5. Emerging retailer pricing trends and practices

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5.1 INTRODUCTION

Retailer pricing is a key element of retailer strategy that critically shapes retailers' fortunes. Many retailers live and die by their pricing strategy. This chapter reviews emerging retailer pricing trends and practices and offers a framework to guide retailers toward profitable pricing strategies. It builds on previous work on retailer pricing (e.g., Bolton and Shankar 2003; Bolton et al. 2007; Grewal et al. 2011; Kopalle et al. 2009; Shankar and Bolton 2004).

We begin by describing the current retailer environment, focusing on how changes in consumer demand, competition and cost over the past decade have created pricing opportunities and challenges. Next, we highlight factors that have contributed to retailer bankruptcies and store closures, as well as mergers and acquisitions, and identify key learnings regarding strategic pricing. Then, we discuss how retailers are facing radically new forms of competition from adjacent markets, discount outlets, resale stores and the sharing economy – and suggest some ways of forestalling competition. The following section describes systematic changes in consumers' shopping habits across different channels and touchpoints, including how shoppers have responded to increased direct-to-consumer activities by manufacturers, growth in online intermediaries and multi-channel or omnichannel retailing. These changes lead to our reflections on how retailers must adopt more nuanced pricing strategies tied to the customer experience. We then focus on the profound effects of technology on retailing, including the pervasiveness of mobile services. Last, we turn to a review of current pricing practices and (especially) the use of dynamic pricing optimization and differentiated pricing based on hybrid bundles of goods and services. The chapter closes by offering a framework to guide retailers in developing a coherent pricing strategy.

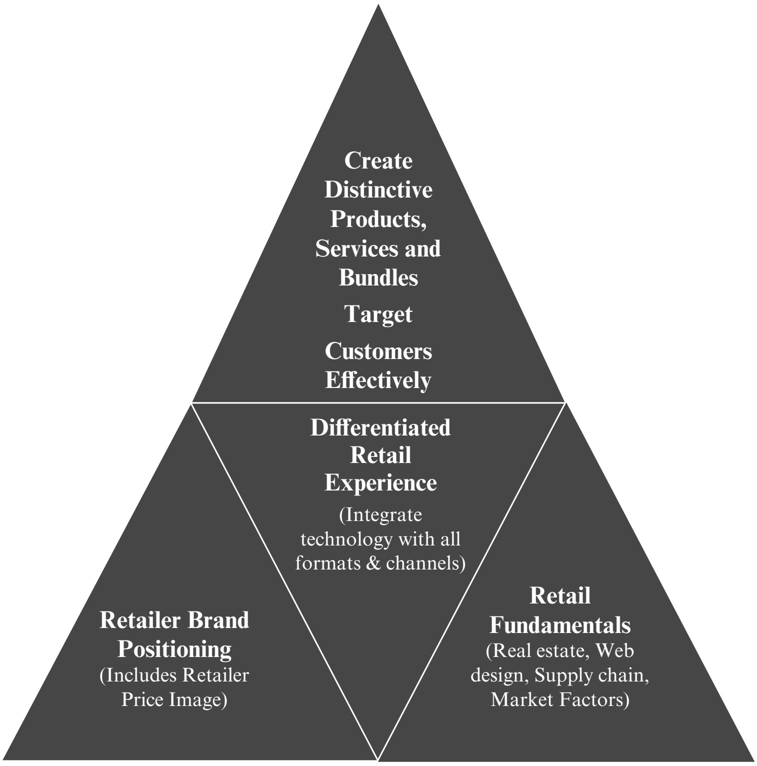

Figure 5.1 Retailer pricing triangle

5.2 TURBULENT RETAILER ENVIRONMENT

Retailers have been challenged by an extremely turbulent environment in the past decade (Ailawadi et al. 2009; Grewal et al. 2011, 2012; Shankar et al. 2010). There have been substantial changes in consumer preferences, as well as increased competition – markedly changing retail sales patterns and consumers' willingness to pay. At the same time, retail costs have risen – with different effects for in-store versus online retail channels. Technological change – and especially the advent of mobile shopping and omnichannel retailing – has exacerbated these trends. Retailers have responded to these many changes with new pricing strategies and tactics. However, demand, competition and costs continue to erode retailer margins in many categories. This section enumerates key environmental trends of the past decade.

5.2.1 Market Changes

Four major demand factors have influenced retail sales patterns. First, consumers have increasingly adopted online and (especially) mobile shopping. This phenomenon reflects the importance of shopping convenience to today's time-pressured consumers (Kim and Kang 1996). Consequently, shoppers are (counter-intuitively) less sensitive to price when shopping online versus in-store – despite the fact that a competitor's offering is only one click away (Krishnan et al. 2013; Shankar et al. 2003). Second, shoppers still seek bargains, but they don't always consider list prices to be meaningful and trustworthy as references prices (Howland 2016a; Kan et al. 2014; Mohammed 2016; Streitfeld 2016b). Indeed, despite the ubiquity of retail price information, a wide range of prices exists for most product categories (Pan et al. 2002, 2004). Some retailers, such as Amazon, have found it advantageous to quietly move away from publishing manufacturer suggested retail prices (MSRPs). They may be leery of potential legal actions arising from "fake discounts." However, another important reason to move away from list prices is that some retailers have sufficiently differentiated their customer experience so that shoppers are loyal (Streitfeld 2016a).

Third, consumers are increasingly willing to mix luxury and discount brands – eroding traditional price-quality tiers that distinguished store brands. Shopping across stores, consumers create "mix and match" outfits by combining luxury designer and low-price clothing. Shopping within stores, consumers purchase organic produce and energy-saving products (which have higher prices), as well as private labels, buy-one-get-one (BOGO) offers, and "rollback specials." This preference shift has spurred sales growth for some off-price retailers, such as T J Maxx and Nordstrom Rack (Banjo 2017) and for some premium retailers, such as Wegman's supermarkets. However, it has decreased sales at some traditional retailers – in some instances, sparking price wars that lead to mixed outcomes for manufacturers, retailers and consumers (Scouten 2016; Sotgiu and Gielens 2015; van Heerde et al. 2015).

