



The Importance of Pricing to Both Shoppers and Retailers



Why Do Most CPG Companies Struggle with Pricing?

The Four Ps – Product, Price, Place, and Promotion – are key marketing elements for any product or service. Even though price is the quickest way to make more money, CPG companies are reluctant to pull the trigger, usually because they fear how shoppers and retailers will react. Setting the right price for your product or service is difficult. In fact, determining price is one of the toughest things a manufacturer must do, in large part because it has such a big impact on the company's bottom line.

The Shopper Perspective

One of the critical “shopper” elements of pricing involves understanding price elasticity. Price elasticity measures how sensitive shoppers are to the price of a product or service. With price, the assumption is that more shoppers will buy more of a product when it is less expensive and fewer will buy less when it is more expensive. In many categories, current buyers will purchase more when it is cheaper. Consumer sensitivity to price varies by category. Understanding how consumers' demand for a product is impacted by price lets you optimize your offer. CPG companies must consider how elastic (sensitive to fluctuations in price) or inelastic, (largely ambivalent about price changes) their products are when contemplating how to set or change a price.

The Retailer POV

Just as important as the shopper's reaction to a price is how the retailer will react. Before the coronavirus pandemic, many CPG categories had flat or declining sales. In this environment, it is often difficult to increase price. And if you do, retailers will be hesitant act on the price increase. The retailer is looking for definitive information that provides assurances they will not lose sales. Ideally, research will show the historical pattern of pricing (elasticities) and the impact a price increase or decrease will have in the marketplace on your brand, competitors, private label and for the category overall. For CPG companies, brand does not live in a vacuum: First, you must set price in conjunction with retailer's pricing. Then, just as importantly, you need to understand what the competitive response will be if you raise or lower your price. Being able to model “what-if” scenarios will provide the necessary proof to retailers that your plan will be mutually beneficial.



- ✓ **CPGs are reluctant to raise prices**
- ✓ **They need to understand price elasticity from the shopper's perspective**
- ✓ **They need to overcome retailer objections**
- ✓ **TABS/DI combined process does this best**



Price Elasticity - How do you measure price elasticity?

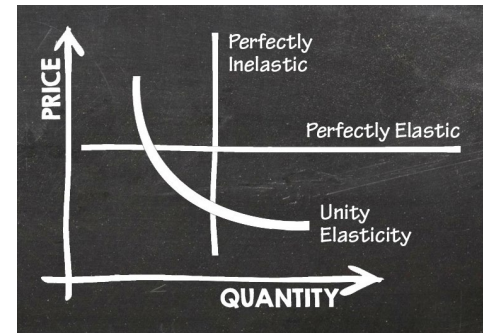
$$E = \frac{(Q1 - Q0) / (Q1 + Q0)}{(P1 - P0) / (P1 + P0)}$$

E=Elasticity

Q=Quantity Purchased

P=Price Sold

Price elasticity measures how sensitive shoppers are to the price of a product or service. Simply put, when there is a change in price, what is the corresponding change in sales? For commodity products, there is a great deal of elasticity because consumers view the products as interchangeable between brands. At the other end are products with strong brands that tend to be more inelastic. So as the price goes up, shoppers are willing to pay more. All products fall along a continuum from Highly Elastic (small changes in price have large changes in quantity purchased) to Highly Inelastic (changes in price have little or no change in quantity purchased). Knowing where your brand falls on the continuum is important. Using the formula above, the higher the absolute value, the more sensitive consumers are to change.



Price Elasticity: The higher the absolute value, the more sensitive consumers are to change.

Approach

TABS Analytics and Decision Insight developed a process to help brands understand price elasticities using advanced analytics combined with virtual shopping.

