

10.2: Pricing and Its Role in the Marketing Mix

Learning Objectives

By the end of this section, you will be able to

- Define pricing.
- Explain pricing and its role in the marketing mix.
- Explain the psychology of pricing.

Pricing Defined

Anytime anything is sold, a price is involved. Recall that during the exchange process, a seller is offering something of value to a buyer in exchange for something also of value. This value to the seller is often referred to as price. The practice of pricing is not a new concept. Some of the oldest records of prices ever discovered were found on clay tablets with symbols in Uruk, located in modern-day Iraq. The records are written receipts of exchanges of sheep, beer, and barley and date back to 3300 BCE (Fishman, 2003)!

You may recall that price is one of the 4Ps of marketing, or one element in the marketing mix. Once a product has been developed, marketers must determine at which price the product or service will be offered to the target market. Today, pricing is one of the more difficult decisions that marketers must make in the marketing mix because it directly impacts the perception of value from the customer as well as the company's bottom line. Poor pricing decisions can have immediate and catastrophic effects on profits that are difficult for companies to recover from. Price decisions must be linked to a product or service's real and perceived value while considering competition, supply costs, and when discounts should be offered.

Simply put, price refers to the exchange of something of value between a buyer and a seller. The price determines how much revenue the company will earn and drives the organization's financial health. However, marketers cannot simply price products and services based on the organization's expected revenue. The price must be set so that the buyer sees value in the product offering and the price they will pay for it. In other words, marketers must put the perception of value in the product's price at the forefront while also considering the financial impact on the organization.

While price is what is referred to when discussing most goods and services, price can take on many terms depending on the exchange that is taking place. In higher education, you are paying tuition—the price—in exchange for your education. If you need an attorney, you will likely pay a fee—the price—for services rendered. When you are traveling and must pay a toll, it is the price you pay for using the road or bridge. Regardless of the exact terminology used, the pricing of goods and services shares the same basic elements.

Elements of Pricing

While a marketer is determining the price of goods and services, they must keep in mind that pricing must benefit both parties involved in the exchange process: the seller (company) and the buyer (customer). Both parties must see value in the product process through pricing for the exchange process to be successful. We'll first discuss how price is an indicator of value to the buyer and then turn our attention to the seller.

Price as an Indicator of Value

When a buyer purchases a product or service, they seek to satisfy a need through the purchase. The customer will, consciously or not, use several criteria to determine the amount they are willing to spend to satisfy that need. These criteria ultimately lead to the value that the customer sees in the product.

The price-value equation is the consumer's subjective assessment of what they consider a value. The price-value equation states that, as a customer's expectations are met at what they consider an acceptable price, value is realized. Value is related to the quality and price of the product, and the formula is:

$$\text{Value} = \frac{\text{Quality}}{\text{Price}}$$

For example, if a consumer purchases a high-end designer Chanel handbag for \$11,000, they might equate the value to a beautiful, high-end, well-made handbag that will last for many years. They may also subconsciously believe the bag will portray a certain

social status while carrying it. For them, the product has value and quality, and they are willing to pay a high price.

Consider another example: you are fixing dinner and realize you don't have enough milk for the dish you are preparing. There is a convenience store just a block away from your house and a grocery store five miles away. If you send your partner to walk to the closer convenience store, they will pay more for the milk than if they were to drive the extra five miles to the grocery store, which would be less expensive. With the higher-priced item at the convenience store, you are paying for the convenience. The value in this scenario is in the time saved, even at a higher price.

In these two examples, the perceived benefits are directly related to the price-value equation. Perceived benefits can include status, convenience, brand, and quality and vary from buyer to buyer or even situation to situation.

Perceived costs can also include a host of criteria in addition to the price printed on the price tag. Let's return to the milk purchase example. If the situation were different—say you were not in the middle of cooking dinner—would your decision change? Perhaps. You will still consider other factors before making the decision. How long does it take for you to drive that extra five miles? Is the grocery store known for having long lines during the time you will be shopping? Do you need other items you can only get at that store? Does the store carry the brand of milk you prefer? These are only a few of the many considerations you make before you decide to make the purchase. These are all perceived costs and are weighed against the perceived benefits the buyer considers when determining value.

Marketing in Practice: Upside



Figure 10.2 Upside is an app that benefits both customers and businesses by playing on the psychological effects of pricing. (credit: "iPhone Home Screen" by freestocks.org/flickr, Public Domain)

Founded in 2016, Upside is an app that promotes itself as saving customers money on purchases at gas stations as well as helping local brick-and-mortar businesses earn more profit. Here's how it works: Upside links to gas stations, restaurants, and grocery stores within a specified mile radius of the user. The user chooses to claim an offer on the app and has four hours to upload the receipt. The linked businesses have contracted with Upside to drive business to their establishment. Once redeemed, cash is deposited into the user's account and can be cashed out for gift cards or to a PayPal account.

