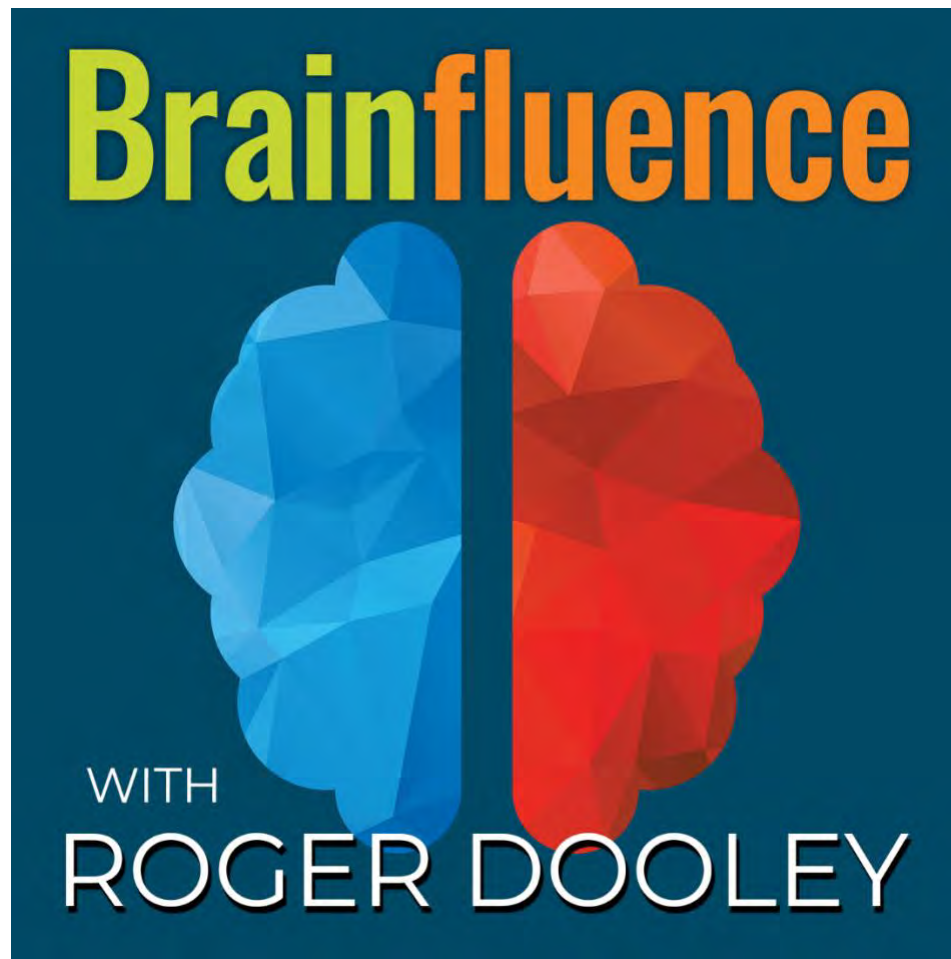


The Psychology of Price with Leigh Caldwell
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Roger Dooley [00:00:06]:

Welcome to Brainfluence. I'm Roger Dooley. Today's guest is Leigh Caldwell. I should add that if you're going to google him, Leigh's first name is spelled L-E-I-G-H. I met Leigh ten years ago when we were both speaking at a conference in Frankfurt focused on conversion. We had a lot in common. Along with several other speakers, we offered ways to increase sales and profits by using behavioral science. What impressed me was Leigh's focus. I had included a short chapter on pricing in Brainfluence,

Roger Dooley [00:00:32]:

But Leigh wrote an impressive book, the Psychology of Price, that is entirely about pricing. Leigh is a behavioral economist and pricing expert with over ten years of experience in applying behavioral science commercially. He's the creator of the system three approach, a topic we'll ask him about. Welcome to the show, Leigh.

Leigh Caldwell [00:00:48]:

Thanks, Roger. Great to meet you.

Roger Dooley [00:00:50]:

So, Leigh, I think that between the two of us and probably many of our audience members, it's an obvious question why people should think about

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the psychology of pricing and sort of non conscious effects on pricing. But I guess as somebody who's been working in this field for years, you probably get some pushback, like saying, well, we don't even control our prices. The market sets our price, or this competitor x sets our price, and so on and so on. What are some of the objections you hear? And how would you answer those?

