



# RETAIL PRICING

CHAPTER 14



# LEARNING OBJECTIVES

- 14-1 What is the difference between high-low pricing and EDLP?
- 14-2 What are the advantages/disadvantages of high-low/EDLP pricing?
- 14-3 What do retailers have to consider when setting prices?
- 14-4 What does it mean to be “price sensitive?”
- 14-5 What is the difference between elastic demand and inelastic demand?
- 14-6 How do retailers set retail prices?
- 14-7 How do you calculate markup as a dollar amount and a percentage?
- 14-8 How do you calculate retail price when a certain markup % is desired?
- 14-9 What is a markdown?

## LEARNING OBJECTIVES (CONTINUED)

- 14-10 What is the difference between an initial markup and a maintained markup?
- 14-11 How do you calculate a maintained markup as a % of actual sales?
- 14-12 How do you calculate an initial markup %?
- 14-13 How do you calculate initial retail price?
- 14-14 What are the different types of markdowns?
- 14-15 What are the different types of variable pricing & price discrimination?
- 14-16 Which pricing techniques can retailers use for increasing sales?
- 14-17 What are some of the legal and ethical pricing issues?

# WHY IS PRICING IMPORTANT?

- Pricing decision is important because customers have alternatives to choose from and are better informed
- Customers are in a position to seek good value

$$\text{Customer Value} = \text{Benefits} - \text{Costs}$$

Price cannot be set higher than the value perceived by the customer!

# 14-1 WHAT IS THE DIFFERENCE BETWEEN HIGH-LOW PRICING AND EDLP?

## PRICING STRATEGIES

### 1. High-Low Pricing

- Discount the initial prices through frequent sales promotions

### 2. Everyday Low Price (EDLP)

- Emphasizes the continuity of retail prices at a level somewhere between the regular non-sale price and the deep-discount sale price of high/low retailers
- Doesn't mean lowest price

## 14-2 WHAT ARE THE ADVANTAGES/DISADVANTAGES OF... HIGH-LOW PRICING?

### ■ Advantages

- Increases profits through price discrimination
- Sales create excitement
- Sells merchandise
- Increases traffic to the store (or website)

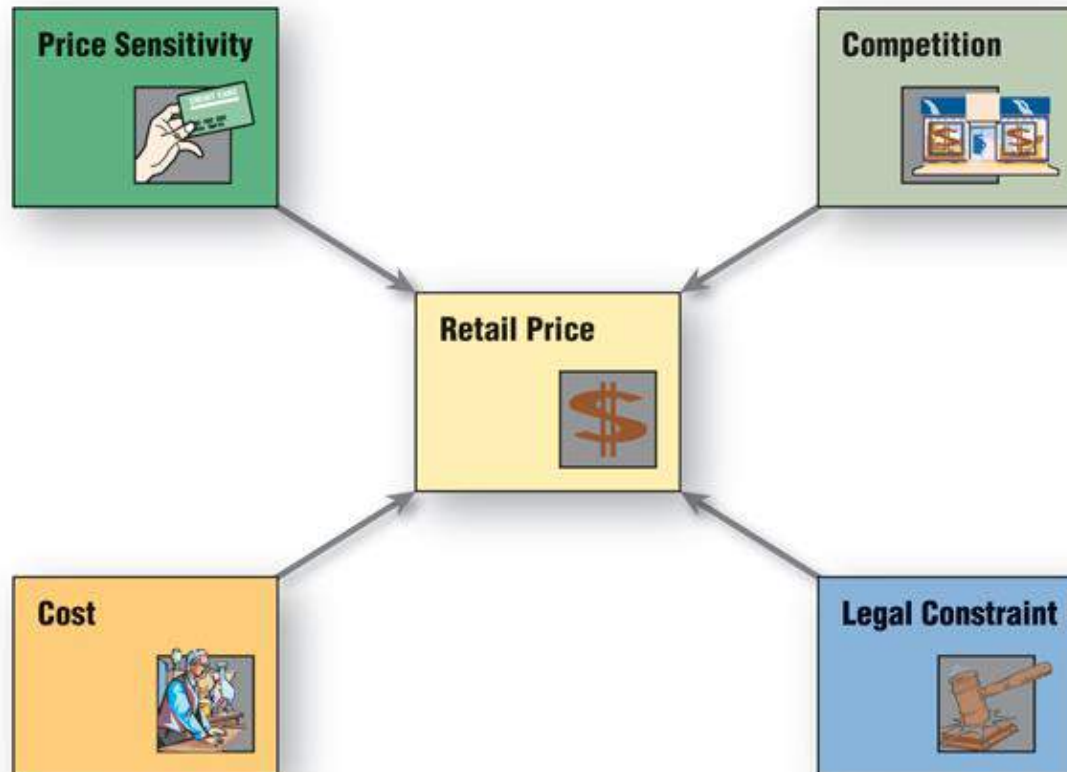
### ■ Disadvantages

- Trains customers to buy and wait on “deals”
- Has an adverse effect on gross margins

