UNIT 10 PRICING

Objectives

After going through this unit, you should be able to;

- understand the impact of consumers, manufacturers, government and
- competition in the retail pricing decision;
- discuss the various types of retail pricing objectives;
- analyze the retail pricing strategies and tools;
- develop an understanding of various concepts related to retail pricing; and
- discuss various pricing techniques and methods.

Structure

10.4 Introduction

10.5 External Influences on Retail Pricing Strategy

10.6 Retail Pricing Objectives

10.7 Retail Pricing Approaches

10.8 Retail Pricing Strategies

10.9 Tactics for Fine Tuning the Base Price

10.10 Setting Retail Prices

10.11 Methods for Setting Retail Prices

10.12 Role of Price Elasticity and Sensitivity - Consumer Responsiveness to Prices

10.13 Summary

10.14 Self Assessment Questions

10.15 Further Readings

10.1 INTRODUCTION

You would agree that the right price can influence the quantities of various products or services that consumers will buy, which in turn determines the total revenue and the profit of the retail store. Hence, sound pricing decisions are important to successful retail business. Systematic and informed decisions regarding pricing strategies must be made while considering a wide range of issues. Profitability is a prime objective of any retail firm which covers the cost of buying merchandise, costs of running business (rent, salary, maintenance cost) and finally to invest in further expansion of the retail business. Profitability of retail business is subject to be influenced by two aspects; one is a profit margin on the offerings that are sold, and second is cost involved with selling the merchandises.

Retailers are required to have understanding of the characteristics of the people who shop at their respective store, reasons why they shop at their store and degree of consistency between the price perception of consumers and store's price philosophy. Understanding of the customer segment is important for the retailers in evolving pricing strategy philosophy of the store. Pricing strategy

philosophy contributes in the positioning of the store in the market and in turn giving store image, which provides it distinctive identify from rest of the competitors in the market.

10.2 EXTERNAL INFLUENCES ON RETAIL PRICING STRATEGY

Using Porter's model to analyze these factors for strategic pricing, they can be broadly segregated into four "forces" - Customers, Suppliers (manufacturers, wholesalers and other suppliers), Competitors and Government.

1) Customers

Every retailer needs to understand the price sensitivity of customers that form his target segment. This price sensitivity is based on various personal, social or geographical factors that presents a major challenge for retailers while setting prices. For example, in the case of the Bangalore-based coffee chain, Cafe Coffee Day (CCD), it plans to expand and set up 200 stores across 60 cities before the end of 2004. Here, it has chosen to increase its presence in the small cities because it is observed that the youth in such small towns have adopted the lifestyles of their counterparts in metro cities..The only challenge company feels is pricing. A cup of coffee at Rs 35 is accepted in metro cities but in small towns such price points may be difficult to sell. The company feels that it may not be possible to change prices in order to retain uniformity and also to build its image among the customers.

Keeping this in mind, the following points can be remembered while evolving the pricing strategy.

- One needs to know their customers' desires for different products and whether price is an important issue in their purchasing decision?
- A price range that people will pay for the product need to be established i.e., what is the high and low price that the merchandise will have to fall within for someone to buy the product?
- Consider an apt pricing strategy, which would be compatible with your store's overall retail marketing mix that includes merchandise, location, promotion, and services.

The retailer is faced with a tough challenge of dealing with price sensitivity and its variability while considering separate consumer segments. Let's discuss on how they target consumer segments based on price sensitivity.

Economic Oriented: They don't differentiate among various retailers on other factors other than price such as store image, service, etc.

Convenience Oriented: They are willing to pay higher prices for reduction in the shopping effort. So, they tend to prefer buying from websites like phoolwala.com, or establishments like Domino's Pizza where there are no delivery hassles and orders can be placed quickly.

Image Oriented: They differentiate between various stores on the basis of image and the products they stock, and not the price. They look for prestige value from their shopping. These customers would prefer retailers like Tiffany, Allukas, Dewan Saheb or restaurants like Ruby Tuesday.

Variety Oriented: They prefer retailers who have a wide range and assortment to choose from and charge fair prices. Retailers that would attract such type of customers are Sears for tools and appliances, Nallis for sarees, etc.

Loyalty Oriented: These customers purchase at familiar places, where the retailer or staff of the retail outlet, recognizes them. They will pay slightly above average prices, or on the contrary they may look for discounts since they have been loyal to that retailer. Indian customers generally look for personalized transactions while buying jewellery. This aspect of consumer behaviour is somewhat peculiar to India because of the huge gray and duplicate goods market.

Key Effects Examining Price Elasticity: While still on discussion about customer, lets touch upon an important point of price elasticity on customer's demand. Price elasticity is a measure of the responsiveness of demand to a change in price. If demand changes by more than the price has changed, the good is price-elastic. If demand changes by less than the price, it is price-inelastic. The following are the key effects while examining price elasticity.

