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Demand Management: EDLP Theoretical Framework Does Not Transpire to the Practical Sector

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Table of Contents

[Introduction 1](#_Toc418511203)

[Hi-Lo Pricing 2](#_Toc418511204)

[Hi-Lo Differing from EDLP 3](#_Toc418511205)

[Everyday Low Pricing in Theory 3](#_Toc418511206)

[Everyday Low Pricing Strategy in Practice 4](#_Toc418511207)

[Differentiation Theoretical and Practical EDLP 5](#_Toc418511208)

[Competitor response 6](#_Toc418511209)

[Consumer Response 10](#_Toc418511210)

[EDLP Strategy Implemented Successfully 13](#_Toc418511211)

[Wal-Mart 13](#_Toc418511212)

[Poor Implementation of EDLP Strategy 17](#_Toc418511213)

[JCPenney 19](#_Toc418511214)

[Key Focus of Implementation of EDLP Strategy 21](#_Toc418511215)

[Step 1: Alignment of Pricing Strategy 24](#_Toc418511216)

[Step 2: Consumer Management 25](#_Toc418511217)

[Step 3: Cross-Enterprise Focus 26](#_Toc418511218)

[Step 4: Consumer perceptions and reference price 26](#_Toc418511219)

[Wal-Mart’s Fit 27](#_Toc418511220)

[JCPenney Fit 28](#_Toc418511221)

[Conclusion 30](#_Toc418511222)

[References 32](#_Toc418511223)

# Introduction

Many authors explain the crucial role that the pricing strategy has for retailers’ marketing and sales strategies with complex tactics involving promotion depth, frequency, duration, displays for brands and categories (Lal, Rao, 1997; Dhar, Hoch, 1997; Hoch et al., 1994: Levy, Weitz, 1998). Pricing strategy is vital to retailers’ survival with almost $1.4 trillion coming from food, beverage, drug, and department stores (Grewal, Ailawadi, Gauri, Hall, Kopalle, Robertson, 2011). This vast market potential gives retailers’ a desire to choose correct pricing strategies. The strategy chosen affects two major groups: [1] the consumer and [2] competitors within the local region (Ailawadi, Lehmann, Neslin, 2001). Authors have noted that pricing strategy must go deeper than just the pricing level and can often create a 22% increase in operating profits (Levy, Grewal, Kopalle, Hess, 2004; Hinterhuber, 2003). The common theme of retailers choosing between two major competing strategies EDLP and Hi-Lo pricing has major implications on the retailers’ profits and consumers shopping decisions.

 Throughout the supply chain world experts, business professionals, and researchers have been coming up with strategies to reduce the severity of the bullwhip effect within an organizations’ supply chain. The bullwhip effect causes an amplification of demand variability as one moves further “upstream” in the supply chain from the end customer. There are many challenges to reducing the severity of the bullwhip effect due to poor forecasting techniques, lack of information, and fluctuating demands that cause product shortages or excess inventory. Companies have made attempts to reduce the bullwhip effect with little success since many companies are not willing or do not share information with one and other. Companies find ways to reduce the fluctuation with a myriad of strategies. One major strategy to reduce the bullwhip effect that built moment in the business sector during the early 1990’s was the everyday low pricing (EDLP) strategy (Ortmeyer, Quelch, Salmon 1991; Bell, Ho, Tang, 1998; Bell, Lattin, 1998; Hoch, Purk, Dreze, 1994; Partch, 1992). Industries from discount retailing to manufacturing, implemented EDLP strategies with prominent companies including, Wal-Mart, Proctor and Gamble, and Lion all having implemented an EDLP strategy. The only company that still employs an effective EDLP strategy is Wal-Mart. So this question has to be asked why did EDLP work so well in a theoretical framework but didn’t transpire in the business world?

We will first look at the most commonly used pricing strategy Hi-Lo pricing and the how it is used in practice.

## Hi-Lo Pricing

The Hi-Lo pricing strategy is the strategy that is most predominant in the business world. The Hi-Lo pricing strategy is most commonly used to exploit price discrimination among consumers (Hoch, Dreze, Purk, 1994). Hoch (1994) goes on to say that Hi-Lo will attract price sensitive consumers to the store. They will switch brands based on the current price of a product due to the promotion. The Hi-Lo pricing strategy has been used for many years and is ingrained in the consumers mind to seek out these sales or temporary decreases in pricing. An example of a Hi-Lo pricing strategy would be paint being normally $12.99 a gallon but, will be advertised as a sale for only $9.99. The consumer believes that they will save three dollars on the gallon of paint. The goal of this adverting, more importantly, is to make the consumer come into the store because if the consumer buys the gallon of paint they will also consider buying paint brushes, painters tape, and other anecdotal items needed.

Pure Hi-Lo Strategy: Stores will create promotional activities on selected product categories all throughout the store and base Hi-Lo pricing of the categories from prior purchasing trends, customer preference, excess inventory, push sales strategies from suppliers, and high and low moving inventories. This strategy will have the highest promotional activity and cost, but will also increase foot traffic of potential buyers and product switchers. Stores will implement the Hi-Lo strategy most commonly to increase profits. Hi-Lo strategies are also the easiest to advertise to consumers, since they do not need to be taught about the promotional activity.

The Hi-Lo pricing strategy has many variations from EDLP which will be covered next with the theoretical view of EDLP.

