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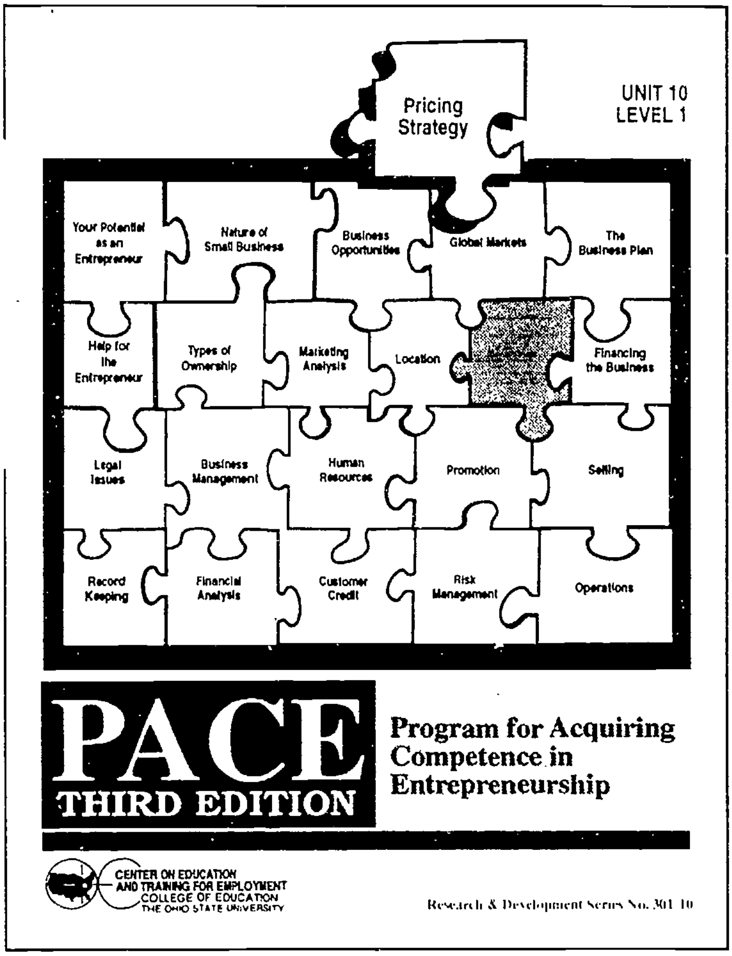
ABSTRACT

This instructor guide for a unit on pricing strategy in the PACE (Program for Acquiring Competence in Entrepreneurship) curriculum includes the full text of the student module and lesson plans, instructional suggestions, and other teacher resources. The competencies that are incorporated into this module are at Level 1 of learning--understanding the creation and operation of a business. Included in the instructor's guide are the following: unit objectives, guidelines for using PACE, lists of teaching suggestions for each unit objective/subobjective, model assessment responses, and overview of the three levels of the PACE program. The following materials are contained in the student's guide: activities to be completed in preparation for the unit, unit objectives, student reading materials, individual and group learning activities, case study, discussion questions, assessment questions, and references. Among the topics discussed in the unit are the following: pricing as a marketing function, costs that affect pricing, competition's role in the marketplace, ways competition and consumer demand affect prices, supply and demand, effects of product image on price. (MN)



INSTRUCTOR GUIDE

Unit 10

Pricing Strategy

Level 1

Objectives:

- Define pricing as part of the marketing mix.
- Identify costs that affect pricing.
- Explain how competition affects pricing.
- Describe the impact of consumer demand on prices.
- Discuss the relationship between image and price.

HOW TO USE PACE

- Use the objectives as a pretest. If a student is able to meet the objectives, ask him or her to read and respond to the assessment questions in the back of the module.
- Duplicate the glossary from the *Resource Guide* to use as a handout.
- Use the teaching outlines provided in the *Instructor Guide* for assistance in focusing your teaching delivery. The left side of each outline page lists objectives with the corresponding headings (margin questions) from the unit. Space is provided for you to add your own suggestions. Try to increase student involvement in as many ways as possible to foster an interactive learning process.
- When your students are ready to do the *Activities*, assist them in selecting those that you feel would be the most beneficial to their growth in entrepreneurship.
- Assess your students on the unit content when they indicate they are ready. You may choose written or verbal assessments according to the situation. Model responses are provided for each module of each unit. While these are suggested responses, others may be equally valid.

Objectives	Teaching Suggestions
1. DEFINE PRICING AS PART OF THE MARKETING MIX	
Is pricing a marketing function or an accounting function?	Have students suggest all the business activities they associate with marketing. Students may suggest sales, advertising, and product development, etc. Write these suggestions on the board. Then, introduce the concept of the FOUR Ps of marketing. Go back to the board and put the business activities the students have suggested into one of the FOUR P categories. Discuss marketing activities within any of the FOUR P categories students have missed. Note that in this unit you will be concentrating on price.
2. IDENTIFY COSTS THAT AFFECT PRICING	
What are the costs that affect pricing?	Have the students identify the fixed and variable costs for several different businesses. For example, you might choose a shoe manufacturer, a restaurant, and a florist.
3. EXPLAIN HOW COMPETITION AFFECTS PRICING	
What is the role of competition in the marketplace?	Ask the students if there are any monopolies in United States. Discuss the major utilities as monopolies. Who controls their rates? What would happen if their rates were not controlled?
How does competition affect prices?	Have students examine (taste) two competitive brands of cookies. Choose one name brand and one similar off brand. What are the features of each brand (shape, ingredients, packaging, name brand). Compare the prices of the two brands. Are the price differences justified?
4. DESCRIBE THE IMPACT OF CONSUMER DEMAND ON PRICES	
What is supply?	Ask the students to imagine that they are the sole manufacturer of pet sea shells. It costs you $.50 to paint a face on the shell and package it. How many would you produce if consumers were willing to pay $0.25? $0.50?, $1.00?, $2.00?, etc. What would prevent you from charging $100.00? Answer: Lack of demand and increase in competition. On the board of on an overhead, relate this example to the supply curve.

