ELEVENTH EDITION

MARKETING

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CHAPTER

13

BUILDING THE PRICE FOUNDATION

NATURE AND IMPORTANCE OF PRICE
WHAT IS A PRICE?: THE PRICE EQUATION

➤ **Price**

➤ **Barter**

➤ **Price Equation**

Final Price = List Price – (Incentives + Allowances) + Extra Fees

➤ **Price and the Global Marketplace**

➤ **Pricing Objectives**

- **Sales ($)**

- **Market Share ($ or #)**

- **Unit Volume (#)**

- **Survival**

- **Social Responsibility**

STEP 2: ESTIMATE DEMAND AND REVENUE
FUNDAMENTALS OF ESTIMATING DEMAND

➤ **Movement Along vs. Shift of a Demand Curve**

- **Movement Along a Demand Curve**

- **Shift in the Demand Curve**
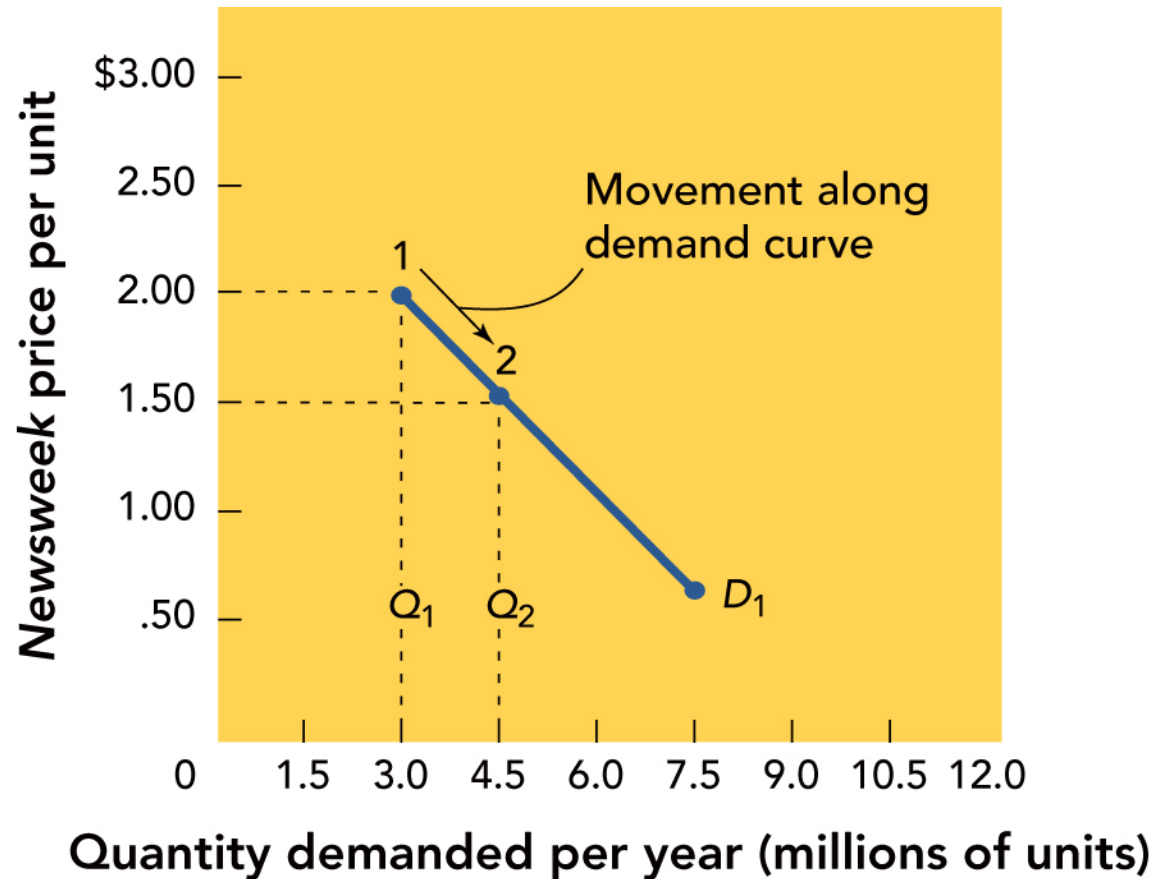
STEP 2: ESTIMATE DEMAND AND REVENUE
FUNDAMENTALS OF ESTIMATING DEMAND

