Managing Strategic Change – A Consultant's Perspective

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When buying something, are you aware of the price? Of course you are. When buying a new shirt or a few reams of paper, or making your weekly trip for groceries, do you ever wonder how that merchant determines what price to charge? When you think about the different businesses you frequent, have you labeled each of them in your mind with a certain pricing classification – for example, "expensive", "competitive", "cheap"? Do you combine it with other shopper related observations such as "helpful sales force", "large selection", "mediocre quality" or "lots of out-of-stocks"? Have you ever seen a retailer move from one classification to another over time? I'm sure you have, and sometimes for the better and sometimes not. One of the major factors behind this is a change in the seller's pricing strategy – some are successful; some are not.

Working with numerous clients enacting strategic redirection, there is a common underlying pattern to the transformation that can serve as the template for success. It is a multidimensional template, and failure to address any one of the components can lead to consternation, frustration, and eventual project (or entire company) failure. While the specific strategic elements involved may differ, how they need to be considered and sequenced is a constant. The CPA/CGMA, a quantitatively-oriented trusted advisor, can play a critical analytics role. The CPA_CITP, focused on process, project structure and technological enablement, can provide the needed infrastructure and encourage operational discipline - the practitioner having a keen understanding of the end to end process being the linchpin.

**Art or Science**

Consider a client wishing to change their approach to retail price setting. While there is some art involved to price setting, there is far more science than many people realize. Within this science, there are varying philosophies and methods. The philosophy in combination with the method selected, overlaid with the art, results in the desired strategy. Using this to guide the execution of specific analyses and the implementation of precise tactics is how the merchant delivers the new strategy.

An example of the "art" is the decision around rounding rules: For years retailers would only end prices in "9's" or "5's". Over time some expanded to include "7's" and "3's". Some retailers still refuse to end in "0's" or use whole dollar amounts; others leverage these price points as deliberate tactics. Various psychological impact studies have been performed, but have yielded different results on whether consumers react positively or negatively to various ending digits. The final decision on rounding policy comes down to the subjective judgement of the client's merchandising management.

With respect to philosophy, the simplest example is the retailer deciding to lead or follow the market with respect to price changes. As a product's cost changes, the merchant must decide if they adjust their retail immediately, or to wait and assess what the rest of the market does. Sometimes the decision to lead or follow may differ depending on whether it is a cost increase or a decrease. A retailer may adopt the philosophy to "lead down, but lag up". Others may choose the opposite.

Moving to method, the retailer typically decides to implement either a margin-based retail setting technique or a competitive price indexing methodology. In the first instance, the merchandiser determines what a reasonable and feasible (from a budgetary perspective) profit margin is, and sets retails based on that mark-up. With the latter method, the merchant decides how they want to be price-positioned in the market – a certain percentage cheaper than a competitor, not to exceed a certain percentage higher than a competitor, or equal to a competitor. The retailer then conducts frequent competitive price checks in the market and determines their index to the competitor(s). They compare this to their targeted differential - then adjust prices to attain the desired index. Regardless of the method selected, the retailer makes specific determinations by department and/or major category, further tailoring them by what the merchant considers to be its strong or weak product offerings with respect to the remaining market and the target customer.

Assessing the feasibility of the respective retail pricing choices requires a great deal of modeling. The models must reflect not only the projected changes in retail pricing, but also anticipated sales volume changes (up and down) across major item groupings. There are a number of regression-based pricing elasticity tools that can help the retailer. However, for clients with limited budgets, basic elasticity coefficient estimates can be developed using internal point of sale history. While, in general, price decreases usually result in volume increases, and price increases usually result in volume decreases, projecting the magnitude of the change in relation to the size of the retail change is challenging when there have been varying promotions over time intermixed with regular retail changes. Understanding how to establish basic coefficients and weed through the noise is where the CPA/CGMA can deliver a great deal of value to the project team.

Additionally, cannibalism – that is, a customer simply switching from one product to another resulting in no net change to overall volume, is an ever-present compounding variable. Cannibalism's sibling, halo, is also in the mix. This is where the volume of a related product lifts because of its complementary usage – a better price on shampoo can lift the volume of conditioner even though the price of the conditioner didn't change.

Another factor that must be considered when developing a pricing strategy is how to position corporate brands. Will the retailer employ a margin-based approach, a competitive index or use a percentage gap based on the retail they set for the equivalent national brand. Yet another factor is around size parity. That is, as the size of the item increases (e.g. a 20 oz. can versus a 12 oz. can of the same product). Will there be an improved price per unit? If so, what will be the percent of savings offered across that product line or category?

Each factor adds to the complexity of the forecasting model needed to vet the final strategy and provide support for its ultimate approval by management. The CPA/CGMA can help ensure the model is able to handle the interplay between the various factors as different assumptions and competitive scenarios are iterated through and evaluated.

**Now the excitement really begins**

Even with a sophisticated set of modeling tools, applying the science is not as simple as selecting the options and feeding them into the bat cave computer. No easy answer spits out for the pricing hero to just run and implement. Pricing strategy is not a component that's managed in isolation. The impact on business process caused by, and needed to support a shift in pricing strategy cannot be understated. Failure to manage change through the entire process will result in old downstream maintenance processes remaining, and the former strategy slowly re-emerging by default. Worse yet, the re-emerged pricing strategy may be further out of step with the rest of the retailer's revised go-to-market strategies and marketing program.

No matter how much thought has gone into the new prices, or how intricate the new pricing tools and techniques, the law of the four P's of Retailing 101 still reign: Pricing, Promotion, Placement, and Product – pulling one lever implicitly impacts the others. [Note: Placement includes in-stock condition and related store service & cleanliness; Product includes quality, range of assortment, and cost of goods.]