Objectives	Teaching Suggestions
What is demand?	Now, ask the students to imagine that they are crazy about pet rocks. They want to take them to school. They want to swap them with their friends. They want a whole family—a whole community of pet rocks in their home. Who would buy them if they cost $100? (A few hands go up.) Who would buy them if they were $50.00?, $20.00?, $10.00?, $5.00?. $2.00?, $1.00?, $0.50? (More and more hands go up?) On the board or on an overhead, relate this example to the demand curve. Ask students, if pet rocks were popular, how much would they sell for? Why? Talk about the interaction between demand and supply. Include competition and costs in your discussion.
5. DISCUSS THE RELATIONSHIP BETWEEN IMAGE AND PRICE.	
What is the image of a product?	Ask the students what the image of the following cars is: Mercedes, Cadillac, Ford Taurus, Escort, Ferrari, Mazda, etc.
How does price affect image?	Ask the students if they were able to buy a $30,000 Mercedes for $10,000 would it affect their image of the car? What would they think about an Escort which costs $30,000?

MODEL ASSESSMENT RESPONSES

1. Pricing is one of the FOUR Ps of marketing. Accounting functions determine how much it costs to produce a product. In the long run, a product can not be priced below the production costs, or the company will go out of business. However, marketing concerns such as market demand and competition actually determine what the customer is willing to pay for the product.

2. The fixed and variable costs must be covered in order for the company to make a profit. Variable costs change with the number of items are produced; while fixed costs are constant no matter how many items are produced.

3. As competition increases, prices for the product decrease. For example, as more and more manufacturers enter the CD disc player market, the price of CD disc players has declined.

4. Consumers' demand for a product and the manufacturers' willingness to supply that product intersect at the equilibrium point. When the product is priced at the equilibrium price, the amount of the product produced by the manufacturers will equal the amount of the product purchased by the consumers.

5. Price creates image for a product if very little else is known about the product. For example, when Toyota introduced the Lexus brand name, very little was known about the car. However, since it was very expensive, consumers assumed it was a luxury car. In this case, price created the image for the product. On the other hand, the Mercedes is very well known as a high quality, high powered, prestigious automobile. This image justifies its high price.

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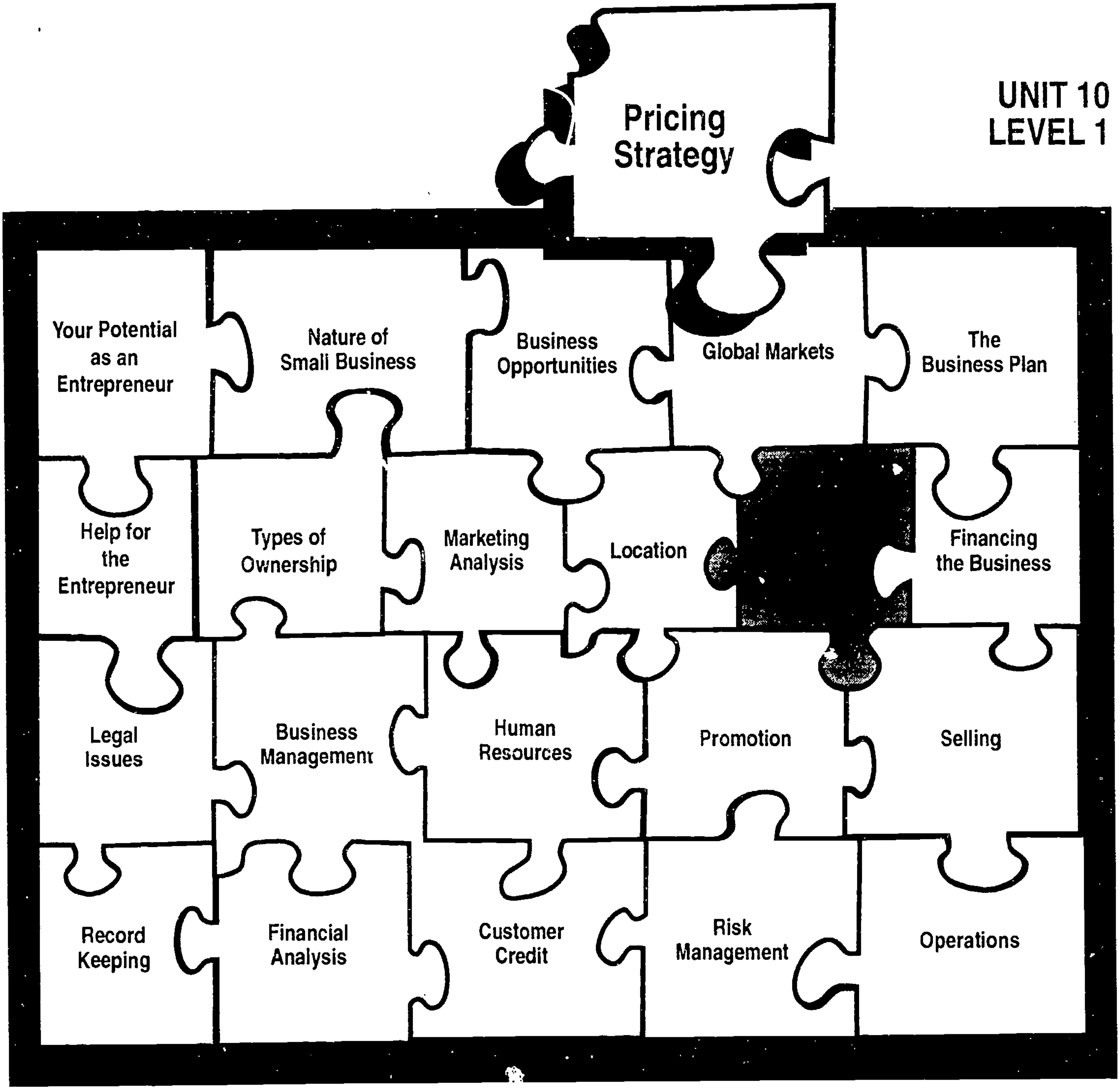
UNIT 10
LEVEL 1



