RETAIL MARKETING AND BRANDING

A DEFINITIVE GUIDE TO MAXIMIZING ROI

Second Edition

JESKO PERREY
and
DENNIS SPILLECKE

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FOREWORD

How can retailers combine traditional and new marketing vehicles? How can they stay on top of what their customers want? How can they reach them effectively? Do shoppers still look at leaflets, or should retailers shift local marketing funds to social media?

These were the questions that gave rise to this book a little over two years ago. As it turns out, they are no less relevant today. If anything, the high pace of innovation in areas such as store formats, big data, advanced analytics, shopping-related mobile apps, and multichannel retailing has made them even more pressing.

In this book, Dr. Jesko Perrey and Dr. Dennis Spillecke consolidate McKinsey’s perspective on these pressing questions. They worked with a team of more than 30 distinguished marketing practitioners and experts to incorporate our latest thinking regarding, for example, format development, advanced marketing mix modeling, highly granular geo-marketing, digital media, and fact-based promotion management. A unique combination of strategic thinking and leading-edge analytics makes this volume essential reading for retail CEOs and marketing enthusiasts alike.

Published to great acclaim in 2011, Retail Marketing and Branding: A Definitive Guide to Maximizing ROI successfully launched our series Perspectives on Retail and Consumers. It is my privilege to present the second edition today, as well as to announce an upcoming new volume, on technology in consumer industries, due for publication in 2013. I hope you
will share my excitement about these books and be encouraged to seek out future volumes in the series.

Dr. Klaus Behrenbeck
Director, McKinsey & Company, Inc.
Leader of the European Consumer Sector
Cologne, January 2013
INTRODUCTION TO THE SECOND EDITION

Selling something you have in stock at your store to someone who wants it – that’s not a deal; that’s a transaction. But getting ready to sell things you don’t yet have to people who don’t yet know they want them – that’s more like a deal.

As you read this, the reality of retail is shifting from traditional transactions to real deals. Retailers operate in an environment of fragmented needs, hybrid consumption, changing channels, multiple formats, big data, and real-time decisions. Building strong brands, developing compelling propositions, and managing marketing ROI is now more complex than it ever was. New entrants, many of them pure online players, are changing the rules of the game. Ever more demanding shoppers want it all—everywhere and all the time. Social media spread the news at the speed of light, whether of a good deal or of a broken promise. Retail marketing may rarely have been more challenging, but it was also never quite as rewarding as it is today.

When Retail Marketing and Branding: A Definitive Guide to Maximizing ROI first came out two years ago, it struck a chord with retailers old and new. It turned out that tools for complexity reduction and approaches for balancing analysis with pragmatism were exactly what senior retail executives were looking for. Enthusiastic feedback from readers all over the world encouraged us to up the ante for an enhanced second edition:
all-new chapters on format development and fact-based promotion management;

thoroughly revised chapters on digital evolution and digital marketing excellence;

new interviews with Thomas Wagner of SevenOne Media, Armando Branchini of Altagamma, and Uwe Becker of OWM;

more than a dozen new case studies, including Amazon, American Express, Asos, Burberry, Dell, and Tesco;

updated facts and figures throughout, including three dozen all-new exhibits.
SECOND EDITION ACKNOWLEDGMENTS

We are indebted to all our fellow authors and the teams that have supported them in updating existing chapters and creating new ones, as well as to our distinguished external partners and collaborators for their contributions. Specifically, this is to thank the following individuals:

• Emma de Carolis at IP for contributing a case study on post-merger brand integration in the Italian petroleum market;
• Armando Branchini at Altagamma for an interview on the impact of digital media on luxury retail;
• Thomas Wagner at SevenOne Media for an interview on the changing TV advertising landscape;
• Uwe Becker at OWM for an interview on media planning and purchasing.

Special thanks are due to our colleagues and trusted advisors for their commitment over the entire course of this project. Specifically, this is to thank the following individuals:

• Anja Weissgerber for coordination and publisher management;
• Tobias Karmann for consistency checks and clearance control;
• Sanya van Schalkwyk for contributing new facts and figures;
• Cornelius Grupen for end-to-end executive editing.
Thank you also to our colleagues Frank Sänger, Andrea Zocchi, and Harald Fanderl for acting as independent reviewers.

Jesko Perrey and Dennis Spillecke
Düsseldorf, January 2013
The occasion is the weekly management meeting of a leading food retailer. The CFO’s report gets the ball rolling: “Sales are down five percent from the same period last year, for the third week in a row.” The CMO takes his chance: “This clearly shows our brand is losing attractiveness. We need to ramp up our share of voice on TV!”

Then all hell breaks loose.

“You keep saying that,” the northern region’s commercial director yells, “but your fancy commercials just don’t sell the goods. We should run more in-store promotions. That’s where people make their choices.”

The southern regional manager echoes: “Absolutely! In-store is the way to go. Why don’t we also send out an additional leaflet next week? That’s how we’ll lure shoppers back into the store.”

The CEO, who had been staring out of the window until this moment, now turns to the group. “TV, promotions, leaflets. I’ve heard it all before. It’s the same story week in, week out. But can any one of you tell me what we really get out of any of these things?”

Silence fills the room. The CMO reaches for his coffee. The commercial directors fiddle with their BlackBerrys. The CFO keeps staring at the sales chart, as if to reverse the trend line through sheer willpower. But they all know that none of them has a real answer to the CEO’s question. What a way to start the day!
Why you should read this book

Most readers will have been in similar situations at one time or another. Marketing and branding discussions that take place in the boardrooms of retail companies are frequently laden with emotion. Due to the lack of hard facts and quantified impact, decisions are all too often based on gut feeling, individual experience, or plain hope. But retailers are acknowledging the increasing importance of marketing and branding as key factors in the success and the sustainability of their business. Consequently, they have started to bring a more fact-based approach to their marketing efforts.

With this book, we aspire to contribute to the demystification of marketing and branding discussions. The idea for the book emerged in conversation with executives who complain that most retail marketing books tend to be either theoretical or trivial, and usually fail to give them any meaningful guidance on how to run their business. What they were looking for, they told us, was a systematic, yet practically relevant treatment of the subject. In response we have compiled this practical guide on how to maximize the return on marketing investment in retail, based on the experience derived from hundreds of retail marketing and branding projects. We have made a point of covering both the conceptual and analytical foundations as well as their application, enriched by a wide range of retail case examples and practical hints. Unless otherwise noted, all references to the practice of individual companies are based on outside-in research.

Who this book is for

We are confident that what we say in this book will be relevant to retail executives all over the world, no matter whether their retail organization is large or small, whether it operates in the food or non-food segment, or whether it sells its goods through brick-and-mortar outlets or e-commerce shops.

Companies working with retailers as their suppliers, distribution partners or marketing service providers may want to use this book to deepen their understanding of the marketing and branding questions faced by retailers, and to adapt their proposals or services accordingly.
Also, executives from other consumer-facing industries such as FMCG, consumer electronics, energy, or telecommunications will be able to derive considerable benefit from this book. Because of its sizeable marketing budgets and huge customer databases, retail is one of the most active and most sophisticated sectors when it comes to marketing and branding.

We hope the book will also help academics, students, and other marketing professionals to acquaint themselves with some of the latest and most advanced tools and methods retailers use to measure and manage the return on marketing investment.

How this book was created

To leverage the widest possible range of expertise and experience, we have invited the cooperation of the leading retail marketing specialists among our colleagues, both from Europe and from overseas. Yet this is anything but a run-of-the-mill editor book. We have both taken an active role in shaping the structure and the content of all chapters, in close cooperation with the respective teams of authors. As a result, this book is not a collection of loosely connected articles, but a consistent compendium. Each chapter builds on the foundations laid in the earlier parts of the book, and they all highlight different aspects of retail marketing ROI optimization. This approach will be immediately apparent, even to the most casual reader, due to the consistent look and feel of the chapters. As a result, the book presents an integrated and consistent body of knowledge on the subject.

How you should read this book

This book is comprised of three principal parts:

I. Building Superior Retail Brands
II. Optimizing Marketing ROI
III. Ten Perspectives on Retail Marketing.
In the first part, we focus on building strong retail brands, covering topics such as segmentation-enabled target group selection, retail brand management, store brand portfolio optimization, and private label management – all based on a conceptual approach to brand management that revolves around the interplay of art, science, and craft.

In the second part, we discuss sizing the overall marketing budget, as well as its allocation to different formats, stores, regions, and marketing instruments. In addition, we present guidelines on how to make the most of key retail marketing instruments, including digital media, POS, local media, classical media, and CLM. This part concludes with our view about how to optimize the purchasing of marketing-related goods and services.

The final part is a short manifesto of our core beliefs on retail marketing and branding.

We hope you will feel free to read this book in whatever order you see fit. We would be more than happy if you choose to read this book cover to cover, but it is equally possible to go directly to a specific chapter. While later chapters build on the earlier ones, each chapter is also written to be a stand-alone treatment of its subject.

Each chapter starts with a short overview of its key topics to facilitate browsing. At the end of each chapter, you will find a list of key takeaways. We trust that you will come back to certain parts many times, and that you will use this book as a work of retail marketing reference. As this is intended to be the first volume in a series of books on related subjects, we would very much welcome your feedback. All comments, criticism, and suggestions for improvements should be addressed to the authors.
We are indebted to all our fellow authors and the teams that have supported them in researching and developing each of the chapters. They all share the experience of having gone through many rounds of writing and editing as the book evolved. Additionally, a few individuals from McKinsey & Company’s international leadership group have kindly acted as an internal sounding board, namely Peter Dahlström, Tjark Freundt, and Frank Sänger. We would like to thank all of them for their commitment and patience.

We would also like to thank our external partners and the companies that have supported this effort through participating in the co-creation of knowledge, in the clearance of case examples and in granting permission to use quotes, images and other materials in the text or in the exhibits. Special thanks are due to our interview partners for sharing their views on retail marketing and branding: Pia Marthinsen Mellbye at ICA, Thomas Koch at TKM, Alastair Bruce at Google, Michael Trautmann at kempertrautmann, and Daniela Mündler at Douglas.

Special thanks are due to Klaus Behrenbeck, Peter Breuer, and Nicolò Galante, our colleagues at McKinsey & Company, for their commitment in seeing this project through from the initial idea to the finished book. Thank you to Anja Weissgerber, who led and coordinated this effort on behalf of McKinsey’s European Consumer Industries & Retail Group, and to Tobias Karmann for tying up all the loose ends. Very special thanks to Cornelius Grupen, our Expert for Marketing Knowledge Development, for making
the whole more than just the sum of its parts, and to Ivan Hutnik for his meticulous editing. In addition, we also thank our secretaries – Michaela Dülks, Claudia Schmidt, and Stefanie Schmitz – for keeping us on track throughout this project.

We hope that this book not only makes good reading, but that it will also help its readers to build strong retail brands that generate superior returns on marketing investment.

Dr. Jesko Perrey and Dr. Dennis Spillecke
Düsseldorf, January 2011
**COMMONLY USED ACRONYMS**

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<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tr>
<td>ATL</td>
<td>Above the line media (e.g. TV)</td>
</tr>
<tr>
<td>BTL</td>
<td>Below the line media (e.g. POS materials)</td>
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<td>CLM</td>
<td>Customer lifetime management</td>
</tr>
<tr>
<td>CLV</td>
<td>Customer lifetime value</td>
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<tr>
<td>CMO</td>
<td>Chief marketing officer</td>
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<td>CPM</td>
<td>Cost per mille</td>
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<td>CRM</td>
<td>Customer relationship management</td>
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<td>ERP</td>
<td>Enterprise resource planning</td>
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<td>GRP</td>
<td>Gross rating points</td>
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<td>KPI</td>
<td>Key performance indicator</td>
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<td>LCC</td>
<td>Low-cost countries</td>
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<td>LoMEX</td>
<td>Local marketing excellence</td>
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<td>MMM</td>
<td>Marketing mix modeling</td>
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<td>OMEX</td>
<td>Online marketing excellence</td>
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<td>OTT</td>
<td>Over the top video</td>
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<td>P&amp;L</td>
<td>Profit and loss</td>
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<td>PL</td>
<td>Private label</td>
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<td>POS</td>
<td>Point of sale</td>
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<td>RCQ</td>
<td>Reach–cost–quality</td>
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<td>RFP</td>
<td>Request for proposals</td>
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<td>RFQ</td>
<td>Request for quotes</td>
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<tr>
<td>ROI</td>
<td>Return on investment</td>
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<tr>
<td>TRS</td>
<td>Total return to shareholders</td>
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<td>TVC</td>
<td>Television commercial</td>
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Part I

Building Superior Retail Brands
Every brand is a promise. And like any promise, brands attract and excite us; they capture our hearts and minds; they give us a glimpse of a better life. But most importantly, brands create tangible value. They are a retailer’s most powerful connection to the outside world. Brands enable retailers to form deep and lasting attachments to customers and potential employees, and even investors, that translate into higher sales, stable profits, superior capabilities, and above-average stock market performance.

This chapter explores the three principal elements of superior brand management – art, science, and craft – and presents a wide range of case examples, illustrating how leading retailers bring these elements to bear on the management of their brands.

Branding is the secret weapon of retail marketing: it can create substantial value, but it is under-leveraged by most retailers.

Brands have many benefits, but above all, they create value. Brands help companies achieve price premiums, and they save costs due to their inherent appeal to customers. Companies with strong brands consistently outperform their peers in the stock market. According to a recent McKinsey analysis, brands with a top ranking in BusinessWeek’s annual “Best Global Brands” report have consistently outperformed traditional benchmarks like the MSCI World or the S&P 500 index over the past 10 years (Exhibit 1.1). Credit Suisse came to a similar conclusion in 2010, based on an analysis spanning a 12-year period: companies that invest at
least 2 percent of sales in their brand (“brand stocks”) have consistently outperformed the S&P 500.

But to what extent do brands make a difference in retail? Research has shown that the impact of retail brands on consumer decision making is substantial; it is based on three key functions:

- **Image**: Retail brands help consumers express who they are, effectively making their choice of retail brands a lifestyle statement – think of IKEA.
- **Orientation**: Retail brands provide consumers with orientation. They make it easier to process information and help consumers save time – think of Amazon.
- **Risk reduction**: Retail brands reduce the perceived risks involved in making a purchase. They provide consumers with a “safe choice” – think of John Lewis.

Are leading retailers capturing the full value of these opportunities? You would think that at least some of them do. Surely, well-known global
retail brands like H&M, IKEA, or Tesco must be among the world’s most valuable brands? Not so: H&M, the top retail brand, does not make it into the top 20 of any brand ranking of note – and all other leading retailers are even further away from true branding excellence. (Source: Interbrand Brand Marketers Report.)

There is a simple reason for this situation. For decades, retailers have not made branding their priority. Until very recently, many retailers, especially those in Europe, have been focused on price, with leaflets promoting low prices being their most important marketing instrument. But retailers around the globe are gradually waking up to the challenge of professional brand building and management. For example, eBay, Sears, and 7-Eleven have received EFFIE awards in recognition of the effectiveness of their advertising.

It takes three elements to build and sustain a strong brand in retail: art, science, and craft

- The art is about endowing the brand with a relevant, credible, and unique value proposition that is up-to-date, consistent, and executed in a creative way.
- The science is about understanding and measuring relevant consumer needs, as well as the performance of the brand in the targeted customer segments.
- The craft is about managing the brand rigorously in all its individual aspects throughout the organization and across all customer touch points.

Of course, a brand can be strong without attaining perfection in all three areas. Inevitably, companies have different approaches to brand management, and their organizations have different strengths and weaknesses. Nonetheless, however well a company might master an individual element, we believe that this single element will be of little use to them if they do not achieve a minimum standard in the other two elements as well (Exhibit 1.2).
The art is about balancing creativity with consistency to endow a brand with an emotional appeal that builds on its heritage.

To succeed, retail brands must strike the right chord to make them appeal to consumers and generate demand. They need to engage consumers emotionally, yet their claims must also be credible and trustworthy. But with which brand elements should you start as a retailer? Should you focus on rational elements, like price or location, which give consumers concrete reasons to buy or at least to visit a store? Or should you prioritize emotional elements like honesty or modernity that speak to consumers’ feelings?

In fact, strong brands always do both, although the balance between the two varies. There are hardly any strong products or services that are not at least as good as the competition in their rational elements, and they are usually better in one or two attributes. At the same time, real brand champions, like IKEA, H&M, Nespresso, or Apple, stand out because of their emotional appeal. Although the products they offer may not be superior in all cases to competitors’ alternatives, it is the way they make consumers feel about themselves and their purchases that differentiates these brands from others.

But the importance of the art element should not be misread as a license to go crazy. Frequent changes to a brand’s positioning, target group, or communication style will eventually destroy its value. In fact, consistency
is an important element of artful brand propositions. In a survey among 300 marketing experts, consistency was identified as the most important aspect of branding by far, with more than one third of respondents naming it as number one in an open-ended question. (Source: 2007 Brand Marketers Report, Interbrand.)

Consistency is not to be confused with stagnation. Had it stayed true to its roots as a run-of-the-mill DIY retailer, Germany’s Hornbach would never have become the premium brand it is today. In effect, consistency is about balancing relevant innovation and originality with a brand’s heritage. A now-legendary example is that of how Roberto Menichetti and Christopher Bailey rejuvenated the Burberry brand over a ten-year period. In 1998, Menichetti famously laid bare the company’s traditional tartan lining and started using it as a prominent pattern for apparel and accessories. By turning a hidden asset into a tangible brand differentiator, his approach was original and creative, yet fully in line with the brand’s heritage.

Another key prerequisite for bringing a brand’s emotional appeal to life is the creativity of its communication. Some brands achieve consistent competitive advantage by means of superior creativity in their communication; they have mastered the art of placing the bait exactly where the fish will bite. Strong brands are highly effective in the use of creative campaigns that distinguish them from the competition, strengthen their brand image, and leverage this image to generate sales.

As a joint study by McKinsey & Company and the Art Director’s Club on “Creativity in Advertising” has shown, creativity can take many different forms. (See Chapter 16: “Excellence in Classical Media” for details of this study.) Successful creative advertising often contains a disturbing element—one that initially seems irritating, provocative, or funny, whether in pictures or in words. One example of this phenomenon is a campaign by German DIY retailer Hornbach. In one of their TVCs, we see a shopper pouring out his heart to a store employee over the death of a beloved pet: “I ran over my son’s rabbit!” he says, before bursting into tears. The spot closes to Hornbach’s brand claim: “If you trust us with your remodeling, you can trust us with everything.”
There is more to strong brands than awareness: the science is in measuring a brand’s strengths and weaknesses across the entire purchase funnel

Science is the second element of superior brand management. Most retail marketing managers and agencies still use brand awareness and advertising recall as the primary or even exclusive indicators of brand performance. While there is nothing wrong with these metrics in themselves, we believe they are insufficient to capture the specific strengths and weaknesses of a brand, let alone the root causes of its performance. In some cases, the focus on awareness and recall may even create the illusion of a healthy brand, when in fact the brand is in trouble. Retailers should expand their brand management toolbox and then use the extended toolkit comprehensively in their brand management decisions.

There are many hazards of the traditional approach. While a given brand may, for example, score highly on both awareness and advertising recall, its target audience may know next to nothing about the specific benefits provided by the brand. And how can you be sure the promoted benefits are even relevant to the target group? To distinguish a well-known brand from a really strong brand, you need a sense of whether consumers know what the brand stands for in terms of products or services, and whether they favor the brand over its competitors in their purchase considerations. In other words, strong brands perform well along the entire purchase funnel from awareness and consideration to purchase, repurchase, and loyalty. For details on the concept of the purchase funnel and its stages, please see Chapter 3: “A Guide to Excellence in Retail Brand Management.”

This is not to say that all strong brands perform equally well at each and every stage of the purchase funnel; most brands reveal slight weaknesses at one stage or another. Whatever the case, the accurate measurement of a brand’s relative strengths and weaknesses in the target group’s purchase funnel is the starting point for fact-based brand management.

Rigorous retail brand managers look beneath the surface of awareness and advertising recall. They explore the strengths and weaknesses of their brands across all stages of the purchase funnel and each customer’s life
cycle. They take detailed measurements and constantly hone their measurement techniques.

The craft is about bringing the essence of the brand to life at all touch points

It is one thing to put the brand positioning on paper, but it is quite another to make it a real presence in consumers’ lives: in TV commercials, print ads, leaflets, newsletters, store displays, loyalty programmes, and personal interactions. Retailers with strong brands go to great pains to ensure a superior and consistent consumer experience of the brand’s proposition at all touch points. (See Exhibit 1.3 for an overview of in-store touch points.) For example, imagine “freshness” is one of the differentiating attributes in your brand positioning. While it may seem obvious what this means for touch point 5 (“products offered”), it is a lot less obvious how freshness could be brought to bear on the store’s exterior or at the checkout.

In terms of holistic activation of the brand positioning at all touch points, many of us would agree that Apple sets the standard. The company does
a fantastic job when it comes to translating their brand values of stylish design, creativity, and uniqueness into products like the iPod, the iPhone, or the iPad, as well as into a unique experience at its more than 300 Apple stores worldwide, many of which have won architectural awards.

Excellent execution is not necessarily limited to tangible touch points like store design. For Aldi, the discount retailer, price is key. Consumer perception of the company as a provider of good value for money has made the Aldi brand strong, and low prices are the source of Aldi’s competitive advantage. Its private label products nevertheless provide A-brand quality. Right from the start, Aldi stressed that every article it sold was cheaper than the equivalent found elsewhere. Based on this premise, it has turned simplicity of execution into a guiding principle, from its no-frills stores to its narrow assortment of around 750 products. Logistics cost plays a major role when establishing a new outlet: the store must be accessible to articulated trucks, and the aisles must be wide enough to maneuver pallets. Aldi’s stores are usually located either on side streets near high-traffic areas, or on the edge of town where there are good parking facilities and low rental costs. Its comparatively narrow assortment of goods ensures simplicity in buying and handling, and its scale gives it massive bargaining power in negotiations with suppliers. Aldi also keeps labor costs down by reducing management to an absolute minimum. For example, the company’s central functions have a very low headcount.

Last, but not least, excellent craftsmanship in brand management also demands sufficient attention and leadership from top management. The CEO or other chief caretaker of a brand should live and breathe its positioning in order to be able to manage the day-to-day trade-offs between generating additional revenue and protecting the brand heritage. While it may be tempting, for example, to engage in a short-term price war with a brand’s closest competitor, it could well damage the brand’s reputation as a provider of reliable quality in the longer term.

Decisions such as these illustrate that brand management is a top management issue; it cannot safely be delegated to product managers, external agencies, or any other third party. The late Steve Jobs, for instance, made it a point to approve every new product design and every global advertising
campaign personally, thus making sure the brand’s value proposition is reflected in every aspect of Apple’s business.

But craft is by no means the prerogative of established brands. For example, newcomer Zalando, a German online shoe retailer, has proven particularly crafty in the way it manages brand activation across touch points. To build brand awareness quickly, Zalando aired its first TV commercial less than one year after its launch in 2008. This was made possible through a “media for equity” deal with ProSieben, one of Germany’s leading private television networks (compare the interview with Thomas Wagner of SevenOne Media in Chapter 16: “Excellence in Classical Media”). Tied in with banner ads and a customer magazine, the TV commercial received widespread attention and drove brand awareness to 85 percent in Germany (mid-2010). In 2011, Zalando received a GWA Effie award for its efficient marketing communication.

As illustrated by such examples, many retailers excel at one of the elements of superior brand management: the art, science, or craft. But only a select few master all three elements in equal measure.

We conclude this chapter by taking a close look at IKEA, Starbucks, and Asos, all of whom display excellent brand management in their respective sectors. In Chapter 3, we look at the specific success factors of retail brand management in more detail, based on McKinsey & Company’s BrandMatics approach.

More than okay coffee

*Case study: Starbucks*

Protecting a brand’s heritage is a top management job. When Howard Schultz, who had earlier stepped down as the CEO of Starbucks, decided he had seen enough of what he called “the commoditization of the Starbucks experience,” he took decisive action. In a memo to the company’s leadership group, he criticized a series of decisions which, though they might have seemed right on their own merits, diluted the Starbucks’ brand when taken together. For example, the introduction
of automatic coffee machines increased the speed of service and efficiency, but destroyed much of the romance and theatre afforded by the old machines. Moreover, the height of the new machines blocked the customer’s line of sight, making eye contact with the barista nearly impossible. Similarly, while the introduction of flavour-locked packaging clearly improved the quality of the fresh-roasted bagged coffee, it also meant that the smell of coffee that had previously filled the premises was gone. Schultz considered the coffee aroma one of the brand’s most powerful nonverbal signals. As a result of these changes, the stores lost their former soul, the warm feeling of a neighbourhood store, and instead began to seem like chain stores. To make things worse, the increasing number of merchandising articles, such as music CDs, took Starbucks even further away from its heritage as a coffee shop. “In fact, I am not sure people today even know we are roasting coffee. You certainly can’t get the message from being in our stores,” Schultz wrote.

Less than 12 months later, Schultz returned as CEO to help the company refocus on the original Starbucks experience. One of his first decisions was to stop selling hot breakfast sandwiches. These sandwiches accounted for revenues of around USD 500 million for the company, but they made the stores smell like cheese factories and the baristas feel as if they were working in a fast-food store. “The decision and the courage it takes to remove something when there’s pressure on the business – like the sandwiches – is emblematic that we’re going to build for the long term and get back to the roots and the core of our heritage, which is the leading roaster of specialty coffee in the world.”

Starbucks then ordered all new espresso machines from Thermoplan, a relative newcomer in the sector long dominated by traditional Italian manufacturers. Thermoplan’s USP was that the coffee is ground individually for each cup of espresso. What is more, the new machines are much lower than the earlier automated machines, restoring eye contact between the barista and the customer. Schultz says the new machines were meant to bring back some of the old charm: “Once
again, it will be all about the coffee.” James Alling, responsible for the company’s overseas business as President of Starbucks International, sums up the company’s ongoing brand management challenge as: “There’s always going to be someone selling okay coffee at a low price. It’s our job to make sure Starbucks is more than okay coffee.” (Source: Roland Lindner, ‘Die neue Bescheidenheit von Starbucks’, 22 March 2008, No. 69, p.20; interview with James Alling, President of Starbucks International, ‘Wir dachten, die Kunden kommen von selbst’, Frankfurter Allgemeine Zeitung, 21 March 2008, www.faz.net/.)

Much has happened since the early days of the return of Howard Schultz. For one thing, many Starbucks outlets have added panini sandwiches to their menu again. But there is no denying that the focus on core competencies and brand heritage triggered by Schultz’s memo played an important part in the company’s ultimate recovery.

**Best practice example**

**IKEA: combining art, science, and craft**
IKEA, the largest furniture retailing chain in the world, is a fine example of how art, science, and craft work together to create and sustain a superior brand. As of 2011, IKEA had more than 280 stores in 26 countries, generating revenues of EUR 25.2 billion (Exhibit 1.4). Wherever you shop, IKEA stands for furniture and home accessories that combine function and design at affordable prices. We will look at each of the three elements in more detail to find out how IKEA does it.

The art: creative communication creates emotional appeal. Many of IKEA’s campaigns have presented ingenious decoration or storage solutions achieved with the help of their products. But artful communication is not only about original messages. It can also be about clever media selection: for example, the company’s recent store opening in Malmö, Sweden, was supported by intensive use of social media. They
created a Facebook profile for the store’s manager and uploaded pictures of the store’s showrooms. By tagging products featured in these pictures, Facebook members could enter a prize draw for these products. The campaign created enormous excitement: users kept asking for more pictures and shared them with thousands of people via newsfeeds and links. (Source: Most Contagious Report 2009; also see Chapter 17: “Digital Marketing Excellence” for further details.)

In Tokyo, the company built fourteen small “IKEA 4.5 museums.” In an area the size of just four-and-a-half tatami mats (around 7.5 m², slightly smaller than the standard room size in Tokyo), IKEA showcased how to make the most of small rooms using its furniture. The campaign led to a new record in store visitors and was awarded a Cannes Golden Lion in 2007. (Source: Hajo Riesenbeck, Jesko Perrey, *Power Brands: Measuring, Making, and Managing Brand Success*, Wiley, 2008, p. 44.)
IKEA’s most important tool for building relationships with its customers, apart from the stores themselves, is its catalog. Almost 200 million copies are printed worldwide, and more recently IKEA has introduced the unique concept of a personalized catalog. Customers have their photos taken at one of the stores, and a few days later they can pick up a copy of the catalog featuring pictures of themselves, rather than those of a professional model, in the catalog’s living room illustrations. This not only brings customers back into their stores, but creates a deep personal connection with the brand. The personalized catalog is yet another example of how the company’s communication conveys the impression that the brand has a lot more to offer than just affordably-priced pine furniture.

The science: systematic consumer research ensures fact-based brand management. IKEA engages in extensive market research to ensure the brand meets consumers’ needs at key touch points, such as the product and store experiences. The retailer explores what it calls the “three moments of truth” in its research: the planning of the shopping trip, the core brand experience at one of the IKEA stores, and the product experience once back home. By using a wide range of observational techniques, the retailer aspires to generate insights that will enable it to develop inventive interior decoration solutions that solve customer’s real-life problems, rather than merely providing them with items of furniture.

Consumer feedback management is another area in which IKEA adheres to strict and systematic standards to ensure that it is provided with continuous input on the quality of its products, stores and services. Shopper insights derived from transaction data and the “IKEA family” loyalty card are pooled and leveraged systematically. Partly as a result of the targeted offers it produces based on these insights, the retailer generates more than half of its total revenues through non-furniture sales, including small design items and snacks.

Even when their apartments are fully equipped, shoppers can be lured back for smaller, more decorative items, or for the sheer store
experience. Says former CEO Anders Dahlvig: “We are trying to become like Disneyland.”

The craft: a consistent global brand promise, carefully adapted to local needs. At IKEA, brand management is all about consistency. The store is largely standardized wherever it is located around the world. The same is true for the product line-up. Product developer Tomas Lundin says, “A product must do well in all countries to be successful.” The catalog, however, can be adapted more easily and cost-effectively, presenting the company to the world as one that thinks globally and acts locally. Although the country editions of the catalog are all produced in Sweden, they reflect local peculiarities: television sets in the American edition are bigger than elsewhere, while the Chinese edition features kitchen supplies labeled in Chinese characters.

IKEA sums up its brand promise as: “Trends come and go, but combining a low price with good design and function never goes out of style.”

Get the look

Case study: Asos

Launched in the UK in 2000, Asos operates a branded online shop that sells clothes as worn by celebrities in the media. This promise is embodied by the brand name itself: Asos is an acronym and stands for “As Seen on Screen.” Its value proposition is three-fold:

• celebrity-driven styles;
• multi-brand assortment;
• strong social media presence.

Asos enables its 16-to-34-year-old, fashion-oriented target group to “get the look,” i.e. to find the clothes and styles worn by their favorite
celebrities. Offline competitors include Topshop, Zara, and H&M. The Asos offering comprises some 50,000 product lines from more than 800 fashion brands, including regular retail brands, such as G-Star and Polo Ralph Lauren, as well as designer brands, e.g. Karl Lagerfeld and Sonia Rykiel. About a thousand new products are added every week. In the UK, Asos is the no. 5 online fashion destination, with more than twice as many unique visitors as H&M (February 2012). The company’s entire range is available both through the company’s website and through Facebook, where visitors can browse the catalog and make purchases without ever leaving the social network.

The company’s economic footprint is impressive, especially given its relatively recent launch and its pure play strategy. Asos generates almost half a billion UKP in annual revenue, up from just over 40 million five years ago. Fifty-seven percent of sales originate outside the UK. Currently at almost GBP 70, the average basket size has nearly doubled since 2006. In terms of Facebook “likes,” Asos has not yet entered the league of Zara and H&M, both of which achieve well over 10 million “likes.” But with its 1.6 million followers, Asos is impressively close on the heels of its most important local competitor, Topshop, which leads the pack in the UK at about 2.1 million (February 2012).

Asos is uniquely positioned as a fast-fashion, online-only brand for digital natives. Reflecting this position, the company has found its own way of striking the art-craft-science chord:

• It employs art in the way it manages its small but growing portfolio of e-tail brands. Asos, as the umbrella brand, has already spawned several spin-offs, including Asos Outlet (“off-price”), Asos Mobile (“fashion at your fingertips”), and Asos Marketplace (“recycle your wardrobe”). Other subsidiaries include Crooked Tongues, an e-shop dedicated to sneakers and sports apparel. Four years ago, Asos also launched its own branded range of products. Today, the company employs seven in-house designers and generates as much as 70 percent of womenswear sales through its own range.
A lot of *craft* goes into the way Asos brings its value proposition to life at a wide range of touch points. While all distribution is strictly digital, the company’s communication mix is far more comprehensive. Of course, Facebook, Twitter, Youtube, fashion blogs, and review sites are core elements for a pure player. But Asos also sponsored the Next Top Model franchise on Living TV, makes extensive use of outdoor advertising, and engages in event partnerships, such as the Capital FM Summertime Ball.

Asos leverages *science* by adding new functionality to its website and mobile presence continuously. In 2010, the company integrated its entire catalog with Facebook and launched a transactional iPhone app. In 2011, Asos introduced Fashion Finder, a platform that enables shoppers to search for user-generated content and purchase products mentioned by other users. Asos says they also use Google Analytics and various types of cookies to improve and customize site navigation, shopping experience, and targeted campaigning.

The jury is still out on the sustainability of the company’s single-channel strategy, especially since single-brand retailers, such as Topshop and Zara, and marketplaces, such as eBay and Amazon, are intensifying their efforts to gain or reclaim their shares of online retail. Nevertheless, Asos has managed to build a strong brand with dedicated followers and robust operations over a relatively short time span.
Key takeaways – Art, science, and craft

1. It takes three elements to build and sustain a strong brand in retail: art, science, and craft.
2. The art is about balancing creativity with consistency to endow a brand with an emotional appeal that builds on its heritage.
3. The science is about measuring a brand’s strengths and weaknesses across the entire purchase funnel: there is more to strong brands than awareness.
4. The craft is about bringing the essence of the brand to life at all touchpoints.
Market segmentations are the maps you need to navigate the world of marketing. But as anyone with even a passing interest in cartography knows, there are many ways to describe the complexity of three-dimensional reality in a two-dimensional representation – and every projection is compromised in some way or another. While segmentation is well understood and widely used in consumer goods companies, the ins and outs of retail can easily turn segmentation into an expedition into the wilderness. For one thing, retail as a business is a lot less homogeneous than FMCG across regions and countries. What is more, with its continual fast cycle of testing and learning, the pace of change in retail marketing is much more rapid than in the management of international consumer brands.

Additionally, the questions that segmentations need to answer differ greatly between retailers, or even between different categories. For example, grocery retail is all about location. In high-involvement, low-frequency categories such as fashion or electronics, however, the key is the range and type of brands and products featured in a specific format.

Yet we believe that a robust consumer segmentation is as advantageous to a retailer as it is to a consumer goods company. While the objectives and uses may be slightly different, the strategic relevance is the same. In this chapter, we will focus on what it takes to make segmentation matter in retail: solid strategy, top management attention, market research expertise, superior statistical skills – and sound judgment.
Segmentation is just as important to retailers as it is to consumer goods companies – but for different reasons and in different ways

Consumer goods companies use segmentations to understand variations in consumer needs, brand image, product preference, or usage occasions as the basis for targeted brand management, product development, and distribution strategy. For retailers, in contrast, market segmentation is a key source of information for making more informed decisions on store formats, assortment strategy, featured brands, and CRM activities – all of which are ultimate profit drivers. By association, this makes segmentation a major factor to improve a retailer’s return on marketing investment.

The example of a US-based grocery chain can show us what segmentation can do for a retailer. At the start of the segmentation effort, it was the marketing department’s firm belief that shopper needs were similar within a given region, but differed greatly across regions. Based on this assumption, the company had one type of store in region 1 and another type of store in region 2. After all, retail is a location game, isn’t it? Yet the segmentation proved this assumption to be very wide of the mark. It turned out that there was considerable heterogeneity at the region level, but that there were a few distinct types of shopper, occurring in similar proportions across all regions.

Why should the company care? Because, in this case, the needs of these different types, or segments, were the direct drivers of both store and brand choice. This link becomes more obvious once you take a closer look at some of the segments the grocery retailer identified (Exhibit 2.1).

- The “cost-conscious homemaker” has a love of food, but a tight budget, and is looking for a broad but affordable assortment. For practical reasons, these customers have a clear preference for one-stop shopping at a large store.
- The “daily-routine shopper” is driven primarily by convenience, both regarding products and store locations. These customers typically look for pre-cooked meals in a neighborhood or downtown store.
- The “highly involved gourmet” has little or no price sensitivity, a strict preference for the best unprocessed ingredients, and the willingness to shop at multiple stores to get exactly the right products.
In an ideal world of one-to-one retail, you would build a different kind of store for each of these types. In reality, the company used these insights to prioritize their budget allocation to different store formats and assortment categories. Marketing investments were tied directly to the size and attractiveness of the various segments, resulting in significantly higher marketing ROI once the changes took effect.

Segmentation is a strategic topic and deserves top management attention: *if the CEO doesn’t care, nobody will*

Segmentation matters. When budgets are tight, a new retail segmentation can be a great way both to prioritize investments and enhance the fact base for marketing decisions. But how do you build a segmentation that stands the test of time and becomes the ongoing basis for marketing decisions? In a survey conducted by the Economist Intelligence Unit among 200
senior executives in 2005, every second company said they used market segmentation, or had at least launched a segmentation project. Quite a few retailers develop multiple segmentations to fit the requirements of different store formats, vendors or countries. But whether you opt for a “one segmentation fits all” approach or believe “the more the merrier,” experience shows that the vast majority of segmentations are one-shot efforts, filed away for good once the project is wrapped up. What a waste!

So what can you do to increase the segmentation’s longevity? The answer is simple: before you start building a segmentation, decide what you want it for. As the US grocery retailer example shows, segmentation findings can change the fundamental assumptions behind a business strategy. Superior understanding of shopper needs can be a substantial source of potential competitive advantage, and as such it deserves the undivided attention of a retailer’s most senior executives.

There are many potential purposes for a segmentation. For a global multi-category retailer, a segmentation might be required to track down the last unclaimed consumer niches or to identify new types of shopping behavior emerging from changing consumer lifestyles and trends. By contrast, a segmentation for a newcomer to a specific category would typically fulfil a much broader purpose, e.g. to generate the fact base to define and profile the company’s primary target group.

Either way, the segmentation will only be truly useful in informing the way a retailer does business if it reflects the top management agenda. No matter how inventive the segmentation approach or how original the segment names, if the segmentation doesn’t help answer the questions on the CEO’s mind, it can only ever be a theoretical weapon. But attention from senior management is critical for more mundane reasons as well: only top management can ensure the involvement of all the executives from functions that will be affected by the outcome of the segmentation. Depending on the exact purpose and nature of the segmentation, it can impact commercial strategy, marketing, supply chain and vendor management, store management, and the merchandising department. All the relevant stakeholders will need to have a say in the process if they are to embrace the results of the segmentation.
In many of the segmentation efforts we have seen, companies and their service providers spend a lot of time fine-tuning their arsenal of statistical methods and clustering techniques. Of course, there is nothing wrong with the aspiration to apply first-rate research and analysis methodology. However, this all too easily puts the cart before the horse, as the entire effort will go to waste unless senior stakeholders fully buy into the strategic priorities and the future use of the segmentation at the outset. To ensure its strategic relevance, the retailer will want to align the criteria used in the segmentation with the targets of their most important long-term business objectives – such as revenue potential or profitability.

Defining the relevant market

One of the most important issues in any segmentation – one that deserves top management attention – is the definition of the relevant market and study sample. For example, if you are looking for growth, the market definition should be relatively broad, perhaps including other retailers that you would not normally consider direct competitors because of their assortment or price position. Also, you will want to include consumers who are not currently your customers. But if profitability is your primary worry, the market definition should be narrower, and more granular, to ensure that you end up with the required level of detail; for example, data on customer lifetime value. In this case, it may be sufficient to limit the sample to current customers – an easy way to save time and money. But watch out: you might need to understand consumers other than those who actually do the shopping in order to improve your business. As any parent can tell you, at least when it comes to candy bars or cereals, their choice of product and brand is often driven by their children’s preferences – and this will not show up in any standard shopper survey. Even strict vegetarians might well pick up steaks and sausages for their carnivore family! Focus groups and store-exit interviews are quick ways to help you avoid such pitfalls.
Consumer needs are at the root of shopper behavior and should be the basis of a strategic retail segmentation

Top management needs to agree on the objectives of a segmentation and what use it will be put to – but any such decision is unlikely to be unanimous. It is quite likely that the different functional departments will have different and potentially conflicting views about the questions the segmentation should answer. For instance, the heads of sales and marketing might wish to cluster shoppers based on their turnover potential, and generate insights about how to address the most promising ones. For this purpose, factors like disposable income and demographic data would be relevant segmentation variables. In contrast, a regional store manager will probably be more interested in shoppers’ brand preferences and other purchase drivers as a basis for streamlining the in-store category mix and brand selection. But since brand preference and demographics do not usually correlate, a single segmentation cannot answer both sets of questions at the same time with the same level of granularity and precision.

If there were actually a good correlation between demographic data and behavior, then a demographic segmentation would be the natural first choice; demographic data is easily available and facilitates the targeting of segment members. However, this is not the case. Take two British subjects: both male, both born in 1948, both in their second marriage, both affluent and from well-known families. The first is Charles, Prince of Wales; the other is Ozzy Osbourne, Prince of Darkness. From their outfits and hairstyles alone it is clear that their purchasing behavior is probably very different, despite the demographic similarities!

So if demographic data doesn’t do the trick, which variables or lenses should a strategic retail segmentation be based on? McKinsey has carried out segmentations in many different countries and sectors; our experience confirms that the best course is to turn to the deepest level of shopper motivation, to the “Why?” that drives their preferences and actions. To determine why a purchase is made, it doesn’t help to look at the identity of the shopper. Rather, retailers will want to explore the shopper’s needs (Exhibit 2.2). A segment defined based on needs (e.g. ”health-conscious
cocooner”) may be harder to track and target than a simple demographic segment (e.g. “single female aged 40–50”), but to succeed in the marketplace, retailers have to understand what shoppers want, not who they are. Since the vast majority of purchase decisions are made in the store, it is far more important to understand category needs. This understanding enables the retailer to create the right shopping experience – including, but not limited to, the product range, brand choice, price points, store layout, look and feel, and customer service.

To make the segmentation even more useful, it is advisable to introduce a second dimension to these needs that examines their context – thereby, in effect, creating a segmentation matrix. People’s needs differ, depending on the situation they are in. To account for this, the default secondary segmentation dimension is “occasion” or “state.” For example, in the American apparel market, the needs of jeans buyers are shaped predominantly by whether the pair of jeans will be worn at work, on weekends at home, to go out at night, or for outdoor activities. The usage situation determines what people are looking for in terms of style, cut, material, and price point.

<table>
<thead>
<tr>
<th>Lenses Variables</th>
<th>Who</th>
<th>What</th>
<th>When/where</th>
<th>Worth</th>
<th>Why</th>
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<tbody>
<tr>
<td></td>
<td>Consumer</td>
<td>Category/behavior</td>
<td>Occasion (time, location)</td>
<td>Value</td>
<td>Needs</td>
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<td>Examples</td>
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<td></td>
<td>Demographic (e.g. gender, age group)</td>
<td>Main product category (e.g. food, apparel, electronics)</td>
<td>Time of day, week, or year</td>
<td>Revenues</td>
<td>Attitudes (e.g. price conscious, convenience seekers, variety seekers, pure luxury buyers, individual style seekers)</td>
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<td></td>
<td>Sociographics (e.g. income, education, neighborhood)</td>
<td>Sub-category (e.g. cookies, hair care, LCD TVs)</td>
<td>Buying occasion (gifts, before holidays)</td>
<td>Profitability</td>
<td>Buying factors (for specific category, e.g. jeans)</td>
</tr>
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<td>Life stage (e.g. marital status, number of kids)</td>
<td>Repurchase rate</td>
<td>Stock renewal frequency</td>
<td>Lifetime value</td>
<td>Passions (e.g. sports, media consumption, literature)</td>
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<td></td>
<td>Region</td>
<td>Price level</td>
<td>Channel mix/ preference</td>
<td>Cost to serve</td>
<td>Emotions</td>
</tr>
<tr>
<td></td>
<td>Firmographic (SoHo, SMB, large enterprise)</td>
<td>Brand loyalty</td>
<td>Store-location (e.g. mall, train station, city)</td>
<td>Single or multi-supplier</td>
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<tr>
<td></td>
<td>Region</td>
<td>Single or multi-category purchase</td>
<td>Store loyalty</td>
<td>Purchases per year (number, value)</td>
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<td></td>
<td>Internality</td>
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<td>Shopping type (e.g. planned vs. impulse, alone or with others, specific products or for leisure)</td>
<td>Scale potential (share of purchasing volume)</td>
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<td>Decision maker (single, group)</td>
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Exhibit 2.2 Overview of segmentation lenses.
In order to create a fact base that reflects these variations, the segmentation should include both needs and states. Only by producing such a matrix is it possible to identify the most attractive target segments and create the right product mix for different store formats to satisfy these segments.

In the US grocery example mentioned earlier, the basic needs segmentation was greatly enhanced by adding states as a second dimension. It turns out that the differences in shopping behavior between the needs segments were rather small, but once the frequency of shopping trips and the average basket size was added into the mix, the results became much more meaningful. Once it is known how often a member of a specific segment comes to the store, on which occasions they shop and how much they are willing to spend, it becomes easier to develop targeted propositions for such individuals.

(Exhibit 2.3).
Some retailers even rethink their format strategy based on the insights generated from a two-dimensional segmentation matrix. Says Mike Ullman, Chairman and CEO of J.C. Penney: “We are learning off-mall stores can be very productive in big mid-week presence. It’s closer to people’s homes. It’s not a mall trip. It’s easier to drive to the door. It has a certain presence in the middle of the week, whereas malls perform in key holidays.”

As a consequence of these insights, J.C. Penney is concentrating most of its store growth in off-mall locations. In 2008, Ullman reported they were “performing better than on-mall stores in terms of general transaction levels.” (Source: Andria Cheng, “J.C. Penney scales back growth plans; Weak economy muddies earnings outlook,” MarketWatch, April 16, 2008.)

Segmentation methodology

This chapter is not intended as a discussion of the statistical methods (such as hierarchical clustering or latent class) or the alternative software packages (e.g. SPSS or SAS) that are used to derive segments from a given research sample or data set. For these more technical questions, please refer to the academic literature in the field. Established sources include:

Creating segmentations that reflect consumer needs accurately and provide insights that retailers can act upon is a three-step process:

1. Create and test the questionnaire, conduct the survey, and clean the raw data as received from market research agencies. Typically, the cleaning process includes removing respondents who do not meet the filter criteria or have given invalid answers, as well as excluding statements with sub-critical variance across the entire research sample.

2. Run applicable segmentation analyses and decide on the number of segments used to cluster respondents. Segments that turn out too small, or insufficiently differentiated, may be merged or removed to increase the practical relevance of the segmentation solution.

3. Assign names, and possibly prototypical pictures, to segments, and create segment profiles detailing demographics, behavior, preferences, and other relevant attributes. Many companies find that bringing a segmentation to life in a suitable fashion can be make or break for its actual everyday application. See the final section of this chapter for details.

While superior technical and statistical skills are indispensable for successful segmentation solutions, retailers do not necessarily need to possess these capabilities in-house. Specialized service providers such as market research agencies and consumer insight consultancies offer anything from selective support to integrated full-service solutions.

**There should be a central strategic segmentation:** *any secondary segmentation should be aligned with it*

While separate segmentations for each store format, vendor, or country can lead to levels of complexity that are hard to manage and communicate, this does not mean that there should only ever be one single segmentation. Additional secondary segmentations can provide additional insight in
certain circumstances. Such segmentations might be required for tactical reasons – for example, for the addition of a specific function, such as CLM, or for a specific purpose, such as the launch of a new store format or entry into a new region or territory. The more clearly defined the purpose of such secondary segmentations, the better. For example, a leading European health and beauty retailer created an auxiliary segmentation strictly for customer life cycle management (CLM) purposes. This segmentation was used to pre-select the most receptive target groups for specific promotions and campaigns, based on their shopping history as stored in their loyalty card profiles. The power of this solution was enhanced by linking it to the company’s high-level strategic segmentation, enabling marketers to apply proven CLM filters even to non-cardholders. To this end, demographic proxies were used to predict the responsiveness of non-cardholders to certain types of campaigns. For example, families with young children living in rural areas would receive promotions for a discounted bubble-bath bundle, but not for high-end decorative cosmetics. For further detail on operational segmentations, see Chapter 18: “Maximizing Customer Value with Data-driven CLM.”

Any additional or secondary segmentations need to be aligned with the strategic segmentation in order to leverage the existing knowledge and ensure the consistency with the retailer’s marketing approach. The most common reason for an additional segmentation is to add in a new market in a specific country or region. It is well known that market characteristics differ greatly between countries. In the case of personal care retail, for example, “a good choice of self-tanning products” is very important in most Western markets, while consumers elsewhere in the world often look for “mild but effective whitening products.” While this difference may be easy to accommodate in a two-dimensional segmentation based on needs and skin types, things get trickier if the needs vary more fundamentally. In India, for example, many shoppers are on such a tight budget that they can only afford mini-packs of most beauty products. This situation might require an alternative second axis, such as “category budget,” to derive the appropriate segment marketing approach. However, in order to maintain the link with the central strategic segmentation, it is important to keep the
primary axis – usually that of category needs – stable across all markets. Similar rules apply to any secondary segmentations for specific functions.

If a subsidiary or third-party service provider has made its own segmentation, this can sometimes be turned to advantage for enriching and enhancing the retail company’s central strategic segmentation. For example, the local media agency might hold valuable information on shoppers’ media usage. If this can be matched to the existing needs segments, then the data might be used to optimize the relevant reach – and ROI – of the media mix in the retailer’s advertising budget. However, it is likely that the local agency will not have used the same needs profiles as the retailer; to make the segmentation data compatible, the retailer will need to introduce a needs proxy to bridge the gap between the two sources. For instance, in categories driven by the consumers’ stage of life, such as furniture or DIY, a reliable proxy could be a combination of age, marital status, and number of children. For example, if a single female, aged 27, has just had her first child, there’s a fair chance she’s in the market for an affordable cot.

**To get the most out of a segmentation: keep it simple, bring it to life, and spread the word**

Many retailers who carry out a segmentation fail to leverage it fully. Getting the most out of a segmentation requires making it both tangible and memorable, and then promoting it through an internal marketing campaign. In our experience, a segmentation really starts to work once stakeholders from all parts of a retailer’s organization are so convinced of its value that they start acting in sync to deliver their brand’s value proposition.

The first rule for ensuring that the segmentation is both practical and memorable is to keep the number of segments as low as practicable – without sacrificing essential granularity and statistical differentiation. As a rule of thumb, the segmentation should have no more than ten segments. Any more than this, then all those using it will have difficulty in remembering and communicating the distinctive characteristics of the different
segments. It also becomes a very complex task to serve each segment with a differentiated value proposition and tailored marketing activities.

The second rule is to make the segmentation both tangible and memorable: this will bring it to life for those who use it on a daily basis. For example, calling a segment “Harry Handshake” is much more memorable than referring to it as “Pragmatic male deal-seeker,” especially if it comes with a full and vivid description of Harry Handshake’s characteristics. For instance, the segment portrait of a key target segment could be displayed as a Western-style “Wanted” poster. It pays to go beyond the characteristics that directly define the segment, adding attributes and other elements that help create a rich, true-to-life impression of the type of individual in question. For example, a leading grocery retailer used pictures to visualize the average age and predominant gender of the members of a given segment, but also added details on food preferences, typical products bought, and media usage patterns (Exhibit 2.4).

<table>
<thead>
<tr>
<th>Tom, the self-made chef</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description</strong></td>
</tr>
<tr>
<td><strong>Size</strong></td>
</tr>
<tr>
<td><strong>Spend</strong></td>
</tr>
<tr>
<td><strong>Main drivers</strong></td>
</tr>
<tr>
<td>- Loves food, cooking</td>
</tr>
<tr>
<td>- Enjoys having a sophisticated kitchen with the best utensils available</td>
</tr>
<tr>
<td>- Enjoys the shopping experience</td>
</tr>
<tr>
<td>- Is willing to pay for the best quality</td>
</tr>
<tr>
<td><strong>Need themes</strong> (relative to total average, in %)</td>
</tr>
<tr>
<td>Price sensitivity</td>
</tr>
<tr>
<td>Convenience driven</td>
</tr>
<tr>
<td>Preference for large formats</td>
</tr>
<tr>
<td>Loves food/ cooking</td>
</tr>
<tr>
<td>Looks for easy real solutions</td>
</tr>
<tr>
<td>Seeks food shopping as a chore</td>
</tr>
<tr>
<td>Looks out for special ingredients at home often</td>
</tr>
<tr>
<td>Entertains friends at home often</td>
</tr>
<tr>
<td>Likes to cook new recipes</td>
</tr>
<tr>
<td><strong>Category spend</strong> (relative to total average, in %)</td>
</tr>
<tr>
<td>Fresh food</td>
</tr>
<tr>
<td>Bakery</td>
</tr>
<tr>
<td>Frozen food</td>
</tr>
<tr>
<td>Drinks</td>
</tr>
<tr>
<td>Baby</td>
</tr>
<tr>
<td>Health and beauty</td>
</tr>
<tr>
<td>Pets</td>
</tr>
<tr>
<td>Household</td>
</tr>
<tr>
<td>Home &amp; entertainment</td>
</tr>
<tr>
<td><strong>Shopping frequency (in %)</strong></td>
</tr>
<tr>
<td>Every day</td>
</tr>
<tr>
<td>Every other day</td>
</tr>
<tr>
<td>A few times a week</td>
</tr>
<tr>
<td>Once a week</td>
</tr>
<tr>
<td>Once a fortnight</td>
</tr>
<tr>
<td>Once a month</td>
</tr>
<tr>
<td><strong>Media consumption</strong></td>
</tr>
<tr>
<td>- More likely to watch TV, e.g. cooking and home improvement shows and lifestyle channels</td>
</tr>
<tr>
<td>- Less likely to read newspapers, but more likely to read cooking magazines</td>
</tr>
<tr>
<td>- Active users of online food related forums, recipe websites and Facebook</td>
</tr>
<tr>
<td><strong>Key demographic characteristics</strong></td>
</tr>
<tr>
<td>- Slightly older, more than 60% over 40 years</td>
</tr>
<tr>
<td>- 55% are men, 57% are married, more than 70% own their own home, 20% have children</td>
</tr>
<tr>
<td>- Most likely to hold a professional/executive position</td>
</tr>
<tr>
<td><strong>Opportunities for marketing managers</strong></td>
</tr>
<tr>
<td><strong>Product</strong></td>
</tr>
<tr>
<td>- High quality ingredients</td>
</tr>
<tr>
<td>- Kitchenware</td>
</tr>
<tr>
<td>- Recipe magazine</td>
</tr>
<tr>
<td><strong>Price</strong></td>
</tr>
<tr>
<td>- Premium, no sales promotion</td>
</tr>
<tr>
<td><strong>Advertising</strong></td>
</tr>
<tr>
<td>- Messages around joy of cooking for friends in own home</td>
</tr>
<tr>
<td>- Targeting communities</td>
</tr>
<tr>
<td><strong>Place</strong></td>
</tr>
<tr>
<td>- Shaping store around fresh ingredients</td>
</tr>
</tbody>
</table>

Exhibit 2.4 Sample segment profile created by grocery retailer.
The internal communication effort should seek ways to engage the staff in a truly memorable manner. This could include active learning tools: for instance, a self-typing tool based on short questions that enables employees to find out which segment they belong to. Some companies go much further in certain cases, even hiring actors to play out the defining traits of key segments during internal training sessions.

