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How to make price and promotion work harder

Three-quarters of consumer product (CP) companies are struggling to grow both revenue and profitability.[1] What worked before does not work today.

Companies are finding it hard to keep pace with fast-changing consumer needs and digital disruption while overemphasizing cost cutting to boost profits and satisfy shareholders. All of this adds up to increasing pressures on revenue and profit margins. Although CP companies recognize the need to change their business operations, almost half (46%) of the CP executives find previous attempts at changing ways of working have failed.[2]

One obstacle is the historical focus on deep discounting as the key to promotion. Cutting promotion spending can provide one-time gains in earnings, but it does not address the need for growth and is risky for a company's long-term health.

Pricing and promotion value levers, however, can increase profitable growth if managed appropriately. Companies can build a clearer, fact-based understanding of what actually drives a successful promotion, and manage those levers better. They can then run promotions that strike a better balance between investment and return — and achieve profitable growth at an affordable cost.

The scope for improvement is vast. **Our analysis of over 2,000 promotion events for 25 promoted product groups (PPGs) across more than 14 US retailers found that, while close to 20% of manufacturer revenue was invested on trade promotion, on average events lost money [average return on investment (ROI) was 95% vs. break-even of 100%].**

Five steps to improved pricing and promotion

1. Optimize everyday prices
2. Use smaller discounts — only go deep for feature or display
3. Rethink duration, timing, shopper marketing and co-promotions
4. Create promotion strategies at the retailer and PPG level
5. Build profits for both the retailer and the manufacturer

Benefits include:

- Volume up 1% to 4%
- Sales revenue up 8% to 10%
- Gross profit up 8% to 12% (net of trade spend)

In the first half of 2016, EY worked with Sequoya Analytics and the Promotion Optimization Institute (POI) to understand what enables price and promotion actions to be profitable. The study covers two years of data from a broad range of CP manufacturers in the US food, beverage, and health and personal care categories sold through US grocery, drug and mass merchandise channels. A special thank you to POI, Sequoya, and the manufacturers who shared their data, time and energy to enable this analysis.

[1] *2016 EY consumer products and retail executive survey, EYGM Limited, 2016*
[2] *Ibid*

1

Optimize everyday prices

When is pricing more important than promotion?

Standard discounts and general promotions seldom work. Our analysis confirms that nearly 70% of such promotions lose money. They widen the gap between gross and net revenue, ultimately reducing earnings per share.

Nearly 70% of events lose money

To increase ROI, companies need to start by establishing the "right" everyday price. For the PPGs and retailers we studied, **more than 80% could improve volume, revenue or profitability by changing everyday price** (see Figure 1). About half of them could improve profitability by taking their price up, with limited impact on volume or revenue.

Analytics will help CP companies to pinpoint the right everyday price. CP companies that have a data-informed view of price elasticity – the effect of price changes on demand – can create better pricing strategies and spot opportunities to drive margin, volume and revenue. They can also clarify whether it's better to go with an "everyday low price" (EDLP) strategy, or to take a more standard "hi-lo" route, where a product is offered at a high price and then heavily discounted.

A range of factors come into play here – from changes in the weather to rival offers from competitors; companies can use predictive modeling to assess their impacts. If the analysis shows the company's products are more sensitive to everyday price changes than promotion discounts, then it's time to consider an EDLP strategy. We've simulated what happens when a food company moves from hi-lo to EDLP to show the profit this could deliver (see Figure 2).

This kind of analysis can help a company to decide how important price is compared to promotion in its overall marketing mix, and how to best use an EDLP strategy across categories and channels.

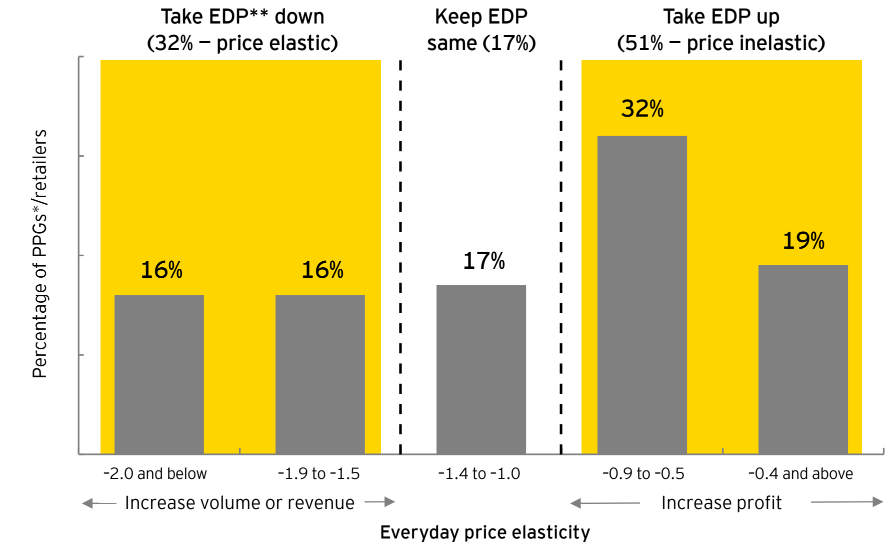
Is it time to cut the "deadwood" spend?

