CHAPTER 26
Pricing Strategies

Chapter Objectives

After reading this chapter, you should be able to:

- Name three pricing policies used to establish a base price
- Explain the two polar pricing policies for introducing a new product
- Explain the relationship between pricing and the product life cycle
- 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

EXPLORE THE PHOTO

Market Talk Product prices change all the time. Sometimes a new product or new technology becomes more common, so prices drop. At other times, retailers and service providers have sales and promotion events.

Quick Think Name a product you like whose price has changed in the past few years. Why did the price change?

Naljah Feanny/Corbis

THE DECA CONNECTION

DECA Events These acronyms represent DECA competitive events that involve concepts in this chapter:

AAM	**EMDM**	**HMDM**	**RMS**
ADC*	**FMML**	**MMS**	**SEM**
BMDM*	**FMML***	**QSRM** *	**SMDM**
BSM	**HLM**	**RFSM***	**TMDM**

Performance Indicators The performance indicators represent key skills and knowledge. Relating them to the concepts explained in this chapter is your key to success in DECA competitive events. Keep this in mind as you read, and write notes when you find material that helps you master a key skill. In these DECA competitive events, you should follow these performance indicators:

- Explain factors affecting pricing decisions

The events with an asterisk also include:

- Set prices
- Select pricing strategies
- Adjust prices to maximize profitability

Some events include these performance indicators:

ADC	Identify factors affecting the pricing of advertising/promotion services
BMDM	Describe pricing strategies
BSM	Describe considerations for pricing business services
EMDM	Describe the impact of e-commerce on pricing decisions
FMAL/FMML	Explain the effect of pricing on seasonal promotional activities
FMML	Select approach for setting a base price
QSRM/RFSM	Describe pricing strategies Select approach for setting a base price
SEM/SMDM	Describe pricing issues associate with sport/event products Set ticket/event prices
TMDM	Set price of group tour

DECA PREP

ROLE PLAY Check your understanding of DECA performance indicators with the DECA activity in this chapter's review. For more information and DECA Prep practice, go to the *Marketing Essentials* OLC through **glencoe.com**.

SECTION 26.1

Basic Pricing Policies

READING GUIDE

BEFORE YOU READ

Predict Name four reasons why prices vary.

OBJECTIVES

- **Name three pricing policies used to establish a base price**
- **Explain two polar pricing policies for introducing a new product**
- **Explain the relationship between pricing and the product life cycle**

KEY TERMS

- **markup pricing**
- **cost-plus pricing**
- **one-price policy**
- **flexible-price policy**
- **skimming pricing**
- **penetration pricing**

ACADEMIC VOCABULARY

You will find these words in your reading and on your tests. Make sure you know their meanings.

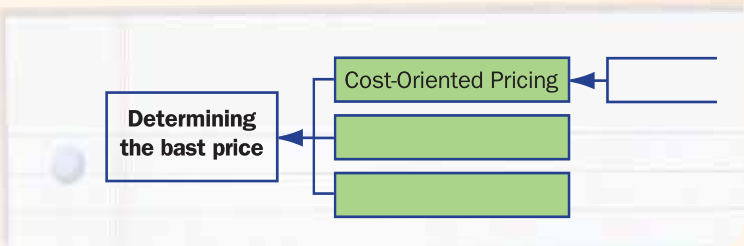
- **allocate**
- **relationship**

THE MAIN IDEA

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

GRAPHIC ORGANIZER

Draw this chart to take notes about the pricing policies that can affect the base price of a product.



Go to the OLC through glencoe.com for printable graphic organizers, Academic Vocabulary definitions, and more.

ACADEMIC STANDARDS

English Language Arts

NCTE 1 Read texts to acquire new information.

Math

NCTM Algebra Analyze change in various contexts.

AS YOU READ

Analyze Identify policies and situations that marketers use to establish the base price for new and old products.

Basic Pricing Concepts

A major factor in determining the profitability of any product is establishing a base price. Cost, demand, and competition influence pricing policies and are important in establishing a base price for a product. Each factor is the basis for a different method of setting the base price of any given product: cost-oriented pricing, demand-oriented pricing, and competition-oriented pricing.

Cost-Oriented Pricing

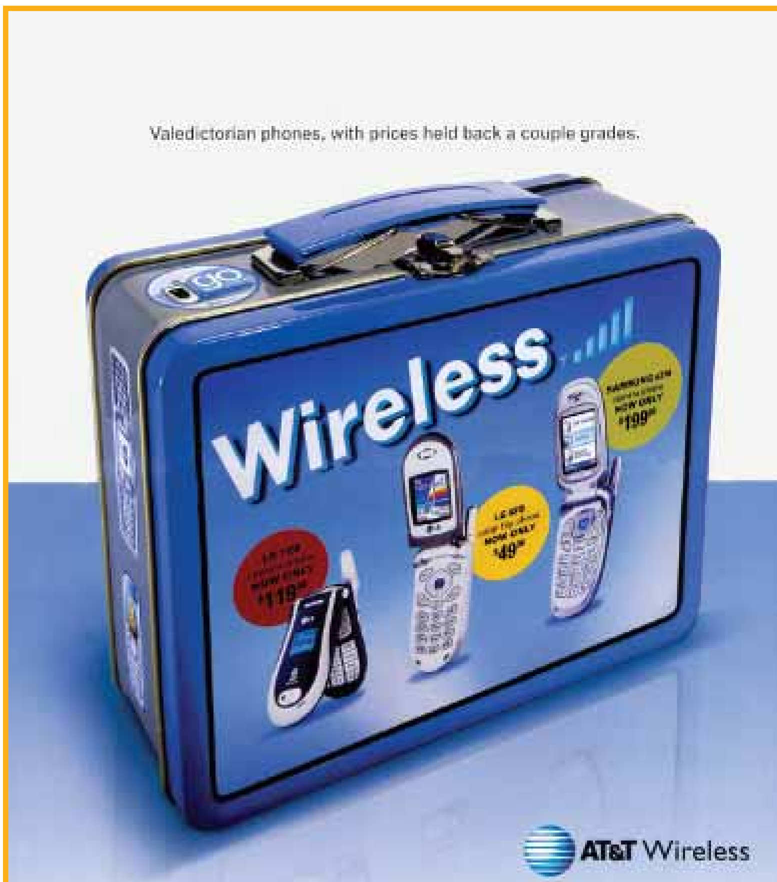
In cost-oriented pricing, marketers first calculate the costs of acquiring or making a product and their expenses of doing business; then they add their projected profit margin to these figures to arrive at a price. Markup pricing and cost-plus pricing are two of the most common methods of cost-oriented pricing.

