Smart KVI Pricing: A Game-Changer in Retail Portfolio Management

About the author

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Pricing Expert helping businesses to transform by implementing innovations at the junction of strategic planning, process design & analytics, systems automation, change management, and people's development. Now, Marina is focused on helping retailers as a Pricing Solution Consultant at Competera, a pricing tech company that's revolutionizing the field by introducing the latest and greatest AI algorithms to retail operations. Prior to joining Competera, Marina spent around 8 years crafting her skills and expertise in pricing by working at Metro Group, Farfetch, and Sonae

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1. Introduction to portfolio pricing

Retailers are deliberately and aggressively reducing low-profit and non-strategic categories in an effort to promote spectacular growth through the introduction of novel products and services.

To guarantee effective execution, they should fully understand product types in their portfolio and product dependencies. Precise research, consumer insights, and complete objectivity are all necessary for this endeavor.

Retail industry leaders are building the portfolio of the future now by paying attention to product classification and cross-functional impacts.

1.1 What are the key types of products in the portfolio?

By segmenting the assortment, different types of pricing strategies can be applied to other products. The methodology is based on categorizing the assortment into several distinct groups that serve different functions. We will focus on these three major categories.

Key Value Items (KVIs) or Categories (KVCs) – important products or categories that drive store traffic and influence price perception. These products/categories draw customers into the store, increasing the number of online sessions or daily visitors. Key value indicators are typically competitively priced.

Volume drivers - Once a customer has entered the store as a result of a competitive KVI offer, it is time to build profitability.

The second stage of the customer journey is volume drivers.

These items have high unit sales and can be found in various baskets. Their profitability is low, but it is higher than that of KVIs. Volume drivers' goal is to recoup some of the customer acquisition cost from competitively priced KVIs.

Profit drivers - The products in this category have a high-profit margin but a low sales volume. Customers consider these products to be non-essential, and their contribution to profit exceeds their contribution to revenue.

According to McKinsey, in modern retail KVIs should be reconsidered all the time, while before it was done only once a year or after a major economic or political shock.

Traditional key value items (KVIs)	**KVIs in a digital retail era**
Single static list of 200-300 items	Dynamic list of 1,000+ KVIs in multiple segments
KVIs identified and refreshed annually	KVIs move across segments dynamically, based on multiple inputs (eg. velocity, reviews, etc.)
All KVIs relevant	Not all KVIs relevant for any single channel
KVIs index set based on fixed set of competitors	KVIs indexes set based on different competitors by channel and category
Index set once per year and refreshed only after significant external or internal shock	Index refreshed frequently based on a set of triggers (eg. share, inventory)

Source: McKinsey report, Pricing in retail: setting strategy

Identifying and reconsidering these types of products requires knowledge of your online store's total stock as well as the value of your users' shopping carts. Thanks to this data, you'll be able to know firsthand what the purchase recurrence is for each of them, as well as which other products they're closely related to.

2. KVIs: the main focus

KVI positions are an important part of an optimal pricing strategy and help retailers attract price-sensitive buyers and increase margins. In other words, your key value items are the key products in your store that enable you to increase overall sales. How? By attracting users with optimal prices and presenting them with related products from the rest of your catalog. However, depending on the industry, the type of pricing strategy might not be the same.

2.1 Why KVIs are crucial in retail?

Products known as key value items, or KVIs, are essential to a retailer's or e-commerce business to make a profit. Prices for KVIs are closely checked by the manufacturer, the retailer, and both to make sure that they stay competitive and appealing to customers. These products are frequently aggressively advertised.

KVIs are frequently referred to as the "bread and butter" of a store's goods in the world of retail. These can be the most popular things offered in the store, or they might be necessities for the business to stay competitive. To set KVI prices that are lucrative for the retailer and desirable to customers, retailers frequently collaborate closely with manufacturers.

KVIs can take on numerous forms in e-commerce. E-commerce retailers could concentrate on a limited selection of products, but they still need to make sure that these items are well-priced and in high demand. To do this, e-commerce companies must keep a close eye on consumer behavior and market changes, and adjust their pricing strategy as necessary.

No matter what shape KVIs take, their significance for a retail or e-commerce business' overall performance cannot be underestimated.

Now, let's look at KVI pricing strategies examples that differ in groceries, electronics, DIY, and apparel retail.

