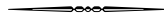


## Introduction

**T**here are many capabilities that may allow a company to perform better than its competitors. Of these, a full range of pricing capabilities, which we call the price advantage, is one of the most powerful tools a company can possess. The price advantage can be achieved by most businesses and is worth pursuing. Analysis shows that a 1 percent increase in price can increase operating profits by 11 percent, using average economics for a Global 1200 company. On the other hand, a 1 percent reduction in variable costs or fixed costs can increase operating profits by only 7.3 percent and 2.7 percent, respectively, while a 1 percent increase in unit sales volume triggers only 3.7 percent additional operating profit. It is quite rare that a price cut can generate nearly enough additional sales volume to offset the revenue loss and produce incremental profitability.

The objective of this chapter is to demonstrate that pricing is a powerful profit lever and that establishing appropriate prices and developing an appropriate price strategy can set the stage for a company to grow profits effectively and quickly. At the end of this chapter you will understand that active price management is increasingly important—particularly in today’s business environment, where various factors create unprecedented downward pressure on prices—and can bring substantial returns.



1. Give three reasons why managing price is so important.

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

2. What is the result of the price advantage?

- a. Customers are charged unsustainably high prices.
- b. Firms are able to employ tricks to gain undeserved revenues.
- c. Customers knowingly pay appropriately higher prices for a company’s goods and services.
- d. Firms are unable to procure higher prices for superior products.

3. List at least four reasons why companies have not been able to achieve the price advantage.

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

4. \_\_\_\_\_

4. Assume that a company, with price indexed at 100, has a fixed cost consuming 30 percent of price, with another 60 percent being attributed to variable costs. Use these fundamentals to answer the following questions.

1. What is the average return on sales (ROS)?

a. 9.1 percent.

b. 15 percent.

c. 10 percent.

2. A 1 percent increase in average price by the firm (without any changes in costs or volume) is likely to lead to how much change in operating profits?

a. 15 percent increase in profit.

b. 9.1 percent increase in profit.

c. 15 percent decrease in profit.

d. 10 percent increase in profit.

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3. A 0.5 percent decrease in average price by the firm (without any changes in costs or volume) will lead to what change in operating profits?
- a. 5 percent increase in profit.
  - b. 5 percent decrease in profit.
  - c. 10 percent decrease in profit.
4. A 1 percent decrease in fixed costs, while keeping the price and sales units constant, will lead to how much improvement in profit?
- a. 3 percent increase in profit.
  - b. 10 percent increase in profit.
  - c. 5 percent increase in profit.
5. Increasing sales volume by 1 percent while keeping fixed costs and prices constant will lead to how much improvement in profit?
- a. 3 percent increase in profit.
  - b. 6 percent increase in profit.
  - c. 4 percent increase in profit.
  - d. 9 percent increase in profit.

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6. What is the percent change in the break-even volume required when the price is decreased by 5 percent?
    - a. 17.5 percent increase in volume.
    - b. 14.3 percent increase in volume.
    - c. 10 percent increase in volume.
  
  7. What is the anticipated price elasticity at the above decrease in price (5 percent)?
    - a.  $-3.5:1$
    - b.  $-2.9:1$
    - c.  $-1.7:1$
    - d.  $-1.8:1$
  
  5. Why is the price advantage important in today's consumer markets?
    - a. More consumers have higher disposable incomes.
    - b. Discount retailers are becoming larger and exercising their market power to push prices lower.
    - c. Internet shoppers are able to find and compare prices of competitive products.
    - d. The quality of private-label packaged goods is improving.

- e. Premium products are launched more frequently by big consumer product firms.
  - f. Several innovative products are launched every day, making it harder for consumers to compare prices carefully.
  - g. Baby boomers and later generations are becoming more price-sensitive.
6. Why is the price advantage important in today's business markets?
- a. Buyers are becoming sophisticated in comparing prices.
  - b. Efficiency programs have led to excess capacity.
  - c. Distribution channels are becoming concentrated and more powerful.
  - d. Closed book accounting is preventing buyers from assessing manufacturing cost.
  - e. Suppliers are more confident and willing to compete on price.
  - f. Global companies are becoming increasingly regional and not taking the time to shop for suppliers.