

# Considerations in the Selection of a Price Optimization Solution

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The recent combination of maturing optimization technology and challenging economic conditions have combined to encourage many retailers and FMCG (Fast Moving Consumer Goods) companies to investigate the addition of a price optimization solution to their overall business strategy. Indeed, after the optimization of supply chain, hiring practices, and workforce deployment, the last retail “great frontier” is the application of science and the necessary delivery of technology to drive margin gains without negatively impacting consumer perception or competitive positioning.

While the view that price optimization is a critical component of the retailer’s go-forward strategy has been widely documented and supported by industry analysts, less has been written about the relevant considerations in selecting a price optimization solution. The focus of this white paper is to provide guidance to the retail executive seeking to select the solution that will provide maximum benefit to the business, with consideration paid to the unique needs inherent in every company.

### Examine Your Business Needs and Capabilities

Retailers must examine their business with an eye towards factors that will influence their price optimization choice, asking questions such as:

- What is my total SKU (Stock Keeping Unit) count?
- What percentage of the total SKU count represents FMCG (as opposed to prescription drugs, for example)?
- How many items in the store have clean cost information available (some items, such as deli sandwiches, are notoriously difficult to cost with precision due to the myriad ingredients assembled in varying amounts)?
- How often are cost changes received from suppliers?
- Does the organization perform TPRs (Temporary Price Reductions) regularly?
- Approximately what percentage of the time does your organization run promotions?
- What is your organization’s current approach to markdowns and clearance scenarios?
- How much sales history is available for export?
- Will the back-office and POS systems support the necessary data exchange?
- How many price changes per week is my organization physically capable of executing at a store level?
- What are the net margin and sales increase goals for the project?
- What recourse is available if these goals are not being achieved?
- How will change management issues be addressed?
- What is my budget for the project?

Examining the answers to each of these questions will provide a useful framework to evaluate price optimization solutions against to insure that your organization’s needs and requirements are taken into account.

**SKU Count** – The greater the FMCG SKU count, the greater the overall benefits possible with the right price optimization solution. However, the solution must be robust enough to process the high counts on a frequent basis to achieve the maximum impact. Businesses with over 30,000 fast-moving SKUs per store should pay careful attention to this criterion to insure they select a price optimization solution that is up to the task.

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**Cost Data** – Cost data is an essential component of any optimization equation, so the essential question is whether it is readily available in an electronic format. Items such as perishables and bulk foods often present a challenge from a costing perspective, so the availability of cost data will put limits on what can be price optimized in a given retail operation. It should be noted that cost history is not important to the price optimization equation—only current cost information is relevant.

**Cost Frequency** – Each time cost data changes, the shelf price would ideally need to be readdressed via optimization to reflect this change. Hence, the more frequent your cost changes are, the more robust your price optimization solution will need to be.

**TPRs** – While most retailers do not choose to optimize TPR prices, a price optimization solution should be able to handle TPRs from a price centralization standpoint to avoid having to employ separate systems to process TPR changes. The significance of this capability increases in direct proportion to the number of and frequency of TPRs a given retailer deals with on an annual basis.

**Promotions** – Optimizing promotions via “sandbox” modeling which takes cost, elasticity and supply into account allows the retailer to extend the power of a price optimization solution beyond its traditional playing field of base price analysis. The more frequently a retailer promotes, the more vital this capability becomes.

**Markdowns** – For most retailers, the markdown phase is an important final step in the price lifecycle of a product. Whether markdowns are the result of seasonal changes, new packaging, or other reasons, markdown optimization is an oft overlooked opportunity for price optimization to help achieve inventory management and sales goals through consumer demand intelligence. If markdowns are a fact of life in your business, consider a price optimization solution that compliments your efforts in this area.

**Sales History** – Most price optimization providers agree that two years of sales history is the best amount to have on hand at the beginning of the project, as additional years are of little value due to obsolescence. However, should you have less than two years of history available or if you are continuously opening new stores, you will want to consider a price optimization provider that has an effective means of extrapolating from known data and quickly accumulating predictive data from transactional information on a go-forward basis.

**Back-office/POS systems** – Since these systems will be both the source of price optimization data and the recipient of the optimized prices, it is crucial to note the interface capabilities of each (or the lack thereof) in order to review compatibility issues with your price optimization provider to insure that the necessary data exchange can take place. This is especially important in light of the fact that some price optimization providers charge significant sums to create interfaces to less popular back-office and POS systems, adding significantly to the cost of the project and negatively impacting rollout dates.

**Price Change Capacity at the Store Level** – It is vital to have a clear understanding of the number of price changes per week that existing store resources can handle. While a price optimization system may easily be capable of producing thousands of changes per week, often the most that can be effectively administered is less than 1,000. If this is the case, you will want to look for a pricing optimization solution that effectively prioritizes and regulates the flow of price changes to your stores.

