AN RIS NEWS WHITE PAPER

PRICE OPTIMIZATION AND PROMOTION MANAGEMENT:
POWERFUL TOOLS FOR TOUGH TIMES AND BEYOND

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THE LONG-RUNNING TV GAME SHOW IS CALLED "THE PRICE IS RIGHT." BUT IT'S NO GAME FOR RETAILERS, FOR WHOM SETTING THE RIGHT PRICE IS BECOMING A MATTER OF SURVIVAL— AS WELL AS AN ENORMOUS OPPORTUNITY.

Getting a price "right"—to a level that a retailer's customers are willing to pay, while still maintaining margins—has always been a tough proposition. Even those retailers with effective pricing strategies have often faced practical challenges in executing them down to the store, shelf and product level. Increasing calls for more localized product assortments, designed for the shoppers in a particular region or even a particular store, have added complexity to price planning and execution processes, as have retailers' expansion into multiple sales channels.

These long-standing issues have been thrown into sharp relief by the global economic recession, which has reduced consumer spending overall. Some retailers have made significant, across-the-board price cuts in response, which may be a good short-term survival strategy but can cause long-term problems. In addition, while some private label brands have benefited from consumer bargain-hunting, their increased roles in retail assortments could add new complications to pricing calculations and promotion management.

Industry experts have identified just how complex the issues around pricing can be. Pricing "is a critical tool retailers need to entice share of wallet out of ever scarcer consumers, while struggling to stay on top of wildly fluctuating commodity and transportation costs," write Nikki Baird and Paula Rosenblum, Managing Partners at Retail Systems Research (RSR). "A rash of product discontinuations and introductions from manufacturers who face the same challenges increase retailer pressure to find optimal starting prices, promotion opportunities, and end-of-life pricing to balance gross margin dollars against sell-through. Concurrently these same retailers find themselves pressed to manage rapidly declining inventory investments," write Baird and Rosenblum in "Going Local: Emerging Best Practices in Localized Pricing and Promotions," (RSR Benchmark Study, January 2009).

Faced with this host of challenges, many retailers have turned to price optimization and promotion management solutions, seeing in them a means to preserve margins, maintain sales and manage inventory more effectively during the economic crisis. But such solutions, when used correctly, are capable of much more. They can help retailers create price and promotion strategies that are true competitive weapons, using new, highly relevant data sources (both internal and external), and applying powerful analytical tools that take into account the realities of today's retail marketplace. With these solutions, retailers can better understand product mix, consumer preference and demand—and then take action based on their improved understanding.

These advanced solutions also solve many of the execution problems retailers face, by sharing information from a common platform with an expanded range of internal business users, and automating pricing and promotion tasks that previously required manual intervention.

VIEWING PRICE MANAGEMENT IN A LARGER CONTEXT

Given the new complexities of pricing, it's essential for retailers not to view it in isolation. Too many other business processes are affected, directly and indirectly, by pricing—from the deepest reaches of the supply chain all the way to the tags on the store shelf.

