How to Set Prices in a Retail Business

A Step by Step Guide to Pricing in a Retail Store (Pricing Strategies)

By BizMove Management Training Institute

Other free books by BizMove that may interest you:

Free starting a business books

Free management skills books

Free marketing management books

Free financial management books

Free Personnel management books

Free miscellaneous business management books

Free household management books

Table of Contents

1. Introduction

This Setting Prices in a Retail Store Guide is a checklist for the owner-manager of a retail business. These 51 questions probe the consideration - from markup to pricing strategy to adjustments - that lead to correct set prices decisions. You can use this checklist to establish setting prices in your new store, or you can use it to periodically review your established pricing policy.

A retailer's set prices influence the quantities of various items that consumers will buy, which in turn affects total revenue and profit. Hence, correct setting prices decisions are a key to successful retail management. With this in mind, the following checklist of 52 questions has been developed to assist retailers in making systematic, informed decisions regarding pricing strategies and tactics.

This checklist should be especially useful to a new retailer who is making pricing decisions for the first time. However, established retailers, including successful ones, can also benefit from this Guide. They may use it as a reminder of all the individual pricing decisions they should review periodically. And, it may also be used in training new employees who will have pricing authority.

Go to Top

2. How to Set Prices for Optimal Profitability

A major step toward making a profit in retailing is selling merchandise for more than it cost you. This difference between cost of merchandise and retail price is called markup (or occasionally markon). From an arithmetic standpoint, markup is calculated as follows:

Dollar markup = Retail price - Cost of the merchandise.

Percentage markup =

$$\frac{\text{Dollar markup}}{\text{Retail price}}$$

If an item cost $6.50 and you feel consumers will buy it at $10.00, the dollar markup is $3.50 (which is $10.00 - $6.59). Going one step further, the percentage markup is 35 percent (which is $3.50 divided by $10.00). Anyone involved in retail pricing should be as knowledgeable about formulas as about the name and preferences of his or her best customer!

Two other key points about markup should be mentioned. First, the cost of merchandise used in calculating markup consists of the base invoice for the merchandise plus any transportation charges minus any quantity and cash discounts given by the seller. Second, retail price, rather than cost, is ordinarily used in calculating percentage markup. The reason for this is that when other operating figures such as wages, advertising expenses, and profits are expressed as a percentage, all are being based on retail price rather than cost of the merchandise being sold.

Go to Top

3, Target Consumers and the Retailing Mix

In this section, your attention is directed to price as it relates to your potential customers. These questions examine your merchandise, location, promotion, and customer services that will be combined with price in attempting to satisfy customers and make a profit. After some questions, brief commentary is provided.

1. Is the relative price of this item very important to your target consumers?

The importance of setting prices depends on the specific product and on the specific individual. Some shoppers are very price conscious. Others want convenience and knowledgeable sales personnel. Because of these variations, you need to learn about your customers' desires in relation to different products. Having sales personnel seek feedback from shoppers is a good starting point.

2. Are set prices based on estimates of the number of units that consumers will demand at various price levels?

Demand-orientated pricing such as this is superior to cost-orientated pricing. In the cost approach, a predetermined amount is added to the cost of the merchandise, whereas the demand approach considers what consumers are willing to pay.

3. Have you established a price range for the product?

The cost of merchandise will be at one end of the price range and the level above which consumers will not buy the product at the other end.

4. Have you considered what price strategies would be compatible with your store's total retailing mix that includes merchandise, location, promotion, and services

5. Will trade-ins be accepted as part of the purchase price on items such as appliances and television sets?

Go to Top

4. Supplier and Competitor Considerations in Setting Prices

This set of questions looks outside your firm to two factors that you cannot directly control - suppliers and competitors.

6. Do you have final pricing authority?

With the repeal of fair trade laws, "yes" answers will be more common than in previous years. Still, a supplier can control retail prices by refusing to deal with non-conforming stores (a tactic which may be illegal) or by selling to you on consignment.

