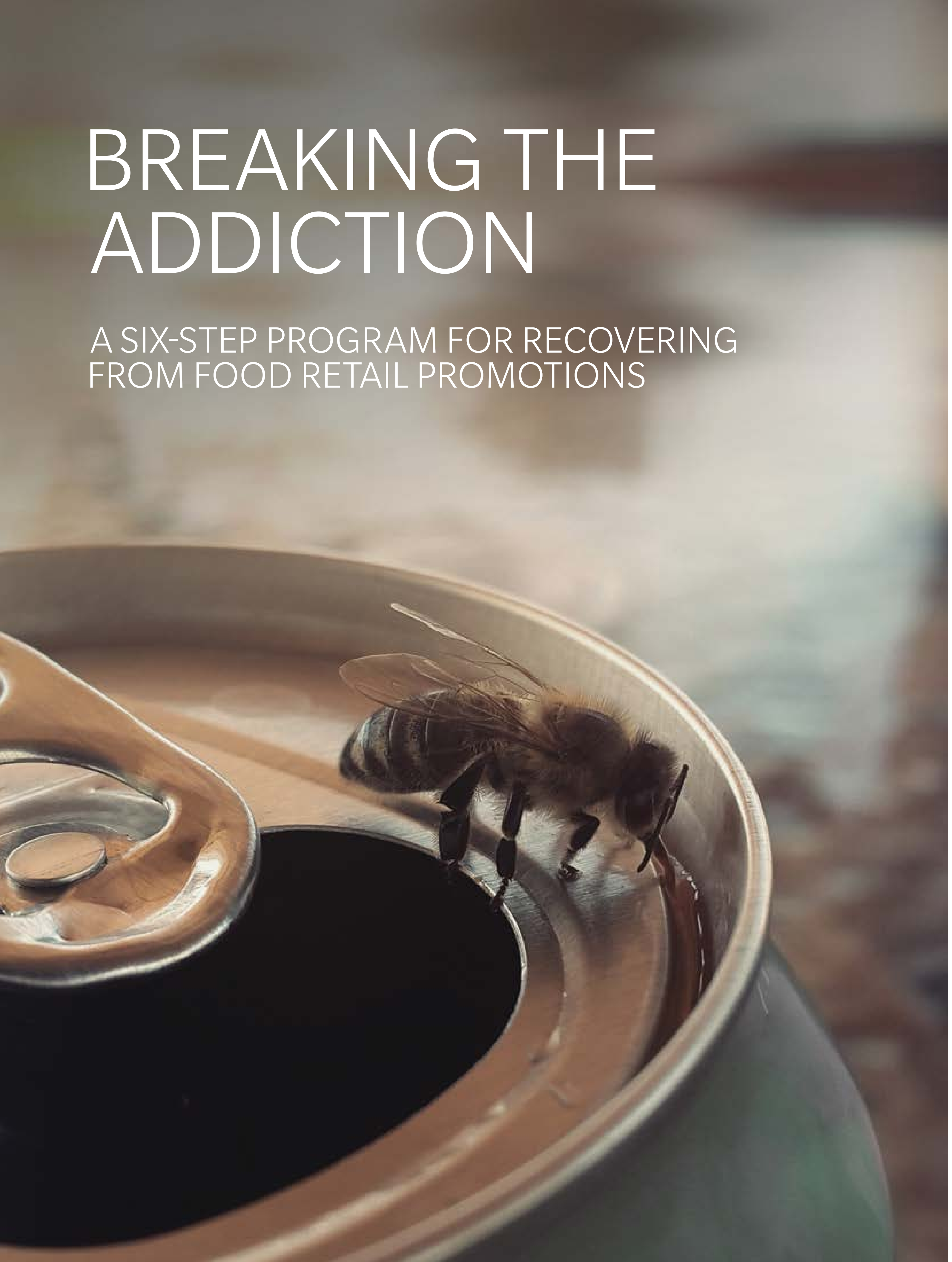
BREAKING THE ADDICTION

A SIX-STEP PROGRAM FOR RECOVERING FROM FOOD RETAIL PROMOTIONS



Promotions are the hard drugs of the retail system: They ease the pain in the short term, but as use increases, so does dependency and it becomes harder and harder to quit. After decades of misuse, the side effects are starting to damage the whole retail ecosystem, and we believe more and more retailers will need to break free from their addiction to promotions.

