

Retail Pricing Strategy: Insights and Opportunities

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Frazier-Coleman brings over 20 years of retail grocery industry experience and expertise to Revionics, with previous executive level roles in purchasing, loyalty marketing, advertising, merchandising, project management, and strategic planning. Most recently, Ms. Frazier-Coleman was with Basha's Supermarkets of Chandler, Arizona. Named as one of the top 50 female executives by Progressive Grocer in 2007, Frazier-Coleman has been a featured speaker at many industry events, including FMI, Gemcon, National Center for Database Marketing, and NFRA. Experienced in highly competitive retail markets, Frazier-Coleman has developed a keen sense of customer focus, managing over 50 focus groups and key retail initiatives to drive consumer loyalty. In her role at Revionics, Frazier-Coleman will lead Revionics Price Strategy and Consulting Organization.



Abstract

Today's modern retailer of fast-moving consumer goods faces more pressure than ever to compete and succeed. Understanding the impact of an optimization-enabled price strategy and the powerful options that this strategy can unleash empower retailers to achieve new levels of business success.

This paper addresses the critical role pricing strategy should play for retailers of all sizes. As advances in science and technology allow retailers to integrate real-time consumer demand data, competitive activity, along with pricing rules, creating and implementing a sophisticated price strategy is emerging as a powerful opportunity for retailers to increase revenue and profit. By leveraging the intelligence and discipline of the latest price optimization tools, along with the insights of a qualified price strategist who is responsible for the design and management of the strategy, retailers can find real opportunities in at least five areas of practice.

“Aligning business goals and pricing policy seems common sense, but too often retailers lack the insight and technical ability to plan and price strategically.”

Why Is a Modern Price Strategy So Important?

To survive and thrive in the highly competitive retail world, retailers must become more attentive and meticulous with their pricing. More than ever before, the financial success of companies selling retail goods depends on their price strategy. Consumers demand fair prices in exchange for their business and are constantly comparison shopping. With the ever-present pressures from shrinking margins, rising costs, and competition, winning in the retail arena today demands price strategies that reliably and frequently guide retailers' decision-making.

New advances in price optimization science and technology offer retailers an unprecedented opportunity to align pricing policy with strategic business objectives. Aligning business goals and pricing policy seems common sense, but too often retailers lack the insight and technical ability to plan and price strategically. Instead, retailers too often rely on a basic “cost-plus” strategy to maintain margins, follow their competition, or adopt wholesale-supplied pricing. Smart retailers know they should set prices in line with their own business objectives instead of simply reacting to competitors, cost changes, and margin objectives.

Competition is by no means removed from the equation in a modern, optimization-based price strategy. But modern price strategies reflect an analytical, big-picture approach. They include a far wider variety of factors such as pricing gaps, ending number psychology, brand sensitivity, and product movement. These factors enable retailers to manipulate pricing to align with their broader strategic business objectives. These options were previously not available in traditional pricing systems.

When competitors introduce a new product or slash prices, retailers who have developed a strategic-level pricing regime can respond with a multitude of options. The first and most typical option might be to respond immediately with similar changes. However, an optimization-based strategy can introduce additional options for retailers, providing them a deeper understanding of the long-term financial impacts of reactionary changes. Optimization environments can suggest alternative actions to make up for those losses caused by fierce competition.

The ability to accurately predict consumer responses to certain changes enables this new strategic thinking.

This typical situation is one of many constants in the retail environment. Will there always be loss leaders? Probably. Will there always be profit sacrifices on certain items? Most likely. Will shrink and other cost issues erode margin? Again, probably. None of these, however, should deter retailers from adhering to their pricing strategy to minimize these short-term negative effects over the long-term.

A solid strategy factors these elements into the equation and still delivers value to the customer. In the end, price strategy must accomplish its objectives without negatively impacting customer expectation and perception. AMR's Research Director Mike Griswold recently wrote, "Retailers need to articulate (internally and externally) their price message and position. These statements provide the guardrails that guide pricing tactics across the organization. Without these guidelines, organizations can get into schizophrenic pricing practices that confuse the customer."

A modern pricing policy must vigilantly protect the consumers' perception that they are choosing the best place to shop for their families. Consumers who are confused by non-palatable prices tend to shop elsewhere. Many retailers inadvertently confuse customers by setting prices without a comprehensive policy, by being reactionary to competition, or pricing strictly on margin goals. Although few customers may be able to articulate why they feel confused in a given retail environment, research from the Wharton Business School indicates that consumers typically rely on three reference points when determining what they think is a fair retail price: 1) how much an item cost in the past; 2) how much competitors charge for the same item; and 3) their perception of the associated costs of selling an item.

Relative to other areas of business improvement, creating and deploying a strategic pricing regime can produce higher returns compared to other loss-control efforts. Wharton Professors Z. John Zhang and Jagmohan S. Raju documented an important statistic in a recent research paper:

A one-percent reduction in fixed costs boosts profits 2.3 percent; a one-percent increase in volume will result in 3.3 percent increase in profits; a one-percent reduction in variable costs can produce a 7.8-percent rise in profit; but a 1-percent improvement in pricing will boost profits by a whopping 11 percent.

