

# Accenture Precision Pricing: Blending the Art and Science of Pricing

Creating Customer and Shareholder Value  
in the Retail Marketplace  
Part VI



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Price optimization. It's the latest buzzword among retailers. How nice it would be to plug in a solution and have all the answers. The emerging reality is quite different. Accenture is finding that the creation of successful pricing strategies involves a spectrum of solutions—from the simple to the sophisticated that may or may not include pricing optimization. Accenture believes that there is no one-size-fits-all answer to pricing, but that there is a right answer for each individual retailer that helps bridge the gap between the art and science of pricing.

Accenture has worked with retailers across a number of major verticals—including grocery, mass, discount, department store, specialty, quick service restaurants and drug/convenience—to seize on new pricing opportunities by blending an appropriate mix of strategies, processes, tools, technologies, vendors and solutions. Results achieved have been as much as a 15 percent increase in sales, up to a 30 percent increase in profits, and a 10 to 15 percent improvement in margin. Read on to see how you can avoid leaving money on the table.

• Consulting • Technology • Outsourcing

## The Impact of Price

It used to be that merchants could eyeball a product and “know” at what price to sell it. Today, little has changed in the way retailers go about pricing. But the art of pricing has become more complex as the number of new competitors, new channels and new markets has exploded, not to mention the proliferation of SKUs and stores. The result: Pricing has increasingly become more reactive than proactive, leaving many retailers struggling to achieve profitable margins. Once a seemingly simple act, setting the right price is proving more difficult to do.

Recent developments in technology along with the growth of scientific retailing concepts are beginning to change the way retailers go about pricing. Several vendors of software tools and solutions have emerged that now offer optimization solutions targeted to specific types of pricing.

These solutions have matured significantly over the last few years. They generally encompass the familiar core concepts of price rules, demand forecasting and elasticity modeling. The real breakthrough, however, has come through advances in computing technology and statistical modeling that enable the end user to now manage and model thousands of prices across thousands of stores. When integrated with a retailer’s strategy, processes and organization, price optimization technologies can prove to be powerful tools for driving increased sales and higher margin.

Yet, at this point in time, no single proven solution exists that spans and links all types of pricing decisions—regular, promotion and exit pricing—that retailers face. Accenture believes that there is no one-size-fits-all answer to pricing, but that there is a right answer for each individual retailer that consists of a blend of strategies, people, processes and technology. We call this approach Accenture Precision Pricing.

## Accenture Precision Pricing: Taking a Comprehensive Approach

Retailers look to pricing programs to drive financial and shareholder value as a way to achieve strategic objectives, such as: Where can we position ourselves relative to the competitive landscape? What customer segments are we after? How do we leverage value-related messaging to appeal to key target segments? What categories drive their perception of our store? And how do we price accordingly to appeal to them?

The Accenture Precision Pricing approach looks across all the different types of prices a retailer must manage as well as across all the varying steps of the pricing process to create pricing programs that deliver value.

Our experience with retailers reveals that a full spectrum of pricing solutions exists—from simple, ad hoc to highly engineered, scientific ones. Not every retailer is ready to implement price optimization, nor will that be the end game for all. Yet, some retailers are ready for it. Each organization faces different issues that will require different solutions within pricing. What matters most is

# Setting the Foundation for a Comprehensive Solution

developing solutions—however simple or sophisticated they may be that are comprehensive and tailored to an individual company’s needs that drive benefits over the long term.

In our pricing work with retailers, Accenture draws on its experience to leverage a proven set of capabilities that bring “science” to the art of retailing by relentlessly driving fact-based retailing into an organization. Every undertaking for the retailers we have worked with has been different, but for each we have created powerful “toolkits,” or combinations of new concepts, analytical techniques, tools/technologies, methodologies and processes in varying forms to drive substantial, sustainable value.

Pricing is a complex system that is best looked at comprehensively. It is important for retailers to step back and look at the entire pricing process from end to end to understand how each component influences another of an entire pricing system. As events change, so too, should a pricing system.

Developing a complete pricing solution involves tackling the unknowns and complexities associated with pricing. In collaborating with retailers, Accenture takes a cohesive view of pricing, working at all levels within an organization to navigate the complex issues, obstacles and decisions that revolve around the life cycle of a product.