7. Do you know what direct competitors are doing price-wise?

8. Do you regularly review competitor's ads to obtain information on their prices?

9. Is your store large enough to employ either a full-time or a part-time comparison shopper?

These three questions emphasize the point that you must watch competitors' prices so that your prices will not be far out of line - too high or too low - without good reason. Of, course, there may be a good reason for the out-of-the-ordinary prices, such as seeking a special price image.

Go to Top

5. Setting a Price Level Strategy

Selecting a general level of prices in relation to competition is a key strategic decision, perhaps the most important.

10. Should your overall strategy be to sell at prevailing market price levels?

The other alternatives are an above-the-market strategy or a below-the-market strategy.

11. Should competitor's temporary price reductions ever be matched?

12. Could private-brand merchandise be obtained in order to avoid direct price competition?

Calculating Planned Initial Markup in setting prices

In this section you will have to look inside your business, taking into account sales, expenses, and profits before setting prices. The point is that your initial markup must be large enough to cover anticipated expenses and reductions and still produce a satisfactory profit.

13. Have you estimated sales, operating expenses, and reductions for the next selling season?

14. Have you established a profit objective for the next selling season

15. Given estimated sales, expenses, and reductions, have you planned initial markup?

This figure is calculated with the following formula:

Initial markup percentage =

$$\frac{\text{Operating expenses} + \text{Reductions} + \text{Profit}}{\text{Net sales} + \text{Reductions}}$$

Reductions consist of markdowns, stock shortages, and employee and customer discounts. The following example uses dollar amounts, but the estimates can also be percentages, and if the retailer desires a $4,000 profit, initial markup percentage can be calculated:

Initial markup percentage =

$$\frac{\$34,000 + \$6,000 + \$4,000}{\$94,000 + \$6,000} = 44\%$$

The resulting figure, 44 percent in this example, indicates what size markup is needed on the average in order to make the desired profits.

16 Would it be appropriate to have different initial markup figures for various lines of merchandise or service?

You would seriously consider this when some lines have much different characteristics than others. For instance, a clothing retailer might logically have different initial markup figures for suits, shirts, and pants, and accessories. (Various merchandise characteristics are covered in an upcoming section.) You may want those items with the highest turnover rates to carry the lowest initial markup.

Go to Top

6. Setting Prices Store Policies

Having calculated an initial markup figure, you could proceed to set prices on your merchandise. But an important decision such as this should not be rushed. Instead, you should consider additional factors which suggest what would be the best price.

Policies are written guidelines indicating appropriate methods or actions in different methods or actions in different situations. If established with care, they can save you time in decision making and provide for consistent treatment of shoppers. Specific policy areas that you should consider are as follows:

18. Will a one-price system, under which the same price is charged every purchaser of a particular item, be used on all items?

The alternative is to negotiate price with consumers

19. Will odd-ending prices such as $1.98 and $44.95, be more appealing to your customers than never-ending price

20. Will consumers buy more if multiple pricing, such as 2 for $8.50, is used?

21. Should any leader offerings (selected products with quite, low less profitable prices) be used?

22.Have the characteristics of an effective leader offering been considered?

Ordinarily, a leader offering needs the following characteristics to accomplish its purpose of generating much shopper traffic: used by most people, bought frequently, very familiar regular price, and not a large expenditure for consumers.

23. Will price lining, the practice of setting up distinct points (such as $5.00, $7.50 and $10.00) and then marking all related merchandise at these points, be used?

24 Would price lining by means of zones (such as $5.00 - $7.50 and $12.50 - $15.00) be more appropriate than price points?

25. Will cent-off coupons be used in newspaper ads or mailed to selected consumers on any occasion?

26. Would periodic special sales, combining reduced prices and heavier advertising, be consistent with the store image you are seeking?

27. Do certain items have greater appeal than others when they are part of a special sale?

28 Has the impact of various sale items on profit been considered?

Sales prices may mean little or no profit on these items. Still, the special sales may contribute to total profits by bringing in shoppers who may also buy some regular-price (and profitable) merchandise and by attracting new customers. Also, you should avoid featuring items that require a large amount of labor, which in turn would reduce or erase profits. For instance, according to this criterion, shirts would be a better special sales item than men's suits that often require free alterations.

