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NETSUITE

UK Discount Pricing Strategies

Optimising operational, merchandising & promotional plans

February 2016

PlanetRetail

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Executive Summary

Amid price wars, promotional fatigue and ever decreasing margins, new research confirms UK retailers are selling an increasingly large proportion of inventory off at discounted prices. This is good news for consumers, who have become accustomed to searching out bargains during the likes of discount events like Black Friday and Cyber Monday. However, this trend is having negative impact on the UK retail's bottom line.

Prompted by the acknowledgement of the damaging effects of Black Friday by such UK retail giants as Tesco, Asda and John Lewis, research carried out exclusively by Planet Retail for cloud-based financials, enterprise resource planning (ERP) and omnichannel commerce software provider NetSuite has found the discounting habit will deny some £20.3 billion in retail contributions to UK economic output this year alone.

> "Without more sophisticated retail management systems retailers cannot modify and optimise their merchandising, promotional and pricing strategies.

The research findings support the warnings of a growing number of industry stakeholders who are questioning the long-term viability of retailers' current competitive sales and promotional activities, and liken it to a drug that is responsible for bad buying and pricing habits as well as poor profits on the part of retailers, and unreasonable expectations of an unsustainable supply of cut-price goods on the part of their customers.

This white paper argues that, without more sophisticated retail management systems that can provide an accurate, real-time view of sales, inventory and customers, retailers cannot modify and optimise their merchandising, promotional and pricing strategies, let alone better manage the negative effects of discounting on the bottom line.

The main findings of the research are that:

- Based on the average percentage of sales of marked down goods in 2015, discounting is eroding retail's contribution to UK economic output – the corrosive effects of relentless discounting costs UK Plc over £20.3bn.
- As a result, UK retailers will lose over £38bn in potential revenue on marked down sales this year.
- More than £95bn worth of UK retail revenue will be generated from discounted sales this year – well over a quarter of total annual UK retail sales.
- Black Friday is emerging as the most important UK discount event, accounting for more than £1bn over the 24-hour period alone.
- The majority of retailers believe their current retail management systems lack the capacity to mitigate the loss of revenue on discounted sales of marked down goods by supporting the ability to offer more personalised or location-based discounts, offers and promotions.

Indeed, an examination of where, when and how often goods and services are discounted reveals that retailers risk a race to a progressively less profitable bottom line if they do not adopt more advanced retail IT systems that can holistically manage accounting, enterprise resource planning (ERP), customer relationship management (CRM), merchandising, assortment, pricing and promotions operations processes, and so support sophisticated markdown strategies that enhance their brands, and deliver on customer expectations.

1. Situation Overview

Towards the end of every year most retailers' minds turn to the key holiday and New Year trading season, where many generate a large proportion of the sales that goes towards their target annual revenue. But, the growing popularity of new, additional discount events has given retailers reasons to question the sustainability of the likes of Black Friday, and the impact on those traditional shopping periods that they now supersede.

Andy Street, Chief Executive of the John Lewis Partnership (the UK's fifth largest retailer by banner sales), famously suggested that heavy discount events, such as Black Friday and Cyber Monday, were having a detrimental impact on the key Christmas trading period particularly. "It is not in the interests of retailers to grow the pace of Black Friday at the expense of other weeks," he stated.

Street made his comments in response to the John Lewis Christmas 2014 trading update revealed at the turn of this year, which showed the department store and grocery retailer's sales during the week including Black Friday actually outpaced pre-Christmas sales. Fluctuating electrical goods sales were of particular concern, sliding 14.7% in the two weeks before 28 November 2014, followed by a rise of 41% on Black Friday itself.

After helping to introduce the UK to Black Friday in 2013, Asda – the UK arm of US retail giant, Walmart – recently followed a number of US retailers in saying it would not be participating in Black Friday. In a statement, Asda said it would "step back" on its Black Friday plans due to "shopper fatigue setting in around flash sales on big-ticket, non-essential items at Christmas".

> "I've been in retail for 30 years. There has been more change in the last five years than in the previous 25 years.
>
> **Andy Clarke**
> CEO - Asda (Walmart)

Instead the supermarket said it was planning to spread £26m of price cuts over the festive period, rather than unleash a one day bargain bonanza, while Tesco opened its doors at 5am instead of midnight on Black Friday to avoid a frenzied rush of shoppers both instore and online. While the focus may fall on pre-Christmas discounts, retailers' recent reactions suggest that they have reached the limit of their capacity to offer any more discounts overall.

