Distinguishing between transaction value and acquisition utility

By Rory Sutherland

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You are on a deserted beach on a hot day. You've been there a while and you are thirsty. A friend of yours has spotted a single place selling beer a few hundred metres in the distance. He explains that he's just off to fetch a bottle of beer for himself, and wonders if you would like one too. "Let me know how much you are willing to pay for a chilled bottle of, say, Heineken from that [beach-shack/luxury resort hotel] over there." he explains. If the price is below your maximum, I'll buy it. If it's higher, I won't."

A fairly simple exercise, you might think. Actually, this experiment, which was devised by Professor Richard Thaler, reveals something rather interesting. Because, even though the two products - and their value to the drinker - are in theory identical, in experiments it was found that almost all people - even trained economists - were willing to pay considerably more for the bottle when the vendor was a fancy hotel than when it was a beach shack (in 1980s dollars, the average answers were $2.65 and $1.50 respectively).

What's going on here? Well, for a start, it may suggest that our conception of value seems to include some concept of fairness and proportionality - and does not reside exclusively in the personal utility we enjoy from the purchase. So we unconsciously understand that a boutique hotel has higher overheads than a shack, and make allowances for that in our appraisal of a just price: if the price seems unfair, we won't pay, even for something we really want.

An economic conundrum

So although we might enjoy a pricey beer from a beach-shack if we are thirsty enough, if our inner moralist believes that too much of the surplus value from the transaction has been captured by the seller we might choose to punish him by not buying at all. The unjustified high price from the beach shack would just "leave a nasty taste in our mouth", which would offset the pleasure we would get from a nice drink.

This same dichotomy - between what we would like to buy and the pain we experience in buying it - exists in another economic conundrum: the fact that people are generally happy to drive across town to save $10 on a $30 clock-radio, but wouldn't cross town to save $10 on a $1000 television. Theoretically, either it's worth making the journey to save $10 or it isn't. But, instinctively, we may feel that our local electronics shop is cheating us when charging an extra 50% for a radio, but not when it adds 1% to the price of a telly.

Thaler explains these discrepancies by first suggesting a very simple distinction. He proposes that "consumers get two kinds of utility from a purchase: acquisition utility and transaction utility."

As he describes the two, "Acquisition utility is a measure of the value of the good obtained relative to its price, similar to the economic concept of consumer surplus. Conceptually, acquisition utility is the value the consumer would place on receiving the good as a gift, minus the price paid."

By contrast, "Transaction utility measures the perceived value of the 'deal'. It is defined as the difference between the amount paid and the 'reference price' for the good, that is, the regular price that the consumer expects to pay for this product."

What it boils down to is this...

But this isn't just about deal-seeking - and Thaler acknowledges this. Essentially, it boils down to this: some things are nicer to buy than they are to own; other things are nicer to own than they are to buy. For the first, think about those unworn shoes which you bought because they were 50% off; for the second, think about, say, the guilty indulgence which you ask your spouse to buy you for Christmas - a lavish present or a day at a spa.

The principles of what is called "Mental Accounting", in particular this distinction - between transaction value and acquisition utility - are vital in marketing. In fact, until you understand the distinction, many consumer behaviours simply make no sense at all.

For a start, it helps explain why so many corporate incentives revolve around enforced extravagance: why a company car, say, can be more rewarding than the cash alternative. Why is it much nicer for your employer to give you a Jag than to be given a pay rise sufficient to buy one? Because in the first case you come home with a Jag; in the second you have the guilty feeling that you are buying a Jag with money that you probably should use to pay off your mortgage.

The distinction also explains the peculiar nature of Christmas presents: why, rather than giving each other cash, we tend to give each other things we love to own but hate to buy*. And it explains the disproportionate popularity of points programmes, since we feel we can spend points more frivolously than we spend the cash equivalent.

And it also explains why there are different kinds of advertising - why "the brand campaign" is not the same thing as the "sales campaign", even though it has become fashionable to claim that there should be no distinction between them.

**Oddly this includes not only luxuries such as perfume or jewellery, but also socks. One of the best things you can do as a man to improve your quality of life is to buy 24 pairs of identical socks, but socks are nicer to own than they are to buy.*

Nedbank Digital Edge Live

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