Retail Product Merchandising: Retail Buying-Selling Cycle

SECTION 2: Establishing the Retail Merchandise Mix

Part 1: The Basics of the Retail Merchandise Mix

Part 1: 1-7 Pricing Strategies

When establishing the retail merchandise mix, the retailer must consider the "right price" for each product classification in order to attract and retain the store's target consumer. *Price* is the terminology to designate the retail price of a product while *cost* is the term to denote the wholesale cost of that same product. Therefore, the retailer pays wholesale cost to the vendor for products purchased to build the store's merchandise mix.

Frequently, the retailer uses the wholesale cost as the base figure to calculate the retail price of the product. In other words, the retailer determines the retail price of an item by establishing markup dollars (i.e., difference between the retail price and wholesale cost of goods) needed in order to run a profitable business operation. (This concept will be explained in-depth in the following discussion of pricing strategies and types.)

Besides the wholesale cost of the product, the retail price of an item is impacted by the current health of the overall economy, trend modifiers, and consumers' perceptions of price versus value, as well as competitors' prices and the channel of distribution in which the product is offered. Additionally, the fashion level of the merchandise and the industry zone in which the merchandise is produced dictates retail price.

Based on the above factors, retailers use many different types of pricing strategies and policies in order to establish the "right price" for their merchandise mix. One most frequently used is *price lining* or *product line pricing*. For a particular product classification, the retailer determines the highest price (i.e., ceiling) and lowest price (i.e., floor) at which to offer the product to the target consumer. In between those prices are various *price points* or specific prices for retailing the item. Thus, a range of prices are created.

For example, a retailer might decide to retail sweaters in the Contemporary Department from $100.00 (i.e., floor price) to $300.00 (i.e., ceiling price). In between those prices (i.e., price points) other sweaters might retail at $150.00, $175.00, $200.00, $250.00, $275.00, etc. The consumer not only has a wide selection of product but also has a choice of prices at which to purchase the product category.

When introducing new, innovative product into the marketplace, retailers use one of three types of pricing: market skimming, market penetration, or market trial. When retailing the product, *market skimming* is based upon the concept of considering the fashion level of the product, store image cues, and unique product attributes in order to price the product at a premium or *prestige price*. The retailer then realizes or "skims" higher profits from sales of the product, regardless the amount of the sales volume realized when selling the product.

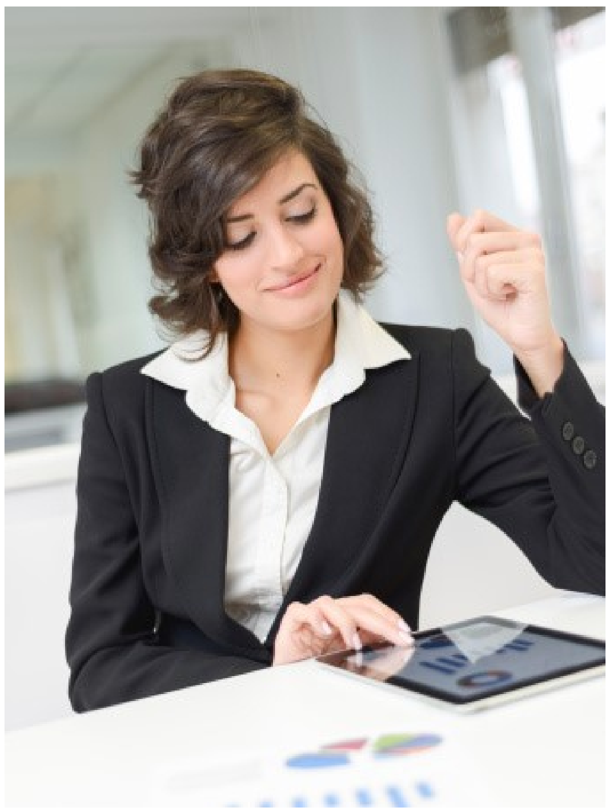
The opposite of market skimming is market penetration. When utilizing *market penetration pricing*, the retailer prices a new product at a low price in order to create a large sales volume as well as to build a large market share. As demand for the product increases, the costs for producing the product is lowered. The large sales volume generates revenue to cover the operating costs and desired profits for the retailer. An example of this policy is the *everyday low prices (EDLP)* Walmart® offers its customers.