Difficult Comparison Effect: Customers are more sensitive to price when it is easy to compare competing offerings. A retailer cannot charge higher prices on Amul Butter, which is widely available and where customers can easily compare prices. So, many retailers have developed their own private label merchandise. For example, Food World sells its own branded rice. It is very difficult for the customer to compare prices of private labels.

Benefits/price Effect: This defines the relationship between people's perception of the benefits they receive from a product and the price they pay for it. For example, a customer would buy a Mont Blanc Pen at a much higher price even if similar quality pen is available at a lower price.

Situation Effect: Customers' sensitivity to price can differ depending on the situation. For example, when people go on an outing to a hill station then they don't hesitate to buy an item for double the price that they can get in their local market. This is because this shopping is a part of the entire outing experience.

Many restaurants take advantage of the situation effect. Their lunches cost less than their dinners because customers expect to pay less for a lunch. On the other hand, "low price" retailers maintain a utilitarian environment with minimum decorations.

2) Suppliers

Both the retailer and the supplier like to have control and want to price according to their own image, goals and objectives. With the advent of Internet manufacturers are selling their goods directly to the final customer. In case of an exclusive distribution net-Work, the retailer carries products of the particular manufacturer only. The manufacturer is able to exercise fairly large amount of control in this case. Then, some manufacturers first estimate the price at which the goods would be sold to the customer and subtract the required profit margin of the retailer/wholesaler to determine the selling price to the retailer. For example, if the estimated final price is Rs. 100, and the accepted profit margin is 25% on sales, then the manufacturer would sell to the retailer at Rs.75. So if the retailer buys at Rs.75, he can make a profit of 25% on the selling price of U10V i.e., R*25. Apart from the manufacturer or wholesalers, the other suppliers to the retailer are his employees, landlord, suppliers of fixed assets, etc. - Following characteristics influence the bargaining power of supplier:

- Number of supplier, few large suppliers or fragmented source of supply,
- Number substitutes for the particular merchandise,
- The switching costs from one supplier to another,
- Supplier's level of forward integration in order to obtain higher prices and margin

3) Competitors

Competitors, are the most influential factor in determining the price. The competitive environment affects the freedom of a retailer to fix prices to a great extent. Competition can range from being perfect competition to a monopoly.

- ***A perfectly competitive market*** is the most competitive market imaginable. Products are homogeneous and information is perfect. Everybody is a price taker where firms earn only normal profit. If firms earn more than that (excess profits) the absence of barriers to entry means that other firms will enter the market and drive the price level down until there are only normal profits to be made.

- ***A monopoly*** is said to exist when the production of a good or service with no close substitutes is carried out by a single firm with the market power to decide the price of its output. It decides its price by calculating the quantity of output at which its marginal revenue would equal its marginal cost, and then sets whatever price would enable it to sell exactly that quantity.

- ***Oligopoly*** is when a few firms dominate a market. They either behave so by forming an alliance or plan informally to prefer a non-price competition. When they do compete on price, they may produce as much and charge as little as if they were in a market with perfect competition. An example of oligopoly is the cola, industry where there are only two major players, Coca Cola and Pepsi.

- ***Monopolistic competition*** lies somewhere between a perfect competition and a monopoly. It is also known as an imperfect competition. Here, there are fewer firms than in a perfectly competitive market and each can differentiate its products from the rest somewhat, perhaps by advertising or through small differences in design. As a result, firms can earn some excess profits, although not as much as a pure monopoly, without a new entrant being able to reduce prices through competition,

4) Government

Legal issues affecting the retail environment can be broadly divided into two. One that affects the buying of merchandise, such as price discrimination and vertical price fixing and the other that affects the customer (horizontal price fixing, predatory pricing, and bait and switch tactics). Let's examine the different techniques of price setting.

Price Discrimination: This means when a vendor sells the same product to two or more customers at different prices. This discrimination can occur between retailer and customer or between the retailer and his vendor. In the USA, price discrimination between vendors and their retailers is generally illegal, but there are three situations where it is acceptable.

Vertical Price Fixing: It involves agreements to fix prices between parties at different levels of the same marketing channel (e.g. retailers and wholesalers). The agreements are usually to set prices at the manufacturer's suggested retail price. So pricing either above or below MRP is often a source of conflict. Retailers cannot sell above the MRP however. It is not permissible under law.

Horizontal Price Fixing: It involves agreements between retailers that are in direct competition with each other to have the same prices. Horizontal price fixing is always illegal since it suppresses competition while often raising the cost to the consumer. Suppose there are three stores in a locality. Two of them join hands and start selling groceries at very low prices, as loss leaders. If the third store is selling only groceries, he would lose sales and would have to shut shop.