UK at centre of a perfect storm

Admittedly products sold during these new events activity are typically supplier-funded or already set for mark down, and so cannot always be considered as fully marked down goods. Nevertheless, given consumer demand it is important to understand the industry and macroeconomic factors conspiring to create a trading climate where Black Friday can prove both so popular in terms of both sales and volumes, and polarising when it comes to retailer and public opinion.

Unlike the US, where pre-Christmas discount events work as a prelude to Thanksgiving, which is unique to that country, the adoption of and reaction to such events on the opposite side of the Atlantic also serves to underline the global importance of retail trends in the UK, as a core global market, the sixth-largest economy in the world, and Europe's third-largest in terms of gross domestic product (GDP)[2]. In the UK, increased discounting arguably has a greater impact.

Like the rest of the world, it was in 2010 that the UK started to recover from a sharp decline in output during the recent global recession that began in 2008. Since then, consumer confidence has showed signs of a more sustained recovery – with house prices on the up. However, the housing market and record low interest rates in particular have put retail spending in a vulnerable position, putting those retailers that discount too heavily in an even more precarious situation.

Predicated on the robust property market, any UK interest rate hikes will quickly make themselves felt in terms of higher mortgages, which puts pressure on disposable incomes. Even excluding mortgages, average household debt in Britain is the highest in Europe. But improving GDP growth and unemployment rates have seen consumer confidence rise to support relatively high prices for consumables in comparison to the rest of Europe.

This is why, in spite of inflation remaining well below the Bank of England's target rate of 2% in the medium term, Planet Retail therefore forecasts that any price increases will be slow to take hold. However, price levels will remain comparatively high for many consumables, including energy and food, conspiring to make the average UK consumer particularly price conscious and susceptible to offers of a bargain.

The effect of lingering pre-2010 recessionary trends in pricing reinforces the effects of increased market share won by discount grocery retailers for example, and growing private label investment in particular. Meanwhile the saturated, competitive UK retail landscape has also conspired to maintain the pricing status quo, where the top five retailers account for some 50% of all consumer spending on groceries, for instance.

The UK: A dynamic retail sector facing rapid change

Key characteristics of the changing UK consumer

- Time poor
- 'Value-orientated'
- Willing to trade up and down
- Promiscuous
- Shifting online
- Open to new technologies

Source: Planet Retail

Breaking bad retailing habits

With high prices and low inflation in a saturated competitive market, it is easy to understand why retailers may be relying heavily on discounting to drive sales. But is this to the detriment of profit and margin? The entry of dedicated discounters in the grocery space, including Aldi and Schwarz Group-owned Lidl, has certainly led to erosion of market share of traditional players, like Tesco, for example, and an increase in so-called grocery 'price wars'.

But this shift towards everyday discounting in the grocery sector is only part of a wider domestic trend. Indeed, the proportion of this market shared by grocery discounters was only half the European average last year, suggesting that it is this sector's best opportunity for further growth. Planet Retail predicts discount will remain the UK's fastest growing bricks-and-mortar channel, with almost a doubling of sales to £20bn by 2018.

