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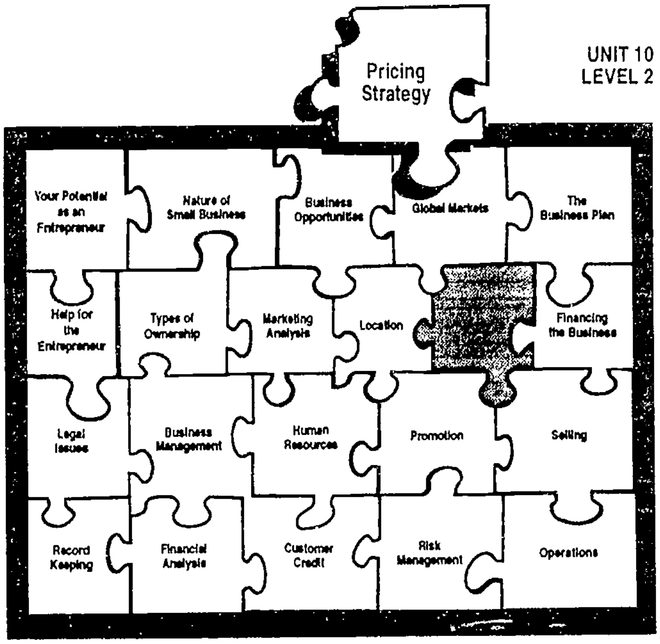
ABSTRACT

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 2 of learning--planning for a business in one's future. 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: factors affecting price decisions, profit margin, computing markup, pricing incentive options, and pricing strategy choices. (KC)

UNIT 10
LEVEL 2



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. 302-10

INSTRUCTOR GUIDE

Unit 10

Pricing Strategy

Level 2

Objectives:

- Identify factors that affect pricing decisions.
- Describe profit margin.
- Determine how to compute the markup.
- Identify pricing incentive options.
- Discuss pricing strategy choices.

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. IDENTIFY FACTORS THAT AFFECT PRICING DECISIONS	
What are the factors that affect pricing decisions?	Ask the students to think of products which are priced higher than their physical features seem to justify, such as perfume. What factors, other than physical features, do they think have an impact on price?
What is price power?	Ask students who they think has price power in various product lines. For example, for personal computers IBM and Apple. You may want to ask about vacuum cleaners, baby diapers, canned soup. Do similar competitive products usually have a higher or lower price? Why?
What is the product life cycle?	Discuss the life cycle of black and white televisions from their introduction in the 1950's, growth in 1960's, and maturity/decline in the 1970's. Be sure to mention the heavy promotion of color television in the 1970s.
	Ask what stage of the product life cycle the following products are in: laundry detergents (maturity), CDs (growth), small calculators (maturity to decline), videophones (introduction).
2. DESCRIBE PROFIT MARGIN	
How is profit margin determined?	Ask students to identify the variable costs (ingredients, packaging, and labor) and the fixed costs (rent, insurance, salaries) involved in making a carry-out hamburgers.
	Work the following problem on the board. Write the appropriate equation above the calculations.
	If the total of the variable costs is \$.50, and the total of the fixed costs is \$1,000 a month, what is the total cost per hamburger if 10,000 are sold in a month? (\$.50 + \$.10 = \$.60).
	What is the profit if the hamburger is sold for \$2.00? (\$2.00 - \$.60 = \$1.40).
	What is the profit margin? (\$1.40 / \$.60) X 100 = 233%.

Objectives	Teaching Suggestions
3. DETERMINE HOW TO COMPUTE THE MARKUP	
What is markup?	Ask the class if anyone has ever shopped at a factory outlet store? How did the price at the factory outlet store compare to the price of the same merchandise at a regular retail store? How do they account for the difference in prices? Answer: it is the retail markup.
How are distributor costs justified?	Ask the individuals who have purchased at the factory outlet store whether the outlet was close to their home. In most cases, the outlet will not be close to their home. Then, ask how long it took them to get the factory outlet store. Put a price tag on the round trip transportation time, such as $5.00 times 2 hours equals $10.00. Finally, ask the students whether they found as wide an assortment of merchandise at the factory outlet store as at the regular retail store. Is it valuable to them to be able to choose from a wide range of merchandise? Ask the individuals who purchased at the factory outlet stores whether they saved sufficient money to justify the trip. Discuss their responses.
Who pays for distribution?	Show the class several items with manufacturers prices printed on the label to demonstrate how a manufacturer might predetermine the retail price.
	Through a contact in the retail business, find out their cost on one particular item. Be sure to specify size and brand name. Then, compare retail prices for this item at a convenience store, grocery store, and discount store. (Hint: Since convenience stores carry a limited number of products, check to make sure the convenience store carries a particular item before talking to your business contact.) Have students calculate the markups. Discuss and justify the higher markups.

