

ther. The highest levels of insured people and the highest per capita incomes are concentrated in the areas hit hardest by the recession – along the Northeast corridor from Washington, D.C., to Boston, in the far West, and in the areas around Chicago, Minneapolis, and Denver. Moreover, of the high-income states, only Nevada, Colorado, and Washington have seen strong income growth since the end of the recession, and recent layoffs at Boeing may threaten Washington's prosperity.

So what's needed to achieve universal coverage? Strong, uninterrupted economic growth across the country. Fortunately, this is beginning to happen in some of the areas where the need for coverage is greatest: most states in the South and Southwest with high levels of poverty and uninsured people have been enjoying moderate to strong personal income growth in the current recovery. For self-financing to be an option, this economic surge in the South and Southwest must continue.

Charles W. McMillion

Everyday Low Profits?

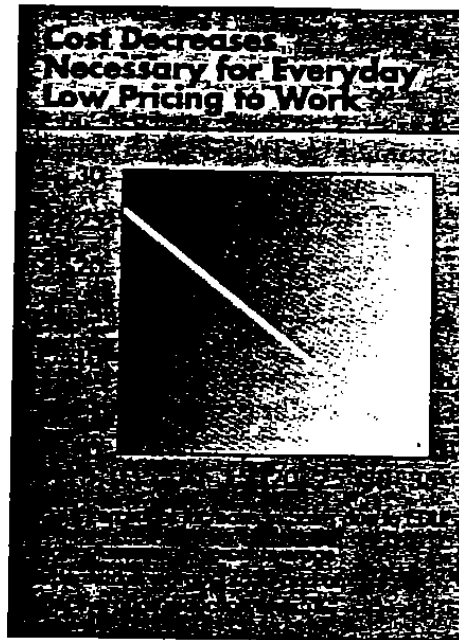
Why Manufacturers Should Leave Pricing to the Retailers

A study just released by the University of Chicago business school finds that confusion between two similar pricing trends – one wholesale, one retail – can rapidly erode retailer profitability and hurt manufacturers in the long run as well.

□ **Trend #1: EDLPP – Everyday Low Purchase Price.** Following Procter & Gamble's lead, many manufacturers are smoothing out the traditional roller coaster of wholesale prices.

□ **Trend #2: EDLP – Everyday Low Pricing.** Following the lead of Wal-Mart, Kmart, and wholesale clubs, some retailers are dropping average prices by about 9%.

But does EDLPP require EDLP? Professor Stephen Hoch, MIS director Xavier Dreze, and micromarketing project manager Mary Purk of the University of Chicago business



school answer this question with a firm no. Yet such a requirement is just what many manufacturers are pushing on their retailers.

Media hype aside, everyday low pricing may be a bad idea for many retailers to adopt. In their research at Dominick's Finer Foods, where 28% of Chicago area residents buy their groceries, Hoch, Dreze, and Purk found that EDLP gave manufacturers a small win (3% increase in units sold) at the cost of a big loss for retailers (18% decrease in profits). "The bottom line is that EDLP did not drive volume sufficiently to compensate for lower profit margins," explains Purk.

The truth is, it's hard to imagine how everyday low pricing could ever work for a typical grocery store. The researchers calculate that volume must increase 39% for a supermarket to avoid losing money after a 7% price drop, which is a far shot from the 3% volume increase they observed. "Location remains the most important reason people choose a given grocery store," notes Dreze. In fact, the most profitable stores in the study were those where average prices rose 10%. Volume fell 3%, but the wider profit margin boosted profitability by 15%.

Increased volume isn't the only argument one hears in favor of everyday low pricing; EDLP is also billed as a substantial cost cutter. But this assertion is wrong too. "The low

cost structure that makes EDLP a success at stores like Wal-Mart is simply not attainable for most retailers," explains Hoch. "When a 10% price drop boosts sales by only 3%, operating costs must drop 14% for the retailer simply to break even." But warehouse, shipping, and inventory holding costs usually make up only 13% to 17% of operating costs, whereas labor expenses make up 50%. "Given that cost structure, it is difficult to imagine how EDLP could reduce costs enough to make the operating-cost arithmetic pay out," adds Hoch.

Everyday low purchase price has helped retailers and manufacturers alike by reducing retailers' inventory and administrative costs and by alleviating manufacturers' production problems. But EDLPP does not equal EDLP. "Manufacturers aren't retailers. If they were, they wouldn't



need grocery stores," concludes Purk. "Instead of attempting to impose everyday low pricing on their retailers, manufacturers should focus on improving back door logistics and let the retailer take care of the front door in terms of pricing and merchandising."

Manufacturing

Maximizing Service, Minimizing Inventory

Professor Joseph Thomas of Cornell's Johnson School of Management has a new answer to a persistent riddle: How do manufacturers produce a variety of goods and fill customer orders quickly without