PRGX

SET AND MEASURE EVERYDAY LOW PRICING WITH TRUE NET COST ANALYSIS

OVERVIEW

It's no secret that 2020 has been a challenging year for retail businesses. Although overall sales have gone up in many sectors such as grocery, there has been a drastic change in prices, cost of goods, and promotions due to the impact of the COVID-19 global pandemic.

According to Nielson Intelligence Analytics, in November 2020, the percent of products sold on promotion in the UK was down a little under 15% year over year. Early in the COVID-19 pandemic that percentage variance was considerably greater as retailers sought to secure supply over volume-led promotional activity.

Putting the COVID-19 pandemic aside, the grocery market in the UK was already on the path towards more of an everyday low price (EDLP) strategy to address:

- Increasing market share, of "discounters", like Lidl and Aldi;
- Reduced cost of managing a high/low pricing strategy, and a more predictable demand profile; and
- Consumer changes – which have led to a rethink of pricing strategy.

In this white paper, we outline how true net cost analysis can assist with setting everyday low pricing by providing key data related to products and categories, as well as information to assist in negotiating with suppliers to establish the best pricing and margin targets. We will also explore:

- True Net Cost and Margin Analysis: a deeper level of visibility into product and vendor performance
- Every Day Low Price (EDLP) Strategy: Using True Net Cost Analysis to set targets and measure effectiveness

TRUE NET COST AND MARGIN ANALYSIS: A DEEPER LEVEL OF VISIBILITY INTO PRODUCT AND VENDOR PERFORMANCE

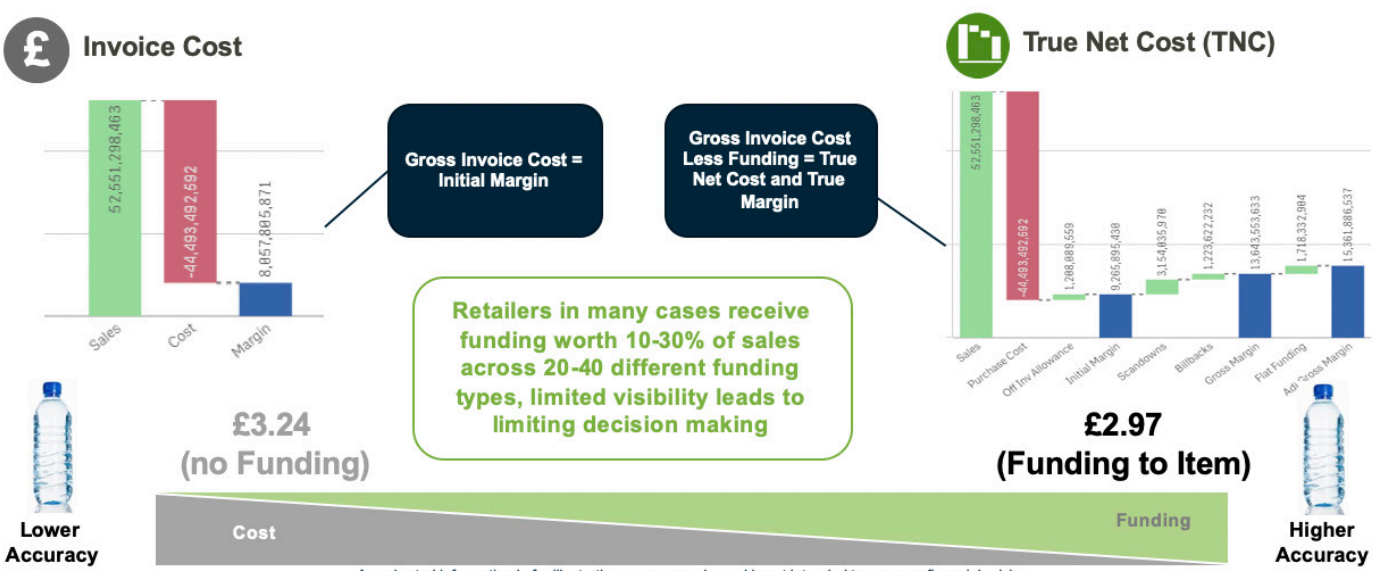
What is True Net Cost?

