Chapter 10: Pricing and Credit Strategies

### Pricing and Credit Strategies

Factors Affecting Price

- Product or service costs
- Customers’ characteristics
- Market forces
- Competitors’ prices
- Sales volume
- Company’s image
- Customers expectations
- Economic conditions
- Seasonal fluctuations
- Customers’ price sensitivity
- Psychological factors
- Credit terms and purchase discounts
- Desired image

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What determines price?

- Price Ceiling (“What will the market bear?”)
- Acceptable Price Range
- Price Floor (“What are the company’s costs?”)
- Final Price (What is the company’s desired “image?”)

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Pricing: Dealing with Rapidly Rising Costs

- Communicate with your customers
- Include a surcharge
- Eliminate discounts, coupons, or “freebies”
- Focus on efficiency
- Consider absorbing cost increases
- Emphasize the value your company provides to customers
- Try to lock in prices with suppliers

Three Pricing Forces: Image, Competition, and Value

- Price conveys image
  - Prices send signals to customers about quality and value
  - Key is understanding your target customers
- When setting prices, business owners must consider competitors’ prices
  - Competitors’ locations
  - Nature of the competing goods

(Continued)

Three Pricing Forces: Image, Competition, and Value

- When setting prices, business owners must consider competitors’ prices
  - Avoid price wars!
- Focus on value
  - Objective value vs. perceived value
  - Three reference points:
    - Price paid in the past
    - Prices competitors charge
    - Company’s costs
New Product Pricing

Three types of products:
- Revolutionary products transform an industry
- Evolutionary products make improvements to products that are already on the market
- Me-too products are those that allow a company merely to keep up with competitors

Pricing flexibility for each type?

Introducing a New Product

Three Goals:
- Get the product accepted
- Maintain market share as competition grows
- Earn a profit

Introducing a New Product

Three Strategies:
- Penetration
- Skimming
- Life cycle pricing
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Pricing Established Goods and Services
- Odd pricing
- Price lining
- Dynamic pricing
- Leader pricing

Pricing Established Goods and Services
- Geographic pricing
  - Zone pricing
  - Uniform delivered pricing
  - F.O.B. seller
- Opportunistic pricing
- Discounts (or markdowns)
- Multiple pricing

Pricing Established Goods and Services
- Bundling
  - Optional product pricing
  - Captive product pricing
  - By-product pricing
- Suggested retail prices
- Follow-the-leader pricing
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Pricing for Retailers: Markup

Dollar Markup = Retail Price - Cost of Merchandise

Percentage (of Retail Price) Markup = \( \frac{\text{Dollar Markup}}{\text{Retail Price}} \)

Percentage (of Cost) Markup = \( \frac{\text{Dollar Markup}}{\text{Cost of Unit}} \)

Example:

Dollar Markup = $25 - $15 = $10

Percentage (of Retail Price) Markup = \( \frac{\$10}{\$25} = 40\% \)

Percentage (of Cost) Markup = \( \frac{\$10}{\$15} = 67\% \)

Pricing for Manufacturers: Cost-Plus Pricing

Selling Price

Profit Margin

Selling and Administrative Costs

Direct Labor

Direct Materials

Factory Overhead

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Pricing for Manufacturers: Breakeven Selling Price

Breakeven Selling Price = \( \text{Profit} + \left( \frac{\text{Variable cost per unit}}{\text{Quantity produced}} \times \text{Quantity produced} \right) + \left( \frac{\text{Total fixed costs}}{\text{Quantity produced}} \right) \)

Example:

Breakeven Selling Price = \( \$0 + \left( \frac{\$6.98/\text{unit} \times 50,000 \text{ units}}{50,000 \text{ units}} \right) \times \$110,000 \)

= \( \$9.18 \text{ per unit} \)

Pricing for Service Firms: Price per Hour

Price per Hour = \( \frac{\text{Total cost per productive hour}}{1 - \left( \frac{\text{net profit target as a % of sales}}{100} \right)} \)

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Pricing for Service Firms: Price per Hour

\[
\text{Price per Hour} = \frac{\text{Total cost per productive hour}}{1 - \text{net profit target as a } \% \text{ of sales}}
\]

Example: Ned's TV Repair Shop

\[
\text{Price per Hour} = \frac{\$18.59 \text{ per hour}}{1 - .18} = \$22.68 \text{ per hour}
\]

Consumer Credit

- Nearly 144 million Americans have credit cards
- Average person has 4 credit cards
- Customers use credit cards to purchase $1.8 trillion of goods annually
- Customers make 30% of personal consumption expenditures with either credit or debit cards

Credit and Pricing

- Merchants incur fees to be able to accept credit cards
  - Application fee
  - Transaction fees
  - Interchange fees
  - Equipment fee
  - Licensing fee
  - Holdbacks and chargebacks