Upside is banking on the value equation as well as psychological factors of pricing to attract both buyers and sellers. Gas prices, for example, are relatively unchanged from station to station in a small geographical area. If the user can get 25 cents cash back per gallon on their fill-up, they may swap the convenience of the closer station with that of getting a cash reward at a station a few miles away. If the buyer chooses the station with cash back over one without, the seller (gas station) also finds value in a one-time or new customer.

For more information about Upside, visit [the app's website](#).

Price in the Marketing Mix

Recall that the marketing mix elements include product, price, promotion, and place. Marketers create value by maximizing of benefits within an acceptable price point using the marketing mix elements. Price, however, is the only element of the marketing mix that directly produces revenue for the company. The other elements are considered costs to the organization. Another way to think of price as differing from the other elements is to understand the price not only creates perceived value for the customer but also harvests monetary value for the company. Because price is the revenue-generating element of the marketing mix, it is vital that

marketers set the right price both to match buyer perceptions and to maximize company profits. Profit is determined by subtracting total expenses from total revenue.

The Profit Equation

Recall that the goal of any for-profit company is to make a profit. The price marketers set for goods and services offered will have a direct impact on the company's profit-making ability. Therefore, the price set must be one that achieves value not only for the buyer but also for the company. Certainly, buyers would prefer a lower price—or even free—for goods and services. It's simply not feasible for a company to give its products and services away for free; the company would cease to exist very quickly, which does not serve either the company or the buyer well. Rather, it is in the company's interest to set prices that create value for the buyer and profit maximization for the company, as this gives the organization the best chance of continuing to create value in the long term.

So what is the best price that creates value for the seller? In short, it's the one that creates value for the buyer while simultaneously generating the maximum profit. If a price is set too high, the buyer may refuse to purchase because they do not see the value; in turn, the company loses out on profit. Alternatively, if the price is set too low, the company may lose out on profits when a buyer would be willing to pay a higher price.

Profit is the financial gain of a company, or the difference between the amount earned and the amount spent in buying, operating, or producing something. It is the difference between total revenue and total costs and is calculated with the profit equation.

$$\text{Profit} = \text{Total Revenue} - \text{Total Costs}$$

Let's look at this formula more closely.

- Total revenue is the money generated from normal business operations. It is calculated by the sales price of a product times the quantity of units sold. For example, a company selling wireless earbuds for \$19.99 that has sold 5,000 units in one period has revenues of \$99,950.
- Total costs of a company are the costs of sales and operating expenses. It is all expenses related to operating the business that are directly related to producing a good or service and indirectly related to producing goods and services. In other words, it includes items such as building leases, employee salaries, and electricity, as well as direct costs in producing the product, such as parts and equipment.

Total costs can be categorized as either fixed or variable. Fixed costs are those expenses that do not change regardless of the number of units sold. For example, if the company selling wireless earbuds makes one unit or one million units, the company still has to pay the mortgage for the building it is occupying; the mortgage payment does not increase or decrease based on the number of units produced. Alternatively, variable costs do change based on the number of units produced. In the wireless earbud example, the company would spend more per unit if it ordered fewer units. If it ordered a higher quantity of units, the unit price would decrease.

In determining profit, the total costs include both the fixed and variable costs. The formula is

$$\text{Total Costs} = \text{Fixed Costs} + \text{Variable Costs}$$

When setting prices, the marketer must determine how much profit can be made from the sale of goods and services. However, as mentioned earlier, profit is not the only deciding factor in price. Much research has been done on how psychology also affects the perception of pricing.

The Psychology of Pricing

From a marketer's standpoint, these are all factors that must be considered when setting price. In addition to the value perceived by the buyer, the marketer must also understand other psychological factors that influence the buyer's perception of price. Several psychological pricing examples are discussed next.

Price Anchoring

When Steve Jobs introduced the Apple iPad during a Keynote in 2010, he showed off the high-resolution screen and talked about its revolutionary features. "What should we price it at?" he asked. "If you listen to the pundits, we're going to price it at under \$1,000, which is code for \$999." He put a giant \$999 on the screen. He said, "I am thrilled to announce to you that iPad pricing

starts not at \$999, but at just \$499.” The screen then showed the \$999 price being crushed with the \$499 price (Jobs, 2010). The crowd went wild!

The concept of price anchoring relies on the first piece of information a buyer sees. This acts as an anchor, or a frame of reference for what the buyer expects a price to be. Steve Jobs used this concept in his introduction of the iPad. The anchor price he quoted was \$999. This immediately made buyers believe the product should be priced around \$999. However, when Jobs showed the actual price, starting at \$499, the buyers immediately believed, psychologically, that it was a great deal. Viewers did not know what the worth of the iPad was; they just believed they were saving nearly \$500 by having the initial anchor of \$999.