But even if your segments are tangible, memorable, and low in number, communicating them internally is often still a major project. You will need to show each member of your staff how the segmentation will change daily operations – and do so graphically, preferably in clear and simple language. This is no easy task, given the size of many modern retail organizations. But it is a task that cannot be avoided: the real value of a segmentation is only fully realized when all front-line staff thoroughly understand it.

Finally, like most management tools, a segmentation needs constant care if it is to prosper and remain useful in the longer term. It therefore pays to set up a small task force to monitor the ongoing validity of the segmentation solution, enrich the segments with additional information as new data becomes available, and point out new uses for the segmentation. This team, or its steering committee, should include representatives of all management functions affected by the segmentation. Ideally, it should also involve key contacts from the most important service providers (e.g. creative agencies, media agencies and POS specialists), at least as corresponding members. Service providers will not only be able to contribute to the richness of a segmentation, but will also help reach the segments effectively and efficiently. Some retailers take this approach even further and collaborate with their top vendors in developing segment-specific products or packaging. Again, a segmentation is like a map: the more you unfold it, the more you see.
Key takeaways – Segmentation

1. Segmentation is just as important to retailers as it is to consumer goods companies – but for different reasons and in different ways.
2. Segmentation is a strategic topic and deserves top management attention: if the CEO doesn’t care, nobody will.
3. Consumer needs are at the root of shopper behavior and should be the basis of a strategic retail segmentation.
4. There should be a central strategic segmentation: any secondary segmentation should be aligned with it.
5. To get the most out of a segmentation, keep it simple, bring it to life, and spread the word.
Traditionally, branding has not been a top priority for most retail CEOs. But the times, they are a-changing, and leading retailers are starting to discover their brands as a potential source of competitive advantage. Typically, this leads them to ask two kinds of question:

- How do consumers perceive our stores and our brand?
- How can we use brand management to improve our business performance?

BrandMatics, a comprehensive brand management approach developed by McKinsey & Company, provides the answers to these questions. The approach has been successfully applied in retail, as well as in other industries. In this chapter we will walk you through the most important BrandMatics concepts and analyses, including the brand diamond and the brand funnel. We will also look at how several best-practice retailers have mastered the art of consistent end-to-end brand delivery.

The brand diamond helps retailers map the attributes of their brand in a structured and comprehensive way

In the consumer’s mind, a retailer’s brand is the focal point of a wide range of perceptions about the retailer. To get to the heart of your brand...
image and create a fact base for targeted improvements, you need a robust understanding of how and why the brand influences your customers. The relation between brand perception and consumer behavior has been thoroughly researched by practitioners as well as academics. Building on this research, McKinsey & Company has developed its own framework for mapping brand image in a systematic way: the McKinsey brand diamond. This tool has been used widely as the starting point for comprehensive brand transformation efforts. The brand diamond uses four dimensions to structure brand associations (Exhibit 3.1).

The **tangible attributes** are the characteristics of the brand that are perceived by looking, listening, touching, smelling, or tasting. In a retail context, these physical assets are often subdivided into four categories:

- store and location, e.g. the number of outlets, the layout of a store, the in-store merchandising, or the availability of customer parking;
- price and promotions, e.g. the overall price level or the type and number of promotions and discounts;
• assortment, e.g. the total number of SKUs in a store, the range in a given category, or the relative share of branded and private label products;
• service, e.g. store opening hours, number of staff, return policies, or customer reward programmes.

The intangible attributes are the characteristics that collectively make up the identity of the retail brand, e.g. its origin, reputation, or personality. Examples include:

• The Body Shop is perceived as a “socially responsible brand.”
• Harrods is considered to be a retailer “with a long tradition.”
• IKEA is strongly associated with its origin – “being Swedish.”

In some cases, intangible attributes may be associated with tangible attributes. In the case of IKEA, for example, the colors blue and yellow support the image of being Swedish because they are also the colors of the Swedish national flag.

The rational benefits are the reasons to buy, derived from a brand’s tangible attributes.

• Price-related benefits, e.g. buying at a discounter like Aldi helps you save money.
• Product-related benefits, e.g. shopping at Whole Foods helps you to stay healthy. Similarly, the products of a fashion retailer like Abercrombie & Fitch will give you a young and trendy look.
• Convenience, e.g. Tesco Express helps satisfy all your basic shopping needs in one convenient location.
• In-store experience, e.g. a visit to Harrods department store in London, the Apple flagship store in New York, or Globetrotter’s outdoor store in Cologne all offer unique shopping experiences.
• Service experience, e.g. Nespresso will pick up a defective coffee machine from your home and provide you with a substitute machine for use during the time it is being repaired.
The emotional benefits are the elements of a brand that help consumers express or reinforce the image they have of themselves. In our experience, many retailers have a tendency to overlook the importance of emotional benefits and focus mostly on rational buying factors, though there are some prominent exceptions.

• Customers of Prada or Louis Vuitton rarely buy the products purely because of the tangible attributes ("hand-sewn," "finest leather") they provide. Recent McKinsey research shows that most luxury brands capitalize on a combination of their emotional appeal and their long-lasting products. In effect, shopping at luxury stores and being seen with luxury items is, in fact, a lifestyle statement.

• Similarly, for pre-teen girls, shopping at American Girl Place is as much a form of self-realization as it is a commercial transaction. Or think of the music lover frantically downloading songs on iTunes and leaving his stereo playing even when he is not at home – creating a soundtrack to his life.

• Although a self-proclaimed provider of "casual luxury," Abercrombie & Fitch has not become the cult classic it is today solely because of its high-quality T-shirts. Rather, it aspires to create a whole world for shoppers to live in. Says CEO Mike Jeffries: “You buy into the emotional experience.” (Source: Stacy Perman-Reynoldsburg, “Abercrombie’s Beefcake Brigade,” Time Magazine, February 14, 2000.)

The most important function of the brand diamond is that it acts as a template to prepare and structure market research. To derive an accurate description of the image of the brand, including its strengths and weaknesses, it is imperative to capture all the aspects that define it (the “brand attributes”). Any other statements that also have an influence on consumer behavior should be included as well, even if they are not currently part of the retailer’s brand identity (the “market drivers”).

The brand diamond is highly effective in structuring the discussion and research about retailers’ brands, ensuring that no aspect is overlooked. Typically, following from a brand workshop or a focus group session preceding in-depth quantitative market research, you will emerge with an
An extensive list of statements. We recommend that you narrow down the list to no more than 30 to 50 statements for quantitative research purposes. Determining the actual number requires making a trade-off between the cost and reliability of the market research on the one hand (the fewer, the better), and the depth of insights generated on the other hand (the more, the merrier). See Exhibit 3.2 for sample statements that have proved useful in the retail context.

Based on the resulting shortlist of attributes and benefits, you should conduct quantitative consumer research that includes your own as well as your key competitors’ customers. This will create an accurate map of the relative strengths and weaknesses of all the companies in the market. When defining the research sample, bear in mind that there can be significant regional differences, especially in retail. The regions chosen for the research should be representative of your business as a whole. The research sample must also be large enough to allow for reliable observations at the intersection of customer groups and regions. Market research
agencies and analytical specialists will be able to help determine the exact number of observations required to ensure statistically reliable results.

The brand purchase funnel helps retailers benchmark the performance of their brand across the consumer decision journey

The brand diamond reveals how well consumers perceive a brand in relation to competitor brands. This information can form the basis for a comprehensive brand transformation effort, but in order to identify brand image refinement opportunities, one further step is required: taking stock of the brand’s performance at each stage of the consumer’s decision journey. The tool used for this purpose is the brand purchase funnel (or brand funnel, for short). The brand funnel is based on, but by no means limited to, the AIDA model (attention, interest, desire, action). The brand funnel tells you what percentage of the relevant target group fulfill each of the following criteria:

- is aware of the retail brand;
- lives near a store and considers purchasing there;
- has made a purchase there in the last months;
- uses the store frequently;
- is a loyal customer making almost all purchases there.

Exhibit 3.3 presents an example of the brand funnel as applied to a retailer’s brand. Note that almost any stage of the funnel can be further subdivided in order to increase the granularity of insight. For example, providers of products with high ticket prices and low purchase frequency, like automobiles or real estate, will be looking for additional detail in the pre-purchase phases – for instance, regarding how specific brands enter or exit the consumer’s consideration set. In contrast, retailers will typically wish to increase the resolution of the later funnel stages to reflect the fact that “repurchase,” “favorite retail brand,” or “long-term loyalty” are often make-or-break factors for retailers.
Adjusting brand funnel research for store network effects

As the retail industry is a highly local business, you need to take special precautions to ensure that the purchase funnel is comparable across competing retailers. This can either be done by limiting the research sample to those who have stores of all the relevant competitors in their neighborhood, or by including a filter or funnel step such as “... lives near a store” or “… has stores that are accessible to me” explicitly (see Exhibit 3.3). Without this kind of adjustment, the brands of retailers with an extensive store network will appear to be disproportionately strong.

Exhibit 3.3 The brand funnel in retail.

The values at each stage of the funnel indicate the percentage of customers in the sample who have reached this stage. For example, the brand featured in Exhibit 3.3 is known to 62 percent of the survey’s participants. The transfer rates from one funnel step to the next indicate what percentage of customers has completed the transfer. In Exhibit 3.3, 25 percent of
those who regularly purchase at one of the brand’s stores also say that they are loyal to the brand.

Exhibit 3.4 provides a real-life example of brand funnel research, in this case conducted in the German drugstore market in 2012. As Exhibit 3.4 shows, dm and Rossmann achieve the same brand strength throughout the early stages of the funnel from awareness all the way to occasional purchase. Further down the line, however, dm pulls away from its rival Rossmann. For a third of all consumers in the sample, dm is the drugstore at which they shop “most often,” compared to about a fifth for whom Rossmann is the default drugstore. This gap is all the more remarkable in light of Rossmann’s slightly larger store network, comprising some 1,600 outlets, compared to only about 1,250 for dm. In order to close this performance gap, Rossmann would need to focus on building loyalty rather than awareness.

Factoring in the consumer’s average basket size and purchase frequency will enable the retailer to estimate the sales uplift that would result from increasing the transfer rate from one funnel stage to the next. The result of this calculation is often referred to as the “customer conversion value.” But understanding the root causes of a given gap in

![Exhibit 3.4 The brand funnel – example from German drugstore market.](image-url)
the funnel is even more important than the size of the prize that can be claimed by closing it. In the German drugstore example from 2012, for instance, Rossmann would want to know what it could do to improve their transfer rates from “occasional purchase” to “regular purchase” and “purchase most often” in order to close the gap to its rival dm.

**BrandMatics is a comprehensive brand management approach** for assessing and improving brand performance across all stages of the brand funnel

BrandMatics is a comprehensive brand management approach. It goes beyond the diagnostic insights provided by the brand diamond and brand funnel research to enable retailers to identify the specific attributes they need to address in their marketing mix in order to improve their performance in the purchase funnel.

Typically, the first step in tailoring the BrandMatics toolkit to the retailer’s target groups is to conduct a market segmentation. This enables the retailer to identify its principal audience and to define specific target groups based on the criteria of attractiveness and accessibility; see Chapter 2: “Segmentation” for further details.

BrandMatics is a five-step process (Exhibit 3.5):

- **Conduct market segmentation**: Use consumer segmentation to determine your target audience and pre-select segments for the funnel analysis.
- **Identify brand drivers**: Analyze how the attributes and benefits identified by the brand diamond drive consumers through the funnel.
- **Identify brand funnel gaps**: Compare the transfer rates of the brand with those of key competitors to identify bottlenecks.
- **Analyze strengths and weaknesses**: Identify the relative strengths and weaknesses of the brand in terms of the most important brand drivers.
- **Derive a matrix of options**: Combine the insights from the first four steps to derive a set of strategic options to improve the performance of the brand.
The brand driver analysis helps determine the root causes of consumer behavior for each step of the brand purchase funnel.

Let us return to Rossmann’s hypothetical question: what do we need to do to improve our brand’s performance in the latter stages of the funnel in order to close the gap to our main rival dm? Conceptually, brand drivers are the brand items (attributes or benefits) that have the greatest influence on consumer purchasing behavior, so to answer this question Rossmann first needs to understand what turns its occasional customers into regular ones, defined as the group that shops at Rossmann more often than anywhere else.

There are many approaches to analyzing the behavioral relevance of brand items. A simple and popular method is to ask consumers what they value in a retail brand, or to carry out a direct survey of the criteria they use to make their purchases. But the results of these approaches can be misleading, because respondents have a tendency to say they want it all: low prices, top quality, end-to-end convenience. But offers that satisfy all these criteria in equal measure simply don’t exist. What is more, stated importance often doesn’t reflect actual importance. For example, while
many car buyers say they make their choice based on safety and fuel economy, the evidence generated by more sophisticated research shows that brand image and design are actually more important to their purchasing behavior. To adjust for these factors – the lack of differentiation and the mismatch of stated and actual importance – we recommend that the brand drivers be derived using statistical analysis rather than by relying upon survey results. To do this, you look at the perceived strengths of the brand or product a given consumer has actually purchased.

The results of the driver analysis in our drugstore example in Exhibit 3.6 shows the key purchase drivers, ranked according to their behavioral relevance. “Trust” emerged as the most important driver, but accessibility aspects, such as “can be reached easily,” and price-related attributes, such as “store is good value for money,” turned out to be similarly important to drive customer conversion.

Once the brand drivers have been determined, the next step is to carry out an analysis of the strengths and weaknesses of the brand. To this end,

<table>
<thead>
<tr>
<th>Top 10 brand drivers (T-test results) [Number of responses = 1609]</th>
<th>Value for money</th>
<th>Convenience</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is the store I trust most</td>
<td>10.0</td>
<td></td>
</tr>
<tr>
<td>Can be reached easily</td>
<td>8.0</td>
<td></td>
</tr>
<tr>
<td>This store is good value for money</td>
<td>7.8</td>
<td></td>
</tr>
<tr>
<td>Has attractive private label / own brand products</td>
<td>7.0</td>
<td></td>
</tr>
<tr>
<td>Has branches very close to my home or place of work</td>
<td>6.9</td>
<td></td>
</tr>
<tr>
<td>This is my preferred store for treating myself</td>
<td>6.8</td>
<td></td>
</tr>
<tr>
<td>Is a store for frequent small purchases</td>
<td>6.7</td>
<td></td>
</tr>
<tr>
<td>…</td>
<td>…</td>
<td></td>
</tr>
<tr>
<td>This retailer has a loyalty card with good rewards</td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>This store has an attractive online offer</td>
<td>2.3</td>
<td></td>
</tr>
</tbody>
</table>

SOURCE: Drugstore rapid branding research March 2012

Exhibit 3.6 Brand drivers in German drugstore market – trust and accessibility drive conversion.
you compare the performance of your brand on the key brand drivers to the market average and the performance of the most important competitors.

The resulting matrix of options can be used to improve the brand’s performance in the purchase funnel by deriving concrete measures for brand building and brand management:

- **Close the gaps in critical areas**: If the retailer’s brand shows weaknesses on highly relevant market drivers, correcting these is the natural starting point for making improvements to the brand’s image and performance.
- **Expand competitive differentiation for the top drivers**: If your brand is very strong on items with high behavioral relevance, these strengths should be maintained or further expanded as key differentiators for the brand.
- **Reserve the right to play in less critical areas**: Areas that have low behavioral relevance do not deserve action if they show satisfactory levels of performance; however, see the advice in the “Identifying the hygiene factors” box below. These areas only need be addressed if there is evidence of major weakness.

As with the brand driver analysis, a matrix of options can be generated for each step of the purchase funnel. However, most retailers choose to focus their attention on the stage that shows the greatest performance improvement potential for their brand. Where more than one stage is highlighted, a matrix of options across the entire brand funnel can be useful in prioritizing the actions that need to be taken. Exhibit 3.7 is an example of such a matrix for our drugstore example: the vertical axis shows the importance of the brand drivers for consumer behavior and the horizontal axis shows how consumers perceive the Rossmann brand in comparison to its competitors. Its right-hand side (“strengths”) shows that Rossmann is perceived as a brand whose stores can be reached easily, that provides attractive promotions and an has an attractive online offer. The top left-hand corner, however, reveals the brand’s numerous perceived weaknesses in areas of high importance, plotted relative to Rossmann’s key rival, dm. For example, Rossmann’s image is lagging in areas such as trustworthiness, private label offering, and store design.
But brand building is more than just identifying individual brand elements for targeted improvements. It also requires strategic direction setting, ideally in the form of a synthesis of what the brand is about in plain and simple terms.

**Identifying the hygiene factors**

Not all the attributes and benefits that emerge as highly important from the brand driver analysis will necessarily have the potential to be brand differentiators. For example, though possessing sufficient parking space might be a “must-have,” it is unlikely to be a decisive factor in differentiating one brand from another. Such attributes are often referred to as “hygiene factors.” They can easily be identified: they achieve high scores in the strength and weakness profiles of all players, but low scores for overall behavioral importance.
The brand promise captures the essence of a brand completely, yet concisely, synthesizing it in plain and simple terms.

The brand promise describes both the essence of the retail brand and its differentiation from the brands of other retailers. The promise should take into account the brand’s performance as well as more general strategic considerations. Summarizing the brand promise in a concise yet complete manner is one of the most challenging tasks of branding.

A certain retailer, for instance, defined its brand promise using 15 brand values, including “inspiration,” “ingenuity,” “fun,” “self-confidence,” “honesty,” “trust,” and “good value for money.” In short, nothing was left out. The trouble with this brand promise is that it could apply to any number of retailers, from Prada to H&M. It may be complete, but it is anything but concise.

Checklist for brand promise definition

- **Distinctiveness**: Concentrate on the unique and distinctive brand elements; include only those elements that differentiate your brand from others.
- **Relevance**: Use the brand driver analysis to identify the root causes of consumer behavior. If your customers don’t care, neither should you.
- **Credibility**: Ensure that the brand promise is credible and fully reflects your brand’s perceived strengths.
- **Consistency**: Build on the heritage of the brand and do not stray too far from its historical brand promise.
- **Feasibility**: Only include those elements your organization can deliver on. Make sure you have the resources and capabilities for keeping the promise over an extended period of time.
- **Honesty**: Don’t fool your customers, or yourself, especially when it comes to price. Not every retail brand can, or should, be a price leader.
Besides the checklist presented here, another helpful tool in defining the brand promise is the retail pentagon. This summarizes and simplifies a brand’s rational benefits in five areas: price, assortment, in-store experience, service, and location. The core idea of the retail pentagon is that any retailer should be really distinctive in at least one of the five areas – and no retailer can be distinctive in more than two areas. Exhibit 3.8 presents an example of the pentagon for US home improvement chain Lowe’s. It shows that Lowe’s focuses on assortment and in-store experience in its value proposition. The company is especially known for its wide, innovative, and exclusive assortment that goes beyond what you would normally expect at a DIY store. The wide assortment and attractive in-store layout turn each store visit into a fun experience. As a result, Lowe’s is more attractive than many of its competitors to female shoppers, for example.

Here are some examples of clearly defined and well-differentiated retail brand promises.

**Exhibit 3.8** Applying the retail pentagon – example Lowe’s.
• Edeka: “We love food” – focus on quality, trust and commitment.
• Mercadona: “Your trusted supermarket” – focus on regional products to ensure superior quality and freshness.
• 7-Eleven: “Fast, convenient. 7-Eleven. Oh thank Heaven.” – focus on convenience.

**Branding is more than advertising:** *the brand promise needs to be delivered consistently at all customer touch points, from ATL advertising to after-sales service*

A creative advertising campaign, a great website, or an inspiring store visit may trigger a positive association, but a strong and lasting brand image only comes with multiple positive interactions over a longer period of time. Consistent brand delivery requires particular attention to retail, as retailers typically have hundreds of stores and thousands of employees. After all, nothing hurts the brand more than a broken promise.

To ensure the brand promise is delivered consistently at all touch points from newspaper advertising and Internet banners to the stores and after-sales service, you have to address three challenges:

• Create a brand mindset for all employees.
• Translate the brand promise into concrete actions.
• Set up the organization necessary to institutionalize the brand promise.

Creating the brand mindset necessary to keep the brand promise is a four-step process (Exhibit 3.9).

• The first step is to *inform*: All employees need to know about the brand promise. This can be done by means of a CEO presentation, a corporate information day, or a feature in the corporate magazine.
• The second step is to *get buy-in*: The employees need to believe the brand promise and start explaining it to each other. Relevant formats for achieving this include workshops, internal trainings and interactive discussions. An effective tool through which to engage employees is to develop a “brand book” – a document that summarizes the brand
promise which can be shared widely across the organization and provides a common language.

- The third step is to *live up to the brand promise*: This means ensuring that the new brand becomes a living reality. To achieve this, executives should go beyond merely explaining the new promise and start acting as role models. Also, they should provide front-line staff with the tools, coaching opportunities and materials they need to become brand ambassadors themselves.

- The fourth step is to *promote the brand promise*: This is the job of all employees and will, therefore, take some time to achieve. The company’s processes, such as its incentive schemes, will need to be aligned with its brand promise. Successful promotion of the brand promise requires stability: once a new brand promise has been defined, stick to it.

Leading retail brands infuse their brand promise with fresh energy on a regular basis – be it in trainings, CEO speeches, or letters to the employees. A new brand promise also has implications for HR processes, specifically for employer branding, recruiting and people development – in short, for a company’s overall value proposition for current and future employees.
However, according to a McKinsey survey, 60 percent of brand transformation efforts are considered failures, often because they lack commitment from senior management. CEO sponsorship for something that is meant to affect every part of the retail business system is essential. It is also vital that the CEO and the management team live up to the brand promise by becoming brand role models for the company.

We will now examine selected examples of best practice to provide a sense of what it takes to translate a brand promise into concrete actions in the various marketing mix elements.

**Keeping it simple**

*End-to-end minimalism at Muji*

Muji provides an outstanding example of end-to-end brand delivery. The Japanese company, which manufactures and distributes stationery, household goods, clothing, and small items of furniture, offers a brand promise of sleek minimalism. Somewhat paradoxically, the company has made “no brand” its brand philosophy: the brand name, derived from the Japanese phrase *mu jirushi*, translates as “no logo.”

Its brand promise has been implemented so rigidly that it is widely considered a role model for brand delivery. Tadao Ando, the celebrated Japanese architect, sums up the company’s philosophy as follows: “Muji’s succinct design reveals a Japanese aesthetic that values sustaining simplicity by completely discarding all worthless decoration.” (Source: Bianca Beuttel, ‘Muji – markenlose Qualitätsprodukte’, Hochschule für Gestaltung, Offenbach am Main, February 2004.) Nearly all its products are white or colorless and made of natural materials like unprepared wood and matte aluminium. Likewise, the retailer’s shopping bags are made of plain and recycled paper, showing just the company logo. In order to ensure that its brand delivery is totally consistent, Muji operates all of its 439 outlets itself (as of February 2011). Muji’s consistent delivery of its minimalistic brand promise is attracting a growing fan base: sales have grown by 8.1 percent between 2007 and 2011 (Source: Ryohin Keikaku Co., Ltd, annual report, 2011).
Powered by service

Building a distinctive e-tail brand at zappos.com

Founded in 1999, zappos.com set out to become the premiere online destination for shoes. Taken over by Amazon for a reported USD 1.2 billion in 2009, the company has since added clothing and accessories to its product portfolio. In 2008, zappos hit the mark of USD 1 billion in annual sales. But most importantly, zappos is widely recognized as one of the most admired online brands. From day one, its brand promise has been centered around customer service. Says founder Tony Hsieh: “We’ve been asked by a lot of people how we’ve grown so quickly, and the answer is actually really simple. We’ve aligned the entire organization around one mission: to provide the best customer service possible.” (Source: about.zappos.com.)

Underpinned by values such as “do more with less” and “be humble,” the zappos brand claims to be “powered by service” (Exhibit 3.10). This promise is certainly as distinctive and as relevant as they come in a market riddled with poor fulfillment, shoddy back-ends,

<table>
<thead>
<tr>
<th>Awareness</th>
<th>Consideration</th>
<th>Purchase</th>
<th>Loyalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Generating traffic through social media</td>
<td>▪ Competitive pricing</td>
<td>▪ 24/7 support</td>
<td>▪ Shoppers feel they are part of the company, e.g. through employee tweets and videos</td>
</tr>
<tr>
<td>▪ Very good search engine visibility</td>
<td>▪ Ability to deliver items quickly</td>
<td>▪ 365 days return policy</td>
<td>▪ Unique shopping experience</td>
</tr>
<tr>
<td>▪ All communication contains links to site</td>
<td>▪ All items available for purchase (no out of stocks)</td>
<td>▪ Free shipping both ways</td>
<td>▪ Opportunity to write reviews and become part of a community</td>
</tr>
<tr>
<td>▪ Wide base of online brand ambassadors</td>
<td>▪ Reviews and forum to answer questions</td>
<td>▪ Various payment methods</td>
<td></td>
</tr>
<tr>
<td>▪ Unique ATL communication</td>
<td>▪ Comprehensive, user-friendly website</td>
<td></td>
<td></td>
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</tbody>
</table>

SOURCE: Press search, company’s website, Facebook, Twitter

Exhibit 3.10 Best practices at zappos.com across the brand funnel.
and widespread neglect for customer satisfaction. The call center is one of the focal points of the zappos customer experience. Following four weeks of customer loyalty orientation, all new employees spend a minimum of two weeks on the phone, talking to customers. Lines are open at all hours, and there are neither scripts nor time limits for the calls. Call center agents are encouraged to do whatever it takes to make a customer happy. The service promise drives everything the company does, from its corporate culture of inclusiveness to its focus on personality in recruitment. When it comes to operations, zappos has a strict policy never to display items that are out of stock.

The promise is activated comprehensively and consistently, from social media to ATL awareness campaigns. In some of the company’s most popular TVCs, puppets act out real life calls between customers and call center agents, many of them revolving around hassle-free returns and exchanges. On Twitter, zappos aggregates all posts in which the company is mentioned or linked to. CEO Tony Hsieh himself has nearly 2.5 million personal Twitter followers (July 2012). Additionally, employees post tweets and links to YouTube videos, providing customers with a peep behind the scenes. On Facebook, brand ambassadors generate positive buzz with next to no effort from the company’s moderators. Zappos’ aspiration to provide world-class service at all touch points is widely recognized and amply rewarded by shoppers. According to the company’s website, 75 percent of purchases are repeat purchases.

Rebranding between tradition and innovation

Post-merger integration in the Italian petroleum market
by Emma de Carolis, IP Marketing Manager, and Marco Mazzù, McKinsey & Company
In 2005, api (Anonima Petroli Italiana) acquired IP, bringing together two well-known brands in the Italian petroleum market. Founded in
1933, api was one of the market’s most traditional players, while IP was known for its innovative power. The resulting entity was one of the principal players in the Italian petroleum market, with a network of more than 4,000 points of sale.

**Strategic options**
After two years of dual branding that emphasized the extensive network of the group (“Wherever there’s a road”), the company engaged in research aimed at identifying the most promising overall positioning for the network as a whole. Possible scenarios included:

- Maintaining both brands, supported by a series of joint promotional initiatives.
- Maintaining only one of the two brands, IP or api, and discontinue the other.
- Creating a new brand that retains clear references to both existing brands.
- Creating a completely new brand with no reference to either api or IP.

To find the optimal solution and formulate a new branding strategy, the company explored all of these scenarios, using internal data accompanied by qualitative and quantitative research.

**Brand analysis**
First of all, the level of awareness each brand enjoyed individually was determined, focusing on the principal iconographic elements of the two logos. For the api brand, these were the dark horse; the oval shape of the logo; the white, green, and yellow colors; and the red dot over the i. For the IP brand, the key visual was its “flowing,” dynamic orange script on a blue background. In a second step, the strengths of the two brands were determined:
• Shared strengths: Italian heritage, proximity thanks to the large station network, rich tradition.
• Strengths of api: courtesy and kindness of the api station managers.
• Strengths of IP: dynamism, youthful image, efficiency, and professional service of the IP sales outlets.

Subsequent research included the profiling of the customers of both brands, quantitative analysis of the current and potential customer bases of either brand, and market surveys conducted to gauge customer perception of the merger itself. The results of the research showed that the customers of the two brands were quite different socio-economically:

• api customers: Adults (over 55), primarily women of medium to low professional level, located in central Italy, and resident in medium-sized cities.
• IP customers: Young people (18–34), mostly women of medium to high professional level, located in northern Italy, and resident in large cities (over 100,000 inhabitants).

The quantitative analysis of the customer base, which measured the combined strength of the two brands in the market, confirmed the considerable reach of the combined api and IP sales networks. More than half of all Italian motorists were already loyal or sporadic customers of at least one of the two brands.

The principal finding of the qualitative survey conducted among customers was that they considered the acquisition of IP by api as courageous, surprising, and capable of conveying a desire for innovation. Verbatim comments included: “finally a large Italian company,” “it will have a large distribution network,” “it will improve service,” “it will create competition in the market,” “I’ll be able to find it everywhere,” “it’s close to me.”
All the research indicated that the new player created by the merger of api and IP would be the largest, most widespread Italian petroleum distribution group, and that the identity of the two brands had common values such as “Italian heritage” and “professional service,” as well as complementary values such as “tradition” (api) and “innovation” (IP).

Based on these results, and after verifying the feasibility of each of the initial scenarios, the group decided to develop a new brand based on a synthesis of the common and complementary values expressed by the two brands: one that would retain clear references to the original brands and create value by exploiting the solid reputation shared by both brands.

**Positioning of the new brand**

Having understood the strategic importance of creating a new, combined brand, the next step was to define its positioning in the reference market, based on a few fundamental drivers:

- Common values of both api and IP: leadership in Italy in terms of size of the private distribution network, proximity, Italian heritage.
- Complementary values for api and IP: tradition and dynamism, courtesy and professional service.

The most important step in the rebranding strategy was the creative development of the new logo, which was intended as the visual expression of the results of all analytical and strategic efforts. The starting point was to identify not only what the new logo should be, but also what it should not be. To capture and preserve the full value of both brands, the logo was not supposed to be:

- a logo simply synthesizing api and IP;
- a completely new logo;
- a logo with an exclusive api connotation;
- a logo with an exclusive IP connotation.
The company decided to retain the IP logo as the commercial brand while including elements of the api identity, raised to the group level to sustain its strength. The company pursued an elaborate creative process, initially qualitative and later quantitative-comparative, resulting in a logo with the IP name on a blue background enhanced by a white sparkle, at the base of which the api group name is accompanied by another tricolor sparkle, representing the dot on the i of the words “Gruppo api.” The result is esthetically pleasant, innovative but not disruptive, striking and capable of expressing the api-IP merger in a balanced fashion. The “sparkle logo” is now the sole banner of the company.

Core values
The core values of the new brand include Italian heritage, confidence, proximity, leadership, and renewed tradition.

The Italian heritage is the cardinal value, since both api and IP are perceived by customers as Italian companies, and it is essential that this value be preserved and adapted. The blue trademark with the tricolor sparkle, in fact, strongly recalls the blue of the national sports teams and the Frecce Tricolori precision air team, both of which are established national symbols in Italy.

The values of trust and proximity were selected as the pillars on which to build the relationship between the company and its customers, and thus on which to build and develop communication of the new brand, with a more direct tone (“I’m near you, understand you, offer you what you need”). They are preserved in the iconographic representation by the phrase “Gruppo api” as an integral part of the logo: to reassure api customers, who see their brand elevated to the group level, and to convey a sense of growth to IP customers, whose brand becomes part of a large group and renews itself.
1. The brand diamond helps retailers map the attributes of their brand in a structured and comprehensive way.
2. The brand purchase funnel helps retailers benchmark the performance of their brand across the consumer decision journey.
3. BrandMatics is a comprehensive brand management approach for assessing and improving brand performance across all stages of the brand funnel.
4. The brand promise captures the essence of a brand completely, yet concisely, and synthesizes it in plain and simple terms.
5. Branding is more than advertising: the brand promise needs to be delivered consistently at all customer touch points, from ATL advertising to after-sales service.
CHAPTER 4

DEVELOPING AND REFINING RETAIL FORMATS

Peter Breuer, Thierry Elmalem, Stefanie Möller, Tobias Wachinger

The right format is the foundation of a retailer’s success. It is, after all, the real-life representation of a retailer’s value proposition, comprising location, assortment, price, in-store experience, and service – as introduced in the retail pentagon in Chapter 3 (Exhibit 3.8). Any decisions that affect the choice or evolution of formats are, therefore, among the most important decisions a retailer will ever make.

Store formats used to be static over long periods of time. In the 1970s, successful formats showed steady growth for more than a decade without any real modification. Today, however, a new concept has often run its course after just a few years (Exhibit 4.1). The pace of change in consumer needs is quickening, and digital distribution channels are eating into the share of traditional retail. Especially in saturated markets, simple sales space expansion does not generate profitable growth anymore.

In fact, increasing sales space per inhabitant generally leads to a decrease in overall area productivity, with the exception of players that have a superior format. The expansion of such successful formats, then, leads to a further increase in sales area density, resulting in even lower sales area productivity in the overall market. As a result, retailers are under pressure to refine their formats continuously, or reinvent them completely, before others seize the day.

Apart from a decreasing sales area productivity, which is further accelerated by the growing importance of the online channel, digital trends represent a significant challenge for retailers and force them to reinvent their physical store formats. For instance, consumers request more and
more a “true” multichannel experience, which implies the need for a seamless integration of offline and online channels. In addition, new technologies such as smart phones or special apps for product scanning also require changes in “traditional” store formats, but at the same time offer new opportunities such as greater possibilities for personalization in store (see also Chapter 12).

**There are two basic types of retail format development:** *optimization of existing formats, or launch of a new format*

*Optimization of an existing format* is aimed at enhancing a retailer’s value proposition. For example, Carrefour started implementing its umbrella brand strategy in 2008, rebranding all its Champion stores as Carrefour Market. This process involved numerous changes to the store format. The company extended its range in the former Champion stores, introduced a new entrance area focusing on fresh, listed Carrefour private label
products, invested in prices, and made shopping easier for customers by introducing a new store layout and simpler navigation. The transformation was successfully completed in 2011. It led to significantly higher sales, as well as to a rise in market share.

Another example is the recent large-scale format optimization effort at Marks & Spencer in the UK. Focusing on their apparel offering, the company set out to give its various brands a stronger identity by moving from “labels” to “brands.” To do this, the brands were displayed in clearly delineated areas of the stores, similar to the approach used by high-end department stores. Marks & Spencer also introduced new signage to make it easier for shoppers to find their way around the stores.

If consumer needs, the competitive environment, or other parameters change fundamentally, optimization may also take the form of an even more fundamental format re-design. One example of such an overhaul is the reaction of many non-food retailers to the dramatic growth of e-commerce as a share of total sales. The British electronics chain Dixons Retail, for instance, has brought together its brands Currys and PC World under the roof of a new two-in-one megastore format over the last few years. This move has improved shoppers’ in-store experience considerably and improved the incumbent’s position relative to pure online players. In addition, Dixons has achieved significant cost synergies from the joint use of sales space by the two brands.

In other cases, retailers have made structural format adjustments because of major changes in purchasing behavior. Some retailers, such as E.Leclerc or Auchan Drive, are currently testing so-called “click and collect” formats. This is their reaction to a common trend in France, where customers are increasingly unwilling to sacrifice a lot of time shopping in self-service stores. The two retailers have developed a solution that relieves shoppers of the chore of having to enter a physical store at all. Leclerc and Auchan have radically altered their operating model, creating pick-up stations at which staff gather and pack the goods that shoppers have previously ordered online.

When they launch a new format, retailers are hoping to capture growth potential that they have been unable to tap with their existing formats. REWE, for example, is currently testing a small-scale format for convenience shoppers in highly frequented locations in Germany, ReWe to Go. This
new form of outlet has a greatly reduced range, focusing on fresh, ready-to-eat products such as sandwiches, fruit, salads, and sushi, with microwaves on hand to heat up ready meals. This concept is already well-established and still growing in Asia, the US, and Great Britain. In Germany, the key target group—convenience shoppers—has so far depended on gas stations or kiosks to satisfy their needs.

Hennes & Mauritz is an example of a retailer that has introduced an entirely new apparel format with its Cos (Collection of Style) stores in several European countries. Cos offers timeless, high-quality clothing for ladies, men, and children at outlets that are approximately 500 m² in size. The format targets shoppers in their thirties with a “metropolitan outlook” who rate individual style higher than fashion trends. Experts believe that Hennes & Mauritz is hoping Cos will appeal to a more sophisticated, wealthier consumer segment than the company’s main brand.

The key to successful format development is a systematic, four-step process: investigate, incubate, iterate, ignite

Regardless of which of these types of format development a retailer pursues, the stakes are high, for any such change goes to the very heart of a retailer’s business, and any number of things can go wrong along the way. A retailer’s format epitomizes its value proposition and touches all of its core processes. To steer clear of the pitfalls and maximize value creation, we recommend following a structured four-step approach (Exhibit 4.2).

Step 1 – Investigate: Why does store performance differ, and what do shoppers really care about?

The first step is a thorough diagnosis of the status quo. Only retailers with a clear sense of why format change is essential will be able to develop a promising concept. We have found that those responsible for format overhaul often agree all too swiftly on a concept that is limited to store layout and design. But these obvious elements are rarely the principal value drivers. Generating precise insights into the needs and preferences that
drive shopper behavior is crucial: What are the real causes of differences in performance between stores? What, exactly, is it that drives shoppers to buy from competitors? What will inspire them to return?

In many cases, we find that this investigation of root causes is lacking. And without it, format development usually just leads to spruced-up stores with more space and fancier fittings. These changes certainly drive up cost, but they do not necessarily bring in substantially higher revenues. To avoid costly mishaps, retailers should determine the drivers of variance, take a full market perspective, and be prepared to take inspiration from others:

- **Determine drivers of variance.** Retailers should establish why certain stores are better or worse off than others. Drivers of revenues, growth, and profitability of the stores can be identified with the aid of multivariate, nonlinear regressions that capture the influence of both internal and external factors (see box below).
- **Take a full market perspective.** Evaluations of shopper satisfaction should not be limited to a store’s own customer base, but should reflect the entire market. The ultimate aim is, after all, to acquire and lock in new

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**Exhibit 4.2** Systematic format development in four steps.
customers. Using the purchase funnel (see Exhibits 3.3 and 3.6 in the previous chapter), market research should aim to identify the drivers that determine customer behavior. This helps to verify and substantiate the value proposition of the new format.

• *Take inspiration from others.* Prior to their own format development efforts, retailers will want to examine successful as well as at less successful formats in other countries and industries – to learn from best practices and avoid the mistakes others have made before.

**Multivariate analysis: case example**

A Spanish food retailer initially divided its outlets into three performance clusters according to the store margin. Then they investigated possible parameters that would determine the cluster into which a given store would fall. These parameters included store-specific factors, such as location or region, age of the store, parking availability, and space allocation. Other parameters the company examined included the local competitive environment and shopper structure, covering population density, purchasing power, and the age profile in each catchment area. The analysis revealed that the difference in performance was largely determined by two factors: the age of the store and the local population density, which differed greatly between stores situated in urban areas and those in rural areas. Secondary factors included store location and the proximity of a specific competitor. The recognition of these drivers was critical to setting the right priorities for developing and rolling out the new format.

If retailers engage in root cause analysis and keep in mind their diagnostic findings during planning and execution, they will be richly rewarded in the subsequent phases of format development. Any such efforts should also take advantage of the brand management tools as introduced in the previous chapters, namely segmentation and brand funnel analysis. For example, a new format should reflect the needs of its primary target
group as derived from a needs-based segmentation (see Chapter 2). Value seekers, for instance, might be willing to tolerate suburban locations and no-frills store design, if only prices are competitive and promotions attractive. Urban convenience seekers, on the other hand, would probably insist on downtown locations and late opening hours, while their price sensitivity would be expected to be much lower. Similarly, retailers can take advantage of the brand funnel (see Chapter 3) to identify opportunities for format optimization or re-invention. Assume, for example, that “can be easily reached” is a key driver in a given retail environment. In this situation, a 24/7 “city” format with reduced floor space and a limited assortment might provide significant growth opportunities. Many retailers find it helpful to use the brand pentagon, as introduced in Chapter 3, to log these and other insights from various sources, and revisit them at later stages of the format development process.

**Step 2 – Incubate: What shape should the new format take, and how can retailers ensure profitability?**

The next step involves specifying the cornerstones of the future value proposition and designing the new format. To do this, the retailer needs to align the vital elements from a shopper’s perspective with one another to make it unmistakably clear what the new format stands for in terms of location, assortment, price, in-store experience, and service (Exhibit 4.3). Experience shows that sustainably successful formats are clearly superior to those of competitors in one or two dimensions of the brand pentagon, and achieve at least the average of their competitors in all others. In addition, it is crucial to treat format design not in isolation, but in conjunction with the definition of a retailer’s overall value proposition and brand promise; compare the checklist for brand promise definition in Chapter 3. As the most important and most visible embodiment of what a retail brand stands for, the format should fully reflect the brand identity and its core attributes. Imagine, for example, a retailer that communicates “accessibility” as one of its core brand attributes, but fails to provide sufficient parking space. Shoppers would rightly be disappointed and take their business elsewhere.
It is also important to check how possible changes to the value proposition will affect a retailer’s business model, especially its support functions such as purchasing, store processes, or logistics. These factors will determine the economic feasibility of the new format. Hence retailers are well advised to draw up a solid calculation of the expected positive effects and the estimated costs of format revision. For example, twice-daily delivery of fresh foods to inner-city locations may be desirable from a value proposition perspective, but might mess up the supply chain and cause prohibitive costs. Often, several iterations will be necessary to find the optimal trade-off between a superior value proposition and a viable business model. For example, a retailer might be able to limit daily delivery to weekdays that are especially heavy in shopper traffic, such as Fridays and Saturdays. At a fraction of the cost, this might still have the desired effect on shopper perception of the value proposition.
A large European retailer managed such trade-offs by conducting three months of cross-functional top management workshops to define the cornerstones of the new format. Once the main issues had been resolved, the various functional departments involved went on to draw up the concept, supported by regular approval rounds with top management. A detailed model for simulating the impact of possible format changes on profitability was perceived as particularly helpful. The model enabled the project team to assess the impact of any changes they had discussed after every workshop, adapting them until the concept met all the requirements.

**Step 3 – Iterate: Which aspects of the new format should the test phase focus on, and how can success be quantified?**

Instead of polishing a new format for too long, retailers should engage in early testing and adapt the concept accordingly. Meticulous planning is pivotal to make this work. Speed, focus, quantifiable targets, and selection of the right pilot stores are key success factors:

- **Speed.** Move to the pilot phase quickly, but allow ample time to run the pilot and incorporate lessons learned into the format prototype.
- **Focus.** Run hypothesis-driven tests and change only one variable at a time to ensure you can track cause and effect. Derive clear insights for fact-based optimization.
- **Quantifiable targets.** Define clear quantitative and qualitative KPIs. Measure pilot performance rigorously. Make sure you evaluate the format, not the execution.
- **Store selection.** Select a diverse mix from stores that are neither too good nor too bad to test the format under normal operating conditions (Exhibit 4.4). Ensure easy access to these stores for the project team. Ideally, put the pilot team on the ground.

Format designs are seldom perfect from the outset, nor can they be. If formats do fail, they are rarely completely flawed. And even successful formats usually have room for improvement. But, often, a lack of systematic pilot design lets subsequent optimization opportunities go to waste.
Step 4 – Ignite: What preparations are required for implementation, and how can retailers foster seamless format rollout?

After planning and testing the new format, the next step for retailers is to prepare the rollout carefully. For example, should the stores be closed completely for the redesign, or renovated in stages during and outside opening hours? It is imperative to consider the pros and cons of these options carefully. Closing may sidestep the problem of customers being inconvenienced by construction work, and the retailer can leverage the “big bang” of a real reopening to its advantage. However, it also means a substantial loss of revenues.

Retailers also have to account for the practical prerequisites of a successful rollout – developing a rollout plan, assigning an implementation team, and preparing a handbook that describes the store switchover process in detail. The rollout plan should put special emphasis on stores
in which the effect is expected to be the greatest. The plans should also make allowances for potential resource bottlenecks and network effects. For example, supplying certain stores with a different assortment may necessitate additional supply-chain capacity. Contingency plans may be required to hedge the risk of initial glitches in logistics. In some cases, regional adjustments to the format may be necessary for a successful rollout.

Of course, change of this kind is never entirely predictable. This fact makes superior process management all the more important. Retailers will want to pay special attention to shopper expectations. For example, the length of the renovation period and the inconvenience it brings about should be minimized to curtail revenue losses. The retailer also needs to send clear and consistent messages about when a given outlet will open again, and what alternatives are available to shoppers in the meantime. Since closing a store completely increases shoppers’ expectations upon reopening, retailers will want to be mindful of potential disappointment in case the changes fall short of what shoppers were hoping for. Generally, postponing the reopening date or unveiling a half-finished store is a proven recipe for disaster. No matter how plausible the explanation, the retailer will never get a second chance to make a good first impression.

Checklist for format rollout

- Start with a mini-wave to test and refine the rollout approach, then roll out in waves of stores.
- Set up dedicated rollout teams to establish a “learning system.”
- Monitor and review store performance closely during and after the implementation of the new format.
- Use top-performing stores from previous waves as training grounds for other store personnel.
- Put dedicated coaches in place during the entire implementation process.
The format development process needs to be supported by systematic project, HR, and communication management

Developing and implementing a successful format is not something that can be done on the side. Developing and refining formats is a top management task. It takes the finest minds and the superior skills of the most motivated teams from all divisions to pull it off. This aspect of format development – “incorporation” – runs parallel to the other four steps, and it forms the bedrock of the entire operation. We recommend a central project office to track progress regularly, to identify potential bottlenecks before they even arise, and to manage interfaces that help avoid silo thinking.

In our experience, seamless front-line implementation is at least as important as concept quality. To account for this fact, retailers will want to incorporate store personnel from the beginning and build their commitment through a series of interactions. A leading European non-food retailer even included members of the store staff in the format renewal project team from day one. Because of this, practical obstacles were recognized and overcome during the design phase, rather than at the last minute of implementation. These team members also helped build on-the-ground acceptance of the format, effectively acting as ambassadors to their colleagues. This retailer also paid great attention to capability building. A training plan for all levels of the organization – from store managers to sales clerks – included orientation days in pilot outlets, as well as follow-up sessions supervised by coaches in the weeks and months after the rollout of the new format.
Format innovation example

Tesco’s virtual “Homeplus” subway stores in South Korea

Recognizing that many Korean customers are focused on getting to and from work, and feel they have little time for supermarket shopping, Tesco created virtual “Homeplus” stores in subway stations in Seoul, meant to blend into people’s everyday lives. The displays are designed to look exactly like those in actual stores, from display layout to merchandise. Using their smart phones, customers can scan QR (quick response) codes and put products in their virtual shopping carts. Once the purchase is confirmed, the merchandise is delivered directly to customers’ homes. More than half a million users downloaded the “scan-and-shop” app within just four months, and online sales increased by 200 percent over the same period. Homeplus has become the number one online store in South Korea and has raised the stakes in the offline market. In the meantime, this idea has also been copied by several other retailers in Europe. (Sources: The Inspiration Room, June 22, 2011; Most Contagious 2011; Penn Olson, September 20, 2011).

Key takeaways – Developing and refining successful retail formats

1. There are two basic types of retail format development: optimization of existing formats, or launch of a new format.
2. The key to successful format development is a systematic, four-step process: investigate, incubate, iterate, ignite.
3. The format development process needs to be supported by systematic project, HR, and communication management.
CHAPTER 5

STORE BRAND PORTFOLIO MANAGEMENT

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In the early days, being a retailer meant opening a store – a single store. Some of the pioneers carry the location of their original premises in their store or product brands to this day – think of Smythson of Bond Street, Hermès 24 Faubourg, or Saks Fifth Avenue. The next phase was characterized by physical expansion: the setting up of new outlets, usually under a single brand. The retailer’s brand became the promise of reliable quality, value, and service, regardless of which outlet the customer bought from.

In our day, leading retail groups are juggling a multitude of networks, formats, and store brands. In part, this is driven by retailers’ aspirations to differentiate their value proposition according to the needs of different customer groups and purchase occasions. In part, it is a side effect of consolidation through mergers and acquisitions. The result is that retailers are left with a portfolio management challenge: does the differentiation afforded by multiple brands or formats outweigh the synergies of a monobrand strategy? Does it pay to launch an entirely new brand for a given country or target group, or should we try to refine the positioning of an existing brand or product? This chapter outlines the BrandMatics Advanced approach, an integrated methodology that creates a robust fact base for retailers’ brand portfolio decisions.
Increasingly, retailers are operating multiple formats and brands under one roof to address a wide range of consumer needs and purchasing occasions.

To address the increasing fragmentation of consumer markets and needs, retail companies have created an ever-wider array of retail formats and brands (see Chapter 2). The purpose of these new formats and brands is usually to offer more targeted propositions for specific customer groups or purchasing occasions.

Tesco, for example, has six different store formats, differentiated by their size and the range of products sold, but all are branded as variants of the Tesco umbrella brand; examples include Tesco Extra (hypermarkets), Tesco Superstores (large supermarkets), and Tesco Express (convenience stores). Most major retailers that did not have a convenience format, such as Tesco Express, before launched new formats in the past two years, most of them under their umbrella brand. Examples include REWE (Rewe to go) in Germany; Denner (Denner Express) in Switzerland; Morrisons (M Local) and Waitrose (Little Waitrose) in the UK; Asda (Asda supermarket) in Northern Europe; and Ahold (Ahold to go).

Ahold, an international retailer present in both the United States and Europe, has differentiated its branding by geography. Its US hypermarkets are operated under the Giant brand, while its outlets in the Netherlands and Sweden are branded as Albert Heijn and ICA respectively. The reason Ahold operates different brands in different countries is rooted in its history of non-organic growth: while the Netherlands represents the company’s home turf, the US business was acquired, and ICA is part of a joint venture. In Sweden, ICA itself runs an umbrella strategy not unlike that of Tesco, with sub-brands including ICA Maxi, ICA Kvartum, and ICA Supermarket.

Inditex, to take a fashion example, also operates a sizeable portfolio of brands. In total, the Spanish group runs 5,618 stores in 84 markets, according to company information (August 2012). Store brands include Zara (including Zara Home), Bershka, Massimo Dutti, Pull and Bear, Oysho, Stradivarius and, as the most recent addition, Uterqüe (launched in 2008).
In all such cases, the increasing proliferation of formats and brands brings about entirely new management challenges for retail companies. How does an additional brand or format affect the others in the portfolio? What is the real cost of introducing a new brand? How does the management of a wide range of formats or brands differ from a mono-brand approach? Are we losing efficiency if we scatter our marketing funds and resources over multiple brands?

These concerns have led to a drop in enthusiasm for adding new retail brands in the recent past. More and more retailers have gone from a multi-brand strategy (several individual brands) to an umbrella brand (multiple, yet related, brands under the same roof) or a mono-brand strategy (single brand), and are often housing multiple formats under one brand. The umbrella and mono-brand strategies are clearly superior to a multi-brand portfolio in terms of efficiency, for example, in terms of advertising expense and image transfer. The downside is that they provide less flexibility and differentiation for addressing the needs of different customer segments. Carrefour in France is, perhaps, the most prominent example of brand consolidation in retail. In 1999, Carrefour merged with Promodès and added the Champion brand to its portfolio. This situation remained unchanged until 2007, when Carrefour rebranded six of the Champion stores in Brittany as Carrefour for test purposes. The test was successful, and, as a result, Carrefour decided to rebrand the entire network of more than 1000 Champion stores as Carrefour over the course of the next two years. (Sources: Financial Times, March 13, 2009; Ouest France, September 27, 2008.)

Germany’s Edeka has taken the umbrella brand to all formats except discount (Netto) and specialty retail, but allows for a certain differentiation by adding subtitles for different formats, e.g. “Edeka nah & gut” (close and good) or “Edeka Center” (E-Center).

But how do you determine what is right for your company? What are the criteria you should use to define the optimal store brand portfolio? Which brands have the highest potential to serve the different customer segments successfully? The challenge for retailers is to increase profitable penetration without creating more management complexity and inter-brand cannibalization than is absolutely necessary.
**BrandMatics Advanced** allows retailers to assess the real economic impact of brand portfolio management decisions

To address these questions, McKinsey has developed a systematic portfolio management approach that enables retailers to derive and manage multi-brand strategies: BrandMatics Advanced. It informs the assessment and evaluation of brand consolidation, new brand introduction, or the acquisition and integration of new retail brands or formats. BrandMatics Advanced is based on the three golden rules of brand portfolio management:

- **Take a full P&L perspective**: Assess the top-line impact as well as the marketing and format cost implications (see an example of this in Exhibit 5.1).
- **Don’t neglect interdependencies**: Assess spill-over effects on other brands and the potential risks of any changes being considered.
- **Make a discernible difference**: Translate the new portfolio strategy into action and make it work.

<table>
<thead>
<tr>
<th>Illustrative retail P&amp;L</th>
<th>Hypotheses on the effects of a rebranding</th>
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</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>Increase in customer attractiveness</td>
</tr>
<tr>
<td>COGS</td>
<td>Potential adjustments on the format and/or the degree of company-internal value-add</td>
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<tr>
<td>Gross profit</td>
<td>Potential adjustments on the format and/or the degree of company-internal value-add</td>
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<tr>
<td>Personnel costs</td>
<td>Almost no effects</td>
</tr>
<tr>
<td>Other store-related costs</td>
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<tr>
<td>Marketing costs</td>
<td>Reduction due to the realization of economics of scales in marketing</td>
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<tr>
<td>Other head-quarter costs</td>
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<tr>
<td>Operating profit</td>
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**Exhibit 5.1** P&L effects of store brand portfolio management – an example.
Use the brand space map to derive different portfolio scenarios, **then evaluate them with the help of customer conversion value modeling**

For the retailer to be able to assess the sales impact of any changes to its brand portfolio, it needs to simulate potential customer migration between brands. In retail, this is more complex than in other industries because of local differences. To ensure a robust simulation of top-line impact, McKinsey has devised a three-step process.

