Retail Management
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Module No # 07
Lecture No # 31
Pricing in Retail

Hello everybody welcome to this NPTEL swam course on retail management. This is Professor Swagato Chatterjee from VGSOM, IIT Kharagpur who is taking this course for you, this is week 6 lecture 31 and we will be discussing pricing in retail.

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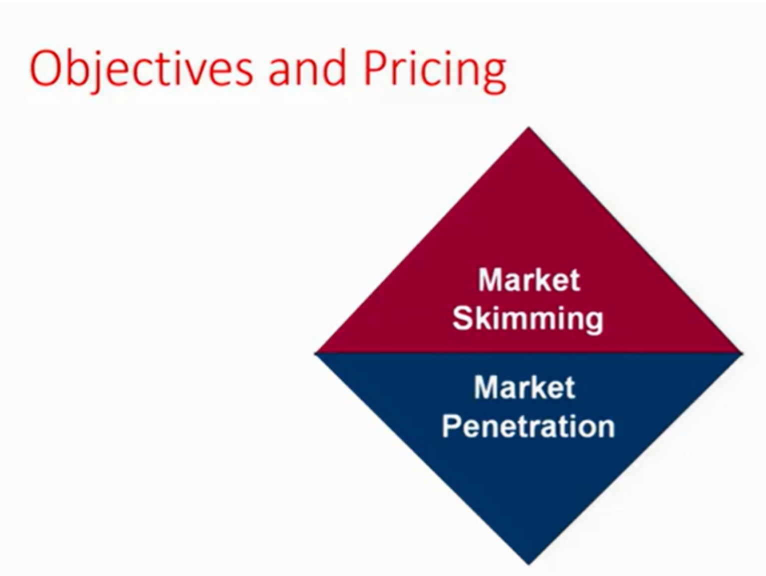

So, in the last class we were discussing about something called objectives and pricing and I told about 2 different kinds of pricing mechanism called Market Skimming and Market Penetration. Now in this particular class I am discussing about what are the various aspects which decide that why you will basically choose a particular marketing pricing strategy?

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So, those specific pricing objectives are like, to maintain a proper image, to encourage shoppers not to be overly priced-conscious. So they do not buy your product just because of the fact that the price is very high. To be perceived as fair by all parties so this is very important on all parties means even the suppliers. If the suppliers think that you are not paying them well.

However you are charging a lot to the customers from the customers that they bad mouth about you and they when they bad mouth about you that impacts your bad image at the end of the day. So, to be perceived as fair by all parties that is important when you are choosing pricing even let us say by other context in in what other context this fairness comes into the picture.

Let us say you have so flash cell have you heard about this term flash cell is basically when a very lucrative product is giving in a e-commerce platform, let us say something like Amazon or Flip kart for a very small period of time. So let us I am launching a iPhone or I am launching a new MI kind of a high end MI mobile phone. So what I will give is that the mobile phone costs around 51,000 or 60,000 rupees.

And for a very brief period of time I will allow people to buy it through Amazon only at a price of let us say 25,000 rupees. So now many people will try to buy at that point of time and only let us say handful of people let us say 100 or 200 people will get ultimately get the chance to buy it. So what happens is? By using this classical kind of mechanism people try to create a bazz the brand managers try to create a bazz.

That people will know about your brand people will create so the number of people who are trying to buy becomes advertising point. So they create I would say sense of scarcity, sense of exclusivity of that particular product, which ultimately leads to higher branding. However, there is a problem there is a backfire there is a probability of backfire. That a customer who did not get the product at a price of 25000 might start feeling that it is not fair.

That some of them just because they have got good internet connection or good whatever be they know the gimmick of how to get this thing the other customer got and I did not get it. So when I did not get it they might start feeling that I will not buy anymore. So this kind of a backfiring they might start thinking that this particular brand does not focus on fairness, does not give value to fairness, that kind of feeling might impact a brands perception.

So that is why this perceived to be fair by all parties becomes very important. To be consistent in setting prices to increase customer traffic during slow periods, for example we use coupons are heavily used to do this. For example, at one point of time people in the newspaper cutting or with the newspaper leaflets were being distributed by a retail manager. And what this particular cutting or the coupon will do is that you can redeem the coupon of 20% discount or 30% discount only at a certain time period.

