



ACHIEVING HIGHER FUEL & RETAIL PERFORMANCE – DYNAMIC PRICING & PERFORMANCE MANAGEMENT

KSS White Paper

1.0 SUMMARY

Today's price volatility and economic uncertainty renders current strategies ineffective and companies are left struggling with unacceptable profitability. Leading fuels retailers are using a new approach to maximize their business performance: **Dynamic Pricing and Performance Management**. This approach extracts maximum insight from operational data, allowing executive management to understand what business performance is possible and thereby drive maximum results in all timeframes, from hours to years.

In addition to dealing with today's challenging environment, retailers are starting to plan for the inevitable shift to a healthier, more robust market. How prepared are you and what can you do today to ensure you're ready to embrace the changes when they come?

2.0 INTRODUCTION

Many of today's fuels' retailers are struggling with unacceptable profitability. Old world business school models of "strategize, plan, execute", based on static analysis and formal reports aren't enough: they don't deliver sustained performance improvement.

Companies need a more dynamic approach, capable of quickly adapting to changing conditions, to satisfy their stakeholders and to stay ahead of the competition.

WHERE WILL THESE NEW SOLUTIONS COME FROM?

Most retailers have reduced their costs repeatedly and have little upside from this route. Today's market leaders have decided to take a different approach. They

are going back to basics, and directly reconnecting their strategies with real-time customer insights. Until recently, this was heavily constrained by a lack of tools and systems, as this requires daily fuel volume, price and store data from a retailer's own sites, competitor and market intelligence.

With the availability of business intelligence tools, advanced performance optimization suites, such as KSS' K3SL and pricing & performance management systems, including PriceNet from KSS, this approach can now be included in routine performance management.

We call it *Dynamic Pricing and Performance Management*.

INTRODUCTION TO DYNAMIC PRICING AND PERFORMANCE MANAGEMENT (DPPM)

At its core is a philosophy which recognizes that businesses can deliver performance improvement by extracting more insight from operational data – insights regarding customers, competition and the market environment down to local site or terminal level.

These quantitative insights can then inform key strategic planning processes in three (3) time horizons, as indicated in figure 1 below.

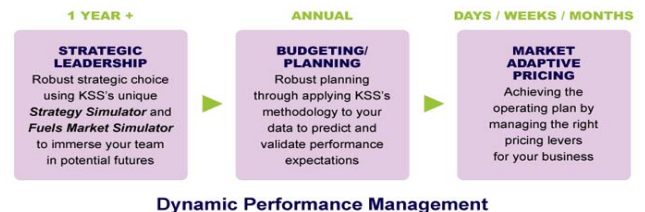


Figure 1 – Planning Horizons

At the heart of the DPPM framework is a capability to analyze, predict and optimize

performance – whether through process change and/or the application of technology – which is combined with existing expertise and a revised ability to deal effectively with process complexity. This core capability is illustrated in figure 2 below.

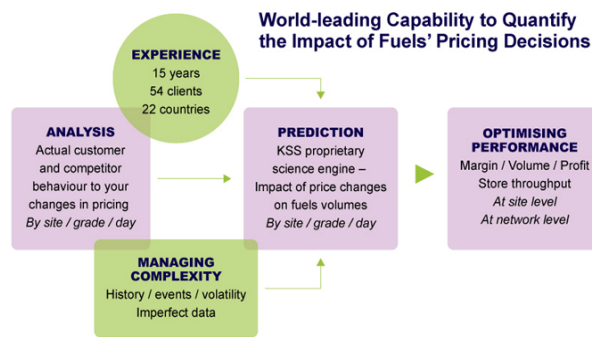


Figure 2 – Core DPPM Process

The core DPPM “analyze-predict-optimize” process is then placed within the broader continuous improvement framework illustrated in figure 3 below, which provides the means to constantly monitor performance and quickly adapt to changes in your operating environment as they occur.



Figure 3 – DPPM Continuous Improvement Methodology

Dynamic Pricing and Performance Management has 5 key interventions through which Fuels retailers can significantly increase their business performance:

- I. Creating a dynamic model of the customer purchasing behavior, by location, as the basis for challenging existing pricing strategy and/or developing revised strategies
- II. Segmenting locations according to customer purchasing behavior
- III. Creating a Market Simulator, allowing what-if analysis of the profit / volume potential under a range of existing or potential market scenarios
- IV. Optimally allocating profit / volume targets to each location, based on capability to stretch performance
- V. Implementing and performance managing the upgraded strategy using the dynamic model in a continuous improvement framework.

This approach typically adds 0.5 to 1 cent per gallon, even for a well-run business. For a typical 500 site Convenience-store network operator, this equates to \$1.5 mln to \$2.5 mln p.a of improvement, with substantially more upside for lower performing businesses.

DEPLOYMENT OF DYNAMIC PRICING AND PERFORMANCE MANAGEMENT

The approach can be applied to the whole gamut of strategic planning, operational budgeting and planning or operational improvement within year. Indeed, it is most effectively deployed to connect all three time horizons.

Typical applications include:

1. Developing strategies for managing market transitions e.g. price deregulation, entrance of new competitors, significant shifts in market dynamics
2. Quantifying the volume/profit potential of a given network of locations under different pricing strategy scenarios

3. Annual budgeting - allocating network volume/profit targets by location to optimize the profit/volume mix
4. Maximization of overall fuel+store profitability across networks of retail outlets

The following example demonstrates its application to improved operational planning and deployed performance improvement.

