RetailWire m·Paper®

BUILDING A DATA-DRIVEN PRICING STRATEGY

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Contents

The Situation: An Era of Price Hyper-consciousness

We live in an era in which smart pricing strategies can catapult new brands and retailers to quick success. At the same time, failure to project the right price image can seriously undermine the prospects of businesses.

Think of Dollar Shave Club, an e-commerce subscription start-up that grew rapidly on the promise of providing "a great shave for a few bucks a month." Consider also, J.C. Penney, a 113-year-old chain that stumbled badly when its then-CEO Ron Johnson tried to convince customers that an everyday low price scheme made more sense than the high-low pricing they were used to. And then, of course, there are widely admired brands such as Apple, Patagonia, American Eagle and Lululemon that have largely avoided discounting based on the merits of their product quality.

As these examples demonstrate, price plays an important role in establishing the brand image and what it stands for. A brand that dependably connects with shoppers through its price message is typically a brand that enjoys long-lasting customer loyalty.

Pricing is also the lever that has the most immediate impact on maximizing profit and, when managed well over time, leads to steady growth in profits.

Yet many companies find it difficult to tap into this potential because they lack a pricing strategy that supports their branding goals. Many also lack the means to gain visibility into the true profitability of their sales. In the absence of a data-driven and centralized pricing analytics function, companies resort to gut instincts that can lead to missed opportunities and exposure to unnecessary compliance risk.

How Analytics Can Help Manage Pricing Priorities

As complex as pricing analytics may seem, managing a brand's price position is crucial to the way it is perceived by consumers. Marketers need to be fully involved in establishing a meaningful pricing strategy to assure that the brand's price image reverberates through all marketing and promotional messaging.

It's also important to note that a manufacturer's pricing is fundamental to the health of its relationship with its retail accounts and to maintaining healthy margins.

Lately, as CPG brands work with retail partners that insist on driving much of their promotional activity with discounting, margins have become an overriding issue.

However, the good news is that retailers recognize the ability of pricing analytics and data-driven management to improve margins. According to RSR Research's "Pricing 2015" report, retailers see improving margins as among the "top three opportunities for pricing to contribute to business strategy." Also cited was the need to "create more profitable promotions" and to "create a more price competitive image."

> ***With predictive analytics, marketers find themselves increasingly in the driver's seat, making discreet judgments on how much margin to reserve on particular products relative to the competitive situation.***

CPG companies, from their perspective, are greatly concerned about the impact on their brand image as retailers apply deep discounts to their goods. And as retailers hone their skills with data-driven, dynamic pricing, brands see themselves losing influence over pricing decisions, according to a recent IRI report (IRI Point of View, Aug. 2015). In order to re-establish a healthy collaborative relationship, according to IRI, brands need to rebuild their credibility with their retail partners as experts in understanding consumer and market dynamics relative to price.

In a sense, pricing analytics and related tools are making MSRP (manufacturer's suggested retail pricing) obsolete as a universal reference point. Retailers essentially view the MSRP as the guaranteed highest price on the market, one they are generally loath to present to their shoppers.

And so, CPG brands must employ more sophisticated techniques to assist their retail partners in establishing a fixed retail price.

The customization of a recommended price should be dictated by the retailer's:

- **Overall price position/image (discounter vs. premium, etc.)**
- **Strategic plan for the said product and category (traffic-driver vs. margin-driver)**
- **Inventory capacity (long-term supply vs. quick turnover)**

Pricing analytics can play a key role in bypassing the need for a MSRP and help create customized recommended prices. A good example of a retailer using intelligent application of pricing analytics is Amazon, which makes over 2.5 million price changes per day, often changing the price of a single item several times within 24 hours.

Pricing plays the leadership role in many marketing campaigns, piloting the way for promotional activities and merchandising support at retail. In the process, pricing must be responsive to numerous factors: regional, demographic and, certainly, seasonal flux. Pricing schemes must also fluidly re-align to the distinct demands of various retail channels — web and mobile vs. in-store promotion, for example.

With so many constantly shifting factors to consider, marketers are understandably anxious when faced with the challenge of formulating pricing strategies.

