Kurt Salmon

EXECUTIVE BRIEF

Pricing Pressure:
How High Should You Go?

The industry knows consumer prices will have to rise this year. Now the question is, by how much?

Thanks mostly to a dramatic rise in input costs, retailers are being forced to rework their pricing strategies, shifting focus from permanent markdowns to initial and temporary promotional pricing.

But the current economic landscape—rising commodity and labor costs against a sharply falling dollar, tight credit, sluggish housing markets and cautious consumers—means retailers are particularly wary of passing along any significant price increases to consumers, especially on discretionary items.

The challenge then is how to deliver acceptable margins and stave off competition while still maintaining brand position and retaining core customers. In short, retailers are overhauling the very core of their pricing strategies, asking:

1. Will my customers accept higher retail prices? If so, in which categories and by how much?

Successful retailers will not assume they instinctively know the answers to these questions; instead, they will leverage multiple data sources to determine their customers' likely attitudes and behaviors toward prices.

For example, while it's a fair assumption that wealthier customers with larger disposable incomes will be less impacted by price increases, retailers catering to this segment can still use data to understand the point at which these customers feel the impact of rising prices and which items create important price impressions on the rest of a retailer's offerings.

These insights can be gained through a combination of focus groups, historic elasticity curves, competitive intelligence, a deep understanding of each category's role in the overall assortment and price tests. These price tests may have surprising results—many retailers with whom we've worked report conducting selective price increases over the past several months and not one reported a greater-than-expected drop in demand.

2. How can we ensure we continually maintain our price positioning relative to our competitors?

The best way for retailers to maintain their relative price positioning is to leverage a series of processes and robust tools that continually monitor competitors' pricing across all channels and enable quick adjustments to meaningful disparities.

Leading retailers will also gather customer feedback to ensure that, in addition to these tactical maneuvers, they maintain their desired overall relative market positioning. Retailers often overlook qualitative customer feedback, failing to recognize that customers can be influenced by effective branding and marketing campaigns that use emotion to overcome facts.

3. How do we determine prices at each stage—initial prices, temporary promotions and permanent markdowns—to optimize realized margin dollars?

Each stage of the pricing continuum is addressed individually, yet within the context of an overall set of financial objectives. Of the three pricing stages, initial pricing likely offers most retailers the greatest opportunity for enhanced precision and margin improvement. Making this stage more thoughtful, scientific and consistent by incorporating a fact set of customer insights, competitive intelligence, historic analytics and category strategy will help achieve greater efficiency and precision.

As retailers seek to protect margins, they may reduce the depth or length of promotional discounts; as a tactic, this may fail to stimulate sufficient demand from customers who've become accustomed to discounts of 50% or more. For permanent markdowns, many retailers have shifted to optimization tools that apply scientific algorithms to achieve specific margin results. In these last two pricing stages, retailers must not only monitor the effects of their price changes on customer demand, but must also carefully monitor any price changes taken by their competitors across all relevant channels. Thankfully, some new monitoring tools can make this process more "real time," consistent and fact-based.

Once these questions are explored and answered, creating a singular, integrated pricing strategy with a defined process and specific owners for each step will help ensure these new pricing decisions are implemented correctly. This proactive process must establish objectives and align incentives across the organization (including merchandising, planning, marketing and store operations) to create and capture value most profitably. It is this cross-functional integration and orchestration that forms the essential backbone of any pricing strategy and ensures that every part of the organization shares a common set of goals.

As these pricing strategies are implemented, they may require:

- Visible and continuous sponsorship from senior leadership to ensure that everyone in the organization will embrace the changes
- Rethinking long-held pricing practices and organizational structures (such as the roles and responsibilities of those who manage pricing)
- New capabilities and tools to continually monitor, measure and manage the effectiveness of the strategy
- Mid-course corrections to address competitors' moves and customer feedback
- An intense focus on change management at all levels

Above all, leading retailers will make a long-term commitment to building a strategic pricing capability, a likely mandate as retailing grows increasingly complex and competitive. ❖

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