Chapter 13: Distribution and Pricing: Right Product, Right Person, Right Place, Right Price (pp. 210-0)

LEARNING OBJECTIVES

After studying this chapter, you will be able to…
LO1 Define distribution and differentiate between channels of distribution and physical distribution

LO2 Describe the various types of wholesale distributors

LO3 Discuss strategies and trends in store and nonstore retailing

LO4 Explain the key factors in physical distribution

LO5 Outline core pricing objectives and strategies

LO6 Discuss pricing in practice, including the role of consumer perceptions

Distribution and pricing are not the most glamorous elements of the marketing mix, but managed effectively, they can provide a powerful competitive advantage. While this chapter will cover distribution and pricing strategies separately, keep in mind that the two are linked both with each other, and with the product and promotional strategies of any successful brand.

LO1 Distribution: Getting Your Product to Your Customer

Next time you go to the grocery store, look around—the average U.S. supermarket carries about 50,000 different products.1 Is your favorite brand of soda part of the mix? Why? How did it get from the factory to your neighborhood store? Where else could you find that soda? How far would you be willing to go to get it? These are marketing distribution questions that contribute directly to the distribution strategy: getting the right product to the right person at the right place, at the right time.

The distribution strategy has two elements: channels of distribution and physical distribution. A channel of distribution is the path that a product takes from the producer to the consumer, while physical distribution is the...
actual movement of products along that path. Some producers choose to sell their products directly to their customers through a **direct channel**. No one stands between the producer and the customer. Examples range from Dell computers, to local farmers markets, to factory outlet stores. But most producers use **channel intermediaries** to help their products move more efficiently and effectively from their factories to their consumers. Hershey’s, for example, sells chocolate bars to Costco—a channel intermediary—which may, in turn, sell them to you.

### The Role of Distributors: Adding Value

You might be asking yourself why we need distributors. Wouldn't it be a lot less expensive to buy directly from the producers? The answer, surprisingly, is no. Distributors add value—additional benefits—to products. They charge for adding that value, but typically they charge less than it would cost for consumers or producers to add that value on their own. When distributors add to the cost of a product without providing comparable benefits, the middlemen don't stay in business. Fifteen years ago, for instance, most people bought plane tickets from travel agents. But when the Internet reduced the cost and inconvenience of buying tickets directly from airlines, thousands of travel agencies lost their customers.

One core role of distributors is to reduce the number of transactions—and the associated costs—for goods to flow from producers to consumers. As you’ll see in Exhibit 13.1, even one marketing intermediary in the distribution channel can funnel goods from producers to consumers with far fewer costly transactions.

Distributors add value, or utility, in a number of different ways: form, time, place, ownership, information, and service. Sometimes the distributors deliver the value (rather than adding it themselves), but often they add new utility that wouldn't otherwise be present. As you read through the various types of utility, keep in mind that they are often interrelated, building on each other to maximize value.

Form utility provides customer satisfaction by converting inputs into finished products. Clearly, form utility is primarily a part of manufacturing. Nabisco provides form utility by transforming flour and sugar into cookies. But retailers can add form utility as well. Starbucks, for example, converts coffee beans into iced coffees and espressos.

Time utility adds value by making products available at a convenient time for consumers. In our 24/7 society, consumers feel entitled to instant gratification, a benefit that distributors can provide more easily than most producers. Consider one-hour dry cleaning, or even vending machines. These distributors provide options for filling your needs at a time that works for you.

Place utility satisfies customer needs by providing the right products in the right place. Gas stations and fast food, for instance, often cluster conveniently at the bottom of freeway ramps. ATMs—essentially electronic distributors—are readily available in locations that range from grocery stores to college cafeterias.

Ownership utility adds value by making it easier for customers to actually possess the goods and services that they purchase. Providing credit, cashing checks, and delivering
transactions through marketing intermediaries © Cengage Learning 2013

ATMs provide time and place utility, offering their customers 24/7 access to cash in a variety of convenient locations. © Jack Hollingsworth/Photodisc/Jupiterimages

products are all examples of how distributors make it easier for customers to own their products.

Information utility boosts customer satisfaction by providing helpful information. EB Games, for instance, hires gaming experts to guide its customers to the latest games and systems. Similarly, most skateboard stores hire skater salespeople who gladly help customers find the best board for them.
Service utility adds value by providing fast, friendly, personalized service. Examples include placing a special order for that part you need to customize your computer, or picking out outfits that work for your body type in your local clothing boutique. Distributors that provide service utility typically create a loyal base of customers.

The Members of the Channel: Retailers Versus Wholesalers

Many producers sell their goods through multiple channels of distribution. Some channels have many members, while others have only a few. The main distinction among channel members is whether they are retailers or wholesalers. Retailers are the distributors that most of us know and use on a daily basis. They sell products directly to final consumers. Examples include 7-Eleven markets, Starbucks, and Urban Outfitters. Wholesalers, on the other hand, buy products from the producer and sell them to businesses (or other nonfinal users, such as hospitals, nonprofits, and the government). The businesses that buy from wholesalers can be retailers, other wholesalers, or business users. To complicate this fairly simple concept, some distributors act as both wholesalers and retailers. Sam's Club, for example, sells directly to businesses and to consumers.

