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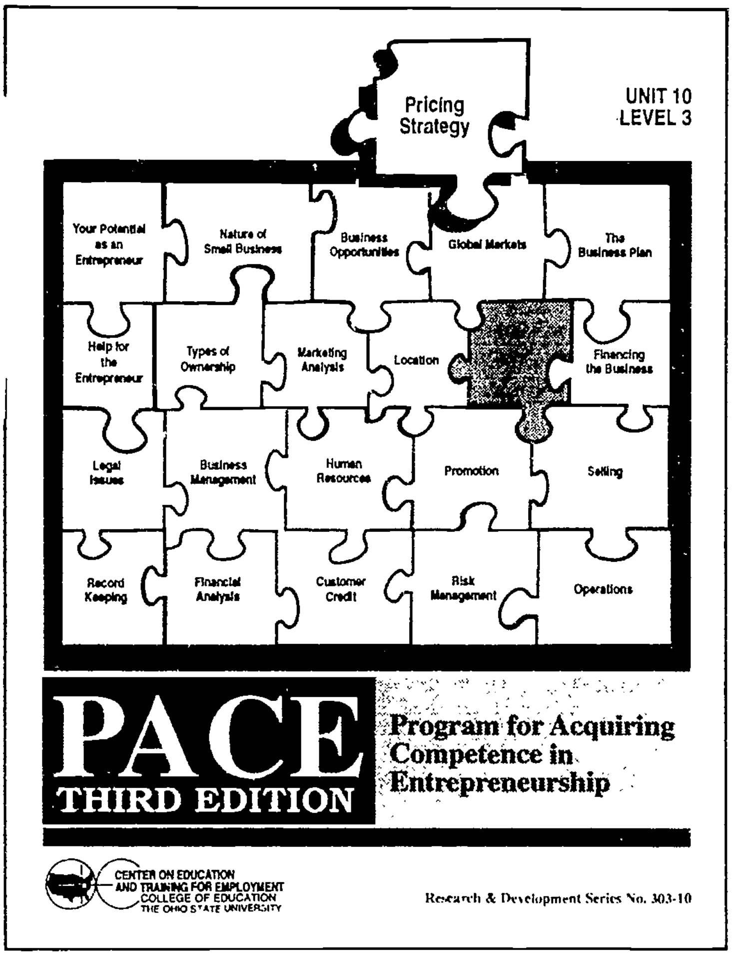
ABSTRACT

This instructor guide for a unit on pricing strategy in the PACE (Program for Acquiring Competence in Entrepreneurship) curriculum includes the full text of the student module and lesson plans, instructional suggestions, and other teacher resources. The competencies that are incorporated into this module are at Level 3 of learning--starting and managing one's own business. Included in the instructor's guide are the following: unit objectives, guidelines for using PACE, lists of teaching suggestions for each unit objective/subobjective, model assessment responses, and overview of the three levels of the PACE program. The following materials are contained in the student's guide: activities to be completed in preparation for the unit, unit objectives, student reading materials, individual and group learning activities, case study, discussion questions, assessment questions, and references. These five objectives are addressed: determine the costs that will affect pricing; identify other factors that will affect one's pricing strategy; illustrate how markup strategies affect one's pricing; design pricing incentives for one's business; and determine appropriate pricing strategies for a business. (YLB)



INSTRUCTOR GUIDE

Unit 10

Pricing Strategy

Level 3

Objectives:

- Determine the costs that will affect pricing.
- Identify other factors that will affect your pricing strategy.
- Illustrate how markup strategies affect your pricing.
- Design pricing incentives for your business.
- Determine appropriate pricing strategies for a business.

HOW TO USE PACE

- Use the objectives as a pretest. If a student is able to meet the objectives, ask him or her to read and respond to the assessment questions in the back of the module.
- Duplicate the glossary from the *Resource Guide* to use as a handout.
- Use the teaching outlines provided in the *Instructor Guide* for assistance in focusing your teaching deli\ ,. The left side of each outline page ,lsts objectives with the corresponding headings (margin questions) from the unit. Space is provided for you to add your own suggestions. Try to increase student involvement in as many ways as possible to foster an interactive learning process.
- When your students are ready to do the *Activities*, assist them in selecting those that you feel would be the most beneficial to their growth in entrepreneurship.
- Assess your students on the unit content when they indicate they are ready. You may choose written or verbal assessments according to the situation. Model responses are provided for each module of each unit. While these are suggested responses, others may be equally valid.

Objectives	Teaching Suggestions
1. EXPLAIN THE VALUE OF MAINTAINING ACCURATE RECORDS	
Why should a new business owner keep records?	If a new business owner did not keep records what would happen? Propose this scenario to the class and discuss what might happen.
2. DETERMINE ALL RECORDS NEEDED FOR YOUR BUSINESS	
What are source documents?	Throughout this unit, you will need to refer to a number of bookkeeping records. A business owner/guest speaker may be willing to share copies of their records with the class. Or, you may take a field trip to a record keeping service center and ask them to show you their records. Other possibilities are to obtain copies of a small business' bookkeeping records or samples of bookkeeping software printouts. In this section, show some of the source documents such as invoices and purchase orders. Then, demonstrate how source documents are recorded in the journal.
Who should maintain the business records? Why have an accountant?	Ask students what characteristics they would look for when hiring a bookkeeper or accountant.
What should you discuss with your accountant?	Show the class copies of the bookkeeping records mentioned in this section. Ask what source documents would be needed to create these records.
What is double-entry bookkeeping?	Track journal entries from your sample bookkeeping material to the appropriate ledger entries.
What journals are most commonly used by small businesses?	Lay out all the different sample journals on a table and discuss their use.
What are accounts payable and receivable systems?	Track several accounts receivable and accounts payable entries on the sample ledgers.
What is needed for payroll records?	Examine a payroll register sample.

