

PRICING POLICY IN ORGANIC FOOD RETAIL TRADE

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Abstract. Imperfection of the Polish organic market, particularly in the area of distribution channels fosters high level of organic food prices, which in turn reduces the demand. Therefore, recognition of price determinants, pricing strategies, activities and tools applied in frames of pricing policy in organic food retail is very important. This paper presents the results of research on pricing policy conducted in retail outlets offering organic food. The investigation was carried out between 2011 and 2012 in three types of outlets, i.e. specialist shops, groceries and retail networks. Price-promotional and price-quality strategy as well as adaptive and innovative pricing strategy were the most often indicated pricing strategy. Retailers mainly fix prices based on costs and apply periodical discounts.

Keywords: prices, organic food, pricing policy, pricing strategies

INTRODUCTION

Recently, organic farming in Poland has been developing very dynamically as a result of state support for organic production (area payments). Simultaneously, there is growing consumer interest in organic food. Nevertheless, the production volumes and the resulting retail offering are quite modest for various reasons, including the insufficient development of distributional solutions that would ensure profitable sales of organic products. On the other hand, consumers look for a diversified product range at the lowest prices matching their incomes. Therefore, it is essential to conduct research on organic food distribution. Retail trade is an

important part of the distribution chain because it delivers the products to final buyers and greatly affects their purchasing decisions. The consumers' decisions are mainly driven by prices which are relatively high in the Polish organic market. Consequently, the pricing process gains importance as a way to establish such a price ceiling which would assure, on one hand, adequate revenues for organic food distribution channel participants and, on the other, stimulate demand for the organic products offered. The retailers face a challenging task, and therefore their pricing policy, strategies and instruments should be based on reliable market information.

The purpose of the paper is to identify the activities and tools supporting the development of pricing policies in organic food retail trade. The research was conducted in 2011–2012. Three types of shops offering organic food were covered: specialist outlets, groceries and retail chain stores; the results are discussed later in this paper.

DETERMINANTS OF ORGANIC FOOD PRICE LEVELS

In Poland, organic food price levels are high when it comes to both domestic and imported products. In some cases (e.g. chocolate, bread, corn flakes, wheat flour), the price premiums (differences between organic and conventional food prices) reach several hundred percent (Dykiel et al., 2016; Łuczka-Bakula and Smoluk-Sikorska, 2010). In turn, according to a study on consumer acceptance of organic food prices, while

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the consumers are not willing to accept such high price levels (Koreleska, 2009; Nestorowicz et al., 2016; Żakowska-Biemans et al., 2012), they consider the price premiums ranging from 10% to 20% to be acceptable (Grzybowska-Brzezińska, 2005; Łuczka-Bakuła, 2007). Also, as shown by a world literature review by Aschermann-Witzel and Zielke (2014) and Padel (2016), the price is the main obstacle when buying organic food.

The high level of organic food prices is mainly conditioned by low supply. Generally, organic farms are run on a subsistence basis whereas intermediaries and processors prefer large and regular deliveries. Therefore, the basic sales channel is direct selling, which enables obtaining relatively high prices while minimizing the costs of goods sold. However, as direct selling takes place in rural areas only, it does not allow to target all consumers interested in purchasing organic food. It limits the accessibility of organic food, especially when it comes to fresh products, thus additionally affecting the price level of organic foods.

Another important determinant of organic product prices is the irregular supply, primarily resulting from poorly developed logistic facilities (e.g. lack of adequate warehouses, cold stores or transportation). According to a research by Aertsens (2011) on differences between the prices of organic and conventional food sold by farms and retail prices of fresh products, the price premiums are, respectively: 91% and 63% for cauliflower; 76% and 40% for potatoes; 23% and 45% for milk; and 38% and 41% for beef. Therefore, the author claimed that organizational improvements to the supply chain could influence its efficiency and, as a consequence, reduce the retail prices of organic products. This is confirmed by the fact that, in recent years, the prices of organic food in Switzerland have significantly dropped due to more efficient distribution operations and strong engagement of retail chain stores in this field (Kilcher et al., 2011).

Irregular deliveries are also caused by low levels of integration between farmers who could, for instance, associate into producers' groups. A group of producers enables stable supply in domestic products; as a consequence, shortages occur less frequently which is reflected by lower imports and price stability. In this case, the key role may be played by state support for the establishment of producers groups.

