ZUMO retail

Profit Accelerator Tool

Using prices to “talk” to your customers

Introduction

When you go shopping at Harrods in London, you know that whatever you buy will be expensive. On the other hand if you go shopping at Bunnings Warehouse in Australia and New Zealand (or Home Depot in the USA, or B&Q in the UK), you know before you go — because they promise you — that their prices are at the lower end of the range.

For all of these famous retailers the prices they charge are **an integral part of their branding and market positioning.**

This is not an accident! What you are about to read tells you why.

This chapter is about using prices across a range of products to position your retail store against your competitors, and in the minds of the public. The discussion that follows is about **KVIs**, variously known as **Key Value Items** or **Known Value Items**. We prefer to use the term Known Value Items.

The concept involved is easy to understand, but you need to do quite a lot of work to provide a statistically sound basis for setting up your system of pricing.

What we will do is show you how to go about the task and having established your system of KVIs, how to use it to enhance the performance and positioning of your business.

The basic idea is to give you another way to be competitive against retailers in the same line of business, and against retailers who sell similar products as part of a wider activity. (Think of supermarkets, or discount warehouses.)

[We won’t endlessly repeat the clumsy phrases “product or product category” and “stock item or stock category” but mostly use “product” to mean both of them.]

The point of the exercise

You need to manage your prices all the time.

For example:

The price you can get for Christmas cards is higher on December 24 than it is on December 26.

There is a way to find out what the difference should be!

There is also a way to find out what your price should be relative to your competitors.

The way you structure the prices and discounts on a selection of the products you offer, has a powerful effect on the tone of your shop and the way it looks to your customers and your competitors.

At the heart of this need to manage prices is the set of prices that are called **Known Value Items.**

Definition:

KVIs help you to identify which products have the most influence on your customer's price-to-value perception, and are the first products that cause a customer to switch to a competitor when your pricing is not properly pitched.

(And that can also mean that the customer might switch from another retailer to you!)

Knowing that you are fairly priced removes from your customers one reason not to shop at your store.

A word about categories

Your first job is to collect similar products into **categories.**

Definition of a category:

A collection of retail products grouped together by their common characteristics — price; end use; competitive qualities; and so on.

Grouping these products simplifies their management — where they are displayed; how they are promoted; what they contribute to your profit; what customers they satisfy; and so on.

Every category behaves in a different way! Your indispensable job is to understand that behaviour, because the judgements you make depend on it.

For the purposes of this document we will propose **a ranking of categories** to demonstrate their relative importance to any retail business.

(If you don't like the names we have given them, choose your own. But always, always do the ranking!)

"Signature" categories

These are your **most important categories**.

They group together the products (and sometimes services) **for which you are most famous.**

Think of Bunnings, B&Q or Home Depot again. Their "signature" categories are home handyman and building trade products like garden supplies; paint; power tools; timber.

And here's the important thing: These products are especially price sensitive. Your customers "know" what the prices should be.

"Priority" categories

These products "support" your signature categories.

It is logical for a petrol station to offer automotive lubricants as well as motor fuel. A pharmacy logically offers first aid products to support its pain relief category. if Bunning's, B&Q and Home Depot sell building timber, why would they not offer nails and screws?

Customers are less price-conscious when they buy "priority" categories, but the products fit naturally in your store.

"Basic" categories

Products classified as "basic" to your store have one and sometimes two characteristics.

1. The customer expects you to have them in stock. (And they help to identify what kind of store you are operating — **they are another tangible statement of your branding.**)
2. The customer's awareness of what they should cost is less than products classified as "signature" or "priority."

This lack of customer sensitivity to prices often allows you to lift your margins on such products.

"Occasional" categories

Think about these as gift lines, or seasonal merchandise.

Your customers are relatively insensitive to price for such products, and they can quite easily bear high margins.

To summarise

You will quickly see that customer sensitivity to price — and to the prices charged by your competitors — is highest for your most important products.

It follows that when you are setting prices — KVIs — you should concentrate on the "Signature" and "Priority" categories you have decided upon.

In those parts of your store where you display "Signature" and "Priority" merchandise, you are most vulnerable to the activities of other merchants, and at the same time you are earning your best profits.

So there are some powerful reasons why you should get it right!

How to measure, control and use "Known Value"

To understand how why your products and categories behave as they do, you have to understand why your customers behave as they do.

Many retailers, especially those running smaller operations, know this intuitively. It's harder for a big store in a big town with many staff, and such enterprises need to invest in some research.

Here are some of the things you need to know:

- Unit and dollar sales values of your "Signature" and "Priority" categories, broken down into individual products.
- What contribution are they making to your whole-store profits?
- Who is buying them?
- Where do those people live?
- How well do your customers "know" what they are prepared to pay?
- What do your competitors charge for the same or similar goods?

Remember this, always:

You do NOT have to be the cheapest! People will pay you more for the same goods as they buy from your competitors, if you have positioned yourself correctly in the market.

(But of course, it can help!)

The other thing to remember is:

You cannot stop measuring the effects of your prices on your customers. The market keeps moving and changing; your competitors mount promotions; your suppliers will pester you to sell more.

You need to stay on top of all these variables, and more.

Some examples of the arithmetic

First, have an aim in mind:

Use the following list of calculations and actions **as an example**. Your own experience is what counts!

Set prices for all your "Signature" and "Priority products that will get results like these:

- An acceptable overall Gross Profit
- An increase in Gross Profit dollars.
- An increase in the number of units sold.

Decide what you want each category to do (and set your prices accordingly):

- To fit your customer profile.
- To open up promotional possibilities.
- To suit your display space and design.
- To provide your store with income proportional to the category's importance in the total selling effort.
- To feel "right."

Measure (and rank) category performance often:

- Numbers of units sold. (Measure the trend of sales, too!)
- Value of category sales.
- Gross profit achieved (express this as a percentage of retail, or a percentage margin added to cost).

- Observe what your competitors are doing in the category. (And check how your prices compare.)
- Measure the effect of your promotions.

Knowing enough to test your prices

If you are measuring product and category performance well, and also keeping a watch on what your competitors are doing, you are ready to select products to be considered **KVIs**.

Known Value Items share these characteristics (which you can now measure):

- They are being promoted by your competitors, and sometimes also by you.
- The top 3% of category unit sales can be considered **Known Value Items.**
- Think like your customers. eg: Do they choose one pack size in preference to another?
- Compare your prices with your competitors'. Remember, though, that competitors are not all the same, and you need to think about those whose businesses are similar to yours. **When Harrods of London sell a set of barbeque tongs, their customers do not compare them with Bunnings Warehouse, whose tongs work just as well.**

Conclusion

The most important feature of the products or categories which you have classified as **Known Value Items** is that they are made up of the merchandise in your store which comes under the greatest margin pressure.

Customers are always sensitive to price, and will often seek out the same (or similar) goods where they can save even a little. This is as much influenced by your positioning in the marketplace as it is by your competitors' promotional activity, but it is real nonetheless.

Your task, then, is **always** to know what products are under margin pressure from all those competitive influences out there.

(If you need to, negotiate with your suppliers for extra margins — a tactic that will succeed much better if you can show increases in sales volumes in return.)

The crux of all this is to give you a way to watch the performance of those categories and products which make up the core of your business, and to suggest the disciplines which this inescapably involves.

Want to know more? At Zumo Retail our consultants can help you determine pricing strategies for your business. For more information contact: info@.zumoretail.com