But for example, let us say I know that every Wednesday the second half that means the afternoons are less amount of footfall is happening. Because in the mid-week and then afternoon means the working period people are generally busy so the footfall remains low. But I want some amount of people who are price conscious at least to come because see a vacant store does not mean I can close the store.

I have to keep the stores open, I have to pay to my employees, I have to keep my electricity's lights and fans and AC is open, because I have to pay for them so all this thing is a problem. So what people do then is that they ask the retail managers ask the customers to redeem that coupon on those particular days. So those who are price conscious will be probably coming to that particular time period, so it will increase the customer traffic during slow periods.

So to clear out seasonal merchandise you will see that year-end sales and the stock clearance sales are very common to match competitor prices without starting a price bar. So it is better so sometimes we do pricing in such a way that we price match we do not go for a competition that you reduce I reduce you decide because then the both the competitors will basically kill each other.

So rather than doing that they decide that this is the range of the price that I will keep you also keep in that range only not exactly same but within a range. So that people who come to your shop will not be pached by me, or people who comes to my shop will not be poached by you, so that kind of balance is there.

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What other objectives are there to promote we will not be undersold philosophy so if you do not want to although sell that**,** I will not reduce the price at a below a certain point that kind of a message can be given by pricing policies. To be regarded as the price leader in the market area by consumers so if you want to be a price leader means you set the price based on that other people said the price heavily happens in the case of real estate.

A big builder a well-known builder a branded builder will set the price and then based on that other people will set their prices and that is how particular areas per square feet cost will be understood. To provide ample customer service so you charge a lot of price so that sometimes you charge an extra premium to so that you can give customer service that is that you want to give.

So if otherwise, probably will only the customers will not be interested with those customer service or they will not even know that they are interested with that customer service. To minimize the chance of government actions relating to price advertising and entry task matters. So this is important, so government basically regulates prices for not only for commodities, sometimes for products also.

So we have to be sure that we do not by through pricing we are not attracting the attention of the government regulators who will then take strict actions against us. To discourage potential competitors from entering the marketplace so this is a very good strategy we call it a entry barrier, that you charge so low that the potential cost competitors will not even think of coming.

So this is done majorly when let us say you want to capture a market a big market is there you want to capture based on the volume, and you do not want a competitor to bring in which is often foreign competitors. To create and maintain customer interest and to encourage repeat business, so these are some of the pricing objectives based on all based on these also the decisions will change.

For example, if you we want to regard it as the pricing leader, then your strategy will be branding, and you want to make sure that your brand is differentiated from other bands. However if your strategy is to not let other people enter the market your pricing should be as close as to the cost. And because you are economies of scale is high because you are already in the market and you have invested a lot and your economies of scale is high your cost is already low.

So if your price is just a little bit higher than the cost, then anyway the new entrants will be not able to come in, because new entrants will not have that much of economies of scale. So they have to price a little bit higher and if you are you are playing on the prize game then they will not be able to compete with you. Only those people will be able to compete with you, who are ready to incur a huge amount of loss in the initial years, and they will also capture the market and they will compete.

So that initial huge amount of loss small companies will not be able to compete with you because they do not have that much of deep pocket, only big companies are very large investments will be able to basically come into your market. So that is the pricing strategy that sometimes the bigger organizations take to ensure that the new entrance does not come into the market so that is another pricing objective.

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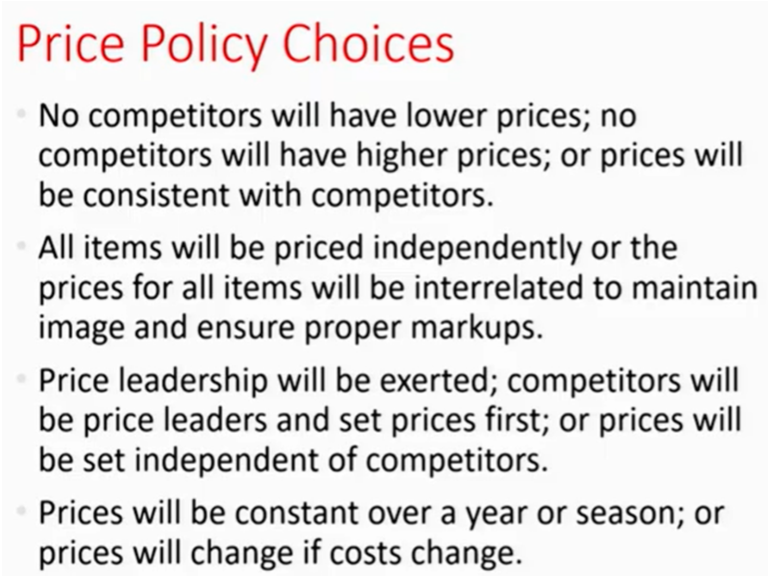