2.2 KVI management in Grocery retail

Understanding demand relationships between items in a shopping basket can be used to implement profit attribution. The loss on one item can be made up for by purchasing another item that will most likely appear in the same basket. This strategy is called a loss leader strategy. In a nutshell, loss leaders are products that are intentionally sold at a loss or minimal profit margin to attract customers and increase overall sales.

> **Consumers typically buy more than one item at a time from a grocery store, so demand relationships within and between products in baskets are critical in determining how retailers set prices.**

A loss-leader item, such as a discounted pumpkin for Halloween, can be used to increase traffic and offset price increases on complementary items, such as the tealight candles that go inside.

Because KVIs are competitively priced, it is a regular thing to attribute profit proportionally, so that the KVIs receive their fair share of overall basket profitability. Adopting a loss-leader strategy helps to attract new customers to the category and enables retailers to take advantage of a larger variety of promotions, discount giveaways, and loyalty programs that improve price perception. But retailers need to pay attention to the impacts it can have on the margin and value perception of the products.

When carried out manually, the success of a loss leader strategy is based more on chance - customers purchasing items they would not have purchased otherwise. Can grocery stores afford to rely on hope in today's data-driven world, where competition forces low-margin pricing in nearly every aisle? Well, it seems like they can't. Grocery stores can increase sales by leveraging competitive intelligence and tools to capitalize on more price-competition opportunities. Lowering prices without fully understanding the impact and motivation behind the price change is usually ineffective, especially over time.

2.3 KVI management in Consumer electronics

The ability to calculate price elasticities at the product and category levels is especially important for the consumer electronics industry. Because margins in the consumer electronics industry are frequently very low, many product prices have little room to fluctuate, especially when compared to competitors. Price elasticity enables retailers to capitalize on market opportunities.

> **Marketplace prices should be used as a reference but not as a driver to immediate changes, that way you will avoid unhealthy reactive pricing. Instead, use this data to negotiate prices with suppliers.**

It is critical to be able to consider complementary goods and substitutes strategically, as well as price them separately when it comes to dynamic price optimization.

Purchased complementary goods, such as an iPhone and an iPhone cover, can be determined using cross-price elasticities and sold directly as a bundle. The main advantage of this strategy is that bundles can boost both profit and frequency. Pricing software should account for substitutes to avoid cannibalization so that the sale of one item does not automatically lead to a decrease in demand for its substitutes.

To sum up, retailers can maximize the yield from their remaining inventory by combining advanced machine learning models with real-time, reactive price changes. These models also account for cross-elasticity, which reduces the cannibalization effect on the remaining assortment. It is also relevant to have the ability to have real-time data from competitors to be able to support real-time decision-making as well as planning by knowing historical patterns regarding competitors' price positioning.

2.4 KVI management in DIY retail

High competition, a lack of omnichannel maturity, and rising procurement costs, on the other hand, have put a significant strain on efficiency and margins in DIY retail.Identifying product families and inter-product dependencies within the assortment, such as different-sized packs or branded vs. private label products, is a critical area that DIY retailers must examine and address.

Because most DIY store customers buy multiple items in a single visit the same as for Groceries, demand relationships between the items in baskets are critical in determining how retailers set prices for KVIs.

Competitor sensitivity is another metric that assists retailers in transitioning from gut-feel responsive pricing to a scientific approach in KVIs selection. Using historical data, the competitive sensitivity coefficient calculates the impact of a competitor's price change on a specific product or category. Once the coefficient value is determined, it can be used to create sophisticated rules for reacting to competitive price changes. This becomes an essential tool for both price perception/customer lifetime value and profit in the DIY space, where different categories may compete with different retailers.

You can position your KVIs a bit higher, if your service, such as delivery, outstand your competitors. However, make sure your customer is aware of the value you bring outside pricing.

Seasonality and weather trends have a significant impact on DIY retail demand. The right system can ramp down inventory at the end of the season, identify which stores have excess inventory that needs to be marked down, and then optimize those markdowns to maximize margin while clearing inventory before it goes out of season.

2.5 KVI management in Apparel retail

The apparel industry is more difficult because of the number of brands. The first thing you would like to focus attention on during KVIs selection is separating new season items from carryovers. For example, separating new trendy items from plain t-shirts, straight jeans, etc. Since the carryovers tend to migrate from season to season, regardless of trends, you should refill your stock consistently and leave them out of promotions and markdowns. New season KVIs, on the other hand, are trend-sensitive and stock-limited.