The word "net" in terms of cost or financial data, means that there is a corresponding "gross" or total figure. The net or "true" cost of an item is the original cost after deducting all connected monetary "offsets" - cash and trade discounts, promotional funding, rebates, allowances, credits, sales taxes, refunds, commissions, etc.

When comparing margin, the default measurement is to subtract cost from the sale price. And too often, this is where the margin calculation stops; whether it's because the additional necessary data isn't available or the effort to get to the true margin is too difficult and costly.

In order to gauge the true cost and margin of product sales, retail businesses must factor into the mix the promotional income received on products. Due to the variety, timing, types, different points of application, and how funds are applied – correctly applying promotional funding to the product margin is often prohibitively difficult, but absolutely necessary to avoid margin erosion when setting the new product price point.

According to this chart, you can be reviewing the same product with the same sales and costs. On one side, without funding, you have a lower accuracy where you think the product cost is £3.24. However, on the other side, if you correctly allocate the promotional funding, the cost becomes £2.97 which then allows you to calculate the true product margin.



Any charted information is for illustrative purposes only, and is not intended to serve as financial advice

Margin Analysis

It is critical to accurately apply promotional funding to each individual product, vendor and category. This can be accomplished with the right expertise, data model and purpose-built platform. A partner with a proven track record of success and value in this area is a pivotal accelerator to gaining true net cost and true margin visibility into all of your products and vendors.

In addition, an experienced partner can also provide a wealth of analytics that focus on hidden opportunities such as; seeking missing promotional income, unmet contractual obligations, cost changes, shifts between regular and promotional product mix, and various other insights to help maximize your sales and margin.

EDLP STRATEGY: USING TRUE NET COST ANALYSIS TO SET TARGETS AND MEASURE EFFECTIVENESS

Everyday low pricing (EDLP) is a pricing strategy that offers a fixed low price that is maintained long term, assuming that product costs are consistent over the same term. This is different than a high/low pricing strategy which relies on a higher base price that is discounted through promotions or sales events. An EDLP strategy results in the reduction of promotional sales offers such as buy one get one free, and multi-save discounts, and provides the consumer with a clearer and consistent price point – usually focused on branded staples. The EDLP strategy shift has been cyclical in the UK market, and not limited to grocery, but there has been a recent resurgence attributable to macro factors in the market, and consumer and legislative changes.

The information gained from understanding the true net cost and conducting a margin analysis is key to correctly establishing those new low retail and cost price points, as retailers switch to selling products under an EDLP strategy. Generally, this pricing strategy transition takes time, and tends to be a staged or phased by category or department.

When seeking to understand the true net cost of products, retailers would typically look to understand the price point to set items at based on the prior twelve months of activity, including applicable seasonality. Historically, retailers have been dependent on suppliers to provide much of this information as access to it in the retailers own organisation isn't always straightforward. Having direct access to this information, puts the power back into the retailer's hands to be more confident in negotiations due to the robust data that they are seeking to determine the new price points.

Typically the errors that occur when retailers seek to establish the true net cost of products are:

- Missing Funding – all funding provided not captured in baseline price and margin
- Implementation errors – administrative errors such as formula errors on spreadsheets
- Missing products - de-listed products and new products
- Volume calculation errors
- Volume inconsistencies – using historical, current and future volume trends

These errors are all avoidable with the correct access to data and information to set and validate pricing decisions and avoid margin erosion as a result. Additionally, recovering from these errors, if identified, can be challenging as suppliers are unwilling to reduce price and Groceries Supply Code Of Practice would restrict any retrospective adjustment.

