1. “Listen, elasticity is important,” said the director of the aquarium, “but we borrowed $21.6 million (for 20 years, other fixed costs are $10,000 per month; total fixed costs per month are $100,000) to build the aquarium last year. We need to set a price of $16 to be able to pay our debt since variable costs are four dollars per person, and we use a standard markup of 300% of variable costs (current price is $12). I've already reduced my promotion budget to pay the debt. If last month's attendance is any indication (only 10,000 customers), we will have to raise prices and maybe eliminate promotion. We can estimate elasticity when the debt is paid, although I don't think it is important since we are the only aquarium within 150 miles. Furthermore, there are 4,000,000 people in the metropolitan area. If 50% of them visited the aquarium once (at $16 per person), we could pay off our debt immediately.”

Do you agree or disagree with the director's approach? Explain.

Note: The aquarium is open 30 days per month, eight hours per day. Do not limit your answer to price alone.

Secondary data (comparable city’s aquarium)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Price | Attendance | Quantity | (Q1 + Q2) / 2 | Price | (P1 + P2) /2 |
| $10 | 12,000 (12K) |  |  |  |  |
| $12 | 10,000 (10K) | 2K=(12K-10K) | 11K=(12K+10K) /2 | -2=(10-12) | 11=(10+12) /2 |
| $16 | 8,000 (8K) | 2K=(10K-8K) | 9K=(10K+8K) /2 | -4=(12-16) | 14=(12+16) /2 |

Elasticity: Breakeven:

Quantity / (Q1 + Q2) / 2 Fixed / Contribution Margin

Price (P1 + P2) / 2

Elasticity 10 to 12

Elasticity 12 to 16

**2.** The Tropical Paradise Resort is located on the coast of an exotic Pacific island. Room rates are $300 per night, which includes free access to the pool, gym, and tennis courts. The resort also offers the following services:

* Aerobics classes ($5 per)
* Therapeutic massages ($40 per)
* Scuba-diving trip to a nearby coral reef ($60 per)
* Day trips to an island volcano ($100 per trip)

The average stay is five days. The hotel is considering two pricing options:

1. Charge the regular room rate and charge separately for the four services above

2. Charge a higher room rate, which includes the services

The resort’s objective is to maximize long-term profits by attracting repeat and new customers. Should they price their services separately or bundle them? Why? Besides prices, what other factors are important in your decision?

**3**. Corben Inc. has a successful brand with the name Crunz. The market size in which Crunz competes is $4 billion, and Crunz has generated sales of $400 million. It has a contribution margin of 30% and annual fixed costs of $20 million. Corben Inc. is thinking of introducing a new brand under the name of Zaturn. Zaturn will compete in the same market as Crunz. The annual fixed costs for this brand are expected to be $40 million.

If it is launched, Zaturn will capture 10% of the market. It has a contribution margin of 40%. Half of the sales of Zaturn will be cannibalized from the sales of Crunz. An alternative strategy for Corben Inc. is to cancel the introduction of Zaturn and instead to spend the $40 million (on an annual basis) to promote Crunz. This action is expected to increase the sales for Crunz by 50%. Both brands (Cruz and Zaturn) sell at the same price.

Where should the company spend the $40 million and why? Show all calculations!