PACE
THIRD EDITION

Program for Acquiring Competence in Entrepreneurship

CENTER ON EDUCATION AND TRAINING FOR EMPLOYMENT
COLLEGE OF EDUCATION
THE OHIO STATE UNIVERSITY

Research & Development Series No. 301-10

PRICING STRATEGY

BEFORE YOU BEGIN . . .

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.

2. Read What are the Objectives for this Unit on the following page. If you think you can meet these objectives now, consult your instructor.

3. Look for these business terms as you read this unit. If you need help with the meanings, ask your instructor for a copy of the PACE Glossary contained in the *Resource Guide.*

   Demand/supply
   Market equilibrium
   Place
   Price
   Product
   Promotion

PRICING STRATEGY

WHAT ARE THE OBJECTIVES FOR THIS UNIT?

Upon completion of this unit you will be able to—

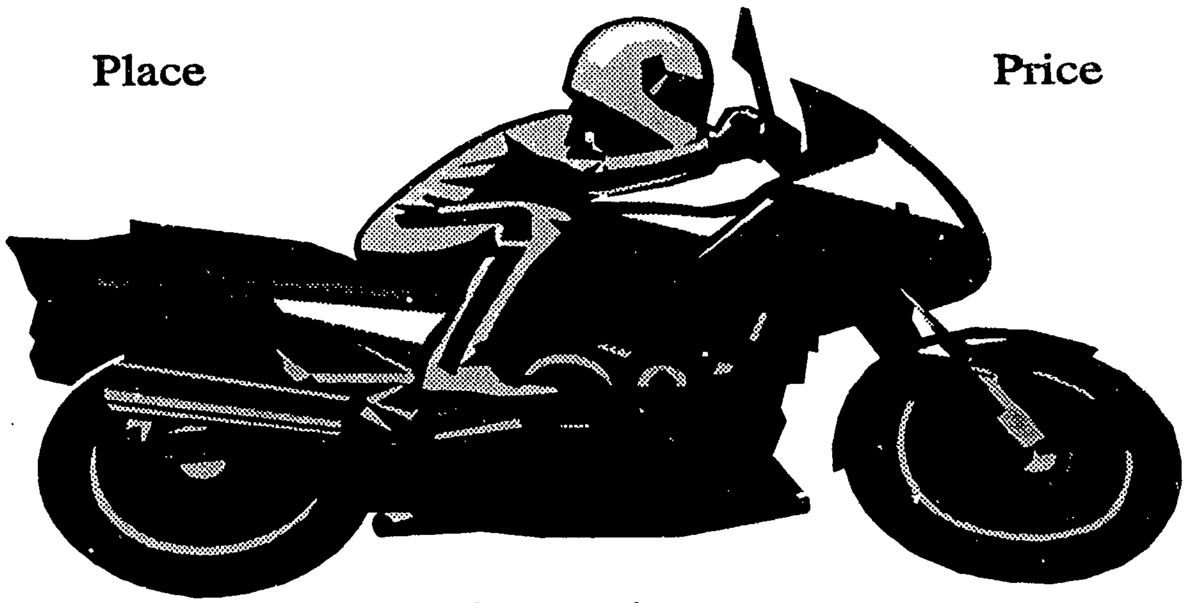
- define pricing as part of the marketing mix,
- identify costs that affect pricing,
- explain how competition affects pricing,
- describe the impact of consumer demand on prices, and
- discuss the relationship between image and price.

WHAT IS THIS UNIT ABOUT?

Have you ever wondered how different manufacturers and marketers come up with the prices that they place on their goods and services? For example, why is it that a motorcycle can cost $8,000, when you can buy a car for $7,000? Clearly, there is a lot more metal, rubber, and plastic in a car than there is in a motorcycle. Certainly a car takes longer to manufacture, and is more costly to transport than a motorcycle. Yet, consumers will willingly pay even $10-15,000 for a motorcycle, when there are very nice cars available for less than that.

Let's look at another example. How do realtors arrive at the prices of houses? The price of a house in one neighborhood could be half that of an identical house in another neighborhood. You are correct if you said that the price or value of the land will vary in this equation, with the house on the more valuable land being more expensive than the house on the less valuable land. So, how do you put a value on land? Presumably the land is composed of essentially similar materials including dirt, rocks, and maybe sand. How can the land in one place be worth more than the land in another? It is the answers to these kinds of questions that will be determined in this unit.

The purpose of this unit is to gain an understanding of pricing and the impact that the pricing function has on a small business. The price of an item is the amount of money a consumer will have to pay to receive ownership of the item. Pricing is the activity of



determining what price the consumer will have to pay.

