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METHODS OF PRICING

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Abstract:

Determining prices – and overall pricing strategies – is one of the toughest challenges most businesses face. Should you be the low-price provider? Should you charge premium prices for premium products or services? What happens if competition enters – or leaves – your marketplace? Many business owners default to a common position: They determine what the competition charges and then try to either meet or beat those prices. Over the short term that approach can be successful, but since many customers make purchase decisions based on considerations other than price, low-cost providers sometimes struggle to attract customers who make decisions based on a comparison of price and value.

Keywords; Cost, Demand, Competitive, Oriented, Pricing.

INTRODUCTION

To develop a pricing strategy, the first step is to gather data:

- Competitor prices and pricing strategies
- Customer perception of products and services
- Customer benefits of products and services
- Cost of producing, procuring, or generating products and services (variable costs)
- Fixed business costs (overhead)

The goal is to understand your business model and operating costs as well as the current pricing strategies and price points in the marketplace.

Basic Pricing Methods

There is no "one right way" to calculate your pricing. Once you have data in hand, apply one or more pricing methods to the specific business and market:
The various methods available for setting consumer products are:

1.Cost-Oriented Pricing

The executives of some firms especially the owners of small firms which manufacture to order are virtually obliged to use cost-plus pricing. Cost plus also known as full cost involves taking the total cost of production and adding on a fixed percentage of profits as expressed in the following formula.

Price = Cost of Production + Profit Margin
(Fixed Costs + variable Costs) (Percentage)

The percentage of profit is determined by the management before. Such a percentage may vary from industry to industry and firm to firm within the same industry. It is used mostly by retailers and heavy industry, less often by packaged goods. The advantage of cost-plus pricing is simplicity and quite probably, less price competition between firms.

But the limitations of the methods are overwhelming for producers in highly competitive markets, since it does not take into account consumer or competitive reaction. Further it fails to pay any attention towards the demand curve for the product. A price increase due to cost pressure may reduce sales volume resulting in the decrease of profit.

2. Demand-Oriented Pricing

This strategy determines the price on the basis of demand of the product. In fact it is a better method as it takes the market response into account. The philosophy of this strategy is to charge high price in high demand and low price in low demand, regardless of fluctuations in unit costs. Thus, it suggests pricing on the basis of consumer reactions rather than costs.

3.Competitive Pricing

Many firms determine their prices on the basis of competitors pricing structure. It does not mean that a firm will necessarily adopt the same price structure as its competing firms but that it will give due consideration to competitor’s price than cost and demand factors.

A firm has two alternatives either to frame its prices in line with those of its competitors or below or above it. Thus, under such strategy a firm strictly follows the competitor’s pricing regardless of fluctuations in production cost or in demand.

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