on market changes; setting price independently of the rest of the marketing program rather than as an intrinsic element of market-positioning strategy; and not varying price enough for different product items, market segments, distribution channels, and purchase occasions.

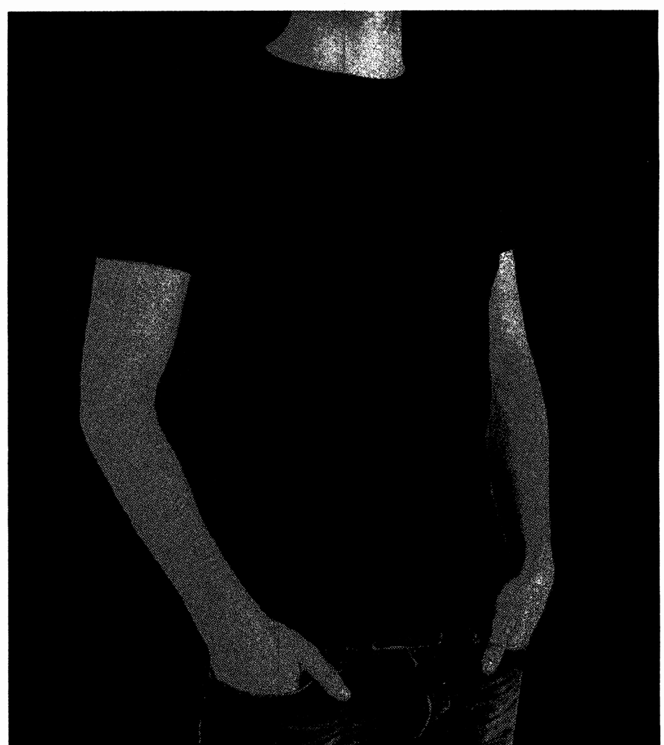
For any organization, effectively designing and implementing pricing strategies requires a thorough understanding of consumer pricing psychology and a systematic approach to setting, adapting, and changing prices.

CONSUMER PSYCHOLOGY AND PRICING

Many economists traditionally assumed that consumers were "price takers" who accepted prices at face value or as a given. Marketers, however, recognize that consumers often actively process price information, interpreting it from the context of prior purchasing experience, formal communications (advertising, sales calls, and brochures), informal communications (friends, colleagues, or family members), point-of-purchase or online resources, and other factors.[12]

Purchase decisions are based on how consumers perceive prices and what they consider the current actual price to be—*not* on the marketer's stated price. Customers may have a lower price threshold, below which prices signal inferior or unacceptable quality, and an upper price threshold, above which prices are prohibitive and the product appears not worth the money. Different people interpret prices in different ways. Consider the consumer psychology involved in buying a simple pair of jeans and a T-shirt.[13]

JEANS AND A T-SHIRT Why does a black T-shirt for women that looks pretty ordinary cost $275 from Armani but only $14.90 from the Gap and $7.90 from Swedish discount clothing chain H&M? Customers who purchase the Armani T-shirt are paying for a more stylishly cut T-shirt made of 70 percent nylon, 25 percent polyester, and 5 percent elastane with a "Made in Italy" label from a luxury brand known for suits, handbags, and evening gowns that sell for thousands of dollars. The Gap and H&M shirts are made mainly of cotton. For pants to go with that T-shirt, choices abound. Gap sells its "Original Khakis" for $44.50, though Abercrombie & Fitch's classic button-fly chinos cost $70. But that's a comparative bargain compared to Michael Bastian's plain khakis for $480 or Giorgio Armani's for $595. High-priced designer jeans may use expensive fabrics such as cotton gabardine and require hours of meticulous hand-stitching to create a distinctive design, but equally important are an image and a sense of exclusivity.



Source: ©Peshkov Daniil/Shutterstock

For even something as simple as a black t-shirt and a pair of jeans or pants, consumers may choose to pay as little as $50 or hundreds of dollars instead.

Understanding how consumers arrive at their perceptions of prices is an important marketing priority. Here we consider three key topics—reference prices, price-quality inferences, and price endings.