CP companies often increase prices to a level that's not sustainable, and then cut them back to a more realistic point. But this "deadwood" discounting reduces the profitability of the product, or the promotion. Setting an artificially high price requires a greater discount to hit the desired price, thereby increasing promotion spend.

CP companies should replace deadwood spending where possible and invest in activities that drive greater shopper loyalty, such as product innovation, better in-store positioning and promotion events.

Figure 1

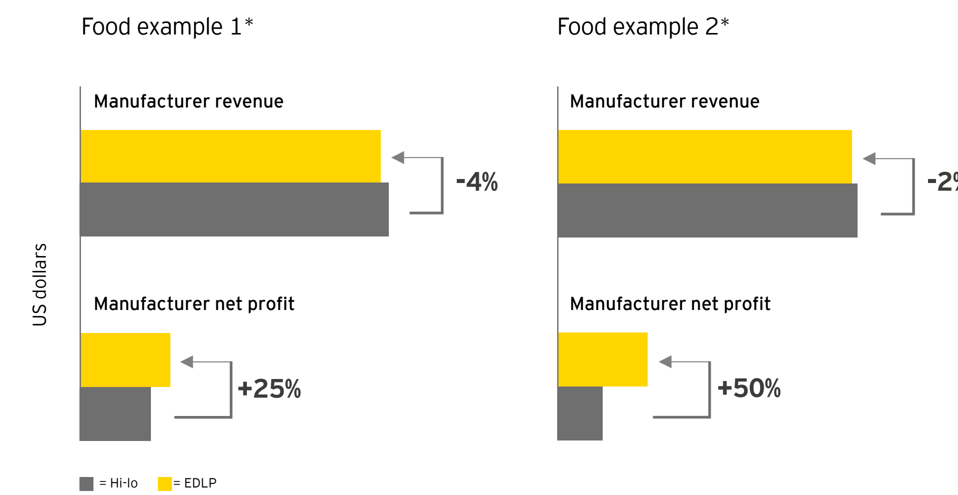
Adjusting everyday pricing will improve performance



*Promoted product groups
**Everyday price

Figure 2

While hi-lo may yield similar revenue, EDLP may deliver higher profitability



*On the basis of Sequoya analytics simulation

2

Use smaller discounts – only go deep for feature or display

When do discounts make a difference?

Nearly 40% of the PPG and retailer combinations we analyzed could make their promotion events more profitable by offering smaller discounts (see Figure 3). Typically, CP manufacturers rely far too heavily on deep, temporary price reductions.

The success of a promotion will depend on a company's ability to get multiple points of detail right across consumer, channel and category – and the quality with which it executes those details. But heavily discounted events largely lead to negative ROIs.

Discounts are essential, but promotions do not succeed by price alone. CP manufacturers often try to reach their financial targets by using temporary price reductions in isolation. For example, our analysis suggests that 6% of TPR events are run without merchandising. Promotions that use temporary price reductions are more likely to increase revenue and profit when they are combined with merchandising – especially display or feature and display.

This is true across channels and categories. Figure 4 makes the point. The data here shows that feature-aided promotions are not as successful as discount and display combinations. This might be a result of decreased or lower shopper awareness of the feature.

When do deep discounts work?

Events that combine temporary price reductions with merchandising displays (in-store, visual shelf or aisle PPG promotions) perform better than discount tactics alone. They produce higher revenue and profit. But **without merchandising (TPR only), discount levels of 20% or below deliver better results.**

Heavily discounted events typically lead to lower ROIs

Given this, manufacturers should only use deep discounting as a bargaining chip to gain access to merchandising. In the food and beverage categories, where discounting is frequently used to negotiate space and prominence in the grocery store, this strategy of using discounts as a way to secure merchandising tactics can be very effective.