Predatory Pricing: This means establishing merchandise prices to drive competition away from the marketplace and it is illegal. A retailer can however sell the same merchandise at different prices at different geographic locations if the costs of sale or delivery are different.

In the Indian context, government exercises a very strong influence on the prices through its legal and policy directives. As per the Weights and Measures Act, it is illegal to sell goods above MRP (Maximum Retail Price). A customer can negotiate and purchase goods below MRP, but a retailer is not supposed to sell the product above the mentioned MRP. However, in practice, it is not uncommon to see goods being sold above their prescribed MRP. Like in the case of cinema halls, roadside dhabas and. also sometimes in selling cigarettes.

Activity 1

List from your observation for each retailer adopting the above mentioned pricing technique

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10.3 RETAIL PRICING OBHCTIVES

Retailers are supposed to determine their objectives as first step in pricing. When deciding on pricing objectives retailer needs to consider:

1) The overall financial, marketing, and strategic objectives of the retail business;

2) The characteristics of product or brand;

3) Consumer price elasticity and price points; and

4) The resources available.

With these broad objectives, the retailer could be trying to fulfill four specific objectives such as:

1) Profit-Objective

The retail store may price its product with the objective of maximizing profits in the short run or long run or both. The objective of profit maximisation must be studied carefully because: it may lead to unethical practices such as overcharging or deceiving the customers. This in turn may lead to some form of intervention by either the government or consumer groups (NGOs). At other times, the marketer may price his products with the objective of obtaining only a target rate of return on his investment. This is particularly so with products in the mature stage of the product life cycle.

2) Market Share-Objective

The retailer or marketers may also price his product with the, intention of increasing his market share, or stabilizing his market share. He can set the price of his product lower than that of his competitors.

3) Competitor-Oriented Objective

The retailers or marketer may price his product to counter any existing or prospective move by his competitors. Retailer may deliberately price its merchandise low to:

- Discourage potential retailer from entering the market,
- Advance the exit of the potential competitors and marginal firms from entering the market,
- Spoil the market of retail competitors with the eye on getting future benefits.

With a low price, the marketer can prevent price-cutting by competitors. At other times, the retailers may cooperate with his competitors by setting a common price. A good example of this type of pricing is very common among traditional business centres in India where all retailers dealing in similar merchandise set similar common prices. This practice is common among retailers of Beauty salons, Garment Retailers and Grocery etc.

4) Buyer-Oriented Objective

Another pricing objective adopted by retailer may be buyer-oriented. The aim of such pricing is to maintain socially acceptable prices and to be fair to customers. The prices of goods of super bazaars Margin free (Kerala) and Rythu (Andhra Pradesh) can be considered buyer-oriented as these retail chains practice the professed pricing objectives of bypassing intermediaries and sharing savings with the ultimate consumers. Most of the five star hotels stress on the kind of ambience and services extended by their hotel, as these are of prime concern to their customers. Tanishq, the jewellery retail chain, emphasises on the other elements of the marketing mix, such as heavier promotion and advertising, as well as highlighting the quality and the characteristics of their offerings primarily to justify the relatively higher prices charged by them.

5) Government-Oriented Objectives

The pricing of some products may be constrained by existing laws or may be influenced by government action. The prices of petrol, grocery items, vegetables in India are, to a large extent, controlled and influenced by government action. Consumer Protection Act 1986, Indirect Tax provisions and MRTP has a bearing on the pricing of the merchandise.

6) Product-Oriented Objectives

The retailers or marketers at times make their offerings more "visible" by means of pricing. Customers are usually attracted by the advertisements in newspapers highlighting special offers and discounts. With a lower price, the retail store can therefore catch the attention of buyers and this will help him to introduce new offerings, increase the sale of weak products etc. Many of the retail stores in India such as Big Bazaar are using these pricing techniques.

Activity 2

Compare the pricing objectives of

a) an independent retailer dealing in footwear.

b) a retail chain outlet dealing in footwear.

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10.4 RETAIL PRICING APPROACHES

You would appreciate that Pricing strategies affect both margins and positioning of the retailer. Various pricing strategies can be followed by the retailer depending on his business objectives, the influence of other external factors and the impact of the pricing strategy on other aspects of the marketing mix.