**Step 1: Situation analysis: which positions in the brand space are covered by the different retail brands?**

Only a thorough analysis of the relative positions of the retailer’s own brands and those of its competitors can reveal any weaknesses in its portfolio, as well as any opportunities for further growth. The tool of choice for this purpose is a two-dimensional map that plots the brands according to their specific positioning in the market (see Exhibit 5.2).

The brand position map is derived from the brand’s drivers (see Chapter 3 for details). The closer a brand is to a given arrow head at the border of the map, the stronger is its performance in terms of that respective driver. Exhibit 5.2 shows, for example, that Discounter B is perceived as the price leader. It also shows that the different retail formats stake clear positions in the brand space (e.g. discounters versus supermarkets). While discounters show a good performance regarding “low prices” and “promotions,” supermarkets are perceived as strong in terms of the level of service offered. In other words, customers have a clear and distinct perception of how the value proposition differs across the different retail formats, and this perception is directly linked to the individual brand drivers. In this example, this means it might be difficult to use the same brand across multiple formats. Consumers may be confused or even put off by a retailer that tries to carry over its discount brand into its supermarket format.

Once all your brands are plotted on the brand space, both the unclaimed areas (the “white spots”) and the over-served segments (the “consolidation opportunities”) immediately become apparent.
Step 2: Scenario development: what scenarios are possible?

Is it possible to reposition individual brands to gain more customers? Are there any brands in the portfolio that should be eliminated or consolidated with another brand? Are there any white spaces that call for the launch of a new format or brand? The brand space map is the reference point for answering these questions. For example, if you consider launching a new retail concept under a new brand, this should be plotted into the brand space alongside the existing brands. Likewise, if you consider repositioning an existing format or brand, then to see how this fits into the retail landscape is simply a matter of moving its present position on the brand map to its target positioning.

Until 2006, the store brand portfolio of Germany’s REWE Group consisted of several store brands all focused on the same format (large supermarkets): e.g. miniMal, HL, Otto Mess, Stüssgen and Petz. (Sources: Nina Trentmann, “Eine Marke für den Markt,” Die Welt, June 22, 2007;
“REWE: on the attack,” Datamonitor News, January 25, 2007; Susan Hasse, “Immenser Kraftakt,” Lebensmittelzeitung, September 29, 2006.) Some of these brands were just regional brands (e.g. Otto Mess and Stüssgen), while other brands were national brands (e.g. miniMal and HL). REWE could have kept all the individual brands extant so as to achieve maximum penetration in the large supermarket format (a multi-brand strategy). Alternatively, the group could have consolidated all its large supermarkets under the same brand (a mono-brand strategy). Inditex found itself in a similar situation as it also had multiple brands, though in fashion retail rather than grocery. We will follow what these companies did and how they fared in the following section.

Step 3: Scenario evaluation: what is the business impact of the different scenarios?

In order to assess the business impact of various repositioning scenarios and other portfolio moves, you have to simulate future customer migration. Since every change in positioning alters the balance of strengths and weaknesses of a brand, it will also change its attractiveness to specific customer groups. The brand purchase funnel can be used to determine how this change in attractiveness will affect customer decisions, producing a reliable estimate of how many people will buy from the new or adapted format or brand. This approach is often referred to as customer conversion value modeling (see Chapter 3 for details).

Any change that is made to a given retail format or brand also has implications for other brands in the same market. To account for these feedback effects, you will also need to estimate internal migration (“cannibalization”) as well as external migration (“participation”) in order to derive the net impact. In other words, you will need to get a sense of how many customers will switch brands as a result of your repositioning scenarios, both within your own portfolio and across retail companies (Exhibit 5.3).

Let us return to the examples of REWE and Inditex. The two companies opted for different strategies. While Inditex still runs a multi-brand store portfolio strategy, the REWE Group rebranded most of its large supermarket stores, including miniMal and HL, as REWE. The benefits to REWE are
clear: the rebranding of its stores not only strengthened REWE’s brand image, but also helped improve and expand its private label range. REWE’s own brand took the place of a wide range of private labels, such as Erlenhof and Salto, thereby generating additional economies of scale. (Source: Christian Lattmann, “Handelsmarken zahlen auf die Händlermarke ein,” *Lebensmittelzeitung*, May 30, 2008.)

**To assess the full impact of a portfolio move,**

*estimate the one-time rebranding cost, changes in continuous marketing cost, and potential risks and synergies*

To get from the top-line to the bottom-line impact of a given scenario, you need to estimate its cost effects. Typically, the one-time cost involved in (re-)launch, repositioning or rebranding efforts is the biggest single position – but changes in marketing costs, especially advertising spend, should by no means be neglected.

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### Exhibit 5.3 Brand switcher analysis to determine net scenario impact.

<table>
<thead>
<tr>
<th>Customer movement</th>
<th>Participation from</th>
<th>In EUR millions</th>
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<tr>
<td></td>
<td>Competitor 1</td>
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<td></td>
<td>Competitor 2</td>
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<td>Competitor 3</td>
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<td></td>
<td>Competitor 4</td>
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</tr>
</tbody>
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### Positioning scenario: New store brand

- **A**
- **B**

Cannibalization from existing store brand...

Net effect...
The **rebranding cost** includes all the expenses necessary to rebrand outlets or offices, administrative buildings, in-store merchandising, letterheads, and other materials; this has a negative impact on the cost base of the company. Proven sources for estimating this effect include expert interviews and case studies of previous rebranding efforts. REWE, for example, set aside some EUR 60 million (USD 47.6 million) in 2006 to bring all the group’s 2,600 stores under the REWE brand. (Source: Susan Hasse, “Immenser Kraftakt,” *Lebensmittelzeitung*, September 29, 2006.)

The **impact on advertising expenditure** depends on the required brand investment and potential advertising synergies. In general, fewer brands mean higher advertising spend synergies, for instance, because of standardized communication processes, lower creative agency fees, and higher volume discounts for specific marketing vehicles, such as leaflets. Key sources for estimating the changes in advertising cost include expert interviews, internal cost data, or competitors’ ad spend, as observed by tracking agencies.

As well as calculating the expected costs of brand portfolio moves, you will also want to anticipate the potential risks involved. This is particularly important in the case of brand consolidation. Often brand consolidation is carried out in order to bring the stores of a “weaker” or smaller brand or format under the umbrella of a “stronger” or bigger brand or format – as in the case of Carrefour’s integration of Champion in France or REWE’s rebranding of miniMal stores as REWE stores. In such cases, retailers should be wary of potential negative spill-over effects. Adding less attractive store locations, or stores of inferior look and feel, that previously belonged to the discontinued brand can weaken the overall perception of the stronger brand. This effect needs to be reflected in the top-line assessment. In general, mono-brand and umbrella brand strategies are also more vulnerable to scandals or other reputation-related issues than multi-brand strategies. If one brand is severely damaged, multi-brand players can offset the negative effects with their other brands to some extent. A mono-brand player, however, will feel the downside across its entire network.

Of course, brand consolidation also affords substantial synergies. Leveraging a single, strong brand across multiple formats makes for more efficient communication and less organizational complexity. What
is more, the positive perceptions associated with a strong brand can often be carried over to stores previously operated under other, less prominent brands. Retailers contemplating brand consolidation will want to consider the potential risks as well as the expected synergies carefully before they go ahead with any re-branding efforts.

BrandMatics Advanced can be used not only to manage existing store brand portfolios, but also to analyze and optimize the portfolio of branded goods and private label products it features in a given format. In many sectors and countries, an increase in store brand strength is accompanied by the growing importance of private label products in retailers’ assortments. In the past, private labels were often perceived as the affordable alternative to manufacturer brands. But as branding evolves into a source of differentiation for retailers, private labels start playing a more strategic role. The next chapter (Chapter 6) will explore this changing role of private labels in more detail, paying particular attention to late-generation private labels which, increasingly, are evolving into brands in their own right. The more private label items compete directly with manufacturer brands, the more you will have to depend on sophisticated portfolio management approaches for determining the optimal mix of products in your stores.
Putting brand positioning into action

Once you have selected a specific scenario for implementation, the next step is to make the changes work. Each brand, be it repositioned, consolidated or launched from scratch, should have its own, distinct profile and value proposition. Imagine, for example, that you have decided to reposition a specific retail brand to increase its service orientation and, ultimately, attract additional customers. How do you bring the service aspiration to bear on daily operations? In a given case, the analysis of the influencing factors of “good service” revealed that the guarantee period granted to customers was one of the key drivers of service perception. But how long is long enough? A deep dive showed that prolonging the guarantee period from six months to one year increased customer satisfaction by 20 percent, while prolonging it from three to five years only added an extra 9 percent. Conducting similar calculations across all key touch points can help retailers to determine the concrete operational changes that will generate the greatest value for a new or repositioned brand. For details on brand promise and brand delivery, please see Chapter 3.
Key takeaways – Store brand portfolio management

1. Increasingly, retailers are operating multiple formats and brands under one roof to address a wide range of consumer needs and purchasing occasions.
2. BrandMatics Advanced allows retailers to assess the real economic impact of brand portfolio management decisions.
3. Use the brand space map to derive different portfolio scenarios, then evaluate them with the help of customer conversion value modeling.
4. To assess the full impact of a portfolio move, estimate the one-time rebranding cost, changes in continuous marketing cost, and potential risks and synergies.
Private labels used to be positioned at the bottom of both the shelf and the price range, often as quick fixes to accommodate dips in consumer spending during periods of recession. Those days are gone. Private label brands are here to stay, and they have conquered new territories beyond “no frills.” The latest generation of private labels is, in fact, venturing into premium segments as well as consumer niches. While this promises higher returns and greater opportunity for differentiation, it also means that retailers find themselves competing head to head with brand-name manufacturers. To tackle this twofold challenge, this chapter presents a simple, yet systematic framework that helps retailers to answer three basic questions.

- What is the most promising private label branding strategy?
- Which categories have the highest potential?
- Which capabilities do retailers need to deliver on their private label strategy?
Private labels are here to stay: their share is growing across countries, sales channels and product categories

The share of private labels, or PL, is growing in most major European markets and in the US. With a PL share of more than 42 percent, the UK has the most developed PL market in Europe, followed by Spain with 38 percent (Exhibit 6.1). Spain in particular has seen spectacular PL growth in previous years (e.g. +13.3 pp share gain between 2007 and 2010), whereas in Germany PL have stagnated in 2008/09 and even lost market share in 2010.

Initially, PL growth was driven mainly by discount retailers, but now mainstream retailers are just as active in this area. Although the PL share of classical grocers in Germany is just 14.2 percent, this market segment

Exhibit 6.1 Private label value market shares.
PRIVATE LABEL BRANDING

has the highest PL growth rate. According to Nielsen Markettrack, it was growing at 16.3 percent between 2007 and 2008. Leading retailers in the UK already have a PL share of more than 45 percent. Although PL shares vary by product category, there is a clear growth trend that spans almost all categories (Exhibit 6.2).

To a large extent, this growth is triggered by consumer behavior. Economic crises usually favor the development of private labels: consumers buy as much as ever, but at lower prices. In essence, they switch to cheaper alternative products (“consumer downtrading”). Private labels allow consumers to get a very similar product at a lower price – without the added emotional value provided by an A-brand. But, often, consumers’ PL product experience is positive. As a result, they don’t return to their original, more expensive product even when the crisis is over. This effect is evident in a long-term overview of the PL share, as presented in Exhibit 6.3 (US food example).
But consumer downtrading is by no means the only reason for PL growth. Historically, growth has been continuous and was driven by many factors, including retailer consolidation, increasing retail marketing sophistication, the growth of hard discounters and increasing consumer acceptance.

For obvious reasons, retailers don’t mind. For them, PL growth is a strategic priority because of the multiple benefits it affords:

- margin advantages derived from value chain integration;
- coverage of a wide range of price bands to cater to all customer budgets;
- the opportunity to use private label products to strengthen the retail brand itself and foster customer loyalty.

When almost every retail chain is stocking the same “must-have” brand-name products, private labels increasingly become instruments...
of differentiation for retailers. Recent figures for Germany provided by GfK confirm that mid-tier and premium private labels are currently the fastest-growing segment in the German market (Exhibit 6.4). As a result, less prominent manufacturer brands find themselves under increasing pressure.

But brand-name companies are fighting back. And for the first time, they seem to be making some headway, successfully deploying higher advertising pressure, promotions, and new basic ranges to recapture market share from PL after the most recent crisis (compare Exhibit 6.1 above). For example, Procter & Gamble has successfully introduced “basic” brands, positioned at lower price points than the established brands in their portfolio, in a range of product categories such as toilet paper, paper towels, diapers, and detergents. These and similar moves have resulted in a loss of market share for entry-level private labels for the first time in 2009.
PL – the Achilles’ heel of brand manufacturers?

Because of the persistent market share gains of private labels, brand manufacturers are under increasing pressure to take action. This is especially true for mid-segment brands, that is, B- and C-brands that are neither especially innovative nor perceived as particularly strong brands by consumers. Yet most brand manufacturers are hesitant to enter the PL business, either independently or in cooperation with retailers. They fear a loss of focus and identity, but most of all, they fear the negative impact on their A-brands. Will consumers still pay extra for A-branded product if they can get what they perceive as similar tangible benefits at a much lower price?

A recent study by the University of Hamburg, overseen by Professors Sattler and Clement, has shown that manufacturers don’t have much reason to worry in most cases – at least not about the short-term effect on consumer perception. In fact, most consumers simply assume that brand manufacturers also produce PL products, regardless of whether this is really the case. For example, noted personal care player Beiersdorf, the company behind the Nivea brand, expressly states that it does not produce any PL products. Even so, many consumers believe it does, usually because of the remarkable similarity between Beiersdorf’s Nivea brand and the PL brand “Balea” in terms of packaging, logo and brand name. Yet in reality, Balea is owned by dm, a drug store chain. In particular, Beiersdorf does not manufacture products sold under the Balea brand.

But the good news according to the study is that this kind of assumption, faulty as it may be, doesn’t usually damage manufacturers’ A-brands. There are some exceptions: market segments dominated by emotionally charged brands, consumer target groups characterized by high quality consciousness, and product categories with high consumer involvement. In these cases, brand manufacturers would have good reason to be sceptical about being associated with PL brands or products. For details, see Henrik Sattler, Was ist in der Handelsmarke?, Hamburg 2009.
PL has evolved beyond its origins in generic products and value segments. The most recent PL generation is even venturing into the premium segment

As we noted at the beginning of this chapter, retailers used to position private label products at the bottom of their shelves and at the bottom of their price architecture. But private labels have evolved from cheap alternatives in the entry-level price segment all the way up to the premium segment. Today, PL brands cover almost all product categories and price segments. They have become an integral part of most major retailers’ category strategy. As a result of their expanding presence, different PL tiers serve different objectives.

- In the entry-level price segment, classical retailers use PL products to defend market shares in their daily battle against discounters.
- In the higher price-level segment, retailers use PL to strengthen their retail brand (especially its perception as a provider of “value for money”), create sustainable competitive differentiation and increase customer loyalty.
- Across all price segments, the greater control over the value chain afforded by PL ensures savings in sourcing, marketing and selling costs compared to branded products. These savings are typically split between consumers (in the form of lower prices) and retailers (in the form of higher margins).

This differentiation of PL objectives has spawned four distinct types of PL strategy, also known as the four generations of PL. Although they have entered the market one after the other, they now exist in parallel (Exhibit 6.5).

The first and second PL generations mainly help retailers create a competitive offering in the entry-level price segment, thus improving their perception as providers of value for money. This strategy serves to defend a company’s market position, particularly against discounters, by offering lower-cost alternatives to the leading brand or brands. In most cases, this strategy seems to be working. Quantitative analyses have demonstrated...
that PL is one of the top drivers of value-for-money perception in the largest European markets. For these early PL generations, brand perception and image are only of secondary importance. Although there is a long-term trend towards more differentiated PL in higher price bands, the latest economic crisis has engendered a revival of second-generation PL products. Since many consumers are switching to lower-priced products, traditional retailers have launched massive advertising campaigns promoting their own entry-level price brands to prevent customers from churning to discount stores altogether. In Germany, Edeka’s low frills “Gut & Günstig” brand is perhaps the most prominent example of this strategy.

But today, PL isn’t only used by retailers to drive their value-for-money perception. The increasing sophistication of retailers’ brand portfolio management has given rise to third and fourth generation PL products that venture into categories and price bands previously deemed unattainable for private labels. Third-generation private labels are those that present consumers with a direct alternative to the national market leader, and produce

<table>
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<tr>
<th>Description</th>
<th>1st generation Generics</th>
<th>2nd generation Value</th>
<th>3rd generation NBE</th>
<th>4th generation Premium/niche</th>
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<td>Low prices in generic product categories</td>
<td>Lowest possible prices for basic, ‘no frills’ products</td>
<td>Same quality as brand leader at a better price</td>
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<td>• Offer consumers better value for money</td>
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<td>• Improve retailer’s price perception and defend against discounters</td>
<td>• Improve retailer’s price perception and defend against discounters</td>
<td>• Increase bargaining power and margins</td>
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<td></td>
<td></td>
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<td>Tesco Organic</td>
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1 NBE = national brand equivalents
SOURCE: Bruhn 1997

Exhibit 6.5 Four generations of PL.
higher retail profit margins than A-brands – although not always higher absolute profits, because of the lower ticket prices. Third-generation PL puts retailers in direct opposition to the leading brand manufacturers. The main strategic objectives of this PL generation are to improve margins, to reduce the dependence on A-brand suppliers and create negotiation leverage, and to foster customer loyalty.

In general, third-generation PL is a more strategic game than the more tactical earlier generations. Consequently, retailers usually launch third-generation PL products in several product categories and make consumers become gradually more aware of this PL generation as a real brand, not just as a range of cheaper, alternative products. Today, most national brand equivalent (NBE) PL brands are branded with the retailer’s own brand name.

The fourth generation of PL brands is tapping into the higher price ranges as well as into specific niche target groups. These PL products are usually priced at or above the level of premium products, either because of their superior quality or because of some other special benefit, e.g. organic ingredients. Premium PL brands are often used in categories where there are no strong brands, effectively making the PL the reference brand. Examples include ready meals or fresh products like fruit, vegetables, and meat. Most retailers carrying several PL generations have defined a portfolio of PL brands to ensure they cover all the various product and price segments. Take German grocery retailer Edeka, for example. Alongside its classic low-priced own brand “Gut & Günstig,” Edeka uses PL brands such as “Edeka Bio” to reach selected target groups, while its “Edeka Selection” brand targets various categories in the premium segment.

Consumer electronics retailing is another instructive if recent example of the rise of PL across generations. Electronics retailers have been slow to jump on the PL bandwagon, chiefly because of the above-average brand relevance in the category. Relying on major manufacturer brands as tokens of innovation and quality, consumers have traditionally favored branded devices to reduce the risk involved in a high-price purchase. In contrast, electronics PLs have mostly been associated with limited features, poor quality, and limited reliability. As a result, retailers have been hesitant to put their name on PLs until very recently, presenting consumers with nondescript, generic private labels or no-name OEM equipment instead.
But the tide is turning. All over the world, leading consumer electronics retailers are deploying a new generation of PLs. In the United Kingdom, for example, Dixons has created a refined private label architecture in 2010. They have introduced “good,” “better,” and “best” PL tiers, represented by Essentials, Logik and Sandstrom respectively. Their traditional, Japanese-sounding Matsui PL has been discontinued. Dixons use PL especially in high-margin categories like cables, wall mounts, and other accessories, where there are no strong brands, rather than for large appliances and audio-visual equipment. As a non-specialist, the supermarket Tesco successfully introduced Technika as its audio-visual PL brand. Argos has supplemented its own PL range by acquiring long-established brand names like Alba and Goodmans to use them for audio-visual products. The only exception is Comet, the no. 2 in the market, which does not really leverage PL at all so far.

Germany’s largest consumer electronics retailer, Media Markt, launched its PL portfolio as recently as 2010, introducing a total of four PL brands:

- OK as an entry-level range for all types of devices from small appliances to LCD TVs;
- Koenic for high-quality small and large household appliances, comparable to A-brands;
- Peaq for consumer electronics, positioned as an A-brand for demanding consumers;
- Isy for accessories.

In the Americas, Best Buy is using PL to create discernible competitive advantages. Industry experts estimate that as much one fifth of Best Buy’s revenue is already derived from private labels such as Dynex, Rocketfish, and Insignia. In Australia, Dick Smith offers more than a thousand SKUs under its own name, ranging from accessories such as cables, chargers, and batteries to high-ticket-price items such as DVD players and TV sets. On the company’s website, the Dick Smith PL is proudly listed alongside the likes of Samsung, Sony, and Apple in the “Brands” pull-down menu.

So PL is growing across countries, sales channels and product categories. Increasing PL differentiation has given rise to PL portfolios that
frequently extend over multiple product categories and comprise more than a single no-frills white label. Many of these brands are connected with the retail brand by way of umbrella branding or endorsement. As a result, PL management has become much more complex than yesterday’s tactical selection of SKUs. Under these circumstances, retailers need a much more professional PL management approach. Key questions include:

- What is the most promising private label strategy, price tier and brand?
- Which categories have the highest PL potential?
- Which capabilities are required to deliver on the PL strategy?

**PL – only in low-involvement categories?**

Until very recently, the most basic assumption about PL read as follows: the higher the brand relevance in a given product category, the lower the share of private labels. An empirical study conducted by McKinsey & Company and the Marketing Centrum at the University of Münster (MCM) put this hypothesis to the test. Brand relevance was measured for selected categories in three dimensions: prestige, risk reduction, and information efficiency. According to this research and market share data from GfK and Nielsen Markettrack, categories with the highest brand relevance score, e.g. cigarettes and beer, had, in fact, the lowest PL share. Medium brand relevance scores and respective medium PL shares were measured in categories like shower gels and coffee. The lowest brand relevance scores among the categories in scope were observed for paper tissues and wrapping foil. In line with the original hypothesis, these categories also showed the highest PL share in the market. However, the more recent third and fourth generations of PL could change this picture. As consumers increasingly perceive private labels as real brands, these may stand a higher chance of succeeding in categories with higher brand relevance. This is especially true for categories in which retail brands enjoy high credibility, such as food.
These questions are reflected by the simple, yet systematic “3D” approach presented below (see Exhibit 6.6).

- **Define** brand strategy and brand architecture for PL based on strategic objectives.
- **Design** category structure: identify the most relevant categories for profitable PL growth.
- **Deliver** on brand building and portfolio management: build capabilities for excellent implementation.

**Exhibit 6.6** “3D” approach to PL management.

As the foundation of sustainable PL success, retailers need to define their PL strategy, particularly an appropriate price and brand architecture.

Successful PL management starts with the definition of the right price tier derived from your strategic intent when launching or extending a PL
range. The introduction of a first-generation value range, for example, will help retailers to defend their volume against discounters, whereas the launch of a premium PL range might help to attract previously inaccessible customer groups, drive competitive differentiation, and help build customer loyalty. In any case, the purpose and proposition of the PL should reflect your overall strategy.

Once the proposition for the PL range is spelled out, the right branding for this range needs to be defined in the context of your overall PL brand architecture. There are two different basic PL branding strategies, with a range of hybrid strategies in between.

**Umbrella brand strategy**

The umbrella brand name, often the retail brand itself, is also used as a private label brand name, sometimes with a supplement or a descriptive attribute that explains the sub-brands. The value proposition and image of the umbrella brand is, thereby, transferred to the private label products. The entire brand portfolio profits from the umbrella brand’s credibility and sympathy. Umbrella branding offers clear efficiency benefits, e.g. because of communication spill-over effects. In this strategy, the product brand influences the umbrella brand and vice versa. Therefore, umbrella branding is recommended if you have a strong umbrella brand with a positioning that is relevant in the chosen PL product segments. The key challenge results from the fact that the umbrella brand is usually positioned quite broadly without addressing the specific purchase drivers of individual product categories. Tesco is perhaps the most prominent proponent of umbrella branding: they have “Tesco” on all their PL brands. Only recently have they launched a discount range with no reference to the Tesco brand. Many other retailers use their retail brand as the umbrella brand for their third- and fourth-generation PL ranges, but use a different brand for their value range to protect the retail brand from any “discount” associations. Albert Heijn follows a similar strategy with “Euroshopper” as their price entry range and Albert Heijn-branded products in higher price tiers.
Individual brand strategy

In this strategy, each brand in the PL portfolio is autonomous. Individual PL brands shape the image of the retail brand only indirectly, e.g. through their product value proposition and positioning, depending on how much transparency consumers have about the link between the PL brands and the retail brand. Aldi and Lidl are prominent examples of this strategy, given their portfolios of stand-alone PL product brands that are not connected to the respective store brands. Individual PL brands are particularly useful for market segments in which the umbrella brand carries no discernible benefits that are relevant to consumers. This strategy is also suitable for niches where it is crucial to avoid any association with the retail brand. While individual brands allow for greater differentiation, they are less efficient in terms of communication.

To select the most promising SKUs for a given PL effort, it is imperative to design the category structure with a profitable growth mindset

Besides the right branding, retailers need to identify the product categories in which PL will drive profitable growth. This is done by way of a category-by-category assessment based on economic criteria, especially volume and margin potential. For more differentiated niche efforts, such as organic or children’s PLs, growth or profit potential in a specific target group might serve as additional criteria. Especially for first-, second- and third-generation PLs, volume is the most important success factor because of its direct impact on costs and sourcing flexibility. As demonstrated by the brand relevance study quoted above, PL consumer acceptance is generally higher in commoditized market segments. However, in highly commoditized markets, the margin potential may be limited, making volume even more important. The more manufacturers of A-brands spend on marketing and distribution, the higher the margin potential for retailers through backward value chain integration. But in categories or markets with high brand relevance, it often also takes higher price discounts to drive
penetration. This makes it difficult to hit exactly the right price points for a given PL effort. The retailer’s challenge is to find the sweet spot between volume and margin potential.

**To capture the full benefit of PL, retailers need to match the sourcing, manufacturing, and marketing capabilities of brand manufacturers**

The more PL brands become “real” brands, the more retailers find themselves in direct competition with brand manufacturers. At the same time, PL management is very different from the purchasing of manufacturer brands. Retailers need to optimize the value chain all the way back to product specification and production. In the case of first- and second-generation PL, low-cost sourcing is the main additional success factor. But third- and fourth-generation PL ranges take retailers much closer to consumer goods companies in terms of tasks and necessary capabilities, e.g. regarding the specification of products, supplier selection, quality control, and brand building. Fourth-generation PL brands, in particular, require extra attention to product development and innovation abilities, since these brands are differentiated through the novelty of products, excellent quality, and strong value propositions for selected target groups.

While end-to-end management of the value chain is a new challenge for most retailers, they also hold a fundamental advantage over consumer goods companies. Successful PL management requires a deep understanding of consumer behavior, and retailers usually have the best data because of their direct customer relationships. While consumer goods manufacturers will have to conduct costly market research to investigate consumer needs, retailers can simply tap into their pool of transaction and loyalty data.

But retail’s structural advantage doesn’t stop at shopper insights. Direct customer contact also holds opportunities for higher marketing efficiency. In recent years, due to heavy media fragmentation and competitive noise, it has become more and more difficult and expensive for manufacturers to reach broad consumer groups with their brand messages. Retailers, however, own the point of sale and can leverage it as a key element of their
marketing mix. This enables them to reach out and touch their customers every day – a valuable competitive advantage in communication.

The overarching strategic challenge for retailers is to stay on top of category management and ensure consumers find a healthy mix of PL and relevant manufacturer brands in their stores. Yet, complex as it may seem, PL is definitely worth the effort for retailers. According to a joint study by AC Nielsen and McKinsey & Company, retailers with above-average PL shares stand out from their peers in terms of market share and customer loyalty. Usually, they also achieve higher profit margins. So don’t hesitate to reclaim some of the shelves in your store for your own brands!

**Key takeaways – Private label branding**

1. Private labels are here to stay: their share is growing across countries, sales channels and product categories.
2. PL has evolved beyond its origins in generic products and value segments. The most recent PL generation is even venturing into the premium segment.
3. As the foundation of sustainable PL success, retailers need to define their PL strategy, particularly an appropriate price and brand architecture.
4. To select the most promising SKUs for a given PL effort, it is imperative to design the category structure with a profitable growth mindset.
5. To capture the full benefit of PL, retailers need to match the sourcing, manufacturing, and marketing capabilities of brand manufacturers.
Part II

Optimizing Marketing ROI
Most advertising vehicles are a lot less glamorous than the motor vehicles that grace the pages of *How To Spend It*, the monthly magazine on lifestyle and luxury that comes with the weekend edition of the UK’s *Financial Times*. However, “How to spend it?” is the very question that governs media mix optimization: once you know which messages to convey and what the total size of your budget should be, it is all about how to spend it. While this may not be the most entertaining exercise, there is nothing as effective as a perfectly balanced media mix for driving a retailer’s marketing ROI. If you play it right, you may have the means to read *How To Spend It* with a more urgent sense of interest than before.

To support retailers in their efforts to spend their marketing funds in value-creating ways, this chapter outlines recent changes in the media landscape and introduces the three principal media mix optimization approaches:

- testing and learning;
- comparative heuristics;
- econometric modeling.
The media landscape is in rapid transformation, and the media mix used for advertising differs substantially across industries and between countries

The media landscape is changing at breakneck speed. For example, while the average German household had access to fewer than ten TV channels in the late 1980s, in 2012 they have a choice of over 300. The number of radio stations has quadrupled over the same period, now also numbering more than 300. The same is true in most other European countries and elsewhere. And there is no end in sight.

So, is this a golden age for advertisers? Not quite. Today’s environment is characterized by multiple media and hybrid usage: as a result, targeted marketing is anything but a walk in the park. The average consumer is subject to 1,300 commercial stimuli every day, up from a mere 170 in 1980. Advertisers are battling for the consumer’s limited attention and involvement. As in any battle, there are winners and losers. While digital media are on the rise, the impact of traditional channels is dropping. According to an analysis conducted by McKinsey & Company in the US, TV commercials have lost much of their effectiveness within the last 20 years. (Source: David C. Court, Thomas D. French, Trond Riiber Knudsen, “Profiting from Proliferation,” McKinsey Quarterly, March 2006.) In general, consumers have become more educated as media users and more critical of commercial messages. Also, they are becoming accustomed to multimedia campaigns, leaving them potentially less receptive to traditional communication plans. At the same time, retailers have experienced an explosion of shopper data, collected both offline and online. Based on insights derived from these rich sources, new and more targeted retail marketing instruments are taking hold: customized electronic newsletters, personalized direct mail, or leaflets distributed with the help of high-resolution geo-marketing tools, to name but a few.

Because of the dynamics of their business and the privilege of their direct access to customers, retailers typically use a media mix which differs discernibly from that of advertisers in other top-spending industries. In classical above-the-line communication in Germany, retailers rely mainly on print advertising (62 percent), while the food industry favors
TV commercials (86 percent). Car manufacturers, by comparison, use a more balanced media mix (see Exhibit 7.1). Similar splits for below-the-line advertising are, unfortunately, hard to come by, since most research agencies do not track non-classical vehicles systematically.

Even within retail, there are significant differences across formats and territories. For example, many discount retailers typically rely almost exclusively on print advertising, while many high-profile retailers are increasingly using TV commercials to build their brands. But the regional differences are no less distinctive. A comparison of the mix of classical media used by retailers in Germany, France, and the United Kingdom shows that Germany favors print (62 percent), France is unusually fond of radio (34 percent), and British retail advertising is split almost equally between TV (44 percent) and print (40 percent) (Exhibit 7.2). Retailers operating in multiple countries will want to reflect these patterns in their local media mix.

Exhibit 7.1 Advertising spend by media channel in different industries.
In light of the continuous rise of new media, it comes as no surprise that the average retail media mix is evolving (see Exhibit 7.3 for an example from the UK). During the period 2008 to 2011, online media has seen the biggest growth of any vehicle and now accounts for 3 percent of total spend.

**Exhibit 7.2** Retail advertising spend by media channel in different countries.

In light of the continuous rise of new media, it comes as no surprise that the average retail media mix is evolving (see Exhibit 7.3 for an example from the UK). During the period 2008 to 2011, online media has seen the biggest growth of any vehicle and now accounts for 3 percent of total spend.

**Engage on an equal footing with your media agencies to ensure the media mix is tailored to your needs**

Given this diversity and the rapidly changing nature of the marketing environment, retail marketing managers have a lot to worry about. Is the current media mix still in step with the latest trends? Is the budget distributed optimally between classical advertising, digital vehicles, POS activities, and direct marketing? Are your messages being delivered
effectively and efficiently – at the right time, to promising target groups, using the most appropriate channels, and at reasonable cost? Without conclusive answers to all these questions, the hunt for marketing ROI will always be a shot in the dark.

But isn’t this why retailers hire media agencies? Yes and no. It is true that media agencies are the experts when it comes to the evaluation and selection of marketing vehicles. But they can only help you if you know what you want and understand the constraints of their advice. We believe agencies and retailers should discuss media mix decisions on an equal footing. Media agencies can’t read your mind, nor you theirs.

Most media agencies cover only a part of the whole media landscape. They often have little experience with channels outside their scope, and even less interest in recommending them to advertisers. The same is true for instruments that are within their scope but carry low commissions or incentives for the agency. In addition, agencies typically do not have full cost transparency about the advertiser’s real costs for each channel. In

Exhibit 7.3 Development of retail advertising media mix over time.
many cases, they will have a tendency to focus on the cost of media buying, but neglect creative agency fees and production costs. This means that they can only approximate the advertiser’s real investment, an effect that will inevitably blur the marketing ROI perspective.

There are three distinctly different approaches to media mix optimization: testing and learning, comparative heuristics, and econometric modeling

Testing and learning is the most basic approach: this allows the assessment and refinement of individual activities, rather than providing a comprehensive optimization of the entire media mix. Comparative heuristics enables retailers to compare all media on an apples-and-apples basis, but does not yield absolute ROI figures. This is the purpose of the most sophisticated, but also the most time-consuming and expensive, approach: econometric modeling.

We will now take a look at how each of these three approaches work, at their advantages and disadvantages, and at their applicability.

Testing and learning

• How it works: Testing and learning is about tracking the effects of specific campaigns or other marketing activities. Perhaps the most established example of this technique is the analysis of direct marketing activities that include a response element, e.g. a coupon. The ROI assessment of such activities is calculated as “sales (or profit) triggered by response element” over “campaign cost.” To refine the campaign, retailers test multiple executions of the same concept on a small scale. The winning execution will be selected for wider rollout. Sometimes this approach is also used to track activities that are not directly geared to sales stimulation, such as brand image campaigns. In this case, the retailer would assess the pre-campaign image perception and compare it to the image observed after the campaign. The delta will express the campaign’s “return”; see Chapter 16: “Excellence in Classical Media” for further details.
• **Advantages/disadvantages:** The advantage of testing and learning, because it typically uses customer responses to assess the impact of a campaign directly, is that the refinement of the campaign in question can be very hands-on and detailed – and this does not require complex arithmetical methods. You simply go with what works best and then build on that. But the approach has its limitations; for example, it is often difficult to isolate the effect of the test campaign because of the impact of other marketing activities that are being carried out in parallel.

• **Applicability:** Testing and learning is appropriate for optimizing individual activities, as opposed to the entire media mix, because it is usually impossible to test all campaigns in all channels at the same time. The approach works best for direct marketing activities: if these feature prominently in the marketing mix, or the retailer operates in a market characterized by push marketing, then testing and learning should be the tool of choice. Also, testing and learning makes fewer demands on analytical capabilities than the other approaches featured in this chapter.

### Comparative heuristics

• **How it works:** Comparative heuristics is a way of comparing the relative return of marketing investments at different touch points founded on simple linear algorithms. Based on the definition of a common currency (apples-and-apples comparisons), comparative heuristics enables retailers to compare the performance of multiple marketing vehicles. Based on this comparison, you can make fact-based trade-offs when allocating marketing funds to the various channels and vehicles. The “Reach–Cost–Quality” (RCQ) approach, perhaps the most prominent type of comparative heuristics in use in media mix optimization, makes use of “cost per actual reach” as the single currency across all touch points and channels. RCQ will be described in detail in Chapter 10.

• **Advantages/disadvantages:** Comparative heuristics provides a pragmatic approach for optimizing multiple media, or even the entire media mix, but it does not yield a “dollar-for-dollar” ROI. Specifically, it will not pick up touch points generating negative ROI. However, it does provide an efficiency ranking across all touch points within the scope of the analysis.
• **Applicability:** Comparative heuristics is the approach of choice if testing and learning is too narrow to achieve the desired insights, but full-scale econometric modeling is considered too time-consuming or expensive. It allows for robust, yet analytically straightforward trade-off decisions between different vehicles. Comparative heuristics is usually the best choice if the market environment is highly volatile and, hence, not suitable for the statistical analysis required by econometric modeling. The same is true if new media, on which there is little or no historical data, are part of the optimization effort.

**Econometric marketing mix models (MMM)**

• **How it works:** Econometric marketing mix models (MMM) use advanced statistics to determine the impact of advertising expenditure on sales at different touch points (or on other dependent variables, like volume or profit). Developing saturation curve (s-curve) estimates is an important part of MMM: the s-curves help to identify the windows of highest marketing spend efficiency for specific vehicles. MMM not only includes an assessment of the past and current ROI of multiple media, but also serves as the basis for an optimized future marketing mix. MMM is described in detail in Chapter 11.

• **Advantages/disadvantages:** Although marketing mix models provide the most precise ROI output of the three approaches, a true comparison of the sales or profit impact of the various marketing vehicles can only be made reliably in relatively stable market environments. MMM usually requires a large amount of data collection, both for internal spend figures and market data. Because of their high level of analytical sophistication, many marketing mix models are in effect “black boxes,” with little transparency about the rationale of the recommendations they produce; often, this inhibits the acceptance of MMM efforts among marketing executives. Note that while MMM gives you dollar-for-dollar ROI based on sales impact, it does not capture marketing impact on brand equity.

• **Applicability:** As already pointed out, for it to be effective, MMM requires a stable market situation in which historical data can safely be assumed to be representative of current business and marketing dynamics.
It is the most appropriate approach in cases where the company has the requisite data and analytical capabilities necessary for running the modeling and where it plans to introduce few if any new advertising vehicles in the future.

**Practical hints on media mix optimization**

Media mix optimization is riddled with pitfalls. Some of these can be avoided by building safety nets into the methods described in this chapter, but no degree of sophistication can possibly pre-empt all mishaps. Data itself is ignorant, after all, and analysis is a blunt weapon if wielded by a clumsy hand. Letting data dictate the media mix is as dangerous as simply sticking to rules of thumb. But some common sense will help retailers make the most of media mix optimization:

- **Put hypothesis before analysis.** Before retailers engage in any media mix optimization, they should develop strong hypotheses on vehicle selection and budget allocation – e.g. by drawing on past experience and advertising spending tracking. Such hypotheses will help guide the analysis.
- **Ensure close cooperation.** The team charged with budget allocation should include analytical experts as well as seasoned practitioners – to avoid tunnel vision, to make sure all analytical insights are subject to practical sanity checks, and to secure the buy-in of the organization.
- **Learn to drive before you fly.** The lure of fully-fledged econometrics is strong, but retailers should avoid cracking a nut with a sledgehammer. Comparative heuristics can be a great way of graduating from “gut-based” to fact-based allocation. More advanced approaches should be introduced one step at a time.
There are, of course, many variants and hybrids above and beyond these three types of approach. For example, heuristics can be combined with econometric MMM to support a trade-off between short-term sales effects, measured using MMM, and long-term brand effects, measured using comparative heuristics. Before they commit to one of these approaches in a given situation, retailers should also consider their organization’s readiness to accept and implement the methodology in question, as well as the availability of the required supporting tools and IT systems. The best analytical method may not always be the best solution in practice – e.g. if organizational or technical constraints prevent it from being used to its full capacity.

In the next four chapters, we will explore marketing budget management and marketing ROI optimization comprehensively:

- Definition: Chapter 8, “Budget Sizing”
- Allocation: Chapter 9, “Budget Prioritization”
- Comparative heuristics: Chapter 10, “Reach–Cost–Quality”
- Econometric modeling: Chapter 11, “Marketing Mix Modeling.”

Key takeaways – Media mix optimization

1. The media landscape is in rapid transformation, and the media mix used for advertising differs substantially across industries and between countries.
2. Engage on an equal footing with your media agencies to ensure the media mix is tailored to your needs.
3. There are three distinctly different approaches to media mix optimization: testing and learning, comparative heuristics, and econometric modeling.
“Money changes everything.” At least that is what Cyndi Lauper says, and most people would agree she knows a thing or two about marketing, or self-promotion at any rate. But how much money do you need to change the world of retail marketing and make customers swing your way? It’s the million-dollar question – quite literally. Once a retailer’s brand strategy is in place, it is time for the CMO and the CFO to talk dollars and cents. While there may be no single algorithm to calculate the optimal marketing budget, we firmly believe that you will get to a robust and realistic figure by combining three proven perspectives:

- outside-in competitive benchmarking;
- inside-out budgeting based on marketing objectives;
- saturation analysis, used as a “sanity check.”

In this chapter, we will discuss these multiple perspectives, as well as the starting point of any sound budget-sizing effort: transparency creation.

**Marketing budget sizing is the million-dollar question:** it calls for a systematic and comprehensive, yet pragmatic, approach

In February 2008, German consumer electronics retailer Media Saturn embarked on a radical experiment. For an entire month, the company – one
of Germany’s top advertising spenders – cut their ad spend by 60 percent. It was a top management decision, simply to see what would happen. Revenues dropped massively, leaving store managers disappointed at what they felt, in essence, was a corporate betrayal. As they saw their revenue-based bonuses falter, store managers’ motivation plunged to an all-time low. (Source; Lebensmittelzeitung 12, March 20, 2008.) Simply speaking, Media Saturn proved Cyndi Lauper right: money does change everything. Case closed?

Not quite. While the experiment substantiated the direct sales impact of advertising, it still does not say very much about the appropriate budget level; 40 percent of the current budget may be too little, but how much is enough? Not unlike Media Saturn, many retailers look to the past when defining the overall level of their next year’s marketing budget. They start with their current budget and make a few adjustments for inflation, major events in the marketplace, changes in cost, or shifting priorities, according to their own marketing strategy. There is nothing fundamentally wrong with this approach. It contains several key elements of best-practice budgeting: experience, market dynamics, and a glimpse of the future. Yet we believe it is worth any retailer’s while to take a somewhat more systematic approach – without the need to get overly scientific.

Cause-and-effect relationships between marketing spend and market success are notoriously difficult to establish, simply because of the wide variety of influencing factors. In June, you may spend at just the right level, but what good does it do if you are a sports goods retailer and June happens to be the rainiest month in recorded history? In July, you duly ramp up your spend to promote indoor sports with an award-winning campaign, but it is no match for your key competitor’s drastic discounts. August would have been the month of a major co-marketing effort with your biggest vendor, but as it happened, they come under pressure from the financial markets and so slash their marketing budget to boost the bottom line. And so on.

In light of this complexity, no budgeting tool or algorithm can calculate your budget level at the push of a button. What we propose instead is a systematic, yet pragmatic, approach that starts with transparency creation and moves on to combine three perspectives on overall budget size (Exhibit 8.1).
Create full budget transparency: conduct a comprehensive budget stock-take to capture the current budget, its components and its organizational owners.

It sounds simple, but in reality it is not: it can be a major challenge for retailers to find out how much they are currently spending.

Marketing activities are often managed and accounted for in different parts of the organization: international media planning is in charge of classical advertising, the new media taskforce oversees the company’s homepage, and PR expenditure is part of the board’s proprietary budget. Co-op campaigns are partly funded by vendors and may not be considered as part of the marketing budget at all. A substantial share of the total budget, especially funds for local advertising, can also be hidden in the P&L of local subsidiaries or franchise partners. Yet all these activities affect a retailer’s target audience in some way or another, and they all contribute, or fail to contribute, to overall marketing objectives.

So before even looking at the various perspectives on budget sizing, the first step is to compile a comprehensive list of the individual positions in the current marketing budget. Of course the actual number, granularity, and...
naming of these positions will vary from company to company. Conceptually, the marketing budget stock-taking should include all the investments that are made to move current and potential customers through the purchase funnel from awareness and consideration to repeat purchase and loyalty.

For many retailers, classical advertising may be a comparatively small share of the total marketing budget compared to important below-the-line activities such as POS, event, and direct marketing. Any comprehensively defined marketing budget should also account for indirect costs such as agency fees and production costs.

To establish a customer-centric mindset, we recommend making customer touch points the primary dimension for creating budgetary transparency. Ideally, investments should be split according to where and how they reach your audience: on TV, in newspaper print ads or leaflets, in the store, in the form of an addressed direct mailing, or as part of a reward scheme or loyalty program. This kind of split helps the retailer to take a consumer perspective, instead of worrying about budget ownership and organizational responsibility, which may or may not reflect consumer needs.

But keep in mind that costs incurred at the same touch point may be split between multiple departments. For example, a retail company’s corporate website may be co-funded by IT, PR, marketing, and various other departments. Some activities may not be treated as marketing cost positions at all: sales stimulation campaigns directly funded by vendor allowances can sometimes be managed as profit centers in their own right.

Once you have a basic overview of how much is spent at the various touch points, it is often helpful to add the purchase funnel stage as a secondary dimension. Is the investment made to create awareness, to drive consideration, to increase basket size or to foster customer loyalty? Experience shows that the intended purchase funnel impact of a given investment is often hard to define, especially for long-term activities such as co-branding efforts or sponsorships, because sponsorship is often not handled by the marketing department at all and may be out of bounds for the annual budget review for historical or contractual reasons – or simply because it is a board member’s pet project. Yet these “forgotten investments” either strengthen or weaken the brand, and should thus be included in the initial budget stock-take.
Budget transparency creation

The larger and more complex your organization, the more difficult it is to get hold of comprehensive and reliable marketing spend data. Gathering details on all investments and the corresponding communication objectives can take several weeks – but the effort is worth it. In the end, it not only creates transparency about the current budget and its components but can also trigger debate among executives about meaningful allocation keys, appropriate organizational accountability and effective reporting lines.

Use outside-in competitive benchmarking to determine the share of voice required to cut through the clutter in your competitive arena

A retailer’s marketing activities never take place in a void. They compete with competitors’ activities for customer attention. In a noisy environment, it is important for the retailer’s own tune to be heard above the general hubbub. Perhaps the most common indicator of the relative marketing intensity is marketing expenditure as a percentage of sales. This metric varies greatly by segment and country, but it is a quick and easy way of determining whether you are spending within a healthy range.

Take Scandinavian grocery retailers, for example: they spend 0.7 percent to 2.5 percent of their sales revenues on marketing (ATL and BTL). A retailer would need good reason to spend significantly below or above this range; such reasons might include the need to drive short-term profitability or long-term growth. Marketing as a percentage of sales is a highly aggregated figure. Plotting the share of voice versus the share of market (or sales) is usually a more insightful basis for competitive benchmarking. This kind of analysis reveals that the “fair share of advertising” is by no means a linear function of revenue. Rather, smaller players have to set aside a higher proportion of their sales for marketing in order to get noticed, while bigger players can afford to spend less (see Exhibit 8.2 for
a disguised example). In this case, the retailer in question was able to cut their share of voice without compromising market share.

When conducting this kind of analysis, be careful to include only companies you consider to be competitors according to your definition of the relevant market. Separate analyses may be required for different countries or even for different categories. Note that the share of voice (y axis) in Exhibit 8.2 reflects only gross media buy; this is mostly traditional advertising spend. To derive an “apples and apples” comparison of marketing pressure, the share of voice analysis should also cover BTL positions such as leaflets and direct mail. While you will usually know your own BTL expenditure, information on competitors’ BTL spend is often hard to obtain. However, providers of advertising data such as AC Nielsen and Ebiquity have started to track non-traditional media, and benchmarks for ATL/BTL ratios are starting to emerge in many categories. Alternatively, it is possible to approximate BTL spend by deducting the observed ATL spend from the total marketing expenditure as given in competitors’ annual reports.

Exhibit 8.2 Share of voice versus share of market scatter plot.
Reported ad spend versus actual media cost

Note that advertising tracking agencies such as AC Nielsen report gross media spend rather than the advertiser’s cash-out expenditure. Gross media spend is calculated by multiplying observed advertising pressure, e.g. number of prime-time 30-second TVCs, with gross prices as published by media owners. But media owners grant substantial discounts on these gross prices to media agencies and advertisers, sometimes by as much as 50 percent – or even more. In effect, 100 “observed” advertising dollars might actually have cost the advertiser only 50 dollars. Recognizing these rebates is of particular importance when you combine marketing spend data from multiple sources, e.g. using ad tracking data for some parts of the marketing budget and internal data for other parts.

Employ inside-out budgeting based on marketing objectives to estimate the investment needed to advance customers on their purchase journey

Your budget level should be high enough to get noticed in the marketplace, but it should also reflect what you are trying to achieve. In light of the differences in marketing strategy and overall business targets, competitive benchmarking alone is insufficient to determine the appropriate budget level. Take the example of US retail: while some players spend less than 1 percent of sales on advertising, others spend up to 5 percent. These variations indicate differences in overall growth ambition, as well as different operational marketing objectives.

The actual marketing spend has to take into account both the brand’s general strategic ambition and its market share targets. Based on these cornerstones, marketers can define specific activities, ranging from an ongoing support for the brand to the introduction of a new store brand or private label (Exhibit 8.3). Assume a certain retailer is trying to build awareness for a new store brand. Once you know the structure and size of
your target group (e.g. all female shoppers in the greater Los Angeles area aged 15–35) and the quantified awareness goal (e.g. 60 percent unaided advertising recall), media agencies can employ so-called “Morgenszttern curves” to help you calculate the required GRPs (gross rating points) and, subsequently, marketing investments.

Most retailers will want to reiterate this process for the multiple objectives they are seeking to achieve in a given year, and then total up the sum of individual investments to arrive at an overall budget figure. In general, larger companies – or those highly focused on profitability – will spend below their segment’s average. In contrast, small players – and companies with extraordinary growth ambition – will typically find themselves outspending the market in terms of share of voice over share of market, at least for a certain amount of time.

This is, for example, what German consumer goods giant Media Saturn did both prior to and after their fateful budget-cut experiment in 2008. In 2009, their share of voice was a remarkable 85 percent in their category, more than four times their share of market at that time. Media Saturn’s market share increased to 19.7 percent in 2009, up from 17.8 percent in 2007 – but the jury is still out on whether this growth is sufficiently sustainable to offset their massive marketing investment.

<table>
<thead>
<tr>
<th>Examples of activity types</th>
<th>Spending level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ongoing support for store brand</td>
<td>€</td>
</tr>
<tr>
<td>New product range (e.g. new listings)</td>
<td>€€</td>
</tr>
<tr>
<td>Brand stretch (e.g. for existing Private Label)</td>
<td>€€</td>
</tr>
<tr>
<td>Non-innovation led growth (e.g. flyer campaigns)</td>
<td>€€€</td>
</tr>
<tr>
<td>Year-2 support for major brand/private label innovation</td>
<td>€€€</td>
</tr>
<tr>
<td>Brand extension/category launch/major innovation</td>
<td>€€€€</td>
</tr>
<tr>
<td>New brand/private label introduction</td>
<td>€€€€</td>
</tr>
</tbody>
</table>

Exhibit 8.3 Activity-based budgeting.
Engage in saturation analysis, correlating marketing spend with impact to conduct a sanity check on the efficiency of the overall budget level.

Your competitors might be going overboard with their advertising spend, and your ambitious growth targets may also warrant massive investments – but budget sizing isn’t only about spending enough. It’s also about not spending too much. Even if both outside-in benchmarking and inside-out budgeting lead you to believe a very high marketing investment is required, the figure you arrive at may actually be beyond the efficient range. In the disguised case shown in Exhibit 8.4, EUR 23 million represents the total of the investment levels at which the individual marketing instruments – mass, direct, digital, and POS – achieve their ROI saturation points. Simply speaking, every additional Euro invested would decrease the overall profit. Also see Chapter 11 on marketing mix modeling for further details on how saturation curves (s-curves) can be used to optimize the allocation of advertising funds.
Combine benchmarking, objective-based budgeting, and saturation analysis to derive a realistic budget level estimate. Refine as needed.

Each of the three perspectives described above – outside-in benchmarking, objective-based budgeting, and saturation analysis – provide you with a number or, more commonly, a budget range. These ranges should show a fair amount of overlap. To take a fictitious example, a particular retail company may have to spend EUR 100–120 million (USD 80–95 million) to achieve a share of voice in line with their market share and growth ambition. Further assume that to support their purchase funnel objectives, they would need to spend EUR 90–110 million (USD 72–87 million) according to their media agency’s estimate of required GRPs. Their impact sanity check, however, revealed that EUR 100 million was the saturation point for ROI-positive marketing investment. Combining these three perspectives enabled them to arrive at a budget level of EUR 100 million. Exhibit 8.5 shows a visualization of this example. So you need EUR 100 million.

Exhibit 8.5 Three perspectives on total budget level.
That’s it? Not quite. The common ground defined by the overlap of the ranges determined by the three perspectives is only the starting point of budget sizing. On their way from this first estimate to the final cash-out budget, retailers will want to check on the following five issues.

- **BTL spend:** If you have only considered ATL thus far, whether because of data availability or urgency, make sure to set aside funds for BTL activities as well. Even if there is no benchmarking data, the direct and POS marketing plan should provide a good sense of the required budget.

- **Indirect costs:** Activation spend is wasted unless there is something worth activating. Make sure to include creative agency fees and production costs, as well as expenditure for testing and research. The inverse applies to special arrangements, such as sponsorships. These deals need to be activated through communication to take effect. As a minimum, retailers should expect activation spend of the same magnitude as the license fee.

- **Third-party contributions:** While BTL spend and indirect cost increase the cash-out required to reach the desired effective gross marketing spend, co-funding may help to decrease it. Be sure to recognize rebates from media owners and agencies, as well as vendor allowances for co-op marketing.

- **Tactical considerations:** While simply matching competitor activities is usually an inefficient use of marketing funds, spending “against the trend” can prove a very successful tactic, especially when money is tight and everyone else is cutting their budgets. According to a Credit Suisse study, companies that maintained their spend levels during the 2008/09 recession consistently outperformed their peers in the stock markets in the subsequent 12-month period. Smart retailers may want to “zig” when others “zag.”

- **Special circumstances, constraints or unforeseen events:** Anything from new market entry and temporary cash-flow bottlenecks to disruptive competitor moves and understaffed marketing departments may necessitate “manual” adjustments to the budget level as indicated by the combination of the three perspectives.
Budget sizing, as described in this chapter, is neither an automated process nor a black box. Rather, it is a systematic approach that is based on explicit assumptions, employs transparent criteria and allows for manual adjustments. Much of its value resides in the open and rational debate it will trigger among executives. To stay on top of changes in consumer behavior, the competitive environment and their own marketing strategy, retailers will wish to review their budgeting approach at least once a year in any case. And at all times, they will want to make sure their budget is a function of their objectives, not vice versa. If they do so, money might not change everything, but it will make a big difference.

