The DemandTec Experience

Ten Best Practices for Pricing and Promotion in a Down Economy

Ten Best Practices for Pricing and Promotion in a Down Economy

Setting everyday and promotional prices to achieve financial and price image objectives is a powerful capability in any market environment. As the uncertain economic climate presented new challenges and opportunities during 2008, many of the general best practices demonstrated by DemandTec customers over the years have become even more important. Applying these best practices in today's economy can be the difference between merely weathering the storm and winning in this challenging environment.

Background: The Rapidly Changing Retail Environment

U.S. consumers have been tightening their belts in the face of fluctuating fuel and food prices during 2008 and escalating uncertainty about the economy overall. Even as fuel prices have dropped recently with the slowing economy, there are clear signs that shoppers at all income levels are altering their behavior.

Researchers at The Nielsen Company reported in July 2008 that nearly two-thirds of consumers are reducing their spending, an increase of 18 points since June 2007 and 14 points in the preceding six months alone. Said Todd Hale, senior vice president, consumer & shopper insights, "While discretionary spending is likely to be a challenge for most low and middle income shoppers, even affluent consumers are looking for ways to make their dollars go further."

A Nielsen Homescan Panel Views Survey published in April 2008 identified several belt-tightening strategies that consumers are adopting in response to the current economic downturn. Notably, 11% said they would "switch to private label," 8% said they would be "brand disloyal and promotion sensitive," and 7% said they would "switch stores for the best deal."

Recent research by TNS Retail Forward, a retail think tank, found 20 percent of food shoppers switching stores for cheaper prices. The study said shoppers are shaving food bills by trading down to store brands, buying less food and eating at restaurants less frequently.

Adding to the pressure on retailers this year has been a "margin squeeze" caused by rising producer prices and transportation costs for many consumer commodities. Manufacturers have taken more price advances than ever and, to date, consumer price index (CPI) increases have essentially tracked with producer price index (PPI) increases, suggesting that retailers are still passing these cost increases on to maintain margins. But now, even as costs may come down with further slowing of the economy, changes in consumer behavior have created the need for many retailers to begin investing margin in lower prices.

Ten Best Practices

During recessionary or inflationary economic times, there is special value in the ability to understand, predict, and influence consumer demand. Retailers can apply price and promotion optimization to serve customers better and win their allegiance, while also achieving financial objectives. Following are ten best practices to consider when crafting overall merchandising and marketing plans during today's challenging economic environment:

1. Apply store/SKU price elasticity to manage "image" items.

Understanding the elasticity of shoppers' response to price changes can help identify the most important items to price competitively. Many retailers can get credit for lower prices ("price image") by identifying the few key items that drive price image and pricing those items aggressively. Secondary, less price-sensitive items represent opportunities to make up some margin while reducing overall prices in the category. Price optimization solutions let the retailer manage this complexity, even where image items can vary by zone and by customer segment.

2. Use private label to maintain margins while improving price image.

Many consumers report they are trading down by buying less expensive store brands. Because price image is typically based on national brands, this provides retailers with an opportunity to narrow the gaps between national brand and private label and capture margin. Alternatively, optimizing price differentials to "shift the mix" to private label (typically with wider price gaps) can help retailers maintain category profit even as customers seek lower total basket dollars. Whether that means increasing prices of private label, lowering prices of private label, or only changing prices of national or regional brands will depend on unique circumstances.

3. Negotiate costs with vendors... or better yet, collaborate on win-win plans.

Optimization lets retailers strategically shift volume from one vendor to another or to private label, which can dramatically strengthen negotiating position. When multiple vendors in the same category are all raising prices, though, it may be more difficult to negotiate. Now, as the economy continues to slow down, even though fuel and some other costs have dropped, manufacturers may be reluctant to roll back the hard-won price advances they had to take earlier in 2008. Price optimization gives retailers an opportunity to shift share to those manufacturers most willing to work with them on cost structures and deliver more value to the shelf. More importantly, though, price and promotion optimization enable collaborative retailers to work with their category captains or other manufacturer partners to simulate and forecast plans together to find win-win opportunities.

4. Improve price communication to get more credit for lower prices.

Advertising and signage at the shelf or in the store are even more important when seeking credit for new prices or when consumers compare prices more often than before. In many cases, retailers invest millions of margin dollars in lowering prices but fail to communicate the benefit to shoppers. As a result they do not receive full credit for it in the market. The method may be as simple as using in-store signs and weekly circulars to point out new lower prices. Communicating a price reduction across multiple communication channels can be the key to driving a true change to price image. In fact, a modest price reduction with proper communication can yield a greater impact on price image than a deeper price cut without proper communication. Wegmans provided a great example of communicating its price reductions in November of 2008 using in-store signage, corporate website, and press relations.

