MK 322 Retail Management
Chapter 14: Retail Pricing Part I

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Value

- Value is ratio of what customers receive(the perceived benefit of the products and services offered by the retailer) to what they have to pay for it.

- Retailers can increase value and stimulate more sales (exchanges) by either increasing the perceived benefits offered or reducing the price

Value

$$\text{Value} = \frac{\text{Perceived benefits}}{\text{Price}}$$

Pricing Strategies

Pricing Strategies

Two basic pricing strategy

- ✓ High/ low pricing strategy
- ✓ EDLP

High/Low Pricing

- Retailers use this strategy frequently
- Often weekly
- Discount the initial prices for merchandise through sales promotions
- Customers learn to expect frequent sales and simply wait until the merchandise they want goes on sale and then stock up at low prices

Pricing Strategies

The retailer on the left is using a high/low pricing strategy, whereas the one on the right is using everyday low pricing strategy.

Everyday Low Pricing (EDLP)

- This strategy emphasizes the continuity of retail prices at a level somewhere between the regular nonsale price and the deep-discount sale price of high/low retailers
- They occasionally have sales
- Although retailers use EDLP, may not be lowest price in the market, but their sale may be lowest

Advantages of High/Low Pricing

The high/low pricing strategy has the following advantages:

- *Increases profits.* High/low pricing allows retailers to charge higher prices to customers who are not price-sensitive and will pay the "high" price and to charg lower prices to price-sensitive customers who will wait for the "low" sale price.
- *Creates excitement.* A "get them while they last" atmosphere often occurs during a sale. Sales draw a lot of customers, and a lot of customers create excitement. Some retailers augment low prices and advertising with special in-store activities, such as product demonstrations, giveaways, and celebrity appearances.
- *Sells slow moving merchandise.* Sales allow retailers to get rid of slow-selling merchandise by discounting the price.

Advantages of Everyday Low Pricing (EDLP)

The EDLP approach has its own advantages, as follows:

- *Assures customers of low prices.* Many customers are skeptical about initial retail prices. They have become conditioned to buying only on sale—the main characteristic of a high/low pricing strategy. The EDLP strategy lets customers know that they will get the same low prices every time they patronize the EDLP retailer. Customers do not have to read the ads and wait for items they want to go on sale.
- *Reduces advertising and operating expenses.* The stable prices caused by EDLP limit the need for the weekly-sale advertising used in the high/low strategy. In addition, EDLP retailers do not have to incur the labor costs of changing price tags and signs and putting up sale signs.
- *Reduces stockouts and improves inventory management.* The EDLP approach reduces the large variations in demand caused by frequent sales with large markdowns. As a result, retailers can manage their inventories with more certainty. Fewer stockouts mean more satisfied customers, resulting in higher sales. In addition, a more predictable customer demand pattern enables the retailer to improve inventory turnover by reducing the average inventory needed for special promotions and backup stock.

Considerations in Setting Retail Prices

Considerations in Setting Retail Prices

1. The price sensitivity of consumers
2. The cost of the merchandise
3. Competition
4. Legal constraints

Customer Price Sensitivity and Cost

- Generally as price of product increase, and sales decrease due to fewer customers feel the product is good value
- Price sensitivity of consumers determines how many units will be sold at different price levels
- Price-sensitive reactions to a price decrease?

Customer Price Sensitivity and Cost

- Experiment

To determine the most profitable price for a riblet basket, a restaurant chain may set different prices at different locations.

Customer Price Sensitivity and Cost

One approach that can be used to measure the price sensitivity of customers is a price experiment. Consider the following situation: A restaurant chain wants to determine the best price for a new item, a riblet basket. It selects restaurants in the chain with very similar trade areas and sets prices at different levels in each of the restaurants for a week. Assume that the variable cost of the riblets is $5 per plate and the fixed cost of operating the restaurant for a week, the cost for rent, labor and energy, is $8,000.

The results of this experiment are shown in Exhibit 14–1. Notice in Exhibit 14–1a that as prices increase, the fixed costs remain the same, sales and variable costs both decrease, but sales decrease at a faster rate than variable costs (Exhibit 14–1b). So the

Customer Price Sensitivity and Cost

highest profit level occurs at a $7 price (Exhibit 14–1c). If the restaurant considers only customers' price sensitivity and cost in setting prices, it would set the price for the riblet basket with these demand characteristics at $7 to maximize profits. Retailing View 14.2 highlights how showrooming and mobile apps are increasing consumers' price sensitivity.