That's why your other move is to make sure you have a clear strategy according to product positioning. Separate entry prices, standard, and premium items, and select anchors in each category for better awareness of price positioning. Also, those anchors will help you initiate additional purchases, bringing you more control over the pricing of trend-dependent articles.

Using trends to your advantage is an essential skill for apparel retailers. The more your digital marketing strategy influences the trend, the better. It gives you additional control over price positioning and managing stock.

Considering competitors' pricing could be difficult in a multi-brand store. You may need additional attention to the KVI list to do a proper comparison. At the end of the day, your main focus is maximizing sales during the season

Only 10 to 20% of the products are true KVIs. However, retailers mistakenly name KVIs 30-50% of the products.

3. Common KVI mistakes

KVIs are determined only by sales volume
Prioritizing best-selling items and devoting more work to their pricing than low-volume items makes sense. This typical practice is not necessarily a poor strategy, but it is also not the greatest strategy. Advanced science and analytics are used by more sophisticated shops to determine KVIS, which frequently excludes some top sellers while including low-volume items.

Example: As the consumer electronics retailer you may see your KVIs in iPhones and laptops, while in fact, it may be that leg massager from a viral TikTok trend.

A bottom-up, retail-derived strategy
Using a "bottom-up" strategy and letting retailers determine the most crucial components is another common KVI error. This is a method that is essentially ineffective. Instead of being a compilation of several approaches, strategies need to be coordinated. Individual business owners lack a corporate perspective and are motivated to expand their operations even if it hurts other business owners.

Example: In the apparel industry it is common for predicted KVIs to fail, let’s say a designer coat retailers put their stakes on, but consumers may decide to stick with the items such as cotton plain t-shirts.

Inadequate or excessive KVIs
The quantity of essential products is incorrect at several retailers. Simply said, having aggressive pricing on every single item is unprofitable. Nothing is a key item when everything is one. Competition with rival retailers is expensive, and only a small number of businesses can deliver sustainable profit growth while being fiercely competitive on every single item. It is possible to decide which products will have the biggest effects on your sales and pricing perception by taking a balanced approach and employing the right statistics.

Example: In Competera's experience, retailers tend to name 30-50% of their articles KVIs, and it's simply not true. Focusing on that 10 - 20 % of the articles which are really key products for your store will make a huge difference.

> **Competition with rival retailers is expensive, and only a small number of businesses can deliver sustainable profit growth while being fiercely competitive on every single item.**

Wrong time, place, and channel
Retailers selling sporting goods, for instance, would undoubtedly profit from seasonal KVI lists because of the naturally seasonal character of their goods. Regionality can be significant to some businesses as well; every major grocer is aware that crucial items in Texas and California have significantly different appearances. Another area where it could be advantageous to provide various key goods is e-commerce. Remember that adding complexity to your key item approach might reduce its effectiveness and be a KVI mistake in and of itself.
The objective is to make sure that your business is concentrated on the appropriate products in the appropriate location, channel, and season for maximum impact.

Example: It will probably be hard to sell snowboards in Florida, as well as bikinis in Wyoming.

4. KVI category roles: use case

KVI selection process and management details differ from industry to industry. However, many rules and principles are universal. For example, total KVI selection should be up to 25% of the revenue despite the industry.
To demonstrate KVI management principles, let's imagine a local supermarket. We would like to show proper KVI selection for a US grocery store that has $250M annual revenue for 30,000 SKUs.

KVI category roles

First and foremost retailers should understand the category role and the purpose of each KVI. There are many KVI types; even the KVIs themselves could include several product groups depending on the portfolio roles.

For this case, KVI roles could include:

Traffic Generator
Bread, milk, and Coca-cola 6-pack - those goods fall in the traffic generators category. They also have an enormous impact on the price perception of the store. If your milk is unreasonably pricey compared to the next-door store, your whole store will be considered as the pricey one by the locals.

Margin Enhancer
Usually, it's convenience or premium articles such as branded chocolate, expensive wine, etc. For margin enhancer KVI it is obviously important to pay attention to building margins. By using only top sellers and high-frequency articles, you will secure the correct price perception.

