

Techno Pricing

Technology - SN Special Report Excerpt

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The rising cost of food commodities has led to the biggest jump in retail food prices in 17 years, the Wall Street Journal reported on Jan. 3. Food retailers are mostly passing along their higher costs to consumers, but so far companies like Safeway and Kroger say they are not seeing a negative impact on sales. It appears that consumers are willing to pay 5.3% more - that was the jump in the Consumer Price Index for food last year through November. Still, a growing number of retailers, including Safeway, are not relying simply on the good graces of consumers to continue buying higher-priced products. These retailers have invested in price optimization applications that give them a much clearer forecast of what consumers are likely to do - and how profit margins will be impacted - when prices are raised, lowered or left the same.

Price optimization tools have been available to retailers for at least a decade, but the interest in the technology has heated up recently as pricing has grown more complex and competitive pressures have made already slender margins harder to maintain. "There has been a desperation in the past few years, with retailers finally realizing that without a scientific approach to pricing, they are not going to find margin improvement," said Scott Langdoc, vice president of research and business leader, Global Retail Insights, a division of IDC, Framingham, Mass.

Last summer, DemandTec, San Carlos, Calif., went public with an initial public offering. DemandTec's customers include Wal-Mart, Safeway, Giant Eagle, Food Lion, Brookshire Grocery, H.E. Butt Grocery and Best Buy. In addition to price optimization geared to everyday pricing, the vendors also offer promotion optimization tools aimed at finding the best discounts, with many retailers employing both. DemandTec also offers a trade promotion management network connecting retailers with CPG companies.

SUBSCRIPTION RENEWAL

Giant Eagle, Pittsburgh, is near the end of its first three-year subscription with DemandTec for price optimization and plans to renew it, said Stephanie White, vice president of sales systems for the chain. Previously, the chain had to resort to "piles and piles of spreadsheets" to analyze pricing.

The system has helped Giant Eagle deal with the cost volatility that has led to increases on about 60% of its items during the past year, said White. The chain waits until its competitors pass on cost increases before following suit, but uses the optimization tool to "understand the implications of moving prices and forecast the results of doing so," she noted. "And if we hold a price, it tells us what would happen then."

If anything, though, Giant Eagle has endeavored to reduce prices, investing over \$100 million in price reductions over the last three years, said White. "We've used the [price optimization] tool to help us select the items for price reduction."

Retailers typically apply price optimization to a category, changing prices of products within the category to achieve a particular goal, such as profit or revenue maximization. Giant Eagle has applied price optimization to between 70 and 80 categories, with half or more of them targeted for price reductions. In general, "our goal is to drive sales, not maximize margins," White said.

Giant Eagle has also embraced price optimization as a way to handle the sheer complexity of pricing decisions. White pointed out that changing one price in the peanut butter category can lead to thousands of other changes when accounting for all of the sizes, specialty brands, national brands and private-label items, as well as geographic pricing zones and competitive considerations. The technology allows the retailer to impose its own rules on these prices and "see the implications of those rules," she said.

But those strategies and rules have to be in place before the technology can be used. White acknowledged that Giant Eagle "had to get alignment" on its pricing strategies and rules. The chain also created a centralized group of pricing analysts to use the technology in partnership with category managers. White declined to cite the cost of the system, but noted that its benefits have been "pretty significant" - enough to justify renewing the subscription.

Another retail user of DemandTec, who requested that his name and company affiliation not be used, said the system helps his chain ensure that pricing rules are being implemented. "You uncovered a lot of things we were doing wrong," he said.

The technology also enabled the chain to pay attention to slower-moving items that had often been overlooked in the past. "It's constantly looking at our whole product line," he said. Whether lowering prices to be more competitive and drive volume, or raising prices to extract more margin, the system "takes the emotion out of it," he said. But the retailer still makes the final judgment about whether to pull the trigger on price changes, he added.

Overall, the system, in use for several years at this company, has "improved or maintained our profitability - it's been a factor in our profits. The executive said, adding, "It's enabled us to compete with the giants."