LO2 Wholesalers: Sorting Out the Options

Some wholesalers are owned by producers, while others are owned by retailers, but the vast majority—accounting for about two-thirds of all the wholesale trade—are independent wholesaling businesses. These companies represent a number of different producers, distributing their goods to a range of customers. Independent wholesalers fall into two categories: (1) merchant wholesalers, who take legal possession, or title, of the goods they distribute, and (2) agents/brokers, who don't take title of the goods.

Merchant Wholesalers

Merchant wholesalers comprise about 80% of all wholesalers. By taking legal title to the goods they distribute, merchant wholesalers reduce the risk of producers' products being damaged or stolen—or even that they just won't sell. Taking title also allows merchant wholesalers to develop their own marketing strategies, including pricing.

Go Green, Go Local!

Not long ago, summer fruit meant exactly that - but no longer. Thanks to modern agribusiness, technology, and transportation, summer fruit is available throughout the year (sometimes for a hefty price), across the U.S. A few statistics:

- 17% of petroleum demand in the U.S. comes from the food-production industry.
- The food on your plate has traveled an average of 1,500 miles to get there.
- 91 cents of each dollar spent at traditional food markets (e.g., commercial) goes to suppliers, processors, middlemen, and marketers; only 9 cents of each dollar actually goes to the farmer.

If you find these statistics disturbing, one solution lies with local farmers' markets. As of 2010, more than 6,000 farmers' markets were operating in communities in the U.S., selling fresh, locally grown food and developing the businesses of small and medium-sized farmers.

But locally grown does not mean environmentally friendly—harmful pesticides can be used in any location. We do know that industrial food production is entirely dependent on fossil fuels, which create greenhouse gases that are significant contributors to climate change. The biggest part of fossil fuel use in industrial farming is not transporting food or fueling machinery, it's chemicals. As much as forty percent of the energy used in the food system goes towards the production of chemical fertilizers and pesticides.

By adding transportation, processing and packaging to the food system equation, the fossil fuel and energy use of
our current food system puts stress on the environment. Food processors use a large amount of packaging to keep fresh food from spoiling as it is transported and stored for long periods of time. This packaging is difficult to reuse or recycle. Industrial farms are also major sources of air and water pollution. So going greener could be as easy as going shopping at your local farmers’ market.²

- Full-service merchant wholesalers provide a complete array of services to the retailers or business users who typically purchase their goods. This includes warehousing, shipping, promotional assistance, product repairs, and credit.
- Limited-service merchant wholesalers provide fewer services to their customers. For example, some might warehouse products but not deliver them. Others might warehouse and deliver but not provide credit or marketing assistance. The specific categories of limited-service merchant wholesalers include the following:
  - **Drop Shippers:** Drop shippers take legal title of the merchandise, but they never physically process it. They simply organize and facilitate product shipments directly from the producer to their customers. Drop shippers are common in industries with bulky products, such as coal or timber. Amazon, however, successfully pioneered the use of drop shipping in e-commerce, where it has become a standard shipping method for a number of major websites.
  - **Cash and Carry Wholesalers:** These distributors service customers who are too small to merit in-person sales calls from wholesaler reps. Customers must make the trip to the wholesaler themselves and cart their own products back to their stores. Costco and Staples are both examples.
  - **Truck Jobbers:** Typically working with perishable goods such as bread, truck jobbers drive their products to their customers, who are usually smaller grocery stores. Their responsibilities often include checking the stock, suggesting reorder quantities, and removing out-of-date goods.

**Agents and Brokers**

Agents and brokers connect buyers and sellers and facilitate transactions in exchange for commissions. But they do not take legal ownership of the goods they distribute. Many insurance companies, for instance, distribute via agents, while brokers often handle real estate and seasonal products such as fruits and vegetables.

**LO3 Retailers: the Consumer Connection**

Retailers represent the last stop on the distribution path, since they sell goods and services directly to final...
consumers. Given their tight consumer connection, retailers must keep in especially close touch with rapidly changing consumer needs and wants.

Smart retailers gain a competitive edge by providing more utility, or added value, than their counterparts. Low prices are only part of the equation. Other elements clearly include customer service, product selection, advertising, and location. The look and feel of the retailer—whether online or on-ground—is another critical element.

Retailing falls into two main categories: store and non-store. But as we discuss each type, keep in mind that the lines between them are not always clear. In fact, **multichannel retailing**—or encouraging consumers to buy through different venues—is an emerging phenomenon. Some marketers have sold their products through multiple channels for many years. For example, on any given day, you could purchase a Coke from a grocery store, a restaurant, or a vending machine. But the emergence of the Internet has provided a host of new opportunities for firms that hadn't previously considered a multichannel approach. An active relationship between on-ground and online outlets has become pivotal for many retailers.

**Store Retailers**

While other retail channels are growing, traditional stores remain the 800-pound gorilla of the retail industry, accounting for well over 90% of total retail. Stores range in size from tiny mom-and-pop groceries to multi-acre superstores dwarfed only by their parking lots. Exhibit 13.2 highlights examples of different store types.

Both retailers and the producers who distribute through them must carefully consider their distribution strategy. The three key strategic options are intensive, selective, and exclusive.

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<tr>
<th>EXHIBIT 13.2 Retail Store Categories</th>
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<td>STORE TYPE</td>
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<td>CATEGORY KILLER</td>
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<td>WAREHOUSE CLUB</td>
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Intensive Distribution

Intensive distribution involves placing your products in as many stores as possible (or placing your stores themselves in as many locations as possible). This strategy makes the most sense for low-cost convenience goods that consumers won't travel too far to find. Marketers have chosen this strategy for McDonald's, Crest toothpaste, and US magazine, among thousands of other examples.

