Tony Davis

THE EVER-CHANGING PRICE OF YOUR GROCERY BASKET

"What's that got to do with the price of eggs?" is a sarcastic question asked of someone considered to be talking about a boring or irrelevant topic …. yet it raises some very important ideas for FMCG goods brands, looking to deliver maximum performance to their business.

Imagine if you could apply greater science to determining the price of fast-moving consumer goods to improve profit outcomes.

By fully understanding the relationship between customer demand and price, FMCG brands are increasingly harnessing price to control their sales volumes, sometimes clearing stock, at other times boosting margins or turning up the heat on competitors.

Price optimisation is all about setting prices to obtain the best profit/volume outcome, subject to market constraints, production capacities and distribution strength. While retailers often have a significant say in price setting, all wrapped up in a good understanding of category demand, specific brand performance, shelf space and sell-through, the manufacturer can manage price optimisation to deliver good results to please both their masters, as well as maintain retailer happiness.

Techniques required to understand the detailed effects of price changes on sales volumes and profit outcomes have been perfected in many other categories already.

Insurance and banking, hotels and travel have for many years managed their sales conversions and inventory to compete for sales. These same techniques are now offering advanced grocery and retail marketers real sophistication and potential advantages over their laggard competitors.

HUGE VARIATION IN PRICES

I bet you did not know how wildly the price of eggs varies, day-by-day, brand by brand and by egg size, quantity and even 'laying condition' (eg free range). One brand, Pace Eggs, can be seen from Nielsen tracking data to regularly vary the price of two of the largest selling cartons of regular eggs in NSW from between $2 and $4 a carton throughout a two-and-a-half-year period – a variation of a massive 100%. The volume and profit implications of this level of price variation are enormous, with deep discounting potentially resulting in losses, but perhaps securing volumes and share during competitor attack.

Pace appears to have deliberately varied the price of 50g and 59g eggs to test changes in consumer response. This price testing has included setting the prices for the larger eggs above and below the price of the smaller eggs in alternate weeks. Such variation of price is clearly not just a function of supply, assuming that the hens are not given time off from their production duties.

HOW PRICES CHANGE SALES

This rich variation in pricing experience can be observed for all of the major players in the market and provides a wealth of information about how customer purchasing behaviour varies with price, competitive position and egg type. It is possible to use this data to identify different shopper segments, with different levels of price sensitivity. Price inelastic segments are unlikely to change their buying behaviour with price, so giving price discounts to these segments will generate fewer improvements in volume than are possible in more elastic, or more price-sensitive shoppers.

Sales volumes don't just depend on the company's own prices, but also on the prices relative to alternative (competitor) products and substitute egg groups. And it is also important to understand the influence of seasonal effects, advertising and secured shelf facings, prior to making any pricing decisions. But by conducting analysis of sales in this way FMCG manufacturers can identify the precise effects of price on volume in this ever-changing and competitive retail environment. A dashboard which considers all influences enables the smartest operators to manage the volume and value delivery for each brand and product, achieving target volumes or margins in the most complex of markets.

UTILISING INFORMATION

By understanding customer reaction to both the company's own and competitors' price changes, and how these vary at different times of the year, it is possible to predict sales volumes for different egg types under a given pricing strategy. This can then be combined with cost estimates for egg production and distribution to determine an expected profit outcome in each case.

This is where the real power of applying analytics to FMCG pricing bites. It becomes feasible to simulate the expected volume and profit outcomes, without further potentially costly market testing.

Dynamic decisions can therefore be taken, having reviewed a wide range of potential pricing strategies.

These strategies are assessed relative to a number of different external market conditions including competitor prices, stock volumes (including product expiry dates), variations in production and distribution costs and seasonality.

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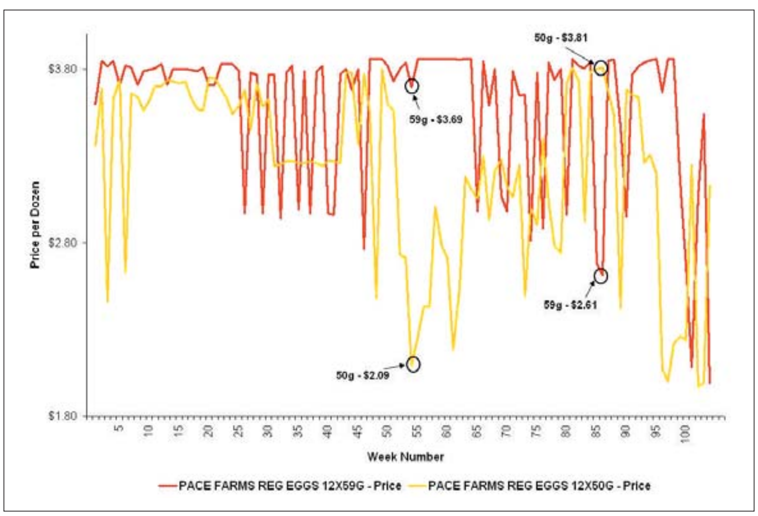

PACE APPEARS TO HAVE DELIBERATELY VARIED THE PRICE OF 50G AND 59G EGGS TO TEST CHANGES IN CONSUMER RESPONSE. (Nielsen tracking data)