PDI TECHNOLOGIES

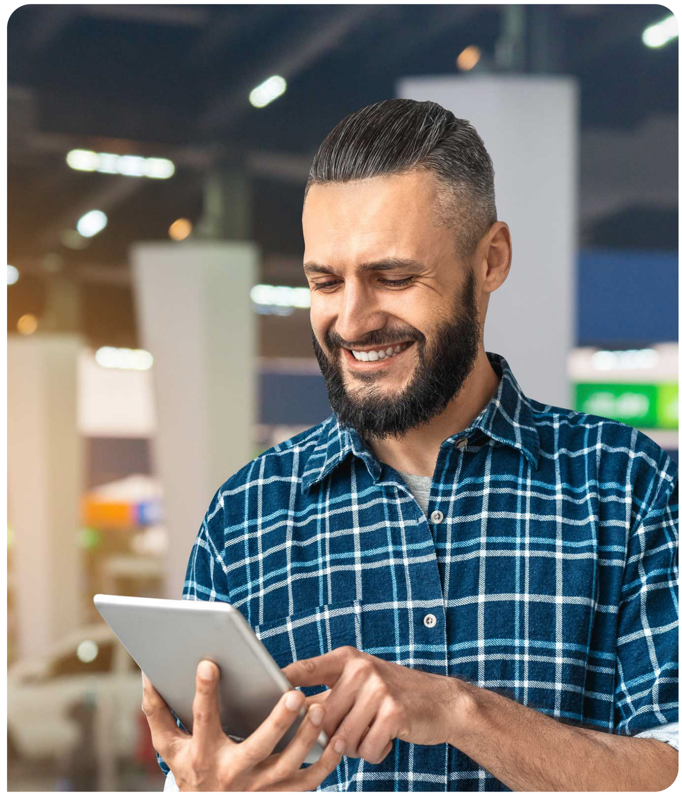
A Guide for
Convenience Retailers:

8 Fundamental Fuel Pricing Strategies

2022

Back to Basics

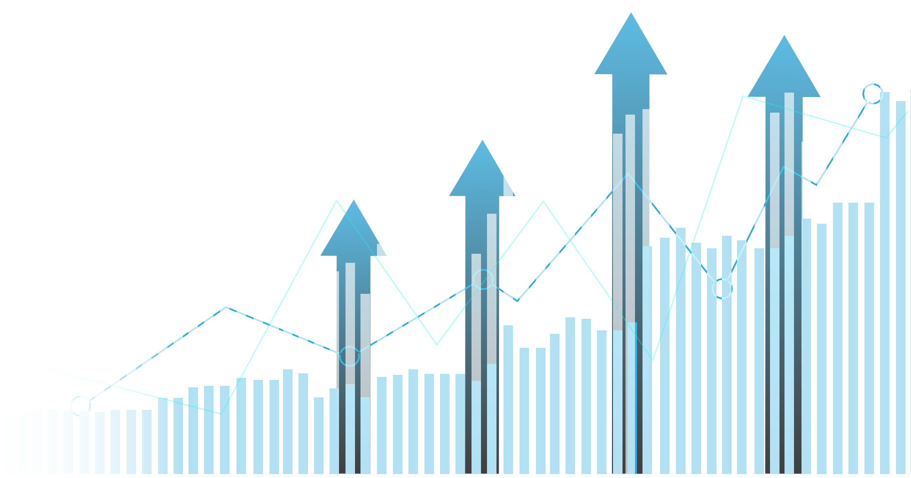
Finding the fuel pricing sweet spot—that delicate balance between volumes and margins—is tough. From complex tax laws in Brazil to dynamic markets like Germany where prices change 15 times a day, a lot goes into finding the right fuel price. Many retailers rely on the artificial intelligence and machine learning capabilities in their fuel pricing technology to set the optimal price.



Sure, talking about cutting edge technology is exciting, but even the most sophisticated technology requires a strong strategic pricing foundation. This is particularly true during times of crisis or disruption. To build that foundation, we're going back to the basics.

The following eight strategies will help shape your business's fuel pricing program now and in the future:

1. Market Penetration Pricing
2. Psychological Pricing
3. Premium Pricing
4. Bundle Pricing
5. Value Pricing
6. Cost Plus Pricing
7. Optional Pricing
8. Competitive Pricing



1 Market Penetration Pricing

Market penetration pricing occurs when the price is set low in order to increase sales and market share. In some cases, a market penetration fuel pricing strategy would be used by a new brand seeking recognition when first entering a competitive market. This, however, is quite rare.