There are three retail-pricing approaches based on the long-term objectives of the pricing decision. They are:

a) **Discount Orientation:** Here low prices are used as the major tool for competitive advantage wherein the store portrays a low status image while profit margins are kept low to target price-based customers. The model works on high inventory turnover and lower operating costs. This is arguably the most common model in India because of the low per capita income and price consciousness. For example, Janpath market in New Delhi.

b) **At-the-market Orientation:** These kinds of stores normally set average prices. It offers solid service, a nice atmosphere to the shoppers, margins are average to good, and it stocks moderate to above quality products. Since this model caters to the middle class, it has a huge target market. Westside in India focuses on providing value for money merchandise for the entire family along with an international shopping experience. The private label of the company gives it the flexibility of a wide range of merchandise and also has the advantage of generating better margins for the company.

c) **Upscale Orientation:** Here competitive advantage is derived from the prestigious image of the store. The profit margins per unit are high, but coupled with higher operating costs and lower inventory turnover. These stores usually stock distinctive product offerings and provide high quality service, building up customer loyalty. The products stored generally go with the image of the store. Like such stores would stock Christian Dior perfumes and Rolex watches. It may be appropriate in situations of inelastic demand in which an organisation decides to keep its prices high.

These approaches may be implemented using various pricing strategies. Discount orientation may take the form of every-day-low-pricing strategy or high-low strategy. Up-scale orientation is reflected in premium pricing strategies. At-the market orientation is reflected in strategies that offer average prices for most products. Hence while stores like LifeStyle and Arcus do reflect an up-scale pricing orientation they do offer rebates and discounts at various intervals.

Hence, the pricing approaches adopted by a retailer should be in accordance with the other elements of the retail marketing mix. The following table offers a representative list of the pricing approaches along with their complimentary retail mix strategies. This is only an indicative list and many retailers do follow a different set of combination to meet their specific requirements.

Retail Marketing Mix Variable	Price below Market Price	Price at Market Price	Price above Market Price
Location	• No Parking • Poor layout • Inaccessible	• Central Business District • Proximity to competition	• Monopoly • Compatible location to target segment
Service attributes	• Self-service • Limited offerings • No salesmen support	• Support from sales people.	• Personalized attention to customers • Home delivery • Exchange facility • Customized offerings
Assortment	• Limited Variety	• Medium variety	• Extensive Assortment
Store Environment	• Poor Quality fixtures, • Limited space to move • Untidy Wall shelves	• Compatible store environment • Arranged wall shelves • Better movement within the space.	• Very Inviting and impressive store décor, • Attractive Visual Merchandise
Nature of Brands	• Unbranded, • Smaller manufacturers	• Best sellers	• Exclusive name brands

Source: Retail Management, Oxford University Press

10.5 RETAIL PRICING STRATEGIES

So, in order to select the various pricing approaches, certain effective pricing strategies need to be implemented in its support. The adoption of these strategies is guided by the basic pricing approach of the retailer.

Every Day Low Pricing (EDLP)

EDLP has been p9pularised by large international retailers like Wal-Mart and Home Depot. This strategy demands stability of retail prices below MRP (maximum retail price)-mentioned on the goods i.e. at a level somewhere between the regular price at which the goods are sold and the deep discount price offered when a sale is held. In India, many co-operative stores have adopted this strategy. One store that uses EDLP is Big Bazaar. Here, goods are either sold below their normal prices, or some sales promotion scheme is available. Subhiksha also possesses the essentials of a discount store. Most of these retailers have discovered the benefits of adopting this EDLP strategy such as:

- Less reliance on price reduction by retailers
- Reduced need of advertising
- Improved customer service
- Better inventory management

High Low Pricing

In High/Low pricing, retailers offer prices that are sometimes above their competition's ELDP, but they use advertisements to promote frequent sales. Nowadays, retailers also use sales to respond to increased competition and a more value-conscious customer. Some of the benefits of adopting such a strategy are:

- Same merchandise can be used to target different segments
- Interest is created amongst customers
- A quality image is created

Leader Pricing

Retailers sometimes price particular fast moving products at a lower price to attract customers to the store. For example: A grocery retailer can sell eggs cheaper than other competing stores so that customers consider him while purchasing foodstuff Since the customer is also likely to buy milk, bread, flour etc along with eggs, these products are priced slightly higher. So, the profit foregone on eggs is more than recovered on other items of groceries.

Sometimes, the fast moving products are sold at cost, or even at a loss. So, these are also called loss leaders. If the sale of other profitable products is insufficient to cover the losses incurred on sales of loss leaders, then this strategy can backfire. The retailer normally chooses his own store brands for higher pricing.. Items such as pulses, rice, flour, etc are priced higher because it is also not easy to compare the price against quality offered by other stores.

Skimming Pricing

Price skimming is a pricing strategy in which a retailer sets a relatively high price for a product or service at first, and then lowers the price over time. It allows the firm to recover its sunk costs quickly before competition steps in and lowers the market price. However positive, there are some potential problems with this strategy such as:

- The inventory turn rate can be very low for skimmed products.
- Skimming encourages the entry of competitors. When other retailers see the high margins available in the industry, they may decide to quickly enter.
- The retailer could gain negative publicity if he lowers the price too fast and without significant changes in product profile.

