Artificial Intelligence Helps Break Revenue Ceilings

Mature retailers have reached the revenue ceiling, which is hard to break by using traditional methods. Artificial Intelligence (AI) and its core element Machine Learning (ML) are gaining momentum as a revolutionary means to bring retailers to the next level of revenue generation.

According to recent Juniper research, by 2022, retail businesses will be spending some $7.3 billion yearly on AI, up from $2 billion in 2018.

This paper briefly outlines how retailers can use AI along with other approaches to offer optimal prices and boost profits.
Industry Challenges

The power in the market is shifting from sellers to buyers, say recent studies by Deloitte and PwC. Therefore, it is becoming incredibly important for retailers to build a frictionless customer experience to differentiate from competitors and retain customers. Being at the core of successful customer experience, the price of a product is what makes consumers shop at a particular retailer, states Global Consumer Insights Survey 2018 by PwC.

Retail giants like Amazon leverage the power of machine learning to build the right price perception among customers. According to the report “How to win in the Amazon era” by Epsilon, as many as 64% of respondents cited price as their primary motivation to shop on Amazon.
Industry Challenges

Meanwhile, it is challenging to find a balance when setting prices, even for advanced retailers. Too low prices send companies bankrupt. Too high prices repel shoppers and, as a result, cut sales. For example, a study by Retail Systems Research states that consumers would rather care about a “fair price” than a “lower price.” Therefore, optimal prices are a must. A core aspect of rewarding customer experience, they are rapidly becoming rocket science even for advanced retailers.

Retail businesses effortlessly reach KPIs which can be categorized as “the higher the better,” e.g. revenue or profit, and “the lower the better,” e.g. costs. These are easy to target and convert into tactics. However, when it comes to “optimal values,” such as prices, retailers find it difficult to calculate balanced prices for the whole product portfolio in real time.
At Competera, we see two major barriers which prevent retailers from setting optimal prices:

The impermeability of the future
There is no ground truth in retailers’ pricing actions. It is impossible to say whether the action was right or wrong because the reaction of sales is very hard to measure. It is difficult because the reaction of demand to price changes is:

- Non-linear;
- Delayed (since customers shop with a certain frequency, they have shopping cycles and get exposed to new prices with a delay);
- Multi-factor (it covers not only absolute price points but also relative factors);
- Heavily biased by other factors like seasonality, distribution, advertisement, and competitive actions, etc.

A very wide product range
By changing the price of a certain product, retailers impact the sales of dozens of other products. Also, large-scale companies need to reprice thousands of products every week, or sometimes daily, which makes the calculations of individual price elasticity for human managers almost impossible.
Available Approaches

Currently, retailers can benefit from three main methods to enhance pricing:

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<thead>
<tr>
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<th>In-house solutions</th>
<th>Consultancy</th>
<th>Technological partnership with AI-provider</th>
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<tbody>
<tr>
<td><strong>Flexibility</strong></td>
<td>Designed for a specific goal, such solutions have no product development team that can help the system evolve along with the needs of the retailer</td>
<td>Hired consultancy teams provide one-time reports per specific requests</td>
<td>The solution evolves along with the needs and goals of the retailer of any size</td>
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<td><strong>Scalability</strong></td>
<td>Scaling up internal systems is time-consuming and requires heavy investment. Also, the retailer’s pricing department should align their plans with the IT department to deploy the system across a wider range of products</td>
<td>Such a solution is not scalable. Everything from adding new products to changing a pricing strategy requires the retailer’s financial and human resources or additional consultancy funding</td>
<td>A technological partner has all the necessary resources and infrastructure on their side, which brings the involvement of the retailer to a minimum.</td>
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<td><strong>Accuracy</strong></td>
<td>In-house solutions are often designed for rule-based pricing and rarely tap into demand predictions</td>
<td>Such reports provide long-term predictions and recommendations rather than short-term ones</td>
<td>AI algorithms are trained and optimized constantly, which helps make short-term predictions more accurate</td>
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</table>
# Available Approaches

| Trustworthiness |雇佣一个信誉良好的咨询公司是安全的，尽管它需要将数据转移到第三方。 | 这种合作关系确保了数据安全，归功于Google云的独立数据存储账户。
| | | 与技术合作伙伴合作，零售商的IT部门可以专注于公司的其他技术需求，而定价部门则可以专注于这样的战略任务：制定平衡的定价策略或与供应商进行谈判。
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Amazon, Walmart, and other big names rule the world of retail. They gain a competitive edge by pumping billions of dollars into R&D; for example, Amazon invested some $22.6 billion in 2017.

