McGRAW-HILL SERIES IN MARKETING

PRICING

Making Profitable Decisions

Kent B. Monroe

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McGraw-Hill Book Company

New York St. Louis San Francisco Auckland Bogotá Düsseldorf
Johannesburg London Madrid Mexico Montreal New Delhi
Panama Paris São Paulo Singapore Sydney Tokyo Toronto

Library of Congress Cataloging in Publication Data

Monroe, Kent B.
Pricing: making profitable decisions.

(McGraw-Hill series in marketing)
Includes bibliographies and index.
1. Price policy. I. Title.
HF5416.5.M66 658.8'16 78-16027
ISBN 0-07-042780-1

PRICING: MAKING PROFITABLE DECISIONS

1 2 3 4 5 6 7 8 9 0 KPKP 7 8 3 2 1 0 9 8

This book was set in Press Roman by Allen Wayne Technical Corp.
The editor was William J. Kane; the cover was designed by Albert M. Cetta;
the production supervisor was Charles Hess.
Kingsport Press, Inc., was printer and binder.

Pricing: Making Profitable Decisions

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Preface

This book is designed to provide the reader with an integrative framework for making pricing decisions. The book synthesizes economic and marketing principles with accounting and financial information to provide a basis for analyzing pricing alternatives within legal and corporate constraints.

Pricing is a multidisciplinary and multifunctional subject. From a corporate viewpoint, it is a responsibility of top management that encompasses financial, marketing, and legal considerations. However, there are conceptual and operational conflicts in theory and practice between economists, accountants, and marketing managers. Because of these conflicts and the many disciplines involved, pricing has not usually been taught as a separate course for business students, nor has a practical and informative book been written for students or practitioners. Indeed, the author's experiences with executives involved with the pricing function indicate that they are often frustrated by the lack of a good, informative source on pricing principles. Further, executives lament the fact that MBA and undergraduate business students lack training in the area of pricing.

BACKGROUND

This book is the result of 10 years of effort in designing both an undergraduate and a graduate business course on pricing. The materials and examples were subjected to considerable testing; some were dropped, others changed or expanded as experience indicated. Moreover, a substantial amount of the material included has already been presented to business executives across the country in pricing seminars. Every technique presented and illustrated in the text is being used by companies in relation to their pricing function, and some of the material was developed at the suggestion of business executives.

CONCEPTUAL PLAN OF THIS BOOK

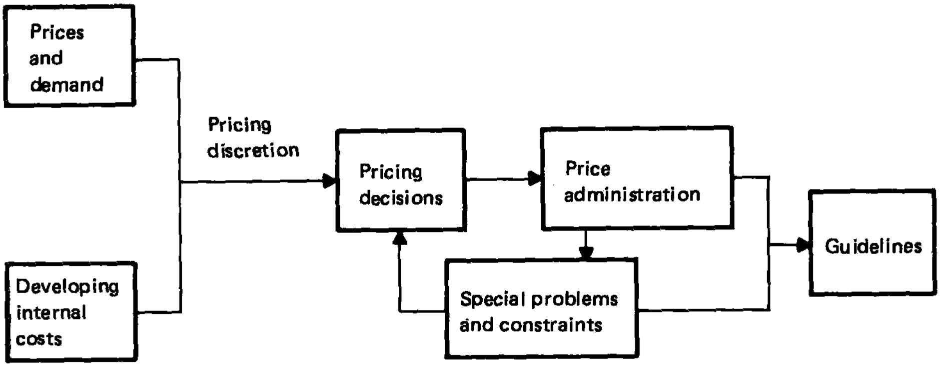
The objectives of this book are to provide a systematic presentation of the factors to be considered when setting price, and to show how pricing alternatives can be developed. As observed in Chapter 1, many contemporary pricing practices are short-run reactions to environmental pressures that have been building for some time, and may not be generalizable. Moreover, such practices are often based on faulty perceptions. This book clarifies many of these issues.

As is well known, price directly affects the quantity that can be sold in the marketplace. Hence, after the introductory chapter, Chapters 2 and 3 carefully review the effect of price on demand. Given a firm's selling objectives, the demand variable provides an upper limit on the pricing discretion of the firm, which is the willingness of buyers to purchase at a stated price. On the other hand, the cost variable sets a floor to a firm's pricing discretion. If prices are too low in comparison with costs, volume may be high but profitless. Thus, Chapters 4 to 8 review the effect of costs on pricing decisions.

