

BREAKING THE ADDICTION

PROMOTIONS IN FOOD RETAIL



INTRODUCTION

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 promotions addiction.

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 programme for successfully addressing the addiction.

A PROMOTIONS ADDICTION IN NUMBERS

ONE

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

x2

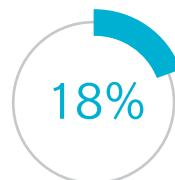
Average uplift ratio from each unit of giveaway – significantly lower than most retailers realise



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



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



Decrease in sales uplift from promotions over the past five years



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

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 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.

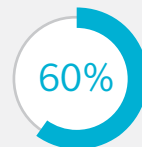
So if promotions do drive sales, bring in customers, and are funded by manufacturers, what is the problem?

PROMOTIONS DRIVE SUGAR CONSUMPTION

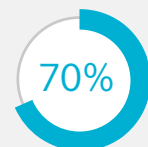
Reducing the consumption of sugar, salt, and fat is an increasing concern for consumers, governments, and health care systems in developed countries. When the role of promotions in diet-related ill health was discussed at our World Economic Forum panel on managing obesity, we decided it was time to take 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 programme



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

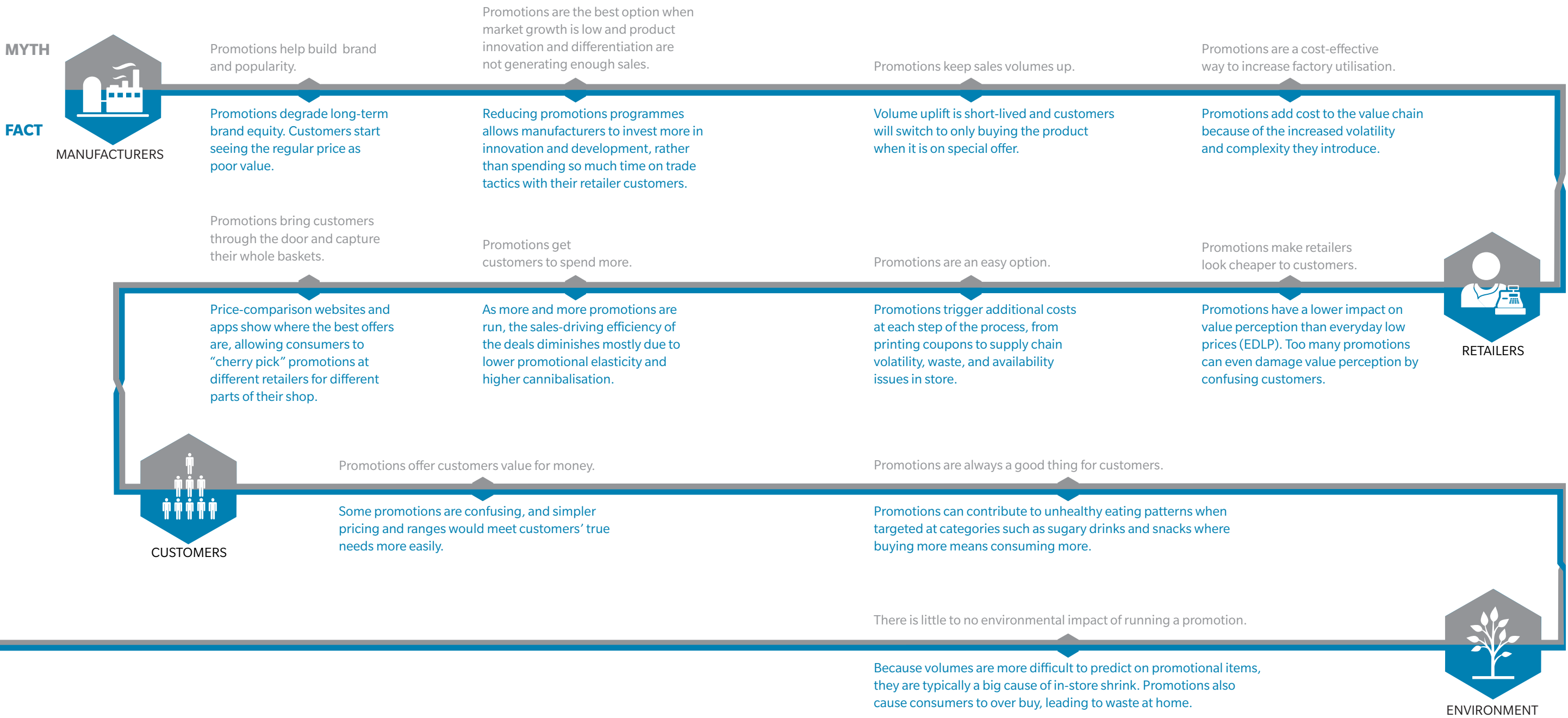


Proportion of supplier funding linked to promotions on sweets, confectionery, sodas, and spirits

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

REVEALING THE TRUE COST OF PROMOTIONS

In fact, promotions are detrimental not just to retailers but also to manufacturers destroying value in the long term for both parties. Indeed, they can also be bad for customers’ health and finances, as well as the environment. We explore these issues below.



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 programmes, and in the next section we explain how this can be done.

GOING INTO REHAB

For retailers who recognise 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.