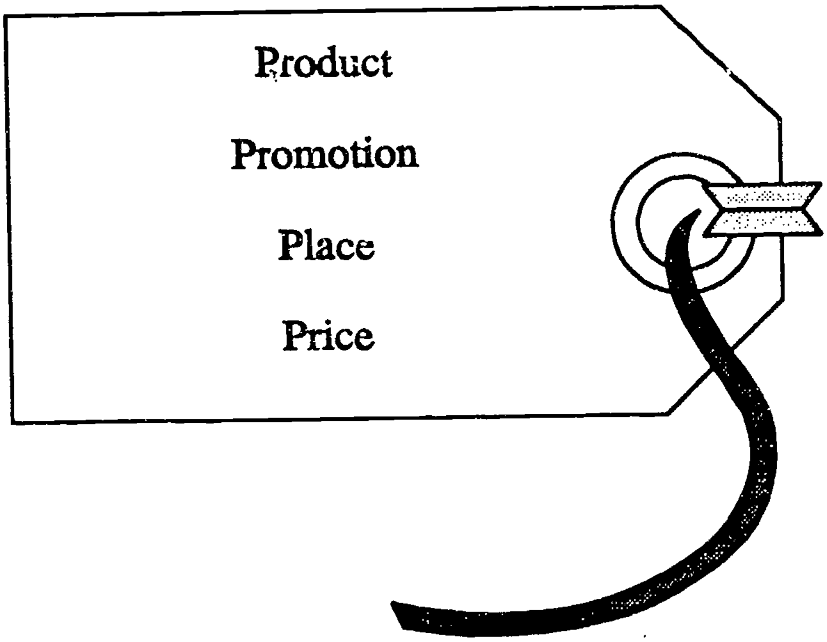
This unit will examine the impact of the pricing function on the various aspects of the business. You will identify the costs that will affect prices, then examine the impact of competition, demand, and image on price.

IS PRICING A MARKETING FUNCTION OR AN ACCOUNTING FUNCTION?

This question gets to the heart of the pricing activity. Pricing is fundamentally a marketing function, not an accounting function. However, the two must be coordinated by the marketing staff in order to maximize profits, which is the objective of most businesses.

To understand this concept more clearly, we must take a look at the role of marketing in the production and sale of goods and services. Often the distinction between marketing and sales is blurred by businesses and consumers alike. As a general definition, *sales* is the disposal of goods and services that have already been produced, whereas *marketing* is the production of goods and services that people will want to buy. The difference is in the *timing*. Salespeople spend their time making goods more appealing, whereas marketers spend their time making more appealing goods.

So, having defined marketing, how is it then that pricing is a marketing challenge? Remember that marketers produce products that are more appealing to the consumer. There are four recognized elements to this production process. These are known as the FOUR Ps of marketing, or alternatively, the Marketing Mix. The four elements are as follows:



1. **Product**. Creating a product or service that meets the consumer's needs.

2. **Promotion**. Promoting the product in such a way that allows eligible consumers to know about the product.

3. **Place**. Having the product available at a place that makes sense for the consumer to purchase it.

4. **Price**. Charging a price that conveys the appropriate value for the product, and is acceptable to the consumer.

Of the Four Ps, each represents an aspect of a product that will have a bearing on the consumption choice of the people in the marketplace. In other words, each of these elements influences how attractive a product is. Let's take another look at the motorcycle example to illustrate this point. As a *product*, the motorcycle has two wheels and an engine which, when combined on a frame, provide the experienced rider with a fast and fun form of transportation.

Without *promotion*, the potential rider would not know either where to buy the machine, or the different types of machines that are available on the market. Manufacturers of motorcycles place advertisements in newspapers and phone books to let buyers know where to go to buy motorcycles.

The *place* that the motorcycle is available is also important because it determines who will have access to the product. As an extreme example, let's say that motorcycles were only available in Japan and Germany. That means that U.S. riders would have to travel to Japan or Germany to buy them. Not many riders would be prepared to do this. Therefore, a motorcycle that is sold

and serviced locally will be more attractive to the consumer.

The final element of this mix is the *price*. If the manufacturer charges $1 million for each motorcycle, then there are very few consumers who would be willing to buy it. On the other hand, if the manufacturer charged $100, he would sell many motorcycles. But, the manufacturer would go out of business because the motorcycle costs more than $100 to manufacture. Therefore, the challenge in pricing is to determine a price that is both attractive to the consumer, and recovers the costs of production for the manufacturer.

The small business person manages each of these four elements in the production and sale of the goods and services. Pricing principles can be applied to the most complicated and expensive products, as well as, to the simplest and cheapest products. The difference will be the depth of the price analysis.

WHAT ARE THE COSTS THAT AFFECT PRICING?

As mentioned earlier, the activities of marketing and accounting are coordinated in setting a price for a good or service. The reason for this is that the price received for a product must be higher than the amount paid to produce it or the firm will lose money with each sale. Therefore, it is crucial that marketers and accountants calculate all of the relevant costs involved in producing a good. They must ensure that the price charged is enough to both cover costs and allow for an acceptable profit.

There are two primary elements in the cost of producing a good or service. They are—

- fixed costs and
- variable costs.

Think back to the motorcycle example. Let's assume that the motorcycle would cost about $1,000 in raw materials. The raw materials for a motorcycle include steel for the wheels, engine, and frame; rubber for the tires; and plastic for the seat. In addition, all of the electronic fittings and lights will cost the manufacturer during production, so they need to be included in the price. These raw material costs are called *variable* costs, because they vary depending on how many items are produced.

Once these costs are summed, the cost of the power to generate the machines, the wages of the line workers and salespeople, the transportation costs, as well as the costs of the machines to build the motorcycles must somehow be covered. The costs of the workers' salaries, the machines used in production, and the land that the factory sits on are called *fixed* costs. No matter how many motorcycles are produced, these fixed costs will remain the same.

Both fixed and variable costs must be somehow incorporated into the price of the motorcycle. The variable cost of the motorcycle is calculated as the sum of all the materials used to produce the vehicle. However, adding an amount for fixed costs is not as simple. The fixed costs must be spread over a larger number of motorcycles, not just one. As a general rule, the cost of the machine must be spread over the number of motorcycles it makes. For example, if a machine that makes engines costs $100,000 and over its life it produces 1,000 motors, then the cost of the machine will even out to be $100 per motor.