Objectives	Teaching Suggestions
4. IDENTIFY PRICING INCENTIVE OPTIONS	
What are price incentives?	Ask students if they have purchased any products recently due to price incentives. Discuss different types of price incentives, i.e., straight discounts, two-for-one, rebates, etc.
What are my incentive options?	Continue the above discussion by asking the same students whether they routinely purchase the discounted product or competitors' products. Determine whether they increased their usage rate. Generalize their purchasing behavior to the market as a whole. For example, if the student normally buys the discounted product, then the discount reduced the manufacturer's profits without increasing sales. On the other hand, if the student bought a brand that they would not normally purchase, then the manufacturer may have achieved their objective of increasing market share.
What is price elasticity?	Ask students to suggest products that have relatively inelastic demand. Answer: utilities and drugs. Then, ask students to suggest products that have particularly elastic demand. Answer: clothing, produce, etc. Ask for what types of products are price discounts most effective. Answer: products with elastic demand.
What are the advantages and disadvantages of incentive pricing?	Is there a business in your area that routinely discounts their merchandise? Refer to this business, and ask students how they would feel about buying merchandise from that store at full price. Emphasize the fact that regular discounting teaches the consumer to expect discounts.
5. DISCUSS PRICING STRATEGY CHOICES	
What are my pricing strategy choices?	Ask the class if a price discount is a pricing strategy. After hearing several responses, discuss the difference between occasional discounting and routine discounting. Note that even organizations with a high price objective may occasionally discount to clear out off season merchandise. Discuss the pricing strategy in terms of long term commitment to price positioning.

Objectives	Teaching Suggestions
How do you determine pricing objectives?	Give the students a list of retail establishments, and ask them to indicate whether the stores have high, low or parity pricing objectives. Your list might include Walmart, Kmart, Sears, JCPenney's, Federated Department Stores, and exclusive clothing stores. Now, give the students a list of different blue jean brand names and ask them to indicate whether they have high, low or parity pricing. Discuss the rationale behind the pricing objectives.
How do I review these objectives?	Ask the students to imagine that they are the manufacturers of a new product. What would they need to know to set the retail price of the product? Answer: fixed/variable costs, customary manufacturer and retailer markup, manufacturer pricing power, stage of the product life cycle, and price elasticity.

MODEL ASSESSMENT RESPONSES

1. A company has pricing power if its product is highly sought after by consumers and yields a good profit margin. A company with pricing power is able to dictate the product price, within reason, to the rest of the industry.

   Pricing decisions are affected by the following factors: company pricing power, market demand, competition as reflected in the product life cycle, product costs, and markup.

2. The product life cycle is a marketing concept used to evaluate the direction the market will take in the short and long run. It divides the stages of the product's maturity into four periods: introduction, growth, maturity, and decline.

3. The profit margin reflects the difference between the costs and the selling price. It is computed as a percentage:

   Profit = Selling Price - Costs

   Profit Margin = Profit/Cost X 100

4. Some of the most common forms of pricing incentives are coupons, bulk buying discounts, and sale prices.

5. The fundamental pricing strategy choices are lower, higher, or parity pricing.

PACE THIRD EDITION

Program for Acquiring Competence in Entrepreneurship

Incorporates the needed competencies for creating and operating a small business at three levels of learning, with experiences and outcomes becoming progressively more advanced.

Level 1 — Understanding the creation and operation of a business.
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Self-contained **Student Modules** include: specific objectives, questions supporting the objectives, complete content in form of answers to the questions, case studies, individual activities, group activities, module assessment references. **Instructor Guides** include the full text of each student module and lesson plans, instructional suggestions, and other resources. **PACE,Third Edition, Resource Guide** includes teaching strategies, references, glossary of terms, and a directory of entrepreneurship assistance organizations.