Poorly diversified production structure also affects the price levels and is reflected by a poorly diversified product range. While product processing means better

opportunities for improving the product range, only a few farmers do so. An additional obstacle is the fact that, in Poland, there is not enough organic food processing companies to ensure an extended product offering. Therefore, imports of organic processed food are quite significant and affect the price levels.

High price levels are also determined by the underdeveloped distribution chain. Poorly developed organic structures of food retail trade are a barrier to price competitiveness. Moreover, the problem is aggravated by the very limited number of wholesalers which makes it necessary to search for alternative suppliers and incur the related additional transaction costs. Meanwhile, according to Padel (2016), the longer is the supply chain (the higher is the number of intermediaries involved), the higher are the costs and retail prices. Therefore, shorter supply chains are more profitable for the organic food market, and it is essential to establish local wholesalers and processors.

ELEMENTS OF THE PRICING POLICY

In enterprises, especially in trading companies, the pricing process is determined by market conditions. Nevertheless, each operator has some freedom in this area. Note that the pricing policy, which covers adequate strategies and tactics, is one of the crucial decisions in a trading company, beside setting the target market and product quality. As mentioned before, the Polish organic food market is small and not transparent, which makes it difficult to pursue the right pricing policy. Between 2011 and 2012, research was conducted on organic food retailers. It covered 131 specialist stores, 109 groceries and 179 retail chain stores, located in the eight largest Polish agglomerations, i.e. the Warsaw, Górny Śląsk, Krakow, Łódź, Wrocław, Poznań, Gdansk and Szczecin agglomerations. The research was an in-depth interview based on a standardized questionnaire (PAPI method), addressing such issues as organic food product range, supply sources, marketing tools and strategies, and pricing policy.

In a traditional approach to the pricing process, the existing product is square one; afterwards, target markets and brand image are selected, and the marketing mix, pricing strategies and tactics are defined (Bennet, 1998). This is applicable to organic food retailers in a situation where the product and its quality are basically given, and decisions are made concerning prices and target markets. Kotler (1994) cites six steps of pricing:

- selection of pricing strategy,
- estimation of demand,
- estimation of costs,
- analysis of competitors' prices and offers,
- selection of pricing method,
- selection of final price.

The pricing strategy selected by a company depends mainly on the objectives it intends to pursue. While the profit maximization rule urges to apply higher prices, a low-price strategy is required to gain a larger market share. The basic pricing strategy for the organic food market in Western European countries is the high price strategy implemented in order to make their group of products stand out from the competition while promoting the image of a high-quality product. This type of pricing strategy includes the skimming strategy which is based on setting the possibly highest prices in a short term. This is applicable to new or innovative products, or products wanted on the market. It is based on the fact that demand is the initial stage of a product's lifecycle while being relatively inelastic. Conversely, in the prestige pricing strategy, a product is perceived as prestigious throughout its lifecycle (Nessim and Dodge, 1997). One of the high price strategy types is a selective strategy where the objective is to gain a small part of the market while targeting high-income consumers. This should result in gaining and increasing profits in short term, as it is applicable to innovative products in the initial phase of their lifecycle (Garbarski et al., 2008).

In turn, an alternative to the strategy discussed above is a low price strategy oriented at gaining a large market share. This includes the penetration strategy which may be effective only if the coefficient of elasticity is relatively high and a price reduction results in a more than proportionate increase of demand. Another example of a low price strategy is that of preventive pricing applied in order to reduce the potential competitors' ability to enter the market. If the competitors lag behind, the enterprise may use the economies of scale and build a compelling image of its products. In turn, the elimination strategy assumes that prices are set on such a level that would eliminate the competition from the market (Nessim and Dodge, 1997).

In addition, other classifications are used, e.g. based on the way a company adjusts its activities to the competitors' behavior. An example of such a strategy is the adaptive strategy which essentially consists in a commitment to maintain the existing market share and imitate

the behavior of the competitors. Nevertheless, this kind of strategy may be applied if the costs are lower than those incurred by competitive operators. The opposite of the adaptive strategy is the innovative strategy which may be based on avoiding competition and searching for such a price level which has not yet existed in the market, i.e. a price gap, or is based on initiating changes in the price range without expecting the competitors to change their price levels, or consists in a price change in the opposite direction to that initiated by the competitors (Garbarski et al., 2008).