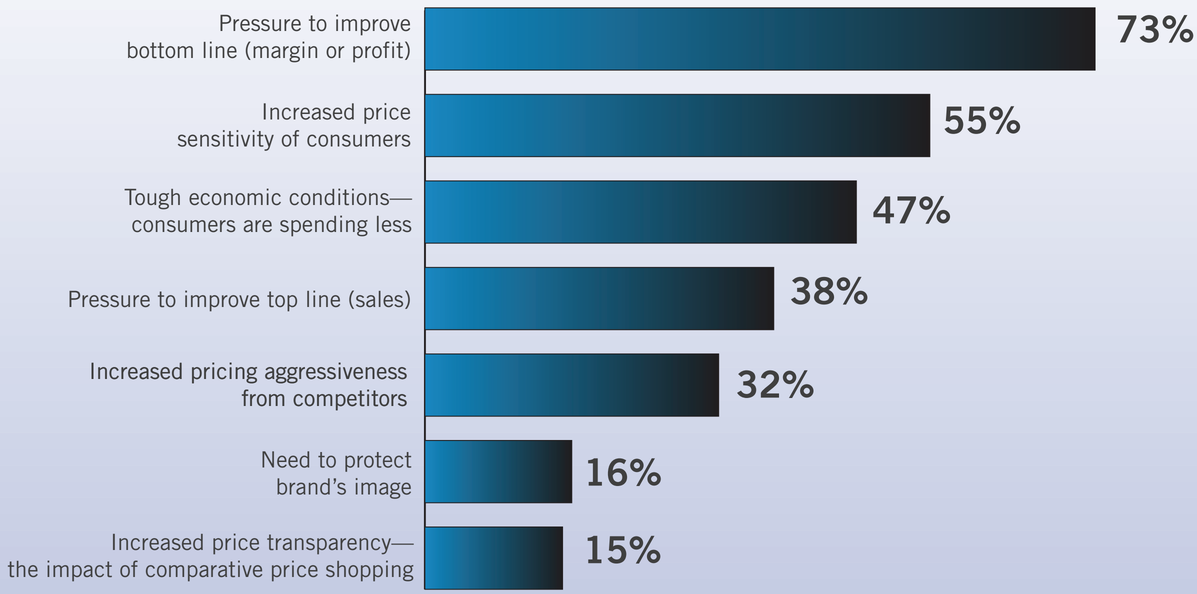
In addition, pricing decisions can have unintended consequences on shopper behavior. Some retailers who made significant price cuts in response to the recession found that their customers quickly became accustomed to the new, lower prices, regarding them as the "new normal." When these retailers tried to raise prices back to previous levels, they encountered stiffer-than-usual resistance from shoppers. Short-term gains from lower prices may have cost these retailers customer loyalty in the long term.

A recent *New Yorker* cartoon commented on the retail pricing challenge. It shows a store's windows proclaiming "No Discounts! No Sales! All Merchandise Full Price or Higher!", with a passerby saying "I guess the economy *is* getting better."

Most retailers are all too aware of consumer price sensitivity. More than half—55%—of respondents to the 2009 RSR Pricing Benchmark Study listed "Increased price sensitivity of consumers" as a top-three business challenge, compared to 39% of respondents to the previous year's survey.

Many industry experts believe that for pricing and promotion management to be effective, it needs to be part of a strategic movement toward consumer-centric merchandising. This approach is designed to incorporate consumer demand across the entire retail merchandising function, from front-end space planning all the way back through the supply chain. This holistic view of merchandising includes providing executives with visibility into the myriad decisions being made simultaneously in merchandising, including price, promotion, space

GROSS MARGIN AND CONSUMER PRICE SENSITIVITY TOP LIST OF BUSINESS CHALLENGES



Source: RSR Research, January 2009

allotments and assortments.

In a May 2009 AMR Research article, Kevin Sterneckert, Retail Analyst at AMR Research, writes that a key element in moving toward consumer-centric retailing is to "Create a master plan that includes all of the opportunity points (e.g. advanced clustering, assortment planning, lifecycle price optimization, supply chain integration, etc.) and use this plan as a foundation for all related projects. It's important to know where you're going by defining an enterprise vision of consumer-centric retailing." ("A Path to Achieving True Consumer-Centric Retailing," AMR Research, May 2009.)

Lifecycle price management, which includes price and markdown optimization, is both a key element within this larger movement and an excellent place for retailers to begin their overall efforts. For starters, lifecycle price management offers significant benefit opportunities, creating a fast ROI. Further consumer-centric initiatives will be an easier "sell" to upper management if initial efforts can be shown to pay off quickly.

BENEFITS CAN BE SUBSTANTIAL...

Lifecycle pricing benefit opportunities

Initiative	Cost Reduction	Ad Response Rate
Promotion Planning and Advertising Execution	5% to 10%	+6% to 8%

Lifecycle pricing benefit opportunities

Initiative	Sales	Units	Gross Margin
Price Determination/Revenue Optimization			
Base Price (non-promoted)	+1% to 3%	+0% to 1%	+2% to 5%
Promotional Prices	+1% to 12%	+1% to 9%	+5% to 20%
Markdowns	+0% to 5%	+5% to 10%	+6% to 10%