Figure 3

Nearly 40% of all PPGs can improve profit by reducing depth of discount

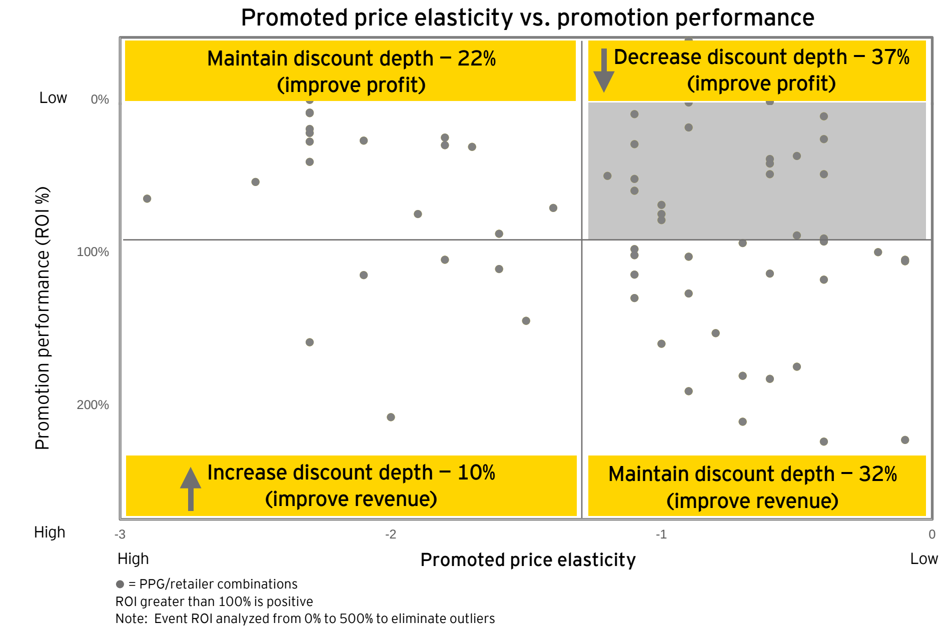


Figure 4

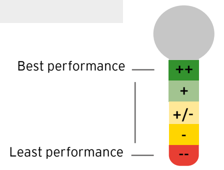
Combining a temporary price reduction (TPR) with feature and display drives revenue and profit

Average manufacturer incremental revenue

Percentage discount	TPR only	TPR + feature	TPR + display	TPR + feature and display
Less than 10%	+	--	++	++
11-20%	+	+/-	++	++
21-30%	+/-	-	++	++
31-40%	+/-	-	++	++
41-50%	+/-	-	++	++

Average manufacturer incremental net profit

Percentage discount	TPR only	TPR + feature	TPR + display	TPR + feature and display
Less than 10%	+	--	++	+
11-20%	+	--	++	+
21-30%	+/-	-	++	+/-
31-40%	+/-	-	++	+/-
41-50%	+/-	-	++	+/-



3

Rethink duration, timing, shopper marketing and co-promotions

Most promotions are too short

Our analysis shows that **four to five weeks is the ideal length of a promotion.** This is where most companies achieve optimal ROI. But the average promotion only runs for around a third of that time (see Figure 5).

A strategic focus on improving ROI across categories, channels and customers will help CP companies to re-evaluate the length of their promotions. Detailed analysis of specific PPG and retailer dynamics will identify the best mix of duration and frequency. This should take into account other factors such as seasonality, competition, share and historical performance.

Timing can make a difference

In the desire to drive volume, many companies promote as often as possible throughout the year. However, CP companies can make their promotions more successful if they time them to coincide with – or to avoid – seasonal and holiday events, such as the arrival of summer or Christmas. Data analysis can make this tactic far more effective by helping companies to pinpoint how and when to best capture the attention of targeted shoppers.

Companies should run promotions for heavily seasonal PPGs (like candy, alcoholic beverages and cold/flu) during core holidays. Our analysis shows that, for highly seasonal products, promotions during non-core holidays or non-seasonal periods are significantly less effective, with lower financial results.

If the PPG is not heavily seasonal (such as cereal, juice or dental hygiene), promotions outside of core holiday windows were often more successful. This inefficiency during holidays may be due to competition with seasonal products.

Is shopper marketing worth the extra cost?

Companies need to weigh the additional cost of promotions that include shopper marketing against the probability of an equivalent financial gain. These are promotions that feature some form of consumer overlay, such as sweepstakes, in-store demo or store TV.

Our analysis of a sample of food and beverage shopper marketing promotions showed that they generated higher revenue than events that did not have shopper marketing. However, because shopper marketing events are generally more expensive than promotions alone, they often result in significantly lower return on investment.

