

THE FACTORS THAT INFLUENCE THE PRICING OF A PRODUCT OR SERVICE

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Annotatsiya

Ushbu maqola boshqaruv hisobi doirasida kompaniyaning kelajakdagi foydasini ta'minlashda narx belgilashning ahamiyatini tahlil qiladi. Narx belgilash ko'pchilik korxonalar uchun asosiy maqsad bo'lgan foydani maksimal darajada oshirishda muhim rol o'ynaydi. Tovar va xizmatlarni tannarxidan yuqori narxda sotish orqali foyda olinadi, sotiladigan miqdor esa ko'pincha belgilangan narxga bog'liq bo'ladi.

Kalit so'zlar: optimal narx; talab elastikligi; xarajat funksiyasi; "cost-plus" narx belgilash; standart xarajat; to'liq xarajat; tegishli xarajatlar; foyda.

Аннотация

В данной статье анализируется значение ценообразования для будущей прибыли компании в рамках управленческого учёта. Ценообразование играет ключевую роль в максимизации прибыли — главной цели большинства предприятий. Компании получают прибыль, продавая товары и услуги по цене, превышающей их себестоимость, при этом объём продаж во многом определяется установленной ценой.

Ключевые слова: оптимальная цена; эластичность спроса; функция издержек; ценообразование «cost-plus»; стандартные издержки; полные издержки; релевантные издержки; прибыль.

Abstract

This article analyzes the importance of pricing in company's future profit in management accounting. Because it makes a vital contribution to profit maximization – the overriding aim of most businesses. Businesses make profits by selling goods and services at a price higher than their cost. The amount that they are able to sell will often be determined by the price charged for the goods and services.

Keywords: Optimum price, elasticity of demand, cost function, cost plus pricing, standart cost, full cost, relevant costs, profit

INTRODUCTION

The price that a business can charge for its products or services will be determined by the market in which it operates. In a perfectly competitive market, every buyer or seller is a 'price taker', and no participant influences the price of the product it buys or sells. Other characteristics of a perfectly competitive market include:

- Zero entry/Exit barriers — It is relatively easy to enter or exit as a business in a perfectly competitive market.
- Perfect Information — Prices and quality of products are assumed to be known to all consumers and producers.
- Companies aim to maximise profits — Firms aim to sell where marginal costs

meet marginal revenue, where they generate the most profit.

- Homogeneous products — The characteristics of any given market good or service do not vary across suppliers.

Imperfect competition refers to the market structure that does not meet the conditions of perfect competition. Its forms include:

- Monopoly, in which there is only one seller of a good. The seller dominates many buyers and can use its market power to set a profit-maximising price. Microsoft is usually considered a monopoly.

- Oligopoly, in which a few companies dominate the market and are interdependent: firms must take into account likely reactions of their rivals to any change in price, output or forms of non-price competition. For example, in the UK, four companies (Tesco, Asda, Sainsbury’s and Morrisons) share about 70% of the grocery market (as per January 2022 figures).

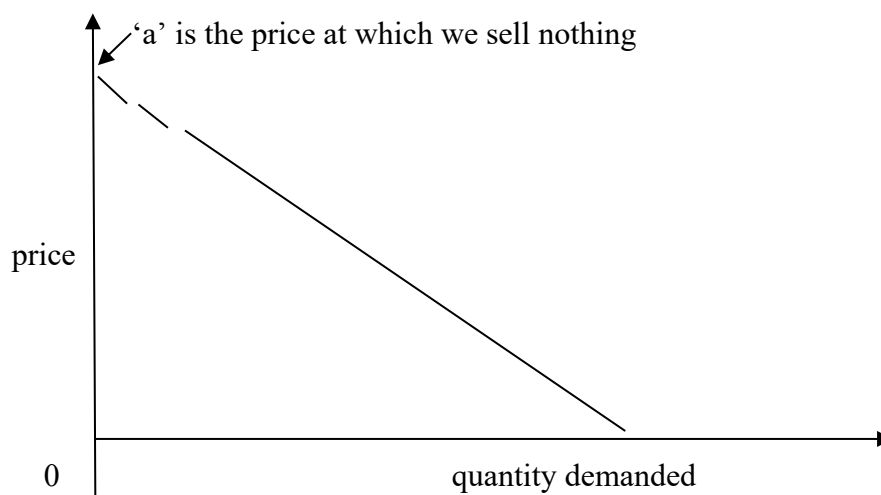
- Monopolistic competition, in which products are similar, but not identical. There are many producers (‘price setters’) and many consumers in a given market, but no business has total control over the market price.

