Restoring Credibility to Retail Pricing

Gwen Ortmeyer • John A. Quelch • Walter Salmon

If it’s October, it must be time for Christmas sales. The increase in goods sold at discount has made consumers understandably suspicious. A list price just doesn’t mean much anymore. Ortmeyer, Quelch, and Salmon argue that retailers must restore credibility to their pricing to remain competitive. Retailers can do this by adopting a strategy that dispenses with most sales and emphasizes consistently low prices. The authors discuss the benefits and applicability of such a strategy and distinguish between a pure version and a modified version that also emphasizes excellent service and attractive selection. Sears, Roebuck and Company’s unsuccessful switch to an everyday low price policy illustrates some of the risks involved.

In the 1980s, driven by excess retail space and only modest sales gains, retailers escalated their use of sale events. In 1988, for example, Sears, Roebuck and Company sold 55 percent of its goods at sale prices. Department store sales that used to begin after Christmas now start weeks beforehand. “Sales” in total accounted for over 60 percent of 1988 department store volume. At the same time, retail list price margins, as a percentage of the original selling price, rose from an average of 47 percent in 1977 to 49.5 percent in 1987. The increasing proportion of merchandise sold at discount and the rise in retail list price margins or “initial markup” have caused some to question the legitimacy of these promotional practices.

The use of inflated initial markups followed by alleged sales has become so severe a problem that some state and local consumer protection agencies are suing retailers. The Pennsylvania Bureau of Consumer Protection has successfully pursued retailers such as John Wanamaker for advertising misleading sale prices. In Massachusetts, regulatory changes have tightened rules for both price comparison claims and the availability of sale-priced merchandise. In addition, in May 1990, Massachusetts also required that sales advertised in retail catalogs state that the “original” price is a reference price and not necessarily the previous selling price.

Consumers as well as regulators are becoming increasingly suspicious of retailers’ high “regular” prices and their frequent “sales.” Retailers, concerned by the new regulations and the lack of consumer credibility for “high-low” pricing, are increasingly looking at the “everyday low pricing” (EDLP) strategy. This strategy establishes initial prices at or close to the competition’s sale prices to both stimulate everyday business and dispense with most if not all sales. EDLP’s use by rapidly growing and exceptionally profitable retailers like Walmart, Home Depot, and Toys R Us has stimulated numerous others to consider shifting to EDLP. Typically, EDLP is accompanied by advertising claims such as Home Depot’s “guaranteed low prices day in, day out.”
EDLP has caught on among certain grocery, general merchandise, and specialty retailers. Today, it is difficult to find a trade class without a retailer that has staked out an EDLP claim. Recent examples include Staples in office products, IKEA in contemporary furniture, and Paperama in paper goods. Sears’ adoption of EDLP in 1989 focused special attention on it. On March 1, 1989, Sears closed its 824 U.S. stores for forty-eight hours to lower its shelf prices on 50,000 items. Sears spent $110 million in advertising during the subsequent three weeks to promote its new pricing strategy.

Dual-income households are disenchanted with sale prices. They are too busy to compare sale prices in newspapers and resent having to time their shopping trips to coincide with sales.

Apart from grocery retailing, most EDLP success stories represent retailers who either commenced operations as EDLP operators or converted to EDLP when they were first expanding geographically. Converting profitably to a credible EDLP policy overnight, however, may be very difficult for a historically high-low retailer for a variety of operational, consumer, and competitor reasons. We discuss these factors below and suggest an alternative means of price stabilization, “everyday fair pricing plus” (EDFP+). EDFP+ means three things: restoration of everyday prices to levels that represent good value to customers even though they do not purport to be the lowest in town; fewer sale events; and, most importantly, excellence in other differentiating elements of the merchandising mix, such as service and assortment. Following our discussion of the benefits and applicability of the two pricing policies, we analyze Sears’ experience with EDLP. Finally, we offer prescriptive advice to retailers switching to a lower, more stable pricing policy.

Benefits of EDLP and EDFP+

Stable pricing can reduce inventory, personnel, and advertising costs, thus allowing retailers to keep their average prices lower and their profits higher than those of high-low retailers that artificially inflate nonsale prices. Furthermore, EDLP and EDFP+ offer the potential for improved customer service and merchandising, for better in-stock conditions, and for advertising that is image, rather than price, oriented. Finally, stable pricing gives a more honest pricing message to the consumer. All of these benefits (described in Table 1) are in addition to ultimately higher sales, which we discuss later.

Lower Costs, Better Service, and Better Merchandising

EDLP and EDFP+ stabilize the peaks and valleys in consumer demand caused by frequent, deep discount sales. Smoother demand means less forecasting error and thus fewer out-of-stocks on sale items. The result is less consumer dissatisfaction and, if rain checks were previously offered on out-of-stock advertised items, lower administrative costs. Additionally, the retailer faces fewer sales leftovers, or residuals, which must be marked down even further. This problem is particularly acute if items have been purchased specifically for sale events. Less forecasting error also leads to safety stock reductions, which means faster inventory turnover and less store backroom and warehouse space for inventory storage. Finally, better demand forecasting leads to improved distribution, as a stable flow of goods allows more efficient delivery scheduling.

