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Manage the Price Gap

... Rather than match the prices

by Brian Woolf (June 29, 2015)

As a general rule, no two competing food retailers have the same cost and profit structure. Therefore, they should not be expected to have the same prices on everything. If they do, the one with the higher cost structure will be at a competitive disadvantage because it will have a lower profit margin. In addition, by matching the low cost leader's prices, it has forfeited the opportunity to "muddify" their pricing differences to minimize, in customers' minds, the perceptual price gap between them.

Currently, in the UK, the four largest food retailers are engaged in various forms of price matching: typically, a combination of copying shelf prices and price difference rebates (where shelf prices have not yet been matched). It has been an extremely costly process for them.

Measuring the Price Gap

By definition, a price gap between the low price leader and a competitor can only be on identical items and sizes. However, a perceptual price gap can arise based upon three factors:

1. An actual identical price gap,
2. The prices of non-identical items between the two competitors (including private label and the quality/grade of meat and produce offered), and
3. The ambience of their stores.

This perception can work in reverse: I have seen upscale retailers perceived as having higher prices because of the ambience of their stores - even though they were price matching most of the identical items. The best advice for such retailers is to match those expectations and transfer the gain from the higher prices into some long-term, memorable price reductions thereby helping to muddify their perceived higher prices..

Measuring the price gap is done in myriad ways: a common practice is comparing the difference in shelf prices of 500 or 1,000 items. These could be the top sellers or a predetermined list. Promoted items, both at the price leader and follower, are usually recorded at the lower price. The prices at both stores are totalled and the difference is the price gap and is expressed as a percentage. The method is repeated on a regular cycle to see whether the price gap is widening or narrowing.

A Better Price Gap Measure

A more scientifically valid methodology is to list all identical items that both the price leader and follower offer and then, each week, a standard number of items are selected at random to have their prices (regular or promotional) compared and totalled. To achieve a mathematically valid overall list, each item's unit movement, ranked from highest to lowest, is recorded and broken into 10 equal groups based on their movement.

This means that the top decile might comprise 2% of the total number of identical items while the bottom decile might have 25% of the total identical items (even though the actual unit movement of both top and bottom deciles are the same.

For illustration purposes, if your weekly price gap shopping basket comprises 20 items and there are a total of 1,000 identical items then, using a random number generator, select two items from each decile, including 2 from the top 20 items (2% of 1,000) and 2 from the bottom 250 items (25% of the 1,000 item total).

This would ensure that fast-moving items (most frequently remembered prices) are regularly in the price gap analysis, whereas individual slow-movers (usually with higher margins and prices) will infrequently appear. Regardless of your actual pricing formula, this will provide a fair basis for on-going price gap management.

It also means that you can model your price gap. Do you want to introduce some loss leaders yet keep the important overall price gap percentage the same? Then enter the proposed lower prices into the model along with a range of higher prices among the slower sellers until your model yields approximately the same price gap percentage.

It is the management of this overall price gap of identical items between you and the price leader that matters, because customers buy both fast and slow-moving items from you; balancing their pricing is key. Using the price gap percentage as your North Star, you have full pricing flexibility to price in a way that improves your price perception. This is superior that just matching all the prices of the price leader which simply puts you into a perpetual less profitable position.

How to Have Lower Prices than the Price Leader and Not Break the Bank

The price leader has the luxury of dropping prices to meet yours if you drop them—except where you structure the offer in such a way that the price leader cannot match you. In this way, you can show price leadership and thus blunt (muddify) his price gap image.

Muddification practices over the years have included such programs as continuities, Thanksgiving and Christmas accumulators, fuel discounts, Meal Deals, other bundled pricing offers, special under-the-radar targeted offers, and surprise rewards and gifts for best customers.

Several years ago muddification was enhanced when Crazy Prices appeared at Dorothy Lane in Ohio offering customers 12-18 items, year-long, at “crazy prices” (eg, eggs at 1¢ each (12¢ dozen) with, say, 200 points,) where the customer earns points on a combination of their total spending, bonus point items, and bonus spending rewards.

And price matching capabilities were thwarted again earlier this month when Waitrose, the UK’s 7th largest grocery chain, launched a program inviting members to receive an on-going 20% discount on their 10 favourite items drawn from a list of 1000 items.

Both these upscale retailers muddified the competitive price gap by creating a meaningful price image that they could never have otherwise gained by matching prices. And, if implemented skilfully, their price gap percentage need not have changed.

The Bottom Line

Focusing on your price gap and the diverse ways to muddify it provides a lot more competitive flexibility, and at less cost, than offering to match all competitive prices either on the shelf or through price rebates. Retailers don’t offer to equally match assortment, quality, cleanliness, service, and ambience: why should we with pricing? Especially when we have the tools to help us compete both differently and effectively.

About the author...

Brian Woolf is a global leader in loyalty marketing and has written three definitive works on the subject, Measured Marketing: A Tool to Shape Food Store Strategy, Customer Specific Marketing, and Loyalty Marketing: The Second Act. He devotes his time to helping retailers develop, critique and strengthen their loyalty programs.

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