Leigh Caldwell [00:01:20]:

Yeah, well, those are certainly two of them. And another one that people, maybe surprisingly, sometimes raise is, oh, I don't want to manipulate my customers. I don't want to play any psychological tricks. I just want to be honest and straightforward and just to give them a good deal. And I don't want anyone to think that I'm trying to pull the wool or manipulate them. And I think the answer to that is, absolutely, you don't want to be doing anything underhand, anything that is against your customers interest. But that doesn't mean that you shouldn't use psychology. So, psychology, when it's about shaping the experience to go with the grain of the customer's decision making, when it's about setting prices that show your customers where the value is in your products, that guide customers to make the right decision for them, pricing can be a really good tool for that.

Leigh Caldwell [00:02:25]:

And it's not about trying to do anything illicit or anything that is detrimental to your customers. It's about just understanding that people make decisions in a complicated way. They're not always logical. They're not always what

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classical economists would call rational. And you should set both your pricing, but also your marketing strategy more widely. To understand that and take that into account.

Roger Dooley [00:02:53]:

I'm a fan of the TV show Shark Tank and I understand there's a UK version of that as well. And one of the questions that comes out in just about every session when the sharks are interviewing an entrepreneur looking for funding, is, well, okay, what's your cost and how much do you sell it for? Cost seems to be an integral part of pricing and of course, the success of the company. How do you take cost into account when you're thinking about pricing strategies?

Leigh Caldwell [00:03:19]:

So cost is important. Of course, cost is often one of the first things that you talk about. And in my book, I actually tackle this in the first couple of chapters. Cost is really your baseline, is your minimum, because cost tells you if you go below this pricing level, then you can't make money. So it gives you one boundary to start with. But what cost doesn't tell you is how much is this product worth to the customer and how much would they pay? And very often I see this, particularly in new businesses. It's very common with, for example, people who are going freelance, maybe selling their services as a consultant, or people who are just buying and reselling something, a product that someone else makes. They set the cost that they think is the

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minimum that they need to make to live on, but usually they could be making a lot more.

Leigh Caldwell [00:04:13]:

They're probably almost by definition, if you have one group of customers who is willing to pay, let's say, \$12 for your product, or who's willing to pay \$100 an hour for your time, if that's your base customers, there's almost certainly a group who will pay double or triple that. And you have to make two choices. Well, the first choice is which group of customers am I going to aim for? Do I want to aim for the \$100 an hour customers or the \$300 an hour customers? And that can feed into your brand positioning where you see yourself. Do you see yourself as a high end exclusive provider or a more everyday kind of provider for everyone? But the second choice you have to make is actually, well, maybe I don't need to make that first choice at all. Maybe I can serve both groups of customers. And this is where you can use techniques like price differentiation so that the customers who are willing to pay you \$100 an hour, you capture those by selling them \$100 an hour product. The customers who are willing to pay more, you give them a better product that you charge 300 an hour. And that same thing applies whether if you're selling a widget for \$12, then make sure you have a 49 95 version alongside it.

Leigh Caldwell [00:05:32]:

If you're selling services, then have multiple tiers. The classic gold silver bronze approach is a great example of this. And you'll see it in every

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industry, from airline tickets, where you have first class and coach tickets, to technology, where you'll have a \$1,500 version of your phone, and a \$700 version. And there's something for everyone. The successful companies are setting multiple price levels to hit different segments of their market.

Roger Dooley [00:06:03]:

I used to be in the it outsourcing business many years ago, and we always had pushback in our pricing. We'd say, okay, we can have somebody work on this for you. It's a \$50 an hour person, and you'd get immediately the it manager, whoever he was on the other, and say, no, we can't do that. These were reasonable prices in those days. We can only do \$30. And I found that one very effective counter to that that almost always worked, was basically saying, oh, you want our \$30 an hour person? We can do that. And immediately, because they were approaching us, because they knew that we had the skilled people to do it, that almost always calls them the back out. No, we understand we want the real \$50 person, and that's not going to work in every situation.

Roger Dooley [00:06:51]:

But by characterizing it as, yes, there is a cheaper price, but it's not the same product that you'll be getting. That can be sometimes at least kind of effective.