Selective Distribution

Selective distribution means placing your products only with preferred retailers (or establishing your stores only in limited locations). This approach tends to work best for medium- and higher-priced products or stores that consumers don't expect to find on every street corner. Marketers have chosen this strategy for Nordstrom, Grand Lux Cafe, and most brands of paintball equipment, for instance.

Exclusive Distribution

Exclusive distribution means establishing only one retail outlet in a given area. Typically, that one retailer has exclusive distribution rights and provides exceptional service and selection. This strategy tends to work for luxury-good providers with a customer base that actively seeks their products. Examples include top-end cars such as Lamborghini, and fashion trendsetters such as Gucci.

The wheel of retailing offers another key strategic consideration. The wheel is a classic theory that suggests that retail firms—sometimes even entire retail categories—become more upscale as they go through their life cycles. For instance, it's easiest to enter a business on a shoestring, gaining customers by offering low prices. But eventually businesses trade up their selection, service, and facilities to maintain and build their customer base. Higher prices then follow, creating vulnerability to new, lower-priced competitors. And thus the wheel keeps rolling.

Although the wheel of retailing theory does describe many basic retail patterns, it doesn't account for stores that launch at the high end of the market (e.g., Whole Foods) and those that retain their niche as deep discounters (e.g., Big Lots! or Taco Bell). But the wheel theory does underscore the core principle that retailers must meet changing consumer needs in a relentlessly competitive environment.
Nonstore Retailers

While most retail dollars flow through brick-and-mortar stores, a growing number of sales go through other channels, or nonstore retailers. The key players represent online retailing, direct-response retailing, direct selling, and vending.

Online retailing

Also known as “e-tailing,” online retailing grew at the astonishing rate of nearly 25% per year for most of the early 2000s. But the torrid pace began to slow in 2008 with the onset of the recession. Online retailing grew only 1.6% in 2009, but growth bounced back to over 14.8% in 2010. Looking forward, experts predict that annual growth will remain robust. Much of the growth will likely come at the expense of on-ground retail, as consumers continue to shift to online channels. The bigger name brands—including online-only brands, such as Amazon, and on-ground brands with a strong Web presence, such as Best Buy—seem poised to benefit most, since cautious consumers are most familiar with them.

Online retailers, like their on-ground counterparts, have learned that great customer service can be a powerful differentiator. Simply “getting eyeballs” isn’t enough, since—depending on the industry—fewer than 5% of the people visiting a typical website convert into paying customers. Over-stock.com, for instance, has been a pioneer in online customer service, hiring and training 60 specialists who engage customers in live chats, available 24/7. When a customer has a live chat with one of its specialists, the average purchase amount doubles. In fact, according to the National Retail Federation (NRF), shoppers have increasingly identified Internet-only retailers among those who offered the best customer service. In 2011, Zappos.com took top honors in the annual NRF/American Express Customers’ Choice survey, and two other online retailers—Overstock.com and Amazon.com—placed in its top five positions for the third year in a row for retailers that offer the best customer service in any retail format.

Despite the advantages, online retailers face two major hurdles. The first is that products must be delivered, and even the fastest delivery services typically take at least a couple of days. But the truly daunting hurdle is the lack of security on the Web. As online retailers and software developers create increasingly secure systems, hackers develop more sophisticated tools to crack their new codes.

Direct Response Retailing

This category includes catalogs, telemarketing, and advertising (such as infomercials) meant to elicit direct consumer sales. While many traditional catalog retailers have also established successful websites, the catalog side of the business continues to thrive. Victoria’s Secret, for instance, sends a mind-boggling 395 million catalogs each year—that’s four catalogs for every American woman between the ages of 15 and 64. Telemarketing, both inbound and outbound, also remains a potent distribution channel, despite the popular National Do Not Call list established in 2003.

Direct Selling

This channel includes all methods of selling directly to customers in their homes or workplaces. Door-to-door sales has enjoyed a resurgence in the wake of the National Do Not Call list, but the real strength of direct selling lies in multilevel marketing, or MLM. Multilevel marketing involves hiring independent contractors to sell products to their personal network of friends and colleagues and to recruit new salespeople in return for a percentage of their commissions. Mary Kay Cosmetics and The Pampered Chef have both enjoyed enormous success in this arena, along with pioneering companies such as Tupperware.
Vending

Until about a decade ago, vending machines in the United States sold mostly soft drinks and snacks. But more recently, the selection has expanded (and the machines have gone more upscale) as marketers recognize the value of providing their products as conveniently as possible to their target consumers. Banana Boat, for example, has placed sunscreen vending units in high-traffic spots across sunny southern Florida. But other countries are far ahead of the United States in the vending arena. In Japan, for instance, people buy everything from blue jeans to beef from vending machines. As technology continues to roll forward, U.S. consumers are likely to see a growing number of vending machines for products as diverse as fresh-cooked french fries, digital cameras, and specialty coffee drinks.

LO4 Physical Distribution: Planes, Trains, and Much, Much More

Determining the best distribution channels for your product is only the first half of your distribution strategy. The second half is physical distribution strategy: determining how your product will flow through the channel from the producer to the consumer.