Now, there are various kinds of price policy choices that are also there for example, no competitors will have lower prices; no competitors will have higher prices; or prices will be consistent with competitors. This is a pricing policy choice that sometimes people take, that my price and your price will be in sync with each other nobody will have higher nobody will have lower.

So this is possible when the volume of the market is big, so that people do not people can coexist 2 organizations can coexist in the market as an oligopoly. Another policy can be all items will be priced independently or the prices of all items will be interrelated to maintain image and ensure proper markups. So you can choose any one of them you can either choose all the prices will be independent so some prices can be high some prices can be low I do not care.

So let us say Amazon's platform if you go there will be that kind of things you can find out. But if I want to have a consistent image then all prices will be interrelated all prices will be in sync in terms of for example, if you are trying to sell through Myntra. Myntra does not have individual brands or individual bands are not that strong. So Myntra’s all the products will be of similar range they are interrelated there will be high low medium range product but still they are interrelated.

It will not as vary as much as that you can get in Amazon will be very highly valid because the individual brands like Philips, LG, Samsung, that are selling through Amazon will have their own say in that particular pricing storage. Price Leadership will be exerted; competitors will be price leaders and set prices fast; or prices will be set independent of competitors. So you can decide which strategy will take whether you will take competition based strategy pricing policy or you will say set independent.

So in a market let us say which is; a commodity market, often this competitor based pricing strategy is taken. For example, cement if I talk about the cement people know that the Laffer, JCC will fast decide their price and based on that the other ones which are smaller brands in the cement market, let us say. So I forgot the names anyway so the smaller brands basically will select their prices based on the market competitors pricing strategy.

So, they are all those dynamic pricing and these and that will not come into the picture, you decide that he has priced on at that particular level I will price in this level. So, the coexistence also remains people try to make sure that the higher order market I will capture, the middle order market you capture, and the lower market I will set aside for somebody else.

So although, these are these collusions are not correct but these kind of collusions are there in the market unwritten rules are there in the market and people price accordingly. Prices will be constant over a year or season; or prices will change if costs change. So sometimes we decide a price and we stick to the price over this year, or sometimes the prices is very fluctuating, depending on the cost, depending on the demand, depending on the market situation. We change the prices.

So these are also another strategy that another pricing policy that an organization can take. Now all these policies are not very distinct, it can also be a fact that certain policy overlaps with other policies. For example, it can be a case that and one organization is going for a constant price, but that price is a market leader focused price, so market leader decides the price, he will choose a price based on market leader, and that price will remain constant over time over the 1 year or over 1, 3 months or 6 months.

So that kind of pricing policies which is a combination of multiple policies that I have talking about here can also be there in the market. Now which one is better, which one is worse, can be decided in multiple ways. One is that you do demand projections and do mathematics to find out that which pricing policies will give you best, but that will require analytics, which will require a little bit of estimations of demand estimation of impact of pricing policy on your business, and etc which requires a little bit of sophisticated mathematics.

There can be psychological aspects also in the pricing that how pricing is perceived to be fair as I told that how pricing will impact customer's decision making how customers will perceive your brand when the prices are not interrelated with each other. So that kind of stuff the psychological part will also come into the picture.

And then accordingly you have to find out certain feasible prices and you have to compare those prices to come up with a decision. Which is itself a separate subject, which should be taught as a separate subject altogether, pricing in retail context, and pricing in any other context for that matter, and but here we are just talking about how retailers can decide among the pricing.

