Views on the world of shoppers, retailers and brands

KANTAR RETAIL

Ehrenberg-Bass

No, the Customer is *NOT* Always Right!!

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Herb Sorensen, Ph.D.

Quite a number of successful retailers, over the years, have attributed a significant measure of their success to the principle that, "The customer is always right." Here I want to give proper credit to this as a public sentiment, and at the same time point out why it is also outrageously WRONG!

Let's begin with the pernicious effects of high-low pricing. For those unfamiliar, HI-LO refers to the widely practiced pricing method of charging really higher than necessary prices (HI) a good bit of the time, but enticing shoppers sufficiently with specials and cut prices (LO) on selected merchandise to give "the customer" the impression that shopping in this store is a good value, or at least, if the shopper is careful, can be a very good value.

Before considering the merits of such a pricing strategy, we need to have an alternative for comparison. The alternative is to simply price everything at relatively constant margin (profit) for individual items, and as low as is consistent with prudent business practices. This strategy is commonly referred to as "everyday low pricing," EDLP.

There is probably no such thing as a retailer that is purely HILO, nor any that are purely EDLP. However, the rational economic approach, and what is best for everyone, really is the EDLP model. This is because of the massive economic inefficiencies that accrue in HILO pricing, which ultimately *must* be charged to the shopper. This is why the prices in HILO stores, on the majority of items, are higher than "necessary." What makes them higher than necessary is two things: to make up for the loss of *necessary* margin and profits on the low price specials, *and to make up for the massive inefficiency of continually raising and lowering prices*.

It is this second factor that is the real culprit. And it is this second factor that led Sam Walton, in seeking to drive prices to their absolutely lowest possible point, to reject HILO pricing, and go for EDLP. This required forced cooperation from suppliers, who were as engrained in HILO as were the shoppers. That is, brand suppliers were accustomed to supporting retailers in their HILO pricing by marking down, from time to time, their wholesale prices.

What Walton did was far more fundamental than simply shifting to a superficial EDLP. He insisted that suppliers remove all non-product costs from their wholesale prices, which included slotting fees, and any other trade and promotional allowances. To understand this, Walton is in effect saying, "I will not pay you one penny more for your wholesale merchandise than it is worth, as delivered. Why should I pay you what you are going to give back to me in slotting fees and promotional allowances? I'll just keep that money and NOT charge you those fees." There is massive inefficency in the retailer paying more than the merchandise is worth, in order to get some of that money back later in rebates, slotting fees and promotional allowances. (There is an excellent discussion of this issue in Kahn's and McAlister's short book, *The Grocery Revolution*.)

There is a great deal more to this story, but the reality is that this is probably the single most important factor in driving the growth of Walmart to be the largest non-oil corporation in the world. The relentless focus on low prices struck at the root of HILO pricing. However, this doesn't mean that shoppers are committed to rational retailing. Far from it. And this is why Walmart still has specials, and advertising campaigns focussing on *falling* prices. This partially explains why, if EDLP is such a good deal for shoppers, and fueled the growth of the largest retailer in the world, it explains why every retailer isn't going with EDLP. In fact, another major retailer switched to EDLP some years ago, and the first year of EDLP received an incredible amount of abuse from shoppers in the form of hate mail and complaints. "We have always relied on you to provide specials and really good prices, and you have now betrayed us." However, the retailer stuck to their shifted strategy, and for the first time in *50 years*, showed a profit on selling groceries! (Many are unaware that the grocer's profits largely derive from those slotting fees, rebates and promotional allowances, NOT from "selling" groceries. See my book.)

Now, if we put these facts about HILO and EDLP in the context of "the customer is always right," at least we can see that, objectively, it depends. After all, it was customers who made Walmart into the world's largest retailer. But the story is a good deal more complex than just this single pricing issue. And for that story, I recommend that you get a copy of *The Walmart Effect* by Fishman. Before we draw a final conclusion here, we need to look at one more customer/pricing illustration.

No discussion of pricing would be adequate without some recognition of the importance of coupons. It should be no surprise to find manufacturers looking to capitalize on the efficiences of EDLP, *sans* coupons, to mirror the great success of their retail partners. But, notice this:

> *[In the 1990's,] Procter & Gamble established an "everyday low-pricing" policy that reduced the retail price of its products without hurting the company's profits. While the move succeeded in reducing "peaks and valleys" in the process of manufacturing and selling products, it was not without controversy. For example, in January 1996, Procter & Gamble announced that it would end the distribution of all coupons and reduce regular prices in three New York cities: Syracuse, Buffalo, and Rochester. Other manufacturers said they would reduce or eliminate couponing in the area. However, Procter & Gamble soon encountered consumer boycotts, public hearings, and a petition drive demanding that they reinstate coupons. In March 1997, the New York State attorney general's office demanded that Procter & Gamble end the test. [Novel Guide.]*

Notice that the self-appointed *consumer advocates* came out in force to bring a halt to this move to EDLP, as if shoppers interests are best supported by a bulwark of HILO, the coupon.

The sum of the matter is that shoppers are more in love with the idea that they are saving money, than the actual saving of money. It is a fact that a shopper who follows closely the weekly specials, clips, organizes and uses coupons copiously, can save substantially, even more than by simply shopping at an EDLP store. But this is at a significant personal cost to the shopper in terms of their time, transportation from store to store, etc. It is actually a worse economic deal than learning to count cards at the casino.

It is a verifiable fact that card counters can consistently "beat the house" when gambling at a casino. Of course, if "the house" recognizes that you are card counting, you can expect to be unceremoniously evicted. Retailers don't typically evict shoppers for excessive use of specials and coupons. Why would they? It's their suppliers that are footing the bill, with a vast and costly engine that prints billions of coupons, (most will be unused and end up in the trash,) distributes them, collects them, and charges the brand, that builds the cost into their price to the retailer, who passes it on to ALL of their customers.

There is a great deal more evidence that shoppers do not behave in rational ways. But then, gamblers don't either. And many shoppers are quite happy to shop in the casino-type HILO stores, thinking that surely all these specials (and maybe coupons,) really are saving us money. As one of my favorite philosophers, Josh Billings, used to say, "The trouble with most people isn't that they don't know, . . . but what they 'know' . . . ain't SO!"

Here's to GREAT *"Shopping!"*
Your friend, Herb Sorensen