Pricing Policies

Basic Pricing Policies

OBJECTIVES

- **List** the goals of pricing.
- **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.

Basic Pricing Policies

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

3 Strategies for Setting Base Prices

Demand

Competition

Cost

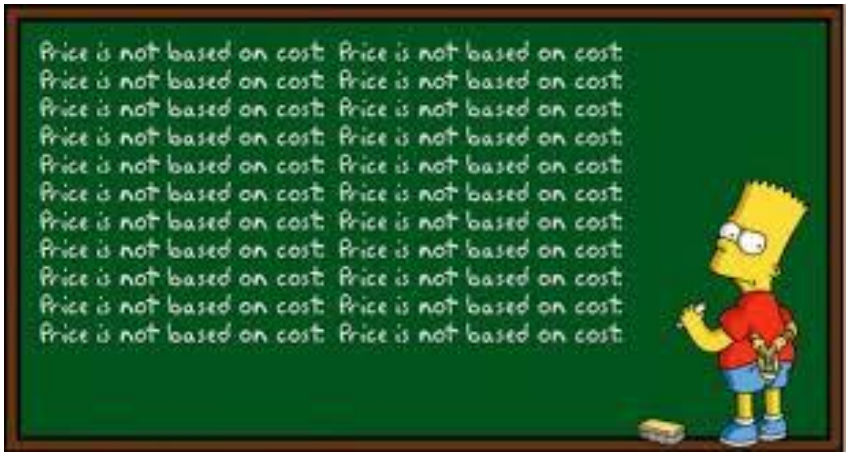
Demand Oriented Pricing

- Attempt to determine what consumers are willing to pay
- Relies on premises of supply-and-demand theory and demand elasticity factors
- Doesn’t look at the competition
- Key is what consumer’s perceived value of the item

Competition Oriented Pricing

- Look at the competitors pricing and adjust accordingly
  - Up
  - Down
  - In line
- May price to gain market share
- Compete on non price factors
  - Examples
    - Customer service
    - Quality
    - Convenience
    - Product uniqueness
- *No relation* between cost & price

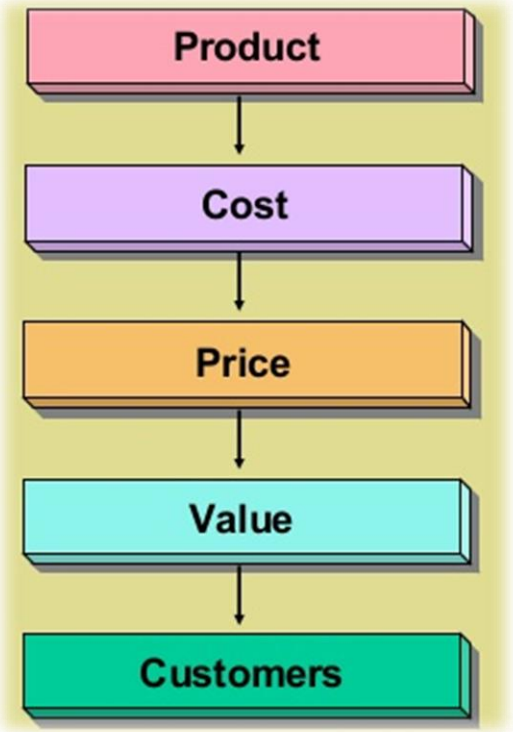
Cost Oriented Pricing



- **Considers earning a profit**
- **Must cover your costs to stay in business**

Cost Oriented Pricing

- Can start with costs to be profitable
- Must consider the customer
- Must also consider competition



Determine Price

Cost Plus

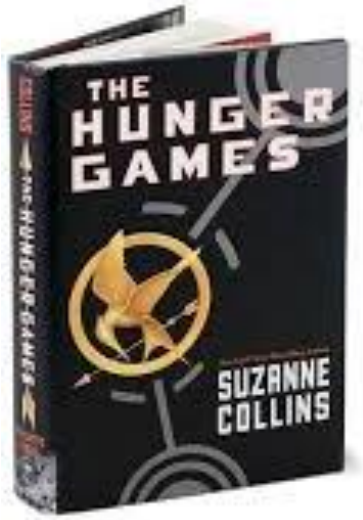
- Determine the costs to make & market the product
- Add amount of profit that you want to determine price

Market

- Price products according to what you think people are willing to pay
- Selling price must be set higher than costs

