NOTE: The following exercises should be completed using the same groups defined for the class project

Group participants (print name, USC id, and sign below):
1- TACO BELL: PRICING FOR VALUE

- **Activity Type:** Video Case

### Questions and Answers

1. One reason Taco Bell raised its prices was the result of an increase in ______.
   - profits
   - costs
   - sales to loyal customers
   - market share
   - competitors’ prices

2. The quick service restaurant (QSR) market is considered an ______.
   - monopoly
   - oligopoly
   - commodities competition
   - monopolistic competition
   - pure competition

3. Taco Bell’s predominant pricing strategy is ______.
   - sales-oriented
   - volume-oriented
   - profit-oriented
   - competitor-oriented
   - customer-oriented
Follow-Up Activity

Although the specific price points have changed, Taco Bell still pursues a value menu strategy today (called the “Why Pay More?” menu), offering individual items from 89 cents to $1.59, and “Why Pay More Deals” for $2.49 (prices as of spring 2014). Taco Bell has also tested a $1 “Cravings” menu in some stores.

McDonald’s, though, has chosen to go in a different direction. Read the following article, then discuss and answer the questions provided.

**McDonald’s Higher-Price-Point Value Menu Could Be A Win**

In the latest attempt to get sales back on track, improve profit margins, and capture the ever-price-sensitive consumer, McDonald’s announced recently that a new value menu—called Dollar Menu & More—could launch nationally this year.

The menu, now being tested in five U.S. markets, features three prices points: $1, $2, and $5. If adopted nationwide, it would replace last year’s Extra Value Menu, which has items priced closer to $2.

Leslie Kerr, a pricing expert and founder of pricing advisory firm Intellaprice, says the new menu reflects the industry’s shift from dollar menus to value menus. She also says the rollout would be a smart move for McDonald’s, as it could allow the brand to focus on customers who aren’t as price sensitive as those who opt for the Dollar Menu.

Kerr says catering to the most price-sensitive guests can be both difficult and dangerous for a brand. “At some point, operators need to ask themselves if a dollar is realistic,” she says. “Consumers realize that prices increase, and holding on to the dollar market is not good business. It just doesn’t make sense.”
Despite this fact, she says the restaurant industry, especially quick serves, have remained attached to low prices on dollar menus over the years, essentially “training guests to be price sensitive.”

“The industry is sensitive to price sensitivity, but I think the industry is also training guests to be price sensitive,” she says. “You want to cater to loyalty and drive frequency and innovate your menu to have such delicious offerings that people want to try them regardless of the price.”

Items on McDonald's Dollar Menu & More include burgers with extra beef patties or bacon, chicken items, and 20-piece Chicken McNuggets for around $5, which Kerr says gives guests a bang for their buck. “You don’t just have to stick to a dollar to convey that an item is reasonable,” she says.

Kerr says add-on items would be primed to succeed on a menu like the new Dollar Menu & More. “If you can try to get your customers to buy mainstay items and then have the upsell opportunity on the dollar menu—like the cookies, like the dessert—that’s a great way to build tickets, not to have your main courses there,” she says.

Though it’s possible some consumers will be turned off by the higher-priced items on the value menu, Kerr says, “it looks like McDonald’s is doing this in a thoughtful way that would be hard for reasonable consumers to hold against McDonald’s. It's a company. They're trying to maintain profitability like all businesses do.”

In addition, Kerr says more limited-service value menus are featuring items at price points like $1.29, $1.39, and $1.59, “and I think that’s just fine with customers,” she says. “They realize that not many things can be bought for just a dollar. So if the price range is expanded and the offerings seem fair, then that's great.”

In order for the menu to be a success nationwide, Kerr says McDonald’s must convey to consumers that the offerings and price points are a good deal, while also providing the profit margins that franchisees need. “That's really a matter of doing homework up front,” she says, “not trying to force fit items to a certain price point.”

In general, Kerr says the idea of the value menu can and should evolve in the limited-service industry. “Operators can still convey value at different price points, which is a concept that seems to be taking on life at McDonald’s with this revised menu that’s in test.”

**Questions**

- Why might $1 (and less) value menus have been more important in 2009–2010 than they are today? (Consider the economy then and now)

- Are there differences in the Taco Bell and McDonald's target markets that might also lead to differences in the strategy?

- Comment on this quote from the article:
  
  "Kerr says catering to the most price-sensitive guests can be both difficult and dangerous for a brand. “At some point, operators need to ask themselves if a dollar is realistic,” she says. “Consumers realize that prices increase, and holding on to the dollar market is not good business. It just doesn’t make sense.”"
Activity Type: Classify price orientation strategies

Different firms embrace different goals. Consequently, these goals affect the pricing strategy. Pricing of a company’s products and services should support and allow the firm to reach its overall goals. In this activity, you will be asked to differentiate among pricing orientations.