In this article, we talk about how promotions became the short-term fix for a suite of issues, and present the case for the detrimental effect their overuse is having on retailers, manufacturers, consumers, and the environment.

We then provide a six-step program for successfully addressing the addiction.

PROMOTIONS ARE FAST AND EASY

Promotions can be an automatic response to tough times, used to help retailers meet targets in a difficult quarter, compensate for declining customer numbers, or increase sales over an important holiday period. In many mature markets, promotions are increasingly used to drive sales once room for additional store growth runs out and participation is rising inexorably: In Europe, promotion participation rose from 20 percent in 2003 to 35 percent in 2015.

The dynamics of funding negotiations also drive promotion participation upwards. As retailers push suppliers for better terms, the suppliers want something in return: an increase in promotional funding and intensity.

So if promotions do drive sales, bring in customers, and are funded by manufacturers, what is the problem?

It could be argued that this situation is no different from five or 10 years ago, and it is true that promotions have always been a source of internal complexity and tough debates.

However, we believe that this time it is different. Pressure from multiple sides – including regulators and government – is forcing retailers to look at this topic again, and the call for action is becoming urgent.

As a result, we think it's time for retailers and manufacturers to reduce their promotions programs, and in the next section we explain how this can be done.

GOING INTO REHAB

For retailers who recognize the damage promotions are causing their business, there are six steps to break the cycle of dependency. Taking these steps will create a competitive advantage of improved value perception, which may prevent sales volume decline and remove costs and complexity from their business.

STEP 1: SEEK CLARITY ON THE ROLE OF PROMOTIONS

As a first step, be clear about the purpose of promotions. What role do they play in the business proposition? Which customer segments buy into them? How do they link with other levers? How do they work in a world that's shifting to one-to-one customer communication?

This should enable a desired level of promotions to be defined – one which is probably significantly lower than today's activities.

STEP 2: UNDERSTAND THE REAL IMPACT OF PROMOTIONS

At both retailers and manufacturers, managing promotions takes a lot of time and energy but only a fraction of this usually goes into measuring the actual business benefit of the offers.

For example, often promotions are assessed by looking only at sales increases on promoted items. This means that side effects such as cannibalization and pull-forwards are ignored.

More fundamentally, the traffic-driving power of the program is not monitored, making it difficult to take a critical look at performance week-by-week.

One of the reasons why it is hard to measure the real impact of promotions is that there are so many factors to be considered. (See Exhibit 1.) The criteria for measuring the impact of any promotion include: direct sales increase; cost of the discount being given away; supplier funding; sales changes in related products and brands (cannibalization); sales changes after promotion versus pre-promotion sales (pull-forward); cost of marketing the promotion; additional store labor and supply-chain costs of processing extra volumes; change in basket size (halo); and change in number of customers (halo).