➤ **Demand Curve**

➤ **Demand Factors**

- **Consumer Tastes**

- **Price and Availability of Similar Products**

- **Consumer Income**

FIGURE 13-5A Demand curve for *Newsweek* showing the effect on annual sales by a change in price caused by a movement along the demand curve

A: Demand curve under inital conditions

FIGURE 13-5B Demand curve for *Newsweek* showing the effect on annual sales by a change in price caused by a shift of the demand curve
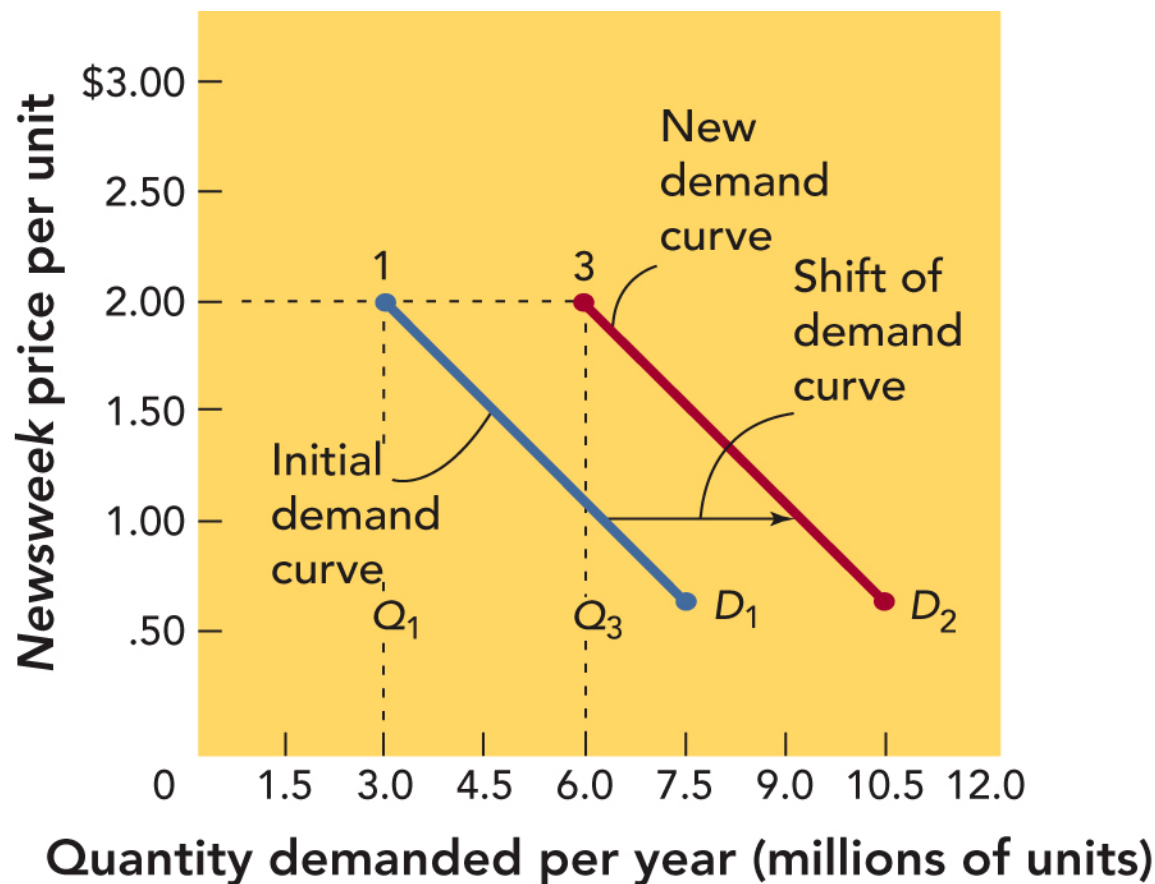
B: Shift the demand curve with more favorable conditions

