

# Module 1: Marketing Mix

## Lesson 3 - Marketing Mix (Pricing)

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### Lesson Overview

In this 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.

### Lesson 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

*Benefits*

*Break-even point*

*Cost*

*False advertising*

*Inflation*

*Price*

*Price fixing*

### This Lesson Bundle Includes:

- Introduction to Pricing - Lesson Outline
- Industry Application: Related Links
- Introduction to Pricing - Slide Presentation
- Burger Time! Establishing Price Visual Case Study
- What is False Advertising? - Slide Presentation
- Quiz

# Lesson 4 - Introduction to Pricing

## PRICING

### 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 the buyer is willing to exchange to receive the 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).

Before a buyer makes an exchange decision, however, they must believe the good or service has value. The value of a good or service depends on what a consumer is willing to pay. For example, a pair of limited-edition sneakers might be estimated to be worth \$1,000, 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 are not necessarily valued at \$1,000. This concept 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 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 what they perceive the **value** of the product or service to be. Each product or service must carry a set of **benefits** that establishes 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 finding the highest possible price point that a consumer is willing to spend.

Criteria consumers consider when evaluating benefits associated with a product or service could include:

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

While things 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 a type of skincare cream that is promoted as a product that reduces acne, the product should perform as promised.

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

## Why is price an important component of the marketing mix?

While it can be fun to consider the other components of the marketing mix (product, place and promotion), making sure to establish a proper 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. Do they feel the value of the product or service is in line with how consumers value the same product or service? There are several reasons why price is such an important component of the marketing mix.

1. Pricing is the only revenue-generating component of the marketing mix. The other three components actually 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.

Finding the right price point is not any easy responsibility. 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.

## 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:

1. Fixed costs
2. 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 could include things like:

- 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 could 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** occurs 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 item sold that contributes to paying fixed costs in a way that provides a profit.

A basic formula for calculating this figure is the following:

$$\text{Contribution margin} = \text{Price per unit sold (PPU)} - \text{Total variable cost per unit}$$

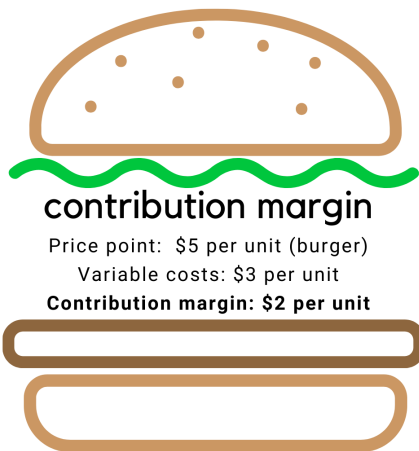
To illustrate, let's examine some hypothetical costs associated with producing a fast-food cheeseburger. A restaurant incurs a variety of costs, including (but not limited to):

#### Fixed Costs

- Building lease
- Franchise fees
- Staff

#### Variable Costs

- Ingredients
- Supplies
- Marketing
- Packaging



In this example, let's assume the restaurant sets the price point per unit (one unit = one burger) at \$5, with total variable costs coming in at \$3 per unit. The result in this scenario is a contribution margin per unit of \$2 (\$5 - \$3).

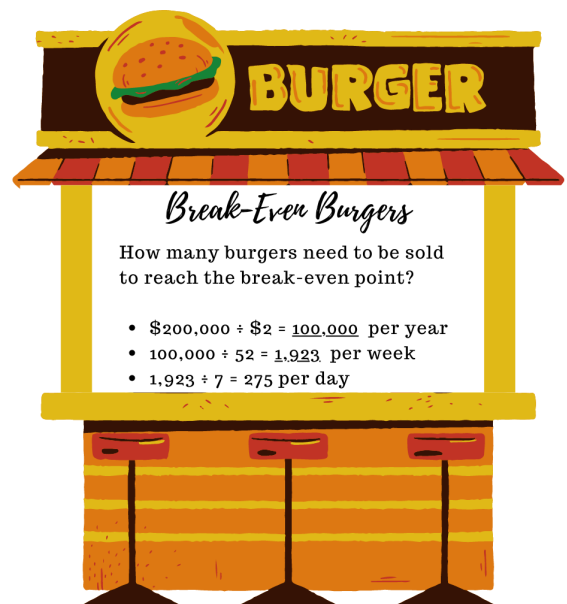
Then, let's assume the fixed costs are \$200,000 per year, which covers franchise fees and the building lease. The restaurant now must determine how many cheeseburgers must be sold to reach the break-even point by dividing the fixed cost total (\$200,000 in this case) by the contribution margin (\$2).

- $\$200,000 \div \$2 = 100,000$  cheeseburgers per year
- $100,000 \div 52$  (52 weeks in a year) = 1,923 cheeseburgers per week
- $1,923 \div 7$  (7 days in a week) = 275 cheeseburgers per day

So for the restaurant to break-even, which is to not lose money but also to not generate a profit, they 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 of 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 protects consumers. Naturally, prices of goods and services will increase over time. 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.

The United States Federal Trade Commission, or FTC, also regulates things like monopolies and shady pricing strategies like “bait and switch” advertising or “false” advertising. **Monopolies** exist 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.

The FTC also seeks to shield consumers from “bait and switch” or “false” advertising practices. This means businesses cannot engage in deceptive advertising in any way. 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 in a way that the customer feels 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.

The FTC also protects consumers from 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 across the board throughout the marketplace so consumers pay higher prices no matter which seller they choose to buy from. This practice, of course, is illegal and is monitored by the FTC.

## Establishing price

So how do marketing professionals determine a price point that will hopefully lead to a profit? In addition to calculating a break-even point, marketing professionals must also consider a variety of 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, drives 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 points, 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 is a lot more that goes into establishing price than simply assigning a value to a product or service that the seller thinks is a fair price. There are many variables to consider, and 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

Compared to its competitors, 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 do Five Guys burgers cost more 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.](#)



### DISCUSSION TOPIC

History is littered with examples of companies engaged in the practice of false advertising. In many cases, class action lawsuits result in a company paying millions of dollars in damages.

Share some examples with your students in class by opening the "False Advertising" presentation included with this lesson bundle. Begin by viewing the company's advertising, then ask students if they can identify if or how the claim could be misleading consumers.



### 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](#)

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

## MODULE 1 - LESSON 3 (PRICING) KEY TERMS DEFINED:

**Benefits** establish a perceived value to the buyer.

**Break-even point** occurs when the total cost and total revenue are equal.

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

**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.

**False advertising** occurs when it promotes claims about a product or service that are not legitimate.

**Inflation** is a general progressive increase in overall price over time.

**Monopolies** exist when there is no competition in the marketplace for a product or service.

**Price** is what the buyer is willing to exchange to receive the product or service.

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