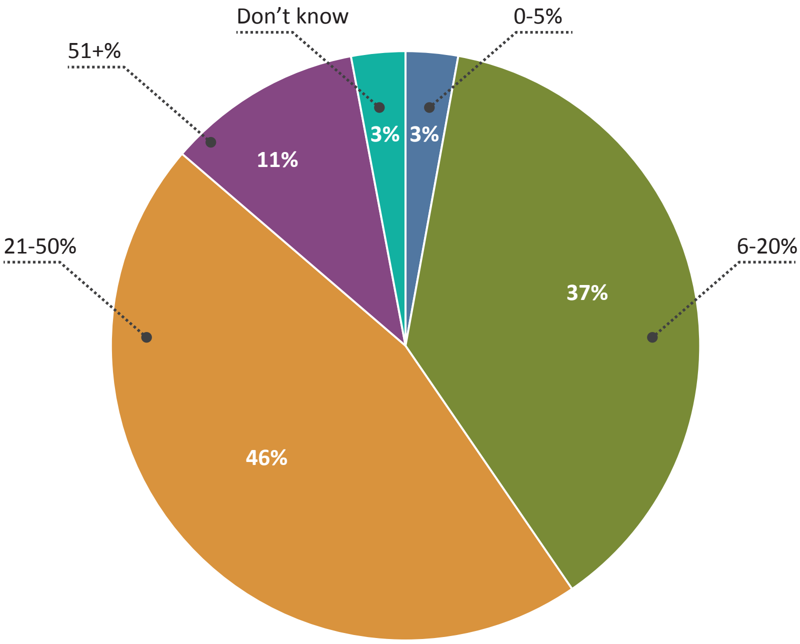
Including the influence of discounters, unchecked discounting becomes untenable when considering markdowns as a proportion of the UK's retail sales – that is, those goods and services sold at an actual selling price that is lower than the original retail price. Markdowns comprise a significant portion of total annual industry revenue. The retail industry contributed 11% or £180bn to UK economic output in 2014, according to Gov.uk[3]. Yet revenue from discounted sales this year will amount to at least £95bn, or 27.6% of total retail sales, according to the retailers surveyed by Planet Retail.

But when examined in detail, the responses also demonstrate these revenues – defined as derived from markdown inventory, sold during a sales event as discounted goods – could actually amount to much more than the industry average. The majority of retailers surveyed admitted that sales periods and discounted revenue accounted for somewhere between 21-50% of their total annual retail sales. The next highest proportion of retailers questioned apportioned between 6-20% of retail sales to discounting (*Figure 1*).

These proportions also broadly reflect how much inventory UK retailers are marking down every year: that is, the largest proportion (45%) said they marked down 21-50% of inventory. But, again an alarming 11% said they marked down over half of inventory during a year. Alarming because, although than just over half (55%) said that discounting improved profitability, 41% felt it either had no impact on profitability or a negative impact on margin. This suggests retailers are perhaps feeling the pressure to offer sales, even though they know they could be shrewder in their pricing strategies to optimise both profits and margins.

Figure 1: What percentage revenue is attributable to sales events or discounts?

One in ten retailers said they derive over half of their annual revenue from sales events or discounts.



Source: Planet Retail

2. Managing margins, making sales

So the Planet Retail survey suggests that UK retailers are selling a large proportion of inventory at discounted prices, and that for many this has a negative impact on profitability. When factoring in the effect of new sales events, like Black Friday and Cyber Monday, the frequency with which retailers are marking down stock can also account for the large stock volumes involved in such activity.

Indeed the greatest proportion of respondents said Black Friday was a key sales period – cited by 60% of retailers – ahead of even Christmas and the New Year, January sales (*Figure 2*). Inspired by the American shopping tradition, the weekend beginning 28 November has grown in popularity to dwarf the traditionally online-only event following it, dubbed Cyber Monday. Some 80% also said they offered sales and discounts both online and instore, suggesting one channel is no more 'discount-friendly' than another.

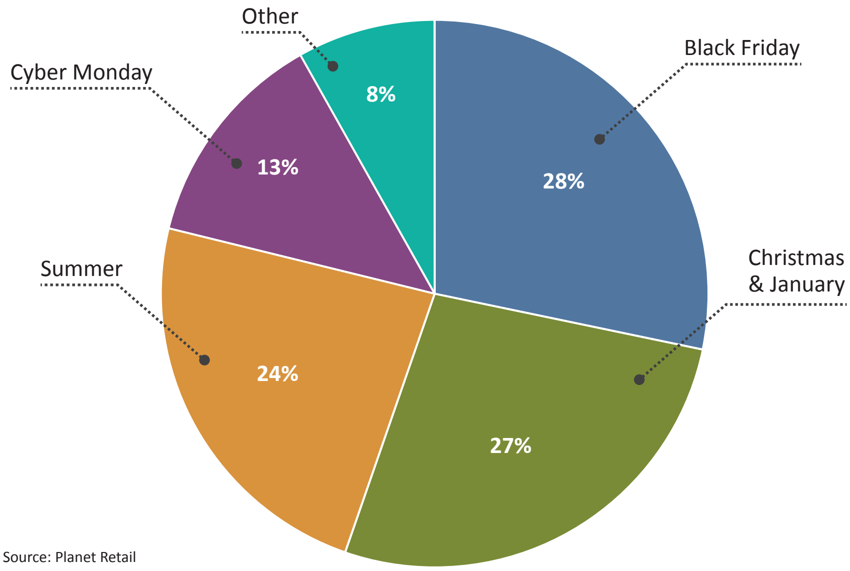
But, as suggested by the moves this year of Asda and Tesco, Black Friday could be doing more harm to sales in the long run. Based on Planet Retail 2015 UK retail sales estimates, sales on Black Friday could amount to nearly £175m more than on any day during other discount sales events. So much so, Planet Retail forecast – in line with general industry consensus – that retailers were set to make £1.05bn during Black Friday alone. This also amounts to a full 20% sales uplift compared to any other discount day. Otherwise, the average discount day brings in nearly 8% less revenue from sales, compared to an average day of normal trading.

