



TOP 10 PRICE OPTIMISATION PITFALLS & HOW TO AVOID THEM

TIPS FOR RETAILER SUCCESS

dunnhumby





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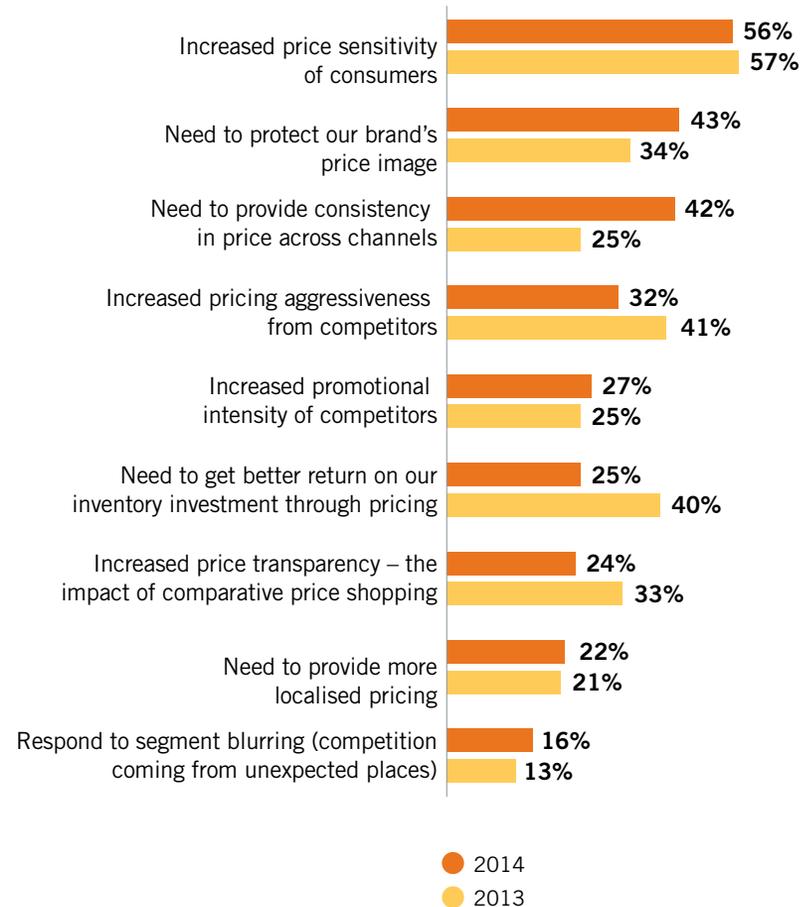
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It's no secret that retailers in every segment are facing increased competition – whether it's from online retailers like Amazon, from discount chains like Walmart, or even from companies expanding into new territories.

Consumer price sensitivity remains high in a recovering economy.

- That's why you must get laser-focused on your pricing strategy, using science and data-driven methods to make smart choices.
- A robust price and promotions optimisation tool is a necessity, enabling you to automate the complicated business of competitive pricing rules, do “what-if” planning, and create accurate forecasts.