Marketers ask themselves:

- **How can I be sure that I am sufficiently informed before making pricing decisions?**
- **Can I test the outcomes before I decide?**
- **Can I be assured that the test results will yield accurate predictions?**
- **Will I have sufficient data to back my decisions in a review meeting?**

Fortunately, CPG and retail marketers are finding answers to these questions by applying analytics to their pricing decisions. Pricing analytics allows companies to create a mechanism that acts as a catalyst for managing profitability. That term alone — managing profitability — is telling. With predictive analytics, marketers find themselves increasingly in the driver's seat, making discreet judgments on how much margin to reserve on particular products relative to the competitive situation.

The Program: The Ammunition Required

When developing pricing strategies, the importance of clean, granular data can never be over-emphasized. If a predictive pricing strategy is your "weapon for managing profitability," the "ammunition" to power that weapon is solid data. While new sources of data and insights are constantly emerging — particularly with the continuing development of online and in-store analytics — most brands today already have access to great resources to aid in designing predictive pricing strategies. CPG brands can typically leverage the following datasets:

- **POS (Point of Sale data)**
- **Promotional data (feature/display/TPR, etc.)**
- **Marketing spend data**
- **Store audit level data (number of facings, placements, etc.)**
- **Macro-economic data (income reports, Consumer Confidence Index, etc.)**
- **Seasonality (weather) information**

What Pricing Analytics Tools Do

Pricing analytics programs are typically run with a suite of software tools and services designed to provide insights and guidance. The best-in-class solutions provide:

Views into Profitability

Pricing analytics applications serve up data-based insights into product demand, customer price sensitivity and pricing effectiveness. They give managers the means to analyze and visualize key data on product velocity, the impact of mark-downs on margins, effectiveness of promotions, and profitability of products across channels.

Identification of Opportunities

Marketers can use pricing analytics tools to spot underperforming segments that are leaking revenue and target them to enhance profitability. Ultimately, insights can be used to fine-tune channel-specific approaches and figure out how to price the most profitable products in given situations with surgical precision.

Monitoring and Refinement

Once new pricing initiatives are underway, managers can measure the effectiveness of both individual price profiles and overall price segments. CPG brands can also use the application to monitor customer compliance, an essential part of assuring program success. By continually monitoring and re-evaluating the plan, companies complete the circle to cultivate a culture of continual improvement.

Executive Access

A benefit of pricing analytics tools that should not be overlooked is their ability to give top decision-makers dashboard views of the program's ongoing progress. With today's cloud-based apps, executives can get up-to-the minute reports generated from operational and transactional data — getting a quick bird's eye view or, when necessary, drilling down to investigate trouble spots. Executives may want to take advantage of pricing simulation tools that can generate various scenarios based on, for example, the company's own price elasticity versus a competitor's (known as cross elasticity) to understand the impact a price change will have on volume.

The Science of Pricing Analytics

In more practical terms, what is the science behind pricing analytics? A good deal of the benefits come from "predictive econometric modeling" that aids in understanding what impact various elements — marketing initiatives, marketplace elements, and so on — have on sales.

For math buffs, a simplistic representation would be:

Sales Volume = f{Own Average Price, Competitors' Average price, Product Placements, Promotional Activities, Seasonality Index, etc.}

The modeling helps marketers understand:

Own-price elasticity:

How changes in your prices affect your sales volumes — capturing the inverse relationship between your own price changes and volume changes.

Cross-price elasticities:

How changes in your competitor's price affect your volume sales — that is, measuring the impact of a competitor's price change on the target item's volume.

Price corridors:

Defined as the price range that you need to maintain with respect to your competition in order to maintain your market share.

Companies looking to fortify their pricing programs with analytics will have some homework to do. There are many excellent solutions in the market, but not all are suitable for all organizations. Firms may find they also lack internal expertise and access to data sources. Hence, they may need to partner with specialized providers who understand the nuances of the industry, have sound analytical domain expertise, and have the tools to provide quick and accurate results.