For information on PACE or to order, contact the Publications Department at the
Center on Education and Training for Employment, 1900 Kenny Road, Columbus, Ohio 43210-1090
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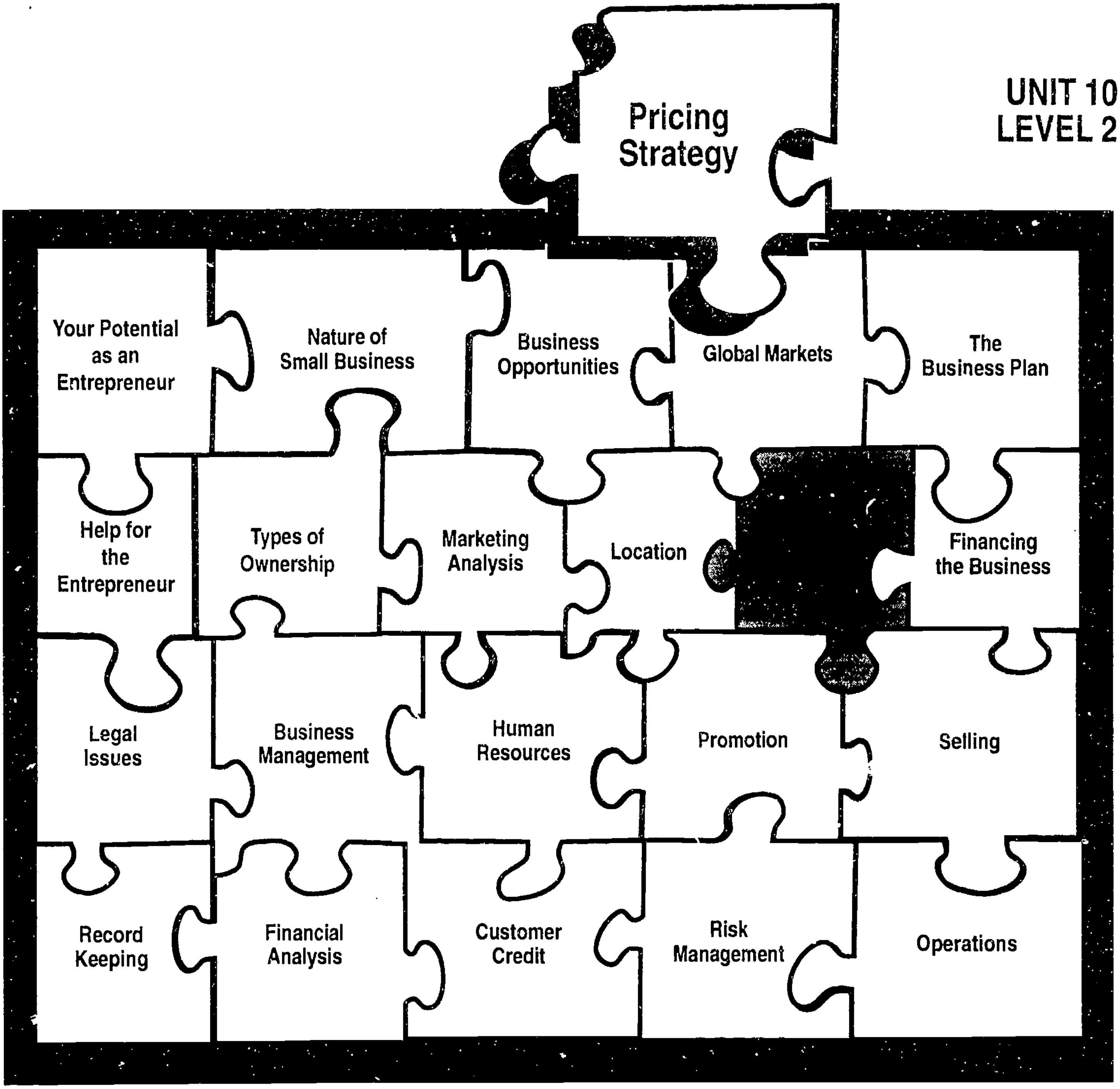
UNIT 10
LEVEL 2



PACE

THIRD EDITION

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Research & Development Series No. 302-10

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. These objectives were met in Level 1:

   - 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.

4. 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.*

   Distribution
   Elasticity
   Fixed/variable costs
   Markup
   Price incentives

PRICING STRATEGY

WHAT ARE THE OBJECTIVES FOR THIS UNIT?

Upon completion of this unit you will be able to—

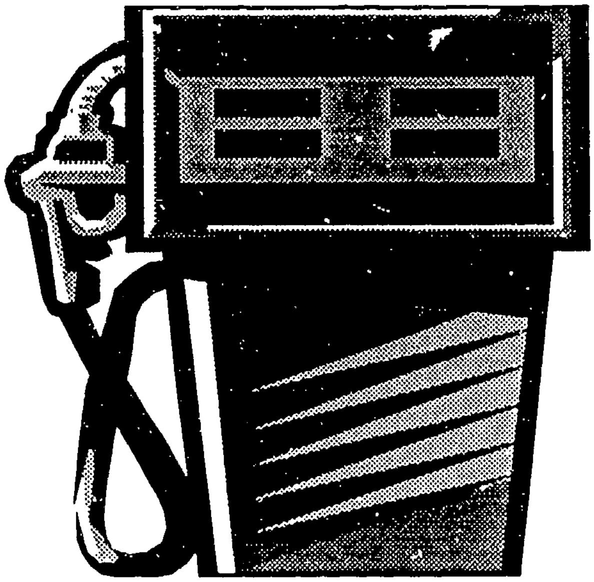
- identify factors that affect pricing decisions,
- describe profit margin,
- determine how to compute profit margin,
- identify pricing incentive options, and
- discuss pricing strategy choices.

WHAT IS THIS UNIT ABOUT?

There are many decisions that face the entrepreneur when bringing a product to the market: decisions about product design and features, methods of distribution, and promotional campaigns. Ultimately, it is the objective of the entrepreneur to develop a viable product, thus creating a profitable business.

