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MARKETING: The Core 5/e

CHAPTER

11

PRICING PRODUCTS AND SERVICES



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VIZIO, INC.—WHERE VISION MEETS VALUE™ IN HDTV



12-4

LO1

NATURE AND IMPORTANCE OF PRICE

WHAT IS A PRICE?: THE PRICE EQUATION

- > Price
- > Barter
- > Price Equation



Final Price = List Prices – (Incentives + Allowances) + Extra Fees



12-5

FIGURE 12-1 The “price” a buyer pays can take different names depending on what is purchased

ITEM PURCHASED	PRICE EQUATION			
	PRICE	= LIST PRICE	– INCENTIVES AND ALLOWANCES	+ EXTRA FEES
New car bought by an individual	Final price	= List price	– Rebate – Cash discount – Old car trade-in	+ Financing charges + Special accessories + Destination charges
Term in college bought by a student	Tuition	= Published tuition	– Scholarship – Other financial aid – Discounts for number of credits taken	+ Special activity fees
Merchandise bought from a wholesaler by a retailer	Invoice price	= List price	– Quantity discount – Cash discount – Seasonal discount – Functional or trade discount	+ Penalty for late payment

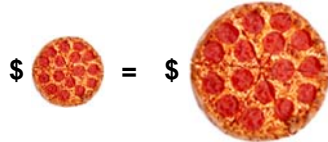
12-6

L01

NATURE AND IMPORTANCE OF PRICE

PRICE: AS AN INDICATOR OF VALUE; IN THE MKT MIX

➤ **Value** $\text{Value} = \frac{\text{Perceived Benefits}}{\text{Price}}$

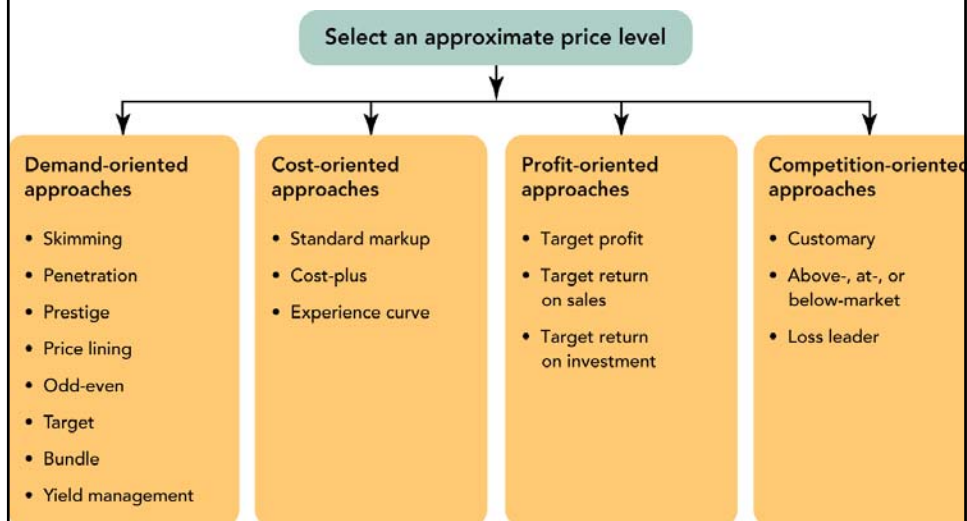


➤ **Profit Equation**

$$\text{Profit} = \text{Total Revenue} - \text{Total Cost}$$
$$= (\text{Unit Price} \times \text{Quantity Sold}) - (\text{Fixed Cost} + \text{Variable Cost})$$

12-7

FIGURE 12-2 Four approaches for selecting an approximate price level



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L01

GENERAL PRICING APPROACHES

1) DEMAND-ORIENTED PRICING APPROACHES

➤ Skimming Pricing



➤ Penetration Pricing



➤ Prestige Pricing



➤ Odd-Even Pricing

\$500.00
vs.
\$499.99

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L01

GENERAL PRICING APPROACHES

DEMAND-ORIENTED PRICING APPROACHES

➤ Target Pricing



➤ Bundle Pricing



➤ Yield Management Pricing: capacity management



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LO1

GENERAL PRICING APPROACHES

2) COST-ORIENTED PRICING APPROACHES

➤ Standard Markup Pricing



Manufacturer's cost = \$51.77; channel markups = 15/20/40; MSRP to consumers = \$100.



