

A New Imperative for Retail Success

To Achieve Maximum Profit, Retailers Must Focus on How Shoppers Define Value at Every Phase of the Product Lifecycle

BY WAYNE USIE



There will always be products, categories and channels that are driven by a lowest-price mindset, pushing other nuances of the retail shopping experience to the background. However, for the majority of items, identifying the right price to drive profitable sales is much more complex.

Before the economic downturn, most retailers respected this complexity. They viewed pricing policies as a strategic tool that could drive higher revenues and margins across their stores. In setting prices, they protected their own margins while also creating an attractive value proposition for shoppers.

The Rise of the Lowest-Price Mindset

The global recession has created a new economy in which virtually every retailer is focused on low pricing to some extent, overlooking the other important factors that drive sales. In this “new normal” retail environment, complex pricing decisions are beginning to be oversimplified to the detriment of many retailers and manufacturers.

Why has this occurred? First, the downturn caused many retailers to cut their prices across the board, simply to stimulate spending and eliminate excess, costly inventory. Second, the simultaneous rise of the connected consumer, empowered by smart phones and other personal technology, has enabled easier information gathering and comparison shopping faster than ever before. Unfortunately, competing solely on the basis of lowest price has not proven to be an effective strategy for most retailers. While low prices might spur short-term sales activity, most retailers are discovering that razor-thin margins do not deliver profitability and growth over the longer term.

Since consumer purchasing has been slow to rebound — and the new normal economy may be here to stay — retailers cannot continue with this lowest-price mindset. It’s time to return to a more strategic pricing mindset that balances price competitiveness with bottom-line profitability.

Lifecycle Pricing: A Strategic Alternative

The first step in moving beyond a lowest-price mindset is understanding that every product in every store is unique, and has its own specific lifecycle. Some products are relatively stable fixtures on the retail shelf over the course of years, while others may have short lives because they are perishable, seasonal or trendy.

Whether a product's lifecycle is two months or two years, there are three key phases of pricing that must be managed strategically in order to maximize ultimate profitability: everyday pricing, promotional pricing and markdown pricing. In order to apply pricing as a strategic tool, retailers cannot apply a one-size-fits-all pricing approach — but must apply the right price at exactly the right time in order to support shopper loyalty and long-term profitability.

Everyday Pricing: Shaping Demand Via Consumer Values

In setting their everyday prices in the new normal economy, retailers have been especially focused on reacting to competitors instead of studying how their own shoppers define value. This approach has shortchanged both margins and revenues as critical pricing decisions have been based on reaction or instinct instead of analysis of consumer needs, shopping behaviors and values.

There will always be entire merchandise categories, or specific stock-keeping units (SKUs), that are driven by price because shoppers enter the store with an expectation of what they will pay. In order to remain competitive, retailers need to retain their lowest-price mindset for these critical products.

But, beyond these products, retailers have an opportunity to shape demand with a diverse assortment that attracts consumers based on features they value — such as perceived high quality, product uniqueness or brand status. By collecting point-of-sale data and other consumer insights, retailers can understand the complex decision-making processes that drive shoppers to choose one SKU over another when they shop. Retailers can then intelligently shape demand by creating the right incentives for consumers to choose higher-margin products.

By preserving their low-price image with competitive prices on key categories or SKUs — then creating incentives that drive higher-value purchases once shoppers are in the store — retailers can create a win-win with consumers. Shoppers feel they have received maximum value while retailers have helped shape and influence demand to meet their own margin and profit goals.



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Since consumer values can vary greatly based on geography or demographics, it is critical to analyze everyday pricing decisions and shopper behaviors on a store-by-store basis. For example, shoppers in Tucson may value perceived high quality or uniqueness more while consumers in Phoenix may be more price-focused.

Once they understand actual consumer values, retailers can create effective everyday pricing policies that optimize the financial potential of every store. By moving beyond their lowest-price mindset, retailers can create a winning everyday value proposition that is based on real-world, granular consumer insights.

Promotional Pricing: Applying an Analytical Perspective

Retailers also need to analyze consumer data and take a fact-based approach in order to create more successful promotional events. When planning promotions, most retailers place a disproportionate amount of emphasis on the price point of the promoted product. But in reality, price is just one aspect of a successful promotion.

