[WHITE PAPER]

PROMOTIONAL EFFECTIVENESS –THE CHANGING DYNAMICS OF MARKETING PROMOTIONS IN FMCG

By: Martin Long – Head of Business Consulting IRI – UK

EUROPEAN HEADQUARTERS:
Eagle House, The Ring
Bracknell, RG12 1HS

Telephone: +44 (0)1344 746 000

Breakthrough Insights. Breakthrough Results.

PROMOTIONAL EFFECTIVENESS

"It is clear that we are not in a traditional recession but actually are seeing a global economic realignment which will redefine our national economies after this downturn."

Thom Blishock – President of Consulting & Innovation – IRI

In the current adverse economic climate, which is without precedent in recent history, manufacturers and retailers are being confronted with some painful realities around the current effectiveness of their promotional activities. As a result in the severe degradation of consumer confidence, marketers, category and brand managers are finding that the type of promotions that have served them well in the past, are no longer as effective.

Marketing mix modeling, forecasting, price driver reporting and various other econometric techniques have been used in the processing of vast volumes of data to produce powerful insights in support of strategic and tactical decisions. They have provided the basic underpinning of "go to market" strategies for promotions and pricing strategy for the last decade and a half. Now we have to face the fact that as a business approach, these may be less effective than we would wish in such a volatile consumer market.

This traditional and rigorous analysis of "past events" limits its impact in a situation which is proving unique to most modern marketers and category managers. The fundamental challenge to be faced today revolves around recognising the need to use more focused and speedy methods of analysis to support brands, as part of a holistic organizational approach, rather than purely as a function Of marketing, sales or, in the context of retail, the buying department.

Aimed at both CPG manufacturers and FMCG retailers, this short paper looks at some of the challenges of measuring promotional effectiveness, the methodologies and the various attributes of product and customer focused approaches. Our aim is to revisit current thinking on promotional planning and measurement and highlight the increasing need for manufacturers, retailers and third party insight providers to work more co-operatively on promotional strategy and tactics.

IRI Breakthrough Insights. Breakthrough Results.

THE CHALLENGE OF CONDUCTING EFFECTIVE PROMOTIONS

Promotions are fact of life and a common currency in FMCG. Many would argue that consumers now have a basic expectation that much of what they buy, from groceries to lifestyle goods, will be subject to a promotional offer at some point or other. In the current economic downturn, the consumer expectation of valuable promotions has been increased as they expect retailers and manufacturers to share their pain. The current squeeze is a perfect storm of cost and demand drivers in a combination not seen before and it is causing consumers to consider affordability above all else in their purchasing decisions.

Intense competition has driven the increased use of promotion mechanics over the last twenty years. Typically, in western economies, FMCG manufacturers have tended to invest around 15-25% of their total marketing budget in promotions. Recent history and current events suggests this spending will be seen to increase further, as consumption slows, in order to sustain sales levels.

Consumer expectation is further enforced by newer transactional vehicles, such as the internet, where additional discounts have been offered against high street store prices by vendors keen to increase sales volumes whilst reducing infrastructure and distribution costs. This combined with the provision of price comparison web sites by third parties such as mysupermarket.com and by retailers themselves (Tesco, Asda etc) further increases the marketers' challenge from the well informed consumer customer.

It is highly unlikely that we will see the demise of promotions in the foreseeable future. The whole philosophy is too deeply entrenched in the retailers' competitive arsenal and the practice is likely to increase markedly, with the greater burden of the cost falling on the major brand manufacturers. Driven by category competition, retailer and consumer pressure and the increasing popularity of own brand and budget lines, CPG manufacturers will need to drive even more innovative promotions to protect market share and brand value.

By the same token, retailers will need to balance short term gains on volume sales on own brand and economy lines, against the longer term impact on the profitability to them of established brands. All of these challenges have to be addressed in an environment where many organizations have reacted to events by implementing restructuring and cost reduction activities, thus putting additional pressure on finite resources.

HOW EFFECTIVE ARE CURRENT PROMOTION MECHANICS?