Top Strategic Pricing Business Challenges



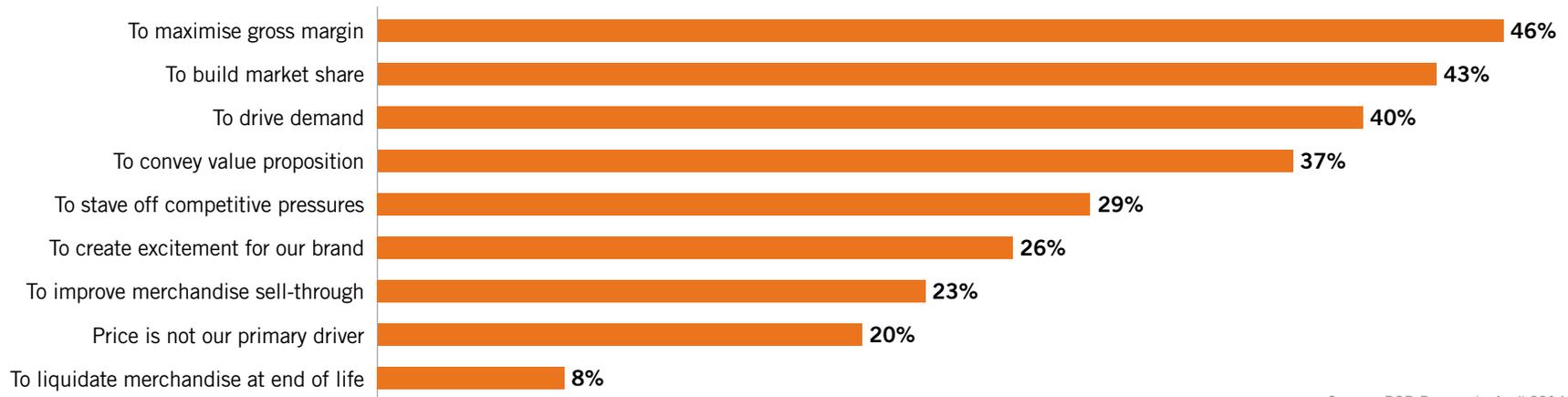
Source: RSR Research, April 2014

Optimising Price and Promotions for Retailer Success

Most retailers see significant improvement from price/promotions optimisation in the areas of:

- **Customer Satisfaction:** Price optimisation helps you plan more compelling promotions, achieve competitive prices, and ensure logic at the shelf, leading to improved brand perception and loyalty.
- **Financial Performance:** Price optimisation is designed to help you increase revenue and gross margins. By using science and predictive analytics, you can plan better, execute better, and support your long-term strategic vision.
- **Price Image:** The last thing any retailer wants is for customers to perceive that their favorite items are priced so far above the competition that they need to leave the store and never come back. Price optimisation can ensure those sensitive items are priced to keep your customers in the store – and coming back.
- **Operational Efficiencies:** Too many retailers are still using spreadsheets to monitor their own pricing as well as the competition's. Price optimisation brings retailers into the 21st century, automating the functions that drive smart pricing. True price optimisation enables you to evaluate your rules and identify areas where you might be leaving money on the table.

Top Objectives of Pricing Strategy



Source: RSR Research, April 2014

Overcoming Fear of Change

Despite all the evidence that price optimisation delivers all this and more, some retailers have hesitated to pull the trigger.

Some fear the risk of a failed implementation. After all, price optimisation implementation requires changes that can be painful. How many retailers are eager to change their business processes at any time, even if the results will be worth it?

Additionally, price optimisation is not an easy-to-implement solution: It takes time and effort to deploy, and some see that investment – in addition to the necessity of changing business processes – as high risk.

Some retail executives simply don't believe that price optimisation can lead to a **2-3% increase in revenue**. It may seem too good to be true. However, when you dig into it, the data and case studies tell the true story: **Most companies will realise a significant uplift in both revenue and profit through true optimisation, using a tool like PriceStrat, so long as it is implemented properly.**

So how can you reap these kinds of rewards? A successful implementation means focusing on the following key considerations.



1 Start at the Top

Sometimes a retailer's pricing or even merchandising leaders may want an optimisation tool, but if it's not a top management priority, then it's likely to fail.

A tenacious executive sponsor is critical to driving the changes necessary for a successful implementation of price optimisation, just like other enterprise software.

Adoption of price and promotions optimisation always needs to be driven from the very top of the organisation, with an executive assigned to take ownership for the entire project.

Although executive sponsors are usually not involved in the implementation day-to-day, they do drive the change, act as a referee, and deal with any internal pushback.



2 Prepare for Change Management

Getting the executive sponsor first is key because introducing price optimisation into your operations can lead to fundamental changes in how you do business. Indeed, according to RSR, resistance to change is among the top organisational inhibitors of success in pricing.*

Optimisation software can sometimes expose disconnects in employee incentives and in how decisions are made in different departments. For example, category managers may be tasked with working to a margin percent goal. But with price optimisation, certain categories may require a shift to revenue or profit dollar goals.

Moreover, the organization may need to define a brand new pricing structure to supplement the merchandising function to fully take advantage of the benefits of price optimisation.

This involves changing employees' roles, adding new roles, new management, etc. A clear, efficient process for making these changes – which often involve legal, human resources, and other departments – will be required. Thinking these changes through and actively managing them is key to buy-in and long-term success.

* Kilcourse, Brian and Rosenblum, Paula. "The Pricing Paradox Benchmark Report," Retail Systems Research, April 2014.

The executive sponsor is the one who makes sure that others in the organisation are engaged so that change happens, and that all of the other adjustments to business rules, category management, and compensation are successfully completed. In addition, executive sponsors are essential to making sure that time and financial resources are in adequate supply long term.