Last, many retailers have adopted an omnichannel shopping strategy based on an enlarged perspective of the customer experience (CX). This perspective considers the customer's experience to unfold within and across retail channels over the purchase journey, encompassing cognitive, affective, social and physical attributes (Neslin and Shankar 2009; Verhoef et al. 2009; Verhoef et al. 2015). Thus, a consumer's retail experience depends on many attributes, including retail atmosphere in bricks and mortar stores, web design in online stores, the staged experience in catalogs and the social environment for all channels. In mature markets, retailers' CX management strategies seek to improve customers' emotional, sensory and social responses to the retail environment. For example, Lowe's (home improvement) "Love Where You Live" program is designed to deepen shopper engagement across all retail touchpoints. CX strategies sometimes include corporate social responsibility initiatives (e.g., using sustainable sources, promoting healthy lifestyles) that influence shoppers' perceptions of price fairness and their purchase intentions (Koschate-Fischer et al. 2016).

5.2.2 Competition

Some established retailers have adapted better to changing market conditions than others. For example, Walmart has continued to perform well, but Sears has struggled; Barnes & Noble continues (albeit with flattened sales), but Borders closed in 2011 (Wahba 2017). A primary reason is that novel forms of competition are emerging beyond online and discount retailers. First, shoppers increasingly prefer experiences, such as travel and cooking classes, to goods, such as watches, televisions and cars (Saiidi 2016). We discuss how retailers compete with service business models later in this chapter. Second, retailers are now facing competitors from adjacent markets. For example, consumption of movie theatre, cable subscription and traditional pay television service have all declined; consumers are moving to online streaming services such as Netflix and Hulu. Third, retailers are (often) facing competition from different retail formats – which may have very different business models. For example, traditional car rental companies (e.g., Hertz, Enterprise) now compete against platform-based ride-sharing companies, such as Uber and Lyft, as well as from novel business models, such as Zipcar. Fourth, as shoppers purchase a product category across retail formats or channels (Fox et al. 2004), different retail formats compete against one another in a phenomenon called channel-blurring (Luchs et al. 2014). For example, Walmart (primarily offline) and Amazon (primarily online) compete head-to-head – where each seeks to improve in areas where the other is superior. Similarly, CVS (a drugstore) competes with Costco (a club store) for products such as diapers and cosmetics.

5.2.3 Supply and Related Cost Structure Changes

Naturally, a key factor influencing retailers' growth and profitability has been the worldwide economic recession of 2008–2009. Both demand and supply plummeted during the recession, leading to retailer consolidation and retail bankruptcies (as discussed below). In the USA, many shopping malls experienced high retail vacancy rates and substantial drops in sales per square foot – triggered by the closure of anchor department stores such as Macy's, Sears and J.C. Penney. However, by 2016, retailer vacancy rates fell to 12 percent in the USA and 10 percent in the UK – with similar trends in Europe and Asia. Consequently, retailer rents have recently risen, especially in high traffic areas, placing upwards pressure on costs and thus prices in many markets. Retail vacancy rates rose to 8.3 percent in the first quarter of 2018 with large mall stores being replaced by digitally native retailers such as Everlance, Glossier, and Away (Fortune 2018).

A second important influence on retailers' cost structures has been the rise in the minimum wage in many countries around the world. This rise has had profound effects due to the pervasiveness of global supply chains. It has increased the cost of manufactured goods (e.g., the apparel industry in India and China), as well as in-store labor costs. In some instances, retailers have closed stores in geographic locations with higher labor costs (e.g., Walmart), as well as introduced self-service technology. There is evidence that retail labor productivity has risen along with labor costs (Irwin 2016). However, traditional bricks-and-mortar retailers are at a considerable disadvantage because online retailers are better able to leverage technology (e.g., automated warehouses) to bring costs down.

A third factor influencing retailer cost structure is the regulatory environment. As we write this chapter, the United Kingdom is preparing to withdraw from the European Union and the USA is preparing to withdraw from the Trans-Pacific Trade Partnership and is considering levying cross-border tax on items from Mexico. Although the future is uncertain, there are likely to be new trade deals – and consequently new tariffs – that will increase retailers' costs. There are also likely to be changes in global supply chains triggered by these events. These changes can have profound effects, as Hanjin Shipping's (Korea) recent bankruptcy filing illustrates.

5.2.4 Pricing Opportunities and Challenges

Shopper response to price is evolving as consumers navigate a complex retail environment (Food Marketing Institute 2016). Shoppers have many different goals, ranging from "fairness to fun" (p. 14), and utilize many different shopping heuristics and tools – not always effectively (Hamilton and Chernev 2013; van Ittersum et al. 2010). In this challenging environment, retailers have struggled to create a favorable price image and execute profitable pricing strategies (Ankeny 2016; Koças and Bohlmann 2008). Due to consumers' shift to online and mobile shopping, many retailers (online and offline) consider Amazon to be a key competitor (Hariharan 2016). Since most retailers cannot match Amazon's prices (due to differences in cost structure and business model), they seek ways to practice differentiated pricing. They can differentiate on product assortment (online or in-store), offer private label merchandise and/or deliver a superior customer experience. For example, Target mixes discount pricing, fun products and an enjoyable shopping experience (Wahba 2016). However, such strategies are difficult to execute because loyal customers may expect – and sometimes receive – price discounts (Wieseke et al. 2014). Business news reports that only 35 percent of US retailers believe their pricing strategies are effective in creating customer loyalty and generating long-run profitability (Ankeny 2016).