These strategies can also reduce personnel costs. With fewer sales, less labor is required to reprice sale items, although this source of savings may decline as bar coding replaces individual item pricing. Still, stable pricing eliminates some of the labor that erects and removes temporary displays and that handles surges in consumer demand during sale periods.

Stable pricing has an additional important benefit, especially in merchandise categories where the customer needs sales assistance. Stable customer traffic patterns, unlike sale-stimulated throngs, allow salespeople to spend more time with customers. The high-low retailer could theoretically offer the same salesperson coverage as the stable pricing retailer but would need to hire additional salespeople for peak sale periods and then lay them off during nonpromotional periods. Both the cost and impracticality of hiring temporary salespeople strongly suggest that high-low retailers will have significant difficulty in providing sales assistance equal in quality to retailers with more stable prices.

Another source of advantage is in advertising. The
<table>
<thead>
<tr>
<th>Benefit</th>
<th>Operational Implication</th>
<th>Customer Implication</th>
</tr>
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<tbody>
<tr>
<td>Fewer stockouts</td>
<td>• Reduced costs of administering rain checks</td>
<td>• Reduction in consumer dissatisfaction</td>
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<td></td>
<td>• Increased sales (if stockouts mean consumers shop elsewhere)</td>
<td></td>
</tr>
<tr>
<td>Fewer residuals</td>
<td>• Decreased margin loss due to leftovers from sales</td>
<td></td>
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<tr>
<td>More efficient inventory</td>
<td>• Improved inventory turns</td>
<td>• More salesperson time spent with customer</td>
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<tr>
<td>management</td>
<td>• Less need for inventory safety stocks</td>
<td>• Better in-stock position on basics and better</td>
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<td></td>
<td>• Fewer inventory counts</td>
<td>in-store merchandising</td>
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<tr>
<td></td>
<td>• Less need for store backroom and warehouse space</td>
<td></td>
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<tr>
<td>More efficient use of</td>
<td>• Less need to pay additional personnel for reticketing and for handling demand surges</td>
<td>• Potential for more image-oriented advertising</td>
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<tr>
<td>personnel</td>
<td>• Less buyer time spent managing sale events and more time merchandising the entire line</td>
<td></td>
</tr>
<tr>
<td>More advertising flexibility</td>
<td>• Less need for weekly fliers announcing sales</td>
<td>• Pricing policy perceived as more honest</td>
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<tr>
<td></td>
<td>• More flexibility in media decisions</td>
<td>• Less need to shop around, less need to postpone</td>
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<tr>
<td></td>
<td>• Catalogs less likely to become obsolete</td>
<td>purchases, and more loyalty</td>
</tr>
<tr>
<td>More consumer appeal</td>
<td>• More sales to EDLP/EDFP+ store</td>
<td>• Lower prices per unit</td>
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Stable pricing strategies limit the need for weekly sale advertising and allow advertising to focus on more image-oriented messages. This encourages the retailer to use such media as television and magazines, which can convey more visually appealing and distinctive messages than newspapers cluttered with sale advertisements. While EDLP or EDFP+ stores still occasionally publish store fliers, their size and frequency can be less than those of high-low chains. In addition, catalogs do not become obsolete as quickly because prices do not change as often.

EDLP and EDFP+ can also produce savings on advertising expense. Wal-Mart spent less than 1 percent of sales on media advertising compared to 2.5 percent for K mart. Retailers changing from a high-low to a stable pricing strategy, however, will not immediately realize advertising savings because they must communicate the strategy change to consumers. In fact, advertising costs typically rise as the retailer promotes consumer awareness and understanding of the new policy, but, if the strategy is sustained, advertising costs should eventually decline to a lower percentage of sales than before.

Stable pricing can also improve merchandising as buyers change their focus from managing sale events to managing their entire departments on a daily basis. Buyers should then be able to improve merchandise planning and assortments and create more attractive and organized displays.

Consumer Appeal
EDLP and EDFP+ also respond to emerging consumer attitudes. Many consumers—particularly younger consumers, with whom retailers must build relationships for their long-term future—are increasingly skeptical about shelf prices. They have developed the habit during the past decade of only buying during sales because they consider regular shelf prices inflated and unrealistic. They increasingly believe that the sale price is the legitimate price. When Workbench, the specialty furniture retailer, shifted to EDFP+ in 1988, it appealed to these sentiments in fliers that decried “the phony pricing policies of competitors that inflate regular prices.”

