Price Planning

Factors Involved in Price Planning

What you'll learn

- The four market factors that affect price planning
- What demand elasticity is in relation to supply and demand theory
- The government regulations that affect price planning

Market Factors Affecting Prices

- **<u>Costs and Expenses</u>** -- Declining profits may be caused by an increase in costs or expenses
- Response may be to
  - make the size of a product smaller
  - drop features
  - improve their products.

Example – Airlines quit serving meals

Break-Even Point

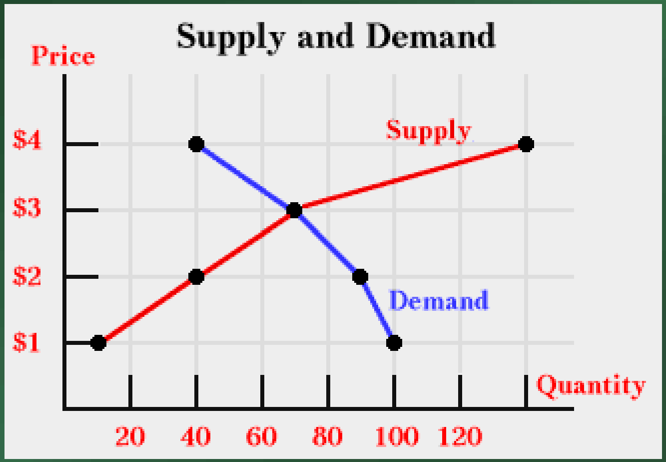
- The point at which sales revenue equals the costs and expenses of making and distributing a product.
- After this point is reached, businesses begin to make a profit on the product.

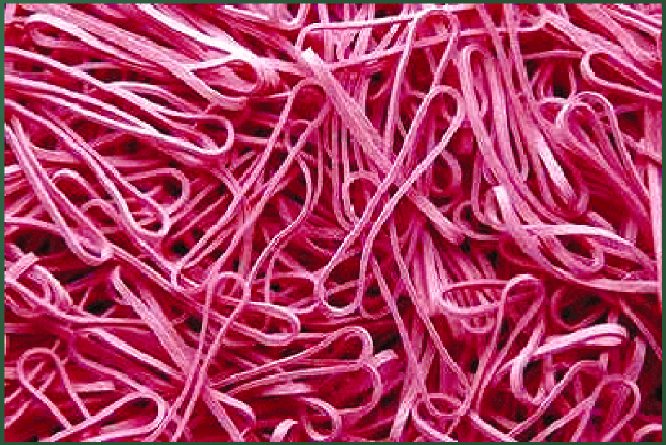
Break-Even Point

- A toy company makes 100,000 dolls to be sold at $6 each.
- What is the break-even point?
- The cost of manufacturing and marketing the dolls is $4.50 each, or $450,000 for the 100,000 dolls.
- $450,000 / 6 = 75,000
- To break even, the firm must sell 75,000 dolls; after that the firm will begin to make a profit.

Market Factors Affecting Prices

- **<u>Supply and Demand</u>**
  - <u>Elastic demand</u> – a change in price creates a change in demand
  - <u>Inelastic demand</u> – a change in price has little effect on demand





ELASTIC DEMAND – A change in price corresponds to a change in demand

DVR Price	Number Purchased	Total Sales
$300	500	$150,000
$400	300	$120,000
$500	100	$50,000

INELASTIC DEMAND -- The demand is constant, even if the product's price changes.

Milk Price (Gallon)	Number Purchased	Total Sales
$2.00	1,000	$2,000
$2.50	985	$2,462
$3.00	975	$2,925

Demand Elasticity Varies

- **Brand Loyalty** -- Some customers won't accept a substitute product – "I will only buy a SONY"
- Demand becomes inelastic.

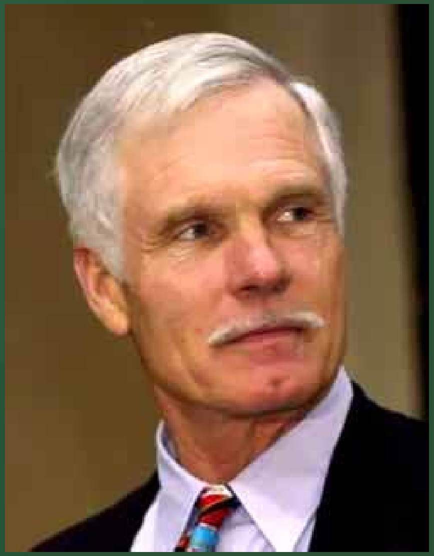
Demand Elasticity Varies

- **<u>Availability of substitutes</u>**
- If a substitute is readily available, demand becomes more elastic.

Demand Elasticity Varies

- **<u>Price relative to income</u>**
- If an increase in price is significant relative to one's income, demand is likely to be elastic.
- A wealthy person may not care about the increasing price of gas.





Demand Elasticity Varies

- **<u>Luxury vs. necessity</u>**
- If a product is a necessity, demand tends to be inelastic.
- If a product is a luxury, demand tends to be elastic.

Demand Elasticity Varies

- **<u>Urgency of purchase</u>**
- If the purchase must be made immediately, demand tends to be inelastic.
- If you’re running out of gas you will stop at a station that charges more.

Market Factors Affecting Prices

- **<u>Competition</u>**
  - Price must be evaluated in relation to the target market
  - Competitors must watch each other closely
  - When one company changes its prices, others usually react.

Market Factors Affecting Prices

- **<u>Consumer Perceptions</u>**

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Legal and Ethical considerations for Pricing

- Federal and state governments have enacted laws controlling prices.

Government Regulations Affecting Price

- **Price Fixing** – when competitors agree on certain price ranges within which they set their own prices. Collusion is evident. It’s illegal.
- **Price Discrimination** – when a firm charges different prices to similar customers in similar situations – creates unfair competition.

- **<u>Resale Price Maintenance</u>** – A manufacturer may suggest resale prices but can't punish retailers that sell at a lower price.
- **<u>Minimum Price Laws</u>** – Prevent retailers from selling below cost

- **<u>Unit Pricing</u>** – allows consumers to compare prices in relation to a standard unit or measure.
- **<u>Price Advertising</u>** – FTC has guidelines – can’t say your prices are lower without proof
  - Bait and Switch – advertising a low price for something the business doesn’t intend to sell -- Illegal