Moreover, the intensity of competition has made price-matching promises more common for stores that compete directly against retail behemoths. For example, Best Buy, Zappos and Target promised price-matching during the 2016 holiday season (Enright 2016).[1] Research indicates that price-matching guarantees aren't profitable when retailers have shelf-space limitations because they must stock identical products, as opposed to competing with differentiated product assortments (Coughlan and Shaffer 2009). Interestingly, Walmart dropped its ad-matching policy, whilst increasing price rollbacks (Hui 2016). Instead, Walmart shoppers can use a mobile Savings Catcher app to scan their receipt and claim a gift card when prices are higher than competitors' (Howland 2016b). As turbulence in the retail market subsides, retailers may find it profitable to move away from cost- and competition-based pricing and towards demand-based pricing (Srinivasan et al. 2008).

5.3 RETAILER CONSOLIDATION AND GROWTH

5.3.1 Bankruptcies and Store Closures

There have been many bankruptcies and store closures over the past decade, but the pace has slowed in recent years. Retailers sometimes attempt to forestall collapse by slashing prices, an approach that ignores the dynamics of consumer demand (especially for seasonal goods). Such price-cutting strategies are unlikely to be effective except under certain conditions (Cai et al. 2016; Soysal and Krishnamurthi 2012). Moreover, malls in many countries are morphing into entertainment centers or mixed-use properties. An Asian think tank predicts that one third of all Chinese shopping malls will close in the next five years.[2]

In discussing store closures, it is useful to make a distinction between experience goods – that is, products and (often) services that the shopper can only evaluate by consuming or experiencing them – and search goods – that is, products or services that shoppers can evaluate prior to purchase. Retailers of search goods (e.g., electronics, apparel and appliances) have been especially vulnerable to competition from online and mobile shopping. In the USA, Sports Authority (sporting goods and equipment) applied for bankruptcy in 2016 and Radio Shack (electronics products) filed for bankruptcy in 2015. In Europe, Irish retailer Primark and Swedish retailer H&M have performed well in the apparel category, but American retailers, Gap and J Crew, have closed stores. Staples (office supply) has closed all its stores in Europe and Marks & Spencer (clothing) intends to close about 30 European stores in 2017, as well as stores in Asia. Other retailers have withdrawn from China – despite rising consumption by Chinese consumers.

In the grocery sector, a notable event was the withdrawal of Tesco from the USA marketplace in 2013. Tesco had introduced Fresh & Easy stores beginning in 2007, eventually operating about 200 stores in Arizona, California and Nevada (Kirka 2013). These stores were similar to Tesco's (small) Metro stores in the UK. Although the economic recession contributed to their failure, there was a general acknowledgment that – although the concept of ready-to eat meals was appealing – smaller stores hadn't matched the shopping habits of sufficient American shoppers (who tend to drive to larger stores once a week). Tesco executives are re-focusing on their existing markets because they believe that Tesco's future sales growth will come from a combination of big stores, local convenience stores and online.

In the toy and durable goods sector, the announcement of the closure of the Toys "R" Us chain will likely have a lasting impact on not just toy retailing but also on the financial health of related companies like Lego and Barbie (CNN Money 2018). Toys "R" Us also closed its web operations and forced liquidation sales (Morris 2018). Price competition from omnichannel retail giants like Amazon, Walmart, and Target accelerated the demise of a primarily brick-and-mortar retailer like Toys "R" Us.

5.3.2 Mergers and Acquisitions

In developing markets, retailers have used mergers and acquisitions to strengthen their competitive position and stimulate growth. For example, Aditya Birla Retail Limited (ABRL) entered the food and grocery retail sectors in India in 2007 with the acquisition of Trinethra Super Retail (Agarwal 2013). It subsequently expanded its capabilities by introducing supermarkets and hypermarkets. Another arm of its parent company, Aditya Birla Fashion and Retail Ltd (ABFRL) focuses on fashion and lifestyle. It has been growing at more than 20 percent over the last five years and recently joined forces with Forever 21. A key differential advantage is its strong distribution network and diverse product assortment.

In mature markets, mergers and acquisitions are an alternative to organic growth (which is subject to diminishing marginal returns). For example, CVS Health Corporation acquired Target Corporation's pharmacy and clinic businesses.[3] During 2016, CVS began operating them through a store-within-a-store format, branded as CVS/pharmacy; some locations will be rebranded as MinuteClinic. This arrangement is consistent with Target's emphasis on wellness, including offering healthy products, thereby creating business synergies that may stimulate growth and create opportunities for novel pricing strategies. In a similar vein, Hudson Bay is reportedly pursuing the acquisition of Macy's stores (de la Merced and Abrams 2017).

Some retailers are also pursuing vertical integration. For example, in the healthcare sector, CVS won approval from shareholders to acquire Aetna, a leading health insurer, in an effort to consolidate its position in the healthcare value chain (LaVito 2018). Not to be outdone, Walmart is reported to be in preliminary talks to buy Humana, another prominent health insurance firm (Coombs 2018). These vertical integration initiatives will significantly impact retail pricing.

5.3.3 Pricing Opportunities and Challenges

Mergers and acquisitions can strengthen a retail brand, stimulating innovation, increasing economies of scale and (thus) creating more flexibility in pricing. For example, Luxottica Group of Italy is a frame manufacturer and retailer with a network of 7,800 retail stores including LensCrafters and Pearle Vision in North America and Sunglass Hut worldwide (Bray and Paton 2016). It is merging with Essilor, a maker of lenses, thereby positioning both companies for growth in the worldwide market in branded eyewear and prescription lenses. In this way, mergers and acquisitions can create opportunities for new and differentiated pricing strategies. However, these opportunities are unlikely to exist when mergers and acquisitions are motivated by real estate or financial gains, such as The Hudson Bay Company's rumored takeover of Neiman Marcus or Macy's, Inc. (Abrams and Austen 2017).

