

The Gambler's Fallacy and Win Probability

**Insights from Behavioral
Economics**

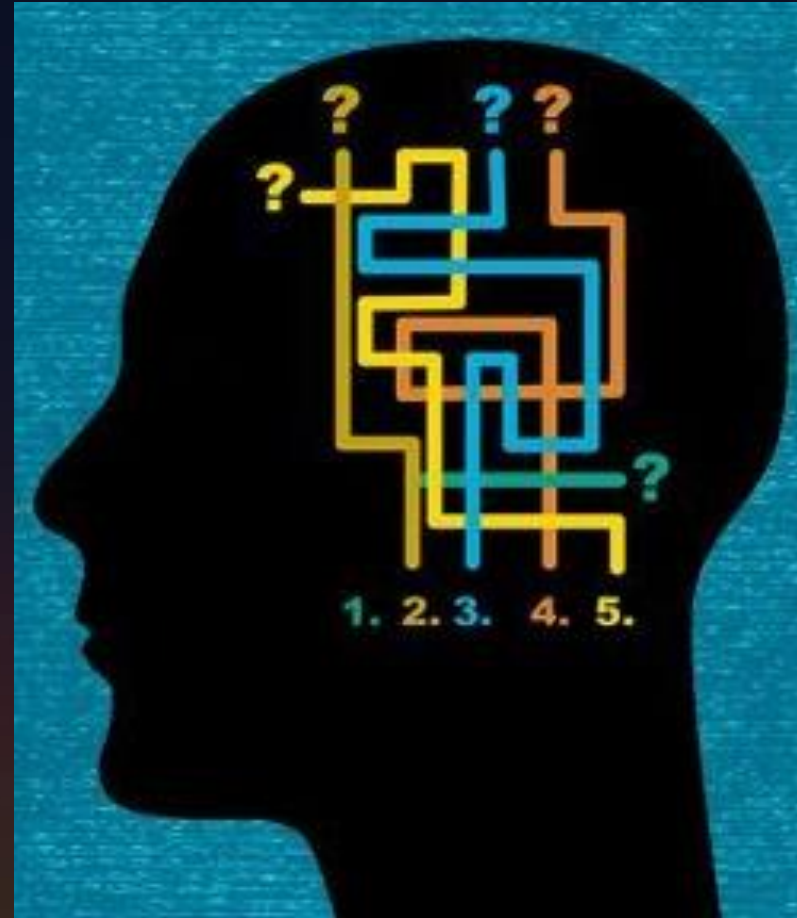
Randy Richter
Chairman, Richter & Company (Retired!!!!!!)





The Gambler's Fallacy

- Define clear and unambiguous requirements
- Purely egoistic
- Consistent pricing motives and reliable decision-making
- Require perfect price knowledge, resulting in absolute price acceptance and maximum willingness to pay
- Relies on detailed analysis



Homo Economicus



- Imperfect requirements and knowledge
- Varying price motives
- Hates to decide...
- ...and hates to be ripped off
- Uses rules of thumb and accepts “good enough”

Homo Sapiens

1 mile + 1 inch (63,361 inches)

1 mile (62,360 inches)