Seasonal
Articles in this category, Christmas sweets or Halloween pumpkins, should be seen as in fact traffic ones, just for a short period of time. And during this period, don't focus on building margin. The importance of building revenue

is on the medium level in this category.

Routine

The remaining articles fall in this category. Using top articles as KVIs would be also relevant to build price perception. There is a medium importance to building revenue or margin in this category, but you should select routine KVI carefully.

Other factors to be considered during KVI selection

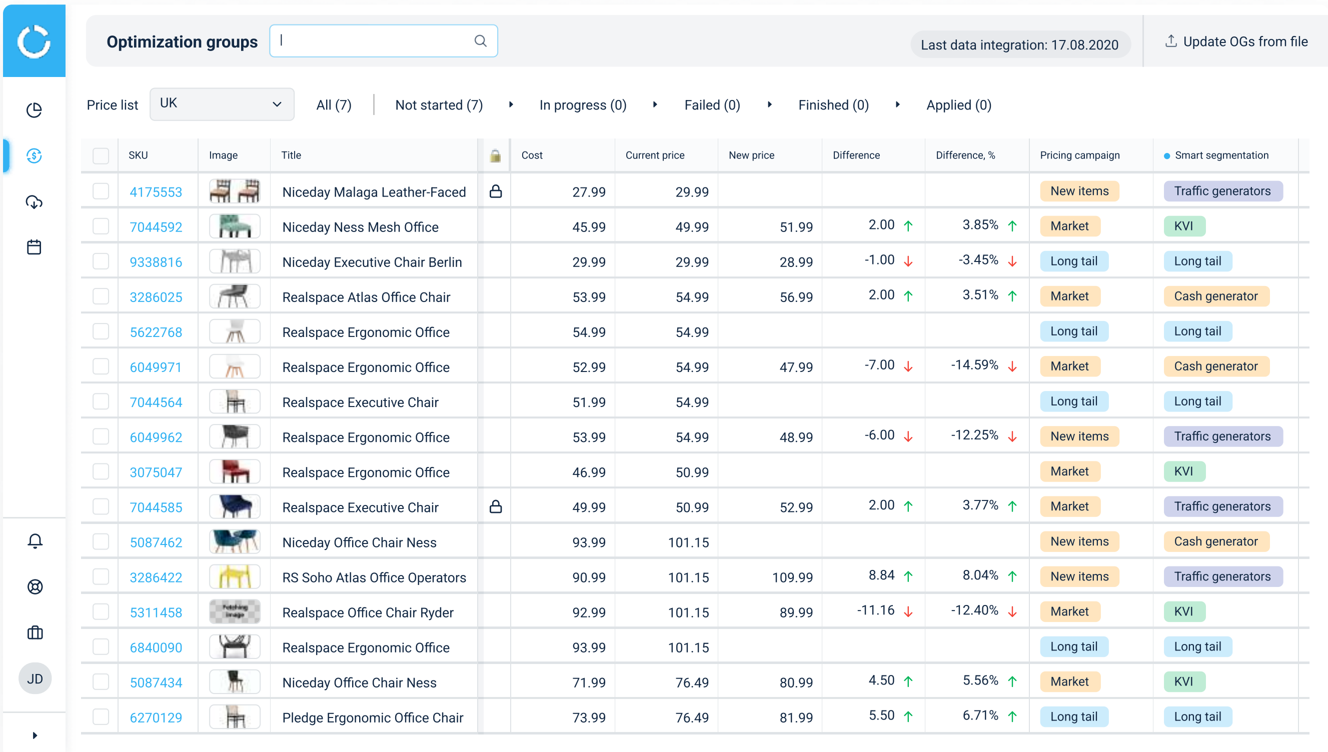
- Market promotions that create awareness
- Basket penetration to identify highly purchased frequency items
- Product Elasticity to address impacts (know the effects of investing in being competitive to drive revenue and possible losses/uplifts on margin)
- Portfolio elasticity to minimize cannibalization effects
- Competitors' Elasticity to consider or how competitors' price changes affect sales
- Top trends in Social media/comparison websites to flag Top KVIs from the customer perspective
- Online metrics: check them to understand what customers are looking for. Also, it's important to address that, if you are not able to convert it into sales, you should probably check your level of price attractiveness vs major competitors'

5. AI pricing: the future of retail

It is safe to assume that artificial intelligence (AI) is revolutionizing everyday life in all aspects. AI is gradually ingrained in everything we do today, from our phones to our cars to the healthcare sector and every other field. The retail industry is also moving towards a new period of predictive commerce. Retailers can now serve their customers down to the last detail thanks to AI, and they can use the technology to streamline their daily operations.