5.4 NEW FORMS OF COMPETITION

5.4.1 Competition from Adjacent Markets

Competition from adjacent markets is becoming more prevalent and requires each retailer to rethink its value proposition. The primary reason for inroads from adjacent markets is that technology has often eradicated traditional barriers to competition. Perhaps the best-known example is Amazon, which began as an online bookseller and leveraged its platform to become a provider of diversified products and services. The retail banking sector serves as a particularly good example of cross-market competition. Safaricom, a Kenyan telecommunications company, pioneered commercial mobile money transfer with the introduction of M-Pesa in 2007. Today, M-Pesa has over 23 million customers and over 100,000 agents operating outlets countrywide. Similar competitive threats have emerged in markets for entertainment, health and other retail services. Competitors often leverage the capabilities offered by technology to expand into traditional retailer spaces. For example, Safaricom introduced mobile loans (M-Schwari) and Amazon has experimented with different store formats in Seattle (Wingfield 2017).

5.4.2 The Rise of the Discount Outlet

Discount outlets have begun to compete directly with premium stores. In the USA, consumers shop at Walmart, Target, and TJ Maxx rather than high-end department stores. In Europe, Aldi and Lidl compete with high-end supermarkets such as Marks and Spencer, Waitrose and Fortnum & Mason (Denton 2016). As American and European markets have matured, retailers have looked to Asia (where markets are more fragmented) for growth. However, there is increased competition from domestic retailers in Asia – and the Asian consumer is increasingly sophisticated. Another novel form of discounting is a practice whereby retailers attract customers from other markets (which they do not serve) by offering discounts (Goić et al. 2011). For example, grocery and gas retailers have joined forces to cross-sell to each other's customers.

5.4.3 The Rise of Resale Stores

Resale store sales have been growing for many years (Darley and Lim 1999; Yin et al. 2010) – partly due to frequent product upgrades, rising retail prices for durable goods and an increased interest in sustainability. Research has estimated that the resale industry in the US had annual revenues of approximately $17 billion in 2016 (including revenue from antique stores which are 13 percent).[4] This category consists of a variety of retail formats, including consignment shops, vintage shops, thrift shops, second-hand shops and so forth. There are currently about 20,000 re-sales stores, so this sector is highly fragmented. The mainstays in this category are charitable organizations, such as Goodwill Industries and the Salvation Army thrift shops. However, the emergence of re-sale store chains, such as Plato's Closet, Clothes Mentor, and Tuesday Morning, suggest that consumers are increasingly willing to shop at resale stores. Some resale stores, such as consignment shops, offer premium goods at higher prices. Darley and Lim (1999) found that shoppers who held more favorable store specific attitudes, and had a positive quality–availability perception, were more likely to shop at a second-hand store.

5.4.4 The Emergence of the Sharing Economy

An unforeseen competitive threat to retailers has been the rise of the "sharing economy" – that is, access-based services that foster collaborative consumption and form interactive services (Bolton and Saxena-Iyer 2009). A key feature of access-based services is that a consumer gains access to an asset *without* ownership transfer (Benoit et al. 2017). Instead, he or she obtains temporary access to an asset from someone (i.e., a peer service provider). The matching of consumers and service providers is facilitated by a technology platform (sometimes operated by a third party). For example, Airbnb competes with other forms of accommodation, such as hotels, by matching consumers who need a place to stay with people who have excess space. This phenomenon is a threat to retailers because consumers can replace buying a retail good with renting or sharing – that is, a service from a peer provider. Thus, for example, a consumer might forego purchasing a car from a local automobile dealership and instead rely on Uber or Lyft for transportation (Bardhi and Eckhardt 2012).

Why do some consumers prefer access-based services? Recent research indicates that consumers' primary motives are financial – i.e., sharing or reducing costs (Bardhi and Eckhardt 2012). In other words, many shoppers simply can't afford private ownership of durable goods at existing prices. Moreover, many poor customers don't have access to low-price shopping options in their neighborhood (Talukdar 2008). Other consumers place less value on ownership – and prefer the flexibility and low risk nature of temporary access – and others value sustainable (green) retail offerings (Benoit et al. 2017). For example, clothing shoppers may prefer to "Rent the Runway" rather than own expensive designer apparel, handbags and footwear. Similarly, shoppers who need baby clothes, toys and equipment, may be satisfied with neighborhood toy libraries and other sharing options. In this way, access-based services directly compete with retailers and offer more affordable prices. Another advantage of renting and sharing is that shoppers can try different brands over a long period.

5.4.5 Pricing Opportunities and Challenges

Competition from adjacent markets, discount outlets, resale stores and access-based services are all threats to retailers. It is noteworthy that these threats have grown as shoppers – especially young people open to novel solutions – seek economical ways to meet their needs, as well as support social and environmental causes. Thus, they have profound implications for pricing. Initially, many retailers introduced economy private label merchandise in selected categories to compete against these competitors (Vroegrijk et al. 2016). However, retailers are beginning to innovate with retail formats tied to new pricing strategies. For example, Macy's pursued two promising new pricing strategies during 2016, developed after extensive testing of different retail concepts. They are: Macy's Backstage (discount stores) and Last Act (simplified deep discount pricing of clearance apparel). At the same time, Macy's is enhancing its website and mobile experience and expanding its fulfillment facilities (e.g., buy online and pick up in store). These innovations are intended to create opportunities for differentiated pricing strategies.

At the same time, retailers may have overlooked opportunities to develop innovative value propositions at affordable price points. A 2014 study found that 55 percent of global online consumers across 60 countries say they are willing to pay more for products and services provided by companies that are committed to positive social and environmental impact (Nielsen 2014). Hence, we believe that there are opportunities for retailers to better differentiate their offerings to support offerings at attractive price points. For example, IKEA emphasizes products that are beautiful, functional and sustainable – such as a well-designed bicycle, low carbon and delicious veggie balls, LED bulbs, and solar panels – these products now generate more than a billion dollars in revenues (Whelan and Fink 2016).

