# Feature | Retail Pricing

## Beyond EDLP and HiLo: A new customised approach to retail pricing

*By Ruth N. Bolton, W. P. Carey Chair in Marketing, W. P. Carey School of Business, Arizona State University, Detra Y. Montoya, Doctoral Candidate, W. P. Carey School of Business, Arizona State University and Venkatesh Shankar, Professor of Marketing and Coleman Chair in Marketing, Mays Business School, Texas A&M University*

### A Changing Retail Landscape

Developing a coherent and profitable pricing strategy has become an increasingly challenging task for grocery retailers in the US. In the past decade, the retail environment has become increasingly more competitive due to retailer consolidation and the growth of Wal-Mart. Innovations in information technology, supply chain management and centralised buying have significantly reduced retailer costs, where lower costs enable retailers to offer consistently lower prices than in the past. Retailers wrestle with a plethora of manufacturer trade deals – and consumers scramble after price discounts. In some instances, retailers are offering price discounts in response to competitive pressures - even when lower prices do not reflect lower costs.

For example, the recent sale of Albertsons, including its Osco drug stores, has a profound impact on the retail landscape. Supervalu is now the number two grocery retailer in the US, while CVS continues to strengthen its position in the drug channel with the acquisition of Eckerd and Osco drug store chains. As new competitors enter a market, existing retailers are scrambling to sustain their market shares and re-evaluating their core marketing mix variables. In an environment of centralised decision-making, how can a local retailer react quickly enough to stay competitive? Our research suggests that there may be some flexibility in pricing decisions depending on local competitive factors. In fact, we have observed that retailers are moving toward an approach we call "customised pricing."

How prevalent are price discounts or 'every day low price' (EDLP) strategies? What retailer pricing strategies are likely to be successful in today's competitive markets? In recent work, these questions have been addressed in a large-scale empirical study (Bolton & Shankar, 2003; Shankar & Bolton, 2004). Based on these findings, we argue that US retailers have been forced to construct new innovative pricing strategies to remain competitive and (in some cases) keep stores open for business (Bolton et al, 2005). We refer the interested reader to these articles for technical details. In this article, we focus on lessons for retailers regarding the customisation of pricing strategies and tactics.

### Current Pricing Strategies: The evidence

Conventional wisdom is that most retailers use one of two store-wide pricing strategies: EDLP or HiLo. An EDLP policy entails offering consistently low prices on many brands and categories. It is practiced by some supermarket chains (e.g., Food Lion and Lucky), as well as Wal-Mart. A HiLo policy is characterised by steep temporary price discounts with higher 'regular' prices for many brands and categories. It is practiced by supermarkets such as Kroger and Safeway. In contrast, recent research suggests that successful retailers have an arsenal of different pricing strategies that are customised to fit brand, category, and market conditions. They include exclusive pricing, moderately promotional pricing, and aggressive pricing strategies.

Bolton & Shankar (2003) analysed data from over 200 grocery stores in 17 chains, including Lucky, Dominicks, Jewel Osco, Safeway and Food Lion in five markets in the US. Data were collected from three large cities (New York City, Los Angeles and Chicago) because they represent a diverse sample of chains and stores (both large and small), as well as two moderate-sized cities (Pittsfield, Massachusetts and Marion, Indiana) that are demographically representative of the nation. The study included a diverse range of product categories, including spaghetti sauce, bathroom tissue, liquid bleach, ketchup, mouthwash and frozen waffles. Altogether, the data base described 1364 brand-store combinations from six categories of consumer packaged goods in five US markets over a two year time period.

Our study is different from most prior research for three reasons.
- Measures were developed to describe retailers' pricing strategies for each brand-store combination, rather than chain-wide or store-wide measures.
- Four pricing dimensions were measured: relative price level within the category, degree of price consistency over time, intensity of promotions or deals, and coordination of deal support with price changes.
- Retailer pricing decisions were considered as continuous rather than as a dichotomous decision. For example, pricing consistency could range along a continuum from low to high, rather than be categorised as low or high.

Table 1 describes the five retailer pricing strategies based on these four strategic dimensions.

Shankar & Bolton (2004) discovered that retailers made pricing decisions for each brand-store combination based on a complex set of factors: market, chain, store (size, category assortment), category (storability, necessity), brand (preference, advertising), customer (price sensitivity) and competitor characteristics. Most remarkably, competitor factors are the most dominant determinant. Specifically, retailer pricing decisions at the brand-store level are heavily influenced by the relative price level and deal frequency of brands in the same category at competing stores.

For example, when competitors charge lower prices, a retailer communicates the relative attractiveness of its offerings through higher price consistency, lower price-promotion intensity and higher price-promotion coordination - while maintaining lower relative brand prices. Price-promotion coordination is strongly associated with lower competitor price levels, suggesting that retailers are exploiting the relative cost efficiency of coordination (compared with setting prices and promotions independently). When competitors offer deals more frequently, retailers are less price consistent, offer aggressive promotions, more actively coordinate price-promotion, and charge lower prices.