Markup

- **Resellers** calculate prices using Markup
- Difference between product's cost and price
- Expressed as %
- Example:



Book costs $10

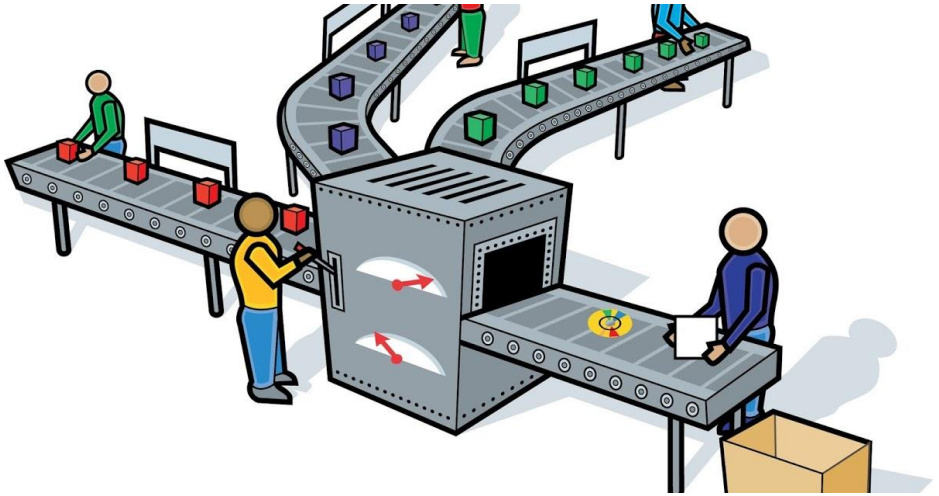
Markup 40%

40% of $10 = $4

Price $10 (cost) + $4 (markup) = $14

Manufacturers & Service Businesses

- Calculate Fixed & Variable Expenses Separately
- When manufacturer runs full capacity % of fixed expenses allocated to each product goes down



Unit Price for Jacket

Materials (fabric, insulation, thread, zipper, pockets	$12.00
Labor (piecework)	$2.00
Fixed Expenses (overhead)	$.75
Intended Profit Margin	$4.25
Price to business customer	$19.00

Manufacturers Suggested Retail Price (MSRP)

- Manufacturers must set prices to cover their costs
- Manufacturers must consider retail prices and work backwards

CALCULATING THE WHOLESALE PRICE

Manufacturer's suggested retail price *(MSRP)*	$100
Retailer's markup *(40% of retail price)*	− $40
Wholesaler's price to retailer *(subtract markup from MSRP)*	= $60
Wholesaler's markup *(20% of wholesale price)*	− $12
Manufacturer's price to wholesaler * *(subtract wholesaler's markup from wholesaler's price)*	= $48

* *This amount must cover costs, expenses, and profit*

Practice

Calculate Wholesale Price

Games R Us has create a new 3-D video game, called Visual Combat. The suggested retail price is $100. If the trade discounts are 25% for retailers and 10% for wholesalers, the wholesalers would pay how much for each game?

Practice

Calculate Wholesale Price

Games R Us has create a new 3-D video game, called Visual Combat. The suggested retail price is $100. If the trade discounts are 25% for retailers and 10% for wholesalers, the wholesalers would pay how much for each game?

MSRP $ _____

Retailer's Markup $ _____

Wholesaler's Price to Retailer $ _____

Wholesaler's Markup $ _____

Manufacturer's Price to Wholesaler $ _____

Practice

Calculate Wholesale Price

Games R Us has create a new 3-D video game, called Visual Combat. The **suggested retail price is $100.** If the trade discounts are 25% for retailers and 10% for wholesalers, the wholesalers would pay how much for each game?

MSRP **$ 100**

Practice

Calculate Wholesale Price

Games R Us has create a new 3-D video game, called Visual Combat. The suggested retail price is $100. If the **trade discounts are 25% for retailers** and 10% for wholesalers, the wholesalers would pay how much for each game?

MSRP		**$ 100**	
Retailer's Markup	**25% of retail**	**$ 25**	**(.25 X $100)**

Practice

Calculate Wholesale Price

Games R Us has create a new 3-D video game, called Visual Combat. The suggested retail price is $100. If the trade discounts are 25% for retailers and 10% for wholesalers, the wholesalers would pay how much for each game?

