Retail Pricing 101 (MSRP)

Has the Manufacturer's Suggested Retail Price (MSRP) outlived it usefulness?

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In today's mass merchandising environment, consumers often wonder how prices are established and more importantly, if there is any way to know if they 'got a good deal' on their purchase. This article provides a glimpse into the world of retail pricing and some of the guidelines savvy consumers pay attention to.

What do all of these acronyms and pricing terms really mean?

Every modern day shopper has been exposed to the huge variety of pricing terms in use today. Such terms as 'Retail Price, List Price, Our Price, MSRP', everyone's favorite 'Sale Price', and a host of additional terms are in use in stores, newspapers, online, virtually anyplace goods and services are sold. To be a smart consumer you need to understand that with the exception of MSRP, every other term reflects a pricing strategy developed and employed by the individual retailer. As such, the pricing term may or may not have any relevance to actual market conditions and pricing. On the other hand, the MSRP is established by the manufacturer of the product being sold and is therefore a guideline or standard with regional if not world wide impact.

Why do I see so many different retail prices for the same product?

We operate in a largely free market environment with many counterbalancing influences. In such an environment, a significant motivating factor is profit. In order to achieve a profit, a business must sell their goods and services for more than it costs to produce and/or distribute them. This exerts pressure on the business to set prices as high as possible. The upward price pressure is offset by the fact that other businesses are also selling the same or similar products and they want your business as well. One popular method used to attract customers is to offer a lower selling price. This 'competitive' pressure tends to keep prices lower and ensures a relative balance between 'desired' and 'acceptable' profit margins.

If you understand the balance in profit margins which results from competitive market pressures; you might expect to see the same price among all vendors of a given product or service. As we all know, real world observation proves that prices most certainly are not the same among all merchants. The vagaries in pricing are the result of differing business models, varying efficiencies, and in some instances a sometimes fatal lack of understanding on the part of the business owner or manager. While the full explanation of this phenomenon would be too long for inclusion in this article, suffice it to say that the more efficient the business model, the lower a business can sell its product while still covering the minimum profitability required to maintain a viable long term business.

In those instances where a business fails to price adequately for the necessary minimum profit, the business looses money and sooner or later it goes out of business.

So how do successful businesses choose a price?

From a purely pricing perspective, perhaps the most important factor is for the business to know and understand its costs. Such costs as rent, power, heating/cooling, salaries, taxes, insurance, benefits, cost of money, inventory, advertising, etc., must all roll into and be covered by the profit margin in the final selling price. While overly simplified, these fixed and variable costs are then balanced against the number of products or amount of services the business expects to sell. In this manner the business can generate a fairly reasonable estimate of how much they must sell each item for in order to cover the portion of the overhead assignable to each and every sale.

It is critical however that the business be able to recognize and make adjustment for any errors in its projections. For example; if the business finds it is selling fewer items than it expected to sell, it is faced with the choice of either increasing its sales price per item to cover the total costs of the business or else it will

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have to reduce its costs to the point they are covered by the number of items actually being sold. In another scenario; if a competitor is selling a similar product for substantially less, the business will either have to come up with a way to compete at a higher price or they will likely be forced to lower their selling price.

Enter the MSRP.

In establishing their selling price there is one more tool that smart business owners use. The MSRP is established by the product manufacturer and is designed to position the manufacturer's products competitively in the marketplace while still making it possible for a well run retailer to make a 'reasonable' profit which will sustain their business in the long run.

The manufacturer has a vested interest in seeing the retailer survive long term as a viable business. In many instances the retailer is the direct interface with the end use customer and is responsible for ensuring customer satisfaction during and after the initial purchase. In some industries the retailer or dealer is responsible for ongoing service and training for the product the customer purchased. Many manufacturers rely on their distributors and dealers to take care of customer needs and to protect the reputation of the manufacturer in the marketplace.

The manufacturer also has a vested interest in selling as many of their products as possible. For this reason they want to be as competitive with the offerings from other manufacturers as they can possibly be. Hence they don't want their MSRP set too high or they will be priced out of the market.

These are the reasons that smart retailers take a long look at the MSRP before setting their own final selling price. If the final selling price deviates too far below the MSRP there is a real risk that their business will fail due to inadequate profitability. If their final selling price is too far above the MSRP they will likely find that their offering is overpriced and they won't sell very much.