Consumers may be spending more during the likes of Black Friday, but – to Andy Street's point – retailers are not making more money from this spending if it requires they discount a greater proportion of revenue that eats into margins and, ultimately, profits. In fact, it seems retailers are willing to make this trade-off for the increased positive influence they perceive the offering of discounts has on brand perception among their customers.

Over three quarters (76%) of the retailers surveyed agreed that the effect of discounting on brand perception among customers was positive. This compared to only 2% who thought it had a negative effect, and 22% who said it was neither negative nor positive. And it follows the sentiment of Shopology respondents during the same period, where price is always the determinative factor of their choice of retailer, with the next most important being "brands that I like," cited by 62%. The correlation between retailer and shopper views further frames why customer perceptions should perhaps compel retailers to use discounting as a mechanism for maintaining a competitive position on both brand and price.

Figure 2: What are your key sales periods?

The most important annual sales period among all those chosen by the retailers surveyed was Black Friday.

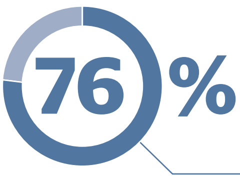


Source: Planet Retail

Even though the majority agreed discounting would boost their brand value, fewer (55%) followed this through by agreeing that customer service and satisfaction levels also increased during markdown events. Over a third thought the effect on service was negative or positive, while 7% actually said it had a detrimental effect.

Strategic discounting at volume

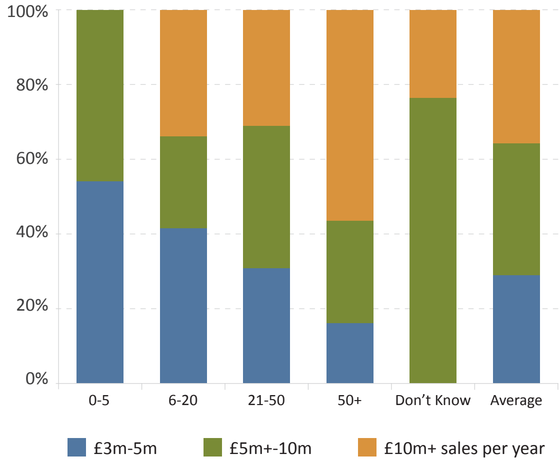
When taken in the context of continued downward pressure on pricing in an increasingly competitive environment where customers are prepared to look and wait for a bargain, the survey findings support the general consensus that discounting is deeper and more pervasive a trend than ever before. This is epitomised by the evidence that Black Friday is now the most important sales event among the retailers surveyed.



of retailers agreed that the effect of discounting on brand perception among customers was positive

But the research also discovered that larger retailers are more likely to drive a greater proportion of revenue from discounts (*Figure 3*). The retailers surveyed with annual sales of £10m or more made up the greatest proportion of those making more than half of their sales from marked down inventory, while also being slightly ahead on average (29.4%, versus 28.8% of revenue for midsized retailers, and 23.9% for smaller ones.)

