PRICING STRATEGY

GLOSSARY OF TERMS

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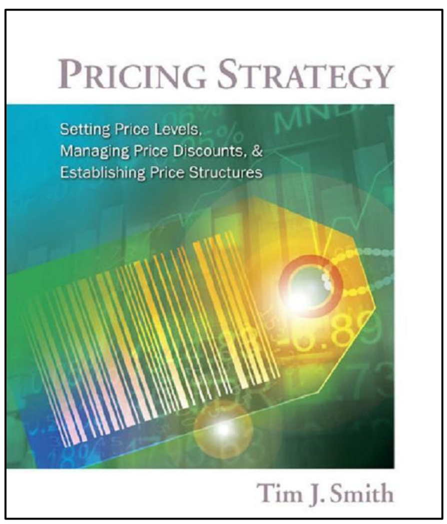

Prepared August 2012

GLOSSARY

The following glossary of terms is derived from and to be used in conjunction with Pricing Strategy: Setting Price Levels, Managing Price Discounts, & Establishing Price Structures by Tim J. Smith, PhD, (Cengage 2012). Please refer to the text for further information.

Term	Definition as used in Pricing Strategy
Accessory Pricing	See Add-On Pricing
Add-On Pricing	A price structure where further modules or products can be added onto the base product to deliver superior value to the customer. The transactional price within an add-on price structure is the sum of the individual unit prices. Add-on pricing is suggested when there is significant demand heterogeneity in multiple dimensions.
Allowable Volume Loss	In conducting a profit sensitivity analysis of a price increase, the allowable volume loss defines the maximum potential volume decrease for a price increase to improve the firm's profits.
Anchoring	When collecting information, humans tend to overweigh the importance of information gathered early in the information-gathering process in comparison to information gained later in the process. Placing excess value on early information is known as anchoring. Displacing a false informational anchor with new information usually requires more effort than placing that anchor initially.
Benefits Bracketed	Customers which have both a benefits floor and benefits ceiling are said to be benefits-bracketed.
Benefits Ceiling	The perceived maximum benefits demanded within a product category, above which the customer or customer segment does not perceive additional value will be derived from the offering.
Benefits Floor	The perceived minimum benefits demanded within a product category to warrant purchase by a customer or customer segment.
Block Tariff	A two-part tariff in which the metered fee is reduced for customers with a higher consumption.
Booking Control	A method of opening and closing different fare classes.
Booking Limit	The maximum number of goods to be sold within a given fare class.
Breakeven Incremental Unit Sales-per-Redemption (BISR)	A method of calculating the effectiveness of a coupon program. The BISR is one of the most effective means of evaluating promotional-campaign effectiveness.
Buyer Self-Identification	In reference to price segmentation: an implication that the actions or behaviors of the customer reveal their willingness to pay.

Term	Definition as used in Pricing Strategy
Campaign ROI	The return on investment of a promotional campaign. When the campaign ROI calculation does not separate incremental buyers from all other buyers who purchased on promotion, the campaign ROI is known to be misleading in evaluating campaign effectiveness.
Comparable Alternative	Any alternative approach to enable a customer to reach the same or similar set of goals as the focal product or service being analyzed.
Comparison Set Effect	The effect of the price of other offers within a product category on the expected price of the focal offering. When some of the products within the comparison set are priced low (high), price expectations will tend to decrease (increase).
Complements	Two goods for which the purchase of one good increases the likelihood of the purchase of the second good. The goods can be products or services.
Complete Price Discrimination	Each transaction is priced so that the marginal benefits to the customer are equal to the price charged. Also known as first degree price discrimination.
Conjoint Analysis	A market research method of defining the price of a product or service that relies upon respondents making tradeoffs between potential offers to reveal their preferences.
Constant Price Differential	In a tiered price structure, a situation in which the differences in prices between tiered products remains unchanged between the list price and the actual transaction net price.
Consumer Surplus	The difference between the overall customer utility and the transaction price.
Convergent Price Differential	In a tiered price structure, a situation in which the differences in prices between tiered products decreases from the list price to the actual transaction net price.
Cost-per-Buyer	The total campaign cost divided by the number of customers attracted by the promotional campaign. Can be used to compare price promotions or coupons to other forms of advertising but is known to be misleading in evaluating campaign effectiveness.
Credence Goods	In consumer behavior theory: goods for which the benefits derived from consumption are inferred by the customer but may never be experienced.
Customer Lifetime Value	The expected value of a customer over the lifetime of purchases.
Customer Period Value	The expected value of a customer over a period of time if the goods are purchased independently.
Customer Utility	The total value a customer gains from a product or service.
Demographics	Objective criteria used to describe people, such as age, race, ethnicity, gender, location, etc.