It is frequently thought that the exact nature and degree of promotional activity is driven by the long term experience and market knowledge of the marketer blended with a blend of intuition and instinct. Whilst this may have been true at some point in history, the reality is that manufacturing and retail organizations acquire and/or accrue vast amounts of data about product performance and the factors that bear upon them.

Indeed, the sheer amount of data collected is almost overwhelming, even for substantial and experienced insight teams. As a consequence of its involvement with CPG and retail organizations, IRI has found that clients have often struggled with the measurement of promotional effectiveness for the following reasons:

>>> Lack of clarity of, or multiplicity of objectives driven by the tactical focus of the promotion.

>>> Impact of other activities such as trade promotions and advertising at the same time as a specific promotion which renders the understanding of the effect of that promotion in isolation almost impossible.

>>> The promotional effects before and after the actual promotion are often not measured (Lead & Lag/stock replenishment)

>>> Nature of promotion displays and the impact of store switching which fall outside the promotion analysis.

It is our view that a truly impactful analysis of a promotion will involve a variety of very different elements such as timing, media and messaging, the nature of the SKU or brand promoted, retailer incentives, levels of discount, target consumer audience etc.

For many resource constrained sales and marketing departments, the demand to build suitable models to deliver this level of detail and complexity, within any timeline that is meaningful and in support of their promotional calendar, means that they inevitably have to compromise on the level of their measurement criteria.

This compromise typically forces a concentration on the basics, which in most contexts means limiting analysis to the impact of a promotion on uplifts in sales volumes and values. All analysts are familiar with the principles of market share variation, incremental sales and levels of redemption. Of these, incremental sales measured against a “off promotion” baseline is the most commonly used technique.

This methodology, relied upon in isolation raises a number of issues around the accuracy and efficacy of the output. The concept relies on the fact that a SKU/Brand/Category will at some points in the year, enjoy a promotion free period from which the baseline can be calculated. Problems can arise with products which, through market pressures, are never off promotion in the year. Analysts then have to calculate an artificial baseline in order to then be able to calculate an output for the promotion in question.

The demand to build suitable models to deliver detailed results leads to compromise.

PROMOTIONAL EFFECTIVENESS

Where promotions are being used to sell an assortment it is difficult to measure the impact of switching and to understand what the actual customer response was to the promotion. This point is particularly relevant to retailers. For all of the above reasons, market share variation tends to suffer from the same issues.

Finally, in the case of redemptions, the returns may not provide a totally accurate picture of promotional effectiveness. Typically, redemptions on coupons tends to languish well below 10% in "catch all" campaigns where customers "clip and carry" coupons.

In one particular promotional event a carbonated drinks manufacturer noted a 34% redemption rate added an associated increase in sales. On that basis, the promotion was initially deemed a great success. However, IRI's subsequent and detailed analysis showed that the coupon redeemers were already brand loyal customers and where taking the opportunity to buy what they would have bought anyway, but cheaper! Take up outside these brand loyal consumers actually indicated a much less successful event.

THE METHODS USED TO MEASURE PROMOTION EFFECTIVENESS

There are essentially two broad schools of thought in terms of the overall approach to measuring promotion effectiveness. Both have been revolutionized by the advent of bar code driven EPOS scanners.

These may be termed the; "product push" approach
And the "customer pull" approach
The most frequently deployed method of analysis, has been developed around a product sales based approach and is heavily used by all the major global CPG manufacturers. This "product push" methodology centers upon, as the name implies, a product/brand and the outcome of various interactions around it.

This can cover everything thing from new product development and launch tracking through to product display, product placement, ranging, sales, promotions, cannibalization, propensity for switching, stock availability, store planning, in fact almost everything involved in the journey from factory to customers' shopping bag.

Through many years of involvement with its clients, IRI has contributed to decisions made around the promotion of a brand or product, which draw on information extracted from data from a variety of processes. These inevitably incorporate both quantitive and qualitative output. IRI EPOS data ultimately reveals the impact of changes to the baseline position of the product whilst our market research, in-store shopper insights, panel data and processes like footfall studies add further qualitative outputs to build a more complete picture.

