



RETAIL 3.0™

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A P O S I T I O N P A P E R S E R I E S

Paper 5:

The Perils of Incrementalism

Retail executives fear to drop long-time marketing programs because of the incremental gain they once provided. By doing so they steadily increase their marketing costs over time—and render themselves vulnerable to 3.0 Retailers aggressively adopting transformative technologies driven by an understanding of customer behavior.

About

The team of Hawkins Strategic is leading and supporting the next-generation retail ecosystem:

Retail 3.0™.

Hawkins Strategic is uniquely positioned to move the industry to this next level through thought leadership, strategic guidance, value creation, and the Center for Advanced Retail Technology.

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CBS Business Network (BNet.com) gives the business definition for Incrementalism as “a collective term for the many initiatives of the 1980s and 1990s that took a small-step approach to improving quality and productivity and reducing costs. Incrementalism encompasses initiatives such as total quality management, continuous improvement, and benchmarking. Although incrementalism originally provided a source of competitive advantage, it is generally recognized today that a more radical approach is required.” Let’s refine the definition for what we’ll call Marketing Incrementalism: The practice of regularly adding new marketing initiatives on top of established practices so long as the newer initiatives provide an incremental gain to the previously established programs.

The Origins of Incrementalism

(Parts of this section may be familiar to readers of previous Retail 3.0™ papers.) The opening of the first self-service supermarkets nearly 80 years ago was a momentous event in the history of retail. For the first time shoppers were free to choose their own products from the shelf, giving rise to the importance of packaging and branding supported by advertising. This new approach also created an awareness of package pricing, with each product on the shelf individually marked or signed. Shoppers

could readily see and compare the prices of competing products.

One of the foundational pillars of this new self service model was sales volume: stores relied on low margins and high traffic to build a successful business. In the supermarket channel it was this that drove previously distinct businesses together under one roof—the butcher shop, the local bakery and the fresh produce stand became the grocery store. This was the origin of the model still in use today: one-stop shopping with low prices, low margins and high volume.

To drive sales, early supermarkets leveraged cost-effective advertising—most notably in the form of printed ad flyers or run-of-press ads featuring their products at low prices. National brand manufacturers quickly moved to secure feature space in retailers' advertising, paying the retailer for ad space in addition to funding a price reduction to the shopper. The practice gave birth to modern day trade promotion. For most of retail there was no looking back. Their advertising—chiefly focused on ad flyers—had become a revenue center, even a profit center: retailers used the promotion funds to offset the cost of printing and distributing the weekly ad flyers.

But soon, advertised weekly specials were not enough. Sales plateaued and so did the funds they received from manufacturers. This led to the creation of new initiatives: temporary price reduction (TPR) programs, managers' specials, and more. These marketing initiatives were layered on top of weekly advertised specials, designed to further the retailer's low price image, create shopper excitement, and access additional trade funds from manufacturers.

A Case Study in Marketing Incrementalism: Loyalty Programs

In the early to mid 1990s a relative handful of supermarket retailers had launched frequent shopper or loyalty programs, and eye-opening data began flowing from these pioneers: the top 30 percent of shoppers were generating 80 percent of the retailer's annual sales, and there were massive differences in these groups' shopping frequency and retention over time. (Many of these insights are taken for granted today, but at the time were earth-shattering to the retail industry.)

Some of these early practitioners began to report substantial gains to revenue or margins as a result of rewarding shopper behavior over time, and loyalty programs became seen as retail's holy grail. The rush was on. Retailer after retailer launched a loyalty program, many times only in response to their competitors or because management read about their success and figured they'd better jump on the bandwagon. In hindsight, the number of retailers who invested significant sums in rolling out a loyalty program is amazing—especially considering how few had any strategic understanding of their undertaking.