## 14-2 WHAT ARE THE ADVANTAGES/DISADVANTAGES OF...EVERYDAY LOW PRICING (EDLP)

- Retailers have adopted a low price guarantee policy to reinforce EDLP strategy
- Advantages:
  - Assures customers of low prices
  - Reduces advertising and operating expenses
  - Better supply chain management
    - Reduces stockouts
    - Improves inventory management
- Disadvantages:
  - Customers have access to pricing info for retailers anywhere (online)
  - Lack excitement of deals and specials (cannot offer discounts)
  - May have to sell a product at a loss
  - Limited service

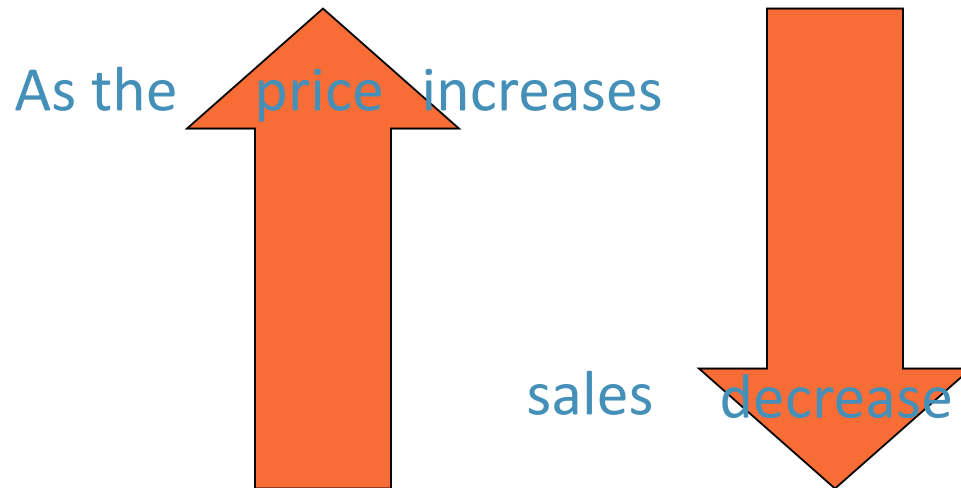
# 14-3 WHAT DO RETAILERS HAVE TO CONSIDER IN SETTING RETAIL PRICES?





# 14-4 WHAT DOES IT MEAN TO BE “PRICE SENSITIVE?”

Generally,



because fewer customers feel the product is good value

Price Sensitivity – the degree to which the price of a product affects purchasing behaviors

## 14-5 WHAT'S THE DIFFERENCE BETWEEN ELASTIC DEMAND AND INELASTIC DEMAND?

- ELASTIC DEMAND – a situation in which consumer demand is sensitive to price changes
- INELASTIC DEMAND – an increase or decrease in price will not significantly affect demand for the product

$$\text{Elasticity} = \frac{\text{Percentage change in quantity sold}}{\text{Percentage change in price}}$$

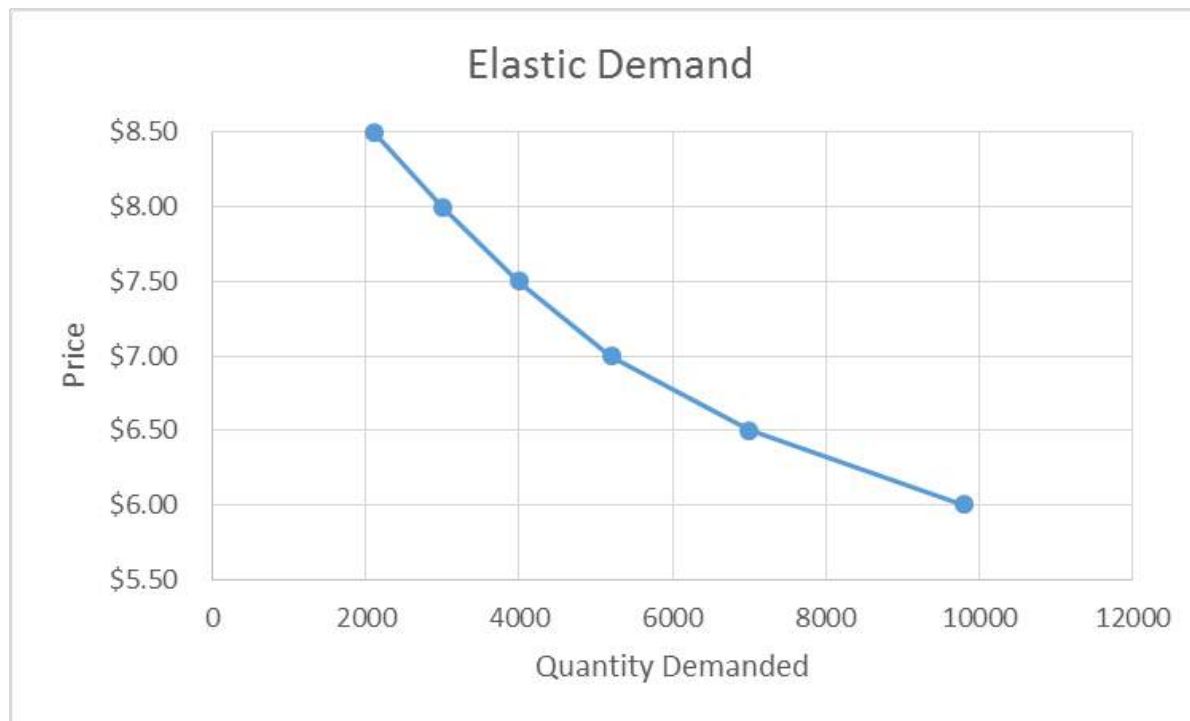
Inelastic demand when elasticity > -1 (price insensitive)