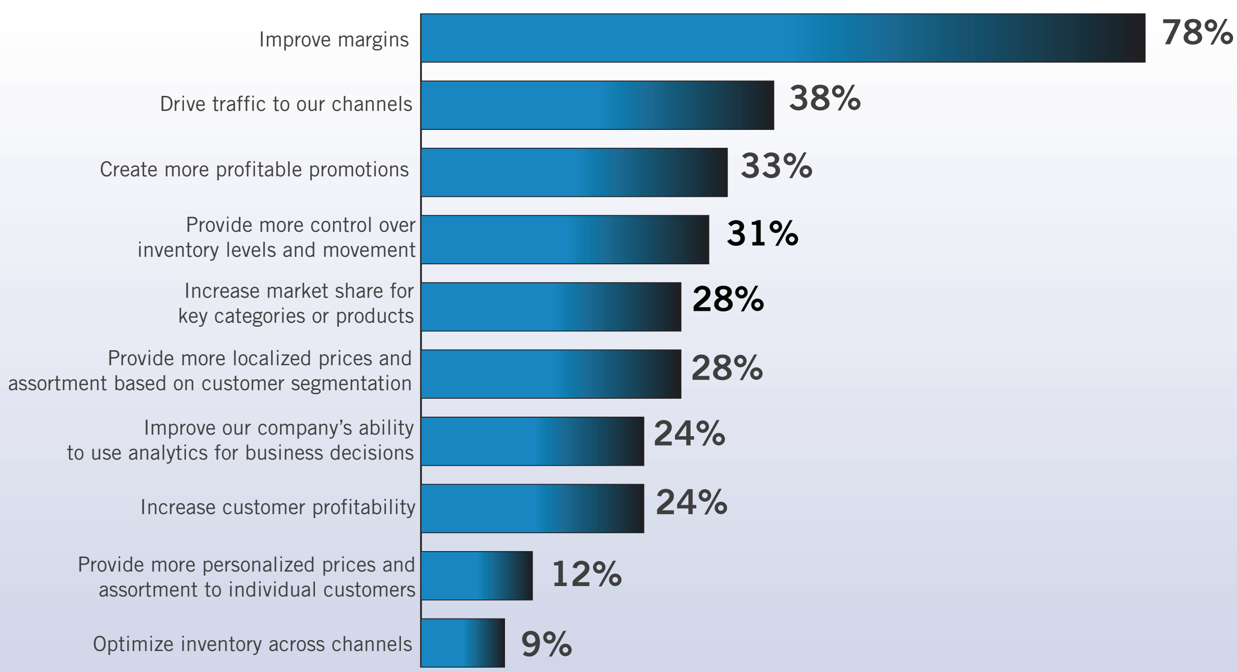
Source: AMR Research, 2008

According to AMR Research conducted in 2008, price determination/revenue optimization solutions can help retailers improve sales on base price (non-promoted) items by 1% to 3%, and improve gross margins by 2% to 5%. On promotional prices, sales increases can range from 1% to 12%, with gross margin improvements of 5% to a high of 20%. Markdown sales can jump by up to 5%, and gross margins can increase in the range of 6% to 10%.

Retailers implementing such solutions would see significant benefits. As an example, using the parameters above, a grocery retailer with $2 billion in annual sales would see incremental sales increases of anywhere between $20 million and $60 million annually, with gross margin dollars increasing by between $20 million and $32 million annually (assuming average gross margins of 20%).

For a $5 billion hardlines retailer, the incremental sales increases would range from $50 million to $150 million dollars annually, with gross margin dollars increasing by between $50 million and $81

OPPORTUNITIES FOR PRICING TO CONTRIBUTE TO STRATEGIC GOALS



Source: RSR Research, January 2009

PROMOTION MANAGEMENT SOLUTIONS IMPROVE SCALABILITY AND SPECIFICITY

As with pricing optimization, retailers face both strategic and tactical challenges with promotions. And as with pricing, promotions are most effective when they are carefully targeted. Well-crafted promotions can achieve many of the same benefits as price changes, including increasing store traffic and boosting unit sales, without the long-term dangers of price-cutting.

"Successful promotional optimization stimulates consumer response by finding the right price for the right shopper segment in the right store, requiring the appropriate blend of science and art conducted in a time-efficient manner," writes Kevin Sterneckert in "The Real Issue Behind Promotion Optimization Adoption," (AMR Research, February 2009.)

