Strategic Pricing:

Why and how

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Almost every cooperative retail grocery is feeling increased competition in its community. Twenty years ago, merely having featured products consistently available was enough for co-ops to be successful, but this is no longer an option. In the last few years, not only has the conventional industry become smarter operators of its natural/organic sets, we have also seen significant growth in new natural/organic retail operators.

The intensified competitive market has created two key trends that should jolt us into action: dwindling center-store sales growth and tightening margins.

Until the recession of 2008-2009, grocery cooperatives had experienced double-digit growth in sales for packaged goods for 25 years. Budgeting and achieving 10 to 15 percent same-store sales growth for the center store seemed to be the norm and produced a sense of complacency among operators: "If we put the product on the shelves, they will buy it." But center-store sales trends over the past three years in food co-ops show a much different picture.

Today, it is rare for a co-op to see 10 percent growth in its center store without having made a major change to its operation. And, if slowing sales growth is a challenge for food co-ops, so is the increasing pressure on margins. Tighter margins have begun impacting operators' approach to overall profitability, because the business model we have most often relied upon over the past two decades requires consistently high margins to cover higher labor costs. The downward pressure on margins is forcing many co-ops to shift strategies to include labor efficiencies in order to create profitability despite lower margins and slowing sales.

It is an economic reality that as an industry matures (and we are still maturing), competition grows and margins become tighter due to greater availability of our products. In general, we operate smaller stores than much of the competition, and we have to adjust our strategy and tactics to compete with larger operators who offer some lower pricing due to their more efficient operational costs and lower margin structure.

Does this mean we have to slash prices across the store? No, but we do have to deal with both the physical reality of competition and, more importantly, our customer's price perceptions, which are built on both reality and some incorrect assumptions. There are highly visible products that we may price significantly higher than the competition, and there are categories where we do as well as or better than the competition. But we have not gotten that message out effectively, and in some cases we are ignorant of our own position in the market.

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Given the recent changes in the marketplace, the most effective way to become more competitive is to move away from a focus on high margins as the primary profit driver to a new focus on having stronger price points and increased product turns, in order to create the gross profit we need to be self-sustaining operations. This entails addressing both the need for stronger competitive price points (actually becoming more competitive) and stronger messaging (managing consumer price perception) about what the cooperative does well.

Essential factors in an overall price strategy

How can we develop and maintain an effective competitive strategy?

First, shoppers' perceptions of our prices may not necessarily match the reality on the shelf tags. Therefore, we need to put together a comprehensive strategy that combines a whole suite of tools and tactics to impact positively our shoppers' image of our competitiveness. A series of independent tactics is not a price strategy; changing perceptions will take a collaborative approach, utilizing many components in the right combination.

The main ingredients that you will need are the following:

• Understanding the basic strategies that most of us use

Grocers who use Every Day Low Pricing (EDLP) as their main vehicle for driving price image and sales try for consistently low prices on the majority of their items all the time. They do not need to orchestrate huge monthly specials, because their everyday prices are low, and they make sure their shoppers understand this. Typically, EDLP retailers are high-sales-volume chains, because placing low margins on a majority of items drives the need for a high volume of sales in order to contribute enough margin dollars overall (think Wal-Mart).

A "Hi-Lo" retailer, by contrast, may not have many low price/low margin items every day but instead relies heavily on strong weekly or monthly promotional programs to convey competitive prices primarily through great deals. To run a successful Hi-Lo strategy, a retailer needs a high level of marketing support to communicate the constantly changing deals to the customers (think traditional Safeway weekly sales flyers).

Food co-ops can harness ideas from both of these—something many co-ops currently do without having an overall strategic approach—and combine them into a hybrid strategy that uses some judiciously selected items for EDLP or intentionally low-margin prices, while augmenting with a large dose of great deals each month. The degree to which a food co-op uses either of these strategies creates the foundation for its overall pricing strategy.

• Sustaining an intentional messaging plan

For changes to a product's price or category tactics, we have to ensure our marketing and promotions teams are fully integrated in the conversation and planning. Making changes without ensuring the message is delivered to consumers in an appropriate manner can be self-defeating. And if we are choosing specific ▶

products to lower our margin in order to have a more competitive price point, we may need to recover those reduced margin dollars through sales volume. Matching promotional plans to price adjustments is vital for financial success.

• Knowing the competition

To be fully aware of the competition's approach to the market, visit their stores regularly. Too often, co-ops are inattentive to their local competition. We have visited cooperatives that have a Whole Foods Market in their trade area, yet the co-op operators treat Whole Foods as if it were a disease, never to be touched. Not only can our cooperatives benefit from gaining a better understanding of the competition's pricing approach, we can learn about their approach to service and merchandising as well.