Objectives	Teaching Suggestions
Why should you control cash flow? How do you control cash flow? How important is the daily sales and cash summary?	Present a sample daily sales and cash flow summary. Ask why can't it be done monthly? Following the form in Figure 3, change the amount of the entries and let students calculate total sales.
What is a journal of sales and receipts	Track entries from the daily sales and cash flow summary to the journal of sales and receipts.
What is a cash disbursement journal?	Present a sample cash disbursement journal.
What is a petty cash fund?	Ask the class why businesses have petty cash funds and how businesses control theft from this fund.
How is the bank reconciliation statement used?	Briefly review the bank reconciliation form from PACE Record Keeping Level 1. Discuss the importance of maintaining accurate records of your bank balance.
What is a general ledger? What about assets and the ledger? What about liabilities and the ledger? What about net worth? What about income and the ledger? What about expenses and the ledger?	Show a sample general ledger. Track several entries from journals to the general ledger. Be sure to include entries from asset, liability, net worth, income and expense ledgers.
What is inventory?	Ask the class what kinds of inventory a restaurant would have. What kinds of inventory would a shoe manufacturer have? Etc.
How much inventory do you need?	Discuss the factors that would affect desirable inventory levels in a restaurant.

Objectives	Teaching Suggestions
What are the functions of inventory control systems? What is a perpetual inventory? What is a physical inventory? What is an electronic inventory system?	Ask the class why controlling inventory is important. List responses on the board. Ask for ways to track your inventory. Be sure to include physical, perpetual and electronic inventory systems.
What are budget systems? What is a sales budget? What are merchandising and purchasing budgets? What is the advertising budget?	Show the sample budgets and discuss how the different budgets are established.
Are there other record keeping needs?	Discuss with the class any other records beyond those covered.
3. DEVELOP A PLAN FOR MANAGING YOUR RECORDS	
How are computers used?	Demonstrate the use of personal computers in record keeping.
Should I protect my record-keeping system from damage or loss?	Discuss different ways records can be protected.

MODEL ASSESSMENT RESPONSES

1. Double-entry bookkeeping is a system based on basic accounting equation that specifies that the assets of a company will equal its liabilities plus its capital. Any transaction will always effect two accounts in opposite directions to maintain the equations balance.

2. The following record-keeping devices should be used in a business: journals, ledgers, merchandise inventory, budget systems, and nonfinancial records.

3. (a) sales journals - register receipts or sales book receipts
   (b) daily sales and cash summary
   (c) accounts receivable
   (d) accounts payable
   (e) payroll register
   (f) inventory control system
   (g) bank reconciliation statement
   (h) petty cash fund

4. The response to this question will vary with the individual student. For example, a student might say that initially they plan to keep the books themselves on a personal computer. As the business expands, they anticipate having less time to do bookkeeping and more complicated records. At this point, they will hire a bookkeeper.

5. Some of the important record-keeping functions that might be performed by a computer include:

   (a) automatically collecting and storing information
   (b) producing financial statements and management reports
   (c) meeting government reporting and documentation requirements
   (d) receiving and transmitting information to other businesses and your customers
   (e) take customers orders and handle customers inquiries

6. Good business records should be: (1) easy to use, (2) easy to understand, (3) reliable, (4) accurate, (5) consistent, and (6) provide information on a timely basis.

PACE THIRD EDITION

Program for Acquiring Competence in Entrepreneurship

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

Level 1 — Understanding the creation and operation of a business.
Level 2 — Planning for a business in your future.
Level 3 — Starting and managing your own business.

