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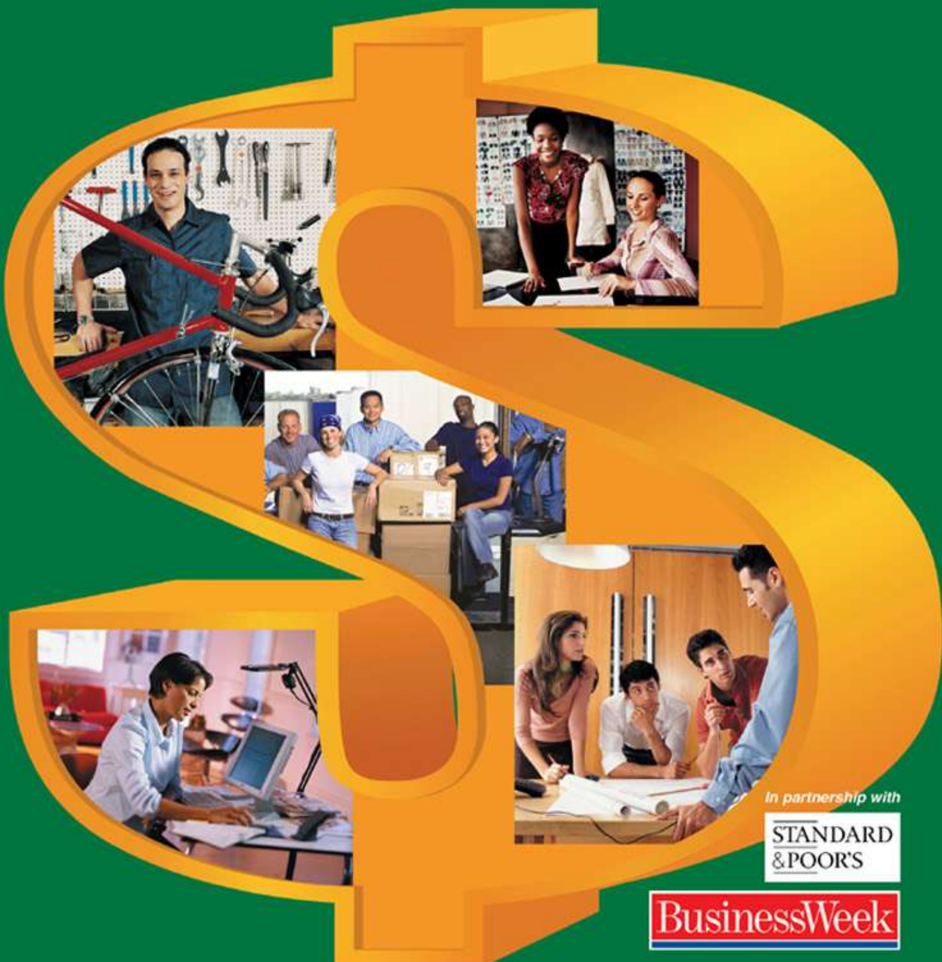
Entrepreneurship & Small Business Management



Chapter 11

The Price Strategy

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The Price Strategy

Section 11.1 Objectives

Identify factors that affect price strategy.

Explain the marketing objectives related to pricing.

Describe the components that go into making price strategy decisions.

Section 11.1 The Main Idea

Developing an effective price strategy is an important part of a marketing plan.