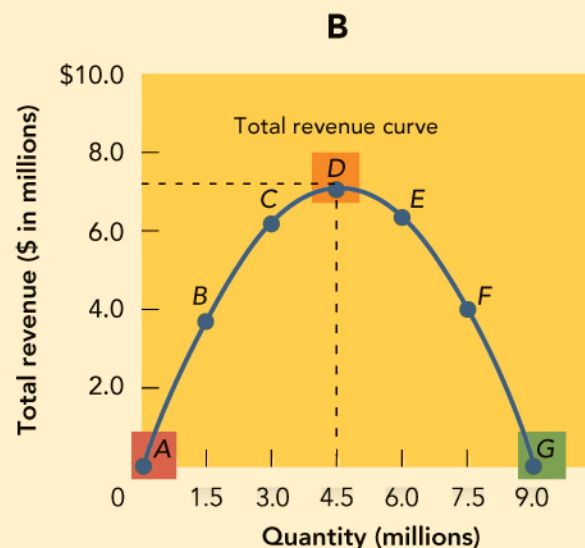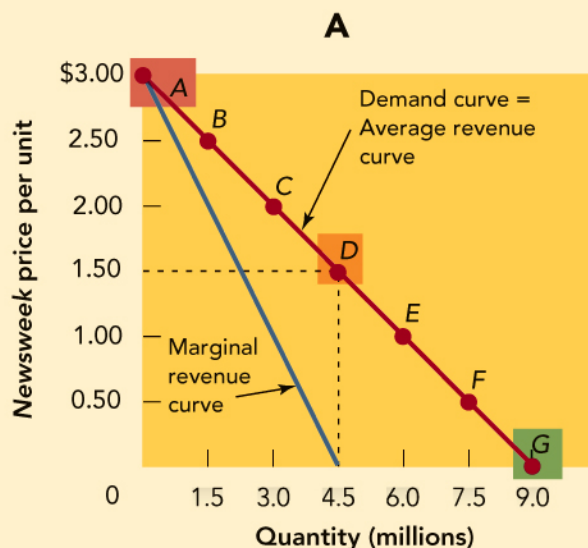# STEP 2: ESTIMATE DEMAND AND REVENUE
FUNDAMENTALS OF ESTIMATING REVENUE

➤ **Total Revenue (TR)**

➤ **Average Revenue (AR)**

➤ **Marginal Revenue (MR)**

➤ **Demand Curves and Revenue**

FIGURE 13-7 How *Newsweek*'s downward-sloping demand curve affects total, average, and marginal revenues

Point on Demand Curve	Price (P)	Quantity Sold (Q)	Total Revenue (P × Q)	Average Revenue (TR/Q = P)	Marginal Revenue (ΔTR/ΔQ)
A	$3.00	0	$0	$3.00	$3.00
B	2.50	1,500,000	3,750,000	2.50	2.00
C	2.00	3,000,000	6,000,000	2.00	1.00
D	1.50	4,500,000	6,750,000	1.50	0
E	1.00	6,000,000	6,000,000	1.00	− 1.00*
F	.50	7,500,000	3,750,000	.50	− 2.00*
G	0	9,000,000	0	0	− 3.00*

*Not shown in Figure 13–6A. [Note that the marginal revenue (MR) curve in Figure 13–6A is the slope of the total revenue (TR) curve in Figure 13–6B.]

➤ **Price Elasticity of Demand**

Price Elasticity of Demand (E) = $\dfrac{\text{Percentage Change in Quantity Demanded}}{\text{Percentage Change in Price}}$