## Hi-Lo Differing from EDLP

Everyday Low Pricing differs from Hi-Lo pricing by reducing the amount of promotional activities used throughout the circulation of promotions. The major difference of the promotional activities is in the form of temporary pricing reductions. The temporary pricing reductions lure customers in to retail stores (Levy, Grewal, Koppalle, Hess, 2004). Companies mark down merchandise based on a variety of percentage mark downs and lengths of time (Levy, Grewal, Koppalle, Hess, 2004). Everyday Low pricing’s major difference is that retailers’ choose a constant lower price that has no temporary pricing reductions (Hoch, Dreze, Purk, 1994). The result that retailers hope for is increased service levels with fewer safety stock of SKU’s, the lower price will hold consumer confidence in price and will increase profits due to volume of purchases increasing (Voss, Seiders, 2003). In order to identify these potential gains an overview of EDLP in theory and how it differs from real-world applications is needed.

## Everyday Low Pricing in Theory

Everyday Low Pricing is a strategy that would reduce the effects of the bullwhip effect. These effects as (Lee, Padmanabhan and Wang, 1997) listed can cause major problems for the business such as, excess inventory, weak product forecasts, and insufficient and excess capacity issues. The EDLP strategy is a demand smoothing process that in theory reduces inventory levels needed, increases forecasts predictability, and can improve profits of the company by reducing the required amount of safety stock to meet a given service level. EDLP works by removing advertising promotions; the reduction in advertising promotions results in demand being smoothened with less demand volatility due to promotional sales activities that can be seen in the Hi-Lo pricing strategy. The results of this smoothing would be increased forecast accuracy which in turn would reduce inventory needs creating smoother production plans, reducing capacity costs, overtime costs, and costs associated with the decrease in inventory. An example of an EDLP pricing strategy would be towels priced at 3.99 and would stay the same price with minimal changes based only by market decisions rather than retailer promotional pricing incentives. This would result in less spikes of demand during promotions creating a more smooth demand schedule as seen in Figure 1 (Hoch, Dreze, Purk, 1994).



Figure 1: EDLP and Hi-Lo pricing framework, presented by (Hoch, Dreze, Purk, 1994)

The marketing goal of the EDLP strategy is to increase volume of purchases due to the low price and reduce price-switching behavior among consumers who are waiting for a sale to take place.

# Everyday Low Pricing Strategy in Practice

With the major benefits of the everyday low pricing strategy many companies take the perspective that it will lower overall business costs, creating a larger profit margin. Many retailers choose EDLP strategy to reduce costs of advertising, inventory, and display turns costs (Lee, Padmanabhan and Wang, 1997). Companies expect that foot traffic in stores will decrease but, overall volume of products sold would increase due to a lack of price-sensitive customers switching stores (Hoch, Dreze, Purk, 1994).

## Differentiation Theoretical and Practical EDLP

Researchers (Hock, Dreze, Purk, 1994; Tom, Ruiz, 1997) in the EDLP sectors have shown that in business sectors, pure EDLP strategies are rarely used. Instead many companies use a mixed strategy that uses product categories that follow an EDLP strategy and other product categories follow a Hi-Lo pricing strategy. Hock et al. (1994) explain how business employ EDLP pricing strategy:

“…non-promotion prototype is not representative of how EDLP actually is executed in the field. Self-avowed EDLP chains do engage in promotional (Hi-Lo) pricing, and in fact some chains do engage in promotional pricing, and in fact some engage in as much promotional activity as the Hi-Lo chains.”

 The most common EDLP strategy is explained below:

 Mixed Strategy: Stores use a mixed approach where selected product categories follow an EDLP strategy and other products follow a Hi-Lo pricing strategy. This allows stores the most flexibility in strategies and can create incentives for customers. The increased foot traffic and benefits from EDLP pricing gives stores the ability to offer higher perceived value to the customer which in turn, creates more value for the stores.

This various from the pure EDLP theoretical model that is explained below. With the largest differences is the use of Hi-Lo pricing and EDLP pricing that is mixed. In the theoretical model the store’s products all follow a EDLP strategy.

Pure EDLP: All product categories use an EDLP pricing strategy with no promotional price decreases or volume increases for the products. Theoretically, this strategy should increase the volume of purchases by capturing the most consumers’ purchase price. The model should also result in the lowest spend in inventory management since demand will be smooth across all product categories allowing for more accurate forecasts and reducing the required amount of safety stock.

The reason retail stores choose the mixed strategy is from the fact that the strategy incentivizes foot traffic while simultaneously smoothing demand for selected categories. To understand the differences of the EDLP strategy and Hi-Lo strategy researchers (Hoch, Dreze, Purk, 1994) viewed stores with predominately EDLP strategies such as Cub, Food Lion, Lucky, Winn-Dixie and Hi-Lo pricing companies such as Jewel, Safeway, and Von’s, respectively. The most interesting findings from the comparison was, EDLP store prices where 9% lower than Hi-Lo stores, 26% of overall store volume is sold with some form of merchandising support in EDLP stores compared to 24% in Hi-Lo stores, and finally EDLP stores on average provide a savings of 33% more than Hi-Lo stores. The findings are interesting, but apply only to a relatively few amount of retailers who run a pure strategy whether it be EDLP or Hi-Lo pricing.

Companies run the mixed strategy in various ways depending on store location, destination, categories, store price perception, and store service perception (Kumar & Leone, 1988). Major retail stores on the other hand have a system-wide character of decisions on pricing and categories that either favor EDLP or Hi-Lo strategy (Levy, Grewal, Kopalle, Hess, 2004). The categories result in traffic-builders, cash cows, fast movers, and staple products (Levy, Grewal, Kopalle, Hess, 2004; Bolton, Shankar, 2003). Companies decide on which categories should follow either strategy that will add most value to company, which could be increased market share, maintain market share, and increased profit strategy. Two major implications that the theoretical model does not take into account are competitors’ response to pricing strategies and the consumers’ response to pricing strategies.