Markup Pricing

In **markup pricing**, resellers add a dollar amount (markup) to their cost to arrive at a price. For example, if an item cost \$10 and the percentage of markup on cost is 40 percent, the retail price would be \$14 (\$10 × .40 = \$4; \$10 + \$4 = \$14). Thus, a markup, generally expressed as a percentage, is the difference between the price of an item and its cost. Markup pricing is used primarily by wholesalers and retailers, who are involved in acquiring goods for resale. The markup on products must be high enough to cover the expenses of running the business and must include the intended profit.

Cost-Plus Pricing

In **cost-plus pricing**, all costs and expenses are calculated, and then the desired profit is added to arrive at a price. Cost-plus pricing is used primarily by manufacturers and service companies. The method is more sophisticated than markup pricing because all fixed and variable expenses are calculated separately. Fixed expenses are those expenses that do not change based on production. Fixed expenses include things such as rent, interest on loans, executives' salaries, advertising, and insurance. Variable expenses are associated with the production of the good or service and include costs related to labor and supplies. When a manufacturer is running at full capacity, the percentage of fixed expenses **allocated** to each product becomes smaller. This permits the manufacturer to charge a



• **PRICING WIRELESS SERVICE** The demand for cell phone service has increased tremendously in the past years.

How has demand affected prices in this case?

lower unit price for goods. **Figure 26.1** illustrates how cost-plus pricing can be used to calculate price for a manufacturer.

Demand-Oriented Pricing

Marketers who use demand-oriented pricing attempt to determine what consumers are willing to pay for given goods and services. The key to this method of pricing is the consumer's perceived value of the item. The price set must be in line with this perception or the item will be priced too high or too low for the target market. Inappropriate pricing could cause the product to fail.

Demand-oriented pricing relies on the basic premises of supply-and-demand theory and on demand elasticity factors. The higher the demand, the more a business can charge for a given good or service, even though the good or service and its cost do not change.

Competition-Oriented Pricing

Marketers may elect to take one of three actions after learning their competitors' prices: price above the competition, price below the competition, or price in line with the competition (going-rate pricing). In this pricing method, there is no **relationship** between cost and price or between demand and price.

Competitive-bid pricing, one type of competition-oriented pricing strategy, determines the price for a product based on bids submitted by competitors to a company or government agency. In such cases, some companies will try to enter the lowest bid in order to obtain the contract.

Establishing the Base Price

To establish the base price or price range for a good or service, all three pricing approaches can be used.

Figure 26.1 Cost-Plus Pricing for a Manufacturer

• **Variable Costs** The example below is for a plain pair of pants.

How would the addition of details, such as four pockets, affect the price to the business customer and ultimately to you, the final consumer?

PLENTY OF PANTS CLOTHING MANUFACTURER: UNIT PRICE FOR A PAIR OF PANTS	
Materials (fabric, thread, zipper, buttons)	$7.50
Labor (piecework)	$1.50
Fixed expenses (overhead)	$.25
Intended profit	$2.25
Final price to business customer	$11.50

Online Action! Go to the *Marketing Essentials* OLC through glencoe.com to find a project on cost-plus pricing for manufacturers.

Case Study

Voice Over Internet Protocol

Once upon a time, there was only one telephone company in the United States. After the government broke up the monopoly in 1982, consumers had many more choices. The invention of mobile phones expanded the number of service providers, and the invention of telephoning through the Web (Voice over Internet Protocol) in the mid-1990s expanded that number again. With all those companies vying for customers, the competition is fierce.

Price Wars

Dozens of companies in the United States offer phone service through high-speed Internet connections. Some compete by adding features such as voice mail or call waiting, but most compete with price.

In 2007, Verizon charged $29.95 and AT&T $29.99 per month for unlimited calling in the United States. Some competitors charged $20 to $25 per month. Less expensive plans limit the number of minutes. Skype uses a different business model, charging about 2.1 cents per minute for calls in 30 global destinations. Some industry insiders warned there was no way to stay in business without charging $35 per month per customer, though the federal courts upheld the Federal Communications Commission's decision to bar states from taxing VoIP providers.

THINK STRATEGICALLY

What additional changes in this service do you predict for the future and how will those changes affect the pricing plans now offered by providers?

Online Action!

Go to the *Marketing Essentials* OLC through glencoe.com to find an activity on new cost-saving technology.

Cost-oriented pricing helps marketers determine the price floor for a product, or the lowest price for which it can be offered and still make a profit. Demand-oriented pricing determines a price range for the product that is defined by the price floor and the ceiling price (the highest amount consumers would pay). Competition-oriented pricing may be used to ensure that the final price is in line with the company's pricing policies such as always offering prices lower than competitors. Combining pricing considerations offers a good range within which a company can establish its base price. If a company decides to go with the competition-oriented pricing strategy, it still knows how much it can lower its prices if necessary, based on the cost-oriented pricing figures.

Reseller Considerations

Manufacturers may also consider the prices they will charge resellers (wholesalers and retailers) for their products in order to establish a base price. This can be done in one of

Figure 26.2 Pricing Backward From the Retail Price

• **Determining the wholesale price** One way for a manufacturer to arrive at a wholesale price is to subtract all the markups for channel members from the suggested retail price.

What problem would this manufacturer have if its costs and expenses totaled $37?

Manufacturer's suggested retail price (MSRP)	$75
Retailer's markup *(40% of retail price)*	−$30
Wholesaler's price to retailer *(Subtract retailer's markup from MSRP)*	$45
Wholesaler's markup *(20% of wholesale price)*	−$9
Manufacturer's price to wholesaler *(Subtract wholesaler's markup from the price paid by wholesalers)*	$\boxed{\$36}$

• Remember this amount must cover costs, expenses, and profit for the manufacturer.