The supply chain for a product includes not only its distribution channels but also the string of suppliers who deliver products to the producers. (See Exhibit 13.3.) Planning and coordinating the movement of products along the supply chain—from the raw materials to the final consumers—is called supply chain management or SCM. Logistics is a subset of SCM that focuses more on tactics (the actual movement of products) than on strategy.

At one time, relationships among the members of the supply chain were contentious. But these days, companies that foster collaboration, rather than competition, have typically experienced more success. Vendor-managed inventory is an emerging strategy—pioneered by Walmart—that allows suppliers to determine buyer needs and automatically ship product. This strategy saves time and money but also requires an extraordinary level of trust and information-sharing among members of the supply chain.
In our turbocharged 24/7 society, supply chain management has become increasingly complex. Gap, for instance, contracts with more than 3,000 factories in more than 50 different countries, and distributes its products to about 3,000 stores in five different countries. The coordination requirements are mind-boggling. Key management decisions include the following considerations:

- **Warehousing**: How many warehouses do we need? Where should we locate our warehouses?
- **Materials Handling**: How should we move products within our facilities? How can we best balance efficiency with effectiveness?
- **Inventory Control**: How much inventory should we keep on hand? How should we store and distribute it? What about costs such as taxes and insurance?
- **Order Processing**: How should we manage incoming and outgoing orders? What would be most efficient for our customers and suppliers?
- **Customer Service**: How can we serve our customers most effectively? How can we reduce waiting times and facilitate interactions?
- **Transportation**: How can we move products most efficiently through the supply chain? What are the key tradeoffs?
- **Security**: How can we keep products safe from vandals, theft, and accidents every step of the way?

And fragile or perishable products, of course, require even more considerations.

**Transportation Decisions**
Moving products through the supply chain is so important that it deserves its own section. The various options—trains, planes, and railroads, for instance—are called *modes of transportation*. To make smart decisions, marketers must consider what each mode offers in terms of cost, speed, dependability, flexibility, availability, and frequency of shipments. The right choice, of course, depends on the needs of the business and on the product itself. See Exhibit 13.4 for a description of the transportation options.

Depending on factors such as warehousing, docking facilities, and accessibility, some distributors use several different modes of transportation. If you owned a clothing boutique in Las Vegas, for example, chances are that much of your merchandise would travel by boat from China to Long Beach, California, and then by truck from Long Beach to Las Vegas.

### Proactive Supply Chain Management

A growing number of marketers have turned to supply chain management to build a competitive edge through greater efficiency. But given the complexity of the field, many firms choose to outsource this challenge to experts rather than handling it internally. Companies that specialize in helping other companies manage the supply chain—such as UPS—have done particularly well in today's market.

### LO5 Pricing Objectives and Strategies: A High-Stakes Game

Pricing strategy clearly has a significant impact on the success of any organization. Price plays a key role in determining demand for your products, which directly influences a company's profitability. Most people, after all, have a limited amount of money and a practically infinite number of ways they could spend it. Price affects their spending choices at a more fundamental level than most other variables.

But ironically, price is perhaps the toughest variable for marketers to control. Both legal constraints and marketing intermediaries (distributors) play roles in determining the final price of most products. Marketers must also consider costs, competitors, investors, taxes, and product strategies.

In today's frenetic environment, stable pricing is no longer the norm. Smart marketers continually evaluate and refine...
their pricing strategies to ensure that they meet their goals. Even the goals themselves may shift in response to the changing market. Common objectives and strategies include building profitability, boosting volume, matching the competition, and creating prestige.

**Building Profitability**

Since long-term profitability is a fundamental goal of most businesses, profitability targets are often the starting point for pricing strategies. Many firms express these goals in terms of either return on investment (ROI) or return on sales (ROS). Keep in mind that profitability is the positive difference between revenue (or total sales) and costs. Firms can boost profits by increasing prices or decreasing costs, since either strategy will lead to a greater spread between the two. Doing both, of course, is tricky, but companies that succeed—such as Apple—typically dominate their markets.

**Boosting Volume**

Companies usually express volume goals in terms of market share—the percentage of a market controlled by a company or a product. Amazon.com, for example, launched with volume objectives. Its goal was to capture as many “eyeballs” as possible, in hopes of later achieving profitability through programs that depend on volume, such as advertising on its site. A volume objective usually leads to one of the following strategies:

**Penetration Pricing**

*Penetration pricing*, a strategy for pricing new products, aims to capture as much of the market as possible through rock-bottom prices. Each individual sale typically yields a tiny profit; the real money comes from the sheer volume of sales. One key benefit of this strategy is that it tends to discourage competitors, who may be scared off by the slim margins. But penetration pricing makes sense only in categories that don’t have a significant group of consumers who would be willing to pay a premium (otherwise, the marketer would be leaving money on the table). For obvious reasons, companies that use penetration pricing are usually focused on controlling costs. JetBlue is a key example. Its prices are often unbeatable, but it strictly controls costs by using a single kind of jet, optimizing turnaround times at the gate, and using many non-major airports.

