Retail Pricing:

Introduction:
We as customers, often get to read advertisements from various retailers saying, "Quality product for right price!" This leads to following questions such as what is the right price and who sets it? What are the factors and strategies that determine the price for what we buy?

The core capability of the retailers lies in pricing the products or services in a right manner to keep the customers happy, recover investment for production, and to generate revenue.

What is Retail Pricing?
The price at which the product is sold to the end customer is called the retail price of the product. Retail price is the summation of the manufacturing cost and all the costs that retailers incur at the time of charging the customer.

Factors Influencing Retail Prices
Retail prices are affected by internal and external factors.

Internal Factors
Internal factors that influence retail prices include the following −

Manufacturing Cost − The retail company considers both, fixed and variable costs of manufacturing the product. The fixed costs does not vary depending upon the production volume. For example, property tax. The variable costs include varying costs of raw material and costs depending upon volume of production. For example, labor.

The Predetermined Objectives − The objective of the retail company varies with time and market situations. If the objective is to increase return on investment, then the company may charge a higher price. If the objective is to increase market share, then it may charge a lower price.

Image of the Firm − The retail company may consider its own image in the market. For example, companies with large goodwill such as Procter & Gamble can demand a higher price for their products.

Product Status − The stage at which the product is in its product life cycle determines its price. At the time of introducing the product in the market, the company may charge lower price for it to attract new customers. When the product is accepted and established in the market, the company increases the price.

Promotional Activity − If the company is spending high cost on advertising and sales promotion, then it keeps product price high in order to recover the cost of investments.

External Factors
External prices that influence retail prices include the following −

Competition – In case of high competition, the prices may be set low to face the competition effectively, and if there is less competition, the prices may be kept high.

Buying Power of Consumers – The sensitivity of the customer towards price variation and purchasing power of the customer contribute to setting price.

Government Policies – Government rules and regulation about manufacturing and announcement of administered prices can increase the price of product.

Market Conditions – If market is under recession, the consumers buying pattern changes. To modify their buying behavior, the product prices are set less.

Levels of Channels Involved – The retailer has to consider number of channels involved from manufacturing to retail and their expectations. The deeper the level of channels, the higher would be the product prices.

Retail Pricing Objectives:

1. Improving Retention
2. Maximizing Profit
3. Increasing Sales Volume
4. Competing With Similar Companies
5. Shifting Brand Image

1. Improving Retention

Customer retention is the sum of a company's efforts to keep its existing customers on board. It's an essential, cost-effective process that any growing business needs to prioritize. And implementing a strategy to improve yours often has a lot of layers.

Doing the practice right involves aspects like:

- Offering exemplary customer service
- Investing in a solid customer success team
- Creating customer loyalty programs
- But the avenues you can take to improve customer retention aren't limited to service — and the impact pricing can have on retention is a testament to that.

Maximizing retention is a popular pricing objective. If you choose to go this road, you may want to tailor your prices to retain the prestige of your product. At the same time, you don't want to raise prices to the point of alienating current customers. That generally translates to keeping prices relatively consistent.

2. Maximizing Profit

Maximizing profit is one of the most popular, conventional pricing objectives. And that makes sense — it's not revolutionary to point out that businesses that don't make money rarely survive.

Businesses that price for profit often do so by raising prices and cutting costs wherever possible. Ideally, they want to see significant improvements in return on investment (ROI). Pursuing this particular pricing objective often comes at the expense of sales volume or general revenue.

3. Increasing Sales Volume

Some companies set and change their pricing strategies to maximize conversions. These businesses set prices specifically to foster immediate, meaningful growth. In some cases, the endgame is getting a business off the ground — carving out a piece of a market and settling in.

In other cases, an already-established business might want to claim or maintain a specific share of its competitive landscape. They strategically adjust their prices to account for shifts and fluctuations that could alter their place in the market.

And sometimes, companies might adjust their prices to make concentrated pushes to maximize their market share. In these cases, their pricing objectives are still set with intention — but are a bit more indiscriminate than they'd be otherwise.

4. Competing With Similar Companies

Sometimes a business needs to make a product or service more competitive within its broader market. Maybe, the sales volume that the company is raking in isn't what they'd like it to be. Their company could also be losing out to lower or higher-priced options.

Competitor-based pricing is common in saturated or competitive industries. It's also typical when a product doesn't have many unique features.

Timing is essential with competitor pricing objectives. You'll also want access to real-time data so that you can adjust your pricing in alignment with your top competitors.

Competitor-focused pricing objectives can help pull customers away from a competitor. They can also help a new business get traction with new customers.

