“Tried-and-true bottom-line improvers” such as cutting costs and increasing volume may seem relatively simple to plan and execute—but they may not be the most effective, either in terms of value or process. Retailers who rely on such tactics are not seeing the whole picture. They must understand their customers and competition well enough to make truly informed decisions about pricing, and to do that, they need a dedicated pricing group. Only a strategic approach will see long-term results.

This article was written by Frank Jones (fjones@alixpartners.com), Vice President with the Performance Improvement Practice of AlixPartners LLP (www.alixpartners.com) in New York. A 14-page overview of the 2006 AlixPartners Consumer Sentiment Index can be found at www.alixpartners.com/CSI2006.

Essential Characteristics of Effective Retail Price Management

By Frank Jones

B e honest. As a retailer, have you all but retired the “pricing” lever from your toolbox of profit-enhancers, falling back instead on “tried-and-true” bottom-line improvers like cutting variable costs, cutting fixed costs and/or increasing volume? You’re not alone: Many retailers today have relegated the price-management function to second-class status, asking questions like, “Why do we need all those price analysts anyway?” or “Why can’t the merchants just handle their own pricing?” In fact, in some extreme cases, retailers, in the process of SG&A cost reductions, have determined that even having a dedicated pricing group may not be worth the cost.

It all sounds like savvy cost-cutting. The problem is there’s nothing at all savvy about such tactics.

That’s because it is a fact that pricing—if executed correctly—is still by far the most effective profit lever. For instance, based on a recent AlixPartners analysis of the 2005 operating results for all publicly held retailers with annual sales of more than $500 million, we found that just a 1% improvement in price raised operating margins nearly 16% (see figure 1). This far outweighs the impact of corresponding improvements in variable costs, fixed costs or sales volume.

The trick, of course, lies in understanding your customers, and your competition, well enough to make truly informed decisions about pricing—be they price increases or strategic price cuts aimed at driving store traffic and/or creating a value image. In short, this means being as truly strategic with your pricing as you no doubt try to be with your supply chain, your store operations and your overall marketing efforts.

Without a renewed focus on price and how it fits in the overall company strategy, retailers run the risk of lost sales and profits. To better understand a strategic approach to retail pricing, let’s look at a brief history of the retail pricing approach, examine the latest research on consumer expectations in retail, frame the pricing challenge for retailers and outline the essential characteristics of a successful pricing program.

Pre-Computer Age Pricing

Having spent most of my adult life in the retail business, with a good portion of that time in retail pricing and decision support, I remember when good pricing meant beating your competition on a head-to-head basis. This was especially true for me since I got my feet wet in the grocery trade, where low price was king, until of course, the profit targets were in peril for the current reporting period and we went to work “massaging” prices where we could in order to make our

![Figure 1: Effect of 1% Improvements on Average Operating Margin](image-url)

numbers! That was as close as we got to price optimization.

The good old days of retail pricing! Enter any pricing office during the pre-computer era and you would find a number of fanfold computer printouts of the company’s item master listing piled high on the desks, along with handwritten price checks gathered from the competitors in various markets. It was sometimes hard to find pricing folks behind all the paper! The gross margin calculation wheel was always within arm’s length, and topping off the pricing arsenal was a box full of colored markers which were used to indicate items on the printouts that had an upcoming price change, short and long-term specials, prices below or above the competition, etc. We were not thinking too much about price optimization in those days. We were happy just to get the price changes done on time so the keypunch department could enter them in the system that downloaded information to the stores.

There were changes in the wind for pricing at the dawn of the computer age with desktop PCs, Lotus 123 and computer-assisted pricing. With advanced technology, price management began to get away from the paper-based process. Unfortunately, we did not stray too far from the original objective of the pricing de-
hassle, even if they wanted to. Smart consumers say, it's that they just don't have enough time to put up with the little more. Why the change? Mostly, if, in many cases, that means paying a fixed price, they meant 'lowest.' This certainty, honesty and fair value – even consistency, honesty and good value. This doesn't mean that retailers have carte blanche to raise prices without understanding markets they serve or how the competition has positioned its own categories and prices. Price too high or make your customers feel ill-treated, and they'll definitely notice, costing you profits and credibility along the way.

‘Honest’ Prices Replacing ‘Low’ Prices

When consumers talk price, what do they mean? Are retailers equipped to deal with the new consumer mindset? In the 2006 AlixPartners Consumer Sentiment Index, we asked 6,000 consumers to rank individual retailers within 13 retail categories, from books to sporting goods. The results were startling, and what we discovered from consumers regarding price gives hope to those retailers looking to find alternatives to a frontal assault on Wal-Mart’s low-price position. Pricing in the mind of your customer today is not just about the lowest absolute price; it’s about honest pricing.

