

DON'T DISCOUNT DISCOUNTING

Can retailers rely on this tried-and-true strategy?



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Entering 2021, retailers are more challenged than ever to find an anchor for measuring performance. For some sectors of retail, the pandemic brought unprecedented growth as customers spent more time than ever at home. For others, 2020 was a year of suppressed sales or even a roller coaster from month to month. For the whole industry, last year's rolling lockdowns and forced store closures mean 2020 serves as a poor benchmark. However, the prior year is not a fair comparison either as we still have a long way to go before getting back to normal. With new variants of COVID-19 begin spreading through the US and Europe, predictability in performance seems more fleeting than ever.

As retailers look to exert some sort of control over sales throughout the year, they are sure to turn to promotions. COVID-19 and its subsequent social disruption have pushed merchandising strategies that retailers used to rely on to the breaking point. Prior to COVID-19, retailers could expect to reasonably forecast week-to-week sales performance based on internal decisions, such as discount programs. Now, however, sales patterns are just as likely to fluctuate based on government orders or the latest epidemiological data. After a year of up-and-down performance, can retailers continue to rely on what was once a tried-and-true strategy of promotions to drive sales growth?

To draw signal out of the noise created by COVID-19, Oliver Wyman took a closer look at what is driving buying behavior in different segments of retail, leveraging our proprietary promotional analytics on hundreds of thousands of product promotions at 10 retail brands in the US and Europe covering grocery, convenience, and specialty retail in the summer and fall of 2020 against performance in 2018 and 2019.

Historically, promotions stood among the few levers that could move the needle on sales in the short term. Today, that once-reliable tool is no match for the impact that factors such as COVID-19 case rates and school closures have on sales. It is important to think through how to incorporate those factors into operational and financial processes by regularly tracking state-specific lockdowns and case rates and building sales projections around them. However, this does not mean retailers cannot turn to promotions for added sales where needed.

MEASURING CONSUMER RESPONSES

Oliver Wyman analyzed the drivers of sales performance for the sector using syndicated data along with a sampling of individual retailer's transactions (See Exhibit 1.) From a sector view, we see external drivers such as the effect of school or restaurant closures significantly outpacing promotional activity as the driver of sales.

Exhibit 1: Drivers of year-over-year performance

Predictive power in determining year over year sales



Source: Oliver Wyman analysis

The story is more nuanced for individual retailers where the specific impact of discounting depends on the role played by the product category in the store. In the aggregate, we see a very slight increase in elasticity today as compared to the pre-pandemic timeframe. More specifically, grocery retail is experiencing an increase in elasticity while specialty retail is seeing a decrease. In other words, customers react well to discounts on the basics and less well to non-essential item markdowns.

From a product perspective, retailers tend to experience increased elasticity in core products at a grocer and decreased elasticity in ancillary products. A grocer’s promotions in fresh are likely to perform better in driving incremental units than the same offer a year ago. However, grocers’ promotions in non-food or general merchandise are more likely to underperform, as consumers are not adding unplanned, out-of-category items as readily. However, the same offer on the same merchandise products is likely to do well at a specialty retailer (See Exhibit 2.)

Exhibit 2: Elasticity on the same product mix has trended differently since COVID

Ratio of additional units from the promotions to discount dollars

Basic general merchandise elasticity compared to pre-COVID-19		Core grocery elasticity compared to pre-COVID-19	
Specialty GM retailer #1	1.4x	Traditional grocer #1	1.1x
Specialty GM retailer #2	1.3x	Traditional grocery #2	1.1x
Traditional grocer #1	0.9x	Specialty grocer	0.8x

Source: Oliver Wyman analysis

In short, your strengths and what you are known for will perform better than ever, and vice versa. Choosing the right promotion in the new post-COVID-19 environment could be worth an extra 35 to 65 cents of sales per dollar spent on discount. Such is the difference between an increase in elasticity of winning categories and a decrease in elasticity of losing categories.

Anticipating and monitoring the differences in elastic response across products in the post-Covid world should become part of every retailer’s toolkit.

FOUR WAYS OF PROMOTING SMARTER

Promotions will continue to be the most important controllable driver of performance in the coming months. To meet the challenges facing retailers, here are four recommendations to weather the tough winter ahead.

Promote the core — and just the core

Retailers should focus promotional activity on the products they are known for, such as their core business. Grocers are experiencing more elasticity in grocery and less in general merchandise — meaning they ought to be focusing promotions on food and consumables rather than on general merchandise or cosmetics. Conversely, retailers should consider pulling back on promotions outside their core. Customer basket consolidation means shopping trips are more mission driven. As such, shoppers may be less likely to pick up ancillary products, and discounts may not be sufficiently offset by additional purchases. This typically holds true whether the baseline (the underlying trend without promotions) is up or down.

Be wary of pulling back too much

Even amidst the pandemic, retailers are not just growing at an unprecedented pace but are also working to outpace competitors for growth to ensure loyalty. Customers continue to respond to promotions. Pulling back too sharply on promotions in the aggregate could mean that your growth — while staying robust thanks to strong underlying customer demand — may underperform competitors who promote smartly. This is all the more true as the uptake in digital shopping has led to greater price transparency.

Retune your core analytics

Many retailers' promotional models were not prepared for the retuning needed. For some, a tuning of the core analytics has increased the accuracy of promotional assessments and forecasts. And it's served to clarify the seesaw effect retailers underwent in the spring, which will bias data for months to come.

Reintroduce merchandising and supply chain

Changes in promotional performance during the initial lockdown were also related to inventory availability. When retailers promoted offers based on inventory, they were able to drive margin by choosing shallower discounts that fit within the inventory constraints.

THE PROMOTION OVERHAUL IS HERE TO STAY

Expecting for past years' best promotions to continue working is no longer viable, given changed consumer expectations, increased online share, and the competitive reset driven by the pandemic. Effective data-driven merchandising calls for more conscientious management of all the available levers of the customer value proposition: customer-relevant shelf-pricing, personalized marketing and optimized promotions. Promoting smarter amid the pandemic is a foundational capability that can fund investment across levers for long term growth.

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In the Retail & Consumer Goods Practice, we draw on unrivaled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique — and over the past 20 years, we've built our business by helping retailers build theirs.

For more information, please visit www.oliverwyman.com

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