

# Module 1: Marketing

## Lesson 2 - Marketing Mix: Price

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### OVERVIEW

In this marketing mix lesson, students will gain a fundamental understanding of pricing, one of the most important concepts in business. This lesson explores the factors that influence price as well as the impact of pricing on consumers.

### OBJECTIVES

1. Define price.
2. Explain the concept of perceived value and its relationship to product and service benefits.
3. Identify criteria consumers evaluate when considering product and service benefits.
4. Differentiate between fixed and variable costs.
5. Recognize how cost impacts price.
6. Define contribution margin.
7. Understand the basics of how the break-even point is calculated.
8. Explain how government regulations can impact price.
9. Describe variables that are considered when a price is established.
10. Recognize how price impacts you as a consumer.

### KEY TERMS

*Price*

*Perceived Value*

*Benefits*

*Quality*

*Resale Value*

*Price Point*

*Cost*

*Contribution Margin*

*Break Even Point*

*Fixed Costs*

*Variable Costs*

*Monopoly*

*Bait and Switch*

*False Advertising*

*Price Fixing*

*Inflation*

### This Lesson Bundle Includes:

- Introduction to Pricing - Lesson Outline
- Industry Application: Related Links
- Introduction to Pricing - Slide Presentation
- Discussion Deck - Burger Time! Establishing Price
- Discussion Deck - What is False Advertising?

# Lesson 2 - Marketing Mix: Price

## MARKETING MIX: PRICE

### What is the Marketing Mix?

Components of the marketing mix traditionally include **product**, **place**, **promotion**, and **price**.

### What is Price?

Price is a critical component of the exchange process. In a business exchange, a seller is offering a product or service, and a buyer has a want or need relating to that product or service. **Price** is what a consumer pays in exchange for a product or service. The term “price” could also refer to things like “charges” (your bank may charge you for a particular type of transaction), “fees” (your credit card company might charge fees for purchases), or “fares” (an Uber ride might charge a fare).

Price does not always refer to a form of currency. “Bartering” can also lead to an exchange. For example, you might offer to show a friend how to unlock a secret character in a popular video game in exchange for a pack of digital trading cards through NBA “Top Shot.” This transaction is referred to as bartering.



### Value

Consumers fulfill individual wants and needs based on the perceived value of the product or service. **Perceived value** is the difference between a buyer’s perception of a product’s cost and benefits and the cost of similar products in the same market.

Each product or service must carry a set of **benefits**, or criteria that establish a perceived value to the buyer. When making a purchase decision, consumers evaluate a variety of criteria that influence what they are willing to give up, or pay, in exchange for the product or service. Most often, consumers prefer to pay as little as possible, while the provider of the good or service hopes to maximize profits by determining the highest possible price point that a consumer is willing to spend.

#### Criteria consumers consider when evaluating product benefits:

- Brand
- Product or service quality
- Convenience
- Value proposition
- Choice/competition
- Promotion
- Supply and demand

While criteria like brand and convenience are important to consumers, most often a purchase decision will be determined by **quality**, which describes how well the product or service works. For instance, if a consumer purchases skincare cream that is promoted to reduce acne, the product should perform as promised.

In many cases, consumers evaluate a variety of benefits. Purchase decisions are not typically influenced by one singular benefit, but rather by a combination of benefits that increase the perceived value of the product or service.



## Resale Value

**Resale value** is the price which something can achieve when sold in the future. Resale value is important when purchasing a product as an investment, or on the secondary market. An item's resale value is determined by a number of factors, including popularity and scarcity.

For example, a pair of limited-edition sneakers might be estimated to be worth \$1,000 on the secondary market, but unless a buyer on a secondary market platform (such as StockX or eBay) is willing to pay a price in that range, the shoes do not have a resale value of \$1,000. The concept of resale value comes into play with any product or service being bought and sold on the secondary market, particularly with collectibles, NFTs, and online auction sites.

## Price Point

A **price point** is a point on a scale of possible prices at which something might be marketed and is relative to similar pricing within the market for a given product or service. Establishing an effective price point is one of the most critical decisions a business can make. Determining price point also represents how well marketing professionals understand the consumer. An effective price point means that a company's value for their product or service is in line with consumer perception of value for that product or service.