Dual-income households are also disenchanted with sale prices. They are too busy to compare sale prices in newspapers and resent having to time their shopping trips to coincide with sales. Also, in some merchandise lines, retailers have deliberately complicated and discouraged shopping around by stocking derivative
models, minor and often meaningless variations of national brands stocked by competitors. Yet, while these consumers resent having to study advertising and to shop around, they want the assurance that if they buy an item at regular price, the store or a competitor will not discount it soon thereafter. To summarize, despite their current sale-motivated shopping behavior, these consumers would prefer to shop at retailers offering fair everyday prices, assuming they found the prices credible.

Once convinced that prices are fair, these shoppers enhance EDLP and EDFP+ store profitability in two important ways. They concentrate their purchases at their trusted chain by buying more each time and by buying more frequently. And for some types of merchandise they buy earlier, rather than postponing their purchases until an anticipated sale. Earlier purchasing particularly benefits fashion retailers. It gives them the jump on competition in ascertaining what to reorder and what to mark down, thus boosting sales and reducing markdowns.

Add to this emerging consumer segment those consumers whose purchase behavior is not currently sale influenced. This group includes higher income households, which are likely to patronize higher-end stores emphasizing assortment and exceptional service (admittedly, this segment may be small and declining given current economic conditions). The EDLP or EDFP+ retailer with appropriate product assortment that also offers exceptional service can expect continued patronage from this segment as well.

These two segments of consumers can be contrasted to more sale-oriented shoppers, often referred to as “cherry pickers” by the trade. This group frequently includes retired persons and two-parent families with only one working spouse. The distinguishing feature of cherry pickers is that they usually have both the time and financial incentive to shop for the lowest prices. When sale-oriented stores adopt EDLP or EDFP+, cherry pickers will compare carefully the new prices to competitors’ sale prices. Thereafter, however, they will shop elsewhere most of the time (except during clearance sales), unless the new prices are truly the lowest in town. Thus the switch to more stable prices may well be accompanied by a loss in patronage from cherry pickers. These customers, however, are less profitable to retailers because they confine their purchases mainly to low or no markup sale merchandise. Furthermore, because cherry pickers buy mainly sale merchandise, they tend to spend less per shopping trip than other customers who prefer the convenience of buying everything they need at one location.

The eventual success of EDFP+ depends critically on whether the lost cherry picker volume is offset by business from remaining and new customers attracted by the fair prices, enhanced assortments, and better service. In markets, such as retiree communities, that are dominated by cherry pickers, high-low pricing may make sense for most if not all competing retailers. In such markets, if most retailers pursued stable pricing strategies, their costs might be lower but their profits would suffer, owing to substantial volume deterioration. In mixed markets, a high-low retailer may be successful at serving the cherry picker segment. Such a retailer, however, must recognize that it serves a less profitable and potentially shrinking customer segment.

There is an inherent interdependency between the successful implementation of EDLP+ and the reinforcement of its nonprice consumer benefits. With successful price stabilization comes greater demand predictability, fewer stock outs, better customer service, and the time to plan appropriate assortments. These advantages constitute the plus that, along with everyday fair prices, reinforces customer loyalty.

**Applicability of EDLP**

EDLP in its purest form—the same, noticeably lower prices every single day—is not feasible for most retailers. Five variables concerning the composition of the retailer’s merchandise restrict EDLP’s applicability: the proportion of comparable products carried, the proportion of frequently purchased products, the price of the merchandise, the percentage of merchandise that is fashion sensitive, and whether the retailer offers complete assortments within categories.

Carrying products and services that can be compared easily among retailers, such as national brands, commodity products (e.g., nails and similar building materials), and oil changes, is important to EDLP...
believability. So is carrying frequently purchased items; consumers have more knowledge about their prices and can, therefore, judge the fairness of an EDLP claim more quickly. And if the retailer carries a high proportion of lower-ticket items, consumers are more likely to value the convenience of shopping routinely at the EDLP store.

Another variable, the proportion of fashion merchandise, relates inversely to a retailer's ability to implement an EDLP policy successfully. Fashion retailers require sale events to sell the last few pieces of a season's line, soiled and damaged merchandise, and fashion mistakes. Such sales inhibit a retailer carrying predominantly fashion merchandise from adopting a pure EDLP strategy.

The final variable, the completeness within categories, affects an EDLP claim because it relates to the retailer's merchandise cost. Retailers with no commitment to complete assortments within a category can switch suppliers depending upon who offers the best deal. Their costs for merchandise are lower than for retailers committed to complete assortments. Moreover, since they may carry only one of several competing brands, they are not concerned with whether higher sales resulting from a very low selling price on one brand will adversely affect the movement of a competing brand. The result is that such retailers can offer consumers exceptionally low prices.

Table 2 juxtaposes the aforementioned factors against five classes of trade, including warehouse clubs, grocery stores, category specialists such as Home Depot, Circuit City, and Toys R Us, general merchandisers such as Sears and Montgomery Ward, and traditional department stores. We also included a retailer well known for its everyday low prices, Wal-Mart. Price stabilization takes different forms for these different classes of trade.