A more common example is when an existing brand opens a new-to-industry store or re-opens a store that was closed for a period of time after refurbishment. For example, a new store is often accompanied by a "grand opening" and very low prices. These low prices help the store quickly gain recognition within the market and redefine the local trade area boundaries in the process. Prices remain low until the new entrant is firmly established in the market.

Perhaps the type of market penetration most applicable to a global crisis is promotional pricing, where prices are set low to increase sales and market share but just for short periods. Independent UK retailers often use this approach when some of their sites are located near aggressively priced big-box sites. While the big-box sites often have deeper pockets, they aren't nimble.

This is where independent retailers have an advantage. In a process known as "flexi pricing," they keep prices low for a day before bouncing them back up. They repeat this about twice per week. Given that it takes most of the big players a day or two to react, by the time they realize what's happened, everything is back to normal. The strategy works best at sites near residential locations where the local population can be trained to become price-sensitive and only fill up their cars two days a week.

2 Psychological Pricing

Psychological pricing occurs when the price is set just below a whole number in order to make the product and price more attractive. Fuel retailers do this a lot, and it works. A price of $1.99 per gallon feels much cheaper to the consumer than a price of $2 per gallon, and the loss of less than one cent is more than made up by the volume gained.

For example, the software should move any price where the last digit is a 4, 5, 6, 7, or 8 up to the next 9; move prices that end in a 0, 1, 2, or 3 down to the next 9; and avoid any price where the previous digit is a 0.

4 Bundle Pricing

Bundle pricing occurs when products are bundled and sold at a cheaper price than buying the items separately. This is a powerful tool in the fuel retailer's arsenal. For example, a retailer may offer a fuel discount to customers who purchase a car wash. Since water is quite cheap, the total gross margin from the car wash is greater than the fuel margin, making it worth more to the retailer.

Bundle pricing presents a great opportunity for retailers to integrate loyalty, pricing, and personalization. If, for instance, a customer is a big fan of energy drinks but typically only fills up with between 10 – 17 gallons, a retailer could use the LCD screen on the pump to offer a "buy one, get one free" on an energy drink if the customer fills up with at least 15 gallons.

The possibilities are endless, and the beauty is that you can do it without alerting your competition.

3 Premium Pricing

Premium pricing occurs when the retailer sets a high price to reflect the premium quality of the product. While this fuel pricing strategy is more complex due to product quality specifications and legislation, some retailers have been successful with it.

Premium pricing can also help retailers differentiate between grades of gasoline, e.g. Regular, Mid, and Premium. Consumers like the appearance of options, though relatively few make the switch. The difference in the wholesale product cost between Regular and Premium grades is surprisingly small, but the difference in the price at the pump can be quite significant. And while premium pricing works for Premium grade fuel, Regular, by contrast, should be more competitively priced since it's seen at the top of the pole.

Your fuel pricing software should offer many ways to price premium grades fixed spreads, variable or flexible grade capping, or complete independent pricing.

5 Value Pricing

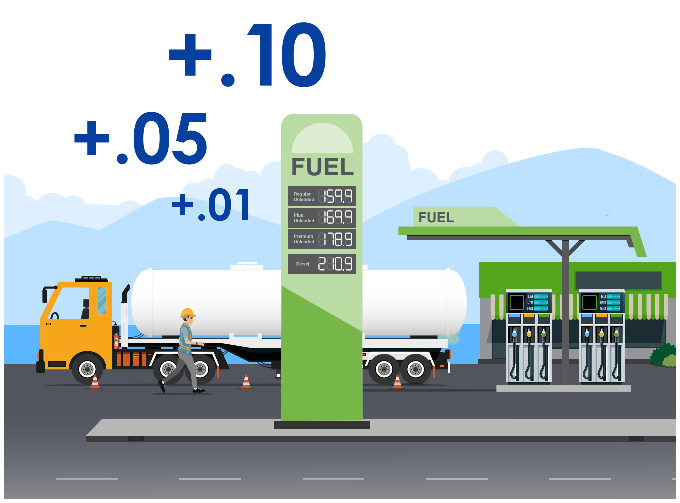
Value pricing occurs when the product's price reflects its value. Many supermarkets and big-box retailers use this strategy. In fuel, with so few products on the forecourt, this one may be a little challenging, but it's doable. In simple terms, value pricing is the exact opposite of premium pricing. In Europe, E10 grade fuel is perhaps the best example of this. To compensate for the lower energy content of the 10% Ethanol retailers set the price lower than Regular unleaded.