- **Elastic Demand**

- **Inelastic Demand**

- **Unitary Demand**

STEP 2: ESTIMATE DEMAND AND REVENUE
FUNDAMENTALS OF ESTIMATING REVENUE

LO4

➤ **Decisions Involving Price Elasticity**

- **Product/Service Substitutes**

- **Products/Services Considered Necessities**

- **Items That Require Large Cash Outlays**

➤ **Total Cost (TC)**

➤ **Fixed Cost (FC)**

➤ **Variable Cost (VC)**

➤ **Unit Variable Cost (UVC)**

➤ **Marginal Cost (MC)**

➤ **Marginal Analysis**

STEP 3: DETERMINE COST, VOLUME, AND PROFIT RELATIONSHIPS
BREAK-EVEN ANALYSIS
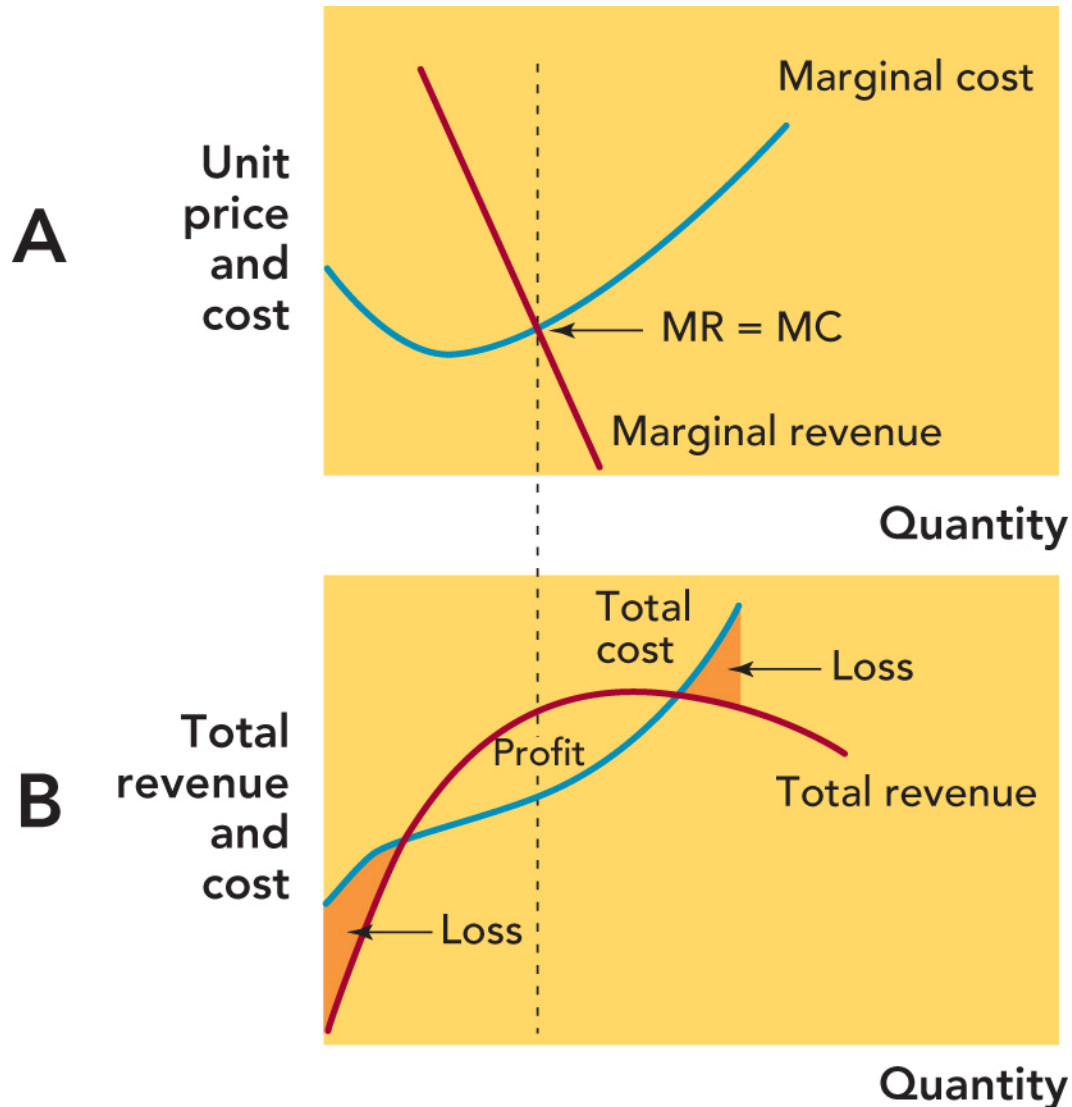
➤ **Break-Even Analysis**

➤ **Break-Even Point (BEP)**

$$BEP_{Quantity} =$$

FIGURE 13-10 Profit is a maximum at the quantity at which marginal revenue and marginal cost are equal

FIGURE 13-11 Calculating a break-even point for the picture frame store shows its profit starts at 400 framed pictures per year

