Price Wars: a primer

An Advanced Pricing Logic White Paper

September, 2013

APL ADVANCED PRICING LOGIC™ | Home of Promoter

SWK TECHNOLOGIES

5 Regent Street, Suite 520
Livingston, NJ 07039
Phone: 973.758.6100 • Fax: 973.758.6120
www.swktech.com

Locations:
Livingston, NJ (Headquarters)
Buffalo, NY | Chicago, IL | Dallas, TX | Los Angeles, CA
Minneapolis, MN | New York City, NY | Syracuse, NY

CHALLENGE

In highly competitive industries, price wars are an expensive possibility. Understanding their origins and effects is the key to prevention and minimization of cost.

ORIGINS

Expanding market share is often the penultimate goal of growing companies; unfortunately this goal can take a grave toll on profit margins. Too often the “strategy” is as follows: decide on a growth curve percentage and then rely on additional volume to make up for the loss in profits due to lower prices and hope this puts the company ahead of the competition.

“If we pencil in a growth curve of “xxx” percent, then the additional volume should make up for the loss in profits from lower prices and put us ahead of the competition”.

This is frequently the justification and rationale when a company starts a price war and in time, profits do plummet. Could it drag the entire industry down? It all depends upon how you and other firms react. In most cases, price cuts only work for a while.

You have more influence and power than you might realize if you are on the receiving end of an aggressive competitor’s move. In retail and distribution, processing greater unit volume does not always equal greater profits. In some cases, more units may afford a cheaper rate of expense from a supplier, but (especially in retail) the expense to process additional units of product can weigh heavily on narrower margins. The equation can be dangerous.

There are many reasons companies feel they must compete on price alone and it cuts across all business types: smaller competitors, new entrants to the market, and bold merchandisers with deep pockets. They often feel that in order to expand their market share, price is the most effective lever they can pull - *at the expense of margin*. Unless there is some particular known edge that your competitor has, at some point they will return their prices to normal. However, this often occurs after a few months of battered balance sheets.

DIAGNOSING

Pricing battles can escalate quickly. Taking time to understand the causes and consequences before reacting will help you better determine what your participation (if any) should look like. The first step is to diagnose. A price war may begin because one party suddenly obtains new, valuable information/insight that was previously unknown to them, or has found suppliers that lowered their cost. This suggests your competitor is implementing a cost plus pricing strategy and is not taking advantage of value-based pricing.

The reason for a price war can be no more complicated than an enterprise wanting to capture more market share. The lower price strategy could be part of a larger, more complex business plan. The company might be thinking lower pricing now, value pricing later. Later when? It depends in no small part upon your reaction to their move. In any event, a competitor willing to dump prices warrants evaluation. Your goal is to end the price war as quickly as possible while preserving your own profitability.

WHAT THEY "THINK" THEY KNOW

Your competitor has more than likely made assumptions about how you will react to their moves. The probability that those assumptions are based on inaccurate or incomplete information is high. It's possible in their anticipation of higher volume that they may not initially be concerned with your reaction and/or they may assume that you cannot react fast enough.

PREVENTION

You must attempt to avoid a downward price spiral, so it is important to quickly signal your pricing intentions in public. This makes it clear to your competitors that they are unlikely to achieve their desired results and will be met with resistance. You must reveal your strategic intentions to your competitors ahead of time. Price matching and other public statements (in your policies, marketing and advertising) will signal to your competitors that you will not tolerate a price war and intend to fight using all resources at your disposal. Make sure that your competitors understand the rationale behind your pricing policies. This will go a long way toward preventing a price war.

Your weapon of choice should be differentiation. When a competitor decides that they want to play in your "sandbox", it should cost them dearly to lower their prices. This is an opportunity to bring in *new sand* by adding features to your offerings that give added value but cost little to implement (defining the differences in the quality of your service, packaging and an otherwise better experience for the customer overall). These differentiation techniques need to be made obvious to the consumer.

Even if a product is identical, you can emphasize many features in your marketing that set you apart. For example, if your product is certain to be in stock at the time of ordering – emphasize it. Can your competitor guarantee that? Maybe they can, but if they fail to mention it – they will lose out. Another powerful tactic is to offer rebates and frequent buyer rewards to your most loyal customers.

It is important to quickly signal your pricing intentions in public, making it clear to your competitors that they are unlikely to achieve their desired results and will be met with resistance.

Understand too that there is a serious downside to lowering prices. Companies would be wise to stress their service, quality and commitment to their customers first, before adjusting price. When the focus is on the brand, competitive prices will appear as a bonus.

If you have a cost advantage, revealing it can be a powerful signal. Letting a competitor know your strategic intentions and capabilities publicly is key to getting them to back off. In reality, if you are using value-based pricing correctly, you'll pay slightly less attention to a competitor's move – and more attention to what your customers are telling you.

In many markets, product pricing varies wildly, and it is rarely the lowest price that matters - as long as the key players are all within certain percentage points of each other. The quality of service, the ability to obtain product when needed and the perception of how easy (or difficult) you are to deal with versus "the other guy" is what ultimately counts. These are all hallmarks that must be properly conveyed to your customers through marketing and advertising messages. You'll have a much easier time with pricing if these other pieces of the overall business puzzle are properly in place.

RESPONDING WITH PRICE

If you must respond with price, the best way is to recalibrate your offerings, so that products that are purchased together can be bundled together for a discounted price. Your customers will appreciate the convenience and discount. Find related products that offer higher margins, and bundle them with items that offer lower margins (so that the overall sale on such bundles remain profitable). Plan ahead of time, then put into practice more complex price offerings with discounts on volume, price promotions and loyalty programs that are not easily duplicated at the time you introduce them.

Taking the time to evaluate the situation and formulate the best response based on *both* your internal and external data minimizes the effects of price wars and can often help you avoid them completely.

As a last resort, adjust the pricing on products that have the highest movement (these are your most visible products – and therefore are the most price-sensitive) to match the competition. Resist lowering prices below the competition. Price matching has the effect of letting the competition know that it is pointless to continue; you're not interested in fighting, you're simply going to match whatever lower price they create.

CHANGING THE GAME

Just as companies lead others into a price war, they can also lead others in raising prices on certain products and lines. Competitors are watching your moves too. If you practice value based pricing, your competitors are bound to notice that some of your prices have moved up, and some down. It is highly likely that they'll start following your moves and this could lead to raising prices across the entire industry and boosting profitability across the board. Competition then becomes about something other than price.

WHAT DOES IT MEAN?

Competitors may lower their prices but it doesn't have to result in a price war. By taking the time to evaluate the situation and formulate the best response based on your internal and external data, the effects of price wars can be minimized and often avoided completely.

ABOUT THE AUTHOR:

Dave Leonard is the CEO of Advanced Pricing Logic. He has over 30 years of executive management experience in multi-channel retail, distribution, manufacturing, and catalog merchandising. Mr. Leonard also has extensive experience in the area of technology analytics as it relates to price optimization for the mass marketer, inventory control and optimization, purchasing optimization, and consumer pricing psychology.

ABOUT APL:

At Advanced Pricing Logic we are dedicated to designing innovative analytic software that makes our customers more profitable. Our software transforms data into insight and provides the platform to turn insight into action. Designed by business professionals, our software follows three guiding principles: encapsulate world class analytics, enable customers to take sound action through easy to use applications and ensure ROI less than a year after purchase.