Lesson B4–8

Pricing Agricultural Products and Services

Unit B. Starting and Operating the Agribusiness

Problem Area 4. Operating the Agribusiness

Lesson 8. Pricing Agricultural Products and Services

New Mexico Content Standard:

Pathway Strand: Agribusiness Systems

Standard: **VI:** Use sales and marketing principles to accomplish an AFNR business objective.

Benchmark: **VI-D:** Merchandise products and services.

Performance Standard: **1.** Identify key components to organize a sale. **3.** Conduct sales presentation. **4.** Provide post-sale service.

Student Learning Objectives. Instruction in this lesson should result in students achieving the following objectives:

1. Identify the major pricing objectives used in business.
2. Identify the basic pricing methods used in business.
3. Explain the different pricing strategies available to business.

List of Resources. The following resources may be useful in teaching this lesson:

Recommended Resources. One of the following resources should be selected to accompany the lesson:

Nickels, William G., James M. McHugh and Susan M. McHugh. *Understanding Business.* Boston, Massachusetts: Irwin McGraw-Hill, 1999. (Chapter 14)

Pride, William M., Robert J. Hughes and Jack R. Kapoor. *Business.* Boston, Massachusetts: Houghton Mifflin Company, 1993. (Chapter 12)

Other Resources. The following resources will be useful to students and teachers:

Newman, Michael E. and Walter J. Wills. *Agribusiness Management and Entrepreneurship.* Danville, Illinois: Interstate Publishers, Inc. 1994. (Chapter 12)

Moorman, Jerry W. and James W. Halloran. *Entrepreneurship.* Cincinnati, Ohio: South-Western Publishing Co., 1993. (Chapter 7)

List of Equipment, Tools, Supplies, and Facilities

Writing surface
Overhead projector
Transparencies from attached master
Copies of student lab sheet

Terms. The following terms are presented in this lesson (shown in bold italics):

Breakeven quantity
Cash discounts
Discount
Fixed cost
FOB point of origin pricing
Geographic Pricing
Loss leaders
Markup
Multiple-unit pricing
Odd pricing
Penetration pricing
Prestige pricing
Price lining
Price skimming
Psychological Pricing Strategies
Quantity discounts
Total revenue

Trade discounts
Variable cost

Interest Approach. Use an interest approach that will prepare the students for the lesson. Teachers often develop approaches for their unique class and student situations. A possible approach is included here.

Begin this lesson by asking the students what the deciding factor would be for buying a new shirt when there were two shirts the student liked, but could only buy one. When a student answers "price," ask them how the business set the price that it will charge for the shirt.

Summary of Content and Teaching Strategies

Objective 1: Identify the major pricing objectives used in business.

Anticipated Problem: What are the major pricing objectives used in business?

I. A firm may have several objectives in mind when setting a price strategy. Before management can set prices for a product, it must decide what it expects to accomplish through pricing. That is, pricing objectives must be set that are in line with both the organizational and marketing objectives of the company. A firm may have several pricing strategies; it must formulate these objectives clearly before developing a pricing objective.

A. Some popular pricing objectives are:

1. Achieving a target profit—Ultimately, the goal of marketing is to make a profit by providing goods and services to others. One long-term pricing objective of almost all firms is to optimize profits.
2. Building traffic—Supermarkets often advertise certain products at or below cost to attract people to the store. These products are called ***loss leaders***. The long-term objective is to make profits by following the short-term objective of building a customer base.
3. Achieving greater market share—A lower price may help capture a larger share of the market. Profit per unit will be lower, but it is hoped to sell a large enough quantity to maintain a high profit level.
4. Increasing sales—Often times a company will lower prices to increase sales. Such a move could hurt profit margins in the short run but will enable the company to become more financially secure in the long run. Then prices could again be raised.
5. Creating an image—By pricing a product high it is hoped to promote the product's image. Proper promotion is a major key in the success of this pricing objective. This objective is used for certain watches, perfumes, and other socially visible products. These items are priced high to give them an image of exclusivity and status.

6. Furthering social objectives—A firm may want to price a product low so that people with less money can afford the product. The government often gets involved in pricing farm products so that everyone can get basic needs such as milk and bread at a low price.

A variety of techniques may be used to assist students in mastering this objective. Students should use text materials to help understand how to identify the major pricing objectives used in business. Chapter 14 in Understanding Business is recommended.