**Key takeaways – Budget sizing**

1. Marketing budget sizing is the million-dollar question: it calls for a systematic and comprehensive, yet pragmatic, approach.
2. Create full budget transparency: conduct a comprehensive budget stock-take to capture the current budget, its components, and its organizational owners.
3. Use outside-in competitive benchmarking to determine the share of voice required to cut through the clutter in your competitive arena.
4. Employ inside-out budgeting based on marketing objectives to estimate the investment needed to advance customers on their purchase journey.
5. Engage in saturation analysis, correlating marketing spend with impact to conduct a sanity check on the efficiency of the overall budget level.
6. Combine benchmarking, objective-based budgeting, and saturation analysis to derive a realistic budget level estimate. Refine as needed.
In Chapter 8 ("Budget Sizing: The Million-dollar Question") we looked at how to create budget transparency and how to size the budget according to the marketing objectives, business opportunities, and competitive benchmarks. In this chapter, we introduce proven approaches and tools for allocating the budget to the various spending units.

The chapter is designed to answer key questions about allocation:

- How much should you spend on a given country, region, or store – and why?
- How granular does the allocation logic need to be?
- How do you account for unforeseen events?

The chapter addresses such topics as whether to make decisions centrally or locally, how to define the right size of units for your investments, and how to create transparency. To help retailers derive or optimize their actual budget split, we also discuss the definition of allocation criteria, criteria weights, and spending thresholds.

**Find the right decision mode:** deciding centrally or convincing locally

Many retailers plan their marketing activities by reviewing their activity plans from previous years and then applying adjustments to the plan
to account for any changes that have taken place in the intervening period. The types of change that can warrant such an adjustment include competitors’ moves, new insights from market research, fresh input from media agencies regarding media trends – or simply changes in costs for specific activities.

Our experience is that you are unlikely to make big mistakes with this “last year +/- x” method. If it worked last year, why change it? In the words of Sir Alf Ramsey, manager of the English national soccer team at the time of their triumph during the 1966 World Cup: “Never change a winning team.” But if you follow Sir Alf’s advice to the letter, you are likely to miss out on certain market opportunities.

To take one example: a retailer that has always invested in billboard advertising near its stores to promote special offers and deals. Now, for some reason or other, the cost of billboard advertising has increased dramatically. Applying the “last year +/- x” approach, the retailer’s reaction would be to increase the billboard budget accordingly; however, this will be at the expense of other media and new advertising opportunities.

The flaw in this, clearly, is that the resulting budget allocation, because it is driven by historical patterns, could miss the newer and emerging chances to win – for example, free newspapers, social media, or search engine marketing. The challenge for marketing managers is to find these pockets of opportunity, compile winning arguments for the budgeting discussion, and convince top management to reallocate funds from established vehicles to the latest and greatest opportunities for maximizing marketing ROI.

In general, according to a recent McKinsey survey of marketing practitioners, high-performing companies prefer a top-down approach to defining their marketing budget. When they encounter any prioritization conflicts, more than two thirds of the most successful companies look to their CMO, or most senior marketing executive, for resolution. For these companies, this clear top-down budget allocation and prioritization process, led by top management, is a key success factor.

Sticking to this rule is easy if marketing decision power resides centrally: i.e. the CMO decides what to spend – and how to spend it. But things get more complicated in companies where there is a high level of local decision-making power, as in many retail organizations. Local P&L accountability
usually means that marketing budget allocation is also done at the local level. The same goes for franchise business models, at least for all budget positions other than classical advertising. In these cases, the responsibility of the CMO at corporate headquarters is limited to international or cross-regional brand building activities. But many local marketers even want their say when it comes to brand image campaigns. It is often up to them to support corporate efforts with local activities of their own, e.g. with leaflets, billboards, and local newspaper advertising. Such local power makes top-down allocation decisions almost impossible.

Yet there are ways to make sure centrally-devised allocation principles are applied consistently across countries and regions, even for the share of the budget that is technically out of central control. For example, the CMO can hand the results of a central prioritization effort to regional managers as a decision-making support. Alternatively, the central marketing function can act as a coordinator for local prioritization efforts. In either case, headquarters needs to convince every regional marketing team that it is in their best interests to apply centrally-developed tools and guidelines to their budget allocation process – an exercise that can prove challenging for both parties.

Budgeting prioritization is usually a four-step process:

1. Define the right investment units.
2. Create full transparency on spend per investment unit.
3. Define the prioritization criteria and weights.
4. Prioritize your marketing investments.

**Define the right investment units:** go granular and find the pockets of growth

Once the overall budgeting responsibilities are understood or clarified, retailers have to determine the appropriate budgetary allocation between investment units. By “investment units” we mean the positions, or
clusters of positions, into which the budget is split for allocation and tracking purposes. There are several well-established dimensions and levels at which marketing spend can be allocated and tracked (Exhibit 9.1). The appropriate level of granularity depends on the given company organization and structure. But whatever the specific characteristics, the basic trade-off remains the same: while higher granularity promises additional insights and more targeted spending, it also brings additional complexity for data gathering and marketing management.

In retail, the most common split is by geography and format, i.e. the budget is allocated by region, county, or city, and for a specific format, e.g. hypermarkets. In non-food retail, assortment category and/or brand(s) are equally important investment units, reflecting the “halo” effect that certain known-value items, categories, or brands have for consumers. At the most granular level of the individual store, all three dimensions – geography, category, and format – converge. This gives rise to two crucial questions confronting every allocation: how much should a given store (of a specific format) spend in total, and which categories or products should get the biggest slice of the pie?

Exhibit 9.1 Dimensions and levels of budgeting granularity.
The key to success is to overcome the “tyranny of the average” and find the pockets of growth (Exhibit 9.2) to prioritize investments accordingly. For example, an average national retail sales growth rate of 6 percent may not appear particularly exciting at first sight. But if you slice the growth rates to represent increasingly granular investment units, a much more differentiated picture emerges, with a spread that ranges from -10 percent to more than 20 percent in the given – illustrative – example. To stimulate overall growth, retailers will want to cut spending on low-growth investment units and focus their funds on high-growth units.

To determine the appropriate level of granularity for use in the budget prioritization, the retailer will need to establish which of its spending units, or groups of spending units, are sufficiently homogeneous to justify a unified approach – as opposed to those units that are sufficiently different from each other to warrant customized solutions.

When determining the appropriate geographical cut, you will first need to answer a series of questions:
• Are there local differences in the competitive landscape?
• Do consumer preferences differ from region to region?
• Is there a higher growth ambition in certain regions?

In cases where there are major local or regional differences, it makes sense to break down the budget accordingly, so as to be able to adjust its allocation to local requirements. Retailers will need to answer similar sets of questions for each of the other dimensions, for assortment categories, brands, store formats and channels.

The budgeting mill grinds slowly, but it grinds exceedingly fine

High budgeting granularity promises targeted marketing investment. But sometimes a very detailed budget breakdown will create more work than added value. For example, if a retailer does not have detailed information on its regional markets, such as the share of voice or growth rates, then there is no point in differentiating the budget for these regions. Similarly, a highly granular budget allocation is not likely to be worthwhile if the retailer does not have the operational means and processes to derive true value from it. For example, it makes no sense to determine the budget for 300 Italian fashion retail outlets at the individual store level if there is no communication plan in place to make sure these funds are used to the benefit of the individual stores.

Create full transparency: understand where the money goes

It’s one thing to make a conscious choice to stick to historical budgets and allocation keys. It’s another thing to be in ignorance of how much you actually spend in the various units. As mentioned in Chapter 8, as much as 20 to 50 percent of all marketing cost is incurred below the radar of marketing executives, often at the regional or local level, or in departments other than marketing.
There are many reasons for this lack of transparency. In the case of decentralized spending, it is not easy for corporate headquarters to keep track of all that goes on at the local level. In the case of central spending, sometimes costs are not allocated to the units that actually benefit from them. In other cases, central spend is accounted for in central departments outside marketing, e.g. in separate online, CRM, communication, or commercial units. Take, for example, the case of POS marketing material designed and commissioned centrally: this can be requested by regional managers according to their demand; often, the central marketing department does not keep track of how much is ordered by region. Reporting back to headquarters about which stores actually used the material is often the last thing on a general manager’s mind. This is just one example; the same issues apply to many forms of local advertising, such as leaflets, billboards, radio, local print advertisements, or consumer events. In total, these local touch points can account for more than 50 percent of marketing spend of retailers (see Chapter 14, “Leaflets and Local Print Advertising: How to Achieve Local Media Excellence,” for further details).

To challenge current spend levels, you need to know how much you currently spend and be able to relate this expense to your business development. But to achieve this level of transparency at the chosen level of granularity takes a dedicated effort, often involving substantial data mining. Yet most retailers who do carry out such an exercise find it well worth their while. True transparency often reveals quite a few surprises – as well as ideas for immediate improvements, both in terms of budget allocation and in organizational accountability.

Once there is full budget transparency, retailers need to decide which part of the total budget should be made available for the actual allocation process (Exhibit 9.2). Though certain central activities, such as training or agency fees, may not be consumer facing, they are nevertheless key enablers of consumer communication. For details on purchasing and nonworking costs, please see Chapter 19: “Smart Sourcing.”
Keeping it flexible

Certain retailers, though they allocate the bulk of their budget to the spending units at the beginning of the year, hold back a fraction as a central “opportunity budget” in order to ensure short-term flexibility. One international company, for instance, has introduced an internal “innovative communication challenge,” in which it asks its national marketing heads to provide creative ideas for direct marketing activities. The best three ideas are rewarded with their share of the “innovation budget” that has been held back in the initial budgeting round. Competitions like this come with a double benefit. They encourage executives to weigh the costs and benefits of specific activities carefully, and they encourage marketing departments to try out new and innovative media formats that might otherwise not find their way into the marketing plan.

Define the prioritization criteria and weights based on what really matters in your budgeting decisions

Once you have determined the total budget, chosen the granularity of the investment units, and finalized the budget structure, the next step is to decide on the criteria by which the budget will be allocated to the investment units. For want of a more systematic approach, many companies take a percentage of sales or use similar allocation keys to make this allocation.

The main challenge in making the allocation is to ensure that the criteria used support the overall business objectives of the company. For example, if the ambition of the retailer is to grow sales in a few selected regions while maintaining current sales levels in all others, it would make sense to use regional growth targets, or budgeted revenue, as the allocation criteria. If, in addition, a number of local markets are planning new store openings, another meaningful factor might be the number of new stores per market. As a
rule of thumb, the greater the business complexity, the greater the number of criteria required; in all cases, however, a weighted average should be used as the ultimate allocation key.

The most common allocation key is revenue per format, region, or store. In general, this makes a lot of sense; its weakness is that it does not take into account relative competitive intensity or specific local opportunities. Because of such factors, it may make sense to fine-tune investment manually. A region with high market share (and high store density) typically needs less marketing support to be visible in the market place than a region where the retailer has a low market share. Pia Marthinsen Mellbye, Head of Marketing at ICA Norway, says, “When looking at revenue per region and linking it back to marketing spend, it became clear that we overinvested in regions with high market share and underinvested in regions with low market share. This wasn’t in line with our growth ambitions for some of these regions. So we made adjustments, primarily by defining regional budgets with leeway for local media in some of the regions.” As a result of this optimization, ICA achieved budget savings of the order of 15 percent and was able to realign its marketing spend with its business goals. For further details, see the interview at the end of this chapter.

In order to pick the right budget allocation criteria, it is critical for the marketing department to have a deep understanding of the company’s business objectives:

- What is the long-term goal of the company, and what is its store portfolio?
- Does the company aspire to expand in a certain region?
- Have new competitors entered the marketplace?
- What are the implications for sales stimulation activities and brand building?

Best-practice retailers make life a lot easier for the marketing department by disaggregating their business objectives by country, format, and region. Among the well-established metrics for marketing investment decisions are: sales, sales growth, sales growth versus market rate (share gain), market share, profitability, competitive intensity (e.g. measured as competitor
ad spend, or share of voice, in a given segment or area), and media cost (see Exhibit 9.3).

But even when a set of relevant criteria has been agreed upon, there is still room for error. Often, there is no common understanding of how a specific metric is or should be defined. Take growth ambition: most marketing managers will agree that units with more ambitious targets will need and deserve more funds. But what is growth ambition? Is it percentage revenue growth? Using this metric would lead to a bias towards units with low current sales levels. Alternatively, is it the absolute growth in EUR or USD? No matter how high this amount, the level of growth could still be at or even below market growth – which should not justify extra funds. So in this case, absolute growth above market level, or above market share gain, would be the best choice. This is just one example that shows how different interpretations of the same metric can lead to fundamentally different budgeting decisions.

Once there is a shared understanding of which criteria should inform the prioritization, the relative importance of these criteria can be defined.

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Operationalization (example)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial</strong></td>
<td></td>
</tr>
<tr>
<td>• Revenue</td>
<td>• Net revenues of business unit by region</td>
</tr>
<tr>
<td>• Revenue growth</td>
<td>• Net revenue growth of business unit by region</td>
</tr>
<tr>
<td>• Gross profit on sales</td>
<td>• Net revenue minus cost of goods sold by business unit by region</td>
</tr>
<tr>
<td>• Gross profit growth</td>
<td>• Difference in net revenue minus cost of goods sold of business unit by region</td>
</tr>
<tr>
<td><strong>Strategic</strong></td>
<td></td>
</tr>
<tr>
<td>• Growth opportunity</td>
<td>• Market size not captured in EUR, e.g. (1 – market share) x factor addressable share</td>
</tr>
<tr>
<td></td>
<td>(considering local competition)</td>
</tr>
<tr>
<td>• Industry competition</td>
<td>• Brand building and promotional spend of competitors</td>
</tr>
<tr>
<td>• Relative individual growth</td>
<td>• Company or segment growth (e.g. discount) of business unit in region</td>
</tr>
<tr>
<td><strong>Marketing-oriented</strong></td>
<td></td>
</tr>
<tr>
<td>• Marketing cost factor</td>
<td>• For example: local cost for typical marketing basket</td>
</tr>
<tr>
<td>• Brand status</td>
<td>• Brand awareness according to market research</td>
</tr>
<tr>
<td>• Event communication</td>
<td>• Store openings, etc.</td>
</tr>
</tbody>
</table>

**Exhibit 9.3** Key elements of marketing budget structure.
Exhibit 9.4 provides a simplified overview of the different strategic options. The basic choice is whether to focus on stability or growth. If the primary objective is to defend current sales, the greatest weight should be given to past or current sales as allocation criteria. If the primary objective is growth, greater weight should be attributed to growth targets or metrics capturing opportunity, e.g. the size of the market not yet captured.

In addition to the weighting of allocation criteria, spend thresholds need to be defined for the different investment units. Thresholds fulfill several roles. They can create leeway for tactical or strategic investments beyond mere financial objectives. An example would be allowing a greater budget than would be indicated by the predefined criteria in cases such as, for instance, where there is a strategic directive to attack a certain competitor in a certain market. Also, a threshold can act as an emergency cap. If, for example, the predefined criteria indicate that a substantial investment increase should be made in an emerging market, but the marketing team in that particular country is unlikely to be in a position to handle the additional funds effectively – because, for example, it is still in the process of being set up – a temporary budget threshold could help prevent the company from wasting its money.

<table>
<thead>
<tr>
<th>Weighting options</th>
<th>Budgeting objectives</th>
<th>Financial</th>
<th>Strategic</th>
<th>Marketing-oriented</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Maintenance orientation</td>
<td>Sales: 20–40</td>
<td>Long-term growth</td>
<td>Events: 5–15</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Profit contribution: 20–40</td>
<td>opportunity: 5–15</td>
<td>Competitive</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Relative growth</td>
<td>intensity: 5–15</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>plan: 10–20</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Events: 10–20</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Competitive</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>intensity: 5–10</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>Growth/ portfolio orientation</td>
<td>Sales: 5–20</td>
<td>Long-term growth</td>
<td>Events: 20–40</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Profit contribution: 5–15</td>
<td>opportunity: 10–20</td>
<td>Competitive</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Relative growth</td>
<td>intensity: 10–20</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>plan: 20–30</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Events: 10–20</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Competitive</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>intensity: 5–10</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>Competition orientation</td>
<td>Sales: 5–15</td>
<td>Long-term growth</td>
<td>Events: 20–40</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Profit contribution: 5–15</td>
<td>opportunity: 5–15</td>
<td>Competitive</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Relative growth</td>
<td>intensity: 20–40</td>
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<td></td>
<td>plan: 10–20</td>
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<td></td>
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<td></td>
<td>Events: 10–20</td>
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<td></td>
<td></td>
<td></td>
<td>Competitive</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>intensity: 20–40</td>
<td></td>
</tr>
</tbody>
</table>

Exhibit 9.4 List of potential criteria for budget prioritization.
Avoid automatic decisions: prioritize your marketing investment in the light of the full facts

All the subjects we have talked about so far in this chapter – top-down budget making; the selection of budgeting units; the assessment of current spend; the choice of decision criteria, weights, and thresholds – need to be combined and integrated to derive a robust allocation recommendation. Best-practice retailers use a scoring model to create full transparency regarding the reasons behind the proposed reallocations (Exhibit 9.5).

By all means, avoid “black boxes.” Full transparency about the reallocation rationale is essential, especially to secure the support of stakeholders who are at the receiving end of proposed budget cuts. To make the reasons for reallocations even more tangible, leading retailers use sensitivity maps that detail the criteria used to shape the decisions about whether an investment unit should lose or gain funds compared to the status quo (Exhibit 9.6).

---

**Excel-based model**

<table>
<thead>
<tr>
<th>Set input and assumptions</th>
<th>Interpret results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decide allocation level and budget structure</td>
<td>View model result</td>
</tr>
<tr>
<td>Enter reference budget allocation</td>
<td>Analyze sensitivity to criteria</td>
</tr>
<tr>
<td>Define allocation criteria and weights</td>
<td>View other reports (e.g. dynamic data plot)</td>
</tr>
<tr>
<td>Determine spending thresholds</td>
<td></td>
</tr>
<tr>
<td>Calculate allocation criteria scores</td>
<td></td>
</tr>
</tbody>
</table>

**Prioritization result**

<table>
<thead>
<tr>
<th>Previous budget transparency</th>
<th>Revised budget according to prioritization</th>
<th>Proposed shift</th>
</tr>
</thead>
<tbody>
<tr>
<td>Region 1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Region 2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Region 3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Exhibit 9.5** An easy-to-use model helps derive a prioritization proposal.
To make sure such prioritization tools are easy to use, their design should allow for convenient changes to the input factors (e.g. in terms of the total budget, the criteria, weights or thresholds being used). Once the tool is in place, it can even be used “live” in decision-making meetings in order, for instance, to illustrate the sensitivity of the allocation to particular changes in the input factors. Its use can make the relative impact of the different factors on the actual allocation recommendations more tangible and transparent. Like every piece of software, however, the effectiveness of such a prioritization tool will depend on the quality and validity of the data it is based upon. In any case, its purpose is not to replace executive decision-making about budgetary allocations, but to inform it.

### Exhibit 9.6 Sensitivity maps help explain the reallocation rationale.

<table>
<thead>
<tr>
<th>Name</th>
<th>Current Plan</th>
<th>Allocation model result</th>
<th>Prioritization criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>Region 1</td>
<td>32%</td>
<td>28%</td>
<td>Net sales plan</td>
</tr>
<tr>
<td>Region 2</td>
<td>17%</td>
<td>9%</td>
<td>Profit contribution plan</td>
</tr>
<tr>
<td>Region 3</td>
<td>15%</td>
<td>16%</td>
<td>Product activities</td>
</tr>
<tr>
<td>...</td>
<td>4%</td>
<td>4%</td>
<td>Competitive intensity</td>
</tr>
</tbody>
</table>

- **Net sales plan**
  - Region 1: 25%
  - Region 2: 15%
  - Region 3: 10%
- **Profit contribution plan**
  - Region 1: 14%
  - Region 2: 5%
  - Region 3: 0%
- **Product activities**
  - Region 1: 28%
  - Region 2: 8%
  - Region 3: 12%
- **Competitive intensity**
  - Region 1: 38%
  - Region 2: 19%
  - Region 3: 8%
- **Segment attractiveness**
  - Region 1: 24%
  - Region 2: 29%
  - Region 3: 16%
- **Growth ambition**
  - Region 1: 17%
  - Region 2: 3%
  - Region 3: 2%
- **Funnel performance**
  - Region 1: 38%
  - Region 2: 6%
  - Region 3: 8%

- **Sensitivity map**
  - Current plan is to spend 17% of marketing budget on Region 2
  - Prioritization model allocates 9% to Region 2
  - For high profit contribution, model allocates an amount below proportional budget
  - For high competitive intensity, model allocates an amount above proportional budget
Interview: Pia Marthinsen Mellbye  
Chief Marketing Officer, ICA AB

ICA AB is one of northern Europe’s leading grocery retailers. They have some 2,200 stores in Sweden, Norway, and the Baltic countries, some of which are operated under franchise agreements. Pia Marthinsen Mellbye is ICA’s Chief Marketing Officer.

Pia Marthinsen Mellbye talked to Ingeborg Molden Hegstad, a retail marketing expert at McKinsey & Company, about ICA’s approach to marketing budget sizing, budget allocation and marketing message definition.

Q: What was your traditional approach to budget sizing like?

Pia Mellbye: The budget was set based on last year’s spend levels, adjusted for inflation and changes in the market place. For example, if we spent EUR 10 million (USD 8 million) on one of our formats last year, we would increase the amount by 2 percent to compensate for inflation. On top of this, we typically made changes to the budget based on a qualitative assessment of the implications of competitors’ moves, such as store openings or seasonal campaigns.

Q: Why did you change the budgeting process?

Pia Mellbye: At the time, the company was in a challenging situation, losing market share and showing low profitability. In addition, our two brands were in a transition phase. The CEO asked me to review our marketing spend to see whether there were any efficiency and effectiveness opportunities. We initiated a project to take a more systematic approach to managing the return on marketing investment.

Q: How did you go about it?

Pia Mellbye: First of all, we created spend transparency. Once we started digging, we found that there was quite a big amount of marketing spend incurred outside marketing, e.g. in the communications department, in the commercial unit, and in local stores. In total, this amounted to more than 20 percent of the marketing budget. This was due to the business model we had in the company, with multiple profit centers, and the fact that some of the marketing spend vanished in the
accounting process because it was offset by marketing funds we receive from suppliers. This made it extremely difficult for the marketing department to have a full overview.

Q: What were the benefits of transparency creation?

Pia Mellbye: Even at the surface level, it was clear we would have to make some changes to the budget. The biggest change was to move accountability for all spend to the marketing department. Also, we started treating marketing activities as true investments. Separating our investments from suppliers’ funds enabled the company to optimize the marketing plan according to what is best for the company, not the suppliers.

Q: How did you define the total level of the budget?

Pia Mellbye: We implemented a systematic approach, relating the marketing budget to revenue and comparing our “share of voice/share of market” ratio with that of competitors to understand the spending levels in the market. This benchmarking analysis confirmed our hypotheses about the market, e.g. that the marketing intensity in the hypermarket format was much higher than in the soft discount segment. On average, hypermarket chains focusing on groceries spent 2 to 4 percent of revenues on marketing activities, whereas soft discount chains were closer to 1 percent of sales. The biggest players spend less relative to sales, given the scale benefits derived from a large store network.

Q: What was the impact of the new budget sizing approach?

Pia Mellbye: Because our brands were in a transition phase, we scaled down the ATL communication significantly compared to previous years. We reduced our budget by as much as 30 percent compared to previous years, resulting in an average marketing-to-sales ratio of approximately 1 percent across our hypermarket, supermarket and soft discount formats. We did this because we realized that overinvesting compared to competitors had not helped us capture additional market share, and because we needed to improve our value proposition in the stores before investing in brand-building campaigns.

Q: Traditionally, how did you allocate the budget to the various activities?
Pia Mellbye: Our budget was developed on a country level – by format and media channel – as opposed to local geographical units. This was a result of our mindset at the time, working closely with the media agency to optimize the efficiency of individual media on a national level.

Q: How did this change?

Pia Mellbye: After assessing this in detail, we decided to allocate and track our spend on a regional basis, instead of by channel on a national level. When we looked at revenue per region and linked it back to marketing spend, it became clear that we overinvested in some regions (regions with high market share) and underinvested in others (regions with low market share). By defining regional budgets with the opportunity to use local media in some of the regions, we improved the situation. We now set the regional budget, e.g. in soft discount, in the range of 0.6–0.9 percent, depending on our local market share, as opposed to, for example, 0.8 percent across the country. Today, we hold a central budget for research, store openings, and special circumstances, such as unexpected competitor store openings or campaigns.

Q: What was the impact of the new allocation approach?

Pia Mellbye: We are developing activity plans that are tailored to the local markets. In effect, we get more bang for the buck. We also choose our media mix based on local and regional reach. Also, the new approach has resulted in a common language, as well as in more transparency about the steps in the budgeting process. This makes internal discussions so much easier.

Q: Historically, how did you define your marketing messages?

Pia Mellbye: Traditionally, we have based our communication messages on different insights about the customer. Up until 2009, we ran various market studies to understand customer preferences, as well as how our formats performed. The range included big surveys on perception, brand equity measurements, ad hoc analyses, and focus groups. A synthesis of the different surveys was the foundation for our marketing messages, enhanced by input from our group and format
organization. The challenge was that the insights from the studies were sometimes pointing us in different directions.

Q: How did this change?

Pia Mellbye: We have implemented the BrandMatics approach. This research basically replaces several of our previous studies and enables us to understand what is important to the customer, and how we perform in the purchase funnel (from “awareness” to “loyalty”) compared to our competitors.

Q: Why is this more insightful than your previous studies?

Pia Mellbye: Our insight is much more crisp and granular. We have defined 120 parameters related to price, service, in-store experience, convenience, and assortment. We measure our performance on these parameters for each stage in the purchase funnel, compared to our competitors. These measurements serve as a unique fact base; it helps us focus on the parameters that are important to the customer. The research also provides the rest of the organization with deep insights on how to improve in areas other than communication, e.g. commercial management and in-store operations. For instance, in our latest study, we found out that high-quality fresh herbs are a key loyalty driver in the “high end” segment, and that a high-quality private label offering is a key driver for trial in the “value” segment.

Q: What is the overall impact of the new approach?

Pia Mellbye: The systematic and analytical way of looking at the world has two types of benefit.

One, we have changed our communication objective: after running the funnel analysis, we realized that we had very high awareness, but low conversion rates from “awareness” to “trial,” as well as from “trial” to “loyalty.” It became clear that we needed to invest more in sales stimulation, e.g. in newspapers and leaflets, and less in brand building campaigns on TV.

Two, we became more fact-based in our messaging: the funnel analysis gave us unique insights into the drivers of the various transfers. We now focus our communication on the attributes that are most important to the customers. This way, we know we are relevant.
Key takeaways – Budget prioritization

1. Find the right decision mode: deciding centrally or convincing locally.
2. Define the right investment units: go granular and find the pockets of growth.
3. Create full transparency: understand where the money goes.
4. Define the prioritization criteria and weights based on what really matters in your budgeting decisions.
5. Avoid automatic decisions: prioritize your marketing investment in the light of the full facts.
• “There is nothing like a TV commercial to build brand image.”
• “If you want to drive sales, you should spend your marketing budget where customers make their choices: at the POS.”
• “I’ve never seen so much impact at such low cost. Our online viral campaign was a real bargain. Why don’t you try it, too?”

You’ve heard it all before; tips like these are a dime a dozen. Yet they often contain a grain of truth. For a given retailer, with a given budget, in a given country and competitive environment, they are all probably true at some point in time. But that doesn’t mean they are true for you, here and now.

In this chapter, we present the “Reach–Cost–Quality” (RCQ) approach, a quantitative method for evaluating, comparing, and selecting different media on a like-for-like basis. It relies on the concept of a common currency across all marketing touch points: real cost per actual reach. Thanks to RCQ, you won’t have to rely on trial and error, gut feeling, or plain rumor any longer. We will walk through this approach step by step, highlighting how it helps you generate a robust fact base for media mix and budget allocation decisions.
Optimizing individual vehicles one by one is challenging enough, but cross-media optimization is next to impossible without a universal metric.

- “Why don’t we run more sales stimulation ads in local newspapers and fewer fuzzy brand campaigns on TV?”
- “What is the most cost-efficient media channel in region X?”
- “Why don’t we use the Internet to strengthen the loyalty of our customers?”

These questions sound simple, but they are hard enough to answer even in isolation – because the data on the success of past marketing activities is often incomplete. In many cases, a retailer’s central marketing department has no transparency on local marketing activities, and lot of research agencies do not track below-the-line activities at all. At the same time, media agencies are not always incentivized equally across different media. As a result, the best solution for the advertiser may not be in the agency’s best interest.

While individual optimization of a given channel, or of a group of media, is challenging enough, optimizing the entire mix is even harder. There are few widely accepted performance indicators that apply across all media. What is more, most retailers are pursuing multiple marketing objectives in parallel, such as sales stimulation, brand building, and customer retention. So which tool or method should you use to bring consistency and analytical rigor to your media evaluation and selection?

RCQ is one of the more promising answers to this question. Of course, it is by no means the only one (see Chapter 7 for an overview of alternatives). RCQ will enable you to increase actual reach at no extra cost (i.e. to increase effectiveness) or reduce costs without compromising advertising impact (i.e. to increase efficiency). The approach combines the core criteria of reach, cost, and quality to create a ranking of communication vehicles, using “cost per actual reach” as the common currency. The RCQ concept is summarized in Exhibit 10.1.

Over the course of this chapter we will look at a concrete, if simplified, media mix question in order to illustrate this approach: “Which of the
following touch points works best for us: classical TVCs, POS promotions or online viral marketing campaigns?”

**Compare apples and apples:** use “cost per actual reach in target group” as the common currency for evaluating and selecting different media

We will now look at each of the components of “cost per actual reach in target group” one at a time. You will find that while cost and reach are more or less straightforward and easily quantified, quality takes a little more creativity to get your hands around.

**Cost**

The first step in RCQ is to define “cost” in a comprehensive way. To obtain a valid indication of the true return on investment, you need to capture the entire investment linked to each touch point (“total cost of ownership”). Media buying is the first item that comes to mind, but it is by no means the only one – agency fees, production costs, and research expenses also need

### Exhibit 10.1 Reach–Cost–Quality approach.

<table>
<thead>
<tr>
<th>Efficiency</th>
<th>Cost</th>
<th>Reach</th>
<th>Effectiveness</th>
<th>Quality</th>
<th>Performance</th>
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<tr>
<td>Cost</td>
<td>Total costs</td>
<td>Unique persons reached in target group</td>
<td>Total costs</td>
<td>Contact Consumer</td>
<td>Instruments</td>
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<tr>
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<td>Creation</td>
<td></td>
<td>Quality rating</td>
<td></td>
<td>Leaflets</td>
</tr>
<tr>
<td></td>
<td>Production</td>
<td></td>
<td></td>
<td>Local print</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Activation</td>
<td></td>
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<td>Radio</td>
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</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
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<td>…</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost per reach</th>
<th>Quality rating</th>
<th>Cost per actual reach</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Exhibit 10.1 Reach–Cost–Quality approach.
to be included. This step often proves quite an eye-opener. Some vehicles will immediately look less expensive than previously thought, while others may well turn out to be a lot more costly. Common assumptions like “email is free” do not survive the sweep of full cost transparency.

A complication is that suppliers often contribute to the costs of retail advertising, as when handset manufacturers pay network operators to push their cell phones in advertising. This makes the creation of full cost transparency quite difficult, particularly because of the opportunity cost effect: supplier funding may make certain touch points look more attractive than they really are. For example, suppliers may favor and subsidize local print advertising because of the opportunity to have their products featured prominently in the ads, but this might not be the most effective touch point for reaching the retailer’s marketing objectives. For instance, it might be that in-store promotions or outdoor advertising near the retailer’s outlets could create a higher sales uplift per EUR/USD investment. Retailers should maintain an independent perspective on the true cost of ownership of individual media. Ideally, the creation of cost transparency should initially disregard all supplier funding. Once the retailer has true transparency on its costs, it is always possible to renegotiate supplier co-funding arrangements in order to support the retailer’s overall marketing and media mix strategy.

To see what this means in practice, let us revisit our example.

- **TV**: for TVCs, you will need to make sure the analysis not only covers the media cost, but also the creative agency fees for developing, shooting, and producing the commercial. If you intend to use the same TVC in multiple countries, you will also need to take account of the additional costs of adaptation and the local rights charged by models, composers, and other artists.
- **POS**: for POS materials, you will not only need to recognize the design and production (or procurement) costs, but also the costs incurred for distribution and maintenance. If there is a response element (e.g. a voucher handed out at the POS), the calculation should also reflect the variable administration costs incurred in handling the responses.
• Viral online: the concrete cost positions depend on the exact setup of an online campaign. For example, placing a clip on YouTube typically requires significant investment in terms of creative agency fees, production, and license fees. The retailer might also wish to enhance access to the clip, for example, by using the services of a professional tremor network to try and start a snowball effect around the clip; these costs also need to be included.

Reach

For it to be reliable, any definition of reach should be based on the actual number of people reached by a given vehicle among the retailer’s relevant target groups. Depending on the overall marketing strategy, these groups might include teenagers, affluent senior citizens, or LOHAS (“lifestyle of health and sustainability”). To establish the actual reach among the target group, you first need to remove all those consumers who do not match the target group characteristics. This is especially important for diffusion media such as TV and radio, as well as for contacts made through local marketing instruments distributed outside a retail outlet’s own patch.

How do you measure reach? Typically, it is not possible to get data on reach for all media from a single source. Media agencies or tracking agencies provide reach data for above-the-line activities, while your own local or regional organization should be able to supply data on reach for in-store activities. Once you have a full set of data, a two-step approach needs to be followed to obtain reach in your target group:

• **Step 1:** Net reach in target group. Start with the gross reach in the population, then subtract the number of contacts outside your specific target group. To complete this step, you may have to conduct market research on the media usage of your target group, unless the media agency, research agency, or consumer insight department is able to supply this information. To derive the net reach from the gross reach, divide the gross reach by the average contact frequency. Finally, exclude all consumers residing outside the catchment area of your stores.
• **Step 2**: Actual reach in target group. This step accounts for the fact that not everyone who has, in theory, been reached by a given vehicle actually receives the message. For example, TV net reach only gives you the reported number of viewers of a given program; this fails to take account of whether an individual viewer was actually watching the TVC, or had just stepped outside for a smoke during the commercial break. Actual reach, therefore, equals net reach minus the number of people who are “tuned out.” The “tune-out” percentage varies greatly across different media; while it is low for personal interactions, it is typically very high for billboards. Frequency is another factor: the higher the “opportunity to see,” the lower the probability of “tune-out.”

“Actual reach in target group” gives you the number of people reached in your target group who live near one of your stores and who have actually had meaningful contact with your ad or message (Exhibit 10.2).

Dividing the full cost per vehicle by the actual reach of that vehicle in the target group yields the actual cost per relevant reach. This number is far more insightful than the commonly used cost per mille (CPM). However,
you may nevertheless need to use CPM for certain media if you don’t have all the data required to make the calculation outlined above. In these cases, you might be able to make rough adjustments to the full cost and actual reach based on the input of marketing experts.

Let us now look at how the calculation of actual reach pertains to our case example.

• TV: TV is among the media that need the highest adjustment in terms of reach. On the one hand, many viewers who are subject to your TVC will not match your target group criteria, and not all of those who do will be tuned in. Of those who remain, quite a few will live outside the local catchment area of any of your stores, especially in the case of nationwide broadcasting. To get a reliable estimate of the relevant radius, you need to understand how far people are willing to walk or drive to your stores, or whether there are competitors nearby that make your store unlikely to attract visitors in these neighborhoods. The best way to establish the number of households that match the target profile within a certain area is to use a geo-marketing tool (see Chapter 14: “Leaflets and Local Print Advertising: How to Achieve Local Media Excellence”).

• POS: Reach data is especially hard to find for POS activities. There is currently no agency that tracks footfall by retail format, let alone shopping frequency and target group fit. To approximate POS reach, retailers typically observe footfall in selected shops and extrapolate from the results to their entire network.

• Viral online: For viral campaigns, there are two kinds of reach: primary contacts generated through exposure to the actual advertising or clip, and secondary contacts generated through word of mouth among those who do not view the ad or the clip themselves. Measuring gross primary reach in online media is relatively easy: this is equal to page impressions. But net reach is more difficult to derive. To obtain full transparency, a response element is recommended, e.g. ”send to a friend.” This serves a double purpose: it identifies unique visitors and also serves to generate email addresses. In contrast, secondary reach can only be captured through consumer surveys. Estimates of both primary and secondary reach are necessary in order to capture the full value of viral online marketing.
Quality

Contact quality is defined as the impact of a given advertising activity on each consumer reached. As campaigns usually pursue several marketing goals at the same time, measuring quality is undoubtedly the most challenging aspect of RCQ. For example, you will often want an ad to stimulate sales, convey the benefits of the product featured, and build the retail brand—all at the same time. However, very few vehicles serve all goals with the same effectiveness. For example, you would expect a digital campaign that links consumers directly to an online shop to have a major impact on sales, while most print ads primarily convey rational reasons to buy; and TVCs, in contrast, strengthen viewers’ emotional attachment to the brand.

So how do you measure quality in a comprehensive and balanced way? Based on the proven psychological assumption that changes in attitude precede changes in behavior, quality measurement needs to assess three different components:

- the ability of a touch point to convey information, such as the price and features of a product (“cognitive attitudinal quality”);
- the suitability of a touch point to evoke emotion, such as the attachment to a trusted brand (“affective attitudinal quality”);
- the ability of a touch point to trigger action, such as increases in traffic or basket size (“behavioral quality”).

It is hard to isolate the nature of a vehicle itself from the quality of a given execution in terms of its creativity and production. However, not all award-winning campaigns result in high sales and brand impact. (For further details, see Chapter 16: “Excellence in Classical Media.”) Suffice it to say, RCQ evaluates touch points irrespective of the quality of execution. If you expect systematic uplift or downturn in specific channels, you would need to adjust the respective quality scores of that touch point. The judgment of experienced marketing practitioners, both within the organization and in the lead agencies, is usually the best basis for making this kind of adjustment. Prior to major campaigns, you might also wish to use advertising pre-tests to control for the quality of a given execution.
**ILLUSTRATIVE EXAMPLE**

- Two-thirds of German companies use social media for marketing.
- Impact of online buzz is often similar to costly TV advertising.
- Successful viral campaigns reach three-figure ROI scores.

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**Exhibit 10.3** Overview of cost per actual reach (RCQ score).

**Exhibit 10.4** Cost per qualified reach (RCQ score) for different retail formats.
See Exhibits 10.3 and 10.4 for sample outputs of RCQ efforts conducted in retail. Please note that the numbers given in these charts are specific to the context in which they were created and are not necessarily applicable in other environments. The nature of these examples is purely illustrative.

A shortcut to media quality

Disaggregated data for the three different components of media quality presented in this chapter may not be available for all vehicles in the scope of an RCQ analysis. Therefore it is common practice for retailers to use only two quality indicators: the propensity of an instrument to push sales (behavioral quality) and the ability to build the brand (attitudinal quality). For example, while leaflets and POS activities are known to push sales, their ability to build the retailer’s brand in areas other than price perception is limited. In contrast, TVCs are ideally suited to conveying emotional brand messages, but their direct sales impact is usually lower. In light of these differences, you may want to adjust or weight your quality assessment of the various vehicles, depending on your overall communication objectives.

The benefits of the RCQ approach are manifold. Because it uses “cost per actual reach” as a common currency, marketing effectiveness and efficiency can be compared on a like-for-like basis across all touch points, including TV, print, direct marketing, events, and even digital. What is more, the RCQ score is based on relevant and actual reach, i.e. on only those contacts that matter to the advertiser. It allows retailers to combine multiple marketing targets, from sales stimulation to brand building. The approach creates full transparency about the reach, cost and contact quality of all the marketing vehicles in scope of the analysis, and all recommendations can be traced back to the components of the RCQ score. Last not least, RCQ is universal in scope. It can be applied to a variety of processes to optimize the media mix, and it can be made to work with different types of source data.
RCQ scores can be used to increase efficiency as well as effectiveness, both within and across communication channels

The “Reach–Cost–Quality” approach has proven particularly helpful in three areas of marketing ROI optimization.

• *Increasing efficiency through internal benchmarking of advertising activities.* For example, a manufacturer of consumer goods found that the cost per actual reach of their online banners ranged from EUR 0.04 to 1.45 (USD 0.03 to 1.15). By cancelling the more expensive banner placements, the company cut their cost for this vehicle by 60 percent without reducing its actual reach. Similarly, a grocery retailer compared its cost per actual reach for different TV campaigns and observed a cost range from EUR 0.15 to 0.55 (USD 0.12 to 0.44). In light of this, it reviewed and adjusted its campaign plan, effectively increasing its proportion of high-impact campaigns on TV.

• *Tailoring media selection to drive efficiency.* Based on RCQ scores, you can rank all media vehicles, for example, to select the best local marketing instruments based on their real cost and actual reach in the given region. As an example of this application, a European grocery retailer discovered
that in one specific region the cost of placing ads in a local newspaper was significantly higher than for distributing leaflets. The spread was even higher in areas with low population. Based on this knowledge, the retailer developed customized regional media plans reflecting the RCQ scores observed in its different local markets.

- **Optimizing the overall media mix to increase marketing returns.** To optimize the entire media mix, you should combine RCQ scores with thresholds of efficient spend for the different touch points. This avoids overspending on vehicles that, while they might look very attractive because of the low cost per actual reach, will nonetheless lose efficiency beyond a certain saturation point. Similarly, spend thresholds help ensure that you invest above the minimal level necessary for your communication to be heard despite the competitive noise at a specific touch point.

In effect, RCQ is an approach for measuring and optimizing the ROI of each media vehicle. It does this by relating the marketing investment (“cost”) to the number of persons reached (“reach”) and the impact per contact (“quality”). Leading companies from industries as diverse as retail, automotive, FMCG, and telecoms have all used RCQ to optimize their media mix; some of them reallocated as much as one third of their total marketing budget to instruments that have greater impact. The efficiency and effectiveness potential they have discovered ranges from 10 to 30 percent of the total marketing investment.
Key takeaways – Reach–Cost–Quality

1. Optimizing individual vehicles one by one is challenging enough, but cross-media optimization is next to impossible without a universal metric.

2. Compare apples and apples: use “cost per actual reach in target group” as the common currency for evaluating and selecting different media.

3. RCQ scores can be used to increase efficiency as well as effectiveness, both within and across communication channels.
Retailers have privileged and powerful access to consumers – especially through promotional activities and loyalty programs. These instruments are direct purchase decision drivers, but they are also highly targeted communication channels, since both the message and execution can be tailored to the needs of individual regions, clusters, outlets, or even consumer segments. Their effectiveness makes them key elements in any retailer’s marketing mix.

In Chapter 10 we discussed the Reach–Cost–Quality (RCQ) approach as an established and pragmatic way to evaluate and balance the role of a wide range of traditional touchpoints, comparing them on an “apples-and-apples” basis. By comparison, marketing mix modeling, or MMM, is a more analytically sophisticated and more powerful tool. It helps retailers create a comprehensive fact base for advanced marketing allocation and activity decisions. Based on econometrical modeling, MMM enables retailers to measure the performance of their current marketing mix and optimize it across advertising vehicles and other touch points, including unique retail levers such as pricing and promotions.

**What it is:** Marketing mix modeling tells you how to spend it

It’s all about the look. You want your ads to look good on the TV screen, your products to look good on the shelf, your brands to look good in the
consumer’s mind – and the bottom line to look good on your company’s income statement. Of course, retail management is more complex than that. But precisely because it is complex, executives in both marketing and sales are looking for a comprehensive, yet straightforward fact base that helps them with the wealth of strategic and tactical choices involved. How do I split my investments between branded and private label products? Which commercial levers are the most effective for driving traffic and revenue? What is the impact of different levels of marketing investment and promotional activity on sales?

Marketing mix modeling is geared towards helping executives in charge of strategic as well as tactical retail management – usually the CMO and the commercial director or head of sales – providing them with a fact base to help them make the trade-off decisions they face, especially regarding the allocation of funds and resources across the various marketing and sales levers. The analysis typically provides answers to three types of question the CMO and commercial director would ask.

- **Performance driver analysis**: What are the true drivers of top-line performance? Which of these are under our direct influence, as opposed to external factors?
- **Impact analysis**: What is the top-line (revenue and/or traffic) impact of our marketing investments? How does the ROI compare for different line items in the marketing budget?
- **Optimization of marketing spend**: What is the optimal allocation of marketing and sales funds? How will budget reallocation influence revenue and profit?

A state-of-the-art MMM analysis is able to capture the influence of a wide range of marketing levers on revenue, traffic, and profit in order to identify the true drivers of performance. Its output helps separate external factors, such as the overall market growth or demographic trends, from the levers that you can pull yourself, such as promotional strategy or advertising investment. MMM also provides revenue and traffic impact measurements across all marketing levers in order to assess their relative business contribution. This type of impact analysis provides an understanding of
whether, for example, advertising is a more effective top-line driver than promotions – in a specific market and situation. Finally, MMM enables executives to keep an eye on price perception. Lowering average applied discounts may be a great way of boosting revenue, but how does this affect profits in the long term? This sensitivity test enables the executive team to balance short-term tactics with long-term strategy.

Ultimately, MMM provides retail managers with the means to investigate the likely consequences of their actions before they act, enabling them to make fact-based decisions, instead of relying on intuition.

**How it works:** MMM compares the relative impact of a wide range of growth levers

The logic of MMM is simple and straightforward, but its mechanics require a sophisticated blend of science (i.e. econometric modeling) and art (i.e. deep, commercial retail expertise). In a nutshell, MMM captures two types of input factor: on the one hand, the marketing mix under the retailer’s control (such as average prices, loyalty schemes, promotions, and advertising pressure) and external parameters on the other (such as competition, demographics, economic and consumer trends, as well as seasonality). The heart of MMM, its analytical engine, models the relative impact of these levers on revenue and traffic, as well as on consumer price perception (Exhibit 11.1).

The analytical engine should be custom-built for each retailer, primarily because data sources and formats, as well as responsiveness of marketing and non-marketing factors, typically differ across retailers. However, three key elements are common to all successful MMM solutions: an integrated input database that is constantly updated; an econometric model that is refreshed periodically; and a user-friendly software interface that allows for ongoing performance tracking and optimization of marketing investments (Exhibit 11.2).

The database is assembled with information from a variety of sources, from in-house data and publicly available market data, right down to proprietary research and general trend information. The database is created
**Exhibit 11.1** MMM: high-level logical architecture.

**Exhibit 11.2** MMM: high-level technical architecture.
after integrating, cleansing, and validating the information from each of its sources. The database is typically built using standard tools such as SAS. The econometric model itself is designed with two objectives: reflect the dynamics of the data, and help answer the business questions at hand. The user interface makes the full power of the tool accessible to executives through features that are directly relevant to marketing decision-making: gap analyses of actual versus plan, “what if” scenario simulations, and interpretation guidelines based on commercial expertise.

If retailers want MMM to be more than a one-time-only analysis, it must be integrated into their established systems and processes. Specifically, the data architecture should be fully compatible with the retailer’s existing IT architecture so that the datasets can be refreshed automatically as new data becomes available, while the output should support ongoing management decision making and reporting.

**What it does: MMM has strategic as well as tactical applications**

Given the data requirements and analytical sophistication, MMM is not a quick fix, but neither is it a once-in-a-lifetime effort. Its true power lies in its continuous and consistent application. As an integral part of a retailer’s management information system, it is a comprehensive decision support tool that yields transparency at a holistic level as well as at the granular level of individual marketing activities.

At the holistic level, MMM informs the retailer’s strategic positioning, including the retailer’s quality/price position, its competitive differentiation, its cross-format policy, and its private label strategy. For instance, a CMO may be looking for the right balance between store brands and manufacturer brands in advertising, or wonder about the optimal trade-off between brand image building and promotional advertising. While MMM can help to generate insights that can inform strategic deliberation, such as the relative importance of the retailer’s average shelf prices compared to its key competitors, it is also a useful tool in day-to-day marketing, such as campaign design and promotion management. By analyzing the effect of
these various levers on revenue and traffic growth on the basis of historical data, MMM enables retailers to run various scenarios and compare their prospective top-line impact.

**What it yields:** *MMM creates transparency across multiple marketing levers*

The specific benefits of MMM in day-to-day marketing mix management include increased transparency about the drivers of performance and the return on investment of different marketing levers.

Exhibit 11.3 shows how MMM can help executives distinguish between the impact of their actions and the effects of general trends in the market. They may find, for example, that a large proportion of the observed sales uplift was driven by extraneous factors like overall market growth, sunny skies, or the closing down of a competitor’s outlet, while only a small part of the growth was actually driven by the retailer’s marketing mix in a given reporting period. This extra transparency gives retailers the ability

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**Exhibit 11.3** MMM enables retailers to identify the drivers of performance.
to build a more realistic and unbiased platform from which to evaluate and optimize their commercial performance.

Not only does MMM help executives understand which performance drivers they should pull, it also identifies the return on investment for the ones they do pull (Exhibit 11.4), or have pulled in the past. While some activities generate solid profits, and others are bottom-line neutral though required for tactical reasons, the activities financial officers really lose sleep over are the ones that burn money. MMM enables them to spot these – and stop them.

Last, but not least, MMM helps retailers to keep track of how their marketing activities influence consumers’ price perception. Exhibit 11.5 illustrates how the insights into the impact of different marketing activities on revenue and price perception can be combined to inform decisions about the trade-off between short-term tactical moves and long-term strategy. While some activities are beneficial from both perspectives (described as the “best moves” in Exhibit 11.5), others are either long-term investments designed to fuel consumers’ perception of the retailer as a provider of good value, or purely tactical moves to drive revenue and traffic in a given market environment.

While MMM lays bare the impact of various marketing activities on sales and price perception, it cannot capture potential changes in brand
image brought about by these same activities. To avoid any damages to brand equity, you should not rely on MMM exclusively for your marketing mix optimization efforts. Rather, you will want to treat the MMM output as the basis for a wider discussion that also reflects other sources, such as consumer market research.

**What to watch out for:** *The devil is in the details of the analysis; cross-functional teams help to ensure the integrity of the data, the calibration of the model, and the correct interpretation of its output*

Econometric modeling is the foundation of marketing mix modeling. While econometrics have been in use for the past few decades in the consumer goods industry, its application to retail is a more recent phenomenon. This is due in large part to recent increases in computational power and platform
sophistication. These advances allow for the automated creation of large datasets, and they enable retailers to build complex models, e.g. including separate analyses to explain store sales vs. product sales. Another factor driving the application of advanced analytics to retail is the increasing complexity of the retail industry itself. While gut-based decision-making has come to its limits, the econometrical approach reflects historic data and applies complex statistical techniques to single out the effects of all relevant factors – marketing as well as non-marketing – on sales or traffic.

Working with a wide range of input factors, the econometric engine that forms the core of every MMM effort recognizes each variable that has a statistically significant influence on sales and traffic uplift, whether it be the CMO’s latest loyalty initiative or the changes to a competitor’s store network. It automatically chooses the most appropriate estimation algorithm and regression model from a range of options to produce the most mathematically accurate and practical explanation of how the marketing levers influence the dependent variables: revenue, traffic, or consumer perception.

From this description it should also be evident that the accuracy of the model is dependent on how well the database of input factors has been built and maintained. To ensure its output is both valid and actionable, the database has to satisfy a wide range of criteria – some of which are, in part, conflicting.

- **Sufficient scope and granularity**: Statistical analysis shows that two to three years’ weekly or daily historical data is necessary to stabilize the model. The data set must be sufficiently detailed to encompass all the relevant influencing factors necessary to describe the retailer’s commercial policies. The data also has to be sufficiently granular to capture all the relevant differences between regions and categories. For example, retailers may want to use multiple POS clusters – e.g. of sufficiently homogeneous regions – rather than the entire universe of all its stores. Similarly, using product categories, such as “dairy products,” “sweets,” and “salty snacks,” will often produce more informative results than using generic sectors like “food.”
- **High reliability and accuracy**: “Garbage in, garbage out” applies to MMM as much as it applies to any other advanced modeling effort. Extra care
is required to detect and fix any gaps or inconsistencies in the database. For example, data on competitors’ activities is often unavailable or incomplete. But even in-house reporting systems are often susceptible to error and corruption, whether because of manual procedures at the POS or because of incompatible data formats. Meticulous merging, cleaning, and validation of data sources are indispensable measures to safeguard the reliability and accuracy of the output.

- **Constant care**: To ensure MMM remains meaningful and relevant in the longer term, the database needs to be fed with new input data on a regular basis, whether through automated or manual updates. Frequent input updates enable the model to capture the market’s evolution and changes in competitive dynamics. If data is uploaded automatically, extra care is required to ensure that the source matches the formats and units of the predefined metrics used in the model in order to maintain the integrity of its impact analysis. After all, it makes a difference whether sales figures are in “m” or “bn”!

To generate and maintain a sufficiently detailed, reliable, and up-to-date database, both functional and technical trade-off decisions are required. In our experience, only a cross-functional team is capable of tackling the challenge of MMM database creation and maintenance. Take the example of advertising spending: while the head of marketing or media might know which vehicles are relevant, it takes a market research specialist to figure out whether it is possible to obtain the ad spend data of competitors, and only a financial controller will know how third-party ad tracking information can be made comparable to in-house figures. And without the help of the IT systems manager, there is no telling which formats and file names are required to fit the model’s operating platform. While a cross-functional team can manage such challenges, finance, marketing, or IT on their own could not.

Despite its analytical allure, MMM is by no means meant to take the place of experience and common sense. Rather, it acts as a complement and potentially a corrective to the gut feelings and good judgment of seasoned marketing and sales professionals. It is a decision support tool, not a retail management robot. Like any management information system, it depends on the wisdom of its users.
MMM applied: best practice, example 1

**Telecoms**

The telecommunications industry is characterized by high levels of advertising spending. This has led the industry to push the limits of tools such as MMM for optimizing ad spend ROI. Telecoms companies work closely with their media agencies to find out where they achieve the best value in terms of consumer contacts (and subsequent revenue) for their ad spend. Their goal is to determine which time slots, channels, and sellers provide the best contact-to-ad spend ratio in their target group. See Exhibit 11.6 for a daytime optimization example and Exhibit 11.7 for an example of how the share of different channels and sellers is adjusted. Based on this kind of information, advertisers are able to fine-tune their choice of advertising opportunities to maximize the effectiveness and efficiency of their media spend.