Elastic demand when elasticity < -1 (price sensitive)

# PRICE SENSITIVITY OF CUSTOMERS (DEMAND CURVE)

## Quantity Sold at Different Prices

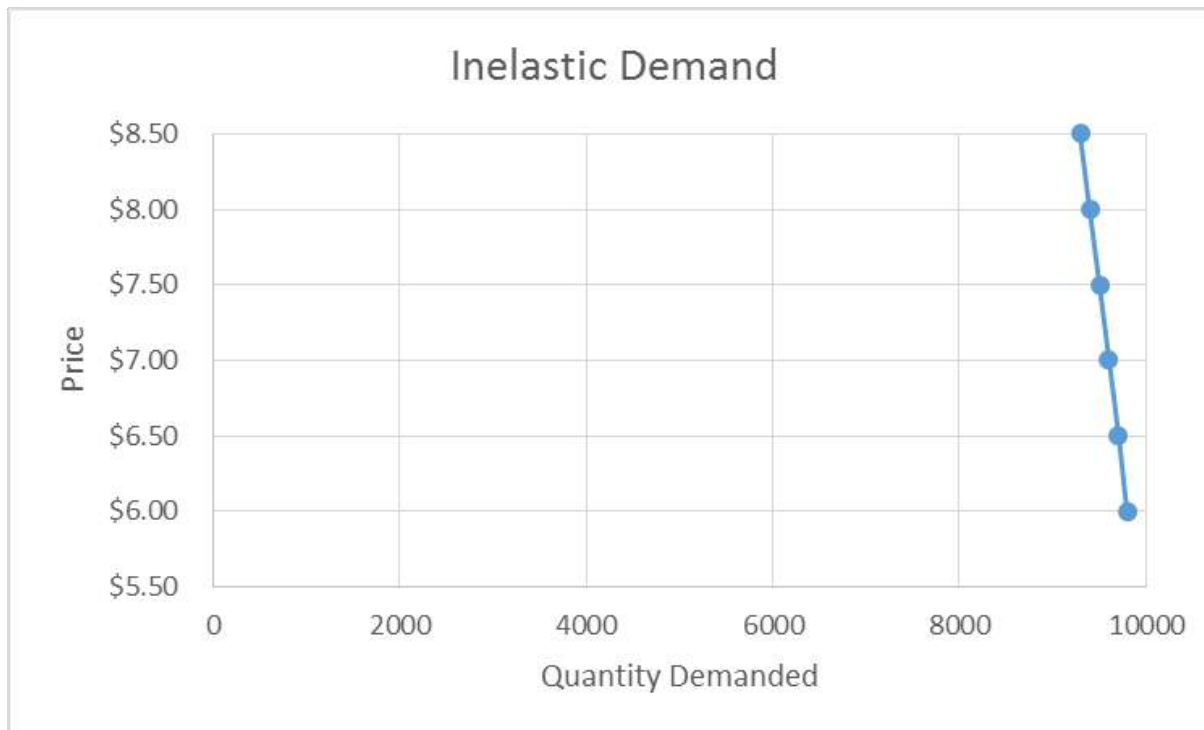
If customers are very price sensitive, sales decrease significantly with price increase



# PRICE SENSITIVITY OF CUSTOMERS (DEMAND CURVE)

## Quantity Sold at Different Prices

If customers are not very price sensitive, the quantity sold will remain relatively constant with price increase