# Competitor response

The competitors’ response to a strategy employed by a specific firm has major implications on the success of the firms’ pricing strategy (Dickson, Urbany, 1994; Hoch, Kim, Montgomery, Rossi, 1995). This paper will look through the competitors’ response in a macro-economic lens due to the fact that most data and recommendations will deal with regional retailers. Research (Ailawadi, Lehmmann, Neslin, 2001) shows that firms’ responses to competitors are based on market share response elasticities, structural factors, and firm-specific effects. The researchers (Ailawadi, Lehmann, Neslin, 2001) state, “…Competitor response to a firm’s change in advertising and promotion is governed by cross-elasticities (how strongly the competitor’s share is affected by the firm’s move).” The most dramatic example of this would be the JCPenney’s pricing shift from a Hi-Lo pricing strategy to an EDLP strategy. The shift however, did not spur on many of JCPenney’s competitors including, Kohl’s, Macy’s, and Dillard’s to shift to an EDLP strategy. The reasons for a lack of response was identified by many researchers (Gatigon, Anderson, and Helsen, 1999; Putsis, Dhar, 1998; Shankar, 1999) to be from companies competing with strong self-elasticities (company’s regional elasticities and synergies) and competitive advantages that are specific to firms.

Structural factors are key forces in a competitor’s response. This is a fairly intuitive concept as competitors take into account the market concentration, share position, and multi-market structural determinates. The more concentrated the industry is with structures such as competitors, distribution channels, strategies, and consumers the more likelihood of competitor response. Changes depended on how major the power of the competitor holds and if this fits the firm’s current strategy. The area uncovers what competitors’ expected response is to major competitors, versus fringe firms (Putsis, Dhar, 1998; Shankar, 1999; Spiller, Favaro, 1984). The logic follows that an industry with tight correlation to structures will have a more significant competitor response to shift in strategies. The other factor, market concentration increases co-operative behavior, and signaling to firms (Qualls, 1974; Ramaswamy, Gatigon, and Reibstein 1994; Scherer and Ross 1990). The higher these co-operative behaviors and signaling to firms allows companies to follow each other’s strategies more closely and strategically. The co-operative behavior and signaling has correlation to the tightly structured firms.

Lastly, competitors’ response to firm-specific events change depending on what resources each competitors has to devote such a shift. (Ailawadi, Lehmann, Neslin, 2001) explain various firm specific effects that firms use to create strategies. “The resource-based view conceptualizes the firm as a unique entity with specific core competencies, leadership, culture, and resources that determine its actions…”. That helps guide the firm’s strategies on resources cost such as structural investments (e.g., number of stores, size of stores, etc.) that can then be base infrastructural investments (e.g., pricing strategy) off of the firm’s unique entity and resources. Firms must stay consistent with both structural and infrastructural investments. Furthermore, in order for firms to achieve their goals the investments must “fit” each other in order to create synergies and more efficient use of resources. Since firms strive to create this “fit” there is often time interdependencies that form with both investments. This means companies are often times unwilling to change strategies since it would cause changes in multiple strategies and not just affect one investment.

One example of competitors’ reaction occurred when Proctor and Gamble (P&G) incorporated an EDLP Strategy. Competitors shifted but, not to the degree of P&G’s EDLP strategy. P&G’s strategy was outlined by (Ailawadi, Lehmann, Neslin, 2001).

“It [P&G] reduced promotion activities: Deal frequency declined 15.7% and coupon frequency declined 54.3%. As a result of the cuts in P&G’s promotion, the net price paid by consumers increased by approximately 20%.”

Figure 2: Trends of P&G's value pricing strategy and competitors’ strategy over a six year period, source (Ailawadi, Lehmann, Neslin, 2001)

This EDLP strategy that P&G followed during the early 90’s created a market response, however the trending market response was smaller due to the preexisting ideas of elasticities, structural factors, and firm specific factors, represented in Figure 2.

Looking at the trends it can be seen that competitors responded most to a decline in coupons and not in deals, advertising expense, or the net price of the product. The reason for this could be due to a pricing strategy that emphasizes more stable, low prices that large-scale retailers are likely to advertise to focus on price position (Voss, Seiders, 2003). Large retailers likely want to give consumer confidence in receiving the best deal which will result in decreasing the need of coupons. Also, the interdependences that make each firm unique would result in only a subtle shift.

The results from the evidence laid forth helps shape how competitors responded to pricing strategies that the focal company follows. Evidence shows that companies will react to pricing strategies only when it depends on the how much the companies share elasticities, firm structures, and firm specifics. This will result in competitors shift in strategies that were found in P&G’s example but, competitors did not shift when JCPenney changed their strategy because the competitors’ structure and firm specifics where too large to equate to any marginal shift in strategy. The other key aspect that companies take into account is the alignment that the strategy will have with consumers. This focus on the customer is also crucial when looking at EDLP in a business contexts.

# Consumer Response

One of the most vital and overlooked responses when companies implement an EDLP strategy is consumers’ responses. The main component that affects consumer response is the consumer’s reference price regarding certain product categories and the anchoring of this price in relation to the price of the EDLP product (Blair, Harris, Monroe, 2002; Chandrashekaran, Grewal, 2003; Kalyanaram, Winer 1995; Kopalle, Lindsey- Mullikin, 2003). If customers believe that the price of the product in their head is not less expensive than the price that is being promoted, the customer will perceive this as a loss; however, if the reference price is higher than the promoted price customers will perceive this as a gain (Levy, Grewal, Koppalle, Hess, 2004). The logic follows that customers are more willing to buy products if the perceived gain outweighs the perceived loss of purchasing products. Some research (Levy, Grewal, Koppalle, Hess, 2004) shows that simply changing the price will not increase sales of product in a pricing mix.