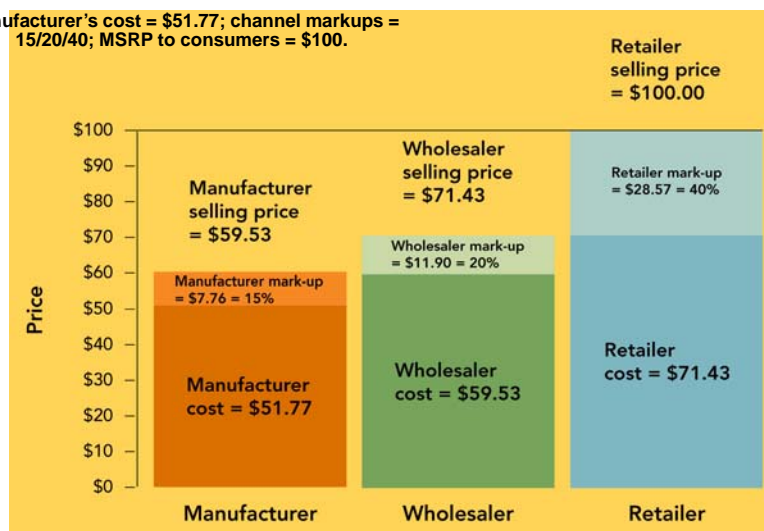
➤ Cost-Plus Pricing



12-12

FIGURE 12-A Markups for a manufacturer, wholesaler, and retailer on a home appliance sold to consumers for \$100

Manufacturer's cost = \$51.77; channel markups = 15/20/40; MSRP to consumers = \$100.



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LO1

GENERAL PRICING APPROACHES

3) PROFIT-ORIENTED PRICING APPROACHES

➤ Target Profit Pricing



$$\begin{aligned}\text{Profit} &= \text{Total Revenue} - \text{Total Cost} \\ &= (P \times Q) - [\text{FC} + (\text{UVC} \times Q)] \\ \$7,000 &= (P \times 1,000) - [\$26,000 + (\$22 \times 1,000)]\end{aligned}$$



Unique product

➤ Target Return-on-Sales Pricing

achieve a profit that is a specified percentage of the sales volume: super market

➤ Target Return-on-Investment (ROI) Pricing

achieve an annual target return-on-investment (ROI): large publicly owned firm.

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LO1

GENERAL PRICING APPROACHES

4) COMPETITION-ORIENTED PRICING APPROACHES

➤ Customary Pricing



➤ Above-, At- or Below-Market Pricing



➤ Loss-Leader Pricing



12-15

L02

ESTIMATING DEMAND AND REVENUE FUNDAMENTALS OF ESTIMATING DEMAND

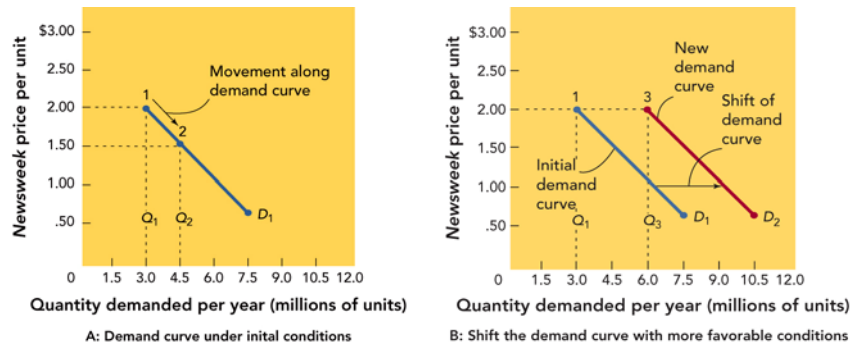
➤ Demand Curve

- Consumer Tastes
- Price and Availability of Similar Products
- Consumer Income
- Demand Factors



12-17

FIGURE 12-3 Demand curves for *Newsweek* showing the effect on annual sales (quantity demanded per year) by a change in price caused by (A) a movement along and (B) a shift of the demand curve