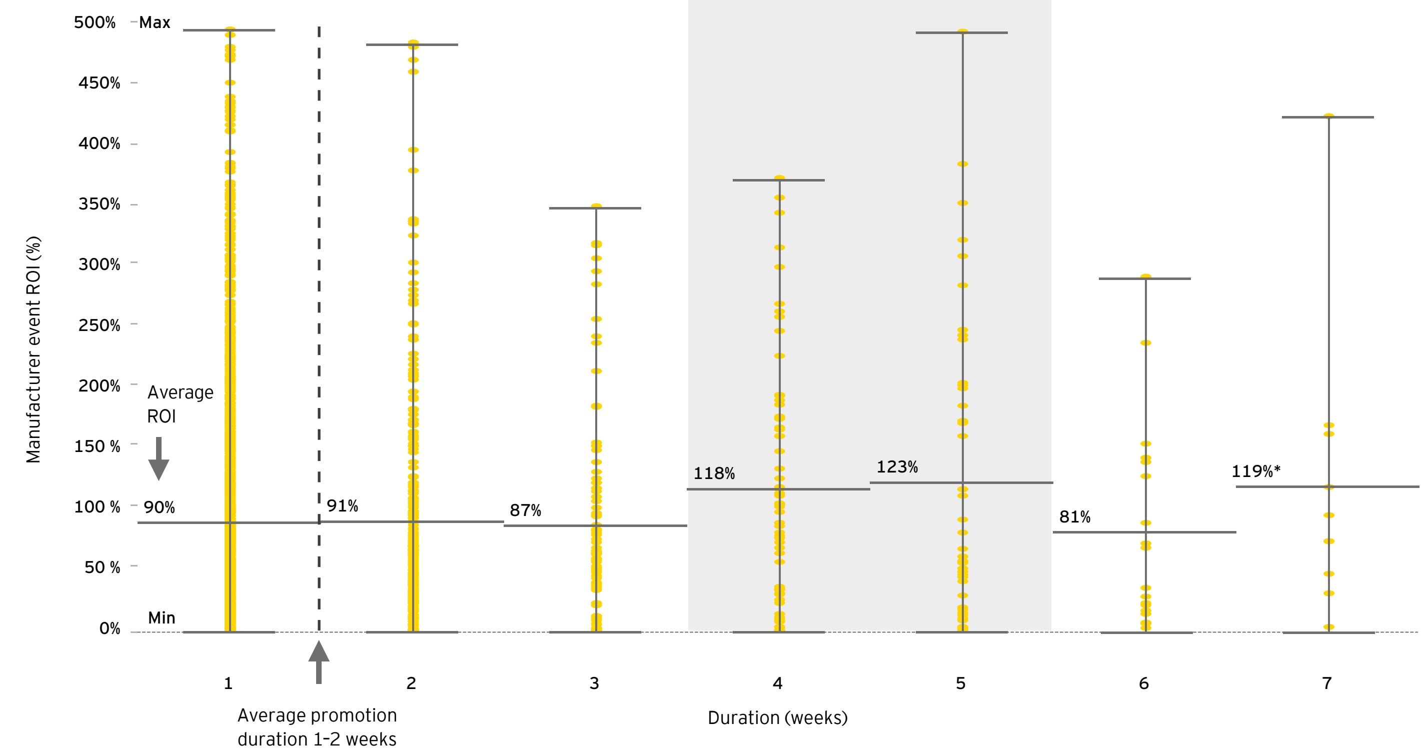
Despite lower ROI, if done properly shopper marketing can build brand equity. Thus, such events should be considered with their short- and long-term impacts in mind.

Figure 5

Events with four to five week durations produce the highest ROIs

Event duration	4–5 weeks	All others
Average manufacturer ROI%	120%	90%

Note: Four to five week event benefits include improved compliance, optimal discount and display periods.



= PPG promotion events

*Due to the lower relative number of events from the sample run at 7 weeks, the average ROI (although high) was not counted as having optimal duration.

When single-product marketing beats co-promotion

When companies combine multiple PPGs in one co-promotion, they risk cannibalizing their own sales. This can lower volume and revenue (and, ultimately, profit). For instance, our study found this happening across multiple beverage PPG promotions. The companies involved could have **increased volume by 30% and revenue by 33% if they had run separate promotions on each product at different times.**

Companies can use predictive analytics, based on historical performance and category factors such as cannibalization, to better understand the risks associated with their promotion tactics and make better decisions.

4

Create promotion strategies at the retailer and PPG level

Detail makes the difference

To improve category, channel and consumer performance, manufacturers need to sharpen the focus of their promotion strategies and tactics at a granular level.

For a variety of reasons (such as tight budgets, timing and resources), they often use promotion strategies based on general trade strategies across a category or channel. This high-level approach will work sometimes. But it will often fail to incorporate different consumer needs and shopping behaviors. Manufacturers will find it harder to meet their – and retailers' – financial goals if they do not tailor their promotions to influence the consumers' purchase decisions at a specific retailer.

Focus at the retailer and PPG level

Not all retailers in a channel are alike – they require different strategies and tactics. Retailers and manufacturers, for example, may differ in pricing methodologies, optimal timing and tactical implementation. CP companies need to take these differences into account.

