Price setting

Pricing

Pricing objectives

1. **Profit Oriented**

-To gain and maximize profit

2. Sales Oriented

-To increase sales and to keep or increase the market share

3. Status Quo-Oriented

- To be potential competitors

- To stabilize the market

Price setting procedures or steps

1. Selecting the price Objectives
2. Determining Demand
3. Estimating Demand
4. Analyzing Competitors prices & offers
5. Selecting pricing method
6. Selecting final price

Price setting methods

1. Cost related Price.

- Cost-plus profit
- Break even price
- Marginal pricing

2. Market related or value based pricing

- Perceived value pricing
- Psychological pricing
- Promotional pricing
- Skimming pricing

3. Competitors related pricing

- Discounting pricing
- Penetration pricing
- Dumping pricing

1. Cost related pricing

1.1. cost-plus-profit

It is adding mark-up from the costs

- Mark-up price= $\dfrac{\text{Unit price}}{1-\text{ Desired return}}$

For example if the unit price is 16 birr and the organization assumed to set the price by adding 20% from there cost. So what is the mark —up price and the mark-up.

Mark up price — unit price = mark up

1.2. Break even pricing

It is the price setting by covering all costs related to the business.

$$B.E.P = \frac{\text{Fixed cost}}{\text{Quantity}} + \text{Variable Cost}$$

Example: if one cooperative fore one Kg onion paid 12 Birr the variable cost and 60,000 fixed cost and the cooperative purchase 10,000 Kg. so what are the mark-up price

$$\frac{60{,}000.00 \text{ birr}}{10{,}000 \text{ Kg.}} + 12.00 \text{ birr}$$

$$= 6+12$$

$$= \underline{18.00} \text{ Birr per Kg}$$

1.3. Marginal pricing

It is a method of pricing. Which is setting a price by adding all costs in each product or service and plus some margin.

If the cooperatives are covered their fixed and variable cost that those incurred in the product they have the cost for the additional product or services are the variable cost. So the price above the variable costs are the profit.

BASIC METHODS OF DETERMINING PRICE

1. Price based on total cost plus a desired profit
2. Price based on a balance between estimates of market demand and supply (the costs of production and marketing)
3. Price based on competitive market conditions

Cost-plus pricing

- With cost – plus pricing the marketer determines the price of are unit of a product by computing the unit's total cost plus the designed profit on the unit.
- In general the steps for computing cost-plus pricing one to estimate the number of units to be produced, calculate fixed and variable costs and add a predetermined profit to costs.
- The formula for cost-plus pricing is

$$\text{Price} = \frac{\text{Total fixed cost + Total variable cost + projected profit}}{\text{Units produced}}$$

Price Based on market demand and cost of production and marketing

Break-even Analysis

- One way to use market demand and still consider costs in price determination is to conduct a break-even analysis and determine break even points. A break-even point is the quantity of output at which the sales revenue equals the total costs, assuming a certain selling price. Sales of quantities above the break-even point result in a profit on each additional unit. Sales below the break-even point result in a loss to the seller.
- Break-even analysis examines the relationship among costs, revenues and profits. Let us assume that

P = unit price, Q = Quantity , R = Revenue (p x Q), F = Fixed cost, V = variable cost per unit

TC = Total cost (F + VQ)

Break-even point – R = TC

$$PQ = F + VQ$$

$$PQ - VQ = F$$

$$Q(P - V) = F$$

$$Q = F/P-V$$

$$\text{Break-even point in units} = \frac{\text{Total Fixed cost}}{\text{Price} - \text{variable cost per unit}}$$

Break even point can also be used in sales volume, this can be dome by first determining the price.

$$BEP = \frac{\text{Fixed cost}}{\textbf{Variable cost per unit}}$$

$$BEP = \frac{F}{1 - \frac{V}{P}}$$

Market demand

If the demand curve lies below the break-even point, we incur loss. Higher price does not necessarily indicate maximum profit and vice-versa. To find the optimum price, which can generate maximum profit, a firm looks for the break-even points that pass along the demand curve, and should choose the break-even point with maximum vertical distance from the total cost line.