Quantity of Pictures Sold (Q)	Price Per Picture (P)	Total Revenue (TR) = (P × Q)	Unit Variable Cost (UVC)	Total Variable Cost (VC) = (UVC × Q)	Fixed Cost (FC)	Total Cost (TC) = (FC + VC)	Profit = (TR − TC)
0	$120	$0	$40	$0	$32,000	$32,000	−$32,000
200	120	24,000	40	8,000	32,000	40,000	−16,000
400	120	48,000	40	16,000	32,000	48,000	0
600	120	72,000	40	24,000	32,000	56,000	16,000
800	120	96,000	40	32,000	32,000	64,000	32,000
1,000	120	120,000	40	40,000	32,000	72,000	48,000
1,200	120	144,000	40	48,000	32,000	80,000	64,000

FIGURE 13-12 Break-even analysis chart for a picture frame store shows the break-even point at 400 pictures
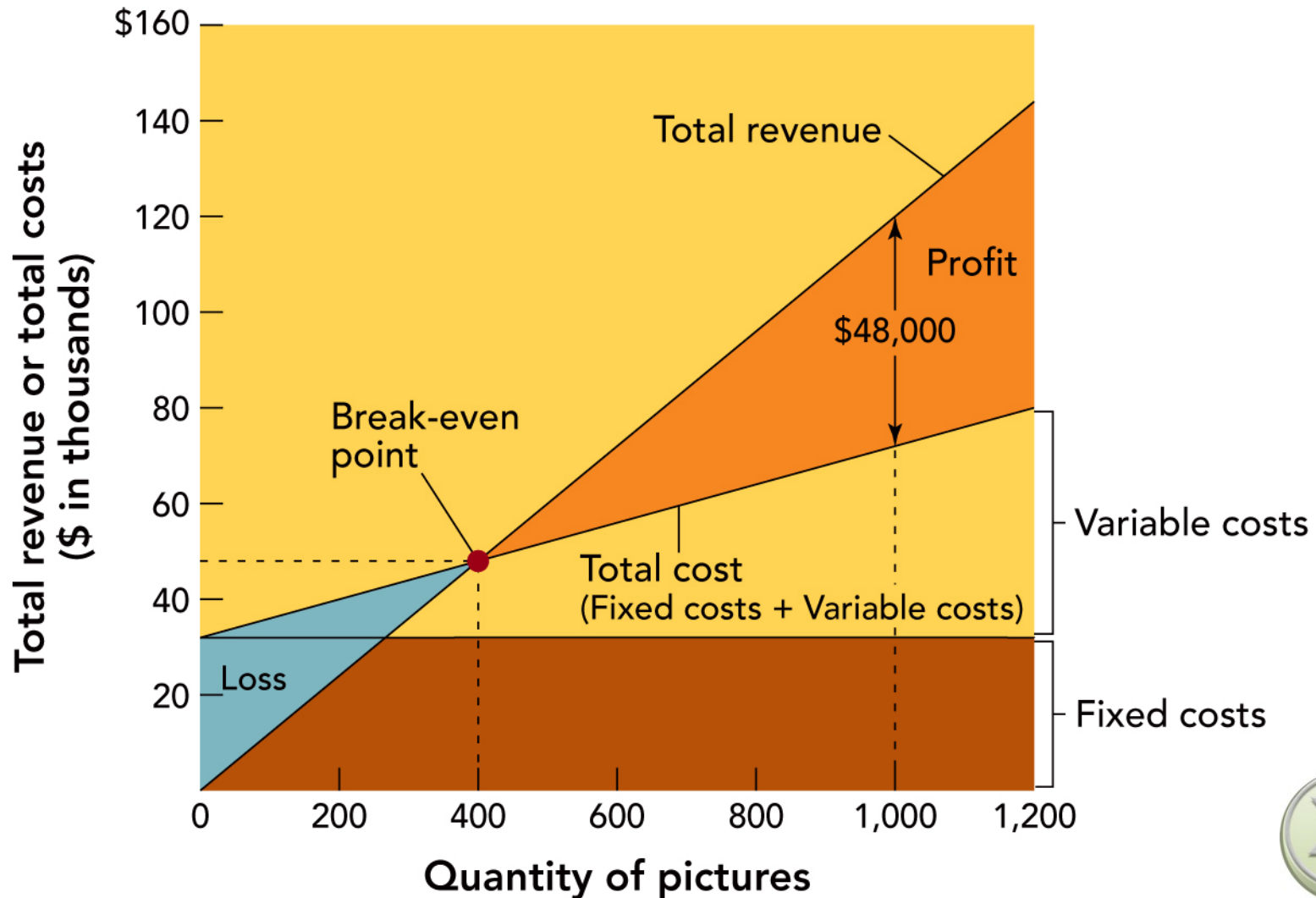
VIDEO CASE **13**