High-level strategies often fail to incorporate different consumer needs and shopping behaviors

Optimal trade promotion tactics (such as discount levels and merchandising) may be similar at the category and channel levels, but the optimal promotion tactics are different at the retailer and PPG levels (see Figure 6).

A product's market position by channel can also help to determine the type of promotion strategy needed to succeed. A better understanding of the relationship between a promoted product's market share and its promotion performance can help a manufacturer decide how to direct trade spending (see Figure 7).

Figure 6

A channel or category approach is not enough to incorporate retailer and product differences

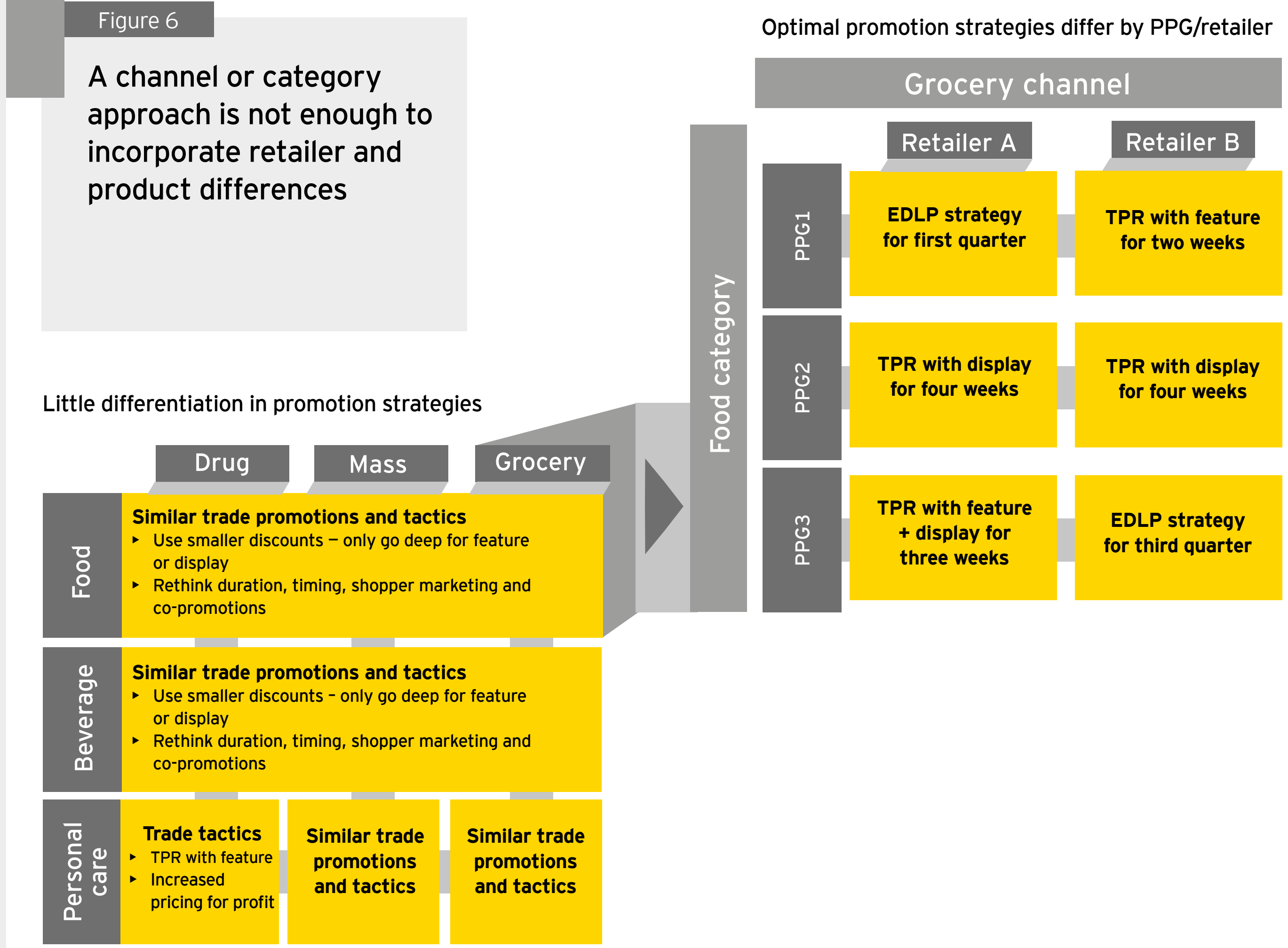
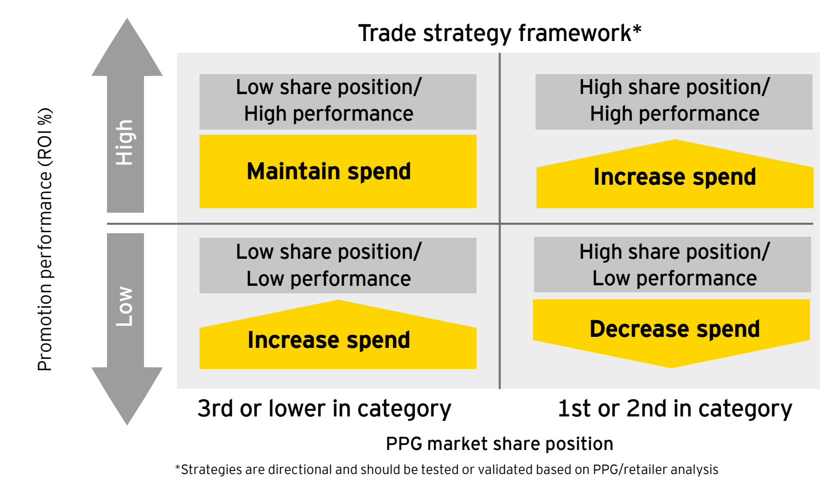