Inevitably, these loyalty programs were incremental marketing initiatives built on top of traditional marketing and advertising. But loyalty programs provided a new platform on which to create and build yet *more* initiatives, things like continuity programs, clubs (baby clubs, lunch clubs, etc.), and targeted direct mail programs. Each initiative was added on top of established programs, each brought with it added cost, and each was approved so long as it provided incremental gain.

Today, far too many retailers have expensive loyalty programs in place from which they execute various loyalty initiatives without any periodic objective review of such programs. Retailers fear to discontinue any given initiative for risk of alienating shoppers and losing the supposed incremental gain the program originally provided. A case in point was a well known regional supermarket retailer that for years advertised turkeys far below cost at the Thanksgiving holiday (as many supermarkets continue still do today). Having rolled out its loyalty program, the retailer launched a free Thanksgiving turkey program in the fall: "Spend this amount by the holiday and receive a free turkey!" ...while continuing to sell turkeys far below cost at the holiday time. The store kept up its original cheap turkey marketing initiative and layered a free turkey promotion on top of it. Cost on top of cost (to say nothing of how this depleted both programs' values).

A Modern Example: Fuel Programs

The retail loyalty landscape continues to provide examples of marketing incrementalism. Another case in point is provided by fuel programs: supermarkets rewarding shoppers with discounts on gasoline purchases tied to shopping. Born at a time of spiking fuel prices, fuel programs were quick to gain traction. Their growth was also driven by the number of supermarkets and discounters opening fuel centers in their parking lots. But fuel programs are not inexpensive to operate and appeal—like any marketing program—to only some portion of the retailer’s shopper base. As fuel prices ebb and flow, retailers have found they must increase investment in the fuel discounts earned to maintain shopper interest.

Fuel programs, which have spread across the US retail landscape much like the original loyalty programs did a decade or more ago, also serve to highlight another important fact: shopper behavior changes early on, but as time proceeds the changes plateau. The result is the retailer has increased its “fixed” marketing costs (the ongoing cost of the fuel program), but the program has ceased to generate strong continued growth in sales revenue. Yet the retailer is reluctant to discontinue the program for fear of alienating participating shoppers. Instead, the retailer looks to the next new marketing initiative for growth, and continues to bear the ongoing costs of the previous program.

Significant Growth in “Fixed” Marketing Costs Over Time

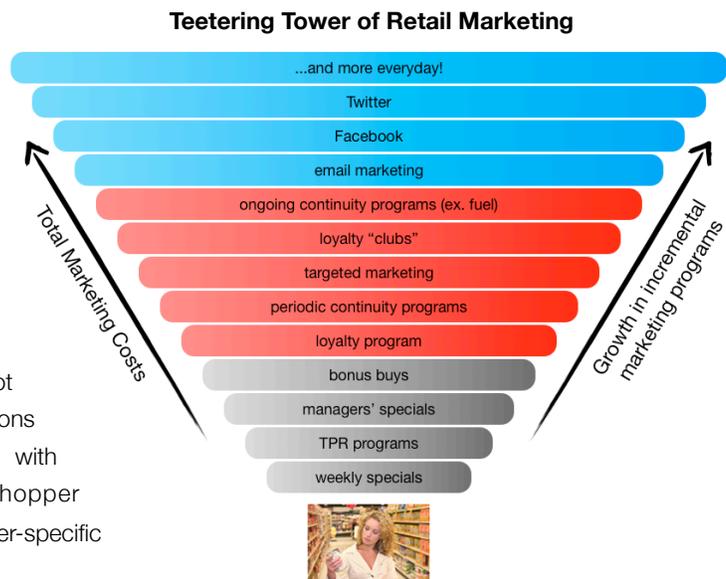
So today, in objectively observing many retailers marketing and advertising initiatives, one can often find an agglomeration of programs that have simply accumulated over the years. Retailers and brand manufacturers are not prone to regular reviews of the efficacy of existing programs, and the end result is a steady growth of retail marketing and advertising budgets, each initiative in which provides less and less return over time.