5.1 AI helps to price KVIs

In essence, pricing analytics software uses a machine learning technique based on a specific statistical model to generate algorithms that automatically detect patterns in the data and estimate prices based on that knowledge. Such data sets can reveal patterns in everything from competitors' prices and inventories to purchase histories, product preferences, demand,

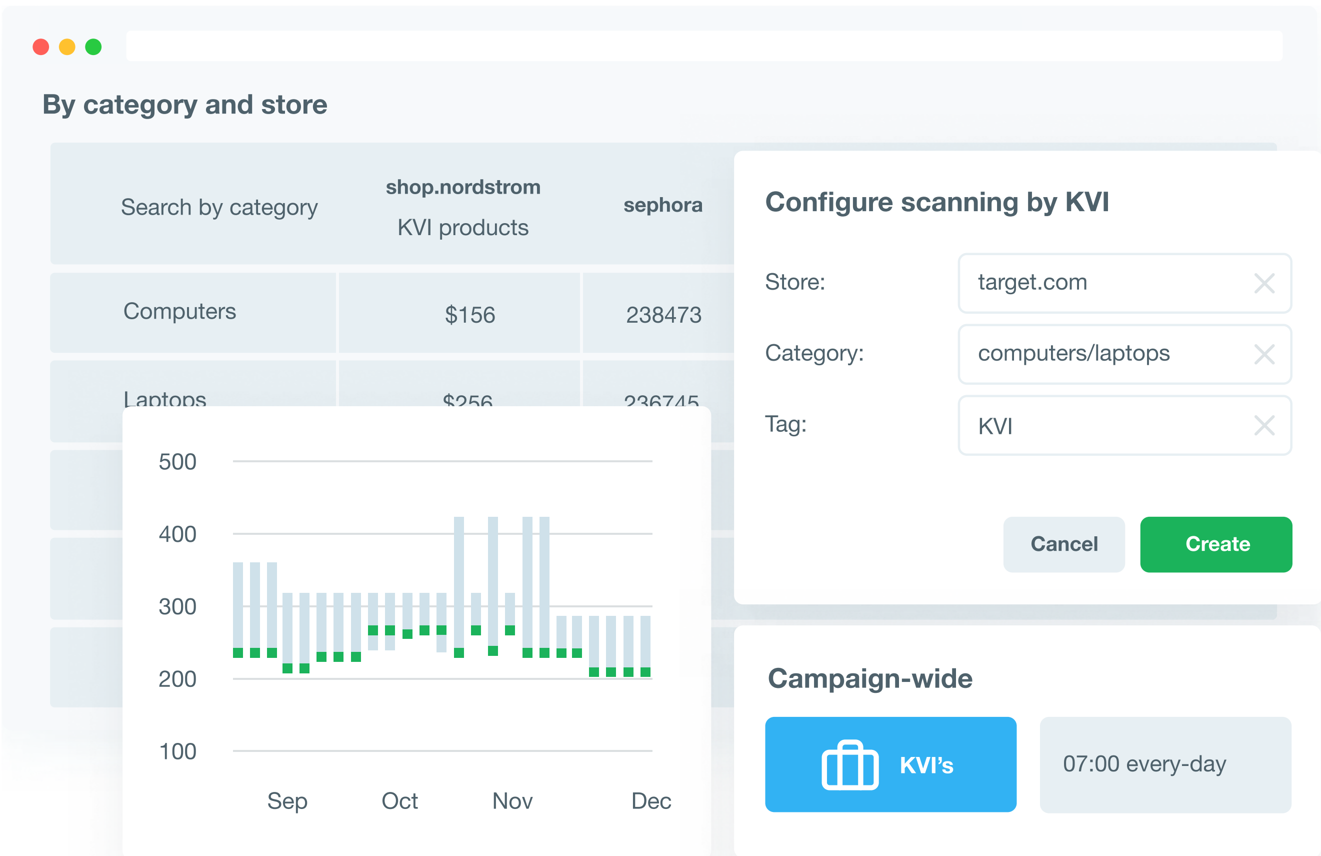


SKU	Image	Title		Cost	Current price	New price	Difference	Difference, %	Pricing campaign	Smart segmentation
4175553		Niceday Malaga Leather-Faced		27.99	29.99				New items	Traffic generators
7044592		Niceday Ness Mesh Office		45.99	49.99	51.99	2.00 ↑	3.85% ↑	Market	KVI
9338816		Niceday Executive Chair Berlin		29.99	29.99	28.99	-1.00 ↓	-3.45% ↓	Long tail	Long tail
3286025		Realspace Atlas Office Chair		53.99	54.99	56.99	2.00 ↑	3.51% ↑	Market	Cash generator
5622768		Realspace Ergonomic Office		54.99	54.99				Long tail	Long tail
6049971		Realspace Ergonomic Office		52.99	54.99	47.99	-7.00 ↓	-14.59% ↓	Market	Cash generator
7044564		Realspace Executive Chair		51.99	54.99				Long tail	Long tail
6049962		Realspace Ergonomic Office		53.99	54.99	48.99	-6.00 ↓	-12.25% ↓	New items	Traffic generators
3075047		Realspace Ergonomic Office		46.99	50.99				Market	KVI
7044585		Realspace Executive Chair		49.99	50.99	52.99	2.00 ↑	3.77% ↑	Market	Traffic generators
5087462		Niceday Office Chair Ness		93.99	101.15				New items	Cash generator
3286422		RS Soho Atlas Office Operators		90.99	101.15	109.99	8.84 ↑	8.04% ↑	New items	Traffic generators
5311458		Realspace Office Chair Ryder		92.99	101.15	89.99	-11.16 ↓	-12.40% ↓	Market	KVI
6840090		Realspace Ergonomic Office		93.99	101.15				Long tail	Long tail
5087434		Niceday Office Chair Ness		71.99	76.49	80.99	4.50 ↑	5.56% ↑	Market	KVI
6270129		Pledge Ergonomic Office Chair		73.99	76.49	81.99	5.50 ↑	6.71% ↑	Long tail	Long tail

and anything directly related to pricing. As the Economist states, using AI price optimization is perfect for increasing profit while keeping prices low on the most popular products. Due to the technology's highly complicated and advanced nature, the fundamental idea remains the same. You have a pricing engine that enables you to track competitor prices continuously. Depending on the many criteria chosen, it then ranks them and compares them to related products before optimizing prices.