29. Will "rain checks" be issued to consumers who come in for special-sale merchandise that is temporarily out of stock?

You should give particular attention to this decision since rain checks are required in some situations. Your lawyer or the regional Federal Trade Commission office should be consulted for specific advice regarding whether rain checks are needed in the special sales you plan.

Go to Top

7. Taking in Consideration the Nature of the Merchandise

In this section you will be considering how selected characteristics of particular merchandise affect planned initial markup.

30. Did you get a "good deal" on the wholesale price of this merchandise?

31. Is this item at the peak of its popularity?

32. Are handling and selling costs relatively great due to the product being bulky, having a low turnover rate, and requiring much personal selling, installation, or alterations?

33. Are relatively large levels of reductions expected due to markdowns, spoilage, breakage, or theft?

With respect to the preceding four questions, "Yes" answers suggest the possibility of or need for larger-than-normal initial markups. For example, very fashionable clothing often will carry a higher markup than basic clothing such as underwear because the particular fashion may suddenly lose its appeal to consumers.

34. Will customer services such as delivery, alterations, gift wrapping, and installation be free of charge to customers?

The alternative is to charge for some or all of these services

Go to Top

8. Market Environmental Consideration

The questions in this section focus your attention on three factors outside your business, namely economic conditions, laws, and consumerism.

35. Are economic conditions in your trading area abnormal?

Consumers tend to be price-conscious when thge economy is depressed, suggesting that lower-than-normal markups may be needed to be competitive. On the other hand, shoppers are less price-conscious when the economy is booming, which would permit larger markups on a selective basis.

36. Are the ways in which prices are displayed and promoted compatible with consumerism, one part of which has been a call for more straightforward price information?

37. If yours is a grocery store, it is feasible to use unit pricing in which the item's cost per some standard measure is indicated?

Having asked (and hopefully answered) more than three dozen questions, you are indeed ready to establish retail prices. When you have decided on an appropriate percentage markup, 35 percent on a garden hose, for example, the next step is to determine what percentage of the still unknown retail price is represented by the cost figure. The basic markup formula is simply rearranged to do this:

Cost = Retail price - Markup

Cost = 100% - 35% = 65%

Then the dollar cost, say $3.25 for the garden hose, is plugged in to the following formula to arrive at the retail price:

Retail price =

$$\frac{\text{Dollar cost}}{\text{Percentage cost}} = $$

$$\frac{\$3.25}{65\% \text{ (or .65)}} = \$5.00$$

One other consideration is necessary:

38. Is the retail price consistent with your planned initial markups?

Set Prices Adjustments

It would be ideal if all items sold at their original retail prices. But we know that things are not always ideal. Therefore, a section on price adjustments is necessary.

39. Are additional markups called for because wholesale prices have increased or because an item's low price causes consumers to question its quality?

40. Should employees be given purchase discounts?

41. Should any groups of customers, such as students or senior citizens, be given purchase discounts?

42. When markdowns appear necessary, have you first considered other alternatives such as retaining price but changing another element of the retailing mix or storing the merchandise until the next selling season?

43. Has an attempt been made to identify causes of markdown so that steps can be taken to minimize the number of avoidable buying, selling, and pricing errors that cause markdowns?

44. Has the relationship between timing and size of markdowns been taken into account?

In general, markdowns taken early in the selling season or shortly after sales slow down can be smaller than late markdowns. Whether an early or late markdown would be more appropriate in a particular situation depends on how many consumers might still be interested in the product, the size of the initial markup and the amount remaining in stock.

45. Would a schedule or automatic markdowns after merchandise has been in stock for specified intervals be appropriate?

46. Is the size of the markdown "just enough" to stimulate purchases?

This question stresses the point that you have to observe the effects of markdowns so that you can know what size markdowns are "just enough" for different kinds of merchandise.

