

When value and price collide

What is and isn't acceptable in pricing can highlight fascinating insights into how consumers and businesses behave



Imagine you've bought tickets for yourself, another adult and two children to see a film at the local cinema of a national chain. You then search online and find you could have paid nearly half if you saw the same film with the same chain but somewhere else. This does not seem fair. This example is taken from a [BBC](#) press report noting parents' objections to paying £34.16 (\$40) for tickets to a cinema in Carmarthen in Wales compared with £19.00 in Cardiff, the Welsh capital. That's 45 percent less.

The accusation of price gouging seems reasonable at first glance

A lack of alternative cinemas and therefore competition in Carmarthen has been blamed by a campaigner for the difference. To rub salt in the wounds, the price for similar tickets at the closer Welsh city of Swansea was £22.96 – still 33% lower. The objection is easy to understand, especially when parents are trying to entertain children during holidays and weekends, and when budgets are stretched. It's useful to note that incomes around Carmarthen are about 25 per cent lower than in Cardiff. The accusation of price gouging seems reasonable at first glance. After all, the cost

of putting on the film is unlikely to be nearly double in one location compared with the other. The price difference and consumer reaction provide some interesting illustrations of how consumers and businesses behave.

When different pricing for similar goods is and is not acceptable

People's willingness to accept different prices for similar goods is something that has been discussed many times by both traditional and behavioural economists. A traditional approach may recognise transactions costs, differences in quality, the convenience of getting something immediately, and supply and demand differences in specific places. On convenience and transactions costs, it appears reasonable from a traditional approach to pay extra and see the film in Carmarthen. After all, it takes about one hour and twenty minutes to drive from Carmarthen to Cardiff. A near three-hour round trip involves significant costs in both time and money which could wipe out the price difference. The 42-minute one-way drive to Swansea could do the same.



Source: www.geograh.org.uk Hywel Williams
The Vue cinema, Swansea

Behavioural approaches also suggest staying in Carmarthen to be a sensible choice. A common example of irrationality is the willingness of some to travel a half hour to get a certain amount off a low priced item (for example, to get a £5 discount on a £10 book) but unwilling to travel the same time for the same discount on a higher priced item (for example, to get the same £5 discount on a £50 jacket). According to both traditional and behavioural approaches, it is rational for the families to see the film in Carmarthen than travel to Cardiff. But that does not make it fair.

Defining fairness

Fairness is a tricky concept, especially when it comes to pricing. There have always been “sharp” operators – those who take advantage of their position to make a quick return. [A classic example](#) from the behavioural literature is the local hardware store that increases the price of the snow shovels during a heavy snowstorm. People consider that unfair. But if the hardware store needs to buy new stock to meet a surge in demand, and increases prices as a result, that is considered fair. The important thing appears to be to give people a reasonable explanation for the price

differences. In technical terms, people have a reservation price or a reference point that they are prepared to accept as a fair price to pay. Stray too far from the reservation price and you can be accused of being unfair. Economics Nobel laureate Richard Thaler explained this in [this article](#) back in 1983.

Stray too far from the reservation price and you can be accused of being unfair

Figuring out the appropriate reference price may depend on what is considered normal. For example, people seem willing to accept that a bank or other lender can and should charge a higher interest on a loan when the person borrowing the money has a poor credit history and therefore a greater risk of not paying the money back. Similarly, people are prepared to pay the same amount for goods at a national chain of supermarkets in a provincial town where commercial rents for the store are much lower than in a major city. One factor here could be that the reference prices appear to be set at the higher level appropriate to the major city. There is no need to imply that people are getting a bargain by shopping in the provincial town than the major city. Another important aspect is how easy it is to compare different prices. The example of the cinema chain highlights two challenges to the reference price. First, it was easy to compare prices. Second, it was seen as charging a higher price in one place rather a lower price in another. People feel as if they are losing – and losses are felt much more severely than gains, as we explain [here](#).

Technology and fairness in pricing

Technology has the potential to change what we consider fair. The ability to change prices quickly as demand increases or decreases is one of the noticeable differences in the way that technology is changing the way prices are set. Companies that adopt a platform approach, where suppliers of a service can decide whether or not to work, may argue that higher prices in times of high demand encourage more suppliers to work and keep the ultimate price lower than it would have been otherwise. For example, if it starts raining and more people want taxis, increasing the price might encourage more drivers to stay on the road instead of going home because they have already made the amount of income they need that day.

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People seem willing to accept this type of surge pricing but not different prices for the same good between customers based on data profiling from their internet search or social media activities. What is and is not acceptable in pricing has always been debated. New technology is presenting new challenges to this debate. The hard-pressed cinema goers in Carmarthen have a point. So too does the cinema chain. I have no idea whether enough people attend the cinema in Carmarthen to make it profitable. If not, new technology may even come to the rescue with some form of video streaming being a possible substitute to the traditional cinema experience.

Note: this article is based on a Twitter exchange between the author and Koen Smets

(@koenfucius). Koen has written elegantly on this topic [here](#).