For example, it is critical to ensure that shoppers are not just selecting low-priced promotional items, only to complete their shopping trip elsewhere. Promotions are only effective if they are increasing total revenue and margin for the entire store. This means that retailers must not only make smart promotional pricing decisions, but also craft the right everyday price for other products that shoppers are likely to buy.

In planning for profitable promotions, retailers need to gain a forward-looking perspective that realistically estimates the actual lift associated with a planned promotion. Retailers also need to consider the effects on other items in the assortment. Some items will be cannibalized while others will be purchased because of their strong affinity with the advertised item. The entire supply chain must be poised to deliver the right inventory quantities to each individual store. Even the best-intended promotions will fail if products are out of stock when shoppers want to buy them. For retailers with e-commerce websites, the global supply chain must be prepared for the multi-channel impact of each promotion.

Retailers must also consider, and plan for, the impacts of different advertising vehicles. This is becoming increasingly complicated in today's socially connected world. Emails might be the best vehicles for home goods promotions, 30-second cable television ads might work for men's apparel and Twitter might attract shoppers of women's apparel. Consumer data can help retailers understand the complex nuances of advertising media (e.g., radio) and its unique promotional campaign characteristics (e.g., 15-second spots versus 30-second spots). All of these factors contribute to promotion success or failure.

Retailers must closely analyze whether advertising spend, media used, discount, sales volume, cross-category lift and other promotional factors can actually meet the ultimate objectives of each promotion. Setting an attractive promotional price is critical, but it is just one part of the formula for a successful, profitable promotional event.

Markdown Pricing: Part of a Season-Long Strategy

Markdown pricing represents an especially daunting challenge: Retailers want to maximize margins on their seasonal or end-of-life merchandise, but also need to clear space for the next season's products. The key is to consider how consumers respond to different prices over the entire life of an item — and make the markdown phase part of an overall strategy.

For example, seasonal merchandise typically peaks early in its lifecycle and then demand begins to steadily trail off. Each spring there is very high demand for swimsuits, gas grills and patio furniture. By the time summer arrives, the majority of the natural consumer demand has already been satisfied — meaning price needs to become a much bigger lever.

Instead of viewing markdowns as an end-of-season challenge, retailers must view the markdown process as just one phase in the overall selling season. Armed with robust forecasting capabilities, they can identify early in the selling season which merchandise won't achieve its sell-through goals. Based on that insight, they can make informed pricing decisions that maximize overall margin potential while still achieving the desired sell-through by season's end. This approach typically results in smaller price reductions earlier in the season when natural demand is still high — versus deeper discounts at the end of the season when demand is at its lowest.

Gaining a granular, localized perspective is crucial for effective markdown pricing. Products must be marked down strategically at both an individual store level and SKU level in order to maximize profitability. While swimsuits are a summer product in New York, demand may peak in Florida during the winter months, when there is an influx of tourists. Snow boots

may represent a seasonal product in Virginia, but a year-round mainstay in Colorado. These nuances must be considered on a store-by-store and item-by-item basis to maximize clearance margins and optimize overall inventory investments.

An Added Benefit: Sharper Forecasts

Assuming a lifecycle pricing perspective delivers higher overall sales, improved margins and stronger relationships with both manufacturers and shoppers. However, retailers can achieve another significant benefit when they integrate their lifecycle product knowledge and sales history into the future forecasts that drive the supply chain. By decomposing historical sales information and quantifying the effects of everyday, promotional and markdown pricing, retailers can create more accurate baseline forecasts for future demand.

Working with a fact-based, enterprise forecast, retailers can not only optimize margins, but also maximize service levels and minimize inventory. As the organization learns more about true demand over time, forecasts will become sharper — and the risk of selling items below cost will drop significantly.

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Customer-centric, lifecycle pricing can be a difficult concept to grasp because of the growing diversity of products and the highly specific characteristics of each individual item's life span. But this concept has become a strategic imperative, and the good news is that sophisticated software tools are available to simplify and automate even the most complex lifecycle pricing decisions.

The more retailers know about what is happening in their own aisles and websites, the better equipped they are to offer the right product at the right price at the right moment — fueling efficiency and profitability across the entire supply chain. ■



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