Term	Definition as used in Pricing Strategy
Differential Value	The difference in value between the focal product or service being analyzed and its comparable alternative.
Difficult Comparison Effect	The reduction in price sensitivity created by increasing the difficulty by which customers can compare the price or benefits across offers within a category.
Direct Price Discrimination	Setting price to different customers based on specific attributes of the customer, such as age, gender or location.
Divergent Price Differential	In a tiered price structure, a situation in which the differences in prices between tiered products increases from the list price to the actual transaction net price.
Dynamic Nesting	A method of booking control that ensures that the highest price class has the highest availability regardless of the order in which customers request price classes.
Economic Price Optimization	A method of finding the theoretically-optimal price for a product from the known price, quantity sold, and elasticity of demand near that price and quantity sold. This approach is not recommended for most pricing problems.
Economies of Learning	Firm-level cost savings that increase with experience as measured by the accumulated output.
Economies of Scale	Firm-level cost savings that increase with the size of the firm as measured by its long-run sustainable rate of output.
Economies of Scope	Firm-level cost savings that increase as the breadth of a firm's activities increase.
Elastic Demand	Demand is said to be elastic when the absolute value of the elasticity of demand is greater than one. Elastic demand implies small changes in price are associated with relatively larger changes in quantity demanded by the market.
Elasticity of Demand	The ratio of the percent change in volume sold to the percent change in price. Elasticity of demand measure the market response of price changes to quantity demanded.
End-Benefit Effect	The increase in perceived benefits from an offer as that offer is increasingly made integral to and related to the true end benefit desired by the customer.
Endowment Effect	The increased value humans place in a product once they possess that product over what they otherwise would. The endowment effect has been shown to be instantaneous in some cases.

Term	Definition as used in Pricing Strategy
Exchange Value	The sum of the price of comparable alternative and its differential value. In other literature, exchange value and its derivation through an exchange value model has been identified as economic exchange value, exchange value analysis, economic value analysis, financial impact value, business impact model, financial value calculator, and many other names. The terms we utilize, Exchange Value and Exchange Value Model (EVM), are chosen to be succinct, concept-capturing, and clearly differentiated from other fields which often identify EVA as "economic value add" in a supply chain analysis.
Exchange Value Model (EVM)	See Exchange Value.
Expenditure Effect	The increase in price sensitivity related to the overall price paid to purchase from that product category. There are numerous counter-examples to this suspected effect.
Experience Goods	In consumer behavior theory: goods for which the benefits derived from consumption can only be determined by their use.
Explicit Knowledge	Knowledge that can be codified and exchanged with others through training or explicit learning.
Fairness Effect	The belief among customers that offers should be made "fairly". There are many moderators to the concept of fairness within a market.
Fare Class	The price associated with a class of service.
Feature Bundle	Combining disparate features and benefits of different products into one single multifunctional product.
Firmographics	Objective criteria used to describe firms, such as industry, revenue, number of employees, location, etc.
First-Degree Price Discrimination	Charging every customer the price that matches their willingness to pay. Also known as complete price discrimination.
Framing Effect	The changes in perceived benefits or expected price that are influenced by the manner in which the offer is made.
Functional Benefits	Benefits that derive from the physical nature or performance characteristics of the product.
Horizontal Price Fixing	Price agreements between competing firms at the same point in the value chain.
Inclined Tariff	A two-part tariff in which the metered fee is reduced for customers with a lower consumption.
Independent Complements	Complementary products for which both goods can be used without the other. Contrast with Tied Complements.
Indirect Price Discrimination	Setting price to different customers based on a proxy that correlates to the willingness to pay of those customers, such as package size, usage quantity, or coupons.