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

For information on PACE or to order, contact the Publications Department at the
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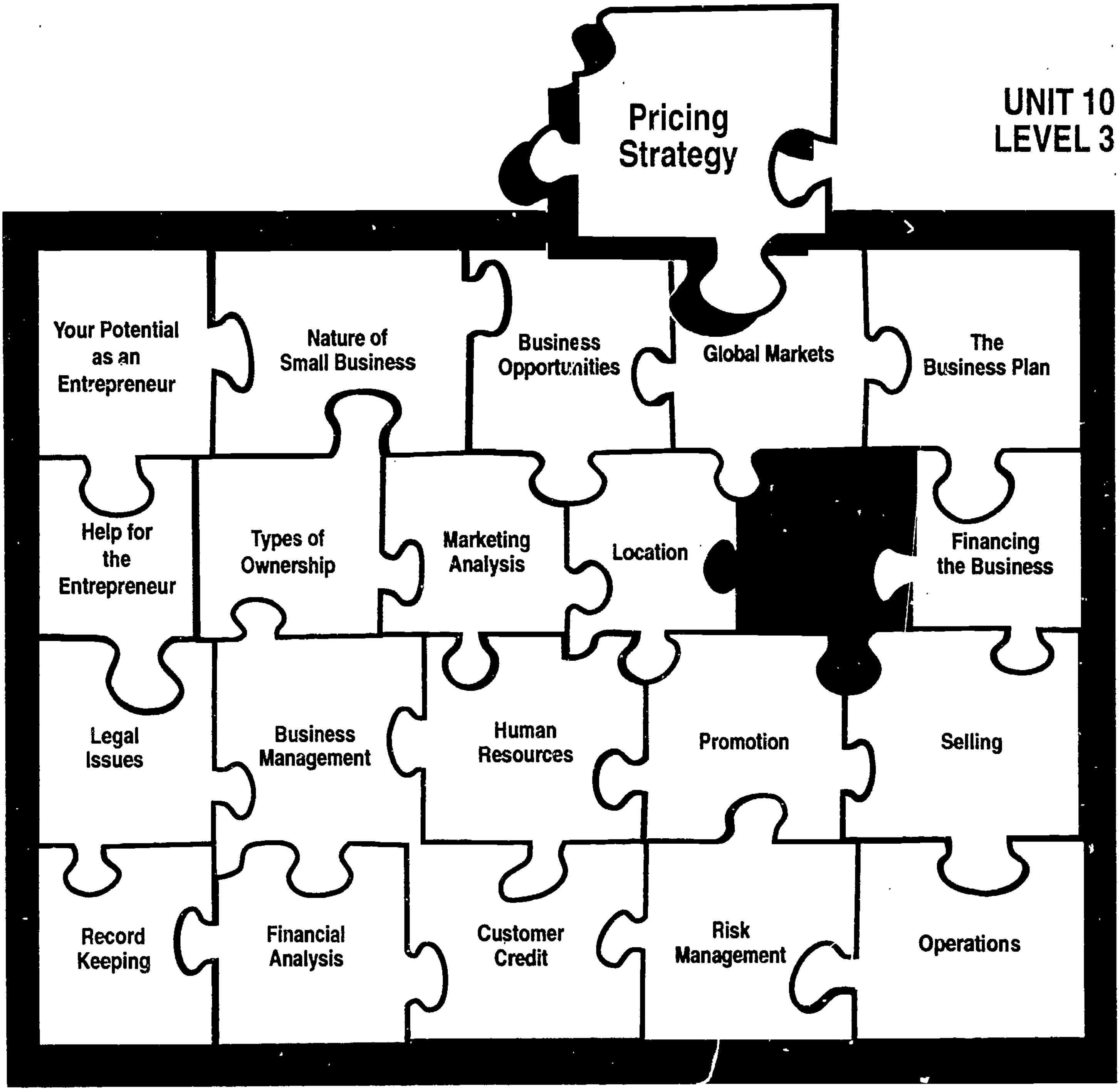
UNIT 10
LEVEL 3



PACE
THIRD EDITION

Program for Acquiring Competence in Entrepreneurship

CENTER ON EDUCATION AND TRAINING FOR EMPLOYMENT
COLLEGE OF EDUCATION
THE OHIO STATE UNIVERSITY

Research & Development Series No. 303-10

PRICING STRATEGY

BEFORE YOU BEGIN . . .

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.

2. Read What are the Objectives for this Unit on the following page. If you think you can meet these objectives now, consult your instructor.

3. These objectives were met in Level 1 and Level 2:

   Level 1

   - Define pricing as part of the marketing mix.
   - Identify costs that affect pricing.
   - Explain how competition affects pricing.
   - Describe the impact of consumer demand on prices.
   - Discuss the relationship between image and price.

   Level 2

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

4. Look for these business terms as you read this unit. If you need help with the meanings, ask your instructor for a copy of the PACE Glossary contained in the *Resource Guide*.

   Cash discounts
   Cumulative discounts
   Fixed/variable cost
   Floor price
   Product life cycle
   Profit margin
   Quantity discounts
   Tactical discounts
   Target markets
   Trade discounts

PRICING STRATEGY

WHAT ARE THE OBJECTIVES FOR THIS UNIT?

Upon completion of this unit you will be able to—

- determine the costs that will affect pricing,
- identify other factors that will affect your pricing strategy,
- illustrate how markup strategies affect your pricing,
- design pricing incentives for your business, and
- determine appropriate pricing strategies for your business.

WHAT IS THIS UNIT ABOUT?

Entrepreneurs rarely truly understand the impact of the development of a pricing strategy. While product development, promotion, distribution, and accounting are all essential to running a business efficiently, only the price will determine how much money will actually come in the door. It is the *price* that the consumer pays that generates the revenues that pay for all of the other activities undertaken by the company.

The information in this unit illustrates the importance of the pricing decision for the profit of the business. Determining the right price for your product or service is critical.

The price chosen impacts the product's profitability in many ways. The price projects an image for the product or service, and plays a major role in the decision-making process of the consumer.

The purpose of this unit is to assist you in developing a pricing strategy. First, the costs that affect the minimum price range will be broken down. After determining the minimum price, you will explore other elements of business that will impact the price. Then, various ways that the business can manipulate the price to gain a competitive advantage will be examined. Finally, you will learn how to put all these pricing considerations together to develop a pricing strategy.