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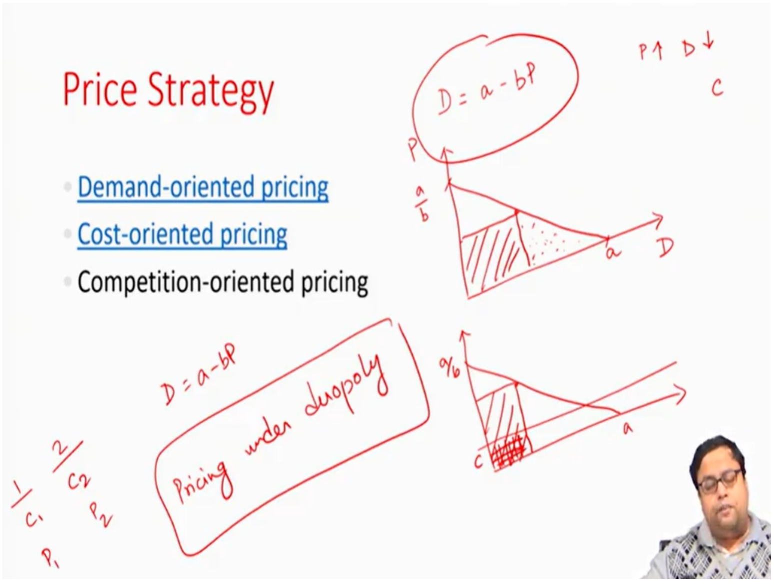

So when we talk about pricing strategy for the retailers these are the major 3 strategies that retailers take, one is demand-oriented pricing, one is cost-oriented pricing, and another is competition-oriented pricing is the 3 main strategies. What is demand oriented pricing? Demand oriented pricing is the one that we discussed in the last class if you remember, that we told d is equal to D = a - b P, when P increases price increases demand drops.

So if I try to draw the line then let us say this is the demand curve price this is the demand this is the price and this is the demand curve when price is zero demand is a when price divided by demand is zero price is basically a by b. And if I note if you are a monopoly this is the price that you go for which is the middle one, now there can be other context for let us say there is a unit cost of C.

If you see unit cost of C then this curve like this and this is your unit cost let us say C and then you go for basically the middle point of this particular if you are a monopoly. So this much is your revenue, and this much is your cost, so the above of that is your profit, and you decided according as per that. Now there if there are multiple players, if there are 2, 3 players then what you decide.

Let us say D = a - b P and let us say there are 2 players, player 1 and player 2 is different based on their cost C 1 and C 2. Now it is a game that comes up and you have to decide that let us say there is a market leader game. What is the market leader game? As I told remember that it is market leader oriented so who is the market leader whose cost is low, why cost is low, because his economies of scale is high or they are technologically powerful.

So I stop I have 2 strategies that I can take, one is that I can choose the price independently, or I can wait and the one let the market leader decide that what is the pricing. How what will I do if the market leader decides what is the pricing, then the market leaders say that market leader decides let us say I the price is P 1 and the price is P 2 here. So a person will come to market leader as long as that so I am getting the same product and there will be a certain valuation of the product.

So some people will come to the market leader, some people will not come to the market leader, so let us say the market leader start the pricing fast decides on the pricing fast. So market leader prices at that particular point which is a by b and a, the market leader let him price. Now based on that this is the area which is not captured till now so I have to I am still I can capture this particular area.

So based on that I can decide the pricing otherwise I can do one I can go and do the pricing together at the same time. So these are some of the strategies which can be answered through game theory models. I am not going to deal it with here but there are certain game theory models based on which you do demand oriented pricing. But ultimately the pricing will be dependent on this D = a – b P.

So you can study about pricing under oligopoly or duopoly, this is 2 people so duopoly but there is a market leader and market follower you can you can study about that and you will get an idea that how these are priced. Oligopoly means when there are few amounts of players are there in the market and you are trying to price accordingly. So, these kinds of pricing strategy are there that we try to take.

Now comes up is the cost-oriented pricing, what is cost oriented pricing? You decide a markup value desired a cost and you decide what percentage of markup margin i can keep which is fair, which is sensible, which covers my cost, which makes sure that my strategic objectives are also made so that is your cost-oriented price.

And competition-oriented pricing is when you are pricing based on the image of the competitor whatever the competitor price you decide? That whether I have the similar kind of image of the competitor or not and based on that you are pricing that is called competitor-oriented pricing. So these are some of the pricing strategies that a customers can take now a company can take a retailer can take.

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Now, demand-oriented pricing has again there is a component called psychological pricing in that. So I took I have shown the picture which is how price demand changes based on price. But there are psychological aspects as well like Price-quality association. Certain people decide things that the product quality that you are providing is a function of the price that you are playing charging.