• Understanding each category's role

We need to define and manage each category to gain the greatest gross profit while supporting the cooperative's overall approach to the market. For example, we could define dairy as a category where we do not want to lose sales to the competition, because losing dairy sales almost ensures you will lose other category sales, too. So, we may choose to front this category with a significant amount of highly visible products with low/competitive pricing. Wellness, to take another example, is a department that we may define instead as a margin generator. This does not mean we do not have to be competitive—we may decide to offer only a few key lower-margin products, such as Emergen-C, Vitamin C, or a line of shampoos, to maintain some price-image strength while preserving margin strength. Each category's role needs to be defined within your competitive landscape.

• Standardizing systems across the cooperative

Not all departments are the same, but some tactics should be shared throughout the cooperative.

The rounding rules your co-op will use, a price-decision tree (see sidebar), standards for multi-pricing, and articulated processes for conducting competitor surveys are all examples of creating standardized systems in the organization.

• Forecasting contribution to margin prior to making final pricing decisions

Using a contribution-to-margin tool allows operators to adjust their pricing and forecast sales to gain an understanding of the potential outcome prior to utilizing a new approach on the floor. As specific products and categories become more competitively priced, we can also look for opportunities for greater margins where feasible. You may want to create several scenarios to understand possible outcomes in order to choose the best option. Once you have forecast potential results, you can line up necessary promotional support and make the needed changes. Then, measure results against the forecast, and adjust your approach as needed.

• Educating staff on the goals and processes of your pricing strategy

The more employees know about how hard we are working to maintain price competitiveness, the more comfortable and effective they will be at responding to comments from your customers. An informed and inspired staff member is much more helpful in recommending products to shoppers or calling attention to a new value line of products.

Key steps to develop a pricing strategy

Step 1: Do your homework.

Understand where you are. What are the perceptions and landscape in which you are operating?

Understand how the co-op's pricing approach is viewed by customers. If you are running a significant number of monthly deals, are you shouting them out enough, or do your customers rarely notice your great sales? If you have a few items in your store that you are intentionally holding at a low price point, do your customers know these are great deals?

Identify your competition. Food co-ops face competition from natural foods retailers and conventional food stores. Other competition may be coming from mass-market retailers such as Wal-Mart, from drugstore chains, local farmers markets, and internet retailers. List your primary competitors, where your shoppers are shopping, and monitor these stores regularly. Some secondary competitors, such as Walgreens, may not carry many of the same brands, but they should be monitored as well because they do have some crossover brands on which they compete very well on price, such as Emergen-C.

Understand your competition's pricing approach. What are your competitors' strategies, and how are they presenting themselves to the community? Do you have a lot of EDLP retailers in your city, or mostly Hi-Lo? Knowing what the main strategy is for its primary competitors helps inform a food co-op's opportunities and plans. Each co-op should develop a competitor survey tool to monitor key products on a regular basis to ensure the co-op's pricing strategy is appropriate.

If you have 10 items identified in your dairy section that you have decided to keep within five percent of certain competitors at all times, you will need a schedule and a tool to record visits and prices. The survey tool doesn't need to be fancy: a list of products down one side and a list of competitors across the top with columns you can drop price data into after each visit. These survey tools should live within the co-op's shared files and become integral in the pricing strategy decision-making process.

Use available external tools to assist in understanding how you are currently positioned. To get a sense of which products in which categories you may want to monitor in your competitor survey, there are a variety of places to look. Programs such as SPINS can be used

Wheatsville Regular Retail Pricing Decision Tree

- Psychological price points
  - Products priced under $3.00: end in $.19, $.39, $.69, $.99
  - Products priced $3.00-$6.00: end in $.39, $.69, $.99
  - Products priced $6.00-$10.00: end in $.69, $.99
- High dollar/low turn products (e.g., oils, vinegars $6.99+): default to ending in $.99
- Products priced over $10.00: end with $.99
- Avoid $.09, $.59 and $.89 retails, except when price matching or under $1, $.49 and $.79: okay if jump from $.39, $.69, $.99 is too much

Competitive market:

dwindling center store sales growth and tightening margins

◀ to evaluate top sellers in each category, and National Co+op Grocers (NCG) members can access some samples and tools on the NCG website. Looking at samples or SPINS data will not tell you exactly what your product list should be, and it does not replace the need for regular local competitor surveys—but it can help you build an initial list of products that you want to monitor regularly.

Know your internal systems and how they will work to support the chosen pricing strategy. Your specific POS, marketing processes, and internal staff communication systems will have to be integrated into the overall plan. Have an initial discussion with all key players to explain what you are working on and what support you will need. As you move along in the process, some of these support people may see ways to improve your approach, since they are the experts in their areas.