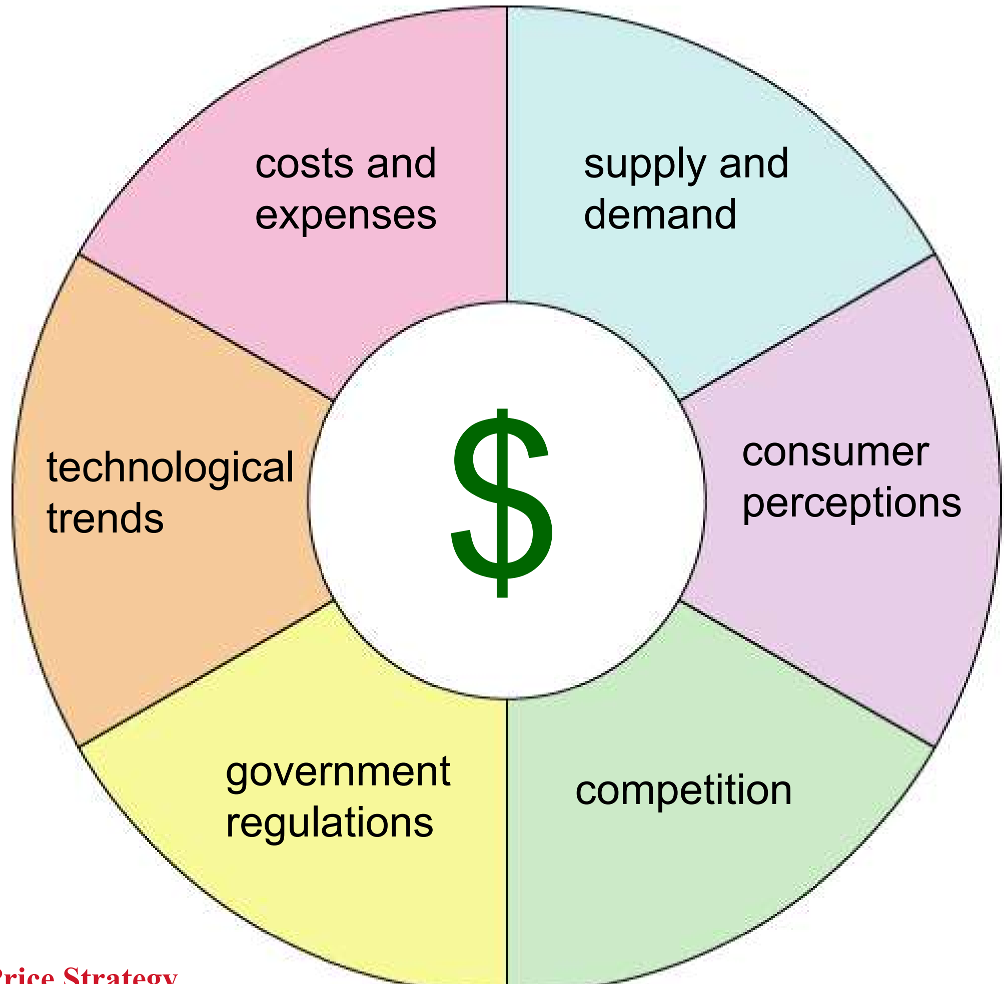
It enables you to set prices consistent with your objectives and appropriate for your target market.

Section 11.1 Key Terms

- fixed
- variable
- price gouging
- price fixing
- resale price maintenance
- unit pricing
- bait-and-switch
- return on investment
- price skimming
- penetration pricing
- psychological pricing
- prestige pricing
- odd/even pricing
- price lining
- promotional pricing
- multiple-unit pricing
- bundle pricing
- discount pricing

Graphic Organizer

Factors Affecting Price



Costs and Expenses

Fixed costs and expenses, such as rent, utilities, and insurance premiums, affect price.

fixed costs and expenses that are not subject to change depending on the number of units sold

Costs and Expenses

Variable costs and expenses, such as the cost of goods or services, sales commissions, delivery charges, and advertising, also affect price.

variable costs and expenses that are subject to change depending on the number of units sold

Costs and Expenses

If you are selling goods, their costs are affected by the pricing structure in the channel of distribution.

Each channel member has to make a profit to make handling the goods worthwhile. Their cost and profit together is your cost.

Supply and Demand

The law of supply and demand also affects price.

When the demand for a product is high and supply is low, you can command a high price.

When the demand for a product is low and supply is high, you must set lower prices.