The pricing discretion afforded by the upper limit (demand) and the lower limit (cost) is narrowed by a number of constraints and considerations. For example, some consideration must be given to the age of the product, the role the product plays in the product line, the competition, the nature of the discount structure, and the cooperation of salespersons and channels. Hence, Chapters 9 to 12 consider the problems of determining a base or list price and the problems of administering such a price. These four chapters utilize the demand and cost framework developed in Chapters 2 to 8 to show how pricing alternatives can be developed and analyzed.

Additional constraints on the firm's pricing discretion may arise as the result of financial objectives, capacity constraints, or the need to consider legal, regulatory, or buyer resistance to price differentials. Chapters 13 to 16 consider these special problems that face the decision maker and present ways to handle them. Finally, Chapter 17 reviews the material presented in Chapters 1 to 16 by offering some prescriptions for improving the overall pricing function of the firm.

Schematically, the organization of the book is as follows:



ACKNOWLEDGMENTS

Over the past few years, many individuals both encouraged and supported the development of this book, and it is not easy to acknowledge every contribution. The reviewers of the text were positive and helpful, and the book reflects many of their suggestions. Charles Schewe of the University of Massachusetts both encouraged the writing of the book and helped shape it with his careful reviews and material suggestions. Jack Nevin, University of Wisconsin, Avraham Shama, Baruch College, and William Dillon, University of Massachusetts, not only tested an earlier draft of the text in the classroom, but also provided useful suggestions for improving the manuscript. Richard N. Cardozo, University of Minnesota, Herbert Katzenstein, St. John's University, Thomas D. Giese, University of Richmond, and Gary M. Grikscheit, University of Utah, also provided valuable suggestions.

A special thanks goes to the students of the University of Massachusetts and of Virginia Polytechnic Institute and State University for their helpful comments and suggestions, and their willingness to evaluate various textual arrangements of the book. The students at the University of Massachusetts not only helped evaluate the material, but did so under the guidance of two different instructors.

Three very special assistants, Mary Dunn, Margaret Opeka, and Blair Smith, provided invaluable help with typing, material collection, and manuscript revisions. They provided excellent assistance while the manuscript was being put into final form, and their dedication and cooperation are sincerely appreciated.

As is always the case, some unsung heroes quietly and unselfishly make their contribution. My wife, Norma, and my children, Scott and Karen, allowed me often to escape to my study to work on the book. I am grateful for their help and understanding while the book was being developed.

Kent B. Monroe

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The purpose of Section 1 is to introduce the topic of pricing and to develop the strategic importance of the pricing variable. Chapter 1 defines price and illustrates seven ways price may be changed. After discussing some important environmental pressures on pricing decision makers, a number of approaches that have been used to cope with these pressures are presented. Chapter 1 concludes with a brief overview of the implications of these current pricing practices.

What for what?

"Hey!"
"Hey yourself."
"You wanna buy this?"
"Let's see it."
"Can't. You might drop it."
"Me?"
"Promise?"
"Well, no . . ."
"No assurance, no bird in the hand."
"I promise."
"Ok. Here it is."
"What is it?"
"Give it back to me."
"Why? I just got it."
"You don't appreciate it."
"I don't even know what it is."
"I can't tell you."
"I don't want it."
"I'll give you a hint."
"OK."
"It's late."
"Late? For what? Dinner?"
"Late. Old. Don'cha get it?"
"You mean late 18th or 19th Century?"
"Slow but right."
"Hmmmmm. It's heavy."
"Right again."
"And expensive?"
"Depending . . ."
"On what?"
"The value of it."
"To me?"
"To you."
"$2.98."
"Bandit. Give it back."
"Relax, I like it."
"So do I. $10 or nothing."
"Give me another hint."
"Geology."
"Geology? It's a disguised rock."
"You have no shame."
"But I have questions."
"It has value."
"$3.98."
"Out of the question!"
"I give up. What is it?"
"It's a . . . no, I can't."
"You really don't know."
"Does a lawyer know law?"
"*You* have no shame."
"But I have answers."
"Answer then."
"Ok. It's a rare Odonsplit."
"What's an Odonsplit?"
"That's it. In your hand."
"What's it for?"
"That's the wrong question."
"That's the only question."
"I have a suggestion."
"What?"
"Take it home and try it."
"Try it? How? What? Where?"
"That's up to you."
"I don't want it."
"Why not?"
"It's a mystery."
"Then it has value."
"Well, yes, but . . ."
"$8.98?"
"$4.98."
"$8.75?"
"$5.25."
"Forget it. I'll keep it."
"I can't forget it now."
"Then you'll take it?"
"On two conditions."
"Speak."
"If I can't use it, I return it."
"Agreed. The other?"
"If I like it, we trade."
"What for what?"
"This."
"What is it?"
"It's a very rare Tickfaw."

David Holmstrom