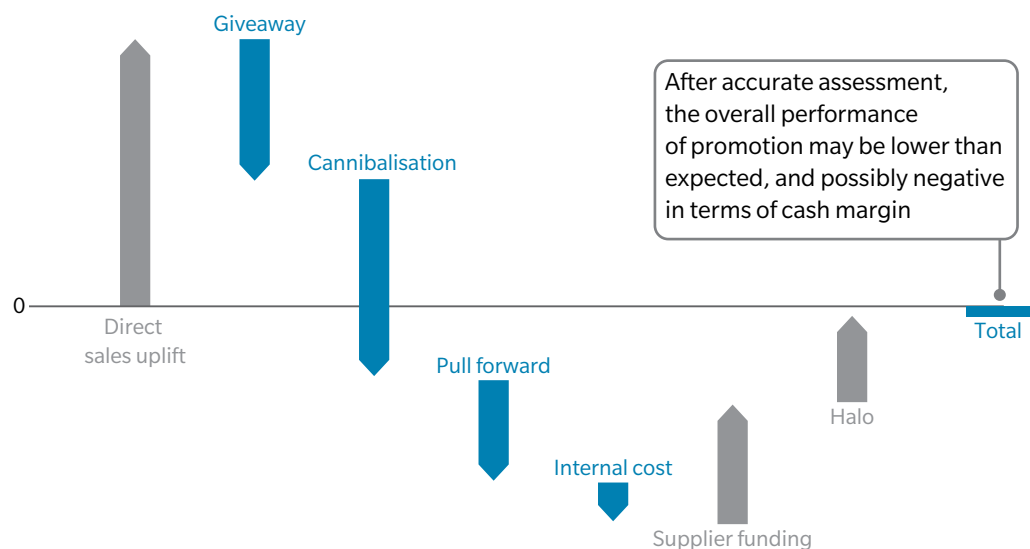
For example, often promotions are assessed by looking only at sales increases on promoted items. This means that side effects such as cannibalisation and pull-forwards are ignored. More fundamentally, the traffic-driving power of the programme is not monitored, making it difficult to take a critical look at performance week-by-week.

One of the reasons for it being hard to measure the real impact of promotions is that there are so many factors which must be considered. Below and in Exhibit 1 we lay out the criteria that we recommend companies measure to understand the true underlying impact of any promotion:

- Direct sales increase
- Cost of the discount being given away
- Supplier funding
- Sales changes in related products and brands (cannibalisation)
- Sales changes after promotion versus pre-promotion sales (pull-forward)
- Cost of marketing the promotion
- Additional store labour and supply chain costs of processing extra volumes
- Change in basket size (halo)
- Change in number of customers (halo)

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

CHANGE IN CASH MARGIN



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:

- Are customers uninterested?
- Is the product placement optimised?
- Is enough stock available on the shelves at all times?

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 programme will highlight products and categories where it would be better to shift away from promotions towards an 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 cannibalisation, low or no volume growth, and degradation of their brand position – making them receptive to partnerships to help correct the promotional strategy.

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.

CONCLUDING REMARKS

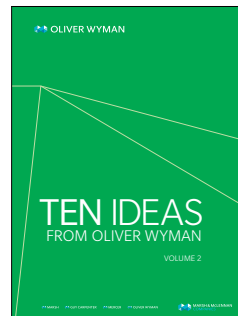
Promotions can be a quick fix, but long term they cause issues for retailers, manufacturers and customers. The promotions addiction has been going on for a long time but we do now see a shift, with retailers wanting to change and manufacturers being willing to participate in programmes to reduce promotional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

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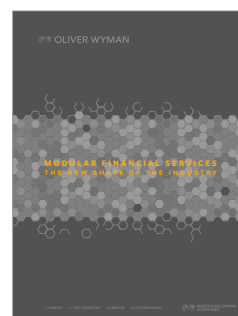
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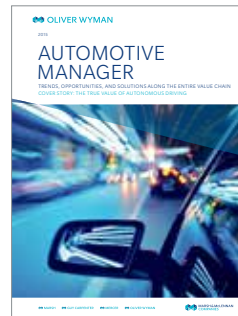
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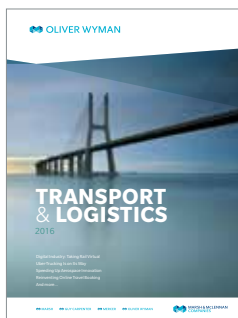
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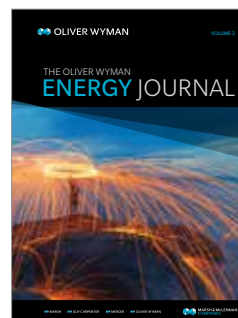
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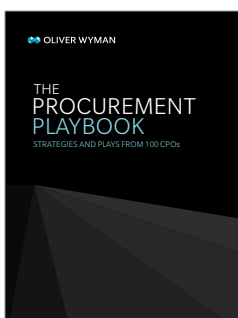
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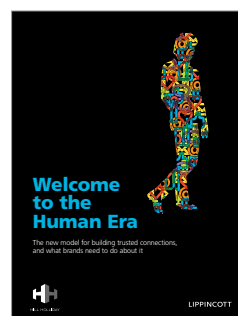
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