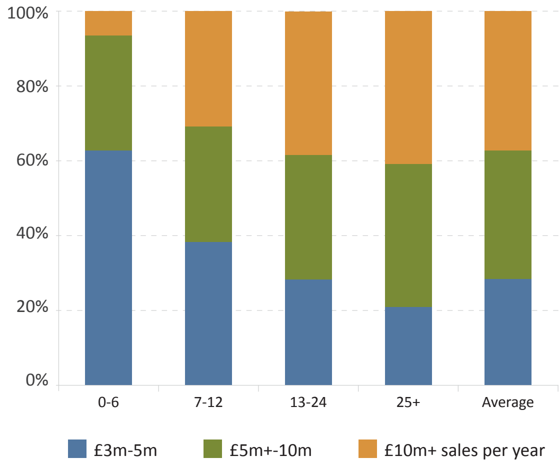
Figure 3: Percentage of revenue attributable to sales or discount revenue, according to size of retailer by annual sales



Source: Planet Retail

This trend is repeated in terms of time spent offering discounted goods in sales (*Figure 4*). Smaller retailers tend to rely less on discounted sales, where midsized and larger retailers, more likely driven by volume-based buying decisions, spend more time in discount mode. Over a third (34.6%) of larger retailers spent more than half of the year on sale, compared to 31.9% of midsized and 17.5% of smaller retailer.

Figure 4: Number of sales weeks per year, according to size of retailer by annual sales

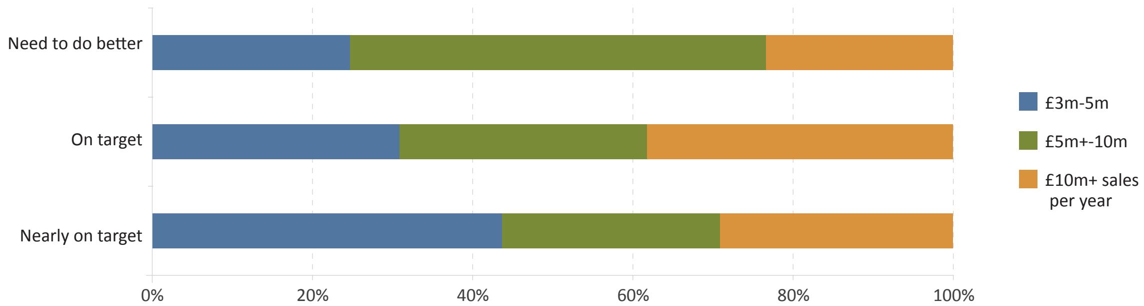


Source: Planet Retail

So it follows that the larger the retailer, the greater the risk of unprofitable markdowns if they devote more time to, and derive more revenue from, the marked down inventory used to drive sales events and discounts. While the survey did not ask whether other revenues, such promotional supplier incentives for example, offset the effects of any discounting, it did ask how close to target these activities brought them.

Those respondents from larger retailers made up the greatest proportion of those saying their percentage of discounting activity was on target; midsized retailers on the whole expressed the need to do better; and, smaller retailers felt they were nearly there. This may seem counterintuitive to the arguments posed by this paper. But it supports the latest thinking that precision discounting strategies from accurate inventory positions can actually work to a retailer's advantage than following mass discount trends.

Figure 5: Percentage of annual inventory markdowns compared to target, according to size of retailer by annual sales



Source: Planet Retail

3. Making more of what customers want

The forecasts, and recent discussions among retailers on the subject of discounting such as those reported on by Planet Retail at the World Retail Congress 2015 for example[4], support the suggestion that that culture of discounting and promotions is here to stay, and set to characterise the UK retail market for the foreseeable future. In addition to delivering on consumer demand, retailers know that markdown sales and promotions drive increased traffic and footfall, which can in turn, support additional sales of full-price products.

The popularity of outlet discount stores, both online and out of town, embraced by even luxury and high-end brands that don't traditionally use sales and discount promotions, suggests the need to sell off for marked down inventory for whatever reason will not reduce anytime soon. Instead, in today's complex trading environment, it stands to reason that each retailer's markdown strategy must increase in sophistication to deliver on the value matrix of factors influencing each sale: brand, price, and availability.

A recent academic study carried out by UC Berkeley's Haas School of Business[5] showed that a strategy that tends towards frequent discounts is generally the most successful. This new strategy sees a retailer: "charge a 'high' price only if demand is indeed 'high,' otherwise offer a discount. This strategy discounts more frequently than would maximise revenue conditional on demand. Nevertheless, the frequent discounts attract consumers."