WHAT ARE THE COSTS THAT AFFECT PRICING?

There are many reasons that people decide to sacrifice the security of a job in a large company to run a business for themselves. For some, it is the sensation of being in charge of your own destiny. For others, it is the feeling that every dollar earned is a dollar for them rather than for someone else. For many, it is the desire to see if their skills and abilities can provide a comfortable life for them and their families, rather than for the employer and his or her business. Underlying these themes is the need for financial security. In fact, profit is often one of the strongest motivators behind many entrepreneurs' decisions to start their own businesses.

Often, small business people overlook the importance of the price they charge for their product or service and its impact on the bottom line. The reason is that many business people are not aware of either the flexibility they have in pricing their products or the constraints in which the price must be set. For example, it is possible that your company can charge 15 percent more for the product you sell without sacrificing sales. Similarly, your company might be losing money on every sale it makes.

In reality, there is a band in which a company can be flexible with its pricing. This band is defined at the low end by the costs. The high price is determined by the point at which the price discourages people from buying the product because it no longer represents a good value.

The profit maximizing price is within this band. In order to find it, the first step is to have a complete and full understanding of the costs involved in doing business. These costs can be divided into two broad categories. These are fixed costs and variable costs.

TOTAL COST = FIXED COSTS + VARIABLE COSTS

Variable costs are easy to allocate and calculate because they are the costs that vary with the volume production of a good or service. For example, assume that your company makes cars. For the sake of simplicity, instead of actually producing any of the components for the car, your company buys everything from an outside supplier. Your variable costs will be the costs associated with all of the components of the car that your company buys. By totaling the cost of the engine, panels, wheels, instruments, seats, lights, transmission, and all of the other components, you will arrive at the total variable cost of the car. Because these costs will vary depending on how many cars you want to assemble, they are considered variable costs.

VARIABLE COSTS: Costs that vary with the quantity of goods and services produced

Variable costs are allocated to the item for which the costs were incurred. Each car has one engine, four wheels, and so on. The product must be priced at least high enough to cover these variable costs. But, what about the costs that are not directly associated with the production of the car? In order to do business, the company must rent or buy office, warehouse, and factory space. The company must pay utility bills and salaries. In fact, the business must somehow pay for all of the costs that are incurred in doing business, regardless of whether they are directly associated with the manufacture of cars.

The way the company pays for these expenses is by generating revenue through sales. In other words, these costs must somehow be incorporated into the selling price. This form of expense or cost is called a fixed cost.

FIXED COST: Costs which are constant at all levels of production

A common strategy for paying fixed costs is to allocate them evenly over the production in the period in which the fixed costs are incurred. Many of the expenses that will be incurred by a business are paid over a regular period of time. Phone, electricity, rent and lease payments are paid monthly. Salaries to employees are often paid twice a month, sometimes weekly. A sensible accounting method of allocation is to attribute the costs of a period to the production of that period.

However, the prices charged for an item should be consistent over the long term. So, the manager must determine an appropriate charge per unit produced that will cover fixed costs over an extended period of time. This could be done by estimating the fixed costs that are incurred over the period of a year, then allocating these costs to the number of cars the business owner expects to produce in that year. In addition, a certain amount might be added to the fixed costs to provide a margin for error. This margin will vary, depending on the accuracy and uniformity of cost incursions. Using this method, the manager can ensure that the price charged will always be enough to cover fixed costs plus incidental costs.

FLOOR PRICE: Fixed Costs plus Variable Costs

The sum of the variable costs and the allocated fixed costs gives you the floor price. In general, the company can not price its products priced below the floor price and remain profitable.

Pricing above the floor price is not sufficient to guarantee profitability. The manager may charge twice the floor price and still lose money. If the price charged is too high, then fewer consumers than anticipated will buy the product. So, there would be fewer units over which to allocate the fixed costs. The result would be that the fixed costs are not covered. The company would be left with a huge fixed costs bill that could not be paid. Let's take a look at this problem numerically.

The variable cost of
producing a car $5,000

The fixed costs over a
period of a year $2,500,000

Number of cars
produced per year 1,000

What is the total fixed cost per car?

FIXED COST Per Unit = total fixed cost/number of units produced

$$\frac{\$2,500,000}{1,000} = \$2,500 \text{ per car}$$

After seeing this number, the manager decides to sell the car for $30,000 and make a huge profit margin on the cars sold.

What was the profit margin per car?

PROFIT MARGIN = Selling Price - Floor Price

$30,000 - $7,500 = $22,500

Unfortunately, the market did not want to pay $30,000 for the car, and only 50 units were sold in the year. If the company only sold 50 cars in the year, how much money did they lose?

The total money spent to manufacture and sell the cars was the total of the fixed costs plus the variable costs per car:

Total fixed costs $2,500,000

Total variable costs for the year ($5,000 x 1,000 cars) . $5,000,000

Total costs for the year . . . $7,500,000

The total income received on the sale of the cars:

Income $1,500,000

Therefore, the total amount of money lost in the year:

Income - Expenses = Profit/Loss

$1,500,000 - $7,500,000 = ($6,000,000) loss

As you can see, the profit margin became irrelevant when it was compared to the number of cars that were sold. For the company to have been profitable, the manager would have needed to find a price that would provide for a small profit per car and yet have allowed all of the cars manufactured to be sold.

