Course: BBA Part II

Paper: IX

Topic: Methods of Pricing

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Methods of Pricing

The two methods of pricing are as follows: A. Cost-oriented Method B. Market-oriented Methods.

There are several methods of pricing products in the market. While selecting the method of fixing prices, a marketer must consider the factors affecting pricing. The pricing methods can be broadly divided into two groups—cost-oriented method and market-oriented method.

A. Cost-oriented Method:

Because cost provides the base for a possible price range, some firms may consider cost-oriented methods to fix the price.

Cost-oriented methods or pricing are as follows:

1. Cost plus pricing:

Cost plus pricing involves adding a certain percentage to cost in order to fix the price. For instance, if the cost of a product is Rs. 200 per unit and the marketer expects 10 per cent profit on costs, then the selling price will be Rs. 220. The difference between the selling price and the cost is the profit. This method is simpler as marketers can easily determine the costs and add a certain percentage to arrive at the selling price.

2. Mark-up pricing:

Mark-up pricing is a variation of cost pricing. In this case, mark-ups are calculated as a percentage of the selling price and not as a percentage of the cost price. Firms that use cost-oriented methods use mark-up pricing.

3. Break-even pricing:

In this case, the firm determines the level of sales needed to cover all the relevant fixed and variable costs. The break-even price is the price at which the sales revenue is equal to the cost of goods sold. In other words, there is neither profit nor loss.

4. Target return pricing:

In this case, the firm sets prices in order to achieve a particular level of return on investment (ROI).

5. Early cash recovery pricing:

Some firms may fix a price to realize early recovery of investment involved, when market forecasts suggest that the life of the market is likely to be short, such as in the case of fashion-related products or technology-sensitive products.

Such pricing can also be used when a firm anticipates that a large firm may enter the market in the near future with its lower prices, forcing existing firms to exit. In such situations, firms may fix a price level, which would maximize short-term revenues and reduce the firm’s medium-term risk.

B. Market-oriented Methods:

1. Perceived value pricing:

A good number of firms fix the price of their goods and services on the basis of customers' perceived value. They consider customers' perceived value as the primary factor for fixing prices, and the firm's costs as the secondary.

The customers' perception can be influenced by several factors, such as advertising, sales on techniques, effective sales force and after-sale-service staff. If customers perceive a higher value, then the price fixed will be high and vice versa. Market research is needed to establish the customers' perceived value as a guide to effective pricing.

2. Going-rate pricing:

In this case, the benchmark for setting prices is the price set by major competitors. If a major competitor changes its price, then the smaller firms may also change their price, irrespective of their costs or demand.

The going-rate pricing can be further divided into three sub-methods:

a. Competitors 'parity method:

A firm may set the same price as that of the major competitor.

b. Premium pricing:

A firm may charge a little higher if its products have some additional special features as compared to major competitors.

c. Discount pricing:

A firm may charge a little lower price if its products lack certain features as compared to major competitors.

The going-rate method is very popular because it tends to reduce the likelihood of price wars emerging in the market. It also reflects the industry's coactive wisdom relating to the price that would generate a fair return.

3. Sealed-bid pricing:

This pricing is adopted in the case of large orders or contracts, especially those of industrial buyers or government departments. The firms submit sealed bids for jobs in response to an advertisement.