## Why is Price Important?

1. Price is the only revenue-generating component of the marketing mix. The other three components contribute to a company's cost.
2. Price impacts a company's marketing strategy, from the way a product is positioned to the way sales professionals are trained to communicate product and service benefits to prospective customers.
3. Price directly impacts sales of products and services.
4. Price influences demand for products and services.

Determining a product's price is not a straightforward process. If the product or service is priced too high, sales will likely not meet expectations. If the product or service is priced too low, the business risks lower or non-existent profit margins. Pricing often requires constant adjustment to meet the challenges of market fluctuations.

## Cost

**Cost** is the expense incurred for a product or service being sold by a business. There are two types of costs associated with the creation and sale of products and services: Fixed costs and Variable costs.

**Fixed costs**, sometimes referred to as overhead expenses, are expenses that a business must pay to remain in operation.

### Examples of fixed costs include:

- Rent
- Leased equipment
- Monthly supplies
- Insurance



**Variable costs** are expenses a business incurs that can be adjusted, based on things like production, inventory or sales.

**Examples of variable costs include:**

- Materials
- Inventory
- Sales commissions

Before determining a price point, it is important for businesses to first identify the break-even point. The **break-even point** is when the total cost and total revenue are equal. In other words, there is no loss or gain for the business at the break-even point. To calculate a break-even point, businesses must also identify the contribution margin.

**Contribution margin** is the amount per unit (item) sold that contributes to paying fixed costs in a way that provides a profit.

**A basic formula for calculating contribution is the following:**

$$\begin{array}{|c|} \hline \text{Contribution} \\ \text{Margin} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Price Per Unit} \\ \text{Sold (PPU)} \\ \hline \end{array} - \begin{array}{|c|} \hline \text{Total Variable} \\ \text{Cost Per Unit} \\ \hline \end{array}$$

## Pricing Strategy

To illustrate pricing strategy, let's examine some hypothetical costs associated with producing a fast-food cheeseburger.

**A restaurant incurs a variety of costs, including (but not limited to):**

Fixed Costs	Variable Costs
Building lease Franchise fees Staff	Ingredients Supplies Marketing Packaging

**In this example, let's assume the restaurant is using the following numbers:**

<b>Price Per Unit (PPU)</b> one unit = one burger	\$5
<b>Variable Cost Per Unit</b>	\$3
<b>Contribution Margin</b>	\$2 (\$5 - \$3)
<b>Fixed Costs</b> (franchise fees, building lease)	\$200,000



The restaurant now must determine how many cheeseburgers must be sold to reach the break-even point by dividing the fixed cost total (\$200,000 in this case) by the contribution margin (\$2).

**Yearly:**  $\$200,000 \div \$2 = 100,000$  burgers/year

**Weekly:**  $100,000 \div 52 = 1,923$  burgers/week

**Daily:**  $1,923 \div 7 = 275$  burger/day

For the restaurant to break-even (neither losing money or making a profit) it would need to sell 100,000 cheeseburgers per year. Based on these calculations, business owners can then adjust variables like cost of ingredients, the amount they plan to spend on marketing or increase the price point to boost the probability of generating a profit.

## Government Regulations

A combination of U.S. government and industry regulations impact the selling price for goods and services. The government seeks to implement certain measures to keep goods and services affordable in a way that helps to control inflation and protect consumers. Prices of goods and services will increase over time due to a number of market factors. This general progressive increase in overall price is called **inflation** and reduces a consumer's purchasing power. For example, several years ago, you could purchase a bag of chips and a seltzer water for under \$5. Today, that same bag of chips and seltzer water might cost \$5.50 after inflation.