DYNAMIC PRICING AND PERFORMANCE MANAGEMENT IN DETAIL

In this example, a fuels retailer was frustrated in the performance management process, which seemed to rely on setting KPI targets based on "last year +/- x%". They wanted to understand the answer to 3 key questions:

1. "What performance is possible from my network?"
2. "What KPIs e.g. volume, profit, are appropriate for each site?"
3. "How can we ensure delivery of the improved performance?"

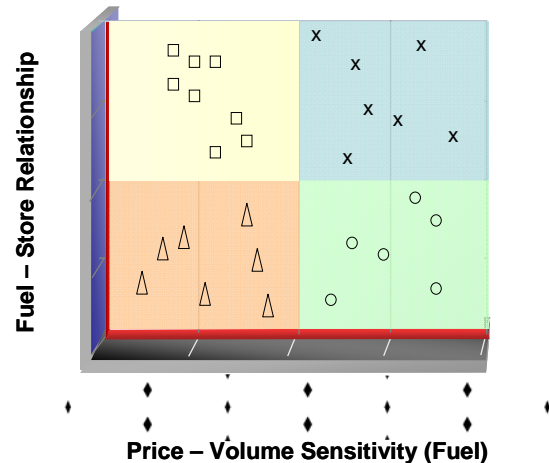
The solution was applied using the 5 key steps outlined earlier.

i. CREATING A DYNAMIC MODEL

Using the clients own historic data on site performance, allied with our K3SL methodology, a dynamic model was created of the customer purchasing behavior, by location, for fuels and store price changes. This model provides the basis to predict and optimize performance at each site and over the entire network.

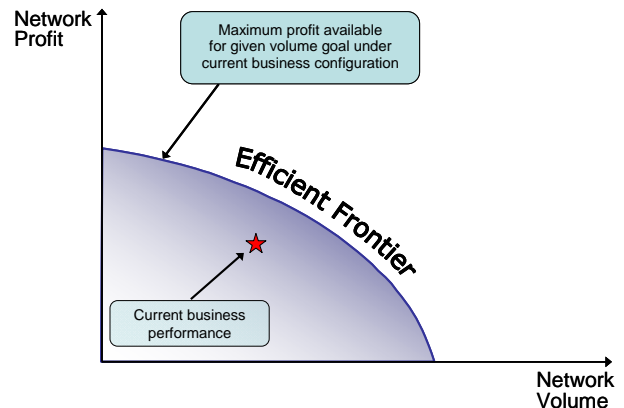
ii. SEGMENTING LOCATIONS

Individual locations are then segmented, according to customer purchasing behavior. In the example shown here, fuel price-volume sensitivity and fuel-store relationship were the key factors driving segmentation.



iii. CREATING A MARKET SIMULATOR

A market simulator was built using the customer purchasing behavior data from each site, to create an Efficient Frontier for the overall network. The efficient frontier defines the maximum achievable profit for each network volume within this strategic option. Current business performance is less than the efficient frontier, mainly because fuel volumes are non-optimally allocated to each site.

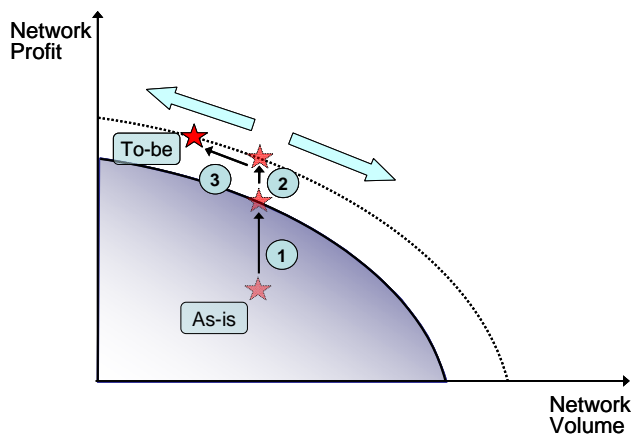


iv. OPTIMALLY ALLOCATING PROFIT / VOLUME TARGETS

The following 3 key steps were then employed to re-budget and improve

performance, as shown in the diagram below.

- 1) Reallocate volumes between sites to optimize profit, based on each sites' customer behavioral response to changes in pricing.
- 2) Deploy a higher value strategic option e.g. optimization based on combined Fuel+ Store performance
- 3) Decision to re-optimize for upside profit gains, based on ceding least profitable fuel volumes.



V. IMPLEMENTATION

ABOUT KSS

KSS, the Fuels Pricing Experts, is the leading global provider of pricing software, analytics and consulting services to fuel retailers and wholesalers in the oil & gas, convenience store and retail industries. KSS helps fuel marketers identify and efficiently execute optimal pricing strategies. The company's US headquarters are located in Florham Park, New Jersey, and its international headquarters are based in Manchester, United Kingdom. For more information about KSS, please visit www.kssg.com.

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KSS supported the client team in deploying the upgraded strategy. The dynamic model is used to performance manage the implementation of the new volume targets & pricing constraints. Weekly performance monitoring & adjustment of fuel tactics is carried out, together with monthly monitoring of site volume performance & re-allocation of site volume targets.

3.0 APPLICABILITY

The KSS Dynamic Pricing and Performance Management framework can be applied to retail and/or wholesale fuels operations, covering refined fuels product distribution at retail gas station, wholesale distributor and terminal levels.

Delivered by KSS Consulting, this suite of performance management services provides a sustainable framework that you can continue to apply to your business far beyond the initial engagement.