5. Use science to select the most effective items to promote.

During an economic downturn, retailers compete more vigorously for market share, using promotions to drive traffic, sales and basket size. Promotion optimization software can help retailers understand which items perform best when featured in an ad, which items respond best to in-store displays, and what price points are most effective in driving consumer response and margin for the retailer.

6. Differentiate discretionary items and align strategy with price elasticity.

For staple goods, which tend to be relatively inelastic, a basic strategy is to price competitively on image items and maintain margins on others. For discretionary items that are more elastic, the right approach might be to stimulate demand through lower prices and increased marketing of the relative value versus competitors, while also analyzing the assortment for potential changes.

7. Monitor and respond to changing consumer demand.

When market prices shift, both for the goods you sell and other items your customers buy, there may be an impact on consumer demand. Optimization solutions are based on a foundation of consumer demand modeling which is constantly updated as new information becomes available. As models are updated, you can detect changes to underlying consumer demand and formulate appropriate pricing and promotion responses.

8. Focus pricing and promotion on your best customers.

Demand and elasticity may vary among customer behavioral segments. Optimizing prices for the “average” shopper is far more effective than not optimizing prices at all, but may be less effective compared with focusing tactics on your highest spending or most loyal customers. By modeling demand by segment and then evaluating what-if pricing and promotion scenarios by segment, retailers can determine what impact a particular pricing or promotion program would have on their various segments.

By optimizing pricing and promotions to meet the needs of its best or targeted customers, a retailer can better focus its efforts during challenging market conditions.

9. Food retailers can capitalize on the opportunity to win share from restaurants.

Increase merchandising and marketing for meal solutions and ready-to-eat meals. Focus on desirable ingredient categories, such as meats and seafood that may be perceived as an affordable alternative to a night out. Use promotions and signage to communicate the store as a destination and an alternative to restaurants. Identify and promote drivers of multi-item solutions such as recipes or food and wine pairings and merchandise related items nearby but at full-margin.

10. Balance market share and profit objectives.

Blind pursuit of market share is dangerous in an environment where margins are weakening. At the same time, pricing to sustain margins may turn off some loyal shoppers. Retailers can best balance these competing objectives using optimization tools that manage the tradeoffs between different financial objectives while managing price image.

Conclusion

Perception is reality. Whether or not we are technically in a recession, today's shoppers are seeing their home values drop, they have been challenged until recently by escalating prices at the pump, they read daily reports about significant financial challenges across the U.S. and around the world, many have seen 401k and other investments lose value considerably, and many are concerned about their own employment. As a result, many shoppers have already altered their purchasing and consumption behaviors. Research shows that people are eating in more and eating out less; they're switching stores looking for better values; and many are trading down to cheaper brands to lower their overall bill at the grocery store and with other retailers.

Understanding consumer behavior and using insights to predict and influence sales is at the core of price and promotion optimization. Understanding how shoppers make tradeoff decisions between stores and brands enables retailers to deploy pricing and promotion strategies and tactics to better compete in today's rapidly changing and very challenging economic climate.

These best practices have been proven by DemandTec customers over many years and most are important in any economic environment. Price and promotion optimization alone is not a strategy. However, these best practices illustrate how the ability to optimize merchandising decisions with precision, based on an accurate understanding of consumer demand, is an important strategic enabler. Leading retailers will use price and promotion optimization to weather the storm and even outpace competitors in today's challenging economy.

About DemandTec

DemandTec (NASDAQ: DMAN) enables retailers and consumer products companies to optimize merchandising and marketing decisions, individually or collaboratively, to achieve their sales volume, revenue, and profitability objectives. DemandTec software services utilize DemandTec's science-based software platform to model and understand consumer behavior. DemandTec customers include more than 140 leading retail and consumer products manufacturers such as Advance Auto Parts, Best Buy, Circle K Stores, ConAgra Foods, Delhaize America, Dr Pepper Snapple Group, Giant-Carlisle, H-E-B Grocery Co., Hormel Foods, Monoprix, Safeway and Sara Lee. Connected via the DemandTec TradePoint Network™, DemandTec customers have collaborated online on more than 1.75 million trade deals. For more information, please visit www.demandtec.com.

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