

**Atlantic Computers: A Bundle of Pricing Options**

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### MAR6805 - Marketing Management in the Global Environment

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**Executive Summary**

Atlantic Computer is a manufacturer of servers and high-tech products. They are facing high performance and basic servers as two segments in the server industry. Atlantic Computer Inc. holds a 20% share of its high-performance market with its Radia server as its premier product. However, the market for basic servers is growing, leading Atlantic Computer to develop and popularize a base server named Tronn and a software tool named Performance Enhancement Server Accelerator (PESA). PESA will allow Tronn to perform four times faster than standard speed and make it easier to access frequently requested information. Therefore, bundling Tronn and PESA is crucial.

At this point, the most important problem is that there are multiple approaches that could be utilized to develop the pricing strategy for the Atlantic Bundle for the exemplary customer. After analyzing on the four price strategy options, we believe the value-in-used pricing strategy is the most suitable one. We also predict what the competitor probably react and provide some countermeasures.

**Background**

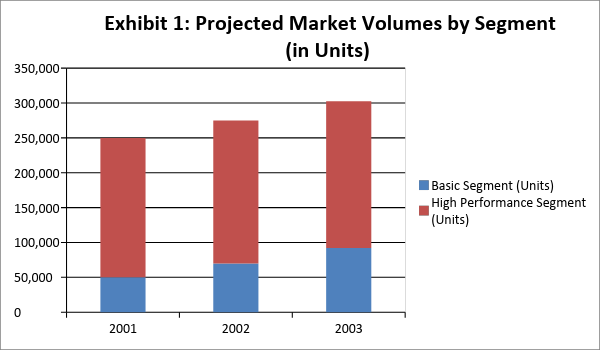
Atlantic Computer is a large manufacturer of servers and other high-tech products. It is the market leader for Radia products in traditional markets (two parts: traditional and basic server markets). Tronn servers are specifically designed to meet emerging market opportunities for basic server users. It also developed PESA (Performance Enhancement Server Accelerator), a software tool, and PESA increased the speed of Tronn servers four times faster than normal. The main purpose and focus of this report is to address these challenges by proposing the right price strategy. This report examines detailed quantitative and qualitative factors such as competition and customer needs and makes recommendations.

**Problem Statement**

The new Tronn server and PESA software tool called Atlantic Bundle require a market pricing strategy that fits the product. The challenge is to attract customers in terms of price, performance efficiency, reliability and quality beyond direct and major competitors. The main competitor in the basic segment is Ontario, whose Zinc product occupies 50% of the basic server market. Ontario's business model allows the company to introduce non-value-added costs so that it can compete in price. Other competitors in the basic server market are made up of many small players.

**Analysis**

**Option 1   Status Quo Pricing**



Note: On page 6, in the small print, you will find the Atlantic’s Market Share of the basic server segment (in units) will be 4% in 2001, 9% in 2002, and 14% in 2003.

|  |  |  |  |
| --- | --- | --- | --- |
|  | | | |
|  | 2001 | 2002 | 2003 |
| Market Demand (units) | 50,000 | 70,000 | 92,000 |
| Atlantic Market Share | 4% | 9% | 14% |
| Atlantic Demand (units) | 50,000(0.04)=2,000 | 70,000(0.09)=6,300 | 92,000(0.14)=12,880 |
| Price Per Server | $2,000 | $2,000 | $2,000 |
| -Cost Per Server | $1,538 | $1,538 | $1,538 |
| Gross Profit | $462 | $462 | $462 |
| Gross Margin | 23.1%=($462/$2000) | 23.1%=($462/$2000) | 23.1%=($462/$2000) |
| Tronn Sales Price | $2000 | $2000 | $2000 |
| Market Share (Units) | 2,000 | 6,300 | 12,880 |
| Projected Sales (Units) | 4,000,000 | 12,600,000 | 25,760,000 |
| Less Cost | $3,076,000 | $9,689,400 | $19,809,440 |
| Net Income | $924,000 | $2,910,600 | $5,950,560 |
| R&D PESA Cost | 2,000,000.00 |  |  |
|  |  |  |  |
| **Total Profit** | **$7,785,160** |  |  |

**Pros**:

* Very Low Price, Customers like
* Traditional Approach, good for senior member

**Cons:**

* Traditional Approach, bad for new generation of members
* Losing Money
* Lose value for PESA software
* Does not cover the cost