<table>
<thead>
<tr>
<th>Period</th>
<th>Revenues per EUR spent EUR</th>
<th>Gross number added per GRP</th>
<th>Share of GRP by period</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Jan–Jun 2009, Percent</td>
</tr>
<tr>
<td>Prime time and late evening</td>
<td>4.3</td>
<td>19</td>
<td>54%</td>
</tr>
<tr>
<td>(19:30–24:00)</td>
<td></td>
<td></td>
<td>58%</td>
</tr>
<tr>
<td>Pre-prime time</td>
<td>7.2</td>
<td>23</td>
<td>57%</td>
</tr>
<tr>
<td>(18:30–19:30)</td>
<td></td>
<td></td>
<td>48%</td>
</tr>
<tr>
<td>Daytime</td>
<td>2.2</td>
<td>8</td>
<td>41%</td>
</tr>
<tr>
<td>(02:00–18.30)</td>
<td></td>
<td></td>
<td>35%</td>
</tr>
</tbody>
</table>

**Exhibit 11.6** Daytime optimization for effective media planning – telecoms example.
Consumer-goods companies are notorious high rollers when it comes to advertising spend. As an industry, FMCG spends the most of any industry on advertising, investing some USD 100 billion worldwide every year. According to The Wall Street Journal, Procter & Gamble’s observed annual advertising volume totals almost USD 3 billion – in the US alone. P&G’s rival Unilever spends similar amounts. But there is no obvious link between marketing data, such as GRPs, and revenue or profit impact.

**Exhibit 11.7** Channel and sales house optimization for effective media planning – telecoms example.

### MMM applied: best practice, example 2

**FMCG**

Consumer-goods companies are notorious high rollers when it comes to advertising spend. As an industry, FMCG spends the most of any industry on advertising, investing some USD 100 billion worldwide every year. According to The Wall Street Journal, Procter & Gamble’s observed annual advertising volume totals almost USD 3 billion – in the US alone. P&G’s rival Unilever spends similar amounts. But there is no obvious link between marketing data, such as GRPs, and revenue or profit impact.
In this situation, MMM helps FMCG companies optimize their budget allocation (Exhibit 11.8). The input factors in these deliberations include their current budget allocation; their business objectives and marketing targets; and, most importantly, the response curves for different media and regions that can be derived through MMM analysis. These response curves plot the revenue impact of GRPs and help determine the marginal utility of additional ad spend: for example, while one TVC per week may go unnoticed by the target group, more than five spots per day might be a waste of money. Based on these input factors, in combination with other relevant corporate guidelines, such as budget caps for specific regions, the MMM tool produces an allocation proposal and simulates its effect on the revenues and market shares of the company in the different regions.

Exhibit 11.8 Budget allocation optimization based on media response curves.
Grocery retail

In many countries, mainstream grocery retail is a low-margin business. Ever since the rise of discount retail some 50 years ago, grocery retailers have not been able to afford to let a single penny slip. As a result, they want the price of each SKU to be exactly on their customers’ price sensitivity curve – no higher, lest shoppers churn to competitors, but certainly not lower either, lest precious profits go unclaimed. Unfortunately, consumer price perception is not the only factor in the equation. Chiefly because of competitor reactions, pricing has become one of the most dynamic of all marketing levers. If retailer A cuts prices for a given item, retailer B might match the new price practically overnight. As a result, the impact of changes in pricing is highly volatile and very hard to predict. Most traditional simulation models underestimate the speed of competitive reactions, especially in mature markets with high retail marketing sophistication. What is more, leading retailers even adjust their reactions depending on the importance of the SKU for consumer price perception. While retailer B may not care about retailer A’s price cut for private label commodities, it is likely to react much more swiftly and decisively if the article in question is a known value item (KVI) that has direct impact on consumers’ general perception of the retailer as a provider of good value for money.

The increasing speed and differentiation of competitive reactions to pricing changes usually lead to vastly exaggerated impact estimates for potential price cuts. In reality, price leadership that lasts only a few days has a very limited impact on shopper behavior. The market share that can be captured from competitors through price reductions isn’t what it used to be. State-of-the-art marketing mix modeling tools recognize these effects. Exhibit 11.9 shows a sample output of an MMM tool that uses recent data on price changes, consumer price perception, and competitive reactions to predict the effects of potential price changes for various categories and SKUs. Based on this type of output, retailers can produce much more realistic estimates for the impact of the price decreases or increases they are considering.
With this worry off their backs, retailers can finally start crafting sustainable strategies that will stop the discount craze and make grocery retail less of a cut-throat business. Once shoppers are willing to pay for quality, convenience, and service, price wars will be a thing of the past. Even marketers can dream, can’t they?

**Exhibit 11.9** Simulation of competitive reactions to pricing changes.

Interactive decision support tools

To embed the MMM approach in their marketing organizations and ensure it is used for front-line decision making, retailers should consider the implementation of interactive decision support tools. Simulation tools that rely on MMM enable marketing practitioners to evaluate different scenarios for their future marketing plans. Exhibit 11.10 shows an illustrative screenshot from such a tool. For simplicity’s sake, this example covers only four marketing investment units: discounts, advertising, display, and on-shelf featuring. By moving the sliders in
the top left-hand quadrant, marketing planners can try out different investment levels for these vehicles. As the investment amounts are changed, the tool recalculates the predicted sales and profit impact; the results are displayed in the top right-hand quadrant. The chart in the bottom right-hand quadrant shows how far the current investment scenario is from the optimum – the maximum profit that is achievable for a given total marketing budget level.

In general, all such tools should reveal how the predicted sales and profit impact is calculated. In this example, users can check whether the simulated output makes sense by looking at the movement of investments along the response curves in the bottom left-hand quadrant. Retailers should avoid using “black box” tools, i.e. tools the inner workings of which they cannot check on.

Exhibit 11.10  Example of interactive decision support tool.
Key takeaways – Marketing mix modeling

1. What it is: MMM tells you how to spend it. (It generates a straightforward yet sophisticated and comprehensive fact base for retailers’ commercial decisions.)

2. How it works: MMM compares the impact of a wide range of growth levers (by modeling their influence on revenues, traffic, and price perception).

3. What it does: MMM has strategic as well as tactical applications. (Its uses range from overall strategic positioning to daily operations.)

4. What it yields: MMM creates transparency across multiple marketing levers (including performance drivers, the ROI impact of different marketing levers, and sensitivity to price perception).

5. What to watch out for: the devil is in the details of the analysis; cross-functional teams help to ensure the integrity of the data, the calibration of the model, and interpretation of its output.
Writing something as permanent as a book about something as ephemeral as the Internet seems paradoxical. But rest assured: unlike Ethan Hunt’s pre-recorded briefings in *Mission Impossible*, this chapter will not self-destruct before your eyes. However, some of the companies mentioned in it might. There is a good chance that some of today’s digital pioneers will be out of business when you read this, and today’s hot topics will surely be tomorrow’s “old hat.” But we believe that the underlying trends we examine in this chapter will continue to change retail marketing fundamentally.

One third of the world’s population is online. Every year, more than 200 million new users link up to the Internet. And connectivity is no longer a privilege of saturated markets: out of 2.5 billion global Internet users, one billion reside in Asia. More than 60 percent of all Internet connections are already mobile connections, and mobile access is growing at a rate of more than 20 percent. Today’s digital natives are online anytime and anywhere. And most importantly, more than two thirds of them say that they use web research to make purchase decisions.

At the same time, users are ever more willing to reveal who they are, what they like, and how they spend their time and money. Currently, there are some 850 million Facebook members, up from 500 million when *Retail Marketing and Branding* first came out in 2010. And 50 percent of consumers say they share purchase-related information online. Increasingly, sharing your preferences does not require any direct action at all. For example, the introduction of Facebook’s Timeline turns members’ profiles into...
semi-automated logs of their lives not only as social creatures, but also as shoppers.

Pure online players are moving swiftly to take advantage of these developments, and they put great pressure on brick-and-mortar as well as multi-channel retailers (see “Learning from the best” below). Their business systems are well adjusted to the digital world, and they have no stores that could slow them down. Why should traditional retailers care? Because offline and online are no longer separate worlds. In many categories, such as books, music, and consumer electronics, these channels are converging quickly.

To stay relevant and define defendable positions in this multi-channel world, retailers will need to embrace five major trends, regardless of their roots (Exhibit 12.1):

- end-to-end digitalization;
- converging sales channels;
- digital localization;
- social media impact;
- content as a retail success factor.

<table>
<thead>
<tr>
<th>What is it?</th>
<th>What is happening?</th>
<th>What does it mean for retail?</th>
</tr>
</thead>
<tbody>
<tr>
<td>End-to-end digitalization</td>
<td>New technology affects multiple retail functions</td>
<td>Watch for game-changing applications, such as micropayment systems</td>
</tr>
<tr>
<td>Channel convergence</td>
<td>Online and offline sales channels are converging</td>
<td>Identify and use key digital touch points along the consumer decision journey</td>
</tr>
<tr>
<td>Digital localization</td>
<td>Digital media are becoming more local and more personal</td>
<td>Gather, integrate, analyze and leverage location-based data, e.g. for CRM</td>
</tr>
<tr>
<td>Social media impact</td>
<td>Opinions are increasingly formed and influenced online</td>
<td>Listen actively and get friends or followers to act as brand advocates</td>
</tr>
<tr>
<td>Content as a success factor</td>
<td>Users are hungry for rich and fresh digital content</td>
<td>Create or source relevant content continuously to enrich consumers’ lives</td>
</tr>
</tbody>
</table>

*Exhibit 12.1* Five major digital trends.
By and large, these trends affect "e-tail" as much as brick-and-mortar retail. In fact, channel choice is the one thing that is not digital about the digital (r)evolution. If you want to survive as a retailer, it’s not online or offline. It’s and.

End-to-end digitalization affects multiple retail business functions

Online stores may be the most prominent and most visible sign of how digital technology is changing the retail landscape, but it doesn’t stop there. Many will be tempted to equate “digital” with “Internet,” but they couldn’t be more wrong. Not a day goes by without new types of digital technology hitting the streets and the shelves of the real world. Some of them have already started to transform daily retail operations. Examples include:

- RFID (radio-frequency identification) microchips that facilitate inventory management, enhance store security, and enable self-checkout;
- micropayment through services like Google Wallet by way of NFC (near-field communication), Bitwallet’s Edy, or Square’s Card Case application;
- new ways of experiencing media content, such as cloud hosting services as offered by Amazon, or Bluebrain’s location-aware audio adventures;
- game-changing user interfaces such as Microsoft’s touchless Kinect system and Apple’s natural-language software assistant SIRI;
- gadgets for wireless connectivity such as Jawbone’s motion-monitoring wristband, or Twine’s web-based remote control for household appliances.

Most recently, innovative providers of retail-related services such as ADT or Path Intelligence are turning heads by using existing in-store security cameras and even shoppers’ cell phones to trace traffic in stores. Says Sharon Biggar, CEO of Path Intelligence: “The FootPath technology allows us to monitor the path you take as you travel through premises belonging to any of our clients. We combine the information detected from the cell phone signal with a proprietary mathematical algorithm. This allows us to
determine your path through premises equipped with our receiver units.” Several UK retailers are already using the system to detect shoplifters, who move in patterns that differ from those of regular shoppers, as well as to redesign store layout and trigger higher sales (Source: “Shops are secretly tracking your every move,” The Daily Mail, November 29, 2011).

But certainly, not every much-hyped gadget or application will revolutionize retail operations. What retailers will want to look out for are advances in hardware, software, or systems integration that help solve relevant problems that suppliers, merchants, or shoppers are experiencing. Take the case of online payment. Many users are tempted to buy even from players they have no previous experience with, but are hesitant to make the actual purchase because of the anonymity, and possible fraudulence, of their potential business partners. Enter PayPal, a player that serves as a neutral intermediary and guarantees safe payment upon completion of a transaction, as well as worry-free refunds if needed. The introduction of the PayPal system was one of the factors that triggered a landslide in mobile commerce; mobile transaction volume handled by PayPal doubled from 2009 to 2010. At the end of 2010, more than 2.5 million users had downloaded one of PayPal’s mobile apps. Total transaction volume went from USD 47 billion in 2007 to USD 92 billion in 2010. Today, about 12 percent of US e-commerce payment volume is processed by PayPal (Source: company filings).

### Criteria to assess the retail relevance of technological innovation

- Does it address one of the retailer’s or the customers’ major pain points?
- Does it drive conversion or basket size at the POS significantly?
- Does it help save money through leaner processes or shorter lead times?

Because of their trial-and-error mentality, retailers are well equipped to adapt to technological changes quickly and capture benefits by streamlining
their supply chains or generating higher revenues. But they will need to stay vigilant and scout the market constantly to identify potentially game-changing trends and take rapid decisions on what to try out, what to implement at scale, and what to dismiss.

**Converging sales channels are transforming the consumer decision journey**

In McKinsey’s recent iConsumer survey, 17 percent of magazine readers and 11 percent of newspaper readers said they were moving from printed matter to online content. And a third of all smartphone users prefer using their phones for web access or email even when they are near PCs. But not only are consumers online anytime and anywhere, they are also increasingly shopping online. Smartphone users say they spend almost one fifth of their total device usage on “browsing” and “shopping.” In some countries, the online share of total retail revenues hit 10 percent as early as 2009. There are some 170 million online shoppers in Western Europe alone, and their number is growing at 5 percent annually, according to Forrester Research.

Digital natives also bring and use their mobile devices when shopping offline. For many of them, the smart phone is the device of choice for targeted product research, price comparison, and post-purchase communication, such as posting product reviews or sharing details of their shopping experience with friends on social platforms. But even for more traditional shoppers, digital media such as online video, outbound email, and exclusive digital content are becoming more and more relevant all over their decision journey (Exhibit 12.2).

Increasing worldwide Internet usage, the growth of e-tail, and the ubiquity of the smart phone as the modern-day Swiss Army knife of commerce have triggered a convergence of offline and online retail. Remarkably, traditional retailers are at the forefront of channel integration. Examples of early movers include Tesco’s virtual Homeplus stores in South Korea (see the insert in Chapter 4 on store formats) and Burberry’s digital retail model in China (see below).
Exhibit 12.2 Digital media are relevant all over the shopper’s decision journey.
Digital makeover for Burberry stores in China

In China, luxury retailers find themselves stuck between a rock and a hard place. On the one hand, shoppers believe that online shopping gives them greater choice and better deals on high-end items than offline retail. On the other hand, a recent McKinsey study revealed that “making contact with the products in stores” was the most important factor driving Chinese consumers’ luxury purchases. In an attempt to give consumers the best of both worlds and rejuvenate its image, Burberry has made China the pilot market for its digital retail model. It combines offline stores with the latest in interactive digital technology. The company is furnishing its Chinese store with oversized touch screens that can display special collections, stream fashion shows from other countries, and play Burberry-produced entertainment. All employees will eventually be equipped with iPads to help consumers order sizes and products that may not be available in stores. In April 2011, Burberry introduced a virtual badge on Jiepang, China’s equivalent of Foursquare, that gives customers access to special sales if they check into the company’s location-based network. The virtual badge features a stylized version of the company’s trademark tartan pattern as rejuvenated by Christopher Bailey a decade ago.

In parallel to the digital overhaul of its stores, Burberry has launched its own online shopping site for Chinese consumers, offering 24-hour customer service through an online chat system. Additionally, the company has set up accounts on Chinese social networking sites like kaixin001.com and douban.com, as well as on Internet television platforms such as youku.com. To top things off, local celebrities are sending comments through the Burberry account on Weibo, a Twitter-like microblogging service. In January 2012, Burberry had 180,000 Weibo followers, up from 90,000 in early 2011 (Sources: The Wall Street Journal, April 14, 2011; Jing Daily, April 7, 2011).
In the future, the challenge for retailers will be to create an offering that not only appeals to their target consumers, but is also delivered consistently across all channels. When the competition is just a click away, it is easier than ever to lose even those customers who have already entered a retailer’s store, and harder than ever to earn or regain their loyalty. Cyriac Roeding, founder of Shopkick, believes that the cell phone itself is the key to the future of store-based retail. Solutions like Shopkick automatically recognize when registered users walk into participating stores with their smart phones. Once the signal is detected, these applications deliver reward points for entering the store, trying on clothes, scanning barcodes, and other such activities. Walmart is already staking its claim to in-store mobile integration; the company has recently acquired OneRiot, a social and mobile ad targeting agency, as well as social media startup Kosmix. Says Jack Abraham of eBay: “If retailers don’t become part of mobile search results, they risk getting lost in the post-PC era.” (Source: Leena Rao, “The Threat and Opportunity of Mobile,” The Crunch, December 26, 2011.)

Digital localization and individualization gain momentum

Access to content and interaction with other users irrespective of one’s location used to be what the Internet was all about. Almost by definition, the prototypical Internet user was what John Lennon, in his infinite wisdom, once called “a real Nowhere Man, sitting in his Nowhere Land.” Not any more. Today’s netizens are on the move, and everybody knows where they are going. Thanks to the positioning functionality of many mobile devices – based on GPS, Bluetooth, WLAN, or cellular network cells – retail-related applications are becoming ever more location-aware. As early as 2007, MobileOne pioneered a service that delivered coupons and discounts for shops, restaurants, and movie theaters to passing mobile subscribers by SMS. More recently, Square introduced its opt-in Card Case application that lets customers explore nearby shops, connect with local merchants, and settle their virtual tabs. One of the most popular geo-location applications today
is Foursquare, enabling users to locate friends and nearby merchants, as well as to obtain discounts and digital coupons. In mid-2011, the company reported reaching 10 million members and an average number of three million check-ins per day. Other providers of location-based messaging and marketing include The Coupons App, Centrl, Zhiing, BluePont, Loopt, Hotlist, Gowalla, Poynt, Yelp, and GeoMe.

Localization obviously holds great potential for customer acquisition, development, and retention. But to reap the benefits, retailers need to start gathering and analyzing location-based customer data, and they have to find cost-effective ways of translating this data into localized marketing communication. Walmart, for example, has reacted to localization by setting up Facebook pages for individual stores (“My Local Walmart”); there are 3,600 locations in the US alone. Each store is responsible for keeping up the dialogue with local customers. “Liking” the stores nearest to them enables shoppers to see specific offers and new merchandise geared to their area. Also, Walmart uses these pages to promote local events such as food samplings and special promotions. There is even a feature that lets shoppers download a map of their local store, pinpointing the exact in-store location of the specific advertised specials.

Another potential game-changer is the widespread implementation of near-field communication (NFC). NFC enables even more granular customization, e.g. by tailoring propositions to individual customers at the POS. For example, special offers or even individual prices may be readjusted and streamed to a mobile device when a registered user steps up to a specific shelf or picks up a product. Jack Stephenson, head of mobile marketing and e-commerce at JP Morgan Chase, believes NFC will fundamentally change the way retailers do business: “My view is that NFC is going to be embedded in phones and that it will be a game changer. More and more smart phones are going to have this technology, which lets you transmit data over short distances. We’ll have NFC chips in posters, and the posters will have some kind of offer embedded. So say I want to get this offer. I tap the poster, and the offer is stored in my digital wallet instantly. It could be a coupon, it could be a song, it could be a video.” (Source: The Atlantic, October 26, 2011)
Social media impact is revolutionizing retail reputation building

By 2011, more than 100 out of Fortune’s top 500 companies had their own blogs, some 300 had set up their own Facebook page, and even more were using Twitter, according to a study by the University of Massachusetts. Worldwide, a growing majority of advertisers is spending money on social media. For example, US social media marketing spend is forecast to grow at 26 percent over the course of the next five years. However, the profound changes brought about by social media go much deeper than advertising. Social network sites are becoming the black holes of the Internet, pulling commerce, content distribution, and CRM into their gravity fields. Social mechanisms are incorporated into everything from supply chains to customer service to product design. As data mining becomes increasingly sophisticated, social channels will register highly on everyone’s radar, from the CMO to the teenager at the checkout. (Source: Most Contagious 2011)

The sheer speed of communication and interaction makes Facebook the world’s largest snowball system, for better or worse. It distributes information at almost the speed of light, and it weights content by the number and followership of those who pass it on. By 2011, more than 2 million websites had integrated their offering with Facebook. Why is any of this relevant to retailers? For two reasons: firstly, word of mouth is the single most powerful purchase driver, especially in categories that are most affected by channel integration, such as electronics and apparel. In a recent survey, respondents said that “hearing others talking about this retailer” was among the top three reasons for them to consider shopping there. Secondly, more than two thirds of consumers globally say they use online product information to make purchase decisions (Exhibit 12.3). As a result, there is no way past social media for retailers. If they don’t see to the buzz-worthiness of their brands and their commercial offer, shoppers will eventually walk away from their stores and their sites, taking their business to the places and players everybody is talking, and posting, about. Among the five trends we are covering in this chapter, social media impact is the one that is perhaps most relevant to pure players. In fact, they are more vulnerable to the highs and lows of online buzz than traditional
retailers. While traditional retailers are rooted in the real world, often with a heritage of trusted service that dates back decades or even centuries, pure players have nothing but their online reputation to play on. And many fast movers among the much-hyped start-ups of the 1990s have found out the hard way that trust is much more easily lost than won.

Regardless of a retailer’s channel coverage, the potential for connection and interaction through social media is huge. Part of its charm is the act of will it takes to become someone’s friend, follow someone’s stream, or like someone’s content. Once users attach themselves to a given social presence, this means that messages and offers will not be perceived as a burden or an intrusion, but as a welcome enrichment of their online experience. If retailers find ways of using this “opt-in” nature of social media to their advantage, they will be rewarded by the loyalty and the advocacy of their followers. Examples of innovative social media leverage include:

- Dell’s Social Media Listening Command Center. Located at Dell’s headquarters in Round Rock, Texas, the unit monitors approximately 20,000 online conversations that deal with Dell computers. The command center tracks the leading topics, who is speaking, Dell’s share
of the conversation, and how Dell is responding. Although the actual communication with customers is the job of the social outreach support (SOS) team, the command center helps the SOS team decide where to spend its energies. In support of the Command Center’s efforts, Dell employs both a Chief Listener, Susan Beebe, and a Chief Blogger, Lionel Menchaca. One of the KPIs Dell monitors very closely is the company’s “demoter to promoter” score, i.e. the ratio of negative to positive advocates. Dell currently has more than a million followers on Facebook, up from about half a million prior to the establishment of the Command Center. The company provides many of its followers with early access to announcements and product information to make them feel like Dell insiders and build brand advocacy. (Sources: ragan.com, April 19, 2011; seekomega.com, June 2, 2011)

• Foot Locker’s Sneakerpedia, a Wikipedia-type platform that allows users to connect around sneakers and upload details of their coveted shoes, complete with pictures of the original boxes, tagged according to brand, color, material, and year. The site is a way of bringing Foot Locker’s brand essence, “enthusiasm beyond reason,” to life. Foot Locker deliberately chose to create a platform from scratch, rather than piggyback on an existing social network or fan portal. Also, there is very little overt branding on the site. Nevertheless, Sneakerpedia enables Foot Locker to draw rich social data about which makes and models are popular. The company encourages new floor staff in stores to join up and immerse themselves in the culture as part of their training. Even during its beta stage, Sneakerpedia reached close to 7 million fans online. (Source: *Contagious* magazine, May 18, 2011; Most Contagious 2011)

• American Express’ “Link, Like, Love” is a Facebook application that provides card holders with offers that are unique to each user based on their own and their friends’ “likes” on Facebook, e.g. from categories including food, fashion, and dining. Customers can claim specific deals they like by clicking “Add to Card” and swiping their American Express card the next time they make a purchase from the given vendor. This enables card holders to claim customized discounts without changing their purchase behavior, and their personal or financial details are not revealed to the transaction partner. “Link, Like, Love” thus combines
customization, convenience, and privacy. (Sources: Most Contagious 2011; Dawn Kopecki, “AmEx Facebook Page Lets Users Get Customized Discounts,” July 19, 2011, Bloomberg.com)

Content emerges as a future retail success factor

Rich, fresh content is the fuel social media run on. Unique content is also one of the key ingredients that drives Google’s page rankings. And increasingly, online buzz makes or breaks a user’s purchase decisions. As the American Express example above suggests, social networking platforms may soon be the principal gateway to consumers’ hearts, minds, and wallets. To stay relevant in this environment, retailers will have to start creating, providing, and enriching “buzz-worthy” content. Posting store opening hours on the company web site and sending out promotional emails does not qualify. Thanks to “over the top” (OTT) video, digital natives have become used to content on demand. Using services such as Apple TV, Hulu, or YouTube, users access videos and TV shows on demand to watch, pause, rewind, and review at their own discretion on computers, smart phones, tablets, and game consoles. According to McKinsey’s iConsumer survey, OTT video usage has tripled over the last three years, and Amazon’s Kindle, Sony’s Reader, and Apple’s iPad have introduced similar usage patterns to the realm of print publishing.

To preempt commoditization of their offering, retailers will have to find new ways to enrich consumers’ lives with relevant content that keeps them engaged and builds brand equity as well as purchase intent. Increasingly, users request added layers of interactivity that take advantage of their smart phones, tablets, or laptops; compare the interview with Thomas Wagner of SevenOne Media, on the role of the so-called “second screen,” in Chapter 16 on classical media below. While commercial enterprises may not necessarily have to create content from scratch, they need to monitor existing consumption behavior closely and augment the user experience with added value. Pioneers include Heineken, Pepsi, and MTV, all of whom have created applications that allow users to interact and connect around events or shows these companies are sponsoring or producing,
such as Premier League Football, The X Factor, or Jersey Shore. (Source: Most Contagious 2011)

How can retailers cash in on this insatiable hunger for augmented content and interaction? Constantly creating and publishing fresh content solves only part of the puzzle, especially given the limited credibility of overt outbound brand communication. Real-time responsiveness is at least as important as in-house content creation. Best Buy, for example, has made significant efforts to become a major force on Facebook. They hired and trained staff to answer questions from consumers almost in real time, staged exclusive presentations of new products, and developed special offers only available to the friends of the brand. As of January 2012, Best Buy had amassed a Facebook followership of almost 6 million users, up from just over a million in mid-2010.

In the future, retailers will have to monitor, analyze, filter, enrich, and integrate content from a wide variety of sources, including in-house information on product availability and pricing, manufacturers’ background information on product origin, ingredients or warranty terms, content created by traditional media or repackaged by online content aggregators, and content created by consumers around the retailer’s offering. Specialized service providers, such as NM Incite, can help companies track and juggle the multitude of relevant online conversations, but it is up to retailers to determine how their brands and their commercial offer will enrich the talk of the town on digital platforms, be it through owned content on the company web site, earned content on Twitter and Facebook, or paid content displayed on banner ads and by contextual services such as Google’s AdWords.

**Don’t forget that multi-channel retailing includes brick-and-mortar**

Digital communication and multi-channel commerce are changing the world of retail in fundamental and sometimes disruptive ways. Some of these changes are happening so quickly that they leave many a retailer’s head spinning with questions: Will there still be brick-and-mortar stores
in the future? If so, how will their role change? Will they become mere physical showrooms for online shopping? How will the role of classical advertising change, when some say that even email is on the way out? Will there still be a need for traditional market research, given that consumers freely communicate their preferences, purchasing decisions, and buying factors on social platforms?

We believe that the answer to many of these questions is “Yes, but”:

- Yes, brick-and-mortar stores will remain an important sales channel for most retailers and categories, but they will have to combine their exclusive benefit of direct sensual product contact with the evolving requirements of multi-channel retailing. In tomorrow’s world, shoppers will call the shots on where, when, and how they get their information and their merchandise. Retailers who deny them the freedom of channel choice will be punished, but those who put consumers in control will reap disproportionate rewards.

- Yes, classical advertising will still feature prominently in many retailers’ marketing mix, but it will be only one element of a more complex communication landscape comprising paid, owned, and earned media. More than ever, retail communication strategists will need to think about the content they are delivering, not just about the delivery vehicles. Creating, synthesizing, analyzing, and sharing localized, augmented content will be crucial to win and maintain consumers’ attention and engagement.

- Yes, traditional market research will remain a crucial source of consumer intelligence, but it will have to be enhanced by social media insights. Powerful and sophisticated technical solutions will become more important to integrate, mine, and leverage big data. The digital trace users leave is more detailed and more up-to-date than any traditional research data set can hope to be. Retailers who move swiftly to develop the tools and the skills to identify relevant information, and act on it, will come out on top.

This is your mission, should you choose to accept it: To persist in the multi-channel world, you will have to upgrade your digital capabilities
and invest in their technological infrastructure. You will need new capabilities in data-driven marketing and content management. In some cases, real-time responsiveness will be required, be it online or at the local POS. But you also need to sharpen your in-store value proposition. While some of you may want to strengthen the unique physicality and personality of live contact, e.g. by hiring or training in-store consultants or stylists, others may want to follow Apple’s lead and recreate the store experience without self-service, without cash registers, and without printed receipts. In either case, coordinating commercial offers and customer relationship management across channels will be crucial. But most importantly, you will have to find ways of achieving multi-channel excellence without sacrificing the things traditional retailers do best: convenient store locations, attractive assortments, competitive prices, and plenty of warm, welcoming smiles.

**Learning from the best**

Over the course of little more than a decade, Amazon has become the world’s largest online retailer, generating almost USD 50 billion in annual sales. Amazon is already the most valuable global retail brand, and many experts believe that it may eventually outgrow traditional retail heavyweights even in terms of sales. The company’s category depth is unparalleled, as is its technological leadership. Investing some 6 percent of its revenue in technology, Amazon outspends its multi-channel competitors by a factor of five to ten (in relative terms). With its lean supply chain model, Amazon is the price leader in many categories and still generates above-average returns. The company’s USD 5 discount for purchases preceded by an in-store price check through Amazon’s bar-code app is just the latest move to put pressure on its competitors.

On average, Amazon has added two categories per year in the US since its launch in 1997 and now offers media, electronics, toys, apparel, personal care products, shoes, auto parts, fabrics, and office supplies, to name but a few. Amazon’s role differs from category to
category. For example, non-food commodity retailers primarily struggle with Amazon’s massive assortment and its price transparency, while upscale non-food retailers feel the pressure that comes with the convenience afforded by Amazon’s free and fast shipping, especially under the Amazon Prime plan. At the time of writing, the jury was still out on Amazon’s ambitions in food, with same-day delivery of perishable goods as a potential threat to established food retailers.

Traditional and multi-channel players are inspired by Amazon in various ways. Many have chosen to partner with pure-play online retailers, aiming for win-win constellations. Traditional retailers are reaping the benefits of the pure players’ superior e-tailing back-end and fulfillment capabilities, while pure players monetize the credibility, category expertise, and physical presence of old-school retailers. But Amazon’s track record of strategic acquisitions shows that partnership with the giant can easily lead to a loss of independence for the junior partner. This is why others seek salvation by way of explicit specialization. Given that Amazon’s scale makes it a mass operation, smaller competitors have chosen to focus on complex, high-touch, high-margin categories that require deep expertise, such as wine or cosmetics. And some of the most daring players are seeking out geographical territories with no or limited Amazon presence, such as Africa or India, to cash in on the first-mover advantage.

But the most promising strategy for the majority of traditional and multi-channel retailers is, by all accounts, to leverage and fortify the one unique asset they have over pure players: the physical store. This strategy can take the shape of creating a unique in-store experience, in order to make shopping an enriching lifestyle activity rather than a chore. Some sociologists go as far as assigning commercial stores the role of modern-day sacred spaces in an increasingly secular world. Another facet of reinventing brick-and-mortar retail is to position stores as showrooms for products that may well be purchased online, either through the retailer’s own website or a third party. Decades ago,
the same line of reasoning led some mail-order companies to open downtown outlets for display and delivery.

Over the course of the next few years, we will see widespread experimentation around the role of the store, with some retailers expanding their footprint to create event locations, and others reducing the store to its bare minimum, creating walk-in window displays for consumers to look up a product, place an order, or pick up the goods. Compare the insert on retailers’ attempts to offset the effects of showrooming in Chapter 18 on CLM.

### Key takeaways – Digital (R)evolution

1. End-to-end digitalization affects multiple retail business functions.
2. Converging sales channels are transforming the consumer decision journey.
3. Digital localization and individualization gain momentum.
4. Social media impact is revolutionizing retail reputation-building.
5. Content emerges as a future retail success factor.
6. Don’t forget that multi-channel retailing includes brick-and-mortar.
The point of sale (POS) is one of the most powerful marketing vehicles available to a retailer. No other marketing vehicle can match its ability to influence consumers at the time of purchase. And while all retailers control their POS, very few reap the full benefit of POS marketing.

POS marketing includes any marketing activity a retailer can unfold in its stores, whether through visual merchandising or through the service and performance of front-line employees. Both elements are potential levers for retailers to differentiate themselves from the competition. POS marketing, when done well, has real and tangible business impact: it drives traffic and browsing, improves conversion, and increases basket size. Yet many retailers consider POS marketing as just another cost position, rather than as an investment in one of the most effective consumer touch points imaginable. This chapter covers a wide range of tools and methods to help retailers unleash its full power – and to bring analytical rigor to the art of POS marketing. We have also included a number of practical hints and examples of best practice.

For retailers, the POS is the most powerful marketing vehicle

The point of sale is not just a place where goods are sold: it is a major marketing vehicle that retailers should use to create a unique consumer
experience, communicate with their target audience, build their brand image, and, ultimately, drive sales. Visiting a store is a multi-sensorial experience: as shoppers enter and walk through a store, they see a myriad of goods, smell the scents, listen to the sounds, touch and try out products, meet sales staff and other shoppers, and, finally, interact with the cashier. No other medium can match the richness of this interaction.

Because of its direct impact on the consumer’s brand experience, POS marketing should be an integral part of every retail branding effort. What is more, its reach exceeds that of most traditional mass-marketing channels. According to media experts, an end-cap at Walmart reaches more people in a week than a 30-second commercial on prime-time television. As the number of advertising vehicles grows and the traditional media landscape becomes increasingly fragmented, the store is, potentially, the last single touch point that can reach “the masses” – after all, everybody has to shop. And most of the people you reach in the store are there with the intention of making a purchase, ensuring that in-store marketing is particularly valuable to retailers and their suppliers.

In-store marketing beats every other medium in terms of its “brain hours” (see Exhibit 13.1) – a measure of marketing intensity that combines

<table>
<thead>
<tr>
<th>Vehicle</th>
<th>Exposure</th>
<th>Estimated time</th>
<th>Reach Percent of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Store</td>
<td>1 visit every two weeks, with an average of 1-3 hrs</td>
<td>1.5 hrs</td>
<td>19</td>
</tr>
<tr>
<td>Leaflets</td>
<td>1 every two weeks, 50 page average</td>
<td>15 min</td>
<td>24</td>
</tr>
<tr>
<td>TV</td>
<td>11 impressions of 20&quot;</td>
<td>4 min</td>
<td>40</td>
</tr>
<tr>
<td>Radio</td>
<td>4 impressions of 10&quot;</td>
<td>40 sec</td>
<td>5</td>
</tr>
<tr>
<td>Paid Press</td>
<td>2 impressions of 1/2 page color</td>
<td>10 sec</td>
<td>7</td>
</tr>
<tr>
<td>Free Press</td>
<td>2 impressions of 1/2 page color</td>
<td>10 sec</td>
<td>2</td>
</tr>
<tr>
<td>Club</td>
<td>Coupon at checkout, mailed to home, SMS mailings, and email</td>
<td>45 sec</td>
<td>3</td>
</tr>
</tbody>
</table>

Exhibit 13.1 Ranking of marketing vehicles by “brain hours.”
the number of people a medium can reach with the length of time they are exposed to that medium. It shows that in terms of its high-intensity interaction with the consumer, the store is an unbeatable marketing vehicle.

But the power of POS marketing is not limited to its high level of exposure and involvement. POS marketing also carries a “halo” effect that extends beyond the shopping experience and touches fundamental aspects of the consumer’s perception of a retailer. A McKinsey survey of about 400 shoppers in a large multi-category retailer’s store in North America highlights clearly the impact of POS marketing on their overall perception of the retailer (McKinsey US consumer survey, March 2009). Participants were asked to assess two stores. The outlets only differed in their POS marketing; all other aspects – assortment, pricing, promotions, etc. – were the same. Not only did the store with the improved POS marketing score 10–20 percent higher on all shopping experience attributes; it also outperformed the control store on attributes such as “quality of the assortment,” “breadth of the assortment,” “quality of the private brand,” and “value for money.”

**Despite its importance, many retailers don’t leverage the store effectively**

According to estimates, 70 percent of all purchasing decisions are made at the point of sale. Even when making basic or repeat shopping trips, most people do not use or do not follow a shopping list. POS marketing reaches consumers just at the decisive moment when it can have a huge effect on their purchasing decisions – in a more direct way than any out-of-store marketing activity. POS marketing has the potential to drive traffic, encourage browsing, improve conversion, and increase basket size. Given this potential, you would expect POS marketing to be a top-priority item for retailers. But surprisingly, POS marketing is often neglected, both in terms of budget and in terms of management attention.

In a McKinsey survey of executives from various functions at six leading North American retailers, “in-store experience” was ranked as the least critical capability necessary for running their business (out of a list of 13; McKinsey survey, May 2010). In consequence, POS marketing is often in
the hands of inexperienced, time-constrained buyers who are given loose guidelines – “make it compelling” or “surprise and delight the shopper” – but who have no tools available to help them make the right decisions. The resulting POS marketing decisions are based on gut feeling and fail to deliver a consistent ROI. One result of this is that many executives entertain fundamental doubts about the value of POS marketing as a whole. And so the vicious circle continues.

Over the course of our work with retailers across multiple subsectors, we have found five symptoms typical of suboptimal POS marketing management:

- A lack of transparency about the return of POS marketing investments, or experience of inconsistent and often negative returns.
- A split in POS marketing responsibility between different functions, with some decisions left to junior employees in addition to their “regular” work.
- POS-related decisions are based on intuition and creative talent, rather than on facts and the evidence from past successes.
- Discussions on POS marketing are overly focused on physical elements, such as signage or lighting, rather than on the overall consumer experience.
- The decision-making process does not have systematic links to merchandising, marketing, consumer insight, or store design groups.

The effect: consumer confusion. Stores to which the above observations apply will have a hard time creating a consistent consumer experience in line with the brand proposition of the retailer. So while their control of the POS puts retailers in a powerful position, many do not make the most of it.

**Systematic POS management** can advance both long-term brand building and short-term business success

To extract the full value of POS marketing, retailers need to set up a disciplined process that covers both sales generation and brand building, as well as the appropriate analytical tools.
Any effective use of POS marketing as a brand-building instrument starts with a clear definition of the message retailers want their stores to convey. Like any other touch point, the store is a communication vehicle that can and should carry the retailer’s overarching message. It can either contribute to the holistic delivery of that message, or it can do a very effective job of confusing consumers. Even a clear message can be delivered unclearly; as the old saying goes, “The road to hell is paved with good intentions.” By analogy, it is safe to say that the store from hell is plastered with signs and posters. The archenemies of clarity in POS communication are inconsistency and clutter.

Inconsistency – of styles and messages – is mainly the result of too many POS marketing decisions being pushed down to the buyer level. This inconsistency is often increased by POS material that suppliers, eager to promote their own brand message and style, manage to push into the stores. Best-in-class retailers set and enforce strict guidelines on style and communication that apply to their entire network, covering three levels: the “sky level” (directional, overhead signage), the “eye level” (top-of-shelf signage) and the “buy level” (on-shelf signage).

But even if the signs and labels are consistent, there can still be too many of them. Clutter is usually the result of retailers trying to compensate for their lack of a clear POS marketing strategy with a proliferation of POS materials. One consumer electronics retailer in North America was able to reduce its POS costs by 20 percent after identifying that 30 percent of its POS materials were ineffective – defined as materials that were noticed by less than 1 percent of shoppers. Best-practice retailers use signage sparingly and only when and where it is truly needed, preferring to let the merchandise speak for itself as often as possible.

But POS marketing does not only mean defining an overarching message and making sure it is consistently communicated in the store; it can also help achieve concrete business objectives. The general situation of the retailer, or of a specific category, should determine which business objective is the most relevant in guiding POS marketing investment decisions. Surveys, in-store observations, and analyses of POS data can help retailers gain a good sense of their strengths and weaknesses. Based on these insights, they can define their areas of focus for POS marketing and then
set hard targets for investments. Typically, POS marketing can serve three types of business objective:

- drive traffic, browsing, and frequency;
- improve conversion;
- increase average basket size.

Imagine a multi-category retailer that wants to drive sales in its underperforming children’s apparel category using POS marketing. The company’s first move is to conduct a shopping funnel analysis to identify gaps in the category relative to external benchmarks (compare Chapter 3 above). It then combines this benchmarking information with insights derived from consumer research on the importance of POS marketing in the different stages of the shopping funnel. Let’s assume that the shopping funnel analysis indicated both that repeat purchase traffic is in line with external benchmarks, and that the retailer’s basket size is clearly better

**Limitations of POS at early purchase funnel stages**

Clearly, consumers are influenced by many factors other than POS marketing – such as classical advertising or coupons – at every step of the purchase funnel. So before deciding to fix a given gap in the funnel with POS marketing investments, retailers are well advised to check whether the in-store experience is really a relevant driver of the transfer in question. In the example described above, a deeper analysis of the purchasing drivers showed that while POS marketing was a key driver of conversion, it was not a driver of first-time traffic. In other words, a superior in-store experience helps to turn visitors into buyers and justifies respective POS marketing investments. But POS marketing does not – and perhaps cannot – lure first-time visitors into the store or the respective department. In consequence, you will need to invest in other activities to drive first-time traffic, such as traditional advertising or billboards placed near the store.
than that of best-practice players. The underperformance of children’s apparel appears to be rooted in the retailer’s inability to drive more first-time traffic into the department, and then to turn these visitors into buyers. The insights of this analysis would indicate to the retailer that it needed to focus its POS marketing investments on driving unplanned traffic and conversion.

The tangible and intangible elements of POS marketing have to work in tandem

Essentially, we believe that POS marketing is composed of a tangible part and an intangible part. The tangible part comprises all types of visual merchandising in the store, e.g. improvements to the look and feel of the store, cross-merchandising and visual promotions. The intangible part is the human factor: the mindset and behavior of the retailer’s front-line employees, such as sales staff and cashiers, who play a vital role for the success of POS marketing. While successful POS marketing depends on the integration and coordination of tangible and intangible elements, a given retail company may want to prioritize either one, depending on its business objectives (Exhibit 13.2).

Exhibit 13.2 Successful POS marketing combines the power of tangible and intangible elements.
Visual merchandising, the tangible part of POS marketing, is a major marketing lever and sales driver for retailers. Using advanced statistical analysis, McKinsey has developed an approach that ties decisions about the look and feel of the store, its use of cross-merchandising, and its display organization and signage to specific business objectives.

- An appealing *look and feel* is primarily intended to attract shoppers to the store or department and encourage browsing. This especially applies to categories within larger stores, where the goal is to leverage existing traffic – that is, to entice shoppers who came into the store for other reasons to visit the department in question.
- *Display organization and decision-support signage* exists to make it easy for shoppers to find the products they want; these are therefore good investments if the objective is to increase conversion.
- *Cross-merchandising* is an effective way to increase average basket size by driving unplanned purchases (see Exhibit 13.2).

One store’s look and feel is not necessarily “better” than another’s. It is simply a matter of creating an experience that matches the target consumer’s needs and expectations. The right question to ask is: how do we come up with the right experience for our target audience? To answer this question, and to help retailers create the look and feel that will attract their target audience, McKinsey has developed an approach to visual merchandising that shifts the retailer’s attention from hard assets (such as fixtures, lighting, or signage) to the overall consumer experience.

We recommend a two-stage approach to optimizing the look and feel of a store. Start by brainstorming about which attributes could potentially be important for the target audience, and then test your long list in a comprehensive consumer survey. Making sure that this consumer survey is truly comprehensive is a critical aspect of this stage. The “visual merchandising triangle” (Exhibit 13.3) is an aid that can help retailers design an exhaustive survey. The triangle’s three sides represent the three main attributes of visual merchandising communication: emotional, rational, and reputational. Carrying out statistical analysis of shopper behavior to determine the ranked importance of the various attributes from a consumer perspective will enable the retailer to identify the aspects that are most likely to drive traffic, frequency, and loyalty.
Don’t let me be misunderstood

When conducting consumer surveys to identify the drivers of traffic, frequency, or loyalty, retailers should be mindful of what the specific attributes actually mean to the survey participants. For example, in one case, “modern-looking” came up at the top of the list of the desired look-and-feel attributes. However, when the company tested this attribute against reference pictures, they found that what consumers considered to be “modern-looking” was the use of wooden fixtures and natural plant decorations, whereas geometric shapes in bold colors and simple lines were considered “old-fashioned.” Obviously, a written statement or attribute can mean different things to different people; it is vital to double-check that the common interpretation is the one the survey designer had in mind.
Once the key design attributes for the store are clear, the retailer should then work with design firms to translate these attributes into alternative look-and-feel options. Each of these options should be tested with consumers, and the top options piloted. While this approach might at first sight seem overly analytical, it actually leaves a lot of room for creativity. Instead of reducing visual merchandising to a set of purely physical guidelines, it creates leeway for the creativity of designers and other specialists. Instead of specifying the colors, sizes, and styles of physical fixtures, it provides general direction for the desired consumer experience, empowering the designers to create new and original solutions. While plunging straight in

Best-practice example

Visual merchandising driven by consumer needs: Best Buy
Once a compelling look and feel has attracted consumers to the store or department, the next task is to drive conversion through intuitive display organization and helpful signage. While the former helps determined shoppers to find the product they want, the latter helps those who are still undecided to choose the right product.

Consider the look and feel of the TV department at a Best Buy store. The setup is built around two critical attributes for buyers of TV sets.

1. Consumers like to see their future TV set the way it will look at home. Based on this insight, Best Buy redesigned its entire TV department to give it a look and feel more like that of a home living room, rather than a traditional electronics showroom.

2. Consumers want no-nonsense information to support easy choices. In response to this desire, Best Buy has put in place signage that explains the key features of TV sets visually and in everyday language. Few consumers know, for example, what “720p” or “1080p” means, but “HDTV-ready, ideal for watching sports” or “Blu-ray-ready, great for movies” will help them make their choice.
and testing various physical aspects of a new store design might seem like a faster route, it is far less likely to deliver a unique store experience.

So much for look and feel. When it comes to display organization, it is worth noting that best-practice retailers use planogramming software to create planograms, i.e. diagrams that show the various product types and locations in each aisle. These planograms can be optimized using four principal types of input:

- the overarching organization scheme (e.g. by brand, color, etc.);
- the retailer’s product goals (e.g. private label products to be given prime positioning);
- the products’ physical characteristics (e.g. size, color);
- sales expectations.

The overarching organization scheme may be the most critical input factor, as it determines whether or not shoppers will have trouble finding the products they are looking for, an aspect that has a direct influence on conversion rates. In our experience, the planograms that drive the greatest conversion rates are organized according to consumer decision trees. Each decision tree shows the order and importance of the various factors shoppers consider when making a purchase in a specific category. For instance, when buying a writing instrument, a particular shopper might first decide on a broad category (e.g. pen or marker), then the brand, followed by the pack size (if appropriate), and, lastly, the specific type of instrument (e.g. rollerball or gel pen). Once the retailer is aware of this decision-making process, it is easy to organize the products on the shelf accordingly.

In addition to considering the look and feel of the store and the location of products, the retailer also needs to consider the role of decision-support signage. Good signage can help shoppers make better buying decisions. The first step is for the retailer to use market research to identify the top four or five product features that are most important to consumers (e.g. sound quality, battery life) for a given product range. Once the top features have been identified, these can be highlighted in ways that are easily absorbed.
Beware of skewed consumer decision trees

Multi-category retailers typically rely on suppliers to provide them with an understanding of the various consumer decision trees. But supplier information is not always reliable. Suppliers will tend, for obvious reasons, to emphasize the brand as the most important factor, even when this is not the case and other factors are, in fact, more important. It therefore often makes sense for the retailer to investigate consumer decision trees independently. Exhibit 13.4 outlines two proven approaches for building accurate consumer decision trees.

A statistical analysis of household baskets, relying on internal POS data (see left-hand side of Exhibit 13.4), can enable retailers to recreate decision trees with great accuracy. In non-recurrent categories, retailers must turn to consumer survey data as the basis for creating a decision tree (see right-hand side of Exhibit 13.4).

<table>
<thead>
<tr>
<th>For recurrent categories</th>
<th>For non-recurrent categories</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statistical analysis of similar household baskets over time</td>
<td>Customer survey</td>
</tr>
<tr>
<td>Example: purchasing pattern of soda-pop for household over 2 years</td>
<td>&quot;Before I got to the store, I knew I was buying ...&quot;</td>
</tr>
<tr>
<td>Percent of times that household purchased ...</td>
<td>Percent of respondents</td>
</tr>
<tr>
<td>Same taste (cola)</td>
<td>80</td>
</tr>
<tr>
<td>Same brand</td>
<td>70</td>
</tr>
<tr>
<td>Same type (reg. vs. diet)</td>
<td>40</td>
</tr>
<tr>
<td>Same pack size</td>
<td>2%</td>
</tr>
<tr>
<td>By applying the analysis to a large sample of households, the typical consumer decision tree can be created with accuracy</td>
<td>Brand</td>
</tr>
<tr>
<td></td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Pack size</td>
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<tr>
<td></td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Subcategory</td>
</tr>
<tr>
<td></td>
<td>10</td>
</tr>
</tbody>
</table>

Exhibit 13.4  Building independent consumer decision trees.
You can have too much of a good thing, however. Each sign needs to justify itself by adding real value. A North American apparel retailer introduced a sign in its underwear category stating that a given product was “available in multiple colors”; however, shoppers were able to see for themselves the range of colors available on the shelf. In this case, the sign was clearly unnecessary. In addition to carrying a cost, it reduced the visual clarity of the display. As a rule of thumb, we have found that “less is more” when it comes to decision-support signage, particularly in recurrent purchase categories.

Once visitors have been turned into shoppers, the third challenge for visual merchandising is to maximize their average basket size through cross-merchandising. The difficulty typically lies in the way store and merchandising staff are incentivized, and in the multitude of possible combinations for cross-merchandising. This challenge is made all the greater because the combinations of cross-merchandising items need to be changed regularly in order to keep the store fresh. This quickly becomes a complex optimization problem.

Many retailers collect data on product affinities (i.e. the product categories that regularly appear in the same household basket), but few are able to use the data effectively. Though this wealth of data is often stored in huge and intricate databases, few retailers have developed the analytical capabilities required to use the information in a systematic process that can identify affinities at the department level, the subcategory level, and item level. The power of such a system is that it can reveal the unexpected. It might, for example, recommend selling sticky notes alongside three-ring binders – maybe not an intuitively obvious pairing, but one that is commonly found in household baskets (see Exhibit 13.5).

Recently, leading retailers have started to experiment with digital technology to enhance the customer experience in stores. Examples include touchscreen order points and video walls at Marks & Spencer, Fashion Week broadcasts with a tied-in iPad application at Burberry, and “smart” changing rooms equipped with ordering terminals at Oasis.
General approach

- Extract department (subdepartment) category "affinities" from POS database (i.e. number of market baskets containing SKUs from the same 2 departments)
- Select the best “type of product” (subcategory) to cross-merchandise based on affinity level
- Select specific product to drive sales or margin

Example of outcome

An advanced version of this approach optimizes cross-merchandising across the store to avoid excess use of any given category (e.g. batteries)

Exhibit 13.5 Optimization of cross-merchandising based on basket affinity.

Innovative cross-merchandising case example

*Albert Heijn “Choose & Cook”*

Cross-merchandising based on basket affinity can prove tricky in practice. For instance, in a number of Western European countries, a typical meal features meat or fish, together with vegetables, noodles or rice, and some kind of sauce. Consumers shopping for such a meal will usually have to visit any number of different aisles to find all the necessary products. Dutch supermarket giant Albert Heijn has come up with a simple but highly consumer-centric solution: in its “Kies & Kook” (Choose & Cook) range, it places all the components of a number of simple meals on a single shelf. Hungry shoppers in a hurry who are looking for a well-balanced and affordable meal can therefore pick and choose all the ingredients they need from the Kies & Kook range without having to roam the store looking for them.
The human factor is “make or break” for the consumer’s POS experience; *front-line employees are a retailer’s foremost ambassadors*

Even the best visual merchandising efforts will only be successful if the store personnel are playing their part. The behavior of store personnel, the intangible element of POS marketing, is at least as important as the tangible elements discussed above. This human factor is especially important in turning visitors into purchasers. In the real-life case of an apparel retail store, for instance, the conversion rate for those consumers who met a sales person while shopping was about 70 percent; this figure plunged to 15 percent for those who did not meet a sales person.

Most retailers are clear about how their front-line employees should behave. The defining element of their work should be the consumer, not the task at hand. They are supposed to be friendly, greeting the shoppers when they enter the store or department, provide advice, encourage them to try on clothes or try out a product, and bid them farewell when they leave. Sales staff ought to provide follow-up recommendations and highlight complementary products; cashiers should be friendly, fast, and efficient, ensuring short check-out times. And so on.

While much of this is uncontroversial, many retailers struggle to ensure that this kind of behavior is adopted consistently in their stores on a day-to-day basis. Retail chains with a large number of outlets try hard to get the best of both worlds by realizing the scale of big-box format while maintaining the quality and individuality of front-line execution found in “Mom and Pop” stores. But these objectives are hard to combine successfully. Scale comes at a price: compared to “Mom and Pop” stores, which can maintain personal relationships, large retailing enterprises have very limited control over front-line interaction. As a result, sales productivity often varies greatly across outlets and employees. In our experience, the top 10 percent of stores are often twice as productive as the bottom 10 percent. Among employees, productivity regularly differs by a factor of five.

Executives in charge of front-line management cite several reasons for this variation. They argue that given the large number and dispersal of outlets, it is only natural for productivity to vary. They say that the skill level of personnel is generally medium to low and that it is difficult to
improve skills adequately through training, partly because of the high rate of staff turnover.

But the biggest obstacles to front-line sales excellence are more fundamental: the lack of clearly defined responsibilities on the one hand, and the lack of knowledge and tools on the other. As a result, many outlet managers are often not even aware of the performance gaps in their stores. The way forward is to improve communication between a retailer’s headquarters and its outlets. Managers at the regional and individual store levels need a clear sense of their roles and responsibilities, and they need the tools to track and improve the performance of their stores and teams. It is essential that clear metrics on the impact of front-line performance are in place (ideally, above and beyond mere sales performance), that store staff are organized and incentivized accordingly, and that regional and store managers act as role models.

A top-down approach is often not the right solution, however. If the corporate board develops the company’s sales strategy, in doing so it will squander the knowledge of its front-line personnel. Such an approach will undermine the entrepreneurial spirit of the organization: managers and sales personnel who feel they have no clear stake in a store’s success will simply do what they are told to do – hopefully no less than that, but definitely no more!

A proven way to correct these performance gaps – balancing the need for common quality standards with that of tapping into local expertise and initiative – is to conduct on-site workshops that welcome and encourage the initiatives of front-line staff. If aided by centrally developed tools and guidelines, front-line staff participating in such workshops will be able to identify and execute improvement measures quickly and easily. Often, they will start to take effect the day after the workshop.

