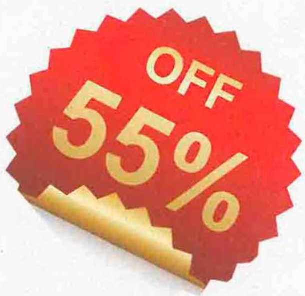
PLAYING THE PRICE GAME



How 'dynamic pricing' strategies could change retail

by LEN LEWIS

There's an old saying that "the price is the price." Looking to 2014 and beyond, the name of the game appears to be changing to "Let's Make A Deal."

The catalyst behind this move is "dynamic pricing," a strategy that is the direct result of Internet price transparency. It refers to frequent price changes based on customer traffic, demand, weather, time of day, loyalty card data, competitive factors and some complex algorithms.

The concept of dynamic pricing has been enormously successful for industries like travel and leisure, home electronics and professional sports teams — the latter of which can base ticket prices on team performance and factors like pitching matchups. Then there are online sellers: Amazon, for instance, implements about 2.5 million price changes per day, according to online monitoring firm Profitero.

For consumers, dynamic pricing has not only raised the question of where to shop — but when. Does this sound the death knell for traditional cost-plus or fixed pricing? And how well can this work in retailing without alienating customers through excessive price changes online or in stores?

'A TRICKY TOPIC'

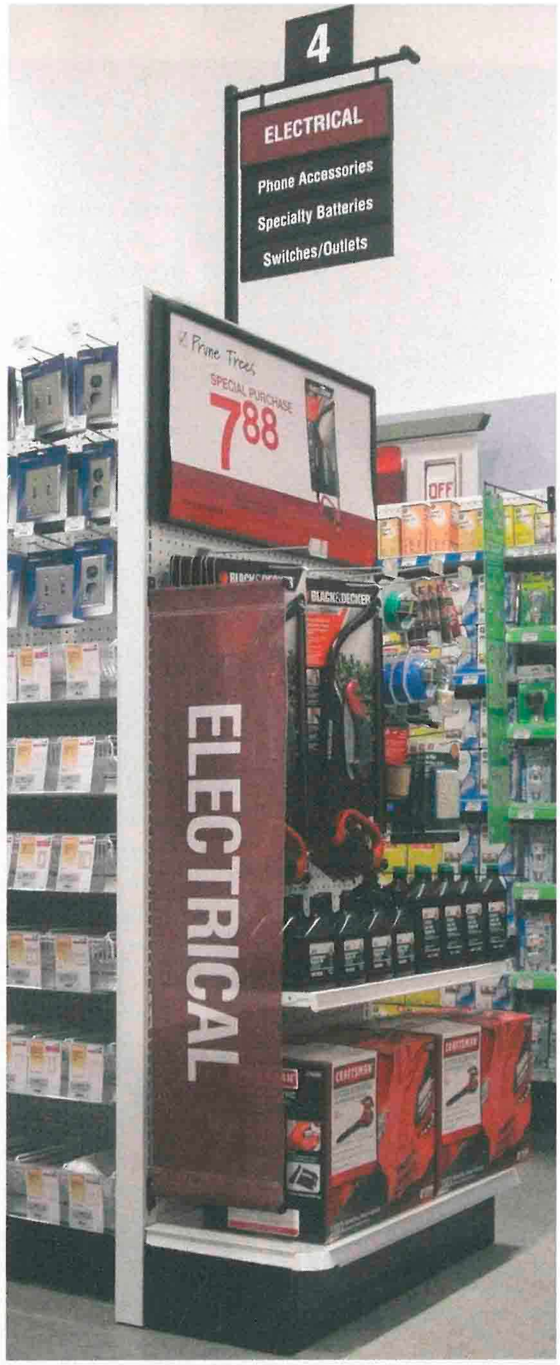
Rafi Mohammed, price strategy consultant and author of *The Art of Pricing*, summed up his perspective in an article in the *Harvard Business Review*. Noting that price swings of 15 to 25 percent are common, he said, "While changing prices may reap short term riches, this practice can destroy long term profits. Retailers need to understand that how they set their prices is a key component of their brand and any changes can adversely affect both their brand as well as how consumers shop."