Market trial pricing is introducing the new product in the market at a very low price and then increasing the price on the item as the demand for the product increases. The entry price is usually marketed as the promotional price of the item; and as demand for the product becomes evident, the consumer pays the increased price in order to purchase and own the new, innovative item already owned by a family member and friends.

As discussed previously, the retailer frequently establishes the retail price based on the wholesale cost of the goods. This policy is a type of *cost oriented pricing* or *markup pricing*. The retailer calculates the price of the product by adding the wholesale cost of the product, the retailer's operating expenses and reductions (i.e., markdowns, discounts, shrinkage), and the retailer's desired profit. Markups vary across product categories, store types, and channels of distribution.

When using this type of pricing, retailers often use a *keystone markup* or a markup consisting of doubling the wholesale cost of the item. However, due to the present economy, most retailers are currently using the keystone method but are adding extra dollars to cover the increase in expenses such as shipping, handling, and marketing costs. For example, a product that is purchased from a vendor at $75.00 wholesale cost might be priced with a keystone + $10.00 markup. Therefore, the retail price would be 2 x $75.00 + $10.00 or $150.00 + $10.00 = $160.00.

In the current competitive retail environment another major policy for pricing product is *competition oriented pricing* or *competitive pricing*. Retailers compare their prices of similar or identical product classifications to the prices of those same products found in the merchandise mix of their major competitors. Then the retailer prices the product to meet the price of the competitors. However, sometimes this policy does not produce the desired sales volume and margins in order for the retailer to cover operating expenses or reach the planned profit margin. Therefore, the retailer must develop options in order to respond to the pricing policies of the competition.



With competitive pricing, the retailer has three options to utilize when attempting to meet the pricing strategy of the competition and run a profitable business. Those options include: above-market pricing, at-market pricing, and below-market pricing. *Above-market pricing* is also known as *prestige pricing.* This type of pricing is calculated with a high markup, thus the product is sold at a higher retail price point. However, with above-market pricing, the consumer expects the retailer to provide a store environment with upscale décor and a merchandise mix with unique, exclusive, differentiated product.

Since many retailers in the same geographical location buy the same designer and/or national brands of merchandise and offer similar or identical product classification, all of these retailers are forced to retail the products at or near an identical retail price. This type of pricing is *at-market pricing* and is the most often utilized type of competitive pricing.

At other times, retailers who sell private label or brands and/or generic brands (refer to *Part 1: 1-8* of this **Section** for a definition of these brands) of similar product classifications use the below-market pricing policy. *Below-market pricing* is selling the same product at a lower retail price than the competition. With this type of pricing, the retailer must make sure that the store reaches its planned sales volume goals and meets it planned profit margins.

With the present economy, a new type of pricing or value based pricing is very prevalent in the retail marketplace. *Value based pricing* considers what the customer perceives as a fair price for the value of the product being purchased. Of course most consumers want the highest value in the product at the lowest price; however, today's savvy consumers understand that price does not always indicate the quality or status of the product.

Two types of value based pricing that are being currently utilized by a variety of retailers include *everyday fair pricing (EDFP)* and *everyday value (EDV)*. Everyday fair pricing (EDFP) implies that a quality product with features and attributes desired by the target consumer is priced at a moderate price point. Usually, retailers using this type of pricing policy offer fewer promotional sales on national brands while highly promoting their own private label or store brand(s) of goods. The marketing message directed to the customer states that the customer receives more value for the money when purchasing the store's private label or store brand! Additionally, some stores use the everyday value (EDV) pricing policy to indicate value-added product benefits in relation to fair pricing of the product.

Most retailers employ more than one pricing type when calculating the retail price of their products. Regardless the type of pricing policy, it is imperative that the retailer understands how the retail price of each product in the merchandise mix impacts the store's sales volume, profit margins, fashion image, and establishment of a merchandise mix that attracts the store's target consumer.

The last segment, *Part 1: 1-8 Types of Brands*, in this **Section** defines the many types of brands available to the retailer for building a store merchandise mix that not only attracts the target consumer and builds a larger market share but also promotes the desired sales volume and profit margin for the retailer to operate a successful business operation.