Consumer Perceptions

The price of your products helps create your image in the minds of customers.

If your prices are too low, customers may consider your products inferior.

If your prices are too high, you may turn some customers away.

Competition

Competition can affect pricing when the target market is price conscious because competitors' pricing may determine your pricing.

Businesses can charge higher prices than competitors if they offer added value, such as personal attention, credit, and warranties.

Government Regulations

Be fair to customers and familiarize yourself with federal and state laws that address pricing, including:

price gouging
price fixing
resale price maintenance
unit pricing
bait-and switch advertising

Government Regulations

A company that engages in **price gouging** or **price fixing** is violating federal and state laws.

price gouging an illegal practice in which competing companies agree, formally or informally, to restrict prices within a specified range

price fixing pricing above the market when no other retailer is available

Government Regulations

Resale price maintenance is illegal.

Unit pricing is required by law.

resale price maintenance price fixing imposed by a manufacturer on wholesale or retail resellers of its products to deter price-based competition

unit pricing the pricing of goods on the basis of cost per unit of measure, such as a pound or an ounce, in addition to the price per item

Government Regulations

Unethical practices, such as **bait and switch**, are not only illegal but also unfair to customers.

bait and switch a deceptive method of selling in which a customer, attracted to a store by a sale-priced item, is told either that the advertised item is unavailable or that it is inferior to a higher-priced item that is available

Technological Trends

The Internet and technological trends affect price strategy.

Adapting to technological changes can give an entrepreneur a competitive edge; not adapting can cause some businesses to become obsolete.

Technological Trends

Before setting prices, consider the following objectives:

- obtaining a target return on investment
- obtaining market share
- social and ethical concerns
- meeting the competition's prices and establishing an image
- survival
- sometimes maintaining the status quo

Pricing Strategy Decisions

Consider your target market as you make these pricing strategy decisions:

Select a basic approach to pricing. → Determine your pricing policy. → Set a price based on the stage of the product life cycle.

Setting a Basic Price

There are three basic approaches to pricing

cost-based pricing	demand-based pricing	competition-based pricing

Pricing Policies

Establishing a pricing policy frees you from making the same pricing decisions over and over again and lets employees and customers know what to expect.

Pricing Policies

A flexible-price policy is one in which customers pay different prices for the same type or amount of merchandise.

A one-price policy is one in which all customers are charged the same price for all the goods and services offered for sale.

Product Life Cycle Pricing

All products move through the four-stage life cycle:

1	Introduction
2	Growth
3	Maturity
4	Decline

Product Life Cycle Pricing

Price skimming is commonly used when introducing a product.

price skimming the practice of charging a high price on a new product or service in order to recover costs and maximize profits as quickly as possible; the price is then dropped when the product or service is no longer unique

Product Life Cycle Pricing

Penetration pricing is also commonly used when introducing a product.

penetration pricing a method used to build sales by charging a low initial price to keep unit costs to customers as low as possible

