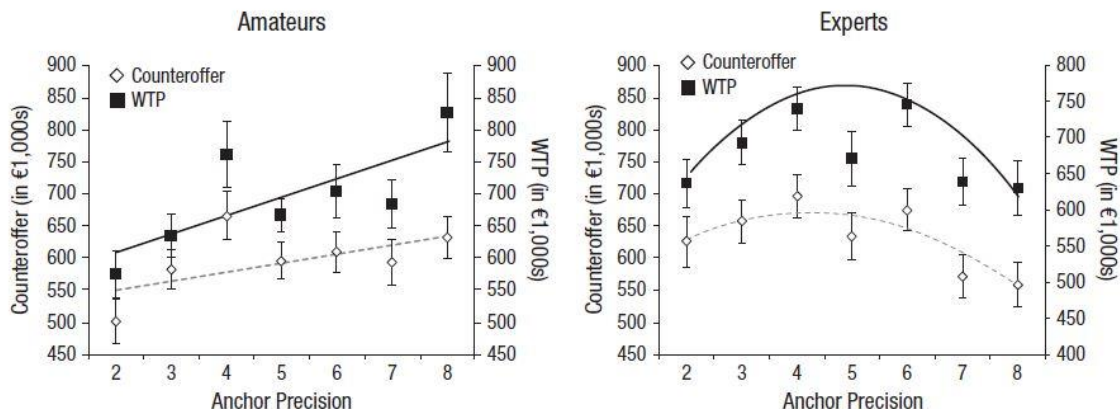


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These results suggest that it pays to put yourself in the shoes of your opponent and to carefully determine offer precision based on the assumed level expertise of the opponent. If the opponent is relatively inexperienced, then it makes sense to make a highly precise offer. But if the opponent is an expert and has deep knowledge of the negotiation domain, there’s a “sweet spot” in how precise an offer should be.

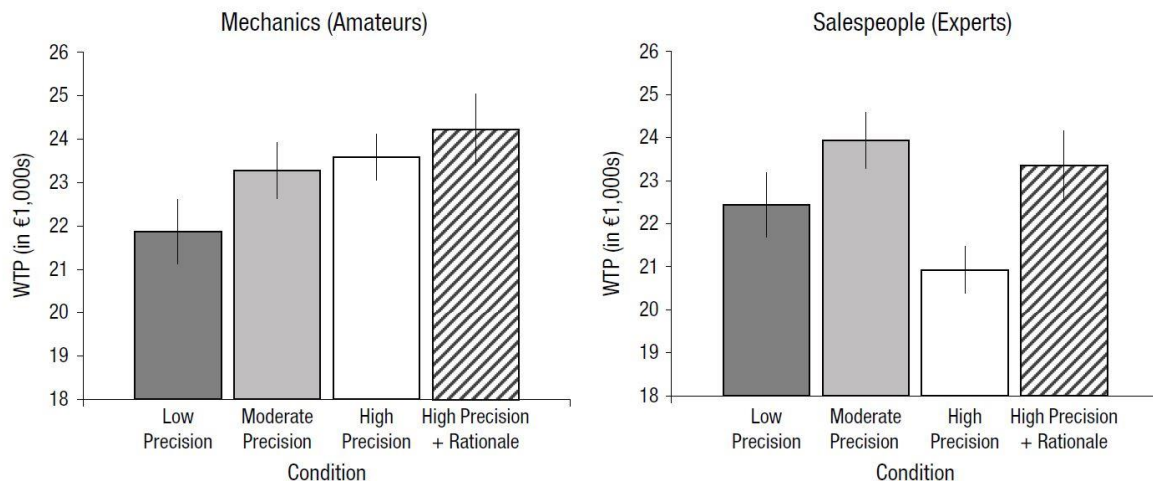
Create a story for the precise price

In reality, however, it is often difficult to obtain reliable information about the counterpart’s level of expertise; for example, when one is negotiating with an interested party for the very first time. Thus, we also looked at ways in which very precise offers can be convincing to both amateurs *and* experts. The studies described in our paper suggest that the reason experts find very precise offers hard to accept is that, to them, an offer that is too precise feels “odd” and implies that the first-mover is lacking competence. But if the offer maker were to explain to the expert that there are plausible reasons for why an offer is so precise, the expert should be more likely to go along with the initial offer and negotiate less aggressively as a result.

In an additional study involving a car price negotiation, the first-moving sellers not only made a numeric offer to the other party (as in the studies described above), but also provided a plausible rationale for why the offer was so precise. Offering a story for the price precision indicated to recipients that the offer maker had arrived at this precise offer not due to inexperience but based on carefully collected information such as an expert's appraisal of the car value, an expert's inspection, and the consideration of minor defects. Doing so allowed first-movers to signal expertise in the negotiation domain and that there were plausible reasons for their highly precise offer. Providing a plausible rationale for a highly precise offer was sufficient to convince experts of the first-mover's expertise and cause them to be anchored in a similar way as amateurs.

The figures below show the effect of offer precision on amateurs' and experts' WTP. For amateurs (see left panel), the more precise the offer became (from low to moderate to high precision), the more amateurs were anchored by that offer. For experts, however, there was an increase only from low to moderate precision, but for high precision the WTP dropped markedly. Importantly, when experts also received a rationale for the highly precise offer, their WTP was again comparable to that of amateurs (see the stripe-patterned bar on the right).

image: <http://knowledge.insead.edu/sites/www.insead.edu/files/images/2017/01/chart.jpg>



Precision is not universal

Although we know a lot about the effects of anchoring in negotiations and other domains, our research shows that anchoring effects do not universally apply to all people in the same way. [People respond differently depending on their level of expertise](#). While making precise offers is generally a good idea, negotiators should be aware of their counterpart's experience and level of expertise and determine their offer accordingly.

Michael Schaerer is a Doctoral Candidate in Organisational Behaviour at INSEAD. You can find him on Twitter [@michaelschaerer](#).

Read more at <https://knowledge.insead.edu/leadership-organisations/when-price-precision-pays-in-negotiations-5143#7ZkQqi2HeV22spJZ.99>