Penetration Pricing

Penetration pricing is the pricing technique of setting a relatively low initial entry price, a price that is often lower than the eventual market price. The expectation is that the initial low price will secure market acceptance by breaking down existing brand loyalties. Penetration pricing is most commonly associated with the marketing objective of increasing market snare or sales volume, rather than short term profit maximization. Price Penetration is most appropriate when

- Product demand is highly price elastic.
- Substantial economies of scale are available,
- The product is suitable for a mass market.
- The product is likely to face stiff competition.
- There is inadequate demand in the low elasticity market segment for price skimming.

Price Lining

Price lining refers to the offering of merchandise at a number of specific but, predetermined prices. Once set, the prices may be held constant over a period of time, and changes in market conditions are adapted to by changing the quality of the merchandise. A limited number of predetermined price points are set at which merchandise may be offered for sale-e.g., Rs. 79.50, Rs.109.50, Rs.149.50.

Psychological Pricing

Psychological pricing is a method of setting prices intended to have special appeal to consumers. This can be conducted in several ways to name a 0w,

- ***Prestige Pricing***

  Prestige pricing uses high prices to convey a distinct and exclusive image for the product. This is done in order to evoke perceptions of quality and prestige with the product or service.'Various clubs like Gymkhana Clubs and DLF Golf Club price their products to indicate exclusivity Similar strategy is R41owed by five star hotels like Taj and Radisson in terms of their menu offerings. For instance a glass of coke at Radisson could cost close to Rs. 75400 and Kababs at its famous Kabab Factory at Rs. 800-1000.

- ***Reference Pricing***

  Reference pricing uses consumers' frame-of-reference that is established through previous experience purchasing the sports product or high levels of information search.

- ***Traditional Pricing***

  Here, traditional pricing uses historical or long-standing prices for a sports product to determine the pricing.

- ***Odd-Even Pricing***

  This is quite a popular. Here the prices are set at odd numbers (e.g. $9.95) to denote a lower price or a "good deal" or setting prices at even numbers (e.g., $ 10.00) to imply higher quality. Many discounters like Big Bazar in India and Wal-Mart in USA use odd prices to denote lower prices. Many retailers in Japan use even pricing to denote quality - a very important issue with Japanese consumers.

Apart from these, few other popular strategies of setting retail prices are:

Multiple Unit Pricing

Retailers use multiple unit pricing to encourage additional sales and to increase profits. The gross margin that is sacrificed in a multiple unit sale is more than off-set by its, savings that occur from reduced selling and handling expenses.

Bundle Pricing

It is the practice of offering two or more different products or services at one price. Price bundling is used to increase both unit and rupee sales by bringing traffic into the store. It can also be used to sell less desirable-merchandise by including it in a package with a product of great demand. Like a hotel can offer a 2 days stay for Rs.5000/- inclusive of lunch, even though separately these two items (stay and lunch) would cost more than Rs.5000/-. In many cases a retailer may bundle a set of extra-large T-shirts with large .size T-shirts to promote the sale of the slow moving item. Same strategy is some times used for low selling shoe sizes.

Pre-emptive Pricing

Pre-emptive pricing is a strategy_ which. Involves setting low prices in order to discourage or deter potential new entrants, to the retailer's market, and is especially suited to markets in which the retailer does not enjoy any market privilege and entry to the market is relatively straightforward.

Extinction Pricing

Extinction pricing has the overall objective of eliminating competition, and involves setting very low prices in the short term in order to `under-cut' competition, or alternatively keep away potential new entrants. The extinction price may, in the short term, be set at a level lower even than the suppliers own cost of production, but once competition has been extinguished; prices are raised to -profitable levels.

Perceived-value Pricing

A method of pricing in which the seller attempts to set price at the level that the intended buyers value the product. It is also called value-in-use pricing or value-oriented pricing. If the perceived value is high the retailer can charge a premium price for the product. The example of well-established traditional independent retailers in small townships can be cited in this respect. They charge a premium price on their offerings because of quality and variety offered to their customers. Kala Mandir, the ethnic women apparel store in Ludhiana, provides exclusive collection of sarees and ladies suits to their customers at prices above the market average

Demand-Oriented Pricing

A method of pricing in which the seller attempts to set price at the level that the intended buyers are willing to pay. It is also called value-in-use pricing or value-oriented pricing.

Fixed and variable Pricing

Most firms use a fixed price policy i.e. they examine the situation, determine an appropriate price, and leave the price fixed at that amount until the situation changes, at which point they go through the process again. The alternative has. been variable pricing, a form of first degree price discrimination, characterized by individual bargaining and negotiation, and typically,used for highly differentiated - items, like real estate, unbranded garments, fresh vegetables and fruits etc. In India there are certain markets which are well known for bargaining e.g. Gaffar market in Delhi, Fashion Street in Bombay, Ranganathan Street in Chennai,S.M street in Kozhikode,Kerala. There are some shops in markets like Sarojini Nagar and LalpatNagar in Delhi which specifically advertise that they do not bargain and have a "Fixed Price"

Considering all the above choices of pricing strategies, it is observed that very few retailers have a clear cut, simple to understand pricing strategy. It differs from time to time, product to product, location to location. Take a look at the below table to familiarize yourself with some of the issues faces by retailers while setting a price.