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L02

ESTIMATE DEMAND AND REVENUE FUNDAMENTALS OF ESTIMATING DEMAND

➤ Price Elasticity of Demand

$$\text{Price Elasticity of Demand (E)} = \frac{\text{Percentage Change in Quantity Demanded}}{\text{Percentage Change in Price}}$$

- Elastic Demand
- Inelastic Demand



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L02

ESTIMATE DEMAND AND REVENUE FUNDAMENTALS OF ESTIMATING DEMAND

➤ Price Elasticity of Demand

- Product Substitutes
- Necessities
- Large Cash Outlays

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FIGURE 12-4 Fundamental revenue concepts

➤ **Total Revenue**

$$\text{Total Revenue} = (\text{Unit Price} \times \text{Quantity Sold})$$
$$\text{TR} = (P \times Q)$$

$$\text{Total Profit} = \text{Total Revenue} - \text{Total Cost.}$$

12-23

FIGURE 12-5 Fundamental cost concepts

➤ **Total Cost (TC)**

$$\text{Total Cost (TC)} = \text{Fixed Cost (FC)} + \text{Variable Cost (VC)}$$

$$\text{Unit Variable Cost (UVC)} = \frac{\text{Variable Cost (VC)}}{\text{Quantity (Q)}}$$

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LO3

DETERMINING COST, VOLUME, AND PROFIT RELATIONSHIPS BREAK-EVEN ANALYSIS AND BEP

➤ **Break-Even Analysis**



➤ **Break-Even Point (BEP)**

$$\text{BEP}_{\text{Quantity}} = \frac{\text{Fixed Cost}}{\text{Unit Price} - \text{Unit Variable Cost}} = \frac{\text{FC}}{\text{P} - \text{UVC}}$$



12-25

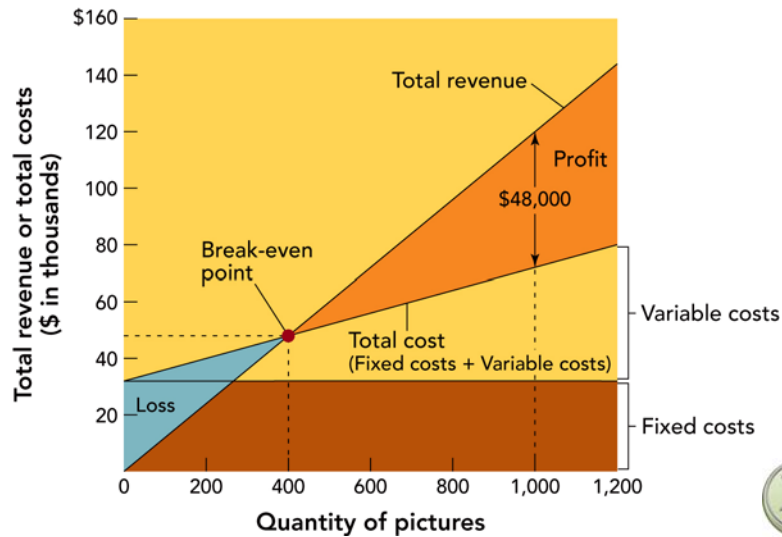
FIGURE 12-6 Calculating a break-even point for the picture frame store shows its profit starts at 400 framed pictures per year

Quantity of Pictures Sold (Q)	Price Per Picture (P)	Total Revenue (TR) = (P × Q)	Unit Variable Cost (UVC)	Total Variable Cost (VC) = (UVC × Q)	Fixed Cost (FC)	Total Cost (TC) = (FC + VC)	Profit = (TR - TC)
0	\$120	\$0	\$40	\$0	\$32,000	\$32,000	-\$32,000
200	120	24,000	40	8,000	32,000	40,000	-16,000
400	120	48,000	40	16,000	32,000	48,000	0
600	120	72,000	40	24,000	32,000	56,000	16,000
800	120	96,000	40	32,000	32,000	64,000	32,000
1,000	120	120,000	40	40,000	32,000	72,000	48,000
1,200	120	144,000	40	48,000	32,000	80,000	64,000



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FIGURE 12-7 Break-even analysis chart for a picture frame store shows the break-even point at 400 pictures