- Match the 4 firms (golf, shoe, grocery, movie) with the appropriate price orientation

- **Golf Course**: Before setting prices, a new golf course surveys its target market to determine what they expect to pay for greens fees.
- **Shoe Company**: A shoe company prices all products with the goal of obtaining a 22% return on investment.
- **Grocery Store**: A grocery store monitors the prices of its competitor’s product and adjusts prices according to how the competitor changes its prices.
- **Movie Theater**: A new movie theater focuses on ticket sales and market share and therefore sets ticket prices lower than do competitors and accepts lower profits at first.
3- U.S. CELLULAR: MATCHING PRICE WITH PERCEIVED VALUE

- Activity Type: Video Case

Questions and Answers

What characterizes a market with oligopolistic competition?
- One firm controlling the market
- The absence of competition
- Many sellers of commodities
- Many firms selling differentiated products
- A few dominant firms

U.S. Cellular sets prices based on adding value to its products and services. Which pricing orientation does this reflect?
- Customer orientation
- Competitor orientation
- Breakeven orientation
- Profit orientation
- Sales orientation

Though confusing to customers, U.S. Cellular priced its bundles very similar to its competitor’s prices. Which competitor-oriented pricing strategy did U.S. Cellular use in this example?
- Competitive parity
- Breakeven
- Premium
- Elastic

If the market is elastic, relatively ____ changes in price generate fairly ____ changes in the quantity demanded.
- large; small
- small; small
- large; equal
- small; equal
- small; large
What does U.S. Cellular need to consider in setting prices for its various data plans?

- Competitors
- Customers
- Company objectives
- Costs
- All of these

4- DECEPTIVE OR ILLEGAL PRICING

- **Activity Type**: classify five deceptive or illegal pricing actions according to the category it represents.

**Activity**

Roll over each item and read the description to determine which type of illegal or unethical price strategy is being used. Then drag the item to the appropriate price strategy.

<table>
<thead>
<tr>
<th>Price Strategy</th>
<th>Example</th>
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<tbody>
<tr>
<td>Loss Leader Pricing</td>
<td></td>
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<td>Bait and Switch</td>
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<tr>
<td>Predatory Pricing</td>
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<td>Price Discrimination</td>
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<tr>
<td>Price Fixing</td>
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</tr>
</tbody>
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- **Loss Leader Pricing**: Very aggressive pricing
- **Bait and Switch**: Advertise an item at a very low price without the intent to really sell any
- **Predatory pricing**: Set a product price very low with the intent of driving the competition out of business
- **Price discrimination**: A firm sells a product to different buyers at different price
- **Price Fixing**: Collude with other firms to control prices
5- PRICING FOR THE WORLD OF HIGH FASHION

- **Activity Type:** Case Analysis

**Case**

Suppose a young socialite walks down Manhattan’s Fifth Avenue wearing a $5,000 silk scarf by Hermès (a French design house) that perfectly complements the $20 peek-a-boo tank top she purchased at Zara.

Style is no longer dictated by price. Price skimming designers are successful, but so are stores using a market penetration pricing strategy.

The stores using market penetration pricing carefully observe the styles and trends of the designer brands and then quickly and efficiently turn out similar lines in their own stores at an affordable price. Sometimes they are even able to beat the designers’ fashions to the stores. To combat these stores’ lower-priced but stylish clothing, high-end designers enhance their accessories and clothing with details that cannot be duplicated at a low cost. For example, they use alligator skin, mink, and fine hand stitching.

Both the affordable clothes of stores like H&M and Zara and the expensive, extravagant lines of Hermès and Chanel sell well. The masses can afford H&M and Zara, and those who value the detail and cutting-edge designs from designers like Chanel are willing to pay the price.

**Questions and Answers**

1. Which of the following is NOT a reason high-end stores such as Chanel would use price skimming?
   - Their customers are interested in the status afforded by names like “Chanel.”
   - Their customers like costly details that are not easily imitated.
   - Their customers want the latest styles as soon as they come out.
   - Their customers make decisions based on convenience and practicality.
   - Their customers are not price-sensitive.

2. Why do companies such as H&M and Zara use penetration pricing?
   - They cannot satisfy a rapid rise in demand.
   - Their customers are willing to pay more for their products.
   - They can raise prices over time.
   - They can build profits quickly.
   - Their competitors are unable to enter the market easily.
Based on _______, Chanel may set high prices for its winter coats because its customers are willing to pay more for a product that will last a lifetime.

