Pricing - introduction

The law of demand states that, for nearly all products, the higher the price the lower the demand. In other words, sales will fall if prices are put up. However higher prices can also mean higher profits. So how does a business decide how to set a price for its products?

A business needs to set a price which maximises their sales revenue. Sales revenue is the total amount of money made from sales and is the price of the product multiplied by the number of sales.

For a new business with a new product setting a price can be difficult to do because they have no experience of what customers are prepared to pay.

Get the price too high and sales are lost, too low and people who are prepared to pay more are not going to.

Businesses use a variety of methods to work out what price they might set:

- Past product data.
- What competitors or similar markets have as prices?
- Surveys and questionnaires.

They are several factors that the business will need to consider in setting the price:

- **The state of the market for the product** – if there is a high demand for the product, but a shortage then the business can put prices up. Recently, when the US government decided to publish guidelines on what to do in the event of war, following the terrorist attacks on their country, people rushed out to buy masking tape. There was quickly a shortage and prices went up. Union Jack flags during the Jubilee year were also subject to higher prices for the same reason.
- **The state of the economy** – some products are more sensitive to changes in unemployment and workers wages than others. Makers of luxury products will need to drop prices especially when the economy is in a downturn.

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