A new paper from the Stanford Graduate School of Business finds that a promotional pricing strategy appears to be a better approach to competing against big boxes than than every-day-low price (EDLP) one.

The study explored market share battles during the 1990s when chains with EDLP models, such as Walmart, Sam's Club, and Costco, began making rapid inroads into the food channel. The study particularly looked at Walmart's entry.

"You need a major event to cause a pricing strategy switch that can be observed, and the entry of Walmart into the grocery market provided that natural experiment," said Harikesh Nair, associate professor of marketing at the business school and a co-author of the study, in a statement. The results were drawn from revenue and price-format decisions for every single retail supermarket and Walmart in the U.S. from 1994 to 2000.

The study found that EDLP reduces inventory costs, better coordinates supply chains, and reduces the risk of stock shortages by smoothing the demand variability induced by frequent sales. On the other side, a promo strategy results in higher revenues. Running calculations on the data, promo pricing for the median store yielded $6.2 million more per year in revenues than an EDLP strategy.

The study offers no conclusions on whether EDLP's cost savings or promo's revenue boost were more effective in the long run.

But promo proved more resilient to the entry of a bigger EDLP rival. Analysis revealed that the entry of Walmart resulted in a $1.7 million loss in annual revenues for the median incumbent EDLP supermarket, while it resulted in a loss of only $690,000 a year for the median promo store.

Also, switching from an EDLP to a promo strategy required only $2.6 million in costs over four years, while switching from promo to EDLP required outlays six times as large. A major investment included educating consumers about the "legitimacy of the new positioning." For example, researchers noted that the Wegmans chain in New York produced videos explaining to customers the benefits of their switch to EDLP. Repositioning costs also involved resistance to change by managers within the firm and the need to rework channel relationships.
"Now we have empirical evidence to show why most stores chose promo pricing and stuck with it during a competitive shock — it earns more revenues and is too expensive to change," said Prof. Nair.

Prof. Nair offered three findings from the study:

- "If revenues are what you care about, do promo pricing,"
- "If you're a new entrant, be careful about your pricing strategy, because once you're locked in, it's difficult to reposition yourself."
- "Price perception is really important. Customers' sense of how you price merchandise drives foot traffic to your store and takes a long time to build up. Violations of that will be costly in terms of the loss of consumer trust and the expense it will take to reeducate them."

- Everyday Low Pricing May Not Be the Best Strategy for Supermarkets According to Stanford Graduate School of Business Research - Business Wire
If a grocer started today, would you suggest a promo, EDLP or hybrid pricing model?

Comments:

I think I do agree. One, it’s a lot harder for a smaller chain to match the EDLP prices of the economies of scale of Walmart. Two, it requires a lot more discipline to maintain an EDLP strategy -- there is always the temptation to promote something, anything, if revenue or margin expectations are missed, and the moment you do that, you’ve trashed your carefully constructed margin plan that enables EDLP. And three, you can still create a pretty strong price image with promotion -- customers don’t care if you’re the lowest price on everything, just so long as you are the lowest price on everything they specifically buy.

As long as shoppers believe they can get good deals at your store, you’ve got something to compete with against much bigger chains. Promotion leaves a lot more room to play with those expectations than EDLP does.

Nikki Baird, Managing Partner, RSR Research

General merchandisers have succeeded through the years with either EDLP or high/low promotional strategies, so there is more than one option for food retailers too. However, it’s too simple to say that promo pricing is “the answer,” because it depends on a variety of factors:

1. Which pricing tactics are more appropriate to your overall brand strategy as a food retailer?
2. Does your specific competitive situation really allow you to be priced higher than EDLP food retailers?
3. Is your customer likely to wait for sales, cherry-pick promoted items and do most of her grocery shopping elsewhere?

I’d suggest a market-basket analysis to provide some empirical evidence one way or the other on this issue, but there is likely to be a valid argument on both sides.