Online Action! Go to the *Marketing Essentials* OLC through glencoe.com to find a project on pricing backward.

Figure 26.3 Pricing Forward From the Manufacturer's Cost

• **Marking up cost** In this pricing method, the starting point is the manufacturer's cost. At each step, a reseller adds a markup to arrive at a new price. The reseller then charges its customers the new price. The final price is the price to the consumer.

What do you see as the basic difference in markup percentage between calculating pricing forward and pricing backward?

Cost of producing the item	$30.00
Manufacturer's expenses and intended profit *(20% of cost)*	+6.00
Manufacturer's price to wholesaler *(Cost plus expenses plus intended profit)*	36.00
Wholesaler's markup *(25% of price wholesaler paid for item)*	+9.00
Wholesaler's price to retailer *(Manufacturer's price to wholesaler + markup)*	45.00
Retailer's markup *(66.67% based on price paid to wholesaler)*	+30.00
Retailer's base price to consumer	$\boxed{\$75.00}$

Online Action! Go to the *Marketing Essentials* OLC through glencoe.com to find a project on pricing forward.

two ways. You can work backward from the final retail price to find the price for the wholesalers. You can also do this in reverse, working forward from costs and expenses to the final retail price. **Figures 26.2** and **26.3** illustrate these two methods.

In Figure 26.2, which describes the steps in working backward, the suggested retail price is set first, on the basis of consumer demand and competition. Next, the markups desired by the wholesalers and retailers are deducted sequentially from the suggested retail price. Finally, the base price that the manufacturer will charge the wholesaler is determined. Note that the price to the wholesaler must be high enough to cover the manufacturer's costs, any expenses, and the intended profit.

Figure 26.3 illustrates the steps for working forward from the manufacturer's cost. Expenses and intended profit must be considered, and then the wholesaler's and retailer's markups are added to the manufacturer's price to arrive at the base selling price. Competition and consumer demand may be left out of the pricing decision if the price is set at this point.

Pricing Policies and Product Life Cycle

A basic pricing decision every business must make is to choose between a one-price policy and a flexible-price policy. A business also needs to consider how a new product will be introduced into the marketplace. That choice will determine the pricing decisions that follow as the product moves through its life cycle.

One-Price Versus Flexible-Price Policy

A **one-price policy** is one in which all customers are charged the same prices. Prices are quoted to customers by means of signs and price tags, and no deviations are permitted. Most retail stores employ this policy. A one-price policy offers consistency and reliability. It also allows retailers to estimate sales and profit because they know the set price.

A **flexible-price policy** is one in which customers pay different prices for the same type or amount of merchandise. This kind of policy permits customers to bargain for merchandise. Most retail stores avoid using flexible pricing because it can cause legal problems and it may keep some customers away. A flexible-price strategy is common for goods such as used cars, artwork, antiques, furniture, and selected jewelry. One disadvantage of a flexible-price policy is that it does not offer consistent profits. It can be difficult to estimate sales revenue because of the fluctuations in price. However, with computer technology and huge databases, this may be changing.

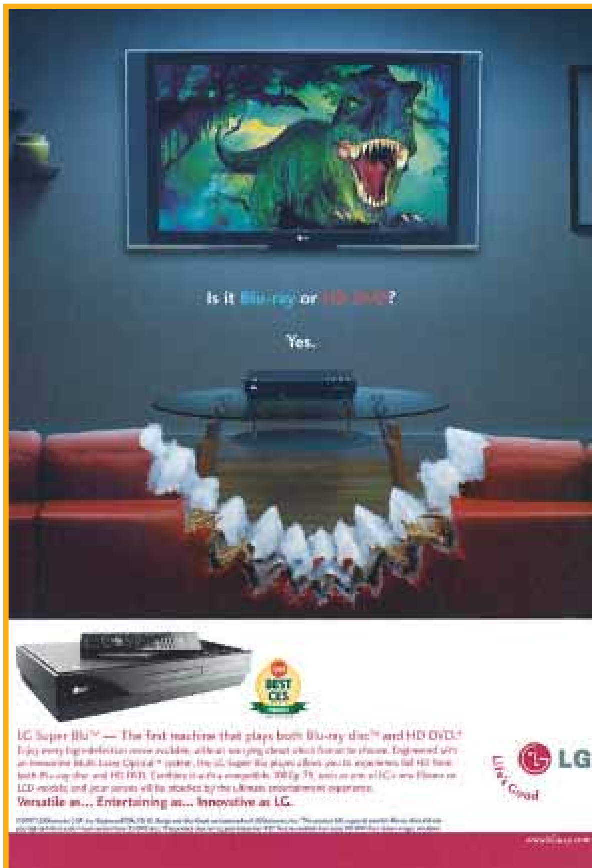
Product Life Cycle

Products move through four stages: introduction, growth, maturity, and decline. Pricing plays an important role in this sequence of events.

New Product Introduction

A business may elect to price a new product above, in line with, or below its competitors depending on the philosophy of the business and market conditions. When a going-rate strategy is not used to introduce a new product, two methods may be used: skimming pricing or penetration pricing.

Method 1 **Skimming pricing** is a pricing policy that sets a very high price for a new



• **PRICING ELECTRONICS** Computers and other electronic appliances quickly go out of date as new technology emerges and becomes more common.

How does this fast product life cycle affect pricing?

MARKET TECH

Pricing and Promotion Software

Chances are you have seen circulars in the mail or in the Sunday newspaper promoting special markdowns or "everyday low prices" at local stores. Stores used to rely on laborious calculations and even guesswork to set prices and decide what products to put on sale. Today, computer software can handle that job.

No More Guesswork

Retail chains including Radio Shack, Albertsons, and Longs Drugs use what is known as retail revenue management software or customer demand software to make pricing decisions.

The computer programs use information collected by point-of-sale terminals, such as sales volume and price. The software combines these data with other factors, including sales and volume goals, price sensitivity, and the prices that the chains pay for their goods.

After crunching the numbers, the software recommends prices and suggests products to put on sale or otherwise promote.