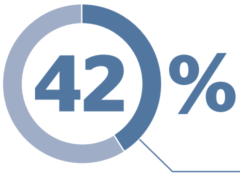
The study found that, as retailers form the long-run pricing strategies that determine their optimal target inventory levels for markdown, they should consider that:

(i) the discount-frequently strategy is optimal (whether capacity is adjustable or not);

(ii) discount frequently is often better than other pricing strategies, especially if no price commitment is made; and,

(iii) "overbuying" capacity (e.g. inventory) to attract consumers (by signalling availability and the likelihood of discounts) is a poor strategy.

In contrast to the limiting of markdowns and purchasing ample capacity, which in turn fuels heavier seasonal discounts as a result of any overbuying, the Haas School of Business study endorses a strategy that embraces frequent discounts and moderate capacity. This is particularly apt when considering the sheer scale of discounting by larger retailers especially, and the promiscuous, value conscious and price-sensitive UK consumer.



of larger retailers agreed that omnichannel systems offering a single strategic view of sales, customers and inventory would most benefit their businesses

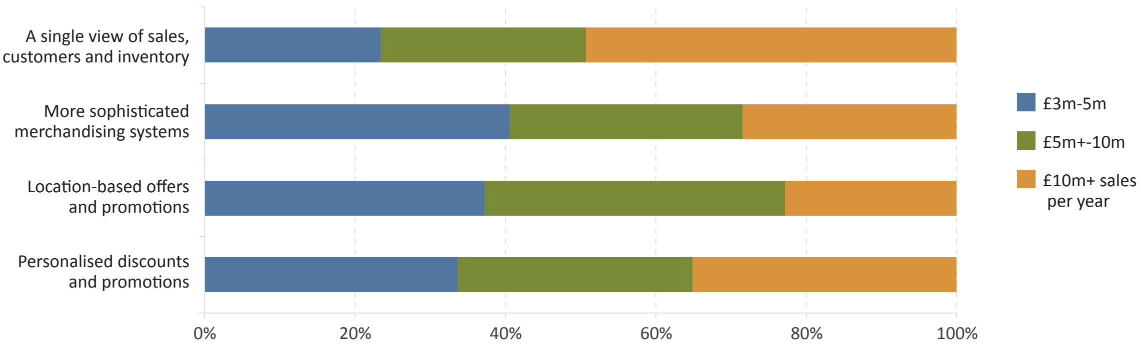
Managing improved markdown performance

Matching long-term demand with frequent discounts and moderate capacity as the optimal business strategy could be said to describe some of the more successful entrants into the UK grocery market over the last 10 years, such as Aldi and Lidl. Moving these levers, as Primark does with its instore-only model for example, sees it mitigate tight margins by charging consistently low prices, at high capacity, with a strict time-limited markdown policy.

This can also support the increased frequency of discount events and inventory volumes they drive. But the survey also discovered such tactics also require better support for more sophisticated pricing and promotional positions, not just buying and inventory control. Retailers highlighted a number of options to optimise sales activity, improve margin and generate greater profit, as well as enhance the customer experience (*Figure 6*).

The majority of larger retailers agreed that omnichannel systems that could offer them a single strategic view of sales, customers and inventory would most benefit their businesses (42%). But this rises to nearly 60% of all retailers polled. Midsized retailers are thinking more tactically, perhaps because they are more geographically focused, and looking for location-based offers and promotions (64%). Meanwhile, the majority of their smaller counterparts want more sophisticated merchandising systems (53%).

Figure 6: Preferred ways to optimise sales activity, improve margin and generate greater profit, and enhance the customer experience, according to size of retailer by annual sales



Source: Planet Retail

4. Conclusion

The fact that more personalised discounts, offers and promotions emerged as the most popular option for improving performance, cited by 57% or all retail respondents, is good news. It tallies with UK consumer sentiment, where over half (54%) of UK shoppers' choice of retailer is influenced by loyalty schemes allowing them to collect and redeem points when shopping. A further 31% of UK shoppers called for a more personalised experience, perhaps like that now offered by the grocery banner of John Lewis, Waitrose, which allows customers to choose their own discounts.

A similar proportion (55%) of UK consumers also wanted appealing offers both instore and online, while location-based offers emerged as the second most popular choice for retailers. But, like personalisation and loyalty, the ability to create offers based on where customers shop is only possible if a retailer has a clear, accurate and up-to-date view of inventory that it can then match with its most loyal and valuable patrons.