Alarming, though, history is repeating itself as retail moves into the digital age. Retailer after retailer is looking to experiment with new digital channels and tools—from text messaging to Facebook, Twitter to FourSquare—but believing they must create new promotions, new initiatives, to populate these new mediums. They’re adding even more incremental initiatives to their teetering tower of marketing. But this time they’re doing it with what can be transformative technology.

Marketing Incrementalism vs. Marketing Transformation in the Age of Retail 3.0™

Retail, especially in the FMCG sector, is conservative in its approach to significant change in business practices. This is especially true with regard to retail marketing practices, given the tie to manufacturer promotional trade funds. But the time is ripe for a marketing transformation of the order that Retail 3.0 forebodes.

An oft-used but still valid analogy is iTunes’ impact on the music publishing industry. The ability to deliver music in a downloadable, digital format was driven by changes in technology, and an analogous shift is at hand for retail marketing. Consider: what if a retailer were to go to market not with traditional same-price-for-all mass promotions communicated in mass advertising vehicles, but with individually relevant promotions for each shopper communicated over digital channels? True customer-specific



marketing. Think about how vastly lower are advertising costs on digital channels compared to printed ad flyers, radio, television, and billboards. Think about the efficiencies and margin gain possible by providing the right discounts to the right shopper in the right place at the right time.

Starry-eyed day dreaming? No way this will happen? Not enough customers are using digital channels to even think about moving away from the traditional ad flyer? Nonsense. Just look at CD sales today.

A Way Forward

The explosive growth of digital communications and applications provides the retail industry a rare opportunity to step back, take a hard look at all marketing initiatives, and boldly transform how it goes to market leveraging these new transformational capabilities. Retailers' marketing conservatism has hindered the development of a digital marketing age, but it cannot stop it. Countless retail executives across the country, from companies of all sizes, are effectively saying the same thing: "Not enough of my customers are using email or their mobiles or Facebook for me to even think about moving away from my traditional advertising vehicles like ad flyers." But this does not have to be so. Retail marketers can choose to sit back and wait for massive consumer use of a given digital channel to develop before moving their primary marketing communications—or they can be proactive. And while some retailers are seeking to steer their shoppers to new channels, they are doing so by creating yet more incremental promotions and marketing initiatives rather than transforming their existing go-to-market practices.

One well known supermarket retailer (a true 3.0 Retailer) regularly measures its percentage of weekly sales coming from shoppers it communicates with over digital channels. These shoppers impact more than 50 percent of this retailer's sales each week, and the number is continuing to grow. Do you know what percentage of your sales are being generated by customers you digitally communicate with each week? This retailer has successfully crafted a value proposition that encourages shoppers to sign up for its emails, sign into its website, or to use its in-store kiosks. That proposition is built upon relevant marketing to each customer household. This retailer is driven by an opportunity to dramatically reduce historical advertising costs as it segues from high cost printed ad flyers to low cost digital communications.

But the world of Retail 3.0 provides even more benefit: not only do digital channels cost far less, they also support the very cost-efficient communication of relevant marketing, and relevant marketing in turn drives increases in customer spending, shopping visits, and retention. As wholesale shifts in consumer behavior are occurring with regard to communications in all forms, the retail industry has a unique opportunity to transform past mass marketing practices and reinvent brick-and-mortar marketing by leveraging digital channels and applications to provide **relevant** communications to **each** shopper with the goal of maximizing customer lifetime value.

Certainly, retail marketing is only part of the equation; successful retailers must provide quality products, good assortment, and great customer service. But Retail 3.0 is upon us, and every retailer must understand its implications: many are at risk of more nimble competitors seizing the opportunity to transform the way retailers typically go to market, relying upon digital channels and relevant marketing at an individual customer level to drive their business. Retail marketers in the world of 3.0 understand the lifetime value of their customers and leverage that knowledge—and combine it with the technological capabilities to act on it. And traditional retailers, increasingly unbalanced by creeping costs of marketing incrementalism, very much risk being upended.