EFFECTIVELY DELIVERING YOUR FUELS STRATEGY THROUGH PRICING RULES

1.0 SCOPE

This White Paper outlines how company pricing policy, or strategy, can be translated into a set of consistent pricing rules that can be efficiently used to guide a fuels pricing process. Once defined, these pricing rules can then be challenged to locate opportunities for volume, revenue or margin growth to meet strategic goals. For those wishing to go one step further by implementing price modeling and/or optimization, these rules are essential to define the constraints (or limits) within which new prices can be generated and authorized. In this case, as well as defining performance goals the pricing rules will help to maintain a consistent price image, minimizing any possibility of damage to brand image.

2.0 PRICING STRATEGY

The process starts with a clear statement regarding company pricing policy or pricing strategy. This can take many forms from highly objective, such as “we are the cheapest in town”, "we’ll always be within 1 cent either side of brand Y", to very subjective such as "we are the value-for-money retailer".

A sound pricing strategy should address three (3) key components as follows:

1. Market-share goals, often represented as volume targets;
2. Price positioning versus competition; and
3. Product and/or service differentiation – the additional value of your brand over a competitor, represented as a price premium or discount.

These components describe the high level goals of the organization and should inform the regular pricing tactics adopted by the company. Experience shows that in many organizations the pricing strategy is confusing, conflicting or not clearly communicated to help those responsible for pricing.

3.0 THE PRICING PROCESS

In order to ensure compliance with the stated company goals, the pricing process itself has to be regulated or guided by the 3 strategic components and it’s critical that pricing personnel align their activities according to these components. The reality however is complicated by one or more of the following:

- Volatile competition – competitors frequently changing prices to gain advantage

- More demanding, price sensitive and better-informed customers

- Increasingly varied forms of competition – e.g. grocers, club stores, DIY outlets selling cut-price gasoline

- Underlying economics, demand seasonality, weather and other causal factors

These complicating factors can result in the pricing process relying heavily on intuition/experience, focusing on highly visible price-cutting campaigns and knee-jerk responses to competition by matching them or maintaining hard-and-fast positions with them. These tactics rarely deliver the optimal balance between volume and margin and can hinder companies from meeting their performance targets.

Help is at hand. There is a class of business software tools known as Price Management systems. These tools are designed to help companies clearly define their pricing strategy, translate that strategy into the tactical guidelines needed for pricing and challenge the guidelines to look for new opportunities. Those guidelines must then be applied quickly, efficiently and consistently to generate new retail prices that meet the company's goals more profitably.

4.0 Defining Pricing Strategy

Effective fuels pricing needs company strategy to be defined in the form of clear constraints and targets as follows:

4.1 Market-share goals

These are typically represented by volume targets and should be expressed as monthly and annual figures.

Fuels retailers may wish to achieve an annual overall volume target for the network of stations they manage. To some extent they don't mind how this overall volume is achieved at individual station level, except that there are minimum/maximum limits for volume associated with, for example, recovery of overheads (minimum) and station capacity (maximum). How does the company manage pricing on a daily basis to steer towards, and hit, the annual volume goal?

4.2 Price positioning constraints

There are two broad categories of price positioning constraints:

- Internal - such as the price differentials, or spreads, between regular, mid and premium gasoline grades; and
- External – such as price differentials with competition, e.g. for regular I want to stay 1 cent below competitor X, whereas premium I can vary by up to 3 cents

The following price positioning rules and constraints need defining for any pricing process:

- Minimum and maximum price limits
- Price rounding rules (prices to always end in a '5' or '9')
- Minimum and maximum price-change limits - the amount by which a price can change per pricing cycle
- Price differentials between own products / with competition

Finally we need to define whether a given rule or constraint is 'hard' (cannot be violated) or 'soft' (can be violated if the overall result is more positive).

4.3 Product/service differentiation

Defined as the extent to which you can differentiate your offer compared to competition or more simply to what extent will your customers accept differentiated prices against your competitors because they perceive greater value, convenience, service, security etc from you.

This form of differentiation needs to be incorporated in the setting of the price differentials referred to above.

5.0 Challenges In Defining Strategy

Price differentials are the most difficult to determine and to subsequently manage consistently. This may be because your business has never formally defined them or only defined the more obvious ones.

When setting price differentials it is important to recognize the following factors as influencing to varying degrees:

- Cross-effects between products - the extent to which price of product A influences the sales of product B - of which there are two types:
    - Cannibalization - product A 'steals' sales from B as it is a substitute (e.g. regular vs. mid-grade)
    - Halo/Complimentary - product A positively influences sales of B (e.g. aggressive premium prices may encourage more regular grade sales as customers perceive the overall site to be very price competitive)
- Not all competitors have the same level of influence and this may vary according to product or location - you will need to rank competition and set differentials accordingly

A critical part of the rule definition and setting process is being able to identify where rule conflicts occur and guiding the user to resolving them quickly and easily. In every customer project that KSS Fuels has been involved with we come across rule conflicts to varying degrees.