In this way, only IT-based retail systems that provide a centralised, accurate, and real-time management of sales, inventory, and customers can empower retailers to optimise buying, merchandising and assortment processes. Such optimisation techniques can be used to determine where the best combination of revenue realisation (i.e. maximised revenue on sales) and terminal inventory (i.e. unsold merchandise) will come from, for example, comparing a tactic of low-level markdowns from early in the season against one of later, deeper reductions.

Adopting management systems fit for purpose

The case for advanced software systems to help obtain that accurate real-time view and management of sales, inventory, and custom becomes all the more compelling when delving deeper into the common reasons high levels of terminal inventory. Markdowns from overbuying, for example, result from poor inventory visibility or the poor scheduling of replenishment and fulfilment resources.

Retailers require more advanced business management software that includes business accounting, ERP, and CRM capabilities, as well as fully integrated customer-facing ecommerce, point-of-sale (POS) and marketing functionality to also combat poor pricing or merchandising practices, which was certainly top of mind tactically for the smaller retailers surveyed in particular.

The bottom line? Only retailers with an accurate, real-time unified view of sales, orders, inventory and customers can effectively achieve the goal of using markdowns for maximum benefit, while also reducing margin erosion. Supply chain, assortment, and merchandising processes need realigning with changing consumer pricing and promotional expectations. Good promotions drive sales and improve price perception. Bad promotions lead to lower sales and destroys price perception, as well as margins.

Therefore, Planet Retail strongly recommends that UK retailers of all sizes abandon cynical discounting for its own sake, or to follow the herd during events like Black Friday and Cyber Monday. Instead, they should adopt more advanced, integrated retail business software to support improved management and integration of key operations and processes, such as buying, merchandising, and promotions. Such investment can:

- **Promote more intelligent buying decisions;**
- **Minimise markdowns and optimise markdown processes;**
- **Optimise customer service levels and experiences; and,**
- **Support more targeted discounts and promotions.**

Right: UK grocery retailer Waitrose this summer launched a 'Pick Your Own' offers for its myWaitrose loyalty scheme members to save 20% on products they select from a range of up to 1,000.


Seriously chocolatey
All butter triple chocolate biscuits
Seriously gingery
All butter dark chocolate & ginger biscuits
from Waitrose
One of many
Pick Your Own
OFFERS
Choose your offers at waitrose.com to get
20% OFF
Terms, Conditions and Exclusions apply. Please see www.waitrose.com/pickyourown for full details.
Seriously chocolatey all butter triple chocolate biscuits
£2.29
125g
3983947 2
£1.83 100g

Footnotes:

[1] **GVA** - gross value added contribution to the economy of the retail industry; The retail industry: statistics and policy, House of Commons *Briefing paper*, Number 06186, 2 October 2015 by Chris Rhodes.

[2] **Calculations are based on total UK retail sales estimates**, according to Planet Retail macroeconomic models and forecasts. Taking an industry average of 40% marked down off RRP, average markdown sales per week, per day and on Black Friday were calculated according to the NetSuite-sponsored survey data (i.e. percentage of annual revenue attributable to discounted sales, how many weeks a year retailers operate sales, and percentage of retailers citing Black Friday as a key sales period).

[3] Planet Retail ***Country report - UK, 2010-2020***, November 2015.

[4] *World Retail Congress 2015: Are retailers hooked on the discount habit?* Planet Retail Insight article, 17 September 2015.

[5] ***Price Commitments with Strategic Consumers: Why it can be Optimal to Discount More Frequently*** ... Than Optimal, UC Berkeley's Haas School of Business, revised 4 January 2015 by Gérard P Cachon and Pnina Feldman.

Methodology - Shopology™ research

Planet Retail conducts a global survey among 22,500 shoppers across 15 markets each quarter to get a complete and up-to-date picture of shopper behavior and sentiment. Unless otherwise stated, this report draws on Shopology™ poll data gathered at the same time and in the same countries as the retailer survey (excluding Canada), between November 2015 and January 2016, from 1,500 consumers in France, Germany, the UK, and the US (i.e. a total base of 6,000 consumers). Global, year-to-date figures are taken from a base of 90,000 responses gathered between November 2014 and October 2015.

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