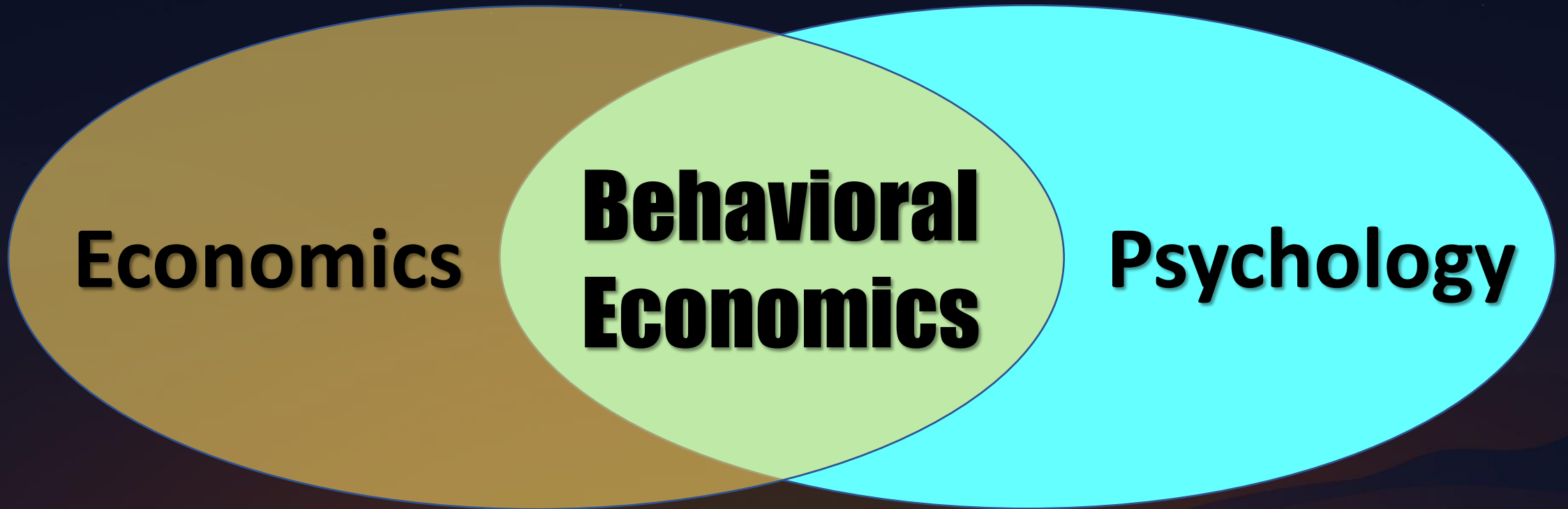
X?

Normative theories

The **Right Way** to think about
a problem
(Use Pythagorean Theorem)

Descriptive theories

The **Actual Way** we think about
a problem
(Use Intuition and Rules of Thumb)





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Key insights from Behavioral Economics

Drivers of Price Acceptance

1. Human decision making is not rational.
2. Choice architecture is as important as solution architecture.
3. Not all irrational decision strategies are the same.
4. People develop price acceptance – and proper presentation can be used to influence it.

Key insights from Behavioral Economics

Implications for pricing

1. What customers value and how they make decisions are key to behavioral pricing.
2. Understand – and measure – success; go beyond “we lost on price”.
3. Differentiate for each customer; one size does not fit all.
4. Effective pricing strategy includes design of price levels, structures, communications, and dynamics.

Key insights from Behavioral Economics

Practical pricing tips

1. Analyze – and learn from - the past
2. Rely on data, not guesses
3. Mind the gap
4. Consider opportunity costs
5. When the odds are not in your favor, walk away

1. Analyze – and learn from - the past



2. Rely on data, not guesses



3. Mind the gap



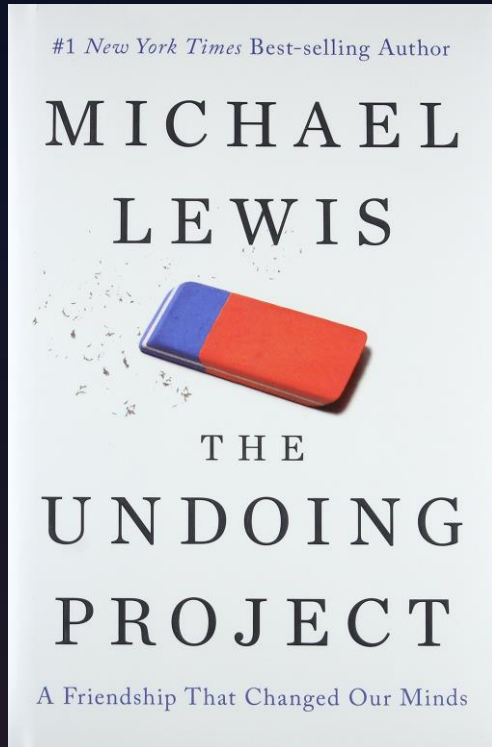
4. Factor opportunity costs in your decisions



