

PRICE & PROMOTION OPTIMIZATION

Introduction

Admit it, you were once seduced in the grocery store – by that fancy end-cap display and in-store coupon that led you to buy the cookies you didn't need. Or the chips. Or the soda. Or even the laundry detergent.

But what was it that really got you? Why did you buy the brand that you did? Was it the Buy One, Get One promotional price? Were you anticipating the big game on Saturday? Or did you grin remembering that snarky TV ad for the product? Or was it because it was simply there? Odds are you felt good walking out the door with your purchase, even if you knew deep down that you had been successfully manipulated.

And, hopefully, both the merchant and the manufacturer were happy too. That's not a given, though. Too many firms fail to realize the profits and volume they should when they execute their price and promotion plans.

We have identified the three key stepping stones of price and promotion management where careful attention – and judiciously applied analytics – can make sure everyone is happy when the consumer leaves, purchase in hand. The path to excellence varies by company, but companies successful in pricing excel in all three areas.

Price Execution

The critical first step to effective pricing is to make sure you are charging what you think you are charging. Many levers can be pulled to affect price, and lots of people have their hands on those levers. Factors include list price, item volume discounts, order volume discounts, freight discounts, annual rebates, in-store promotions, coupons, and so forth. Figure 1 illustrates how one's list price can be chipped away to a final pocket price.

Too often we encounter situations with management surprised by what the data show. Keep track of the number and size of the discount buckets, and actively manage them. You are buying customer behavior with your discount dollars. Are you getting your money's worth?

Price Setting

Once confident that its desired pricing reaches the street, a firm can really distinguish itself with powerful analytics applied to setting prices. We have built sophisticated econometric models that accurately predict consumer response to the factors important to the business. Some are controlled by the price-setting team, whether the everyday price or a slew of possible promotions (which may be deployed alone or in combination). But we can also account for exogenous factors, from routine seasonality, holidays, or even factors like the weather. And we can include competitor data via the likes of IRI or Nielsen. See Figure 2 in the next page.

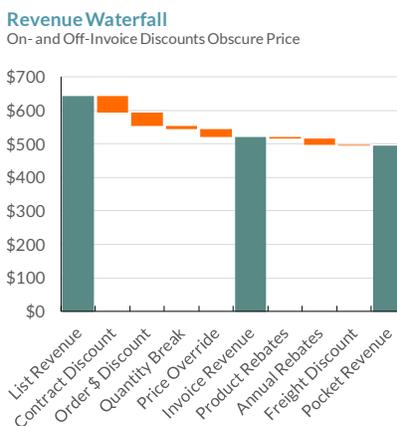


Figure 1

Case Study

One client of ours, a producer of low-cost consumer packaged goods, initiated a substantial project to improve its price setting. We helped the firm to develop and validate the complex econometric models to produce forecasts similar to those seen in Figure 2.

As part of the work, substantial effort went into evaluating the past performance of their vast portfolio of promotional efforts. And, to their surprise, the return on investment for several categories was actually negative – the promotion cost exceeded the benefit. Moreover, a few categories performed much better, financially speaking, than the team had previously realized.

Drilling into the details, we were able to show that overall performance hinged on the relative success of their few biggest promotions. Despite many successful smaller promotions, the poor-performing category was saddled with a handful of big (i.e., expensive) promotions that simply didn't deliver the goods.

With this insight, the firm chose to reallocate its traditional spend on promotion activity. They achieved much better overall results once deep analysis revealed the weak points in their traditional practice.