**Option 2   Competitive Based Pricing**

Charge a price equal to what the customer would pay for four Ontario Zink servers

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2001 | 2002 | 2003 |
| **Price Per Bundle** | **$6,800** | **$6,800** | **$6,800** |
| Market Share | 50,000 | 70,000 | 92,000 |
| Market Demand Rate | 4% | 9% | 14% |
| Market Demand | 2,000 | 6,300 | 12,880 |
| Sales Revenue | 13,600,000.00 | 42,840,000.00 | 87,584,000.00 |
| Cost Per Tronn | 1,538.00 | 1,538.00 | 1,538.00 |
| Total Server Cost | 3,076,000.00 | 9,689,400.00 | 19,809,440.00 |
| Net Income | 10,524,000.00 | 33,150,600.00 | 67,774,560.00 |
| Per Unit Profit | 5,262.00 | 5,262.00 | 5,262.00 |
| R&D PESA Cost | 2,000,000.00 |  |  |
|  | | | |
| **Total Profit** | **109,449,160** |  | |

Competition-Based pricing is a pricing method in which a seller uses prices of competing products as a benchmark instead of considering own costs or the customer demand. In this case, Atlantic’s Tronn was going to compete directly against Ontario’s Zink. And the beta test had confirmed that the PESA allowed Atlantic’s low-end servers to perform up to four times faster than their standard speed when loaded with the PESA software tool. That meant that a business customer could conceivably receive the same level of performance by buying one Tronn loaded with the PESA as compared to buying four basic servers. The price of Ontario’s Zink servers is $1700, and one “Atlantic Bundles” is equivalent to four of Ontario’s Zink servers. Therefore, under the Competition-Based Pricing, the price of one “Atlantic Bundles” would be $1700 x 4 which is $6800. While selling at this price would generate more profits for Atlantic Computers, it is not certain that consumers would purchase the “Atlantic Bundle” at this price.

The Pros of the strategy are that if it works, it's extremely profitable and it gives customer a sense of saving where they only need one Atlantic Server unit instead of purchasing four. And delivers value in cost savings associated with having one server instead of four.

In contrast, consumers would see that they are only getting one Tronn servers at a price that they could get four Zink servers. They may perceive four servers are more powerful. On the other hand, customer may expect a lower price with one server which has less power. Which means customer do not want to spend extra money on the product or service that they do not need. Furthermore, there should be a discount associated with the reduced material costs.

Conclusion, customers would likely not consider purchasing the “Atlantic Bundle” based on Competition-Based pricing because they would not see it as a fair price.

**Option 3   Cost-plus pricing**

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2001 | 2002 | 2003 |
| Price of Tronn | 1,999.40 | 1,999.40 | 1,999.40 |
| PESA | 245.51 | 245.51 | 245.51 |
| **Sales Price** | **2,244.91** | **2,244.91** | **2,244.91** |
| Market Share | 50,000 | 70,000 | 92,000 |
| Market Demand Rate | 4% | 9% | 14% |
| Market Demand | 2,000 | 6,300 | 12,880 |
| Sales Revenue | 4,489,829.27 | 14,142,962.21 | 28,914,500.52 |
| Cost Per Tronn | 1,538.00 | 1,538.00 | 1,538.00 |
| Markup(30%) | 461.40 | 461.40 | 461.40 |
| Cost PESA | 188.86 | 188.86 | 188.86 |
| Markup(30%) | 56.66 | 56.66 | 56.66 |
| Cost Per Bundle | 1,726.86 | 1,726.86 | 1,726.86 |
| Total Server Cost | 3,076,000.00 | 9,689,400.00 | 19,809,440.00 |
| Net Income | 1,413,829.27 | 4,453,562.21 | 9,105,060.52 |
| Per Unit Profit | 706.91 | 706.91 | 706.91 |
| R&D PESA Cost | 2,000,000.00 |  |  |
| Price Per Server | 2,244.91 | 2,244.91 | 2,244.91 |
| -Cost Per Server | 1,538.00 | 1,538.00 | 1,538.00 |
| Gross Profit | 706.91 | 706.91 | 706.91 |
| Gross Margin | 31.49% | 31.49% | 31.49% |
|  |  |  |  |
| **Total Profit** | **14,972,452.00** |  |  |

**Pros:**

* No change in strategy
* Proven to be profitable
* Does better job of factoring in the costs associated with the software development
* More accurate representation of what Atlantic Computers is selling with the basic server.
* Force the Atlantic Bundle, ensuring that the server is maximizing on its performance
* Lower price than the sale of four Zink servers

**Cons:**

* Leaves money on the table (low revenue and difficult to cover costs)
* Second lowest price per unit profit ($707)
* Second lowest revenue
* Second highest breakeven point (units); harder to cover fixed costs.

