How can retailers change consumers' perceptions of price, not just the price itself?

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Introduction

Despite heavy investments in price, promotions and loyalty schemes, many retailers find that shoppers don't seem to appreciate these investments — the shoppers' perception of the retailers is much more expensive than they are in reality. The challenge for retailers is that the way shoppers make decisions about which shop provides good value for money is a much more complex process than just comparing the average price points.

There are many different drivers of price perception, and retailers need to understand and manage all of them to ensure they're getting the most benefit from their price investment (of course, this investment can be in promotions or loyalty schemes, rather than pure shelf prices). Getting these right can significantly improve price perception, and deliver a better ROI from investments in value. We have worked with retailers to deliver a significant perception improvement, driving long-term revenue and margin growth of two to four points LFL. Other retailers have chosen to improve margins by one to two points, while maintaining their perception scores.

A common story in retail

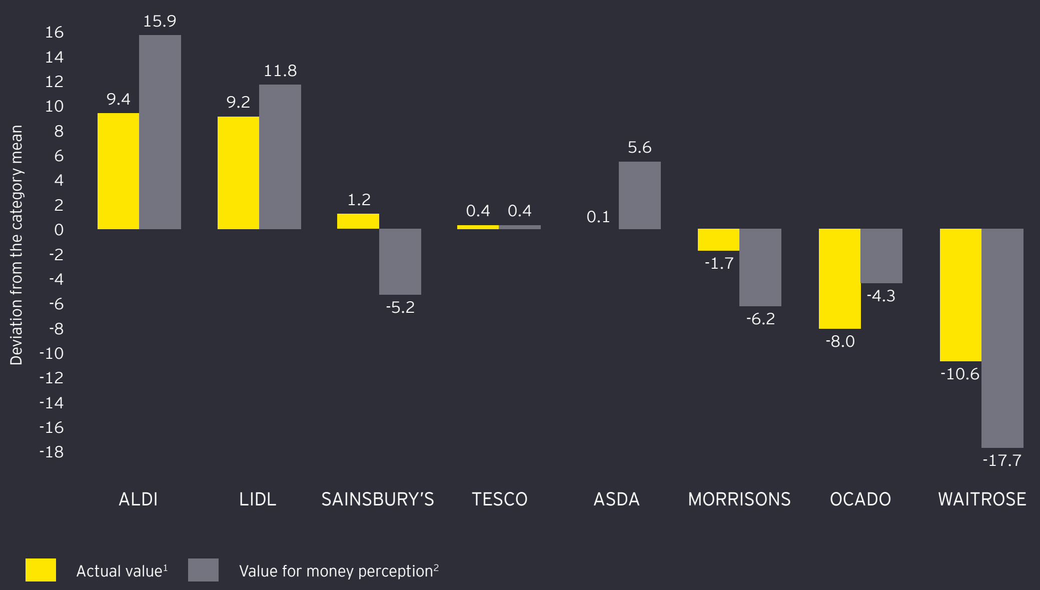
All retailers focus on getting their pricing right. Across all parts of the market, price is the most important dimension in how customers choose where to shop and which products to buy. As retailers navigate the cost of living crisis, this pressure is ever-more acute as shoppers are keen to switch to options they believe are cheaper.

Before the rise of online price comparison, shoppers only received price signals from advertising and what they saw in-store. Due to price transparency, retailers have to ensure that their prices are as sharp as possible, tracking their competitors price positions and continually checking whether products are 'out of line'.

However, often this effort (and investment) goes unappreciated by shoppers. Many retailers have invested huge sums of money in lowering prices, only to find that their customer research stubbornly continues to show poor price perception.

Exhibit 1

Shoppers make their grocery decisions based on value for money perception as opposed to actual value



Source: EY Retail Performance Index (RPI) and Which?

Perception vs. reality

While retailers can build a robust view of the price reality, this is impossible for shoppers. As a result, they make decisions based on their perception, which can be highly resistant to changing.

In the end, perception IS reality: If shoppers believe that Retailer A is more expensive than Retailer B (and that the proposition isn't sufficient to close the value gap!), they'll shop at Retailer B.

The problem for retailers is that they need to improve both the reality and the perception at the same time. And, of course, in these straitened times, there is rarely the money available for large numbers of price cuts.

Retailers also need to understand that consumer perception is complex, and built up from many different elements. Those that understand how shoppers build up their perception of each store are able to ensure that they get the most 'bang for their buck'.

Choosing where to invest on price

Given investment is (usually!) limited, and competition is fierce, most retailers struggle to be cheap everywhere (which is the easiest, but most expensive way to improve perception).

Instead, it's important to decide where to focus investment, and which areas can be used to drive margin to fund investments (across all parts of the proposition).

Most retailers are very experienced with managing the different elasticities across categories – some products (e.g., beers, wines and spirits) are more sensitive to price cuts than others (e.g., fruit and veg). A pound invested in the former is cheaper, as the additional volume makes up for some of the investment. However, some categories are far more important to how shoppers build their perception of a store than others. Lowering prices in these categories is extremely important, as this contributes towards having strong perception. Often these categories have low elasticity, so these price cuts can be expensive, but not as expensive as losing customers!

