

7.4 Determining prices

LEARNING INTENTION

By the end of this subtopic you will be able to explain the ways businesses set the price for their goods and services.

7.4.1 Deciding on price

One of the most important decisions that any business owner has to make is how much to charge for their goods and services. This will have a major impact on the success of the business, as prices set too high may drive away potential customers, while prices set too low may make it difficult to achieve a **profit**.

Businesses can determine their prices by using the recommended retail price, following price leaders, using percentage mark-ups, pricing according to what the market will bear, or offering quotes to customers.

7.4.2 Recommended retail price

Sometimes the manufacturer of a product may provide a recommended price that can be used by **retail** businesses selling that product to consumers. Manufacturers of electrical goods often do this. This price is known as the recommended retail price (RRP). Such a price can only be a recommendation, as it is illegal in Australia for any manufacturer to dictate the selling price. Nevertheless, the RRP can provide a useful guide to the retail business owner, particularly when starting a new business.

FIGURE 1 Electrical goods often have a recommended retail price.



FIGURE 2 Large supermarkets are often price leaders in the grocery market.



7.4.3 Price leaders

Some businesses are more influential in a particular market than others. These businesses are often price leaders — they tend to set the prices rather than follow the prices set by others in the market. In the food and grocery market, the two big supermarket chains (Coles and Woolworths) tend to be price leaders. To survive, smaller supermarkets must compete with at least some of the prices of those larger stores, so their owners will carefully monitor the price leaders. All businesses need to adjust their prices from time to time to ensure they can compete with the prices charged by other suppliers in the same market. They will often look to price leaders as a guide to what is a reasonable price. For example, when Coles and Woolworths lowered milk prices to \$1 a litre in 2011, other suppliers had to follow suit. This practice still operates today.

7.4.4 Percentage mark-ups

Using a **percentage mark-up** is a common way of determining prices. If it costs a certain amount for the retail business to buy the product, a percentage can be added to that cost to ensure the retailer makes a profit. Assume a

profit what remains after all business expenses have been deducted from the money that has been collected from selling goods or services

retail describes a business that sells goods and services to consumers

percentage mark-up a way of determining selling price by adding a fixed percentage to the cost of the product

clothing store has a percentage mark-up of 25 per cent. The store will buy a pair of jeans for \$100. With a 25 per cent mark-up, the jeans will have a selling price of \$125. This \$25 is used to cover the other costs of the business, such as wages and electricity bills, and to contribute to the business' profits. The business owner has to calculate an appropriate percentage mark-up to allow this to happen.

7.4.5 What the market will bear

When setting prices according to what the market will bear, the seller attempts to get as high a price as possible while ensuring that the price is not too high for consumers to pay. The best example of this type of price setting can be seen at an auction. Many houses and other properties are sold via auction. People who want a property determine the price by bidding against each other until one of two things happens: either one bidder outbids all other buyers and becomes the successful buyer, or the property does not sell because no-one is prepared to pay the price the seller wants. In the latter case, the seller and the highest bidder can come together after the auction to negotiate a price that is acceptable to both of them.

FIGURE 4 House auctions are a good example of prices being determined by what the market will bear.



FIGURE 5 Listening to customers can help a business owner to determine what level of prices the market will bear.



Of course, not all businesses can sell their goods or services through an auction process, so determining prices based on what the market will bear often comes down to the experience of the business owner. An ability to understand consumer preferences is an important skill for a business owner. Listening to customers, following what is happening to the products throughout the market and monitoring the prices charged by competitors are all important activities for a business owner.

7.4.6 Quotes

Many service businesses will set a price by offering a quote to a consumer to perform certain work. A business such as a plumber or electrician might find that the amount of labour and the cost of materials used can vary from job to job. Preparing a quote for

FIGURE 6 Tradespeople such as plumbers often use quotes to determine the prices they charge.



each new job may be a better way to determine the price. A quote is an estimate of the costs involved in an individual job, plus a certain amount so the business makes a profit. Consumers will sometimes seek out quotes from a number of competing businesses before choosing one.

7.4 EXERCISE

To answer questions online and to receive **immediate feedback** and **sample responses** for every question, go to your learnON title at www.jacplus.com.au.

Learning pathways

LEVEL 1

Questions
1, 2, 4, 6

LEVEL 2

Questions
3, 7, 8

LEVEL 3

Questions
5, 9, 10

Check your understanding

1. What is a recommended retail price?
2. What makes a business a price leader? Give one example of a price leader.
3. How would a tradesperson calculate a quote for a customer?
4. Why can't a manufacturing business force the retailers that sell its products to sell at the recommended retail price?
5. What factors does a business owner have to take into account when calculating a percentage mark-up to apply to goods for sale?

Apply your understanding

6. Explain why setting the 'right' price is important to a business owner.
7. Explain how a price leader can affect other businesses in a market.
8. Explain why an auction is a good example of a price being determined by what the market will bear.
9. A business selling lawnmowers pays suppliers \$400 for each mower it buys for resale. It sells 10 mowers per week. Each week the owner pays \$1000 in wages to an assistant, \$800 in rent on the shop, and has gas, electricity and water bills of \$200. For each of the following percentage mark-ups, calculate how much profit the owner would make in a week:
 - a. 50 per cent mark-up
 - b. 75 per cent mark-up
 - c. 100 per cent mark-up.
10. In 2011, Coles and Woolworths both lowered the price of a litre of milk to \$1. Discuss why they might have done this.

For sample responses to every question, go to www.jacplus.com.au.

7.5 Influencing overseas producers

LEARNING INTENTION

By the end of this subtopic you will be able to:

- identify an export and an import
- describe the importance of exports to Australia
- identify the advantages and disadvantages of imports.

7.5.1 Exports and imports

Australia is a major trading nation. Australian businesses import (buy goods and services from other countries) and export (sell goods and services to other countries) in order to meet the needs and wants of Australian and overseas consumers. Producers all over the world will not only try to satisfy the demands of consumers within