



retail challenge #2

Increasing Profitability while Maintaining Price Image

summary

Using KhiMetrics' Retail Revenue Management Suite, Company B used its historical point of sale (POS) data to understand demand at the store-SKU level. As a result, the company was able to quickly respond to changing consumer demand giving shoppers lower prices on items they wanted most, when they wanted them most. The company was also able to build margins amidst severe price competition from national chains.

Retail Chain Profile

Company B is a discount retailer that operates stores nationwide and whose wares include highly seasonal hardlines, softlines, health and beauty care (HBC) and prescriptions.

situation

Pricing pressure from Company B's primary national competitors was causing declining gross profit margins. Building new stores was not an option and cost-reduction solutions had already been implemented. The company required an alternative solution to return margins to a healthy level.

Company B had previously implemented a markdown optimization software package with some success. Based on that experience, management realized the opportunity to apply retail revenue management (RRM) to regular pricing and promotional pricing. To minimize the risks associated with adopting advanced technologies, management wanted to partner with a vendor that had the right vision, a mature product and a comprehensive approach.

The right vision meant promoting and maintaining a positive and consistent price image. The client wanted to find a system that could help establish long-term loyalty through a competitive price image, but also wanted to improve profitability at the same time. So, finding a vendor with a data-driven approach to measuring and controlling price image, and capable of managing multiple simultaneous goals, was key.

Product maturity meant having a scalable system that would work with real-world retail POS data. Store and host systems errors, in-store compliance and out-of-stocks often create erroneous demand data that results in a misunderstanding of store-level demand. Most of the company's price changes were small and infrequent, and when prices did change, most happened in concert with seasonal trends, promotions and competitor price moves. Addressing these issues inside of a system that could grow with the customer was key.

Finally, a comprehensive approach meant having a solid, business-focused methodology that adapted quickly and easily to key business needs, such as respecting corporate pricing rules and policies, obeying regional pricing laws, accounting for activity costs and simplifying workflow.

After a thorough survey of the market, Company B chose KhiMetrics based on all of the above factors.

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solution

Based on Company B's needs, KhiMetrics' objective was to implement an RRM solution that would integrate seamlessly and deliver value rapidly without interfering with normal processes. KhiMetrics customized its RRM process to conform to the company's unique needs, including data management, enterprise strategies, product strategies, pricing policies, store-level execution, education and training.

Working with a small number of Company B's IT managers on a part-time basis, the KhiMetrics client services team collected the initial data in just weeks, including historical POS data, cost data, product information and competitive price data. The information was analyzed and refined to ensure accuracy prior to optimization.

The company elected to begin implementation in phases. A control group was used to monitor RRM benefit in phase one. Taking this into consideration, KhiMetrics recommended a strategy that would yield a rapid return on investment (ROI), enabling the funding of a larger enterprise implementation. Using its patented process and the client's store-SKU demand data, KhiMetrics showed Company B the trade-off between enterprise sales and profit. From this, the company was able to select a profit-generation strategy that met its minimum sales objectives.

Next, KhiMetrics recommended category-level strategies that supported Company B's enterprise strategy and showed the forecasted impact of different strategies on category sales, profit and price image. From there, the company set category strategies and a price image—and the RRM application translated them into specific SKU-level price and promotion recommendations.

Users reviewed exceptions and authorized price files via a Web-deployed user interface. Once authorized, the price files were submitted to Company B's price-hosting system for store-level execution.

results

By optimizing four categories in nine stores, Company B was able to achieve **increases of 0.5% in sales and 1.6% in gross margin** compared to a traditionally priced control group. Extrapolating these results over all categories, Company B saw enormous opportunities to improve sales, margin and profitability across their organization. Conservatively, the KhiMetrics RRM solution is expected to create a sustainable gross profit increase, a payback in less than a one year, and a cumulative year-3 **ROI of 250%** or more. Additionally, KhiMetrics' customization of its RRM process enabled the company to manage RRM and improve its forecasting without adversely impacting its day-to-day processes.

Focus group results were measured for both sales and profit against a 26-week average. Throughout the trial, dollar sales, unit sales and profits showed superior results to the control group (see graph). With RRM, Company B generated 2.1% in additional dollar sales over the control group. Unit sales moved up only slightly, as the focus group exceeded the control group by 0.8%, showing that **RRM generated significant financial improvements without sacrificing market share**. And finally, the focus group showed **28.5% increase in additional profit** compared to the control, meeting the project objective.

Fundamentally, benefits resulted from changing prices to better match demand. By using POS demand data, Company B was able to tune into its shoppers' preferences and give lower prices on highly sensitive items while building margins on others.

The results achieved by this project are a direct result of Company B's commitment to success. Responsive service from the IT department's lead contact, teamwork, executive leadership and an ability to "let the application do its job" were all major contributors toward positive results.