Retailers need to understand how to balance investment towards categories that drive their perception, rather than those that are purely elastic, in other words, balancing investments in the categories that support the longer-term, rather than chasing short-term volumes.

Stuck in the value trap

Fruit and veg has low price elasticity. Very few customers will buy fewer potatoes today if the price goes up a little. However, it's a very important category for driving perception. Some years back, a European grocer increased the price of its fresh vegetables, resulting in higher (short-term) margins. Over the medium term, volumes started to drop, leading to further price increases to maintain profitability. Within a couple of years, the products were much more expensive than the competitors, and perceptions had fallen heavily, with shoppers going to other retailers. The retailer had to expensively invest in price, with poor perceptions lingering for many months.

Exhibit 2

Retailers must decide where to spend the investment and balance it towards categories that drive perception

Price elasticity
How sensitive the quantity demanded is to its price

High

High price elasticity and low perception
Optimise your pricing for margin
Example categories: Personal care

High price elasticity and high perception
Invest in price, resulting in volume growth, and improved value perception
Example categories: Wine, beer and spirits

Low price elasticity and low perception
Maximise margin to fund price elsewhere
Example categories: Bakery

Low price elasticity and high perception
Ensure pricing is reflective of positioning against competitors
Example categories: Fruit and veg

Low — High

Category perception
How shoppers build their perception of a retailer

Making value clear to customers

A large part of shoppers' perceptions are built up from the hundreds of 'micro-decisions' they make across a shopping trip. If shoppers can't understand why certain products cost what they do, they often feel they're being taken advantage of.

To manage this, there are four key areas within a category which retailers need to focus on:

Targeting price investment on the right customers:

- Not all products in a category should be driving the same margin. Entry price point products have to be sharply priced for two reasons – shoppers derive a lot of their perception from the price of the cheapest product available, and these products are disproportionally bought by the most value sensitive customers.
- Higher-priced products tend to be more brand and quality led, and bought by less value sensitive customers – these are an area where price is not the dominant purchasing factor, so price investments have limited effectiveness.

- This seems obvious, but recently commodity inflation increased the price of basic foods more than premium products. The retailers that most closely managed this, making ‘fair’ price increases across the whole range tended to perform better.

Clear and consistent trade-ups:

- Often the only information customers have on price is the prices of the products in front of them at the store (or on the website). Customers want simplicity, clarity on what they’ll get for their money, and whether the trade-up and trade-down options make sense.
- If they can see precisely what they get for spending more, and what they lose for spending less, this can be a key contributor in driving a reputation for good pricing (even if the overall pricing is expensive!)
- For example, if a bigger pack is worse value (per unit) than a smaller pack size (which often happens with heavy promotional cycles), this can be a significant hit to perception, undoing much of the benefit of the promotion.

Balancing promotions vs. price:

- Many retailers rely on promotions to deliver value to customers. These are frequently funded by the manufacturers, so can feel like an effective way of ‘reducing prices’.
- However, in many categories, shoppers rarely see promotions as a genuine advantage to them. Often they feel ‘forced’ into buying a different product from the one they wanted, and foolish if they’ve previously bought the same product at full price.
- Our research shows that promotions are roughly one-third as effective (per £ of giveaway) in driving perception as price cuts. Heavy promotions in many categories can lead to excellent price reality, but poor perception.

Insult pricing:

- No matter how smart the rest of the pricing is, no customer will be happy paying more than 20% for a product than they can find at a competitor. Insult pricing has a particularly large impact on perception, and needs to be fixed as an immediate priority.

All of these are part of building a robust category architecture, building on the traditional ‘Good, Better, Best’ principles that have driven successful retailers for over a hundred years. However, many retailers have looked to maximise supplier funding with promotions and listing fees, adding complexity for the shopper. Generally, simplicity and clarity makes a category easier for customers to shop, and they reward you with strong perceptions.

Fewer products, clearer value

A leading European GM retailer significantly simplified their ranges in some of their key categories, focusing on Good, Better, Best principles and making the category easier to shop. Volumes increased, with more customers finding the product that was right for them, including more sales of the own brand range. Customer perception during the launch improved significantly, driving long-term performance of the categories (and retailer). In addition, stock holding for the categories reduced by 20%, driving a significant working capital improvement.

Typical benefits

Most of these steps are not individually difficult, but many retailers struggle to manage the numerous trade-offs and to focus on the medium-term vs. the pursuit of short-term volumes. Providing category teams with strategic clarity on their goals and objectives, and bringing them the right insight, are both key in helping them in making the best possible decisions. Often this will require changes to KPIs, and better tracking of prices and promotions, along with how customers are shopping them.

However, when this is executed well, the benefits can be large. In our experience working with retailers (across multiple sectors), addressing the issues laid out above can drive a significant revenue and margin gain (two to four points of LFL sales, and one to two points of margin rate), without any additional price investment. Often this frees up money for further price investment, improving perceptions and delivering long-term revenue and volume growth.

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