## 14-5 WHAT'S THE DIFFERENCE BETWEEN ELASTIC DEMAND AND INELASTIC DEMAND?

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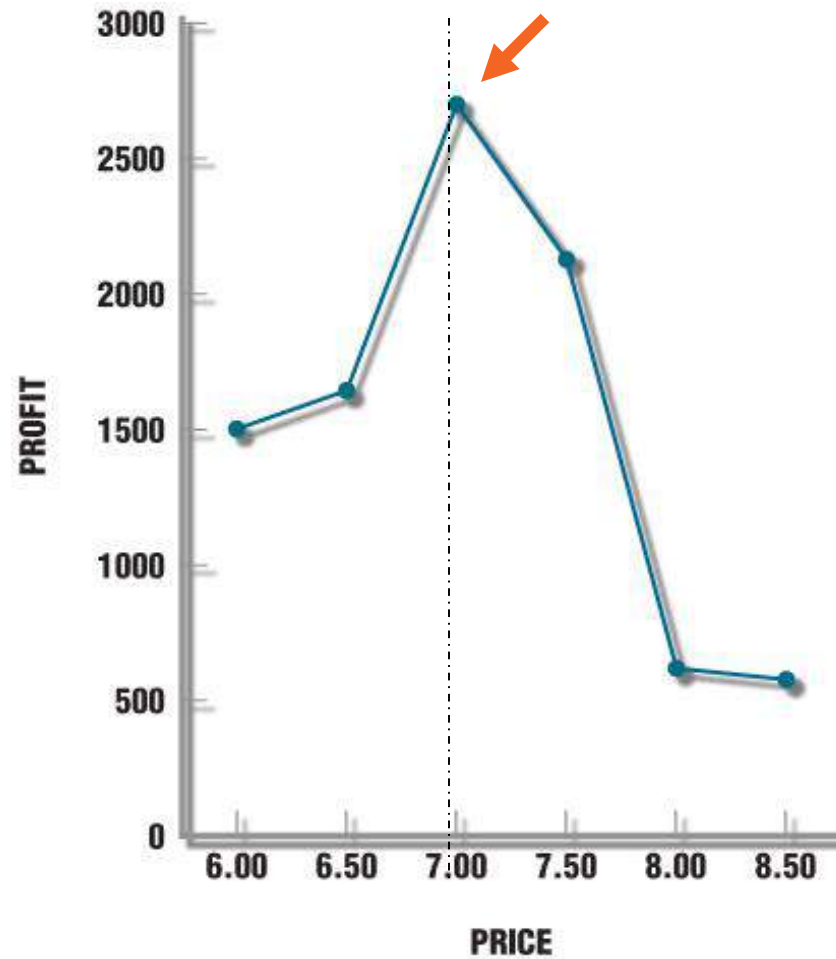
Inelastic demand when elasticity > -1 (price insensitive)

Elastic demand when elasticity < -1 (price sensitive)

## FACTORS THAT AFFECT PRICE SENSITIVITY:

- The number of product options/substitutes
- Price relative to their total income (or budget)
- Product durability
- Purchasing luxury goods vs. everyday items
- A product's other uses

# PROFIT AT DIFFERENT PRICES



## 14-5 HOW DO RETAILERS SET RETAIL PRICES?

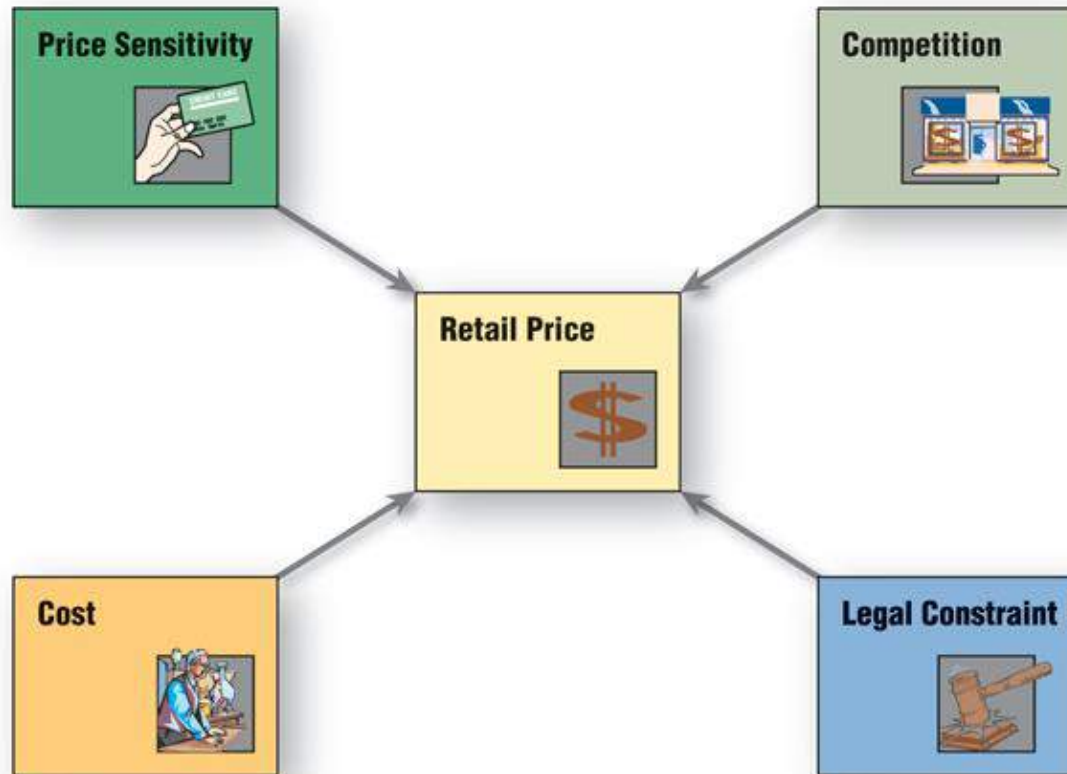
**Theoretically**, retailers maximize their profits by setting prices based on the **price sensitivity of customers** and the **cost of merchandise** and considering the **prices being charged by competitors**.