Figure 7

Share position and promotion performance can help identify trade spend strategies



5

Build profits for both the retailer and the manufacturer

It's not a zero-sum game

Manufacturers need to build more collaborative relationships with retailers, where they each keep the other's interests in mind. Too often they see pricing and promotion as a zero-sum game, where a win for one side implies a loss for the other.

The reality is that opportunities for both sides to improve their business performance occur more frequently than conventional thinking would have us believe. **Of all the promotion events we studied, 35% were "win-win"** – defined as having positive incremental profit for both manufacturers and retailers (see Figure 8).

Characteristics of "win-win" opportunities, on average:

- 60 percentage points greater uplift for manufacturer and retailer (compared to all other events)
- Over 10x more manufacturer incremental revenue per event
- $110k more manufacturer incremental profit per event

Know what's working

Many CP companies struggle to analyze the results of their promotions. Two-thirds have not automated the process and can usually evaluate just the top two or three events from their top five retailers, according to POI 2015 TPx and Retail Execution Survey.[3] Many don't have the predictive capabilities needed to simulate an outcome for a retail partner (see Figure 9).

As more companies measure promotion performance, they must expand their measures to not only include their own manufacturer KPIs – but also those of retailers. These should include metrics such as incremental revenue, incremental profit and margin. This will help manufacturers and retailers to find more win-win opportunities.

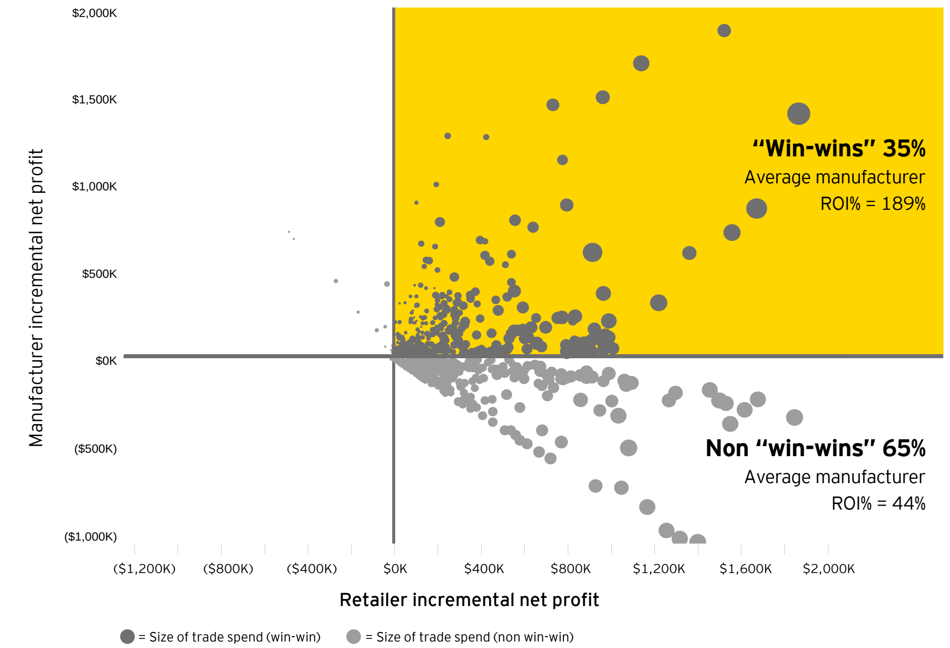
Retailer collaboration is critical. But there is still significant promotion non-compliance. According to POI, only 20% of CP manufacturers are satisfied with their ability to execute at the store level. And nearly 60% said they can put together a good plan, but they have difficulty getting store-level compliance.