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L04

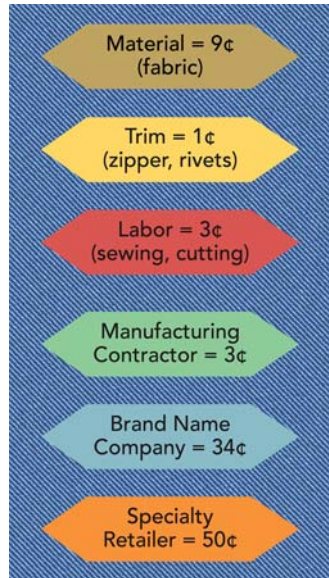
PRICING OBJECTIVES AND CONSTRAINTS IDENTIFYING PRICING OBJECTIVES

► Pricing Objectives

- Profit (\$)
- Sales (\$) 
- Market Share (\$ or #)
- Unit Volume (#)
- Survival
- Social Responsibility

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FIGURE 11-7 Where each dollar spent by consumers for designer denim jeans goes



11-32

L04

PRICING OBJECTIVES AND CONSTRAINTS IDENTIFYING PRICING CONSTRAINTS

➤ Pricing Constraints

- Demand for the Product Class (Cars), Product (Sports Cars), and Brand (Tesla Roadster)
- Newness of the Product: Stage in the Product Life Cycle



12-33

L04

PRICING OBJECTIVES AND CONSTRAINTS IDENTIFYING PRICING CONSTRAINTS

➤ Pricing Constraints

- **Cost of Producing and Marketing a Product**
- **Competitors' Prices**
- **Legal and Ethical Considerations**



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FIGURE 12-C Five most common deceptive pricing practices

DECEPTIVE PRICING PRACTICE	DESCRIPTION
Bait and switch	A deceptive practice exists when a firm offers a very low price on a product (the bait) to attract customers to a store. Once in the store, the customer is persuaded to purchase a higher-priced item (the switch) using a variety of tricks, including (1) downgrading the promoted item, (2) not having the item in stock, or (3) refusing to take orders for the item.
Bargains conditional on other purchases	This practice may exist when a buyer is offered "1-Cent Sales," "Buy 1, Get 1 Free," and "Get 2 for the Price of 1." Such pricing is legal only if the first items are sold at the regular price, not a price inflated for the offer. Substituting lower-quality items on either the first or second purchase is also considered deceptive.
Comparable value comparisons	Advertising such as "Retail Value \$100.00, Our Price \$85.00" is deceptive if a verified and substantial number of stores in the market area did not price the item at \$100.
Comparisons with suggested prices	A claim that a price is below a manufacturer's suggested or list price may be deceptive if few or no sales occur at that price in a retailer's market area.
Former price comparisons	When a seller represents a price as reduced, the item must have been offered in good faith at a higher price for a substantial previous period. Setting a high price for the purpose of establishing a reference for a price reduction is deceptive.

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L05

SETTING A FINAL PRICE

➤ Step 1: Select an Approximate Price Level

➤ Step 2: Set the List or Quoted Price

- One-Price Policy/
Fixed Pricing



- Flexible Price
Policy



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L05

SETTING A FINAL PRICE

➤ Step 3: Make Special Adjustments
to the List or Quoted Price

- Discounts

- Quantity

- Trade (Functional)

- Seasonal



- Cash



\$100, 2/10 net 30.

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L05

SETTING A FINAL PRICE

➤ Step 3: Make Special Adjustments to the List or Quoted Price

- Allowances

- Trade-In



- Promotional

BUY THREE,
GET ONE FREE

- Everyday Low Pricing (EDLP)



12-40

L05

SETTING A FINAL PRICE

➤ Step 3: Make Special Adjustments to the List or Quoted Price

- Geographical Adjustments

U.S. Postal Service Priority Mail Flat Rate Boxes from Denver to anywhere in the U.S.

- Envelope: \$5.15
- Small Box: \$5.35
- Medium Box: \$11.35
- Large Box: \$15.45



- Uniform Delivered Pricing (Multiple Zone)



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VIDEO CASE 11

WASHBURN GUITARS: USING BREAK-EVEN POINTS TO MAKE PRICING DECISIONS



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