A specific type of pricing strategies are those related to other marketing tools, for instance the price-quality strategy based on the dependencies between these two instruments. In this case, an improvement of product quality and distribution, combined with a cost increase, justifies charging a higher price than competitors. In turn, the price-promotional strategy results in applying discounts and periodical price reductions used as promotion tools (Garbarski et al., 2008).

According to research, about 27% specialist shops and 11% of the groceries do not use any pricing strategy. In turn, for the specialist stores, price-promotional, price-quality strategies and adaptive price strategies are the most frequent pricing strategies (Fig. 1). Every seventh respondent declared to rely on the high price strategy, which is justified in the organic market. It is also reasonable to link price with quality because the price indicates a higher value and uniqueness and should convey prestige. On the other hand, prices should not be excessive as it could reduce the demand from a part of consumers. Therefore, the basic issue for the retailers is to set an acceptable price range which would assure adequate revenues while not deterring consumer interest related to price and product perception (Rogoda, 2003). However, in practice, the range of organic food prices is quite wide, and the reason is the poor market information flow.

Most of the grocery owners declare to use the innovative pricing and price-quality strategies. This proves that retailers pay some attention to the quality of organic products they offer while trying to highlight the advantages of organic food, which is the reason why they may charge higher prices. Furthermore, those dealers may successfully use innovative pricing strategies because organic food is an alternative to conventional products offered in their facilities. Therefore, they are able to find a specific price gap, bearing in mind the prices charged

by their competitors who do not offer this kind of food. Only 22% of the respondents declared to rely on a high price strategy, emphasizing the highest importance of the prestige pricing strategy. This type of strategy may become crucial for organic products offered in groceries because its effects may be precisely strengthened by the proximity of stores and by comparisons to conventional products.

In turn, most of the retail chain stores declared to use the low price strategy (based primarily on comparisons to competitor prices) for the entire product range offered in a particular outlet. Even though they rely on this strategy (which generally suggests a gradual reduction of organic food price levels), the market share of organic food selling in supermarkets is still low and has a slight influence on the level of organic food prices. Moreover, retail chain stores selling delicatessen declared to use the high price strategy (especially the prestige pricing and selective strategy), addressing the high income

consumer segment. Every tenth outlet used price-promotional strategy instruments by offering discounts.

The reluctance to use the high price strategy, which proves to be efficient in Western European countries, probably results from the fact that high prices restrict the demand for organic food (Fig. 2). According to the dealers, high prices for organic products imply a decline in revenues. This could be a confirmation of the results of a consumer research which found that the price levels of organic food are too high for the vast majority of consumers.

Some of the outlets surveyed declared to use the price-promotional strategy which is based on two marketing tools. They were also asked how frequently this instrument was used. As shown by the research, while it is a common practice, retail chain stores and specialist shops are far more likely to apply it (Fig. 3).

The use of periodical discounts by the retailers may be considered to be a positive development as it makes