Artificial Time Constraints

Marketers—particularly retailers—often use the psychological strategy of artificial time constraints. These trigger a sense of urgency in the buyer; if they don’t buy today, they’ll miss out on a great deal. Whereas a consumer may have been on the fence about spending money, these artificial time constraints act as a catalyst for consumers to spend money right now. And there is a lot of power in artificial constraints: consumers are afraid of missing out and don’t want to later regret not buying. But consumers can often find the same prices many times throughout the year because retailers use this tactic frequently.

Price Appearance

A study on the effects of auditory representation in pricing showed that buyers believed \$1,555.83 was a very complicated price and difficult to comprehend quickly. The study further outlined that a price of \$1,555 (no cents) was *better* but that buyers were able to more easily and quickly comprehend a price of \$1555 (no commas) and thus more likely to pause and consider the product (Coulter, Choi, & Monroe, 2012).

If you’ve ever gone to a fancy restaurant, you may have noticed the prices on the menu are in a small font and don’t have zeros at the end. The price will be listed as \$29 instead of \$29.00. Psychologically, longer prices appear more expensive because they take longer to read. This effect is augmented by the use of a dollar sign. Similarly, using prices with multiple syllables seems more expensive because consumers pronounce the prices in their heads. In short, the longer it takes to read and pronounce, the more impact the buyer believes it has on their wallet, which is explained by price appearance (Yu, 2021).

Price Gouging

Price gouging occurs when companies or individuals take advantage of a situation, typically an emergency or natural disaster, and charge exceptionally high prices for products or services. In some states, like New York, it’s illegal for businesses to price gouge during a state of emergency (NYC Department of Consumer and Worker Protection, 2022). In fact, New York was the first state to enact a price gouging law. In 1978, when there was a shortage of oil for heating in the winter and the lives of young and elderly people were threatened, the state created a law where companies could not sell goods or services at excessive prices (Ondeck et al., 2020).

Can you think of recent examples where price gouging was a potential concern? During the COVID-19 pandemic, several states posted on their government websites lists of items that couldn’t be subject to price gouging. Currently, the U.S. Department of Justice provides a list of items that can’t be hoarded or subject to price gouging due to COVID-19 precautions, including masks and other personal protective equipment (PPE), respirators, ventilators, and medical gowns (U.S. Department of Justice, 2022). There have been other instances where price gouging was an issue. According to AccuWeather, “some of the most rampant examples of price gouging came during the most destructive storms in recent years, such as Hurricane Katrina, Hurricane Sandy, Hurricane Harvey, and Hurricane Irma” (Puleo, 2019). After Hurricane Katrina, a hotel manager boosted room prices and was sentenced to five years in jail (Puleo, 2019).

Careers In Marketing: Pricing Analyst

A pricing analyst studies the market and analyzes data to determine the best pricing for products. [This article from Zippia provides helpful information about](#) the job role, including qualifications, career paths, salary, education, resume templates, and online courses to improve skills. Indeed.com also provides a thorough job description that outlines top duties and qualifications.

The best way to understand the core of any job is to learn from people who have done the job. Watch this video from a pricing analyst who discusses his career.



Also [check out this article on what makes a great pricing analyst](#). Some people wonder how a pricing analyst and a data analyst differ. Learn the answer to that [question in this article](#).

Once you've determined this may be the career for you, prepare for an interview by watching this video.



Knowledge Check

It's time to check your knowledge on the concepts presented in this section. Refer to the Answer Key at the end of the book for feedback.

1.

You receive an email from your favorite clothing store. It is having a one-day sale where everything is 50 percent off. The retailer is using a form of psychology known as _____.

- a. artificial time constraint
- b. price appearance
- c. profit
- d. fixed costs

2.

Which of the following best describes the profit equation?

- a. Profit = Fixed Costs – Variable Costs
- b. Profit = Total Costs – Total Revenue
- c. Profit = Total Revenue – Total Costs
- d. Profit = Fixed Costs + Variable Costs

3.

Marquis has decided to purchase a new kitchen table. He looks at various brands online and decides to purchase one that is \$500 more than the others because it is a brand his parents had when he was growing up and they offer free delivery. These factors indicate Marquis has perceived _____ in the higher-priced table.

- a. value
- b. artificial time constraints
- c. costs
- d. profit

4.

Kilee sees an advertisement for a new computer. The advertisement portrays an initial price of \$699 that has a large red “X” through it with a new price of \$499. The advertisement is utilizing which pricing concept?

- a. Artificial time constraints
- b. Price appearance
- c. Price gouging
- d. Price anchoring

5.

The perception of a buyer’s value includes which of the following?

- a. Profit a company can expect from sales
- b. Perceived benefits less the perceived costs associated with a purchase
- c. Revenue expected from a sale
- d. Costs of manufacturing the product

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