CONSUMER PSYCHOLOGY TOWARD PRICE
By Gregory Passewitz

Most of us as consumers develop mental attitudes about the price we are willing to pay for a product or service. There is considerable evidence that the importance of price in the decision to purchase varies from product to product and person to person.

There are numerous price strategies used by businesses to take advantage of customer pricing psychology. Three of the more common are:

Multiple Unit Pricing: Simply put, this is a strategy where the consumer perceives quantity buying as involving greater savings. An example is an item that normally sells for $.49 each. Multiple pricing would change this situation to a two for $.89 or perhaps three for $1.39. In general, multiple unit pricing is usually effective in increasing immediate sales, however, this pricing technique may not increase the rate of consumption of the product. People will buy extra units of the product and then use them as needed.

Several factors ought to be considered in the use of multiple pricing. First, the multiple unit price has to be easy to understand. Eight for $.79 is usually less effective than simple multiples of two for $.19. Second, the bargain concept of multiple pricing is not usually effective over the $10 range. It is, however, very effective for item within the $1.00 range.

Odd Number Pricing: Odd number pricing refers to setting a price just below the psychological breaks in the dollar. Thus, a price is set at $.49 or $.99 rather than $.50 or $1.00. Prices are set at $.19 or $.49 or $19.95. This gives the psychological impression to the customer that the price is not $.20 or $.50 or $20.00, but less. Odd number pricing is often avoided in prestige stores or products and higher priced items. Thus, an expensive ladies dress could be priced at $150.00 not $149.95.

Prestige Pricing: Prestige pricing is high markups and/or pricing above the market. Many consumers are willing to pay more for a product or service because the product or service is perceived to be of higher quality or possess brand or manufacturer prestige. Usually above market pricing can be done only when the product is unique or distinctive, or when the seller or manufacturer has acquired prestige in the field.

Pricing Barriers: One of the easiest and fastest ways to increase gross profit, and thereby net profit, is to learn how to use price barriers to your advantage. Every one of your customers has price barriers in mind when they come to your business. Price barriers are simply a series of checkpoints consumers use to determine the relative value of a product. For example, they may look at a piece of pottery and say to themselves (often subconsciously), this is worth more than $10 but no more than $15 so the two barriers involved are $10 and $15. The importance of these barriers vary with each customer and are based on several considerations: 1) the need for the product; 2) the desire for the product; and 3) the amount of discretionary income they have at that moment. There are two types of barriers for all industries; major barriers for the industry and minor barriers peculiar to a specific industry based on the common product level of cost in that industry. Here are some typical major and minor barriers:
Major: $1 - $5 - $10 - $15 - $20 - $25 - $30 .....  

Minor: $1.50 - $2.00 - $3.00 - $7.00 - $8.00 ..... 

Major barriers have the following qualities:

1. They are generally common to all consumers, particularly for those consumers who visit discretionary income businesses, such as an arts and crafts business.

2. They have fairly predictable reactions by consumers so you can take advantage of those reactions with your retail pricing.

3. They offer considerable pricing opportunities once you go over a barrier. This is where most business owners fail to ask customers to pay a little bit more for the product they have already decided to buy.

4. A major barrier should never be slightly cleared. Once you go past a major barrier, keep going until you reach the next price barrier, either major or minor. In other words, if you go over the $5.00 barrier, keep going until you near the $7.00 barrier.

Minor barriers have the following qualities:

1. They are not common to all customers and are less affected by the need/desire conditions. They are more like a little step rather than a barrier.

2. Consumer reaction to minor barriers is much harder to predict than for major barriers, so do some experimenting.

3. They offer less pricing opportunities once they are cleared, because the distance between them is smaller than major ones.

4. In many cases, minor barriers do not exist with a number of consumers and that means you should take them less seriously than major ones.
### PRICE BARRIERS

<table>
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<tr>
<th>Major Price Barriers</th>
<th>Minor Goods Barriers</th>
<th>Suggested Price</th>
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<td>200.00</td>
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Effect on Gross Profit of Price Barriers

Assume you have a product that costs $3.00 and you want to make a 50% gross profit margin (GPM). Normally you would double the price and sell it at $5.99. Let’s look at the pricing from a price barrier standpoint. The major barriers are $5.00 and $10.00 with the next minor barrier at $7.00. Keep in mind there is no minor price barrier at $6.00.

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<th>Cost</th>
<th>Retail</th>
<th>Gross Profit</th>
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<tr>
<td>Normal Price</td>
<td>$3.00</td>
<td>$5.99</td>
<td>$2.99 (49.9%)</td>
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<tr>
<td>Using barrier</td>
<td>$3.00</td>
<td>$6.99</td>
<td>$3.99 (57.0%)</td>
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Increase in Gross Profit $1.00 (33.4%)

Of course, this assumes you would sell exactly the same number of items at $6.98 than you would at $5.98 and you probably won’t. If we are concerned with gross profit dollars instead of sales dollars or number of units sold, let’s find how many less items we can sell and still make the same amount of gross profit.

<table>
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<th>Normal</th>
<th>Price Barrier</th>
<th>Breakeven</th>
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<tbody>
<tr>
<td>Sale of 100 Units</td>
<td>$599.00</td>
<td>$699.00</td>
<td>$524.25 (75 x $6.99)</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td>300.00</td>
<td>300.00</td>
<td>225.00 (75 x $3.00)</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$299.00</td>
<td>$399.00</td>
<td>$299.25</td>
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You find the breakeven point by dividing the normal gross profit dollars by the price barrier unit gross profit per unit ($299.00 / $3.99 = 75 units). This means you only have to sell 75 units at $6.99 to make the same amount of gross profit you would get if you sold 100 units at $5.99. You could lose 25% of the unit volume and still make the same income. Your investment in inventory would also be 25% less since you only need to buy supplies for 75 units instead of 100 units.
In business it is possible to have the very best product or service and have excellent sales volume, but if the wrong price has been set on the product or the service the business will eventually fail. In any business, the ultimate reason for a pricing system is to make a profit from your work. The amount of profit depends on your costs, both variable and fixed, selling price, and the number of items sold or services rendered.