We are discovering that developing the science, or the optimization, is no longer the biggest challenge for retailers because third-party software that incorporates sophisticated math and optimization routines is now relatively well developed. Rather, the challenge lies in understanding one’s own strategy and rules, and consequently, implementing that thinking throughout the organization. Often processes have developed over time in an organization that do not necessarily serve the retailer well when attempting to exploit the benefits of price optimization. It is truly a combination of strategy, processes and technology that is required.

When adding science to the art of pricing, our experience shows that the most successful results generally occur when merchants are engaged early and often. It is useless to bring in new tools and solutions if an organization fails to embrace them. Thus, a first step in developing any pricing program is to involve the merchants—the people closest to the marketplace and pricing—as well as representatives from key functional areas of the business at the start of a project and through all phases of development and implementation.



When we initially meet with a retailer, some of the questions we ask a company to think about include:

- Do I have a clearly articulated and generally accepted strategy around pricing?
- Do I have a category strategy? What is my marketing strategy? Advertising strategy?
- Are my internal processes aimed at and efficient enough to support timely pricing decisions?
- Do I have the right organizational structure to enable new initiatives?
- Who is my competition?
- Am I reactive to others or do I want to make my own statement in the marketplace on other items?
- What key categories am I competing on?
- What prices can my stores change? Can't change? How often do I want to change prices?
- How do I put more rigor into the strategy, pricing and management of my prices?
- What customer segments am I trying to grow?
- If I have customer insight, what things are most important to my core group of customers?
- At what level do I want to price (chain, regional, store)?
- How do I want to manage target out-of-stock dates? What are my clearance vehicles?
- How does my pricing strategy integrate with my allocation or replenishment strategy?

The reason we go through these questions is to look within an organization, specifically assessing its strategies, people, processes and technology relative to pricing activities. Doing so makes it possible to identify and prioritize opportunities to improve the performance of a retailer's pricing programs. In many cases, implementing a less high-tech, intermediate solution may provide substantial value quickly and at a reasonable cost. On the other hand, some retailers will require a more sophisticated solution that may include optimization.

What is important is to understand the desired end state and work toward that end from the onset. Starting down one path only to change gears after significant effort can be frustrating and costly.



# Understanding the Complexities of Pricing Management

Every retailer approaches pricing differently, and within every organization, a myriad of activities occur to price products. In general, retailers are challenged by the complexities associated with effectively managing everyday/regular prices, promotion prices and exit/clearance prices. Accenture's view is that an effective pricing program spans all these three main types of pricing.

To effectively exploit the potential of pricing, retailers must integrate regular, promotion and exit pricing strategies across the entire pricing life cycle. The matrix in Figure 1 below gives a comprehensive view of pricing a product, from setting strategy to analyzing results, with multiple considerations in-between.

## Pricing Lifecycle

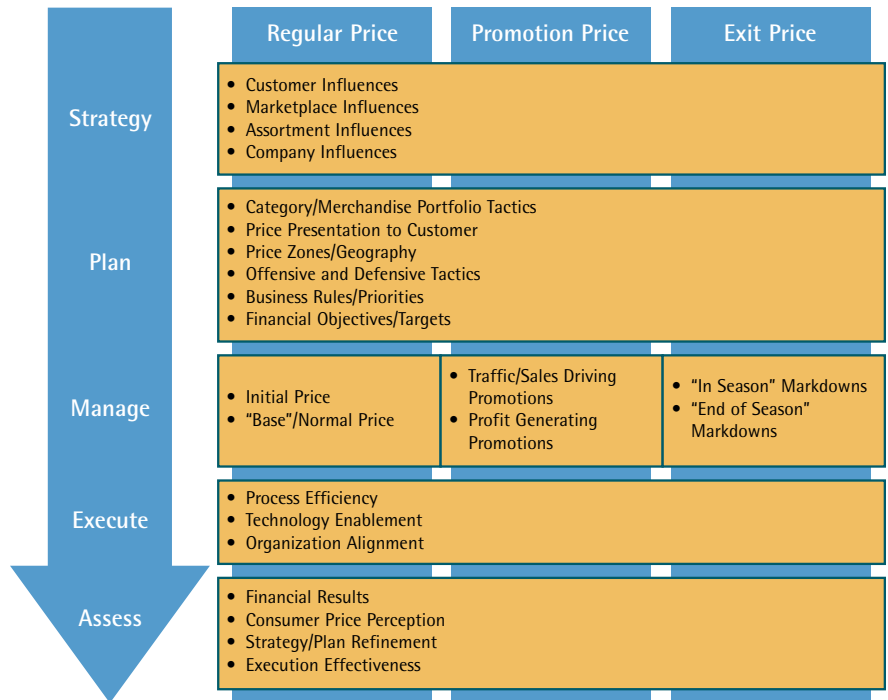


Figure 1. Pricing Life Cycle

As a retailer builds its pricing program, some of the considerations that need to be addressed include:

- How will price be managed proactively and reactively?
- What events should trigger price changes?
- What are the rules that govern pricing strategies, actions and priorities (for example, regular versus promotion versus exit prices)?
- How will price change collisions be resolved (for example, price ladders, substitute products, brand label versus private label)?
- How will the overall execution and results of the pricing program be evaluated/measured?

Too often retailers view the pricing life cycle as pricing a product, receiving it, putting it on the shelf, selling it and promoting it, and once it gets old, putting it on clearance. The problem with this approach is that it omits two important steps: determining a strategy for that product up front and analyzing whether the pricing process was successful at the back end. The pricing life cycle needs to start with setting a clear pricing strategy.

# The Key Influencers That Shape Strategy

Few retailers would disagree that creating a comprehensive, well-coordinated pricing strategy can be a major challenge in their organizations. The same is true for developing an overall pricing program. One reason for these challenges is that retailers are constantly bombarded by a number of influences that either compromise their strategies to pricing or have hindered them in updating or creating new pricing programs. One successful grocery retailer we worked with, for example, was still relying on pricing methods established in the 1970s.

The same story can be told for countless other retailers. In many organizations, fragmented pricing rules build over time to the point where they may no longer even support each other. The pricing rules become so accepted and entrenched that few retailers step back and examine whether they tie together and make sense. The result is a hodgepodge of rules that fails to present a consistent price or value message to the consumer.

To gain a complete picture of pricing within an organization and to begin shaping a **merchandise category strategy**, we typically start by examining factors that influence price according to four key areas:

## Consumer Influences

### The Old View

*Traditional customer segmentation tends to rely on easy-to-capture quantitative metrics. The downside is that this approach can result in large clusters that include consumers that may or may not share similar shopping values and motivations—and may result in strategies and actions that “miss the mark.”*

### The New View

*A newer orientation may focus on segmenting customers based on behavioral and nonbehavioral metrics that would incorporate quantitative and fact-based metrics. The information creates meaningful segments that are distinctly differentiated and enables a retailer to fine tune strategies to satisfy specific consumer values.*

## Market Influences

### The Old View

*A retailer might focus on offering the lowest prices, but this tactic encourages defensive pricing. This in turn prompts reactionary pricing by other retailers. This move is often easy to justify when strategic priorities are unclear. Compounding the problem can be technology limitations that make it difficult to construct offensive pricing programs.*

### The New View

*Reactive pricing is needed in competitive situations, but not everyone can be the low-price provider and survive. Price must be carefully managed; otherwise, retailers with higher cost models will fail. Technologies and analytical engines can now create opportunities to develop more sophisticated pricing programs.*

- **Consumer Influences**  
Includes product demand, value drivers and shopping behaviors/motivations. To understand customers, rather than focusing strictly on demographic and socio-economic metrics, retailers should fully decipher the underlying consumer preferences and shopping motivations that drive customer behavior.
- **Marketplace Influences**  
Includes the economy, competition, vendor relationships and regulations. Marketplace factors define the environment in which a retailer must operate, but often, retailers tend to only react to these influences rather than operate proactively.
- **Assortment Influences**  
Covers merchandise portfolio effects and market-basket links. Setting effective prices requires retailers to fully understand the overall effects on the assortment portfolio (that is, cross-category effects) and distill the salient market-basket insights.
- **Company Influences**  
Spans business strategy, processes, technology and organization. Creating a “winning” pricing program is predicated on a retailer’s ability to execute effectively. Retailers, however, have been traditionally challenged by strategic conflicts, inefficient processes, outdated technologies and less than optimal organizational structures.

Working through these four areas provides the information a retailer needs to shape a merchandise category strategy, the first and critical step of the pricing life cycle. Each stage of the product pricing life cycle, as Accenture defines it, is supported by seven established methodologies, approaches and science coming together to create an integrated pricing program. These Precision Pricing components are shown in Figure 2 and described further in the following section.