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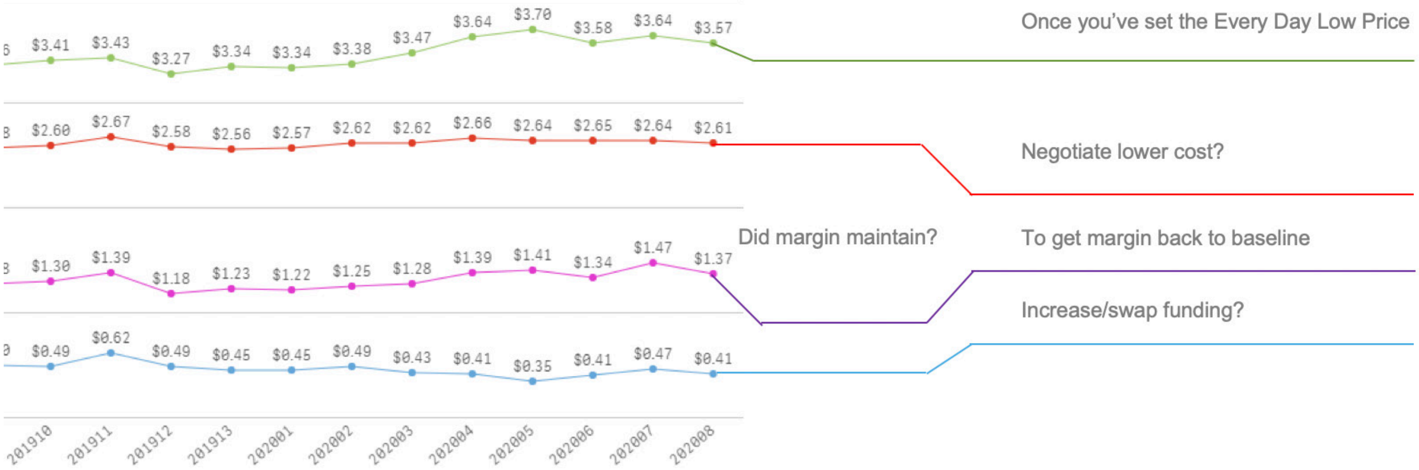

The How: Setting EDLP

When trying to set and find the pricing target it's important to have full visibility into historical changes in price, unit costs, margin and funding at the vendor, category and product level. The more comprehensive and accurate the historical data is, the more accurate the TNC analysis is. As a result, all future price negotiations will derive from that TNC value.

Let's use the above graphic as an example. As the first step, we've set the EDLP for the product or category based on the historical data. When continually measuring margin, you must ask yourself, "Am I maintaining it?" The graphic gives a visual of where the margin slightly drops versus where it was expected to be. As a result, because we have access to the cost and funding information, we can bring it back to a point where the EDLP strategy makes sense by negotiating a lower cost with vendors. Using the data, increase or swap the funding or income type with the goal to get the margin back to the baseline.

It is important to work with an analytics partner who truly understands the data, is able to ingest these huge and complex data sets and make the data readily available in all sorts of different combinations. This information truly supports setting the correct price points and maintaining the margin for retailers in an EDLP strategy. This data becomes a critical part of how the company runs its business, how they calculate pricing, and how they negotiate and work with vendors.

SUMMARY

From a proactive perspective, if a company moves towards an EDLP strategy the data is critical to setting the cost price at the right level. However, compliance is also something to be considered. If EDLP shifts, then performance can be measured to understand, “Are you getting the margins you were expecting from those products?” through monitoring and compliance against agreements and the pricing that was put in place.

In an increasingly competitive marketplace, retailers need to rely on data and technology to help make the right fact-based decisions. That’s why it’s more important than ever to have the right technology and partner to help you quickly gain insight from the data and drive action to maximize your margin and set your EDLP strategy. Using true net cost analysis allows deeper dives into promotional effectiveness and EDLP strategy, fostering decision insights that would otherwise be too slow or time consuming.

PRGX is on the cutting edge of development with many of these emerging trends, and we are ready to partner with companies to help them realize the power of technology, audit and analytics. We are positioned to help retailers with their EDLP strategy:

- Pre-EDLP implementation - to truly understand their TNC to ensure that margin is maximised pre-implementation of any new price points
- During implementation - as validation or compliance
- Post implementation - with continuous monitoring of margin and price variances