REFERENCE PRICES

Although consumers may have fairly good knowledge of price ranges, surprisingly few can accurately recall specific prices.[14] When examining products, however, they often employ **reference prices,** comparing an observed price to an internal reference price they remember or an external frame of reference such as a posted "regular retail price."[15]

All types of reference prices are possible (see Table 16.1), and sellers often attempt to manipulate them. For example, a seller can situate its product among expensive competitors to imply that it belongs in the same class. Department stores will display women's apparel in separate departments differentiated by price; dresses in the more expensive department are assumed to be of better quality.[16] Marketers also encourage reference-price thinking by stating a high manufacturer's suggested price, indicating that the price was much higher originally, or by pointing to a competitor's high price.[17]

When consumers evoke one or more of these frames of reference, their perceived price can vary from the stated price.[18] Research has found that unpleasant surprises—when perceived price is lower than the stated price—can have a greater impact on purchase likelihood than pleasant surprises.[19] Consumer expectations can also play a

TABLE 16.1 Possible Consumer Reference Prices

- "Fair Price" (what consumers feel the product should cost)
- Typical Price
- Last Price Paid
- Upper-Bound Price (reservation price or the maximum most consumers would pay)
- Lower-Bound Price (lower threshold price or the minimum most consumers would pay)
- Historical Competitor Prices
- Expected Future Price
- Usual Discounted Price

Source: Adapted from Russell S. Winer, *Pricing*, MSI Relevant Knowledge Series (Cambridge, MA: Marketing Science Institute, 2006).

key role in price response. On Internet auction sites such as eBay, when consumers know similar goods will be available in future auctions, they will bid less in the current auction.[20]

Clever marketers try to frame the price to signal the best value possible. For example, a relatively expensive item can look less expensive if the price is broken into smaller units, such as a $500 annual membership for "under $50 a month," even if the totals are the same.[21]

PRICE-QUALITY INFERENCES Many consumers use price as an indicator of quality. Image pricing is especially effective with ego-sensitive products such as perfumes, expensive cars, and designer clothing. A $100 bottle of perfume might contain $10 worth of scent, but gift givers pay $100 to communicate their high regard for the receiver.

Price and quality perceptions of cars interact. Higher-priced cars are perceived to possess high quality. Higher-quality cars are likewise perceived to be higher priced than they actually are. When information about true quality is available, price becomes a less significant indicator of quality. When this information is not available, price acts as a signal of quality.

Some brands adopt exclusivity and scarcity to signify uniqueness and justify premium pricing. Luxury-goods makers of watches, jewelry, perfume, and other products often emphasize exclusivity in their communication messages and channel strategies. For luxury-goods customers who desire uniqueness, demand may actually increase price because they then believe fewer other customers can afford the product.[22]

To maintain its air of exclusivity, Ferrari deliberately curtailed sales of its iconic, $200,000-or-more Italian sports car to below 7,000 despite growing demand in China, the Middle East, and the United States. But even exclusivity and status can vary by customer. Brahma beer is a no-frills light brew in its home market of Brazil but has thrived in Europe, where it is seen as "Brazil in a bottle." Pabst Blue Ribbon is a retro favorite among U.S. college students, but its sales have exploded in China where an upgraded bottle and claims of being "matured in a precious wooden cask like a Scotch whiskey" allow it to command a $44 price tag.[23]

PRICE ENDINGS Many sellers believe prices should end in an odd number. Customers perceive an item priced at $299 to be in the $200 rather than the $300 range; they tend to process prices "left to right" rather than by rounding.[24] Price encoding in this fashion is important if there is a mental price break at the higher, rounded price.

Another explanation for the popularity of "9" endings is that they suggest a discount or bargain, so if a company wants a high-price image, it should probably avoid the odd-ending tactic.[25] One study showed that demand actually increased one-third when the price of a dress *rose* from $34 to $39 but was unchanged when it rose from $34 to $44.[26]

Prices that end with 0 and 5 are also popular and are thought to be easier for consumers to process and retrieve from memory. "Sale" signs next to prices spur demand, but only if not overused: Total category sales are *highest* when some, but not all, items in a category have sale signs; past a certain point, sale signs may cause total category sales to fall.[27]

Pricing cues such as sale signs and prices that end in 9 are more influential when consumers' price knowledge is poor, when they purchase the item infrequently or are new to the category, and when product designs vary over time, prices vary seasonally, or quality or sizes vary across stores.[28] They are less effective the more they are used. Limited availability (for example, "three days only") also can spur sales among consumers actively shopping for a product.[29]