Easier said than done, particularly for food retailers that may promote as many as 3,000 items per week. Without scalable solutions, item-level decisions become nearly impossible for most retailers to execute. In fact, many retailers face challenges creating store-specific (or even region-specific) variations that could potentially improve a promotion's chances of success.

Practical execution concerns mean that key choices, such as which items to promote on the cover of a weekly circular and how large a discount to offer, must be executed on a chainwide basis—despite significant differences in shopper demographics and product preferences in the many markets the retailer serves. In addition, many retailers lack easy access to historical information about promotion performance, which is crucial to establishing a baseline for improvements.

Today's promotion management solutions, such as those offered by SAP, take multiple factors into account in offering recommendations, including manufacturers' offerings and historical performance. By bringing in shopper behavior data, these solutions can not only recommend which products to promote but also how much of a discount will be effective in driving traffic. For example, retailers may discover that they can get the same promotional lift by reducing the price of a box of cereal from $4.99 to $3.99 as they would have by reducing the price to $3.49, thus improving their margin. In addition, advanced promotion management solutions include "what-if" scenarios that allow merchants to predict promotion performance.

In his article, Sterneckert identifies key functional capabilities that retailers should look for in a promotion management solution:

- Start where you end today—recommended promotional items. Let the software and science do the heavy lifting and simplify the entire process.

- Include robust workflow/task management as well as role-based activity management and reporting.
- Demystify the black box (science). Merchants should be able to understand the reasons behind a recommendation.
- Don't forget versioning optimization. True consumer-centric merchandising suggests that circulars should differ (items and prices by location or ad zone).
- Integrate or include ad planning tools.
- Have support for trade fund management (not manual entry).
- Include total business halo and cannibalization impacts.
- Embrace customer segmentation capabilities and loyalty pricing.
- Be sure to have e-commerce capabilities for cross-channel retail.
- Ensure the single demand engine receives signals and sends to the supply chain.

Promotion management solutions incorporating these functionalities can help retailers address the increasingly complex nature of promotions, which require precisely timed actions by several departments within the retail organization as well as coordination with external suppliers. With such tools, retailers running thousands of promotions across many advertising zones and geographies can reduce or eliminate the manual processes, wasted time and inevitable miscommunications that make promotions such a challenge, reaping both top- and bottom-line benefits in the process.

million dollars annually (again, assuming 20% average gross margins).

Retailers believe pricing's ability to improve margins is its key strategic role for their companies, according to a January 2009 RSR Research study. "Improve margins" topped the list of strategic opportunities for pricing, with 78% of respondents. In comparison, the second-highest response—pricing's ability to "drive traffic to our channels"—garnered only 38% of survey respondents.

Pricing optimization that creates margin improvements can also impress decision-makers outside the retail organization. "A retailer's gross margins on the products they sell is becoming an increasingly important measurement area," says Dr. Wayne Neale, Vice President of Solution Management for Merchandising Lifecycle Solutions at SAP. "Ensuring that a retailer is profitable on a product-by-product basis is becoming just as much of a yardstick for Wall Street as same-store sales," he adds.

Price sensitivity is also an important lens through which retailers can view their shoppers—and seeing how that sensitivity shifts over time is a crucial step on the path toward consumer-centric retailing. "Understand that reading and sensing consumer behaviors should become a 'way of life' and not a 'point in time' perspective," writes AMR Research's Sterneckert. "Consumers buy differently today than they did just a few months ago."

USING MULTIPLE DATA SOURCES AND DYNAMIC INTELLIGENCE TO SET PRICES

Retailers need to move beyond the traditional factors used to set prices—namely, their own costs and what their competitors charge for the same or similar products. A retailer's overall pricing strategy—somewhere on the continuum between Everyday Low Prices (EDLP) and Hi-Lo—is of course a crucial strategic backdrop to any pricing decision.

Other important factors include general economic conditions, as well as those in a particular region. Shoppers in a city with a high unemployment rate, for example, are less likely to pay what they perceive as high prices, even if they themselves are steadily employed. Weather can also play a role, both in terms of shopping patterns and in demand for specific products.

