Introduction

Price is the most influential term in the profit equation in the sense that a 10 percent improvement in price has a bigger profit impact than a 10 percent improvement in any of the other components of profit (unit sales, fixed costs, or unit variable cost). Consequently it behooves managers to pay attention to their selling prices to ensure that the firm claims the value that marketing helped create and to understand how the firm's prices compare to those of competitors.

When the firm sells a product in a variety of sizes and forms through multiple channels, it will be a challenge just to figure out a single representative price. That's where average price and price per statistical unit come into play. Price minus unit costs is called contribution per unit—a handy number managers need to know to quantify the economic benefits of the increased sales that marketing is responsible for producing. For comparisons across products, contribution is sometimes expressed as a percentage of price to get contribution margin.

One of the most important decisions a marketer is called upon to make is the setting of price. In addition to strategic considerations (price is, after all, one of the four Ps—the other Ps include Product, Place, and Promotion), price should always be selected with an eye toward how it affects unit sales. We can get help negotiating the trade-off between price and units sales by using a simple model of linear demand or by understanding price elasticity. Of course, our carefully constructed demand curves fly out the window if the competition drastically changes its prices. Although price premium is a metric that we can use to track how our prices are changing relative to a competitive benchmark, the real challenge is that pricing is a game or dance in which our fate depends, in part, on what our competitors do. These metrics and concepts will help managers meet the pricing challenge.