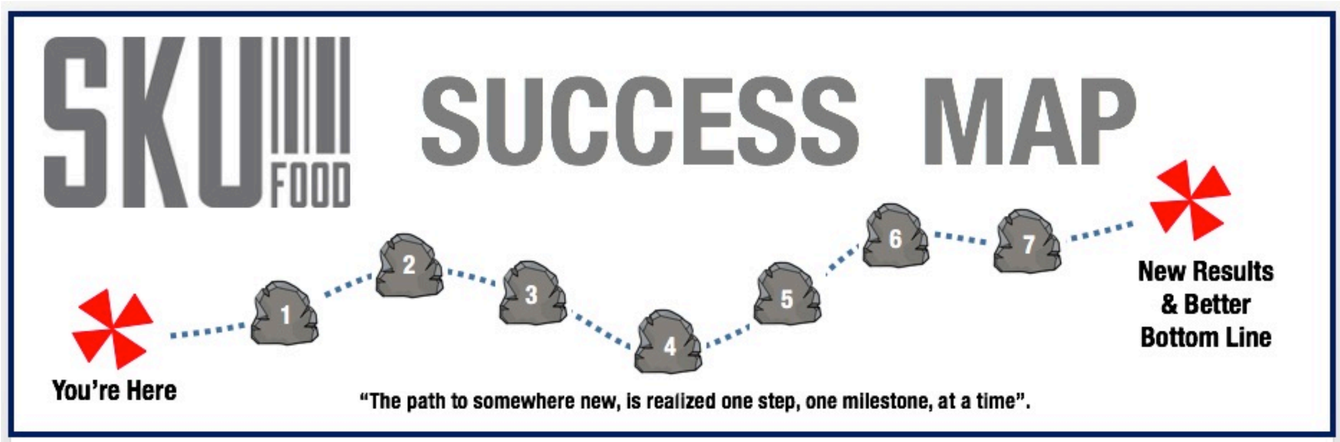

Pricing for Profit

With Peter Chapman & Gary Morton

Where you are today:

- Your prices are too low and your bottom line is not delivering
- You are not selling enough
- You don't understand how your customers determine the retail price

Where you need to be:

- Your products are priced right to maximize profit and volume
- You understand the retailer's math and the impact it has on your bottom line
- You see the category as the category manager does

Pricing products properly is one of the toughest things for suppliers in the food industry. If you sell them to retailers too cheap you give up money that would flow directly to your bottom line, if you charge too much you risk losing the sale or stifling your sales because the retail price is too high.

<u>Our SKUfood Success Map is comprised of 7 milestone implementation steps to ensure that your products are priced right.</u>

Visit the stores monthly

In our industry the store is very important. This is where the consumer makes the decision to buy and where you see the execution and performance of your products. You need to visit the stores every month to experience the shopping environment and understand what is happening with your customers, your products and your competition.

No doubt it can be a challenge to get to the stores. You are busy and your schedule just doesn't allow for time to walk around grocery stores. You have products to produce, staff issues to resolve and many other challenges.

It is also a waste of time to visit stores if you don't have a plan for your visit. Walking around looking at displays of your competitors and getting frustrated can be discouraging.

Your customer makes decisions at the office and the store employees have less influence than they used to.

Strategies

1. **Schedule store visits on the way to work**

This will ensure you get it done before you get focused on other tasks during your day. Mornings are a great time to visit stores. They are not as busy and employees are more willing to talk about your products and share insights into the category.

2. **Schedule meetings at stores**

Encourage your employees to meet you at the store. What better place to discuss your products? You can see it live how the products stand up through the supply chain, how the consumer buys and perhaps even encourage a few extra sales! Most stores have seating accompanied by beverages for your meeting.

3. **Create a simple store visit checklist**

Develop a one page checklist to keep your store visits focused on the topics important to your business. This will allow anyone in your business to check the relevant sections of the store and monitor the issues you see as important. Set an example and complete the checklist on every visit. Offer a small prize for the employee who completes the most checklists. Review the completed checklists at sales meetings and as you get ready to visit your category manager.

Complete a category review

You need to see the category like your customer does. Retailers are looking to do things in each category; drive sales and maximize profit. You need to understand how they do this and where you fit in their analysis.

On your store visits it can be frustrating when you see things happening in the category that don't make sense to you. Decisions are made that impact your products and they can be damaging to your sales and the positioning of your product in the market.

We often see examples where competitor's products seem to get all the opportunities. If there is an ad or an off shelf spot, they are there.

If you aren't on the same page as your customer with what drives sales and profit in the category your efforts will not be successful. You will be putting opportunities in front of them that don't resonate and waste your time and money.