Hoch et al. (1994) conducted experiments of price perceptions that shows intriguing evidence that consumers are not as sensitive to price as previously believed. This sensitivity is the distinguishing factor of EDLP strategies that businesses are trying to get consumers to switch stores based on their price sensitivity. The evidence found that a price increase of 10% led to a volume decrease of only 3 % (Hoch, Dreze, Purk, 1994).

“(Dickson & Sawyer, 1990) examined the extent to which supermarket shoppers were aware of prices paid. They found that 50% could not correctly name the price of the item they had just placed in their shopping cart, and that more than half of the shoppers who purchased an item on sale were unaware that the price was reduced.” (Hinterhuber, 2003)

The research uncovers a common misconception that companies perceive consumers to have higher price sensitivity than what the consumer perceives. Companies must than find other ways to providing value and advertising to consumers, other than just lowering price of products and believing that consumers will be sensitive to the price and any gains the consumer perceives from the price. Companies must look at consumers’ behavior in hedonic benefits and utilitarian benefits. Chandon, Wansink, Laurent (2000) gives three examples of both hedonic (opportunities for value expression, entertainment, and exploration) and utilitarian (savings, higher product quality, and improved shopping convenience) benefits. Companies looking to implement EDLP strategies only think of the benefits of savings, value expression and product quality. Companies look to create a response in consumers that creates beliefs of savings, the value generated from the savings, and established product quality justify lower costs that still offer greater product quality. Companies can create a multitude of displays to evoke consumer response and trust in EDLP prices. Figure 3 puts the framework of common promotional advertising used within stores. 

Figure 4: Hedonic and Utilitarian benefits in a promotion benefits matrix, source (Chandon, Wansink, Laurent, 2000)

The authors then go a step further and explain that consumers do not only respond to monetary savings benefits of sales promotions. In other words, companies pursing an EDLP strategy can look to create ways of promoting utilities other than simply stating price savings that is common among EDLP strategies. More specifically, as explained earlier, consumers are not as price sensitive as previously thought, and thus marketing managers have the opportunity to pursue other solutions to create value in consumers’ minds. The company that seems to be able to add value to consumers’ minds is Wal-Mart. The major reason for Wal-Mart’s ability to generate this perceived utility of EDLP value is due to Wal-Mart being consistently lower priced in the same name brand product categories than other retailer stores, keeping the mindset of “We Sell for Less” (Ghemawat, 2007). This gives consumers more opportunity for value expression and due to the large product offerings gives consumers entertainment and exploration in this value expression. Upon arrival to checkout Wal-Mart gives convenience in multiple offerings of checkout ways (Self, 15 Items or Less, Common checkout, Electronics purchase checkout, Green Thumb checkout) and allows customers to use a “No questions asked return policy” to create synergies between these hedonic and utilitarian benefits allowing Wal-Mart to be a market leader.

The common misconception that advertising and promotion will decline due to EDLP strategy to lower cost seems to be ineffective simply because of marketing and pricing strategy inertia. Consumers have ingrained the idea of deal shopping or waiting until products go on sale in order to buy products. The Hi-Lo pricing strategy drives value to firms by targeting the price switcher consumers. Even major retailers who run an EDLP pricing strategy have promotions at least monthly such as Wal-Mart who runs thirteen promotions a year one each month and two in December due to the holidays (Ghemmawat, 2007). So removing pricing strategy inertia of sales promotions will create a void in the consumer’s mind of value being added of an item purchased at normal price.

 Researchers (Hoch, Dreze, Purk, 1994) touch on the effects of Hi-Lo pricing strategies involvement with increasing store foot traffic. Companies often promote deals not only for the sale on the single product but to also increase foot traffic, consequently increasing the sales of other products.

# EDLP Strategy Implemented Successfully

Three companies that are attributed to being leaders of EDLP strategy are: Wal-Mart, Burlington Coat Factory, and Proctor & Gamble. The success of these companies can be seen through each company’s strong financial performance and how they succeeded in implementing EDLP strategies. These three companies have varying strategies that all have a cultural foundation of having the lowest cost within the industry. The focal point will be on Wal-Mart as this company best matches the characteristics of comparable companies and industries.

## Wal-Mart

Wal-Mart, using their low pricing models, grew from being a little store opened in 1962 in Rodgers, Arkansas to operating 11,453 stores worldwide with 4,516 stores within the United States alone (Wal-Mart, 2015). Founder Sam Walton created a cultural foundation according to (Wal-Mart, 2015) being “The Lowest Prices Anytime, Anywhere” provider of goods. Wal-Mart has successfully created this inertia and culture to consumers worldwide; the first thought in many consumers’ minds when they think of Wal-Mart is low prices on an assortment of products. So how did Wal-Mart become this global giant of lower priced goods? Case analysis done by (Ghemawat, 2007) explains Wal-Mart’s staggering growth throughout the 1980’s. The timing of entry could not have been better for Wal-Mart

“Consumers had become increasingly better informed since World War II. Supermarkets had educated those [consumers] about self-service, many categories of general merchandise had matured, and TV had intensified advertising by manufactures. Government standards also bolstered consumers’ self-confidence. Many were ready to try cheaper, self-service retailers except for products that were big-ticket items, technologically complex, or psychologically significant.” (Ghemawat, 2007)

The foundation of Sam Walton’s views have withstood the test of economic shocks, evolution of business, and lead the industry of retailers once the peak of discount retailing occurred in 1970’s when the number of stores increased by 64%, Wal-Mart was able to grow and become the industry leader (Ghemawat, 2007). The two strategies that resulted of Wal-Mart’s success were targeting small population pockets and unrelenting goal of aligning to their founder’s views. Ghemawat (2007) explained how discounted sales drove the company, with discounted sales accounting for almost 96% of the revenues that Wal-Mart had in 1985.Figure 4 shows the comparison in key ratios and growth of Wal-Mart compared to competitors over a ten year period.