Some components to consider when setting a price include:

- What are customers willing to pay?
- What is the break-even point; are all costs covered?
- How much profit do you want to make?
- What is your competition charging?

**Determining a Product Price**

In determining a price for your product, it is important to use your costs of production as base. Therefore, you must know your cost of production so that a break-even point can be established.

The first step in pricing is to determine your product cost. All costs can be divided into variable and fixed (overhead) costs. Variable costs, sometimes called out-of-pocket costs, are the costs of doing business. These are production-related and include materials, labor, advertising and packaging. The fixed costs are the costs of being in business. They include all items that you pay for regardless of whether or not you are producing or selling a product. Examples are tools, equipment, depreciation, utilities and taxes. Remember, the reason for establishing your product cost is to form the base for your pricing formula.

No single pricing formula will work for all businesses, nor is there a formula that will assure maximum profits in all situations. Every business must approach the problem individually. What follows are several formulas to help you determine a price. Each formula adds an additional item to consider in determining a selling price. By making conscious decisions based on facts, you can determine your price. If, after using the formulas, you find that your selling price is noticeably higher than that of your competitors, you may need to look for ways to lessen your production costs, reduce overhead costs or accept less profit, and become more efficient without affecting the quality of your product.

In helping to compare the pricing formulas, assume a firm has determined that a market exists for guinea pig cages. The cost of materials per cage is $4. It takes 1 hour of labor to construct the cage and the labor rate is $5 per hour. Overhead costs are $2 per cage.

**Formula A**

Materials + labor (production time x hourly wage) divided by number of units = selling price per unit.

Example: $4.00 + $5.00 divided by 1 cage = $9.00 selling price

This approach is often used by beginners because it provides a reasonable wage. You must determine material cost and give yourself a labor rate. There should be a value placed on your time. There is no allowance for overhead costs, inflation or profit.

**Formula B**

Materials + overhead + labor (production time x hourly wage) divided by number of units = selling price per unit.

Example: $4.00 + $2.00 + $5.00 divided by 1 cage = $11.00 per cage

Overhead costs have been added in this formula.

**Formula C**

Materials + overhead + labor + profit divided by 1 cage = selling price per unit

Example: $4.00 + $2.00 + $5.00 + $2.50 divided by 1 cage = $13.50

This is the most individualized approach because a conscious decision is made about the profit you want from your business. You decide on a satisfactory wage and the amount of time you spend earning it. Profit and your labor rate are not the same.

**Formula D**

Wholesale price (Formula C) X 2 = retail selling price per unit.

Example: $13.50 x 2 = $27.00

This is a general distributor or retail pricing formula.
It assumes efficiency in production and a steady demand. When you decide to wholesale you must understand that the buyer will mark up your item a certain percentage. If you sell directly anywhere in the vicinity of the retailer, you must not under-cut the shop that is handling your work.

**Determining a Service Price**

A service-oriented business needs to figure the operating or fixed costs and the variable costs simply to keep the business going. These costs are the same as for the product-oriented business. In a service-oriented business the price should include:

- **Variable costs**
- **Fixed (operating expenses) costs**
- **Profit**

Labor is usually the major portion of the service-oriented business expense. You must figure out what your time per hour is worth for each service job you do and include it in your price.

You may decide to change the hourly minimum wage for yourself. If the service you provide is complicated and/or requires special expertise not readily available, you may want to charge a higher amount for your labor. Keep in mind this will create a higher price and some customers will either be unwilling or unable to buy your service. Some entrepreneurs are willing to charge less than minimum wage for their labor until they have established their business reputation.

Profit should also be included in the price. A business cannot continue to operate if it does not make a profit. You will want to find out the profit percentage made by other similar service-oriented businesses and include a comparable amount in your price.

Use the following formula to determine a price to charge for your services.

- First, you must decide on the amount to charge per hour for your labor.
- Second, determine the amount of overhead and variable expenses you incur to deliver your service.
- Third, decide what you think is a fair and competitive amount of profit.

**Formula A—Price Per Hour of Service**

Labor expenses per hour + overhead and variable expenses + profit = price per hour charged.

**Formula B—Price Per Job**

In lieu of charging an hourly rate for your service, you may wish to have a per job charge. To figure out this price, determine the total hours to do the job, then add this figure to this formula.

Labor expenses per hour x hours needed to do job + overhead and variable expenses + profit = price charged per job.

Remember, the key to setting prices for your product or service is to set them high enough to cover all your costs and low enough to encourage people to buy. Learning to set prices takes some business experience. The information in this fact sheet is presented as a helpful guide; some degree of flexibility is needed.

**Consumer Psychology Toward Price**

Whether they know it or not, most consumers develop mental attitudes about the price they are willing to pay for a product or service. There is considerable evidence that the importance of price in the decision to purchase varies from product to product and person to person.

There are numerous price strategies used by businesses to take advantage of customer pricing psychology. Three of the more common are listed below.

**Multiple Unit Pricing**

Simply put, this is a strategy where the customer perceives quantity buying as involving greater savings. An example is an item that normally sells for 49 cents. Multiple pricing would change this situation to a two for 89 cents or perhaps three for $1.39 price. In general, multiple unit pricing is usually effective in increasing immediate sales. However, this pricing technique may not increase the rate of consumption of the product. People will buy extra units of the product and use them as needed.

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