A Case in Point

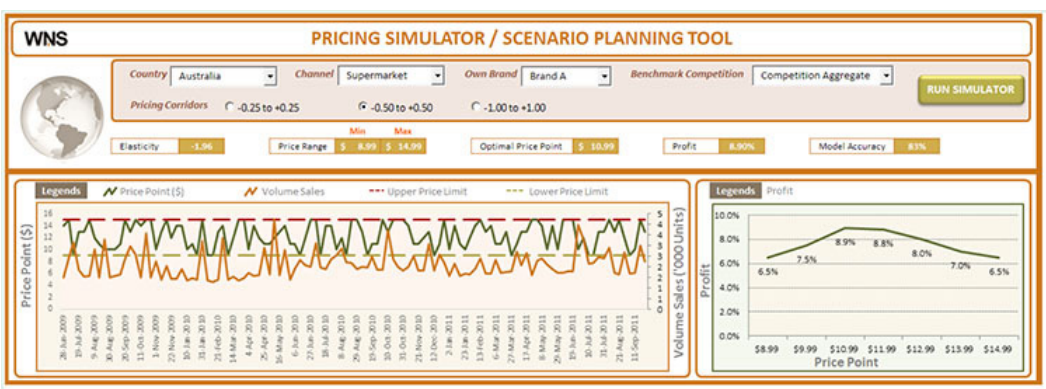
CPG companies generally have a fixed budget, which they spread across various promotions. A leading CPG player set a business goal to optimize its promotion spend.

WNS's due diligence revealed that the CPG player used very little science for allocating its budget for different promotions. WNS brought to the table its domain knowledge of the retail and CPG industries, its analytics expertise and its proprietary pricing simulator to optimize the CPG player's promotion spend.

WNS analyzed various scenarios such as:

- **Which element of the marketing mix would give the best return on promotion spend;**
- **How the promotion fees could be reduced;**
- **If pricing allocation or pricing discounts could be reduced across all stock keeping units (SKUs);**
- **If it is possible to eliminate price discount without impacting its market share.**

Thereafter, historical data was fed into WNS's proprietary "plug and play" pricing simulator, which offered up various scenarios. The primary finding was that the CPG company could optimize its pricing promotion in the range of 5-7 percent without impacting its market share and brand image.



This case shows how pricing analytical tools, backed by clean, granular data, can enable marketers to make informed decisions, which have a bearing on the brand image.

The Components of a Pricing Analytics Package

Regular price promotion: Allows you to set the best price based on critical business factors — the competition, goals, business rules, ad placement, etc. — at an actionable level, for example, customer, market or store level.

Promotion optimization: Delivers the most compelling and profitable customer/consumer-centric promotions. Offers demand modeling and forecasting, optimizing both promotional price and ad placement to capture a bigger share of wallet.

Pricing for future offerings: This allows you to explore the potential of products that would prompt "trade-off" by consumers. Some popular trade-off techniques are: Choice-Based Conjoint; Brand Price Trade Off (BPTO), and Price Sensitivity Measure (PSM).

Conclusion

Pricing needs to support a brand's overall marketing platform. But is that enough to assure consistency of message throughout the organization? Given the far-reaching influence a price position has on a brand, and how various departments need to be aligned to support that position, an argument can be made for treating pricing as a core competency within the organization.

What does this mean in real terms? Pricing is a day-to-day concern for numerous departments throughout the organization. While marketing might use pricing tactics to grow market share, sales teams chase volume goals, and product development teams lose sleep over the price image each product projects.

New sources of real-time data and insights are constantly emerging, especially with the continuing development of online and in-store analytics. Most organizations, today, also have to contend with a huge variety of data — the company's prices and promotions, competitors' prices, product availability, economic and seasonal conditions, among others.

This treasure trove can only be fully leveraged if it is managed through a central function so that all the departments feed off the same data.

Hence, it makes sense for companies to establish a centralized pricing analytics function or a Center of Excellence (CoE). This centralized function can disseminate consistent data insights, enable key decision-makers to trigger initiatives, and keep tabs on the responses from all departments. Marketers can look at partnering with specialist analytics solutions providers with the expertise and experience of establishing and running pricing analytics COEs, such as WNS. With this science, the philosophy of integrating pricing strategies to support brand image goals, at long last, can become a reality.

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Following Up

Industry references:

Pricing 2015: Learning To Live In A Dynamic, Promotional World – Benchmark Report – Retail Systems Research, 2015

From WNS:

Revenue Management Solutions for Consumer Packaged Goods Companies

Armed with Knowledge

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