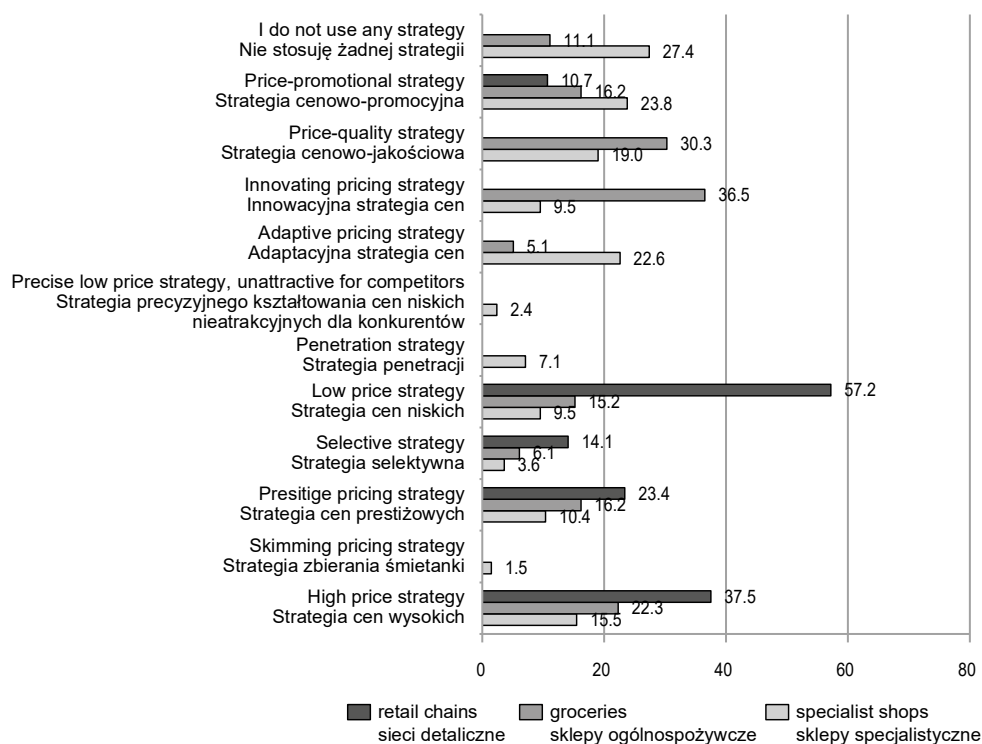


Fig. 1. Pricing strategies used in the outlets covered by this study (%)

Source: own research.

Rys. 1. Strategie cenowe stosowane w badanych placówkach handlowych (%)

Źródło: badanie własne.

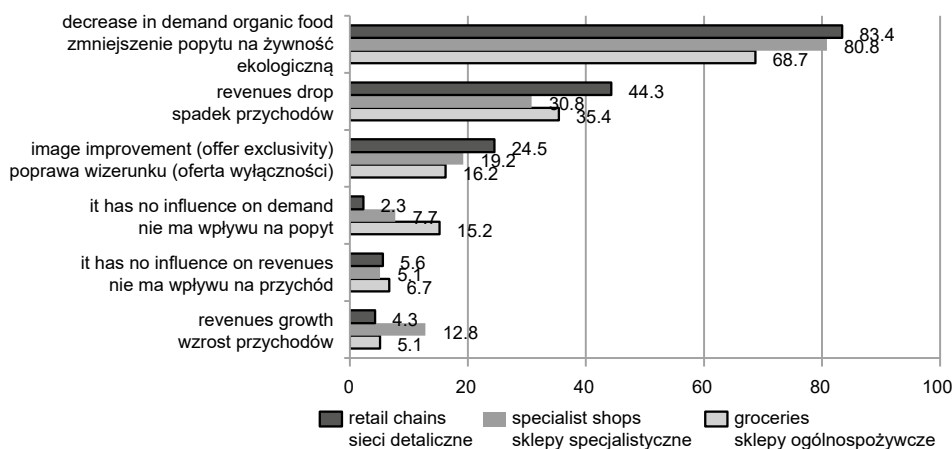


Fig. 2. Effects of high levels of organic food prices (%)

Source: own research.

Rys. 2. Efekty wysokiego poziomu cen żywności ekologicznej (%)

Źródło: badanie własne.

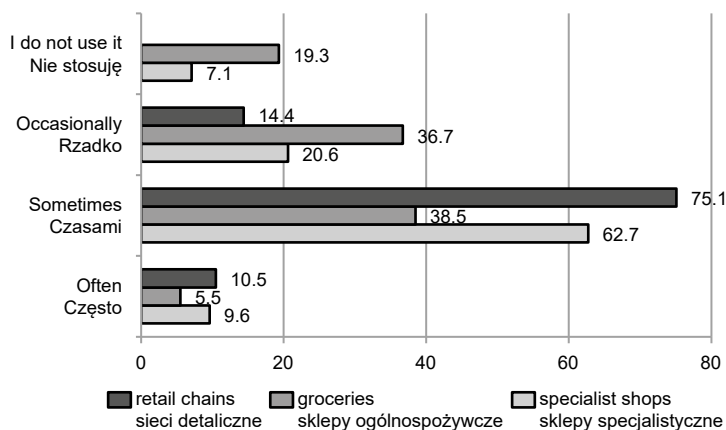


Fig. 3. Frequency of periodical discounts (%)

Source: own research.

Rys. 3. Częstotliwość stosowania okresowych obniżek cen (%)

Źródło: badanie własne.

the products affordable to a larger group of purchasers. Nevertheless, the basic goal of these actions is to sell out stocks at the end of shelf-life (Fig. 4). Also, stimulating the demand and sales, and retaining regular customers (mainly specialist shops) were indicated as the objectives, which is in line with the pricing strategies pursued by the outlets under consideration.