WHAT ARE THE OTHER FACTORS THAT WILL AFFECT THE PRICING STRATEGY?

As the illustration above demonstrates, there is more to pricing than just knowing what your costs are. The price band in which your company can be profitable is determined not only by the costs that are incurred in doing business, but also by the volume of sales. The challenge facing the manager is to determine the most appropriate price given your minimum required profitability level. In other words, the manager needs to find the ideal production level. This is the price at which sales volume and profit per unit combine to produce the maximum profit level.

HOW DOES MARKET DEMAND AND SUPPLY AFFECT PRICING?

The basic assumption for the typical demand curve is that as the price decreases the number of units demanded increases. For the most part this is true. However, there are some products with **inelastic demand** for which a decrease in price will not substantially increase demand. The demand for insulin is inelastic. Even if insulin is sold at a very low price, the diabetic will not buy more than prescribed.

Luxury products are another exception to the typical price/demand relationship. If the price of a fur coat which usually costs

$4,000 is reduced to $2,000 will demand significantly increase? Maybe not!

Consumers might think that the fur coat is of poor quality. Or, perhaps, the buyer might not feel as good in the coat if they know they paid only $2,000.

Now, look at Graph 1. This is the graph of typical relationship between consumer demand for goods in one product category and price. In general, as price decreases, the quantity demanded increases.

Look at Graph 2. This is the graph for the total supply of goods in one product category. As prices increase, manufacturers are willing to supply more product. Why? Assuming that production costs per unit do not increase at the same rate as selling price, then the profit margin increases as the selling price increases. The increasing profit margins motivate suppliers to produce more goods.

Finally, let's put the demand and supply curves together in Graph 3. Note that there is only one point these two curves intersect. This is the equilibrium point, which reflects the ideal production level. Let's examine the graph carefully. Imagine that this is the graph of the sales of color televisions. At the profit maximizing price, suppliers will sell 9,000 units at $350 price, for a total sales revenue of $3,150,000 (9,000 units X $350). If the price is reduced to $300, then the total sales revenue would be $3,000,000 (10,000 units X $300). On the other hand, if the price is increased to $400, then the total sales revenue would be $3,040,000 (7,600 units X $400). So, the supplier makes the most total sales revenue when the color televisions are sold for $350.

Unfortunately, this formula does not work in the real world. While there is a profit maximizing price for any given product or service, finding it is not as simple as solving two equations. The reality of the marketplace is that there are many influences on the price of a product other than how it will affect sales volume. The price will be influenced by the marketing strategy, the relationship the products has with its competitors, and the distribution system.

WHAT COMPRISES A MARKETING STRATEGY?

Most successful products and services have a marketing plan. Often, during the product development stage, the marketing plan is not formalized. However, before the product is commercialized, the elements of the marketing plan need to be considered.

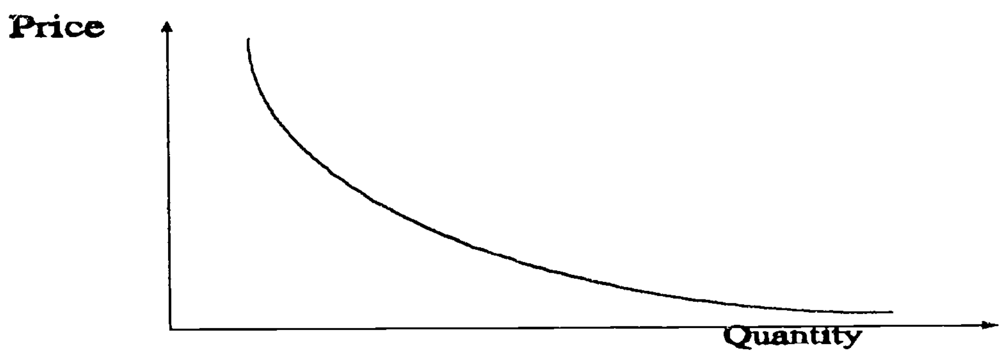
The classical marketing model incorporates four elements. These elements, known as the Four Ps of Marketing, include:

Product: Is the product functional? Does is satisfy a need within the marketplace? How does it perform in relation to its competitors? Which products or processes does this product replace?

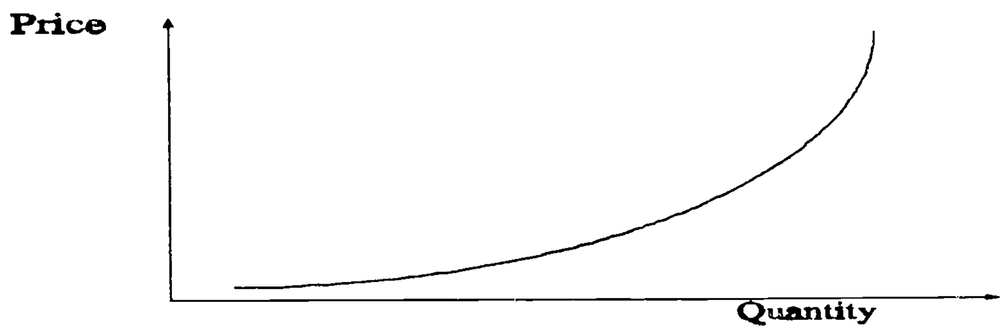
Promotion: What is the best way for a consumer to find out about the product? How should the product be perceived in relation to its competitors?