Cost-plus pricing is determined by adding the direct, indirect and fixed costs associated with a product and converting it into a per-unit cost for the product. A predetermined percentage is then added to these costs to provide a profit margin. The cost of a Tronn server is $1,538 and based on a $1,999.40 ($1,538+ 461.40) price, this additional markup is approximately 30% ($1,538\*30%= $461.40). Adding 30% to the cost of PESA would make the price $188.86 (R&D PESA Cost/ Half Number of the Market Demand= 2,000,000/(2,000+ 6,300+ 12,880)/2 ). As the chart above shows, under the cost-plus method, the price of a Tronn loaded with PESA would be $2,244.91 which is $518.05 ($2,244.91- 1,538-188.86) above the Zink server. Because we are looking at this conservatively, we will assume that one or two Tronn servers are the equivalent of four Zink servers. Therefore, it would cost $4,489.82 ($2,244.91\*2) as compared to $6,800 for the 4 Zink’s price of servers. Again, It would be difficult for Atlantic to persuade customers to purchase the servers based on the Cost-Plus pricing because customers would still only see that they are getting two servers for $4,489.82 whereas they could get two Zink servers for $3,400 and that is $1,089.82 (=$4,489.82- 3,400) more expensive than Ontario’s Zink servers. Without further justification, customers are not likely to accept this additional cost.

For the cost-plus approach, some assumptions will need to be made about the expected sales volume, the PESA attach rate, the time period, and the margin. Given Atlantic’s production constraints, the firm will only be able to produce a limited number of basic servers in the near term. Assume that the firm will be able to sell all of the Tronn servers it can produce, and that Atlantic’s resulting share of the basic server segment (in units) will be 4% in 2001, 9% in 2002, and 14% in 2003. On these shipments, assume a 50% attach rate (i.e., half of all of their basic servers sold will be loaded with the PESA) since this is an entirely new concept and some basic servers are used for applications that will not benefit from PESA. Assume that Atlantic’s software development costs for the PESA will be paid off over three years. Last, target a 30% markup above costs.

**Option 4   Value-in-Used Pricing**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Aggressive | Conservative |  |
| 1 Tronn | 2 Tronn | 4 Zink |
| Price of servers | $2,000 | $4,000 | $6,800 |
| Electricity | $250 | $500 | $1,000 |
| Cost of licenses | $750 | $1,500 | $3,000 |
| Labor fee | $2,000 | $4,000 | $8,000 |
| Total price | $5,000 | $10,000 | $18,800 |
| Total Savings | $13,800 | $8,800 |  |
| 50-50 sharing | $6,900 | $4,400 |  |
| **Price per bundle** |  | **$4,200** |  |
|  | | | |
|  | 2001 | 2002 | 2003 |
| Market Demand | 2,000 | 6,300 | 12,880 |
| Cost per server | $1,538 | $1,538 | $1,538 |
| Total Cost | $3,076,000 | $9,689,400 | $19,809,440 |
| Sales Revenue | $8,400,000 | $26,460,000 | $54,096,000 |
| Net Income | $5,324,000 | $16,770,600 | $34,286,560 |
| Break-even units | 1156 |  |  |
| R&D Cost | $2,000,000 |  |  |
| **Total Profit** | **$54,381,160** |  |  |

* The customers will pay less for the same performance against four Zink servers.
* This method will bring high profit, and also can attract customers by showing the benefits on the savings.
* Avoid the price war that the Atlantic Computer is likely to be put in a bad situation. The cost per server of Tronn is $1,538 and the price per server of Zink is $1,700.
* This price associated with the cost of operating the product such as electricity costs and cos of application software licenses.
* The price is higher than the Option 1, Option 3 and the opponent’s price.
* This method may need more cost on integrated marketing communications and training with sales force.
* The special price will break the original market rules and facing potential risks.