So what does this all mean to the consumer?

Our discussion has now come full circle. If the MSRP is really established with the best interests of both the retailer and the consumer in mind, why doesn't it play a more prominent role in marketing? The fact is that many retailers don't want their customers to know about or understand the significance and value of the MSRP. Some retailers actively work to discredit the MSRP so they can impose their own pricing strategies on the marketplace. By displaying a grossly exaggerated 'List' price, the retailer attempts to make their inflated 'Sale' price seem attractive by comparison. By publishing a nebulous 'Compare at' price they can then show a substantial discount in the 'Our Price' listed in their advertising. By divorcing themselves and their products from the benchmark established by the MSRP, the retailer gains great pricing flexibility but usually at the cost of increased confusion.

Some retailers justify their actions by claiming the MSRP gives too much power to the manufacturer. While there are certainly examples where manufacturers have established an unrealistic MSRP, the market has a tendency to correct such errors. If the MSRP is set too low, retailers will tell the manufacturer and if unresponsive the retailer will find other alternatives. If the MSRP is set too high the market will quickly adopt a 'street' price that more accurately reflects what the market perceives as a fair price.

In addition it is important to understand that by US law retailers are free to sell at whatever price they wish. Manufacturers cannot dictate the price at which a retailer sells the manufacturer's products. The retailer can sell above or below the MSRP as they choose. In fact, if a retailer chooses to sell the manufacturer's products at a loss they are legally entitled to do so. This complete pricing freedom has in some instances been used in an attempt to damage the brand value of various manufacturers. In response, to protect the value of their brand name, more and more manufacturers are implementing Minimum Advertised Price (MAP) policies. While retailers can still sell at whatever price they choose, they cannot advertise the product for sale at a price lower than what is specified in the manufacturers MAP policy.

In conclusion…

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Our discussion started with the question posed in the sub title. “Has the MSRP outlived it usefulness?” It seems only fair that if a question is posed, an honest attempt should be made to provide an answer. While many would argue that total pricing freedom is the best solution in a free market environment that does not necessarily preclude the use of appropriate benchmarks. As long as there are people who make their livelihood selling goods and services to other people, there are going to be some that succumb to greed with the result that people pay more than necessary for what they purchase. On the other end of the spectrum there will also be some who through ignorance or design will sell at bargain prices and leave their suppliers unpaid and their customers unsupported.

It is my belief that greater visibility and adoption of the MSRP rather than less use of the MSRP will serve the marketplace best. Consumers will benefit because they will have a ready point of reference to guide their purchasing decisions. If they proceed with a ‘too good to be true’ offer, they will have been clearly warned and will have no one to blame but themselves. If a retailer offers a 50% or 75% off sale from a bogus and artificial ‘List’ price, their deception and dishonesty will be readily apparent. At the very least, the consumer will be better able to recognize those retailers that are selling within the range which indicates they will be around tomorrow and next year to give service on past, present and future customer purchases.

Honest retailers will also benefit from wider adoption and visibility of the MSRP. Especially when combined with the emerging trend to MAP policies, the retailer will be under less external pressure to put their business, the jobs of their employees, and the future support of their clientele at risk by selling at unsustainably low profit margins.

If the MSRP is such a clear benefit in the marketplace, it begs the evaluation of why it isn’t more widely used and understood. Ultimately I believe it boils down to two points.

- First, those who are profiting from questionable marketing practices don’t want any consumer benchmarks in place and are doing all they can to confuse consumers and to undermine the value of the MSRP.
- The second reason is lack of education among consumers, largely as a result of the failure to deliver a clear and consistent message by those who do or at least should understand the benefits of realistic MSRP benchmarks.

In all fairness the business community is somewhat justified in their past reluctance to boldly proclaim their support of the MSRP. With the flux in US antitrust law, some have been and remain concerned about being accused of price fixing. Judicial support of the emerging MAP philosophy is likely to strengthen support for the MSRP in the future. Based on more than 30 years experience in positions ranging from front line employee to top level management with dealers, manufacturers, and retailers, I believe the MSRP is as relevant as ever and more widespread adoption will benefit consumers, honest retailers/dealers and wise manufacturers.

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