Warehouse clubs, such as Price Club and Costco, can truly promote EDLP as their main competitive advantage because their prices are both consistently and sufficiently low enough to substantiate this claim. Warehouse clubs offer prices 10 percent to 25 percent or more below competition, though at the cost of exceptionally limited assortments, minimal in-store service, no credit, and limited hours of operation. Furthermore, they essentially do not carry fashion merchandise.

Other trade classes have more difficulty using

<table>
<thead>
<tr>
<th>Type of Trade/Retailer</th>
<th>Percentage of Comparable Products Carried</th>
<th>Proportion of Frequently Purchased Products</th>
<th>Merchandise Prices</th>
<th>% of Merchandise That Is Fashion-Sensitive</th>
<th>Category Completeness</th>
<th>Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Warehouse clubs</td>
<td>High</td>
<td>Both frequently and infrequently purchased products</td>
<td>Both high and low</td>
<td>0-5%</td>
<td>Incomplete</td>
<td>EDLP serves as sale point of difference</td>
</tr>
<tr>
<td>Grocery stores</td>
<td>High</td>
<td>Frequently purchased products</td>
<td>Low</td>
<td>0%</td>
<td>Complete</td>
<td>EDLP</td>
</tr>
<tr>
<td>Category specialists</td>
<td>High</td>
<td>Infrequently purchased products</td>
<td>Medium &amp; high</td>
<td>0%</td>
<td>Complete</td>
<td>EDLP</td>
</tr>
<tr>
<td>General merchants</td>
<td>Increasing</td>
<td>Primarily infrequently purchased products</td>
<td>Medium &amp; high</td>
<td>60-70%</td>
<td>Complete</td>
<td>EDLP+</td>
</tr>
<tr>
<td>Sears/Montgomery Ward</td>
<td>High</td>
<td>Primarily infrequently purchased products</td>
<td>Medium &amp; high</td>
<td>10-15%</td>
<td>Complete</td>
<td>Innovator in EDLP</td>
</tr>
<tr>
<td>Traditional department stores</td>
<td>High</td>
<td>Frequently purchased products</td>
<td>Medium &amp; low</td>
<td></td>
<td>Complete</td>
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EDLP as their sole point of difference because their prices are not so clearly the lowest available. These include grocery stores and so-called power retailers such as Toys R Us and Home Depot.

Grocery retailers were among the first to convert successfully to EDLP. Their early and successful adoption relates to the high proportion of frequently purchased national brands they carry. Because customers have good knowledge of such merchandise, they can judge the fairness of the prices quickly. Furthermore, the frequency of grocery store visits encourages time-sensitive consumers to shop regularly at an EDLP retailer. For these customers, “one stop shopping” is preferable to a weekly newspaper and flier search and to multiple store visits to obtain the best available prices.

Nevertheless, because so many major grocery chains have adopted EDLP in at least some of their stores (Supermarket News, for example, lists nine major chains that have adopted EDLP), they cannot use EDLP as their sole point of difference. Furthermore, since price differences between EDLP and more promotional grocery chains are small, consumers are unlikely to visit EDLP supermarkets just to secure the lowest available prices. If price was their only interest, such consumers could patronize warehouse clubs, which offer even lower prices. Thus EDLP food chains, like Shaw’s and Hannaford Brothers, provide superior assortments in all departments, exceptional quality in their high-margin perishable departments, and fast and pleasant assistance in service departments and at the check-out counter as further sources of differentiation.

Even Wal-Mart, an early EDLP adopter, which continues to emphasize this strategy in its advertising and whose prices are considerably lower than competitors such as K mart, supplements EDLP with other appeals. Particularly in competitive market areas, Wal-Mart offers sale-priced merchandise in its monthly circulars. It also provides exceptionally friendly customer service and an outstanding in-stock position. Consequently, 60 percent of Wal-Mart customers shop the chain “regularly” or “most often,” a much higher percentage than the average chain store can claim, and probably much higher than Wal-Mart could claim if it offered only everyday low prices.6

Similarly, category specialists such as Toys R Us and Home Depot, which primarily sell products that are branded or otherwise highly comparable, higher priced, and less frequently purchased, provide EDLP but also offer other sources of distinctive customer value. Most power retailers offer prices perhaps 5 percent to 10 percent lower than those of noncategory specialists, but they are not dramatically lower. The absence of truly rock bottom prices requires these retailers to offer additional sources of customer value. Home Depot, for example, offers enormous selections and exceptional customer service. Toys R Us, in contrast, is in a category that does not require exceptional service; it needs breadth and depth of assortment and an excellent in-stock position. Therefore, Toys R Us not only provides everyday low prices but advertises that it has even the most popular toys in stock.