## Lessons for Retailers: Price customisation

Conventional wisdom suggests that retailers should customise their pricing to the store clientele's price sensitivity. Our research reveals that successful retailers customise prices by many other factors, including competitor prices and deals, brand strength, and category storability.

Table 1 | Pricing strategies and the mean scores on the dimensions, clustering by brand-store

| Pricing dimensions / Pricing strategy (% prevalent) | Relative price | Price variation | Deal intensity | Deal support |
|---|---|---|---|---|
| Exclusive pricing (8%) | High | Medium | Low | Low |
| Moderately promotional pricing (14%) | Average | Medium | Medium | Medium |
| HiLo pricing (11%) | Average | High | High | High |
| EDLP (45%) | Average | Low | Medium | Medium |
| Aggressive pricing (22%) | Low | High | Low | Medium |

*Source: Bolton & Shankar (2003)*

Table 2 | How customised pricing differs from related pricing approaches

| Traditional Pricing Approaches | Customised Pricing |
|---|---|
| **Micro-market pricing** | |
| - Price discrimination using targeted coupons<br>- Carrying assortments according to local taste | - Price of each brand determined by a combination of factors<br>- Coupons and price discounts are just one part of a four-demensional pricing strategy |
| **Value pricing** | |
| - Determination of basis of customer value creation<br>- Adjusting prices by increasing benefits or lowering costs<br>- Fine tuning prices by customer groups according to basis of customer value | - Value pricing could be one price strategy under this approach<br>- Tailoring prices is done based on a variety of factors such as brand equity and category storability |
| **EDLP** | |
| - Maintain lower prices<br>- Minimise the variation in deal discounts | - EDLP strategy may be one pricing strategy under this approach<br>- Includes other pricing strategies such as exclusive pricing |
| **Hi-Lo pricing** | |
| - Maintain high regular prices and vary them little<br>- Offer frequent and/or deep discounts | - HiLo pricing strategy may be one pricing strategy under this approach<br>- Aggressive pricing is an alternative strategy to HiLo pricing strategy, but on selective categories<br>- Includes other pricing strategies such as exclusive pricing |

Source: Bolton and Shankar (2003)

We propose a new customised approach that differs from conventional pricing strategies. Table 2 highlights differences between customised pricing and traditional pricing approaches. Customised pricing comprises the following key steps:

### Identify key determinants of local store pricing

Identify key determinants most relevant to a store pricing strategy, including the market, store, category, manufacturer/ brand, customer, and local competing retailers. This recommendation is consistent with recent trends in retail management. Best Buy, Tesco, and Wal-Mart are "localising" the product assortments in their stores. Rigby & Vishwanath (2006) report that Wal-Mart stocks about 60 SKUs of canned chilli to respond to diversity in local preferences, but carries only three SKUs nationwide. We believe that retailer pricing, as well as product assortment, must be localised to match the market, store, category, brand, customer and competitive characteristics.

### Segment market by store format and cluster

Manage price and promotion based on store format and clusters, including accommodations for chain size, store size, and demographics. Variable pricing can more easily be applied to each format and cluster based on an outlet's individual needs.

### Choose positions on the key dimensions to neutralise price as a competitive weapon

In addition to traditional competitors (e.g. supermarkets), retail pricing decisions are also influenced by category characteristics (e.g. storability), chain positioning and size, store size and assortment, brand preference and advertising, and customer factors (price sensitivity). Neutralise price by setting competitive price points on "known value items" and feature or display them.

### Manage promotion intensity to avoid head-to-head competition

Intensity of retailer promotions depends on market type, chain size, chain positioning, store size, category assortment, storability, necessity, brand preference, relative brand advertising own deal elasticity, cross price elasticity, and cross deal elasticity. Retailers should focus on "known value items" and also consider trade promotion management software for additional support.

### Create distinctive categories

Differentiate categories through distinctive product assortments. A large category assortment targeted towards price-sensitive shoppers can result in high levels of coordination of price with promotions and low relative prices. Highly storable and necessary categories (e.g. bathroom tissue) have high price-promotion intensity compared to non-essential categories. Perishable categories require a more consistent pricing strategy to manage inventory.

### Tailor prices by market, category, customer, competitor, and brand

Retailers typically charge lower prices when consumers are more own-price elastic and less own-deal elastic, but do allow for some flexibility such as for those brands in discretionary categories (less price consistent).

### References

Bolton, R. N. & Shankar, V. (2003) An Empirically Driven Taxonomy of Retailer Pricing and Promotion Strategies *Journal of Retailing* 79(4) pp. 213-224

Bolton, R.N., Shankar, V. & Montoya, D.Y. (2005) Recent Trends and Emerging Practices in Retail Pricing in *Retailing in the 21st Century: Current & Future Trends* Krafft, M. & Mantrala, M. (Eds) Germany: METRO

Rigby, D. K. & Vishwanath, V. (2006) Localization: the Revolution in Consumer Markets *Harvard Business Review* 84 (4) April pp.82-92

Venkatesh, S. & Bolton, R.N. (2004) An Empirical Analysis of Determinants of Retailer Pricing Strategy *Marketing Science* 23 (1) pp. 28-49