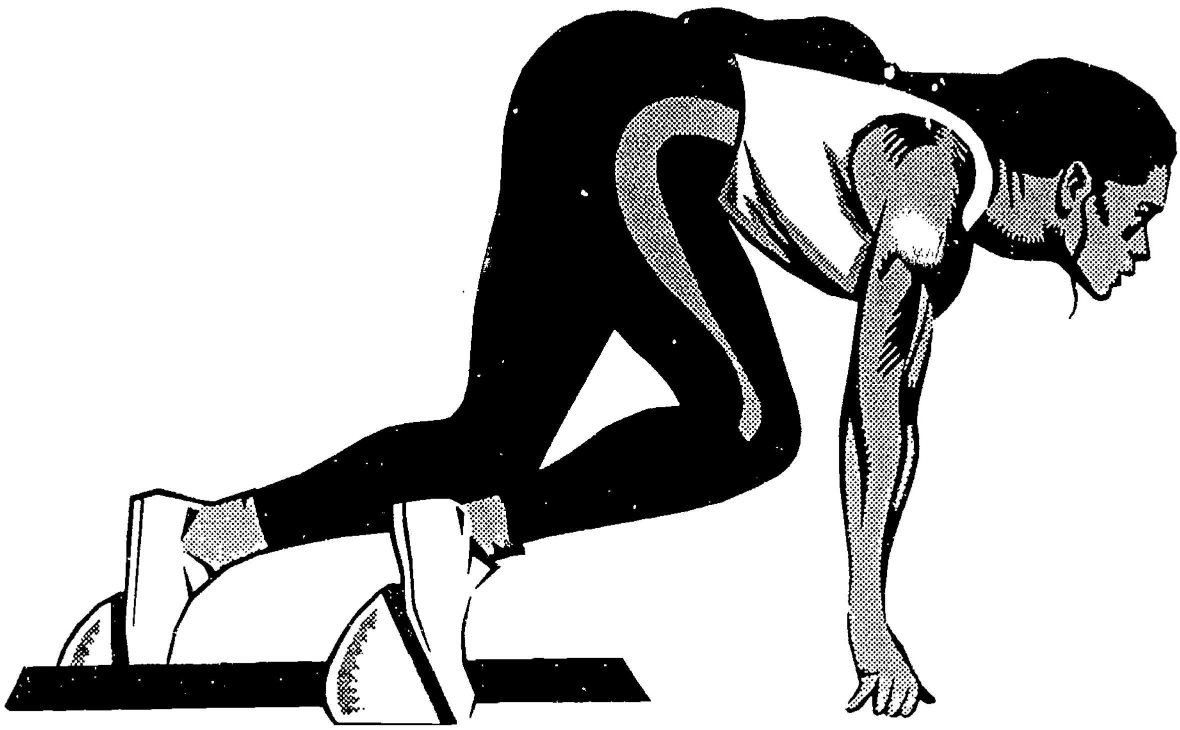
A similar calculation can be applied to all of the components of fixed costs. If the price of the motorcycle is more than the total of the variable costs and the proper allocation of fixed costs, then the manufacturer is making a profit on the sale.

WHAT IS THE ROLE OF COMPETITION IN THE MARKETPLACE?

Almost everything you have ever paid money for was one of a number of alternatives from which you could choose. When you buy a pair of shoes there are literally thousands of different brands, styles, functions, prices, and sizes from which to choose. The same applies to cars, houses, foods, books, radios, refrigerators, and so on. In the marketplace, the variety of options and alternatives available to consumers provides them with the freedom to choose the most appropriate product for their needs. Whenever the consumer is able to choose from among alternatives, the suppliers of those alternatives are facing *competition*.

From a producer's perspective, competition is bad. When there is competition, then consumers can choose between your product and someone else's product. In order to make a sale, your product needs to be somehow superior in the consumer's mind. This makes your job more difficult and costly.

However, from a consumer's perspective, competition is good. Competition ensures that manufacturers sell high quality goods at reasonable prices. Competition forces manufacturers to invest time and money in research and development. Competition helps to ensure that consumers receive value for their purchases.



HOW DOES COMPETITION AFFECT PRICES?

To understand how competition affects pricing, look at this next example. Let's assume for a moment that there is only one make and one model of car available in the market. That would mean that everyone who wanted to buy a car would be forced to buy the same car from the same company. Effectively, the car seller could charge whatever price .ie or she wanted for the car because there is no alternative available. Consumers who wanted to buy a car would be forced to pay the high price. This type of market is known as a *monopoly*. A monopoly occurs when there is only one major supplier in the marketplace. Can you think of any monopolies that exist in the U.S?

Now, assume that there is only one brand of soap on the market. If you want to wash with soap, you must buy this brand of soap. The manufacturer could charge $20 for a cake of soap and people would pay it.

The reason that manufacturers cannot charge extremely high prices is that competition forces them to offer a good value to the consumer. If a soap manufacturer charges too much for a soap product, then consumers will buy a cheaper soap from another soap company.

In fact, competitive pricing plays a major part in helping to determine a price for a product or service. Remember, competition is comprised of the alternatives to your product or service that are available to the consumer. If your product is a breakfast cereal, then think of how many alternatives there are for your product. Not only are there all of the different varieties of cereal (*direct competition*), but there are also a variety of different types of foods you can eat at breakfast (*indirect competition*). For example, you could eat fruit, toast, bagels, yogurt, oatmeal, or leftovers. In fact you could eat just about anything you want to for breakfast as long as you have it available.

The implication of this realization is that as a category, the price of breakfast cereals must seem reasonable to consumers, or they would not consider buying them. Secondly, the price of the different brands of cereals within the category must seem reasonable to consumers. This reasonableness will be based on the types of features offered by the cereal, such as flavor, health benefits, and free gifts. Typically, the product with more features, or higher quality features will sell for a higher price.