Advanced price optimization solutions use multiple factors to make price recommendations, and are capable of making those recommendations down to the level of an individual SKU. According to Neale, "These solutions take into account the market, your competition, and the retailer's own brand and assortment, as well as service levels and store formats, the geographic area you're operating in and the backdrop of the economy, and tell you 'Here's what your customers are willing to pay for this product right now.'"

The solutions are dynamic, taking into account time-based changes, the impact of other prices within the same category, and promotional activity. The solutions apply precise, scientific analysis and make recommendations on where, and how, retailers can best implement their given price strategy.

Price optimization solutions provide retailers with a strong starting point both because they offer fast returns and because they can start to shift the internal culture within a retail organization. "Price optimization begins to get retailers familiar with the concept of science-driven analysis informing the decisions they're going to make," notes Neale. "It doesn't replace the art of the retailer, including their knowledge of local markets and shoppers, but it supports the decisions they need to make."

On a practical basis, the automation that price optimization solutions provide is a necessity in today's business environment. "A retail merchant may have the capacity to deal with only a few hundred products, but they may be responsible for 10,000 products," says Neale. "These solutions do the heavy lifting, but they make recommendations based on very solid scientific principles and analysis."

In addition, many of the data sources and analyses used to make price recommendations are applicable in other key retailing areas, such as assortment planning. And pricing decisions, particularly those involving promotions and markdowns, will be affected by marketing and will in turn have important impacts on areas such as labor scheduling, replenishment, allocation, and store operations.

ADDRESSING PRICING EXECUTION CHALLENGES

Retailers who have already invested in price optimization solutions have realized that their ability to execute on those price recommendations is just as important as the recommendations themselves. But those execution capabilities are only now receiving sustained attention. However, "with retailers starting to do things like setting caps on the number of prices sent to stores per week because stores simply can't keep up with the volume, then it seems to me as if price execution's time is a bit overdue," writes RSR's Nikki Baird in "Oh, Just Give that Margin Away: The Price Execution Challenge," (RSR Research, March 2009).

Retailers' ability to transmit their price strategy to the shelf, and particularly into the minds of their shoppers, is crucial in today's marketplace. But there are several practical hurdles to effective price execution, including store training on pricing execution processes; developing and enforcing price override policies; and communicating prices. These three processes are all owned by different parties within a retailer; for example, marketing and/or merchandising typically owns price communication. In some organizations, responsibility is split even further, with merchandising owning price communication at the shelf while marketing owns price communication beyond the store.

Even in areas where there is a single "owner," price execution processes can be subject to conflicts or fall through the cracks. For example, price overrides at the point of sale are frequently a result of training gaps in price execution at the shelf. Theoretically, store operations handles training for both of these areas; in reality, in many retail enterprises cashier training is handled by a different set of managers than store operations training. Therefore, the link between at-shelf price execution and POS price overrides is never effectively made.

These challenges are only partly cultural and organizational; many are also driven by retailers' IT architectures, which typically include a wide range of disparate systems, both off the shelf and home-

PREPARING FOR PRICE OPTIMIZATION SOLUTIONS: FIVE KEY CONSIDERATIONS

1. Because price optimization systems use item-level data as the cornerstone of price recommendations, ensure this data is accurate, with a process in place for price zone execution.

2. Consider using strategies that involve more than simply rules-based, linear pricing models.

3. Factor customer retention and growth into your strategic pricing plans. Keep in mind that the circular motion of chasing competitors may not be in your customers' best interests.

4. Make sure your merchants are focusing on strategic issues and not manipulating data.

5. Build a solid business case to validate price optimization's benefits and to enhance organizational support.

grown, with siloed databases and costly point-to-point integration. In addition, as retailers move from price optimization to promotion optimization, many underlying technology conflicts come to the surface. "Promotions touches merchandising, price, marketing/advertising, POS, and loyalty—and each of the systems supporting each of these functions may very well provide price execution rules engines, workflows, price masters, and more," writes Baird.

"Without an IT strategy to accompany the price strategy—i.e., how price strategy through execution is going to be supported and enabled by information systems—then any coordination or process work is going to be for naught," she adds.