Decide how your co-op will maintain information (surveys, trends data) and the process by which adjustments and decisions will be made. The goal of developing a pricing strategy for your co-op is to have an effective plan to present the price image you want your shoppers to have. This means that the process you use to reduce margins, modify your promotional plans, or analyze internal and external trends is a building block for a system to ensure you reach your goal. A system means having an established (documented) way that your co-op decides to take in and share information internally and a set process for how decisions or adjustments will be made. The co-op has to be able to gather information and then make smart decisions based on that data. That requires solid systems throughout that are easily understood by all.

Step 2: Assess and decide where to focus first.

Define the value of each category and what you want each category to do for the co-op: profit/margin vs. turns/price image. Some categories, such as dairy or meat, may be easy to define as priced for turns/price image, whereas wellness and general merchandise categories may be priced for higher profit/margin. Define each category not in isolation but within the context of your competition's approach to the market.

Identify key categories and products where you need to be price competitive to drive price perception. Review industry data (SPINS, broker reports, etc.) covering what is selling in your region. If you see key items/categories where your sales are weak, assess the competition's approach to these products. If you conduct annual or bi-annual member/customer surveys, ask where else your customers shop and what they purchase at other grocery stores. Use this data to help identify areas in need.

Consider using the something like the AVPOM model (Arnett Variable Pricing Optimization Model) to create your own categorization matrix. This can be the basis for a systematic approach to competitive and financially sustaining pricing.

Step 3: Establish general rules, then match tools and tactics to each targeted area.

Rounding rules: Up/down, price points ending in 5s or 9s, or perhaps 5s and 9s, but never ending in .09. Explore how your rounding rules will impact your price image and your gross profit attainment.

Pricing-decisions tree: Having an articulated set of pricing guidelines can provide basic structure and consistency to your overall pricing (see sidebar on page 10).

Utilizing critical price points: $1.00, $2.00, $3.00, $5.00, $10.00. The threshold (highest price possible before losing sales) will vary from product to product.

Discontinued product pricing: Establish a percent off retail for all discontinued items. We suggest 50 percent off, with good messaging so the consumer knows it is a deep discount and to help you move these products out of your store quickly.

Introductory pricing: Unknown products benefit from deep discounts to get consumers to try them.

Known products can be accepted with smaller discounts, or none, depending on the competition's approach.

Establish desired goals of achieved margin and standardized applied margins for each category. Approximately 80 percent of the products in a category will receive a standardized margin. Manipulate the pricing on the other 20 percent for price image and/or gross profit (80/20 is not set in stone, but is a good ratio to consider; it will fluctuate depending on the category).

Create a contribution-to-margin spreadsheet for each category—very easy to build using Excel.

Tie each category contribution-to-margin results into a department contribution-to-margin spreadsheet, so that you can see the impact on the entire department when you manipulate one category's pricing.

Use a prioritized approach to price adjustments. Start with your most price-sensitive products first. These are products or categories for which you know, from your competitor surveys, that you need to be more competitive.

Review achieved category and department margins, and review projected margins and sales (using the contribution-to-margin tool). Do they match?

Manipulate prices on products the co-op can price higher without negatively impacting price image.

Step 4. Build strong internal and external partnerships and communication.

Build strategic partnerships with brokers, manufacturers, and local vendors. Consider an annual meeting with each of your brokers to review what you have accomplished, what they think you can do better, and how they view your pricing approach within the market they serve (your market).

Engage the marketing department from the start—they are essential allies in any approach to a pricing strategy. Work with marketing to highlight the changes and adjustments.

Step 5. Commit to rigorous review of results and adjustments.

Closely monitor and analyze the impact of adjustments in order to know which changes have been effective toward reaching your goals and which have not. You may have to change specific tactics in a category a little or a lot, depending on the achieved results. The key to an effective systematic pricing strategy is being responsive and dynamic. A system of continual assessment and appropriate adjustments ensures that it will be living information, used to help the co-op make continual adjustments and improvements to enhance its price perception and margin dollars.

Conclusion

Last fall we concluded our second round of webinars for NCG, titled "Priced to Compete," and focused on the information presented above. It became obvious, by the number of attendees and questions/concerns addressed, that this topic is now on almost everyone's radar. Some co-ops are deep into the process, and others have just begun discussions. If this is an issue that has not been addressed within your management team, the time is now.

If your competitive environment does not currently feel overly threatening, you cannot be assured this will stay the same in the future. In fact, you should assume that greater competition is coming. Begin building a competitive-pricing approach that will enable you to meet the competition. A strong and thoughtful strategy allows you not just to survive, but rather to thrive in the new, crowded marketplace. ■