Retailers are attempting to forestall competition by adopting technology or partnering with companies – with the goal of innovating and improving the customer experience. In the grocery category, Publix and Instacart joined forces in 2016 to offer a service that allows customers to place their Publix grocery orders online and have their items delivered to their door. Publix's strategy makes sense because research indicates that grocery shoppers' price search for grocery products is heavily influenced by geography (Gauri et al. 2008). Technology is also transforming the customer experience. Retailers are using virtual reality (VR) and augmented reality (AR) to differentiate service and improve the customer experience both offline and online (McKone et al. 2016).[5] For example, a camping and outdoor equipment retailer might use VR to immerse shoppers in an outdoor experience that simulates how they will use its products and an apparel retailer might use AR in a "smart dressing room." Empirical work indicates that retailers who differentiate using service, gain pricing flexibility (Umashankar et al. 2016). Moreover, analytic modeling suggests that retailers who create shopping experiences that are superior to competitors (and above a minimum level) need not rely on price advertising to reduce consumer search costs – plus, they will be more profitable (Iyer and Kuksov 2012).

5.5 CHANGES IN SHOPPING PATTERNS ACROSS CHANNELS OR TOUCHPOINTS

5.5.1 Manufacturer Direct-to-Customer Activities

The Internet has enabled manufacturers to engage in a variety of direct-to-customer activities. Some manufacturers have opened online stores, while continuing to sell through retailers and other intermediaries. For example, with the collapse of Sports Authority, Nike increased its store openings. By selling direct-to-customers, Nike gains control over how its brand is presented, acquires customer information and builds direct relationships with customers. Experts have noted that the intermediaries provide three major benefits, serving as: *distribution* channels to create product assortments and facilitate exchanges, *transaction* channels to facilitate sales and purchase activities, and *communication* channels to facilitate information exchange (Peterson et al. 1997). Hence, manufacturers must decide whether the Internet is an efficient and effective substitute for each of these three categories of benefits (previously provided by traditional intermediaries).

Retailers are typically best equipped to act as distribution channels, creating product assortments and facilitating exchanges (except for digital products). However, when goods are augmented by services, retailers may also provide superior transaction functions. In particular, retailers can offer hybrid bundles (of goods and services), such as selling appliances with installation service or pet supplies with grooming or training services (Meyer and Shankar 2016). For example, Sephora is a retailer that sells premium beauty products online and through 2,300 stores in 33 countries worldwide. It also operates stores within J.C. Penney. Sephora's service provides a differential advantage in two ways. In-store shoppers can experiment ("play") with different products, served by employees who offer unbiased advice, in an enjoyable setting. Online and mobile shoppers can access unique content on the Sephora website, as well as through channels such as Youtube or Pinterest. In addition, through its Beauty Insiders loyalty program, Sephora's clients gain access to exclusive gifts and events, as well as early access to select products. Retailers (like Sephora) that provide differentiated services and create store loyalty will have more latitude in pricing. Retailers should assess the relative proportion of switching versus loyal customer segments before developing their pricing strategy (Koças and Bohlmann 2008). For example, premium prices may cushion a retailer from attracting switchers that other firms are likely to target with discounts.

5.5.2 Growth in Online Intermediaries and Channels

Many manufacturers sell through online intermediaries, such as Amazon and Etsy (in the USA) and Taobao (in China). Online intermediaries can offer a plethora of products and leverage their platform to reduce distribution and transaction costs. Since they avoid retail space costs and wholesaler fees, they can usually afford to sell products for less than traditional retailers. Plus, they are able to price in ways that are not possible for offline retailers by creating customized bundles and adjusting price components, such as shipping fees (Jiang et al. 2011; Koukova et al. 2012; Ratchford 2009). In response, many retailers have adopted a multichannel strategy (Grewal et al. 2010; Kushwaha and Shankar 2013), whereby customers can purchase through catalogs, brick-and-mortar stores, mail, telephone or online (including mobile). This shift provides opportunities for pricing innovations. For example, some retailers are experimenting with spatio-temporal targeting – e.g., through mobile promotions (Andrews et al. 2016). Recently, retailers have shifted their focus to "omnichannel" strategies, a change in terminology that emphasizes the goal of creating a seamless customer experience across all retail touchpoints (Ailawadi and Farris 2017). In this way, retailers can offer shoppers in-store benefits that e-tailers cannot duplicate, such as purchase online and pickup or return in store (Mahar et al. 2014).

Some retailers are migrating to primarily online sales. For example, Ann Taylor has been closing its US stores to reposition itself for omnichannel retailing. Its customers are affluent women who purchase professional attire, including dresses, tops, shoes and accessories. The company's rationale is that, since the brand focuses on a specific target market, it does not need a wide presence as some casual apparel retailers with a broader target market do (Team 2015). At the same time, we see a reverse migration: some "pure play" e-tailers have opened bricks and mortar stores, including eyewear retailers such as Warby Parker and fashion retailers such as Spartoo (France), Frank and Oak (Canada) and Bonobos (USA). Bonobos began by opening stores within Nordstrom locations and later opened its own shops, called the Bonobos Guideshop.

5.5.3 Shopping Goals, Showrooming and Webrooming

Consumers use different channels to accomplish different shopping goals, leading to the emergence of different shopping patterns. For example, shoppers who are browsing (a hedonic goal) prefer displays of complementary products (e.g., coordinated clothing outfits) over displays of substitutes (e.g., all shirts together). However, shoppers who intend to buy (a utilitarian goal) consider substitute-based displays as easier, more attractive and preferred (Diehl et al. 2015). In this way, shoppers' goal-dependent preferences create a challenge for all retailers. How should retailers design and communicate product assortments and displays to appeal to customers with different goals? A retailer's task is even more complex because shoppers' goals change as they journey (across retail channels) towards purchase. In addition, global retailers must contend with cross-national differences in shoppers' price and value-consciousness, perceptions of price-quality tiers, and willingness to pay for premium products in different categories (Zielke and Komor 2015).