Value-in-use pricing is a method of setting prices in which an attempt is made to capture a portion of what a customer would save by buying a firm’s product. For this case, we assume a 50-50 sharing of the savings gain with the customer. In addition, the average life of an Atlantic basic server is estimated to be three years, so we use the conservative per annum estimate. F

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Price Per Bundle** | **Revenue** | **Total Cost** | **Profit** |
| **Option 1** | **$2,000** | **$42,360,000** | **$34,574,840** | **$7,785,160** |
| **Option 2** | **$6,800** | **$144,024,000** | **$34,574,840** | **$109,449,160** |
| **Option 3** | **$2,245** | **$7,547,292.00** | **$34,574,840** | **$14,972,452.00** |
| **Option 4** | **$4,200** | **$88,956,000** | **$34,574,840** | **$54,381,160** |

**Recommendations and Conclusions**

Analysis The new Tronn server and PESA software tool called Atlantic Bundle require a market pricing strategy that fits the product. The challenge is to attract customers in terms of price, performance efficiency, reliability and quality beyond direct and major competitors. The main competitor in the basic segment is Ontario, whose Zinc product occupies 50% of the basic server market. Ontario's business model allows the company to introduce non-value-added costs so that it can compete in price. Other competitors in the basic server market are made up of many small players.

Which market should be targeted?

The target market for the “Atlantic Bundle” would be those companies that do a lot of web hosting. It is when the Tronn Server is acting as a web-server and coupled with PESA that the “Atlantic Bundle” is capable of realizing its true potential of being 4 times as fast as the basic server. Additionally, those companies who do a lot of file sharing would also benefit from the “Atlantic Bundle” as it would still enjoy an increase in performance equivalent to 2 basic servers.

.How are customers likely to respond?

At first, customers are likely to question Atlantic Computers’ reasoning for deviating from the tradition of providing performance enhancing/monitoring tools for free. This may be one of the more difficult tasks associated with pricing the “Atlantic Bundle.” Atlantic Computers will have to demonstrate to customers that the PESA software tool essentially doubles and possible quadruples the number of basic Tronn servers. They will need to emphasize that not only are they saving on the number of servers they will need to purchase, but they will also save on other costs. Atlantic Computers will also need to emphasize that it will continue to provide excellent service after purchase and provide customers with peace of mind.

How will Ontario’s top management likely respond?

Short run vs. Long Run

After the first year, it is projected that the “Atlantic Bundle” will only take approximately 4% of the market share of the basic share market. It is unlikely that Ontario would be concerned at this time and would not take any steps to counter-act. It would take until at least the second year and likely the third year before Ontario would begin to take action. At this moment, Ontario’s reaction would be to lower prices in order to stop market loss.

Of course, Ontario will only be able to lower prices for a short period of time before such actions begin to drastically decrease their profits. Ontario will likely begin to copy the PESA software and begin to include it in their Zink server packages. At this time, Atlantic Computers will have recouped much of the research and development costs associated with PESA and can begin to include the software as part of the “Atlantic Bundle” at no charge.

Other problems associated with using Value-in-use pricing.

After years of providing software tools for free with servers, it will take some persuading to get veteran salespeople on board with the value-in-use pricing method. This is especially true because the salespeople derive 30% of their pay off of commission. They know that they will sell more volume if they are able to sell at a lower price. Training the salespeople to show customers exactly the value they will be getting will help the salespeople understand that they will essentially be able to sell more servers at a higher cost, thereby making more money off of commission. The salespeople will need to also demonstrate points of difference between the “Atlantic Bundle” and the next best alternative. Finally, the salespeople will need to stress the fact that customers will continue to get excellent service after the initial purchase.

Conclusion:

Atlantic Computers has decided to enter into the emerging U.S. market for basic servers. It has developed the “Atlantic Bundle” which consists of a Tronn Server and the PESA software which enables the Tronn Server to perform at the rate of four of their competitor’s basic servers. Of the four available pricing options, status quo, competition based, cost-plus and value-in-use pricing, it is recommended that Atlantic Computers implement the value-in-use pricing method. This will allow Atlantic Computers to maximize their profits by demonstrating the value of the “Atlantic Bundle” to the customer. By showing savings of $3,200 compared to the Zink server, Atlantic will be able justify the added costs.

References

Last Name, F. M. (Year). Article Title. *Journal Title*, Pages From - To.

Last Name, F. M. (Year). *Book Title.* City Name: Publisher Name.

Footnotes

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Tables

Table 1

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