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DEFINING PROMOTION EFFECTIVENESS

Promotions are discounts/campaigns run by retail organizations to increase sales turnover by selling merchandise at a price lower than the retail sales price.

There are two ways to measure effectiveness:

- Scale of efficiency—the extent to which cost of promotional spend is minimized.
- Scale of monetary improvement—the extent to which spend on promotion reaps/achieves an increase in sales or profit

Thus, Effectiveness is can be represented as:-

\[
\text{Effectiveness} = \frac{\text{Promotion Cost}}{\text{Incremental Promotional revenue}}
\]

GLOBAL PERSPECTIVE ON CONSUMER SPENDING DURING PROMOTIONAL SEASONS

The vertical wise spending in 2012 indicates that consumers spent nearly 20-25% more on clothing and accessories than on toys, books/CDs/DVDs/video games, electronics, and gift cards during the last shopping season.

However, consumers were speculative when it came to spending on jewelry.

The average consumer spend was found to increase over the holiday season taking advantage of retailer’s holiday/seasonal offers. Research by a leading analyst reveals that channel independent price and promotions offer a significant competitive advantage. However, this approach requires a deep understanding of customer expectations, clearly stated intentions and proper supply chain co-ordination. In addition, the fast pace of change in the retail business environment necessitates the adoption of next generation promotion planning processes focused on:
- Becoming more and more demand driven
- Making promotions an integral part of the end-to-end retail planning processes
- Integrating promotional forecasts into demand driven replenishment / allocation
- Incorporating promotional data into merchandise assortments
- Measuring effectiveness of promotions based on historic performance and success rate
- Providing a collaborative environment to pass promotional cost to vendors with more vendor aligned deals
- Evaluating the impact of promotions on the financials

**FRAMEWORK FOR PROMOTION EVALUATION**

The design and execution of promotions, price changes, markdowns, discounts, clearance, etc. depends on many factors, impacts key retail KPIs/metrics and therefore, forms an important functional component of retail merchandising. However, for modern day retailers, determining the effectiveness of promotions is a critical business requirement. Therefore, in addition to Merchandising Modernization Assessment Framework (refer the ‘Modern Merchandising’ whitepaper published on July 24, 2012), HCL proposes the Promotional Effectiveness framework, because it improves promotion effectiveness by achieving an optimal balance between:

- Controlling key promotional parameters
- Reducing promotional impact vis-a-vis overall cost of operations
- Improving Return on Investment (ROI)

**Figure 2: Promotion effectiveness framework**
Leveraging the Promotional Effectiveness framework for day-to-day Run the Business Operations, would help retailers understand how execution of promotions directly impacts various operational components contributing to their bottom line such as:

- Stock salvage cost
- Costs associated with reorganizing labor/workforce during promotional timeframe
- Average inventory cover/on hold
- Average cost per pallet as a % of revenue for any chosen product line
- Other store operational expenses (visual merchandising)
- It has been observed across many varied clients spanning multiple verticals and formats that top line key performance metrics such as:
  - Gross Profit
  - Net profit margins
  - Sell-through
  - % variance in week-on-week category level sales contribution
  - Optimal break-even threshold for ROI Are, impacted directly by quantifiers/category level settings such as:
  - Promotion peak or threshold (Upper Threshold Level or Not After Level)
  - Promotion uplift (% of promotion that affects the volume or Lower Threshold Level)
  - New store launch date
  - Competitive product launch date
  - Campaign start and end date
  - Modification of trading calendar based on seasons, etc.,

Nevertheless, optimally determining these quantifiers, promises increased category/ brand/ product sales, improved ROI on promotional spend, improved footfalls, and increased share of the wallet or basket spend size. Indirectly, these quantifiers may also influence buying patterns of the end customer. Consequently, when determining the effectiveness of promotions, the impact/ influence of various quantifiers should be taken into consideration and an organized approach with statistical and descriptive analytical models, should be adopted to measure promotion effectiveness.

**HCL PROMOTIONAL EFFECTIVENESS FRAMEWORK – AN ORGANIZED APPROACH TO MEASURE AND MONITOR PROMOTIONAL EFFECTIVENESS**

While, multiple approaches exist–HCL Promotional Effectiveness framework can be used to measure effectiveness by targeting key business parameters, which can contribute to incremental revenue from promotions or reduce the overall cost of promotions.

The table given below shows the methods employed by the HCL Promotional Effectiveness framework indicating how to interpret and draw a business inference to improve the effectiveness of retail initiatives.