Among the most crucial of new product strategic considerations is the price. The reason for this is that the price tells consumers a lot about a product, and the organization that produced it. From a price, a consumer can tell the position of a product, and how it relates to its competitors. In addition, the price indicates its stage in the product lifecycle, and the image of the product. Finally, the long- and short-term organizational objectives for the product, and the market strategy are indicated in the price. All of these factors determine whether it is a viable prospect for the consumer to consider.

The purpose of this unit is to explore issues in pricing. Specifically, this unit covers the factors that affect pricing decisions, profit margin, incentive pricing options, and pricing strategy choices.



WHAT ARE THE FACTORS THAT AFFECT PRICING DECISIONS?

On the surface, pricing seems to be a fairly simple matter. Prices are determined by calculating the firm's costs in creating a product and taking it to the market, plus a predetermined margin for profit. If the company does not have too high a profit margin, then it can expect to be viable as long as there is demand for the product.

Unfortunately, this is not a reflection of reality. Pricing is a complicated issue because it requires detailed analysis of both the firm, and the environment in which the firm operates. The price that a company charges for its products or services is a function of the firm's power within the marketplace and its ability to respond to the changing market demands.

WHAT IS PRICE POWER?

Your pricing flexibility is ultimately a function of the ability to simultaneously dictate and accommodate the pricing moves of competitors. Consider the position of two car manufacturers. Company A produces the best selling car in the compact class. This car is highly sought after, and yields a good profit margin to the manufacturer Company B is also a car manufacturer in the compact class. But, its product is not as popular, and its production processes are more costly. The profit margin that Company B enjoys is far smaller per car than for Company A.

Who do you think holds the balance of pricing power in this market? Obviously Company A does. Company A can afford to lower its prices and still remain profitable. Also, it can lower its prices and have a serious impact on the profitability of Company B. The reason for this is that Company B is likely to respond to the price reduction by lowering its prices. This move has a far more detrimental effect on Company B than Company A. Company B is diminishing an already narrow profit margin, and possibly losing money on every car that is sold. This may force Company B to make substantial product revisions, or exit the market altogether.

Because Company A has pricing power, it is able to dictate prices within a reasonable range. Company A will have a completely different pricing strategy than Company B. Clearly, the pricing strategy depends on the company's relationship with its competitors, and the balance of market power in the environment.

The balance of power in a market will depend on a variety of factors. Many of these factors are described in the product life cycle. The product's position in the life cycle will determine marketing strategies, and long- and short-term strategic objectives.

WHAT IS THE PRODUCT LIFE CYCLE?

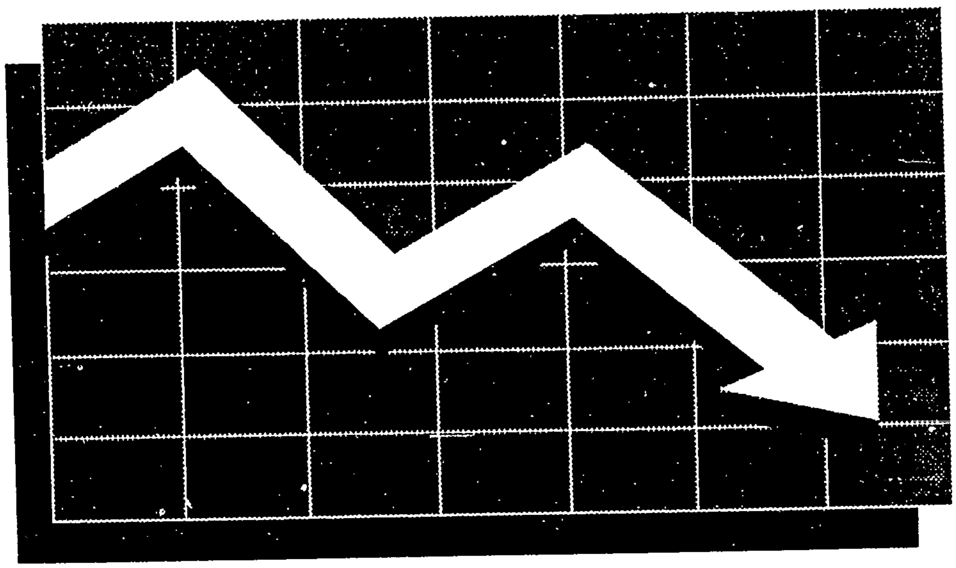
The product life cycle is a marketing concept used to evaluate the direction the market will take in the short- and long-term. The life cycle, in its simplest form, divides the stages of a product's maturity into four periods. These are labelled introduction, growth, maturity, and decline.

At the point of introduction, there are very few products in the marketplace. This is because there are few companies in the market with the technology to manufacture the product. Since demand is likely to exceed supply, manufacturers can charge high prices for their products and make healthy profits. Price will play only a minor role in the consumer's decision-making process. Consumers pay more attention to benefits such as innovation and features.