So then this D = a – b P where I am saying price goes up and demand comes down may not be true always. For example, where let us say I am talking about a demand of a doctor, you will see oftentimes a demand of a doctor is dependent on how much because that price is a signal of what is the quality of the doctor, or the by the quality of the doctor's time. Majorly applicable for hedonic products, majorly applicable for expertise-oriented products, where you do not have the ability to basically judge the quality of the products.

In such kind of context sometimes price is in sync with the demand. For small regions not for very high let us a 100 rupees and 1,000 rupees the demand will be very different. However, within 1000 to 1500, in that range a person may probably go for 1,500 and not go for a 1,000 rupees doctor depending on that price quality association.

So within small buckets this price quality association comes into the picture and the price goes or demand comes down may not work. Another is called prestige pricing sometimes pricing is related is basically I would say gets correlated with the brand image that you have. And you charge high only based on the hedonic benefit that this brand is giving.

For example, Harley Davidsons type of car you have a very powerful engine fair enough but does that powerful engine is to charge let us say around 3 lakhs, 4 lakhs, for a bike it is the cost that is charging that particular increasing the particular price probably no. Probably the image that this particular brand has brought into the picture will actually impact the pricing component that we have. So that is called prestige pricing which also is an important factor when we talk about demand oriented pricing.

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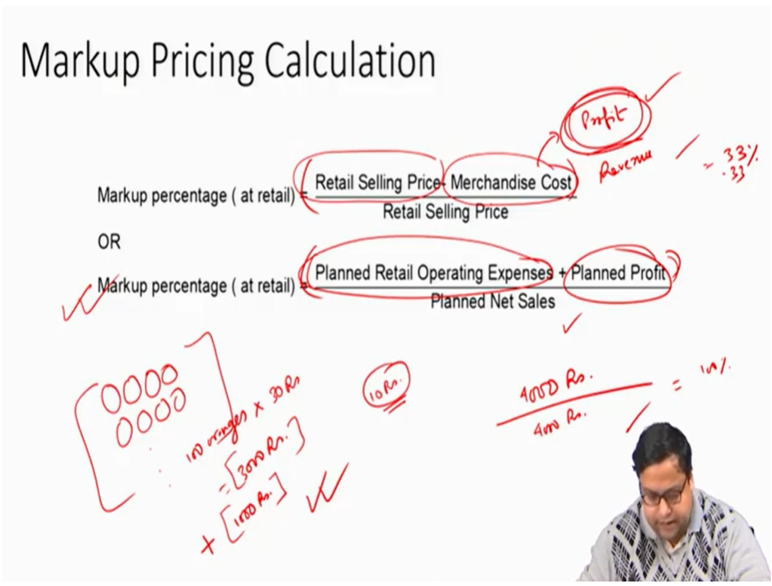

In the markup pricing what is most important is how you calculate the cost and how you input the cost in the in your analysis. For example, in the retail the markup percentage and this is very common in retail because most of the big retailers actually are competing on this markup. So markup percentages retail is the retail selling price myself minus the merchandise Cost.

Merchandise cost means the price at which you bought it from the manufacturer or wholesaler. And retail selling price is the selling price so the so retail selling price minus the merchandise cost is your profit your net margin that the retail again divided by the retail selling price. So that is your markup percentage so basically this is the profit the retailer makes, profit divided by revenue is the markup percentage.

$$\text{Markup Percentage (at retail)} = \frac{\text{Retail Selling Price- Merchandise cost}}{\text{Retail Selling Price}}$$

$$\text{Markup Percentage (at retail)} = \frac{\text{Planned Retail Operating Expenses+Planned Profit}}{\text{Planned Net Sales}}$$

Now the same thing can be seen in a opposite way, so planned retail operating expenses plus planned profit. Whatever, expense that you want to have you have made plus the plan profit this is what you want to incur through this profit basically. So, you want to check make sure that this profit is same to this profit divided by planned net sales. So, sometimes you do the markup you decide the markup based on your planning based on your estimation.

So estimated cost plus the profit that you want divided by the estimated sales will be can also be the markup. So let us say I estimate that I will I if I buy 100 let us say oranges, there are 100 oranges and the cost of oranges is let us say I do not know 30 rupees per each then 3, 000 rupees is my estimated net sales.