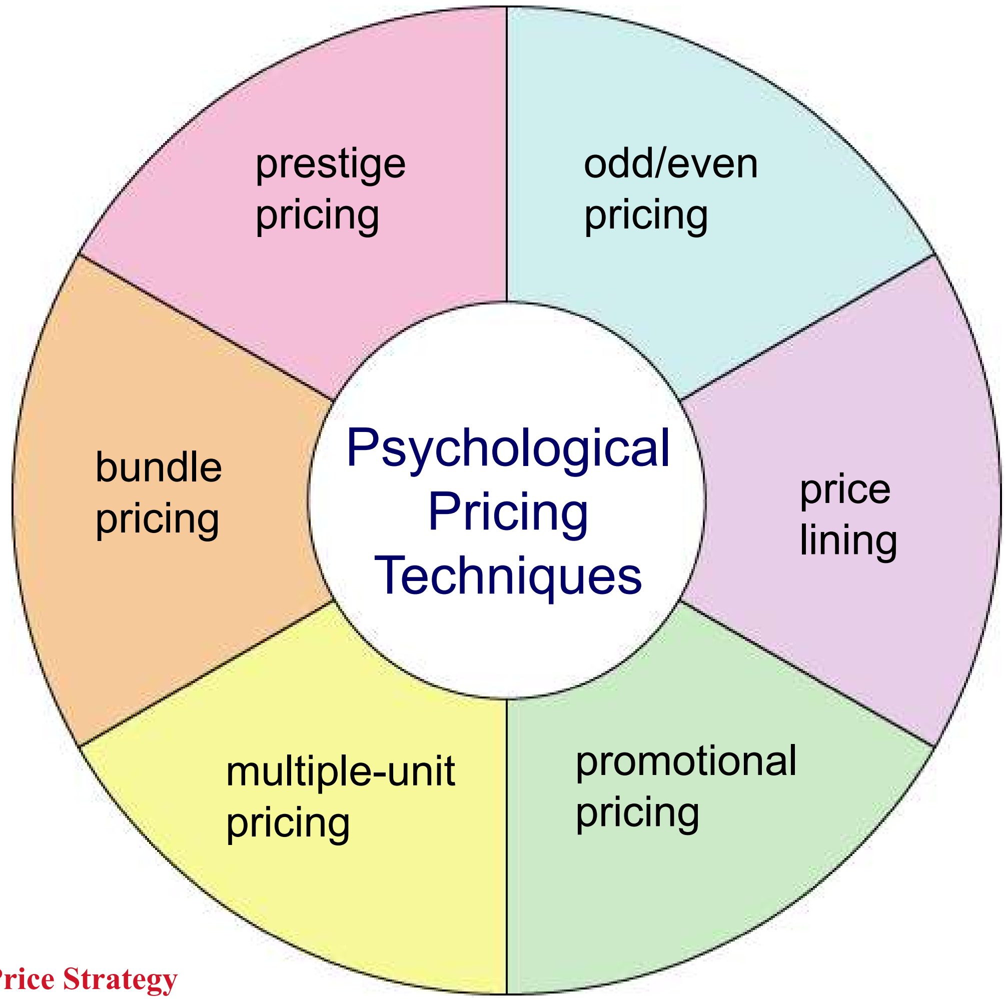
Pricing Techniques

Once you have introduced your new product through penetration pricing or price skimming, you need to adjust your prices so they are more attractive to customers by using **psychological pricing**.

psychological pricing
a pricing technique, most often used by retail businesses, that is based on the belief that customers' perceptions of a product are strongly influenced by price; it includes prestige pricing, odd/even pricing, price lining, promotional pricing, multiple-unit pricing, and bundle pricing

Graphic Organizer

Psychological Pricing Techniques



Pricing Techniques

A business may use **prestige pricing** to foster a high-end image.

prestige pricing a pricing technique in which higher-than-average prices are used to suggest status and prestige to the customer

Pricing Techniques

When a business uses **odd/even pricing**, customers may think they are getting a bargain.

odd/even pricing a pricing technique in which odd-numbered prices are used to suggest bargains, such as $19.99

Pricing Techniques

A store that sells all its jeans at $20, $40, and $60 is using **price lining**.

price lining a pricing technique in which items in a certain quality category are priced the same

Pricing Techniques

A new restaurant that offers "1950s prices for three days only" is using **promotional pricing**, a temporary pricing technique.

promotional pricing a pricing technique in which lower prices are offered for a limited period of time to stimulate sales

Pricing Techniques

When a store sells three pairs of socks for $10, it is using **multiple-unit pricing**.

multiple-unit pricing a pricing technique in which items are priced in multiples, such as 3 items for 99 cents

Pricing Techniques

Businesses that sell computer hardware often use **bundle pricing** to sell software that may not have sold otherwise.

bundle pricing a pricing technique in which several complementary products are sold at a single price, which is lower than the price would be if each item was purchased separately

Pricing Techniques

Discount pricing is used by all types of businesses to encourage customers to buy.

discount pricing a pricing technique that offers customers reductions from the regular price; some reductions are basic percentage-off discounts and others are specialized discounts

Section 11.1 After You Read

1. Identify factors that affect price strategy.

Factors that affect price strategy include costs, expenses, supply and demand, consumer perceptions, the competition, government regulations, and technological trends.