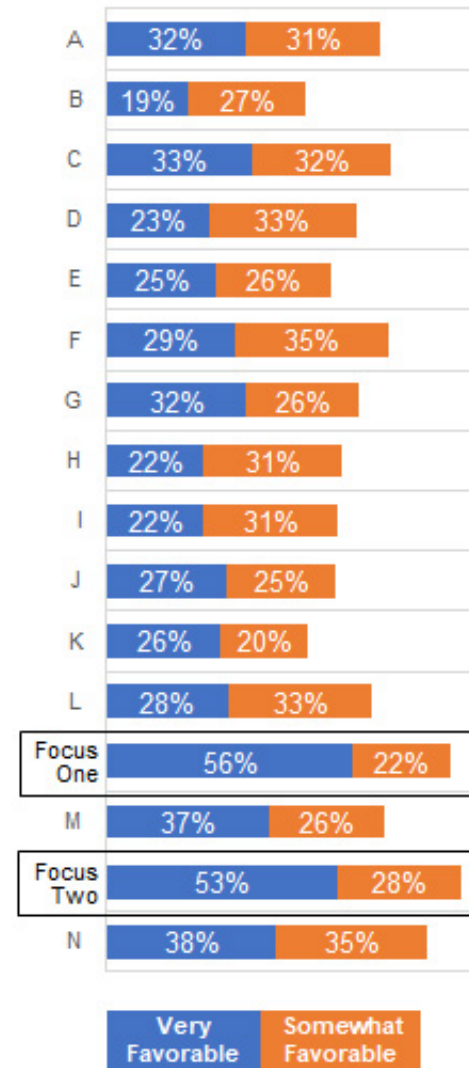
TABS – Advanced Analytics

Using advanced analytics, TABS determines the worth shoppers place on your brand and determine the optimal price you can charge at the SKU level. Combining point of sales data with analytics modeling, the process evaluates units sold by price point to calculate elasticities for your top performing SKUs and cross-elasticities with competitors and private label. This process entails combining your sales volume at a specific purchase price, competitive sales volume at purchase price, private label sales volume at purchase price and finally overall category sales. Since the relationship is logarithmic (not linear), a change in price can have significant changes to quantity purchased.

For example, TABS combined consumer research (survey results) with in-market analysis (price elasticity analytics) to determine pricing strategies for homeopathic healthcare remedies. First, TABS looked at brand awareness for the homeopathic product compared to other key market competitors. While the competitors' products were more familiar, the consumers surveyed looked at the homeopathic brand more favorably than others. TABS's price elasticity analysis across several retailers revealed that the majority of the homeopathic brand's products have inelastic demand. In this case, a 10% price increase would only decrease units sold by 6%, since homeopathic consumers and buyers of this brand associate price with quality.

- Price Elasticity analysis across several retailers show the majority of the brand's products have Inelastic demand.
- Survey data corroborate these results by showing that the brand has very high favorability among those familiar with the brand; this high favorability translates to high perceived quality.
- Homeopathic consumers and buyers of core homeopathic brands are much more likely to agree with the *Price = Quality* relationship.

Healthy Remedy Brand Favorability



Source: TABS Group Survey of 1,046 Primary Household Shoppers 18+.



Homeopathic Healthcare Remedy Brands have very strong favorability scores over other key market competitors. Our Focus Brands lead the pack on this critical metric.

Low Elasticity With an 8% Price Increase

PRICE CHANGE 8%

RETAILER PERSPECTIVE

ELASTICITY	ORIGINAL	-0.6	Inelastic	-1.0	Unit Elastic	-1.4	Elastic
UNITS	1,000	952	▼ -4.8%	920	▼ -8.0%	888	-11.2%
PRICE	\$6.89	\$7.44	▲ 8.0%	\$7.44	▲ 8.0%	\$7.44	8.0%
COST	\$3.45	\$3.72	▲ 8.0%	\$3.72	▲ 8.0%	\$3.72	8.0%
PROFIT PER UNIT	\$3.45	\$3.72	▲ 8.0%	\$3.72	▲ 8.0%	\$3.72	8.0%
MARGIN	50%	50%	0.0%	50%	0.0%	50%	0.0%
REVENUE	\$6,890	\$7,084	▲ 2.8%	\$6,846	▼ -0.6%	\$6,609	-4.1%
PROFIT	\$3,445	\$3,542	▲ 2.8%	\$3,423	▼ -0.6%	\$3,304	-4.1%

PRICE CHANGE 8%

MANUFACTURER PERSPECTIVE

ELASTICITY	ORIGINAL	-0.6	Inelastic	-1.0	Unit Elastic	-1.4	Elastic
UNITS	1,000	952	▼ -4.8%	920	▼ -8.0%	888	-11.2%
PRICE	\$3.45	\$3.72	▲ 8.0%	\$3.72	▲ 8.0%	\$3.72	8.0%
COST	\$0.86	\$0.93	▲ 8.0%	\$0.93	▲ 8.0%	\$0.93	8.0%
PROFIT PER UNIT	\$2.58	\$2.79	▲ 8.0%	\$2.79	▲ 8.0%	\$2.79	8.0%
MARGIN	75%	75%	0.0%	75%	0.0%	75%	0.0%
REVENUE	\$3,445	\$3,541	▲ 2.8%	\$3,422	▼ -0.7%	\$3,303	-4.1%
PROFIT	\$2,584	\$2,656	▲ 2.8%	\$2,567	▼ -0.7%	\$2,478	-4.1%

In this low elasticity scenario, both the homeopathic product manufacturer and retailer can realize revenue and profit gains from a price increase. Even at the slightly higher price, the target customers will continue to purchase the product. Additionally, raising the price will also bring the homeopathic brand's price more in line with key competitors.

As this example illustrates, pricing decisions are too important to be left only to one analytic methodology: consumer research or in-market analysis. Both are needed to ensure that the right pricing decision is being made and, importantly, it can be substantiated when presenting it to the retailer.

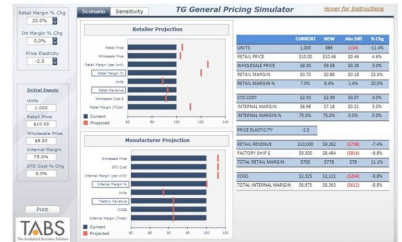
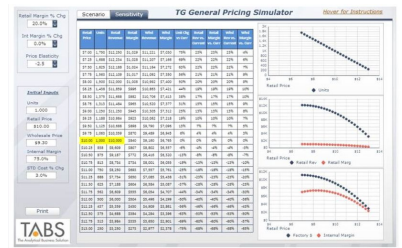
Even at the slightly higher price, the target customers will continue to purchase the product.