Pricing decisions may be separated into three approaches¹:

- 1) Demand-based approaches
- 2) Cost-based approaches
- 3) Marketing-based approaches

METHODOLOGY

Most firms recognize that there exists a relationship between the selling price of their product or service at the demand. By investigating and analyzing this relationship it is possible, in theory, to establish an optimum price. This relationship can often be described by an inverse, linear relationship:



Picture 1. The relationship between price and demand²

¹ Kaplan ACCA performance management financial limited 2023

² Author’s work

There are also two methods of solution to problems investigating the relationship between price and demand: the algebraic approach, and the tabular approach.

Economic theory states that the monopolist maximizes profit when marginal cost equals to marginal revenue.

Establish the linear relationship between price (P) and quantity demanded (Q). The equation will take the form:

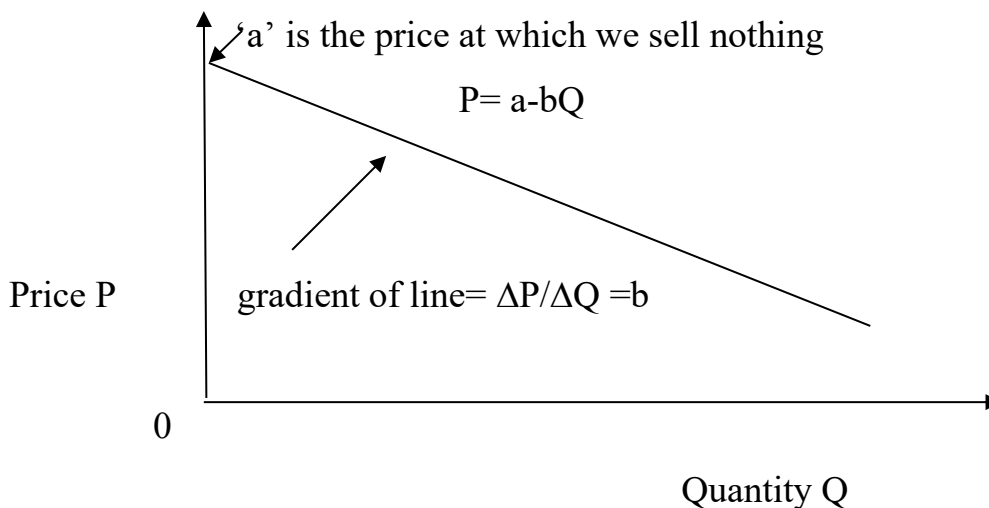
$$P = a - bQ$$

Where:

– ‘a’ is the intercept – here the maximum theoretical price at which demand will fall to zero

– ‘b’ is the gradient of the line – here the amount the price has to change to change the demand by one unit. Since, as the price of a product increases, the quantity demanded will decrease; and the demand increases when the price drops, the elasticity ‘b’ has a negative value, but it is usual to ignore the minus sign.

The equation of a straight line $P = a - bQ$ can be used to show the demand for a product at a given price:



Picture 2. Demand for a product at a given price¹

‘b’ is always negative because of the inverse relationship between price and quantity. Double the gradient to find the marginal revenue — $MR = a - 2bQ$. Establish the marginal cost MC. This will simply be the variable cost per unit. To maximize profit we should equate MC and MR to solve to find Q. Substitute this value of Q into the price equation to find optimum price. It maybe necessary to calculate the maximum profit.