Furthermore, retail giants also invest heavily in marketing and promotional efforts. Competing with them by using traditional methods is not an option in a highly intensive and dynamic market. Meanwhile, a technological partnership can put retailers in a position to fight for and increase their market share.
What Makes Competera Different

Here is what sets Competera apart from competitors:

- highly accurate (up to 98%) demand predictions
- 2-5% margin growth, up to 15% sales growth
- optimal prices at any level — by product portfolio, store, region or country
- real-time analytics for immediate or long-term changes in a pricing strategy
- a sandbox for testing promo scenarios on the fly
- a database for the results of all the bad and good pricing and promo experiments
- rapid scaling to match the needs of a retailer of any size
- evolving along with the needs and goals of the retailer
How It Works

At Competera, we use a two-stage machine learning approach. The first stage is a perfect fit for precise calculation of the effect of price changes on sales. The second stage is state-of-the-art math price optimization which uses the results of the first stage to recommend prices for the whole assortment to reach the retailer’s business goals.

Sometimes retail managers hesitate to apply seemingly counterintuitive price recommendations of the AI algorithm. Humans see the algorithms as a black box, the logic of which they cannot debug and understand.

What if the system would recommend cutting prices by 50% or even 90%? Should such recommendations be taken into account and applied? When in doubt, the answer is to use the “sandbox” option to test every pricing scenario and see its results in real time. Another step would be to set constraints to keep the highly accurate system within necessary limits.
How It Works

1. Collect and structure historical data spanning no less than two years
   - Sales transactions
   - Stock
   - Assortment
   - Repricing activities

2. Indicate business goals
   Choose a repricing model to increase sales volumes or revenue.

3. Define business constraints
   To control the repricing outcomes, provide the algorithm with a number of necessary business rules — from the maximum number of repriced products to costs and the MAP.

4. Receive optimal price recommendations
   Apply the recommended prices to reach previously indicated business goals.
To make every product contribute to revenue generation, retailers need to take the following steps when partnering with Competera:

1. Data processing
2. Market test definition
3. Models training & simulation
4. Market test launch
5. Scaling & Evolution
Run a 60-day market test

Companies do not have to take our word for granted. They can always check our efficacy with the help of a market test.
## How Competera Solves Real-world Retail Pricing Problems

<table>
<thead>
<tr>
<th>Sell stock</th>
<th>React to the rise of purchasing prices</th>
<th>Boost sales of fast moving products</th>
<th>Define the price positioning for new entries</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Actions</strong></td>
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<tr>
<td>Change prices optimally while taking into account the profit margin of the whole product portfolio.</td>
<td>Apply a differentiated approach to pricing. Run several repricing cycles with uneven price ranges to reach KPIs gradually.</td>
<td>Leave as it is or raise prices for a part of the assortment to improve the price perception of chosen products.</td>
<td>Identify latent clusters of similar products, and assign new entries to the most affinitive clusters.</td>
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<tr>
<td><strong>Results</strong></td>
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<tr>
<td>- Loyal customers are focused on high-margin products.</td>
<td>- Retained profitability for the whole product portfolio.</td>
<td>- Fast-moving products generate revenue steadily.</td>
<td>- New products have optimal prices.</td>
</tr>
</tbody>
</table>
Case Study

Foxtrot, an omnichannel Eastern European retailer with $500 million in annual turnover, wanted to stop copying competitors’ pricing moves and maximize revenue without risking profit margins.

The pilot, which involved a test and a control group, had three goals:

1. To maximize revenue without losing margin;
2. To stop mimicking the moves of competitors;
3. To show the feasibility of Competera’s solution.

Solution

Competera suggested switching from expert-based pricing to using state-of-the-art machine learning algorithms as part of the pilot to optimize pricing based on the retailer’s business needs.

The results of a 30-day market test:
Check whether Competera Price Optimization solution can boost your profit margins by 5% & sales by 15%.

If you still have any questions regarding this e-book, or any of the described strategies, do not hesitate to contact us.