Term	Definition as used in Pricing Strategy
Inelastic Demand	Demand is said to be inelastic when the absolute value of the elasticity of demand is less than one. Inelastic demand implies large changes in price are associated with relatively smaller changes in quantity demanded by the market.
Inferior Alternative	An offering is identified as being an inferior alternative to its comparable alternative if the differential value is negative.
Kicker	In reference to a profit-based incentive: a multiplier in identifying the sales credit associated with a sale. Defined as greater than one over the target contribution margin.
Large-Order Bundle	The sale of two or more goods in a single transaction to a specific customer at a price which is below the sum price of the individual goods but above the price of any good within the bundle where the relative discount is granted on the basis of the order size.
Latent Demand	Demand which exists for a good prior to the launch of that good, but which could not be expressed without the entrance of that good.
Limited Transferability	An offering in which a customer finds it difficult to resell the product or service to another customer in an aftermarket.
Littlewood's Rule	A method of finding the optimal booking limit for any two-class revenue optimization problem under a yield management price structure.
Marginal Cost	The firm's cost to produce one more unit of product or service.
Market Heterogeneity	A market with customers that seek different benefits or have different willingness to pay.
Market-Share Taking	Enticing customers who are marginally loyal to a competing product to switch brands.
Market-Size Growth	Attracting marginal customers who otherwise would not purchase from that category of goods.
Minimum Advertised Price (MAP)	A commonly used clause by branded good manufacturers with distributors to discourage pricing below a preset price.
Missed Opportunities	Positioning an offering value-disadvantaged when evidence demonstrates that the firm could profitably lower its price to gain a positive effect on sales quantity demanded.
Net Price	The price paid by customers after accounting for both on- and off-invoice discounts.
Net-Price Band	A histogram of the prices paid by different customers during a relatively congruous period in time. Net-price bands are used to identify both market heterogeneity and transactional pricing errors.
Network Externality	The effect of other users on the value of a good for a given customer. Positive network externalities exist when the value of a good increases with the number of customers who purchase or use that good.

Term	Definition as used in Pricing Strategy
Neutral Pricing	The practice of pricing a new product within an existing product category within the zone of indifference at the offering's launch.
Normal Good	An economically-normal good is one for which the quantity demanded decreases as price increases.
Optional Equipment Effect	The practice of pricing of a base product relatively low to capture customers while simultaneously pricing the tied complements relatively high due to a lower price sensitivity of customers for these add-on units.
Order Bias	The change in selection that is related to the order in which offers are made. Anchoring upon initial offers and loss aversion coupled with a failure to adjust the frame of reference are said to lead to order bias.
Overconfidence Effect	(1) In making a purchase selection where the benefits derived will be dependent upon a change in future behavior, customers are often overconfident with respect to their ability to change behavior and derive value from the future use of the offering, and overconfident with respect to their ability to change their purchase selection in the future to a more economically-valued position. (2) The inability of customers' expressed behavior to match expected behavior with respect to their future self-control and future economic efficiency.
Paired Comparison	A juxtaposition of two offers that eases pragmatic evaluation. This method and its derivatives are used in conjoint analysis to reveal preferences.
Penetration Pricing	The practice of pricing a new product within an existing product category as value-advantaged at the offering's launch.
Perfect Competition	A state facing a firm where the elasticity of demand is infinite and therefore any increase in price removes all sales and any decrease in price adds an infinite number of sales, up to the industry level of demand. Also known as commodity market.
Price Bracketed	Customers which have both a price floor and price ceiling are said to be price-bracketed.
Price Bundle	The sale of two or more goods in a single transaction at a price which is below the sum price of the individual goods but above the price of any good within the bundle as a market wide offering. Distinct from other forms of bundling, price bundling bundles market segment to improve profits.
Price by Market Variable	A graphical depiction of the (net) price paid by different customer segments as defined by a market characteristic. Market characteristics can include both continuous and discrete variables. Can be used to identify more profitable market segments or to identify new criteria for granting discounts.