Such explicit empowerment also fosters local entrepreneurship. Giving credit to the sales staff’s ideas strengthens their commitment to becoming part of a high-performing sales organization. One welcome side effect of the training and empowerment of the front-line staff is that it also maximizes the value that can be extracted from the tangible elements of POS marketing. Well-trained and highly motivated sales people will put the visual merchandising and other POS materials to their best use – and in the process become powerful ambassadors for the retailer’s brand.
Go with the flow

Not all square feet in a store are equal to one another. Most stores have high- and low-traffic areas. While this fact may seem obvious, many retailers underestimate their power to control the traffic. Low traffic in some areas and potential overcrowding in others is often the direct result of store layout issues. To fix these issues, retailers need to know the “hot” and “cold” areas of their stores. A store heat map analysis is a simple but effective way of achieving this (Exhibit 13.6). To create a heat map, walk briskly through the store or department and count the number of customers in each aisle. To avoid skewing the data, repeat this several times over the course of a typical day to account for changes in traffic intensity and patterns. Then map the heat levels, calibrated to the maximum number of visitors in the most populated aisle: i.e. if the maximum level is 15, then the relevant brackets could be 1–3 for cold, 4–10 for medium, 11–15 for hot. Based on the heat map, the store managers – or retail executives, if multiple stores are involved – can make improvements to the floor plan, shelf layouts, and displays to optimize the traffic flow.

Exhibit 13.6 Store heat map example from an electronics retailer.
From smiles to sales

Transforming the store experience in non-food retail

In 2011, a leading North American non-food retailer launched an effort to transform shoppers’ store experience. The approach this retailer followed was innovative in two ways: fact-based category differentiation and holistic touch-point management.

Initially, the company analyzed and subsequently differentiated the shopper experience by store areas. Various areas of the store were redesigned to account for differences in purchasing patterns across categories. For example, the retailer found that many consumers shopping for non-recurrent items with high ticket prices, such as white goods, were looking for personal assistance, and that the respective revenue increase potential would more than pay for the expense that came with assisted sales. In contrast, recurrent purchase categories turned out to be better served through decision-support signage that promised a substantial sales uplift at a much lower cost.

In addition to these specific adjustments, the retailer considered the different elements of the shopper experience holistically. The project team conducted customer observations and surveys to understand, at a very granular level, how all the different touch points that shoppers were exposed to during their decision journeys influenced conversion and basket size. For example, the retailer found that having a sales assistant smile at shoppers was twice as effective to drive conversion in the technology category as having the assistant recommend specific products. To reflect such results in store design and layout, the retailer designed a targeted transformation program that focused on the most effective touch points for each area of the store. The program ultimately drove a 4 percent increase in sales across the store network.
Key takeaways – POS marketing

1. For retailers, the POS is the most powerful marketing vehicle.
2. Despite its importance, many retailers don’t leverage the store effectively.
3. Systematic POS marketing can advance both long-term brand building and short-term business success.
4. The tangible (visual merchandising) and intangible elements (mindset and behavior of store personnel) of POS marketing have to work in tandem.
5. The human factor is “make or break” for the consumer’s POS experience; front-line employees are a retailer’s foremost ambassadors.
Leaflets are to retailers what flyers are to events: invitations to those you want to come. If they don’t know, they won’t show. So it’s imperative to get the word out. Local media is much more than just a sideshow in the retail marketing mix. It is the link between classical nationwide advertising and POS marketing.

We will discuss direct mail in Chapter 18: “Maximizing Customer Value with Data-driven CLM” (customer life cycle management). In this chapter we focus on leaflets and print advertising in local publications. We provide evidence for the importance of local media excellence and present guidelines to help retailers answer two key strategic questions: What should be promoted, and where should it be promoted? In contrast, we will leave the more operational question of “How should it be promoted?” to specialized agencies and service providers such as media agencies, media houses, integrated production companies, freelance designers, print shops, and distributors.

Local media is the true point of sale: consumers’ love for leaflets drives sales and profits

Local media creates a blizzard of paper. In Germany alone, every household receives about 30 leaflets and catalogs per week, adding up to a total of 60 billion leaflets distributed per year. (Source: W+V 2012.) A single
company, the discounter Lidl, distributes up to 28 million leaflets a week. (Source: Lebensmittelzeitung, 29, July 17, 2009, p. 8.) In a country of about 40 million households, Lidl’s coverage is almost absolute – week in, week out. Typically, German discounters send out 25 to 30 million leaflets every week. Electronics retailers distribute an average of 20 million every one to two weeks. For DIY players, the numbers add up to some 10 million leaflets every other week. (Source: EHI 2012.)

This blizzard of paper is the result of the substantial budget share allocated to local media by retailers. According to Germany’s EHI Retail Institute, local print media (flyers, catalogs, magazines) accounted for 46 percent of retailers’ 2011 gross media spend in France, and 48 percent in Germany. (Source: PanoTrade by Le Site Marketing and Yacast, 2011.) Although in a slow decline until quite recently, the share of flyers, catalogs and magazines actually increased between 2010 and 2011 in Germany. (Source: EHI.) The real shares may be even higher, since many research agencies do not include local media expenditure in their tracking and share of voice analyses. And while local marketing is traditionally the province of grocery retailers and drugstores, other sectors are following suit. Consumer electronics, DIY, furniture, and fashion retail are all fighting for consumer attention – so it is likely that we will see even more leaflets and local print ads in years to come.

But is the congestion in the consumer’s mailbox, the considerable effort on the retailer’s part, and the multi-billion expenditure all worth it? The answer is clear and simple: people read leaflets and leaflets work. Specifically, they influence consumers’ purchasing decisions. In France, TNS and Mediapost conducted a survey of consumers’ local media consumption and subsequent behavior. The results were astonishing: 92 percent said they read the leaflets they receive by mail, many of them twice; 74 percent go to the store that sent the leaflet, and 68 percent make a purchase because of the leaflet. (Source: TNS Mediapost survey, March 2009.) In the UK, 29 percent of shoppers say that a leaflet encourages them to visit a store, regardless of whether they find the leaflet in their mailbox or pick it up in a store. In contrast, only 8 percent say they are influenced by TV and national press ads. (Source: Grocer, May 2011.) If you take promotional SKUs as a proxy for local media impact, then up to 30 percent of sales are driven by
leaflets and local ads. Retail CMOs who have temporarily stopped sending out leaflets for test purposes report a drop in revenue by about a third during these periods. Martin Jacobi of the Direct Marketing Union (DVV) says, “The mailbox is the true point of sale for many retailers.”

Local marketing is a complex challenge: to succeed, retailers need to cover all bases from consumers to media owners

To achieve local media excellence, or LoMEX for short, retailers need to manage considerable complexity. They have to cope with large amounts of data, differentiate their approach for different countries and store types, deal with the fragmented landscape of media providers, and account for the differences in reach and quality of the individual media. Because of the importance of these issues to retailers, we will now address each in some detail.

Large amounts of consumer data

Targeted local marketing has to absorb and leverage a wealth of consumer data from a variety of sources. In order to identify and reach the most attractive target groups, you will want to use the most granular geo-marketing data available. However, the resolution of this data varies significantly from country to country. In Germany, for example, data on the average category spend per household is available at the street section level for more than two million cells, every one of which comprises about 20 households. In other countries, the data is less granular. In Italy and France, for example, microcells are comprised of 30 to 60 households. Other highly relevant sources of data for targeted local marketing include insights on geographical distribution of current revenues and customers, gathered through loyalty card programs or consumer surveys, e.g. by asking shoppers’ ZIP codes at the checkout.
Different local marketing formats across countries

In different countries, consumers are used to different types of local media. While leaflets are important in Germany, for instance, print advertising plays a bigger role for retailers in the UK. But even leaflets show considerable variety. In the US, for instance, flyers typically carry coupons and are taken to the store. In continental Europe, in contrast, coupons are far less common and leaflets tend to reflect the overall discount mentality, highlighting percentage price promotions for a large number of SKUs or “Buy one, get one free” offers. In the UK, grocery retailers build their flyers around product packages, e.g. special “meal deals”. The great range of these variations suggests that multinational retailers should depend on the experience and expertise of their local subsidiaries and agencies to handle these local differences. Even the delivery of one and the same format allows for differentiation, given that leaflets, for example, can reach consumers in a number of different ways. In Germany, 60 percent of all leaflets are delivered directly, 30 percent with advertising papers, and 8 percent with daily newspapers. (Source: W+V 2012.)

In a few countries, online portals have started aggregating retail leaflets in digital form, enabling users to browse a wide variety of leaflets for their area of residence. Examples include www.meinprospekt.de and www.kaufda.de in Germany, www.kaufda.at in Austria, and www.ofertia.es in Spain.

Different store types require different promotions

Even within a single country, there can be many differences between store types, regions, and product categories. A German discounter, for example, uses 30 variations of the same basic leaflet. And a chain of partly independent, highly localized grocers in Germany reports an astonishing 700 variations to account for different store types, regions, and owners. In France, Carrefour in effect introduced the mass customization of leaflet production when they launched “Promolibre,” a leaflet concept that lets the customer decide which products they want promoted.
Fragmented landscape of local media providers

Every city has its own advertising papers. In large cities, there are often several different and partly competing players covering individual districts and boroughs. Most direct-delivery providers are also local or, at best, regional players with limited reach. Last but not least, the products, solutions, and tariffs of national mail companies differ from country to country. The resulting local media landscape is immensely complex. The German Association of Advertising Paper Publishers (BVDA), for example, lists 41 direct-delivery organizations and 232 publishers as its members, the latter producing a total of more than 900 advertising papers. To make things worse, there are unique formats like EinkaufAktuell, a German specialty format bundling a no-frills TV guide with a range of leaflets wrapped in foil. The final factor in this landscape of complexity is that the granularity of reach differs significantly across providers. While most traditional newspapers solely cover the municipality or geographical district, some advertising sheets allow differentiation even below the ZIP code level.

Variation in reach and quality of media

Delivery options differ in the reach and the contact quality they achieve. This makes it difficult for retailers to compare their effectiveness and cost efficiency.

Newspapers are probably the easiest to assess. An ad in a newspaper usually generates a lot of attention among those who buy a copy or subscribe to the paper. As an extra benefit, newspaper ads also get through to those who refuse to receive leaflets in their mailbox. However, a newspaper’s penetration is necessarily limited by the extent of its circulation, and the high cost of print ads also limits the number of products that can be promoted through it. In contrast, leaflets can comprise multiple pages, each of which is an opportunity to highlight many products, and can reach every household that accepts promotional mail; however, leaflets are much less likely to be read than newspaper ads. The TNS Mediapost survey, conducted in France in 2011, shows that 15 percent of people receiving advertising leaflets read all of them all the time, 27 percent read them quickly without looking at the
details, 52 percent read only the ones they are interested in, and 7 percent throw all of them away. In Germany, our experience shows that 70 to 90 percent of all recipients look at leaflets distributed with newspapers, and about 40 to 60 percent look at directly distributed leaflets.

The retailer’s sector or category is another factor that determines the potential reach of local media. While leaflets from hypermarkets and supermarkets are the most likely to be read, other sectors, like apparel or DIY, have a harder fight to acquire consumer attention. (Source: LSA magazine survey of 500 French consumers, 9 July 2009.) Assembling such a comprehensive picture of the local media landscape is clearly challenging; but such information can prove invaluable in building an effective local media strategy. For example, based on insights such as these, Aldi Süd, a leading German discounter, has tested the direct delivery of leaflets instead of using print ads, enabling it to reach more households than previously. (Source: Lebensmittelzeitung, 15, April 16, 2010, p. 1.)

**Fine-tuning pays:** optimizing local marketing can increase its efficiency by 30 percent

Local marketing is both large and complex, so managing it effectively can be challenging. Not surprisingly, there are big rewards in making it more efficient. Retailers investing in the optimization of local media find that this can significantly increase its effectiveness and efficiency. In our experience, dedicated local marketing optimization efforts can increase its qualified reach by more than 30 percent – with the same budget. An alternative objective to increasing qualified reach is to reduce cost. IKEA, for example, reports that geo-marketing has helped it to cut the circulation of their catalogs by 500,000 copies in Germany alone. (Source: Der Handel, 09, September 2, 2009, p. 24.)

Exhibit 14.1 highlights the three questions that govern local marketing optimization: what should be promoted, where should it be promoted, and how should it be promoted? The “how” question frequently benefits from the kind of craftsmanship found in specialized agencies and service providers, but the “what” and “where” questions are questions of functional
business strategy that require the attention of a retailer’s experienced executives and their most trusted advisors. We will, therefore, deal exclusively with the “what and where” in the rest of this chapter.

**What to promote:** *what’s on it determines what’s in it for you! Highlight products with high expandability and low substitutability*

Which categories and products should be featured in leaflets and local print ads? The two key criteria featured products should meet are high expandability and low substitutability. Expandability is defined as the expected impact on sales; this is calculated through an analysis of the sales increases resulting from earlier promotions. Substitutability is an indicator of the degree to which the expected sales increase of the promoted SKU will cannibalize the sales of other products in the same category. Selecting categories and products based on these two criteria promises much higher promotional ROI than simply promoting the same kinds of items all the time.
Exhibit 14.2 provides an example of how these two dimensions can be applied to the grocery sector in selecting products for promotion. This sector has not been chosen at random: in general, local marketing is dominated by food. According to GfM&H (Gesellschaft für Markt & Handelsforschung mbH), food accounts for 84 percent of all products featured on the front pages of leaflets, with soft drinks and coffee ahead of all the rest.

Once you have selected the categories and products to be featured in the leaflet, the next task is to decide how many products to display, especially on the front page. The overall number of products promoted in leaflets is decreasing, reflecting consumers’ requests for clarity. In France, for example, the number of products featured has dropped by 5.2 percent between 2008 and 2009 across retail sectors. (Source: Editialis, May 10, 2010.) Though the general trend is clear, there is still considerable variation in the number of products featured.
of products featured on the front page – ranging from 3 to 14, according to an analysis by GfM&H. Displaying only a handful of SKUs makes it easier to position the individual products clearly, but harder to answer a wide range of individual consumers’ needs. For details on fact-based promotion design, see the next chapter.

Where to promote: use granular geo-marketing to reach your most valuable customers

Once you know what to promote, the next question is where to promote. By optimizing the distribution area, media selection, and budget allocation of local media, retailers can increase their reach to attractive households by 25 percent – as seen in our experience in multiple consulting projects in various countries and sectors (see Exhibit 14.3 for an example).

The more granular your data, the more effective your local marketing activity. To determine the appropriate distribution, you need to evaluate each area’s attractiveness at a highly granular, geographical cell level, ideally by street section. The relevant criteria to be used in this evaluation can include: purchasing power, average age of residents, proximity to the nearest store, and local competitive intensity.

Once you have identified the most promising distribution area, the choice of media should be optimized. It should be based on the cost of reach per attractive household. The definition of attractive households follows the same general pattern as distribution area selection, reflecting factors such as purchasing power, store proximity, and so on. Ideally, multiple criteria are combined to create an overall attractiveness score. This proves to be more reliable than using a process in which multiple data sources are reviewed sequentially. To establish a realistic figure for the cost of reach per relevant household, retailers and their partners need to take into account media-specific indicators, such as area and household coverage, distribution quality, and reading rates.

For reasons of cost efficiency, distribution companies do not operate at the highly granular level of the analysis outlined above. So in order to meet distributors’ requirements, retailers should combine a number of
households into attractive clusters or “geo-cells,” each geo-cell comprising a minimum number of households to allow for cost-efficient distribution. The geo-cells level must be sufficiently granular to allow for cherry-picking based on household attractiveness scores, while also being large enough to enable direct targeting by most leaflet distributors and many advertising paper publishers at competitive cost (see Exhibit 14.4).

Exhibit 14.3 The local media excellence (LoMEX) approach – example.

Exhibit 14.4 Geo-cells enable cherry-picking.
When evaluating the attractiveness of geographical cells for leaflet and print ad distribution, keep in mind that the granularity of the information used is a direct driver of ROI. For example, purchasing power should be category specific (if possible). If you are a specialty retailer focused on garden and outdoor products, high overall purchasing power may well be irrelevant if a given cell is dominated by apartment buildings without gardens. To control for this particular issue, the right evaluation focus would be category spend for garden products. Similarly, the distance to the nearest store should not be calculated as the crow flies, but should reflect the actual driving or walking time, taking into account, for instance, rivers, bridges, and highways.

Best-in-class tools, such as LoMEX, perform the analytics as described in this chapter and can be fully integrated with retailers’ standard processes. Key features include in-depth analyses of the catchment area of a given activity, e.g. of the number of customers, penetration rates, and revenues per ZIP code (Exhibit 14.5), as well as the optimization of distribution areas and media choice based on internal and micro-geographic data (Exhibit 14.6).
Case study: Optimization of leaflet distribution for a non-food retailer

Client situation
Our client was a European non-food retailer with several hundred stores, spending more than 60 percent of the marketing budget on leaflets. Distribution areas were selected based on ZIP codes and optimized based on distance and marketers’ experience.

Our approach
Working closely with the client’s local marketing staff, we performed a detailed geographical analyses of revenue and customer distribution. By applying regression analysis, we identified the real drivers of revenue: driving distance to the client’s and its key competitors’ closest stores, purchasing power, and household size.

In a second step, the team assessed street sections by their estimated revenue contribution. With some 50 households per street section, this
approach is far more granular than ZIP codes, each of which typically comprises thousands of households. Based on our findings, the client implemented the LoMEX tool to adjust the overall leaflet budget level, optimize the selection of distribution areas and channels, standardize the decision process, and generate reports, including map-based visualization.

Impact
As a result of our effort, the client was able to reduce their total budget significantly without risking relevant revenue. Additionally, targeted distribution in highly attractive, narrowly defined new areas contributed top-line growth. Depending on the individual store, the client expects a profit increase of 1.5 to 5 percent (Exhibit 14.7).

Additional profit was generated through overall spending reduction and selective re-investment in new areas.

Exhibit 14.7 Case example – Reduction of leaflet spending lead to profit increase.
Key takeaways – Local media excellence

1. Local media is the true point of sale: consumers’ love for leaflets drives sales and profit.
2. Local marketing is a complex challenge: to succeed, retailers need to cover all bases from consumers to media owners.
3. Fine-tuning pays: optimizing local marketing can increase its efficiency by 30 percent.
4. What to promote: what’s on it determines what’s in it for you! Highlight products with high expandability and low substitutability.
5. Where to promote: use granular geo-marketing to reach your most valuable customers.
Next to regular prices, promotions have always been the most important drivers of value perception for retailers, and the recent economic downturn has increased the relevance of promotions for shoppers' choices of stores and items. After years of futile attempts to cut back on promotions, retailers are now actively pursuing aggressive promotional strategies again. As a result, almost a third of all revenues in grocery retail come from special offers in most developed markets. A full 50 percent of these are the result of discount promotions, and promotions absorb up to 50 percent of category managers' time.

There is no denying that promotions are what consumers want. In a recent survey, 25 percent of shoppers said they were actively looking for special offers that enable them to buy their preferred brands despite tight budgets. But even excessive demand does not guarantee success. More than a quarter of all price promotions do not result in higher revenues, but only in decreased margins. According to more conservative estimates, only about 10 to 15 percent of promotions are really profitable – if all commercial and operational costs are taken into account. The principal reason for this comparatively low success rate is a somewhat casual approach to promotion design and execution. Many retailers opt for “last year’s offer” or “what our competitor just ran,” or simply follow the lead of supplier subsidies. Selecting promotions based only on these external factors leads to low or even negative promotional impact. All too often, valuable information such as the real financial performance and loyalty impact of a
promotion is not used. This means retailers are missing out on clear and present opportunities to engage shoppers and grow their business.

It doesn’t have to be this way. Based on a wide range of case studies from various territories (North America, Europe, the Middle East, and Africa) and retail sectors, we have found that best-in-class retailers achieve an increase in sales of up to 2 percent, and around 1.0 to 1.5 percentage points of incremental margin, through optimized promotion management. See the box below for specific examples.

Guiding questions retailers are dealing with in their efforts to optimize promotional impact include: How to balance pricing investment with promotional investment? How to select items and tactics for promotion? How to create win-win partnerships with suppliers? How to ensure excellence in execution?

In this chapter, we will introduce proven tools, advanced modeling approaches, and real-life examples to help retailers find the answers.

**Econometric modeling helps to strike the right investment balance between regular pricing and promotions**

In the past, retailers have often seen promotions as an additional cost factor, rather than as an opportunity to increase revenues and margins. Best-practice players, however, have now become aware of promotions as a true investment that delivers tangible value, much like regular pricing.

But how much should they invest in promotions? Until recently, promotion managers have relied on a combination of experience and market research to answer this question – with mixed results. The key drawback of this approach is that it neglects the wealth of information most retailers hold: general insights about shopper needs, specific category insights, and, most importantly, insights into the performance of past promotions.

Recent advances in econometric modeling provide retailers with the opportunity to tap this goldmine of data and even simulate the impact of future promotions. These methods rely on a thorough stock take of sales drivers. The actual sales of a store are influenced by internal factors under the retailer’s direct control, as well as by several external factors:
• internal factors (overall and by category):
  – price index
  – promotional pressure
  – advertising spend;
• external factors:
  – market seasonality and trends
  – competitive moves and counter-moves
  – weather.

Once retailers have gathered this information, ideally going back two years to warrant robust correlation analyses, they can engage in econometric modeling to find out how the different variables influence promotional impact. This will put them in a position to answer the kinds of questions that are typically top of mind for chief merchandising officers and their teams (Exhibit 15.1): Should I reduce the price gap vs. our key competitor on A-brands? Should I invest the same amount to reduce the regular price of our private labels? Or should I run additional “buy two, get one free” campaigns instead?

<table>
<thead>
<tr>
<th>Percent on total sales</th>
<th>Example of alternative actions with equivalent margin investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>~1% gross margin investment</td>
<td>5% reduction of price gap vs. competitors on A-brands</td>
</tr>
<tr>
<td>...in shelf price</td>
<td>5% price reduction on private label</td>
</tr>
<tr>
<td></td>
<td>8+10% price reduction on health &amp; beauty and household</td>
</tr>
<tr>
<td></td>
<td>15% higher promotional discount on grocery</td>
</tr>
<tr>
<td></td>
<td>+20% number of most sensitive items in promo</td>
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<tr>
<td></td>
<td>Four additional 3x2 promo themes during a quarter</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Estimated impact on store revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Region 1</td>
</tr>
<tr>
<td>2,3%</td>
</tr>
<tr>
<td>2,7%</td>
</tr>
<tr>
<td>3,0%</td>
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<tr>
<td>3,6%</td>
</tr>
<tr>
<td>2,4%</td>
</tr>
<tr>
<td>2,7%</td>
</tr>
</tbody>
</table>

Exhibit 15.1 Deciding the ideal level of promo vs. regular price investment.
Impact of fact-based promotions management – case examples

*Investment decisions.* A leading European retailer has set up tools to enable fact-based decisions on promotional investments, both through better data management and advanced predictive econometric modeling. As a result, the company has been able to achieve an increase in revenues of about 2 percent, and an increase in traffic of about 0.5 percent, without changing their total investment level.

*Promotion design.* At a grocer in Africa, an effort to improve item and tactics selection lead to a margin improvement of more than one percentage point, as well as to an improvement in shopper value perception. Careful attention to implementation was a key success factor. The company invested both in transparent, easy-to-use tools for category managers and extensive capability building. Thanks to these efforts, category managers made the fact-based promotion management approach their own, rather than rejecting it as a black box.

*Supplier management.* A European grocery retailer moved from old-school negotiations with suppliers to a fact-based interaction approach. This resulted in a margin increase of about 0.4 percentage points from better conditions, brought about smoother processes because fewer meetings were needed to reach agreement, and allowed for shorter time-to-market for innovative additions to the assortment.

To achieve these levels of revenue growth and margin improvement, as well as a beneficial shift in customer value perception, retailers typically apply analytics to identify value-destroying and value-generating promotions; they align their supplier agreements to support value-generating promotions; they set up one-time program changes to capture the value; and they put in place a small team and a recurring review process for continuous testing, improvement, and optimization of promotions.
Best-practice retailers use advanced modeling techniques not just occasionally, but as an integral part of their daily promotion management processes. We recommend institutionalizing a tool-based approach to complement the retailer’s strategic thinking and optimize promotional return on investment. Leading players translate the insights derived into commercial policies that serve as input to category managers for their everyday decision-making. Such policies could, for example, specify which categories should be preferred in promotions for a certain channel (e.g. hypermarket). Similarly, they could earmark some categories for an “everyday low price” scheme, and others for a specific level of promotional pressure for a certain period of time.

Of course, promotion management is not an isolated activity, but part of a retailer’s marketing mix that also comprises regular pricing, ranging, loyalty schemes, and advertising pressure. To account for interdependencies and cross-effects between various marketing levers, promotions should not be analyzed and optimized in isolation, but as part of an integrated effort as described above in the chapter on marketing mix modeling (MMM). MMM compares the relative impact of a wide range of commercial levers, and it creates transparency about their contribution to a retailer’s overall performance. Focusing on highly sophisticated promotion optimization may not always be the best use of a retailer’s time and resources. For example, a new entrant to a regional market might see a bigger impact on sales by focusing initially on awareness-building. MMM helps uncover these relative effects and helps retailers take informed trade-off decisions not only within, but also across commercial levers. Compare Exhibit 11.4 for an example.

**Comprehensive, clearly defined KPIs are crucial to optimize item selection and promotional tactics**

Of course, determining the appropriate investment level solves only part of the problem. The next step is promotion design. In recent years, promotion managers have become more sophisticated in balancing new customer acquisition through unbeatable deals for everyone with upselling, i.e. increasing basket sizes and shopping trip frequency through targeted
offers for loyal shoppers. The increasing penetration of loyalty cards has provided ample opportunity to shift the focus from pure price discounts to more subtle benefits, such as extra loyalty card points, free gadgets linked to specific items or basket sizes, and discounts on a shopper’s overall basket, e.g. a EUR 5 (USD 4) discount for every EUR 50 (USD 40) they spend.

Helpful hints on promotion design

- Keep a calendar of key seasonal weeks and big events.
- Put in place clear, yet flexible guidelines for the category mix.
- Derive simple “what if” rules for SKU selection from past promotions.
- Employ a rolling mix of mechanics for constant testing and learning.
- Set and monitor quantified performance targets for each promotion.

A growing arsenal of sophisticated promotion types makes it more important than ever to determine which promotion will give retailers the biggest bang for their buck. While it isn’t necessarily wrong to go by rules of thumb or maximize supplier subsidies, our experience shows that retailers achieve better overall results if they create a complete picture of promotional impact. Sales and margin uplift are, of course, well-established and valid metrics. But additionally, retailers should also look at incremental store traffic (number of baskets) and incremental basket size (Exhibit 15.2). Store traffic provides a reliable indication of whether the promotion helps generate additional shopping trips, whether from new shoppers or through higher frequency from existing shoppers. Basket size will tell retailers what type of shopper the promotion appeals to, e.g. cherry-pickers vs. heavy spenders.

In the previous chapter on local marketing excellence, we have dealt with three fundamental drivers of promotional impact (see Exhibit 14.1):

1. **What** to promote, i.e. which categories and products?
2. **How** to promote, i.e. which types of promotions?
3. **Where** to promote, i.e. in which distribution areas and media?
The third question is addressed by granular geo-marketing tools as presented in the previous chapter. In this chapter, we will focus on the other two drivers, the principal elements of promotion design: item selection and promotional tactics.

- **What to promote?** Which items promise the biggest sales and profit impact in and by themselves? Which will have the biggest impact on the rest of the basket? Which have the highest potential to drive store traffic? (Exhibit 15.3)

- **How to promote?** Which promotional tactics are the most effective for which items? How deep should the discount be if the promotional item in question is featured in advertising? How deep if it isn’t?

This fact-based approach to promotion design will not only help optimize the impact of individual promotions; it also has the potential to preempt and prevent destructive promotion wars. In many cases, limited transparency about actual promotion performance will induce retailers to outdo one another with more and more of the same, often way beyond the saturation point at which additional investment fails to generate any further increase in revenue or value perception.
The way out of such situations is to supplement the art and the experience of category managers with a solid fact base. One of the most powerful initiatives in this area is to create a reliable baseline of past promotional impact, recognizing sales, profit, traffic, and basket sizes. Once this baseline is established, it will become much easier for retailers to determine the real incremental impact of new promotions. Additionally, it will enable them to single out and counter detrimental side effects, such as cannibalization or advance purchasing effects. For example, some purchases of items on promotion will substitute the purchase of another product in the same category. In other cases, shoppers will stock up on promoted items without increasing their overall consumption, causing a drop in sales once the promotion ends.

As with overall investment levels, insights into promotion design should be codified in actionable guidelines to help front-line personnel make smarter item selections, pick the right tactics, and set optimal discount levels. For details on how to activate promotions in leaflets, see the previous chapter on local marketing excellence. In general, best-practice players treat leaflets much the same way they treat their precious store floor space, looking to maximize the return per square inch of any given leaflet.
Retailers should leverage insights about promotional impact in negotiations with suppliers

A constructive business relationship between a retailer and its suppliers is a key enabler of effective promotions, both in terms of sales and in terms of margins. At first sight, however, there is a conflict of interest at the heart of this relationship. While retailers are focused on running promotions that improve their overall economics, manufacturers will want retailers to promote specific items that are particularly important to the supplier, whether to pursue sales targets or to build brand equity, as often as possible. In many cases, these conflicting purposes will not be equally well served by the same items. This is why manufacturers are prepared to offer a significant financial contribution to make retailers swing their way.

This type of incentive often leads to value destruction. Promoting the supplier’s favorite product may not be particularly effective in terms of sales or traffic generation, but the retailer will be tempted to keep promoting it anyway, lest they risk losing the manufacturer’s subsidy. This is a clear case of value destruction. However, in our experience, retailers can turn it around by using factual evidence, such as scenario modeling for alternative promotional parameters, to convince suppliers to change their subsidy strategies. For example, they may ask suppliers to shift their subsidies from SKUs that have been proven to generate low or negative ROI in promotions to more promising items. Failing that, retailers can ask for compensation for past promotions with negative profit impact.

Many retailers believe that sharing information with their suppliers is naïve and will not create any value. In fact, many cases of supposed win-win partnerships are actually sophisticated arm-twisting tactics in disguise. But real win-win deals with selected, large suppliers are not unheard of, especially if both parties are offering some sort of exclusivity, such as preferred placement or expedited delivery of certain items. At any rate, tight budgets make consumers more sensitive than ever to what is being promoted. Hence, it is in the best interest of both retailers and suppliers to leverage any information they can lay their hands on to improve promotional impact, whether through overt information sharing or covert use in negotiations. Potential benefits for retailers include:
- **Better conditions.** Retailers who can demonstrate that a given supplier’s products have achieved below-average margins in a specific category during sales promotion can demand better conditions or compensation (Exhibit 15.4).

- **Lower capital and logistics costs.** When retailers and suppliers jointly leverage demand data and supply parameters, they can optimize inventory management to reduce both out-of-stocks and overstocks.

- **Higher sales and long-term advantages.** Retailer and supplier collaboration models such as “Collaborative Planning, Forecasting and Replenishment” (CPFR) help drive revenues and create competitive differentiation.

Best-practice negotiators employ so-called negotiator checklists, spelling out simple rules such as “no promotions with negative margins,” “promotional contribution aligned with category average,” or “sales uplift meets competitor benchmark.” For details on supplier management, see Chapter 19 on smart sourcing.
Excellence in forecasting, logistics management, and in-store execution can improve margins significantly

Sound strategy and methodical measurement are necessary, but by no means sufficient conditions of optimal promotional impact. In fact, many retailers struggle with low or negative promotional margins that result from poor execution, rather than from a lack of strategy. Key elements of successful execution include:

- fact-based forecasting and ordering;
- flawless logistics management;
- consistent in-store execution.

There is nothing worse than a promotion that runs out of stock before it ends. Shoppers will be disappointed, and the resulting decrease in satisfaction and loyalty can easily outweigh any short-term sales uplift generated by the promotion. However, overly optimistic planning can lead to massive leftover stock at the end of a promotion. To minimize both stock-outs and leftovers, retailers need to upgrade their forecasting and order management capabilities. Traditionally, promotional items are distributed to stores based on a rough-cut central forecast, followed by ad hoc pull orders from individual stores as the promotion proceeds. There are two ways in which retailers can refine this procedure: through more reliable demand modeling and more fact-based replenishment. As richer data on historical promotions and advanced analytical approaches become available, retailers can apply statistical algorithms to predict the expected demand pattern of a given promotion – whether seasonal, trending, or event-driven (Exhibit 15.5). Based on the resulting forecast, retailers can choose from a wide variety of best-practice replenishment approaches. See the box below for an example.
Best-practice replenishment

Traditionally, promotional items are pushed to stores based on a central forecast, and replenished as requested by individual stores. Today, there is a wide variety of more sophisticated approaches. Many leading retailers rely on PPPF (Push-Pull-Push-Flush) because of the iterative way in which it balances demand with supply over the entire course of a promotion:

1. Push: Based on statistical demand modeling, 40 to 60 percent of total stock is distributed to stores.
2. Pull: During the early stage of the promotion, stock is replenished through pull orders from stores, based on daily sales.
3. Push: As the promotion draws to its close, residual volume is sent out to stores based on an adjusted forecast.
4. Flush: After the end of the promotion, leftover volume is allocated or disposed of according to pre-agreed central plans.

Typically, this kind of approach helps retailers reduce stock-outs by up to two percentage points and decrease leftover volume by 10 to 15 percentage points. In a given case at a grocery retailer, a comprehensive promotion ordering optimization effort has helped reduce leftovers by as much as 73 percent – chiefly through more fact-based demand forecasting and adjusted initial orders.

Fact-based forecasting and demand management are only parts of the puzzle that is excellent execution. Flawless logistics management is just as important. Differentiating product flows for promotional items vs. standard stock is now common practice at many leading retailers, as is dedicated coordination of warehousing and distribution for high-profile promotions. But one of the most powerful drivers of promotional margin is still underleveraged by all but the most advanced players: upfront leftover management guidelines. Even sophisticated demand planning will not reduce leftovers to zero, and every residual item decreases promotional
margin because of inventory cost and potential write-offs for unsold items. By defining how to handle leftovers before the promotion even begins, retailers can take precautions to keep these costs at bay. The fundamental question is whether to return residual stock to suppliers, or whether to keep it in stores. For those items that remain in stores, retailers need to decide whether they want to keep selling them at promotional prices, or whether to make them part of the regular assortment and price them accordingly; see Exhibit 15.6 for a heuristics tree that addresses these questions.

When it comes to in-store execution, it is important to guide shoppers to promotional items through clear and prominent signage. In a survey conducted by McKinsey in North America and the United Kingdom, 35 percent of shoppers said they had difficulties finding promotional items that had been advertised in leaflets, and one in five respondents did not find the items in question at all. Proven instruments to prevent this include compelling in-aisle value signage, bold end-cap signage with one or two prominent items per end cap, and big signs that bring visuals and messages from leaflets to life in the store. Obviously, such in-store transformations of

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**Exhibit 15.5** Adaptation of forecasting methods to demand patterns.
shelves, aisles, and signage require careful planning, recognizing central targets as well as local experience. McKinsey analyses show that preparing a store for a promotion can take up to three times as long as estimated in central forecasts. Additionally, store managers need to monitor promotional sales closely to be able to make informed in-flight adjustments to promotion terms. For example, lagging sales in one of the promotion’s later stages could trigger tiered discount increases from 20 percent to 40 percent to 60 percent to balance conflicting objectives: margin protection and leftover reduction.

Finally, retailers need to keep in mind that promotional impact also depends on the right mix of expertise in promotion teams (from marketing and category management to logistics and IT); well-defined and smooth processes; clear roles and responsibilities for various decisions; the availability of hands-on tools; and a commitment to capability building over time. Despite their best intentions, many retailers still fail to use quantitative data and qualitative lessons learned from past promotions for more
informed future decisions. This may sound complicated, but even simple measures often go a long way. For example, a leading grocer laid the foundations for a learning promotion organization by putting up big white boards displaying promotional KPIs in back offices and making promotional performance reviews an integral part of store teams’ daily meetings.

Key takeaways – Profit-driven promotion management

1. Econometric modeling helps to strike the right investment balance between regular pricing and promotions.
2. Comprehensive, clearly defined KPIs are crucial to optimize item selection and promotional tactics.
3. Retailers should leverage insights about promotional impact in negotiations with suppliers.
4. Excellence in forecasting, logistics management, and in-store execution can improve margins significantly.
Video hasn’t killed the radio star, and new media will not kill classical advertising. Although many retailers have started to shift parts of their marketing budget from offline to online vehicles, traditional media still play an important role in their marketing mix – and will continue to do so in the foreseeable future. Admittedly, a significant share of retail advertising budgets is allocated to local media: leaflets and local print ads are indispensable for ensuring targeted communication; see Chapter 14: “Leaflets and Local Print Advertising” for details. But to build strong retail brands and involve consumers on an emotional level, most will turn to a “big bang” ATL campaign.

In this chapter, we present a selection of some of the most successful classical campaigns in retail, and provide a structured approach that will help ensure retailers get their money’s worth from traditional media advertising. The success factors discussed here have been developed over many years in cooperation with leading European retail marketing practitioners.

Yet while terms like “classical” or “traditional” advertising might suggest stability, we find that the world of ATL communication is actually quite dynamic. In recognition of recent changes and challenges, McKinsey has partnered with the German Advertisers Association, OWM, to conduct a series of interviews with media and communications professionals. See the box below for five initial theses on the future of media and communications management that have emerged from this effort. At the time of going to print, the final report was still being prepared.
For many retailers, classical advertising remains a key element in their marketing mix, despite the importance of local media and digital vehicles.

Across Europe, retailers make ample use of traditional advertising vehicles. Traditional media include TV, newspapers, magazines, and radio. They have been around for many decades and are still used by a vast audience as trusted sources of information and entertainment. It’s no surprise that advertisers make ample use of these established audience aggregators. Traditionally, the retail industry ranks among the top three in terms of advertising spend in France, Germany, and the UK. According to Nielsen Media Research, three out of the top five advertisers in Germany were retailers in 2008: Media-Saturn, Aldi, and Lidl. In total, German retailers have allocated some EUR 2.6 billion (USD 2.1 billion), or 90 percent of their above-the-line spend, to classical media in 2009, such as print, TV, and radio (see Exhibit 16.1). Similarly, the top three retailers in the United Kingdom, Tesco, Asda, and Sainsbury’s, spent EUR 217 million (USD 172 million), or 96 percent of their ATL budgets, on classical vehicles. Even IKEA, despite

| Exhibit 16.1 | Net advertising spend by traditional media channel. |
their traditional focus on catalogs, recognizes the importance of classical advertising: “Today’s marketing landscape still calls for traditional media to play a role,” says Magnus Gustaffson, IKEA’s head of marketing.

Some of the biggest success stories in retail advertising rely heavily on classical vehicles. To find out what works well, let’s look at the Cannes Lions International Advertising Festival, the largest and most prestigious get-together of advertising professionals and advertisers from around the world. More than 22,500 ads are showcased here every year. The winners are awarded the highly coveted Lion trophies in eleven categories, including film, press, and radio. Table 16.1 lists the most successful campaigns by retailers, restaurant chains, and fast food outlets from the last five years. From this list it is clear that retailers are not only big spenders but, in the eyes of the advertising industry, are also very successful users of traditional ATL media.

A closer look at some of the Cannes Lion winners shows that retailers’ classical campaigns do not only win awards. They are also successful in shaping consumers’ perceptions of retail brands and value propositions. Take Dixon, for example, a 2010 Gold Lion winner for print. With their “The last place you want to go” campaign, the British electronics retailer took two risks simultaneously: they used offline media to promote their online distribution channel (dixons.co.uk), and they tackled the fading glory of their brick-and-mortar outlets with a humorous twist. See Exhibit 16.2 for a few examples of how this campaign brought out the advantage of the combination of an established high street brand and the convenience of online shopping. The campaign builds on the consumer trend towards multi-channel shopping, and it recognizes the importance of price as a key purchase driver for increasingly opportunistic shoppers.

In their 2009 Silver Lion-winning TV campaign, Spanish optician chain Visionlab used a magical transformation to promote their traditional brand values: sympathy, confidence, and humor. The commercial shows a couple having dinner in a restaurant. She tells him: “Darling, you know, you look much more handsome since you started wearing those trendy new glasses.” He, Pierce Brosnan, replies: “Really? Do you think they make me look different?” He takes off the glasses, changing back into an average-looking man. She motions for him to put the glasses back on, and as soon
### Table 16.1 Cannes Lion winning retailers 2006–11

<table>
<thead>
<tr>
<th>Year</th>
<th>Media</th>
<th>Company</th>
<th>Advertising agency</th>
<th>Lion</th>
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<td>Film</td>
<td>Debenhams</td>
<td>JWT London</td>
<td>Bronze</td>
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<td></td>
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<td>Exclusive Books</td>
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<td>Gamestop</td>
<td>The Richards Group Dallas</td>
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<td>IKEA</td>
<td>Hjaltelin Stahl &amp; Co. Copenhagen</td>
<td>Bronze</td>
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<td>Press</td>
<td>Dank</td>
<td>DDB&amp;CO. Istanbul</td>
<td>Bronze</td>
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<td>Harvey Nichols</td>
<td>DDB London</td>
<td>Bronze</td>
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<td></td>
<td>Y&amp;R Dubai</td>
<td>Gold</td>
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<td>Tribu DDB Heredia</td>
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<td>Radio</td>
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<td>Harvey Nichols</td>
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<td>Press</td>
<td>Norlis Antique Bookstore</td>
<td>Leo Burnett</td>
<td>Bronze</td>
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as he does so he changes back into Pierce Brosnan, reinforcing Visionlab’s brand claim: “You see fine, you look fine.”

Boots, the 2008 Bronze Lion winner for film, approached an even touchier subject in their 2007 “Moment of Truth” campaign. We see a packed beach. People are tanning, reading, taking dips. The crowd is buzzing as a blonde woman enters the scene. But the noise subsides as she gets ready to strip down to her bikini. For many women, this is the most dreaded moment of the year. Luckily, she looks gorgeous, toned, and sexy – because she has followed Boots’ seven-step “Get Beach Gorgeous” regimen. The campaign directly supported Boots’ objective of driving young women into their stores for their summer beauty shopping.

Awards are not everything, of course. Even the more mundane classical campaigns often help retailers to strengthen their brand image, achieve competitive differentiation, and drive sales. But what does it really take to create a good classical advertising campaign, and how do you make it stand out from the crowd?
Creativity matters, but it's not enough: content fit is equally important, especially in campaigns advertising low-involvement, fast-moving products

“Next year, I want to win even more creativity awards!” This statement, made at the 2007 International Advertising Festival in Cannes, did not come from an aspiring art director, but from Jim Stengel, the former CMO of one of the world’s largest advertisers, Procter & Gamble. Winning 14 awards in Cannes was a crowning achievement for the consumer goods giant from Cincinnati. Procter & Gamble’s marketing executives obviously believe that creative excellence and advertising success are linked. But does creativity really make all that much difference? And if it does, is creativity all it takes to create a successful classical campaign?

These questions are as old as advertising itself, but today marketing executives are under more pressure than ever before. Their products have to stand out from competitors – in a world already full of advertising, flooded with information, and inundated with products that seem ever more alike. In this crowded media landscape, consumers are unmoved by brute advertising muscle: the proliferation of TV channels and the power of the remote control nullify the effect of mainstream advertising – and advertisers’ exploding marketing budgets. The only way for campaigns to succeed in increasing sales in this fragmented environment is not through massive presence, but through high quality.

In a pioneering study, McKinsey & Company’s Marketing and Sales Practice, in collaboration with the Art Directors Club for Germany (ADC) and the Berlin School of Creative Leadership, have defined quantifiable metrics for both creativity and content fit to determine their relative impact on advertising effectiveness; see the box below for details.

Using these criteria, the jurors assessed a sizeable sample of advertisements on a scale of 1 (poor) to 5 (excellent). A panel of art directors voted on the creativity criteria, while a group of McKinsey marketing experts, including one of the authors of this book, assessed the content fit of each advertisement.
Elements of creativity

- Originality: Is the advertisement new, original, and innovative? Does it go against conventional norms? Is it surprising?
- Clarity: Is the story, copy, or imagery easy to grasp? Do you understand the content right away?
- Conviction: Are the arguments in favor of the product persuasive and compellingly communicated? Is the campaign coherent?
- Quality: Is the campaign well crafted in technical terms? Do its individual parts fit together well, and do they form a homogeneous whole?
- Want-to-see-again factor: Is it fun to watch the advertisement? Is it entertaining? Do you want to see it again?

Elements of content fit

- Relevance: Is the campaign relevant for the target group and message? Does it fit with the company strategy and the product, brand, or proposition?
- Differentiation: Does the advertising message stand out from competing messages?
- Consistency: Does the advertising fit with previous campaigns? Is it in line with the general communication of the product, brand, and company?
- Credibility: Are the arguments convincing? Do you trust the product, the brand, or the company to deliver the value proposition presented?
- Activation: Will the advertising motivate the target group to go out and buy the product, or go to the store?

Media Markt’s 2004 campaign “Don’t get screwed” scored very high on almost all criteria on both dimensions, creativity, and content fit. The campaign turned out to be one of the company’s most successful advertising
efforts ever, boosting total sales by more than 10 percent and increasing its market share by more than one percentage point.

Clearly, content fit and creativity both have a substantial impact on advertising success. But is one more important than the other? What is the prime determinant of the effectiveness of an advertisement: creative design, or content fit – or a combination of the two? In the past, this question was hard to answer. The assessment of creativity, in particular, was hampered by the lack of objective criteria. In most studies creativity was measured only by the number and prestige of awards won in industry competitions, with juries often voting simply on the basis of what they liked and disliked.

The study shows that, overall, campaigns that score well on both creativity and content fit are the most effective: they drive sales in almost all cases. But the relative importance of the two ingredients depends on the advertiser’s industry. For example, in financial services, creativity and content fit are equally important, as consumers make their choices of insurance or investment products based on both emotional and rational factors. For manufacturers of products with low-ticket prices and limited consumer involvement, content fit is especially important because of the consumers’ somewhat more rational purchasing behavior in such cases. However, any marketer of highly emotional products, such as jewellery or designer sunglasses, will want to prioritize creativity over content fit. Across all industries, we have observed three guiding principles:

- **Creativity and content fit both have a major impact on advertising effectiveness**: Companies that design their campaigns around both elements are highly likely to succeed in increasing sales. Not even the deepest pockets, however, can make up for a campaign that falls short on both dimensions.
- **The right mix of creativity and content fit varies by category**: As a general rule, creativity is even more effective for products with high emotional involvement, while content fit is effective at driving sales of low-ticket price, fast-moving consumer goods that have lower consumer involvement.
Advertisers should use the list of criteria for creativity and content fit, as presented above, for pre-testing. This will help them identify the key factors in a given case. What works well in one country for a specific segment of the market may not necessarily be transferable to other contexts.

Test and learn prior to, during, and after activation to make sure you get your money's worth in terms of target group impact

Advertising is effective if it succeeds in changing the behavior of the consumers it reaches. Different media can convey the same marketing message very differently. To evaluate the effectiveness of each vehicle using a common yardstick, the quality of the medium needs to be taken into account: in this context, quality is defined as the level of influence of a given marketing vehicle on consumer involvement, attitude, and behavior toward a brand, a product, or a service.

Pre-testing is the process of analyzing, testing, and refining the quality of a commercial before airing it, or of a print ad prior to its activation in newspapers and magazines. To make sure the actual activation budget gives them their money’s worth, advertisers and their media agencies use pre-tests to check whether a given campaign will have the intended impact on its target group. Insights gathered from advertising tests can be used to refine the campaign in question, even while it is on air or in print. For example, it is not uncommon for TV advertisers to change the cut or voiceover of TVCs halfway through the commercial’s run in order to optimize its impact on the target group.

Keith Weed, Unilever’s Chief Marketing and Communications Officer, says: “We now have a methodology in place that enables us both to benchmark all our ads against our own proven experience – with reasonable confidence that our large investment in developing and producing ads will indeed pay off – and to understand where an ad is failing and take appropriate remedial action.”

Best-practice testing processes typically include three steps (see Exhibit 16.3):
• **Concept testing:** Testing at an early stage of campaign development will provide valuable insights prior to production. Creative agencies usually present more than one idea, or creative route, for a commercial or a campaign. Thus, it is essential to understand which ideas work best in delivering the advertiser’s message to consumers. To find out how consumers react to different routes, research agencies typically combine field surveys, interviews, and focus groups with quantitative approaches. Modern concept testing relies increasingly on online survey methods; these methods frequently yield more accurate results at lower cost.

• **Pre-testing:** Prior to committing to a given campaign, marketing executives will seek to minimize the risk of airing an ineffectual campaign. Pre-testing allows them to test the entire campaign, including the creative work as well as the media selection, before giving final approval.

• **Post-testing:** Advertisers use post-testing to evaluate and benchmark the accomplishment of an advertising campaign during or after airing. To build on past experience, it is critical to make sure the insights

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**Exhibit 16.3** Three-step test-and-learn cycle to improve advertising impact.
generated during post-testing are fed back into the development of future campaigns.

Media agencies and providers of copy tests offer a wide range of tools and methodologies that can help you predict and track the effectiveness of your advertising campaigns. The process laid out in Exhibit 16.3 can be used as a plausibility check to focus the discussions with the media agency, as well as a more general framework for thinking about the impact of the retailer’s advertising efforts. But keep in mind that even the most meticulous tests can be misleading; their significance depends entirely on the quality of the indicators and benchmarks you use. The key questions you should ask, especially in discussions with external providers of research, include:

- What is the objective of the campaign? Which are the right metrics and indicators to determine whether the objective is met?
- What are we testing for – is this a pre-activation check or a post-campaign analysis? What is the appropriate survey period?
- Do the techniques meet our requirements in terms of reliability and validity? How do we control for biasing effects?
- Which benchmarks should we use – our own past performance, market averages, or specific (sub)category benchmarks?
- Which resources (how much money, what period of time, etc.) should be devoted to testing?

Once the message is clear, optimize it across and within media to ensure that it is delivered effectively to its target audience

The evaluation and selection of different advertising channels and promotional vehicles is the prerequisite for ensuring your marketing messages actually reach their target audience. To compare the efficiency of different vehicles in terms of their impact per EUR, marketers use approaches such as Reach-Cost-Quality (RCQ) or marketing mix modeling (MMM); see Chapters 10 and 11. In essence, the same logic can be applied
within one type of media; for example, in order to select the most efficient TV network and time slot for a given TVC, or the most appropriate print title for a given ad. In the following, we provide guidelines on the relevant criteria and their application – although the actual media planning and buying is the prerogative of media agencies.

Despite a number of recent controversies over undisclosed discounts, the expertise and experience of media agencies is indispensable in light of the considerable complexity created by the proliferation of vehicles and channels. In fact, the selection of vehicles is only the first step. For TVCs, end-to-end media planning comprises the selection of networks, channels, formats, shows, and daytimes, as well as the type, duration, and frequency of actual commercials. Similarly, print planning includes the selection of publishers, formats, titles, and relevant circulation, as well as types and sizes of ads.

To provide a sense of the trade-offs involved in these decisions, we will look a little more closely at the potential for refinement in print:

- **Efficiency**: Magazines and newspapers differ significantly in terms of their reach among an advertiser’s target group, but these differences are not always fully reflected in the selection of titles in a given media plan. Similarly, the cost for a one-page advertisement (per thousand persons reached) varies greatly due to publisher pricing and media agency discounts. The cost of communicating to the advertiser’s target group can easily be determined for each print title by adjusting the cost per mille (CPM) for the share of the advertiser’s target group found among the readership of the title in question.

- **Effectiveness**: The quality of print titles varies significantly, too. Due to differences in editorial content and readership profiles, some newspapers and magazines will fit well with the advertiser’s brand and message while others won’t. The long-term image impact of selected print media on the advertiser’s brand should at least be rated in terms of the brand’s key attributes.

Our experience with retailers across Europe shows that intra-media optimization is usually well rewarded. For example, an assessment of print
Media for a retailer in Germany revealed substantial differences in terms of their cost efficiency and brand impact. The matrix shown in Exhibit 16.4 maps the print titles on both dimensions, in terms of their effectiveness (impact on brand image) and their efficiency (cost for reaching target group). In this example, the titles in the top right-hand quadrant are the most attractive ones because of their high effectiveness and high cost efficiency. This matrix is specific to the context in which it was created and cannot be generalized. The assessment of either dimension depends on a marketers’ target group and objectives. The effectiveness and efficiency ratings can be combined to evaluate the overall performance of each title and so create a ranking of print titles.

But media optimization should not be limited to the choice of titles, networks, or shows. It’s also about getting the intensity right. In Europe, retailers spend more on marketing than most companies in other sectors, but they struggle to demonstrate the effectiveness of their marketing activities. We believe that retailers can make substantial savings by fine-tuning the advertising intensity within specific types of media – without compromising their communication impact.
Many retailers set their media spend too high, others much too low. Of course, it is no trivial matter to strike the right balance: advertising effectiveness studies show that incremental gain in recall drops with increasing contact frequency – depending on the absolute frequency (the second contact is always much more valuable than the tenth) and the vehicle used (for example, the marginal utility of cinema advertising decays much faster than that of radio).

Advertising intensity is measured typically in gross rating points (GRPs). GRPs are calculated by multiplying the percentage of the target group reached by the average frequency in the target group. For example, a TV campaign that is aired three times and reaches 70 percent of the target audience achieves $3 \times 70 = 210$ GRPs. Both the minimum GRP requirements to achieve a competitive market presence and the best-in-class GRP can be determined at the industry level by analysis of comparable companies. Media agencies and independent media auditors can help cut through the increasingly complex media landscape and extract the relevant benchmarks by providing historical intensity levels and real-time changes in advertising activity.

Exhibit 16.5 Advertising intensity analysis – illustrative example.
The pricing of GRPs changes from week to week, varying in line with classic advertising peaks throughout the year. Once you know the cost per GRP and the optimal number of weekly GRPs needed to achieve the target reach and frequency, you can back-engineer the required advertising budget. Exhibit 16.5 provides an illustrative example of an advertising intensity analysis.

**Pick your creative partners carefully.** Tailor the cooperation model to the needs of your brand and company. Don’t be afraid to change horses

Even the most sophisticated retailers depend on external support for many areas of their brand management and marketing strategy: the art, craft, and science of marketing are all well-served by specialists. While the science and craft are the domain of research institutes, analytical specialists, IT companies, and production houses, the art of advertising depends on the inspiration and experience of creative agencies. But there is no one-size-fits-all solution, either in terms of choosing the right agency for the task, or in terms of the appropriate cooperation model.

The list of Cannes Lion winners in Table 16.1 illustrates that both long-standing agency relationships as well as more flexible cooperation models can each lead to success. But which is the right strategy for your company?

