

## Module 8 - Margins and Pricing in the Rural Grocery Store

Profitability is key to keeping a rural grocery store open. Sales are one measure of success, but the rural grocer needs to make money on those sales. Correct pricing can help ensure profitability.

So, how do you determine the correct price? In large part, pricing is determined by establishing a desired gross margin for each department or each individual item. To correctly calculate desired gross margin and price, you must first be able to define gross profit and gross margin. Gross profit is the difference between sales price and cost, in dollars and cents. Gross margin goes a step further and translates gross profit into a percentage. According to The Grocery Store Guy, “margin is the percentage of your sales price that is profit”. (Campbell, 2019) Next, we must understand the math and be able to correctly calculate gross margin and sales price.

Let’s look at a simple example. Suppose the wholesale cost of a particular item is \$1.50 and it is sold for \$2.00. We will first calculate gross profit in dollars and cents by finding the difference in sales price and cost ( $\$2.00 - \$1.50 = \$0.50$ ). We then divide the Gross Profit of \$0.50 by the retail price of \$2.00. That gives us our 25% Gross Margin. Another way to show this is as follows:

Sales Price	\$2.00
Cost	\$1.50
Gross Profit (\$)	$\$2.00 - \$1.50 = \$0.50$
Gross Margin (%)	$\frac{\$0.50}{\$2.00} = 25\%$

If the target margin and item cost is known, we can quickly and easily determine a price. This is done by taking the cost and dividing by the margin (converted to a decimal) subtracted from 1.0. Under the above scenario with a unit cost of \$1.50 and a margin of 25%, we would determine our price by performing the following calculation:  $\$1.50 / (1.0 - 0.25)$  or  $\$1.50 / 0.75$ . Therefore, the retail price would be \$2.00. Here are those calculations:

Cost	\$1.50
Gross Margin (decimal)	0.25
Cost/(1 - Gross Margin)	$\frac{\$1.50}{1-0.25} = \frac{\$1.50}{0.75} = \$2.00$

Now that we have described how to calculate a price based on the desired margin, we must decide where to set our margins for each department and product. There are no hard and fast answers for this issue, just some general guidelines that can be followed. From the article “10 Steps to Successful Online Grocery” from NaveoCommerce.com, we find these suggested margins:

Grocery	25%
Frozen Foods	30%
Dairy	30%
Produce	40-45%
Meat	28-30%
Deli	40%
Bakery	55%

Figure 1 (10 Steps to Successful Online Grocery – Chapter 2: Assortment and pricing, 2024)

As you can see, the desired margin for each department will be different. For example, the produce department margin will need to be higher than dry groceries, primarily due to the amount of shrink (number of items thrown out due to spoilage). Although we may establish a target margin for each department, we may still have some products in that department that carry a different margin. As an example, you might want to keep prices of certain basic staples (bread, milk, etc.) as low as possible to draw customers into the store. Or your store may choose to price so-called “store brand” canned goods more aggressively than national brands.

The aggregate of all the margins of the respective departments result in what is called a blended margin. Typically, grocery stores will strive for a blended margin of at least 25%. In a small store, target margins may be a little higher to make up for the lower volume. To calculate the blended margin the department margins are weighted based on the percentage of sales each department is projected to produce. You will first have to calculate or estimate the percentage of sales for each department. Then multiply this number by the margin for that department to get the “Contribution to Margin”. Add the “Contribution to Margin” percentages together to get the overall blended margin.

For example, using just four departments to keep it relatively simple, here is how we would calculate a blended margin:

<u>Product</u>	<u>Sales</u>	<u>% of Sales</u>	<u>Margin</u>	<u>Contribution to Margin</u>
Meat	310,000	31%	27%	8.37%
Grocery	450,000	45%	24%	10.80%
Produce	130,000	13%	34%	4.42%
Dairy	110,000	11%	25%	2.75%
<b>Total</b>	<b>1,000,000</b>			<b>26.34%</b>

Of course, each store is unique. Stores that have little to no competition may be able to have a larger margin across the board. However, these stores need to be sensitive to being viewed as too expensive or exploitive. Stores with competition, especially dollar store competition, will need to be more sensitive to pricing. Customers are willing to buy and support local, but only to a point. Pricing of products should be seen as an attempt to get the most out of the product up to the point where people still feel like they are getting value for the price paid. Once the price surpasses this point sales, and subsequent profit, will stagnate and may even decline.

As another point of reference, we can look at margins that were recommended in the feasibility study that was done on a potential grocery store in Autaugaville, Alabama by Southeast Research. These are similar to, but different from, the recommended margins we saw above. For the four key departments, the recommendations were as follows:

- Grocery and General Merchandise 24%
- Meat 27%
- Produce 34%
- Dairy 25%

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- Blended 25.96%

(Southeast Research, 2018)

In cases where there is competition, smaller rural grocery stores may need to employ “loss leaders”. These can be popular items (ketchup, eggs, milk, bread, etc.) or sought-after items (in season produce items, such as sweet corn) that are sold at a loss. The idea behind this strategy is to bring people into the store in the hopes that they will purchase other, higher-margin items.

Margins and pricing can be tricky. The key to success is finding and maintaining the appropriate balance that will maximize profit while maintaining sales volume.

## References

- Campbell, J. (2019, August 27). *How to Calculate Markup and Margin for Retail*. Retrieved from The Grocery Store Guy: <https://thegrocerystoreguy.com/how-to-calculate-markup-and-margin-for-retail/#:~:text=Margin%20is%20the%20percentage%20of%20your%20sales%20price,divide%20your%20product%20cost%20by%20the%20retail%20price.>
- Naveo Commerce. (2023). *10 Steps to Successful Online Grocery – Chapter 2: Assortment and pricing*. Retrieved from Naveo Commerce: <https://www.naveocommerce.com/on-demand-grocery-what-to-consider-chapter-2/#:~:text=The%20gross%20margin%20in%20grocery,28%2D30%25%20gross%20margin>
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