Strategies

1. **Complete a category review**

Visit the stores to list all of your competition, including retail prices, sizes, estimate of weekly sales and estimate of their cost. Record specific sales tactics they are using such as loyalty programs, coupons or other promotions. There are other considerations in certain categories such as shelf life that you should record. Include your product and private label products if they are in the category.

Get as much information as possible to complete your category review. How big are the case packs? How can you differentiate yourself from them? Every retailer is different but spend some time looking at the shelf labels. They will often tell you the case pack, retail per volume and other information.

2. **Look at the category like your customer does**

This is the time to assess how your item compares to the competition. **You are now looking at the category the same way the category manager does.** Where do you fit in the category? You can determine what your retail should be given your quality, package size and the value you deliver to the consumer.

3. **Assess your value in the category**

You are always more likely to get the price you need when you deliver value to the customer. Assess where you fit in the category relative to your competition. Do you command a premium or just believe you do. What do you offer that they don't?

Talk to people in the stores

Some of the most valuable insights will come from people who work in the stores, and they are **FREE.** All you have to do is talk to them. They handle your products every day. Consumer research is great but don't forget about the people in the stores.

It can be a challenge to get them started talking because they are busy and some prefer to just put their head down and keep working. They do have different schedules but with a few store visits on different days it is not hard to figure out when they are there.

Strategies

1. **People in the stores like to matter**

Store employees used to have more autonomy. Usually they are eager to share their knowledge if they believe they can make a difference. Tell them who you are and you do value their opinion. Ask them how your product performs and what consumers say about it. If you develop a good relationship with certain employees mention them when you meet with category managers. Chances are it might come up when they have a department manager meeting some time down the road.

2. **They understand your competition too**

It is great to get insights about your products but you can also learn about your competition. Don't expect sales numbers but you can get a sense for how they did with a special theme or if they introduce a new SKU. If they launch a new item and it is a bust you can save yourself a lot of R&D time on the same idea.

3. **Offer them coupons**

You should be able to offer them nominal coupons for your products. You want them to try your items so they can share first hand knowledge with consumers. They can sell your product every day if they like it. Check to make sure it is within the retailer's guidelines but most are ok with this. If they cannot accept the coupon buy the product and let them try it.

Attain the category margin

For you to develop an effective pricing strategy you need to know the category margin. This is a critical piece of information that can be different for each customer.

If pricing doesn't make sense to you in the category then you probably don't have a clear understanding of what your customer is trying to achieve. Category margin also impacts the ad prices you see.

Our experience is that the profit they see retailers making at retail frustrates producers and processors. This is gross margin not profit.

Strategies

1. Ask the category manager

Most category managers will tell you what they are trying to achieve in the category. They have a target and their life is easier if you deliver a cost that will allow them to hit a desired retail price at their targeted margin.

2. Ask employees in the store

If you are having trouble getting the answer from the category manager often the store employees will tell you. Keep in mind each retailer treats the landed cost in the store differently. Some add a percentage for the warehouse and distribution so the store level margin is lower than if they just use your delivered cost right through to the store.

3. Use your retail and your cost

You should always know the gross margin they are making on your items. You know your delivered cost and retail so you can calculate your customer's gross margin. Use the math in table 1 as an example on any item.

Table 1
Regular retail=2.99
Your cost 2.00
Gross margin=(Retail-Cost)/Retail
Gross margin=(2.99-2.00)/2.99
Gross margin=.99/2.99
Gross margin=33%

Determine your actual costs

Correct pricing requires you know your real cost of goods. Make sure you have all costs included such as freight to the warehouse, rebates, seasonal fluctuations in ingredient costs, packaging and all other costs. To maximize your bottom line you need to make sure you know your true cost of goods.

There is no doubt food production and processing are complicated. It is difficult to allocate all costs accurately. Many items are produced on the same line or with the same equipment.

When you understand the category margin and your competitor's retails you wonder how do they do it? It is true there are often sizeable differences and retailers read a lot into the differences.

Economies of scale are either big opportunities or challenges in food, depending on your volume. When you compete against products where volume is much higher the fixed costs are allocated across a much greater number of items.

Strategies

1. **Explore your costs**

Your customers invest a significant amount of resources to reduce shrink and other costs in their business. You should too. This will help your bottom line and put you in a better position with your customer. You will be perceived better if you can tell them you can maintain your cost flat for a year because you were able to offset some increases with efficiencies or lower costs on some components.