## Assortment Influences

### The Old View

While traditional forms of analysis remain valuable, they often lack the sophistication to provide complete insights. Unless confronted with verifiable facts, merchants will continue to drive their individual category and not invest major effort in assessing the impact on other categories.

### The New View

Consumer values and preferences today are more complex and often related to a retailer's value proposition, not just a single value lever. Technologies today enable merchants to analyze the impacts of price on the merchant assortment. Given this fact, retailers must fully understand the interdependencies among value levers.

## Company Influences

### Old and New Views

To get the most out of a pricing program, Accenture believes that a retailer's business strategy and the company's pricing program must be aligned.

The volatile nature of pricing tends to create complex, inefficient pricing-related processes. Despite this, structured processes can be developed that enable a retailer to execute a comprehensive price program at both the corporate and store levels.

Retailers have historically lacked the tools and technology to manage pricing effectively. Today's technologies, however, provide the first true wave of deep analytical tools that can empower retailers to make precise, fact-based price decisions. For example, demand is something measured after sales are achieved by looking at sales reports. Pricing to demand means setting order quantities and assortments based on the previous year and then pricing based on the previous year - perhaps adjusting by a few percentage points to account for variance to plan.

Today, demand and its drivers can be understood in advance. Technologies developed in the last few years give merchants the ability to run what-if scenarios against alternative strategies essentially testing new pricing schemas before they are executed. Changing promotional strategies or assortment strategies can be accommodated, with the resulting pricing implications surfaced for consideration.

Successful organizations result from clear roles and responsibilities, strong communication networks, and well-honed training not necessarily from the type of organizational structure selected.

## Accenture Precision Pricing Components

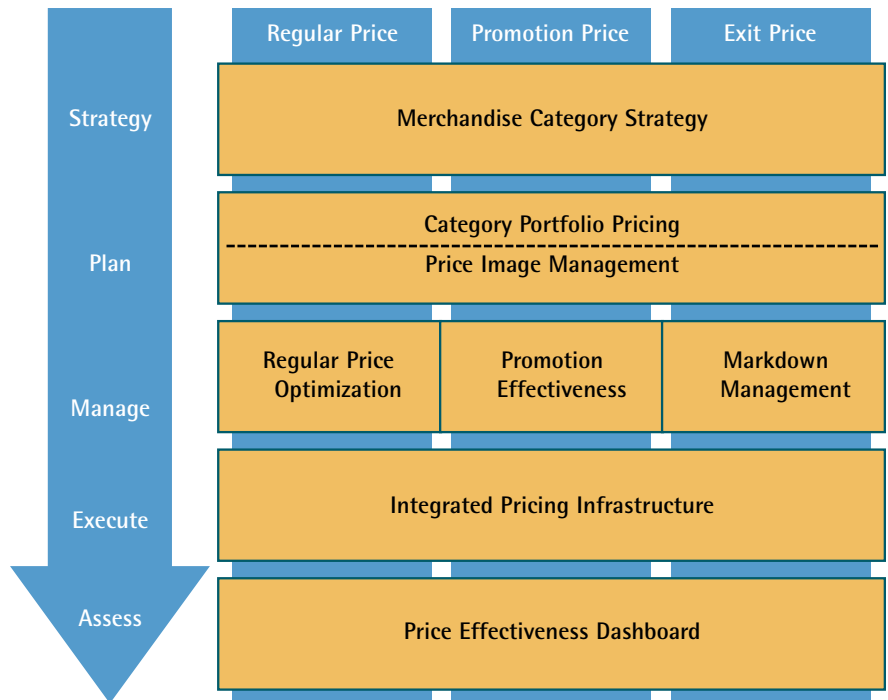


Figure 2. Accenture Precision Pricing Components

Collaborating with leading retailers around the world has enabled Accenture to develop specific solutions that span the pricing life cycle. A sampling of these initiatives is described in the paragraphs below.

## Strategy

### Merchandise Category Strategy

To create an effective pricing program, it is vital that retailers formulate a customer-centric viewpoint that encompasses the four areas of influencers: consumer, marketplace, assortment and company. Accenture teamed with one major mass retailer to develop a customer-centric pricing strategy and an approach that now allows the site merchants to focus on the specific and targeted consumer, drive sales and profits, and enhance overall pricing.

Together, we created an approach by essentially working through three steps with this client: identifying meaningful and differentiated consumer segments, understanding consumer dynamics and developing strategic action plans. We analyzed what the category preferences by segment were and found a subset of categories that really drive this retailer's value message.