Term	Definition as used in Pricing Strategy
Price Ceiling	The maximum price a customer or customer segment can pay for an offering within a product category due to budget constraints.
Price Discrimination	See Price Segmentation
Price Floor	The minimum price a customer or customer segment would expect to pay for an offering within a product category, below which the customer would not believe the firm can credibly deliver the benefits claimed. Other authors refer to the price floor as the marginal cost.
Price Segmentation	Charging different customers or customer segments different prices for a relatively similar or same product category product or service.
Price Signaling	Communicating pricing actions in an open and public forum to customers and investors with credible evidence behind the communication.
Price Structure	The architecture around which prices are associated with transactions.
Price Waterfall	A graphical depiction of the types and depths of different forms of discounts provided to the market by the firm.
Price-to-Benefits Map	The positioning of products on a plane defined by their price on the vertical axis and the value of their benefits on the horizontal axis.
Price-to-Volume	A graphical depiction of the (net) price paid by different customers against the volume of purchases. Can be used to identify unprofitable transactions, clarify needed pricing rules, or encourage new sales initiatives.
Prisoner’s Dilemma	A method of anticipating both the firm’s moves and its competitors’ moves in order to identify the best competitive action or anticipate the effect of a competitive action and reaction.
Process Benefits	Benefits that derive from reducing transaction costs.
Product Engineered	In reference to price segmentation: product-engineered segmentation hedges are created by adding and subtracting different product features to define the price segments.
Product Life Cycle	The product category life cycle (rarely individual products) that divides the expected sequence of market events: introduction, growth, maturity, and death.
Profit Equation of the Firm	Profit is equal to the quantity sold times the difference between the price at which that quantity is sold and its variable cost to produce, less the firm’s fixed costs.
Profit Sensitivity Analysis	An examination of the change in the firm’s profits delivered by deliberately changing one of the variables in the profit equation of the firm and including any secondary impacts of that change to other variables within the profit equation of the firm.

Term	Definition as used in Pricing Strategy
Profit-Based Incentives	A salesperson incentive package that encourages more profitable transactions.
Promotional Bundle	A promotional discount on a combination of goods which must be purchased simultaneously in order to earn the discount.
Promotional Pricing	A form of price segmentation in which the price is temporarily lowered to encourage customer purchase.
Prospect Theory	A systematic study and set of results which describes many predictably irrational behaviors of people when selecting between prospective and uncertain outcomes. Applications of prospect theory are widely found in economics, consumer behavior, and sales tactics, and therefore have broad application to pricing strategy.
Protection Level	The number of seats protected or held for sale at a given fare class or higher.
Rank Ordering	Listing a set of offers in the order of preference. See Conjoint Analysis.
Rating Scale	A scale which allows respondents to reveal their preferences by rating their desire for an offer. This method is sometimes used in conjoint analysis.
Reference Price Effect	The role of a customer's reference price on their response to the current price. The reference price is any price which the customer may have expected to pay for an offering, including the price they last paid or the price of a competitive alternative. Prices above the reference price often decrease the quantity demanded. Prices below the reference price often increase the quantity demanded.
Relationship Benefits	Benefits that are conferred to customers through experience with the seller and may be created through an emotional connection.
Retention Rate	The proportion of customers who can be expected to purchase the next item in a sequence of purchases.
Revenue Management	(1) See Yield Management. (2) Any means of optimizing the revenue earned on a given fixed-cost asset.
Search Goods	In consumer behavior theory: goods for which the benefits derived from consumption can be made explicit prior to purchase.
Second-Degree Price Discrimination	Charging individual customers differently according to the quantity purchased.
Segmentation Hedge	In price segmentation, a method of segmenting the market according to willingness to pay that prevents customers who are willing to pay the high price or higher to purchase at the low price.