This approach has brought significant value to our CPG manufacturing clients who traditionally do not own and manage a direct relationship with the end consumer customer. In order to continue to provide relevance and powerful insights, the major vendors of market information to manufacturers are continuing to develop new and innovative offerings around predictive analysis and "what If" scenario sand box services to reduce time lines and speed of response to the market.

IRI maintain the position of being openly data agnostic (as opposed to a more restrictive proprietary approach) which means that they can merge and blend data from differing sources to drive holistic techniques in the measurement of promotional

PROMOTIONAL EFFECTIVENESS

activities. Current evidence is showing that market information service providers are moving towards a clear managed service approach, delivered via cost effective offshore processing facilities, (thus emulating the success of the IT industry in this area) providing automated insight information at the decision makers' and practitioners' desktop.

What is exciting about the rapidity of these developments is that the established market research organizations are investing heavily in moving ever more quickly to embrace new technology and methods and moving into new areas of business outside FMCG. IRI has been at the forefront of these developments!

Complimentary to the "product push" approach are consumer customer insights which developed from linking scanner technology with loyalty schemes which can identify the individual customer and their personal details, at the point of sale. The so called "customer pull" approach. It comes as no surprise that this has gained huge traction with retailers (it has probably reached its most sophisticated form at Tesco in the UK) although there are still many major retailers who are resistant to any form of loyalty based insight program either in house or externally provided.

There is no doubt that the ability to be able to measure the effects of promotional activity by electronically peering into the consumers' shopping basket provides tremendous benefits, not just about products and brands but also about the socio-demographic nature of the people who buy them. For retailers it also provides the opportunity to strategise smaller, more focused and highly effective promotions to strategically targeted bands of customers using the detailed data captured.

In adopting this approach, it is possible to identify the fulfillment of specific objectives such as the extent to which the promotion initiated a first try of the product, any repurchase history, cannibalization, shift from competitor products/categories/stores etc. This can then be compared with sales lift data to track the promotion by customer segment to identify who took advantage of the promotion.

Combining the two methods in a data integrated approach can provide a powerful engine to drive promotional effectiveness. Clearly, there is a technical challenge in linking product/consumer panel/loyalty data and this is where the global reach, processing power and analysis capability of a major vendor, such as IRI, can be of great benefit. As CEOs and COOs continuously strive to drive more operational efficiency and to reduce costs, the CMO is under constant pressure to drive consistently more effective promotional campaigns whilst proving they are delivering a high Return on Marketing Investment (ROMI). The difficulty for the CMO, is linking all the various interested parties within their organization, who often have differing priorities and performance incentive schemes.

For example, the head of marketing of a significant UK retail organization recently stated that in their company, promotional strategy was primarily driven by their buyers and what discounts they could squeeze from their manufacturer suppliers. This was supplemented with some pricing calculation from the finance department and that marketing was responsible for leafleting and media content. There was no mechanism for accurately measuring the effectiveness of their activities!

For both manufacturers and retailers, there is considerable merit in engaging in a more

PROMOTIONAL EFFECTIVENESS

consultative, managed service approach with key market information organizations to bridge the information gap and break down internal silo mentality. In this way, the service provider becomes the vehicle for accepting all relevant data feeds, collating the data and disseminating actionable business information to support promotional and other data assisted decision making. By working with clients' own insight teams, the service provider can ensure a regular flow of reporting based on current campaign information.

This form of co-operative working also brings the benefits of carrying out "what if" scenario modeling using predictive analytics as an integral part of the overall service provision. This reduces the overall costs of conducting "test & learn" promotions and assists in channeling promotional spend to the most effective types of campaigns and allows the building of useful performance reporting and archive information for future use.

The effect of combining approaches means that the organization can usefully combine the measurement of short term promotional effects from product data with the medium/longer term, loyalty based effects, both in and out of the promotion period.

This is valuable to both manufacturers and retailers, since they can potentially use the combined reporting to target offers based on information about specific responses to promotional activity. In this way the both can not only determine the timing of the promotion but also its nature and target audience.

