Pricing Optimization At Large Catalog Company: Creating Strategic Pricing Capabilitis For Fact-Based And Behavioral-Based Pricing Decisions

The Challenge: CatalogCo, a $700+MM catalog-based consumer products company, had been recently purchased by a PE firm in a highly competitive auction. CatalogCo had been very successful due to its diverse product assortment and positioning as a low-cost provider of consumer goods. After more than doubling sales to $700MM in the preceding 6 years, CatalogCo was looking to further grow its top-line by an additional $200MM over the next 3 years. Based on management's assumption that its customers were not price sensitive, CatalogCo began raising prices, a move that coincided with flat revenue. A preliminary analysis by Gotham revealed that in the period with increased prices, unit volumes declined over 10%. Given the poor performance that coincided with the pricing increases, CatalogCo's management asked Gotham to further investigate the impact of pricing on sales and help them develop a strategic pricing process.

The Partnership:
Analysis: As a starting point for understanding the impact of pricing on unit sales velocity, the Gotham team looked at the effect of price changes on an item basis across multiple product segments and over several years in order to determine the correlation between price and unit sales velocity while accounting for changes in advertising exposure and product lifecycle. This analysis revealed:

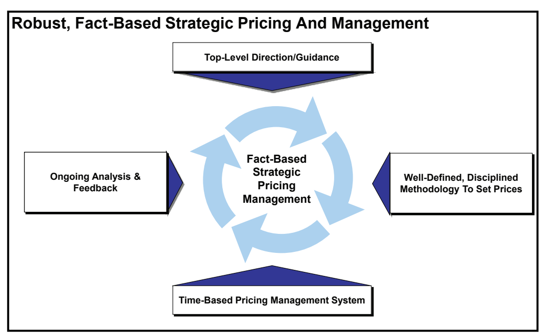
- At an aggregate level, CatalogCo's customers were in fact price sensitive, as evidenced by an increase in unit sales velocity when prices were decreased, with mental thresholds existing for customers at $5, $10, $20, and $30
- In recent years, CatalogCo's assortment mix had changed to include a much more significant percentage of higher priced items that had greater sensitivity to increases in price compared (on a percentage basis) to lower priced items.

The Gotham team then mapped the pricing processes to identify key issues/gaps and discovered:

- An ad-hoc pricing process that was not tied to corporate goals
- Price changes being made with very limited analysis/lack of understanding of sales impact
- No focus on category price point mix, leading to over-assortment and cannibalization at some price points and an under-assortment at other price points
- Merchandisers were managing pricing at a catalog level, leading to price inconsistencies within the same time period.

Strategy: Working with management, Gotham developed three initiatives to quickly correct pricing in upcoming catalogs and to ensure strategic pricing moving forward:

1. Create pricing guidelines based on actual trends/correlations
2. Review pricing in upcoming catalog drops and identify immediate pricing adjustments using the new guidelines
3. Develop robust pricing process that includes:
   - Translation of marketing/financial objectives into pricing constraints
   - A category price point mix reflecting customer buying preferences
   - Time-based pricing to ensure consistency across advertising media
   - Ongoing analysis and adjustments based on performance against regularly tracked key performance indicators.



Execution: To create a quick-win in the upcoming catalog, the Gotham team analyzed recent sales performance for over 1,700 SKUs and identified nearly 900 SKUs as candidates for price rollbacks.

We then worked with the management team to develop pricing guidelines based on the historical analysis. Once completed, we launched a client team to translate the guidelines into process and then roll out the process to the merchandising group. To improve the analytical capabilities of the merchandisers, Gotham created a statistical pricing model that provides both overall directional guidance and sales forecast guidance.

While the process was being rolled out, significant cost increases ($10MM on the existing cost base) were incurred from CatalogCo's main sourcing location, China, necessitating price increases. Gotham built a model to help merchandisers select items where a price increase would have minimal impact on sales.

The Outcome: Over 1,000 items were re-priced resulting in a projected margin increase of $1.3 million. The new processes and modeling tools were integrated into CatalogCo's planning and forecasting process and used to help set the company's SKU assortment.

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