Objective 2: Identify the basic pricing methods used in business.

Anticipated Problem: What are the basic pricing methods used in business?

II. Once a firm has developed its pricing objectives, it must select a pricing method and strategy to reach that goal. The pricing method provides a basic price for each product. Pricing strategies are then used to modify the basic price, depending on pricing objectives and the market situation. There are three basic kinds of pricing methods:

A. Cost-based Pricing—using the simplest method of pricing the seller first determines the total cost of producing one unit of the product. The seller then adds an amount to cover additional costs and profits. The amount that is added is called the ***markup***. The total of the cost plus the markup is the selling price of the product. Cost-based pricing can be facilitated through the use of breakeven analysis. For any product, the ***breakeven quantity*** is the number of units that must be sold for the total revenue to equal the total cost. ***Total revenue*** is the total amount received from the sales of a product. The cost involved in operating a business can be classified in two groups:

1. ***Fixed costs*** are costs incurred no matter how many units of a product are produced or sold. (ex. Rent)
2. ***Variable costs*** are costs that depend on the number of units produced. The more units produced, the higher the cost.

B. Demand-based Pricing—price is based on the level of demand for the product. This method results in a high price when product demand is strong and a low price when demand is weak. Compared with cost-based pricing, demand-based pricing places a firm in a better position to attain higher profit levels, assuming that buyers value the product at levels sufficiently above the product's cost.

C. Competition-based Pricing—a business considers costs and revenue secondary to a competitor's price. The importance of this method increases if competing products are quite similar and the organization is serving markets in which price is a crucial variable of the marketing strategy. A firm that uses competition-based pricing may choose to be below competitor's prices, slightly above competitor's prices, or at the same level. Competition-based pricing can help attain a pricing objective to increase sales or market share.

A variety of techniques may be used to assist students in mastering this objective. Students should use text materials to help understand how to identify the basic pricing methods used in business. Chapter 12 in Business is recommended. Use TM: B4–8A to aid in discussion.

Objective 3: Explain the different pricing strategies available to business.

Anticipated Problem: What are the different pricing strategies available to business?

II. A seller may temporarily or permanently apply various pricing strategies to the basic prices of its individual products or complete product lines. Discussed here are four basic pricing strategies:

A. New-product Strategies—there are two primary types of new product pricing strategies. An organization can use either one or even both over a period of time. They are:

1. Price Skimming—some consumers are willing to pay a high price for an innovative product; either because of its novelty or because of the prestige or status that ownership confers. ***Price skimming*** is the strategy of charging the highest possible prices for a product during the introduction state of its life cycle.

2. Penetration Pricing—at the opposite extreme is ***penetration pricing***. This is the strategy of setting a low price for a new product. The idea is to develop a large market share for the product quickly. The seller hopes that this approach will sell more units during the early stages and thus discourage competitors from entering the market.

B. ***Psychological Pricing Strategies***—encourages purchases based on emotional responses rather than on economically rational responses. They are used primarily for consumer products rather than industrial products. Some examples are:

1. Odd pricing—many retailers believe that consumers respond more positively to odd-number prices such as $4.99 than to whole-dollar prices like $5. ***Odd pricing*** is the strategy of setting prices at odd amounts slightly below an even or whole number of dollars.

2. ***Multiple-unit pricing***—the strategy of setting a single price for two or more units.

3. ***Prestige pricing***—the strategy of setting a high price to project an aura of quality and status. Many buyers believe that high price means high quality for certain types of products.

4. ***Price lining***—the strategy of selling goods only at certain predetermined prices that reflect definite price breaks. An example of this would be a women's clothing store that sold everything for $15.

C. ***Geographic Pricing***—this type of strategy deals mainly with delivery costs. The seller may assume all delivery costs, no matter where the buyer is located. The pricing strategy that requires the buyer to pay the delivery costs is called ***FOB point of origin pricing***. It stands for "free on board at the point of origin," which means that the buyer will pay the transportation costs from the warehouse to the buyer's place of business. FOB destination indicates that the seller will pay the transportation costs to the buyer's location.

D. Discounting—a ***discount*** is a deduction from the price of an item. Producers and sellers offer a wide variety of discounts to their customers. Some examples are:
   1. ***Trade discounts*** are discounts from the list prices that are offered to marketing intermediaries.
   2. ***Quantity discounts*** are discounts given to customers who buy in large quantities.
   3. ***Cash discounts*** are discounts offered for prompt payment.

