Our move to EDLP

The big reset

This year The Warehouse moved to Every Day Low Prices (EDLP) and away from a Hi-Lo pricing model. The new retail landscape of mobile commerce, big data and the rise of omnichannel retailing has meaningfully changed the environment in which we do business and requires an overhaul of the way in which we operate.

EDLP is a stronger and more future-focused retail pricing strategy in the digital era, and it allows us to remain competitive in a continuously changing environment. We observed that globally retailers trading under a Hi-Lo model were failing in the face of developing online pure play competition from the likes of Amazon, eBay and Alibaba. With greater price and information transparency, consumers all over the world are becoming more informed on price and range, and know what a genuine discount looks like.

The Warehouse's move to EDLP was, in part, a customer-driven change intended to resolve questions over price accuracy, which was a major customer pain point. The move has allowed The Warehouse to be more transparent, have greater clarity in offer, as well as provide dynamic and personalised pricing and promotions. It streamlines our business to become even more honest with our customers.

Unlike Hi-Lo, EDLP does not use frequent promotional activity to drive sales. This typically results in a reduction in marketing spend and store labour because having fewer promotions translates to less advertising and less manual re-handling of goods.

We saw a positive customer response as we entered our first Christmas and summer under EDLP. Most notably, our toy category was a top performer, breaking all its own records in sales. More recently, the Big Toy Month event in stores performed exceptionally well also, with the average basket of toys up 6.0% driven by a higher average selling price.

It can be expensive for retailers to switch pricing strategies; however, we are happy with our performance to date. Based on what we've seen from retailers offshore, there was a real risk of experiencing a material sales decline and the transition negatively impacting our financial performance.

As we moved into the world of EDLP we expected a sales decline, due to a reduction in average selling price but knowing this would be offset by an increase in volume sold. Our plan was to improve margin in year one with the goal to achieve significantly better margins over the next three.

In FY18, sales in The Warehouse were down 2.5% and gross margin down 1.0%. While we experienced some impact from the clearance of goods related to range curation, we were successful in mitigating losses through timing of promotions and optimising clearance prices.

One thing we were particularly focused on maintaining was our price perception during the transition to EDLP. Based on customer feedback we believe we are still the strongest in the market on price perception. Since price is held constant rather than relying on promotional activity to drive foot traffic, a challenge under EDLP is generating and maintaining high foot traffic. Our foot traffic continues to be strong in stores and we observed a 2.2% increase in transactions.

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Aligned to a EDLP pricing strategy is the need to focus on product range, design and availability to hit the value-for-money sweet spot. Moving to direct sourcing has been part of the success of EDLP as we change how we source and what we control. We now supply over two-thirds of products sold in The Warehouse through our private-label programme with many designed in New Zealand. We have increased our capability in this area and will continue to make investment into the way we design, plan and source.

In June 2017 last year we held a suppliers' conference to keep our partners informed, and we met with suppliers individually to answer questions regarding our shift to EDLP. By Christmas, 98.0% of our supplier network transitioned to our new way of working.

Another change that EDLP brings is the impact on trading patterns. We're getting used to the new trading cycle and experienced nominal variance against our plan compared with FY17. Overall, our weekly volumes are higher under EDLP than Hi-Lo. In total, volumes increased by 7.9%, which was helped through an increase in average basket size of 5.7%.

Under EDLP we also improved our level of productivity. We achieved store labour savings by reducing the level of re-pricing needed for promotions. Approximate labour savings through greater productivity under EDLP is $1.6m. Looking forward, we expect to see further savings on store labour as we did incur one-off re-pricing costs as a result of our transition. We also realised $5.0m cost savings in marketing due to a reduction in promotional mailers. During the post-EDLP range reduction period, stock was cleared at higher margins than historically, and the overall SKU count reduced by 9.8%. From an operations perspective, we've adjusted well to the significantly higher volumes going through our Distribution Centres. We experienced a 9.0% unit increase in volumes handled.

This year has been a foundation year for The Warehouse to make the changes required to achieve long-term growth. Our focus for FY19 is to further refine our operating model and continue delivering the benefits of EDLP.

A case study on Childrenswear

FROM HI-LO TO EDLP

SALES	3.1%	↑
UNITS	8.5%	↑
AVERAGE SELLING PRICE	4.9%	↓
GROSS PROFIT	3.2%	↑
STOCK TURN	4.9%	↑

Gross profit % improving while units growing

	WAREHOUSING Volumes handled	SALES CYCLE Full price	SALES CYCLE Clearance
HI-LO	6.4m	92.3%	7.7%
EDLP	6.9m ↑	93.5% ↑	6.5% ↓

OTHER SAVINGS UNDER EDLP

Labour savings (The Warehouse)	1.6m	Reduction in re-pricing for promotions
Marketing savings (The Warehouse)	5.0m	Reduction in promotional mailers and advertising spend