By analyzing the motivations of one segment, for example, the "browsing opportunist," we were able to identify that individual's key preferences in terms of product, price, promotion and place. What we found is that price was not the primary shopping motivation for this retailer's consumers. In this way, we clearly determined what categories drive purchase behavior.

Given this, the pricing strategy was able to include healthy margins for most items, sharp prices for a few "price image" items and promotions to drive positive price perception. Gaining such refined insights has enabled the retailer to see improvements in sales mix, basket profitability and price image/perception.

## Plan

### Category Portfolio Pricing/Price Image Management

How do you create the right price image while driving more customer traffic, sales and profits? This is a goal many retailers are seeking to achieve and one that can potentially be reached by focusing on identifying price image items, driving sales profitability and communicating value.

As part of a comprehensive price management plan, a leading "big box" retailer collaborated with Accenture to initiate a promotional program designed to enhance its price image and boost traffic and sales. The approach offered "unbelievable deals" every week. To determine which items to feature, the team identified items that appeal to the retailer's target consumers and that change shopping behaviors as a result of price changes. Pairing price image items with complementary items provided profitable product solutions to recoup profitability.

Sales, profit and price image improved by coordinating merchandising levers to "scream value." The retailer was able to post:

- A 5 percent improvement in incremental revenue
- An 8 percent improvement in incremental gross margin
- A 6 percent improvement in price image

## Manage

### Regular Price Optimization

Fact-based techniques are the key to modeling and isolating the main factors that influence price and generate effective shelf price. When working with retailers, Accenture approaches this area by evaluating the key factors (consumer, marketplace, company and assortment) that influence pricing decisions and conducting rigorous consumer price sensitivity analytics and modeling to identify effective initial prices by item. We then evaluate the results and weigh the influencing factors that subsequently enable a retailer to take action to support financial planning goals.

In a recent price effectiveness exercise we conducted with a major supercenter retailer in France, we analyzed customer price sensitivities at a category level across 115 stores. The findings enabled the retailer to increase prices on inelastic categories and lower price points across key brands of elastic categories resulting in a one-point margin gain per store without an impact on price image. Our key learning was that customer price sensitivity varies significantly between items and significantly between stores, and it can vary significantly between stores with the "same" demographics.





## Promotion Effectiveness

Promotion effectiveness uses sophisticated analytics to understand the key drivers of promotional performance and determine future offers, such as items and deals that will drive substantial incremental sales and margin. This area of Accenture Precision Pricing examines promotional performance based on incremental lift, promotion price, portfolio management and distribution of advertising exposures by discount percentage.

We put this method into action for a major food retailer where fact-based promotion effectiveness has delivered substantial incremental benefits by enhancing the advertised product portfolio and deals. Improved sales and profitability for cookies and sweet breads were achieved by:

- Promoting mass-appeal items rather than niche products
- Featuring well-known brands rather than smaller regional labels
- Showcasing healthy products
- Featuring moderate discounts versus minimal or steep discounts
- Tailoring ad space to specific weekly needs to match consumer demand patterns

In this case, the results for this retailer were:

- 9 percent improvement in sales
- 28 percent improvement in margin

## Markdown Management

For fashion and seasonal retailers, the single largest product cost after cost of goods sold is typically markdowns. Markdowns can account for as much as 10 percent of gross sales for general merchandisers and up to 40 percent for highly fashion-oriented retailers. Each markdown dollar "spent" is an attempt to clear merchandise that would not otherwise clear at full price.

But where and when should these funds be spent for the greatest return? With tens of thousands of items sitting on shelves in hundreds of stores, the number of decisions to make around clearance pricing is overwhelming. Most retailers have survived for years making decisions based on gut feel and spreadsheet analysis at a class and chain average level, but it's becoming clear that this approach to such a large cost component leaves much to be desired.

With Accenture's help, a large US-based department store recently recognized the opportunity to apply forecasting and optimization technology to the problem of giving their merchants better information to make their markdown decisions. A combination of Accenture's process design and execution along with ProfitLogic software was selected to improve the precision with which markdowns are made in terms of timing, depth and location. The goal was to increase overall gross margin and sales while holding markdown spend constant.

