

Pricing Strategies in Multi-Channel Retailing of Seasonal Goods

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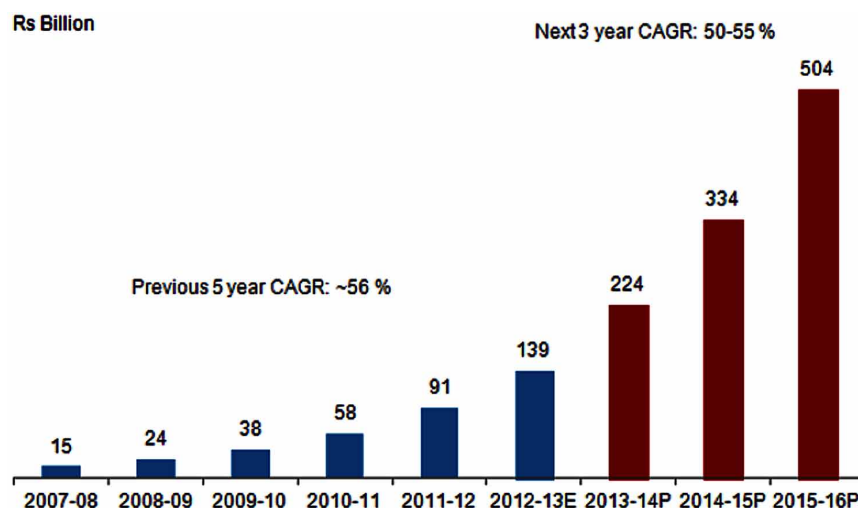
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INTRODUCTION

The rapid development of internet technologies as well as the increase in consumer online spending has opened up plethora of opportunities for traditional “bricks-and-mortar” retailers to expand their business. As per the report published by CRISIL (2014), a leader in business analytics, global ecommerce sale will grow at a 50-55% compounded annual growth rate (CAGR) to Rs.504 billion in 2015-16. The sales data from 2007-08 to projected sales for 2015-16 is presented in Figure 1. So, in this changing face of ecommerce, developing an appropriate strategy to maintain multi-channel coordination between off-line and online business becomes crucial for retailers to achieve success.

Despite providing new business opportunity to retailers, often successful implementation of multi-channel selling is questioned as it employs complex pricing decisions to realize the full profit potential of the different channels. Especially challenging is to determine the prices for seasonal fashion items such as summer wear or winter garments or fall fashion collection. These items go out of style relatively fast. Also, slow selling seasonal items often pose barriers to proper self-space utilization in case of an offline store. For a retailer, it is important to markdown slow selling seasonal items to open up shelf space for new arrivals and ‘in-demand’ items. Now, the dilemma faced by the retailer is whether to start with high

Figure 1. Global E-Commerce sales as per CRISIL's report (CRISIL, 2014)



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prices and then give deep markdowns at the end of the season or price the item uniformly through the season. The difference between the regular-price and the actual-sales dollars is often several hundred million dollars for major retailers (Smith & Archabal, 1998). In addition, high operational expenses related to product display, product change and inventory holding are matters of concern for an off-line store. Online channel solves the issue of space constraint and brings down the aforementioned costs significantly. The cost effectiveness of online channel has been advocated by business leaders such as Hubert Joly, CEO of Best Buy Co inc (Best Buy, 2014).

On the other hand, consumer behavior is more inclined towards traditional off-line stores due to the benefit of experiencing and sampling it before buying. Due to the lack of this feature, online channel often becomes less appealing to the consumers compared to its offline counterpart. However demand is influenced by the prices charged in the two channels and as the customer population becomes more and more price sensitive, strategic pricing decisions can facilitate the retailers in maximizing their profits.

The interdependent demand pattern between the two channels raises the complexity of the pricing problem. At each time period the demand for each channel viz. off-line and online, depends on the respective prices of the item in the stores, each customer's channel preference and their respective valuation of the product. In this dual channel selling environment, price setting mechanism and coordination plays an instrumental role to achieve success. Perfect channel synergy provides the retailer an option to give fewer discounts and maximize profits based on the demand patterns. However, dual-channel operations pose viable market cannibalization threats. In this scenario customers have an option to buy the item from the off-line store as well as from the online store. Giving too much discount or drastic markdown in any of the stores carries the risk of losing additional profit making opportunities as well as lower end-of-season profits for the retailer. Therefore, the retailer needs to develop optimal channel adoption and pricing strategies.

Motivated by this example, this book chapter delves into multi-channel viz. off-line and online business operations of a monopolistic retailer who is selling a seasonal item simultaneously in a 'brick and mortar' store and online, in a two period setting. For expositional convenience, only one offline store is considered. The two period setting helps to capture the decrease in popularity of the product as the first markdown tends to be the dominant decision economically due to short selling season for these products (Smith and Archabal, 1998). In this context, the objective of this book chapter is to devise optimal channel adoption and pricing strategies for retailers involved in multi-channel sales. In addition, a new metric named 'seasonality adjusted cost' designed based on the ratio of additional off-line costs and the seasonality factor of the product is introduced. This metric negatively impacts the overall profit for the retailer. Based on its value and the online channel preference of the customers, the retailer can optimally decide the channel adoption strategy. As per findings, the relative efficiency of the online channel increases with increasing seasonality adjusted cost. In a similar fashion, both inter-channel and inter-temporal discounts rise with the rising product seasonality. In addition, the findings indicate that even if the market strongly favors the 'bricks and mortar' store, profits for the retailer increases if he can influence the online preference of the customer population.

BACKGROUND

The related literature can be grouped into two categories:

1. Optimal dynamic pricing for one store or a retail chain, with independent demands.
2. Pricing in a multi-channel sales environment.

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