3 Educate Users and Get Team Buy-In

Once a solid executive sponsor has been identified, the foundation can be laid for user buy-in and education. While this begins with the executive sponsor, it's critical that the right people at all levels and roles embrace price optimisation. This can be especially challenging.

For example, if a seasoned category manager has very strong beliefs about what works in pricing, that person may resist giving up ideas about how things should be done going forward. And this resistance can be contagious. So it's crucial that you educate users not just on the capabilities of the tool and how to use it, but on why science is more reliable than their gut instincts or other learned methods. Further, you need to reinforce how the efficiencies will benefit them personally, not just the company.

This can be complicated, as many pricing professionals may fear their role becoming obsolete if price optimisation is successful. Yet instead of spending time on time-consuming manual processes, a price optimisation tool frees pricing and category managers to think more strategically and analytically, rather than operationally.

Seeing teams work in this manner can influence senior executives to re-evaluate whether the category manager has the ability to adapt to new processes. (This is where the executive sponsor also needs to determine evolving skill sets for the teams managing pricing, as these can be quite different with a tool in place.)

You need to reinforce how efficiencies will benefit employees personally, not just the company.

A period of persuasion and education is always a part of the implementation process. Ideally, this should be clear guidance on how individual skills need to shift in order to accommodate the price implementation initiative – and what's in it for them (for example, experience and career-extending learning).



4 Weed Out Non-Compliance

Let the Science Do the Work

As positive as user buy-in efforts may be, many merchandising teams still have a persistent urge to “adjust,” effectively hobbling outcomes. For price optimisation to be successful, it’s crucial to allow the science to make the proper recommendations and withhold the natural tendency to want to manually change prices outside of the system.

For example, retailers typically create promotions at least six to eight weeks in advance, and sometimes 12 weeks or longer. If a competitor changes its price at the last minute, many store managers feel compelled to follow suit. But this reactive action at the store level, as much as it may seem necessary in the short term, could have negative long-term consequences – one of which is the impact on forecast accuracy.

It’s crucial to trust the data and take gut instinct out of the equation. This change and restraint can be painful, but the benefits of sitting with the discomfort will likely outweigh the alternative.

This is an area where executive sponsors can intervene, identifying the source of the interference and limit changes. Removing the ability of store managers to make any changes at all is worth pursuing.



Reactive action at the store level, as much as it may seem necessary in the short term, could have negative long-term consequences.

5 Examine Business Process Interactions

When assessing the suitability of price optimisation for a retail operation, the first step is to examine how pricing is currently handled – looking at everyday pricing, promotions, who's involved, timing, and more.

Further into implementation, it is key to look at how the tool will integrate into and change your existing business processes. If this step is missed, you're limiting your potential for success.

For example, Retailer X has a customer manager working with a category manager to make sure the right promotional items are getting onto the right gondolas and end-caps. Prior to price optimisation, the manager went by her gut to determine which promotions to place where, and when.

Now she is able to look at the 30 or 40 items up for promotion for a given period and determine optimal product and placement. Examining the existing process in this way will indicate how the price optimisation tool will be used, when, where, and by whom.

This also pertains to areas like marketing. During an ad planning session, the price optimisation tool can be used to determine the best promotion mechanic (e.g. two for one, 50% off, buy-one-get-one free). The tool can also help optimise what items go on the front page of an advertising circular versus a back page.



Identifying all of the processes that price optimisation can influence and enhance, and how the tool will interact with existing processes, will require focused planning – and yield even greater benefits.

6 Define Your Category Roles

The Interconnectedness of Category Roles

Many retailers lack visibility of what promotions and other events will do within their product categories. It's crucial to understand the interaction of items within the same category, so that individual pricing and promotion decisions are not made in isolation.

For example, those seemingly attractive vendor subsidies can really cannibalise your margins. Do you know what effect that promotion on the big name soft drink will do to sales of your private-label soda? With optimisation, retailers can see what the best combination of price changes for the next pricing cycle will be – and whether or not that subsidy will hurt more than it helps. You can then go back and negotiate with the vendor using real data.

In far too many cases, implementations struggle because retailers have not defined their category roles. So the implementation of price optimisation can help to drive thinking about pricing strategy and how it translates at lower levels across the store (e.g. category-by-category strategies or roles).