As an example, assume that your company makes breakfast cereals. Your technicians have just formulated a cereal that is very similar to "Rice Krispies." You are going to call your product "Paddy Bubbles," and you expect that people will buy your cereal instead of "Rice Krispies."

Question: How much should you charge for "Paddy Bubbles?" Should you charge more, the same, or less than the price of "Rice Krispies?

Answer: If the new cereal provides no benefit to consumers other than the fact that it is an alternative to "Rice Krispies, then consumers will probably not pay **more** for your cereal than for "Rice Krispies." In fact, because people tend to buy things they know they like, if your cereal costs the **same** as "Rice Krispies", then people may still not have a good enough reason to buy it. Therefore, in order to persuade people to buy your cereal, it will probably have to cost **less** than Rice Krispies before people will give it a try.

If you price your product lower than your competitors, you must decide how much less will be enough to take market share from your competitor. If the reduction is too small, then few customers will be persuaded to change. If the reduction is too large, then you will attract all the customers you want at the expense of your profit margin.

One of the ways you might consider attracting new customers without sacrificing long-term profit is with a **price promotion**. This promotion may take many forms, such as a trial offer, a sale price, buy one get one free offers, or coupons.

Coupons are common today because manufacturers like to offer the public an incentive to try their products without lowering the price permanently. Coupons may be mailed, attached to other products, or dispensed at the point of purchase.

Another common form of incentive is the use of a rebate. The consumer mails in a card and proof of purchase and receives a check in the mail. Either way, the manufacturer hopes that the consumer will try the new product, like it, and buy it again at full price. Next time you go shopping, you might want to use coupons to see how much money you can save.

The problem with price promotions is that they may encourage people to buy whatever they have coupons or rebates for. Instead of building loyalty to your product, coupons build loyalty to buying at a discount. When this happens, manufacturers are merely giving away profit and doing themselves more harm than good.

HOW DOES DEMAND FROM CUSTOMERS AFFECT PRICES?

The affect that demand from customers can have on prices is best explained using the economic concepts of supply and demand. Supply is the amount of goods and services provided to the market for consumption. Demand is the amount of goods and services that the market wants to consume. Both of these concepts are governed by the prices for goods and services in the market. The following is a simple example to explain the concepts of supply and demand.

WHAT IS SUPPLY?

Let's go back to the soap example used earlier. The amount of soap supplied to the marketplace will depend on the amount consumers are prepared to pay for it. Assume that it costs 50 cents to make and distribute a cake of soap, and consumers are prepared to pay $20 for it. If soap companies can make a profit of $19.50 for every cake of soap they sell, they will flood the market with soap. In fact, other companies would begin to manufacture soap if they thought they could get that sort of profit from it.

But how would the new manufacturers encourage you to purchase their soap instead of the competition's? They would probably cut the price slightly. Perhaps they would sell their soap for $19.00. Then other manufacturers would enter the market and sell their soap for $18.00 or $17.00, and so on.

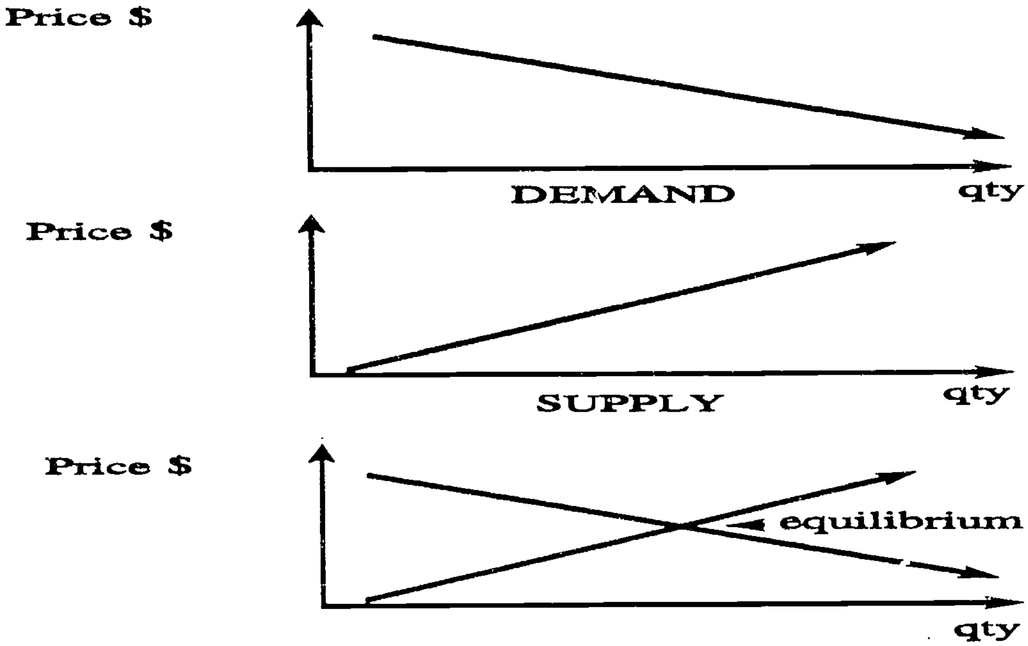
The price would continue to fall until the profits on soap no longer attracted new manufacturers. That price might be $1.50 or lower. Initially, the profit attracted new suppliers to the market. Competition among the new suppliers drives the price and profit down. In the end, the low profit in the market discourages new suppliers from entering the market.

WHAT IS DEMAND?

Now, let's look at this relationship from the perspective of the consumer. Assume that there is only one manufacturer of soap, and that soap is scarce in the marketplace. Assuming everyone washes with soap, if necessary, consumers will be willing to pay a lot for a cake of soap. High demand for a small amount of soap permits manufacturers to charge high prices.