General merchandisers such as Sears and Montgomery Ward face an even more difficult task in adopting an EDLP strategy. They have been increasingly modifying their traditional disposition toward private labels by adding more and more branded merchandise in both hard and soft goods categories. As a result, these retailers have to meet or beat the prices of retailers carrying the same brands, such as Circuit City and Home Depot in some categories and Wal-Mart and K mart in others.

An even more difficult problem confronts traditional department stores such as R.H. Macy and Company and Jordan Marsh. Their assortments include a higher proportion of difficult-to-compare fashion goods of uncertain consumer acceptability. Because the merchandise is hard to compare, consumers find it difficult and time consuming to verify an EDLP claim. Moreover, the merchandise less acceptable to consumers must be sold at marked down prices. The almost unavoidable presence of marked down merchandise makes suspect any claim of everyday low prices.

These circumstances suggest that general merchandisers and traditional department stores will have trouble convincing consumers of their EDLP policy. Nevertheless, for the reasons cited above, such retailers must restore consumer confidence in their everyday shelf prices and overcome the disadvantageous economics associated with high-low pricing policies. For these retailers, we therefore advocate EDLP+, a reduction in both high initial markups and frequency of sales events, with concurrent improvements in other aspects of their marketing formulas to provide better customer value.

For example, Montgomery Ward, in its store-within-
a-store concept departments like Electric Avenue for electronics and Home Ideas for home furnishings, offers fair, if not the lowest, prices, a broad assortment of brand names, plus some merchandise not immediately available at other retailers. Maytag introduces many of its newest models at Montgomery Ward because Ward's EDP pricing policy stabilizes sales, enabling Maytag to predict demand for new models more accurately.

General merchandisers and traditional department stores must, therefore, accompany everyday fair pricing with excellent breadth of selection and, preferably, with informed and efficient personal service in appropriate merchandising categories. Nordstrom, a retailer known for everyday fair prices plus exceptional selections and customer service, exemplifies this strategy.

Switching to EDLP or EDP+, however, is not without risk. We discuss these risks in the next two sections, first by reviewing the Sears experience and then by considering implementation issues.

Risks of a Rapid Transition to EDLP: The Sears Experience

Sears' recent experience suggests that the risks of switching to EDLP are significant, particularly if a quick transition is planned. In the first half of 1990, approximately one year after announcing EDLP, Sears experienced flat sales of $15 billion, and its retail operations' net income fell by 63 percent to $73 million. Sears' cost structure, for a variety of reasons, was not competitive when it introduced its new EDLP policy, and the company appeared unwilling to forego short-term profitability. Its widely heralded 50,000 markdowns were not sufficient to make its prices generally competitive, nor were its assortments or service much improved. Sears' cost structure continues to be a problem; costs rose $600 million in 1989 alone. Moreover, Sears tended to compare prices to the other general merchandise chain, Montgomery Ward and J.C. Penney. It overlooked the need to compare prices, category-by-category, with discounters such as Wal-Mart and Target and power retailers such as Circuit City, Home Depot, and Toys R Us. Sears just did not drop its prices sufficiently, especially on fast-moving identicals, to achieve credible price comparisons.

As its prices were not sufficiently competitive, Sears continued to run sales after its EDLP announcement. Sears' weekly fliers often included brand name merchandise available in "limited quantities" or available only for limited time periods. Between March and October 1989, Sears also ran two extensive, heavily advertised, in-store events involving sale merchandise and contests to build store traffic. The result: massive consumer confusion about the chain's pricing policy. By June 1989, because it heavily advertised its switch to EDLP, Sears was among the top ten companies in unaided advertising awareness. However, an Adweek poll that month found the following confusing perceptions of Sears' pricing among consumers:

<table>
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<tr>
<th>Consumers Aware of Pricing Change</th>
<th>Consumers Not Aware of Pricing Change</th>
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<tbody>
<tr>
<td>Sears pricing policy is:</td>
<td></td>
</tr>
<tr>
<td>• Always full price</td>
<td>16%</td>
</tr>
<tr>
<td>• Full price with frequent sales</td>
<td>41%</td>
</tr>
<tr>
<td>• Discount prices</td>
<td>16%</td>
</tr>
<tr>
<td>• Discount prices with frequent</td>
<td>13%</td>
</tr>
<tr>
<td>• Don't know</td>
<td>14%</td>
</tr>
</tbody>
</table>

Only 16 percent of consumers who were aware of the policy change responded accurately that Sears offered discount prices—compared to 11 percent of those unaware of the change. Although further advertising may have decreased consumer confusion, the research indicates the difficulty that a major chain previously wedded to high-low pricing may have in changing consumer perceptions. If most ads promise everyday low prices, but significant sale advertising persists and much sale merchandise is available in the store, consumer confusion is inevitable. Successful EDLP implementation requires consistent practices and communications, particularly in general merchandising where it may take considerable consumer reeducation to make the price claim credible.

