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Beyond Discounts and Deals:

Achieving Balance in Pricing and Promotion Strategy

Most retailers readily admit that the chronic use of excessive and often unplanned promotions can have serious consequences in terms of margin erosion and erratic sales. Still, most willingly suffer those consequences in exchange for the short-term benefits of hitting top-line sales goals and stealing share from competitors. But what many retailers fail to realize is that this continual reliance on reactive promotions comes at an even steeper long-term cost. It often means foregoing a disciplined execution of a pricing strategy that would both enable precision and optimization and also build customer loyalty by instilling confidence in a consistent price-value proposition.

There is nothing wrong with price-driven promotions in and of themselves. They've been around for a long time and can be an extremely effective way to achieve business goals such as attracting new customers and driving incremental traffic. There is also something inherently exciting about a price promotion, the sense that as a customer you're "seizing an opportunity" or "getting away with something." Promotions condition the customer to expect the unexpected, create a sense of urgency, and can quickly deliver an increased conversion rate or larger basket size.

However, recent promotional excesses may have had an adverse impact on customer behavior. Over the past few years in particular, retailers' frenzied price changes have conditioned customers to think that the ticket price is not real, and cynical customers have become numbed to typical discounts, requiring ever deeper price cuts to stimulate an increase in demand.

Even worse, the demands of maintaining a highly promotional stance force retailers into suboptimal business practices.

» Multiple offers overlapping across channels and media result in indecipherable promotional noise, making it difficult to isolate the costs and benefits of each.

» The broad-brush messaging often required for promotional offers—think 50% off everything in the entire store—destroys a retailer's ability to target price changes by color, style, size and location.

» What's more, executing massive price changes creates significant demands on store labor, not to mention the costs of ad and sign production.

Of course, there is a lot of momentum behind the hyper-promotional trend: The competitive environment compels many retailers to pile on the promotions to stay in the game. Consumers have more access to information and products than ever before, and as a result, they're much less likely to pay full price for anything.

At the same time, retailers are stuck in a kind of prisoner's dilemma. Even though most express a common desire to cut back on promotions, any one retailer who makes the first move leaves a big opening for competitors to exploit, at least in the short term.

The good news is, retailers don't have to quit the promo drug cold turkey. Promotional pricing, when used thoughtfully, can be an extremely effective way to execute against a defined strategy.

The key is making sure a retailer is totally in control of its pricing and promotions. It's fine to rely on frequent promotions, as long as those promotions have been carefully planned and are focused on achieving specific results—i.e., increasing customer loyalty, driving sustained increases in traffic, etc. The alternative—layering promotions on top of promotions to combat the effects of a sour economy, increased competition or poor sales—sacrifices profitability without necessarily encouraging the desired long-term customer behavior.

So how can retailers strike the right promotional balance? A sound pricing strategy is grounded in a well-defined business strategy that is aligned with the right set of performance objectives; a deep understanding of what motivates the retailer's target customer; and clarity on pricing objectives in the context of larger merchandising, planning and strategic goals.

Resolve contradictory performance objectives

Many retailers don't realize it, but the very metrics commonly used to measure and manage overall performance can encourage harmful promotional excesses. Most companies, especially publicly traded companies, are understandably focused on short-term sales and margin targets to bolster the quarterly same-store sales growth and revenue they report to their shareholders. However, this emphasis on short-term top-line growth often drives behaviors that put the retailer at a disadvantage in the long term.

Nowhere was this hyper-promotional, shortsighted discounting more on display than during Black Friday 2011, as retailers fought hard for market share in that four-day period, with little attention to any lasting gains in customer loyalty or, for that matter, the profitability of the entire fall season. One specialty apparel retailer discounted deeply around Black Friday to achieve triple-digit comp sales that weekend, but ended up poorly positioned for the rest of the holiday season. By offering broad storewide discounts that its customers invariably applied to its most popular items, the retailer not only gave up margin while stocking out on some of its best products, but as its less-popular products had never been price adjusted in relative terms, it was stuck with high levels of less-desirable merchandise in January that had to be discounted even more deeply to clear. This resulted in poor January revenue and comp sales and eventually led to a significant drop in its stock price.

The reason many retailers struggle with such situations is because of contradictory performance objectives. On the one hand, short-term performance expectations incent reckless promotions to drive to a monthly or even weekly top-line sales goal. Similarly, end of fiscal period reporting concerns can also lead to irresponsible permanent markdown practices as retailers protect gross margins by deferring permanent inventory devaluations until the next fiscal period. On the other hand, retailers are trying to embrace proactive tactics to maximize profitability over entire product lifecycles and to attract, retain and earn the trust of profitable customers. It's easy to see how these objectives come into conflict in practice. Resolving these contradictory performance incentives is a prerequisite for breaking out of the hyper-promotional cycle.