MSRP		**$ 100**	
Retailer's Markup	**25% of retail**	**$ 25**	**(.25 X $100)**
Wholesaler's Price to Retailer		**$ 75**	**($100 - $25)**

Practice

Calculate Wholesale Price

Games R Us has create a new 3-D video game, called Visual Combat. The suggested retail price is $100. If the trade discounts are 25% for retailers and **10% for wholesalers**, the wholesalers would pay how much for each game?

MSRP	**$ 100**
Retailer's Markup 25% of retail	**$ 25**
Wholesaler's Price to Retailer	**$ 75**

Wholesaler's Markup 10% of Wholesale Price **$ 7.50** **(.10 X $75)**

Practice

Calculate Wholesale Price

Games R Us has create a new 3-D video game, called Visual Combat. The suggested retail price is $100. If the trade discounts are 25% for retailers and 10% for wholesalers, the wholesalers would pay how much for each game?

MSRP	**$ 100**
Retailer's Markup 25% of retail	**$ 25**
Wholesaler's Price to Retailer	**$ 75**
Wholesaler's Markup 10% of Wholesale Price	**$ 7.50**

Manufacturer's Price to Wholesaler $ 67.50 ($75 - $7.50)
(wholesalers price – wholesale markup)

Practice

Calculate Wholesale Price

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Wholesaler's Markup	**$ 7.50**
Manufacturer's Price to Wholesaler	**$ 67.50**

Practice

Calculate Wholesale Price

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MSRP	**$ 100**	
Retailer's Markup 25% of retail	**$ 25**	**(.25 X $100)**
Wholesaler's Price to Retailer	**$ 75**	**($100 - $25)**
Wholesaler's Markup 10% of Wholesale Price	**$ 7.50**	**(.10 X $75)**
Manufacturer's Price to Wholesaler (wholesalers price – wholesale markup)	**$ 67.50**	**($75 - $7.50)**

Practice

Calculate Wholesale Price

Tropical Smoothies is introducing a new smoothie Mango Mush. The suggested retail price for a 5 gallon mix is $60. If the trade discounts are 30% for retailers and 20% for wholesalers, the wholesalers would pay how much for each 5 gallon mix?

Practice

Calculate Wholesale Price

Tropical Smoothies is introducing a new smoothie Mango Mush. The suggested retail price for a 5 gallon mix is $60. If the trade discounts are 30% for retailers and 20% for wholesalers, the wholesalers would pay how much for each 5 gallon mix?

MSRP $ _____

Retailer's Markup $ _____

Wholesaler's Price to Retailer $ _____

Wholesaler's Markup $ _____

Manufacturer's Price to Wholesaler $ _____

Practice

Calculate Wholesale Price

Tropical Smoothies is introducing a new smoothie Mango Mush. The **suggested retail price for a 5 gallon mix is $60**. If the trade discounts are 30% for retailers and 20% for wholesalers, the wholesalers would pay how much for each 5 gallon mix?

MSRP **$ 60**

Practice

Calculate Wholesale Price

Tropical Smoothies is introducing a new smoothie Mango Mush. The suggested retail price for a 5 gallon mix is $60. If the **trade discounts are 30% for retailers** and 20% for wholesalers, the wholesalers would pay how much for each 5 gallon mix?

MSRP	**$ 60**	
Retailer's Markup (.30 X $60)	**30% of retail**	**$ 18**

Practice

Calculate Wholesale Price

Tropical Smoothies is introducing a new smoothie Mango Mush. The suggested retail price for a 5 gallon mix is $60. If the trade discounts are 30% for retailers and 20% for wholesalers, the wholesalers would pay how much for each 5 gallon mix?

MSRP	**$ 60**	
Retailer's Markup 30% of retail	**$ 18**	
Wholesaler's Price to Retailer	**$ 42**	**($60 - $18)**

Practice

Calculate Wholesale Price

Tropical Smoothies is introducing a new smoothie Mango Mush. The suggested retail price for a 5 gallon mix is $60. If the trade discounts are 30% for retailers and 20% for wholesalers, the wholesalers would pay how much for each 5 gallon mix?