Over time, as more manufacturers develop the technology to produce the product, there will be a greater variety of similar products from which consumers can choose. With increased competition, the price of these products will begin to play a more important role. Manufacturers will attempt to distract consumers from pricing considerations by "differentiating" their products from the competitors' products. In other words, they will promote unique qualities of their products as a justification for their price.

An example of differentiation can be seen in the toothpaste market. One brand may focus its promotion on the fact that it prevents cavities, while another brand emphasizes the fact that it prevents the build up of tartar. The third brand may emphasize the fact that it makes your breath smell fresh. The fact of the matter is that these brands may be chemically similar. However, the manufacturers have decided to emphasize one particular benefit for each brand to "differentiate" their products.

Eventually, as a wide variety of manufacturers are able to produce similar products. The product is then considered mature. There are few if any real differences between products that are available to consumers. This type of product is known as a "commodity." Because these products have been on the market for some time, consumers are aware of the features offered and realize that the products are all very similar. Therefore, the price of the product becomes a primary consideration. Unless consumers can see a definite benefit in buying an expensive product, they will buy a cheaper one.



After maturity comes decline. Decline is a period in a product's life cycle at which point there is a decreasing level of demand for the entire category. Black and white televisions are a good example. Regardless of how advanced your black and white TV is, few people will buy it because it has been superseded. Can you think of any other products that are in the decline stage of their life cycles?

In determining the pricing power, careful consideration must be given to the life cycle stage of your product. This can be analyzed by using a variety of methods, including market research and competitive analysis. Your pricing strategy will depend on the outcome of this analysis.

During the introduction stage of the product life cycle, consumers are motivated by a desire to have the most up-to-date products and services. These consumers are willing to pay a high price for innovative products and services. The high price charged for these innovative products helps manufacturers offset the high research and development costs and risks involved in developing them.

Companies that adopt a low-volume, high-profit method of pricing for the introduction of a new product are using a "skimming" model of pricing. The skimming model allows the manufacturer to "skim" the profits out of a market before the competition is able to respond by introducing their own products. Typically, manufacturers will charge the absolute maximum that the market will bear for a product, then gradually reduce the price as competition enters the market.

In a growth market, companies must be prepared to spend money on promotion to differentiate their product. Consumers are still receptive to the notion that there are real differences between products, and they are prepared to pay for those differences.

In a mature market, consumers place a greater emphasis on the price because there are few real differences between products. Therefore, the companies that can remain price competitive will be successful in this market. It is important for these companies to analyze their cost structures carefully, and determine exactly how much each unit costs. Companies that consistently sell their products below their minimum price will eventually go out of business.

Companies that introduce new products to mature markets often price the product below regular prices to induce the consumer to try it. This form of pricing is known as "penetration pricing," because the manufacturer is penetrating the marketplace with price induced trial. Often there is little or no profit margin for the manufacturers. This pricing policy is used to establish a market for a new product very quickly.

In the decline stage, companies reduce prices to the lowest possible level. Since there is no growth potential in the market, the company may stop promoting it. When the product is no longer profitable, the company may cease production all together.

HOW IS PROFIT MARGIN DETERMINED?

There are three major factors in most pricing decisions. These are the demand, the competition, and the costs. The competitive aspect of pricing has been described above in relation to the product life cycle. This segment will discuss costs and their relation to long- and short-run profitability.

The price that the consumer ultimately pays is comprised of the manufacturer's and retailer's costs and profits. The manufacturer's price is known as the "wholesale" price, and it represents the amount that the retailer pays for the product. The retailer then adds his costs and profit margin to determine the "retail" price. This is the price that the consumer ultimately pays.

The costs allocated to a producer are usually comprised of the following:

- The raw materials needed to manufacture the product
- The cost of manufacturing the product (labor & overhead)
- The cost of distributing the product
- The cost of marketing the product

The costs allocated to retailers for selling the product include the following:

- The retailer's purchase price
- The costs of real estate
- The costs of selling the product (personnel, marketing, overhead)
- Costs of preparing and serving the product (wherever appropriate)

Both the manufacturer and the retailer must determine the costs associated with a product in order to determine the selling price of a product.

Costs can be divided into two broad categories. These are *fixed* and *variable* costs. Fixed costs are the costs that will be incurred regardless of how many products are manufactured. For example, salaries may be paid to employees regardless of how many products they make. In addition, machines will be depreciated regardless of how many products are produced. Variable costs increase as production increases. For example, raw materials costs will increase as the number of products made increase.

The price that both the retailer and the manufacturer will eventually sell at must cover both of their fixed and variable costs. The difference between the costs and the selling price is the **profit margin.**

The following example illustrates this concept.

> A Swiss watchmaker spends $50 on the raw materials for a gold watch. Because of the specialized machinery required to make the watch and the highly skilled labor required to operate the machines, the watchmaker spends another $50 per watch on fixed costs. The watchmaker sells the watch to a jeweler for $250. The jeweler allocates $50 per watch to cover his own fixed costs and sells the watch for $400.