Understanding how target customers shop

There is also something inherently contradictory about the way retailers talk about—and talk to—their customers. Depending on which retail pricing tactics a retailer observes, one might assume there are two types of customers at opposite ends of a spectrum. At one end is the savvy customer who researches merchandise online before visiting a store, and once in the store, prowls the aisles, smartphone in hand, scanning bar codes and comparison shopping against retailers online. At the other end of the spectrum is the traditional customer, who faithfully scans weekly flyer inserts, clips coupons, and goes to the store to take advantage of a one-day or one-weekend sale.

In reality, most customers are a bit of both. Retailers revisiting their pricing strategy should understand the range of sophistication among their target customers and whether they demand clear, low prices or whether they are excited by the uncertainty and thrill associated with big promotional events.

For example, consider JC Penney's dramatic attempts to reposition its pricing stance. To the outside observer, it would seem that JC Penney has identified its customers as more like the savvy, no-nonsense shopper. There certainly are advantages to the strategy of ultra-clarity. For one thing, it allows JC Penney to take advantage of price and markdown optimization science to drive margins with pricing precision no longer constrained by the requirement to convey the high/low savings messages on a single sign. It also improves the customer experience with a cleaner merchandise presentation and clarity of offer, and it saves a boatload of money by eliminating hours of store labor and many pages of circulars.

But at the same time, the long-term success or failure of JC Penney and other retailers attempting to reform their pricing strategies ultimately depends on what really motivates their individual customers to browse and buy—whether or not their target customers will be happy giving up on the "treasure hunt" mentality when it comes to bargain hunting and how compelling they find the retailer's more transparent value proposition.

Increasingly, omnichannel retailing provides further opportunities to adapt offers to the varying preferences of individual customers. For example, the online and mobile channels make it possible to customize promotional offers down to each individual consumer. We may still be a few years away from individualized pricing becoming a widespread reality, but retailers are already using customer data in powerful ways to localize and personalize many aspects of retail merchandising, and several are moving aggressively to shift customers' attention from "the" price to "my" price.

Get specific: Set clear objectives for pricing actions

One of the biggest mistakes retailers make is using price as a blunt instrument to "drive the business" without fully articulating a business strategy that drives pricing decisions. Leading retailers start from explicitly defined business and merchandise strategies, which may vary by categories of business and segments of customers. These strategies answer the fundamental question of how the retailer intends to compete and win, and they get translated into specific tactics that guide the assortments offered, the inventory invested, how the merchandise is placed and marketed, and, of course, how it is priced and promoted.

Again, a thorough understanding of the customer is an essential prerequisite to a sound pricing strategy. How the customer shops a given category of merchandise and how retail competitors figure into the customer's decision process help determine the pricing approach.

Consider three key questions:

- » What causes a customer to browse and buy from a particular retailer rather than a direct or indirect competitor?
- » For which products does the retailer compete on price and for which does it compete on other differentiated factors?
- » Which merchandise is more sensitive to price and which is less?

No pricing approach or price optimization program, no matter how sophisticated the underlying technology, can succeed without being tied to a clearly articulated and well-defined strategy.

In the case of promotions, a similar lack of clear purpose marks the promotional practices of lagging retailers. Many retailers admit to a kind of trial-and-error approach—throwing out multiple offers and hoping one of them sticks. The successful promotional retailer starts from strategy and has a clear understanding of the behaviors it wants to influence with each promotion and the specific measurable results it hopes to achieve. These goals are typically much more specific than "comp sales." They are focused on targeted customer behaviors.

- » Drive profitable sales of a promoted item or promote a loss leader to build profitable baskets
- » Attract incremental traffic to the store or grow the baskets of customers already in the store
- » Get additional visits from existing customers or attract new customers
- » Add customers to a loyalty program or harvest more profit from existing loyalty members

Similarly, clearance pricing or markdown optimization works only when the parameters are perfectly aligned with goals defined by the merchandise strategy—precise exit dates and targets for liquidation and inventory productivity.

Ultimately, price has incredible power to shape customer demand. But in addition to understanding what motivates customer behavior, it's imperative to know the objective of any pricing action and how it fits into a retailer's larger strategic goals.

The first step in solving a problem is admitting that one exists. Once retailers realize the devastating impact unplanned promotions and reactive price changes can have on their long-term profitability and price perception, they can begin putting the solutions into place to pursue more disciplined pricing and promotions. Supported by a sound understanding of their customers, a clearer sense of strategic objectives and the right internal incentives, retailers can walk away from reckless promotions and toward a more sustainable financial future. ❖

STRATEGIC PROCESS	STRATEGIC INPUT	OPTIMIZATION PARAMETER	OPTIMIZATION TYPE	OPTIMIZATION OUTPUT
Category planning	Category roles, item roles	Optimization goals	Regular price optimization	Item prices
Promotional planning	Promotion objectives	Target outcomes	Promotional price optimization	Promotional offers
Assortment planning	Item lifecycles	Target exit date, sell-through	Markdown optimization	Item markdowns

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