In **reality**, retailers need to set price for over 50,000 SKUs many times during year

- Utilize merchandise cost and pre-determined markups
- Adjustments based on customer price sensitivity and competition



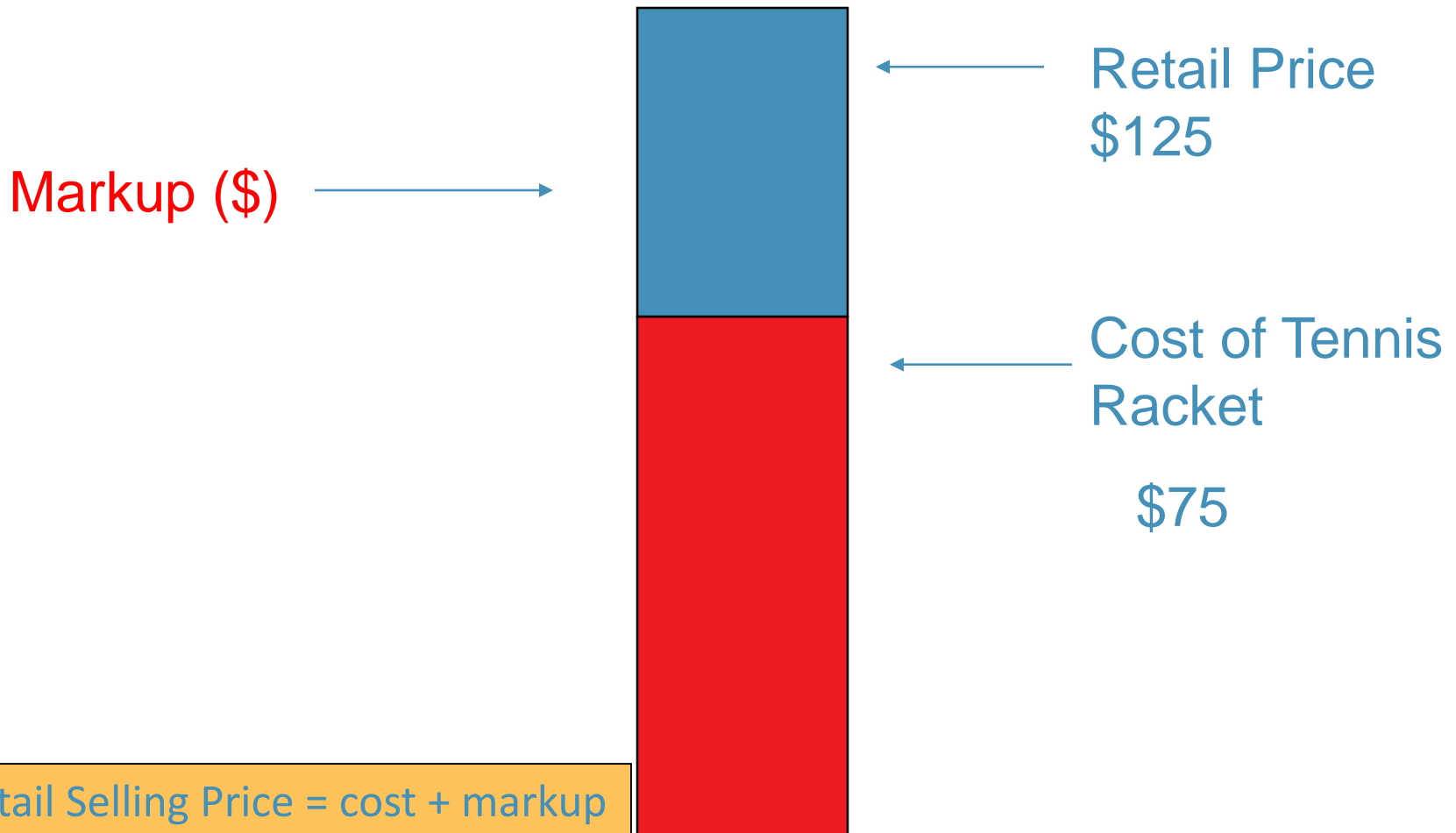
# WHAT DO RETAILERS HAVE TO CONSIDER IN SETTING RETAIL PRICES?