Place: Where will the product be available for consumption? Is location logical and predictable?

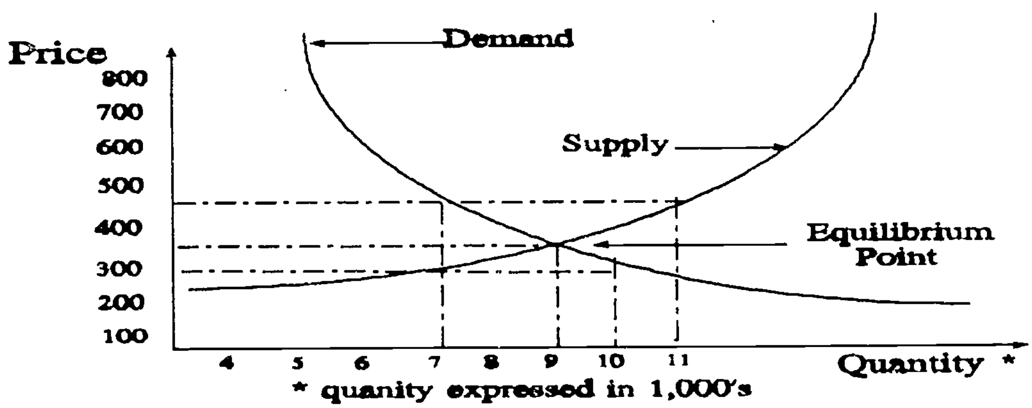
Graph 1: Demand Curve



Graph 2: Supply



Graph 3: Equilibrium Point



Price: Does the product represent value to the consumer? How is the product priced in relation to its competitors? What image is projected by the price of the product?

As an element of the marketing communication process, the price that is charged for a product makes a significant statement about the product. Often, price is used as the major decision criteria for many consumers. In other words, because there is little real or perceived difference between products available, the consumer will use the price as an indicator of quality or value.

The influence that price has over the consumer is dependent upon a number of factors. Generally, price is used as a decision criteria in the absence of more persuasive decision criteria. In other words, all else being equal, consumers will be influenced by the price. However, this rule is not set in stone. In reality, price is considered in making most consumption decisions. But, the influence that price has varies, depending on the value of the other differentiating factors available to the consumer. The influence of price is on a continuum, which is best described using the product life cycle.

HOW DOES THE PRODUCT LIFE CYCLE AFFECT THE MARKET STRATEGY AND PRICING?

The product life cycle describes the competitive stages that a product category will undergo through time. The life cycle is broken into four distinct stages. These are introduction, growth, maturity and decline. The influence that price has over the purchasing decision will depend on the position of the product within the product life cycle.

At the **introduction** stage, price has the least influence over consumers because the product is new and unique. Generally, people who want to be on the cutting edge of technology buy these innovative products. The mass market will not purchase a new product until it has been proven.

If a manager is introducing a product at this stage of the life cycle, then pricing will be influenced by the price of the product that is being replaced. At this stage, however, the manager has a great deal of flexibility to set prices. If the strategy is to capture as much market share as possible, then they will price the product low and adopt a "penetration" approach. If the manager chooses to generate as much profit per unit as possible, then they will price the product high and adopt a "skimming" strategy.

During the **growth** stage of the life cycle, competition begins to duplicate the product which has proven to be successful. Competitors differentiate their product based on a particular target market's requirements. Price will begin to come into consideration as competitors attempt to represent better value to the consumer.

Pricing becomes more important because it acts as an indicator of quality for the consumer. At this time, it is important to match the position of the product with the price. For examp.e, a quality image in packaging, promotion, and product features justifies a higher price.

Next, the product category will enter the **maturity** stage of the cycle. The product is now widely available, and there are numerous competitors in the market. The product has been widely accepted as a permanent technology, and there is little doubt as to the usefulness of the product. The consumer is knowledgeable, and the products that are available are essentially identical.

Price plays a significant role in the decision making process. If two products are nearly the same, then consumers will base their decision on price. Therefore, it is essential for manufacturers to adopt a price point that is acceptable to consumers.

It is likely that cut-priced producers will enter the market during the maturity phase. They will attempt to distract consumers from product features by offering a lower quality product at a reduced price. Manufacturers of higher quality products will fend off such attacks by promoting their differential advantages leading to high promotional budgets. The success of these warring parties will determine the longevity of this stage of the cycle.

Inevitably, the product category will enter the **decline** phase. In this phase, there is decreasing level of market demand for the entire product category. For example, with the advent of CD players, the demand in the United States for stereos has declined.

Manufacturers may slash the prices for products in the decline phase to the lowest possible level. The acceptable pricing band is at its narrowest in this stage of the life cycle. Manufacturers must pay close attention to margins and costs in order to maintain profitability.