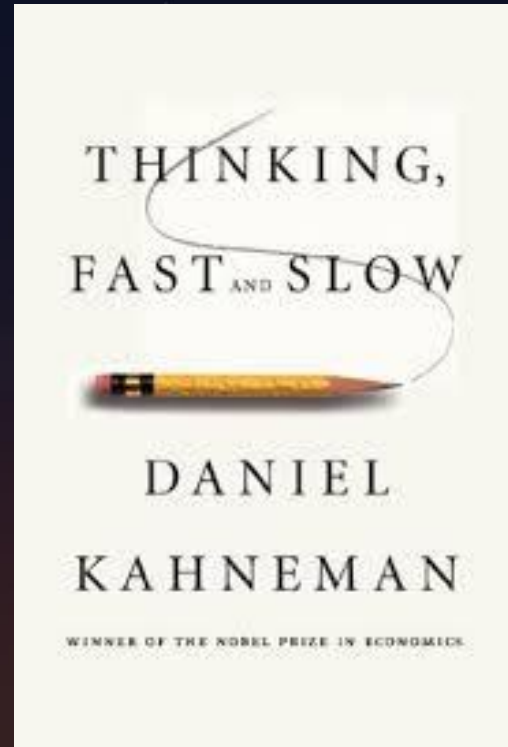
5. When the odds are not in your favor, walk away



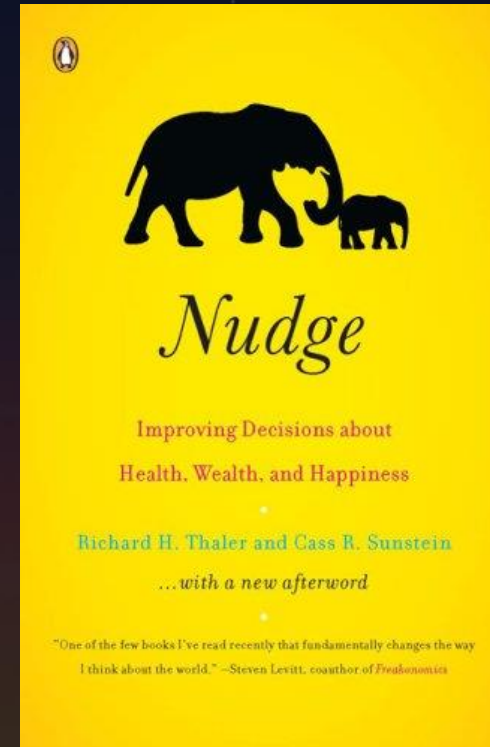
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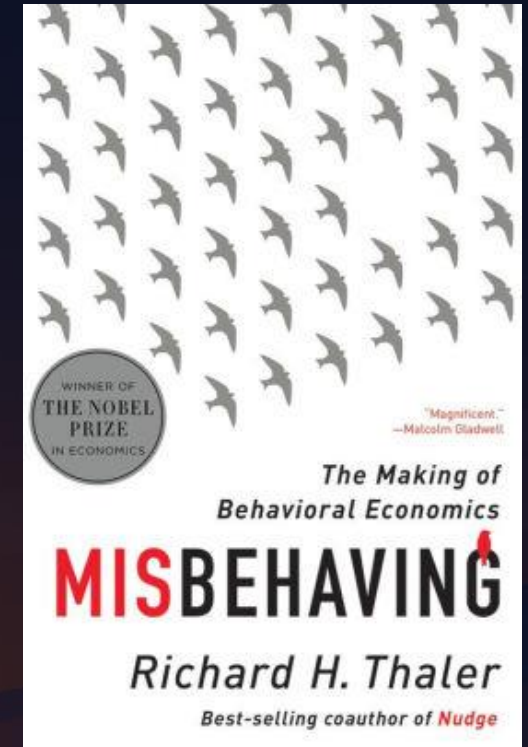
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