Chapter 26
pricing strategies

Section 26.1
Basic Pricing Strategies

Section 26.2
Pricing Process Strategies
Before You Read

**PREDICT** Why do you think there is a variation in the prices of products?
OBJECTIVES

- **Name** three pricing policies used to establish a base price.

- **Explain** two popular pricing strategies for introducing a new product.

- **Explain** the relationship between pricing and the product life cycle.
THE MAIN IDEA

It is important to establish a base price from which price adjustments can be made. Various situations and company policies can affect the pricing of a product.
Basic Pricing Policies

VOCABULARY

• markup
• one-price policy
• flexible-price policy
• skimming pricing
• penetration pricing
Basic Pricing Policies

Notes About the Pricing Policies That Can Affect the Base Price of a Product

- Demand-Oriented Pricing
- Competition-Oriented Pricing
- Cost-Oriented Pricing

Determining the Base Price
Basic Pricing Policies

Section 26.1

Notes About the Pricing Policies That Can Affect the Base Price of a Product

- **Demand-Oriented Pricing**
  - Customer's perceived value
  - Supply-and-demand theory

- **Competition-Oriented Pricing**
  - No relationship between cost and price
  - Price entirely based on competition

- **Cost-Oriented Pricing**
  - Price set by actual costs
  - Projected profit margin added to costs

Determining the Base Price
Basic Pricing Concepts

Three Strategies Used for Setting Base Prices

**Demand-Oriented Pricing**
- Attempt to determine what consumers are willing to pay
- Relies on premises of supply-and-demand theory and demand elasticity factors

**Competition-Oriented Pricing**
- Price above the competition
- Price below the competition
- Price in line with the competition

**Cost-Oriented Pricing**
- Resellers calculate prices using the concept of markup
- Used by wholesalers and retailers

**markup**
The difference between an item’s cost and sale price.
## Basic Pricing Concepts

### Calculating the Wholesale Price

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Manufacturer’s suggested retail price (MSRP)</td>
<td>$100</td>
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<tr>
<td>Retailer’s markup (40% of retail price)</td>
<td>$40</td>
</tr>
<tr>
<td>Wholesaler’s price to retailer (subtract markup from MSRP)</td>
<td>$60</td>
</tr>
<tr>
<td>Wholesaler’s markup (20% of wholesale price)</td>
<td>$12</td>
</tr>
<tr>
<td>Manufacturer’s price to wholesaler * (subtract wholesaler’s markup from wholesaler’s price)</td>
<td>$48</td>
</tr>
</tbody>
</table>

*This amount must cover costs, expenses, and profit*
### Basic Pricing Concepts

#### Calculating the Retail Price

<table>
<thead>
<tr>
<th>Description</th>
<th>Price</th>
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</thead>
<tbody>
<tr>
<td>Cost of producing the item</td>
<td>$40</td>
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<tr>
<td>Manufacturer’s expenses and intended profit (20% of cost)</td>
<td>$8</td>
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<tr>
<td>Manufacturer’s price to wholesaler (Cost plus expenses and intended profit margin)</td>
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</tr>
<tr>
<td>Wholesaler’s markup (25% of price wholesaler paid for item)</td>
<td>$12</td>
</tr>
<tr>
<td>Wholesaler’s price to retailer (Price to wholesaler + markup)</td>
<td>$60</td>
</tr>
<tr>
<td>Retailer’s markup (66.67% based on price paid to wholesaler)</td>
<td>$40</td>
</tr>
<tr>
<td>Retailer’s base price to consumer</td>
<td>$100</td>
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</table>
Pricing Policies and Product Life Cycle

One-Price Policy

versus

Flexible-Price Policy

**one-price policy**
A policy in which all customers are charged the same prices.

**flexible-price policy**
A policy in which customers pay different prices for the same type or amount of merchandise.
Pricing Policies and Product Life Cycle

The goal of marketers is to keep products in this stage as long as possible.