The non-compliance problem

According to our analysis, the average percent all commodity value (%ACV)[4] for promotion compliance is only 67%. Essentially, nearly one-third of retail stores are not running the promotions that were planned to be executed. In order to reach a more acceptable level of 80% or higher, greater execution will require a more coordinated effort among manufacturers, retailers, and their distributor and broker partners.

Figure 8

Over one-third of events were profitable for both manufacturers and retailers

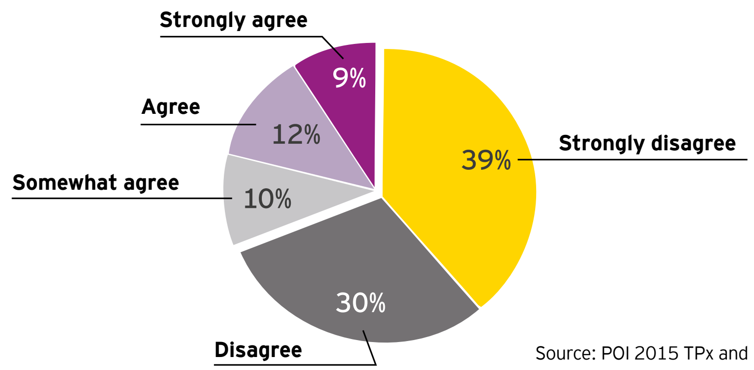


Note: Events analyzed achieved ROIs from 0% to 500% to eliminate outliers.

Figure 9

Only 31% of companies utilize predictive models to determine promotion outcomes

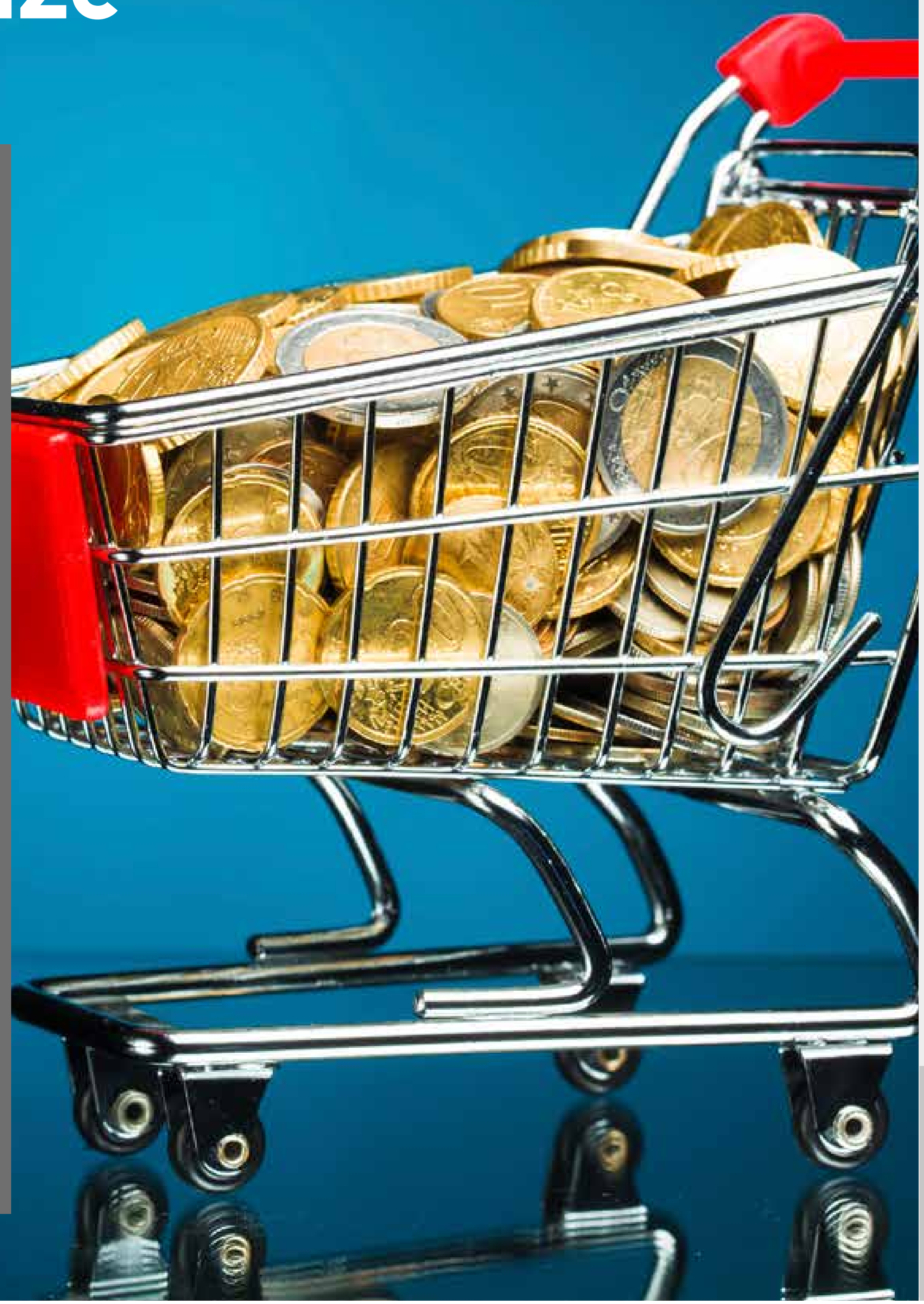
Responses to statement: You have trade promotion optimization ... predictive models to determine promotional outcomes in the hands of field users.