Additional challenges arise when consumers are searching. For example, online retailers can lower shopper search costs by displaying choice alternatives in an ordered way (e.g., top 15 recommended washing machines). However, research indicates that this tactic reduces shopper's ability to make good choices (Diehl 2005). Moreover, increasing the number of rank-ordered choices (e.g., top 50 recommended) also reduces their ability to make good choices. Indeed, a study of an online grocer that had reduced its SKUs showed that shoppers were loyal, continuing to buy goods in the same categories, despite their preferences for certain brands and sizes (Boatwright and Nunes 2001). These findings highlight how consumers are using heuristics (whether they are effective or not) to cope with the complexity of today's retail environment.

Two common shopping patterns – showrooming and webrooming – have placed price pressure on retailers. Showrooming is the shopper practice of visiting a store to examine a product before buying it, usually at a lower price, online (Arora et al. 2017; Zimmerman 2012). In contrast, webrooming is the shopper practice of researching products online before buying them in a physical store through price matching. Both practices are facilitated by the ubiquity of online and mobile shopping applications that support browsing, search and purchase activities. Shoppers can also use price comparison websites (Bodur et al. 2015). To counter these trends, both online and offline retail channels have attempted to engage consumers (creating "stickiness") so that shoppers stay longer and (ultimately) buy rather than switch channels. To minimize showrooming and webrooming, many retailers are offering price-matching guarantees.

5.5.4 Pricing Opportunities and Challenges

In response to these market developments, retailers are developing more nuanced pricing strategies. A European study has shown that retailers increasingly engage in channel-based price differentiation – that is, identical goods are priced differently in a retailer's online versus offline store (Wolk and Ebling 2010). The magnitude of price differences varies by category, but significant differences were observed for electronics, beauty products, sneakers, canned food and so forth. Retailers are not applying a uniform price differential; it depends on the product. (Indeed, it is not uncommon for product availability to differ across a retailer's online and offline channels). This strategy can make sense for both retailers and consumers for two major reasons.

First, due to the proliferation of retail channels and touchpoints, retailers must align themselves with customers' goals – or else customers will go elsewhere. By creating unique product assortments (e.g., including private label merchandise and customized services), retailers create a differentiated shopping experience, build loyalty and thereby garner pricing latitude (Rooderkerk et al. 2013). Note that differentiating through unique product assortments implies moving away from optimizing prices on individual products within categories and (instead) considering shoppers' preferences, substitution patterns and cross-selling opportunities. Both relatively new retailers such as Sephora (founded in 1999) and established retailers such as REI (founded in 1938) have built strong relationships with their customers – beauty enthusiasts and outdoor enthusiasts respectively – by *not* directly competing on price.

For example, REI closed its offline stores on "Black Friday" (i.e., the day after Thanksgiving) in 2015 and 2016 – garnering accolades from customers (who are also the cooperative's members) (Cassidy 2016). In 2016, nearly two million people endorsed the closures by clicking a button on the REI site, which also helps people find outdoor activities near them.

REI's store closure decision was an outgrowth of its strategic re-focus on the customer experience that began in 2014. Every REI activity is viewed through the lens of enhancing the customer's outdoor experience: offering expertise and relevant information, ensuring faster delivery and easing returns, being a good environmental steward, and connecting with customers by learning what they want and delivering authentic experiences. (Some companies refer to this approach as "simplifying the customer experience.")

Second, academic research has shown that, contrary to conventional wisdom, consumers' image of retailer's prices isn't determined solely by the retailer's average price level. It depends on the dispersion of prices, price dynamics, price-related policies, price-related communications, average price level, and physical attributes, service level, and non-price policies (Cunha and Shulman 2011; Hamilton and Chernev 2013). Shoppers' price image for a particular retailer may vary from objective reality, but they do learn about retail prices over time (Jensen and Grunert 2014; Ofir et al. 2008). Hence, retailers should reinforce their positioning in the marketplace by managing all dimensions of shoppers' price image: price evaluations, price fairness, store choice and purchase quantity. Thus, customers perceive that REI prices are fair, their evaluations are favorable for REI's product assortment (which encompasses multiple price/quality tiers) and choosing REI aligns with their preferences as outdoor enthusiasts. Beyond influencing customers' perceptions of prices, lower average price levels are profitable when return store traffic is a consideration – that is, retailers should forego current profits (at higher prices) to obtain increased long-term profits from (somewhat) lower prices (Danziger et al. 2014; Fox et al. 2009). Taken together, these observations suggest that retailers must find ways to implement customer relationship management (CRM) principles in developing pricing strategies for today's dynamic omnichannel environment (Bolton 2016).

5.6 TECHNOLOGY

Beyond economic conditions, the most profound effects on the retailing landscape are due to changes in technology (e.g., electronic price tags, RFID, in-store digital messaging, mobile phone apps, Internet of Things [IoT]) – especially shopper-facing technology (Inman and Nikolova 2017). Technology influences demand – and consequently consumer willingness to pay – as well as costs. However, retailers have lagged in adapting to changes induced by technology. Specifically, retailers can leverage technology to influence consumer perceptions of value through effective use of online, social, mobile, localization, and personalization strategies (Grewal et al. 2012). Many opportunities for innovative pricing strategies exist because retailers are better able to target shoppers using loyalty program or online history data to offer products at attractive price points (Dost et al. 2014; Grewal et al. 2011; Meyer-Waarden and Benavent 2009).