Q. What is the profit margin for the watchmaker?

A. Total cost = $50 + $50 = $100
Selling Price = $250
Profit = $250 - $100 = $150
Profit Margin = Profit/Cost x 100
= $150/$100 x 100 = 150%

Q. What is the profit margin for the jeweler?

A. Total Cost = $250 + $50 = $300
Selling Price = $400
Profit = $400 - $300 = $100
Profit Margin = Profit/Cost x 100
= $100/$300 x 100 = 33.3%

WHAT IS MARKUP?

For every product or service sold, there should be a marketing plan. The marketing plan should incorporate the four elements of the marketing mix. These elements are *product*, *promotion*, *place*, and *price*.

The reason that price is such an important part of the marketing mix is that it is the price that ultimately pays for the other elements of the mix. The costs incurred during promotional efforts must be recouped when the product is sold. The costs incurred in the development of the product must also be recouped. Finally, the cost of distributing the product to a place where consumers are able to purchase the product must also be incorporated into the price and ultimately paid for, if the company is to make a profit.

In addition to these costs are the overhead costs that are associated with the production of each unit. These include the employee salaries, rent, and insurance, etc. The dollar value of the allocation of fixed costs and profit is called the "markup" on the variable costs, often presented as a percentage.

Once the product is sold to the retailer, another type of markup is added to the wholesale cost of the product. This markup, known as "retail markup" is a payment for making the product available. Effectively, this is a way that the consumer pays the distributor for the convenience of having the product available in the present location.

HOW ARE DISTRIBUTOR COSTS JUSTIFIED?

The distributor gets the product to the customer. Distribution and product placement are very important to the success of a product. If the product is not distributed conveniently, then consumers will purchase the competitor's product.

The selection of a distribution system and location is an important decision. The consumer must know where the product is sold and have easy access to it. For example, where would you go to buy milk? You would probably take a trip to the corner grocery store, not the clothing store across town. So, if a company produces milk, where should the product to be sold? Obviously, at a convenience store, or the grocery store. It is most profitable for companies to place their products in locations that have the most likelihood of attracting potential consumers.

Distributors provide a service at some expense and expect to make a profit. The method most commonly used for paying distributors is a markup. The markup is added directly to the price of the product. The amount paid to the distributor is determined by the quantity of product sold. The markup is usually a percentage increase over and above the wholesale price. The wholesale price is the price at which the distributor buys the product from the manufacturer.

WHO PAYS FOR DISTRIBUTION?

There are a variety of arrangements that can be created to finance distribution. The most common of these is that the distributor purchases the product at one price, then charges the consumer a higher price. If a distributor charges $1.30 for a gallon of milk for which they paid $1.20, then they make $0.10 per gallon. Effectively, the distributor makes money by providing an outlet for the manufacturer.

Often the distributor, not the manufacturer, is responsible for setting the price. However, even though the distributor has the ultimate authority to set the price, the manufacturer may predetermine the price for the distributor. In this case, the manufacturer determines the price at which the retailer (distributor) will sell to the consumer, then subtracts the retail markup from the selling price to allow the retailer a reasonable profit. Thus, the manufacturer sets the retail price, and then calculates the wholesale price by subtracting the retailer's markup from the retail price.

For example, assume that your company manufactures shampoo. Through intensive market research, you have determined that there is demand for a shampoo that is priced at slightly less than the premium product (most expensive), but slightly higher than the general product. Let's assume that the most expensive shampoo on the shelf costs $3.50 to buy. The average price is $3.25. You have determined that your price should be $3.40. In order to control the price to the consumer, you sell the shampoo to the retailer for $2.72 to allow the retailer a 24 percent ($0.68/$2.72) markup.

But, how much of a markup does the retailer need? The answer to this question will depend on a number of factors. The most important of these is the amount of leverage that you as a manufacturer have with the retailer. If your products traditionally sell well with retailers, then the retailer has a higher probability of making money with your product. For that reason, the markup that the retailer will charge will be less than if your products are untested in the marketplace.

The retailer makes money on the space they have available to consumers. Therefore, the price that the retailer will charge the manufacturer will be determined by the return on the space that the retailer provides. This return will be calculated as a function of the amount of profit per sale multiplied by the expected number of sales in a given time period. If your product is a high-volume, low-margin product, then the retailer will charge a small markup, but expect to receive it many times. If your product is a low-volume, high profit margin item, then the retailer will charge a large markup to compensate for the fact that sales are low. Grocery stores will charge as little as 2 or 3 percent markup on items such as milk or eggs, whereas jewelers may charge two or three times the price they paid for exotic jewelry.

WHAT ARE PRICE INCENTIVES?