A variety of techniques may be used to assist students in mastering this objective. Students should use text materials to help understand how to identify the basic pricing methods used in business. Chapter 12 in Business is recommended.

Review/Summary. Use the student learning objectives to summarize the lesson. Have students explain the content associated with each objective. Student responses can be used in determining which objectives need to be reviewed or taught from a different angle. Questions at the end of each chapter in the recommended textbooks may also be used in the review/summary.

Application. The following student activity can be used to apply the student learning objectives:

LS: B4–8A Understanding Pricing Strategies

Evaluation. Evaluation should focus on student achievement of the objectives for the lesson. Various techniques can be used, such as student performance on the application activity. A sample written test is attached.

Answers to Sample Test:

Part One: Matching

1. a
2. e
3. f
4. c
5. b
6. d

Part Two: Completion

1. Trade discounts
2. Total revenue
3. Price lining

Part Three: Short Answer

See lesson for scoring this question.

Sample Test Name: _____

Test

Lesson B4–8: Pricing Agricultural Products and Services

Part One: Matching

Instructions. Match the term with the correct response. Write the letter of the term by the definition.

a. Geographic Pricing
b. Psychological Pricing Strategies
c. Markup
d. Loss leaders
e. Breakeven quantity
f. Penetration pricing

_____ 1. This type of strategy deals mainly with delivery costs.

_____ 2. The number of units that must be sold for the total revenue to equal the total cost.

_____ 3. The strategy of setting a low price for a new product.

_____ 4. The amount added to the cost of an item to cover other costs and profit.

_____ 5. Encourage purchases based on emotional responses rather than on economically rational responses.

_____ 6. Products at or below cost to attract people to the store.

Part Two: Completion

Instructions. Provide the word or words to complete the following statements.

1. _____ _____ are discounts from the list prices that are offered to marketing intermediaries.
2. _____ _____ is the total amount received from the sales of a product.
3. _____ _____ is the strategy of selling goods only at certain predetermined prices that reflect definite price breaks.

Part Three: Short Answer

Instructions. Provide information to answer the following question.

Compare and contrast fixed costs and variable costs.

BASIC PRICING METHODS

Cost-based Pricing—The seller first determines the total cost of producing one unit of the product. The seller then adds an amount to cover additional costs and profits.

Demand-based Pricing—Price is based on the level of demand for the product. This method results in a high price when product demand is strong and a low price when demand is weak.

Competition-based Pricing—A business considers costs and revenue secondary to a competitor's price.

Name: _____

Lab Sheet

Understanding Pricing Strategies

Directions: Read the following scenarios and identify which type of pricing strategy is used.

1. A grocery store is offering cases of pop at two for $10.00. If only one is bought, the price is $5.99 for the case.

2. An automobile manufacturer introduces a new model of a pickup truck. It includes features that make it different from any other made available. It sets the introductory sticker price at $33,500. After the first six months, the manufacturer plans to drop the sticker price to $32,000.

3. An oil company sets the price of gasoline at $1.75 per gallon for distributors in Hawaii. the same gasoline is available to distributors in the midwest at a price of $1.30 per gallon.

4. A wholesaler offers a 5% discount on all purchases that are paid for within 10 days. The discount is not available to customers paying their invoices that are over 10 days old.

5. A department store offers men's suits at $349.99.

6. A computer company introduces a new lap top computer that carries a basic price of $1,200. The computer is not any different than those offered by other companies. These companies sell their lap tops for between $1,400 and $1,600.

Lab Sheet Key

1. Multiple unit pricing—a special price is offered if two or more cases of pop are purchased at the same time.
2. Price skimming—the manufacturer is attempting to charge the highest possible price during the truck's introduction to the market.
3. Geographic pricing—the oil company charges higher prices to distributors in Hawaii because delivery costs will be higher than in the midwest.
4. Cash discount—the wholesaler is offering a discount to customers who promptly pay what they owe.
5. Odd pricing—the store is selling men's suits at a price slightly below $350.00. This has a psychological effect that encourages a customer to buy the suit since it is "only $349.99.
6. Penetration pricing—the computer company is trying to penetrate the market by offering a comparable computer at prices below the competition's.