MSRP	**$ 60**
Retailer's Markup 30% of retail	**$ 18**
Wholesaler's Price to Retailer	**$ 42**

Wholesaler's Markup 20% of Wholesale Price $ 8.40 (.20 X $42)

Practice

Calculate Wholesale Price

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Retailer's Markup 30% of retail	**$ 18**
Wholesaler's Price to Retailer	**$ 42**
Wholesaler's Markup 20% of Wholesale Price	**$ 8.40**

Manufacturer's Price to Wholesaler $ 33.60

($42 - $8.40)

(wholesalers price – wholesale markup)

Practice

Calculate Wholesale Price

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Practice

Calculate Wholesale Price

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Wholesaler's Price to Retailer	**$ 42**	**($60 - $18)**
Wholesaler's Markup 20% of Wholesale Price	**$ 8.40**	**(.20 X $42)**
Manufacturer's Price to Wholesaler (wholesalers price – wholesale markup)	**$ 33.60**	**($42 - $8.40)**

Can Reverse the Process

CALCULATING THE RETAIL PRICE	
Cost of producing the item	$40
Manufacturer's expenses and intended profit *(20% of cost)*	− $8
Manufacturer's price to wholesaler *(Cost plus expenses and intended profit margin)*	= $48
Wholesaler's markup *(25% of price wholesaler paid for item)*	+ $12
Wholesaler's price to retailer *(Price to wholesaler + markup)*	= $60
Retailer's markup *(66.67% based on price paid to wholesaler)*	+ $40
Retailer's base price to consumer	= $100

- Can build the retail price based on cost
- But must also consider
  - Demand
  - Competition
  - Market Position

Earn a Profit

Companies are in business to make a profit.

If they don't make a profit, they lose money and cannot stay in business.

Companies analyze how much a product is making, or the ROI.

Note: not covered in the textbook in Chapter 26

Return on Investment (ROI)

financial calculation that is used to determine the relative profitability of a product

Rate of Return = Profit/Investment

Note: not covered in the textbook in Chapter 26

ROI Example

Rate of Return = Profit/Investment

Example:

Sales price for watches = $9/watch

Investment for watches

(cost to make & market watch) = $7.50/watch

Profit = $9 - $7.50 = $1.50/watch

Rate of Return = ($9 - $7.50) / $7.50 = 20%

Note: not covered in the textbook in Chapter 26

Practice

Two young entrepreneurs, Pete and Joey, open a lemonade stand in front of their house. It costs them 25¢ to make one glass of lemonade. They sell the lemonade for 35¢ a glass. What is their ROI?

Practice

Two young entrepreneurs, Pete and Joey, open a lemonade stand in front of their house. It costs them 25¢ to make one glass of lemonade. They sell the lemonade for 35¢ a glass. What is their ROI?

- What is the sales price?
- What is the investment?
- What is the profit?

Practice

Two young entrepreneurs, Pete and Joey, open a lemonade stand in front of their house. It costs them 25¢ to make one glass of lemonade. They sell the lemonade for 35¢ a glass. What is their ROI?

- What is the sales price? **35¢**
- What is the investment? **25¢**
- What is the profit?

Sales Price - Investment

35¢ - 25¢ = 10¢

Practice

Two young entrepreneurs, Pete and Joey, open a lemonade stand in front of their house. It costs them 25¢ to make one glass of lemonade. They sell the lemonade for 35¢ a glass. What is their ROI?

- What is the ROI?

Rate of Return = Profit/Investment

Practice

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What is the ROI?

Rate of Return = Profit/Investment

Profit = 10¢

Investment = 25¢

ROI = 10¢ / 25¢ = 40%

Practice

Two young entrepreneurs, Pete and Joey, open a lemonade stand in front of their house. It costs them 25¢ to make one glass of lemonade. They sell the lemonade for 35¢ a glass. What is their ROI?

What is the ROI?

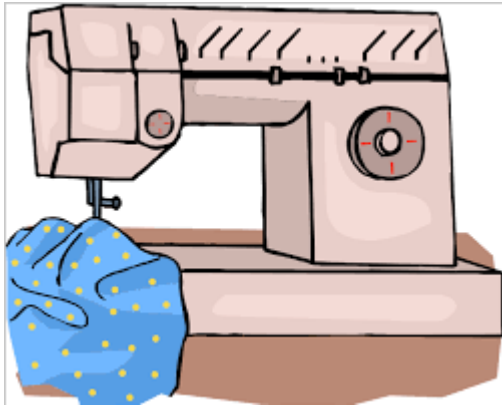
Rate of Return = Profit/Investment

ROI = 10¢ / 25¢ = 40%

Should they stay in business?