Since there is very little chance of rejuvenating the market, manufacturers tend to decrease their promotional investment in declining product categories. Instead, they may choose to invest their promotional dollars in other high growth industries. When the product is no longer profitable, the manufacturer may stop production of the product all together.

Knowing where your product is placed in the product life cycle will help you to predict target markets, competitive moves, pricing tactics, promotional campaigns, and distribution strategies. This knowledge will form an integral part of your overall product strategy.

HOW DO DIFFERENT MARKUP STRATEGIES AFFECT YOUR PRICING?

It is best to price products based on their perceived value to the consumer. Unfortunately, calculating perceived value may be extremely difficult if not impossible. This is complicated by the fact that perceived value may often be different between customers even though they pay the same price for a service or product.

The solution that many businesses find to this problem is to calculate their variable costs and add a percentage to cover fixed costs and profit for the business. This percentage is called a *markup*.

Some companies use a standard markup percentage on all items. This form of pricing can be successful or practical when it is difficult to evaluate between alternatives.

Another option is to use a variable markup system. This is common for manufacturers or retailers who stock a wide variety of products, each of which may have a different type of appeal to the consumer. The percentage markup is varied between products because consumers use different valuative criteria for the products. If price plays a major role in the evaluation procedure, then the markup is likely to be narrow, and should be watched carefully. If price is not so important, then the markup can be higher.

WHAT ARE PRICING INCENTIVES?

Given accurate information about pricing, the entrepreneur has great flexibility in pricing tactics. One of the most common forms of rapid, tactical price change is that of a strategic discount. This discount can be applied for a variety of reasons and will produce a variety of end results. The most popular is that discounts tend to increase sales.

However, discounting decisions cannot be taken lightly. Price cutting sends a signal to the marketplace, the interpretation of which is not easy to control. The reason for this is that there are a number of objectives that can be achieved through exactly the same price cut. They may include the following:

- An attempt to attract new customers to the market
- An effort to increase usage rates among existing customers
- A method of taking customers away from competitors
- A means of discouraging existing customers from switching to competitors
- An approach for encouraging customers to buy now instead of later
- A technique for discriminating among different types of buyers
- A means of using the low price of one product to sell another product in the line

Each of these reasons represents an entirely different rationale for the discounting tactic. The impact of the price discount will depend on how it is communicated to the consumers. For these tactics to be effective, they must be part of an overall pricing strategy which is being objectively measured and evaluated by management.

WHAT ARE THE DIFFERENT TYPES OF PRICING INCENTIVES?

Pricing incentives can take a variety of forms, depending on the strategy being deployed. The most common types of pricing incentives selected include the following:

- **Tactical Discounts.** This discount takes the form of a temporary consumer price reduction which increases the perceived value of the product to the purchaser.
- **Quantity Discounts.** Discounts are often granted to buyers who purchase in

large quantities. The rationale behind the discount is that often there is a cost savings to the manufacturer if customers buy large volumes of items. Specifically, many of the overhead costs involved in a sale are reduced per item if they are spread over a greater number of items. For example, if a sales call costs the manufacturer $50, and the salesman sells 50 items, then the cost per item is $1. However, if the salesman sells 500 items, the cost is $0.10 per item. Therefore, the manufacturer can afford to charge less and still make a good profit on the sale. This type of incentive is useful if such cost savings can be realized.

- **Cumulative Discount.** This discount is similar to the quantity discount. It encourages consumers to continue to buy from one supplier over an extended period. The discount becomes more valuable the longer the customer remains loyal to the supplier.

- **Trade Discount.** This is a discount that is applied to the distributor as a reward for either stocking or pushing a product. It is used to encourage the distributor to place items in a more favorable position within a store to make the item more noticeable to the consumer. This is similar to a cash discount, which is an upfront price reduction to the retailer. This encourages the retailer to replace their existing products with your new product. Often this type of incentive is the only way that a manufacturer can get a retailer to make room on a shelf for a new product.

- **Cash Discount.** The vast majority of sales in industry are made on a credit basis. The objective is for the retailer to buy the merchandise on credit, sell the product, then pay for it. Manufacturers will offer retailers incentives for paying for their products as early as possible, because the sooner they get their money the better off they are. Therefore, they will offer a cash discount for the payment before it is due. Often this discount will take the form of a percentage of the total amount owed.

HOW DO YOU DETERMINE APPROPRIATE PRICING STRATEGIES FOR A BUSINESS?

This unit focused on the importance of pricing as a marketing activity in the marketplace and in the development of a marketing strategy. The following steps will act as a guide in the development of a comprehensive pricing strategy.

1. **Determine buyer needs, wants, and desires.** This is a fundamental step in the development of any comprehensive marketing plan. The answers to these questions will allow an evaluation of the value placed on the services you will provide.

2. **Determine market position.** What do consumers think of your product or service? Is your product a viable alternative? What are its strengths and weaknesses? Is it vulnerable to attack by

competitors? From which directions and using what tactics?

3. **Evaluate your competition.** Take a look at what your competition is doing. Leave your office and visit the major points of distribution and see your competitor's packaging, pricing, promotional displays, and any other means that they are using to attract customers. Pretend to be a customer and ask the salesman's evaluation of your product and your competitor's products. How have your competitor's prices changed in previous months? Have they introduced any new products? What are they doing differently and why? What do your competitor's moves tell you about their strategies and the direction of the market?