Leigh Caldwell [00:07:04]:

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Yeah, very much. This is part of that psychology of negotiation, is make sure that if somebody gets a discount from you, that they're giving something up in return so that there's a little bit of pain for them, and that will let you test really how far they're willing to go. Do they have to reduce the price? Do they really have only the budget that they say they have? Or are they just trying to squeeze you and get a little back? And if you make sure that they have to give something up for every discount, then soon enough you'll find where they're willing to stop.

Roger Dooley [00:07:38]:

Another interesting strategy I recall from many years ago, I worked for a large corporation, and one of our sister divisions made abrasives, equipment for cleaning auto parts and such, using abrasive materials. And then this is a great business to be in, because inherently the products wear out, because you're shooting high speed abrasives through the machinery, through pipes and everything else. So you're guaranteed that you're not going to have stuff that lasts for an extended period of time in the customer's facility, but they were always looking for ways like better materials that would extend the life of the products, because obviously it was expensive to take a machine down and change out its parts or some of the parts. And they had a brilliant pricing strategy. This was long before behavioral economics, but if they found a solution that would make a part last twice as long, they charged twice as much. They have the data to show that would last twice as long. And they simply pointed out, but think of what you're going to save on downtime and labor. And it was brilliant, and it allowed them to really maximize profit.

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Roger Dooley [00:08:41]:

And the whole cost thing never really came into it. We're going to let you double the time between changing it out.

Leigh Caldwell [00:08:47]:

Yeah. I mean, in some ways, that's a no brainer for the customer, because they're getting twice life in their abrasive or their oil. They are paying twice as much. But per day or per year, presumably it's going to be the same amount.

Roger Dooley [00:09:04]:

You use the example of chocolate teapots in your book, which as a person in the States, I didn't immediately sort of get the analogy, but in the UK, that has a sort of special meaning. Right, the chocolate teapot concept.

Leigh Caldwell [00:09:19]:

So this is a kind of phrase and idiom that we have that we say something is about as useful as a chocolate teapot. And it means, obviously a teapot, if it was made of chocolate, would melt pretty quickly when you put hot water into it. I guess we have hot tea here. I know you sometimes have iced tea over there. Maybe I should have thought of a different metaphor, but you probably have your own version. You have people saying, as useful as an

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ashtray on a motorbike and this kind of thing. I just wanted something that I knew wouldn't be a real product to use as my example in the book, so that everybody could kind of project and see their own product in it without being too hung up on, oh, but if you're selling cereal and I sell it services, that's really a different thing. So I couldn't possibly learn anything.

Leigh Caldwell [00:10:14]:

I just wanted something that was abstract enough that anybody could relate to it.

Roger Dooley [00:10:18]:

Well, I love that. For me, that was a big takeaway, Leigh, because despite the massive numbers of books by english writers that I've read and tv shows and movies and so on that I've watched, that was the first time I'd heard that expression. And there is an american equivalent, but it involves a bull, and we won't actually repeat it here at this time, but probably many of our listeners and watchers will know what that is.

Leigh Caldwell [00:10:41]:

Okay, I have an idea, I might look that up afterwards.

Roger Dooley [00:10:47]:

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Leigh, are there some pricing strategies you see that businesses employ that commonly backfire on them?

Leigh Caldwell [00:10:53]:

Interesting. Well, I mean, I think at a time like the last twelve to 18 months we have seen a lot of businesses trying new pricing strategies that they haven't really had to use for many years. So we have a period of high inflation which maybe it's coming down, getting under control right now, but certainly over the last 18 months there's been high inflation in many countries. And so a lot of businesses that have been able to just tweak the price, every so often just a 2% here, 3% there have been confronted with the necessity but also the opportunity to raise prices more significantly. And so you see a couple of times when companies mess this up. One example is where people just impose a blanket price rise across the board. So all my prices go up by 7%. So that has the benefit of simplicity, but it doesn't take into account the fact that different people are buying your different products.

Leigh Caldwell [00:12:05]:

Some people are more price sensitive than others, some people are suffering more than others in the current economic environment. And so it's very likely that you will have some products which can bear a higher price rise than others. And so you want to differentiate once again between the products that are bought by people who are better off and are willing and able to spend more. The other thing that people forget is that pricing is a

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way of, it's not just a number, it's not just your income, it's a way of signaling. So price is a way to tell your customers what you care about, what you value, what the nature of your relationship with them is. And so we did a research study recently where we tested five different price change strategies. So we took 1000 respondents into a simulated grocery store. They walked through this grocery store, they chose products from the shelves to fill their trolley and to feed their family for the week.