Practice

Allie started her own business stitching sports figures on sweatshirts to sell at craft shows. It costs her $9.00 for the sweatshirt, $3.50 for the canvas, and $1.50 for the special thread. If she sells the shirts for $30.00, what is the ROI on each shirt?



Practice

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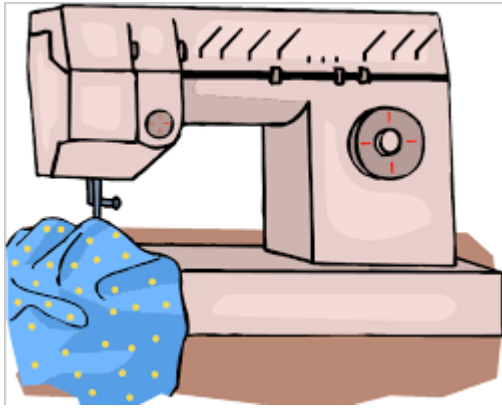
What is the sales price?



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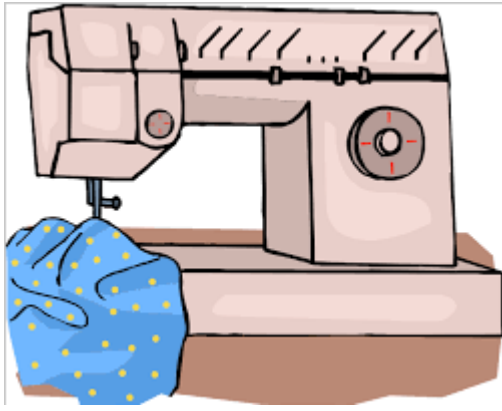
What is the investment?



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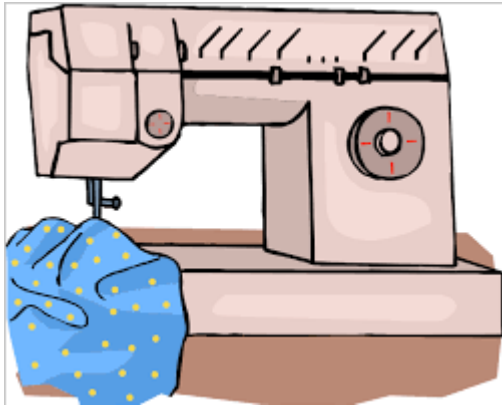
What is the investment?

sweatshirt	$9.00
canvas	$3.50
thread	$1.50
Total Investment	$14.00



Practice

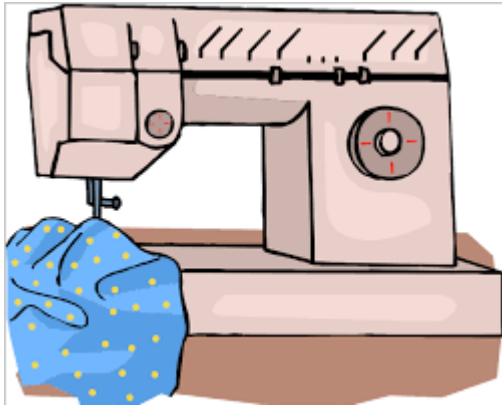
Rate of Return = Profit/Investment

Allie started her own business stitching sports figures on sweatshirts to sell at craft shows. It costs her $9.00 for the sweatshirt, $3.50 for the canvas, and $1.50 for the special thread. If she sells the shirts for $30.00, what is the ROI on each shirt?

Total Investment $14.00

Price $30.00

What is the Profit?



Practice

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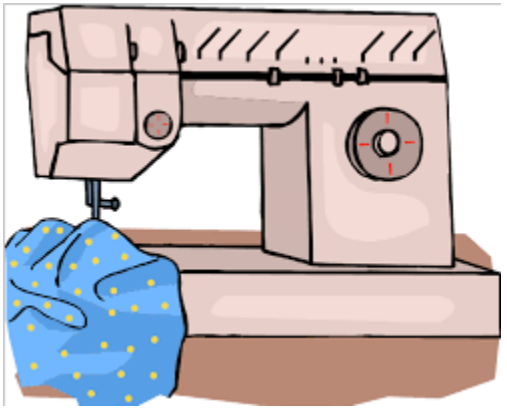
Allie started her own business stitching sports figures on sweatshirts to sell at craft shows. It costs her $9.00 for the sweatshirt, $3.50 for the canvas, and $1.50 for the special thread. If she sells the shirts for $30.00, what is the ROI on each shirt?