**Everyday-low pricing**
Also known as “sustained discount pricing,” **everyday-low pricing (EDLP)** aims to achieve long-term profitability through volume. Walmart is clearly the king of EDLP with “Always low prices. *Always!*” But Costco uses the same strategy to attract a much more upscale audience. The difference between the two customer groups quickly becomes apparent by glancing at the cars, while strolling through the two parking lots. Costco customers are typically seeking everyday discounts because they want to, not because they need to. The product mix—eclectic and upscale—reflects the customer base. (Costco sells discounted fine wine, low-priced rotisserie chickens, fresh king crab legs, and high-end electronics.) While Costco posted years of healthy, sustained growth, the firm ran into trouble at the end of 2008. As the recession tightened its grip, sales began to soften, especially in non-food categories, suggesting that EDLP may be most effective for less-upscale products. By 2010, Costco had recovered and returned to its historical growth trajectory.

**High/Low Pricing**

The **high/low pricing** strategy tries to increase traffic in retail stores by special sales on a limited number of products, and higher everyday prices on others. Often used—and overused—in grocery stores, drug stores, and department stores, this strategy can alienate customers who feel cheated when a product they bought for full price goes on sale soon afterward. High/low pricing can also train consumers to buy only when products are on sale.

**Loss-Leader Pricing**

Closely related to high/low pricing, **loss-leader pricing** means pricing a handful of items—or loss leaders—temporarily below cost to drive traffic. The retailer loses money on the loss leaders but aims to make up the difference (and then some) on other purchases. To encourage other purchases, retailers typically place loss leaders at the back of the store, forcing customers to navigate past a tempting array of more profitable items. The loss-leader strategy has been used effectively by producers, as well. Gillette, for instance, gives away some shavers practically for free but reaps handsome profits as consumers buy replacement blades. Similarly, Microsoft has sold its Xbox systems at a loss in order to increase potential profits from high-margin video games. But the loss-leader strategy can't be used everywhere, since a number of states have made loss leaders illegal for anticompetitive reasons.

If automobiles had followed the same development cycle as the computer, a Rolls-Royce would today cost $100, get a million miles per gallon, and explode once a year, killing everyone inside.

—Robert Cringely, technology journalist

**Matching the Competition**

The key goal is to set prices based on what everyone else is doing. Usually, the idea is to wipe out price as a point of comparison, forcing customers to choose their product based on other factors. Examples include Coke and Pepsi, Honda and Toyota, Chevron and Mobil, Delta and United. But sometimes one or two competitors emerge that drive pricing for entire industries. Marlboro, for instance, leads the pack in terms of cigarette pricing, with other brands falling into place behind.

**Right Is Always Right, But Sometimes Left Is Wrong**
Confused? This twisted bit of wisdom comes from UPS, whose drivers worldwide log about 2 billion miles a year. In a
determined effort to go green and reduce costs, UPS company leaders determined that eliminating left-hand turns
from delivery routes—and the sitting in traffic that accompanies them—could dramatically improve gas mileage, so
they implemented computer-generated delivery routes that eliminate as many left turns as possible. According to
UPS, the new system “shaved nearly 30 million miles off UPS's delivery routes, saved 3 million gallons of gas, and
reduced emissions by 32,000 metric tons of CO₂—the equivalent of removing 5,300 passenger cars off the road for an
entire year.” The resulting publicity has drawn attention to relatively minor driving changes that even small
businesses and individuals can make to waste less gas and create less pollution. Other high-impact driving “tweaks”
include driving under 60 mph, maintaining recommended air pressure in tires, and replacing clogged air filters. UPS
vividly demonstrated that small, positive changes can pay huge dividends for business and the environment alike.7

Ooops! What were they thinking?: “Slippery Finger” Pricing Goofs
If a price seems too good to be true, it probably is. But seeking an incredible bargain can still make sense—dollars and cents. Due to “slippery finger” typos, frequent price changes, and programming glitches, online retailers are especially vulnerable to pricing mistakes. Without human cashier confirmation, it's tough to catch the goofs. And to magnify the problem, quick communication on the Web almost ensures a flood of customers placing orders as soon as the wrong price goes live.

A sampling of recent online “deals”:

- Free flights from Los Angeles to Fiji
- Round-trip tickets from San Jose, CA, to Paris for $27.98
- $1,049 televisions wrongly listed for $99.99 on Amazon
- $588 Hitachi monitors mistakenly marked down to $164
- $379 Axim X3i PDAs wrongly priced at $79 on Dell's site
- Five watches, worth $11,332, briefly sale-priced at $0.00 (with free shipping) on Ashford.com

After the first few high-profile pricing disasters, online retailers have taken steps to protect themselves through specific disclaimers in their terms of use. And the courts have generally ruled that a company need not honor an offer if a reasonable person would recognize that it was a mistake.

But disclaimers and legal protections won't protect a retailer from customers who feel cheated. So companies that post pricing mistakes must choose between losing money by honoring offers or losing customer goodwill by canceling them—there simply isn’t a winning option. But Travelocity—home of those unintended free tickets from Los Angeles to Fiji—has at least found a way to handle snafus with grace. Its Travelocity Guarantee program notes “If, say, we inadvertently advertise a fare that’s just ‘too good to be true,’ like a free trip to Fiji, we’ll work with you and our travel partners to make it up to you and find a solution that puts a smile on your face.” So—happy shopping!

**Creating Prestige**
The core goal is to use price to send consumers a message about the high quality and exclusivity of a product—the higher the price, the better the product. Of course, this strategy works only if the product actually delivers top quality; otherwise, nobody would buy more than once (and those who do so would clearly spread the word). Rolex watches, Mont Blanc pens, and Bentley cars all use prestige pricing to reinforce their image.