Figure 5: Comparison of financial ratios and growth of Wal-Mart and competitors from 1974 to 1984, source (Ghemawat, 2007)

The astounding 40% in sales growth can be a result of Wal-Mart’s pricing strategy and promotions that continued that volume of growth. During this time of growth Wal-Mart focused on hard goods such as housewares, hardware and small appliances which, constituted 28% of Wal-Mart’s sales while soft goods accounted for 29% of sales where as the industry average had 35% soft good sales and 22% hard good sales. Marketing was tailored to this focus with 70% of merchandise being common in all stores and followed the mantra of “We Sell for Less” with price-sensitive consumers shopping mainly for housewares, appliances, health and beauty aids. This lead to 13 promotions each once a month except for December having two (Ghemawat, 2007).

Fast forward to the current times and Wal-Mart is dominating the global landscape of retailing and super markets. Currently, Wal-Mart has the third largest market share according to IBIS World with 10.8% in the department stores industry with only Macy’s (17.3%) and Sears (15.3 %) having more, respectively. This number is misleading since Wal-Mart can be categorized as a retail store, supermarket store, and department store. With that said Wal-Mart is still staying true of having the lowest operating cost of major discount retailers as Figure 5 indicates. Over the last five years Wal-Mart has been under 20% operating expenses while the industry average still lingers above 25%. This illustrates the ability that EDLP strategies have to cut costs.

Figure 6: Comparison of operating expenses as a % in the discount retail industry, source (Morningstar, RMA E-statements 2005-2015)

Wal-Mart is able to achieve such staggering share, inertia, and financials by using a cross-functional mentality when it comes to the pricing strategy and superior use of technological information to create suggested merchandising mixes for each store based on the demographics, climate, and ethical mix than allowing managers to have leeway in choosing specific merchandise, that the manger will find, consumers prefer (Ghemawat, 2007). Wal-Mart has taken the use of technological information one step further and is now able to predict what consumers will be wanting depending on conditions. (Friedman, 2007) states that Wal-Mart is able to predict product mixes,

“It [Wal-Mart] also knows that when hurricanes are coming, people tend to drink more beer. So the minute Wal-Mart’s meteorologists tell headquarters a hurricane is bearing down on Florida, its supply chain automatically adjusts to a hurricane mix in the Florida Stores-more beer early, more Pop-Tarts later. Wal-Mart is constantly looking for new ways to collaborate with its customers.”

The ability of Wal-Mart to pull data from customers and work with the customers to find product categories that mix with both the consumers’ needs and the pricing strategy that is implemented has helped Wal-Mart become a leader.

# Poor Implementation of EDLP Strategy

There can be many reasons of why an EDLP strategy can go wrong. I will try to find the core issues of why companies have struggled in implementing and EDLP strategy. The first reason involves the consumer and the perceptions they feel when companies introduce an EDLP strategy. A study conducted by Tom, Ruiz (1997) pitted the perceptions of customers and the offerings they felt, either saving more or paying too much. The study used Nordstrom’s and Macy’s to find out how consumers’ perceptions of EDLP and sales price turned consumers off of the EDLP strategy. In Figure 6 the results of the study clearly shows that consumers felt that they were saving more with the sale price than with the EDLP price. Consumers felt that they were paying too much for the EDLP strategy compared to the sales price for both stores and products.



Figure 7: Customer perceptions involving EDLP and sales price, source (Tom, Ruiz, 1997)

The reason for the failure of changing customer perceptions can be pinpointed to both perishability of fashion trending items selected, the consumer being taught to purchase items on sale, and selecting items that are perceived as high quality by consumers. The second reason for poor implementation is the effects of profits on the company that implements such a strategy. The study conducted by (Hoch, Dreze, Purk, 1994) showed that even with 3% more sales volume increase, the decrease in profits was substantial, with 18% profit lost compared to the control measurement. The reason for such a decrease in profits was due to consumers’ price insensitivity being lower than the demand needed to provide profits following an EDLP strategy. This sheds light on the price elasticity of demand for a given category; meaning if the elasticity is less than 1 for a selected category than profits will decrease. Pricing elasticity that brings in a demand of less than 1 for every dollar dropped than the product will decrease profits. The poor implementation of this strategy could also be attributed to the study not allowing for promotion of the EDLP strategy, which can be linked back to the first issue of consumers not perceiving a savings and not being taught about the EDLP pricing strategy to change consumer perceptions. A company that was in the spotlight for their EDLP strategy was JCPenney and the poor results of their implementation.