TABS Analytics provides a Pricing Simulator that enables you to evaluate a range of pricing scenarios to determine what optimizes sales for your brand and the category and is operationally feasible. The calculation of elasticities involves a lot of nuances. TABS Analytics' offering is best-in-class because of its attention to detail:

- Price elasticities are not linear, but exponential – Small changes in price can have significant changes in sales.
- Price elasticities are retailer-specific – Shoppers have different expectations and react differently at Target than Walmart or at drug stores compared to grocery stores. Ideally, analysis should be completed by retailer.
- Elasticities vary by pack size – Historically, smaller sizes have higher elasticities.
- Elasticity varies by season and times of economic disruption – This included time periods such as the recession in 2008/2009 or the upheaval caused by COVID-19 to the marketplace during 2020.

In addition, TABS includes economic variables into the modeling to align results with microeconomic theory and the laws of demand. While these steps may seem to be a given, all too often we see competitive services providing results that do not take these details into account, which results in models that are economically impossible.



Our Pricing Simulator web-enabled software simulates the sales and profit effects of pricing by controlling internal, retailer, and competitive actions.



Decision Insight – Virtual Conjoint

Just as important as understanding the impact of price changes is the effect of changes in the marketplace, which enables brands to prove to the retailer that the recommended pricing will be positive for the brand, for private label, and for the category. Decision Insight's Virtual Conjoint goes beyond how products have been historically priced to what shoppers are willing to pay today and tomorrow. Based on the Laws of Choice, Virtual Conjoint evaluates multiple options, evaluating a variety of price points for your brands, as well as enabling you to model competitors' reactions to your change with "what-if" scenarios. As market leader, if you change your product's price, and other national brands follow suit, what will private label do?

Virtual Conjoint embedded in online shopping directly measures the impact that pricing changes on your brand and competing brands have in the marketplace and how the products interact based on price as an isolated variable. This process reflects real-world consumer decision-making more closely than purchase intent scores. With Virtual Conjoint, shoppers evaluate multiple sets of products on an aisle, and then shop them. This approach exemplifies how consumers make choices at the point of purchase by evaluating multiple offers on a combination of variables, including price.

The online virtual shopping exercise recreates a typical shopping experience in a simulated environment. First, participants enter the virtual store and shop as they would in real life. They can interact with shelf variations, scroll through the aisle to view different products, click on individual items to pick them up to learn more, then return the item to the shelf or select it to purchase.



Virtual Conjoint answers:

- What are the appropriate price/size combinations for brands to maximize revenue?
- Which combination of features, sizing, and pricing best improves purchasing?
- How will incremental price changes impact demand?

How Virtual Shopping Works:

1 Participants enter a virtual store...



2 where they shop as they would in real life, interacting with shelf variations.



3 and click on items to pick them up, learn more, return to shelf, or select to purchase.



Virtual Conjoint is extremely powerful because it:

- **Reveals the underlying structure of decision making** – This enables us to build mathematical models of what shoppers are likely to do and why. With choice, we know the outcome AND understand the decision making behind it.
- **Is more efficient than concept testing** – Concept tests are static and require large sub-samples to evaluate ideas one at a time, independently of all others. A choice study can simulate thousands of concept evaluations, each within the context of any others.
- **Can be used to predict choices and marketplace activity** regarding products, ideas, and concepts.

The objective is to identify guiding principles based on what solutions benefit the retailer, the shopper and your brand.

The success or failure of your brand often depends on your pricing decisions. This service developed by TABS Analytics and Decision Insight ensures that you have the best information available to make optimal pricing decisions. In addition, by demonstrating the change will be positive for the category and not hurt private label, CPG brands can use this research to demonstrate the benefits to retailers and overcome objections and concerns that they normally have.



Testing shopper choice, we know the outcome AND understand the consumer decision making behind it.

About TABS Analytics

TABS Analytics is a technology-enabled analytics firm servicing the consumer products industry. Our mission is to simplify and improve the way analytics is conducted through analytical innovation, which translates into a competitive advantage for our clients. TABS is the leading outsourced sales and marketing analytics firm in the consumer-packaged goods (CPG) industry.

For more information about TABS Analytics services or this white paper, please contact Robert Baldwin at robertbaldwin@tabsanalytics.com.

About Decision Insight

Decision Insight (DI) is a leading shopper insights and retail strategy firm that uncovers shopper behaviors and motivations. Twenty years of partnering with leading CPG companies have trained the team at DI to actively anticipate emerging needs to deliver **solutions** that lead to activation, triggering higher shopper satisfaction and increased sales. Our Test & Learn research is forward-looking and based on shopper behavior.

For more information about Decision Insight Virtual Conjoint and pricing research offerings, email Leslie Downie at leslie@decisioninsight.com.