

BWH News Letter

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What is in a Retail Zone?

It is a common practice for most retailers to maintain store level prices based on some type of Retail Zone configuration. Historically, this was done because the communication with store level personnel was often by printed price books or shelf labels produced by an offset printing process based on duplicating a "master sheet". With the advent of laser printers and the ability to produce customized price books and sets of shelf labels (or even electronic shelf labels), the whole concept of what we call a Retail Zone needs to be reconsidered.

The requirements of Retail Accounting have been another big factor in retail management. Retail accounting requires the retailer to record all store receipts at both cost and retail. This means the retail must be known when merchandise is received and any adjustments to retail must be allocated to inventory. If the item sells at a different retail than when it was received, this must be captured and reported. If the retail is changed, the value of remaining inventory must be adjusted. Missed differences will appear as losses or gains in inventory (ie shrink). Retail accounting has been used because it made record keeping much simpler than tracking individual items. Modern inventory management applications require item level inventories in order to manage replenishment cycles. Modern inventory applications track receipts, adjustments, and sales by item and report shrink by item. The result is a much better understanding of where inventory losses are occurring and elimination of the need to account for every retail change. This leads to much easier implementation of dynamic pricing applications.

The traditional Retail Zone establishes a set of prices for a certain location. The prices to use are usually based on some kind of competitive analysis that says this store needs to meet competitor X in order to maintain market share. That is why consumers are always told to "shop at a market with competitors on the other three corners". The opposite is the store that enjoys a "geographic monopoly" as the only store within a reasonable distance of the consumer. This simplistic view of the Retail Zone leads to a

proliferation of zones that have to be individually managed and reviewed each time a cost or competitor change occurs. There must be a better way.

First we must consider the contents of a Retail Zone. In the past, retail zones held prices. But the prices in a zone were based upon some sort of rules and objective for that zone. The category manager or pricing manager maintaining the prices knew that zone A was meant to "be competitive with competitor X" or that zone B was the "high gross zone". So, the prices in the zone were based on the rules for that zone. When you think about it that way, the price zone does not determine price (that was the role of the pricing manager), the price zone determines what rules to use. So if instead of storing prices by zone, if we store the rules and objectives by zone we can set the prices by knowing the facts that currently exist. Facts would be things like "what competitor x is currently charging" or "the high gross margin for this category". Then the prices that result will reflect the goals of the pricing manager or category manager based on the rules they have established without them needing to change anything. By changing the contents of a zone, to be the rules and objectives for the prices in the zone, we have eliminated the need to constantly maintain prices.

But there is another perspective of zones which makes their management even easier. Instead of using the same rules and objectives across a whole store, we allow them to be set by category. This lets each individual category manager set their goals for a store. The category manager for bakery products who has a store that competes with a local bakery shop can target the local bakery. The other categories in the store can be set based on their particular competitive situation. It may turn out that some categories will carry others in order to provide a total shopping experience to the consumer. The overall performance of the store will be the result of the interaction among the various categories.

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One of the big challenges with this approach is that all the facts have to be kept current. If we don't know the competitor's retails, we can't keep ours in line. Maybe in an environment of "perfect knowledge" this approach would work, but we can make things a lot easier if we just use receipt cost and replacement cost as the driving facts for pricing decisions. We can use receipt cost to drive decisions in highly competitive situations and replacement cost in less competitive situations. We don't adjust the retail price in highly competitive situations until the store authorizes them. A few days after the receipt cost changes, we begin to report the need to authorize a retail change. If the item is very sensitive, the store can postpone the change. In less competitive situations, we adjust the retail price when the replacement cost changes. The point is that we need a rule for timing when retail changes will be made.

With the timing of retail changes based on cost changes, we need to define gross margin objectives (low, medium, and high) to know how to set the new retails. The gross profit dollar objective is set for the category overall (or deduced from the department goal) and the gross profit margin is set by item. If the item is one of the "price sensitive" items for a store it is given a lower gross profit objective. Price sensitive items are determined from scanning and frequent shopper data to identify the frequently bought items that the consumer is likely to monitor. The overall gross margin of the category is managed in such a way that the price sensitive items meet the minimum gross profit margin and the price insensitive items never exceed the maximum.

In addition to knowing when and at what level to set a new retail, we need to understand other rules about establishing regular retail prices. Some retailers want only their sale prices to end in "9". Other retailers do not want to use multiple prices in certain categories. All these rules can be established by the price zone so that individual stores can be targeted to specific zones and rules.

Targeted promotions are making the zone margins less predictable. Facilities exist in all POS systems for point of sale discounts based on frequent shopper ID. How frequently and how creatively these capabilities are used

depends on the individual retailer and their ability to handle the new transactions. Historical data on individual shoppers can tell the retailer in which categories they are brand loyal and which ones are price sensitive. They can integrate this data into targeted promotions that in effect create individual price zones for each customer. To customer A, the store is low price. To customer B, the store is reasonably priced and includes discounts on their favorite brands. Finally, customer C always buys the same brands in each category and rarely buys extras during promotion so that they are impervious to price and are really there because of other reasons. No discounts for customer C, but the store manager should get to know their name and greet them at the door.