# WHAT IS A MARKUP?

- *Retail Selling Price = Cost of the merchandise + Markup*
- So, a markup is the difference between the retail selling price (SP) and the cost of the merchandise (C)
- *Markup = Retail Selling Price – Cost of merchandise*

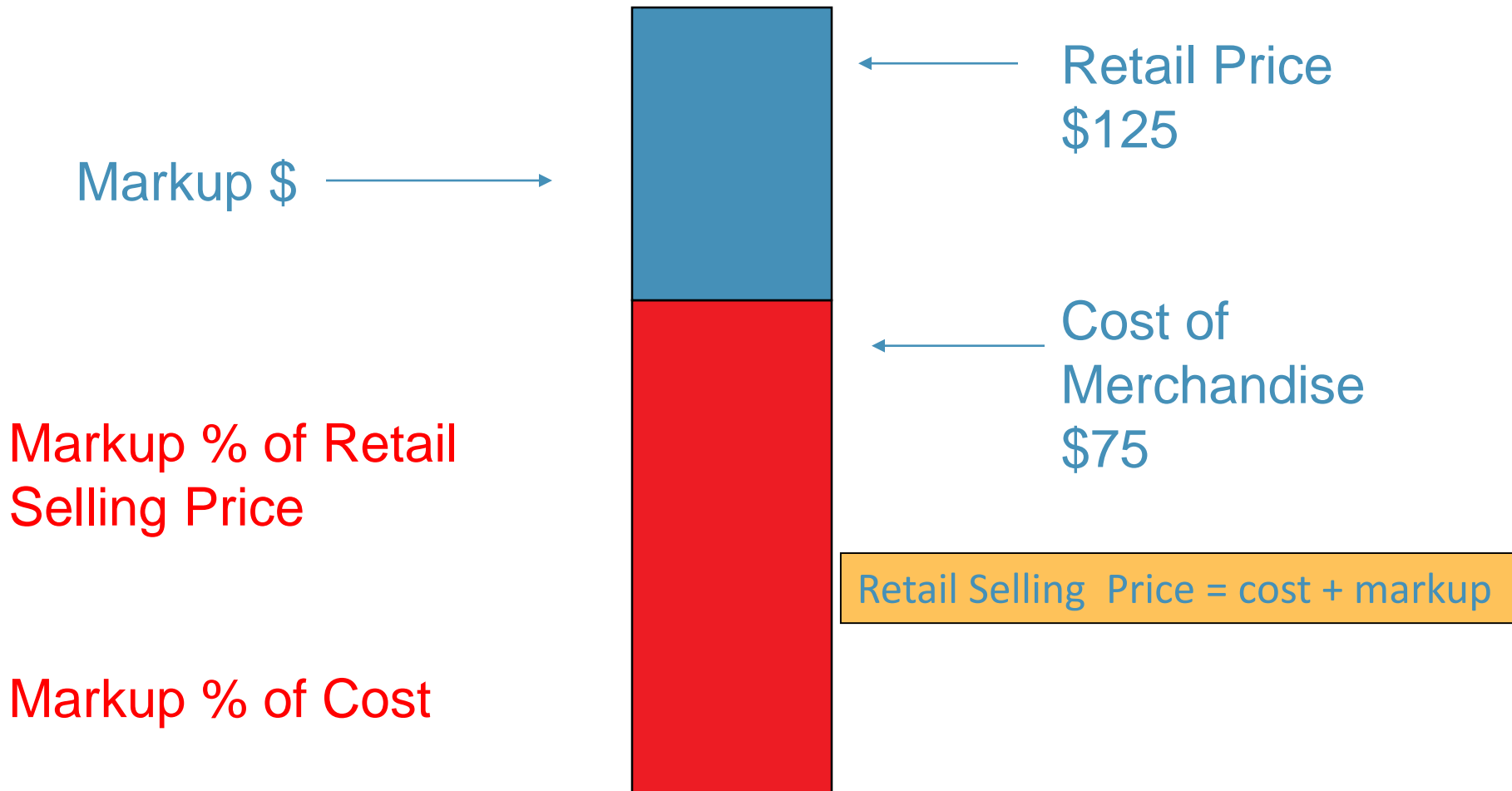
# 14-7 HOW DO YOU CALCULATE MARKUP AS A DOLLAR AMOUNT? (TENNIS RACKET)



## 14-7 HOW DO YOU CALCULATE MARKUP AS A PERCENTAGE?

- *Selling price = Cost of merchandise + markup*
- $M = SP - C$
- Markup is expressed as either a percentage of cost or as a percentage of selling price
- $\text{Markup \% on } SP = \frac{SP - C}{SP}$
- $\text{Markup \% on Cost} = \frac{SP - C}{C}$

# 14-7 HOW DO YOU CALCULATE MARKUP AS A PERCENTAGE?



## EXAMPLE PROBLEM:

- If the retailer buys a product for \$40 and sells it to customers for \$65
  - What is the markup in dollars?
  - What is the markup as a percentage of the selling price?
  - What is the markup as a percentage of the cost?

## EXAMPLE PROBLEM:

- If the retailer buys a product for \$180 and sells it to customers for \$225, what is the markup as a percentage of the selling price?

