

BY JOE SKORUPA

PRICING WITH CONFIDENCE

Uncovering the pricing opportunities retailers chase and the challenges they face

Pricing optimization solutions are one of the essential tools used by merchandise and promotions management teams to make sure their prices are optimally set to drive sales and business performance. Yet these deployments, which are frequently cited as being capable of delivering increases of one-to-two percentage points in revenue and two-to-three percentage points in profit, sometimes produce disappointing results because of organizational limitations that get in the way of meeting expectations.

The reason, according to Robert Hetu, research director retail merchandising for Gartner, is that, “Unfortunately, optimized prices are ignored by the user community (buyers, planners, category managers and pricing specialists) or they are so tightly constrained by business rules that no optimization can take place.”

This means that the problems that crop up are not necessarily found in the technology solution, but instead are found in the merchandising team and how it puts the tools to use. In this custom research report, we examine the state of price optimization in retail today and uncover both the challenges that retailers face and the opportunities they chase.

When deployed correctly, pricing optimization solutions are powerful tools that deliver a clear business edge to retailers. Not only are they capable of setting prices for promotional products that enable marketing campaigns to hit their goals, but they also ensure that the entire catalog of products consistently sells at full price. Leading retailers who use pricing optimization tools correctly sell more than 90% of products at full price, which has a powerful impact on improving business performance.

Inside the Black Box

For this report, we define price optimization as an application of analytics that predicts consumer behavior at a micro-market level to maximize outcomes. It does this by using internal and external price data to gain insight into price elasticity. It also supports what-if scenarios to determine pricing outcomes based on a range of parameters that the pricing team sets to align business rules with corporate goals.

Pricing optimization tools like these are sophisticated solutions, so it is not surprising to learn that only about a quarter (26%) of retailers say their price optimization software is up to date. Despite not having up-to-date pricing tools retailers still set prices every day and reap the consequences. (See Figure 1.)

Most retailers set prices the way they have always done it by using a mixture of gut instinct and analysis of past perfor-