Skimming Pricing

This new product pricing strategy is a subset of prestige pricing. **Skimming pricing** involves offering new products at a premium price. The idea is to entice price-insensitive consumers—music fanatics, for example—to buy high when a product first enters the market. Once these customers have made their purchases, marketers will often introduce lower-priced versions of the same product to capture the bottom of the market. Apple used this strategy with its iPod, introducing its premium version for a hefty price tag. Once it had secured the big spenders, Apple introduced the lower-priced iPod Nanos and Shuffles with a powerful market response. But keep in mind that skimming works only when a product is tough to copy in terms of design, brand image, technology, or some other attribute. Otherwise, the fat margins will attract a host of competitors.

**LO6 Pricing in Practice: A Real-World Approach**

At this point, you may be wondering about economic theory. How do concepts such as supply and demand and price elasticity affect pricing decisions?

Even though most marketers are familiar with economics, they often don't have the information they need to apply the theories to their specific pricing strategies. Collecting data for supply and demand curves is expensive and time consuming, which may be unrealistic for rapidly changing markets. From a real-world standpoint, most marketers consider market-based factors—especially customer expectations and competitive prices—but they rely on cost-based pricing. The key question is: what price levels will allow me to cover my costs and achieve my objectives?

**Breakeven Analysis**

**Breakeven analysis** is a relatively simple process that determines the number of units a firm must sell to cover all costs. Sales above the breakeven point will generate a profit; sales below the breakeven point will lead to a loss. The actual equation looks like this:

\[
\text{Breakeven Point (BP)} = \frac{\text{Total fixed costs (FC)}}{\text{Price/Unit (P)} - \text{Variable cost/unit (VC)}}
\]

If you were selling pizza, for example, your fixed costs might be $300,000 per year. Fixed costs stay the same regardless of how many pizzas you sell. Specific fixed costs might include the mortgage, equipment payments, advertising, insurance, and taxes. Suppose your variable cost per pizza—the cost of the ingredients and the cost of wages for the baker—were $4 per pizza. If your customers would pay $10 per pizza, you could use the breakeven equation to determine how many pizzas you'd need to sell in a year so that your total sales were equal to your total expenses. Remember: a company that is breaking even is not making a profit.

Here's how the break-even analysis would work for our pizza business:

\[
BP = \frac{\text{FC}}{P-VC} = \frac{\$300,000}{\$10 - \$4} = \frac{\$300,000}{\$6} = 50,000 \text{ pizzas}
\]

Over a one-year horizon, 50,000 pizzas would translate to about 303 pizzas per day. Is that reasonable? Could you do better? If so, fire up those ovens! If not, you have several choices, each with its own set of considerations:
• **Raise Prices:** How much do other pizzas in your neighborhood cost? Are your pizzas better in some way? Would potential customers be willing to pay more?

• **Decrease Variable Costs:** Could you use less-expensive ingredients? Is it possible to hire less-expensive help? How would these changes affect quality and sales?

• **Decrease Fixed Costs:** Should you choose a different location? Can you lease cheaper equipment? Would it make sense to advertise less often? How would these changes affect your business?

Clearly, there isn’t one best strategy, but a break-even analysis helps marketers get a sense of where they stand and the hurdles they need to clear before actually introducing a product.

**Fixed Margin Pricing**

Many firms determine upfront how much money they need to make for each item they sell. The *profit margin* — which is the gap between the cost and the price on a per product basis — can be expressed as a dollar amount but more often is expressed as a percent. There are two key ways to determine margins.

1. **Cost-Based Pricing:** The most popular method of establishing a fixed margin starts with determining the actual cost of each product. The process is more complex than it may initially seem, since fixed costs must be allocated on a per-product basis, and some variable costs fluctuate dramatically on a daily or weekly basis. But once the per-product cost is set, the next step is to layer the margin on the cost to determine the price. Costco, for instance, has a strict policy that no branded item can be marked up by more than 14%, and no private-label item by more than 15%. Supermarkets, on the other hand, often mark up merchandise by 25%, and department stores by 50% or more. Margins in other industries can be much thinner.

**Putting iTunes on the Spot**

The Apple iTunes store has enjoyed fantastic success since its introduction in 2001. The iTunes pay-99-cents-per-track pricing format revitalized a music industry badly battered by the wild popularity of music pirating sites such as Napster. Over the years, iTunes has had little or no meaningful competition, garnering 200 million accounts by 2011. But music fans in Europe may be just as likely to get their music from Swedish music subscription service, Spotify.com, which has a free, ad-supported option available to customers, as well as a premium service for unlimited access to the tracks on mobile phones and offline for about $16.50 per month. In mid-2011, Spotify announced a major service update, allowing people to sync the songs in their Spotify playlists with the iPod Classic, iPod Nano, and iPod Shuffle. According to the company, people will need only to plug their iPods into their computers via USB, and they will see the player pop up in the Spotify app’s “Devices” section. From there, they can sync all the MP3s in their playlists in a single step. Spotify’s service upgrade, plus its active pursuit of licensing deals with major music labels, may pave the way for Spotify to enter the U.S. market and offer some real competition to Apple iTunes.
2. **Demand-Based Pricing**: This approach begins by determining what price consumers would be willing to pay. With that as a starting point, marketers subtract their desired margin, which yields their target costs. This method is more market-focused than cost-based pricing, but it's also more risky, since profits depend on achieving those target costs. A number of Japanese companies, such as Sony, have been very successful with this approach, achieving extraordinarily efficient production.