Many advertisers, like McDonald’s, prefer to develop long-term relations with a single lead agency – in a true partnership that seeks to ensure consistency in their brand communication. But consistency isn’t everything. To combine the benefits of global consistency with local relevance, Coca-Cola has pioneered a global advertising model that is based on the central development of a single creative idea, in some cases even by non-traditional challenger agencies, with subsequent orchestration by local agencies.

Clearly, not all long-term or single-source relationships are healthy. They also carry the danger of losing touch with current communication trends, shifts in media usage, or changing consumer lifestyle. Quite a few advertisers experience a certain degree of inertia on their lead agency’s part
after a few years. And even when brand managers make a conscious decision not to change horses, they may not always get what they bargain for. Because of churn and frequent account team changes within many agencies, loyalty to the same agency over extended periods does not necessarily protect companies from inconsistencies or brain drain. In light of these facts, the benefits of the fresh thinking that challenger agencies provide can sometimes outweigh the advantages of long-term agency relationships.

More and more companies are moving from the traditional model of a single roster agency to a small group – or even a larger pool – of agencies. Since 2004, IKEA has worked with a network of partners, for example. It has modularized its creative service requirements and it now selects its agency partners depending on the media for which the creative concept is to be developed. While IKEA adheres to the concept of having a lead agency for a particular vehicle – in Germany this is Grabarz & Partner for classical advertising and Grimm Gallun Holtappels for Internet marketing – it also works with other agencies on a project basis, such as DBB, or Hjaltelin Stahl & Co. So far, this approach seems to be working for IKEA.

Grabarz & Partner appears to have developed a deep understanding of IKEA’s evolving brand promise that combines affordability with the idea of a holistic experience.

In yet another relationship model, certain companies continue to partner with a global roster agency, but at the same time invite other agencies to pitch for specific projects, based on the budget, its strategic importance, special skill requirements, or the type of communication objective. For example, the lead agency may be in charge of all brand campaigns, while selected product introductions, the launch of a new store format, or new market entry may be handled by challenger agencies.

Forming more complex relationship patterns does have a downside: it requires more management input. In our experience, innovative models, such as challenger agency pools, selective pitches, or modularized service procurement, require bigger efforts on the advertiser’s part to ensure communication consistency and protect the heritage of their brands.
The future of media and communications management

Initial results of a joint study by OWM and McKinsey

In recognition of recent changes and challenges in media and communications management, McKinsey has partnered with the German Advertisers Association, OWM e.V., to conduct a series of interviews among more than 30 industry professionals, among them leading executives at advertisers, creative agencies, media companies, and media auditing firms. The five theses below are based on these interviews; they demonstrate the considerable dynamics in the field and discuss future opportunities for joint value creation by advertisers, agencies, and media owners.

Thesis 1: Complexity is growing at an increasing rate.
Marketing has always been an intricate discipline, comprising aspects of art, science, and craft. But, currently, the playing field of media and communications management is changing fundamentally, and the rate of change is increasing. All interviewees agree that the sheer scope of channels has reached unparalleled proportions, fueled largely by new media that did not even exist a few years ago, such as online and mobile. To avoid a loss of core competencies, systematic monitoring of new media trends is required.

Thesis 2: Advertisers need to adopt an entrepreneurial mindset.
It sounds like a truism: companies should manage their agencies, not the other way around. However, years and years of outsourcing have robbed many advertisers of the required capabilities. Frequently, marketing managers feel unable to grasp their agencies’ recommendations fully, let alone challenge them. As a result, media and communications management does not get the top management attention it deserves, despite the considerable investment in this area. To counter this development, advertisers should reclaim true ownership of strategic communication and hold their agencies accountable.
Thesis 3: Tomorrow’s managers will have to be integrators.
The complex and dynamic environment in classical media calls for a new breed of media and communications managers. In the future, the ability to coordinate and steer different internal and external resources will become a core competence, aided by sound marketing knowledge. But fewer and fewer high potentials are attracted to jobs in media and communications management. Employers need to create attractive career paths to attract the right talent, lest media and communications management ends up in the hands of self-appointed amateurs.

Thesis 4: Agencies need to update their functional expertise.
There are two respects in which marketing executives find their creative agencies wanting. Firstly, they observe a lack of functional expertise. Many agencies are perceived to be stuck in an advertising world that revolves around TV. As a result, most campaign concepts are still essentially ideas for TVCs. Secondly, marketers feel that “integrated communication” is usually little more than a buzzword. In reality, few agencies have the capabilities to master all communication disciplines, and the concept of a “lead agency” that steers other agencies has not always proven successful either. To ensure consistent communication, integration and strategic management should remain in the hands of advertisers.

Thesis 5: Media and communications managers need to account for the value they add – before others do it.
For a long time, financial controllers let media and communications managers get away with the claim that it is impossible to measure marketing success. Not any more. In an increasingly ROI-minded environment, media and communications managers are under pressure to quantify the added value of each and every cost position. In fact, scores of controllers are already developing their own outside-in KPIs to measure marketing success. It comes as no surprise that these KPIs do not always reflect actual marketing performance accurately. Marketers should try to gain ground by coming up with few, but meaningful
Interview: Thomas Wagner

General Manager, SevenOne Media

SevenOne Media is a subsidiary of Germany’s ProSiebenSat.1 Group and sells advertising on the group’s German-language networks SAT.1, ProSieben, kabel eins, and sixx. SevenOne Media also offers advertising on the group’s digital platforms, including pay TV, video on demand, online, mobile, and games. The company’s portfolio of marketing services also includes licensing, direct marketing, CRM, and events.

Thomas Wagner talked to Boris Mittermüller at McKinsey & Company about SevenOne’s perspective on the future role of classical media in retail advertising.

Q: Why will TV remain an important element in tomorrow’s retail marketing mix?

Thomas Wagner: TV advertising is the most reliable foundation for brand building. Other communication activities can build on the awareness base it creates. TV advertising quickly generates high reach, it plays on emotion and suggestiveness, and it ensures optimal contact quality. Just compare almost four hours of daily TV consumption to a bare 82 minutes of private Internet access per day. TV also enables advertisers to specify and control the quality of the environment in which their messages appear. And the more fragmented the media landscape becomes, the more important TV will be as a proven provider of reach.

indicators to demonstrate the added value they deliver. Needless to say, they should also be prepared to measure up to these indicators.

While this book was being printed, the second, quantitative phase of this study was conducted. Further information on the results of the study are available upon request from the authors of this book.
How can retailers make optimal usage of TV advertising in the future?

Thomas Wagner: Media usage is changing, and we are all called upon to track this shift and adjust brand communication accordingly. At the ProSiebenSat.1 Group, we have made it our mission to provide advertisers with effective and efficient consumer touch points – be it in linear TV, online, or mobile; and on the first or on the second screen. Our “Connect” service, as featured on “The Voice of Germany,” is an incentive to use TV and online or mobile in parallel. During the live show, the audience was able to answer questions, vote, or chat on their second screens. This dual usage drives attachment and involvement. Additionally, HbbTV (Hybrid Broadcast Broadband TV) provides new opportunities for retailers, enabling direct consumer interaction through the TV set. This allows advertisers to integrate TV and online seamlessly, combining emotional involvement with background information and interactivity – all using the same device.

Q: How is the usage of TV advertising changing? What are the long-term trends?

Thomas Wagner: Parallel usage of TV and online is increasing. Often, users will access information online that is directly related to what they are seeing on TV. This makes TV an engine of online communication, e.g. in social networks. For example, “The Voice of Germany” has more than a quarter of a million fans on Facebook. The related “Connect” applications make the show accessible on PCs, laptops, smart phones, and tablets in parallel. Additionally, we consider decentralized TV advertising an important opportunity for retailers. Working closely with cable network operators, we are now able to air different TVCs in Germany’s five major regions. This will enable advertisers who have primarily used print ads in the past to start using TVCs with similar regional granularity.

Q: Digital media are growing in importance. How does this affect TV advertising?

Thomas Wagner: The development of what we call the second screen, e.g. on smart phones or tablets, allows for interaction during
broadcasting and opens up new inroads to consumers. This is why we believe digital will not substitute, but enrich, TV as an advertising vehicle. Our research, conducted in collaboration with the agency network pilot in 2011, shows that pure TV contacts and spill-over effects resulting from combined TV and online contacts jointly account for 90 percent of campaign reach. Only 10 percent of net reach can be attributed to pure online contacts. This confirms that TV is indispensable to build reach.

Q: How will so-called “performance marketing” change TV advertising?

Thomas Wagner: TV drives online search. This is why performance marketing, especially search engine marketing, will keep growing dynamically. Since we believe this facet on search engine marketing has previously been underestimated, we are investing in this area and have recently acquired Booming, an agency specializing in search engine marketing and search engine optimization. This means we are in a position to provide advertisers with an integrated product in certain areas, combining search and TV. This should be an interesting option, especially for retailers.

Q: What is the long-term advantage TV has over digital media?

Thomas Wagner: TV drives brand communication and sales. It combines high reach with quick scale-up and substantial suggestive power. In a fragmented media landscape, the relevance of TV to create reach is growing. The role of TV as a lead vehicle is also confirmed by media usage patterns. Next to the Internet, TV is the only vehicle that gains in usage. While total media consumption has only increased by 5 percent in the past, TV consumption has grown by 9 percent. What is more, parallel usage is growing. For example, 42 percent of those aged 14 to 49 years use TV and the Internet in parallel, creating ample opportunities for advertisers to engage in integrated communication. In the long run, TV itself will, of course, become digital. Eventually, all moving images will be equal, and content quality will be the sole driver of attractiveness, regardless of technical platforms. Classical TV is well prepared for that era. Creating professional content is our core competence – now and in the future.
Key takeaways – Classical Media Excellence

1. For many retailers, classical advertising remains a key element in their marketing mix, despite the importance of local media and digital vehicles.

2. Creativity matters, but it’s not enough: content fit is equally important, especially in campaigns advertising low-involvement, fast-moving products.

3. Test and learn prior to, during, and after activation to make sure you get your money’s worth in terms of target group impact.

4. Once the message is clear, optimize it across and within media to ensure that it is delivered effectively to its target audience.

5. Pick your creative partners carefully. Tailor the cooperation model to the needs of your brand and company. Don’t be afraid to change horses.
Even if they don’t plan to sell their goods online anytime soon, or ever, retailers can’t afford to ignore the realm of digital marketing. The digital universe is evolving quickly, and it holds tremendous opportunity. Self-empowered users go online to locate stores and research products prior to their offline purchases. They share their in-store and product experiences with millions of other users via social network sites and blogs. They reach out to companies to provide feedback and input, and they freely reveal their needs and preferences to everyone who cares to listen. Who would want to miss out on this wealth of information, interaction, and influence? But online marketing requires other approaches, tools, and capabilities than the offline world. Everything happens in real time, and word of mouth spreads at a tap on the pad. Reputation may be gained more quickly than in a traditional media environment, but it can be lost just as easily. And even if the vehicles are virtual, successful digital marketing is still about the ROI of real dollars and cents.

In this chapter, we will show what it takes to succeed in this changing environment. We will discuss the development of a digital strategy, and cover what we consider today’s three most important digital touch points: search engine marketing, display advertising, and social media (see Exhibit 17.1 for digital marketing investment levels). Finally, we will examine how to integrate the management of digital activities into the entire retail organization.
Digital technology affects the entire retail value chain. Pick your battles wisely to differentiate your value proposition

Even if most retailers have passed the “We should have a website!” phase, there is still a lot of confusion around the rationale for their digital presence: Are you doing it because everybody else is doing it? To promote your brand? To generate leads? To interact with consumers? To foster loyalty? Given that digital technology is in the process of transforming the entire retail value chain (see Chapter 12 for examples), a solid strategy and clear objectives are more important than ever. Opportunities include:

- **Insights generation.** Digital natives are very generous when it comes to information on their identity, their needs, and even their shopping behavior. Within the boundaries of data protection acts and privacy regulation, digital media offer rich opportunities for retailers to gather insights about current and potential customers. They leave a digital trace when they search for information, make a purchase, or discuss...
the merits of a given product or service with their friends and peers. Starbucks is among the pioneers when it comes to engaging consumers to share ideas through the dedicated portal MyStarbucksIdea.com. There are nearly 30,000 ideas for new coffee drinks – but also more than 8,000 on social responsibility. Starbucks makes a point of telling all users what happens with their ideas.

- **Marketing and branding.** Perhaps most importantly, the digital arena has become an environment in which brands are built and consumer involvement is fortified. Take the example of IKEA’s Facebook showroom. For the launch of a new outlet in Sweden, IKEA uploaded pictures from the store’s showrooms. Followers could, then tag themselves to specific items and thereby enter a prize draw to win that particular product. The campaign created a buzz across thousands of friends’ profiles – at almost no cost. (Source: Most Contagious Report 2009.)

- **Sales stimulation.** More and more customers are researching online and purchasing offline (ROPO), or they go directly to an online shop. So even if you don’t have an e-commerce channel, you can still use digital media to stimulate offline sales. Examples include Esprit, the apparel retailer. Their website features a store finder as well as an online inventory tool. It lets consumers check in real time whether a specific garment, including its color and size, is available in the store they have chosen based on the ZIP code of their current location.

- **Service.** Hundreds of companies are already using micro-blogging platforms such as Twitter as convenient service channels to gather customer feedback, provide outbound updates, and prioritize after-sales issues as they arise. And ever more customers expect companies to do so. Take the example of a telecommunications company that started reaching out to its customers through social media in 2009. According to external company presentations, the share of resolved reach-outs handled through Twitter and Facebook increased by more than 30 percent within the first nine months. In Germany, one in four major companies uses social media as a service channel.

Other applications of digital technology in retail include external communication, human resources, and internal collaboration. Leading retailers use digital media to build their reputation in blogs and boards, to interact
with potential hires through career portals, and to streamline internal coordination across stores and regional hubs. Additionally, digital tools can help simplify or streamline other customer related processes, e.g. in areas such as call center management, to increase marketing effectiveness and efficiency. However, given the focus of this book, we will concentrate on digital media as marketing vehicles in this chapter.

**Digital marketing excellence starts with the consumer.**

Develop your digital strategy based on your target group’s decision journey

Most marketers would agree that successful marketing starts with consumer understanding. Of course, this applies online as much as it applies offline. The so-called “customer (or consumer) decision journey” is perhaps the most common way of mapping the steps customers go through en route to a purchase. Conceptually, the decision journey is a way of looking in more detail at the “consideration” and “purchase” stages of the brand funnel, as introduced in Chapter 3: “A Guide to Excellence in Retail Brand Management”). But while many retailers know a lot about shoppers’ offline behavior, they are often in the dark about what is happening online. In the past, many offline decision journeys were often reasonably straightforward. A shopper would visit a shop, seek advice, make a purchase, and eventually return for supplies or service.

In contrast, today’s decision journeys are often much more complex, especially since digital touch points are seeping into the decision journey of almost all shoppers; see Exhibit 12.2 in Chapter 12, “The Digital Retail (R)evolution”). In this hybrid world, retailers are wondering how shoppers search, which sites they visit, and how much information they are willing to absorb. To make digital marketing excellence even more challenging, many online touch points are outside a retailer’s control. Examples include boards, blogs, social networks, and price comparison sites.

In light of this complexity, analyzing the shopper’s decision journey in a given retail category is an indispensable prerequisite of successful digital marketing:
• What is the initial shopping trigger?
• How do shoppers build their consideration set?
• How do they evaluate different brands, products, and retailers?
• How do they make their purchase, and how do they pay for it?
• What do they need to enjoy their purchase fully?

Retailers will find that there is not one answer to most of these questions, but several. In fact, decision journeys differ widely across categories. It comes as no surprise that the purchase of a high ticket-price item, such as a car, is preceded by a lot of research through multiple channels, while low-price items or recurring purchases will often be a matter of one-click shopping. But even within the same category, individual paths may still differ significantly. Take consumer electronics as an example. Hi-fi enthusiasts enjoy following innovations online and are constantly on the lookout for new products to complement their high-end stereos. Their “decision journey” is really not a journey at all, but a loop of continuous scouting. Less experienced or less involved shoppers, however, may only be in the market for a consumer electronics product once every few years, and chances are that they will be overwhelmed by the wealth of options and information the enthusiasts thrive on. In all probability, the second group of shoppers will seek advice and recommendations, rather than plain factual information. And, typically, there is also a group of savvy shoppers with a keen eye for specials, coupons, and discounts. These value seekers wouldn’t dream of buying a new TV unless it is on sale.

When building their digital strategy, retailers should cover four bases:

• a digital branding concept that prioritizes digital opportunities for the retailer’s umbrella brands and relevant sub-brands or store formats;
• a media strategy that reflects the usage pattern of their target group across the entire customer lifecycle, starting with the decision journey;
• a communication strategy that details messages and types of content, including a sourcing strategy (in-house vs. co-creation vs. external);
• an innovation program to test new digital business models, such as an e-commerce pilot, and to develop new technologies and tools.
To balance the use of digital media with other marketing vehicles, retailers should engage in marketing mix modeling (see Chapter 11), including key digital touch points in the analysis. In the remainder of this chapter, we will focus on digital media strategy, highlighting marketing opportunities afforded by the most important digital touch points: search engine marketing, display advertising, and social media.

Digital diagnostics

Before they start developing their digital marketing strategy, retailers should have a clear picture of their current digital footprint. Until very recently, this was very difficult: while the digital arena is characterized by a proliferation of data, there are very few established, widely accepted, and comprehensive indicators of digital marketing performance. To get a first picture of the specific dimensions of the performance of a website, free tools available on the Internet like Alexa, Insights for Search, or Socialmention can help with indicators like visitors, reach, and sentiment – just to name a few. But, increasingly, holistic tools covering a brand’s entire digital presence are on the rise.

One example of this kind is McKinsey & Company’s Online Marketing Excellence, or OMEX, tool, developed in cooperation with Google Germany (Exhibit 17.2). While most conventional tracking approaches are confined to individual metrics such as click rates or mentions in social media, OMEX is holistic in nature. It captures a retailer’s marketing performance across all digital touch points along the customer’s decision journey. In total, OMEX combines some 20 key performance indicators, quantitative as well as qualitative. What is more, OMEX covers input factors, such as digital marketing
spend, as well as rich output metrics, e.g. quality traffic or conversion rates.

But there is no need to get overly scientific. Rather, retailers should start with a pragmatic diagnostic covering the most important touch points and objectives. Based on initial results, industry benchmarks, and expert hypotheses, it will be much easier to identify individual touch points, target segments, or purchase funnel stages for further deep dives. Because of the high pace of digital media, speed is sometimes more important than 100% accuracy.

### Exhibit 17.2 OMEX: Online Marketing Excellence Tool.
Search engine marketing drives online visibility. Manage paid and unpaid listings actively

Digital marketing excellence is a function of excellence at the digital touch points that matter most to customer acquisition and retention. Starting with search engine marketing, today’s most important digital touch point, we will examine the mechanics of different digital vehicles, as well as the success factors that apply for retailers.

SEM: What it is and how it works

Search engines influence a shopper’s decision journey at various stages. Usually, they are the starting point for a product search. Shoppers also use search engines during the evaluation phase in order to find related products or identify the shop that has the best price or sufficient stock. The journey usually ends with typing the shop’s domain, or a similarly focused search phrase, into Google. In short, search engines are with shoppers almost every step of the way. This is why search engine marketing (SEM) is now often considered a business model, rather than a form of advertising, at least for dedicated e-tailers.

But even retailers without e-commerce ambitions cannot afford to neglect search engine marketing. It helps retailers improve the visibility of brands and products in search engines like Google, Bing, and Yahoo. Search engine marketing comprises two types of activity. Search engine advertising (SEA) is about paying for listings on search engine results pages. Search engine optimization (SEO) aims at increasing the rank and number of unpaid listings in search engine results. In the case of Google, results pages are clearly structured. Paid listings (“Adwords”) are displayed at the top, the right-hand side, and sometimes at the bottom of the page. They are clearly marked as advertising. Framed by these paid listings, Google usually displays 10 unpaid results, populated by Google’s proprietary algorithm. Other players, however, do not differentiate visibly between paid and unpaid results, leaving users in doubt about whether a given listing is driven by content quality or advertising money.
SEM: How retailers can use it

Because of the short attention span of most users, successful SEM is plain and simple: make it to the top of the first results page. On Google, approximately 90 percent of all clicks originate from the first page. The top three paid listings capture 39 percent of the clicks, the top three unpaid listings another 45 percent. Only some 10 percent of clicks originate from areas outside the user’s immediate view, i.e. those areas that are only accessible by scrolling down or sideways. This is why there is only one proper way of doing SEM: with full steam. This is mirrored by the fact that search engines rake in the bulk of digital advertising spend. In Germany, some 40 percent of digital net ad spend is allocated to search engine advertising. At market shares of more than 90 percent in all Western European countries, Google is the primary beneficiary of these investments. In the following, we will focus on Google as the top dog. The basic principles, however, are also applicable to other search engines such as China’s Baidu, Russia’s Yandex, or Microsoft’s Bing.

Search engine advertising (SEA)

For retailers, Adwords – paid listings on Google – offer the opportunity to make it to the first page of the search engine’s results right away. It takes just three things:

- Create an ad text, i.e. the listing users will see on the results page.
- Select the keywords, i.e. users’ search phrases that will prompt your ad to be displayed.
- Place a bid, i.e. specify the amount you are willing to pay for every click on your ad.

In general, competition on the first page is tough. Google positions a given ad based on the expected yield to maximize the return on the available space. Adword ranks are calculated based on the advertiser’s willingness to pay (i.e. the maximum cost per click) and a quality score that depends on the actual click rate, the relevance of the ad for the search, and the quality of
the landing page. Every time a user searches the web, Google conducts an automated auction based on these calculations and delivers the ads based on this ranking. While highly popular search phrases, such as “buy wine,” promise a lot of clicks because of the high search volume, they are also subject to intense competition by advertisers. This is why many advertisers try their luck with the “long tail” – keyword strings with very low search volumes, but also low cost per click and higher conversion rates.

**Search engine optimization (SEO)**

Advertising on results pages for highly popular, yet costly keywords may be uneconomical for retailers, but that does not mean these phrases are entirely out of reach. Retailers can try to get their share of this traffic through search engine optimization, i.e. by spending money to improve their ranks in unpaid listings. Although growing, this type of SEM is currently underleveraged. While more than 50 percent of all clicks originate from unpaid listings, companies only invest about 10 percent of their digital budget in optimization – usually because Adwords is a more convenient way of generating reliable returns (Exhibit 17.3). As advertisers, companies get

![Exhibit 17.3](image)

**Exhibit 17.3** Unpaid search engine listings are currently underleveraged in SEM.
support from Google, as well as from online agencies and other specialized providers. Their brands or products are visible on Google almost in real time, and they receive all the data they need to calculate marketing ROI. In short, SEA is a marketing activity even the CFO will understand and approve of.

In contrast, optimizing a website for Google’s search engine algorithm is tedious. It takes a lot of time, it is an ongoing process rather than a project, and the details are highly technical. However, SEO holds the promise of boosting sales at very low cost. A lot of factors go into the algorithm that determines a website’s rank in the unpaid section of the results page. The

**Technical hints on SEO**

While the number of links from other pages and the quality of the content provided are the main ranking drivers in unpaid search results, there are also some technical prerequisites retailers should observe to make their sites “crawler-friendly,” i.e. easily accessible to Google’s automated ranking tools:

- Build sites with flat hierarchies, i.e. maximize the number of pages on one level and minimize the number of levels.
- Set up keyword-based internal link structures, i.e. avoid lengthy, complex, or graphical hyperlinks.
- Make cautious use of animation, such as Flash, and other formats that might prevent automated readout.
- Ensure fast loading times.
- Watch out for updates to Google’s algorithm and adjust your site accordingly.

Powerful software suites, such as Sistrix, SEOlytics, Searchmetrics, SEOmoz, XOVI, or Xamine provide marketers with clear KPIs regarding their visibility on Google and other search engines. These software packages conduct predefined searches on Google and show aggregated results for unpaid as well as paid listings.
most important ones are links from other pages, so-called “backlinks,” and the quality of content provided. Following the citation logic academics have long used to gauge the relevance and quality of publications, Google treats links from other pages as a proxy of the destination’s importance. Most recently, Google has started to combine search with social media (“search plus your world”). The objective is to make Google recognize not only content, but also people and their relationships. This is good news for retailers who have a solid footprint in social media, since it will eventually improve their ranking.

**Display advertising** is a retailer’s online shop window. **Fine-tune ad formats and user targeting to minimize scattering losses**

**Display advertising: What it is and how it works**

After search engine marketing, display advertising is the second most important digital channel today. In 2011, more than a quarter of net digital advertising spending was allocated to display advertising, including animated ads (rich media). According to McKinsey’s iConsumer survey, OTT (over-the-top) video usage has tripled over the last three years, and Amazon’s Kindle, Sony’s Reader, and Apple’s iPad have introduced similar usage patterns to the realm of print publishing. A prominent example of rich media advertising is IKEA’s “Unbox the banner” promotion. IKEA developed this online campaign as a digital embodiment of the company’s do-it-yourself philosophy. Customers save money when they assemble the ad themselves – with the help of a detailed IKEA-style manual, of course.

Traditionally, a lot of display advertising has been displayed on pre-booked websites, irrespective of the users who would see them. But increasingly, digital ads are targeted towards pre-selected groups of users. This trend is supported by the fact that ads are not limited to websites anymore, but also appear on mobile platforms, in applications, and in games. Current trends in mobile advertising include location-based marketing (e.g. geographically triggered mobile coupons or displays; see the insert on managing relationships in the digital domain in Chapter 18), gamification (advertising in gaming-inspired formats), and augmented reality (e.g.
virtual mobile shopping with scanned body metrics). However, demand for display ads has not kept pace with the increasing usage of the Internet, resulting in declining prices. Many ads are still booked on a cost per mille (CPM) basis, but performance-related clearance is on the rise.

**Display advertising: How retailers can use it**

Regardless of the channel or type of ad, retailers use displays either to increase brand awareness or to generate sales (Exhibit 17.4). Essentially, brand-focused display ads are the online equivalent of classical ATL advertising. Typically, a media agency is involved, and payment is based on a CPM billing model. The main difference between offline and online advertising is the opportunity to reduce scattering losses through more accurate targeting of digital display ads. All offline advertising is environment-based: ads are displayed during a TV show, in a magazine, or on an outdoor billboard. Initially, online display advertising used the same principle, tying ads to a given website or frame. But, increasingly, targeting is user-based rather than environment-based. By storing small

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**Exhibit 17.4** Two types of display advertising.

1 CPM = cost per mille
2 CPC = cost per click; CPL = cost per lead; CPO = cost per order
pieces of data ("cookies") in the user’s web browser, retailers or specialized service providers can create a record of a user’s browsing history and general online behavior. This allows advertisers to trigger ad delivery to the target group regardless of the websites visited at that moment. Most media owners now offer semantic, behavioral, and local targeting of display advertising, enabling retailers to focus their spending on specific audiences.

When it comes to ads that aim to generate sales, one of the most popular targeting methods is what experts refer to as “retargeting.” The ad is displayed to users who have already taken a certain action, e.g. quit an ordering process without completing it. Customers who have not completed the purchase process are recognized via cookies, even during a separate session at a later point. To increase the effectiveness of retargeting, retailers may choose to include products the shopper has previously looked at or put into the basket.

Today, the most common KPIs used in display advertising include reach (cost per mille) for branding-focused ads and clicks (cost per click), leads (cost per lead), and orders (cost per order) in sales-focused ads. Google predicts that, in the near future, new KPIs will emerge to measure the success of ad campaigns. Examples include interaction rates, video view from beginning to end, impact on web search results for brands, and changes in sentiment in social media. From a retail perspective, the most important emerging KPI is perhaps the change in foot traffic brought about by geo-targeting, i.e. incremental store visits triggered by an ad mentioning the respective store.

Social media is more than meets the eye. Integrate social media marketing with business strategy and listen actively

Social media marketing: What it is and how it works

At first sight, Facebook is to social media as Kellogg’s is to cereal: for all apparent intents and purposes, it defines the category. But upon closer inspection, it becomes clear that social media is more than meets the eye. Specifically, social media is more than Facebook (Exhibit 17.5) and more
than a consumer goods phenomenon. It spans industries as diverse as healthcare, personal finance, and automotive. As it happens, retailers are already among the more prolific users of social media. In a recent survey among major consumer-facing corporations, we found that about one in ten social media pioneers was a retailer. There is certainly room for growth, but retailers are apparently standing at attention.

Not that long ago, social networks were perceived and promoted mainly as yet another communication channel. When media agencies talk about the distinction between “paid,” “owned,” and “earned” media, social networks almost always feature prominently as prototypical examples of “earned” media, implying that they generate attention and exposure at no (direct) expense. Leading experts agree that social media have long outgrown more traditional “earned” exposure, such as editorial coverage on TV or in print publications. And there is really no disputing the reach and the relevance of social media. Two thirds of all Internet users in Europe and the US are also social media users, and social media provide unparalleled opportunities for informal reputation building. In short, social media
are indeed a formidable marketing vehicle, but they are so much more. Our work with clients and our Social Media Excellence Survey indicate that social media are relevant along the entire value chain. Sales, external communication, and service are the most important applications next to marketing today.

**Social media marketing: How retailers can use it**

We have found that any sustained impact companies derive from social media activities is based on closely integrating social media with the general strategy. As many as 75 percent of social media pioneers in our survey say that they do indeed have a comprehensive social media strategy, and that this strategy is fully integrated with other business functions. Key steps en route to a robust social media strategy include:

- **Step 1:** Prioritize value chain steps. Retailers need to identify which value chain steps hold the greatest potential for their social media applications. Usually, the business model and overall strategy will provide good guidance in this area. Marketing and reputation building are obvious choices. But in a given case, using microblogs, such as Twitter, for customer feedback and after-sales service may be the better proving ground for social media beginners.

- **Step 2:** Define audience. Building on the prioritized value chain step or steps, retailers need to specify the audience they wish to engage with using social media. Obviously, different outreach strategies apply depending on whether a retailer seeks to build relationships with suppliers, excite consumers, or present themselves as an attractive employer to potential hires. Market research and buzz analysis will help gauge the engagement level, ideally differentiated by decision journey stages.

- **Step 3:** Select platform. As a general rule, retailers will want to go where shoppers spend their time. Furthermore, the selection of specific social media platforms and applications should reflect the overall strategy. In our experience, most companies tend to limit themselves to existing platforms in their assessment. In some cases, however, custom-made, proprietary platforms will provide a better fit with the given business need.
Once retailers have defined their social media strategy, continuous impact tracking is crucial to determine what works and what doesn’t work. Active listening and sentiment analysis are excellent starting points (Exhibit 17.6). Services like nm Incite, a joint venture by Nielsen and McKinsey & Company, can help retailers mine the world of blogs, message boards, and social networks for relevant information. A marketing executive at Marks & Spencer in the UK says, “We started with product reviews to bring conversations onto our website,” but adds, “It is hard to measure the value of this, but it is intuitively clear that there is a value. We are moving into a phase of constant listening.” According to Retail Week, Marks & Spencer has two full-time employees dedicated to social media, monitoring customer feedback and escalating pressing issues to departments such as customer

### Social GRPs

So far, there is no common currency that reduces the multitude of social media KPIs to a common denominator and makes them comparable across different social media platforms like Facebook, Twitter, or blogs. For traditional media, gross rating points (GRPs) fulfill this function by measuring the advertising intensity of a campaign as a whole. McKinsey has created an online analogy to this: social GRPs, a metric that specifically measures a company’s performance in social media. This measure is based on the number and reach of company-related postings across social media platforms and serves as input into marketing mix models to determine the impact of social media on the company’s business performance. Various sources provide the necessary information, e.g. social media monitoring and panel data and platform-specific tools such as Facebook Insights. Compared to classic GRP data, social GRP values have a critical additional dimension: sentiment. After all, social media postings can also contain negative comments, making it necessary to differentiate between negative, positive, and neutral social GRPs. In real-life cases, we have found that the effect of social media activities can reach similar levels as expensive TV advertising.
While SEM, display advertising, and social media marketing are the most important digital touch points for retailers today, they are just the tip of the iceberg. Affiliate marketing and outbound email are among the more promising potential revenue drivers for retailers. Affiliate marketing is the online equivalent of sales co-promotions and partner programs. The affiliate – who can be any website owner other than the retailer – displays the retailer’s advertisements in exchange for a performance-based commission (per click, lead, or order). Outbound email, usually in the form of newsletters, is the online equivalent of direct mail. In many countries, like Germany, email marketing requires the recipient’s permission, limiting its use to customer loyalty management. Although “spamming” has somewhat diminished the perceived value and credibility of email marketing,
leading e-tailers like Amazon make ample use of outbound emails for push marketing purposes. Based on past purchases, customers receive emails with customized offerings, e.g. for discounted products in categories recently purchased or researched.

**Digital marketing is the new way of doing marketing.**

**Coordinate centrally, build key capabilities in house, but keep the setup flexible**

Digital marketing is not an additional way of doing marketing – it is, in many respects, an entirely new way of doing marketing. As such, it will and should leave a lasting impression on a retailer’s marketing organization. Digital marketing affects structures, roles, processes, talent, and the corporate culture. One of the most pressing issues for retailers is the integration of new vehicles, such as search and social, with established ones, such as leaflets and classical advertising. And while new vehicles bring about new requirements, they do not and should not invalidate proven approaches that are rooted in the offline world. Questions that are top of mind for retail CMOs include: Should there be a separate function for digital marketing? How can we ensure the coordination of digital activities across countries and store networks? Should I build up in-house capabilities or rely on external resources?

There are three organizational archetypes for digital marketing: a central operative team, a central catalyst, and a local model with light central coordination (Exhibit 17.7). In our experience, there is no way around a certain degree of centralization. While managers of regions, stores, and categories often control budgets and are held accountable for their respective profit centers, many of them lack the skills required for successful digital marketing. Mild centralization is also required to capture synergies across sub-brands, formats, and target groups. While the power and role of the central unit depends on a given retailer’s overall structure, there are some no-regret moves in specific functional areas. For example, all digital media management should be set up centrally to leverage volume discounts for digital advertising and other forms of digital media purchasing. And
while the content management system is a central responsibility to ensure company-wide compatibility, actual content management will have to reside locally, at least in part and especially in multinational retail organizations, simply to ensure that the content created is relevant to local shoppers. See the section on content management in Chapter 12 above.

New media also require new capabilities. Today, most online marketing activities are implemented by specialized agencies and service providers. Nevertheless, some capabilities are too important to be in foreign hands. In all cases, retailers should stay on top of digital marketing objective setting and performance tracking. If you don’t set clear guidelines on what you are trying to achieve, and how to measure whether it’s working, you will not get the best value from third parties. Many best-practice players also keep digital insights management in-house to stay on top of customer knowledge.

Irrespective of the exact split between internal and external resources, vendor management is a key element of digital marketing management. And it requires more flexibility than most retailers are accustomed to, chiefly

Exhibit 17.7 There are three prototypical ways to set up digital activities.
because of an increased variety of activities, more frequent interactions with vendors triggered by real-time data, more short-term contracts, and more changes due to the dynamics of the digital media. Because many trends rise and subside almost overnight, digital marketing does not lend itself to rigid structures or long-term planning. A digital marketing team needs to have an appropriate mindset and flexibility. For new retailers, it can be useful to hire a few dedicated digital marketing specialists, ideally experienced practitioners from digital marketing agencies or seasoned web enterprises, such as Google, Amazon, and their peers. The hallmark of digital pioneers is a well-anchored center of digital excellence, a clear definition of responsibilities across the entire organization, and the integration of all customer processes across touch points, whether online or offline.

Retailers should not underestimate the strategic importance and the practical complexity of building the necessary capabilities. At a recent CMSO conference, four out of five CMOs and CSOs from various industries said that they did not feel well prepared to meet the digital marketing challenges of the next five years. In reaction to this capability gap, McKinsey founded the “Digital Marketing Factory”. It revolves around the Vinoya online wine shop – a learning workshop with real campaigns, real customers, and real sales. In a real, yet risk-free environment, up to 20 participants can collect first-hand online marketing experience. The fundamental idea: practical experience makes for lasting effects. The Digital Marketing Factory is not about transferring technical expertise. The point is to provide participants with the basics of digital marketing and increase their decision-making confidence in this area, enabling them to interact with service providers and media partners on equal footing.
Hands-on digital media optimization

Grocery example
A large European grocery retailer took a simple, but systematic, approach to developing a rough blueprint for their digital marketing mix, comprising three steps:

- quick, but fact-based, diagnostic;
- prioritization of digital vehicles;
- set-up of lean structures and processes.

Within the diagnostic phase, in a first step the grocery benchmarked its performance with a comprehensive set of KPIs. Here, they used OMEX, NM Incite, and some internal sources and agency data to understand their current digital performance compared to competitors. As a result, the grocer got a first systematic idea of how they are doing: of traffic within their target group, how long people browse on their website compared to competitor websites, and how much “buzz” they create in social media. The gaps to competition along these KPIs served the client as a fact base to prioritize their “digital objectives” along the decision journey.

In a second step, the retailer assessed the performance of digital marketing instruments, like banners, displays, SEO marketing, etc. along the decision journey using the RCQ approach. Combining these results with their benchmarking results and gap analyses helped the client to re-prioritize which digital marketing instruments to use and how much to invest. As a result, the grocer came up with a set of “must-have” digital instruments that they focused their activities and marketing money on; a cluster of “test and learn” instruments that they wanted to use very selectively; and a bucket of “wait and see” vehicles which they decided to not use in the short run.

Finally, to learn and optimize continuously, the retailer installed a comprehensive Digital Marketing Performance dashboard with 25 KPIs and assigned a small but dedicated group to digital marketing.
Marco Mazzù, Partner in McKinsey’s Rome office, spoke with Armando Branchini, Executive Director of Fondazione Altagamma, about how digital technology affects luxury retail. Fondazione Altagamma represents 77 Italian luxury brands.

Q: Most people think that the Internet is a “mass” phenomenon, and that it is primarily relevant for commodity or convenience categories. How does it affect high-end categories, if at all?

Armando Branchini: Until about 2005, the Altagamma companies chose to “wait and see.” Luxury companies believed that the online customer experience was simply no match for the traditional retail experience. But since then, advances in technology have made it possible to develop online content that is not only informative, but also emotional. As a result, many high-end companies decided to invest in an online presence. Companies like Gucci and Louis Vuitton are among the pioneers in this area. They have enhanced their online presence, not only with extensive information on the range of products offered, but also by providing consumers with relevant recommendations beyond their own assortment, e.g. regarding travel, food, and culture. For example, Gucci has designed the “Little Black Book” application for the iPhone and the iPad. It points users to the location of the nearest Gucci boutique, but the app also suggests fine restaurants, places to visit, and everything else you need to live a full life in Gucci style. In contrast, Burberry uses its online presence to create a two-way relationship with consumers, enabling them to customize and design their own products.

Q: Will digital grow at the expense of traditional sales channels, or will they jointly create net value and provide access to new consumer target groups?

Armando Branchini: I don’t think the future growth of the digital channel will be the end of traditional sales channels. Our research on
the “Digital Luxury Experience,” conducted by the Altagamma Foundation in collaboration with McKinsey, indicates that the high-end consumer is essentially “omni-channel.” More than 50 percent of consumers in the US, Europe, and China follow a structured purchasing process that starts with online research. They sift through corporate sites, blogs, and magazines that talk about the culture and style of high-end products, and they proceed to purchase at a traditional store. What is more surprising is that the majority of those who buy online go to the store first to experience the “touch and feel” of the product.

Q: What are the success factors for luxury brands and high-end retailers in the digital world? Which challenges and trade-offs do they encounter?

Armando Branchini: The customer experience is the key. Emotional content is essential, as is the quality of the service, both upon delivery and after sales. Only large companies with a presence in at least 50 countries can resolve after-sale issues quickly and efficiently. More generally, it is of paramount importance to enrich and enhance traditional retail through constant innovation. In this spirit, an online shop should be considered a true retail media channel, with dedicated resources and investments. Online retailers have to go further than specialized blogs or social media sites, some of which are of great quality and achieve impressive numbers of followers.

Q: What changes has digital retail brought about for the Altagamma brands? What do you expect for the future?

Armando Branchini: Most importantly, brands are moving from purely informational sites to sites that have richer content, including those with electronic commerce content. Internally, companies are investing in organizational resources, and they seek the talent that is able to supervise and develop this area. As far as the future is concerned, I think the most significant transformation could occur through the integration of the online channel and the traditional retail channel. Perhaps there could be more relatively small stores that provide some sort of online buying service, complementing the flagship store trend.
I am also convinced that retail and entertainment will become more integrated, eventually resulting in “retail-tainment” that takes advantage of the latest digital technology to enhance a brand’s cultural identity. I think the ideal market in which to test an innovation of this kind is China. Chinese luxury consumers are younger than those elsewhere in the world, they are more technologically inclined, and they are passionate about products that carry high symbolic value.

Q: What are the key differences between different high-end categories?

Armando Branchini: Regardless of the category, luxury is always about creating a unique value proposition that can be customized to the individual customer. An instructive example is the automotive industry, where car manufacturers offer a wide range of options, especially in the luxury sector. I think that most buyers of a Porsche, Mercedes, or Audi will probably use the “car configurator” in advance to explore the technical, design, and décor options available to make the car fit their personal style needs. However, I think those who go to buy a Ferrari, Maserati, or Aston Martin have a completely different approach. These cars are essentially the result of traditional craftsmanship, with small numbers of products that are truly made to measure, with a very high number of options.

In the personal luxury goods sector, I believe that putting consumers in a position to compose their own combinations as their private “unique value proposition” can and should be enabled by information found on the Internet on how to combine clothing and accessories. I think this is increasingly becoming an area where luxury companies will have to establish themselves, which means not only featuring a celebrity who acts as a shopping assistant, but also providing a range of ideas and tips on how to use the products.

Q: Which sector should high-end companies take inspiration from in order to improve their performance?

Armando Branchini: I believe that the best practices are right inside the high-end businesses. High-end companies have the extraordinary
ability to manage tangible assets in an integrated way, together with the specific intangible assets of these companies, such as content, values, heritage, and image. Another strength of our sector comes from the fact that high-end industries are creative and cultural industries. The way we dress and the way we furnish our homes reflect not only our personality, but also our economic, political, and social standing. A Bulgari bracelet or a Riva yacht dazzle us with more than their prices. They embody both craftsmanship and culture. The European brands draw great self-confidence from their history. In the contemporary society, in which consumption plays such an important role, the luxury goods industry has been crucial in shifting the perception of goods from mere commodities to carriers of values. Creativity and innovation is intrinsic to our business: to its strategies, its corporate visions, its cutting-edge designs, its communication, and its unique way of creating value from technological innovation. For example, the Burberry show of their autumn/winter 2010 collections, employing the latest 3D technology, was an imaginative way of using new technology to create an improved experience for viewers and customers that stirred the awareness of audiences around the world.

Our offline and online retail environments are designed in collaboration with leading architects and designers to create an inspiring, unique customer experience. The luxury industry has been particularly innovative in the online space by linking the physical nature of our products and services with the opportunities created by the digital revolution, resulting in a rich and seamless customer experience.
1. Digital technology affects the entire retail value chain. Pick your battles wisely to differentiate your value proposition.
2. Digital marketing excellence starts with the consumer. Develop your digital strategy based on your target group’s decision journey.
3. Search engine marketing drives online visibility. Manage paid and unpaid listings actively.
4. Display advertising is a retailer’s online shop window. Fine-tune ad formats and user targeting to minimize scattering losses.
5. Social media is more than meets the eye. Integrate social media marketing with business strategy and listen actively.
6. Digital marketing is the new way of doing marketing. Coordinate centrally, build key capabilities in house, but keep the setup flexible.
Like fine wines or vintage cars, customers become more valuable over time. But like other collector’s items, they need special care as they mature. This is what customer lifecycle management, or CLM, is all about. CLM is the key that unlocks each customer’s full value over the entire lifecycle from acquisition and development to retention – and, if need be, reacquisition or reactivation.

CLM-based activities comprise a wide variety of marketing vehicles, such as direct marketing campaigns, that unfold across multiple channels, e.g. online or at the POS. Typically, these activities aim to improve a retailer’s performance in the later stages of the purchase funnel, especially conversion, repurchase, and loyalty. For example, CLM helps retailers ensure that high-value customers receive special attention and service. Generally, CLM enables retailers to use customer data to optimize their marketing investments, making it a direct driver of marketing ROI.

In this chapter, we will discuss the relevance of CLM for retailers and outline the “dos” and “don’ts” along the four steps of customer lifecycle management. Specifically, we will demonstrate that CLM is more than fancy math applied to optimize direct marketing campaigns. As we see it, CLM is a holistic way of thinking about quantified customer lifetime value (CLV) that can be applied to inform decisions about almost all the elements of a retailer’s marketing mix. To illustrate its power, we will present a wide range of case examples.
CLM helps drive effectiveness and efficiency in targeted marketing, enabling retailers to extract the full value from their customer base.

Because of the scope and richness of customer information it generates, retail is in a better position to benefit from CLM than many other industries. Transaction data typically includes the number, type, price, and category of products purchased, as well as the date, time, and location of the purchase. One major US retailer, for instance, processes one million customer transactions every hour, feeding databases that exceed 2,500 terabytes in size. This dataflow does not stop at the checkout. Transaction information is enhanced by personalized data gathered from loyalty-card programs over long periods of time. Not only do the majority of top retailers run loyalty programs, but the use of credit and debit cards now accounts for up to 50 percent of all transactions in some countries. Furthermore, some retailers enrich their data through third-party sources such as geo-marketing data, and they use sentiment analyses to extract relevant data from social media.

This abundance of information, in combination with today’s affordable supercomputer power, enables even smaller retailers to “slice and dice” the data any way they wish. In short, now is the time for retailers to set up CLM programs in order to reap the benefits over the entire lifecycle of their customers in terms of new customer acquisition, customer development, and customer retention (Exhibit 18.1).

- **Customer acquisition**: By quantifying the impact of specific promotions and other activities on conversion, retailers can allocate their marketing spend where it makes the biggest difference – e.g. by shifting funds from TV advertising to more targeted media. CLM can also help identify the most valuable targets for new customer acquisition and create a fact base to target potential customers in the places in which they spend their time, such as in online social networks. In short, it enables retailers to acquire new customers more quickly and efficiently, increasing the share of new customers who stay valuable in the longer term.

- **Customer development**: CLM supports retailers in their efforts to encourage customers to buy more often, to include more products in each purchase,
to try new categories, and to increase their commitment to the brand. For example, by employing recommendation engines, retailers are able to identify the most promising categories, product groups, or SKUs for cross-promotions. CLM also provides the facts to improve a retailer’s overall category strategy and product assortment.

- **Customer retention and win-back**: CLM enables retailers to devise early-tenure interventions if certain indicators point to an increased probability of churn. For example, if a customer’s shopping trip frequency, basket size, or number of purchase categories drops, the retailer can trigger targeted promotions or special offers, such as rewards for multiple trips, to minimize attrition rates. It also enables them to identify the customers who matter most and reward them with special loyalty tiers, exclusive offers, or VIP events. Ultimately, it can also be used to pinpoint and win back high-value former customers.

But CLM is not only of help to retailers in increasing the effectiveness of their targeted marketing activities; it also helps increase cost efficiency. For example, CLM data can be used to pick the most cost-efficient communication channel for a given cross-selling campaign in a specific high-value

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<tr>
<th>Acquisition</th>
<th>Development</th>
<th>Retention</th>
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<tr>
<td>• Monster’s click-through optimization based on browsing behavior</td>
<td>• Virgin Mobile’s automated top-up SMS reminder</td>
<td>• ebay’s special offers and discounts based on churn prediction</td>
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<td>• Restoration Hardware’s prospecting based on 3rd party data</td>
<td>• Best Buy’s loyalty redemption expiry warning</td>
<td>• Lufthansa’s distinctive superior service for top frequent flyer tier (“HON circle”)</td>
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<tr>
<td>• Neiman Marcus’ re-activation of “dormant” high-value customers</td>
<td>• Amazon’s customized recommendations</td>
<td>• Bertelsmann’s dynamic discounts based on customer tenure and value tier</td>
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<td>• Harrah’s differentiated offers based on expected customer value</td>
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Exhibit 18.1 Best-practice examples along customer lifecycle.
segment, be it direct mail, email, or phone outreach. More broadly, it can help retailers move from mass-marketing campaigns with low response rates to highly tailored campaigns with higher response rates and lower costs and, ultimately, to integrated social engagement management (Exhibit 18.2).

CLM-based refinement and reallocation recommendations have a big impact due to the size of the marketing budgets of many retailers. Investments in CLM have yielded significant economic results in a variety of situations and industries. Amazon, for example, is widely known to make systematic and comprehensive use of CLM for loyalty management and targeted marketing. The company has outperformed the market on all the important KPIs, such as market share, revenue, EBITDA, and TRS. But it is not only the market leaders who are able to benefit from CLM; companies newly embarked on such a program frequently report profit increases of the magnitude of 20 percent or more.

**Exhibit 18.2** Definitions of CLM-level sophistication.
So the size of the prize is substantial. But what do retailers have to do to claim it? Leading CLM practitioners set themselves apart not by the vehicles they use, but by how they deploy these vehicles. These companies understand their customers at a deep level and use this information to extract more value from their customer base than their peers. What is it that these CLM leaders, specifically, do differently? We have observed four defining characteristics:

• **Create the analytical foundations.** Leading players combine the analysis of past performance with predictive modeling to quantify customer profitability. The results guide the prioritization of customer segments, either to protect the value of high-performing customers, or to increase the value of low-performing customers.

• **Build predictive models for future campaigns.** Best-practice companies adhere to the basic belief that customer value is not a constant, but a moving target that can be positively influenced through targeted marketing activities. Leading practitioners carefully select marketing vehicles according to their expected impact on customer profitability.

• **Conduct and refine targeted test campaigns.** CLM pioneers constantly test new approaches in multiple channels and at various stages of the purchase funnel. Such testing and learning creates a constant feedback loop that informs data-driven segment prioritization and vehicle selection as detailed above.

• **Put in place the structures and capabilities required for sustainable impact.** Successful players make customer value an integral part of their organization, encompassing structures, processes, people, systems, and technological capabilities. In conjunction with the other elements, this creates a virtuous cycle of value-based customer centricity.

In the following, we will examine these principal elements of CLM-based campaign optimization (Exhibit 18.3) in more detail.
Successful CLM requires a deep understanding of your customer base: identify relevant data and aggregate the information in meaningful ways

The first step to successful CLM is to create a clear and comprehensive picture of your customer base. In most cases, the issue is not the lack of information but its excessive abundance. In order to avoid drowning in data, we recommend creating an overview of existing data sources (Exhibit 18.4). Once they have this kind of transparency, retailers should conduct a few straightforward analyses:

- an overview of revenue percentiles;
- the creation of value flow diagrams;
- a segmentation matrix;
- customer lifetime value (CLV) models.

Simple and well known as some of these analyses might be, such analyses are often very instructive, both in their own right and as the basis for fact-based campaign optimization.
Customer percentiles can provide a good start for understanding the customer base. Using net present value (NPV), or revenues if cost information is unavailable for individual customers, the customer base is split into equally sized groups, e.g. five (“quintiles”) or ten (“deciles”). A profile is then created for each percentile, including demographics and behavioral indicators, such as trip frequency, basket size, favorite brand, or weekend purchase share. The result is a one-page overview of who the most valuable customers are and how they differ from lower-value customers.

Customer value flow analysis provides a sense of how well you are developing your customers over their lifecycle. The diagram shown in Exhibit 18.5 works like a magnifying glass, revealing, for instance, that even when revenues have changed very little, there can be substantial shifts in the customer base. Understanding which customers have traded down, or churned out, and which customers have increased their average purchase, is critical to safeguarding the future economic health of the company.

A segmentation matrix aggregates information from multiple sources to inform target selection and targeted marketing. While Chapter 2: “Segmentation” provides more background on its use as a strategic tool,
segmentation in the CLM context is usually more hands-on. Typically, CLM segmentations are limited to a retailer’s current customer base and leverage available data on past customer behavior. For example, a retailer may use a CLM segmentation to run a dedicated campaign for buyers of high-end items who make frequent trips to the store.

The revenue-based percentile analysis, the customer value flow diagram, and the segmentation matrix are all powerful tools that provide a good indication of the nature of the customer base. However, these are only snapshots of your clientele. To obtain a comprehensive and dynamic overview of the customers and their value, retailers will want to model the customer lifetime value (CLV) of each individual customer. A robust CLV model should include all the revenue and cost generated in each customer relationship. Understanding the CLV of customers – and its drivers – is the only reliable basis for value-creating targeted marketing.

Leading companies calculate individual net present value at a very early stage of the customer relationship to determine whether it is worth their while to invest in acquiring, developing, and retaining a given customer.

**Exhibit 18.5** Value flow diagram.
The richer the basis of this CLV calculation is, the more reliable will its output be. Retailers can use indicators, such as the acquisition channel and the initial response behavior, to obtain an early sense of a customer’s future value – and to differentiate their targeted marketing accordingly. For example, a visiting shopper from out of town – lured into the store only by a voucher offering a large discount from the local paper that came free with their hotel breakfast – might not be the world’s most valuable customer. In contrast, a new loyalty club member, signed up by a friend as part of a “member gets member” program, probably has a much higher lifetime value and is hence more worthy of the retailer’s attention.

**Up-front impact estimates allow for more targeted CLM activities:** *use predictive modeling to assess probable customer reactions before piloting*

CLV is the gold standard of value-based, targeted marketing. If you know who your most valuable customers are, you can focus your funds and resources on them. But to fine-tune your marketing mix, you also need to understand the expected impact of different activities on customer value. It is all well and good to know that “Mr. Luxury,” a highly involved shopper with a penchant for upscale items, is a high-value customer, worthy of your best cross-selling efforts. If he has a loyalty card, you might even know who he is, where he lives, and how to reach him. But how do you succeed with this kind of customer? Is it by offering discounts on selected luxury items in outbound emails? Is it by announcing a VIP reward scheme in the customer club newsletter? Or is it by highlighting exclusive offers in personally addressed direct mail?

CLM-based predictive modeling answers these questions. Its objective is to predict the reaction of customers to different marketing activities and, frequently, predict their bottom-line impact. Certain modeling approaches use regression analysis to predict the CLV impact of specific marketing activities, but such models make high demands, both in terms of analytical capabilities and maintenance, chiefly because they require the many assumptions in the model to be revised and adjusted for each new modeling
effort. Because of these challenges, most retailers predict customer *behavior* rather than customer *value*. Campaign-responsiveness modeling, for example, calculates the likelihood of particular events, such as a specific customer reaction to a potential campaign. A simplified output of this kind of model could read: “If we send Mr. Luxury a personalized letter offering an exclusive preview of the new collection, there is a 55 percent chance that he will show up at the store (if you have the capability to measure store visits) and a 32 percent chance that he will make a purchase.”