## Monopolies

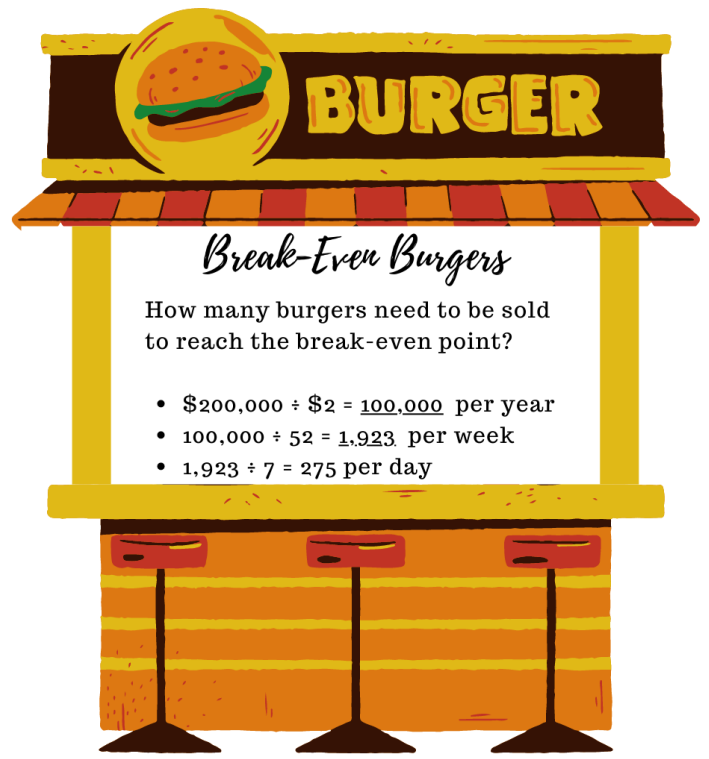
The United States Federal Trade Commission, or FTC, also regulates business practices to help protect consumers. The FTC prevents businesses from forming monopolies in the marketplace. A **monopoly** exists when there is no competition in the marketplace for a product or service. For example, if Delta Airlines were the only commercial airline in the U.S., they could charge passengers incredibly high prices for airline tickets because consumers would not have an option to purchase from any other airlines. It is the role of the FTC and U.S. government to keep this type of market power under control.

## Deceptive Advertising Practices

The FTC also shields consumers from deceptive advertising practices, whose purposes are to trick the consumer. It is illegal for a business to intentionally mislead consumers about the price of its products.

**Bait and switch** occurs when a business advertises a product or service to make the consumer feel they are getting a good deal, but an inferior or more expensive product is then substituted for the product being advertised. Let's say a local retailer advertises they have one of your favorite brands on sale for 50% off. When you visit the store, however, the retailer says the product is no longer available, then proceeds to try selling you a much more expensive item.

**False advertising** occurs when a company makes claims about a product or service that are not legitimate. Imagine you purchased your favorite sports drink based on a list of unique, performance-enhancing ingredients and a promise of "low sugar." Then you find out those unique ingredients that were "scientifically proven" to boost your energy levels and metabolism, only to find out those claims were actually untrue. Later, it was revealed that your interpretation and the brand's interpretation of "low sugar" were very different, and you had actually been intaking far more sugar than you originally thought. That practice is false advertising, and not only is it unethical, but it is illegal in the United States.



## Price Fixing

The FTC also protects consumers against price fixing. **Price fixing** occurs when businesses within the same industry get together and agree to charge the same prices. Price fixing results in the establishment of a higher price point throughout the marketplace so consumers pay higher prices no matter which seller they choose to buy from. This practice is illegal and is monitored by the FTC.

## Establishing Price

So how do marketing professionals determine a product price that will hopefully lead to business profits? In addition to calculating a break-even point, marketing professionals must also consider the following variables:

- Perceived value
- Supply costs
- Competition
- Supply and demand
- Market size
- Economic conditions

To help establish price, marketers should be in tune with how consumers perceive value by evaluating the benefits provided by the product or service being offered. When setting prices, businesses will also consider the costs of supplies (ingredients required for making a cheeseburger) while evaluating competition. How many competitors are in the marketplace? What do competitors charge for their products? Are there substitute products available to consumers? If so, how much do they cost?

Marketers will also take into account demand when establishing price. When certain goods, like crops, are out of season, supply is low which, in turn, drive up prices. For other goods, like swimwear, prices might drop when cooler temperatures arrive and Summer comes to a close. The concept of demand explains why the price of a dozen roses at many retail locations increases the week of Valentine's Day or before Mother's Day weekend.

To further illustrate how these variables might impact how a business establishes price, let's once again consider our hypothetical cheeseburger restaurant. In addition to evaluating the break-even point using fixed and variable costs, how might things like perceived value and economic conditions factor in when determining a price point for the restaurant's cheeseburgers?

**Perceived value** - Are consumers as familiar with the product as they might be with other established cheeseburger brands like the Big Mac or Whopper? Do they have an expectation that the product features high quality ingredients?

**Supply costs** - How much will it cost to use high quality ingredients? Is it necessary to use the absolute highest quality ingredients?