Pricing Issues and Store Policies
• Setting the price must be compatible with your established store policies and your desired image.
• Will a one-price system, under which the same price is charged to every purchaser of a particular item, be used on all items or is the price negotiable with the customer?
• Will odd-ending prices such as $1.97 and $44.95, be more appealing to your customers than even-ending prices?
• Will consumers buy more if multiple pricing, such as 2 for $8.50, is used?
• Should any loss leader product pricing be used?
• Will price lining, the practice of setting up distinct price points and then marking all related merchandise at these points, be used?
• Would price lining by means of zones be more appropriate than price points?
• Will prices include applicable taxes for customer convenience?
• Will cent-off coupons be used in newspaper ads or mailed to selected consumers on any occasion?
• Would periodic special sales, combining reduced prices and heavier advertising, be consistent with the store image you are seeking?
• Has the impact of various sale items on profit been considered?
• Will "rain-checks" be issued to consumers who come in for special sale merchandise that is temporarily out of stock? Rain checks are written promises that the store will sell the merchandise that is out of stock at sale prices as and when the merchandise arrives.

10.6 TACTICS FOR FINE TUNING THE BASE PRICE

Following are some of the tactics used by retailers to fine tune the base, price:

a) Coupons

These are documents that provide a right to the holder to purchase at a reduced a price or entitle him or her to a discount on the product. The coupons are disbursed by retailers through various means, depending on the type of customers that they want to target, economy of distribution,etc. Sometimes coupons are issued in newspapers for cut-out; they can be given along with purchase or purchases of particular product/products,, above a certain amount. E.g. anybody who buys a television would get a coupon entitling him to avail of a discount on microwave oven purchases. Or, anybody who buys goods worth Rs 5,000 would get a coupon to purchase Rs 500 worth of goods free of cost. Coupons are used to attract customers to buy for the first time, convert those first-time customers to regular ones, induce large purchases and increase usage.

b) Rebates

Rebate is basically money returned to the buyer on the basis of some portion of the purchase price. The buyer would return the empty packaging, or anything that would serve as a proof of purchase, and the retailer/manufacturer returns the mentioned amount to the buyer. For example, one scheme could be that if the

his future purchase. Or, if the pack is worth Rs.50, then on returning the pack, the buyer would be returned Rs.5. Rebates are used when the price is large, because for small amounts the handling costs do not justify rebates.

But let's examine a review of the pricing strategy on private labeled brands in Indian fast moving consumer goods market.

Private Label Brands

A study by Economic Times (2004) reports that these brands are cheaper by 20-25% than the organised FMCG majors in the market place. Attractive pricing had helped these brands catch the customer's eye. The margins on own-store brands are nearly two-and-half times higher than on regular FMCG brands. Food, grocery and tobacco account for 72.2% of the total Indian retail market. Store brands owned by FoodBazar, the food retail division of Pantaloon Retail (India), are steadily gaining market share. This is to a large extent driven by the performance of in-house Foodbazar brands. Hence, they have started thinking of launching new products under different brand names. The company sells salt, tea, masala and pulses under the Food Bazar label and dal and spices under the Premium Harvest label. The company's in-house brands have garnered a market share in the range of 25-40% at its existing stores. Foodbazar's in-house tea brand, which is 20-30% cheaper than major FMCG brands, has cornered a 40% market share. In the salt category, the Foodbazar brand has cornered a market share of 40-45%. The company has launched a premium health salt in the price range of ordinary iodised salt from Tata Chemicals and HLLL.It is believed that retail chains are offering products at cheaper prices through direct tie-ups with tea gardens and salt refineries. Similar strategies are being followed by major retail chains like FoodWorld, Shubhiksha and Nilgiris. Ability to offer customers better value for money is attributed to better management of supply chain and logistics. Wide options in everything from snacks, grocery items like atta, salt and grains and other household food products coupled with attractive discounts and free gifts seem to have appealed to the customer.

Source: `Private labels peel big brands out of stores', Economic Times, January 21, 2004

Activity 3

Select 2 food supermarkets in your city and compare their pricing strategy for their respective private labels.

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10.7 SETTING- RETAIL PRICES

to set retail prices it is important to understand some of the concepts and calculations related to it, basic methods employed for setting prices and factors like price elasticity and price sensitivity which impact the effectiveness of the pricing strategy.