Assume that your company manufactures breakfast cereal. You have noticed a steady decline in sales growth over the past couple of months. Among many options to improve short-term performance, you might consider a temporary reduction in your prices to stimulate sales. This is a form of incentive pricing option that may make your product more attractive to the consumer. The consumer will buy your product because at a lower price it becomes a better value. This form of temporary price reduction is extremely popular, especially in industries where it is difficult to differentiate between brands. Price reductions are commonly found in grocery stores where many brand name products are very similar.

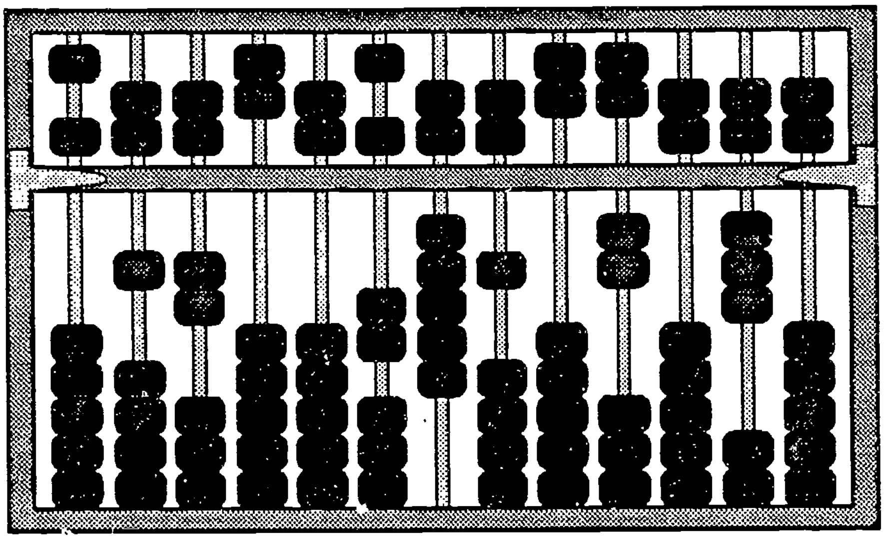
WHAT ARE MY INCENTIVE OPTIONS?

Price incentives can take an infinite variety of forms depending on the level of imagination of the discounter. The most common forms of incentive are coupons, bulk buying discounts (two for the price of one), and sale prices. In many cases, the incentive is designed to encourage people who would not normally buy the product to try it. The expectation is that once a consumer tries the product, they will buy it again. In general, incentives are used to:

- increase market share by taking customers away from competitors,

- increase usage rates among existing customers,
- encourage people to buy this type of product for the first time, and
- discourage your customers from switching to another product.

As mentioned earlier, products are discounted for a variety of reasons. Each pricing strategy may require a different deduction in order to achieve its objective. The way to determine the appropriate deduction is to establish a strategy with an objective, for example to build market share by 2 percent, then measure the effectiveness of the discount against the objective.



WHAT IS PRICE ELASTICITY?

The question now is by how much do you discount in order to attract the right customers? Obviously the answer to this question depends on a number of complicated issues, each of which will be different for every product on the market. Like pricing, discounting is an inexact science. The most successful discount may not be calculated mathematically, but may be discovered through experimentation and by experience.

Ultimately, the way consumers will respond to the discount will depend on their price sensitivity. Price sensitivity is simply the amount of change in the quantity that consumers purchase for a given reduction in price. For example, if you drop the price of your cereal by 5 percent and sales do not increase, then your customers are price insensitive within the given price range. Any price reduction is a complete waste of money because it does not encourage people to buy more of your product. On the other hand, if there is an overwhelming change in the amount of product sold when the price is reduced, then the consumer is price sensitive within the given price range. In this case, price incentives may be a very effective promotional tool.

WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF INCENTIVE PRICING?

The single largest criticism of incentive pricing is that discounters teach consumers to purchase products because they are discounted rather than for their unique features and benefits. Price cutting may not build customer loyalty, but instead attracts price shoppers. It allows people who would have bought the product anyway (loyal customers) to buy it at a cheaper price. If that is the case, then regular customers will stock up their pantries whenever their favorite products are on sale.

WHAT ARE MY PRICING STRATEGY CHOICES?

Ultimately, the pricing strategy is a key to long-term profitability and a company's overall viability. The pricing strategy that is adopted is the culmination of setting pricing objectives and reviewing the most appropriate way of achieving those objectives.

HOW DO YOU DETERMINE PRICING OBJECTIVES?