**Consumer Pricing Perceptions: The Strategic Wild Card**

You just don't know if you've found the right price until you figure out how consumers perceive it. And those perceptions can sometimes defy the straightforward logic of dollars and cents. Two key considerations are price—quality relationships and odd pricing.

The link between price and perceived quality can be powerful. Picture yourself walking into a local sporting goods store, looking for a new snowboard. They have several models of your favorite brand, most priced at around $450. But then you notice another option—same brand, same style—marked down to $79. Would you buy it? If you were like most consumers, you'd probably assume that something were wrong with a board that cheap. Would you be right? It's hard to know. Sometimes the relationship between price and quality is clear and direct, but that is not always the case. Regardless, consumers will use price as an indicator of quality unless they have additional information to guide their decision. Savvy marketers factor this tendency into their pricing strategies.

Marketers also must weigh the pros and cons of **odd pricing**, or ending prices in numbers below even dollars and cents. A micro stereo system at Target, for instance, costs $99.99. Gasoline, of course, uses odd pricing to 99/100ths of a cent. But wouldn't round numbers be easier? Does that extra penny really make a difference? While the research is inconclusive, many marketers believe that jumping up to the “next” round number sends a message that prices have hit a whole new level. In other words, they believe that the **perceived** gap between $99.99 and $100.00 is much greater than the **actual** gap of 1%. And it certainly makes sense from an intuitive standpoint.

Odd prices have also come to signal a bargain, which is often—but not always—a benefit for the marketer. For instance, a big-screen TV for $999.99 might seem like a great deal, while knee surgery for $4,999.99 sounds kind of scary—you'd probably rather that your doctor charge $5,000. Likewise, a fast-food joint might charge $3.99 for its value meal, while fine restaurants almost always end their prices in zeros. Marketers can determine whether odd pricing would work for them by evaluating the strategy in light of the messages it sends to the target market.

**Go Figure!!**
Classic economics – plus common sense – says that as consumers we will research and weigh our options and make the best choice. But in the real world, consumers are not so rational. Our emotions can trump our minds. In fact, recent research shows that money can act like a drug on our brains. Even just counting your money can literally raise your pain threshold. Pricing hot buttons, such as “FREE!,” “99 cents!,” and “limited time!” can play games with our minds, too, luring us to purchase and consume products that we don’t really even want! But the good news for marketers is that consumers are irrational in somewhat predictable ways – go figure!

Mere exposure to a high price makes a lower price seem reasonable, even if it isn’t. So smart marketers often keep overpriced items in their line simply to promote sales of other items. For instance, if the most expensive necklace in a jewelry store is $100, and no one wants to buy it, the owner might add a $200 necklace to boost sales of the $100 necklace. Economists call this effect anchoring. And research shows that anchors are tough to shake. One key takeaway that goes beyond consumer goods: “be first to name a price in a negotiation – especially a salary negotiation – and don’t worry about being overly reasonable.”

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The Big Picture

Distribution and pricing are two fundamental elements of the marketing mix. In today’s frenzied global economy, marketers are seeking a competitive edge through distribution management. Creating a profitable presence in multiple retail venues requires constant focus throughout the organization. And managing the supply chain—how products move along the path from raw materials to the final consumer—plays a crucial role in controlling costs and providing great customer service. Integrating effective technology during the entire process can separate the winners from the losers.

Pricing objectives and strategies are also pivotal since they directly impact both profitability and product image. As the market changes, successful companies continually re-evaluate and modify their approach, working hand in hand with their accountants.

Looking ahead, a growing number of companies will probably move toward collaboration, rather than competition, as they manage their supply chains. And pricing will likely become even more dynamic in response to the changing market.

Careers in Distribution and Pricing
As the economy globalized, the process of distributing countless numbers of goods and services around the world as efficiently as possible led to the rise of the field of logistics, which encompasses transportation, warehousing, inventory management, and inspection. Specific jobs include truck driver, freight agent, warehouse manager, inspector, purchase agent, and scheduler. Some positions do not require higher education, but virtually all demand superior organizational skills and an entrenched detail orientation, plus a deep understanding of the complex web of rules, regulations, and laws that govern many aspects of logistics in our increasingly globalized world economy. In 2011, the median salary for logistics professionals was $90,000, with job growth anticipated in the south and southeast regions of the United States, plus significant opportunities abroad.11

In most companies, pricing is an integral part of the marketing manager's job – rather than a separate position – typically handled with support from cost accountants. Determining effective, profitable pricing strategies requires strong analytical skills and a broad strategic perspective with a focus on the long term.

What else?

RIP and REVIEW CARDS IN THE BACK and visit www.cengagebrain.com!