<table>
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<tr>
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<th>APPROACH DESCRIPTION</th>
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<th>INTERPRETING THE STATISTIC</th>
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<td>Co-efficient of variation (% variation to mean) between ‘Normal Forecasted sales’ and ‘Actual sales during Promotional period’</td>
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<td>Lower the lost sales and the promotional spend, higher the revenue from promotions</td>
<td>High impact, as ‘Incremental Revenue from Promotions’ increases</td>
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<tr>
<td>#</td>
<td>Approach Description</td>
<td>Influencing Factors</td>
<td>Statistical Measurement Criteria</td>
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<td>Sensitivity analysis of promotional price-to-sales</td>
<td>Variance in promotional price impacts demand &amp; forecast accuracy</td>
<td>More sensitivity (variance to mean) makes it more challenging to forecast demand for products Less sensitivity makes it – easier to forecast demand</td>
<td>Sensitivity indicates impact on replenishment &amp; allocations (downstream) &amp; ordering to suppliers (upstream)</td>
<td>Variance in daily sales, possibility of going out of stock &amp; cost impact on supply chain during the promotional period</td>
<td>High impact. Promotion effectiveness decreases as cost of promotion increases</td>
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<td>Sensitivity analysis of promotional price and stock availability</td>
<td>Variance in promotional price impacts shelf stock availability, can result in more lost sales</td>
<td>More sensitivity (variance to mean) makes it more challenging to predict lost sales Less sensitivity makes it easier to predict lost sales</td>
<td>Sensitivity indicates problems in automated logic for downstream supply chain replenishment &amp; allocations</td>
<td>Variance in shelf stock availability, instances of out of stock and hence cost impact on supply chain during the promotional period</td>
<td>High Impact. Promotion effectiveness decreases/ reduces as cost of promotion increases along with the increase in number of lost sales</td>
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<td>Linear and non-linear impact of promotional type on retail sales across various store formats, thereby gauging the effectiveness per promotion type</td>
<td>Impact of variation in historic promotional sales to actual sales</td>
<td>No variation – Equal slopes for each regression line per promotional type per store format (i.e. no relationship between type of promotion, historic sales, store formats, etc.) Presence of variation – unequal slopes for each regression line per promotional type per store format (i.e. significant relationship exists between types of promotion, historic sales, store formats, etc.)</td>
<td>Statistical p-value determines significant interaction between the regression lines for different promotion types per store format Analyze changes to p-value based on elimination of causal factors, which may not impact retail sales. For example, store format may not impact retail sales. In this case, this causal factor can be eliminated from analysis</td>
<td>Presence of interaction, increases the complexity in predicting which promotion type or store format causes maximum impact on sales</td>
<td>High Impact. More impact on sales i.e. less revenue from promotion – decreases overall promotion effectiveness for the chosen ‘Promotion Type’ for a chosen store format</td>
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CONCLUSION

A balance needs to be maintained between the price range, stock available during the season/week and type of promotions by taking into consideration externally impacting factors such as store format, geographical presence, demographics near the store location, competitive pricing, new product/category launch schedules, seasonal campaigns, dynamically changing customer responsiveness, etc.

Additionally, improving the effectiveness has a direct impact on the promotional pending and related supply chain costs. Therefore, gauging the most profitable promotional range and the type is expected to reduce any lost sales and improve store sell-through while increasing the revenue during the season.

Considering the huge amount of money invested in the planning and execution of marketing campaigns and promotions, even a little percentage of improvement in effectiveness would bring significant profits. However, this requires an in-depth assessment of the business processes and potential improvement opportunities.

Therefore, next generation retailers need to adopt a more transformational approach for Run the Business Operations to increase the incremental revenue from seasonal promotions vis-à-vis balancing to reduce the overall cost and thereby improving effectiveness of promotions.

ABOUT THE AUTHOR

Hari is currently a solutions principal with HCL’s Retail & CPG Vertical Solutions team. He has over 8 years of consulting experience as a Retail and CPG Industry Solutions principal. His expertise extends to business analytics, merchandising, supply chain and stores and he has worked as a Solution Architect for HCL’s Merchandising Assessment Maturity Framework and model definition. He is a process consultant experienced in conducting business analysis and defining business requirements for large business transformation and IT enhancement programs across the retail value chain.

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HCL Technologies is a leading global IT services company, working with clients in the areas that impact and redefine the core of their businesses. Since its inception into the global landscape after its IPO in 1999, HCL focuses on ‘transformational outsourcing’, underlined by innovation and value creation, and offers integrated portfolio of services including software-led IT solutions, remote infrastructure management, engineering and R&D services and BPO. HCL leverages its extensive global offshore infrastructure and network of offices in 31 countries to provide holistic, multi-service delivery in key industry verticals including Financial Services, Manufacturing, Consumer Services, Public Services and Healthcare. HCL takes pride in its philosophy of ‘Employees First, Customers Second’ which empowers our 84,403 transformers to create a real value for the customers. HCL Technologies, along with its subsidiaries, had consolidated revenues of US$ 4.5 billion (Rs 24,709 crores), as on 31st March 2013 (on LTM basis). For more information, please visit www.hcltech.com
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