THINK LIKE A MARKETER

Why is the information collected at point-of-sale (POS) terminals not enough for this software to accomplish a complete price analysis?

Online Action!

Go to the *Marketing Essentials* OLC through glencoe.com to find an activity on pricing and technology.

product. This kind of policy can be used any time demand is greater than supply. Such a policy is designed to capitalize on the high demand for a product during its introductory period.

Businesses that use this method recognize that the price will have to be lowered once the market for the product changes to more price-conscious customers. While the product is hot, the business will enjoy a high profit margin. Another advantage of skimming pricing is that the price may be lowered without insulting the target market.

One disadvantage of skimming pricing is that the high initial price generally attracts competition. In addition, if the initial price is far above what consumers are willing to pay, sales will be lost and profits diminished.

Method 2 **Penetration pricing** is the opposite of skimming pricing; the price for a new product is set very low. The purpose of penetration pricing is to encourage as many people as possible to buy the product and thus penetrate the market. This type of pricing is most effective in the sale of price-sensitive products (items with elastic demand). Sony used a penetration pricing strategy when it introduced its first PlayStation game console.

To penetrate the market quickly with penetration pricing, mass production, distribution, and promotion must be incorporated into the marketing strategy. The product should take hold in a short period of time. This allows the marketer to save on fixed expenses (through mass production) and to increase the profit margin (through volume sales).

The biggest advantage of penetration pricing is its ability to capture a large number of customers in a relatively short period of time. This blocks competition from other companies.

If the product is not in high demand, however, the lower price will cause the marketer to suffer a bigger loss than it would have if a higher initial price had been set.

Other Product Stages

Pricing during subsequent periods in a product's life cycle is determined by which pricing method was originally used, skimming or penetration. Sales increase rapidly during the penetration stage, and total costs per unit decrease because volume absorbs fixed costs. The main goal of marketers is to keep products in this stage as long as possible.

Sales of products introduced with skimming pricing should be monitored. Once sales begin to level off, the price should be lowered for the price-conscious target market.

Very little price change will be made in the growth stage for products introduced with penetration pricing. When demand decreases and sales begin to level off, competition is generally very keen. Marketers look for new market segments to hold the prices for their products. A baking soda marketer may stress noncooking uses for baking soda, such as deodorizing refrigerators.

The marketer's goal during the maturity stage is to stretch the life of a product. Some companies reduce their prices. Others revitalize products by adding new features or improvements, or by looking for new target markets. Another option is to seek new markets in other nations in the global marketplace. Products that are obsolete in the United States due to technological advances may be in the introductory or growth stage in other places. By using such techniques, marketers can significantly extend a product's life cycle. When efforts are not successful, however, a product moves into decline.

Sales decrease and profit margins are reduced in the decline stage. Companies are forced to reduce the price to generate sales. To maintain profitability, marketers reduce manufacturing costs or cut back on advertising and promotional activities. Once a product is no longer profitable, it is phased out.

26.1 AFTER YOU READ

Key Terms and Concepts

1. Name and explain the two most common methods of cost-oriented pricing.
2. What is the key to demand-oriented pricing?
3. What three actions may marketers elect to follow in competition-oriented pricing?

Academic Skills

Math

4. Use the "pricing backward from retail price" approach to calculate the manufacturer's price to a wholesaler for a product that has a suggested retail price of $200. Assume that the retailer's markup on the retail price is 40 percent and the wholesaler's markup is 20 percent.

Social Studies/Government

5. What is competitive-bid pricing, and why must marketers understand this if they want to sell products to the government?

CONCEPT **Problem Solving: Backward Pricing** To determine the manufacturer's price, work backwards from the retail price. Subtract the retailer's and wholesaler's markup from the manufacturer's suggested retail price.

1. To solve this problem, multiply the retail price by the decimal equivalent of 40 percent to determine the retailer's markup.
2. Subtract the value of the retailer's markup from the retail price. This will give the wholesaler's price to the retailer.
3. Multiply the wholesaler's price to the retailer by the decimal equivalent of the wholesaler's markup, 20 percent, and subtract this amount from the wholesaler's price to determine the manufacture's price to the wholesaler.

Math For help, go to the Math Appendix located at the back of this book.

Online Action! Check your answers at the *Marketing Essentials* OLC through glencoe.com.

SECTION 26.2

Strategies in the Pricing Process

READING GUIDE

BEFORE YOU READ

Predict How and why do you think prices change?

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**

KEY TERMS

- **product mix pricing strategies**
- **price lining**
- **bundle pricing**
- **geographical pricing**
- **segmented pricing strategy**
- **psychological pricing**
- **prestige pricing**
- **everyday low prices (ELP)**
- **promotional pricing**

ACADEMIC VOCABULARY

You will find these words in your reading and on your tests. Make sure you know their meanings.

- **ultimate**
- **vehicle**

THE MAIN IDEA

Price adjustments are a marketer's way of being creative with pricing. Businesses use them to stay competitive. The right pricing strategy can help increase sales and profitability.

GRAPHIC ORGANIZER

Draw this chart to identify the strategies for adjusting prices, and the steps in setting prices.

Price Adjustment Strategies

1. Product mix strategies
   a. Price lining
   b.
   c.
   d.
2.

Go to the OLC through glencoe.com for printable graphic organizers, Academic Vocabulary definitions, and more.

ACADEMIC STANDARDS

English Language Arts

NCTE 1 Read texts to acquire new information.

English Language Arts

NCTE 3 Apply strategies to interpret texts.

AS YOU READ

Connect Note pricing strategy examples from your own experience.

Adjusting the Base Price

Marketers can use specific pricing strategies to fit different economic and market conditions. To adjust base prices, marketers use the following pricing strategies: product mix, geographical, international, segmented, psychological, promotional pricing, discounts, and/or allowances. Using these strategies in the appropriate situations helps businesses remain competitive.

Product Mix Strategies

Product mix pricing strategies involve adjusting prices to maximize the profitability for a group of products rather than on just one item. With this method, one product may have a small profit margin while another may be high to balance the effect of the lower priced one. They include price lining, optional product pricing, captive product pricing, by-product pricing, and bundle pricing.