Predicting Consumer Response to Price & Promotion

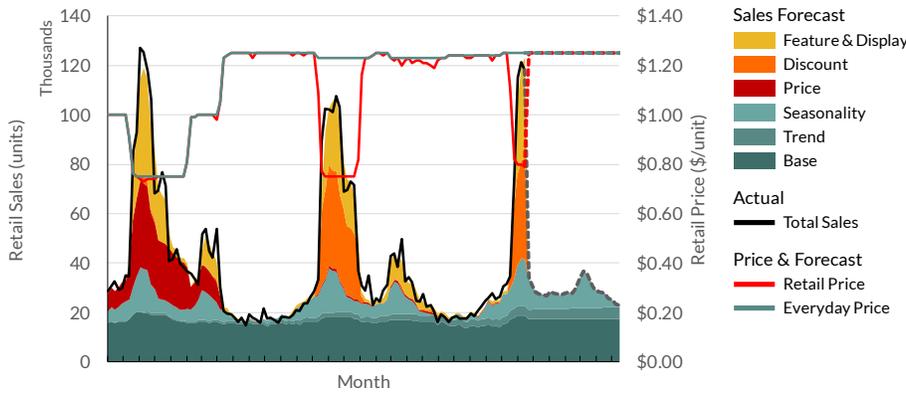


Figure 2

The analytical models determine price elasticity, and they help identify the profit-optimal price to set. The models also help assess the effectiveness (i.e., profitability) of promotions. Many clients are surprised to discover how poorly some promotions perform, yet they run the same ones year after year. Insight from modeling helps them to reallocate funds to promotions yielding a higher ROI.

Optimizing list prices, promotional activity, and promotional spend typically leads to margin increases between 5-10% while maintaining overall volume.

Pricing Strategy

Price setting and execution are done under the umbrella of pricing strategy. Many firms underinvest here, tucking the pricing function as an afterthought into Sales, Marketing, or Finance. True pricing strategy balances the volume targets of Sales, the messaging of Marketing, and the high margin desired by Finance.

First, make sure you staff the pricing function adequately and provide the team with the tools needed to do the job. We have seen a major firm manage their seven-figure rebate program with paper and pencil. Imagine their chagrin when we pointed out a \$250,000 error in the customer's favor.

More importantly, make sure to avoid cases where customers think they are paying more than they really are. Such can happen when there are lots of ways to discount price, as in Figure 1. Restructuring volume discounts can help. For example, a focused program with a substantial rebate for hitting an annual volume target drives better customer behavior. If Figure 1 was the "before" view, Figure 3 shows the "after." The program change resulted in a higher pocket price but a lower perceived price on the part of the customer, the moves reflected in Figure 4.

Revenue Waterfall

Discounting Drives Proper Behavior

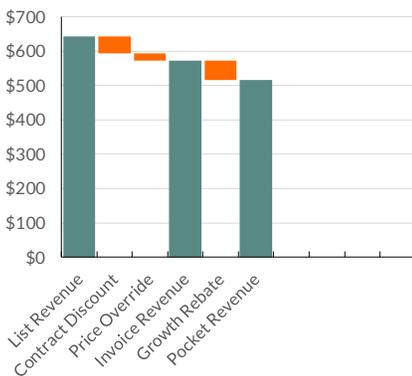


Figure 3

Price and Perceived Value

Relative to Market's Price/Value Tradeoff

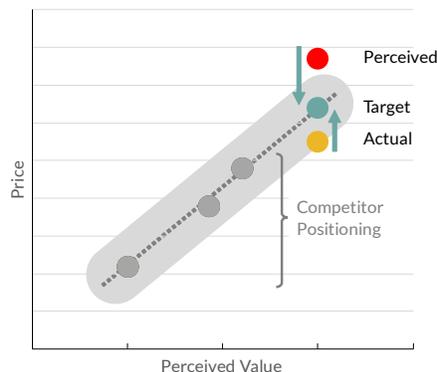


Figure 4

Why End-to-End Analytics?

Insiders know there's a lot behind the number on the price tag. Managing a company's pricing – from developing a consistent strategy to setting individual prices and planning promotions to executing to that plan – is devilishly difficult. Just managing the vast amounts of data is a chore. Knowing what to do with the data to make good decisions can be absolutely overwhelming.

End-to-End Analytics offers a team of pricing experts who can help. The End-to-End team combines experts in data management, manipulation, and mathematical modeling with seasoned professionals with substantial hands-on experience in both business-to-business and business-to-consumer pricing. They know how to balance the use of tools with practical, solid and repeatable day-to-day business processes to help a company succeed.

Getting Started

To learn more please visit us at www.e2eAnalytics.com or contact by email at info@e2eanalytics.com