Calculating Markup: A Merchandising Tool

Part 3: 3-2 Pricing Types

Pricing strategies usually consist of different **types** of pricing models from which the retailer may choose in order to select the best strategy and type for its store image, product offering, or channel of distribution. Additionally, it is also important to note that due to the stage of the merchandise in the **Product Life Cycle** (i.e., innovation, introduction, growth, maturity, and decline stages), not all product categories or classifications within the retailer's merchandise mix will have an identical price structure or use the same pricing strategy or types. Thus, the stage where the merchandise is positioned within the Product Life Cycle plays a major role in determining the retailer's pricing strategy.

There are two major types of pricing for the **New Product Pricing strategy: Market Skimming and Market Penetration**. Selecting a new product pricing strategy is very challenging, since the retailer is introducing a novel product to market and setting a price for the new product. The consumer is not familiar with this product and usually has no reference points for comparison to other similar items. Therefore, the consumer may not be able to determine the value of the merchandise.

Many companies use **market skimming** or setting the initial price high when introducing a new product. In other words, the company is "skimming" as much from the market as the market will allow from consumers willing to pay the higher price. The company makes fewer sales but the sales are more profitable ones. Then the company lowers the price after the initial introduction in order to attract more buyers who desire the product but are unable to pay or, do not want to pay the initial high price for the item.

On the other end of the spectrum, a company might introduce a new product with **market penetration** pricing. The price is set low in order to attract as many buyers as possible in order to create a high sales volume and a large market share. Eventually, due to the large volume of product being demanded by the customer, the cost of the product will decrease. Some refer to this technique as **Everyday Low Pricing (EDLP)**. For both market skimming and market penetration, certain market conditions are needed for the retailer to be successful.

The **Consumer Demand Pricing strategy** consists of determining the correlation between what the consumer demands and what quantities that consumer will buy when the product is offered at different retail prices in different markets. In other words, if the retail price changes on a product classification how does the change in price impact the quantities sold of that particular product. The retailer must determine if there is a significant change in the quantity of product sold with the price change, or if there is very little change in the quantity sold with the price change.

There are two types of Consumer Demand Pricing: **Target Costing** and **Segmented Pricing**. **Target costing** assesses what the customer will pay, or the "wished for" retail price, for a specific product. Then the product is developed at a cost which meets the ideal customer price, yet assures a profit for the company. **Segmented pricing** consists of adjusting the price of an identical product for differences in customers, products and geographical locations. In other words, an identical product with the same wholesale cost is priced at different retail prices based on the customer, the product or location. For example, on a specific day of the week, a retailer may offer its senior citizens a discount off selected products, while remaining customers purchasing the same product on that specific day pay the original retail price for the item.

Another pricing strategy commonly used in today's retail environment is coined as **Customer Value Based Pricing**. To set the retail price for the product, the consumer's perception of value (Reference *Part 3: 3-1*) is considered as well as what price the consumer assigns to that perceived value. Thus, consumer value perceptions become the main aspect with regard to pricing the goods. Therefore, pricing is considered at the initial innovation stages along with the development and design of the product and creation of the marketing program. There are two major types of Consumer Value Based Pricing: **Everyday Fair Pricing (EDFP) or Everyday Value Pricing (EDV)**; and **Value Added Pricing**.

Due to the current economic conditions in the marketplace and consumers' new buying patterns, many retailers currently use **EDFP**. Frequently, this pricing has resulted in new versions or less expensive designs of previous products offered at a similar quality or even lesser quality and at a lower price. Usually with this type of pricing, fewer discounted sales events are held during the selling season and more promotion of private label or store brands that have value-added features are included in the marketing strategy. With this type of pricing, a combination of quality merchandise and adequate services at a price considered as fair by the customer is essential.

Value Added Pricing has also become more popular in this competitive marketplace. When value added features, services or some types of exclusivity are added to differentiate the retailer's product and service offering, the retailer can demand higher prices. This technique also helps the retailer to position itself in the marketplace and to differentiate itself from its competition in order to gain a competitive advantage.

When a retail price is based on the costs for developing, producing, distributing, marketing and selling the product as well as realizing a profit for the company, the pricing is termed **Cost Oriented Pricing.** The pricing type that utilizes this pricing model is known as **markup pricing**. A standard markup is added to the cost of the product. This markup must cover the costs of the product, operating expenses, reductions, and profit. As previously discussed, markup is the difference between retail price and wholesale cost of goods for the retailer. This type of pricing is very common in the retail industry.

Another pricing strategy often used by the retailer in today's price sensitive market environment is **Competitive Pricing**. This pricing is based on conducting a competitive product analysis of similar or same merchandise classifications carried by the retailer and the retailer's competition. Then, retail prices are based on the competitors' pricing strategies, merchandise mix, and other market offerings. The types of pricing using the competitive pricing strategy include: **above-market pricing**, **at-market pricing**, and **below-market pricing**.

With **above-marketing pricing** (aka **prestige pricing)**, the retailer prices its merchandise with a higher markup than the competition. However, in order to use this type of pricing the retailer must maintain an upscale image with exquisite décor, an exclusive merchandise mix, value-added customer services and amenities, and be located in an ideal location with an attractive environment.

Most of the time, the at-market pricing type is utilized for competitive pricing. With **at-market pricing**, the retailer prices similar or identical merchandise near or at the same price as its competition. On the other hand, if the store has less overhead than its competition, operates on a lower profit margin than the competition, or needs to build additional foot traffic, the retailer may sell a similar or identical product at a lower retail price than its competition. This type of pricing is known as **below-market pricing**.

Selecting a pricing strategy and type is very complicated. Not only must retailers incorporate a mixture of strategies based on merchandise assortments and the competition, but also they must determine what types of strategies will be the most profitable for their store, while meeting the expectations of their target consumer segments. These pricing strategies and policies are under constant evaluation. Pricing of product drives the operations and profit of the store as well as determining customer satisfaction.