- the improvement value method
- the competitor-based pricing method
- everyday low pricing
- the cost of ownership method
- high/low pricing

Suppose Zara wants to know how much more consumers are willing to pay for its clothing line relative to other comparable clothing stores. The company performs research to determine how its customers value Zara’s clothing—in terms of quality, style, and versatility—compared with similar clothing that the customers have purchased elsewhere. Which method is Zara using to determine pricing in this scenario?

- Reference pricing
- High/low pricing
- Improvement value method
- Cost of ownership method
- Everyday low pricing

Suppose Zara features in its advertisements and in signs around the store both the original prices and sale prices of certain items. This is an example of _________.

- horizontal price fixing
- everyday low pricing
- cost of ownership pricing
- high/low pricing
- improvement value pricing
With 108.7 million subscribers, Verizon leads the pack in the cellular market. Verizon hosts the largest 4G LTE network, and offers service in 195 countries. While AT&T is second to Verizon in subscribers (100.7 million), it earns more revenue. AT&T claims to have the fastest network and promises the widest international coverage, with 99.99% reliability. Sprint Nextel holds third place with approximately 55 million customers. It currently runs separate networks: the Nextel 2G service, and the Sprint 3G and 4G lines, which is expensive. To cut costs, Sprint plans to decommission its Nextel services by 2013. T-Mobile USA is owned by Deutsch Telecom and has 33.8 million subscribers. Throughout 2011 and 2012, T-Mobile USA was the target of several acquisition attempts by AT&T, Sprint, and others.

As the cost of cell service has continued to decline, increasing prices is not an option for building revenue in this market. With no new customers to attract, the major phone companies have sought instead to increase their share of the market. Accomplishing that goal has meant competing ferociously to attract customers from competitors. But if the companies tried to lure subscribers with reduced rates, they ran the very real risk of causing harm to their economic bottom line. At the same time, the players could not afford to sit on their hands and do nothing, especially as consumers gave up their home phones, leading to contraction in the landline businesses.

The tactics the competitors use are constantly changing. Let’s consider what happened at the introduction of 4G services. Verizon offered a data rate of $50 per month for 5GB of usage on the 4G network—less expensive than its $60/month rate for 3G services. Sprint priced its services at $60 per month for unlimited 4G data usage and 5GB of 3G usage. But 4G is not as widely available as 3G. Thus the best option for each customer depends largely on how much data he or she plans to use each month, which remains a difficult estimate for most users.

While advanced data plans on smartphones and tablets are becoming the norm, there remains a market for voice-only options as well. Verizon Wireless cut prices for its unlimited talk, and unlimited talk & text plans. AT&T promptly matched Verizon’s changes. T-Mobile already had an unlimited talk plan for $60, $10 less than the new prices at AT&T and Verizon. Sprint can claim that its Everything Data plans already were cheaper than Verizon’s, saving individual users as much as $240 per year. A common goal of price cuts in voice plans is to get customers enrolled in more expensive unlimited plans, especially for data. Verizon Wireless, for example, may give up $540 million in voice revenue but experience a net gain of $90 million because of the healthier margins associated with data plans.

Networks account for only a piece of a wireless company’s revenue stream. Customers need handsets, which are becoming more sophisticated. But here again, companies are cutting prices on handsets in an effort to attract market share. The war is far from over, especially in such a rapidly changing, frequently innovating market. If voice plans drop further, revenue from data plans may no longer provide the margins cell phone companies need. Some wireless providers may consolidate; others will fade away.
Questions and Answers

1. Verizon offered a lower data rate for its new 4G service ($50 per month) than for its existing 3G service ($60 per month). This pricing strategy is called __________.
   - high/low pricing
   - market penetration pricing
   - price skimming
   - cost-based pricing
   - leader pricing

2. To capture market share, all the companies in the case used the same basic strategy, which was to __________.
   - use leader pricing
   - raise prices
   - engage in price fixing
   - reduce prices
   - raise costs

3. When the cellular providers began offering 4G service, they needed to estimate how much more (or less) consumers would be willing to pay for the product relative to other comparable products. This pricing consideration is the __________ method.
   - cost of ownership
   - EDLP
   - improvement value
   - cost-based
   - competition-based

4. If any of the companies in the case set a very low price for one or more of its products with the intent to drive its competition out of business, they would be guilty of the illegal pricing practice known as ______.
   - vertical price fixing
   - price discrimination
   - bait-and-switch
   - horizontal price fixing
   - predatory pricing
One pricing tactic Verizon could offer consumers is to issue a refund as a portion of the purchase price returned to the buyer in the form of cash. This tactic is called a(n) __________.

- rebate
- quantity discount
- seasonal discount
- coupon
- allowance

Most cellular providers now offer a free phone when you subscribe to their advanced data services. This is a pricing tactic called __________.

- a quantity discount
- leader pricing
- price lining
- an allowance
- price bundling