He cited Apple's introduction of the iPhone in 2007; the company originally sold the device for $599 and then dropped the price to $399 some 10 weeks later — infuriating customers who had paid the earlier price. To make amends, Apple gave a $100 merchandise credit to early purchasers.

"Three years ago, weekly or monthly price changes were reasonable — even for digital marketers — and dynamic pricing as an operational discipline didn't yet exist," says Eric Best, founder and CEO of Mercent, a cloud-based retail merchandising and pricing platform. "Last year … we saw the majority of our sophisticated and successful merchants move to a daily pricing model. Over the past 12 months, frequency moved from an hourly to even an intra-hourly paradigm."

"It's a tricky topic," says Leslie Hand, research director with IDC Retail Insights. "Depending on the category you might be able to barter price. There's something in dynamic pricing that erodes consumer trust in a chain. But it all depends on how you do it."

Frequency seems to be a key element for bricks-and-mortar retailing. During November 2013, Best Buy and Walmart each made more than 50,000 price changes, according to Digital Journal. Even supermarkets are jumping



on the bandwagon thanks to shopping apps like Safeway's Just for U personalized pricing program.

ONE-TO-ONE PROMOTIONS

Dynamic pricing has picked up quite a bit of steam over the last two or three years, largely driven by Amazon," says Andy Voelker, retail pricing strategy manager for Ace Hardware. Ace has worked closely with 360pi, retail price monitoring firm, whose clients include bricks-and-mortar, e-commerce and multi-channel retailers.

"But every retailer is doing dynamic pricing on their own terms. We don't look at it from the perspective of frequency: We want to be able to keep up with the market and be relevant. That means changing [prices] but not intra-day or even daily," he says, noting that price changes can be challenging for the Ace co-op, which is comprised of more than 4,000 independent retailers.

"One of our big transitions over the past couple of years was going from one national price into regional or zone pricing in order to treat individual markets differently," he says. "We target a competitive set that includes Home Depot, Lowe's and Menards," retailers that also use regional and zone-based pricing.

"I don't see more frequent prices changes, due to the cost to independents and the churn it would cause at retail," says Voelker, citing the high cost of electronic shelf tags. "Stores would end up turning away from us and doing their own thing."

But a key aspect of pricing is definitely shifting to one-to-one promotions. "The question is how to get those offers closer to the point of purchase," he says. "Mobile will play a huge role. If we can get information to customers in the stores, that could push them to a purchase.

"Online is tricky and we're going to spend some time on that this year in order to make sure we're getting a broader assortment on our website and aligning the online channel with our stores," Voelker says, noting that stores and websites have to operate together as part of a larger plan.

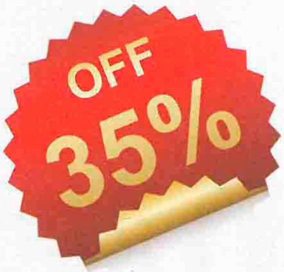
"Having one price in the store and another on a customer's mobile phone is a shotgun strategy indicating that everyone is operating in a silo," he says. "If you're trying to drive a promotion online that the stores don't know about, it catches them caught off-guard. They won't know how to handle customer interactions and you can end up with a very disappointed customer."

Hand insists retailers can undertake dynamic pricing "without eroding consumer trust, but it has to be done as a transparent stepwise program in order to achieve better pricing. I think it can be part of a customer relationship program that may provide a way to earn better pricing. ... it may turn out that the old in-store or manager's special is the best mechanism for giving a store an edge."

Retailers should, however, avoid multiple price changes during the course of a day, she says. "I'm afraid that people will sit in front of a console until an item meets their price target. It's like the stock market or Priceline on steroids: It's an auction that never stops and actually slows down purchasing more than encouraging it. I'm not sure it's good for retail when everyone's trying to chase Amazon."