Let’s look at one of the critical findings of the 2006 Consumer Sentiment Index:

“In the past, many, if not most, retail executives felt that when consumers defined price, they meant ‘lowest.’ This latest research, however, is irrefutable: When it comes to price today, consumers mean value. They resent needing to hunt for bargains, but even more, they really resent being taken advantage of, being deceived or being made to work to receive real value. What they crave: consistency, honesty and fair value – even if, in many cases, that means paying a little more. Why the change? Mostly, consumers say, it’s that they just don’t have enough time to put up with the hassle, even if they wanted to. Smart retailers will look for a way to differentiate themselves in relation to the issue of time compression, which will continue unabated into the foreseeable future for most Americans.”

Time compression has created a time-starved consumer looking for consistency, honesty and good value. This doesn’t mean that retailers have carte blanche to raise prices without understanding markets they serve or how the competition has positioned its own categories and prices. Price too high or make your customers feel ill-treated, and they’ll definitely notice, costing you profits and credibility along the way.

Clearly, successful price management is not simply about having the lowest price. If that were the case, Kmart might have avoided disaster in late 2001 with its “Blue Light Always” campaign, where it lowered thousands of prices to compete directly with Wal-Mart. The impact of that move is now part of retail lore.

Managing price in retail today clearly presents huge challenges – and not just the obvious ones from Wal-Mart. Technology has enabled consumers to have more choices and more information about prices than ever before. Today’s “multi-channel” customer challenges retailers to work in the world of “clicks and picks” as well as the world of “bricks and mortar,” as the Internet has become a completely “normal” shopping channel.

Technology has changed the nature of competition, as well. More and more retailers have begun to realize that price-optimization tools, coupled with the right processes and strategic approaches, can radically improve the value of the price-management function. Meantime, companies that lag behind more and more find themselves also-rans in the race to react effectively to consumer demand.

Essential Characteristics

What’s a retailer to do? A good starting point may be an internal review of your price-management function using the questions listed below:

1. Do I know where I stand on price vs. my key competitors?

It’s truly amazing how many retailers have no idea where they actually stand on price against their primary competitors. It’s like a pilot flying around the sky with the plane’s radar in the off position!

Do you know your actual price position by competitor, market, category and key items? Competitive benchmarks, i.e., in-store checks that compare your pricing to the competition on directly comparable items, are essential to create a strategic target and determine the cost to reach the desired price structure. In addition, this information can help you understand whether your consumers’ perception gap (see #2 below) is due to real price differences or other factors, such as signage, in-store environment or your overall marketing message.

2. What is the current consumer perception of my company relative to price?

Do you know how consumers view your company’s pricing position, and why they view it that way? All too often,
general consumer perception is far different from the actual measured price gap. In other words, consumers' general perception of price and actual prices are not always in sync. Among consumer electronics retailers, for example, shoppers perceive that Best Buy has the lowest prices, when, in fact, Circuit City is generally at parity with its everyday prices (and often lower in its weekly-ad prices). Best Buy has bigger stores, more of a "warehouse" look and, arguably, even the chain’s name (Best Buy) says "lowest price," but actual prices are in fact about the same.

The lesson here is that retailers need to understand how consumers view prices and what factors contribute to that perception. If there is a problem, i.e., you are viewed as too high priced vs. the competition, you need to know whether it is because the actual prices are in fact too high or whether other cues (e.g., marketing message, in-store presentation, advertising, etc.) are creating the high price image you want to avoid.

3. Do I know what it will take to satisfy my customers on price, and am I delivering against those expectations?

As comprehensively documented in his best-selling book, The Myth of Excellence, Fred Crawford, a managing director at AlixPartners, showed that the recipe for success at retail today is to focus on exceeding customer expectations – though not in all five key areas of retail (price, product, service, access and experience), but rather in just two ... while settling for industry par on the remaining three. In other words, "wow" your customers in one key area (e.g., service) – while differentiating in a second (e.g., product). Put the lion’s share of your time and resources into excelling in two highly relevant areas, and it’s OK, even advisable, merely to meet expectations in the other three.

Companies ignoring this advice seldom end up with the kind of identities that resonate with consumers. And when it comes to pricing, in particular, retailers must decide if they want to excel in that area (i.e., be known primarily for low price) or whether they want to ensure their prices are at par for their segment while focusing on excellence in other aspects of their operation. Target, for example, has done this by making sure its prices are not the rock-bottom lowest, but competitive (i.e., “industry par”), while focusing on excellence in their product assortment and overall store experience.

4. Have I defined category roles and a pricing approach for each category?

Have you assigned business roles (e.g., destination, traffic driver, profit generator, etc.) for each major category in your company? With these roles defined, your price management team can effectively support and interact in the category management process to ensure a consistent pricing approach.