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**Net Margin and/or Sales Increase Goals** – At the project’s inception, clarify your goals. How will you measure success? Defining up front the results your organization is seeking will be helpful in multiple ways: First, your organization’s price strategy may need modification to achieve the results you are seeking. Second, you will want to select a price optimization provider who has achieved similar results to what you are targeting (with other clients). Third, these margin and sales goals form the basis for your internal ROI calculations used to justify the project, and later, to measure its efficacy.

Moreover, it is highly useful to identify what steps you would propose to take should you fall short of your margin and sales goals for some reason. If you are locked in to a particular pricing strategy or deployment approach because you have selected a provider that makes it difficult or expensive to make mid-course corrections, your options to address shortfalls in performance will be limited.

**Change Management** – With any significant technology upgrade, success hinges on proactive change management. The effort must have highly-visible sponsorship from the top levels of management and new processes carefully designed, communicated, and monitored. Some price optimization providers offer help with change management as a value-add, while for others it is managed as a profit center under the professional services umbrella. Still others lack change management consulting capacity and routinely refer their clients to third parties. In short, it is vital to have a change management plan for a price optimization project and it is equally vital to know up front the participation level you can expect in this area from the provider you ultimately choose.

**Project Budget** – Identifying budgetary expectations and limitations up front will be helpful in defining both the scope of the project and which provider business model will best fit for your needs. Some price optimization providers require that software, hardware, and services be purchased up front at the beginning of the project, while others offer a pay-as-you-go approach that limits initial capital expenditure. Having at least an approximate idea of your budget for price optimization will thus aid you in the provider selection process and position you to ask the right questions about cost.

Having done your homework relative to your organization’s needs and limitations will pay off in the selection process and prepare you to examine price optimization offerings with greater clarity.

## Reviewing a Price Optimization Solution

Doing your homework, you will be in position to effectively evaluate price optimization solutions against your own criteria. As you review the solutions offered, the following are critical items to consider:

**How often does the system optimize prices?** With costs and consumer demand changing rapidly in today’s market, experts agree that the more frequent the optimization, the better the end results will be; with most agreeing that weekly optimization is the ideal frequency. Be sure to find out if the system you are considering supports weekly (or more frequent) optimization and recalculates the consumer demand component (elasticity) as a part of the weekly optimization exercise rather than applying cost changes to existing demand signals which may be outdated. Also find out if there are additional costs associated with performing optimization on a weekly basis.

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**How well-proven is the science?** – At the heart of a price optimization solution lies the science that drives the consumer demand forecast—essentially predicting the future relative to what consumers will buy at a given price point. Look for science that has produced demonstrably positive results, developed by credentialed scientists with long-term backgrounds in pricing optimization and demand forecasting. You should also seek to form an opinion as to whether a given provider’s scientists are positioned to continually evolve and enhance the science behind the product offering to adapt to changing market conditions.

**Is the solution easy to use?** – User-friendliness is a key concern when selecting a price optimization solution. The typical installation will have a combination of both skilled and unskilled computer users, and a user-friendly application with speed-up acceptance time, shortens training windows and helps to insure consistent usage. Studies have shown that a difficult to use application—regardless of its power and functionality set—will not see regular use in the field. Look for intuitive, consistent screen design, help information availability, and fewer screen views to complete common tasks such as reviewing pricing recommendations.

**Does the solution handle full lifecycle pricing?** – While all price optimization systems have the capability to address base retail pricing, a comprehensive solution will also handle promotions and markdowns. For simplicity and ease of use, look for a single system that can handle all the elements of lifecycle pricing.

**What business model does the solution provider offer?** – To achieve your ROI goals for a price optimization project, it is important that you are able to accurately account for all costs involved in the installation and operation of a solution. Some vendors charge for additional modules beyond their base price offering. Others charge for each optimization run, support call or modification to your pricing strategy. Be sure to investigate the provider’s cost structure up front, as well as whether the provider you are reviewing operates under a traditional (pay up-front) or a software-as-a-service (“SaaS” pay-as-you-go) business model.

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## Conclusion

The suggestions listed in this white paper are but a few of the considerations to review prior to selecting a price optimization provider that is right for your business. However, these suggestions do represent a good starting point for investigating this powerful business technology.

Whatever price optimization solution you ultimately select, you are to be congratulated for being on the vanguard of retail business thought by using this technology to bring the most effective prices possible to your stores.

Revionics is a leading provider of full-lifecycle price and promotion optimization technology for retailers and distributors in the fast-moving consumer goods industry. The Revionics Advanced Pricing System (RAPS) generates increased sales and profits through sophisticated demand intelligence and proprietary pricing science. The system optimally determines base pricing, promotional and ad pricing, temporary price reductions (TPRs) and markdowns. The Revionics offering is available as a Software-as-a-Service (SaaS) subscription offering over the Internet. The service includes advanced price modeling, optimization on-demand, scenario forecasting, and advanced category analytics.