Sears' problems were compounded by the aggressive and predictable competitive response that its EDLP advertising inevitably stimulated. For example:
- T.J. Maxx ran ads that asked, "Why should Sears wait 102 years to cut prices?" and claimed that T.J. Maxx had carried brand name fashions at 20 percent to 60 percent savings "since day one."
- Wal-Mart ran ads that exclaimed, "Don't be fooled! There's always someone trying to imitate Wal-Mart's Everyday Low Prices."
Competitive advertising stimulated consumers to evaluate the relative attractiveness of Sears’ retail prices. Had Sears not been so aggressive in its advertising, competitors might have been less vigorous in their responses and in slashing their own prices to meet or beat Sears on key items. Ironically, but predictably, Sears used a blockbuster advertising campaign to announce its EDLP program, which ignited a vigorous competitive response that, when combined with a confusing pricing strategy, successfully hindered the advertising’s objective.

The Sears experience suggests the difficulty in quickly converting from a high-low pricing policy to EDLP. First, consumers’ pricing perceptions have been conditioned by past pricing practices and may be hard to change, particularly for retailers well known for their weekly fliers and special events. As a result, even a retailer that switches to truly competitive everyday low prices may find that consumers initially perceive the new regular prices as higher than competitors’ sale prices. Second, an aggressive adoption of EDLP may precipitate a price war. Therefore, a retailer switching to EDLP should expect its profits to decline substantially for a prolonged period of time as a result of lower gross margins and higher advertising expense, and quite probably more price reductions and more advertising to combat competition. Thus the Sears example suggests that most general merchandise retailers will find price stabilization through EDFP+ preferable to a more dramatic shift to EDLP.

Implementation

EDFP+ versus EDLP

Figure 1 shows the timeline for EDFP+ execution. If a retailer intends to adopt EDFP+, it must improve the other elements of its merchandising mix (service, assortment, etc.) prior to announcing EDFP+. It can make these improvements by gradually stabilizing demand: holding fewer sale events, reducing the number of sale items per event, reducing promotional fliers, and narrowing the gap between list and sale prices. Switching to EDFP+ also means using floor displays to highlight exceptional everyday values and redirecting the store’s advertising—in particular, dropping the midweek sale events in favor of focusing on the nonprice elements of the merchandise mix. The resulting stability in the flow of goods improves costs, thus permitting lower shelf prices and further enhancements of service, assortment, and merchandise availability. Continuing improvements in cost position, in the availability of more products at everyday fair prices, and in the enhancement of nonprice elements should culminate in the official announcement of EDFP+.

For example, Montgomery Ward converted department by department, starting with automotive products. It reduced its operating costs, rationalized its product lines, and began changing its store environment before announcing its EDFP+ policy. Ward’s success in automotive, a product category with many well-known brands, persuaded skeptical executives in other departments to accept the concept.

In Table 3, the requirements for a gradual implementation of EDFP+ are contrasted with those for a successful shift to EDLP. An aggressive EDLP announcement requires very competitive prices, particularly for fast-moving identicals. The new prices must be the focus of a heavy storewide and regionwide introductory advertising campaign designed to encourage customers to come in and compare prices. Few if any sale events should be planned; these are inconsistent with the EDLP claim. In contrast, the gradual adoption of EDFP+ emphasizes decreasing but...
not eliminating the retailer’s reliance on sales and, concurrently, focusing consumer attention on the retailer’s other sources of differential advantage.

Profit and Sales Implications
These differences in execution suggest that the retailer adopting EDFP+ should not experience the sharp profit deterioration that Sears incurred when it aggressively reduced its shelf prices without concurrently improving its cost position. Figure 2 compares our expectations of the sales projections for the two approaches. The intensive advertising campaign that heralds the switch to EDLP initially increases sales as customers (both those disposed to stable pricing and the cherry pickers) check out the new, lower prices. When the cherry pickers recognize that the new everyday low prices are not necessarily the lowest available, they are likely to decrease their patronage of the EDLP retailer, thus the drop in sales. Moreover, if the skepticism of the remaining customers is reinforced by significant availability of sale merchandise, which is difficult to avoid in fashion businesses, they too may be resistant to the new pricing policy. Eventually, however, with consistent everyday low pricing, consumers will accept the change, and sales will improve.