Total Investment $14.00

Price $30.00



What is the Profit?

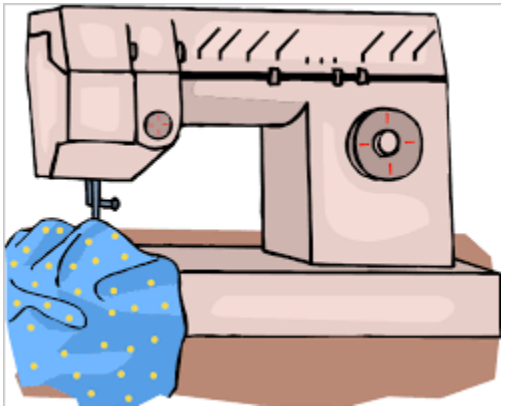
Price – Total Investment

$30 - $14 = $16

Practice

Rate of Return = Profit/Investment

Allie started her own business stitching sports figures on sweatshirts to sell at craft shows. It costs her $9.00 for the sweatshirt, $3.50 for the canvas, and $1.50 for the special thread. If she sells the shirts for $30.00, what is the ROI on each shirt?



What is the ROI?

Profit $16

Investment $14

Profit/Investment

$16 / $14 = 114%


ROI
Return
On
Investment
Let's
Practice!

Break Even Point

- Point where sales revenue equals costs to make & distribute product
- Profits start after Break Even Point
- Determine Break Even Point:

$$\frac{\text{Total Product Cost + Expenses}}{\text{Selling Price}}$$

Note: not covered in the textbook in Chapter 26

Break Even Point Example

- **Purses R Us** expects to sell 75,000 purses at $300 each. The cost of manufacturing and marketing them is $125 each.
- Calculate the break even point:

$$\frac{\text{Total Product Cost}}{\text{Selling Price}}$$

$$\frac{75{,}000 \text{ X } \$125}{\$300} = \frac{\$9{,}375{,}000}{\$300} = 31{,}250$$

Note: not covered in the textbook in Chapter 26

Practice

A firm expects to sell 60,000 pairs of pants at $12.50 each. The cost of manufacturing and marketing them is $10.00 each. Calculate the break even point for the pants.

Calculate the break even point:

$$\frac{\text{Total Product Cost}}{\text{Selling Price}}$$

Practice

A firm expects to sell 60,000 pairs of pants at $12.50 each. The cost of manufacturing and marketing them is $10.00 each. Calculate the break even point for the pants.

Calculate the break even point:

$$\frac{\text{Total Product Cost}}{\text{Selling Price}} = \frac{\$10 \text{ X } 60{,}000 \text{ pairs}}{\$\ 12.50}$$

$$= \frac{600{,}000}{12.50} = \textbf{48,000 break even point}$$

Practice

A firm expects to sell 2,000,000 pencils at $.25 each. The cost of manufacturing and marketing them is $.20 each. Calculate the break even point for the pencils.

Calculate the break even point:

$$\frac{\text{Total Product Cost}}{\text{Selling Price}}$$

Practice

A firm expects to sell 2,000,000 pencils at $.25 each. The cost of manufacturing and marketing them is $.20 each. Calculate the break even point for the pencils.

Calculate the break even point:

$$\frac{\text{Total Product Cost}}{\text{Selling Price}} = \frac{\$0.20 \text{ X } 2{,}000{,}000 \text{ pencils}}{\$\ 0.25}$$

$$= \frac{400{,}000}{0.25} = \text{1,600,000 pencils break even point}$$

Practice

A firm expects to sell 30,000 pairs of shoes at $50 each. The cost of manufacturing and marketing them is $20 each. Calculate the break even point for the shoes.

Calculate the break even point:

$$\frac{\text{Total Product Cost}}{\text{Selling Price}}$$

Practice

A firm expects to sell 30,000 pairs of shoes at $50 each. The cost of manufacturing and marketing them is $20 each. Calculate the break even point for the shoes.

Calculate the break even point:

$$\frac{\text{Total Product Cost}}{\text{Selling Price}} = \frac{\$20 \text{ X } 30{,}000 \text{ pairs shoes}}{\$ 50}$$

$$= \frac{600{,}000}{\$50} = \text{12,000 pairs shoes break even point}$$

Practice

A firm expects to sell 50,000 blazers at $25 each. The cost of manufacturing and marketing them is $15 each. Calculate the break even point for the blazers.