ADVANCED TOOLS OFFER VISIBILITY AND COORDINATION CAPABILITIES

Price optimization and promotion management solutions from SAP can help retailers craft an IT strategy that supports the advanced capabilities they need to compete in today's environment. Even for retailers who are just beginning to move into these areas, SAP solutions offer a "crawl, walk, then run" approach, starting slowly and then building.

"We can quickly bring in the experience we've had helping other retailers in areas such as customer profiling and campaign management, and then help retailers organize their own data, using best practices to get the core Key Performance Indicators together that they would need to analyze," says Rob Wilson, Global Director of Retail Solutions at SAP BusinessObjects. The company can also help retailers organize their data overall, as well as by business processes and by individuals' roles. "Retailers need to understand what data people need and when they need it in order for them to do their jobs better and faster," says Wilson. "We're very skilled at diagnosing this and getting the lay of the land."

Retailers can build up their capabilities on a module-by-module basis. "SAP has been known for 30-plus years as an integrated platform, and this provides many advantages to our customers," says SAP's Neale. "However, that is not a requirement to run the applications. The applications are able to operate on a common business platform that allows them to share different information, and the services-oriented architecture means the applications can call on intelligence when they need it, but the intelligence doesn't have to be a part of every single application."

In fact, because the price optimization and promotion management solutions are completely integrated with more extensive business intelligence offerings from SAP BusinessObjects, they can easily address the needs of many lines of business within the retail organization. "We see our solutions in terms of business intelligence opportunities," says Russ Hill, Senior Director for Retail, Consumer Goods, and Wholesale Distribution Global Marketing for SAP BusinessObjects. "It's not just pricing and store operations; we can spread to the supply chain for the handling of promotional requirements, and look at demand for understanding the impact of pricing relative to specific campaigns."

The solutions also deliver information in a number of different ways, expanding the universe of users within the organization. "We can deliver information in the discovery, search and explore mode, as well as through roles-based dashboards and scorecards," says Hill. "That means we're reaching all the way from the C-level offices down to the business users. They all have the ability to understand, in near real-time, the impact of markdowns and promotional campaigns. They can segment the data by different store clusters, or by product categories or departments, and the information can be rolled up through multiple levels—to a department manager, a store manager, a district or regional manager, or even further."

Other new features include in-memory

technology, which allows users access to multiple data sources comprising millions if not billions of records, but with extremely fast response times. Queries that might have taken minutes or even hours with previous technology are now virtually real-time interactions that allow users to "slice and dice" data on the fly. The capability is also largely self-service, requiring little or no training and offering a Web-like experience to users.

The user interfaces may be simple, but the analytics powering the solution are powerful and complex. "We offer deep, specific applications and tools around pricing optimization, with very extensive algorithms that are purpose-built for pricing optimization," says Wilson. "Analysts can use these powerful predictive analytics engines to mine data, crunch it, and figure out what it's telling them—and in the same platform, they can expose it out to casual users or analysts who don't require those kinds of 'super-user' capabilities."

The solutions also encourage greater communication, providing the ability to export or email information in a number of different textual or graphic illustration formats directly to other business users. "All the tools work together, and all the data is the same behind the scenes," says Wilson. "You could be in a dashboard that surfaces key metrics and shows you how a recent promotion performed. You can link from there and, maintaining the same view, move into a tool where you can do an ad hoc slice-and-dice or 'what-if' scenario around that particular intersection of data.

"That's only part of the process," he adds. "The collaboration aspect—the fact that you can email someone that exact view and they can then push it on to the next level or take action—is what puts this on steroids. Everyone is operating off of the same playbook, and this puts people into a whole new arena in terms of driving business and tightening up business cycle times. People can make more rapid decisions and adjustments on the fly, versus waiting until week's or month's end or until batch runs are completed."

The combination of visibility and collaboration is a powerful one for retailers, particularly in the areas of pricing and promotions, where each decision that's made can cause ripples—and unintended consequences—throughout the enterprise. "Everyone is on a common platform, with everyone seeing the same view," says Hill. "Even if they have different tools because their job requires a different level of analytic horsepower, it's all the same data, and they can pass their perspectives to and fro. And with a common business intelligence platform tied to the ways we deliver this information, they can take that information and make it actionable." ■