Using Roles to Drive Financial Objectives

Every category has its role defined from a customer perspective. For example, you might have traffic drivers, signature items (produce, meat, bakery, etc.), priority high-profit items (e.g. private-label products), revenue drivers, and more.

The implementation of price optimisation can help to drive thinking about pricing strategy and how it translates at lower levels across the store.

When you have accurately identified each category's purpose based on how your shoppers interact with it, you can then map financial expectations based on those respective roles. Expectations can then be translated into financial objectives, and the price optimisation tool can be used to drive to those objectives.



7 Identify Your Price-Sensitive Items

Items with high price sensitivity are those that customers purchase frequently and are important to them. Milk, bananas, and yogurt are examples of usually sensitive items in grocery; in convenience stores it might be coffee; motor oil is an example in auto parts. **Successful retailers typically have identified these as Key Value Items (KVIs) and Key Competitive Items (KCIs).**

It's critical that you identify these specific items for each category, so that the appropriate business rules can be put into place for pricing them. Having the right rules in place will help ensure that your customer always sees your most competitive price and isn't compelled to walk out of the store and never return.

A sharp price optimisation tool can further use market basket transactional data to understand item sensitivity at a more granular, customer-centric level, and then incorporate that item sensitivity data into the optimisation of both prices and promotions.



8 Evaluate Your Competitive Rules

Analyse and Challenge

Retailers know their long-term strategic objectives, but the tools they use often do not. Real-time optimisation, vital to making the smartest decisions without long latency times, must be at your fingertips, too. Analysing and continually challenging business rules is a critical aspect of price optimisation. From price image to competitive realities, the ability to calculate and recalculate impacts in a matter of seconds, as opposed to hours or days, provides a huge advantage.

Analyse and Challenge

Traditional retailers set pricing based on two things: margin and competitors. By accurately identifying the right strategy, the right rules, and sensitive items, you can lead the competition rather than follow. Shifting from a manual, instinct-based process to automated, science-based optimisation can totally change the competitive dynamics for an entire category. Mapping competitive rules more tightly toward the most sensitive KCIs, while loosening your grip on others, helps you gain margin while protecting your all-important customer price image.

Smart Pricing Brings Return Customers

As an example, if milk is priced 15 cents higher than the competition's, customers may leave. But if milk is smartly priced to keep customers coming back to the store, the prices of other items – for example, cat food, laundry detergent or charcoal – probably won't even be noticed. Store price image will remain high and you will be able to better meet business objectives.

Machine Learning Helps Growth

The combination of identifying those sensitive items, putting the right business rules against them, and deploying a category-based pricing strategy can bring unprecedented growth. Even better, real-time machine learning means that true price optimisation tools are getting smarter all the time, using historical data from every item, category, and transaction to better forecast and predict prices based on actual shopper behavior.

9 Check Your Assumptions about Shelf Logic

Every retailer works to ensure logic at the shelf, right?

For example, you want to make sure that buying a larger package of motor oil or car wax yields a greater value for the shopper, or that all flavors of the same brand of yogurt are priced the same.

Many retailers believe they have good compliance with logic at the shelf, but often don't. That's how confusing inconsistencies in pricing can emerge, making the customer less apt to shop (or shop with less frequency) at your store.

Taking it for granted that logic at the shelf is present is just one example of the kind of assumptions that can interfere in price optimisation. A solid price optimisation tool can incorporate rules to help enforce consistent logic at the shelf, with no rogue items slipping through the cracks. Putting rigor and automation around such processes first starts with checking your assumptions.



10 Document Your Success

The Proof is in the Documentation

To support your executive sponsor, it's crucial to capture and document the proof that price optimisation is helping your retail operation to achieve its business objectives better than the traditional approach.

Make It Easy to Tell Your Success Story

Considering the significant investment of budget, time, and other resources, it's likely that your board of directors will be watching how price optimisation performs for your store. Having real life case studies that show a clear return on investment can help justify and solidify that investment. Further, it can ensure that you're tracking on the measures that the board agreed to in terms of return on investment (ROI), rather than just blindly trusting or thinking that the tool works. Creating processes around outcomes means the success story is easier to tell – and more widely appreciated throughout the organisation.