Price elasticity measures how responsive demand is to a change in price. The price alasticity of demand measures the proportional or percentage change in demand as a result of a corresponding proportional or percentage change in price. It can be calculated dividing change in quantity demanded, as a percentage of demand into

¹ Author's work

change in price, as a percentage of the price.

- If the % change in demand > the % change in price, then price elasticity > 1. Demand is elastic, very responsive to changes in price. When the price is reduced, total revenue increases, and when price is increased total revenue decreases. Therefore, price increases are not recommended but price cuts are recommended.

- If the % change in demand < the % change in price, then price elasticity < 1. Demand is inelastic, not very responsive to changes in price. When the price is reduced, total revenue decreases, and when price is increased total revenue increases. Therefore, price increases are recommended but price cuts are not recommended.

A tabular approach to price setting involves different prices and volumes of sales being presented in a table. When data in the exam is given in tabular form and there is no simple linear relationship between output and profit – the tabular approach is likely to be the best to define optimum profit and the associated selling price. Then it makes sense to calculate the profit for each price and quantity combination, and finally select the price at which the level of profit is maximized.

ANALYSIS AND RESULTS

Many businesses adopt simple cost-plus pricing techniques: Price = cost per unit + chosen margin or mark-up. There is a difference between a mark-up and a margin. A mark-up is the profit expressed as a percentage of cost (cost is 100%). A margin is the profit expressed as a percentage of the sales price (sales is 100%). When using cost-plus pricing the following options are available:

- Actual or standard cost — The advantage of using standard costing is that prices can be set in advance and fixed for the period concerned. This makes marketing simpler and may attract customers who value knowing exactly how much they will pay. The main disadvantage is that if significant variances occur, then the price may have been set too low and a loss ensues. The main advantage of using actual costs is that a profit is guaranteed. However, there is less incentive for the supplier to control costs as inefficiencies can be passed on to customers. Such a contract may discourage some customers from dealing with the firm concerned.

Marginal or full cost — The use of marginal cost is simpler as there is no need for the absorption of fixed overheads and could be argued to be more consistent with the use of contribution in decision making. The main difficulty lies in setting an appropriate margin or mark-up as this will need to ensure that fixed costs are covered. In practice the danger is often that prices are set too low. Marginal costing is particularly useful in short-term decisions concerning the use of excess capacity or one off contracts.

CONCLUSION AND SUGGESTIONS

The use of full cost ensures that all costs are incorporated into the pricing decision, so should ensure a profit is made, provided the target volume is achieved. However, to calculate the fixed cost per unit an assumption must be made concerning sales volumes, which in turn depend on the cost per unit.

There are a number of different pricing strategies available to a business:

- Cost — plus pricing
- Market — skimming
- Penetration pricing
- complementary product pricing
- product – line pricing
- volume discounting
- price discrimination
- relevant cost pricing

To sum up, pricing is a complex and strategic aspect of any business, directly influenced by a combination of internal and external factors. Internally, elements such as production and operational costs, marketing expenses, company goals, and profit margins play a critical role in determining the price. Externally, market demand and supply, the level of competition, customer preferences, economic conditions, and government policies significantly affect how prices are set and adjusted over time.

Moreover, globalization and digitalization have introduced new variables, such as online price comparisons, global competition, and dynamic pricing strategies, which further shape pricing decisions. Businesses must also consider psychological pricing and customer perception, as the perceived value of a product or service can greatly impact a buyer's willingness to pay.

For a company to succeed in the long term, it is essential to maintain a balance between affordability for customers and profitability for the business. Therefore, a well-informed and flexible pricing strategy—based on thorough market research and continuous evaluation—is key to staying competitive in today's rapidly changing economic environment.

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