We hypothesize that the retailer gradually adopting EDFP+ will experience the same general sales trends but not the extreme highs and lows. Many consumers already will have adjusted to the new pricing and merchandising policies prior to the retailer’s announcement of EDFP+. As cherry pickers take note of the retailer’s decreasing frequency and intensity of discounting, they may decrease their patronage. However, shoppers more interested in stable prices and better service and assortments may mitigate the effects of this loss. The EDFP+ announcement will generate less interest and less dramatic results than EDLP both because the claim is inherently less dramatic and because the introductory advertising is not as intensive. Sales will not decrease as steeply because many cherry pickers will have already departed. Sales may turn around sooner because cus-

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<tr>
<th>Table 3</th>
<th>Implementation of EDLP and EDFP+</th>
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<tbody>
<tr>
<td>Prices (interim)</td>
<td><strong>Dramatic Shift to EDLP</strong></td>
</tr>
<tr>
<td></td>
<td>• Very competitive, particularly on fast movers.</td>
</tr>
<tr>
<td>Advertising</td>
<td>• Heavy, with emphasis on price, including announcements of new pricing and price comparisons.</td>
</tr>
<tr>
<td>Frequency of sale events</td>
<td>• Very low.</td>
</tr>
<tr>
<td>Price comparisons</td>
<td>• Essential.</td>
</tr>
<tr>
<td>Conversion</td>
<td>• By store and by region.</td>
</tr>
<tr>
<td>Other sources of differential advantage</td>
<td>• Not primary focus—consistent low prices are the primary focus.</td>
</tr>
<tr>
<td>Gradual Shift to EDFP+</td>
<td>• Decreasing initial markups and markdowns.</td>
</tr>
<tr>
<td></td>
<td>• Decreases in weekly flyers and midweek sale advertisements. Advertising emphasis is on elements of merchandising mix other than price.</td>
</tr>
<tr>
<td></td>
<td>• Decreasing.</td>
</tr>
<tr>
<td></td>
<td>• Comparisons made as prices stabilize and become lower.</td>
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<tr>
<td></td>
<td>• Flexible (geographic or department by department).</td>
</tr>
<tr>
<td></td>
<td>• Excellent assortment and service are critical as prices decline and stabilize.</td>
</tr>
</tbody>
</table>
tomers will be recognizing the ongoing merchandising and service improvements. Since the EDFP+ prices are not intended to be among the lowest available, however, sales increases should not be as dramatic as they are for the EDLP retailer. Because introduction of EDFP+ will have a less pronounced and sudden effect on the marketplace, we also anticipate a less vigorous competitive response. Nevertheless, retailers embarking upon either an EDLP or EDFP+ policy should anticipate some competitor response. They should be prepared to take appropriate action, such as additional price reductions, stronger price guarantees, or increased advertising spending, at the expense of an additional adverse impact, in the short run, on both profits and cash flow.

As shown in Figure 3, we also hypothesize that the profit projections for the EDFP+ transition will be less traumatic than for the EDLP announcement. The EDFP+ announcement should not produce such a steep profit decline because of both less introductory advertising and less severe gross margin reductions. Profits may have declined in the preannouncement period, however, as margins decreased and the loss of cherry pickers was not offset by other business. During the EDLP transition, the retailer can expect substantial initial profit losses owing to a short-term escalation in advertising expenditures, a sharp decrease in average gross margin, and the certainty of aggressive competitor reaction. For both EDFP+ and EDLP, profits should eventually exceed those of the preannouncement period; the retailer can expect consumer demand increases and greater operating efficiencies. The turnaround is likely to happen sooner for the EDFP+ retailer who reduces operating costs, lowers prices, and improves assortments and service before the policy change announcement. EDFP+, in other words, represents an evolution in pricing, merchandising, and service policies rather than a pricing revolution.

In-Store Communications
In implementing EDFP+, in particular, the retailer has to reconcile store communications that emphasize consistently low or fair prices with the merchandising realities that cause some prices to vary. Retailers often need to reduce prices to take advantage of manufacturer deals, to liquidate slow-selling or discontinued items, and to compete with the temporarily low sale prices of competitors.

Montgomery Ward has developed a logical price sign program to distinguish among these circumstances by using differently colored triangles that clearly communicate whether an item is an Extra Value (green triangle), a Super Buy (yellow), on Sale (red), or on Clearance (no triangle). At the inception of EDFP+, of course, there was a preponderance of green triangles. The Super Buy triangles were used to match competitors’ prices when they had temporarily underpriced Montgomery Ward on branded items. Sale triangles identified temporarily lower prices arising from manufacturer deals or special purchases. This pricing structure, which was explained to consumers in handouts, on posters at store entrances, and in fliers, built trust in the store’s new pricing policy.
Table 4  Montgomery Ward Pricing Structure

<table>
<thead>
<tr>
<th>Price Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extra Value</td>
<td>&quot;Compare our price! Buy with confidence! If you find this item advertised anywhere for less within thirty days we’l gladly match that price!&quot;</td>
</tr>
<tr>
<td>Super Buy</td>
<td>&quot;We’ll match anyone’s advertised price! We’ll never price it for less! Plus, if competition advertises it for less, we’ll gladly refund the difference.&quot;</td>
</tr>
<tr>
<td>Sale</td>
<td>&quot;Buy today and save! Reduced for a limited time only. If we advertise it for less within thirty days, we’l gladly refund the difference.&quot;</td>
</tr>
</tbody>
</table>

addition, for six months after embarking on EDFP+, Montgomery Ward showed the previous retail prices of all merchandise marked down under the new program (see Table 4).