Calculate the break even point:

$$\frac{\text{Total Product Cost}}{\text{Selling Price}}$$

Practice

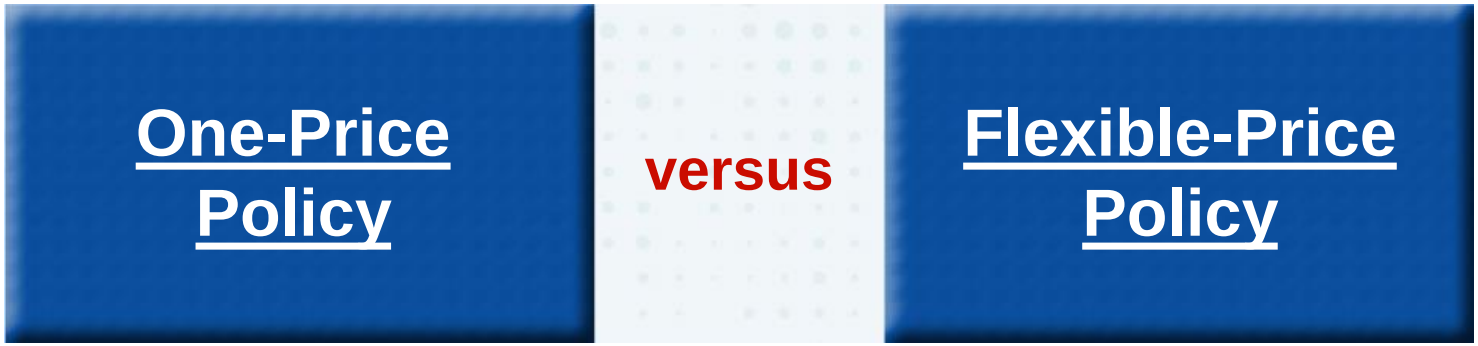
A firm expects to sell 50,000 blazers at $25 each. The cost of manufacturing and marketing them is $15 each. Calculate the break even point for the blazers.

Calculate the break even point:

$$\frac{\text{Total Product Cost}}{\text{Selling Price}} = \frac{\$15 \text{ X } 50{,}000 \text{ blazers}}{\$ 25}$$