5. Shifting Brand Image

Pricing has a significant impact on how consumers perceive a business. Ideally, higher prices create an air of prestige and luxury, while lower one's signal value. But public perception doesn't always shake out how companies want it to.

If your pricing objectives center on brand equity, creating a long-term strategy is important. While some pricing approaches can fluctuate, consistency matters. Brand-focused pricing needs to appeal to your target audience.

Certain prices or pricing models might leave a business with an image it's not particularly happy with. In those instances, companies might look to raise or lower prices to capture and project fresh brand identities. That might mean changing to branding that your target consumers will be receptive to.

Retail Pricing – Approaches & Strategies

Demand-Oriented Pricing Strategy
The price charged is high if there is high demand for the product and low if the demand is low. The methods employed while pricing the product on the basis of demand are −

Price Skimming − Initially the product is charged at a high price that the customer is willing to pay and then it decreases gradually with time.

Odd Even Pricing − The customers perceive prices like 99.99, 11.49 to be cheaper than 100.

Penetration Pricing − Price is reduced to compete with other similar products to allow more customer penetration.

Prestige Pricing − Pricing is done to convey quality of the product.

Price Bundling − The offer of additional product or service is combined with the main product, together with special price.

Cost-Oriented Pricing Strategy
A method of determining prices that takes a retail company's profit objectives and production costs into account. These methods include the following −

Cost plus Pricing − The company sets prices little above the manufacturing cost. For example, if the cost of a product is Rs. 600 per unit and the marketer expects 10 per cent profit, then the selling price is set to Rs. 660.

Mark-up Pricing − The mark-ups are calculated as a percentage of the selling price and not as a percentage of the cost price.

The formula used to determine the selling price is −
Selling Price = Average unit cost/Selling price

Break-even Pricing − The retail company determines the level of sales needed to cover all the relevant fixed and variable costs. They break-even when there is neither profit nor loss.

For example, Fixed cost = Rs. 2, 00,000, Variable cost per unit = Rs. 15, and Selling price = Rs. 20.

In this case, the company needs to sell (2,00, 000 / (20-15)) = 40,000 units to break even the fixed cost. Hence, the company may plan to sell at least 40,000 units to be profitable. If it is not possible, then it has to increase the selling price.

The following formula is used to calculate the break-even point −

Contribution = Selling price − Variable cost per unit

Target Return Pricing – The retail company sets prices in order to achieve a particular Return On Investment (ROI).

This can be calculated using the following formula –

Target return price = Total costs + (Desired % ROI investment)/Total sales in units
For example, Total investment = Rs. 10,000,

Desired ROI = 20 per cent,

Total cost = Rs.5000, and

Total expected sales = 1,000 units

Then the target return price will be Rs. 7 per unit as shown below –

Target Return Price = (5000 + (20% * 10,000))/ 1000 = Rs. 7

This method ensures that the price exceeds all costs and contributes to profit.

Early Cash Recovery Pricing – When market forecasts depict short life, it is essential for the price sensitive product segments such as fashion and technology to recover the investment. Sometimes the company anticipates the entry of a larger company in the market. In these cases, the companies price their products to shorten the risks and maximize short-term profit.

Competition-Oriented Pricing Strategy
When a retail company sets the prices for its product depending on how much the competitor is charging for a similar product, it is competition-oriented pricing.

Competitor's Parity – The retail company may set the price as close as the giant competitor in the market.

Discount Pricing – A product is priced at low cost if it is lacking some feature than the competitor's product.

Differential Pricing Strategy
The company may charge different prices for the same product or service.

Customer Segment Pricing – The price is charged differently for customers from different customer segments. For example, customers who purchase online may be charged less as the cost of service is low for the segment of online customers.

Time Pricing – The retailer charges price depending upon time, season, occasions, etc. For example, many resorts charge more for their vacation packages depending on the time of year.

Location Pricing – The retailer charges the price depending on where the customer is located. For example, front-row seats of a drama theater are charged high price than rear-row seats.

Price Setting Methods:

Pricing method leads to a specific price. There are various methods used for setting price of the product. Some methods are cost-oriented while some are market-oriented. Each of the methods has its plus and minus points, and applicability. Marketing managers apply the appropriate method for setting the price. The appropriate method can be decided on the basis of the study and analysis of internal and external aspects as well as suitability of the method. Following part describes some widely used pricing methods.

1. Mark-up Pricing Method:
This is the most commonly used method. The method is also known as cost-plus pricing. In this method, a standard mark-up (or profit margin) is added to the product costs. This method is used in construction business, professions, and even for consumer goods. The method can be used only when company has necessary data about various costs and expected sales. Company may prefer fixed per cent of costs or fixed per cent of selling price.