The price that a customer pays for an offering comprises of two main components: the cost of the offering or the price that retailers pays to a supplier/ manufacturer, and the gross profit margin, which is selling price minus the cost of the product.

In the retail business, the cost of goods (costs of acquiring products) includes the price paid for the merchandise, handling, freight charges, and import duties. Operating expenses include rent, wages, advertising, utilities, and supplies.

A) Mark Up

Markup is the difference between the price you pay for the product and the selling price. The markup can be established as a percentage of the cost or as a percentage of the retail price. A price based on markup percentage on cost is determined by adding a percentage of cost to the cost of goods as follows:

Cost of shirt: Rs 20.00

X Markup % 25%

Markup amount Rs 05.00

Cost of shirt Rs 20.00

+ Markup amount 5.00

Selling price Rs 25.00

Percentage Mark up is expressed as a percentage of cost.

(Mark up _ Cost of goods) x 100

Retailer can decide to use a standard markup percentage for all the merchandise, or have different markups for different products. The key is to make sure the average markup or gross margin is enough to cover the operating expenses and meet its target profit margins. When establishing the markup on particular merchandise, two points should be noted:

- The cost of the merchandise used in calculating markup consists of the base invoice price for the merchandise plus any transportation charges minus any quantity and cash discounts given by the seller.

- Retail price, rather than cost, is ordinarily used in calculating percentage markup. The reason for this is that when other operating figures such as ,, wages, advertising, and profits, are expressed as a percentage, all are base on retail price rather than on the cost of the merchandise being sold.

But while calculating such prices, it is essential to know the following important data:

- **Cost of Goods Sold (COGS)**

COGS takes into consideration every expense incurred to bring the goods to the point of sale, it includes other expenses besides the invoice cost of goods moved out of stock. COGS is the largest expense incurred by a retailer and the price is generally determined by adding a margin for other expenses plus profit to service and replace the capital. COGS would typically include:

a) The purchase cost of all the goods that have moved out of stock. This movement may be by means of sales, or theft, breakage and other losses. This purchase cost is the price charged in the purchase invoice. Trade discounts given in the invoice are considered (therefore subtracted from purchase price) however, cash discounts are not considered.

c) Expenses incurred to bring the goods to the point of sale such as carriage inwards (freight), travelling expenses incurred by the buyer to purchase the goods, etc.

d) Depreciation on the remaining stock at the end of the period.

e) Transfers from other departments or branches.

Therefore, Cost of Goods Sold can be calculated by the given formula:

- Opening Stock (at cost or market price, whichever is lower) + Purchases & additions during the year (after including the costs as detailed above)
- Closing Stock (valued on the same basis as opening stock)

Net Sales

This is the total sales figures adjusted for goods returned by customers and allowances. Net sales is therefore, gross sales less returns and allowances.

Gross margin (also called gross profit)

It is the difference between net sales and the cost of goods sold. Net sales means sales adjusted for any goods returned.

Percentage Gross Margin (or Gross profit percentage)

This is the gross margin expressed as a percentage of net sales (Gross margin, Net sales) x 100

B) Markup and Margin

Markup is a percentage of the cost. Margin is the same rupee amount as mark-up, but expressed as a percentage of the selling price.

Example
Item costs Rs. 20.00; Item sells for Rs 25.00
Markup is Rs. 5.00 or 25 % of the cost.
Margin is Rs. 5.00 or 20 % of the selling price.

This is the easiest way to determine prices but can get into trouble if the margin between the cost of goods and the suggested retail price is not enough to cover operating expenses. The income of the retail business is determined on the basis of the gross profit margins and number of goods sold. This provides resources to incur expenditure towards the stock purchases, meeting operating costs and investing funds for expansion of business. In order to achieve desired success in retail business, setting of prices by retailer is important. Retailers are expected to take into account these factors while setting prices of its offerings:

- Owner's returns
- The portion of rent going for storage space
- Maintenance and repairs
- The costs of business services (such as accounting and legal services)
- Advertising and promotion costs, insurance premiums, interest payments etc.

This is a reduction on the normal selling price. Sometimes, a particular line of goods is not moving, therefore the retailer reduces the price on such goods to make them attractive to the customers.

Mark down = Normal selling price - reduced selling price

One needs to understand the various uses of mark-downs and factors that ultimately result in a mark-down.

1) Correctional mark-downs are used to encourage customers to respond more satisfactorily to a line. For example, if a new product has been launched, it may be sold at a reduced price to induce customers to purchase it.

2) Operational mark-downs are used to sell off obsolete, end-of-season goods. Or goods that are damaged, shopworn and broken. For example, if a lot of crockery has been chipped, then it can be sold at a reduced price.

3) Promotional mark-down is used to increase sales by offering the customers the incentive of lower prices.

4) Correctional mark-down is used to correct errors resulting from wrong pricing, buying or selling.