**Competition** - How many competitors are in the marketplace? How much do they charge for their cheeseburgers? What other substitute products are available (Chick-fil-A, Applebee's, etc.) and how much do they charge for similar products?

**Seasonality** - Does the cost of onions or tomatoes increase when they are out of season? Do certain times of the year (back-to-school) impact demand?

**Supply and demand** - How much fluctuation might there be in supply and demand? Are more people eating chicken sandwiches because it is trendy? How might that impact the price of a cheeseburger?

**Market size** - How many consumers are in the marketplace? How could that impact demand?

**Economic conditions** - How might periods of higher inflation or a recession impact price decisions?





## KEY TAKEAWAY

There are many variables to consider when establishing price, beyond simply assigning a value to a product or service that the seller thinks is a fair price. Math is required to determine things like break-even points and profit margins, which are essential to effective pricing strategies.



## CASE STUDY FIVE GUYS BURGERS & FRIES

A cheeseburger at Five Guys burgers is more expensive than a cheeseburger at just about any other fast-casual burger joint. For example, a double cheeseburger at the iconic In-N-Out burger costs about \$4.70. In the same market, a cheeseburger at Five Guys is priced significantly higher at \$9.29.

Why does Five Guys charge more for their burgers than most competitors? According to data from Mashed.com, the company uses only fresh ingredients and more expensive packaging, resulting in a much higher cost of production.<sup>1</sup> For a look at competitor prices and a breakdown of what drives the cost up at Five Guys, review SCC Insights' "Burger Time!" visual case study and discussion.



<sup>1</sup> <https://www.mashed.com/758390/we-finally-know-why-five-guys-is-so-expensive/>



## INDUSTRY APPLICATION

Connect your classroom with industry examples by reviewing the following news stories relating to concepts covered in this lesson:

**Costs** - [Louis Vuitton set to raise price tags this week as costs climb](#)

**Inflation** - [U.S. consumer prices post largest annual gain in 40 years as inflation becomes widespread](#)  
[Interactive Graphic: Track grocery price trends](#)

**Monopolies** - [Can Facebook monopolize the metaverse?](#)

**Price Fixing** - [Pilgrim's Pride Ex-CEOs Face Felony Trial Over Alleged Price-Fixing In Chicken](#)  
[Chicken of the Sea price fixing settlements totaling \\$39.5M approved](#)

**Establishing Price & Pricing Decisions** - [Why Dollar Tree's price hike to \\$1.25 could be 'one of the worst decisions in retail history'](#)

[Rivian rolls back big price increases on preorders after customer backlash](#)

[Amazon, Netflix and 10 Other Brands That Are Raising Prices](#)

[How companies are hiding inflation without charging you more](#)

**Supply, Demand & Seasonality** - [Seafood prices on the rise as Lenten season begins](#)

[The cost of Valentine's Day roses is soaring because air freight rates are up](#)

**Supply & Demand** - [Taco Bell pulls 'Mexican Pizza' from the menu after supplies run out](#)



## KEY TERMS DEFINED:

**Price:** What a consumer pays in exchange for a product or service.

**Perceived Value:** The difference between a buyer's perception of a product's cost and benefits and the cost of similar products in the same market.

**Benefits:** Criteria that establish a perceived value to the buyer.

**Quality:** How well the product or service works.

**Resale value:** The price which something can achieve when sold in the future.

**Price Point:** A point on a scale of possible prices at which a product or service might be marketed, relative to similar pricing within the market.

**Cost:** The expense incurred for a product or service being sold by a business.

**Fixed costs:** Sometimes referred to as overhead expenses, are expenses that a business must pay to remain in operation.

**Variable costs:** Expenses a business incurs that can be adjusted, based on things like production, inventory or sales.

**Break-even point:** When the total cost and total revenue are equal.

**Contribution margin:** The amount per unit (item) sold that contributes to paying fixed costs in a way that provides a profit.

**Monopoly:** When a business has no competition in the marketplace for a product or service.

**Bait and switch:** When a business advertises a product or service to make the consumer feel they are getting a good deal, but an inferior or more expensive product is then substituted for the product being advertised.

**Inflation:** The general progressive increase in prices over time.

**False advertising:** When a business promotes claims about a product or service that are not legitimate.

**Price fixing:** When businesses within the same industry get together and agree to charge the same prices.