Also vital to the credibility of both EDLP and EDFP+ claims are price guarantees. A guarantee typically applies for a limited time period, usually thirty days, and protects the consumer against price reductions by the seller and competitors. The guarantee’s credibility is often diluted, however, when competitors sell similar items with different stock numbers (derivative models) at lower prices. To sustain the guarantee’s believability, Montgomery Ward draws up lists of derivatives considered equivalent to the specific models it carries and matches prices on them.

Retailers that pursue a more aggressive EDLP policy tend to place fewer restrictions on their guarantees and, like Home Depot, offer to beat competitors’ prices by a stipulated percentage. They must, however, make sure that their price guarantees do not substitute for initially attractive everyday low prices on well-known brand items. Consumers will quickly lose faith in an everyday low price policy that relies unduly on the price guarantee to live up to its claim.

Monitoring of Price Perceptions

Longitudinal surveys to track consumers’ changing price and other perceptions are essential to monitor the effectiveness of any newly implemented EDLP or EDFP+ program. Such tracking studies should evaluate:

• Whether consumers are aware of the retailer’s new pricing policy, understand what it means, and can correctly identify the retailer’s advertising slogan.

• How consumers perceive the retailer’s current prices, on average and for key reference items, relative to its former prices, and whether they see current prices as higher or lower than those of other stores.

• The extent to which consumers both perceive and value the retailer’s improvements in service, assortment, and display.

Internal Marketing

Before instituting one of these strategies, a retailer must ensure that executives and other employees are committed enthusiastically to it and recognize its importance and advantages. Internal acceptance is particularly important for EDFP+ because buyers, store managers, and salespeople will be responsible for developing the service and merchandising improvements that are key to EDFP+’s success.

• Buyers who are used to frequent sales and high-low pricing will have to be educated to the advantages of consistently attractive prices. The higher the percentage of a department’s goods that have been sold on sale, the greater will be the buyer’s anxiety. Montgomery Ward buyers are now very supportive of EDFP+ because they have witnessed its favorable effect on sales and expenses and can now devote time to important merchandising activities that used to be spent on changing prices and revising sales forecasts.

• Store managers who maintained only limited knowledge of other stores’ prices will have to be trained to monitor carefully and frequently competitive prices on high-profile items. Wal-Mart, for example, insists that its store managers change prices in response to local competition on the 300 to 500 fastest-moving items and on high-profile slow movers. Similarly, at Montgomery Ward, when a competitor prices an item below the Extra Value price, the store manager must reduce the item to a Super Buy.

• Store salespeople who are used to a high-low sale environment and a price-oriented sales pitch (e.g., telling consumers to “buy now before the sale is over” or not offering to call the customer when the item next goes on sale) need to understand the ramifications of the new pricing policy. Effective selling in an EDFP+ environment requires in-depth product knowledge and a customer service orientation. Salespeople must also understand the terms of any price-matching guarantees. Another concern is that salespeople compensated on commission will likely resist a switch to EDLP or EDFP+ because of the anticipated
short-term drop in sales and the additional demands on them for professional selling. Because employee buy-in is critical to the new strategy’s success, salespeople’s earnings must be at least partially protected during the transition.

- Suppliers often support stable pricing because it encourages a sales pattern with fewer peaks and valleys of demand, which, if reflected in their production schedules, can reduce manufacturing and distribution costs. Some manufacturers, therefore, offer customers an everyday low purchase price that is a weighted average of the trade deal price and the regular purchase price. Vendors in fashion lines, however, sometimes resist EDFP and EDLP because they fear that the remaining high-low retailers will discontinue or de-emphasize the vendor’s line. Overcoming this vendor resistance is an unavoidable problem for fashion retailers switching to a more stable pricing policy.

Conclusion

Our investigation has highlighted the difficulties that department stores and general merchandisers, in particular, have in switching to an EDLP claim. If they remain with high-low pricing policies, however, these retailers risk both a continuing decline in market share and lower sales. They also risk more prosecutions from regulatory authorities. These risks increase as additional retailers change to pricing policies that are both more attractive to most consumers and more cost effective, and as they begin to offer improved service, assortment, and display along with more reasonable list prices. Therefore, the issue is not whether to shift to an EDLP policy but how to shift to an EDFP policy.

A gradual transition to EDFP is more appropriate for most retailers for two reasons. First, only a limited number of retailers, such as warehouse clubs, can make a credible EDLP claim. From most other retailers, consumers want fair prices but also other benefits, such as complete assortments and excellent service. Therefore, most retailers who concentrate solely on low selling prices do not convey a desirable offering to a majority of consumers.

Second, switching to an EDLP policy for these retailers will be an expensive and unrewarding investment. They will be better served by exchanging their current high-low promotional pricing for everyday fair prices plus other consumer benefits.

References


3. Financial and Operating Results of Department and Specialty Stores in 1987, National Retail Merchants Association.


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