But, what happens when these other manufacturers enter the market? There will be more soap available to consume, so people will pay less for it. Like jewelry, the more there is available, the less valuable it becomes. Demand is measured by the amount someone is prepared to pay for something. Therefore, as the quantity of soap available increases, the price people pay for it decreases.

Note that the graphs of supply and demand, behave in the opposite manner. As the price increases, the quantity supplied to the marketplace also increases. This is depicted in



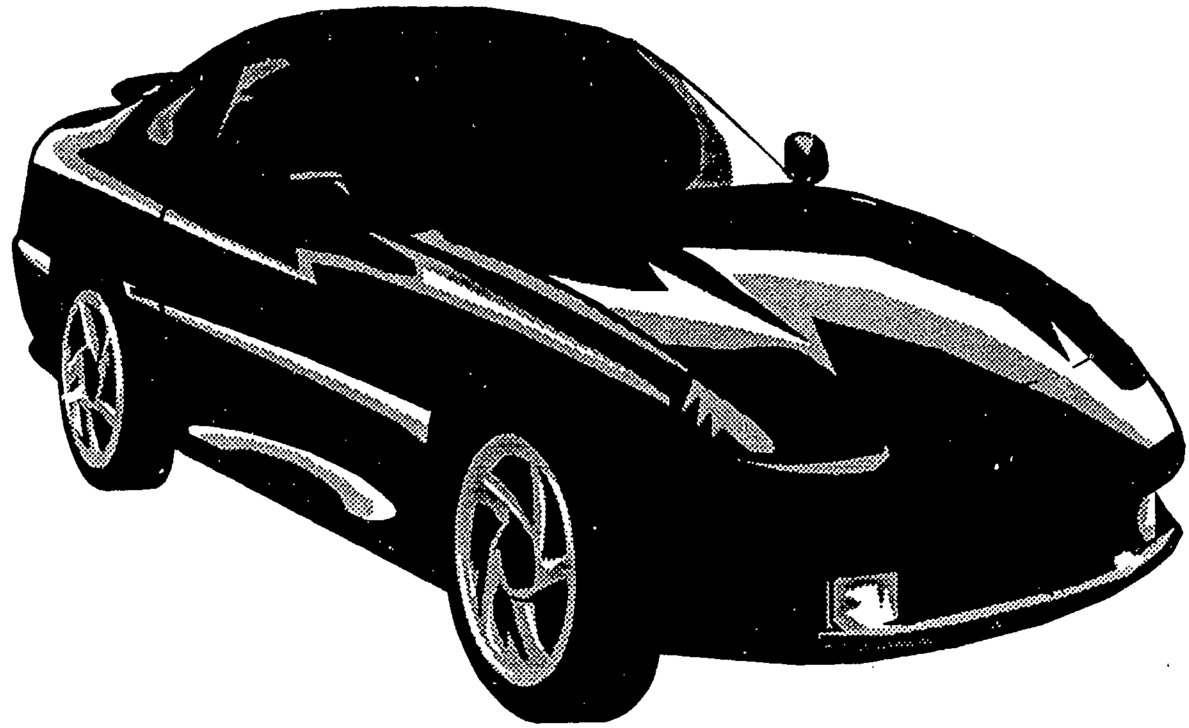
a graph that slopes upward and to the right. Demand is just the opposite. As price decreases, the quantity demanded by the marketplace increases. This is depicted by a graph that slopes downward from left to right.

If you were to lay these graphs one on top of the other, the point where the two lines meet is called *market equilibrium*. Equilibrium is achieved when the price is high enough that manufacturers can make a satisfactory profit, and consumers are willing to pay that price.

The forces of supply and demand act together to create a market equilibrium. If demand is too low, then prices will fall to a point where more consumers are persuaded to buy the product. Thus, the market returns to equilibrium. If demand is too high, then manufacturers will raise the price of their products to make more profit. The higher prices will discourage shoppers, and demand will level off once again to a point of equilibrium.

WHAT IS THE IMAGE OF A PRODUCT?

Have you ever wondered why some people are prepared to pay tens of thousands of dollars more for a luxury automobile than a standard car? Without question, the engineering, materials, manufacturing processes, and design of a luxury car make it more expensive to produce than a standard car. However, it is not true that it costs five times as much to manufacture a Mercedes



than to manufacture a Chevrolet. So, what is it about a Mercedes that makes people pay so much more for it? The reason is that the Mercedes has an image of luxury, status, quality, engineering, and social achievement. The consumer is not only paying for the automobile and its functions, but also for its image.

The image a product portrays is very important to consumers. Without being able to make an independent evaluation of every product that is available, consumers will rely on image to indicate product quality.

Think of the importance of image for a product that has a lot of competition. Using our soap example, presume that there are 15 competing brands of soap on the market, and that you walk into the grocery store with soap on the shopping list. Assume for the moment that all of the soaps are exactly the same price. How will you choose between them?

In the absence of other criteria, image will play a major role in your evaluation of a product. For example, assume Brand A is sold as a beauty soap, Brand B is sold as a baby soap, and Brand C is sold as hypoallergenic soap. Note, all of these soaps may be nearly the same chemically, but they have different images. However, because of the images of these soaps, you will choose Brand B for your baby or Brand C for sensitive skin.

The image of a product is created by the manufacturer to attract specific groups of consumers. This image is as much a part of the product as its physical make-up.

HOW DOES PRICE AFFECT IMAGE?

In addition to product features, and promotion, the price that a manufacturer charges for a product will have an impact on the image of the product. At the same time, the image of your product will affect the amount you can charge for it.