The Wharton research validates what new-era price optimization strategists have asserted since 2005: pricing is one of last retail frontiers where significant gains can be immediately realized with proper strategy, technology, and support.

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Essential Components of a Modern Price Strategy

Establishing a formal pricing strategy is a long-term commitment to a set of over-arching business goals tied to a set of decision-making processes, technology, and actions. These four attributes characterize today's most effective pricing strategy:

- Embraces a long-term approach that creates a perception of value in the customers' minds
- Balances short-term, proactive tactics with long-term margin enhancements in other areas
- Contains well thought-out and imbedded mechanisms for measurement, evaluation, and course-correction Ultimately delivers the corporation's financial goals

Science and Technology as Catalysts to Pricing Systems

Price optimization science is maturing rapidly – and being applied to retail environments in ways that most retailers had never thought possible. The challenges of managing multiple zones, the proliferation of items and formats both internally and externally, dictate a new approach. Retailers using older, single-threaded, rules-based systems, or who still rely heavily on spreadsheets or tables are finding that they cannot keep up with cost changes and competitors. The decision to evolve pricing from “gut” feel or “follow-the-leader” strategies is, for many retailers, a daunting but essential first step in order to maintain profits and customer perceptions of value. For those who decide to develop true pricing strategies, however, technology can provide significant risk-mitigation as well as comfort (in the form of experienced and committed implementation support, depending on the vendor chosen).

Technology is more important than ever in creating and executing a pricing strategy. The best systems allow retailers to regularly review market factors and change prices. They can look at large numbers of items easily and respond rapidly to market changes. For example, competitive data should not stale waiting for review but can be acted upon as collected. Science-based optimization systems now enable retailers to measure the effectiveness of system-recommended price changes and adopt new tactics as the system interprets results. Retailers should train their pricing managers to understand and act upon the new systems’ feedback. This should be the top priority of any company adopting a strategy-based pricing system to meet the corporation’s financial obligations.

The Human Element

Dedicated human resources are another essential component, worth discussing. Retailers should empower individuals to learn, monitor, implement, and adjust the company’s pricing. Empowerment should be coupled by the appropriate authority and accountability that convey the role’s importance. Multiple layers of decision makers in multiple departments often blur the purpose and unison of the strategy. Total responsibility must reside in one department with those goals being visible across the entire organization. This is a key area that often requires change management activities if responsibilities are adjusted in any way.

Other employees are also a part of the equation. Communicate the strategy’s importance and purpose because evolving traditional ways of thinking and implementing a new pricing system must occur on an organizational level. Internal buy-in and understanding leads to a more consistent, less-ambiguous set of communications to the public. Although prices themselves represent one important channel of communication to customers, public-facing employees can also help or hinder this communication.

Measurement and Adaptation

It’s one thing to develop a powerful strategy or deploy a robust optimization system, but many retailers find execution and measurement equally challenging. To some retailers, price recommendations generated by their optimization systems make perfect sense on paper, but when several hundred or several thousand price changes occur every week, they need the reassurance the system is working.

“Retailers must choose a system that measures the impact of their price changes.”

Many leading software products can determine the impact of price changes on consumer demand cycles and profit margin, but without a process in place to evaluate and implement changes, many such opportunities go unnoticed. Therefore, retailers must choose a system that measures the impact of their price changes. Retailers need to regularly measure and evaluate these results, to ensure not only pricing consistency (a key factor in generating increased revenue and profit) but also to codify the system's importance to the entire organization.

Pricing is a very personal activity. It represents the relationship to the community, suppliers, and manufacturers, and the results create the corporation's financial report card. It is serious business.

Key Opportunities to Leverage Price Optimization

Most retailers understand that being competitive on price-sensitive items helps build store traffic. But staying competitive on price-sensitive items can result in minimizing or sacrificing profit on those items. So, how can retailers attain profitability and maintain a competitive footing? Emerging price science helps retailers create a personalized strategy in a wide variety of dimensions. Below are five key areas of opportunity that can be leveraged to maintain financial stability over the long term. A thorough price strategy incorporates each of these components.

Zone Analysis

Many retailers already practice grouping stores into zones. These groups were originally set up using a cost-to-serve model driven by geographies, distribution centers, or critical suppliers. Retailers today sit on both ends of the spectrum with only one zone or too many to manage.

Determining an optimal price strategy through zone configuration requires a deep understanding of many factors, including cost. Cost serves an important purpose, but certainly should not be the only factor. Even retailers with several outlets in one geographic area do not have identical economic, cultural, and demographic identities within every store. These differences become evident with basic price elasticity studies. Such store-specific insights can empower a retailer to anticipate and react to factors such as job growth, housing, and other economic trends that can greatly impact consumer price sensitivity and competitive activity. For example, the price of a large bag of flour is highly sensitive in a Hispanic family community, where baking and cooking at home are a way of life versus a community of homes with no children or parents who often travel and seldom cook at home. Both of these extremes exist in the same cities and states across the country. Why rely then on just one factor to set pricing?