And out of this is my operating expenses so this is my expenses and I assume that I will make. So I am investing 3,000 rupees I should get some amount of profit so I am expecting that by investing 3,000 rupees which will the orange will get bad after 7 days, or 10 days, or 15 days. But in these 15 days I should earn another 1000 rupees so my plan profit is 1000 rupees.

So, then 4,000 rupees is what I expect to be my plan profit, and out of this thing how many will be sold not 100 oranges will be sold. So I have to estimate that in 15 days how many can I sell in general. I am buying more than that because I want to make a little bit of there can be fluctuations in the market and not want to lose market. So I am assuming that let us say 80 I will be able to sell.

So 80 if I sell it at a rate of let say the 50 rupees then or let us say 40 rupees then let us say, so then 80 into 40 will be 3200 or something like that. Or if I want to if I can sell 100 only and if I want to sell it in forty rupees so then 100 into 40 will be 4,000 rupees. So then what will be the percentage basically 100%, so my markup price so this is 3,000 rupees I am making 3,000.

So, 10 rupees is my margin which is basically the plan net sales comes up to be so if the 10 rupees is my margin, I have to make sure that this is equal to this at the end of the day. So whatever markup percentage I am calculating that should be equal to the net selling price minus the merchandise cost the net selling price is 4,000 rupees minus the merchandise cost is 3,000 rupees divided by the selling price which is 33%. I have 33.33% as per this calculation.

I have to make sure that my operating expenses and my plan profit should also be in that range. If my operating expenses plus planned profit divided by the planned net aales are also in this range then this is a correct markup percentage that I am choosing.

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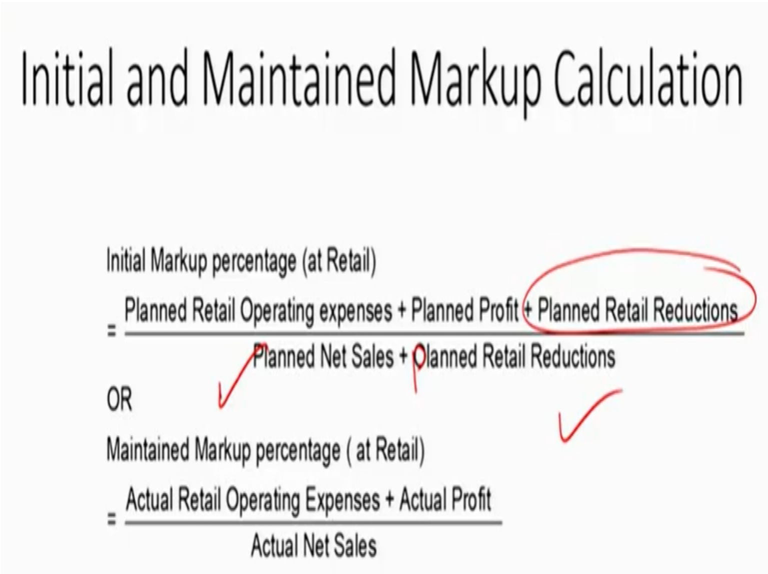

I can also go for initial and maintained markup calculation, how so the initial markup percentage is the planned operating expense plus the plan profit plus the planned retail reduction. So there will be certain amount of retail reductions come certain retail cells will come back. So I have to also make sure for that and there will be planned retail sales plus planned retail reduction, so this part will also be taken care of.

So this maintained markup percentages actual retail operating expenses plus actual profit divided by the actual net sales. Because certain amount of net sales will also come back because of the product returns and etc. So I should make sure that the markup price that I am charging is also thinking about that particular amount is also taken care of.

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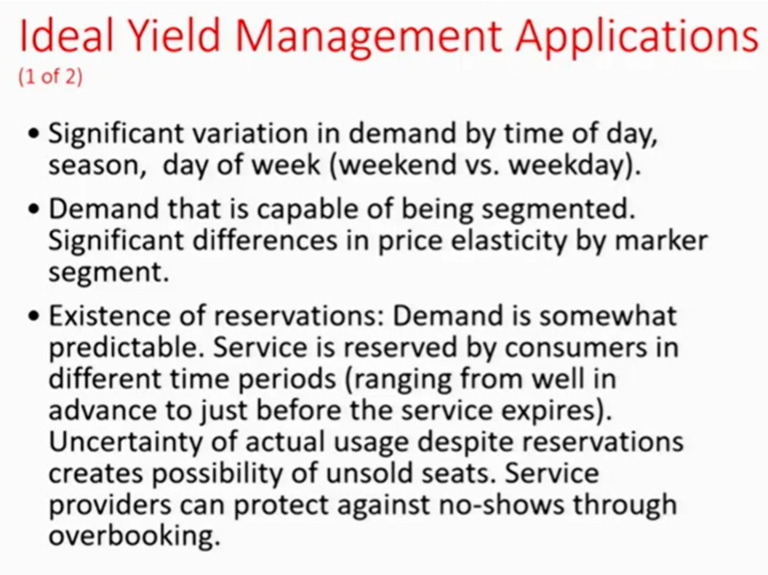