Price Lining

Price lining is a special pricing technique that sets a limited number of prices for specific groups or lines of merchandise. A store might price all its blouses at $25, $35, and $50. When deciding on the price lines, marketers must be careful to make the price differences great enough to represent low, middle, and high quality items. Price lines of $25, $26, $27, and $28, for example, would confuse customers because they would have difficulty discerning their basis.

An advantage of price lining is that the target market is fully aware of the price range of products in a given store. In addition, price lining makes merchandising and selling easier for salespeople, who can readily draw comparisons between floor and ceiling prices.

Optional Product

Optional product pricing involves setting prices for accessories or options sold with the main product. One example is options for cars. All options need to be priced so that a final price for the main product can be established.

Captive Product

Captive product pricing sets the price for one product low but compensates for that low price by pricing the supplies needed to operate that product high. Ink-jet printers are low in price, but the ink cartridges required to operate the printers have high prices.

By-Product

By-product pricing helps business get rid of excess materials used in making a product by using low prices. Wood chips that are residual by-products from making furniture may be sold at a very low price to other manufacturing companies that use that material in making their products.

Bundle Pricing

With **bundle pricing**, a company offers several complementary products in a package that is sold at a single price. The one price for all the complementary products and the main item is lower than if a customer purchased each item separately. Computer companies use bundle pricing when they include software in the sale price of a computer. Bundling helps businesses sell items (parts of the package) that they may not have sold otherwise, which increases their sales and revenue.

Geographical Pricing

Geographical pricing refers to price adjustments required because of the location of the customer for delivery of products. The delivered price includes the cost of the item and delivery charges. In this pricing strategy, the manufacturer assumes responsibility for the cost and management of product delivery.

International Pricing

When doing business internationally, mar keters need to set prices that take into con sideration costs, consumers, economic conditions, and the monetary exchange rate. Costs may include shipping, tariffs, or other charges. Consumers' income levels and lifestyles will require adjustments to the price.

Segmented Pricing Strategies

A **segmented pricing strategy** uses two or more different prices for a product, though there is no difference in the item's cost. This strategy helps businesses optimize profits and compete effectively. Four factors can help marketers use segmented pricing strategies: buyer identification, product design, purchase location, and time of purchase.

Buyer Identification

Recognizing a buyer's sensitivity to price (demand elasticity) is one way to identify a customer segment. For example, to attract customers on fixed incomes, some businesses offer senior citizen and student discounts. Airlines offer different classes of travel—first class and coach. First-class travelers pay a significantly higher price to get to the same destination.

Product Design

Manufacturers may also create different prices for different product styles that do not reflect the cost of making the item but, rather, the demand for a given style.

Purchase Location

Purchase location involves pricing according to where a product is sold and/or the location of the good or service. Tickets for Broadway shows in New York City will be priced higher than those for the same show when it goes on the road.

Time of Purchase

Some types of businesses experience highs and lows in sales activity. During peak times, they are able to charge more because of increased demand. Telephone companies often charge more for long-distance calls made during business hours, a peak time.

Psychological Pricing Strategies

Psychological pricing strategies are pricing techniques that help create an illusion for customers. They are often based on a buyer's motivation for making a purchase and purchasing habits. Among common psychological pricing techniques are odd-even pricing, prestige pricing, multiple-unit pricing, and everyday low prices (EDLPs).

Odd-Even Pricing

A technique that involves setting prices that all end in either odd or even numbers is known as odd-even pricing. This strategy is based on the psychological principle that odd numbers ($.79, $9.95, $699) convey a bargain image. Even numbers ($10, $50, $100) convey a quality image. Marketers use the odd-even technique to project an image.

Prestige Pricing

Prestige pricing sets higher-than-average prices to suggest status and high quality to the consumer. Many customers assume that higher prices mean better quality. Rolls-Royce automobiles, Waterford crystal, and Rolex watches are all prestige priced.

Multiple-Unit Pricing

Some businesses have found that pricing items in multiples, such as three for $1.00, is better than selling the same items at $.34 each. Multiple-unit pricing suggests a bargain and helps to increase sales volume.

Everyday Low Price

Everyday low prices (EDLP) are low prices set on a consistent basis with no intention of raising them or offering discounts in the future. Everyday low prices are not as deeply discounted as promotional prices might be, which creates sales stability. Other benefits include reduced promotional expenses and reduced losses due to discounting.

Reading Check **Analyze** **Why would a higher price benefit a high-end product?**

Promotional Pricing

Promotional pricing is generally used in conjunction with sales promotions where prices are reduced for a short period of time. Common types of promotional pricing are loss leader pricing (discussed in Chapter 25), special-event pricing, and rebates and coupons.

Loss Leader Pricing

Loss leader pricing is used to increase store traffic by offering very popular items of merchandise for sale at below-cost prices. The theory behind this practice is that customers will be attracted by the low price. Once in the store, they will buy regularly priced merchandise in addition to the loss leader item.

Special-Event

In special-event pricing, items are reduced in price for a short period of time, based on a specific happening, such as back-to-school, Presidents' Day, or anniversary sales. Manufacturers offer special promotions to wholesalers and retailers willing to advertise or promote a manufacturer's products.

Rebates and Coupons

Rebates are partial refunds provided by the manufacturer to consumers. To receive the rebate, a customer buys the product and then sends in a rebate form along with the product proof of purchase and a store receipt. Manufacturers offer rebates to wholesalers and retailers too, for purchasing certain quantities of goods prior to running promotions that will generate business for those resellers. Coupons allow customers to take reductions at the time of purchase. Coupons may be found in newspapers, advertisements, product packages, and even on sales receipts printed by retailers, such as supermarkets.

Discounts and Allowances

Discount pricing involves the seller offering reductions from the usual price. Such reductions are generally granted in exchange for the buyer's performance of certain functions. These include cash discounts, quantity discounts, trade discounts, seasonal discounts, and special allowances.

Cash Discounts

Cash discounts are offered to buyers to encourage them to pay their bills quickly. Terms are generally written on the invoice, for example, 2/10, net 30 means that a 2 percent discount is granted if the bill is paid in ten days.