Leigh Caldwell [00:13:16]:

And each group of respondents saw a different set of prices. So we tried five different pricing strategies and the most successful strategy was what we call a mixed strategy where some products were increased by say 20%, others products were increased by ten or 7%. But some products were actually reduced in price. And so what that enables you to do is to send a signal to your customers. Look, we know that you are potentially struggling right now. We know that times are hard, so we're going to help you by giving you a reduction on these key products. So it could be something like the milk or bread that you might be a real family staple. And then that gives you the emotional cover or the emotional reward that allows you to increase price somewhere else.

Leigh Caldwell [00:14:10]:

So people feel, well, you know what, you're taking care of me. And so I give you permission to charge more in another area. So really I think the key lessons there, one is to make sure that you are being sophisticated and

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diverse around the price changes you make, but also communicate, tell people about the reductions that you've made and make sure you get credit for them. And then that will allow you a bit of moral licensing to be able to increase elsewhere.

Roger Dooley [00:14:42]:

I think, Leigh, probably that also helps by making the mental calculation more difficult for the customer. I'm going to ask about bundling products in a minute, but it's sort of like that where if you've got some products went up and some that went down, the individual customer is not really going to be able to be doing that mental math saying, well, gee, I'm about 7% higher than I was last week. It's just going to seem kind of like a mix, unless they're some kind of savant. But with bundling, it's the same thing. When, whether it's an automaker or anybody else, incorporates multiple things into a bundle, it disguises the individual pricing of those things. The classic example, like leather seats in a car, well, I could compare that to, say, a leather couch. And wow, \$3,000 for leather seats. I could buy a pretty nice couch for that, maybe two couches.

Roger Dooley [00:15:33]:

On the other hand, if it's part of the luxury package that includes a sunroof and a better sound system, then it's like, well, who knows what's going on in there? But I like all those things, so I think I'll buy it. But bundling doesn't always work. Do you have any advice on how to bundle products in the most effective way? Because probably most of our audience members at one time

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or another do combine products to try and offer a consumer a better value proposition.

Leigh Caldwell [00:16:00]:

Yeah. The reason that bundling works similarly to that mixed pricing strategy is you don't want people to be trying to do calculations around your pricing. You don't want them to say, oh, but this costs 7% more than last month. What you want is for them to say, is this worth the money? Will I get enough happiness or enough pleasure or enough benefit or utility from this purchase to be worth the money that I'm spending? And any kind of comparisons people might make, oh, but it cost more than last year, or it costs more than the guy down the street. All of that is kind of irrelevant is if you're getting a good deal for this product, then it's worth it. You want people to be thinking about the overall deal, and that's why bundling works, because you don't want them to say, oh, but you know what? If I bought a sofa, if I bought a couch, it would cost me \$2,000. Well, you're not going to put a couch into your car, so it's kind of irrelevant even though you want to make that comparison. The thing about bundling is that there are only certain products that go together, and it's much easier to just try and throw things together than it is to design something that really works.

Leigh Caldwell [00:17:18]:

And you've got some classic bundles. The car example is perfect because you have this overall holistic experience in your car. You're driving, you've invested in a car with a good engine. You want it to have comfortable seats,

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you want it to have a good sound system so that everything elevates the rest. The McDonald's Happy meal is another classic example. You've got your burger, you want your fries, you want a drink. These all complement each other very naturally, but sometimes you will see people just mixing together. Buy this book and get a free t shirt.

Leigh Caldwell [00:17:53]:

Well, a book and a t shirt don't really have much in common. You're not really going to wear the t shirt every time you read the book. It doesn't particularly work. So bundling really needs some consumer insight into what do people use together? What are the different parts of a product that actually people will use simultaneously? Which ones will enhance each other and which ones provide that commonality of experience. So that luxury experience in the car, it works nicely with the examples you gave. But you could imagine another feature on a car, like a tow bar for towing a trailer or a boat. Well, that's a good feature, but it's not really connected with the luxury experience. It's probably for a different type of customer, for a different experience.

Leigh Caldwell [00:18:46]:

It goes on a truck rather than a sedan. And so that would be a bundle that wouldn't necessarily go together naturally.

