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## Harnessing the power of high/low promotions

By Kurt Jetta and Kelly Marion

Everyone has heard the cliché that there are no silver bullets. Like many clichés, it's not true. News about retail sales for much of the year has been fairly dismal, with reports for most months showing same-store sales either flat or down.

However, virtually every drug chain, most supermarket operators and all discounters, except Wal-Mart Stores Inc.,

Kurt Jetta and Kelly Marion are partners in TABS Group, a sales management and technical marketing consulting company.

possess a silver bullet and don't realize it exists.

What is this silver bullet? Properly executed and aggressive high/low promotions. It's a weapon that has been in existence for decades; yet both retailers and manufacturers are only extracting a fraction of the value that these vehicles can generate when utilized properly.

What's at stake? How does \$2 billion to \$3 billion in incremental sales sound? And that's just for large national drug and discount retailers (excluding Wal-Mart).

What is the basis of these stunning assertions? Over the past 10 years we have analyzed more than 40,000 promotional events across virtually every re-

tailer and most general merchandise and health and beauty care categories, and dozens of food categories as well.

Our analysis reveals that manufacturers generate incremental profits on only 10% of the trade events that they run. Furthermore, retailers maximize the sales potential of these promotions less than a third of the time.

To cite just one example, we conducted an analysis for a major drug chain on the effectiveness of its private label vitamin promotions. Our analysis found that only two of 22 promotions were truly optimal. The opportunity cost to the drug chain for not running maximized events the other 20 times was \$10 million to \$12 million in retail sales and \$3 million to \$4 million in incremental gross margins. For the manufacturer that's a sacrifice of about \$4 million in sales.

If the solution is so available, and the upside so significant, why are so few doing it effectively? The answers are numerous, but they fundamentally boil down to a lack of knowledge that has supported an industry-wide paradigm. This paradigm manifests itself through self-limiting behaviors on both the supplier and retailer side.

Manufacturers categorize all trade funding as an "expense," driven by the belief that incremental profits cannot be generated by trade funds. Consequently, they make little or no effort to control the flow of these funds to retailers. For their part, retailers have structured their co-op programs as profit centers focusing on collecting funds versus maximizing consumption and generating incremental profits.

The biggest limitation to improving this dysfunctional system is the "fixed pie" mentality of both retailers and suppliers. That is, both parties subscribe to the paradigm that retail sales gains from promotional activity

are not incremental but simply a shift of business from one source to another.

Here are some of the most common industry myths that we encounter due to the fixed-pie paradigm. With each myth we provide the reality as based on our extensive database of promotional observations:

- **Pantry loading:** Most manufacturers believe that promotional sales increases aren't truly incremental; they just take business from future weeks by "pantry-loading" by the consumer.

- **In reality, point-of-sale (P-O-S) data shows that sales rarely fall below baseline following a promotion, no matter how long one extends the post-promotional analysis period. In fact, in less than 1% of the promotions tracked was there any discernible decrease in post-promotional sales levels. In each of those instances the decrease was due to out-of-stocks from empty shelves, not consumer-loading.**

- **Channel switching:** Promotional sales gains just take volume from other channels; it's not truly incremental.

Again the facts clearly disprove this notion. Data is available to track three-outlet sales in markets where aggressive trade promotions are implemented. After several hundred times completing this analysis we've stopped, because we have never seen any instance where one retailer's promotional sales increase caused a decline at a competitive retailer.

For example, when Walgreen Co. runs a strong promotion behind a leading brand in the Chicago market one will never see a sales decline in that brand at Osco Drug, Wal-Mart, Target Stores, Dominick's or any other retailer in that market.

- **Dilution of brand equity:** It's funny, most people, particularly from the marketing discipline, feel that a brand offered on deal

"cheapens" the image of that product. On the flip side, there are some major consulting companies that claim that frequent promotions can actually enhance brand equity. Both of those claims are based on either a theoretical framework of consumer behavior or analysis of data from such sources as frequent shopper programs or panel data.