Without this level of sophistication, one cannot guarantee that resulting prices convey a consistent price image and the company goals of revenue and profit are achieved.

6.0 The Tactical Pricing Process

Once the market-share goals are defined and the price positioning constraints are in place, it is now the job of the pricing system to determine prices that comply with these bounds and enhance business performance towards the company goals.

Step 1 is to ensure that whatever competitors do with their prices, you can move quickly so that your prices remain within the defined limits. This is a classical rules management process that simply ensures your prices comply with the price positioning constraints.

In many instances, the trigger for a price change is the fact that a competitor(s) has moved to such an extent that one or more of your price positioning rules with them has been violated. The only way to correct the violation is to move your price so that the price rule (often a price differential) is satisfied.

This process sounds straightforward for a single product at a single location but imagine looking after 4 or 5 products, with a significant proportion having 3 or more competitors, across 10’s or 100’s of locations with prices moving at least once per day. This requires a system that can maintain all these relationships and immediately alert users to any violations, helping them to resolve them quickly and easily - KSS Fuels tools are designed to perform this task efficiently.

As a further example of where complications can occur, assume you have a price rule with competitor X that states you should match price on regular gasoline and a rule with competitor Y that states you can be up to 1 cent below. What if competitor X cuts price by 1 cent and Y doesn’t move? To match competitor X means undercutting Y by 2 cents at best – what do you do? The answer depends on who the stronger competitor is - something you can only truly quantify with KSS Fuels tools.

Step 2 is then to determine the retail price within the bounds that meets your goals for market share and grows revenue and/or profit margin. For this you need a pricing tool that can quantify the impact of price on volume and then optimize price - a process of finding a new price that still meets your price positioning goals and market-share targets and yet increases margin.

7.0 Getting it wrong

It appears pricing can be a complex and time-consuming practice. It needn't be with the right supporting tools - designed to make the process more efficient by managing the complexity for you and allowing you to focus on the decision-making task.

The prize for getting it right can be very significant - sustainable performance improvement, enhanced customer loyalty, consistent price image and rapid response to competitor actions. For companies who have adopted KSS Fuels systems they experience a significant improvement in profitability.

Getting it wrong can be disastrous and could result in more than just lost sales or margin; it could mean losing customers to your competition. Winning them back again can be a lengthy and expensive process - much more so than keeping them satisfied in the first place.

8.0 Conclusions

We've explored how any pricing process needs to be informed by the strategy of the company in order to meet the goals of the organization and to maintain a consistent brand image and consumer price perception. This strategy needs to be translated into a set of pricing rules (or constraints) that regulate the price-setting process.

We've noted that the level of complexity regarding these rules will escalate dramatically with the number of products, number of outlets and the nature and quantity of competition. Finally, the act of determining price needs to comply with all these rules and yet still drive incremental performance improvement.

Having the rules in place then forms the basis for more sophisticated pricing capabilities such as price modeling and optimization.

It is KSS Fuels' belief that achieving this demands a dedicated system to define, manage and update pricing rules consistently, help those responsible for pricing to resolve conflicting rules quickly and easily and to then assist in determining prices that meet company goals more profitably. This process needs to be capable of being operated in a reactive or proactive manner, depending upon whether you wish to follow or lead the market in terms of price activity.

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9.0 Recommendations

To judge the effectiveness of your pricing rules in driving an effective fuels pricing process, honestly answer the following:

1. Can all my pricing analysts clearly and consistently state my pricing strategy – is there bias or differences of understanding across 2 or more analysts?

2. How long does it take for me to respond to a competitor – from capturing the new competitor price to implementing a new price at my store? If it takes more than 5 minutes you are missing opportunities.

3. Do my pricing analysts have to make compromises on price positioning in order to react to competitors, i.e. how many occasions do my analysts make a judgment call because they can't meet all my desired competitor price differentials?

4. How do I rank competition around a given site? Geographic proximity, brand, retailer type etc. Is the ranking different for different grades – does it change seasonally or by day of week?

5. Is the pricing strategy documented so that if a pricing analyst is no longer with the company we are still able to follow the pricing changes that have been implemented? And do we have a sufficient data trail to support these pricing changes in the event of an audit?

About KSS Fuels

KSS Fuels is the leading global provider of pricing software, analytics and consulting services to fuel retailers and wholesalers in the oil & gas, convenience store, grocery and retail industries. Providing "Knowledge beyond the numbers," KSS Fuels helps fuel marketers and distributors implement effective pricing solutions and increase profitability through the use of knowledge and numbers. 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 Fuels, please visit www.kssfuels.com.