Term	Definition as used in Pricing Strategy
Shared Cost Effect	The reduction in price sensitivity of a customer or customer segment created through the perception, real or unreal, that part of the purchase price is paid for by a third party of the firm itself.
Signpost Pricing	Pricing a popular or frequently purchased good at a relatively low price point in order to signal to customers that the overall prices within the store are also relatively low. Sometimes referred to as loss-leader pricing or milk pricing.
Skim Pricing	The practice of pricing a new product within an existing product category as value-disadvantaged at the offering's launch.
Small Pie Bias	In negotiations, the belief of both negotiating parties that the value under negotiation is less than the true range of values that could be explored.
Software as a Service (SaaS)	A price structure in which software is purchased as a subscription and delivered as a service.
Stockpiling	A practice of holding inventory by customers or distributors to be used or sold at a later date. During a price promotion, stockpiling creates increased demand during the promotional period due to forward buying, which suppresses demand during the period after the promotion.
Strategic Price Segmentation	Price segmentation defined through the prices of offers or the price structure of the offering.
Subscription	A price structure in which a series of goods to be delivered over time are sold as a single item. Some authors have analyzed subscriptions as a form of price bundling; it is not positioned in this manner in Pricing Strategy due to the non-contemporaneous nature of the delivery of goods and the desire to clearly distinguish concepts.
Substitutes	Two goods for which the purchase of one good decreases the likelihood of the purchase of the second good. The goods can be products or services.
Superior Alternative	An offering is identified as being a superior alternative to its comparable alternative if the differential value is positive.
Switching Costs	Any product-specific psychological or financial investment that a customer makes in a firm's product that they have purchased in the past which reduces their willingness to select an alternative firm's products.
Tacit Knowledge	Knowledge held that cannot be easily codified or exchanged with others outside of experience or direct interaction with the knower.
Tactical Price Segmentation	Price segmentation that is situationally dependent. E.g. promotional discounts or customer-specific discounting.
Third-Degree Price Discrimination	Charging separate customer segments different prices where the segmentation hedges can be derived from different attributes, features, or benefits associated with the offer, or from attributes of the customer themselves.

Term	Definition as used in Pricing Strategy
Tied Complements	Complementary products for which one of the complementary goods is intended only to be used in conjunction with the other. Contrast with Independent Complements.
Tiered Price Structure	A price structure which attempts to price segment customers according to their willingness to pay for marginal improvements in attributes, features, and benefits. Tiered pricing is suggested when there is sufficient demand heterogeneity along a single dominant dimension.
Tit-for-Tat Pricing	Sequentially mirroring the price moves of a competitor.
Total Period Price	The total price a customer would for a collection of goods over the same period as that of a comparable subscription if the items were purchased independently.
Two-Part Tariff	A price structure in which a customer must buy both the durable and the consumable parts of the offer in order to derive value. The durable part of the offer will be priced relatively high to extract value from customers, while the consumable part will be priced relatively low but above the marginal costs per unit. At times, the price of the durable good is known as the entry fee and the price of the consumable good is known as the metered fee. Contrast with Tying Arrangement.
Tying Arrangement	A price structure in which a customer must buy both the durable and the consumable parts of the offer in order to derive value. The durable part of the offer will be priced relatively low to encourage purchase while the consumable part will be priced relatively high to extract value from customers. Under certain circumstances, tying arrangements are illegal. Contrast with Two-Part Tariff.
Unharvested Value	Positioning an offering value-advantaged when evidence demonstrates that the firm could raise its price without effect on the sales quantity demanded.
Value Equivalence Line	On a price-to-benefits map, products which offer improvements in benefits commensurate with an increase in price define the value equivalence line.
Value-Advantaged	A product or service that offers more benefits than the price extracted, relative to its competitive alternatives. In a price-to-benefits map, value-advantaged products would be positioned below the zone of indifference.
Value-Disadvantaged	A product or service which offers fewer benefits than the price extracted relative to its competitive alternatives. In a price-to-benefits map, value-disadvantaged products would be positioned above the zone of indifference.
Versioning	See Tiered Price Structure.

Term	Definition as used in Pricing Strategy
Vertical Price Fixing	Price agreements between firms at different points in the value chain.
Volume Hurdle	In conducting a profit sensitivity analysis of a price decrease, the volume hurled defines the minimum required volume increase for a price decrease to improve the firm's profits.
Willingness to pay	The amount of money a customer is willing to pay for an offer.
Yield Management	A price structure in which the price of the good increases as the time to purchase approaches the time of use. Yield management has been recommended for goods in which capacity is limited and perishable, customers can reserve units of capacity in advance, and the firm is able to sell the same capacity at different prices.
Zone of Indifference	The area around the value equivalence line at which small changes in price or benefits are associated with no substantial change in quantity sold or have inconsequential impact on the perceived relative value of the offerings.