We will study this concept from different directions. A Mercedes automobile is renowned for its quality. It has the highest level of safety features, the finest engineering, the best materials and workmanship, and a very powerful image of quality. Because this car has such an image, consumers expect to pay a high price for it. The image gives an indication of the expected price.

When Toyota introduced the Lexus brand name, very little was known about the product. It was essentially a new brand name for an entirely new and untested line of automobiles. About the only thing consumers could say about the Lexus was that it was by far the most expensive Japanese car on the market. Since the Lexus was so expensive, consumers thought it was equivalent in quality to the Mercedes. In this case, in the absence of other information, the price is an indicator of the quality.

This phenomenon can be seen in a variety of products. Consumers will often compare products on the basis of price, then choose the product that is the most expensive assuming it is the highest quality. So, why don't all manufacturers charge high prices to indicate that their products are the highest quality? The reason is that if consumers buy a mediocre product at a high price, they will be disappointed in the product's value. Then, the consumer will not buy the product again. In addition, the product will gain an image of being a poor value for the price. Because of this negative product image, total corporate sales of the product will decline.

To be profitable, products must be sold at a price which more than covers their costs and adjusts to market demand. Fixed and variable costs, as well as desired profit margin, must be calculated. In addition, the successful entrepreneur must be sensitive to market demand and product image.

ACTIVITIES

The following activities are designed to help you apply what you have learned in this unit.

INDIVIDUAL ACTIVITIES

A.

Go to your kitchen at home and choose three different types of products. Perhaps choose pasta, potato chips, and soup. Ask whomever bought those products (the person who does the grocery shopping) why they bought that particular product. The reasons might include the following:

This product tastes the best.
The packaging is the nicest.
The price is always good.
We had a coupon.
We have always bought this product.

B.

For those products where the reason for purchasing was related to price, ask if the consumer (the person who bought the product) would be willing to pay 10, 20, 30, 40, or 50 cents more for the same product. If the consumer is prepared to pay more, then the manufacturer could have made a larger profit on the sale of that product if he had known how much the consumer was prepared to pay.

C.

For each of the following products, identify each of the four elements of the marketing mix:

ITEM	(1) **PRODUCT**	(2) **PLACE**	(3) **PROMOTION**	(4) **PRICE**
Automobile	Buick	Car Dealer	T.V. Ads	$15,000
Cereal				
Computer				
Athletic Shoes				

On a separate sheet of paper, identify these four elements using five products of your choice.

GROUP ACTIVITIES

A.

In teams of 4-5 people, create a list of six items that are commonly found in all grocery stores. Make sure that each team knows exactly what brand and size of item it must look for. Now select three of that items' competitors for comparison purposes. Each member of the team should go to a different grocery store and find out the prices of the items that have been selected. Now, divide the items into categories and place them in descending order of price (i.e., from most expensive to least expensive).

Questions:

1. Are the prices of similar items the same in different stores?
2. Are the prices of competitive goods the same in each of the stores?
3. Are the items in the same price order in different stores?
4. Why might the prices be different between different stores.

B.

Each team member is asked to examine the contents of the breakfast cereal aisle in the grocery store, answer the following questions, then meet but as a group and discuss the findings.

1. How many different individual brands of cereal are there?
2. What is the range of prices?
3. Using a rating of 1 as the cheapest looking and 10 as the nicest looking, rate each of the cereal packages.
4. Ignoring size as a factor, is there a relationship between the quality of the appearance of the products and the price?

CASE STUDY

A young entrepreneur is considering operating a home delivery taco restaurant from her house. Each meal will be the same size and will be made from a popular taco dinner set that is available from the grocery store. The meal is designed for big families, as each order consists of 12 prepared tacos, a jar of picante sauce, and a bag of nacho chips. The meals will be delivered hot within 30 minutes of ordering. Drivers will service an area of not more than 10 minutes from the house.

The entrepreneur has surveyed the neighborhood. She has determined that there is a definite need for this type of service due to the large number of families in the area, and the lack of any direct Mexican restaurant competition. The following is a breakdown of the expected cost per meal:

Taco Dinner Kit	$2.50
Picante Sauce	$1.50
Ground Beef	$1.50
Nacho Chips	$1.50
Lettuce	$0.80
Tomatoes	$0.50
Sour Cream	$0.50
Cheese	$0.50

It takes about 10 minutes on the grill and 5 minutes in the oven to get every meal ready to go. The cost of the gas for the oven is $0.50 per hour. Once the meat is ready, putting the tacos together for consumption takes about 10 minutes. The entrepreneur will pay herself $9.00 per hour as a salary for preparation, and the driver will be paid whatever tip he or she receives for the delivery.

DISCUSSION QUESTIONS

1. Which of the above costs are fixed; which are variable?

2. What is the total cost per taco meal that is prepared?

3. What should be the price of the meal using a cost plus 15 percent rule?

4. What are the direct competitors to this service? (For example, who else delivers meals at home? Who are the indirect competitors? How much do competitors charge for their services?)

5. Would this product be competitive at this price? What would be a more competitive price and is there any way that you could charge that much?

ASSESSMENT

Read the following questions to check your knowledge of the topics presented in this unit. When you feel prepared, ask your instructor to assess your competency on them.

1. Describe the relationship between marketing and accounting in the determination of prices.

2. Describe the accounting elements of a price that must be covered in order for a company to make a profit on the sale of its products.

3. Explain the relationship between the level of direct and indirect competition and price.

4. Describe the relationship between supply and demand.

5. Describe the circumstances under which price creates an image for a product. Describe the circumstances under which the image of a product justifies its price. Give two examples of each.

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PACE

Units on the above entrepreneurship topics are available at the following levels:

* Level 1 helps you understand the creation and operation of a business
* Level 2 prepares you to plan for a business in your future
* Level 3 guides you in starting and managing your own business