4. **Conduct a complete analysis of costs.** Costs must be analyzed so that prices can reflect cost behavior. This will prevent or help reduce the risk of low or negative profitability.

5. **Prepare product or service line financial statements.** It is important to know the exact contribution to profitability of each item in the line of products and services. This knowledge will allow you to determine the exact role that each product plays in the overall picture of your company operations. Again, this analysis should be conducted in fine detail in order to derive a completely accurate understanding of profit centers.

6. **Assess your existing and future operations.** As important as your ability to analyze your cost and profit structures is your ability to track them over a period of time. Your management information system must be capable of providing accurate and timely financial information. An information system must have the capacity to grow with the company, and be able to adjust to inclusions and subtractions from the product line on an ongoing basis.

7. **Communicate with employees, distributors, and retailers.** The people who will ultimately implement and adhere to pricing policies must be brought into the communication process. These are the people who must buy into changes. They will greatly benefit from a complete understanding of the rationale behind any moves.

8. **Communicate with buyers and users.** Price changes that are considered unreasonable can cause great alienation of customers and users alike. Communicating directly with those who must evaluate the value of your products and services will facilitate cooperation.

9. **Monitor results.** The strategies of a pricing program must be designed to accomplish specific goals. It is crucial that the results of any pricing program be monitored and tracked against some prespecified targets. If results are not as planned, then strategies and tactics must be modified. This procedure is crucial if the organization hopes to improve on an ongoing basis.

To set a profitable price, the entrepreneur must be aware of both costs and market conditions. Price is a cue to the consumer about product quality. It ultimately determines the profit margin for each unit sold, and the financial success of the business.

ACTIVITIES

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

INDIVIDUAL ACTIVITIES

A.

The following list of costs pertain to automobile production. Identify which of the costs are fixed and which are variable:

Salaries for line workers paid on a production basis.

- Rent on premises
- Salaries for management staff
- Leasing of equipment
- Glass for windshields
- Plastic for the dash board
- The base salary component of a salesman's salary
- Advertising expenses
- Research and development costs

Determine the most appropriate method for charging the fixed component of these costs to the selling price.

B.

The following costs pertain to the factory described in the first activity:

Fixed component	$100,000 per month
Variable component	$5,000 per car
Selling price	$10,000

What number of cars need to be sold per month before the company begins to make a profit? What is this quantity known as?

GROUP ACTIVITIES

A.

In groups of three, choose a product that is familiar to each member of the group. Conduct a marketing analysis on the product focusing on the following three areas:

Product. What are the product's unique benefits to the consumer? How is this product superior/inferior to its competition?

Promotion. What methods are used to promote this product to the consumer? What benefits are portrayed in the promotion? (not necessarily the same as above)

Distribution. Where is the product available? What does the point of distribution say about the product?

After discussing these components, determine an appropriate price for the product given the influence of the other components of the marketing mix. Is the current price of the product appropriate based on your analysis?

B.

As a group, choose a product whose manufacturing components you are all fairly familiar. Consider the following:

- Define each step of the manufacturing process from raw materials through to finished product
- Estimate the costs associated with production including the process and the raw materials
- Determine the volume required to break even on your estimated costs.
- Adding a component for additional overhead, estimate the price of the product. How close were you to the actual price of the product?

CASE STUDY

Jane Rice is a graphic designer and layout specialist who has operated her own business from her home for several years. She has earned a reputation for working accurately and skillfully. Her secret to success has been her ability to turn jobs around quickly and with very little notice. Her clientele consists of several major advertising agencies, magazine publishers, and quick printers in Cincinnati.

Jane is considering updating her computer capabilities and production facilities to include special printers. These printers would allow her to eliminate one step in the production process. She currently leases all of her equipment. Her leasing company is prepared to allow her to trade her old equipment for new with a minimal transaction fee. However, the new lease payments would be approximately 38 percent higher than those she currently pays.

The equipment she is considering purchasing has several advantages over her current equipment. The computer has a much larger screen, and is much faster. It will allow her to open several programs at once. In addition, it has a larger storage capacity, and the capability of a direct link to her customers via modem. The printers will allow her to produce proofs for her clients which would have ordinarily been prepared by an outside vendor. This will save her clients time and the expense.

DISCUSSION QUESTIONS:

1. What factors will affect the service Jane can provide?
2. What are some alternative approaches to making this decision?
3. How will this decision affect the price she can charge for her services?
4. What factors will ultimately determine if Jane should go ahead with the purchase?

ASSESSMENT

Read the following questions to check your knowledge of the topics presented in this unit. When you feel prepared, ask your instructor to assess your competency on them.

1. What are the costs that affect pricing? How are they calculated?

2. What are the other factors that affect the price your company charges?

3. What is a markup and when is it assessed?

4. What are the different types of pricing incentives available and how do they affect your customers? What can they be used for?

5. What is the procedure for selecting appropriate pricing strategies?

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PACE

Units on the above entrepreneurship topics are available at the following levels:

* Level 1 helps you understand the creation and operation of a business
* Level 2 prepares you to plan for a business in your future
* Level 3 guides you in starting and managing your own business