Richard Seesel, Principal, Retailing In Focus LLC

I for one believe in some form of EDLP program, because the customers today know the price of all major food items, and if you are gouging them, the results will be ugly. There is a perception out there that Walmart is the King of low price, and it is just not true. However, in the minds of consumers, and some economists, they believe it to be, so it makes it very hard to break through all the rhetoric to make your case to the consumers.

The top 200 items are where the bread and butter is in every store, and to me it is vital to be right, on those items. I have to buy deal to deal in order to keep the cost down, and will continue to follow that strategy, even if I run out of something for a week or two.

Now is not the time to be raising prices without large increases in wholesale, and all of us need to hold supplier’s feet to the fire, in order to get the best deal. Much more time is spent on procurement than ever before, because the buying cycles for hot deals need to be monitored closely in order to gain the edge in your purchases. Good luck to all stores
Tony Orlando, Owner, Tony O's Supermarket & Catering  (/profile/33222/tony-orlando)

First, EDLP doesn’t really mean low price, it means average fair market price. It depends what kind of competitor you are. A chain like Wegmans which offers a superior shopping experience doesn’t need promo pricing. EDLP works best for them. Customers want a fair price, but not a Walmart price in their shopping experience. The plain vanilla chains like Kroger, Safeway, Winn-Dixie, Supervalu, Roundys etc, they are better off with promotional pricing. Those chains are getting their teeth kicked in by Walmart and they need to "shock" their customers to keep them coming back with a few major loss leaders, fuel perks, double coupons, and perhaps some signs saying they have lowered 5,000 prices (not really, just for perception purposes). Stores that offer superior customer service like Hy-Vee, Publix, and H.E.B are just fine with EDLP. These companies don’t need a paper from a business school to figure that out. They learn very quickly when Walmart opens what they need to do.

David Livingston, Principal, DJL Research  (/profile/16536/david-livingston)

I think we left out a third type of format. The stores that have both EDLP and promotional pricing. Chains like Woodmans (WI & IL), Crest (Oklahoma), and WinCo. They have near Walmart pricing while offering promotional rock bottom give-aways. Those million dollar plus (in some cases $2 million plus) per week stores tells me this might be the best format of all. But those chains are rare, usually employee owned, and not greedy.

David Livingston, Principal, DJL Research  (/profile/16536/david-livingston)

I agree promotional pricing is stronger for smaller grocers when competing against the giant EDLP chains. There is no long-term survival for a smaller chain competing in this model.


I tend to agree with the findings but this suggests a dichotomy between EDLP and Hi/Lo. In fact, most retailers are hybrids.

I think the key is to understand the marketplace and choose a positioning that works. Perception of low prices is often more important than actual price points. It is critical to offer low or promotional prices on trip generating items. Supplemental or impulse items can be higher priced.

Raymond D. Jones, Managing Director, Dechert-Hampe & Co.  (/profile/6391/raymond-d-jones)

Aggressive couponing and threshold offers (spend $50, get $10 off or spend $50 and get free holiday signature item (ham, turkey), access to website coupons from CPGs, e-coupons on grocer sites and reward programs with bonus
points on featured items -- savvy shoppers who know and understand price/value relationship are all putting enormous pressure on grocers.

Being a promo priced merchant vs. EDLP -- the path is clear, chose promo and give yourself the best opportunity to influence key metrics. Without significant buying leverage, EDLP isn't an option.

David Slavick, VP, Retail Consulting, Customer Communications Group (/profile/174680/david-slavick)

I am reminded here of the immortal line from "The Princess Bride":

"You fool! You fell victim to one of the classic blunders - the most famous of which is 'never get involved in a land war in Asia' -- but only slightly less well-known is this: 'Never go against a Sicilian when death is on the line'!" [laughs maniacally, then keels over dead]

I hereby offer up the third-most-well-known classic blunder: "Never go up against Walmart using an EDLP pricing strategy"!

You'll have better luck winning a land war in Asia....