Roger Dooley [00:18:53]:

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One funny example of bundles we have locally here in the state of Texas, there's a huge supermarket chain, Heb, that is only in Texas. And oddly, it is ranked number one for supermarket customer experience across all of the supermarkets in the United States. They really do a fantastic job with many things. One of the things that they do on a weekly basis is they have all these little sales where they have little yellow tags in the store where if you buy one of these you get one of these other things free and they have what they call combo locos, crazy combos, basically. And sometimes they are bizarre, like you gave the example of a book and a t shirt. Well, they don't sell those things, particularly there, but two totally unrelated products that they've just put together. And I think that just the novelty of that thing help. Many of their other combos do make sense.

Roger Dooley [00:19:43]:

If you buy this main course, we're going to throw in these three side dishes for free. And that makes total sense. But I think that sometimes you just sort of startle the consumer into paying attention to what you're doing.

Leigh Caldwell [00:19:57]:

Any rule that works, 90% of the time, people will notice when you break that rule. And so if you do it in a way that is quite conscious and quite humorous, then sure, I'm sure that goes down very well. And we have a supermarket chain here, one of the discount chains called Aldi and Aldi and Lidl are the two kind of competing discount chains in Europe. And they have one aisle down the middle of the store where you have the most bizarre

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products that they're nothing to do with your weekly shop. You have like a unicycle or some kind of tools for your toolbox that nothing you would buy with your groceries. But they do that for one because it's novelty. So it helps kind of people go in to see what on earth are they going to have this week. But also because I think it sends a signal once again.

Leigh Caldwell [00:20:54]:

Well, you've gone around the warehouses of Europe to find the best and cheapest products and you found this weird garden furniture thing for 14 pounds. Well, I might not want it, but it looks like a really good deal. And if you've worked that hard to find a good deal on this object, maybe you probably got me a good deal on my cheese and my pasta as well.

Roger Dooley [00:21:19]:

Great example. Maybe they could call that the isla loca or something, the crazy aisle. I'll give that to them for free. Actually, they're in Texas, I believe, at least in their Trader Joe's format. I don't know if they have all these stores in Texas, they aren't here locally, but they do a fantastic job overall. And Trader Joe's is one of their operations and it's totally revered. People will create websites to try and attract Trader Joe's to their areas. That's how much in demand they are.

Leigh Caldwell [00:21:47]:

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I didn't know. I've heard of Trader Joe's, but I didn't know it was the same brand. Okay, that's nice.

Roger Dooley [00:21:52]:

Yeah, it's a very different approach. It's smaller product selection, but unique products, a lot of private label stuff. It's just a different experience that people tend to like very inexpensive wines that may not be the smellier's choice, but are most people find very drinkable despite their low price? So a good approach. One area that I think is kind of interestingly is the whole software as a service area, because we've probably both seen hundreds of pricing pages for different software products.

Leigh Caldwell [00:22:23]:

Sure.

Roger Dooley [00:22:24]:

And they've always got maybe the free level, the basic level, the pro level, and then the enterprise level or something. And there's all sorts of different variations on that. The order that you put them in, the differences between the levels, and often the cost difference may not be that great between them, really. They're often selling the value of different approaches, three users versus one user or whatever. What are some insights that you've had from that space as far as what kind of, first of all, how you determine the pricing and how to present it?

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Leigh Caldwell [00:22:55]:

Software is a really interesting case because, as you say, it has virtually no cost to provide. There's a little bit of cost of cloud storage and data, but it's almost nothing. And so you have no baseline. Well, your baseline is zero. You could go down to zero and still sell the products without losing money. Pretty much. And so everything that you do in software pricing is around pure value. Everything you're selling is intangible.

Leigh Caldwell [00:23:30]:

Everything you're selling is something that has to be created out of nothing. There is no base cost. And so that gives you a lot of tools to play with. It means that you're telling stories about the benefit that people might get from this software. You are almost playing a game where you could give this feature for free. Doesn't cost you anything, but you're choosing not to. You're choosing to hold it back from the bronze user so that the silver user can have it and the silver user will pay a little more for it. It really does kind of take pricing science or pricing arts to its highest point.