6 Cost Plus Pricing

Cost plus pricing occurs when a retailer puts a percentage profit on the cost of producing or acquiring the product. While some retailers may regard this as an unsophisticated strategy, it's one we often see. For example, if the cost of producing the product—including taxes, freight, credit card fees, etc.—is $1 and the target margin is 10 cents per gallon, then the selling price will be $1.10 per gallon. Its strength and weakness are that you don't need competitor prices to operate this strategy.

In fairness, obtaining competitor prices in some markets can be either time consuming or expensive, so there is a place for this strategy. Even in markets where most products are priced competitively, it is still common to see cost plus pricing for fuel grades that have infrequent wholesale price moves. Liquified Petroleum Gas (LPG) is a good example.

In addition, fuel retailers must decide how to calculate margin for the fuel they sell. They can base it on the current cost to replace that gallon (i.e. replacement or replenishment cost), the cost of the fuel when they purchased it (i.e. first in, first out cost), or the average cost of all the product in their tank (i.e. weighted average cost). A good fuel pricing solution can support all of them.



7 Optional Pricing

Optional pricing occurs when a retailer charges extra for optional products that are sold with the main product. A great example is when fuel retailers offer self-service or full-service fueling stations but charge substantially more for the latter. Like psychological pricing, this strategy can accommodate any other desired strategy.

Fuel retailers can also expand this strategy beyond the forecourt. Many drivers, for example, will pick up a coffee while filling up with fuel on their morning commute, so understanding the interaction between forecourt and c-store is essential. In some cases, it can make sense to set lower prices at the pump, sacrificing fuel margins to attract higher foot traffic in the c-store. Retailers should set prices with the intention of optimizing the gross margin dollars across the site as a whole.

Your fuel pricing solution should be able to model the margin impact derived from in-store sales as part of the pricing strategy for fuel.

8 Competitive Pricing

Competitive pricing occurs when retailers base fuel price changes on what they see their competitors doing. It's a common fuel pricing strategy. However, the overall strength of the offer will include many other factors such as the location, the operation, and the facilities.

Here are a few examples. A PDI customer recently entered the Mexican market, which was deregulated a couple of years ago. The sites were rebranded from the old state-owned Pemex, and a substantial "brand premium" was applied to the price. Despite this price rise, the volumes at the new sites increased considerably in initial months and continued performing well thereafter.

Another PDI customer's strategy is to invest heavily at the site, maybe adding a Starbucks and/or a Subway franchise. The station becomes more than just a place to buy fuel; it becomes a "destination," able to support higher fuel prices with little or no sacrifice to volumes.

Key Takeaways

One of PDI's customers in the UK, not a Major but an Independent, sells around 1 billion gallons of fuel every year. If, for example, they set attractive prices that can improve margins by just 0.5 cents per gallon, without sacrificing volume, they could increase profits by $5 million a year. That is the power of pricing.

Changing your prices, even a little, can impact consumer demand and your margins. Knowing your market and customers allows you to adapt your strategy to deliver the best value to price-sensitive customers as well as the best return for your business.

Yes, fuel pricing solutions are important to helping automate processes and achieve your goals, but they're not much help unless you have over-arching strategies. When developing your strategy, ask yourself a few questions:

- What makes your brand special?
- What's your unique selling proposition (USP)?
- What's your brand trying to achieve?

There is no magic formula to determine the best pricing strategies. What works well in one market for one customer may not make sense for a different customer. Discover what works for you, and partner with an experienced solution provider to help you along the way.

PDI can be that partner. We combine best-in-breed technology with the proven industry expertise of our data science team to help maximize the return on your fuel pricing strategy. Contact us today!

About PDI

Professional Datasolutions, Inc. (PDI) software helps businesses and brands increase sales, operate more efficiently and securely, and improve critical decision-making. Since 1983, PDI has proudly served the convenience retail and petroleum wholesale industries. Over 1,500 companies, representing more than 200,000 locations worldwide, count on PDI's solutions and expertise to deliver convenience and energy to the world.

For more information about PDI, visit us at **www.pditechnologies.com**.

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