Quantity Discounts

Quantity discounts are offered to buyers for placing large orders. Sellers benefit from large orders through the lower selling costs involved in one transaction as opposed to several small transactions. Quantity discounts also offer buyers an incentive to purchase more merchandise than they originally intended to purchase.

A MATTER OF ETHICS

Some supermarkets offer special discounts on selected items to customers who have a frequent shopper card, but not to those without one. Consider two customers at the checkout counter, both purchasing the same loaf of bread. The customer with a card pays $2.00 for a loaf of bread, while the other without a card pays $2.99. Frequent shopper cards are available to all customers who request one.

Opting Out

Some customers simply do not want their purchases traced through participation in a frequent shopper program. They feel it is an invasion of their privacy. However, they also object to paying higher prices than other customers.

THINKING ETHICALLY

Are loyalty-card programs ethical?

Online Action!

Go to the *Marketing Essentials* OLC through glencoe.com to find an activity on ethics and pricing.

There are two types of quantity discounts: noncumulative and cumulative. Noncumulative quantity discounts are offered on one order, while cumulative quantity discounts are offered on all orders over a specified period of time. Cumulative discounts may be granted for purchases made over six months, for example, in which case all purchases for that period are used to determine the quantity discount offered. In other cases, buyers may be required to sign a contract that guarantees a certain level of business. Advertisers who agree to use a specified number of column inches in their newspaper ads might be charged cheaper contract rates. Generally, the more you advertise, the less you pay per column inch.

Trade Discounts

Trade discounts are not really discounts at all but rather the way manufacturers quote prices to wholesalers and retailers. Many manufacturers establish suggested retail prices, or list prices, for their items. They grant discounts from the list price to members of the channel of distribution. A manufacturer might grant wholesalers a 40 percent discount from the list price and retailers a 30 percent discount.

The manufacturer might also quote the discounts in series, such as 25 percent and 10 percent for retailers and wholesalers, respectively. Series, or chain, discounts are calculated in sequence, with discounts taken on the declining balance as shown below. The example is based on a list price of $50.

Retailer's discount
$\$50 \times .25 = \$12.50$

Cost to retailer
$\$50 - \$12.50 = \$37.50$

Wholesaler's discount
$\$37.50 \times .10 = \$3.75$

Cost to wholesaler
$\$37.50 - \$3.75 = \$33.75$

In series discounts, note that the wholesaler's discount is based on the retailer's discount, not the original list price.

Seasonal Discounts

Seasonal discounts are offered to buyers willing to buy at a time outside the customary buying season. Manufacturers offer discounts to obtain orders for seasonal merchandise early so that production facilities and labor can be used throughout the year.

Other businesses use seasonal discounts to cut anticipated costs. Many retailers, for example, drastically reduce prices on swimsuits after the summer season. Such retailers prefer to sell this merchandise at a lower markup than pay the costs of warehousing it until the following year. A variation on this device is used by vacation resorts. They offer vacationers lower rates to encourage use of resort facilities during the off-season.

Allowances

Trade-in allowances go directly to the buyer. Customers are offered a price reduction if they sell back an old model of the product they are purchasing. Consumers are generally offered trade-in allowances when purchasing new cars or major appliances. Companies are usually granted such allowances when purchasing machinery or equipment.

The Pricing Process and Related Technology

The pricing process is ongoing, as you will see in the steps of determining a price. As one of the four Ps of the marketing mix, pricing is the most flexible because pricing strategies and prices can be changed quickly.

Steps in Determining Prices

There are six basic steps that are used to determine prices (see **Figure 26.4**):

Step 1: Establish pricing objectives
Step 2: Determine costs
Step 3: Estimate demand
Step 4: Study competition
Step 5: Decide on a pricing strategy
Step 6: Set prices

Step 1: Establish Pricing Objectives

The first step in the process of pricing a product is to determine the pricing objectives. Pricing objectives must conform to the company's overall goals: making profit, improving market share, and meeting the competition. To be effective, pricing objectives should be specific, time sensitive, realistic, and measurable. Increasing sales of a given product is not a good pricing objective. Increasing unit or dollar sales by 20 percent in one year compared

Figure 26.4 Six Steps in Determining Price

• **A Set Procedure** Whether setting a price to launch a new product or adjusting the price of an existing product to increase sales, the process of determining price is the same.

What are some factors affecting this process?

STEP 1: ESTABLISH PRICING OBJECTIVES

The main goals of pricing are to make a profit, increase market share, and stay competitive. Remember that objectives should be time sensitive, realistic, and measurable. The objective for this product might be to increase market share by ten percent in the coming year.

STEP 2: DETERMINE COSTS

Costs are an important consideration in pricing. A company must price its product high enough above costs to make a profit. Costs for a soft drink manufacturer include raw materials, bottling, and labor.

STEP 3: ESTIMATE DEMAND

Through market research, a company must determine the size of the market and how much customers would be willing to pay for their product.

STEP 4: STUDY COMPETITION

Knowing what the competition charges for similar products is key to determining price. If a company prices its product too low, it misses out on potential profit, too high and it risks losing customers to the competition.

STEP 5: DECIDE ON A PRICING STRATEGY

The pricing strategy for a product depends on a variety of factors, including whether the product is being sold to segmented markets, whether there is a seasonal market, and where the product is sold. When a company sells soft drinks at a sporting event, purchase location is an important factor in determining price.

STEP 6: SET PRICES

Based on all the information gathered in the first five steps, a company sets a price for its product. Remember, though, that this price is subject to change.

@ Online Action!

Go to the *Marketing Essentials* OLC through glencoe.com to find a project on pricing.

with the previous year would be better. Why? Because the latter objective satisfies the requirements of being time-sensitive (one year) and it is specific and measurable (20 percent increase). At the end of one year, a company can evaluate the pricing objective to see if it was met. If not, the company can review the objective and the pricing strategies used to reach that objective.