47. Has a procedure been worked out for markdowns on price-lined merchandise?

48. Is the markdown price calculated from the off-retail percentage?

This question gets you into the arithmetic of markdowns. Usually, you first tentatively decide on the percentage amount price must be marked down to excite consumers. For example, if you think a 25 percent markdown will be necessary to sell a lavender sofa, the dollar amount of the markdown is calculated as follows:

Dollar markdown = Off-retail percentage x Previous retail price

Dollar markdown = 25% (or .25) x $500 = $125

Then the markdown price is obtained by subtracting the dollar markdown from the previous retail price. Hence, the sofa would be $375.00 after taking the markdown.

49. Has cost of the merchandise been considered before setting the markdown price?

This is not to say that a markdown price should never be lower than cost, on the contrary, a price that low may be your only hope of generating some revenue from the item. But cost should be considered to make sure that below-cost markdown prices are the exception in your store rather than being so common that your total profits are really hurt.

50. Have procedures for recording the dollar amounts, percentages, and probable causes of markdowns been set up?

Markdown analysis can provide information for assist in calculating planned initial markup, in decreasing errors that cause markdowns, and in evaluating suppliers.

51. Have you marked the calendar for a periodic review of your pricing decisions?

Rather than making careless pricing decisions, this checklist should help you lay a solid foundation of effective prices as you try to build retail.

Go to Top

9. How to Raise Prices Without Losing Customers

Everyone has to increase their prices eventually. If you're fortunate your customers won't notice. But in a budget conscious economy, the chances are they will.

If you run a contract- or consulting-based business, it can be doubly difficult to raise your rates because you're going to have to be upfront about the changes, and in all likelihood negotiate a new contract.

So it all makes for a worrisome situation. However, done right, raising your prices should not alienate your customers – particularly if they value you and your services. Here are some tips for raising your prices without losing customers.

1. Have a Pricing Strategy

A pricing strategy is a well-thought out plan that helps you calculate the prices, rates, or fees associated with your products or services. This may be reviewed monthly, quarterly, or annually depending on market forces, wholesale prices, and other "cost-of-doing-business" expenses. This way you can make rate increases a regular part of your business instead of waiting until it's too late.

2. Change Your Pricing Structure

Changing how you package and price your product or service is a very common way of making more money from customers without a rate hike and without ruffling feathers. Here are some ways to do this:

* Cross-sell Your Services – "Would you like fries with that?" Cross-selling is an easy way to increase sales of related services and meet your customer's needs. For example, a spa business could tag on a range of manicure services to its menu of massage services at a packaged price.

* Tier Your Pricing – Offering multiple price points across your business is a great way to up-sell products and services without raising prices. The plan here is that the tempted consumer will opt for the higher end of the tier. For example, a coffee shop may offer the following options:

1. Cappuccino @ $1.50

2. Cappuccino with a Shot of Syrup @ $2.50

3. Cappuccino with a Shot of Syrup and Cream @ $3.50

The variations are tempting, the value is clearly advertised and the decision to spend more is ultimately in the hands of your customer. The same basic, middle, and premium tiers can also be used in among consulting businesses.

* Change How You Bill Your Time – If you are a consultant or provide any service that involves selling your time in blocks, think about switching how you package your time. Trying to increase your hourly rate can be tough, instead sell your time in different chunks at different rates:

2 hours @ $85 per hour

5 hours @ $75 per hour

10 hours @ $65 per hour

3. What about Consultants or Service-Based Businesses?

If you operate a service-based business or are a freelancer/consultant, consider putting a stake in the ground and raise your rates after you've reached a certain client threshold. Options include raising your rates each year for new customers or after every 5 or 10 new customers, depending on how many clients you have on the books.

In the case of existing customers, approach your client directly and expect to negotiate your rate hike. If you are 100% confident in the value of your services then it's likely that your clients are too and are fully expecting this. Provide a heads up – if you plan on raising your rates in the new year, engage the client in November – this gives them enough time to review your proposed rate, negotiate, and plan accordingly.

