



Chapter 11

Pricing Decisions: Objectives, Strategies, and Tactics

Price

“The exchange value of a good or service in the marketplace.”

Value is based on:

- **tangible** and **intangible** benefits
- Brand **perception**



Raw materials quality
Leading edge technology
LeBron endorsement
Impress peers

Nike

Influences on Price Decisions

1. Production and Marketing Costs
2. Channel Member Profit Expectations
3. Consumer Demand – Price Elasticity
4. Pricing Objectives

Production and Marketing Costs

Figure 11.3 Cost Components of a Packaged-Goods Product

	Cost Items	Actual Cost
	Ingredients	\$15.75
	Packaging (inner/outer)	1.79
	Shipping case	0.68
	Labour	1.48
	Manufacturing	0.20
	Warehousing	<u>0.34</u>
	Total Plant Cost	<u>20.24</u>
Add:	Freight cost	<u>1.36</u>
	Total Product Cost	<u>21.60</u>
Add:	Gross profit margin (40%)	<u>8.64</u>
	List Price	<u>30.24</u>
Add:	Retail profit margin (25%)	<u>7.56</u>
	Retail price (per case of 24)	37.80
	Selling Price at Retail	<u>1.57</u>

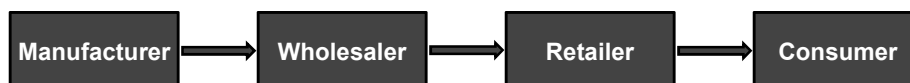
24 units
margins

Reducing Costs that Influence Price

To protect profit margins a manufacturer will consider programs to **reduce costs**.

- Improve operational efficiency
- Use less expensive parts and materials
- Shrink the size of the product (packaged good)
- Relocate manufacturing facilities (lower labour rates)

Channel Members Profit Expectations



Each level (member) of channel must make adequate profit.
Price of a product increases each time it changes hands.

Periodic price reductions (promotions) are offered by the manufacturer to encourage marketing support.

Practice: Margin Pricing ***Pricing Supplement in Textbook***

Figure the Retail Price:

- \$57 – production cost
- Monthly fixed costs are \$15,000
- Desired retail margin = 18%

$$\text{Retail price} = \frac{\$57}{1 - .18}$$

$$\text{Retail price} = \frac{\$57}{.82} = \mathbf{\$69.51}$$

Check ...

$$\mathbf{\$69.51 - 18\% = 56.998 \text{ or } \$57}$$

$$\text{Retail price} = \frac{\text{Cost}}{1 - \text{Desired return}}$$



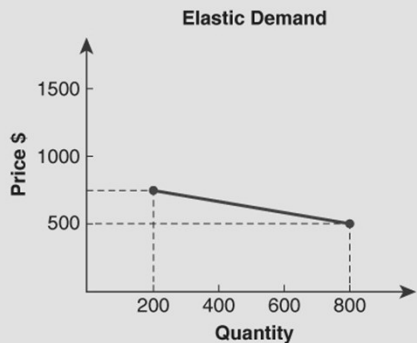
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Consumer Demand: Elasticity

If demand is elastic, consumers are price sensitive. When price increases, demand goes down significantly.

In the illustration, when price increased from \$500 to \$750, revenue declined from \$400 000 (800 units × \$500) to \$150 000 (200 units × \$750).



If demand is inelastic, consumers are not price sensitive. A large increase in price has a limited effect on sales volume.

In the illustration, when price increased from \$750 to \$1500, revenue increased from \$225 000 (\$750 × 300 units) to \$300 000 (\$1500 × 200 units).