Step 2: Determine Costs

For resellers (wholesalers and retailers), costs involved in the purchase of a product from their vendors and freight charges constitute the cost of the item. Businesses that provide services must take into account the cost of supplies used in conjunction with performing the service and the cost of labor help. A hair salon's shampoo, gels, hair spray, dyes, permanent wave solutions, and the like, as well as employee salaries, all need to be considered when determining the cost of providing those services. In manufacturing, the cost of materials and labor used in the manufacture of the product makes up the cost of an item. Costs can vary due to ever-changing economic conditions. A business needs to maintain accurate records and keep abreast of any change in its costs, which may affect its **ultimate** pricing decision.

Step 3: Estimate Demand

Marketers will study the size of the market to determine the total number of possible customers for a given product. For example, let's say the market is for a new soft drink. Sales of soft drinks for the past few years would be studied to see if sales were on the rise or the decline. Additional research might be conducted with consumers to see how they viewed soft drinks versus other beverages, such as water and juice alternatives. From their basic research, estimates would be made regarding the percentage of potential customers who might buy that new product. Much of this analysis is based on supply-and-demand theory and on the exceptions that occur because of demand elasticity.

Step 4: Study Competition

Studying your competitors is the next step in the process. You need to investigate what prices your competitors are charging for similar goods and services. Businesses subscribe to services that provide competitive information on a daily basis.

Step 5: Decide on a Pricing Strategy

Steps 2 through 4 help to establish a base price. In Step 5, you need to revisit the pricing objectives and decide on a pricing strategy or strategies that will help you accomplish your objectives. Everything you learned in Section 26.2 will help you in this endeavor. However, you must remember that as economic and market conditions change, strategies may require changes too.

Step 6: Set Prices

The final step is to set the price that will be quoted to customers, which is the published price that can be found on price tickets, company Web sites, and price sheets, as well as printed in catalogs and promotional materials. For that reason, it is important that all the above steps are carefully considered. Marketers must decide on how often they want to change their published prices. In addition to the cost of changing printed materials, customers' reactions to price changes must be considered.

Pricing Technology

Technology related to pricing can be seen in data that are now made available to marketers when making pricing decisions, as well as in the **vehicles** for providing price information to customers.

Smart Pricing

Smart pricing, as it is sometimes called, allows marketers to make intelligent pricing decisions based on an enormous amount of data that Web-based pricing technology crunches into timely, usable information. For example, Northern Group (a Canadian retailer) uses software that combines sales data with inventory data. The result is pricing recommendations that the pricing team can decide to accept or reject. Historical sales data are compared with current sales data from the store's point-of-sale system, as well as with its merchandising system, which includes the inventory levels for specific items. Combining all these data helps to suggest prices for new merchandise, as well as when to take markdowns, if any, on current merchandise in stock. This system gives this company the ability to adjust prices according to changing market conditions.

Communicating Prices to Customers

To complement these advances in pricing decisions, electronic gadgets provide customers with real-time pricing information. Retailers that invest in electronic shelves and digital price labels can change prices quickly and easily. They also can send messages to shoppers while they are in the store alerting them to deals on goods of interest to the customer based on their buying habits.

We have already seen kiosks in retail stores where customers can scan a product to determine its price. In supermarket chains, we have seen self-check-out counters, where customers scan their own merchandise and pay for the products without the assistance of a clerk. With these new technological advances, price-marking techniques, such as printed price tags, are quickly becoming a thing of the past in certain industries.

Upcoming Technology: RFID

Upcoming technology that will revolutionize pricing and inventory control is called radio frequency identification, or RFID. RFID is wireless technology that involves tiny chips imbedded in products. A chip has an antenna, a battery, and a memory chip filled with a description of the item.

26.2 AFTER YOU READ

Key Terms and Concepts

1. What is the key factor in deciding price lines?
2. Why does bundling discourage comparison shopping?
3. Name four factors that can help marketers use segmented pricing strategies.

Academic Skills

Math

4. Determine the price a wholesaler would pay for an item with a list price of $35 if the series trade discounts were 40 percent for retailers and 10 percent for wholesalers.

Social Studies/Geography

5. What factors would come into play when setting the price for a child's bicycle if you were selling it in Mexico or China?

CONCEPT Numbers and Operations: Discounts Discounts are usually presented as a percent off of the manufacturer's price. To determine the value of a discount, convert the percent to a decimal number and multiply it by the regular price. To determine the price after a discount, simply subtract this value from the regular price.

1. To solve this problem, convert the percent discounts to decimals by moving the decimal place two places to the left.
2. Multiply the decimal numbers by $35 to determine the value of the discount.
3. Subtract the retail and wholesale discount amounts from $35 to determine the respective prices after the discount.

Math For help, go to the Math Appendix located at the back of this book.

Online Action! Check your answers at the *Marketing Essentials* OLC through glencoe.com.

CAREERS IN MARKETING

RYAN WILSON
CO-OWNER
VEGAN ESSENTIALS

What do you do at work?

I run a new organic food store. With the hiring of additional employees, my position has become a bit more focused in the past year rather than running almost everything myself. Now, my primary focuses are setting a pricing policy, marketing, product research, customer service, and purchasing.

What skills are most important to you?

General management skills from having to run so many aspects of a business. Internet marketing, customer and vendor relations, and product research are other much needed skills. Setting pricing, researching competition's prices and setting the right pricing policy for products that are not widely marketed is a challenge. In retrospect, the jobs I had to do working for others were far easier because my position was focused in one direction.

What is your key to success?

Dedication. There have been countless 12–15 hour days, slow periods, vendor problems, and numerous other issues we've come across, and the only way to be successful has been to persevere through the rough times and keep looking forward. Never lose sight of what you want to accomplish with your business.

Aptitudes, Abilities, and Skills

Organizational skills, general business management, creativity, and flexibility

Academics and Education

Courses general business, management, accounting

Degrees BA, MBA

Career Path

Retail careers often begin with entry-level positions in established stores. Niche retailers often spring from a personal hobby or interest (as in the case of this vegan-oriented store).

Career Outlook

Growth about as fast as average for the next ten years

Source: *Occupational Outlook Handbook*

THINKING CRITICALLY

What can a business do to make sure its prices are competitive?

Online Action!

Go to the *Marketing Essentials* OLC through glencoe.com to find a career-related activity.