Section 11.1 After You Read

2. Explain the marketing objectives related to pricing.

Marketing objectives related to pricing include obtaining a target return on investment, obtaining market share, considering social and ethical issues, meeting the competition's prices, and establishing an image. They may also include surviving and maintaining the status quo.

Section 11.1 After You Read

3. Describe the components that go into making price strategy decisions.

To determine a pricing strategy, (1) select a basic approach to pricing (cost-based, demand-based, or competition-based), (2) determine your pricing policy (flexible-price policy or one-price, (3) set a price based on the stage of the product life cycle (introduction, growth, maturity, or decline) using an effective pricing technique (psychological pricing or discount pricing).

Section 11.2 Objectives

Carry out a break-even analysis.

Apply formulas used in calculating markup and markup percentages.

Employ formulas used to compute discounts.

List considerations for updating the price strategy.

Section 11.2 The Main Idea

Implementation of the price strategy requires an understanding of pricing formulas.

Keeping your price strategy in tune with your market requires ongoing review and revision.

Section 11.2 Key Terms

- break-even point
- selling price
- markup
- markdown

Break-Even Analysis

To calculate the **break-even point**, you divide fixed costs by the selling price minus your variable costs.

break-even point the point at which the gain from an economic activity equals the costs involved in pursuing it

Break-Even Analysis

Break-even analysis does not tell you what price you should charge for a product, but it gives you an idea of the number of units you must sell at various prices to make a profit.

Markup

Businesses that purchase or manufacture goods for resale use **markup** pricing based on the cost of the item.

markup the amount added to the cost of an item to cover expenses and ensure a profit

Markdown

Entrepreneurs may use **markdown** pricing to tempt shoppers to buy in order to reduce inventory.

markdown the amount of money taken off an original price

Discounts

A discount is a reduction in price to the customer.

multiply the item price by the discount percentage then subtract the discount dollars from the price

Possible Changes to Pricing Strategy

- Adjusting prices to maximize profit
- Reacting to market prices
- Revising terms of sale

Adjusting Prices to Maximize Profit

Before you adjust prices to maximize profit, ask yourself two questions:

Are your products' prices elastic or inelastic?	What are your competitors' prices?

Reacting to Market Prices

As part of ongoing market research keep an eye on current market prices for your products.

If competitors' prices fall, you will lose customers if you do not lower prices.

If competitors' prices rise, it is important to your business's financial health to raise prices.

Revising Terms of Sale

Another way to change your pricing strategy is to revise the terms of sale, such as

- changing credit policies
- introducing discounts
- offering leasing
- arranging financing

Section 11.2 After You Read

1. Explain how to Carry out a break-even analysis.

Divide fixed costs by the selling price minus variable costs.

Section 11.2 After You Read

2. Apply formulas used in calculating markup and markup percentages.

Markup percentage on cost is determined by dividing markup by cost. Markup percentage on selling price is determined by dividing markup by selling price.

Section 11.2 After You Read

3. Employ formulas used to compute discounts.

To compute discounts, the item price is multiplied by the discount percentage; then the discount dollars are subtracted from the price. Series discounts are calculated in sequence.

Section 11.2 After You Read

4. List considerations for updating the price strategy.

Considerations for updating price strategy include a review of basic price strategies, pricing policies, shifts in product life cycle, and pricing techniques. Another consideration is reviewing the overall effectiveness of the price strategy. Adjustments to price strategy should reflect any changes in objectives. These changes may lead to changes in the marketing plan.