As a consequence of the immaturity and poor recognition of the Polish organic food, the process of retail pricing does not enable taking several market factors (e.g. demand or competition) into account. Factors specific for a market at the initial growth phase have a major influence on price. In the shops covered by this survey, costs-based methods were prevalent in the pricing

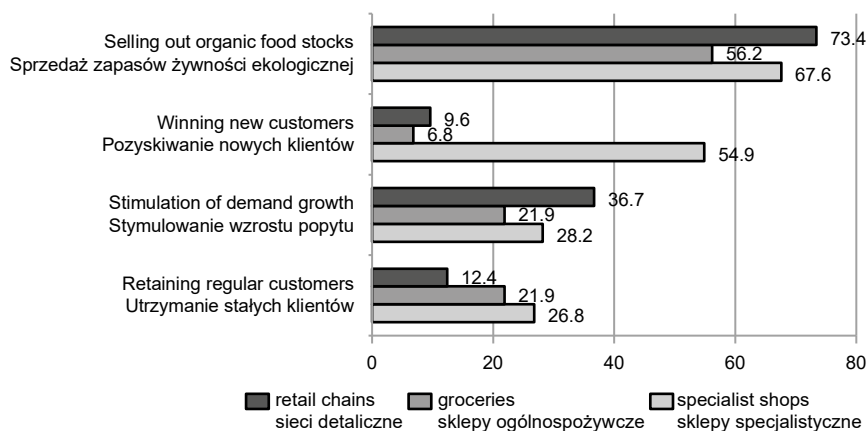


Fig. 4. Reasons for using discounts (%)

Source: own research.

Rys. 4. Motywy stosowania obniżek cen żywności (%)

Źródło: badanie własne.

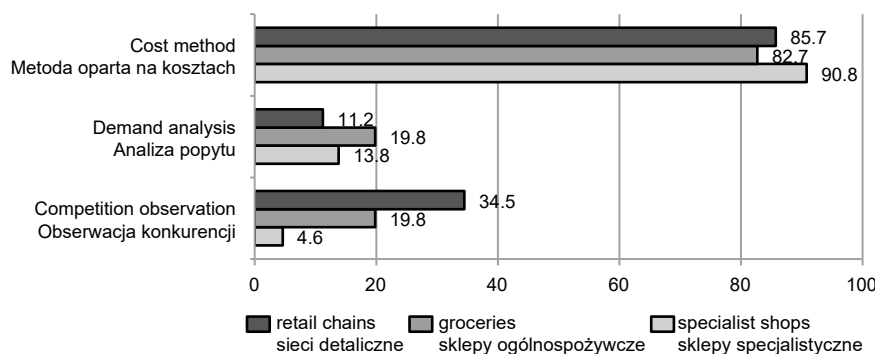


Fig. 5. Pricing methods in the outlets surveyed (%)

Source: own research.

Rys. 5. Metody ustalania cen przez badanych detalistów (%)

Źródło: badanie własne.

process. Only some of the respondents declared to rely on a method based on demand analysis or competitors' behavior (Fig. 5). Note also that market observations are carried out more frequently by specialist shops than by groceries.

The vast majority of specialist shops and groceries covered by this survey assessed their own price levels to be average (compared to competitors), or were unable to make such an assessment (Fig. 6). This could suggest poor knowledge of the market and the absence of competitor analyses. In turn, the declared price levels of

organic food in retail chain stores are usually lower than those charged by their competitors, which is in line with the adopted low price strategy.

The relatively high prices of organic food are conditioned by such factors as the underdevelopment of distribution chains (mainly including logistic chains). Currently, low development levels of the logistics system may be compensated by short and relatively cheap sales channels. Generally, organic products are sold directly to retail shops at relatively lower prices than goods purchased through longer distribution chains.

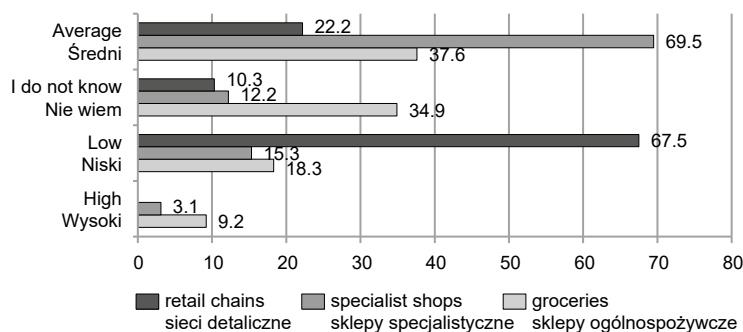


Fig. 6. Price level in the outlets surveyed compared to competitors (%)

Source: own research.