10.8 METHODS FOR SETTING RETAIL PRICES

Generally one of the following three methods could be used for setting retail prices - cost oriented, competition oriented and demand oriented method.

1) Cost Based Method

This is the most fundamental method of setting prices. The retailer adds a standard mark up to the cost of goods to arrive at the selling price. This is a fairly simple approach an easy to implement. However, it ignores the prices set by competitors and the demand for the product.

2) Competition Based Method

This method means closely matching the prices of competing retailers. This method is very easy to implement, as it does not need forecasted demand as in the case of demand oriented pricing. A retailer merely follows his competitors and cannot differentiate himself from his peers. It does not allow a retailer to maximise profits because demand and costs are not considered while pricing.

The competitive markup method is used to price the goods similar to those of the competitors. In effect, the markup is controlled by competitors and it fluctuates based on what the competitors are charging for their products and services. Retailers can price either above, below or at parity with the competition. A low-cost provider would try to price below competition while a retailer with high quality image, unique merchandise, etc would price above competition. Stores like Shoppers Stop, which has a significant brand image, sell above competitor's prices.

3) Demand Oriented Pricing

Demand oriented pricing should be ideally be used along with cost-oriented pricing. When these two are used in conjunction, the retailer can not only consider their profit structure but also the impact of price changes on sales. For example, if the customers are insensitive to price (the demand is price inelastic), an increase in pric^e^s would result in higher profits, as sales would decrease

insignificantly. Similarly, if customers are price sensitive, a decrease in prices would actually result in greater profits, as sales increase much more to offset the decrease in prices. Demand oriented pricing, therefore, seeks to maximise profits.

10.9 ROLE OF PRICE ELASTICITY AND SENSITIVITY -- CONSUMER RESPONSIVENESS TO PRICES

While setting retail prices it is important to understand the impact of various price points on demand. In this context the various price elasticities need to be factored in for the calculation of price. While price elasticity is a characteristic of the product price sensitivity is a characteristic of the consumer. Price sensitivity in turn affects price elasticity.

Price Elasticity

Price elasticity of an offering plays key role in the setting of prices. Price elasticity determines the extent to which demand for an offering responds to change in price. Retailers required to identify will customers still buy its offerings, even if the price is high? Or do significantly more customers buy the product if the price is low?

- If an offering is **price elastic**, a change in price will cause an even larger change in the quantity demanded. This usually means that if retailer lower price of its merchandise, the quantity demanded of product or service will increase.

- If retailer is selling **price inelastic** product or service, a change in price will cause less of a change in quantity demanded. So, whatever price you charge, your demand will be relatively stable. Items that are price inelastic usually have no similar items available, and no substitutions for the product exist.

Price Sensitivity

To determine retail prices, the price sensitivity of the customers needs to be determined price sensitivity is influenced by a number of factors like substitute awareness effect and income effect.

- **Substitute awareness effect**

When there are a lot of substitutes available to the customers, and comparing prices among them is easy, the price sensitivity is high. The customers can switch easily if they perceive that the price they are paying is high.

- **Total expenditure effect**

The customers are price sensitive when the expenditure incurred on the particular product is high. The expenditure is large both in terms of absolute rupees as well as a percentage of the customers" income.

10.10 SUMMARY

We have understood that pricing is a critical decision for the retailer. `Various consumer, supplier, government and competition related factors affect the pricing decision of the retailer. The retailer can use various pricing approaches. The most popular ones are - discount orientation, at the market orientation or up-

scale orientation. Based on its basic pricing approach a retailer can design his pricing strategy. Pricing strategy can be a combination of some or all of the following strategies: Every Day Low Price; High-Low Price, Skimming Pricing, Penetration pricing, Loss-leader pricing, Price Lining, Psychological Pricing, Bundle pricing, fixed and variable pricing, perceived value pricing, demand-oriented pricing, multiple unit pricing, preemptive -pricing and extinction pricing. Tactics like coupons and rebates can be used to fine-tune the base price. The role of pricing strategy in the context of private label brands is also discussed. Also,Prices can be set based on cost based, competition based or demand based methods. Price elasticity and consumers sensitivity to various price levels should also be factored in while setting retail prices.

10.11 SELF ASSESSMENT QUESTIONS

1) How important is the role of pricing in retail marketing mix?

2) Examine the various pricing objectives in the retail sector?

3) What is the difference between margins and mark down? Explain it with an example and also when and how is it implemented?

4) Discuss any three pricing strategy used in retailing and how commonly is it adopted by retailers.

10.12 FURTHER READINGS

Chetan Bajaj, Rajnish Tuli, Nidhi. V. Srivastva (2005) Retail Management, Oxford University Press.

Dodds, W'B and Monroe, K B (1985), `The effect of brand and price information on subjective product evaluations', *Advances in Consumer Research*.