Source: POI 2015 TPx and Retail Execution Survey

[3] http://poinstitute.com/wp-content/uploads/2016/04/POI-The_State_of_TPx_and_Retail_Execution_for_Global_Consumer_Goods_and_Retail_Report.pdf
[4] %ACV represents the total annual sales volume of all products in a given set of stores divided by total annual sales volume of all products in the universe (e.g. retailer accounts).

Getting to the prize



Companies that make better use of analytics to refine and implement their pricing and promotion strategies can achieve greater profitability without significantly sacrificing revenue. The most effective strategies tend to be those that consider pricing and promotion in tandem – rather than as separate challenges – and that manufacturers and retailers develop together.

Key steps include:

- **Set clear priorities:** Effective pricing and promotion strategies target the right balance between volume and profit. And there's often a trade-off between the two so management needs to be clear on what is most important.
- **Embrace analytics:** Decision-makers need access to powerful, relevant data analytics. Many companies in the industry are piloting tools in this area, but analytics needs to be in the fabric of the business.
- **Work together:** Companies need to create a collaborative mindset where people work together, both across internal functions and with their retailer/manufacturer counterparts.
- **Build capabilities:** Companies need to strike the right balance between short-term actions that lead to better revenue or profit, and initiatives that deliver the capabilities to sustain long-term success.

Collaborative efforts to develop processes, tools and skills are essential. Companies have made great progress, but there is still plenty of room to grow. By dismantling pricing and promotion — and applying the right insights — companies can improve top- and bottom-line results.

Lastly, by better understanding the role of price and promotion, companies can rely less solely on these tactics to drive growth. And instead think more about how to use other, equity-building vehicles (innovation, assortment, etc.) to create a 'win-win' for the manufacturer, retailer and, ultimately, consumer.

About the analysis

Modeling approach

Promoted product group (PPG) and retailer-level models were created from 104 weeks of historical syndicated data. Using the models, the team was able to identify the impact (i.e., coefficients) of both base and incremental variables. Base variables included everyday price and seasonality. Incremental variables included multiple forms of temporary price reductions — such as discounts, bonus packs and BOGOs — as well as feature and display activity. We reinforced the incremental variables with manufacturer-specific overlays such as shopper marketing events and holiday and calendar effects. The models were supplemented with promotion event spend and financial margins to allow an understanding of profitability.

To perform the analysis, we used a two-stage approach. In Stage 1, we conducted post-event analysis to understand how each event performed in terms of ROI, lift, and incremental revenue/profit (including pantry loading). In Stage 2, we used the variable coefficients from the models to perform predictive analytics (i.e., "what-if" simulation), thus enabling us to test various scenarios/hypotheses. Lastly, PPG-level product interactions were modeled among a manufacturer's own brands to incorporate the effects of cannibalization.

About our collaborators

Sequoya Analytics: Over the last 20 years, Sequoya has been building Consumer Demand Management models and software solutions for some of the world's largest CP manufacturers. Sequoya's experience spans five continents and hundreds of engagements across diverse consumer categories. Its proprietary technology uses non-linear regression modeling to identify the volumetric value of each historical activity in each historical location to most accurately predict consumption, and therefore, the forecasted financial results of business decisions. Its solutions are used by numerous companies to improve the outcomes of their pricing and promotion decisions.

Promotion Optimization Institute (POI): The Promotion Optimization Institute brings together manufacturers, retailers, solution providers, analysts, academics and other industry leaders to work together to improve the promotion and distribution of consumer goods. Members of the Institute share cross-functional leading practices. They also benefit from industry alliances, the Certified Collaborative Marketer program, and industry-leading summits around the globe. POI aims to instill a financial and metrics-based discipline not typically found with other trade groups. The goal of its innovative approach is to optimize promotion through collaboration.

Contact information

Gary Singer
Principal, Advisory
Retail and Consumer Products
EY US LLP
Tel: +1 312 879 5878
Email: gary.singer@ey.com

Ken Dickman
Principal, Advisory
Retail and Consumer Products
EY US LLP
Tel: +1 312 879 5020
Email: ken.dickman@ey.com