In addition, as you go through the process of defining your category strategies, don’t overlook house or private-label brands. Too many retailers leave money on the table by discounting the need to define the role and pricing approach for their house brands. In a recently released study of private-label products strategy, ACNielsen noted that “significant financial benefits are possible when retailers apply ... fact-based methods to challenge outmoded pricing rules ... and establish superior category assortment and pricing strategies.”

5. Do I have the right pricing organization?

Amazingly, many retail companies, even large ones, try to manage price with just a handful of analysts or worse, none at all. The pricing organization can and should be a valuable company asset, but it will not achieve that status without the right people. Pricing requires retail savvy and experience, along with the ability to dig into the numbers and produce actionable information for an audience that sometimes does not have time to perform detailed “What if?” analyses.
As noted several years ago in the MIT Sloan Management Review, “If pricing isn’t a strategic capability – a contributor to a company’s ability to devise and implement its strategy – it’s probably a strategic liability… An effective pricing process can’t be run on automatic pilot: It requires well-trained people who understand the company in all its complexities – its strategy, range of products or services, customers, suppliers and competitors.”

6. Is there organizational alignment within my company?

In retail, merchants are ultimately responsible for the performance of their respective business units, and they usually feel as though they “own” the setting of retail prices – which is good. However, this does not mean they should be able to establish retail without a degree of oversight and significant support, nor does it mean that they are the sole stakeholders in the retail pricing process.

AMR Research notes that implementation of a strategic rules-based pricing approach can improve a retailer’s margins by as much as 4%-6%. Implementation of even a rules-based pricing approach (let alone sophisticated optimization tools) requires that your pricing group “finds its place” in the organization so it can act effectively to ensure strategy, process, technology and company culture mesh. Pricing as a function across the enterprise has many “moving parts,” and to ensure a disciplined and well-choreographed approach to pricing, the pricing framework must be well-established and communicated across the enterprise.

7. Does my company have the right information to truly drive fact-based pricing decisions?

Do your company decision-makers “shoot from the hip” on pricing? Clearly, in today’s environment, information is no longer difficult to obtain, so there’s no excuse for being anything other than fact-based in your key merchandising decisions. As previously noted, consumers are smarter, too, and good retailers obtain and utilize information to drive fact-based decisions. Are you a leader or follower in this regard? Without competitive intelligence, real-time financial metrics, scorecards, robust pricing analytics, etc., you cannot make decisions that drive business success.

8. Am I still running our business with spreadsheets?

Too many retailers are still involved in “Microsoft price management,” i.e., dependence on disparate pieces of information and analysis residing in Excel spreadsheets and Access databases. With tools widely available that allow retailers to effectively manage pricing across all phases of the product life cycle, you risk being at a competitive disadvantage if investments are not made to get pricing away from the dependence on spreadsheets.

And, yes, advanced pricing tools do justify the investment. In our experience at AlixPartners, optimization tools can pay huge dividends across the entire retail product life cycle (regular, promotional and clearance pricing) to companies willing to make the commitment to improve the pricing process.

Using Price Strategically

Based on our experience with retail clients and others across a number of industries, AlixPartners believes many retailers have significant opportunity to improve both their strategic pricing capabilities and their overall pricing processes. It is an effort that can create tangible value in terms of financial and process benefits. As already noted, even a basic approach has the potential to improve retail margins by 4%-6%. Develop capabilities beyond the basics, e.g., price optimization, integration of pricing with category management and promotional planning, etc., and the benefits become even more attractive.

Remember Marketing 101 and the “4 P’s of Marketing – product, price, promotion and place”? Retailers that ignore the pricing function to focus on other approaches to margin improvement will find themselves as a three-legged table – able to stand, but in a precarious state when the weight of competition is applied. As noted from the outset, there really is no other profit lever that has the same level of bottom-line impact as pricing. For companies ambitious (and smart) enough to seize the opportunity, pricing becomes a strategic capability that contributes to the long-term health of the business.

Figure 3: Effective Price Management Creates Tangible Value

<table>
<thead>
<tr>
<th>Financial Benefits</th>
<th>Process Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Increased Gross Margin Dollars</td>
<td>✓ Improved Category Management</td>
</tr>
<tr>
<td>✓ Increased Sell Thru</td>
<td>✓ Better Visibility into Pricing Decisions and Impact</td>
</tr>
<tr>
<td>✓ Increased Revenue</td>
<td>✓ Ability to Assess Strategic Pricing Alternatives</td>
</tr>
<tr>
<td>✓ Improve Working Capital</td>
<td>✓ Store Labor Savings</td>
</tr>
<tr>
<td>✓ Reduce Inventory Liability</td>
<td>✓ Improve Corporate Efficiency Around Pricing Processes</td>
</tr>
<tr>
<td></td>
<td>✓ Improved Seasonal Transitions</td>
</tr>
</tbody>
</table>