4. What if a Customer Balks at the Price Hike?

Everyone has a reason and a right to raise their prices. But be prepared for some push-back and get ready to explain your increase. Explain your price hike in terms of the added value you bring and highlight any investments you have made in yourself (such as training) or your business that justifies the investment.

Above all, expect to negotiate and use your pricing strategy to plan for this. Don't go in too high to start with, because an educated client will almost certainly reject your opening rate without discussion. Likewise, ask yourself how low are you willing to go? What is the ideal mid-point at which you'd be happy to accept a negotiated rate?

Go to Top

10. Calculating Hourly and Project-Based Pricing

If you're a consultant, freelancer or any business that charges by the hour, you are going to have to determine and continuously review your pricing structure. For example, do you charge by the hour? What's a reasonable rate to ask? Are you better off charging clients on a project basis?

Here are some tips for calculating your hourly and project rates and how to negotiate pricing with your client.

1 Determining Your Worth

Deciding what to charge clients is a balancing act between market factors, business costs, and the value you bring to your clients. Before you quote any work, ask yourself these questions:

What is the market rate for work like yours in your industry and location?

How experienced are you? Not just in your line of work, but as a business owner? Being good at a skill is one thing, but being able to manage deadlines, meet expectations and above all, being dependable, are essential qualities for freelancers and consultants.

What rate are you willing to accept and will it cover your costs?

2. Calculating an Hourly Rate

If you've been a salaried employee all your life, making the switch to self-employment requires a change of thinking. Some companies may be tempted to coerce you into a rate that reflects what they'd be willing to pay a salaried employee. But self-employment brings its costs and credit to you. Your rate should reflect this, as well as your expertise.

If you are used to being a salaried employee, here's a good rule of thumb to follow when determining an hourly rate:

Divide your former salary by 52 (work weeks); then divide that number by 40 (the number of work hours in a week). Then mark it up 25-30%.

Your mark-up covers both your value and experience, but also takes care of our business costs such as networking, selling, and other administration, not forgetting your self-employment tax obligations and healthcare insurance costs.

3. Calculating Project Rates

Many clients will prefer to manage their costs and ask for you to price your work as a fixed project fee. This can also work to your benefit, if you price it right. However, it can also work against you, especially if your client is new and the project scope creeps beyond your original expectations.

The best way to calculate project rates is to spend some time scoping out what you'll deliver. For example, if you are a freelance copywriter and a client wants you to price out a two-page white paper, use your knowledge of your own work methods and familiarity with the subject matter to structure your time commitment, for example:

•Research: 2 Hours

•Interview subject matter expert: 1 Hour

•Produce First Draft: 4 Hours

•Two rounds of edits: 2 Hours

Total: 9 Hours @ $x hourly rate = $x

Remember, you don't have to put this calculation in front of your client, but it gives you a useful framework for covering your costs and delivering within scope. Don't forget to add a caveat to address that any work done over and above this scope of work will be charged at an hourly rate

4. Negotiating Your Rate

Negotiation is hard to avoid and can often shed light on whether this is a client that you really want to work with. If you are confident that your pricing reflects your value and the market rate, being haggled hard on price can get a relationship off on the wrong foot. Likewise, being locked in at a low rate can quickly devalue the relationship from your perspective.

So, when it comes to negotiating, be prepared to stand your ground but be willing to compromise. If you foresee further business here, try to be flexible. For example, could you deliver a one-page white paper, instead of two or cut back on the review cycles?

5. What About Retainers?

If a client starts to send a lot of volume your way, retainer-based pricing can be advantageous, even if it's at a lower hourly rate than your advertised price.

A retainer is a fee paid for a pre-determined amount of time or work (usually within a month) and is often paid up-front. A retainer agreement can deliver the benefit of predictable work and income while giving your client the reassurance of having you on "stand-by" and a clear view of monthly costs.

Many consultants charge the full retainer fee, even if they don't work the entire hours allocated. If you value the relationship, steer clear of this; instead, roll unused hours over to next month.

* * * *

Go to Top