Figure 1

Status of pricing optimization software in your organization

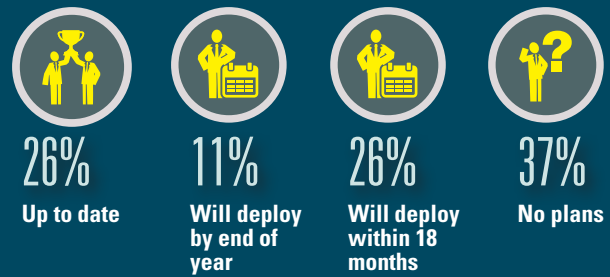


Figure 2

Kind of solution used or planned to use for pricing optimization

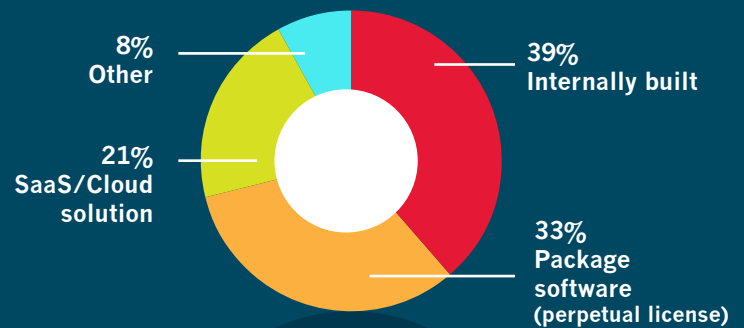


Figure 3

Top priorities for next major pricing optimization upgrade



Figure 4

Department primarily in charge of pricing

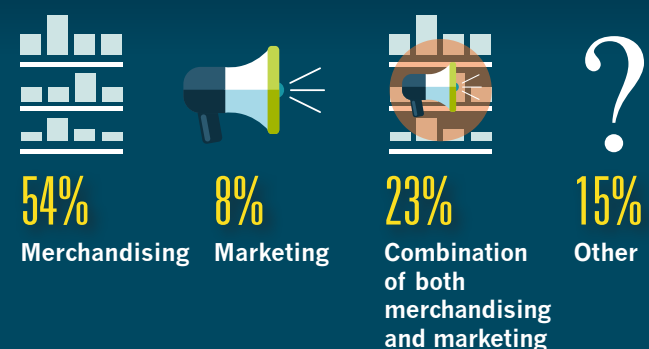


Figure 5

Data sources that contribute to competitive pricing intelligence

Promotions	77%
Inventory levels	64%
Seasons/holidays	56%
Supplier discounts/rebates	51%
Third-party data services	49%
Geography	46%
Website crawling/scraping	41%
Real-time competitive pricing feeds	41%
Mystery shoppers	33%
Weather	31%
Internally built aggregators	28%
Store cluster	28%
Social signals (product reviews, Facebook likes, Twitter mentions, etc.)	13%

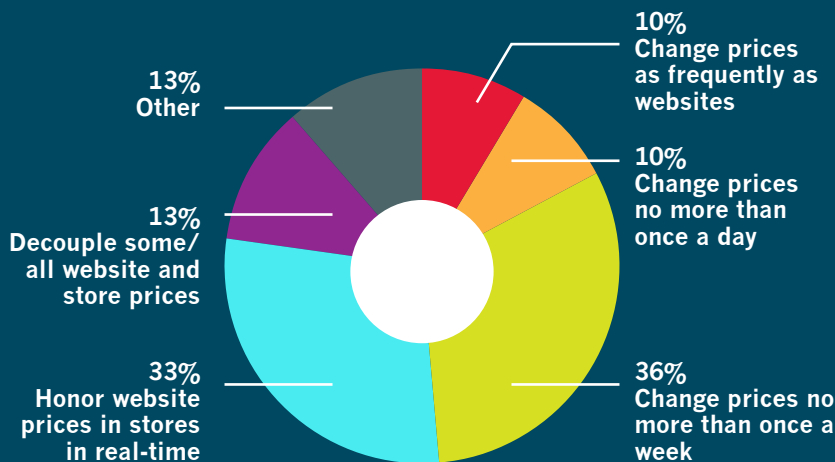
Figure 6

Which pricing strategy best describes your approach across selling channels?



Figure 7

Organization's policy for handling frequent price changes on shelves and items in brick-and-mortar stores



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mance. However, leading retailers are no longer satisfied with the inconsistent performance this approach produces. They don't want to rely on frequent markdowns to cleanup mistakes and instead seek a new level of accuracy where nine out of 10 products are sold at full price.

For these reasons study data shows that more than a third (37%) of retailers say they will be investing in pricing optimization software within 18 months – 11% will invest by the end of the year and 26% within 18 months.

As noted, retailers currently set prices and use pricing systems every day even if the tools are Excel spreadsheets or highly modified on-premises applications that were purchased many years ago but kept in use because the retailer owns a perpetual license. We see evidence of this in Figure 2, where 39% of retailers say they are gravitating toward internally built applications.

The question these retailers have to ask themselves is: Will a continuation of current internal processes improve pricing performance by one-to-two percent of sales and two-to-three percent of margins? If not, then the option to move ahead with an internally built solution is probably not the best choice.

One third of retailers say they are gravitating toward packaged software (33%) and a fifth (21%) want a SaaS or cloud solution with a subscription or limited contract model.

Cost Analysis

When retailers examine the priorities behind their next major pricing optimization upgrade they clearly put cost analysis in the cross hairs. Total cost of operation, chosen by 68%, was by far the top priority. (See Figure 3.)

Another cost factor, return on investment (ROI), came in second on the priority list with 47%. And this was not just any ROI, it was ROI within one year, which is a fair expectation. If the organization trains and restructures its pricing team correctly, then sales and margins should rise above historical levels and the hard dollar increases should produce ROI.

The top data sources that contribute to competitive pricing intelligence within the organization today are promotions (77%), inventory levels (64%) and seasons/holidays (56%). Not far behind are supplier discounts/rebates. (See Figure 5.)

The more data sources a retailer uses to set prices the more accurate they will become. In addition to the traditional data sources shown in the top five places in the chart we see evidence that many retailers are adding such new sources as website crawling/scraping (46%) and real-time competitive pricing feeds (42%) to increase their accuracy.