## JCPenney

JCPenney has been a market leader in the retail industry, however, due to slowing growth management shifted, headed by Ron Johnson, from a Hi-Lo pricing strategy to an EDLP strategy in 2011. JCPenney started out in Kemmerer, Wyoming in 1902 with the first store being founded by James Penney. JCPenney currently owns 1200 locations in the United States of America, mostly at major population dense locations and malls (Aisner, 2013). The context that led up to JCPenney’s pricing shift happened just after the great recession occurred with sales falling from $18 Billion dollars to $17 Billion dollars. This resulted in JCPenney seeking cost cutting strategies with the EDLP strategy creating a win-win scenario of increased sales and reduced operating expenses. Another major supply chain flaw that JCPenney ran into was the result of a B2B partnership that failed between JCPenney and Martha Stewart line of products. This exclusive deal fell through and resulted in JCPenney having undesired exclusive product offerings, this combined with the EDLP strategy to become a failure (Marse, 2013). The major issue with JCPenney’s failure to implement the EDLP strategy stems from failure to be aligned with the company and industry images of having middle-income family buyers going and finding “to good to be true” clothing sales (Aisner, 2013). Instead consumers were confronted by prices that had no deals or promotions, left with a void of not finding an incredible deal that must be bought right at that moment (Aisner, 2013). Before implementing the EDLP strategy consumers where used to JCPenney creating this sales image, with 20% of the store space being on sale that is a staple to both the company and the consumers within the industry (Moss, 2012). This poor alignment of strategy and failure to train or have customers recognize the savings is the downfall of this cost cutting strategy. The result was a decrease in revenue from $17.7 billion at the start of 2011 to $12.985 billion in 2013 when the EDLP strategy was scraped. This resulted in an operating margin decrease of 10%. When comparing the operating expense of JCPenney and their competitors an interesting finding is found that

Figure 8: Comparison of operating expense between JCPenney and Competitors the dashed segment is when JCPenney implemented their EDLP strategy, source (Morningstar, 2015)

with an EDLP pricing strategy implemented operating expenses actual increased by 5% rather than decreased. This can be seen in Figure 7 with the dashed line being the time of implementation of the EDLP strategy. This poor implementation results of many failures involving a focus on cutting costs rather than a focus on the consumer and the needs that they are signaling to the company. JCPenney was not able to successfully implement the EDLP strategy due to poor alignment of the company’s strategies with consumers’ values and the implementation of the EDLP strategy raised operating expenses. This poor implementation had drastic effects on both JCPenney’s profits, stock price, and market share. Before implementing the EDLP pricing strategy JCPenney’s stock price was selling at $34.96; two years after the implementation of the EDLP strategy in 2013 JCPenney’s stock fell to $18.26 a fall of 47% in just a two years (Yahoo! Financial, 2015). The reason for this drop in investor confidence of JCPenney can be seen in the lack of profits that JCPenney made during the EDLP pricing strategy. In 2011 JCPenney had a net income of $-152 million, after the implementation of the pricing strategy the net income of JCPenney was $-985 million, a change of -548% in net income after the implementation of the EDLP strategy (Morningstar, 2015). The large losses that JCPenney felt from this strategy caused them to convert back to a Hi-Lo pricing strategy in March of 2013.

# Key Focus of Implementation of EDLP Strategy

In order for companies to successfully implement pricing strategies that can be a source of competitive advantage I have identified four key concepts that can ease the introduction of an EDLP strategy. Other strategies and processes must be added for a proper implementation of the strategy. However, these four are essential in order for companies to use an EDLP strategy successfully in this context. The four focuses are:

1. Alignment of pricing strategy with companies’ inertia, strategies, competencies, vision, mission, and goals.

2. Heavy involvement of consumer management when implementing pricing strategies.

3. Pricing strategies need to have a cross-enterprise focus involving marketing, supply chain, consumer management, and the consumers themselves.

4. Focus on consumer perceived product categories and the reference price that can follow EDLP product strategies and product categories that should follow a Hi-Lo pricing strategy.

These four layers should be the foundation of an EDLP strategy that is self-reinforcing and all four elements are need to drive the EDLP pricing strategy. Following these four internal foci of a company I have identified three key external forces that play a role on the company implementing the pricing strategy. The three external forces are

* The company’s overall pricing inertia that they had prior to implementing an EDLP strategy.
* The industry that the company is in will also be swayed by that industry’s “rules of the game”, based on how competitors, distribution channels, consumers, and the overall industry has a common or norms on pricing strategy.
* Consumer pricing inertia is the idea that consumers are used to certain products having three options. Option 1: Hi-Lo pricing strategy on items such as electronics on black Friday. Option 2: Consumers having no preference of pricing strategy. Option 3: Consumers perceive that no sale will be held for selected high quality items.

Figure 9: Framework for Implementation of pricing strategy


## Step 1: Alignment of Pricing Strategy

[[1]](#footnote-1)In order for any major strategy that impacts a company to succeed, full support from C-Suite level management is essential in order to create motivation, culture, accountability, and change. Employees will be more willing to accept changes that affects them if their managers are supportive of the new potential strategy. Given the obvious need of aligning the company strategy with its pricing strategy, companies have a host of issues to think of in order to align company resources to successfully implement an EDLP pricing strategies. This begins with C-Suite level management correctly identifying the company’s competitive core competencies that will create the most value the company is looking to accomplish with the EDLP strategies. If the company’s core competencies do not mesh with a proposed EDLP strategy, implementation should not occur. Once alignment between core competencies and the EDLP strategy is identified managers must look at the current allocation of the firm’s resources and create a plan to reallocate resources to both maintain existing core competencies and implement an EDLP strategy. Companies must correctly identify and create “alignment” between supply chain strategies and the customer markets that are segmented by buyer behavior to help identify correct pricing strategies (Christopher, Gattorna, 2005). An example of this reallocation would be moving resources from advertising into a collaborative, planning, forecasting, and replenishment (CPFR) team to handle the transition of inventories needed and view the demands of customers that want selected product categories to remain in an Hi-Lo pricing strategy and which product categories can follow the EDLP strategy.