$$= \frac{750{,}000}{\$25} = 30{,}000 \text{ blazers break even point}$$

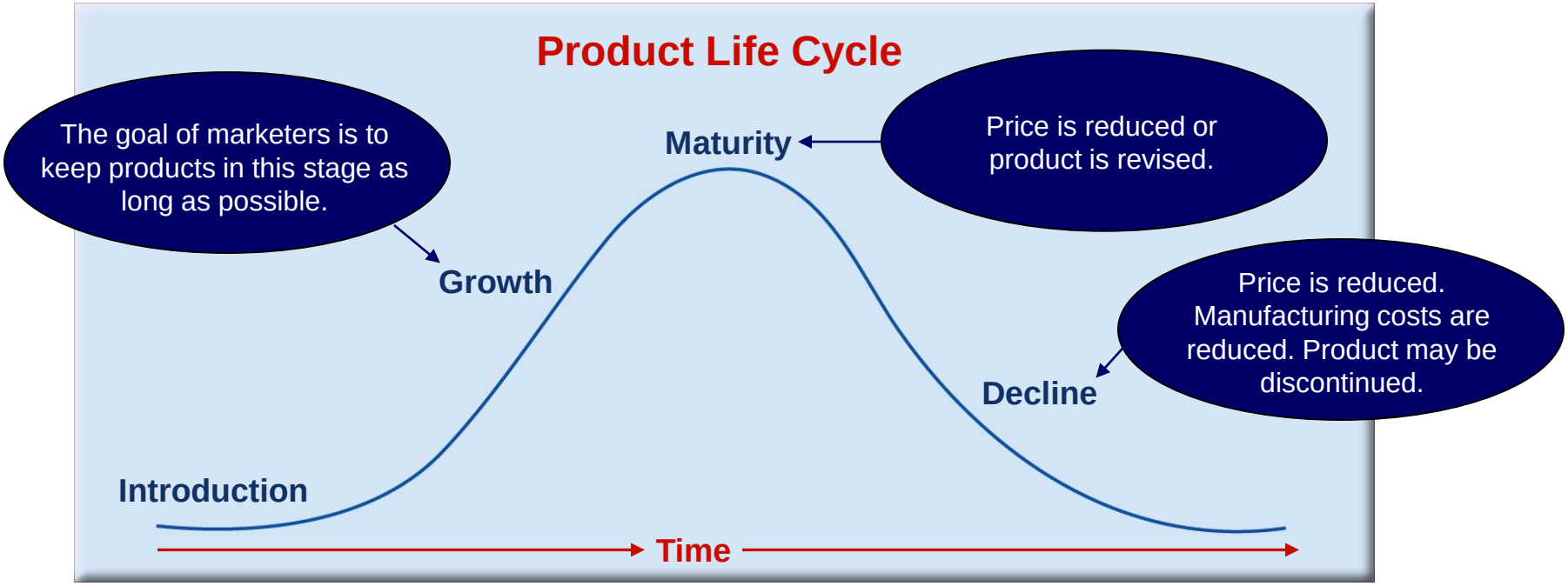
Basic Pricing Policies



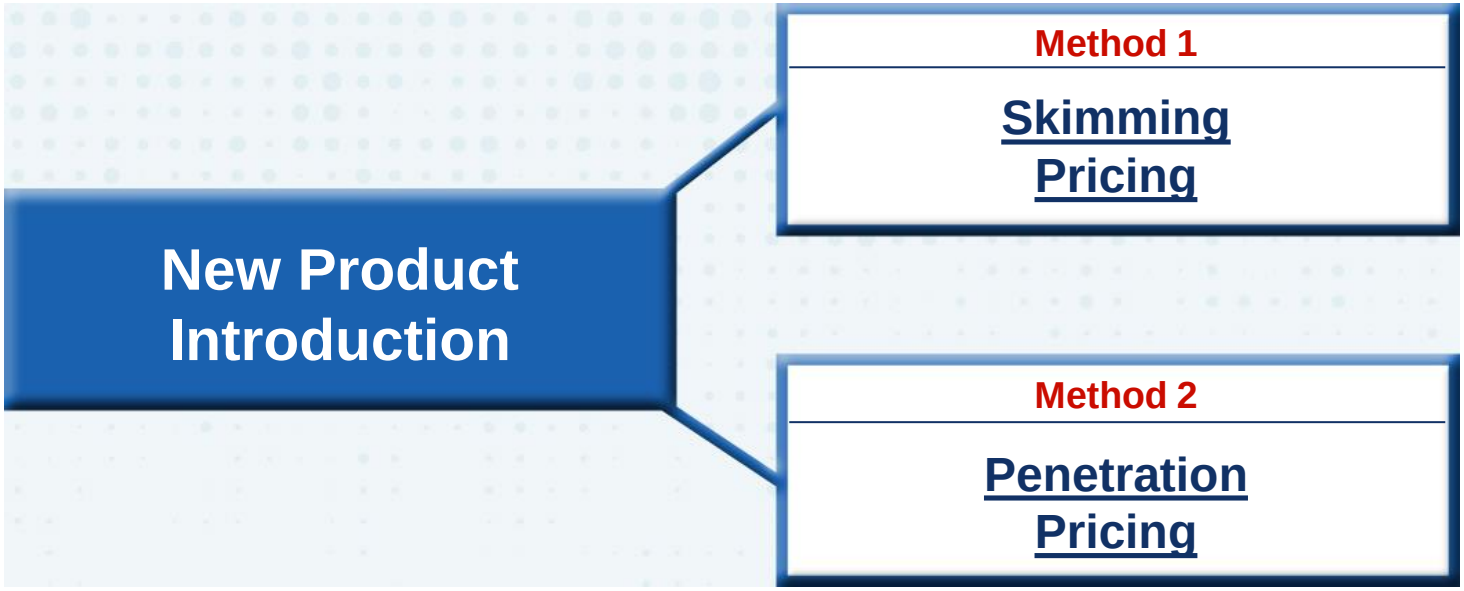
A policy in which all customers are charged the same prices.

A policy in which customers pay different prices for the same type or amount of merchandise.

Price Policies & PLC



Pricing Policies and Product Life Cycle



Price Skimming

High price for a new product

Price Penetration

- Initial price is low
- Encourage more product trials

Introductory Price

Summary

- 3 price strategies
  - Demand
  - Competition
  - Cost
- Markup
- ROI
- Break Even Point
- PLC & Pricing Policies
- Price Skimming & Price Penetration

Basic Pricing Policies

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.

Basic Pricing Policies

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.

Basic Pricing Policies

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.