It appears that the current economic downturn may already be driving closer linkages between the "product push" and "customer pull" techniques. Prior to 2008 many large manufacturers conducted analysis to support a twice yearly approach to promotional and category planning.

The relative stability of markets over a long period of time coupled with an explicit understanding of brand value meant that they could plan with a considerable degree of confidence.

The current market volatility and inexorable global slide in recession has introduced new dynamics in the art of measuring promotional effectiveness. Many current analysts and marketers have not experienced this type of phenomenon during their careers and unfortunately, the ferocity and extent of the current event, is tending to negate some of the knowledge accrued over the last fifteen or more years.

The diagram below illustrates the ferocity of the current global economic climate;

Based on current events and market predictions for the next twenty four months, IRI recognized that there was a need to review current practices and deliver more relevant insights based upon innovative predictive modeling capabilities coupled with dramatically increased speed of reporting. This is in order to drive pro-active responses to what is happening on a daily and weekly basis for our clients.

This is proving to be the correct early strategy as other evidence emerges that at the cutting edge of analytical insights, other providers are trying to develop new offerings to help "war game" promotional campaigns. This, together with developing new concepts in price modeling, will change the way we look at promotional effectiveness during and beyond the downturn.

Breakthrough Insights. Breakthrough Results.

PROMOTIONAL EFFECTIVENESS

WHAT IS NEXT?

From a manufacturer's perspective, despite the downturn, one may be adopting a positive stance and take the opportunity to enhance one's brand with promotions which are intended to secure market share at the expense of the competition.

Those global companies who have worked aggressively to build their brand value and secure market share have deployed innovative promotional activities to support this strategy. In 1993, the Coca Cola Corporation operating in a Mexico which was then crippled by 30-40% inflation and approaching currency devaluation took the view that there was an opportunity to establish themselves as the predominant brand in carbonated drinks.

Whilst their competition reduced their operations in the difficult prevailing economic climate in that country, Coca Cola used highly focused and measured promotional activities geared to capture market share. Coca Cola increased their market share by over 30% and still hold their dominant position today, with 60% of the market to their major rival's 30%.

Does the situation in the UK & Europe justify this strategic approach?

In the UK, it has been widely reported in the media that in the twelve weeks up to the end of July 2008, food inflation had hit 15% when in fact the true figure, according to statistics provided by IRI and TNS indicated a true figure or 6.8%.

According to a BBC Panorama programme survey; public perception in the same period reflected a highly pessimistic view but did reality match that perception?

Some of the UK statistics make interesting reading;

>>> **75% of those surveyed claimed monthly outgoings have risen by more than £50 with 28% believing they have increased by more than £150**

>>> **The price of fuel has risen the most (42%) followed by energy bills and then food**

>>> **Nearly 75% are still surviving on their monthly salary with most cutting back by eating out less often**

>>> **Only 4% have lost their job as a result of the current situation but 40% feel less secure**

>>> **Whilst one-third of respondents have no debts beyond their mortgage the same proportion owe up to £10k**

(*Source: 'Feeling the Pinch' questionnaire, 8770 responses)*

WHAT THE CURRENT DATA IS ACTUALLY TELLING US AT THE MOMENT IS THAT;

- There are differences between what people say and what they do.
- Despite the crisis people are buying more and paying more.
- There is an element of trading down happening in the marketplace.
  - In most cases driven by a combination of factors rather than a unique cause
  - We think this is unlikely to change significantly unless household incomes also change dramatically
- Consumers aren't the only driving force behind what will happen – retailers also have a key part to play.

PROMOTIONAL EFFECTIVENESS

As stated earlier in this document, the key to maintaining promotional effectiveness in the current climate lies in understanding more completely what the return data is telling us, measuring results more frequently and most importantly then deploying the accrued knowledge to drive high levels of responsiveness to market forces.

Some would argue that this might constitute a "knee jerk" reaction which itself would be damaging to brand values. Alternatively one might assert that in a global market seeing unprecedented levels of change; the biggest threats to brand value come from the aggressive emergence of deep discounters and the marked growth budget and own label alternatives.

One might also take the view that the true danger to brand value is losing significant market share now and then face a steep challenge to subsequently recover as consumer purchasing habits change irrevocably.