5.6.1 Mobile

Mobile, referring to technology, device, channel, and app, is increasingly having a significant impact on shopper behavior and retailer prices (Shankar and Balasubramanian 2009; Shankar et al. 2010, 2016). The shopping environment today is sometimes characterized as 'mobile-first,' in the sense that shoppers often use a mobile device or channel to access information throughout the purchase journey. Shoppers use mobile for discovery, product evaluation, price comparison, purchase and post-purchase evaluation and feedback (Shankar et al. 2011, 2016). With the emergence of price comparison bots and apps, prices for standard products are more transparent than before.

Mobile also allows marketers to better interact with shoppers, know their preferences, and proactively offer customized products and services at different times, locations and prices. Mobile coupons serve to lower the price paid. Retailers like Walmart and Best Buy offer price-matching guarantees for mobile shoppers who price compare. Thus, mobile is a double-edged sword for retailers. On the one hand, it can be a pricing tool as outlined earlier. On the other, it has elevated price competition to levels never witnessed hitherto. Retailers can't live without mobile, but they haven't found a way to thrive with mobile.

5.6.2 Social Media

Social media such as Facebook, Twitter, Tumbler, and Youtube has an important influence on pricing. Gen Y and millennials are prolific users of social media. Their social media usage has tremendous implications for pricing (Bolton et al. 2013). First, price information travels fast on social media, resulting in greater price transparency on the part of retailers. Second, the spread of price and product information through social media leads to greater customer self-selection. Third, retailers can use social media to test proposed prices of new offerings. Fourth, retailers can use social media to announce promotional prices to induce a temporary lift in sales. For example, many retailers ask shoppers to like their Facebook page to obtain coupons or price discounts.

5.6.3 Internet of Things (IoT)

The Internet of Things (IoT) refers to the ecosystem comprising multiple sensors from devices directly connected to the Internet and able to perform several functions (e.g., home security, thermostats, and coffee makers). According to some estimates, by 2020, 50 billion devices will be connected to the internet (Evans 2011), and the IoT market size will be $3.7 billion (McKinsey 2015). Many retailers and service providers now market IoT-based offerings. The success of IoT-based services depends on the business model: whether the IoT-based service adds value to customers and, if it does, how much value it contributes. The pricing of IoT-based services is a big component of the business model and depends on the value provided.

For example, Sonos, whose speaker sets connect and "talk" to each other, partners with retailers like Spotify and Amazon for streaming services to add value to the end user. Conceptually, there is value creation and a value capture in this business model. Retailers will need to work with technology partners to leverage the IoT, even if it means stumbling to find a valuable business model. Framing the IoT-based offering will enhance the price customers will pay. For example, iControl's CMO, learned that customers were willing to spend $35–45 a month when the offering was framed as a 'home security system' rather than a 'home automation system.' IoT business models are still evolving and accordingly retailers' pricing models are also changing (Shankar 2017).

5.6.4 Servicescape

Servicescape refers to the design of stores (online or offline) utilizing technologies such as virtual reality and augmented reality to enhance and create new customer experiences (Bolton 2016). For example, Lowes uses virtual reality to let consumers imagine how its kitchen products such as the countertop and shelves will look in their kitchen and allow customers to sit down on patio furniture and better experience the feeling. By offering shoppers new and value-added experiences, retailers will be able to command higher prices. However, online and offline experiences must work together seamlessly; online experiences create offline expectations and vice versa. Retailers can do much more to enhance their servicescapes – current examples are primarily experimental. For example, new technology lets shoppers try on virtual clothes before they buy (e.g. MemoryMirror at Neiman Marcus).

5.6.5 Pricing Opportunities and Challenges

Technology offers two important pricing opportunities, but retailers have been slow to capitalize on them. First, technology has the capability to transform customers' retail experiences in radical ways – thereby creating more flexibility in pricing. Retailers can create customized services by integrating technology into the customer experience – thereby enabling a price premium. For example, The North Face (an outdoor apparel and equipment retailer) has partnered with Jaunt (a technology company) to create a virtual reality experience that immerses in-store shoppers in the outdoors. In this way, The North Face is leveraging its servicescape to communicate with customers in a compelling way – and creating emotional and social bonds with customers – that are likely to stimulate purchase and usage of its products. There are many opportunities to enhance the retail experience through technology. The business press has reported successful experiments with drones offering same-day delivery, one click mobile orders prior to pick-up and so forth. Ideally, retailers should leverage technology to create retail brand enthusiasts (Iyer and Kuksov 2012).

Second, technology is creating vast amounts of data – so that an integrated database is critical to business success. Retailers can use business analytics to identify new sources of revenues from customers that create topline growth, as well as implement profitable CRM strategies (Bolton 2016). In today's retailing environment, CRM strategies must be location-specific and time-specific, as well as customer-specific. The McKinsey Global Institute has predicted that retailers embracing big data can increase their operating margin by more than 60 percent (Saran 2015); other consultancies have made similar predictions. At the same time, many highly publicized data breaches of retailers have heightened consumers' concerns about privacy; people expect to be able to control how their personally identifiable information is used. Hence, retailers must be sophisticated in their use of technology and scrupulously follow security procedures. However, privacy concerns should not be a reason for failure to embrace the promise of data-driven decisions – especially about price. Retailers that leverage data with business analytics will be able to identify profitable products and services, as well as target customers effectively throughout their purchase journeys.

5.7 CURRENT AND FUTURE PRICING PRACTICES

5.7.1 Current Practices

Retailer prices depend on the triad of demand, cost and competition. The set of factors affecting retailer prices appears in Figure 5.2. We have examined the effects of some of these factors in the previous sections. Other factors that directly affect retailer prices include retailer positioning and other marketing mix decisions of the retailer. Retailer positioning strategies, such as EDLP, Hi-Lo and value pricing, closely impact retailer pricing (Bolton and Shankar 2003; Shankar and Bolton 2004; Shankar and Krishnamurthi 1996). Furthermore, retailers' decisions on other marketing mix variables, such as advertising and promotion, also affect prices (Ailawadi et al. 2009). In addition to technology and retailer consolidation (that also directly affect retailer prices), manufacturer prices, labor and real estate influence retailer costs.

