Price Perspective

Understanding price anchoring may help make you a more savvy marketer.

by **Kindra Gordon,** *field editor*

Browse through your local farm and ranch supply store and you are sure to see a few sale signs denoting price reductions and suggesting a "good deal" for buyers. It's a common marketing strategy, but it's also a strategy worth evaluating, says Patrick Patton, president of the agricultural marketing firm Stewart-Peterson, which is based in West Bend, Wis.

Why? Patton explains that the varying prices we see — for everything from clothing to automobiles, equipment and feedstuffs — can actually influence human behavior with regard to buying and selling decisions. Specifically, he says, when people observe a set price and then see that price go lower or higher, it creates bias in their minds.

For your consideration

Price examples

To illustrate this bias, Patton gives the example of shopping for a new jacket. You see one marked down from $89.99 to $59.99.

"Is it a good deal?" Patton asks.

Your brain probably says yes. Studies conducted by behavioral economists show that the human brain will tend to see the lower price as a value, Patton shares. However, he cautions, your mind usually doesn't recognize that the lower price may not be a good value at all. Perhaps the $89.99 jacket should have had an original retail price closer to $59.99 to begin with. Instead, the higher price was intentionally presented so you'd set your anchor to it, explains Patton.

To apply this price bias and anchoring concept to agriculture, Patton gives the example of buying corn for feed from the local elevator. This time we are looking at rising prices.

Consider a scenario where corn is selling at $3.90 per bushel. Patton notes that a livestock producer could fulfill some of his feed needs at this price. However, earlier in the year the producer saw corn at $3.60 per bushel (bu.). Because of that price anchor in his mind, he decides to wait.

However, the price climbs to $4.20 per bushel.

"Now, $3.90 looks like a good value," Patton says, "so $3.90 becomes the producer's new price target to hit."

What's going on in these scenarios?

It's a cognitive bias that economists call "anchoring."

"There is a common tendency for people to rely too heavily on the first piece of information they are offered," Patton explains. "In short, you anchor to it. The anchor is your reference point from which you make decisions. Once the anchor takes hold, your bias is to continually make decisions relative to the anchor."

For instance, consider the scenario of $3.90-per-bu. corn.

"That was a good value all along relative to 10-year market averages," says Patton. "That price represented a great opportunity to fulfill at least a portion of the producer's feed needs. Unfortunately, biases such as anchoring compel people to act irrationally where money is involved."

Agricultural producers have another anchor that may influence their decisions when assessing feed and commodity prices: cost of production, Patton notes. "While this number has to be considered, and it's always top of mind, commodity markets don't move based on cost of production. Try to avoid anchoring to it."

Other anchor examples

Patton suggests that producers can become more aware of their price bias and commodity price anchoring mistakes by learning from past examples. One instance is the price of soybean meal in 2016. Patton notes that in February of that year, it hit a

low of about $260 per ton. At the time, U.S. soybean carryover was projected to be 400 million-plus bushels — the largest since 2006. There was also ample world carryover and almost no impetus for prices to move much higher. For many farmers, $260 per ton represented a place to drop anchor, says Patton.

Amid the bullishness, Patton and his firm presented a scenario in which soybean meal futures could rise to $377 per ton, he says. "We saw little interest from buyers in purchasing meal." A few short months later, the July futures contract for soybean meal topped out at $432.50 per ton.

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"When prices move fast, it's remarkably difficult to take action if you're anchored to a price," Patton says of the real-world scenario. "This is even truer when price moves within a narrow range."

Commodity price forecasting is useful in planning marketing strategies and feed buying, he says. "The chief risk in relying on forecasts is not recognizing their limitations."

He explains: "Analysts base forecasts on a blend of current conditions, historical prices and an educated guess of future activity. Certainly, analysis gets much more complicated than that, but there is no tried and true forecasting methodology that offers a consistently accurate track record over time."

For instance, Patton notes, if the prevailing sentiment is corn futures could fall to $3.60 per bushel by harvest, feed buyers likely will anchor to that price and become complacent. Conversely, if popular outlook calls for $4.30 corn at harvest, buyers might start feeling a bit antsy, he says.

Bottom line, Patton says, "Price forecasts inherently create anchors because they generate reference points. That's not all bad; it helps to start with a reference point when planning. The key is to recognize a forecast is only the first step in planning marketing and feed-buying strategies."

Breaking free from your anchor

All total, Patton encourages producers to recognize that the presence of an anchor is unavoidable because every product has a price.

With that said, Patton advises: "In commodity markets, there is always a starting price, and the price will always change. The key is to overcome the tendency to rely heavily on the price that sets anchor in your mind."

He suggests one way to do so is by not limiting yourself to a single point of view.

"Seek information from a variety of sources and view situations from different perspectives," he says. "Apply some basic math in a way that calculates possible future price scenarios. From there you can see what effect marketing decisions will have on any given strategy and sharpen strategies as needed."

Commodity marketing should not be an all-or-nothing endeavor, Patton says. "Make incremental sales to increase your average sold price."

Most importantly, Patton tells producers to commit to consistent marketing for the long term, and to accept that humans are not wired to always act rationally.

"Consistency combined with disciplined decision-making will help you avoid anchoring. It can also reap dividends over accepting the market price," he concludes.

Editor's Note: *Kindra Gordon is a freelance writer and cattlewoman from Whitewood, S.D.*