Now last topic under this pricing is called yield management. So yield management is basically it is related to that I have certain items in my hand, it can be hotel rooms, it can be let us say it can be seats of air lines. Similarly in this particular case in the service context this yield management comes into the picture. So significant variation in demand by time of day, season, day of week, happens in a retail store and you have a huge retail store.

And that is a basically an investment on the infrastructure and you have to make sure that that infrastructure investment is taken care of. So how do you do that so demand that is capable of being segmented you try to segment that like for example, I told you about the coupon example.

By coupon you are basically segmenting the overall customer based on the price consciousness of the customers, and price conscious customers come at one way, price on price less sensitive customer will come and basically buy in any day. But price sensitive customers you are trying to be bringing in a certain day in which day the significant variation in demand means demand is low, and demand is not very high. But still you have to open up your store in that day you are trying to bring in the price sensitive customer.

So you are basically segmenting the customers doing a strategy. Another way of doing this Existing of reservations sometimes people pay for reservations reserving at booking a table it will be charged let us say 200 rupees extra. So that is I am a person who is very sensitive towards waiting, so if there is a demand fluctuation if certain days the demand will be very high. I do not want to book the means stand in the queue in the restaurant so the restaurant charges you money so that they can book the table.

So they are ensuring that the table does not remain backend and they are charging you money for that. So in this case demand is somewhat predictable so the restaurants come to know that how much how much food footfall will happen previously. For airlines also the same thing happens service is reserved by consumers in different time periods. So if there is too much heavy footfall in one particular day too much heavy demand.

You can ask them that why do, not you please shift your plan to some other day so then you can probably adjust people. For example, this is heavily applicable for let us say doctor's the appointment or let us say spa, restaurant this kind of things appointment. Where; you can probably ask them to come at a different period of time so that your demand fluctuations can be taken care of. And you do not have to invest a lot on infrastructure, or service providers, or manpower.

Uncertainty of actual usage despite reservations creates possibility of unsold seats so service providers can protect against no-shows through overbooking. So sometimes if you are not charging for the booking, you can go for over booking, you can book 10% extra, of the number of people that is there so you always can estimate that 10% people will not arrive.

But the problem is if that all people arrives and the number of footfalls is higher than the number of service facilities available. Then you might have to pay that particular customer a little bit to keep him happy, who is waiting. So that is a cons but people actually do the retailers actually measure the pros and cons and go for over booking is a very common strategy in case of yield management.

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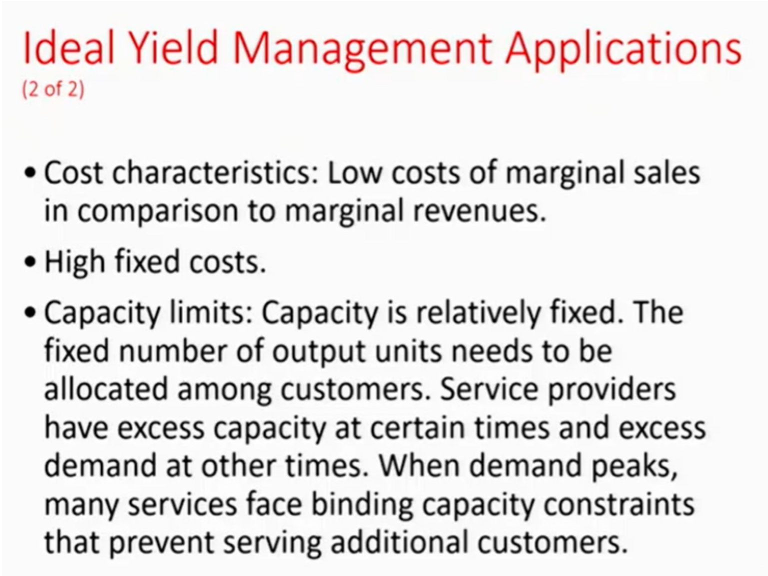

What are the cost characteristics involved here low cost of marginal sales in comparison to marginal revenues, so serving cost is low in this context yield management will apply. The fixed cost is high you have invested on infrastructure as I told it is airlines, or restaurants, or retail stores, where you have invested a lot on the infrastructure and the infrastructure is sitting idle is something that will basically create a loss for you. So you do not want to do that so for those kind of situations yield management will be applied.