- **Introduction**: Price is reduced or product is revised.
- **Growth**: Price is reduced.
- **Maturity**: Manufacturing costs are reduced. Product may be discontinued.
- **Decline**: Price is reduced. Manufacturing costs are reduced. Product may be discontinued.
**Basic Pricing Policies**

**Pricing Policies and Product Life Cycle**

**New Product Introduction**

- **Method 1**
  - **Skimming Pricing**

- **Method 2**
  - **Penetration Pricing**

**Skimming Pricing**
A pricing policy that sets a very high price for a new product.

**Penetration Pricing**
Setting the price for a new product very low to encourage as many as possible to buy the product.
1. **Name** the types of businesses that use markup to determine prices.

   Markup is used primarily by wholesalers and retailers who are involved in acquiring goods for resale.
2. Explain why manufacturers consider the final consumer with a suggested retail price when calculating the price to charge wholesalers.

Manufacturers will often do research to determine the price the final consumer is willing to pay for an item. That price becomes the manufacturer’s suggested retail price (list price) from which the company expects wholesalers and retailers to take their customary markups. Customary markups are well known in each industry.
3. **List** the advantages of using a one-price policy.

The advantages of using a one-price policy are that they offer consistency and reliability, which allows retailers to estimate sales and profit because they know the set price.
PREDICT Why do you think prices change over time?
OBJECTIVES

• Describe pricing strategies that adjust the base price.

• List the steps involved in determining a price.

• Explain the use of technology in the pricing function.
Price adjustments allow businesses to stay competitive. The right pricing strategy can help increase sales and profitability.
VOCABULARY

- product mix pricing strategies
- price lining
- bundle pricing
- geographical pricing
- segmented pricing strategy
- psychological pricing
- prestige pricing
- everyday low prices (EDLP)
- promotional pricing
### Identify Strategies for Adjusting Prices and Steps in Setting Prices

<table>
<thead>
<tr>
<th>Price Adjustment Strategies</th>
<th>Six Steps in Determining Price</th>
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</thead>
<tbody>
<tr>
<td>1. Product mix strategies</td>
<td>1.</td>
</tr>
<tr>
<td>a. Price lining</td>
<td>2.</td>
</tr>
<tr>
<td>b.</td>
<td>3.</td>
</tr>
<tr>
<td>c.</td>
<td>4.</td>
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<tr>
<td>d.</td>
<td>5.</td>
</tr>
<tr>
<td>e.</td>
<td>6.</td>
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</table>
### Section 26.2

**Pricing Process Strategies**

#### Identify Strategies for Adjusting Prices and Steps in Setting Prices

<table>
<thead>
<tr>
<th>Price Adjustment Strategies</th>
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<tbody>
<tr>
<td>1. Product mix strategies</td>
<td>1. Establish pricing objectives</td>
</tr>
<tr>
<td>a. Price lining</td>
<td>2. Determine costs</td>
</tr>
<tr>
<td>b. Optional product</td>
<td>3. Estimate demand</td>
</tr>
<tr>
<td>c. Captive product</td>
<td>4. Study competition</td>
</tr>
<tr>
<td>d. By-product</td>
<td>5. Decide on a pricing strategy</td>
</tr>
<tr>
<td>e. Bundle pricing</td>
<td>6. Set prices</td>
</tr>
</tbody>
</table>
Adjusting the Base Price

Product Mix Pricing Strategies

- Price Lining
- Optional Product Pricing
- Captive Product Pricing
- By-Product Pricing
- Bundle Pricing

**Product mix pricing strategies**
Adjusting prices to maximize the profitability for a group of products rather than for just one item.

**Price lining**
A pricing technique that sets a limited number of prices for specific groups or lines of merchandise.

**Bundle pricing**
Pricing method in which a company offers several complementary, or corresponding, products in a package that is sold at a single price.
Adjusting the Base Price

What is geographical pricing?

geographical pricing
Price adjustments required because of different shipping agreements.
Adjusting the Base Price

With FOB (Free on Board) destination pricing, the seller pays for the shipping and assumes responsibility for the shipment until it reaches the buyer.
Adjusting the Base Price

Considerations for International Pricing

- Consumers
- Competition
- Laws
- Regulations
- Economic Conditions
- Monetary Exchange Rate
- Shipping and Tariff Costs
- Distribution Systems
Adjusting the Base Price

The **segmented pricing strategy** helps businesses optimize profits and compete effectively.