In the customers' eyes, this interrelationship manifests itself in the Value Equation where Value = $f$(Quality, Service, Selection, Price). Budgetary constraints come into play, and program priorities must be set that best support the new pricing strategy. For example, if the retailer intends to reduce prices (thus product gross profit), can they still afford to provide the same level of in-store service? If not, what services should remain? If the retailer decides to raise prices, do they need to invest in expanding assortment to enhance the customers' selection options? Will a shift in meat pricing require a change in the grade offered? Will it include an impact on the staffing level or the hours of operation of the meat counter? When managing a significant strategic shift, it's not just managing a project; it's managing the merchandising portfolio.

Realizing benefits of a change in strategy don't materialize overnight. It takes time for customers to recognize a change has occurred and adjust their habits accordingly. While needing to be prepared to make alterations based on competitive response, if management doesn't give sufficient time for the new strategy to "bake", inconsistent moves by management during the deployment period can confuse the customer or result in erosion of trust. The CPA/CGMA can help council management regarding the need for discipline prior to embarking on a strategic redirection.

**Organization and Support**

To help the client through this, the engagement team must serve in many capacities. The CITP and/or CGMA is well suited to fulfill or guide them.

- Project Management – Budget, Timeline & Integration Dependencies
- Subject Matter Expertise (SME)/Content Management
- Business Process Architecture & Management
- Scenario Management & Modeling

Depending upon the CITP's or CGMA's background, the needed SME may be sourced by an industry expert facilitated by the CITP or CGMA; managing the merchandising portfolio also comes into play.

By engineering and orchestrating a balanced value equation presentation to the customer, a holistic approach to pricing should enable the client to grow sales and profits with existing customers, increase its percentage of core shoppers, and attract new customers. Minimally, it should allow the client to protect market share. These objectives need to be clarified and quantified at the outset of the project. They should form the basis of the project charter and become its guiding principles.

***Warning***: In complicated areas, it's easy to slip into a solution cycle of increasing complexity (versus "step-wise refinement/simplification"). Therefore, the project team should always follow the tenets of practicality and feasibility, and should have regular scope-to-actual check points to ensure it's remaining on this path. The engagement team must continually satisfy themselves that the client will be able execute the solution after the project team departs. The targeted end state process also should be designed to integrate with, and be supported by, existing pricing and promotional ***execution*** processes and will continue to support the existing retail accounting and shelf tag creation processes. The last thing the client needs is a three-eyed creature it can't house and care for no matter how mesmerizing it may seem.

At the core of the engagement teams' work effort is analyzing, designing & enhancing business processes; understanding how the new process will differ from the existing process, then identifying what is needed in terms of people and technology to implement & support it. This includes the tools & procedures needed to model, execute and monitor. This new framework must recognize that major store departments need to be positioned differently and/or leverage different "value equation" tactics. By understanding the entire portfolio, the practitioner can help identify strategic conflicts before finalizing plans.

**The approach**

The following has been a successful template for helping develop and implement a change in strategy.

1. Ensuring that overall company vision serves as the foundation for the new pricing strategy development. Sessions are conducted with senior management to ensure this vision has been sufficiently articulated and documented; that management as a whole understands and supports this vision, or recommends revisions if appropriate. This should speak directly to the four P's.

2. Executing initial interviews with key business leads around current merchandising/pricing/ promotion tools & operations to develop basic "as is" process flows. These serve as the foundation for building the "to be" design and transition plans. It helps provide that a pathway has been built to transition from the old to the new.

3. Reviewing/assessing the competitive & economic landscape and basic customer trends; the results are used to categorize related opportunities and threats. This serves as input to the "to be" design.

4. Assessing what data and data sources (e.g. competitive price checks) are available or need to be secured, and need to be incorporated into the "to be" processes. This includes determining how this can be most practically & cost effectively executed and maintained long term.

5. Reviewing the current basis for departmental or major product category classification and the criteria for selecting the degree of pricing competitiveness for each; helping ensure there is harmonization across groupings.

6. Using the results above, develop the "to be" process. These results will aid management in determining what related promotion, placement and product levers to pursue simultaneously, resulting in priorities for the "to be" end-state process. Developing this process includes price modeling, using management assumptions as input. Ongoing support tools are identified and respective ownership & responsibility charts are developed.

7. Identifying a set of metrics & reporting for the ongoing monitoring & management of the process.

    a. Establishing baselines and targets.

    b. Building an annual calendar to provide for periodic process reviews. This helps introduce process discipline as sufficient "ramp-up time" is required before the effects strategy changes truly can be measured. (i.e. prevent a "variance" from being interpreted as a "trend".)

8. Identifying any new post-implementation integration points.

As a final step before implementation and hand-off, the engagement team takes the client through a "conference room pilot" where the execution and management of the new pricing strategy is taken from beginning to end, with each step owner demonstrating what their step(s) consist of, including key inputs and outputs. This is an opportunity to validate that all integration points have been identified and addressed.

**Conclusion**

While no entity wants to languish in an in-between state for any length of time, moving from the old state to the new state is not flipping a light switch.  It's not uncommon for changes in strategy to take between nine and eighteen months to be realized.  Maintaining focus on the overall objective and maintaining operational discipline during transition are key to attaining the final goal.  Because many retailers have detailed promotional planning lead times of eight to twelve weeks, the transition, which will be conducted in waves by product line, requires the attention commensurate with that of choreographing a ballet to ensure the changes in regular retails are properly synchronized with advertised promotions.  Underestimating the time and attention required to transition to the new state can jeopardize a tremendous investment.  Once in that new state, the benefits can be enormous.