Ben Sprecher, Founder and VP, Marketing, Incentive Targeting, Inc. (/profile/130940/ben-sprecher)

Interesting findings considering that this year, Walmart, J.C. Penney and Lowe's all made various vows to end promotional shenanigans and either return to (Walmart) or initiate (the others) EDLP-ish models. With the big guys zigging to price consistency, smaller-scale competitors would seem to have a mighty zag in moving toward promotional pricing.

Carol Spieckerman, President, newmarketbuilders (/profile/17150/carol-spieckerman)

Interesting stuff. I think EDLP ultimately holds much more sway with consumers (think of all the companies that have become great successes being low price). The issue is that it is very hard to beat Walmart at EDLP -- and being second-rate EDLP in a sector is a losing proposition. You're better off having promo pricing.

For those that have a great twist on a concept, EDLP is often still the way to go. I think of Grocery Outlet or WinCo on the West Coast, who re-sell distressed inventory at incredible values. Or the dollar stores, which have smaller footprints to get them into many more markets.

Jonathan Marek, Senior Vice President, Applied Predictive Technologies (/profile/118867/jonathan-marek)

No. BUT ... it all depends on the timeline.
Heavy promotion can obviously build share in the short-term but I still believe it just encourages bad consumer, i.e., margin-eroding, behavior in the long-term.

Of course, since retailers have, in so many cases, walked away from any value proposition other than price they have eroded their price integrity to the point that they may not have other options.

Consumers still see promotional pricing for what it is -- they've just learned to exploit it better. You can buy share but you can't buy loyalty.

Ryan Mathews, Founder, CEO, Black Monk Consulting (/profile/15078/ryan-mathews)

The bottom line is that EDLP is in the best interest of the shopper, in the long term, because of the increases in efficiency. However, shoppers are not that rational. Hi-lo pricing creates essentially a "casino" atmosphere in the store, where the shopper always COULD win, even though, over time, they don't.

I discussed this issue, including couponing, in "No, the Customer is NOT Always Right!" (http://www.shopperscientist.com/2009-07-23.html)

Herb Sorensen, Ph.D., Scientific Advisor TNS Global Retail & Shopper, Adjunct Senior Fellow, Ehrenberg-Bass Institute (/profile/7814/herb-sorensen-ph-d)

In a fashion, I must disagree with Tony O's statement that "the customers today know the price of all major food items." On the contrary, research over the years has shown that individual shoppers remember the prices of a maximum of seven items. That's what makes the high/low strategy work. That's what makes "now on sale" speak to some shoppers more strongly than "trust us, we're lower overall." If a shopper is inclined to look for deals on the items they prefer, then they're also often inclined to do the rest of their shopping in the store offering those deals. Who has time to cherry-pick one store and then burn gasoline to drive to the regional Walmart for fill-in items? And after all, the likelihood they'll know the price difference on a fill-in item between a high/low store and an EDLP store is remote. What is likely, though, is that they've already purchased some of their up-to-seven remembered items on sale.

M. Jericho Banks PhD, President, CEO, Forensic Marketing LLC (/profile/13276/m-gericho-banks-phd)

Very insightful article -- highlights the importance of an integrated, predictive promotional program. Also reinforces the need for tight coordination between corporate marketing and promotional activities.

Bruce Pagliuca, Principal North American Pricing Practice, Capgemini

My only concern with Hi/Low is that it can drive long-term shopper disloyalty as customers realize that they should never buy on "high" and simply wait until "low" comes around. This can induce them to pick up the product category at another retailer in the interim. I would recommend adding a true loyalty program that rewards increased spending and loyalty... behaviors the retailer wants. Done right this creates a discount level that the retailer can honestly afford over the
long haul.

Peter Leech, Partner, The Partnering Group

Consumers like the treasure hunt that a promotional strategy allows. However, it doesn’t mean your prices can be high. You still have to compete.

Christopher P. Ramey, President, Affluent Insights (profile/114480/christopher-p-ramey)