Other types of probabilistic modeling go one level deeper and focus on customer product preferences to help retailers select items for targeted promotions. “Next Product To Buy” modeling, or NPTB, is based on an association analysis of the products in customers’ baskets that predicts what they will buy next. These models can be combined with real-time feedback loops to improve their predictive power continuously (Exhibit 18.6). For example, once you know Mr. Luxury is probably looking for a shirt and tie to go with his new suit, you can use this information to make a targeted offer. But it also works the other way around: if you sit on a stack of last season’s dress shirts earmarked for promotion, NPTB helps you to select the group of customers who are most likely to respond and make a purchase.

### Exhibit 18.6 Recommendation engine with real-time feedback loop.

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<th>Product recommendations and timing</th>
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<tr>
<td><strong>Product</strong></td>
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<th>Predictive algorithms</th>
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<td>Next product to buy</td>
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<td>Product-DNA</td>
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<td>Response modeling</td>
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<td>Frequency modeling</td>
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<td>Social media</td>
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<th>Real-time feedback loop</th>
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<tbody>
<tr>
<td>A Purchasing history</td>
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<tr>
<td>B Predictive algorithms</td>
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<tr>
<td>C Product recommendations and timing</td>
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<tr>
<td>D Real-time feedback loop</td>
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The more historic data is fed into the NPTB model, the higher its predictive reliability. Exhibit 18.7 shows a real-life example of a Best Buy campaign that leverages basic NPTB thinking to drive repeat purchases. (For more details, please see the article on “Supermodeling,” by Ben Armstrong and Ian Ross, in McKinsey & Company’s The Journal of Problem Solving, 2009.)

While NPTB draws its inferences primarily from the track records of customers’ past purchases, product DNA modeling recognizes specific product characteristics as input factors. Product attributes such as price level, color, and shape collectively represent the product’s “DNA.” DNA modeling was pioneered by online providers, such as Netflix and Pandora, for matching movie and music recommendations to users’ past favorites. The same kind of approach can be put to good use in retail. By matching the DNA of a given product with the customer’s preferences derived from their purchasing history, retailers can identify the most attractive target group for the item in question. This approach is particularly valuable for recent additions to a retailer’s assortment when there is no prior transaction history. Based on DNA analysis, the brand new, machine-washable wool overcoat might turn out to be just the thing for Mr. Luxury.
The practical relevance of probabilistic approaches, such as NPTB and DNA modeling, can be further enhanced by adding a secondary dimension: time. The models that use this extra dimension to predict the distribution of a customer’s additional purchases over a given time period require a number of additional input factors, such as the time elapsed since the last purchase (“how recent”) and the number of purchases made in a given period (“frequency”). A number of retailers combine responsiveness modeling and purchase distribution analysis to capture both the “what” and the “when” in their predictions of future customer behavior.

Multi-channel retailers should link all predictive modeling efforts to their customers’ online purchase histories. This will eventually enable them to tailor their offering to the needs of users who are registered or recognized with the help of cookies (see Chapter 17, “Digital Marketing Excellence”, for details) – to drive repeat store visits, improve online conversion, and foster basket expansion.

**Optimization starts with knowing what works and what doesn’t work:** test different campaigns and keep track of their parameters as well as impact metrics

Once you know who your most valuable customers are and which types of campaign stand the highest chance of eliciting positive responses, it is time to put the CLM model to the test. Despite all efforts to fortify its conceptual backbone, retail marketing is still a question of testing and learning. This is particularly true for outbound marketing campaigns. But the analytical foundations and predictive models described above make campaign pilots more valuable than ever. Target audiences can be preselected with high granularity, and offers can be tailored to the needs of a given audience. Still, the pilot should follow the long-established foundations of systematic testing and learning.

- *Define the objectives clearly and specify relevant metrics:* The retailer will need to decide at the outset whether the pilot’s objective is new customer acquisition, the development of the existing customer base, churn prevention, or the reacquisition of former high-value customers.
Relevant metrics need to be specified to track the results. These could include, for example, the conversion rate for acquisitions, campaign response rate for cross-selling offers, or repurchase rate for overall development of the customer base.

- **Log all parameters for future reference:** Prior to an actual pilot, it is imperative to specify and log the key parameters for future reference, analysis, and refinement. How has the target group been defined? Which communication channel is used? At which point in time does the campaign reach the customer? Which products and services are promoted? What is the incentive for the customer (e.g. the discount rate)? What promotion materials were used?

- **Use control groups to capture the value the campaign adds:** The target sample should be divided into a test group that receives the mailing, newsletter, text message, email or other relevant materials, and a control group that does not.

- **Track and review the campaign’s impact:** The predefined metrics (such as the conversion rate or response rate) and other more general impact indicators (such as revenues, profit, or average basket size) should be tracked carefully. Once the pilot has concluded, its results should be reviewed by the CLM team in order to identify improvements to be introduced in future campaigns.

### Testing and learning: Vistaprint case example

Vistaprint, an online business serving small companies with professional marketing products and services such as business cards, has excelled in its ability to use testing on the Internet to optimize its website and increase the value generated from customer visits. It tests across all levers, from new products and services to creative layouts and contact strategies. Recently, the company tested different frequency of contact rates. Higher-frequency contacts can lead to increased short-term sales, but they often do so at the expense of long-term customer value. This is due to the fact that overly frequent contacts may cause customers to churn to avoid “spamming.”
Retailers find that targeted CLM campaigns based on robust analytical foundations and predictive modeling yield much higher success rates at lower costs than generic offers made available to broad audiences. Ted Brewer, Vice President of Customer Information Management at Royal Bank of Canada, confirms this: “Thanks to the Customer Relationship Management solution, RBC has reported direct marketing campaign response rates as high as 40 percent, compared to the industry average of 2 to 4 percent.” (Source: “RBC Royal Bank uses a Teradata Warehouse and Teradata Value Analyzer to realize its CRM strategy,” Teradata 2004.)

Once the pilot is complete, the design of all stages of the campaign process, including its key parameters and impact metrics, should be stored in a standardized campaign library so that the insights derived from the campaign’s development and testing are available for later use. Based on the insights from multiple cycles, retailers will be able to roll out proven campaign formats across multiple stores, regions, and formats to capture scale advantages – and boost their marketing ROI.

**Build sustainable CLM capabilities:** secure top talent, set up clear interfaces and processes, and take precautions regarding data availability and quality

Successful CLM implementation requires the combination of a clear strategy, well-structured CLM operations, and robust analytics, supported by superior technology and IT infrastructure. There are three main prerequisites that need to be put in place to ensure these elements work together smoothly and effectively:

- the right people, endowed with a true CLM mindset;
- an efficient CLM set-up, with clear processes and interfaces, both within and beyond the CLM team;
- reliable CLM data, supported by powerful IT infrastructure and technology.

In terms of talent, you need a dedicated CLM manager with a strategic marketing mindset to develop a long-term CLM strategy, define the priorities
for specific programs and campaigns, and assume overall responsibility. Secondly, the CLM team should also include at least one hands-on marketer who has the product or category management experience necessary for managing campaign execution. Thirdly, you need at least one business analyst with strong quantitative skills, ideally with previous experience of the relevant software, such as SQL, SAS, or SPSS, and advanced modeling techniques. Even if the bulk of the analysis is conducted by outside vendors – or by a dedicated corporate department – it is still important to have someone on the team who can manage and audit their work. Last but not least, CLM depends on a skilled and dedicated IT taskforce that is able to take care of the technical side of data gathering, data mining, and output consolidation.

Managers of newly established CLM units will need to ensure that their team does not overindulge in advanced analytics and highly customized marketing activities. You can always get sophisticated once the basics are in place. A number of companies also find it useful to set up a cross-functional CLM steering committee to manage and monitor the CLM team.

But even the world’s greatest team needs a game plan to score. Make sure roles and responsibilities of individual team members, the processes within the CLM team, and its interfaces with other departments are clear and well documented. While the interface between the marketing department and the IT department may be the most important one for development, modelling, and testing of CLM, the link to commercial operations is key for ensuring its ultimate impact. To this end, the executives in charge of CLM should make sure that its insights are made available to all the key players in their company’s principal commercial processes. The finest insights into the world’s most valuable target group, or the most promising high-impact campaign format, will be wasted if line managers in a retail organization’s functional or regional departments don’t know about them.

Once you have hired – or trained – the right people and set up the appropriate processes, the remaining challenge is data quality. Data is the raw material of CLM: without readily available, reliable data, the CLM engine will not run. But where do you start? The list of potential sources is endless: POS transaction data; financials like revenue and cost on a daily, weekly, monthly, or quarterly basis; loyalty-card schemes; customer
surveys; payment details; aftersales service logs; social media; general market research – and so on. Fortunately, the essentials required for basic CLM are simple and straightforward:

- **Customer data:** addresses; sociodemographics; store preferences; start dates of loyalty program membership; “permissions to contact” for promotions and other activities.
- **Transaction data:** dates of transactions; products purchased; prices of products purchased; stores; payment methods; returns (if any).
- **Social media windfall:** level and sentiment of online buzz regarding brands, products, and recent campaigns.
- **Marketing details:** selection of customers for specific campaigns; campaign dates; coupon redemptions.

Additional customer data on household income or household size can be gathered through surveys or by purchasing third party data; however, since these details regularly change over time, it can be challenging and costly to keep them up to date. To ensure the sustainability of CLM data, it is preferable to work with only a few sources, so that the respective data can easily be updated and maintained.

Ideally, all data should be consolidated into a single, dedicated CLM database to create an integrated view of the customer. If this proves to be impracticable for any reason, robust data-matching and verification procedures need to be put in place to ensure that the data is compatible and easily digestible by the CLM model.

But never forget that tons of data and fancy technology alone won’t get you anywhere. Rich customer data and advanced modeling techniques are part of the CLM toolkit, but to see real impact, you have to pay at least as much attention to organizational factors like information flow, decision patterns, incentives, and mindset. Simply speaking, the concepts of the customer lifecycle and its stages, as well as of customer value and its drivers, have to become a living part of a retailer’s organizational DNA. Leading retailers maximize value generation from CLM by ensuring cross-functional coordination between the CLM team and other departments,
whether portfolio planning or store management. A proven way of driving everyday impact is to make CLM-related information available to the front line, e.g. by displaying relevant purchase histories of registered customers on sales reps’ terminals, especially in categories with high involvement, such as telecommunications or personal finance.

Managing relationships in the digital domain

Digital technology provides opportunities across the entire retail value chain, including customer relationship and lifecycle management. Leading retailers are using new media to stir up excitement, create commitment, and encourage cross-selling. As new devices, platforms, and software solutions become available, technology companies and service providers are racing to develop tools and applications for retailers. While many of these applications are perishable goods, we believe that some trends are here to stay. Examples include:

- Geo-fencing. Traditional retailers dread “showroomers,” i.e. shoppers who go to a store to look at a product, but make the actual purchase online. To counter this development, brick-and-mortar retailers are using shoppers’ smart phones to target those nearby with deals or promotions. Walgreens, for example, uses the mobile social network Foursquare to reward consumers who check into a store with instant coupons that are sent to their smart phones and can be scanned at checkout. According to Juniper Research, more than 3 billion mobile coupons were redeemed in 2011 globally. Meijer Inc., a US chain of supermarkets, uses in-store sensors to guide shoppers through the aisles, based on shopping lists users can prepare online.

- Personalization. Amazon’s recommendation engine is legendary, and now the online giant is using shoppers’ Facebook profiles to feed it. Users receive purchase suggestions based on their Facebook
interests, obtain gift ideas for friends whose birthdays are coming up, and get to browse items that are popular with their online friends. Similar services are sometimes also provided independently, e.g. through apps such as fashiontag. But personalization can also backfire easily. In an attempt to customize their website for frequent customers based on gender, an apparel retailer found that female shoppers often also bought men’s items and rejected gender-based marketing, as the *New York Times* reports.

- **Social shopping.** Almost all retailers are looking for ways to leverage social networks to drive sales. At the same time, scores of specialists are developing tools that empower shoppers. Examples include myshopanion, an app that allows consumers to scan items while shopping and receive reviews from social networks instantly; itspot, an app that lets users take a picture of a product and ask their Facebook friends for advice; and shopsocially, a social commerce site on which users can post shopping-related questions and receive feedback from a community of trusted advisors. Sears, the US home appliance retailer, is recruiting brand advocates through its loyalty website; advocates receive kickbacks of up to 2 percent of sales for all recommendations leading to purchases made by friends and family. The program combines loyalty building among current subscribers with an expansion of the customer base. (Source: Sears Begins Offering Personal Shopping With Web’s Help, 21 March 2012, Dow Jones News Service.)

- **Multi-channel rewards.** Many shoppers, especially in the US, are obsessed with cutting out coupons to obtain in-store discounts or other benefits. Leading retailers are trying to carry this conduct over to digital media. Tesco, for example, uses an RSS (“RDF Site Summary”) feed to provide subscribers with the “deal of the day.” Express, an apparel retailer based in Ohio, gives out loyalty rewards not only for purchases in stores and online, but also for social media usage, such as posting product reviews on express.com and following the company on Twitter.
• Mobile loyalty. Successful mobile applications lock in customers by providing clear benefits, e.g. by saving time or enhancing the in-store experience. Starbucks, for example, created an app that enables customers to pre-order drinks. It ties in with the existing Starbucks loyalty scheme, and it provides users with location details to find the nearest coffee shop. It also supports mobile payments. Not only was the app downloaded by 3 million users in its first 12 months, but it has also generated a lot of positive buzz. One of the related posts read: “If you have an account with Starbucks, you are going to love this app. The app easily syncs with the Starbucks Cards and My Starbucks Rewards. So now you can manage your account more conveniently.”

For more information on how digital technology is changing the face of retail, compare Chapters 12 and 17 (on digital evolution and digital excellence).

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**Practical hints for increasing data availability and quality**

• Start programs to *capture e-mail addresses and cell phone numbers*; make sure you also get customers’ permission to use these vehicles for advertising (“opt-in marketing”).

• Pay special attention to the *quality and reliability of customer data*, and make sure it is up to date, so you can reach customers with direct marketing activities when you need to.

• To compensate for customers who do not use their loyalty card at all times, *employ alternative means to link a customer’s identity* to a given transaction:
  - campaign response elements: e.g. personalized coupons;
  - online data: e.g. login data, cookies, or shipping addresses;
  - payment details: e.g. account details from credit or debit card payments.

• At all times, make sure you know and observe local *privacy protection regulation*. Certain countries, for instance, prohibit the use of payment details for marketing purposes.
CLM need not be limited to direct marketing but can be applied to areas such as category management and format development

Conceptually, CLM is about understanding the distinct stages of a customer’s lifecycle and the drivers of customer lifetime value. Operationally, it is about optimizing the drivers of customer value using all the available levers. Direct marketing is just one of these levers, although it is often the one where results are seen most quickly. There are other levers. These include assortment strategy, pricing, and store operations. Let’s take a look at a few real-life examples of CLM applications in areas beyond direct marketing.

- **Assortment and pricing in category management**: Details on segment-specific customer preferences and product penetration can be used to inform assortment reviews and pricing. In these processes, the preferences of predefined high-value target segments should carry disproportional weight. Mr. Luxury, the prototypical top-target customer, has a weakness for specific brands and products in the high-price band of a given category; this suggests that the retailer should carry a relevant selection in this area. Similarly, price setting for a given SKU should reflect the price sensitivity and overall price perception implications for preselected target segments.

- **Promotions in category management**: CLM enables retailers to disaggregate the impact of promotions: increases in traffic, entries into new categories, premium switches, value switches, cannibalization, stocking-up, simple discounts. Based on this information, category managers can optimize promotions.

- **Network and format development**: Retailers can use CLM-based information on customer preferences to optimize their store network, fitting formats and layouts to the needs of local user pools and specific high-value customer segments.

- **Personalization of in-store offering**: Retailers can leverage the CLM database to provide their commercial functions and stores with periodic,
structured analyses of consumption trends and customer characteristics. Based on this information, managers can optimize the in-store experience at both the store cluster and the individual store level. If the majority of the user pool of a given store, for example, has a special preference for fresh fruit, the store can reflect this in its assortment.

- **Localization of the go-to-market approach**: A CLM database and campaign library that covers multiple regions or countries will also enable retailers to account for local differences in customer preferences. These might be in the assortment, for example: while grocery shoppers in downtown areas might show a preference for convenience products and prepared foods, a cluster of suburban outlets could find that the high percentage of single mothers in their user pool makes it advisable to stock a small selection of toys. Or take beauty retail, where “functional skin care” means very different things in different contexts, depending on the continent: sunscreen in Australia, whitening cream in Asia, and self-tanning lotion in Europe. Similarly, the success rates of different promotion types varies greatly by territory: while many US shoppers thrive on coupons, most European customers are much more responsive to in-store discounts or bundling offers. Localization can go as far as format strategy and store layout. While shoppers in one region or country will be attracted to branded “store-in-store” concepts, shoppers elsewhere might expect to find all the items from the same category in the same section of the store, whatever the brand or the price band.

CLM is not a specific tool or approach, but a way of thinking. Its value is not limited to direct marketing; it can be brought to bear on many other key elements of the marketing mix to enable it to extract the full value from customers over their entire lifecycle. Thorsten Ganzlin of Adidas says: “Without the transparent and real-time understanding of a customer’s interactions [provided by CLM], sales per retailer would have dropped rapidly.” (Source: Wolfgang Martin Team, “Strategic Bulletin: CRM 2005,” Annecy, November 2004.)
McKinsey Consumer Marketing Analytics Center (CMAC)

McKinsey has recently founded the Consumer Marketing Analytics Center (CMAC) with the objective to leverage advanced analytics on “big data” to make better business decisions. CMAC is a network of global experts anchored by a growing number of regional hubs and accessible to teams at McKinsey’s 100 global offices. It also includes the full range of required enablers – such as hardware, software, and intellectual property (e.g. algorithms, tools, processes), to operate along the entire value chain of data analytics. If they wish, clients can outsource their entire analytics work to McKinsey. The offerings of CMAC are organized in so-called service lines focusing on specific content areas (such as customer life cycle management, pricing, marketing mix modeling) or specific industries (e.g. telco, banking, retail). CMAC is going to trigger nothing short of a revolution in fact-based management decision support. It is designed to absorb data from a host of sources, whether clients’ transaction records, third-party research, or proprietary social media screening. This ever-growing data pool is subject to an advanced analytical engine that draws from the latest

Exhibit 18.8 CMAC – the missing link.
insights mining techniques, predictive modeling, and industry-specific business rules. CMAC is not a temporary project, but the backbone of an initiative that is built to last and create impact for clients in three respects:

- Generate and integrate big data across touch points.
- Derive and synthesize commercially relevant insights.
- Empower executives to use insights for more informed daily decisions.

CMAC translates these success factors into an integrated approach to sustainable data-driven value creation; it comprises diagnosis, optimization, and transformation (Exhibit 18.8).
**Interview: Daniela Mündler**

*Board member for international marketing at Douglas: “CLM takes us closer to customers”*

Daniela Mündler is in charge of international marketing at Douglas, a leading European fragrance and beauty retailer.

**Q:** What role does CLM play in your marketing efforts?

**Daniela Mündler:** I think CLM is one of the most important levers available for active marketing. As offers, channels, and target groups become increasingly fragmented, all marketing decisions and actions need to be based on real, individual customer behavior.

Consider that 90 percent of the population regards our industry’s products to be luxury items – in other words, not something people really need. Yet CLM provides us with a tool to develop relevant, attractive offers for every customer. This ability represents a real competitive advantage for us. Of course we can communicate with customers in a number of ways. But the best way to get closer to customers is to understand what their behavior tells us.

**Q:** What is the key benefit CLM offers to Douglas?

**Daniela Mündler:** The focused view of our customers that CLM provides opens up many opportunities for us to improve. Of course, considerable potential exists in the areas of campaign design and cooperative efforts with manufacturers. Optimized campaigns help us to build long-term loyalty to the Douglas brand by providing each individual customer with tailored offers. In terms of working with manufacturers, not only can we target our efforts to support new product placements even more precisely, but we can develop innovative packages of offers as well. But CLM can also help us with decisions regarding assortment and pricing, the breadth of our offering, product development, store location, and of course customer acquisition.

**Q:** What factors determine whether CLM is successfully implemented?
Daniela Mündler: Obviously, you need high-quality data, a corresponding IT infrastructure, and highly skilled employees. But what matters most is a strategic perspective for the longer term. Only companies that are willing to make the customer the centre of their world will reap the full benefit of CLM. Customer relationships are like living organisms, constantly changing in a continuous process that demands ever better skills. The entire organization must accept this fact.

Q: What skills do employees need?

Daniela Mündler: The main prerequisite is very good analytical skills. This sounds obvious, but often proves to be a problem in practice: marketing functions, where CLM is generally located, tend to be full of people who think they can get by without numbers. This belief is a fallacy for any marketer, and in this case an especially dangerous one.

But analytical abilities alone are not enough. Openness, curiosity, creativity, a critical spirit, and a strategic bent are needed too. CLM will never be a success story if employees cling to their routines. Rather, they must be able to accept that things are always in flux. To be successful, you must constantly review your systems to see if better solutions are possible.

Q: How will CLM develop in the future?

Daniela Mündler: I am convinced that marketing departments will increasingly need to ask whether they are investing their money efficiently. In the future, we will focus even more on how precisely marketing efforts reach their targeted audiences and how accurately their impact can be measured. I therefore see CLM as a key future tool for realizing tailored campaigns as cost-effectively as possible.

This is a good thing, because it will be possible to steer marketing activities much more effectively. But the flipside is that some CLM devotees have a tendency to want to steer everything, sometimes to such an extent that no leeway remains. When it comes to image campaigns, we also have to acknowledge that impact requires a certain amount of time to become apparent and cannot always be measured directly.
In any case, only very few retailers will be able to get by without CLM much longer. The days of mass target groups are definitely drawing to a close. Of course we would still like to see as many people as possible coming to our stores – but we can no longer afford to take a one-size-fits-all approach to get them there. CLM offers an excellent alternative.

Q: What experiences with CLM have surprised you the most?

Daniela Mündler: I was initially surprised that CLM can be applied at so many different levels. Later, I also realized how much can be mined from existing data and how much potential can be tapped in this way.

Having this extensive data led to another “Eureka!” moment: watch out for supposedly logical explanations! In the past, I had a tendency to respond to particular findings by saying, “Of course, this or that is the reason for it.” But you can’t do that with this volume of data. For example, a CLM analysis may reveal completely unexpected customer behavior. When something like this happens, we have to see how we should deal with the analysis, what new findings we can extract, and what old beliefs we need to throw out.

That was probably the biggest surprise for me. I have been in the fragrance business for many years now, and I was certain that I fully understood it. CLM taught me better. You can never assume that you know it all. This insight alone was immensely valuable.
1. CLM helps drive effectiveness and efficiency in targeted marketing, enabling retailers to extract the full value from their customer base.
2. Successful CLM requires a deep understanding of your customer base: identify relevant data and aggregate the information in meaningful ways.
3. Up-front impact estimates allow for more targeted CLM activities. Use predictive modeling to assess probable customer reactions before piloting.
4. Optimization starts with knowing what works and what doesn’t work. Test different campaigns and keep track of campaign parameters as well as impact metrics.
5. Build sustainable CLM capabilities. Secure top talent, set up clear interfaces and processes, and take precautions regarding data availability and quality.
6. CLM need not be limited to direct marketing, but can be applied to areas such as category management and format development.
CHAPTER 19

SMART SOURCING

Benjamin Brudler, Steffi Schreiner

Retail marketing executives often look at their peers in consumer goods with great envy: “Why is it that manufacturers of beverages, snacks, or household products pay only a single-digit commission on activation to their creative agencies, while the same agencies charge us 10 percent or more and keep asking for extra compensation as soon as we request a single change to a TV commercial or print ad?” Surely, advertising volume cannot be the only reason for this difference? It is not. Of course, consumer goods companies’ huge global accounts make it easier for agencies and other service providers to offer them favorable conditions. But, to a large extent, marketing efficiency is a function of smart sourcing management. While most consumer goods giants have already implemented comprehensive marketing procurement programs, many retailers are still in the early stages of efficiency optimization.

In this chapter, we show that smart sourcing is much more than simply a case of outmaneuvering suppliers and providers in negotiations. Most importantly, it includes a critical review of internal demand and procurement process management at retail companies. To illustrate both some key levers and the impact of smart sourcing efforts, we have included an exemplary deep-dive examination of commercial print, an important line item in the marketing budget of many retailers.
Increasing marketing efficiency might be hard work, but it is well worth it: smart sourcing yields sizeable savings without compromising quality

Marketing spend effectiveness is familiar territory for many retailers. Topics like brand positioning, message definition, budget allocation, and media selection feature prominently on their agenda (see Chapter 18, “Maximizing Customer Value with Data-driven CLM”). By comparison, marketing efficiency – the improved purchasing of marketing-related goods and services – is less well established. Yet improved efficiency enables retailers to capture substantial savings without compromising the quality of services rendered; alternatively, it can help them improve the service level without changing the budget. In short, marketing effectiveness is about doing the right things, while marketing efficiency is about making sure the right things are done at a fair price.

The scope of marketing efficiency programs typically ranges from creative agency services to the production of physical materials such as leaflets. In general, they comprise three types of spend:

- above the line (ATL): media booking (TV, radio, print, online) and related media agency cost, as well as sponsorships and events;
- below the line (BTL): POS material, catalogs, direct marketing, and promotional items;
- services: creative agencies, creative production, market research, and marketing-related IT support.

It is clear even from this simplified overview that retailers will have to deal with a large number of different external partners in order to optimize their marketing efficiency. This is no simple matter, especially since service providers such as creative agencies and media agencies have undergone large-scale consolidation through M&A in recent years (Exhibit 19.1). As a result, marketing is one of the most consolidated professional service industries. As buyers of marketing services, retailers now face global conglomerates with considerable negotiating power. Additionally, media markets are highly opaque. Media agencies are often granted considerable
discounts and kickbacks from media owners. In many cases, these benefits are not passed along to advertising companies.

The structural complexity and scale of the service provider landscape is not the only obstacle in the way of retailers’ marketing efficiency efforts. There are also serious internal challenges. Responsibility for marketing spend is often scattered across many functions, regions, or business units. The budget is highly fragmented, especially in BTL, both in terms of territories and in terms of individual cost positions and items. Since most executives are reluctant to relinquish or even suspend their decision power, it can be very challenging to overcome traditional “silo” thinking and establish a comprehensive efficiency mindset.

This problem is further aggravated by the fact that marketing and purchasing functions often fight over budget clearance procedures. While major cost positions, such as lead agency contracts or media buying, are usually handled by both functions, or at least overseen by purchasing, smaller line items are often still under the marketing department’s exclusive control. With marketing focused on effectiveness and purchasing focused on efficiency, target conflicts are bound to arise.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{chart.png}
\caption{Top 5 as percent of top 20 revenues}
\end{figure}

\begin{table}
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\begin{tabular}{|l|c|}
\hline
\textbf{Percent} &  \\
\hline
Law firms & 34  \\
Investment banks & 61  \\
Consulting firms & 65  \\
Accounting firms & 85  \\
Marketing services firms & 67  \\
\hline
\end{tabular}
\caption{Top 5 as percent of top 20 revenues}
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\hline
\textbf{Example of largest worldwide networks} &  \\
\hline
Dentsu & Prophet, Attik, World Sports Group  \\
WPP & JWT, Ogilvy, Millward Brown, Mindshare  \\
OmnicomGroup & TBWA, PhD, Ketchum  \\
Hakuhodo & Percept, Impress, Mendelsohn, Fischer  \\
\hline
\end{tabular}
\caption{Example of largest worldwide networks}
\end{table}

\textbf{Exhibit 19.1} Marketing has become one of the most consolidated professional services industries worldwide.
So is it worth the fight? Absolutely. Companies that conduct comprehensive marketing efficiency efforts often capture savings of the magnitude of 5 to 30 percent of their marketing investment – without compromising effectiveness. This impact goes straight to their bottom line. Exhibit 19.2 shows a disguised example of the savings opportunities across all major line items of the marketing budget.

Marketing efficiency is not only about saving money. By streamlining demand and consolidating their suppliers, retailers can also improve the consistency of their marketing mix. Says Toni Palmer, CMO of Kimberly-Clark, according to Advertising Age (April 2007): “We […] have a big opportunity around the efficiency of our marketing spend. As a company, we’re not using our scale as effectively as we could, for example, with our service providers […]. Increasing the consistency in strategy and creative implementation is another key factor for managing the spend.” It is also worth noting that optimizing efficiency does not necessarily mean picking the cheapest option available. Especially when it comes to media planning, a trade-off needs to be made between costs per gross rating point (GRP).
and the quality of the media format in question; see the interview with Uwe Becker of OWM below.

Scope of marketing efficiency efforts

The positions covered by marketing efficiency programs are sometimes referred to as non-working spend or indirect cost, defined as investments that are necessary enablers of marketing effectiveness but which do not actually reach end consumers. But both terms are misleading, since media buying is often one of the biggest line items in the marketing budget and should, therefore, be part of any holistic marketing efficiency effort. Media buying includes all expenses incurred to secure customer contacts, e.g. TV airtime or print advertising space purchased through media agencies or directly from media owners such as TV networks and publishing houses. Comprehensive marketing efficiency efforts should, in fact, include all external marketing cost positions.

Efficiency levers include rigorous supplier management, streamlined demand management, and procurement process optimization

Marketing efficiency can be improved by pulling three types of levers: supply levers, demand levers, and process levers. While most traditional cost reduction efforts cover only supplier management, our experience shows that the improvement potential is just as substantial, or even larger, in the areas of demand management and purchasing process optimization. For example, a global retail company found that 60 percent of its marketing efficiency improvement impact came from demand and process levers.

Supplier management

Supplier management is about paying less for what you buy, i.e. improving sourcing conditions without changing the character or quality of products purchased and services rendered. Examples include:
• **Bundling volume:** Buying from fewer suppliers or service providers enables retailers to capture volume discounts. Relevant cost positions include creative agency services, production services, media agency services, and media buying. Volumes can be bundled across legal entities, business units, departments, brands, regions, and countries.

• **Switching to cheaper providers:** While switching creative agencies may be too sensitive from a strategic perspective, less critical items, such as POS materials, can often be purchased more cheaply from providers in low-cost countries (so-called LCC sourcing). A point to note is that it is important to have a physical presence in the low-cost provider’s home country in order to be able to monitor quality.

• **Negotiating rigorously:** With thorough preparation and full data transparency, retailers frequently succeed in reducing commission percentages, establishing performance-based fees, or extending payment terms in their negotiations with suppliers.

**Demand management**

Demand management is about defining what you really need and getting rid of the waste. It comprises all activities that cut the volume or reduce the complexity of products and services purchased. Examples include:

• **Standardizing/harmonizing:** By reducing the number of specifications of certain media products (e.g. formats of a catalog, variants of POS displays), you can increase demand volume and decrease complexity. This usually results in lower design and production costs.

• **De-specifying/"design-to-value":** By reducing product or service specifications to what is really needed and valued by consumers, you can reduce costs significantly. For example, an addressed direct mailing in black and white may be just as effective as a full color version at a much higher price.

• **Configuring materials just-in-time:** For example, pre-producing a standard media product (e.g. a TV commercial for all European markets) and then tailoring it to specific needs late in the value creation process (e.g. by adding a voiceover in the local language) is much less costly than individual local versions, and might be just as effective.
Process optimization

Process optimization is about increasing the internal transparency and discipline around the sourcing of materials and services from external providers. Examples include:

- *Introduce advanced procurement processes.* To capture the benefits of smart sourcing sustainably, standardized, streamlined, and automated procurement processes are crucial. This includes applying advanced sourcing techniques across the company, such as IT-enabled auctions or sophisticated online catalogs.

- *Improve inventory and logistics management.* In the case of physical marketing materials, inventory and logistics are major drivers of cost and working capital for many retailers. For example, by optimizing your network of print shops, you can often capture major transportation cost savings.

- *Optimize demand planning, approval processes, and order management.* Streamlining the planning cycle and approval processes, reducing the number of decision makers, and using off-peak production periods increases efficiency. In addition, you should also review your order management process. Simple measures, such as ensuring planning is carried out sufficiently early and that clear guidelines are put in place on minimum order quantities, can save a lot of money.

- *Centralize or introduce best-practice sharing.* The provision of central online catalogs, the centralized coordination of content and materials management, and the exchange of best practices all enable the whole company to leverage existing content, materials, and expertise more effectively.

- *Introduce performance and compliance tracking.* In order to ensure the potential savings or improvements that have been identified are actually realized, retailers should define relevant KPIs, set up a tracking system, and monitor the performance of external service providers. Similarly, executives in charge of smart sourcing should put in place procedures and incentives that ensure internal functions and departments comply with the new sourcing guidelines.
Efficiency optimization is a five-step process: gather facts, create a long list of improvement ideas, select ideas for execution, negotiate, and implement.

A typical smart sourcing process comprises five phases (Exhibit 19.4). Because of the complexity of marketing efficiency improvement, you should set up a dedicated team to run a pilot program in selected formats, categories, countries, and/or regions before rolling it out to the wider organization. This two-stage approach will help generate results quickly, focus the effort on the biggest levers, and enable the rollout to be based on insights gleaned from the pilot phase.

We will now examine each of the five steps in more detail.
1. Establish a fact base and define the approach

At the outset of an efficiency improvement effort, you should put in place a strong cross-functional and cross-regional core team comprising marketing executives, media planners, procurement experts, and experienced analysts. As a first step, the team should compile detailed data (ideally in an integrated database) on activation and enabling expenditure. This data will need to be retrieved or collected from internal sources such as the enterprise resource planning (ERP) system, marketing plans, procurement contracts, and various types of internal performance tracking. Wherever possible, the sourcing team should leverage data already gathered for similar or related marketing ROI efforts. Almost always, however, data sources of external providers will also have to be tapped, e.g. agency data or external market research data.

All the data should be segmented according to preset criteria, such as the category, subcategory, supplier, internal purchasing organization, spend location, and so on. It should span several years and comprise sourcing-specific information, e.g. specification descriptions of individual

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Exhibit 19.4 Five-step sourcing optimization process.
products or service types. During the classification of individual investment items, the team will frequently encounter cost positions that do not, in fact, represent marketing activities. Examples include internal events or gifts for employees. While these investments may be necessary and well-justified, they should be budgeted for accordingly in the respective budget, lest they reduce the funds available for actual marketing. Cutting or re-allocating these hidden items often allows for “quick win” savings in the first phase of a smart sourcing effort.

Once the fact base has been established, analyses and qualitative interviews should be conducted to prioritize categories, regions, or business units that will be addressed first, often as a pilot effort. The selection criteria should include the potential impact, ease of implementation, absolute size of spend, and strategic relevance of the category, region, or business unit in question.

Finally, the broader internal marketing and procurement community, as well as the company’s key suppliers and service providers, should be informed about the program. Continuous communication throughout the process, both internally and externally, is essential to ensure the buy-in, commitment and cooperation of all involved.

2. Develop the sourcing model, including quality improvement and cost reduction ideas

In phase 2, the team compiles a long-list of improvement ideas. The overview of the levers listed above – i.e. supplier management, demand management, and process optimization – can act as a guiding framework in this phase. Relevant sources for improvement ideas include the initial analyses carried out in the first phase, interviews, selective in-depth research in market supply, and internal optimization workshops. The latter are a good way to leverage the wisdom of the entire organization, especially regarding the harmonization and de-specification of services or products. For instance, who is in a better position to assess the required paper and printing quality of POS posters than a store manager? These workshops are also a good format for involving marketing stakeholders outside the core team in the process in order to ensure their buy-in from the outset.
This phase will produce a long list of improvement ideas: these should include ideas by category as well as overarching process improvement ideas. Additionally, supply market scans should be consolidated into a long-list of potential suppliers and providers for each category. Finally, the team should define guidelines for the sourcing process, the so-called sourcing model, for each category. The sourcing model should comprise any decisions that need to be made about the sourcing process, such as whether to source directly from the manufacturer or from the distributor, the types of requests for proposals and quotes, the negotiation process, and an overview of the regional sourcing markets in focus. At the end of this phase, the team should have produced strong hypotheses about which of the existing contracts should be terminated.

3. Finalize, approve, and execute the improvement ideas

In the third phase, the team will short-list the improvement ideas that deserve closer inspection. Each short-listed idea will eventually be backed by a solid savings estimate, an assessment of its feasibility, an overview of the additional analyses that will need to be conducted, and the identification of the person or sub-team that will be in charge of implementing the idea. Quantifying the savings potential can be difficult, especially if solid benchmarking data is not available. A proven way to quantify potential savings and set ambitious, yet realistic targets is to build an economic model of core suppliers by assessing their cost structures and margin expectations. External reports, e.g. on salary structures in creative agencies, are helpful in doing so.

In parallel, the long-lists of suppliers and providers should be whittled down to short-lists. Requests for proposals and/or quotes (RFPs, RFQs) should be developed and sent to the short-listed suppliers and providers. At this stage, a separate taskforce should outline all the implementation requirements (e.g. organizational changes, roles and responsibilities, capabilities, IT support). Because of the sensitive nature of this part of the effort, the taskforce should be kept as small as practicable. Additionally, it should be overseen by senior executives.
4. Prepare for negotiations, negotiate, and select providers or suppliers

Once suppliers and providers have submitted their proposals and quotes, these will be analyzed and validated by the team. As soon as any questions that have arisen in this process are resolved, the suppliers and providers should be short-listed for negotiation. In the case of creative agency services, this is usually the point at which the pitch process begins. Because of the high strategic relevance and visibility of creative services, this part of the process often takes several months.

Thorough negotiation preparation should include the following array of activities: setting negotiation goals; aggregating all available supply market data; constructing supplier profiles; summarizing internal requirements; comparing in detail the price points and other conditions; analyzing the negotiating power and option spaces for each of the parties; composing the negotiation team; determining the roles for each of the negotiation participants; and assessing the roles and characters of the negotiators on the supplier side. Based on these preparations, the team should define a negotiation strategy for each supplier and contract, including any potential tactical moves. To balance content expertise with contract term expertise, both marketing and procurement should be represented in negotiation teams. Many companies outsource negotiations with media owners entirely to media agencies. But often, the media agency will not necessarily act in the advertiser’s best interest, depending, of course, on the agency remuneration model. Given that hundreds of millions of euros can be at stake, advertisers should play an active role in negotiations with media owners.

Once all the preparations have been completed, the negotiation teams will conduct the initial rounds of negotiations and then submit their outcomes for sign-off to the board or other relevant internal stakeholders. When approved, the final agreements, conditions, or frame contracts will be negotiated with suppliers and providers. At the same time, internal stakeholders should sign off on any major changes to relevant processes such as lead times for ordering POS material.

5. Track performance and prepare for roll-out

In the last phase of the efficiency improvement process, the team should
finalize the contracts and – where appropriate – hand over the operational responsibility to dedicated personnel, ideally in the procurement department. Best-practice retailers set up functional or strategic units within their procurement departments to acknowledge the fundamental difference between basic materials sourcing and the procurement of elaborate products or services. The operational owner of a given type of service or product will place the orders and monitor pre-defined quality indicators. The team should also prepare guidelines for the implementation of process improvements, e.g. how to select suppliers.

Compliance with the new processes and guidelines is best enforced through a comprehensive governance model that includes control functions, a systematic tracking system, and transparent enforcement mechanisms. For example, a leading FMCG player established a simple “media buying calendar,” detailing key dates in order to ensure that media are booked in time to take advantage of early booking discounts. The calendar was distributed to all brand managers, resulting in savings of 3 percent without any loss in effectiveness and very little internal cost. As a final step, the team should consolidate the insights generated during the project or pilot for future rollout to other categories, countries, regions, or business units.

Follow best practice in preparation, negotiation, and implementation to capture the full value of smart sourcing efforts

How do you prepare for the unpredictable? Only advanced game theory would enable you to map out all the potential moves of internal stakeholders and external partners in the complex web of marketing services. However, over the course of conducting many smart sourcing projects in retail and in other industries, we have compiled a set of hands-on guidelines to help navigate this web. In the words of Louis Pasteur, “Chance only favors the prepared mind.”

- **Involve all relevant functions, regions, and business units in the core team:** The team should consist of marketing, media, and procurement experts. Clarify the roles and responsibilities at the outset to avoid last-minute
discussions about who gets to participate in negotiations or sign-off procedures. For example, a retail client put the marketing team in charge of evaluating and ranking different agency proposals, while the actual negotiations of contract terms were left entirely to the procurement staff, thus taking emotion out of the equation and enabling negotiators to focus solely on a favorable commercial agreement.

• **Communicate to all relevant marketing stakeholders:** In order to ensure buy-in from your entire marketing community, all the relevant senior marketing stakeholders, both central and local, should be informed about the objectives of the program and process early on in the proceedings. Involve the marketing stakeholders in idea generation or optimization workshops, then keep in contact with them throughout the course of the project, providing them with updates and asking them for their input. In addition, the wider marketing community, including regional or local marketing staff, should receive regular progress updates. For example, a large retailer found that the initial skepticism of the marketing department regarding a smart sourcing effort waned when top management demonstrated that the effort would not only result in substantial savings, but also in the opportunity to re-allocate funds to more impactful marketing programs.

• **Centralize steering, but ensure local involvement:** The more centralized the smart sourcing process, the higher the improvement potential. On the other hand, an increase in centralization usually brings about less local entrepreneurship and local buy-in. This is not only a political issue but also carries with it the danger that you could neglect local consumer needs. Nonetheless, at the very least, all the marketing managers (both central and local) need to commit to the final implementation plan. Without this commitment, they will be the first to bypass the global frame contract and hire their own favorite local agency. In some cases, it can be advisable to leave some smaller line items untouched, especially if they are of high emotional importance to internal stakeholders. For example, an FMCG player decided to set aside a modest budget for local sponsorships, given the high symbolic value these carried for local sales reps.

• **Pick your battles:** At the lowest level of detail, a retailer’s marketing budget can sometimes comprise more line items than there are SKUs in the
store. Global retail corporations face additional complexity that arises from operating in multiple regions and countries that often have incompatible reporting standards and use different marketing terminology. You are bound to fail if you try to optimize everything at once. The best approach is to conduct pilots in a select number of countries or categories in order to identify the biggest levers prior to wider roll-out. As a rule of thumb, it is often better to opt for implementing fewer categories and then to roll these out rigorously to all the relevant regions and/or business units before adding more. This ensures that there is full leverage in terms of volume while it reduces the complexity of implementation.

- **Strive for win–win situations with providers and suppliers:** Many interactions with providers and suppliers happen in a distributive bargaining context, but there is often also room to create win–win situations and performance partnerships. For example, many retailers underestimate their strategic importance as a client for creative agencies. If advertisers grant their agency some freedom to try out new ideas that might win them a creative award, the agency might be more willing to agree on more competitive rates in return.

### Negotiation role-plays

Even the most thorough negotiation preparation can go to waste if your negotiators are taken by surprise during the actual talks. In order to prepare for a variety of different scenarios in a risk-free environment, many companies conduct role-playing sessions prior to the actual negotiations. Based on these sessions, you can refine the negotiation strategy and the tactics of individual negotiation team members. If the team comprises a large number of people, the role-play “dry runs” also serve a useful purpose in providing a safe environment in which to address and resolve any internal conflicts that might exist, thereby improving the alignment of the team during the actual negotiations. Last but not least, role-plays can help alleviate some of the anxiety that even experienced executives are likely to feel prior to and during high-profile negotiations.
Optimizing commercial print sourcing, an important cost position in retail marketing, can yield cost savings of 10–30 percent

The commercial print category comprises a wide array of formats and applications: catalogs, mailings, leaflets, brochures, calendars, greeting cards, cardboard displays, and so on. Since local marketing is an important element in the marketing mix of many retailers, commercial print can be a major cost driver. But most retailers source print locally and have no standardized sourcing process in place. As a consequence of this, print spend is usually fragmented across hundreds or thousands of items, with each region or business unit having established different cooperation models with suppliers, different contract terms, item specifications, and quality standards.

The print provider supply base in most countries is also very fragmented, and in recent years many providers have struggled with low utilization rates and structural overcapacity. Commercial print has high fixed costs, making utilization a key profitability driver. In times of low utilization, printers are therefore keen to lock in volume and so are willing to enter into longer-term contracts that will provide them with predictable demand. Because of the considerable fragmentation of materials, formats, services, and suppliers, agencies or brokers that specialize in print services can act as valuable intermediaries in print buying.

Specific supply levers in commercial print

- Consolidating volume across brands, business units, or countries into a limited number of vendors, e.g. by establishing national contracts for paper and freight.
- Sourcing printing services directly, e.g. by limiting the use of brokers to cases of high complexity.
- Unbundling selected value-chain steps, e.g. print production could be separated from paper supply, and pre-production services (creative, layout, logistics) could be separated from the print production.
• Applying more rigor in negotiations, e.g. by conducting reverse auctions to take advantage of the spot market prices for large projects.

In general, as part of the sourcing model, you need to determine whether you want providers to pitch for every single product or service, or whether you prefer to enter longer-standing relationships with a small number of vendors. Working with just one vendor – even if this were feasible – is clearly not to be recommended, as it could result in a loss of price leverage and certainly increases the danger of serious damage to your business if there were to be any disruption of service on the vendor’s part.

**Specific demand levers in commercial print**

Print products are traditionally considered to be highly creative. But often this is used as an excuse for avoiding any discussion about the necessary specifications of printed advertising. Retailers need to take a sober “design-to-cost” approach and identify the drivers of perceived quality on the consumer’s part. Many characteristics of print products that are often deemed necessary are in fact over-specifications that can be the source of considerable savings. Examples include:

• Standardizing paper types and formats, using cheaper alternatives and reducing general specifications for paper (e.g. weight, composition, coating, finish/varnish).
• Simplifying the printing process itself. For lower print runs, the key issue is whether to use offset printing or digital printing. While offset usually provides higher image quality, digital allows for cheaper low-volume printing.
• Reducing the number of colors used in printing and even the quality of the ink used.
• Reducing the complexity, in terms of the number, form, and size of flaps and folds, and simplifying the binding (e.g. stapling vs. saddle stitching vs. gluing).
• Reducing the degree of customization or personalization and the number of additional extra features.
To identify opportunities such as these, you can conduct classical physical “tear down” exercises or idea generation workshops, followed by a detailed target cost analysis. To make sure harmonized or reduced specifications are actually adhered to, make sure to put in place clear and strict design guidelines.

Even before starting the harmonization and de-specification discussion, the retailer should challenge the purpose, circulation, and management of its commercial print items. Is it really necessary to mail four catalogs a year? Does every customer need the full catalog, or can you restrict this to A and B customers, sending a stripped-down ten-pager to C/D/E customers? Can you increase page density (i.e. show more items per page) and, hence, reduce the number of pages?

Another driver of cost savings can be to establish a central repository of creative materials and rights (e.g. photos, standard mailing layouts, etc.); these can be leveraged across the entire company.

The disguised example in Exhibit 19.5 shows the specification reduction for a mail-order catalog; the savings impact was 15 to 20 percent of cost.

<table>
<thead>
<tr>
<th>Example of specification</th>
<th>Existing spec</th>
<th>Proposed spec</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of pages</td>
<td>32</td>
<td>28</td>
</tr>
<tr>
<td>Number of colors</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Page finish</td>
<td>Varnish on both inside and outside</td>
<td>Eliminate varnish on inside pages only</td>
</tr>
<tr>
<td>Paper grade</td>
<td>80#</td>
<td>80# for cover 60# for inside pages</td>
</tr>
<tr>
<td>Binding construction</td>
<td>Saddle-stitch binding</td>
<td>Glued binding</td>
</tr>
<tr>
<td>Coupons and other bind-ins</td>
<td>3 coupons included in every catalog</td>
<td>E-mail 2 coupons 1 remaining coupon should be glued to inside cover, rather than bound</td>
</tr>
</tbody>
</table>

**Exhibit 19.5** Example for specification reduction in commercial print.
The dangers of unbundling

Despite the promise of better terms for products and services sourced individually, unbundling does not always make good sense, and so it needs to be evaluated on a case-by-case basis. For example, in times of rising costs for basic materials like paper, it might be advisable to bundle the purchase and have the vendor bear and hedge the risk. Furthermore, a large paper buyer, such as a major printer, is always likely to get more favorable terms due to their volume.

Specific process levers in commercial print

One of the biggest levers on the process side of print is to streamline the coordination, review, and approval procedures: pre-press management, electronic press checks, online audits, regular feedback regarding print quality and color variance (to ensure consistency), and electronic file sharing. This will reduce complexity and lead times. A retailer’s internal order process management also often holds significant improvement potential. Typical levers include refined forecasting and order planning, the extension of acceptable lead times, ensuring that orders are placed on time, minimizing the number of rushed orders, reviewing the cost of warehousing and distribution costs, and optimizing order quantities. Furthermore, retailers with high print spend should investigate the possibilities for minimizing transportation costs by picking their printing locations strategically. Finally, introducing semi-automatic pricing mechanisms, which calculate the price of the product from a base price, adding a variant-specific mark-up, can help avoid having to price each individual item separately and so limit the need for individual pricing to the rare occasions on which truly unique printing products are requested (Exhibit 19.6).
Situation
- Global specialty retailer with USD 10 bn in annual sales and distribution of printed materials to more than 20 countries
- Purchasing of printed materials already centralized
- Initial target to achieve 3–7% savings; 15% over a three year period
- Relatively fragmented supplier landscape with >20 paper suppliers and >30 printing firms
- Many different paper and print specifications

Key savings levers
- Leverage company-wide spend through unified request for proposal process
- Unbundle paper, printing, binding, and distribution, thereby eliminating printer markups
- Bid out most predictable projects
- Use requests for proposals to identify potential specification changes that generate additional cost savings
- Consolidate spend and lock in pricing for 1-3 years with a small base of “preferred” paper suppliers and printers

Impact
- Total annual spending, USD mn
  Before: 110
  After: 89–95
  -14–19%

- Huge savings from price reduction on printing (30%), smaller price reduction on paper supply (5%)
- Additional 20–30% savings identified, including specification changes for paper and printing and moving printing to low cost countries
- Rigorous internal process to avoid over-specification and late changes

Exhibit 19.6 Commercial print sourcing at a global retailer.

Interview: Uwe Becker

*Media Director at Unilever Germany/Austria/Switzerland, Chairman of OWM (German Association of Advertisers, representing more than 100 major advertisers)*

Q: In which respect is media purchasing different from the procurement of other goods and services?

**Uwe Becker**: Media is not a commodity. There is no neutral indicator measuring “media quality,” such as a DIN norm. Therefore, “media purchasing” is a misleading term in itself. One should rather speak of media planning and optimization. The objective of this function is to
guarantee the best communication performance possible, at the best price the market offers. Naturally, this does not mean that the cheapest option should always be preferred. Higher investments might be well justified if they come with a higher performance, e.g. in terms of fit with the target group.

Q: Many advertisers feel they do not fully understand media plans, and fear they might not get the best buying conditions. What is your advice?

Uwe Becker: Building trust-based relationships with agencies is key, as is a common understanding of the company’s objectives in marketing communications. To support this, performance-based fees can be a powerful instrument. Bonuses payable to the agency should take into account both the company’s business performance and the performance of the agency, e.g. with respect to media consulting. Above all, transparency is crucial in media management. The agency’s performance and the outcome of communication activities need to be monitored continuously – and potentially be optimized.

Q: What are core capabilities advertisers should build in the area of media planning?

Uwe Becker: In general, a company needs the capabilities to make its investment decisions with confidence, especially given the high investments involved in media. Just as a brewery needs to have expertise in purchasing malt and barley, or as an automotive company needs specialists for purchasing electronic components, each advertiser needs media management experts. Of course, this depends on the size of the company and its communications budget. For large advertisers, it makes sense to employ one or more media specialists. As a minimum requirement, companies should always be in a position to understand and challenge recommendations by their media agencies.
Key takeaways – Smart sourcing

1. Increasing marketing efficiency might be hard work, but it is well worth it: smart sourcing yields sizeable savings without compromising quality.
2. Efficiency levers include rigorous supplier management, streamlined demand management, and procurement process optimization.
3. Efficiency optimization is a five-step process: gather facts, create a long list of improvement ideas, select ideas for execution, negotiate, and implement.
4. Follow best practice in preparation, negotiation, and implementation to capture the full value of smart sourcing efforts.
5. Optimizing commercial print sourcing, an important cost position in retail marketing, can yield savings of 10–30 percent.
Part III

Ten Perspectives on Retail Marketing
CHAPTER 20

TEN PERSPECTIVES ON RETAIL MARKETING

Jesko Perrey, Dennis Spillecke

1. **Brands are value generators.** In an increasingly differentiated retail and media landscape, consumers use brands as signposts for their decision journey. As a result, brand image is a key factor in retail customer acquisition, development, and retention efforts. This makes branding a top management topic that should not be delegated to marketing departments or agencies.

2. **Brand management requires a combination of art, science, and craft.** A large part of this book focuses on the analytical foundations of retail marketing. But successful brands also depend on the art of creative minds and the craft of seasoned practitioners. It is through the interplay of the three elements that strong brands are created – and sustained.

3. **Retail branding is a three-front war.** Retailers face brand-related challenges at three levels: umbrella branding, store branding, and product branding, especially regarding the ever-changing mix of manufacturer brands and private labels. This calls for a systematic approach, but one that leaves room for flexibility in daily brand management decisions.

4. **Format follows branding.** New lifestyles and hybrid consumption give rise to a proliferation of formats, from subterranean smart stores to suburban multi-brand malls. But always remember that the store format is where your brand promise takes shape. Keep innovating, but make sure new formats fit and support your brand.
5. **Money doesn’t change everything, after all.** A bigger budget is not necessarily a better budget, especially as earned media – such as social networks – are on the rise. Strive for clarity in what you are trying to achieve in the marketplace, then align your budget level, activity allocation, and capability building with these objectives.

6. **New media are affecting the entire retail value chain.** Digital technology is no longer limited to online brand building. Dynamic new touch points provide opportunities for value creation across functions, from web-based insights generation to eCRM.

7. **Hands-on local media will remain important.** Shopping is an everyday activity, and it requires customer contacts in everyday contexts. ATL image campaigns will complement rather than displace leaflets and local print ads.

8. **Make the most of your direct customer relationships.** Retailers enjoy the unique privilege of direct relations with shoppers, both offline and online. The potential for direct communication, tailored propositions, and personalized offers is greater than in any other industry.

9. **Leverage data wisely to create competitive advantage.** Retailers possess reams of data, but only a fraction of it is commercially relevant. To avoid drowning in data, make strategy the guide of your data mining, not vice versa. This will enable you to derive activities that are reliably relevant to shoppers and trigger quantifiable responses.

10. **Keep core capabilities in-house.** While some services, such as research or analytics, can be outsourced to vendors, brand positioning and marketing strategy should be retained by retailers. As content evolves into a differentiating factor, make sure to secure the services of the best content creators you can find, be it in-house or externally.
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