As noted, more than a third of retailers say they are at some stage of planning a major upgrade of their pricing capabilities and the top two problems they want to solve with their upgrade are: prices are changed too late to achieve the desired outcome (41%) and that prices are sometimes set too high to hit sell-through goals (41%).

One thing to note about all the problems cited in Figure 9, is that the only way to achieve measurable improvements in sales, margins and business performance by upgrading pricing

Figure 8

Important to consider when creating rules for pricing optimization

Average margin	72%
Competitive pricing	67%
Sales channel (store, online, etc.)	51%
Promotion campaign	46%
Supply of product	44%
Length of promotion	41%
Days on hand	39%
Season	36%
Rate of inventory turn	31%
Geographic location	31%
Customer segment	23%
Loss leader	21%
Ceiling price	18%
Basement price	18%
Customer segmentation/profiles	15%
Pricing for kits/product bundles	8%

Figure 9

Top problem areas in pricing that have a negative impact on sales, margins and business performance

41%	41%	33%	33%	26%
Prices are changed late	Prices are sometimes too high	Can't change thousands of prices at one time	SKUs are not rationalized/consistent	Markdowns are too steep
23%	23%	21%	18%	8%
Prices are sometimes too low	Mark-downs are not steep enough	Can't do cost-based price analysis	Pricing management is spread across multiple silos	Pricing infrastructure is separated into multiple silos

Figure 10

Top software usability goals for price optimization solution

Leveraging pricing and product data from multiple sources	56%
Easy import/export of data	54%
Automated price changes based on rules/approvals	49%
Managing/changing large groups of prices at once	41%
Change once and publish in every channel	41%
Creating repeatable processes/templates	33%
Flexible/serial scheduling of price changes	31%

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optimization tools is by initiating a review aimed at upgrading three key organizational elements: technology (data systems), business processes currently in place, and pricing team structure and training. It is worth noting that upgrading all of these elements won't fix bad strategies unless they, too, are fully reviewed and modified.

Key Additional Findings

Other key findings in this report include:

- By a wide margin, retailers say they want a consistent pricing image across all channels. (In this question, see Figure 6., retailers were constrained to pick only one response to determine the primary pricing strategy.) Tied for second were two strategies: different pricing between stores and digital channels (18%) and no set pricing strategy across channels (18%).
 - Due to labor constraints retailers say they change prices in brick-and-mortar stores no more than once a week (36%), but they honor website prices in stores in real-time (33%). In this question (See Figure 7.), like the one above, retailers were constrained to pick only one response. Few retailers have an appetite to change prices in stores as frequently as websites or decouple website and store prices.
 - The top three considerations that retailers weigh when creating rules for pricing optimization are average margin (72%), competitive pricing (67%), and sales channel (51%). You have to wonder how high on this list "gut instinct" would have placed had it been among the options. (See Figure 8.) This could be a good option to insert into the next pricing study.
 - When retailers spec out their next pricing optimization upgrade (See Figure 10.) they say they are seeking to achieve three top usability goals: the ability to leverage pricing and product data from multiple sources (56%), easy import/export of data (54%), and automated price changes based on rules/approvals (49%).

Methodology

This study was conducted during the month of February and only senior executives from national or large regional retailers were invited to participate. The results do not include any store-level, field-level or regional employees. Only headquarters-level staff responses were included.

Conclusions

When deployed correctly, pricing optimization solutions are powerful tools that deliver a clear business edge to retailers who have progressed beyond internally built or modified software. Not only are science-based, algorithm-enabled tools capable of setting prices for promotional products that hit merchandising and marketing goals, but they also ensure that the entire catalog of products consistently sells at full price.

Retailers should view pricing optimization solutions as having two over-arching goals: 1. Drive sales and margins by measurable metrics (whether it is one percent, two percent or three

Figure 11

What retail segment is your primary business model?



Figure 12

Revenue in the most recent 12-month period



Figure 13

Sales performance in the most recent 12-month period



percent); and 2. Achieve a 90% or greater sell through of the overall product catalog at full price.

Finally, note that the only way to achieve measurable improvements through an upgrade to sophisticated pricing optimization software is to also review and revise business processes and the pricing team itself. Ineffective pricing teams and strategies can negate the positive effects of pricing optimization software. As always, it comes down to a well-balanced approach to people, processes and technologies to make a major upgrade work. **RIS**