## 14-8 HOW DO YOU CALCULATE RETAIL SELLING PRICE WHEN A CERTAIN MARKUP% IS DESIRED?

- *Retail selling price = Cost of merchandise + Markup*
- $SP = C + (SP \times \text{Markup \% of } SP)$ 
  -
- $SP = C + (C \times \text{Markup \% of } C)$



## EXAMPLE PROBLEM:

- If the retailer can sell an item at \$35 and needs a 20 percent markup on retail price to meet profit objectives, what is the maximum amount that the retailer should pay for the item?

## 14-8 HOW DO YOU CALCULATE RETAIL SELLING PRICE WHEN A CERTAIN MARKUP % IS REQUIRED?

- $$\text{Retail selling price} = \frac{\text{Cost of merchandise}}{(1 - \text{Markup \% on SP})}$$

## EXAMPLE PROBLEM:

- A retail buyer for BestBuy purchases BluRay players for \$60 each and needs a 40% markup on the selling price. What should the retail selling price be for each BluRay player?

## 14-9 WHAT IS A MARKDOWN?

- Reductions in the retail selling price
  - To clear out (or dispose of) merchandise
  - For promotional reasons (create excitement

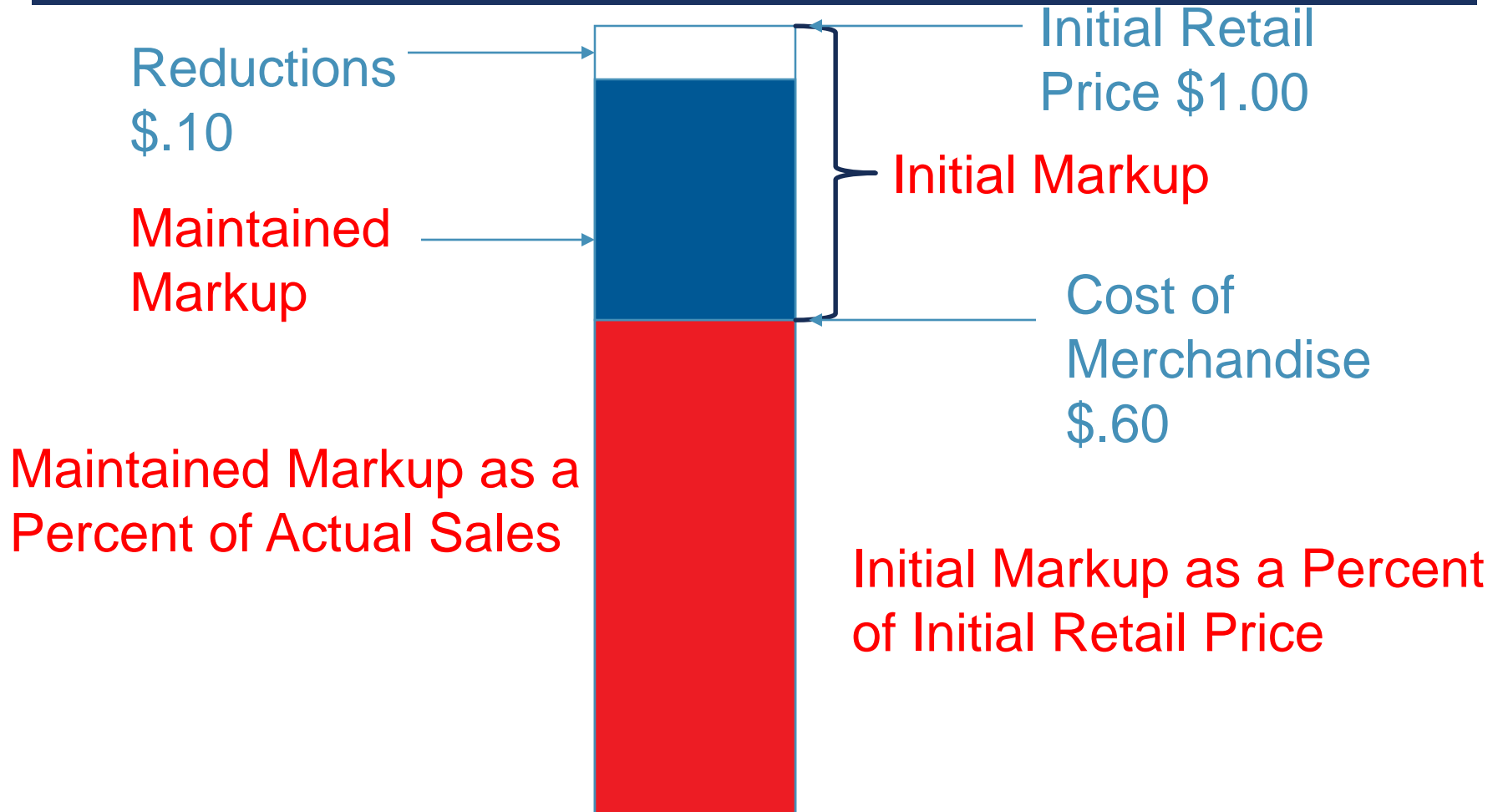
# 14-10 WHAT IS THE DIFFERENCE BETWEEN AN INITIAL MARKUP AND A MAINTAINED MARKUP?