Category Groupings

Retailers tend to apply a general margin goal to categories of like items when using price management systems. This is largely a function of how earlier pricing software was written, in accordance with historically popular rules-based approaches to pricing. Mature category management systems, new product innovations, health and wellness attributes, green products, and convenience foods are creating opportunities with new segments within standard categories. Today, it benefits retailers to look inside categories for margin opportunities. For example, the rise in popularity of specialty teas has put those items in a category of their own, capable of performing much better than the general category of coffee and tea. Retailers who lack insight into these buying trends miss opportunities to reshape a price strategy.

New-era price optimization systems are designed to consider how categories and product groupings should be priced and manage them much easier than older systems. By breaking up traditional categories and price families, and creating groups based on product benefit, health and organics, or convenience, retailers create profit opportunities in areas not typically leveraged in the past.

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Creative Pricing

Creative pricing pushes consumers into action when they consider making a purchase. "Should I buy it now or later?" is a question that too often is answered, "later." "Should I buy one or two?" Is often answered by "one". For items not promoted through advertising, retailers can build their pricing strategy to leverage specialized, creative appeals that drive product movement based on the perception of added value or savings.

Successful retailers in every market use tactics like offering better single price points only if multiple purchases are made, cash discounts for purchasing a "suite of products", discounts on fuel for purchases made in-store, and any other strategies to generate larger orders and take customers out of the market on key items. Since these prices are built around large purchases, smaller orders can become more profitable as those offers do not apply. These tactics MUST be supported by:

- Clear, simple communication to both employees and customers.
- A great in-store merchandising program

Such tactics can help convert part-basket customers into full-basket customers.

Private Label

Private label brands and strategies are evolving quickly. Retailers have learned that a good private label strategy pays off big dividends in customer loyalty, margin enhancement, and category control over national brand manufacturers. Retailers should be aware of the emerging best practices in pricing private label.

Supporting private label growth should be top priority in time and management as it adds profit at a much higher rate than any other category in retail. Establish an ideal price gap between private label and national brands, recognizing the consumer will evaluate the core suite of items (by size). Support a value-price perception by adopting both long-term and seasonal pricing practices that capture margin targets. Avoid line pricing organics or "better for you" products with mainstream items. They offer additional benefits and have competitive items of their own to take into consideration.

Private label also enables retailers to fill a hole in their product mix with the added benefit of not being subjected to a direct-price comparison by developing new products of a different size, added features, unique flavors, or even different packaging. This practice has resulted in multiple tiers of private label offerings but has some private label items taking on the popularity of a national brand with consumers. By having a comprehensive data file that can be intelligently and systematically analyzed, retailers can "reverse engineer" price gaps to identify the right size and package for their new private label initiatives. Set a competitive price that generates better-than-average margins.

In terms of managing gaps between multiple private label tiers, a consistent and purposeful price strategy is critical.

Vendor Management

What is the message you send to your customers when they stand in front of your shelves? Does the message "shout" about a specific brand? Or does it shout about your price/value message?

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Retailers have grown understandably reliant on manufacturers and distributors for guidance when it comes to pricing and shelf management. After all, vendors have traditionally been a great source of information. Their size and experience has given many vendors a deep knowledge base of customer behaviors and category trends.

But sophisticated, analytics-based pricing technology now empowers retailers to take control - and with good reason. Retailers' and vendors' motives are often similar, but not the same. A retailer with a well-reasoned pricing strategy and reliable data is suddenly in a position to negotiate effectively towards common goals. Retailers who leverage technology end up being better supported by manufacturers and distributors. The retailer provides reliable pricing leadership by aligning pricing to longer-term goals and strategies that, by and large, account for manufacturer best interests.

By making item optimization metrics available, retailers can negotiate meaningfully with vendors and manufacturers. As an example, retailers whose price optimization systems generate customer demand curves are equipped to talk on-par with manufacturers or vendors on performance criteria, promotional vehicles, floor placement, item authorization, or cost increases. When negotiating with vendors, understanding product demand factors based on different strategies offers a powerful tool.

Conclusion

The old adage "knowledge is power" is once again proving true in the arena of retail price optimization. The historic reliance on human knowledge to set pricing is now giving way to tried-and-true price optimization science. This new retail knowledge source is arriving just in time. Broader economic and societal pressures and competition from larger, increasingly sophisticated retailers is forcing retailers of every size to develop and execute strategic, proactive pricing.

Truly leveraging the technology that generates the kinds of insights outlined in this paper requires more than an organizational commitment and a purchase order; it requires a consultative approach to creating a comprehensive price strategy designed for the unique needs and objectives of each retailer. As was the case with earlier generations of software that were capable of doing much less, the new generation software is only as good as its users and their customer data. As such, a pricing consultant who not only understands the potential of the software, but also can train others to use it, should carefully guide the early stages of adoption. Constant measurement must be in place along-side a long-term price strategy which incorporates these important feedback loops from the consumer. Over time, as the system learns, profit building opportunities will explode.

Sources

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"By making item optimization metrics available, retailers can negotiate meaningfully with vendors and manufacturers."

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.