5.2 How advanced solutions help retailers with pricing?

Competera Pricing Platform enables continual pricing optimization and aids in the development of new business models that can boost revenue and stop leakage. It provides real-time insights based on market signals, competition intelligence, and changes in client preferences and purchasing propensities using powerful ML and AI. Using these insights, businesses can design and roll out the best pricing situations and customer experiences to stimulate development.



Data-driven decisions rather than gut instincts
Retailers get a complete picture of the performance of every product in their portfolio. With this data, pricing experts can develop and implement an optimal pricing strategy.

Quick, on-the-spot, and accurate repricing
There is no manual data processing. Algorithms quickly provide findings after analyzing a vast amount of information. Retailers regularly track changes to the KVIs list and proactively react by adjusting prices.

Flexibility in setting super KVI prices
Setting the lowest price is not necessary to outbid competitors. Alternatively, retailers might develop ideal prices depending on a variety of variables (such as promo elasticity, basket analysis, and competition data).

5.3 Three easy steps to define and set the prices for your KVIs

Get inputs
Product categorization is more precise the more data retailers have. The data set required for ML-driven segmentation typically consists of:

- consumer research data
- ABC analysis results
- sales data
- competitor elasticity check
- web traffic analysis
- promotions

Analyze inputs
Large volumes of information can be processed fast thanks to algorithms. The outcomes of the analysis are then taken into account when formulating pricing recommendations. Retailers may automate and regularize product categorization using Competera's technology (e.g. every 3, 6, or 12 months).

Dynamic reconsideration is essential because external circumstances alter customer behavior patterns, which affects demand.

Use outputs for pricing decisions
Algorithms define product roles in a portfolio. The system works with different variables, processes them, and enables retailers to take the outputs into account while deciding on the best-performing strategy for this role and its contribution to the overall portfolio goal.

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