Upon completion of C-Suite levels involvement with the EDLP strategy senior department managers must create new processes and metrics to be able to manage the successes and failures of the EDLP pricing strategy. Metrics can include cycle time of products that follow a Hi-Lo pricing strategy and cycle time of products that follow an EDLP pricing strategy. Management must also identify if taking this strategy will create value for the firm using economic value analysis, cost-volume profit analysis, and competitive analysis to provide insight into the industries desire for an ELDP strategy (Hinterhuber, 2003).Once in place, the firm, must implement a slow rollout of the pricing strategy to characterize if consumer perception of the strategy can withstand the three external factors mentioned. When rapid introduction of the EDLP strategy is introduced consumers may not understand this new strategy and will not accept it as was seen with JCPenney’s introduction of their pricing strategy.

## Step 2: Consumer Management

It is paramount that consumer management is needed when implementing a pricing strategy. Due to the vast use of Hi-Lo pricing that consumers’ experience, consumer management will needed to educate new consumers and reeducate loyal consumers. To manage the consumers the EDLP strategy must not have cost cutting as the singular focus and must encompass as much data and information of the consumers’ perceptions, judgments, and perceived gains from the strategy. In order to gain access to this data slow implementation of a few stores will allow creation of more understanding of the consumer’s beliefs of the EDLP strategy and if consumers will accept the strategy or reject the strategy. Some tools for gathering this information are:

* Focus groups
* Questionnaires
* Advertisement of EDLP to consumers
* Impacts of metrics before the implementation of the EDLP strategy

 Once the data and information is extrapolated companies must continue with education of the EDLP strategy. If the data suggests that consumers are willing to take part in the strategy, decision should be made to identify which regions and products are most conducive to using EDLP. Consumer management must continue to be involved throughout the duration of the EDLP strategy in order to continue to inform consumers and reduce consumer’s concerns of the EDLP strategy and the affects that the strategy will have on them. The data and information that the consumer management department finds needs to be align with the other department’s data to find other potential value increasing strategies. Also consumer management teams should look at other promotional activities other than advertising. The reason is with cuts in promotion and increases in advertising results in a little to no growth in market share for mature products categories (Ailawadi, Lehmann, Neslin, 2001).

## Step 3: Cross-Enterprise Focus

To continually be adapting to consumer’s preferences, reference price, competitor strategies, and industry norms the company needs to have a cross-enterprise focus when dealing with overall goals and implementation of the EDLP strategy. The involvement of departments and how they impact the EDLP pricing strategy will allow for more information to flow through the company allowing for synergies to appear and allow departments to react more effective and efficiently. The company must also speak with consumers and continue to shape and educate them. Enterprise-wide teams should allow for regional segments to meet each other and understand why certain processes, stores, and strategies succeeded and why others have failed to help find common ground and understand why failures occur. This allows for regions to create category-specific pricing strategies that add the most value to the firm (Bolton, Shankar, 2003). This allows the freedom for managers to select product mixes that will create the most value to both the company and the consumer a strategy that Wal-Mart follows (Ghemawat, 2007).

## Step 4: Consumer perceptions and reference price

The final step for a company to successfully implement an EDLP strategy is correctly identifying consumer perceptions and reference price of what a “low price” is for certain product categories selected. To correctly identify both, companies must look at local competitors’ pricing and verify with consumers their perceptions of reference prices in various categories to identify segments conducive to implementing EDLP. Consumer perceptions of products and reference price are always changing, and the companies often have little control depending on the amount of advertising the firm is willing to allocate to these resources. In order for companies to properly advertise both categories companies should have advertising expenses that follow a mixed strategy. Companies must understand that consumers may not recognize the perceived value of EDLP and the lower price that is shown (Tom, Ruiz, 1997). Companies will allocate advertising based on the percentage of the products that follow a Hi-Lo pricing strategy and percentage of products follow an EDLP strategy.

With the framework in place the similarities can be seen in the reasons for Wal-Mart’s successful implementation of an EDLP strategy and JCPenney’s shortcomings in the implementation of their pricing strategy.

Wal-Mart is a prime example with many overlying concepts found in their business strategy and the framework that I will expanded on.

## Wal-Mart’s Fit

Not surprisingly Wal-Mart being a leader and having the EDLP strategy as a competitive advantage immediately gets the first step, aligning the company’s competitive advantage with the EDLP strategy. As mentioned earlier Wal-Mart was built on the bases on the founders words “The Lowest Prices Anytime, Anywhere” (Wal-Mart 2015). The alignment of the correct resources can be seen with high inventory turnovers of 10.54 showing that Wal-Mart has the volume of purchases to successfully leverage the first step of alignment of competitive advantages with the EDLP strategy.

In step 2 Wal-Mart is able to manage consumers by following consumer purchases and continues to run promotions throughout the year, as opposed to completely removing ads. Wal-Mart recognizes key consumer metrics and benchmarks these metrics with industry averages. Oddly enough, the most purchased item in Wal-Mart is one of the most perishable items, bananas (Lutz, 2013). The spokesperson believes this is due to the low cost and healthy food that all members of the family can enjoy, with an emphasis on low cost. Wal-Mart understands the consumer so well that they have created product mixes that are predictable given future events (Friedman, 2007). Recognizing and continually adjusting to consumer demands and manage consumers in the belief that Wal-Mart guarantees the lowest prices and consumers agree to this with sales the company having $476 billion dollars last year in revenues (Wal-Mart, 2014).