Merits:

Keeping in mind a lot of forces affecting market, the mark-up rate may be kept high or low, fixed or variable.

This method is widely used. It offers following merits:

1. It recovers costs as rapidly as possible.
2. It is relatively a simple method to practice.
3. If it is used by the entire industry, price tends to be similar. And, price competition can be minimized.
4. Experts believe that cost-plus pricing method is fair for both – buyers and sellers.

Demerits:

The method suffers from following limitations:

1. It ignores current demand.
2. It ignores consumers' perception of price.
3. It doesn't consider competition. (However, mark-up rate may be decided on the basis of competition).
4. It is difficult to estimate exact sales.
5. The method is meaningful only if price of raw material and other inputs remain unchanged. Otherwise, the method may be misleading.

2. Perceived-value pricing Method:
Perceived-value pricing is a market-oriented method for setting the price. Here, price is based on the consumers' perceived value of the product. Consumers' views on price are

given priority. Company takes consumers' perception of value as a key to set the price, and not its own cost and objectives.

Company tries to measure the views of buyers regarding price of the product. Manager explains the consumers about total offers, including core product (key benefits and features), product-related aspects (like brand image, reputation, novelty, etc.), and product- related services (such as after-sales services like free installation, free home delivery, guarantee, etc.) and asks them to estimate price for that product or for total benefits offered by the product.

The key to the perceived-value pricing method is to measure accurately the market's perception of the offer's value. The seller with inflated views of his offers will overprice the product while with underestimated views will charge less than what it should be. Market research is needed to estimate market perception of price. Let us take an example,

ABC Company Limited wants to set price for the motorbike by the perceived-value method. Market research officer considers following aspects and takes the views of buyers.

Merits:

This method offers following merits:

1. Perceived-value method matches with consumer orientation.
2. It considers indirectly competitors' offers.
3. It is more realistic than any other method.
4. Perceived-value can be taken as base, with little adjustment in costs and objectives, the most suitable price can be set.

Demerits:

However, there are certain practical problems in setting price via this method.

Main limitations include:
1. It is practically difficult to measure perception of the market. Unless relatively a large sample of consumers is contacted, views may be misleading.
2. A lot depends on the person who estimates buyers' perception of price. Possibility of bias cannot be ignored.
3. The method is based on the trust. If their response is not normal, it is a wasteful exercise.
4. All the limitations of marketing research are equally applicable to this method.
5. It is, compared to the first method, difficult and complex to understand and apply.

3. Going-rate Pricing Method:
This is also said as competitive parity method. Even, sometimes, it is called as competition- oriented pricing. The method is, normally, followed by small firms, said as 'the followers' In going- rate pricing method, the company gives less attention to its own costs, objectives, or product demand. But, pricing decision is largely based on competitors' prices.

The company may charge the same, more, or less than major competitors. The notion is "follow the leader," or "leader is right." One must note that company doesn't select a price, which is far below or much higher than the real. However, competitors' pricing is taken as a base. And, final price may be set slight high or low depending upon objectives, qualities of product, and services offered.

Merits:

The method can be justified on the following grounds:

1. It is the only way to set the price when costs are difficult to measure and competitors' response is uncertain.
2. It considers competitors pricing policies as a base. In contemporary marketing practices, it is more relevant method.
3. Going rate pricing brings uniform pricing in the industry. It ensures fair return to sellers and harmony in industry.
4. It may protect consumers' from cheating and misguiding. They can buy the similar product at a, more or less, same price.

Demerits:

Going-rate pricing method has been criticized as under:

1. This is not an ideal method for pricing because it is one-sided, i.e., only competition factor is considered.
2. Company's objectives, costs, qualities, services, and consumers' perception of value have been ignored.
3. It is senseless to follow blindly the leaders or strong competitors as every firm has its special problems, opportunities, situations, and capabilities.
4. Temporary pricing of competitors may lead to erroneous decision.

4. Sealed-bid Pricing Method:

Sealed-bid pricing is followed in construction or contract business. It is also a competitive pricing method. Here, price is selected on the basis of sealed bids (quotation or estimated price) for the jobs.

The firm sets its price on expectations of how competitors will price the product. The firm wants to win the contract requires submitting the lower price than competitors. However, costs and profits are not totally ignored. The firm cannot set price below the costs.

It is called as tender pricing also. In response to the proposal of jobs or works, interested parties (businessmen or marketers) have to fill the tender (send quotation or estimated costs) stating price and conditions of work and send in forms of sealed-bids.