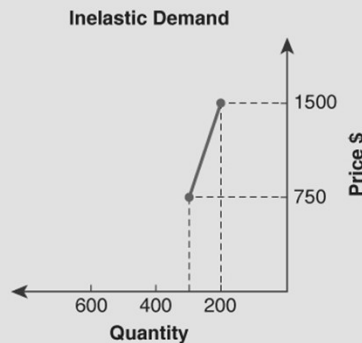


Figure 11.2 The Differences between Elastic and Inelastic Demand

Price Elasticity of Demand

$$\frac{\% \text{ of change in Quantity}}{\% \text{ of change in Price}}$$

I sold 100 @ \$4 each. When I upped the price to \$5, I only sold 85. Is this elastic demand or inelastic demand.

$$\frac{100 - 85}{\$5 - \$4} = \frac{15}{\$1} = \frac{15\%}{25\%} = .6$$

Pricing Objectives

Typically, there are three basic **pricing objectives**:

1. Maximizing Profit
Profit = Revenue - Expenses
2. Maximizing Sales Volume
3. Establishing a Competitive Position

Pricing Strategies

Textbook Pricing Supplement

1. Price Skimming
2. Price Penetration
BE = *Fixed cost*
Price - Variable cost
3. Competitive Pricing (Status Quo)

Price Skimming

Establishing a **high entry price** so that a company can maximize its revenue early.

Apple launched the iPod, iPhone and iPad with a skimming strategy.

Companies known for innovation have an advantage in terms of setting prices.



Figure 11.4 A reputation for innovation allows Apple to introduce new products with a high price.

Setting high prices attracts competitors to a market.

Price Penetration

Establishing a low entry price to gain wide market acceptance quickly.

Competitive Pricing

The price decision helps establish a **desired competitive position** in the market.

- Above competition
- Equal to competition
- Below competition

***Q-tips** sets its prices well above its competitors.*

***Walmart** sets its prices below all other department stores.*

Price Tactics

Organizations might employ to motivate purchase

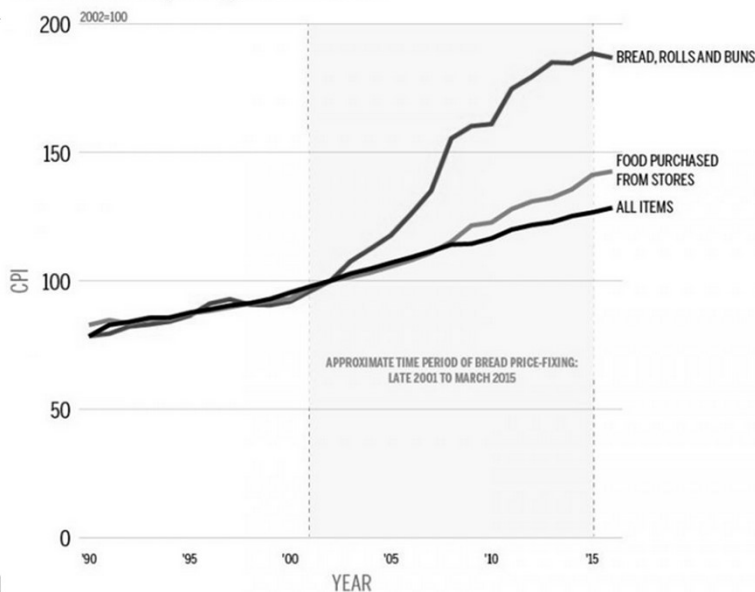
- Source Pricing and Offering Discounts
- Quantity discounts
- Cash Discounts
- Trade or Functional Discounts
 - Slotting Allowances
 - Off-Invoice Trade Allowances
 - Performance (Promotional) Allowances
- Seasonal Discounts
- Rebates
- Trade-In Allowances
- Promotional Pricing
- Flexible Pricing
- Geographic Pricing
 - F.O.B. Origin (Plant)
 - F.O.B. Destination (Freight Absorption)
 - Uniform Delivered Pricing
 - Zone Pricing
- Other
 - Psychological
 - Add-On



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Consumer price index: how bread, rolls and buns compare to other items, yearly, 1990-2016



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Experience Marketing: General Mills

- Factors that influence pricing
 - nature of the market
 - consumer demand
- Type of market environment = price decision criteria
- Consumer demand analysis
 - price elasticity (elastic or inelastic?)
 - consumer behavior?
- Competition



Pricing Exam

- End of Chapter Review Questions – great study!
- Formulas:
 - Break even calculation
 - Price Elasticity
 - Mark up vs. Margin

Manufacturer Production cost: 4.62; desired margin 15%

Wholesaler requires 7% margin

Retailer requires 20% margin

What is Retail Price?