What we find curious is that no one actually looks at the ultimate verification — retail sales data. After one looks at the trends several thousand times one sees that the effect of frequent and aggressive trade promotions on brand equity is neither positive nor negative. After looking at retailers running monthly promotions on such megabrands as Centrum multivitamins, Tampax tampons, Pantene shampoo and Colgate toothpaste the baseline always stays steady until a new line extension hits the market. During the year baseline sales neither increased nor decreased. We would submit that this type of analysis is the ultimate refutation of the "brand equity" effect.

The common denominator in all three myths is that the fixed-pie paradigm is embedded in the attitudes of retailers and suppliers. It's the market share mentality that says that one party's gain must be another's loss. The reality is much different: It is quite easy to build sales that are truly incremental at the category level. Now that manufacturers know the real deal they can go out and start booking these events.

So what's stopping them? It seems that suppliers' mind-sets aren't the only barriers to efficient and profitable promotional practices. Retailers also place their own roadblocks in the process. Some of the most common barriers we have encountered are:

- **The "bucket mentality:"** Re-

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tailers give more focus to selling advertising space than generating incremental sales from the ad blocks. Their task is to fill each profit center bucket, with little consideration given to maximizing promotional sales.

There are hundreds of instances every week of retailers running ads on small brands just because they are willing to fund the space. Rarely have we encountered a situation where any consideration is given to offering advertising space to a larger brand at a reduced cost so that more margin dollars can be generated from the fixed ad space. Retailer promotional programs should be managed in the same manner as shelf space — maximum profit from the fixed space.

• **Rigid margin guidelines:** Retailers set up unreasonable margin and scandown policies. We are continually amazed at the number of ill-informed manufacturers that will readily agree to hold a retailer's penny profit to receive a reduced price.

How great is that for the re-

tailers? For that one week they turn a standard 20% to 40% gross margin percentage into a monstrous 50%-plus, all because the suppliers won't push back on that unreasonable demand.

In most instances it is also unreasonable for the retailer to expect to hold its margin percentage. It is unreasonable because, if executed properly, retailers will make more gross profits from promotions even if they cut their margins. The percentage increase in unit sales will exceed the percentage reduction in margins.

As more retailers start sharing the cost of the price reductions the financial picture for manufacturers becomes much more attractive in running more frequent and aggressive events.

• **Questionable price-point requirements:** Many retailers establish rigid price-point requirements rather than agreeing to run percentage-off events across product families. It's unclear why these retailers require that only specific price points can be run in an ad. It probably has something to do with opera-

tional efficiency.

What is very clear, however, is that ads that feature multiple products generate more incremental volume than ads that feature just one or two. That constraint presents a huge opportunity cost for retailers and manufacturers. Retailers sacrifice anywhere from 50% to 75% of the incremental sales potential of an ad with those policies.

• **Automatic co-op deductions:** Retailers do not seem to care whether manufacturers make money on their promotional programs. Consequently they just automatically deduct a fixed co-op percentage each month with no regard to the performance provided for those funds.

One of our clients is currently negotiating an annual promotional program with a buyer. The buyer would like to continue on the current program: Deduct 10% of net shipments each month, with the retailer controlling all promotional program performance.

The client offered to spend up to 15% of sales in return for (a) letting it pay out funds on an

event-specific basis, and (b) having the retailer take a reduced margin on promotion. Our analysis showed the retailer would generate a 10% increase in sales and a 5% increase in gross margin dollars versus its current promotional program. Seems like a no-brainer, doesn't it? The buyer rejected the offer.

So how can manufacturers and retailers start collecting the incremental \$2 billion to \$3 billion in sales that is there for the taking? Simply put, both suppliers and retailers must break out of the fixed-pie paradigm and embrace the facts that sales from trade promotions are truly incremental to their overall business. That will lead retailers to become more flexible in their trade deal structures and allow manufacturers to generate a positive return on investment from their co-op spending. This will begin a positive cycle of increased spending with the retailers.

The concept seems simple enough; the challenge will come in making it happen.