Over the course of two years, this retailer has seen the following benefits:

- A 2 to 3 percent increase in gross margin dollars
- Smoother seasonal transitions through predictable clearance
- Greater efficiency of merchants, who now have enhanced information to make decisions as well as optimized recommendations

# Execute

## Integrated Pricing Infrastructure

To make pricing strategies, tactics and analytics possible, it is important for retailers to have an integrated infrastructure that links pricing processes, execution technologies and the business organization together.

Ideally, business processes are built off a common foundation and tailored to the different parts of a retailer's portfolio of businesses. Implementing the right technologies links and synchronizes pricing systems, thereby ensuring the right price is active at the point of sale. When a business organization operates with clear roles and responsibilities, it is able to develop a clear pricing strategy and execute effectively.

At one multibillion dollar retailer with whom Accenture collaborated, an integrated pricing process enabled the organization to gain stronger strategic, tactical and execution control of the price management activities. We helped them align pricing strategy, tactics and execution. The new processes ensure pricing actions directly support financial objectives. Price management is now synchronized across the business life cycle.

In addition, integrated processes now mean that pricing decisions are integrated throughout the organization and regular, promotional and exit pricing programs are coordinated. The retailer also has a simplified structure for managing pricing complexity. Activities can be broken down so that actions can be taken when they are most appropriate. And, the retailer is better at communicating price-related information to relevant stakeholders.

# Assess

## Price Effectiveness Dashboard

Tracking and assessing the impact of pricing on a retailer's business is often a daunting task. The volume of price changes for a large set of items across time makes it difficult for retailers to glean the salient insights about their pricing actions. Is the company's brand and price image being reinforced effectively? Are prices set in an optimal fashion so that sales and margin goals are achieved? How do prices compare to the competition? Questions like these are often asked but rarely answered in a complete and coordinated fashion that provides a "full view" of a retailer's pricing program.

To fully assess the impact of a pricing program, retailers need to synchronize a collection of information. This collection of information is commonly referred to as a pricing effectiveness dashboard. A properly constructed dashboard comprises two key elements. First, it provides management information across a range of internal and external metrics. Internal metrics provide fact-based insights to financial (for example, sales and margin) and operational effectiveness. External metrics (for example, surveys, market share statistics) provide fact-based insights to consumer perceptions and competitive positioning.

Second, the dashboard presents the information through multiple levels of reporting that range from strategic insights (for example, Is our price image rating increasing?) to detailed tactical performance (for example, What is our

price position on product XYZ vs. the competition?). These multiple levels of information provide custom views that meet the needs of a specific audience (for example, executives, pricing director, pricing analyst). The reporting levels should be synchronized so that retailers can quickly determine the root cause of their successes and challenges.

At one major retailer Accenture teamed with, we devised a pricing effectiveness dashboard that created the first holistic view of the company's pricing activities. Previously, the retailer had used numerous measurement techniques including customer surveys, competitive shops and data mining its own price changes to evaluate sales elasticity. Despite "all this great information," the company was not confident that it was fully leveraging pricing as a strategic business lever. Without a full assessment of the company's pricing program, it was difficult to properly evaluate pricing decisions and take proper action. Through a comprehensive pricing dashboard, this retailer defined a manageable reporting mechanism that enables confident, fact-based decision making.

## Sustaining the Benefits

These examples and other pricing developments point to an exciting time for retailers in the area of pricing. A comprehensive approach to pricing that takes into account strategy, people, processes and technologies can potentially result in powerful programs that hold the possibility of creating sustainable benefits in the way of greater precision to the art of pricing, ability to make pricing changes quickly, better analysis and better predictability of business results.

Sustaining the benefits, however, entails institutionalizing new changes throughout the organization. In working with retailers, Accenture has helped to establish pricing initiatives by effectively developing change management programs. Accenture collaborates with retailers to develop ways to promote acceptance to new tools, processes and systems as well as to deploy new capabilities.

Regardless of how big or small the retailer or how simple or sophisticated its operations, a solution to pricing can be fashioned from the full spectrum of pricing possibilities today. What matters most is developing the right solution that fits a retailer and one that delivers results.





Accenture's Precision Pricing approach has delivered notable results to retailers around the globe. Contact us to learn how our innovative approaches can help your organization.

Chris Donnelly  
+1 312 693 5509  
[christopher.donnelly@accenture.com](mailto:christopher.donnelly@accenture.com)

Christopher Goodin  
+1 216 535 5546  
[christopher.goodin@accenture.com](mailto:christopher.goodin@accenture.com)

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