STEP 3: ACT ON THE KNOWLEDGE YOUR DATA GIVES YOU

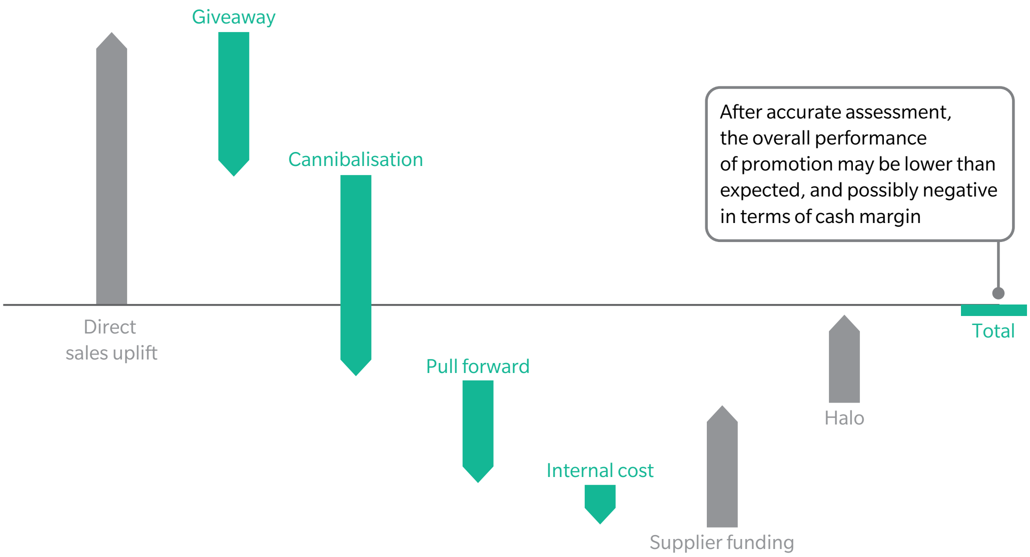
Once these effects have been measured, it is possible to work out why some promotions do not work economically.

If there is not much uplift, retailers need to ask themselves: Are customers uninterested? Is the product placement optimized? Is enough stock available on the shelves at all times?

Exhibit 1: Measuring the real effect of a promotion on cash margin

Multiple factors play a role in measuring the impact of promotions

CHANGE IN CASH MARGIN



Source: Oliver Wyman analysis

Even if there is uplift, challenge whether the effect is from the promotion or an external factor, such as good weather driving ice cream sales or a competitor receiving some bad press.

Improved understanding of the true performance of each promotion will lead to better decisions regarding the promotions companies choose to run. Armed with this information, it is possible to decide what to keep promoting, what to stop promoting, and how to manage each of the factors affecting a promotion's profitability, in order to drive additional sales and margins.

STEP 4: MOVE AWAY FROM PROMOTIONS WHERE POSSIBLE

Once the true benefits of promotions are identified and unprofitable promotions are removed, a more thorough analysis of the remaining program will highlight products and categories where it would be better to shift away from promotions towards an every day low price (EDLP) approach. These will typically be categories where promotions participation is high (40+ percent), where uplift has been decreasing (any money spent on promo yields lower returns), and where the amount of supplier funding is massive (typically covering 80+ percent of the discount).

It is likely that some suppliers within these categories are suffering from the same vicious cycles as the retailer – high cannibalization, low or no volume growth, and degradation of their brand position – making them receptive to partnerships to help correct the promotional strategy.

REVEALING THE TRUE COST OF PROMOTIONS

Promotions are detrimental not just to retailers, but also to manufacturers destroying value in the long term for both parties. Indeed, they can be bad for customers' health and finances, as well as the environment.

MANUFACTURERS

MYTH	FACT
Promotions help build brand and popularity.	Promotions degrade long-term brand equity. Customers start seeing the regular price as poor value.
Promotions are the best option when market growth is low and product innovation and differentiation are not generating enough sales.	Reducing promotions programs allows manufacturers to invest more in innovation and development, rather than spending so much time on trade tactics with their retailer customers.
Promotions keep sales volumes up.	Volume uplift is short-lived and customers will switch to only buying the product when it is on special offer.
Promotions are a cost-effective way to increase factory utilization.	Promotions add cost to the value chain because of the increased volatility and complexity they introduce.