In the USA, this is particularly being seen in the "ready to eat" meals category which has seen a marked diminution of sales as Americans have moved to purchasing cheaper basic ingredients, planning their weekly meal program and preparing meals themselves. The so called "switching on the dining room lights" effect. These trends are also starting to become very apparent in the UK and other northern European economies.

Interestingly, IRI has found that the biggest trade downs in the UK are not necessarily in the most inflationary categories!

We might well ask ourselves whether consumer behaviours will change as a result of the increase of financial pressures upon them or whether retailer strategy will accelerate the change in their decision making.

To counteract this, many CMOs, CSOs and brand and category managers are looking for the most effective levers to pull to counteract these emergent consumer buying trends. There is a tremendous long term opportunity to work with organisations like IRI to rationalise the mountains of localised and departmentalised data by combining existing data, modelling and research sets (segmentation, consumer decision trees, spending patterns, market research, footfall analysis, store planning etc.) to drive and subsequently measure the net effect of promotional activities.

The aim should be to build a unified approach to boosting promotional and brand effectiveness

This would include;

>>> Identification and incorporation of all customer communication and promotional spending, both inside and outside the domain of the marketing department.

>>> Define the most important drivers across brands and measure those drivers' impact across relevant segments and media channels

>>> Drive promotional activity on an "apples to apples" basis using simple metrics and distinguishing between maintenance and growth promotional activities as well as tried and tested and experimental activities.

>>> More effectively use predictive analytical tools and approaches to run promotional models in a test environment before executing them in the live environment.

>>> Link promotional modeling with predictive price coefficient generators to more effectively co-ordinate the marketing and sales functions in integrated consumer customer focussed activities.

PROMOTIONAL EFFECTIVENESS

As departmental budgetary constraints tighten it would be easy to defer or delay such decisions. However, times of adversity often herald acceleration in innovation and the development of new business solutions. Certainly in the UK, the speedy demise of a number of well established brands and high street retail organisations, as a result of a collapse in consumer credit and confidence, only highlights the need for some fundamental changes in the way companies operate.

By working collaboratively with research, insight and media providers, both manufacturers and retailers have the opportunity to positively change the ways that we think and behave, much of which based on a different and golden age of consumerism. By deploying exciting new developments in technology and solutions, we can track the detail of the consumers' exposure to promotional activity through a multiplicity of media channels, with actual purchasing behaviour.

In closing, a few thoughts;

- We have already moved beyond established norms and sensitivities of our markets and shoppers to a completely different situation, therefore
  - *Detailed and up-to-date understanding of an increasingly difficult market place is critical to success*
  - *It is vital to know which shoppers represent the biggest risks (and opportunities!) to your brands*
- There is a need to balance response to short term pressures versus longer term brand objectives
  - *Where do you want your brand to be when things improve?*
- More than ever, excellence in day-to-day business management is key – the need to maximise every shopper interaction is greater than ever through;
  - *New Product Development*
  - *Merchandising*
  - *In-store execution*
  - *Promotions*
  - *Media*

What is certain, the global events of 2008 will fundamentally change the speed and conduct of future promotional events and help define a new breed of successful and profitable brands, based on the provision of high quality business information to drive strategic and tactical promotions.

About IRI
IRI is the world's leading provider of consumer, shopper, and retail market intelligence and insights supporting 95 percent of the FORTUNE Global 500 consumer packaged goods (CPG), retail and healthcare companies. Only IRI offers the unique combination of integrated market information, automated and predictive analytics, innovative enabling technologies, and domain expertise. With IRI, leading retailers and manufacturers are able to quickly discover breakthrough insights driving smarter decisions and actions across the enterprise for breakthrough results. Companies around the world depend on IRI for improved productivity, stronger brands, and dramatic revenue growth. For more information, visit www.infores.com.

EUROPEAN HEADQUARTERS:
Eagle House, The Ring
Bracknell, RG12 1HS

Telephone: +44 (0)1344 746 000

Author: martin.long@infores.com

IRI Breakthrough Insights. Breakthrough Results.