**segmented pricing strategy**
A strategy that uses two or more different prices for a product, though there is no difference in the item’s cost.
Adjusting the Base Price

Four Segmented Pricing Strategy Factors

- Segmented Pricing Strategy Factors
- 
- 
- 
- 

Section 26.2

Pricing Process Strategies
Adjusting the Base Price

Four Segmented Pricing Strategy Factors

- Buyer Identification
- Product Design
- Purchase Location
- Time of Purchase
Section 26.2

Pricing Process Strategies

Adjusting the Base Price

**Psychological Pricing Strategies**

- Odd-Even Pricing
- Prestige Pricing
- Multiple-Unit Pricing
- Everyday Low Prices (EDLP)

**psychological pricing**

Pricing techniques that create an illusion for customers.

**prestige pricing**

Higher-than-average prices to suggest status and high quality to the customer.

**everyday low prices (EDLP)**

Low prices set on a consistent basis with no intention of raising them or offering discounts in the future.
Section 26.2

Pricing Process Strategies

Adjusting the Base Price

Briefly Describe Each Pricing Strategy

- Odd-Even Pricing
- Prestige Pricing
- Multiple-Unit Pricing
- Everyday Low Price

Psychological Pricing Strategies Goal
Section 26.2

Pricing Process Strategies

Adjusting the Base Price

Briefly Describe Each Pricing Strategy

Odd-Even Pricing
odd numbers: bargain image; even numbers: quality image

Prestige Pricing
High prices often suggest higher quality and status.

Multiple-Unit Pricing
Bundling items may suggest increased value to customers.

Everyday Low Price
Consistent low prices appeal to cost-conscious consumers

Psychological Pricing Strategies Goal
to create a specific illusion in a customer
Adjusting the Base Price

Promotional Pricing

- Loss Leader Pricing
- Special-Event
- Rebates and Coupons

Promotional pricing
Used in conjunction with sales promotions when prices are reduced for a short period of time.
Pricing Process Strategies

Section 26.2

Adjusting the Base Price

Discounts and Allowances

- Cash Discounts
- Quantity Discounts
- Trade Discounts
- Seasonal Discounts
- Special Allowances
The Pricing Process and Related Technology

Identify the Purpose of Each of the Six Steps Used to Determine Price

- **Step 1**: Establish Objectives
- **Step 2**: Determine Costs
- **Step 3**: Estimate Demand
- **Step 4**: Study Competition
- **Step 5**: Decide on Strategy
- **Step 6**: Set Prices
Identify the Purpose of Each of the Six Steps Used to Determine Price

Step 1
Establish Objectives
- Should make profit, improve market share, meet competition

Step 2
Determine Costs
- Depends on whether wholesaler, retailer, or service provider

Step 3
Estimate Demand
- Estimate number of potential customers

Step 4
Study Competition
- Investigate competitors’ prices for similar products and services

Step 5
Decide on Strategy
- Revisit objectives to help in choosing strategy

Step 6
Set Prices
The Pricing Process and Related Technology

Pricing Technology

- **Smart Pricing**: Decisions are based on large amounts of data.
- **Communicating Prices to Customers**: Electronic gadgets and kiosks provide consumers with real-time information.
- **RFID Technology**: Radio frequency identification (RFID) transmits information wirelessly.
1. **Identify** the key factor in deciding price lines.

   The key factor in deciding price lines is the differential between the levels of pricing. The prices within the line must be far enough apart so that the customer can perceive that there are significant differences between the groups.
2. **Explain** why bundling discourages comparison shopping.

   Bundling discourages comparison shopping because the grouping of products in the package may differ among competitors, making it difficult to see which one is the better deal.
3. **Compare** everyday low pricing with promotional pricing.

In everyday low pricing, the prices are low and they remain low with no intention of changing them in the future. In promotional pricing, prices are lowered for a short period of time, after which they go back up to the original price when the promotion is over.
End of

Chapter 26

pricing strategies

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Basic Pricing Strategies

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Pricing Process Strategies