Dynamic Price Optimization: A notable change over the past decade has been some retailers' adoption of dynamic pricing (cf., Elmaghraby and Keskinocak 2003; Grewal et al. 2011; Liu et al. 2008). Three factors have contributed to this phenomenon: the increased availability of demand data, the ease of changing prices due to new technologies, and the availability of business analytics and tools to support rapid price changes. Online, retailers can (and do) change prices – easily and

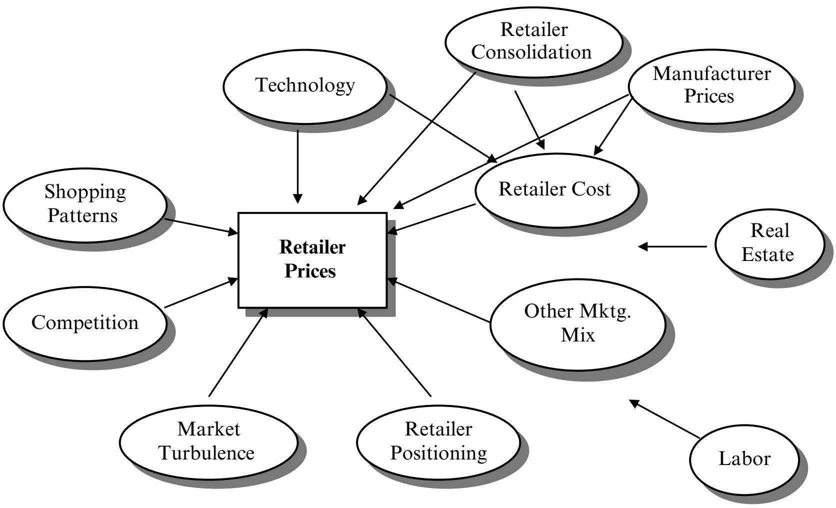

Figure 5.2 A framework of factors affecting retailer pricing

frequently. They have also leveraged price bundling strategies, including how they present shipping costs (e.g., Amazon Prime, Walmart in-store pickup), to take advantage of how shoppers make decisions. However, there are implementation challenges to adopting dynamic pricing practices offline. Besides the cost of tagging and retagging products, shoppers can experience confusion and perceive price unfairness – concerns that are difficult for retailers to handle. At the same time, there are several larger issues at stake. First, retailers tend to have better information about costs than demand, so that "optimal" prices may not in fact be optimal. Second, dynamic price optimization at the level of SKUs does not (as yet) adequately recognize how shoppers interpret prices, fill their shopping baskets and cross-buy value-added services (e.g., Shankar and Kannan 2014).

Challenges: Today's strategies are increasingly data-driven. However, where are retailers vulnerable or blind in the current environment? It is probably in the accurate assessment or prediction of the dynamics of consumer preferences and demand over time. Retailers have paid too much attention to inventory management (cost) and competition – presumably because they are easily observable – and insufficient attention to consumer demand. A failure to understand consumer demand is the primary obstacle to realizing the promise of "shopper marketing – the planning and execution of all marketing activities that influence a shopper along – and beyond – the path-to-purchase, from shopping trigger to purchase, consumption, repurchase, and recommendation stages" (Shankar 2011; Shankar 2014). Retailers' pricing strategies are unlikely to be successful, given the shortfalls in their implementation of shopper marketing strategies that create enjoyable retail experiences and build profitable customer relationships.

5.7.1 Future Pricing

The fundamentals of retailer pricing remain unchanged: demand, cost and competition are the triad that supports all pricing strategies and tactics. See Figure 5.1. However, some retailers have remained mired in the past – focusing on competitors and market boundaries that no longer exist. The transformative nature of technology and the success of competitors from adjacent markets call for a fresh assessment of the retail brand's position in the broader marketplace. The key to successful pricing is to understand the retailer's core value proposition: (1) How do customers perceive their experiences across the entire purchase journey? and (2) What is the corresponding retail price image? Building on these two basic components, retailers can then create (or co-create with customers) a differentiated retail experience, across all touchpoints, that leverages all its capabilities (people, servicescape, technology, business analytics).

The capstone step is perhaps the most difficult: a broader notion of dynamic pricing that incorporates how shoppers' goals, as well as how their preferences and demand change over time. As illustrated by some of the examples in this chapter (such as Sephora and Lowe's), successful retailers are already moving in this direction. MGM Resorts is a retailer that generated more than $200 million in pure retail sales in 2015. In a recent interview (Greene 2016), Steve Schnur, the company's director of merchandise planning and analytics, described the company's approach as "want and need" pricing. Like other retailers, MGM works with a technology partner and uses dynamic pricing, including sophisticated predictive analytics. It relies on pricing recommendations, self-tuning price scoring and real-time "what-if" price planning. Schnur noted: "When you start to separate the want versus the need, the analytics are completely different. We try to understand why the guest is buying it, what the pricing is, what are the right transition periods to get out of it." Ultimately, these decisions entail a trade-off between the retailer's profit goals and the shopper's goals.

NOTES

1. Zappos is a subsidiary of Amazon, which usually doesn't match prices (except on TVs). See Enright (2016).
2. http://www.mingtiandi.com/real-estate/china-retail-real-estate-news/chinese-think-tank-says-13rd-of-mainland-malls-to-close-within-5-years/.
3. CVS.health.com press release, https://cvshealth.com/newsroom/press-releases/cvs-health-and-target-announce-completed-acquisition-targets-pharmacy-and.
4. http://www.firstresearch.com/industry-research/Used-Merchandise-Stores.html.
5. VR immerses the consumer in a simulation using headsets and so forth, whereas AR overlays virtual elements onto the real world as seen through a smartphone or tablet.

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