RETAILERS

MYTH	FACT
Promotions bring customers through the door and capture their whole baskets.	Price-comparison websites and apps show where the best offers are, allowing consumers to "cherry pick" promotions at different retailers for different parts of their shop.
Promotions get customers to spend more.	As more and more promotions are run, the sales-driving efficiency of the deals diminishes mostly due to lower promotional elasticity and higher cannibalization.
Promotions are an easy option.	Promotions trigger additional costs at each step of the process, from printing coupons to supply chain volatility, waste, and availability issues in store.
Promotions make retailers look cheaper to customers.	Promotions have a lower impact on value perception than everyday low prices (EDLP). Too many promotions can even damage value perception by confusing customers.

CUSTOMERS

MYTH	FACT
Promotions offer customers value for money.	Some promotions are confusing, and simpler pricing and ranges would meet customers' true needs more easily.
Promotions are always a good thing for customers.	Promotions can contribute to unhealthy eating patterns when targeted at categories such as sugary drinks and snacks where buying more means consuming more.

ENVIRONMENT

MYTH	FACT
There is little to no environmental impact of running a promotion.	Because volumes are more difficult to predict on promotional items, they are typically a big cause of in-store shrink. Promotions also cause consumers to overbuy, leading to waste at home.

A PROMOTIONS ADDICTION IN NUMBERS

ONE

The number of points of profit erosion to expect from each 10 points of promotions participation

x2

Average uplift ratio from each unit of giveaway – significantly lower than most retailers realize

1/3

Proportion of promotions that do not really drive sales and actually reduce profit before funding from suppliers, destroying value for both the retailer and the manufacturer

20%

Amount by which cannibalization has increased in Europe over the past 10 years

18%

Decrease in sales uplift from promotions over the past five years

20%

Proportion of promotions in fresh categories, despite the strategic importance of these areas

PROMOTIONS DRIVE SUGAR CONSUMPTION

Reducing the consumption of sugar, salt, and fat is an increasing concern for consumers, governments, and health care systems in developed countries. When the role of promotions in diet-related ill health was discussed at our World Economic Forum panel on managing obesity, we decided it was time to take a look at a typical promotions programme and see if sugary products really were on promotion more often, and what the increase in consumption patterns really was.

x2

Products and categories with above average sugar content are twice as likely to end up in the promotions program

60%

Rise in consumption of high-sugar products due to promotions; primarily driven by the participation of lower socio-economic groups

70%

Proportion of supplier funding linked to promotions on sweets, confectionery, sodas, and spirits

The reputational risk to retailers is real, providing an additional reason to reduce promotional participation in these categories.

STEP 5: WORK WITH SUPPLIERS TO TRANSITION FUNDING STRUCTURES TO EVERYDAY LOW PRICES

As mentioned earlier, one of the main issues contributing to promotions proliferation are the terms and conditions negotiated over time between retailers and manufacturers.

This reliance (on both sides) on promotional funding needs to be addressed. While such discussions are hard work, a change is ultimately good for both parties, breaking the cycle of promotions addiction.

Moving to an EDLP structure ultimately makes funding flows less fixed – increasing the degrees of freedom for the retailer to find better ways to win customers and drive share, and helping suppliers to put their money into the places where growth lies.

In Europe, we are seeing renewed interest from both sides to address this issue.

STEP 6: CONTINUE TO INVEST IN TECHNOLOGY AND CAPABILITIES

Understanding and managing promotions requires analytical horsepower as well as excellent operational workflows. Many retailers and manufacturers have invested heavily in new technology but are joining an arms race: only those on the leading edge will win customers and drive financial returns.

Technology has a tangible impact on the business when it comes to the power of promotional forecasting. In the past two years, there has been a shift from more traditional linear forecasts towards sophisticated machine learning approaches, which can cut error rates by more than 50 percent.

CONCLUSION

Promotions can be a quick fix, but long term they cause issues for retailers, manufacturers, and customers. The promotions addiction has been going on for a long time, but we do now see a shift, with retailers wanting to change and manufacturers being willing to participate in programs to reduce promotional intensity. Doing this is not easy but it can be done, by following a systematic data-driven approach to reducing dependency.