2. **Reduce costs that don't differentiate you**

Producers and processors are proud of what they do and they put great effort into getting it done. Explore the costs that don't differentiate your products. Freight for example is one necessary cost but your customer only wants it delivered. Perhaps you could share a truck with other items or change the pallet configuration to get more cases per pallet. The food business is built on slim margins so a few cents on the cost of cardboard or freight or ingredients can make the difference.

3. **Reduce costs that don’t add value**

Explore the important issues to your customers and consumers. What are they really looking for and do your products deliver this? There are many examples of products that include a specific ingredient that is important to the processor but does it really deliver value to the customer or consumer. Sometimes the answer is yes but just as often it is no. Each category has different priorities and as a supplier you need to explore them and review your cost components to ensure you are investing where it will resonate with customers and consumers.

Understand retailer’s math

Retailers calculate margin as their selling price minus their cost, divided by their retail. They do not calculate margin as a mark up from cost.

It is not easy to understand category pricing. Often there are different forces at play such as competitor’s retails, support brands or category captains and ad prices that impact regular retails.

It is very important to use gross margin as opposed to mark up. Retailers will see you in a different light if you understand their math. It is also very costly to have a retailer tell you the retail and category margin is you use mark up to determine your cost.

Strategies

1. **Estimate your selling price using category margin and regular retail**

   Using your retail from the category review and the expected category margin, here is the formula to determine an estimate of your selling price to the retailer. Keep in mind not every item is at exactly the category margin. The retailer could be higher or lower due to inventory issues, competitive pricing or trying to compensate for lower margins on other items.

Regular retail=2.99

Category margin=45%

$$\frac{2.99-(\text{your selling price})}{2.99}=.45$$

2.99-(your selling price)=1.35

-(your selling price)=-1.64

your selling price =1.64

2. Estimate your retail using category margin and your selling price

If you know your selling price and the category margin here is the formula to determine the approximate retail you will see in the store. In this example the retailer would likely go to 2.79 unless there are competitive reasons to be 2.69.

Your selling price to the retailer=1.50

Category margin=45%

(1.50/(1-.45)=retail

(1.50/.55)=retail

2.73=retail

7 Impact of promotions

Retailers will want to promote your item, which will deliver incremental sales. These sales will come at a cost. You must determine the best pricing strategy for your items.

When items sell significantly more on temporary price reduction it is very costly to suppliers. The timing of the draw for ad items can also impact your cost.

You hear retailers talk about every day low cost and high/low and you aren't sure which one is right for you.

Strategies

1. **Every day low cost (EDLC)**

Some customers will want an every day low cost (EDLC), which means your factor in the promotions and they pay the same price 52 weeks of the year.

The benefits to EDLC are that you simplify the business and the retailer will make the decision to promote your item. They will decide how much margin they want to invest each time the item is promoted. The down side is that you don't have the chance to offer incentives to promote the item when you want to and they dictate the size of the discount.

To determine what your EDLC would be take the total sales you did to the customer in the previous year and divide by the total number of cases. This would be the average cost, including all of the discounts you offered.

2. **High/low**

Some retailers will still want you to have a regular price and offer discounts throughout the year to support in store specials or ad opportunities.

The benefits of the off invoice strategy are that you can have more influence about promotion timing and discounts. The down side is if the retailer puts a low price on the product and the sales go crazy, you will be on the hook for the reduced selling price on all of the volume.

This strategy gives the supplier more chance to negotiate incremental volume opportunities but there is more risk if they invest in your item and you have to support the reduced selling price for the entire inventory they sell.

3. Determine the best strategy

Calculate your expected volume for promotions based on history and what you see happening with other similar items in the category. This will give you an estimate of the promotion activity and allow you to determine if you want to encourage the retailer to use an EDLC or an off invoice strategy.

Some retailers will tell you what it will be and others will consider the options. It can be different by category as well.

No doubt the EDLC is a simpler method of doing business however you have to be careful that you don't agree on an EDLC and then support over and above activities with further discounts. That can be costly!

Summary Checklist

Following each of the milestones in our SKUfood Pricing for Profit Success Map will ensure the following:

Milestone	Checklist	√
1	I visited my customer's store (s) to learn more about my product category.	
2	Completed a category review that provides me with the customer's perspective of the category.	
3	Built valuable relationships with store employees to provide more information about both my product (s) and my competitor's products.	
4	I know and understand the category margin the retailer is trying to achieve.	
5	Explored and challenged all costs to determine if they're as low as they can be.	
6	I understand the retailer's math (Margin verses Mark Up)	
7	Assessed the cost of promotion and the impact it has on my selling price.	

Congratulations, on achieving all seven "Pricing for Profit" milestones.

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