PATH TO PURCHASE

The whole concept of dynamic pricing hearkens back to the idea of loss leaders. Grocers, for instance, "would sell an item like Diet Coke for a penny under their purchase price every other week to get consumers in their stores," Hand says. "I'm not sure you want to price down like that just to win footfall.



"You don't always want to be the lowest," she says. "You want to hold a certain position in the

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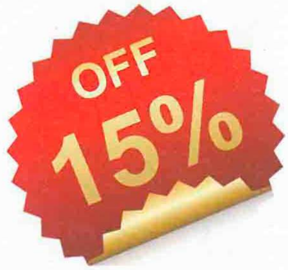
— Leslie Hand, IDC Retail Insights

market. If loss leaders are all retailers are paying attention to, they'll be driven out of business."



This means understanding new pricing opportunities and competing in an omni-channel environment, says Jim Sills, president and CEO of pricing and promotions management firm Clear Demand, who insists it's critical for retailers to understand the path to purchase. For instance, while Cyber Monday sales grew 20.6 percent in 2013, the number of people shopping with their phones on Cyber Monday increased 45 percent year over year.

"In the past few years, we've seen retailers resorting to across-the-board price matching," Sills says. "But it's not sustainable. It's a race to the bottom and they've got to come up with something different, like competing on essential items."

This means having across-the-board price intelligence that lets retailers know where the competition is on every item on a daily basis, he says. "Instead of immediately responding to every price change, retailers have to look at how things are trending and what averages look like [to] offer customers a consistent experience."

"Think of it as an arms race … the balance of power is with shoppers. … most consumers have as good or better data at their fingertips by virtue of their smartphones as the typical merchandiser has on his desktop."

— Eric Best, Mercent

For Sills, it comes down to execution. "Kohl's has done a great job with electronic shelf tags and can respond [to price changes] in the stores almost as fast as they can online," he says. "On Black Friday, Walmart was having multiple events and pricing almost by the hour in order to drive traffic at certain times of the day."

But dynamic pricing is something different and innovative in which all retailers, regardless of size, can participate. "We're working with a number of small chains, and dynamic pricing could change the game by leveling the playing field," Sills says. "But again, they need the business intelligence that enables them to compete on items when they need to."

DETERMINING EFFECTIVENESS

Mercent's Best emphasizes that the most important variables in any company's merchandising strategy are pricing and shipping. The combination of the two gives the "total price."

"The number of retailers using dynamic pricing software day-to-day has increased consistently and so has the speed with which pricing information is collected [and] analyzed and prices are modified," Best says. "In essence there are two metrics to look at: the number of product prices being modified and the frequency of price changes."

Best concedes there are limitations to how quickly prices can be modified. "It takes time even for a platform like Amazon or eBay to parse a price change request from a retail merchant," he says. "So there's a synchronization challenge when you get into price changes that occur more frequently than 10-15 minutes."

The industry is at a point where the effectiveness of dynamic pricing can be determined. Players like Google and Amazon are making price information more transparent and important in terms of merchant relevancy, and aggregators of e-commerce product information are making it easier for consumers to quickly compare offers from competing merchants. "Think of it as an arms race … the balance of power is with shoppers," Best says. "Arguably most consumers have as good or better data at their fingertips by virtue of their smartphones as the typical merchandiser has on his desktop."

And when you combine price transparency with same-day shipping, he says, "it becomes increasingly likely that an e-commerce order will substitute [for] an in-store purchase. Best Buy and other retailers are fighting back with a technology-enabled response that enables better pricing relative to e-commerce retailers."

Consumers, meanwhile, "have to get comfortable with the fact that during the course of a day the price of a flat panel TV might swing 50 percent one way or the other," Best says. "They have to think of prices as fluid signals rather than the fixed long-term value of a given product. Retailers will increasingly rely on mobile devices to provide in-store shoppers with real-time price information. And the more flexible retailers are in terms of price-matching policies, the better." **STORES**

Len Lewis is a veteran journalist and author covering the retail industry in the U.S., Canada, Europe and South America.