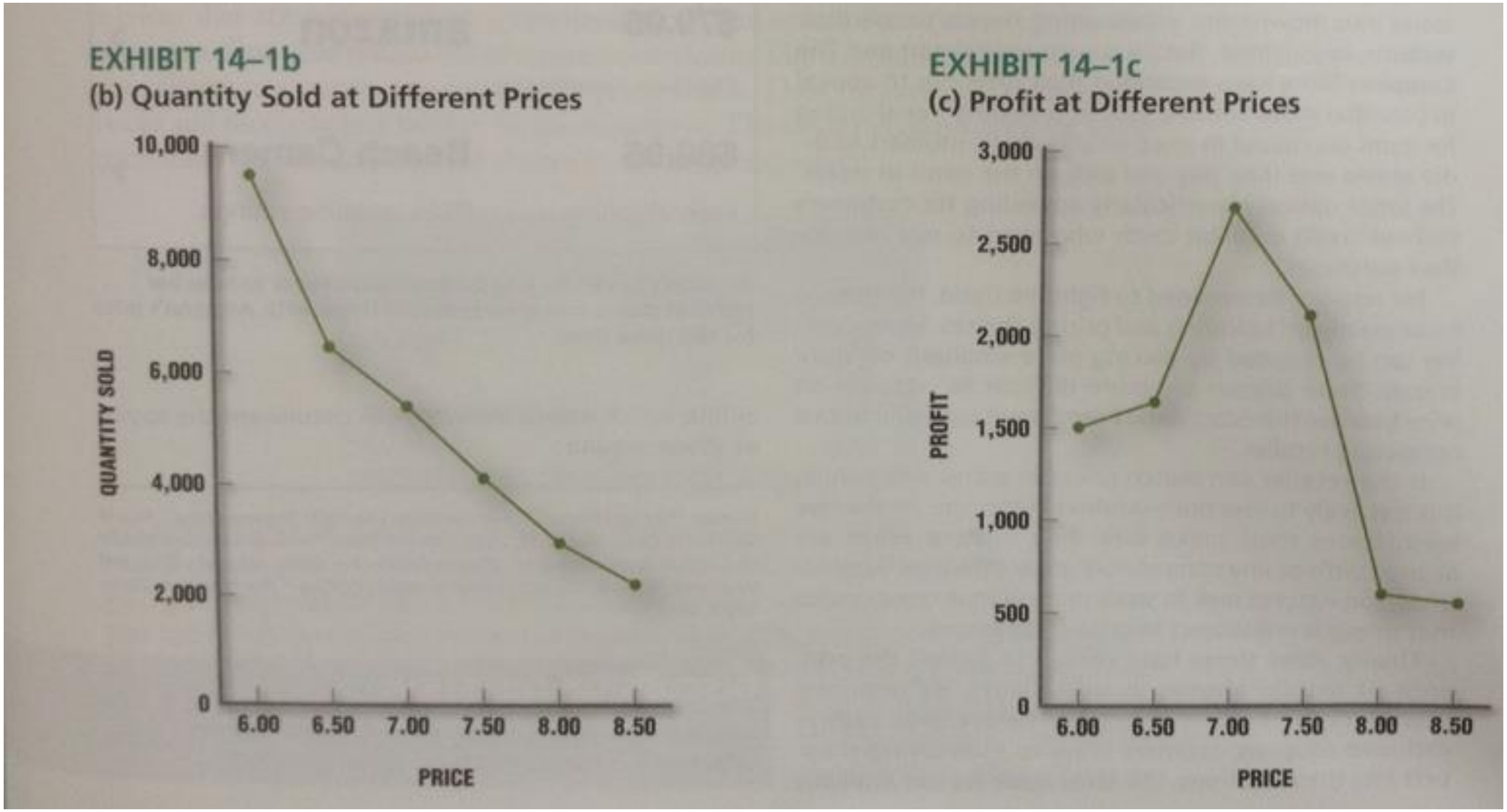
Customer Price Sensitivity and Cost

Price Experiment EXHIBIT 14–1

(a) Data from Price Experiment EXHIBIT 14–1a

(1) Theater	(2) Price	(3) Quantity Sold	(4) Column (2) × Column (3) = Revenue	(5) Column (3) × \$5 Variable Cost per Riblet Basket = Variable Cost	(6) Fixed Cost	(7) Column (4) − Column (5) − Column (6) = Contribution to Profit
1	\$6.00	9,502	\$57,012	\$47,510	\$8,000	\$1,502
2	6.50	6,429	41,789	32,145	8,000	1,644
3	7.00	5,350	37,450	26,750	8,000	2,700
4	7.50	4,051	30,383	20,255	8,000	2,128
5	8.00	2,873	22,984	14,365	8,000	619
6	8.50	2,121	18,029	10,605	8,000	−577

Customer Price Sensitivity and Cost



Customer Price Sensitivity and Cost

- Factors affecting price sensitivity

1. Substitutes- fastfoods (price-elastic)
2. Products and Service that are neccesity – medicare (price-inelastic)
3. Products that are expensive relative to consumer's income- cars (price-elastic)

Customer Price Sensitivity and Cost

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

Assume that a retailer originally priced a private-label DVD player at \$90 and then raised the price to \$100. Before raising the price, the retailer was selling 1,500 units a week. When the price increased, sales dropped to 1,100 units per week. The calculation of the price elasticity is as follows:

$$\begin{aligned}\text{Elasticity} &= \frac{\text{Percentage change in quantity sold}}{\text{Percentage change in price}} \\ &= \frac{(\text{New quantity sold} - \text{Old quantity sold}) \div (\text{Old quantity sold})}{(\text{New price} - \text{Old price}) \div (\text{Old price})} \\ &= \frac{(1100 - 1500)/1500}{(10 - 9)/9} = \frac{-0.2667}{.1111} = -2.4005\end{aligned}$$

Customer Price Sensitivity and Cost

Various factors affect the price sensitivity for a product. First, the more substitutes product or service has, the more likely it is to be price-elastic (sensitive). For xample, there are many alternatives for a riblet basket at a restaurant like Applebee's, nd thus fast-food prices are typically price-elastic, but branded luxury goods have lmost no substitutes and are price-inelastic (insensitive). Second, products and ervices that are necessities are price-inelastic. Thus, medical care is price-inelastic, vhereas airline tickets for a vacation are price-elastic. Third, products that are expen-ive relative to a consumer's income are price-elastic. Thus, cars are price-elastic, and ooks and movie tickets tend to be price-inelastic. The estimated elasticities for some ommonly purchased items are shown in the following table.[1]