WASHBURN GUITARS:
USING BREAK-EVEN POINTS
TO MAKE PRICING DECISIONS

1. What factors are most likely to affect the demand for the lines of Washburn guitars (*a*) bought by a first-time guitar buyer and (*b*) bought by a sophisticated musician who wants a signature model?

2. For Washburn, what are examples of (*a*) shifting the demand curve to the right to get a higher price for a guitar line (movement of the demand curve) and (*b*) pricing decisions involving moving along a demand curve?

3. In Washburn's factory, what is the break-even point for the new line of guitars if the retail price is (*a*) $349, (*b*) $389, and (*c*) $309? Also, (*d*) if Washburn achieves the sales target of 2,000 units at the $349 retail price, what will its profit be?

4. Assume that the merger with Parker leads to the cost reductions projected in the case. What will be the (*a*) new break-even point at a $349 retail price for this line of guitars and (*b*) new profit if it sells 2,000 units?

5. If for competitive reasons, Washburn eventually has to move all its production back to Asia, (*a*) which specific fixed and variable costs might be lowered and (*b*) what additional fixed and variable costs might it expect to incur?

Price (P)

A **price (P)** is the money or other considerations (including other products and services) exchanged for the ownership or use of a product or service.

Barter

Barter is the practice of exchanging products and services for other products and services rather than for money.

Value

Value is the ratio of perceived benefits to price; or
Value = (Perceived benefits divided by Price).

Value-Pricing

Value-pricing is the practice of simultaneously increasing product and service benefits while maintaining or decreasing price.

Profit Equation

The **profit equation** is:

Profit = Total revenue − Total cost; or

Profit = (Unit price × Quantity sold) − (Fixed cost + Variable cost).

Pricing Objectives

Pricing objectives specify the role of price in an organization's marketing and strategic plans.

Pricing Constraints

Pricing constraints are factors that limit the range of prices a firm may set.

Demand Curve

A **demand curve** is a graph relating the quantity sold and price, which shows the maximum number of units that will be sold at a given price.

Demand Factors

Demand factors are those that determine consumers' willingness and ability to pay for products and services.

Total Revenue (TR)

Total revenue (TR) is the total money received from the sale of a product.

Average Revenue (AR)

Average revenue (AR) is the average amount of money received for selling one unit of a product, or simply the price of that unit.

Marginal Revenue (MR)

Marginal revenue (MR) is the change in total revenue that results from producing and marketing one additional unit of a product.

Price Elasticity of Demand

The **price elasticity of demand** is the percentage change in quantity demanded relative to a percentage change in price.

Total Cost (TC)

Total cost (TC) is the total expense incurred by a firm in producing and marketing a product. Total cost is the sum of fixed cost and variable cost.

Fixed Cost (FC)

Fixed cost (FC) is the sum of the expenses of the firm that are stable and do not change with the quantity of a product that is produced and sold.

Variable Cost (VC)

Variable cost (VC) is the sum of the expenses of the firm that vary directly with the quantity of a product that is produced and sold.

Unit Variable Cost (UVC)

Unit variable cost (UVC) is variable cost expressed on a per unit basis for a product.

Marginal Cost (MC)

Marginal cost (MC) is the change in total cost that results from producing and marketing one additional unit of a product.

Marginal Analysis

Marginal analysis a continuing, concise trade-off of incremental costs against incremental revenues.

Break-Even Analysis

Break-even analysis is a technique that analyzes the relationship between total revenue and total cost to determine profitability at various levels of output.

Break-Even Point (BEP)

A **break-even point (BEP)** is the quantity at which total revenue and total cost are equal.

Break-Even Chart

A **break-even chart** is a graphic presentation of the break-even analysis that shows when total revenue and total cost intersect to identify profit or loss for a given quantity sold.