Continuous Improvement is the Long-Term Win

You'll typically see more dramatic results in the first year, when retailers tend to compare “before optimisation” to “after.” Gartner recommends focusing in later years on metrics such as revenue, units, and margin against plan and see ROI in terms of continuous improvement.*

Powerful Reporting Yields ROI Clarity

To demonstrate ROI, it's important to choose a price optimisation solution with powerful reporting capabilities. A budget should be created for each category so you can further track budgets over time, and the software should be able to create reports for department level, company level, and more, to show how store locations are tracking against objectives. If you can show results to your executive team via visual dashboards, then you'll give them the confidence in your optimisation project.

Conclusion: The Real Payoff

When it comes to price optimisation, many retailers are working with tools that are one step above pencil and paper in terms of scientific precision.

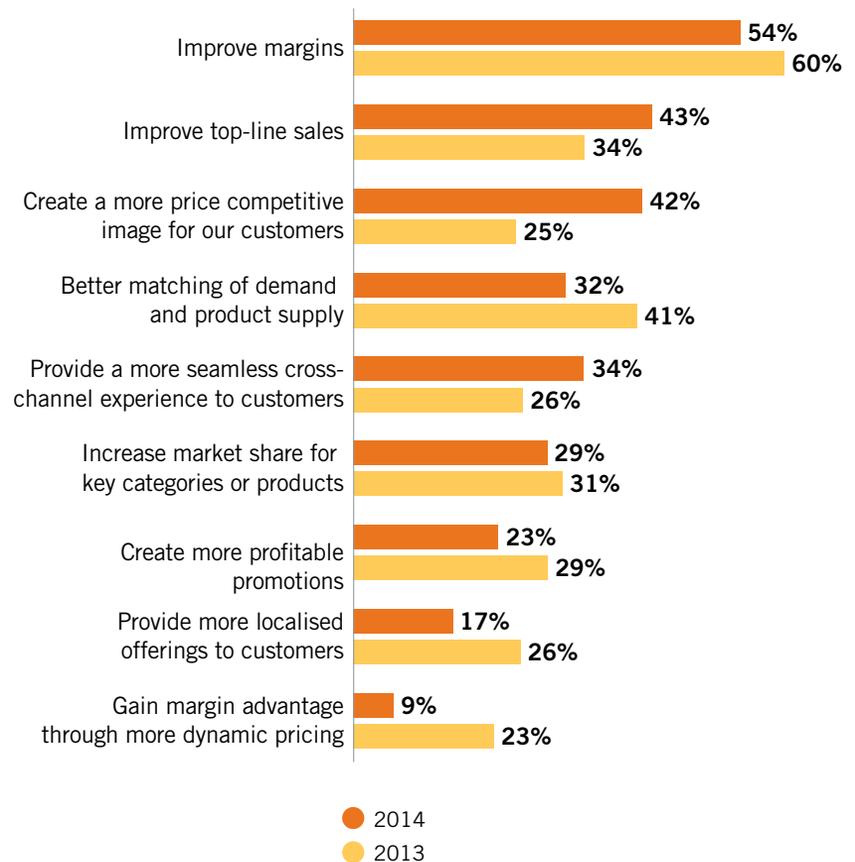
Whether it's dumping numbers into a spreadsheet or going down the impossible road of building a solidly crafted in-house solution that yields precise, science-driven outputs, big money is being left on the table due to the lack of scientifically sound methods.

With a best-of-breed price optimisation tool, 1-2% uplift in annual profit is a conservative estimate of the financial impact of optimisation, according to reports. Those are results a spreadsheet is never going to yield, no matter how much of an ace you are with formulae.

But price optimisation will never just be about the tool. The data shows that the winning combination combines a world-class tool with a logical, science-driven strategy.

Meticulous, scientifically precise price optimisation can help deliver more value to the right customers, increase profits, and reduce uncertainty as data-driven retail trends change the way you do business. Without it, you're limiting your performance and possibly lagging behind your competition.

Top Three Opportunities for Pricing to Contribute to Business Strategy in the Next Two Years



Source: RSR Research, April 2014

What Next?

Follow these best practices to make your implementation as smooth as possible. And if you need help, dunnhumby has an expert professional services team with decades of experience in pricing and promotions.

If you'd like a deeper look at the science behind price optimisation, and what to look for in a solution, visit our website at dunnhumby.com/priceandpromotion





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THE DUNNHUMBY DIFFERENCE

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CONTACT US

Steven Hasen

Steven.Hasen@dunnhumby.com
+1 (678) 732-0833

Sean Dangler

Sean.Dangler@dunnhumby.com
+1 (908) 672-1287



www.dunnhumby.com/priceandpromotion

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