MAXIMIZING COMPETITOR-MATCHING POLICIES THROUGH RULES-BASED PRICING

1.0 SCOPE

The current pricing stance of many gasoline retailers who have sites located in competitive areas is to set the retail price of their headline, or most important, grade using one of the following methods:

- Always match the price of an identified main competitor

- Maintain a fixed price difference with a main competitor

Very often the prices of other grades of gasoline and diesel are then determined by applying a fixed price difference to the headline grade (e.g. premium unleaded is always 10 cents higher than regular unleaded). The driving force behind this stance is the belief that the main competitor sets the price "standard" for the market area and any difference between your price and the main competitor will result in lost volume.

2.0 INTRODUCTION

Gasoline pricing is developing into a loss-leading activity as new forms of competition such as the hypermarkets seek to attract customers onto a site by posting low gas prices and then recovering lost gasoline margin in the store.

The inability to clearly differentiate most gasoline grades and the similarity in customer "offer" at most modern sites forces consumers to use gasoline price as one of the prime factors in their decision as to where to purchase fuel.

Many gasoline retailers conclude that the only way to remain competitive in a given market is to retain parity with the perceived "market-leader" in terms of gasoline price. Many believe that the consequences of staying above a main competitors' price for any length of time are a significant drop in the number of customers that are difficult and costly to win back. The reality, as KSS have found with PriceNet implementations is that this is actually an area where significant gains can be made - if managed properly.

There are a number of situations or factors that can lead gasoline retailers to identifying incorrect main competitors. One example is location - "I must be competitive with the competitor directly across the street from me". In reality the traffic flow and direction may result in your site competing more strongly with another competitor further down on the same side of the street, even if that site is located further away. This can be explained by the fact that traffic flows past your site towards the end of the day when people have more time to re-fuel their vehicles and check your price versus the competitor on the same side of the street further up - as opposed to traffic passing the site opposite in the morning, when people have little time to consider stopping for fuel. Not crossing the street for a penny.

KSS Fuels experience across a variety of petroleum markets indicates that this policy of matching main competitor (or marker) is commonplace and can in some cases severely restrict the potential for a gasoline retailer to be more competitive and improve margins. More importantly, during the evaluation and implementation of the PriceNet system KSS Fuels have found that this policy can be flawed in a number of critical areas.

The competitor-matching policy, although simple and efficient to implement, effectively results in the main competitor dictating the prices of other gasoline retailers in a given trading area. The key questions that need to be addressed in relation to this are:

- How do you confirm, quantitatively, the true competitor?

- Is the true competitor for the headline unleaded grade the same competitor for other grades?

- If a consumer cannot switch between unleaded and diesel, why set diesel prices using a fixed price difference to unleaded?

The consequences of matching or price positioning against the "wrong" competitor can be disastrous. At best, opportunities for volume or margin growth will have been missed. At worst, the real competition will have been growing market-share and taking custom from you without a response.

We will focus on providing answers to the above questions, for every site in your network, enabling you to re-adjust pricing policy to be more competitive and to locate opportunities for market-share and/or margin growth. The intention is to indicate that the same policy can be operated more effectively or we can use objective, quantitative decision support information to challenge whether a change to policy should be implemented.

3.0 IDENTIFYING YOUR COMPETITORS

Identifying True Competition for a Headline Grade

This is usually based upon intuition, experience or other qualitative factors. KSS Fuels take a different approach by helping to answer:

- Who are the true competitors, by grade?
- How are they ranked?
- What is the quantitative impact of their price moves on our volume sales?

This is achieved using the consumer demand model within PriceNet. This model, effectively a sales forecasting tool, contains cross-elasticity relationships with competition that quantitatively describe the unique effects that each competitor has on your performance. These cross-elasticities are created by analyzing recent historical data and then updated each week by PriceNet using achieved sales information. They describe the change in your sales that result from a change in competitor price and can be interpreted as follows:

- A cross-elasticity value of 1.5 indicates that a 1% decrease in competitor price will bring about a decrease of 1.5% in volume at your site

If the current policy is to match SHE-2471 on unleaded (95) prices, then the policy is consistent with the strongest competitor for that grade. If the policy is to match JET-2917 the result will be lost volume by not tracking the real competitor - in this case the SHE- 2471 site.

Using this qualified competitor strength analysis, a retailer can ensure that (a) they are price-positioning against the right competitor and (b) other competitors for a given product are treated according to their ranking (or relative strength).

Identifying Competition for other grades

The same process described in 1 above can be repeated for the other grades. KSS Fuels experience indicates that on many occasions, the main competitor brand for the headline grade is not the same for the other grades.

If the current policy of matching SHE-2471 on all grades is to be followed, then we are no longer positioned against the strongest competitor and volume loss will result.

Relaxing fixed price differentials in favor of differential ranges

Fixed price differentials can exist between a retailers own grades and between own and competitor grades. They are easy to administer but ignore opportunities that may occur across grades for volume or margin growth.

Examples of fixed price differentials:

1. "I am always +1 cent on regular unleaded compared to brand X"

2. "Premium unleaded must always be + 5 cents above the regular unleaded grade"
3. KSS Fuels experience has indicated that the demand relationships for certain grades differ significantly from other grades and that the relative changes in demand across grades changes over time also. Situations where it is possible at certain times to price above a competitor, rather than always equal on price, have also been observed with no damaging effect on sales volumes.

4. Also, if ahead on volume for given grade, switch to more margin-orientated policy and vice versa.

5. Needs system to continuously monitor performance against targets and allow goals to be steered.

These observations prove that it is possible to operate with price differential ranges - between own grades and between own and competitor grades.

To accommodate these dynamic relationships, it is necessary to apply price differential ranges. The difficulty is in deciding the range and then managing it efficiently.

Examples of price differential ranges:

1. "My regular unleaded price must be no less than brand X's regular unleaded and can be up to 2 cents higher"

2. "My premium unleaded price can be between 2 and 5 cents higher than the regular unleaded price"

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.

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