Rys. 6. Poziom cen w badanej jednostce w stosunku do konkurencji (%)

Źródło: badanie własne.

Therefore, despite high transportation costs incurred both by farmers and by retailers, the possibly shortest distribution chains are preferred. These are collaborative supply chains primarily based on mutual confidence and credibility. An additional benefit for the retailers is the fact that they may impose higher margins on cheaper products originating from organic farms. However, the downside is that the offer of organic food delivered by farms is quite narrow (and mostly includes unprocessed products). Therefore, support for on-farm processing is essential as it may result in a reduction of retail prices which could be followed by a demand growth.

Moreover, it might be expected that along with market development, the demand-related factors will become increasingly significant as price determinants. For the Polish organic food consumers, price is still the key driver of demand, unlike in Western European countries where non-price factors play a significant role. It is highly probable that in the future, the Polish market will develop in that direction and such determinants as quality and uniqueness will become more important.

Organic products are goods of higher order; therefore, higher prices induce specific behavior of different consumer groups. Priced at this level, the organic food offering is targeted at buyers with relatively higher incomes, provided that they are highly environmentally aware. Higher price levels build a positive perception of organic food while providing a competitive edge in the target segment (Śmigielska, 2004).

Currently, the target group of organic food consumers remains quite small because of the low levels of

prosperity and environmental awareness in the society. However, as the incomes grow, this segment will expand and the interest in organic food will increase. This is because the health and environmental determinants of demand will become increasingly important (Urban, 2002).

CONCLUSIONS

Currently, the development of organic farming in Poland is mainly driven by financial support accessed by farmers. In order for this support to be fully justified, there must be enough market demand. The most important demand driver are prices, which remain relatively high in the case of organic food. Therefore, it is vital to establish such price levels which, while acceptable to consumers, ensure decent revenues both to the producers and dealers. The retailers face a challenging task because they are the ones who set the final price for the buyer.

As shown by this research, the majority of specialist distributors use the price-quality and price-promotional pricing strategies and the adaptive pricing strategy. In turn, the groceries declared to rely on the price-quality strategy and innovative pricing strategy. The chain stores indicated that the low pricing strategy was used for their entire product range. Only some of the distributors adopted the high pricing strategy, used in most Western European countries. This is because the retailers believe that excessive prices entail a decline in demand and revenues. The population surveyed use

periodical discounts on a regular basis; however, the only purpose of the discounts is to sell the organic food stocks. The vast majority of retailers do not carry out any market research, so the price is established based on costs. Nowadays, most markets demonstrate the characteristic features of the buyer's market, and therefore it is crucial to establish such price levels which are adequate for the consumers. Consequently, as the market develops, it is necessary to perform some marketing activities, including market observation, which would allow for defining the adequate price level and selecting the optimum pricing policy tools.

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POLITYKA CENOWA W HANDLU DETALICZNYM ŻYWNOŚCIĄ EKOLOGICZNĄ

Streszczenie. Niedoskonałość polskiego rynku żywności ekologicznej, zwłaszcza pod względem kanałów dystrybucji, sprzyja wysokiemu poziomowi cen ekoproduktów, co z kolei ogranicza popyt. Dlatego istotne jest rozpoznanie strategii, działań i instrumentów stosowanych w polityce cenowej dotyczącej żywności ekologicznej. W artykule zaprezentowano wyniki badań dotyczących polityki cenowej prowadzonej w sklepach detalicznych oferujących żywność ekologiczną. Badanie przeprowadzono w trzech typach placówek, tj. placówkach specjalistycznych, ogólnospożywczych i sieciach detalicznych w latach 2011–2012. Najczęściej wskazywana przez badanych detalistów była strategia cenowo-promocyjna i cenowo-jakościowa oraz adaptacyjna i innowacyjna strategia cen. Handlowcy najczęściej ustalają cenę na podstawie kosztów i w większości stosują okresowe obniżki cen.

Słowa kluczowe: ceny, żywność ekologiczna, polityka cenowa, strategie cenowe

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