Leigh Caldwell [00:24:17]:

Similarly to some of the luxury goods market or maybe the arts market, where the value placed on a piece of art because it is fashionable, because it touches on certain themes, or because the artist has just died, for example. Yes, that creates a scarcity, but it doesn't fundamentally change the

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aesthetic quality of the art, and yet it changes how people perceive the art. It moves the product into this realm of subjectivity. And I actually think that in some of my economics work, the papers that I write in that field. I talk about subjectivity as a factor of production. So the factors of production traditionally are land, capital, labor. They're the basic things that you put together to make a product, and each one has its own value. But I think that the subjective perception of a product is equally one of those factors.

Leigh Caldwell [00:25:16]:

And it affects not just the price that you can charge, but the genuine value that this product creates. Somebody who's hanging a painting on their wall, that is by Jean Michel Basquiat, will have a whole story, a whole part of their identity, maybe bound up in that it gives them something in their life. That would not be the case if a painting that looked the same, but by a different person. And so you are. Well, as a pricer, you want to be able to charge for that subjective value that you've created, and then you want to go hunting for new ways to create more subjective value and make sure you can package and sell it, because that value does make people's lives better, and it's part of what they're willing to pay for.

Roger Dooley [00:26:05]:

One last thing. I did tease at the beginning that you would explain your system three approach. I think most of our audience is somewhat familiar with system one and two. If you could just mention those and then explain your system three.

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Leigh Caldwell [00:26:16]:

Leigh. Absolutely. I may have previewed it a little with this subjectivity idea. So, system one and system two. This is one of the divisions that is often made within behavioral science. We look at the different ways that the mind works. We look at the decisions people make, and you can often classify those decisions. If it's a decision that is made very intuitively, very fast, based on habits, based on an emotion, then we often call that system one.

Leigh Caldwell [00:26:50]:

And that is the decisions that the brain almost makes without us noticing. Then you have the decisions that are made by thinking carefully. So let's say I'm buying a house. I'm going to take out a mortgage. I'm going to very carefully look through all of the different options in the market. I'm going to work out how much can I afford in repayments monthly? Is this a good interest rate? Will my income still be the same in five years time? So I'll do a very slow, careful, logical calculation in that system, too. However, there are other decisions that don't fit into these categories. So let's take an example.

Leigh Caldwell [00:27:26]:

Let's say I am going to buy this piece of art that I was talking about. Now I am thinking about, yes, there's a little bit there of, well, will it have a resale value if I sell it in ten years, will it be worth the same? But that's really, it's impossible to know. What I'm really thinking about is how will I feel when I

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see this art, when it sits on my wall and I look over, I'm working hard at my desk and I'm feeling stressed, and I look over this beautiful piece of art? Will I be transported to a different place? Will I feel that's why I'm doing this? If I am taking a vacation next year, I'm going to project myself forward into the beach that I might be standing on with the waves lapping on my feet, the beer in my hand. I'm going to be imagining the experience of this product and evaluating that and deciding, is this a good purchase? Do I want it? And that is what we call system three decisions. They're based on imagination. They're based on the stories that we tell ourselves about our experiences, which are pieced together from all our past experiences and kind of reformed into a new direction. And so there's some really interesting research that we do around how people tell those stories. What are the stories that happen inside your head and how do you reform those to predict your future outcomes? And then how do you buy products that will deliver those outcomes? So that's the world of system three.

Leigh Caldwell [00:28:55]:

And maybe another time we'll have more time to go into detail on that. But I think it's a really interesting expansion of that vision of how the mind works and a really important type of decision, especially in marketing.

Roger Dooley [00:29:09]:

Fantastic. Leigh, how can people find you and your ideas online so you can reach.

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Leigh Caldwell [00:29:14]:

My company is irrational agency, so just head to irrationalagency.com. You can find me on Twitter, which is or sorry, x at @leighblue. Leigh, as you said, is Leigh. Blue is the color blue. And you can drop me an email at Leigh@irrationalagency.com. And Psychology of Price you will find on Amazon and most other online sources. It's probably not in most local bookstores anymore, it's been a few years, but they can order it for you. And I would love to hear from any of you via email, Twitter or LinkedIn if you want to chat. Great.

Roger Dooley [00:29:51]:

Well, we will link to all of those places on the show notes page at rogerdooley.com/podcast. Leigh, thanks so much for being on the show. It's been great to catch up. It's been too long since we met in person. Hopefully before too long. We'll do that again.

Leigh Caldwell [00:30:05]:

It was great to see you again. Yeah, let's catch up soon. Thanks.

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