E-Commerce Payment Methods

After creating an inviting e-commerce environment for shoppers, you will want to be sure they can easily and quickly pay for their purchases.

Consumers can pay for online purchases using credit cards, debit cards, e-cash, smart cards, and e-wallets.

Tech Terms

debit card
a card issued by a financial institution than can be used as an alternative to cash; purchase amounts on a debit card are withdrawn directly from the purchaser's checking or savings account

e-cash
a legal form of electronic money transfer used in e-commerce and transacted via the Internet

Tech Terms

e-wallet
a software application that stores a customer's data, such as name, address, and credit card number, for easy retrieval during online purchases

merchant account
a bank account that enables a business to receive the proceeds of credit card purchases

return on investment (ROI)
the amount earned as a result of an investment

Tech Terms

selling price
the actual or projected price per unit

smart card
an electronic prepaid cash card that includes a computer chip that can store data; used to make purchases or financial transactions over the Internet

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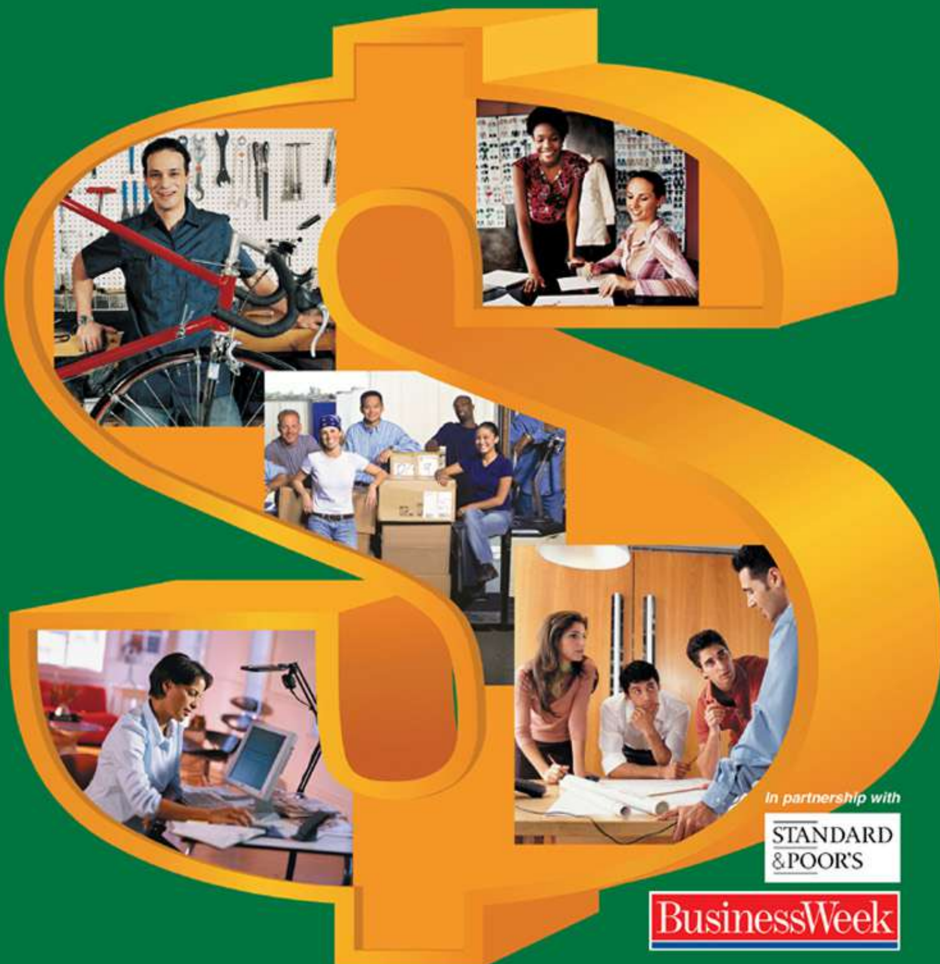

End of Chapter 11

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