CHAPTER 26 REVIEW

FOCUS on KEY POINTS

SECTION 26.1

- Establishing a base price for a product can be accomplished by combining cost-oriented, demand-oriented, and competition-oriented policies, as well as considering resellers' needs.
- Businesses must decide whether to use a one-price policy or a flexible pricing policy.
- The product life cycle needs to be considered in the pricing process. Two polar pricing strategies for the introduction of a product are skimming pricing and penetration pricing.

SECTION 26.2

- Once a base price is established, price adjustments are made using pricing strategies: product mix pricing, geographical pricing, international pricing, segmented pricing, psychological pricing, promotional pricing, discounts, and allowances.
- Six steps to determine prices are: establishing pricing objectives, determining costs, estimating demand, studying competition, deciding on a strategy, and setting actual price.
- Pricing technology has revolutionized the way businesses make pricing decisions.

REVIEW VOCABULARY

1. On a sheet of paper, use each of these key terms and academic vocabulary words in a written sentence.

Key Terms

- markup pricing (p. 545)
- cost-plus pricing (p. 545)
- one-price policy (p. 549)
- flexible-price policy (p. 549)
- skimming pricing (p. 549)
- penetration pricing (p. 550)
- product mix pricing strategies (p. 553)
- price lining (p. 553)
- bundle pricing (p. 553)
- geographical pricing (p. 553)
- segmented pricing strategy (p. 553)
- psychological pricing (p. 554)
- prestige pricing (p. 554)
- everyday low prices (ELP) (p. 554)
- promotional pricing (p. 554)

Academic Vocabulary

- allocate (p. 545)
- relationship (p. 546)
- ultimate (p. 558)
- vehicle (p. 558)

REVIEW FACTS and IDEAS

2. List three ways to find a base price. (26.1)
3. What are two polar pricing methods to introduce a new product into the market? (26.1)
4. Explain pricing and product life cycle. (26.1)
5. What are six types of pricing strategies that may be used to adjust the base price? (26.2)
6. List six steps in the pricing process. (26.2)
7. How is technology used in pricing? (26.2)
8. How does price lining benefit the consumer? (26.2)
9. Name the four things that affect international pricing. (26.2)
10. List three prestige-priced items. (26.2)
11. List three types of promotional pricing. (26.2)

CHAPTER 26 REVIEW

BUILD REAL-WORLD SKILLS

12. Workplace Skills

Human Relations You work for a department store in the women's dress department. A customer approaches you with two dresses that are identical, except that the one from the petite department is not marked down, while the other one is marked down. None of the petite dresses have been marked down because the buyer for that department did not elect to do so.

How will you handle this customer who wants to buy that dress style in the petite size?

13. Technology Applications

Computer Skills Set up a spreadsheet to demonstrate bundle pricing of a computer and needed software. Show the savings when buying the advertised bundle price as compared with buying each item separately.

BUILD ACADEMIC SKILLS

14. Math Practice

Incentives Promotional discounts are given to stores by manufacturers to place products in preferred locations or to pay for ads, displays, or in-store demonstrations. Calculate the store's net cost to stock the following items and the percentage of the discount given.

Item	Purchase Amount	Discount Amount	Net Cost to Store	Percent Discount
Snowboards	$5,650	$847.50	______	______
CD Players	$535	$42.80	______	______

CONCEPT **Problem Solving: Percent Discounts** When a discount is given in a dollar amount, it can be converted to a percent by dividing the dollar value of the discount by the purchase amount and then multiplying by 100.

Math **For help, go to the Math Appendix located at the back of this book.**

15. English Language Arts

Compare and Contrast Skim the chapter and look for two different pricing strategies. Write a paragraph describing the differences between the two strategies you choose. Explain why that policy would work when selling such a specific product.

DEVELOP CRITICAL THINKING

16. Life Cycle

Select a product that interests you and research its pricing history and its competition on the Internet, through the company site and through competitors' sites. Also research companies on their sites at your local library. Make a list of details such as how long a product has been on the market and any product improvements. In which product life cycle stage is it? Why?

APPLY CONCEPTS

17. Cost-Plus Pricing

Using cost-plus pricing, establish a price for a car wash fund-raiser. The local community center will allow you to use its parking lot and water supply for $10 per hour from 9:00 a.m. to 5:00 p.m. on a Saturday. To arrive at prices you can advertise, purchase all the cleaning supplies and determine how much you will use per auto. Labor costs will be $2 per hour per worker.

Activity Write a short report that outlines your pricing strategy and calculations.

NET SAVVY

18. Comparison Shopping

Browse computer companies' Web sites, such as Dell, IBM, HP, and Gateway, to see pricing strategies in action. Try to find the best price for a laptop computer for your firm. What pricing strategies made comparison shopping difficult?

STANDARDIZED TEST PRACTICE

1. ***Directions*** Choose the letter of the best answer. Write the letter for the answer on a separate piece of paper.

   What is the percentage of a $60 rebate on a $135 product?

   A 50%
   B 54%
   C 64%
   D 44%

2. ***Directions*** Choose either True or False as the answer. Write the letter for the answer on a separate piece of paper.

   In mark-up pricing, resellers add a dollar amount to their cost to arrive at a price.

   T
   F

Test-Taking Tip

Just before taking a test, avoid talking to other students. Test anxiety is contagious.

THE DECA CONNECTION

Role Play
Frame Store Employee

Situation Assume the role of employee of a custom-framing store. In addition to custom framing, the store carries a large selection of pre-made frames in several sizes, prints, and posters. The store's owner (judge) has never used promotional pricing for the custom framing services or for the manufactured frames. The store's owner (judge) is considering some type of special sale prices as part of the business's anniversary celebration. The store's owner (judge) is not familiar with promotional pricing and has asked for your input.

Activity You are to prepare your ideas about promotional pricing in general and the different types of promotional pricing. You are then to make a recommendation about the use of promotional pricing to celebrate the store's anniversary.

Evaluation You will be evaluated on how well you meet the following performance indicators:

- Explain factors affecting pricing decisions.
- Describe pricing strategies.
- Select pricing strategies.
- Make oral presentations.
- Demonstrate orderly and systematic behavior.

Online Action!

For more information and DECA Prep practice, go to the *Marketing Essentials* OLC through glencoe.com.