In the third step Wal-Mart continues to create value by driving information from selected stakeholders to provide value to the company. Wal-Mart strives to meet consumers’ needs with business operations by implementing cross-functional segments that are kept in check by consumers. David Cheesewright stated “To drive sales and build long-term value, we’re focused on price leadership and operational excellence while investing in the formats and channels that customers’ want.”(Wal-Mart, 2014). Wal-Mart is able to provide cross-enterprise (alignment of competitive advantage with pricing strategy) success by implementing a business strategy called “Everyday Low Cost (EDLC)” which aids in creating the EDLP exaltation that Wal-Mart has embodied by finding lower cost in logistics, procurement, and consumer checkout that all lowers costs that can be passed on to the consumer (Wal-Mart, 2014).

This leads up to the final step of the process of consumer perceptions of product categories following the EDLP strategy and reference price which can be a no brainer when any one thinks of low prices they think Wal-Mart. Wal-Mart’s drive to lower cost of products and identify which product categories consumers perceive as being EDLP such as certain food categories, clothing, and hard goods.

## JCPenney Fit

JCPenney’s implementation as stated earlier was a failure, forcing the company to switch back to the original pricing strategy of Hi-Lo. Applying the same framework as we did with Wal-Mart to JCPenney it is easy to see why the EDLP strategy did not work. Starting with step 1 it is clear that C-Suite level management was trying to align JCPenney’s competitive advantages with the EDLP strategy and had brought in major executive changes including, Ron Johnson becoming CEO, bringing with him Michael Francis (President), Mike Kramer (COO), and Dan Walker (Chief Talent Officer), in order drive the transformation of the company from an Hi-Lo strategy to an EDLP strategy. Although JCPenney started on the right track in getting top management that had shifted EDLP strategies in the past they did not look at the competitive advantage of the company to find synergies that could create a more productive EDLP strategy. It should be noted that since a poor alignment between competitive advantages and C-Suite level strategy JCPenney should have either A: continued to move around resources to create new advantages or B: identify that EDLP strategy would not be plausible considering their competitive advantages.

Do to the large investment and drive by C-Suite level management, the implementation at JCPenney did not work due to the three distinguished external factors that are out of JCPenney’s control that compounded on the poor implementation of JCPenney’s EDLP strategy. Mentioned in JCPenney’s 2011 annual report Mr. Johnson explains that the current “games” of the industry cause stores to compete in price wars that Mr. Johnson felt erodes consumer confidence in the stores and prices being promoted (JCPenney, 2011). JCPenney failed to manage consumers who often times found discounted items at competitor stores that were less than JCPenney’s (Chernev, 2012). The pricing inertia from both the consumer perspective and company perspective helps explain why consumers and JCPenney abandoned the EDLP strategy. Prior to implementing the EDLP strategy, JCPenney, had 78 percent of apparel sold was marked down, (Levy, Grewal, Kopalle, Hess, 2004) creating a large amount of inertia both within the company and from consumers’ inertia of buying only when sales occurred. JCPenney only had 1% of revenues coming from products that were not marked down (Chernev, 2012). The external forces were too extreme for JCPenney to overcome and even following the framework JCPenney’s EDLP strategy would have likely shown poor returns compared that to competitors following the Hi-Lo pricing method.

# Conclusion

The formation of EDLP strategy in the early 1990’s gave supply chain managers a brilliant way of smoothing demand in a theoretical sense, however, the reasons why EDLP did not catch on in the business world can be seen with the lack of awareness of consumer demands, competitors’ responses, and pricing inertias. Companies that deployed the EDLP strategy often viewed the strategy as a cost cutting technique and did not think of the consequences from the backlash of consumers who did not perceive the EDLP strategy as adding value for a myriad of reasons. The most overlooked ailments when implementing an EDLP strategy was the consumer response and competitor response to these pricing strategies. To combat these ailments, looking towards Wal-Mart, the leader in EDLP pricing strategy, it can be seen what and how Wal-Mart is able to create a competitive advantage from their strategy and the alignment to the framework created in this paper. Reviewing the core competencies, the implementation of an EDLP strategy from the framework represented in figure 8 helps to lead and guide companies who look to implement the strategy. The framework consisted of four internal factors that included:

 1. The alignment of the company with the EDLP pricing strategy.

 2. Consumer Management with the introduction of EDLP.

3. Cross-Enterprise collaboration with vital stakeholders including marketing, consumer management, logistics, distribution, store managers, and customers.

4. Consumer perceptions and reference price management

The implementation of this strategy starts from the top-down focus and must be follow steps the potential for companies to revert back to prior pricing stratgey depending of strategy, competitor response, and consumer response. The framework also outlined three major external factors that affect how the EDLP strategy will succeed the factors include:

 1. Consumer pricing inertia

 2. Company pricing inertia

 3. Industries “rules to playing the game”

Companies must be aware that these forces will play a large role in the implementation of the pricing strategy to the point that it can overwhelm a reasoning of EDLP strategy simply because these external forces play too much of a role.

I took the framework and applied it to the mega-retailer JCPenney who had recently tried to implement an EDLP pricing strategy. Finding that JCPenney could not overcome the three external factors and had a multiplier effect of both poor implementation and external factors working against JCPenney causing negative profits, market share loss, and reversion to the Hi-Lo pricing. Overall companies can create successful EDLP strategies if it is looked at more holistically and far more intricately than just a cost cutting strategy.

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1. Companies need also, align employee incentives to enforce change and make employees accountable for new pricing changes and create synergies within both competitive advantages, C-Suite management, and incentives. The incentives should align managers with team performance based on the consumers’ acceptance of EDLP that can be seen from profits, volumes, or market share increase. For individual performers incentives should be align with the EDLP strategy based on recognition of the EDLP in the work that is being performed and the impacts that can increase the effectiveness of EDLP. [↑](#footnote-ref-1)