The bid is an offer of price for particular work or product. Generally sealed-bids (sealed envelops containing a bid) are invited for a competitive work. Offers or proposals come from charitable trusts, companies, organisations, or governments. In our country, we say this method as "tender," and proposal of jobs as a "tender notice."

Mostly, the tender notice is published in newspapers or circulars. The offer or proposal for work contains type of work or job, time to complete the work, quality of work, and other similar conditions.

5. Target Return Pricing:
This is one of the cost-oriented methods for setting price of the product. Here, the firm determines that level of price at which it can yield the target return on investment. Here, return on investment is taken as a base for price determination.

Attempts are made to recover the cost of investment. Mostly, government Companies, public utilities, cooperative societies, and the similar organisations fix pricing for their products on this basis to ensure minimum return on investment.

For example, Jai Hind Private Limited company expects to sell 10000 school bags of premium quality in the current year. Fixed costs allocated to this line is Rs. 5, 00000. Variable costs estimated for each bag is Rs. 100. Total investment (covering development, production and marketing) on this line is Rs. 50, 00000. Company wants 20% return on investment.

Return on Investment (ROI) = Rs. 5000000 x 20% = Rs. 1000000

Costs per unit = variable cost per unit + fixed cost per unit

= Rs. 100 + (Rs. 500000 ÷ 10000 units)

= Rs. 100 + Rs. 50

= Rs. 150.

Target return (profit) per unit = Rs. 1000000 + 10000 units = Rs. 100.

Selling price per unit = cost of product + Return on Investment.

= Rs. 150 + 100

= Rs. 250.

If company wants to earn 20% ROI (Return on Investment), the selling price should be Rs. 250. If RIO is more, definitely selling price will go up and vice versa.

This method can be used only when company is capable of estimating accurately the sales, variable costs, and fixed costs. The price so determined will be meaningful only if the company can achieve expected sales. Here, we assume that company might have estimated sales keeping in mind quality of product on one hand, and competition on the other hand.

6. Break-even Analysis Method:

Some companies set the price for their products by Break-Even Analysis (BEP method). It is a managerial tool that establishes relationship among costs, volume of sales, and profits. It is also known as cost-volume-profit analysis.

It involves developing tables and/or charts that help a company to determine at what level of sales, the revenue will be equal to the total costs. Under this method, attempts are made to find out volume of sales at which total costs are just equal to the sales revenue. This is such a level of sales at which there is no profit, no loss.

Sales Revenue = Total Costs.

This level is called BEP (break-even point), at which the firm has neither profits nor losses. The firm just covers its total costs. When sales revenue exceeds the total costs, the result is profit; and when sales revenue is less than total costs, the result is loss. Thus, BEP is the position of sales at which sales revenue is just equal to total costs. BEP can be calculated either by a formula or by a chart.

Formula Method:

BEP can be calculated using formula as under:

For example,

Hindustan Products Pvt. Ltd. gives following details:

Selling price is = Rs. 200 per unit.

Variable cost is = Rs. 100 per unit.

Fixed cost is = Rs. 500000.

Contribution is = selling price – variable costs

= (Rs. 200 – Rs. 100) = Rs. 100

Let's calculate BEP by using the Formula

BEP = Fixed Cost + Contribution

= Rs. 500000 + Rs. 100

= 5000 units.

Or

Sales Revenue is (5000 units x Rs. 200) Rs. 1000000. If the company achieves sales of 5000 units, there is no profit, no loss position. Pricing is the decisive or critical factor in the break-even analysis. An increase in selling price enables the firm to reach break-even point much rapidly, that is, at less sales volume; and, lowering price needs to achieve more sales volume, assuming costs will be equal.

Based on ability of the firm to achieve sales, the price is set accordingly. By trial and error method, a table can be prepared with different level of price to see how much sales a company must achieve to offset costs against sales revenue. And, suitable price can be picked up.

7. Graphic Method:

By trial and error method, a table can be prepared to find out the break-even point and can be presented graphically; the same result can be arrived at. We may take different level of sales at fixed price to find out break-even point.

BEP is essentially a tool for mark-up or cost-plus pricing. It can be said as an extension of mark-up pricing method. Here, it is assumed that sales will remain stable at different level of the selling price. (This is hardly possible). Similarly, fixed and variable costs remain unchanged.

This method is used only when data on sales, costs, etc., are accurately available. While estimating sales, apart from the BEP at particular price, market forces should also be considered. But, all depends on the estimates. It is a useful tool. However, for setting price of the product, it should be used with care and caution. It may be used along with other price setting methods.