Price determined in relation to market alone

Cost- plus pricing is one extreme among pricing methods. At the other end of the scale is a method where by a firm’s prices are sets in relation only to the market price disregarding cost. This method is used to meet competition or it may be set either above or below the market price.

Pricing above the market

This is based on charging prices that are higher than those of competitors. It may also be referred to as skimming pricing when producers introduce a new product. The producer charges a high price during the introductory stage, and later reduces it when the product is no longer a novelty and competition heats up. The price is set high relative to the cost, which results in high gross profit. Consequently, it often attracts competitors. Companies, which adopt a skimming policy, try to cover their development costs as quickly as possible through high initial prices.

Pricing below the market

Charging prices, which are below those of competitors, is called pricing below the market. It is also called penetration pricing. Producer’s charges a low price during the introductory stage and plan to get back to the initial investment through big sales. It may be economical because producing large quantities- production oriented approach-saves money. This policy is practiced by a company coming in to a market in which competitors are well established.

Pricing with the market

Premium pricing is another name for pricing with the market. It is charging prices that match with the market or those of competitors. By pricing with the market producers avoid tremendous effort required to find out what the consumer would actually pay. This pricing also creates a business climate in which all firms can avoid the unpleasantness of price competition. Companies prefer to compete through brand differentiation rather than through price competition although competitors gain a small profit per unit.

PRICING PROCEDURES

The procedures to determine the price of a certain product are similar for a new and existing products. In fact to set price for a new product is more difficult than for already established products. The pricing procedures adapted by many firms are following.

- **Estimation of demand for a product**

Demand estimation is an important step in pricing a product. It is easier to estimate the demand for an established product than for a new one. Two steps in demand estimation are first, to determine the expected prices. And second to estimate the sales volume at different prices.

- The expected price for a product is the price at which consumers consciously or unconsciously value it looking the expected price from the point of view of consumers. The expected price is usually expressed as a range of prices, rather than as a specific amount. It is possible to set a price too low but if the price is much lower than the market expects sales may be lost because consumers may be suspicious about the quality of the product or their self-concepts will not let them to buy such low-priced merchandise. To set appropriate expected price a firm has to use the following sources:
- approaching experienced middlemen
- judgment of potential customers
- approaching an engineer working with prospective products
- Marketing the product in a limited area – the most effective but costly method.
- In obtaining the expected price using different sources firms may be faced with two problems. First, the expected price may be below the cost of the product. Even if it equals the cost the firm does not generate profit and is faced with heavy resistance. This problem can be overcome by introducing more attractive product features to the product, and under taking different promotional activities that can increase the apparent price of the new product.
- The second problem is the intended price may be less than the expected price. It is possible to set a price too low but sales may be lost because consumers may be suspicious about the quality of the product or their self-concepts will not let them to by such low-priced merchandise.
- The second step in estimating the demand for a product is estimating sales at various prices. Determine the expected sales volume to conduct market testing, offering the product at a different price in each market and measuring consumer purchases at these different prices. Or some firms can get these estimates by surveying their wholesalers and retailers.

Anticipate competitive reactions

- Present and potential competition is an important influence in determining a base price. Even a new product is distinctive for only a limited time, until the inevitable competition arrives. The threat of potential competition is greater when the field is easy to enter and the profit prospects are encouraging. Competition can also come from three other sources:
- Directly similar products – metal (aluminum and iron)
- Available Substitutes _ plastic Vs metal
- Unrelated products _ two different products with similar money value

Consider company marketing policies

- In setting a price management should take into account the impact of different marketing policies and considerations. The policies concerning the product and its attributes, the channels selected and the types of middlemen used; and the promotional methods used, and the extent to which the product is promoted by the manufacturer or middlemen are of significant impact on pricing.

Select pricing strategy to reach the market

- The most dominant and basic pricing strategies are of three types: skimming, penetration, and premium pricing strategies.

Select a specific price.

- Based on an appropriate method(s) assumed by the firm, we select a specific price that best matches the market and generates higher profit.