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Distribution and Pricing: Right Product, Right Person, Right Place, Right Price: Rip and Review 13

LO1 Define distribution and differentiate between channels of distribution and physical distribution
Distribution is the element of the marketing mix that involves getting the right product to the right customers in the right place at the right time. A channel of distribution is the path that a product takes from the producer to the consumer, while physical distribution is the actual movement of products along that path. Distributors add value by reducing the number of transactions—and the associated costs—required for goods to flow from producers to consumers. Distributors can also add a range of different utilities:

- **Form Utility:** Provides customer satisfaction by converting inputs into finished products.
- **Time Utility:** Adds value by making products available at a convenient time for consumers.
- **Place Utility:** Satisfies customer needs by providing the right products in the right place.
- **Ownership Utility:** Adds value by making it easier for customers to actually possess the goods and services that they purchase.
- **Information Utility:** Boosts customer satisfaction by providing helpful information.
- **Service Utility:** Adds value by providing fast, friendly, personalized service.

Wholesalers buy products from the producer and sell them to other businesses and organizations. The two key categories of wholesalers are:

- **Merchant wholesalers,** who take legal title to the goods they distribute. Full-service merchant wholesalers provide a wide array of services, whereas limited-service merchant wholesalers offer more focused services.
- **Agents and brokers,** who connect buyers and sellers in exchange for commissions but without taking legal ownership of the goods they distribute.

Retailers are the final stop before the consumer on the distribution path. The two main retail categories are **store and nonstore,** but the line between the two has blurred as more and more retailers are pursuing a multichannel approach, with online and offline outlets supporting each other. Key nonstore retail approaches include online retailing, direct-response retailing, direct selling, and vending. As competition intensifies, a growing segment of retailers (both store and nonstore) have distinguished themselves by offering their customers an entertainment-like experience.
distribution strategy A plan for delivering the right product to the right person at the right place at the right time.

channel of distribution The network of organizations and processes that links producers to consumers.

physical distribution The actual, physical movement of products along the distribution pathway.

direct channel A distribution process that links the producer and the customer with no intermediaries.

channel intermediaries Distribution organizations—informally called “middlemen”—that facilitate the movement of products from the producer to the consumer.

retailers Distributors that sell products directly to the ultimate users, typically in small quantities, which are stored and merchandised on the premises.

wholesalers Distributors that buy products from producers and sell them to other businesses or nonfinal users such as hospitals, nonprofits, and the government.

independent wholesaling businesses Independent distributors that buy products from a range of different businesses and sell those products to a range of different customers.

merchant wholesalers Independent distributors who take legal possession, or title, of the goods they distribute.

agents/brokers Independent distributors who do not take title of the goods they distribute (even though they may take physical possession on a temporary basis before distribution).

multichannel retailing Providing multiple distribution channels for consumers to buy a product.

wheel of retailing A classic distribution theory that suggests that retail firms and retail categories become more upscale as they go through their life cycles.

supply chain All organizations, processes, and activities involved in the flow of goods from their raw materials to the final consumer.

supply chain management (SCM) Planning and coordinating the movement of products along the supply chain, from the raw materials to the final consumers.
logistics A subset of supply chain management that focuses largely on the tactics involved in moving products along the supply chain.

modes of transportation The various transportation options—such as planes, trains, and railroads—for moving products through the supply chain.

penetration pricing A new product pricing strategy that aims to capture as much of the market as possible through rock-bottom prices.

everyday-low-pricing (EDLP) Long-term discount pricing, designed to achieve profitability through high sales volume.

high/low pricing A pricing strategy designed to drive traffic to retail stores by special sales on a limited number of products, and higher everyday prices on others.

loss-leader pricing Closely related to high/low pricing, loss-leader pricing means pricing a handful of items—or loss leaders—temporarily below cost to drive traffic.

skimming pricing A new product pricing strategy that aims to maximize profitability by offering new products at a premium price.

breakeven analysis The process of determining the number of units a firm must sell to cover all costs.

profit margin The gap between the cost and the price of an item on a per-product basis.

odd pricing The practice of ending prices in numbers below even dollars and cents in order to create a perception of greater value.

LO4 Explain the key factors in physical distribution

As marketers manage the movement of products through the supply chain, they must make decisions regarding each of the following factors:

- **Warehousing**: How many warehouses do we need? Where should we locate our warehouses?
- **Materials handling**: How should we move products within our facilities? How can we best balance efficiency with effectiveness?
- **Inventory control**: How much inventory should we keep on hand? How should we store and distribute it? What about taxes and insurance?
- **Order processing**: How should we manage incoming and outgoing orders? What would be most efficient for our customers and suppliers?
- **Customer service**: How can we serve our customers most effectively? How can we reduce waiting times and facilitate interactions?
- **Transportation**: How can we move products most efficiently through the supply chain? What are the key trade-offs?
LO5 Outline core pricing objectives and strategies

Many marketers continually evaluate and refine their pricing strategies to ensure that they meet their goals. Even the goals themselves may shift in response to the changing market. Key objectives and strategies include:

- Building profitability
- Driving volume
- Meeting the competition
- Creating prestige

LO6 Discuss pricing in practice, including the role of consumer perceptions

While most marketers are familiar with economics, they often don't have the information they need to apply the theories to their specific pricing strategies. Because of those limitations, most companies consider market-based factors—especially customer expectations and competitive prices—but they rely on cost-based pricing: what should we charge to cover our costs and make a profit? Common approaches include breakeven analysis and fixed margin pricing. Many marketers also account for consumer perceptions, especially the link between price and perceived quality, and odd pricing. If no other information is available, consumers will often assume that higher-priced products are higher quality. Odd pricing means ending prices in dollars and cents rather than round numbers (e.g., $999.99
versus $1,000) in order to create a perception of greater value.

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**Footnotes**


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