There has a capacity limit for example restaurant has a sitting limit, or air plane has a sitting limit, or a hotel will have a limit in terms of how many rooms are there. So capacity if it is not flexible you cannot stretch the capacity based on the demand then you have to make sure that the demand gets distributed over the various time periods. So capacity is relatively fixed the fixed number of output units needs to be allocated among customers.

Service provider has excess capacity at certain times and excess demand at other times, so if I can move the excess demand from one time to other when the access capacity is there then i can make more money. So when demand peaks many services face binding capacity constraints means problem basically that prevents serving additional customers. So this additional customers if I can switch to another time period when there are less amount of customers and more amount of facilities available.

Then I can basically make money from both the customers even when they are additional customers, they will not leave I can make sure and that is done through over booking, through primarily booking or scheduling, and then through over booking, sometimes by giving this customer coupons, and etc. So that they can come at us certainly sometimes giving discounts at a certain period of time like happy hours is a classic example of that you 7 pm to 8 pm in the evening nobody wants to come to have dinner.

But 8 pm onwards 8 to 10 pm everybody wants to come, and there is a huge line and 10 pm after 10 pm there is nobody again in the dinner. So you can give a happy hour from 7 pm to 8 pm at the early hours early dinner hours so that that is the moment your restaurant is relatively I would say vacant. And if somebody comes you can ask them to come and have their dinner at that point of time and then they can go.

So that is basically managing the crowd and if a person is not price conscious they will not come at that point of time, but if there are customers who are price conscious they will come at that point of time, and then buy the food and you will make money from price conscious and price sensitive and price (()) (34:55) both kind of customers through yield management strategies which is also one kind of a pricing strategy.

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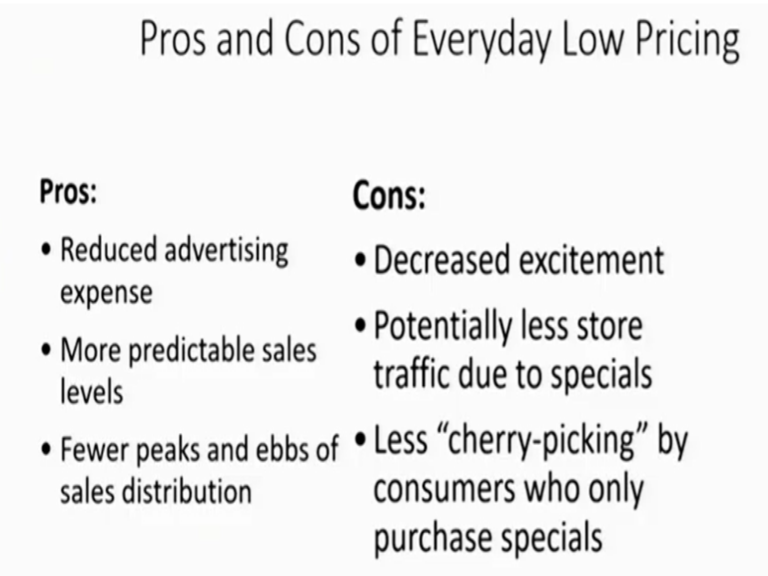

So what are the Pros and Cons? Reduced advertisement expense, more predictable sales level, fewer peaks and ebbs of sales distribution, more managed sales distribution are Pros. Cons is discreet decreased excitement, potentially less store traffic due to specials, and less cherry-picking by consumers who only purchase special, so this is something that can happen. So these are everyday low pricings pros and cons which is also another strategy under pricing strategy.

I mean I will stop here basically in this particular video, and there is small 2, 3 components that will come in the next class and we will discuss about that in the next video. So thank you very much on being with me in this pricing strategy, and I will see you in the next video.