	PRICE ELASTICITY	
Product Class	Short Run	Long Run
Clothing	−0.90	−2.90
Wine	−0.88	−1.17
Jewelry and watches	−0.44	−0.67
Gasoline	−0.20	−0.60

Customer Price Sensitivity and Cost

$$\text{Profit-maximizing price} = \frac{\text{Price elasticity} \times \text{Cost}}{\text{Price elasticity} + 1}$$

So, if the private-label DVD player described in the preceding example costs $50, the profit-maximizing price would be:

$$\text{Profit-maximizing price} = \frac{\text{Price elasticity} \times \text{Cost}}{\text{Price elasticity} + 1}$$

$$= \frac{-2.4005 \times \$50}{-2.4005 + 1} = \$85.70$$

Competition

- Retailers need to consider competitor's pricing when setting their own
- Routinely collect price data and adjust prices to remain competitive

Pricing Strategies

Target is reinforcing its low prices by highlighting its price match guarantee.

Pricing Strategy Used by Services Retailers

- The need to match supply and demand
- The difficulties customers in determining service quality

Pricing Strategy Used by Services Retailers

Airlines use yield management to adjust prices in response to demand.

Matching Supply and Demand

- Yield management is the practice of adjusting prices up or down in response to demand to control sales generated
- Computerized programs monitor the reservations and ticketing for each flight and adjust prices according to capacity utilization
- Prices are lowered on flights when sales are below forecasts and there is significant excess capacity
- As ticket sales approach capacity, prices are increased

Determining Service Quality

- Often difficult for customers to assess service quality due to intangibility
- Assessment offered to fees charge, ie. Legal service
- Higher risk situations tend to arise in relation to credence services – legal, medical services, and even hair salons
- Need to carefully select price as customers depend on price as cue for quality and helps retailers in capacity management


That's All Folks