Pricing objectives generally focus on the following three issues:

- Lower, higher, or parity pricing
- Geography of pricing
- Timing of the pricing

In order to determine if your company should occupy a lower, higher, or parity price position, you should review your marketing strategies and consider the following factors:

Low price objective. The reasons for low price are usually the following:

- To expand the market and attract new customers who would ordinarily not purchase your products
- To induce trial among your competitor's customer base
- To help improve profitability due to a large increase in the volume of a less profitable product
- To help steal market share and discourage or deflect competitive moves
- To remain competitive on the basis of price
- To discourage competitors from entering the market

High price objective. Often a higher priced product will yield substantial profits in spite of lower volumes of sales. Justification for higher prices include the following:

- A need for a fast recovery of the firm's investment

- A commitment to generating revenues to cover research and development costs

- To support the image of superior quality

- Where price increases result in only minor reductions in sales volume

- The product is in the introductory phase of the product life cycle

- The product has a short life span in which the entire profit on the product must be realized

- The product has patent protection or other monopoly qualities

Parity price objective. For this pricing strategy the price of a product is roughly the same as the price of a competitor's product. The manufacturer chooses to use other product features, such as superior image or service, rather than price to differentiate the product.

HOW DO I REVIEW THESE OBJECTIVES?

The following steps should be taken when setting pricing objectives:

- **Review marketing strategies and their relationship to price.** Price is an integral part of the way the company communicates with its customers. Therefore, the price must mesh with the rest of the marketing plan.

- **Review your pricing mathematics.** You should completely understand your cost base and your break-even quantities. Ensure that the overall profit and growth strategies can be accomplished with the forecast profitability of your selected price.

Once these elements of the plan have been thoroughly reviewed, you can begin to write and execute specific strategies for accomplishing your growth, market share, and profitability objectives.

Pricing is both a science and an art. To select a profitable price, the entrepreneur must first be sure to cover their fixed and variable costs. Then, they must understand the market and their competition. Most successful business owners have a feeling for their product's market position. With this qualitative and quantitative information, the entrepreneur can set the product price high enough to be profitable and low enough to sell.

ACTIVITIES

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

INDIVIDUAL ACTIVITIES

A.

Collect coupons for a large category of grocery store products (breakfast cereal would be a good choice). Tabulate a list of current brands that are available in the store and rank order them based on price. Be careful to ensure that the products are the same size or weight for comparison purposes.

Questions:

1. What do you notice about the features and packaging differences between the most expensive products and the least expensive products?

2. Are the differences meaningful or valuable to you personally?

Now reorder the products based on the coupon prices, including those products that have no coupon or discount offered.

3. Does the order change significantly? Does the price change affect your impression of the product?

B.

A bicycle manufacturer produces a mid-range mountain bike for resale through full line sporting goods stores. Each bicycle costs $70 in raw materials, is allocated $30 in fixed costs, and costs $10 to ship to the store. The manufacturer sells the bike to the sporting goods store for $180. The store then adds $20 to cover the costs of assembly and $50 as a profit margin.

Questions:

1. What is the selling price of the bike to the consumer?

2. What is the profit margin for the retailer?

3. What is the profit margin for the manufacturer?

GROUP ACTIVITIES

A.

As a group, select a product that you are all familiar with. Each group member should select one of the following areas for investigation:

- Product features
- Promotion
- Distribution points
- Price

Identify the current manufacturer's strategy regarding these features. Does the strategy appear consistent across the categories?

B.

Each group member should choose one of the following products:

- Sugar
- In-line skates
- Automobiles
- Breakfast cereals

For each of these products, determine its position in the product life cycle. Think about the following issues when attempting this problem:

1. Are the prices falling, rising or staying stable for this product over time?
2. Do manufacturers promote on the basis of product features or price?
3. How long has the product category been active?
4. How many competitors are there in the category?

CASE STUDY

John Dickson makes guitars by hand in his shop in Boston. He has been making guitars by hand for 15 years and has developed a clientele that includes some of the world's most successful musicians. The reason that John has such high demand for his products is that he uses traditional methods and materials for production. He is known for his attention to detail.

For the first time, John has decided to begin to produce a line of guitars for the general public. His line will carry his name and will be priced at the high end of generally available instruments. The guitars will still be made by hand, but due to the volume of guitars required, John has decided to hire three guitar makers to help him cope with the manufacturing demands. Each of the makers will be paid a straight salary.

As part of his move to become more productive, John has decided to do a thorough analysis of his costs, which will then assist him in his pricing strategy. His cost breakdown is as follows:

Raw Materials	\$300 per guitar
New machinery	\$200 per month (leased)
Owner's salary	\$3,000 per month
New hire's salaries	\$25,000 per annum each
Shop Rent	\$1,400 per month
Electricity	\$200 per month
Old machinery	\$400 per month

John figures he can sell the new guitars for \$3,500 each to guitar shops, who will add their own margins and sell them to the public.

DISCUSSION QUESTIONS

1. What are the fixed costs per month?
2. What are the variable costs per guitar?
3. What is the profit margin per guitar if the company can produce 30 guitars per month?

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. What are the factors that affect pricing decisions? What is pricing power?

2. What is the product Life cycle? What are its four stages?

3. What is profit margin and how is it computed?

4. What are the most common forms of pricing incentives?

5. What are the fundamental pricing strategy choices?

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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