- **Initial markup** – retail selling price initially set for the merchandise minus the cost of the merchandise.
- **Maintained markup** – the actual sales realized for the merchandise minus its costs



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# 14-11 HOW DO YOU CALCULATE MAINTAINED MARKUP AS A % OF ACTUAL SALES?



# 14-12 HOW DO YOU CALCULATE INITIAL MARKUP %? 14-13 HOW DO YOU CALCULATE THE INITIAL RETAIL PRICE?

$$\text{Initial markup \%} = \frac{\text{Maintained markup \% (as a percent of actual sales)} + \text{Reductions \% (as a percent of actual sales)}}{100\% + \text{Reductions \% (as a percent of actual sales)}}$$

$$\text{Initial retail price} = \frac{\text{cost}}{(1 - \text{initial markup \%})}$$

# INITIAL MARKUP AND INITIAL RETAIL PRICE

Merchandise costs \$.60. If the buyer planned on reductions of 10% of sales and wanted a maintained markup of 33% for the merchandise,

$$\text{Initial markup \%} = \frac{\text{Maintained markup \%} + \text{Reductions \% of actual sales}}{100\% + \text{Reductions \% of actual sales}}$$

$$\text{Initial retail price} = \frac{\text{Cost}}{1 - \text{Initial markup \%}}$$



# PRICE ADJUSTMENTS

Retailers adjust prices over time (markdowns) and for different customer segments (variable pricing / price discrimination)

# 14-14 WHAT ARE THE DIFFERENT TYPES OF MARKDOWNS?

- **Clearance Markdowns** to get rid of slow-moving, obsolete merchandise
- **Promotional Markdowns**
  - To increase sales and promote merchandise
  - To Increase traffic flow and sale of complementary products generate excitement through a sale
- To generate cash to buy additional merchandise



# PRICE OPTIMIZATION SOFTWARE

- Traditional Approach – Use a set of arbitrary rules
  - **Sell-Through:** Identifies markdown items when its weekly sell-through percentages fall below a certain level
  - **Rule-based:** Cuts prices on the basis of how long the merchandise has been in the store

# OPTIMIZING MARKDOWN DECISIONS

- **Markdown Optimization**
  - Software is used to determine when and how much markdowns should be taken to produce the best results by continually updating pricing forecasts on the basis of actual sales and factoring in differences in price sensitivities

## 14-15 WHAT ARE THE DIFFERENT TYPES OF VARIABLE PRICING & PRICE DISCRIMINATION?

Retailers adjust prices over time (markdowns) and for different customer segments (variable pricing / price discrimination)

### Price discrimination

1<sup>st</sup> degree – individualized (auction bidding)

2<sup>nd</sup> degree – self-selected (markdowns, coupons, etc.)

3<sup>rd</sup> degree – different prices to different consumer groups

# 14-15 WHAT ARE THE DIFFERENT TYPES OF VARIABLE PRICING AND PRICE DISCRIMINATION?

- Clearance Markdowns for Fashion Merchandise
  - Coupons
  - Price Bundling
    - McDonald's Value Meal
  - Multiple-Unit Pricing or Quantity Discount
- 2<sup>nd</sup> degree price discrimination
- Variable Pricing by Market Segments – Charge different groups different prices
    - Seniors Discounts
    - Kids Menu
  - Zone Pricing – Charge different prices in different stores, markets, regions
- 3<sup>rd</sup> degree

# 14-16 WHICH PRICING TECHNIQUES CAN RETAILERS USE FOR INCREASING SALES?

- Leader Pricing
- Price Lining
- Odd Pricing



# LEADER PRICING

- Certain items are priced lower than normal to increase customers traffic flow and/or boost sales of complementary products
- Best items: purchased frequently, primarily by price-sensitive shoppers
- Examples: bread, eggs, milk, disposable diapers



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# PRICE LINING

- A limited number of predetermined price points.
- Ex: \$59.99 (good), \$89.99 (better), and 129.99 (best)
- Benefits:
  - Eliminates confusion of many prices
  - Merchandising task is simplified
  - Gives buyers flexibility
  - Can get customers to “trade up”

# ODD PRICING

- A price that ends in an odd number (.9)
- \$2.99
  - Assumption:
    - Consumers perceive as \$2 without noticing the digits
    - 9 endings signal low prices
    - Retailers believe the practice increases sales, but probably doesn't
- Does delineate:
  - Type of store (downscale store might use it.)
  - Sale

# 14-17 WHAT ARE SOME OF THE LEGAL AND ETHICAL PRICING ISSUES?

- Predatory Pricing
- Resale Price Maintenance
- Horizontal Price fixing
- Bait and Switch tactics
- Scanned vs. Posted Prices
- Deceptive Reference Prices



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