Understanding the ROI of promotions through advanced analytics

By Ina Oosthuizen

1 Jul 2021

The retail industry is becoming more competitive by the day and promotions can be an effective way to increase demand. To do so optimally remains a challenge for businesses - even if the increased volume is positive. What really matters is the total profits compared to the discount; the return on investment (ROI).

Source: www.unsplash.com

The ROI is what separates a good promotion from a bad one. Driving promotions without looking into the inherent factors that influence the ROI can lead to promotions that damage the bottom-line. Adapting a centralised solution to give stakeholders a comprehensive view of the various facets is the key to effective promotions that grow the business. By using advanced analytics, a company can take all inherent factors into account and determine its real promotion ROI. Here are some strategy points to consider when thinking about these concepts:

Inherent factors of promotions

There are five inherent factors of promotions that business leaders should be aware of and monitor closely:

- Baseline: This accurately calculates the incremental sales lift required to have a consistent sales volume. If not, determining how much of the sales were due to promotional activity will not be possible.
- Stocking up: More for less inevitably leads to stocking up. Taking the drop in sales into account straight after a promotion due to forward buying is important to gain a holistic ROI.
- Cannibalisation: Cannibalisation will consider the effect the promotional products have on unpromoted items and whether there was a loss in sales due to the increase in sales of the promoted items.
- Market share: Did the increase in sales create a higher demand for the products by reducing demand from competitor products?
- Promotional incremental: Consumers who only purchased the product because it was on promotion and would

otherwise not buy this product.

Actual incremental volume uplift

The actual incremental volume uplift is the sum of the additional volume redirected from gaining market share and the customers that bought the product purely because it was on promotion. This could also include customers who purchased more of the product because it was on promotion - they would have bought a certain baseline amount but because it was on promotion they bought more.

Indirect promotional cost

The indirect promotional cost associated with the following three factors need to be considered:

- Baseline: Revenue is lost on the items that are sold at a discount when the consumer would have bought them at the original price.

- Stock up: Sales may go down after the promotion has passed due to customers stocking up.

- Cannibalisation: Revenue is lost on the items that are sold at a discount when the consumer would have bought another product at that product's original price. This effect can be positive if the promotional item is more profitable. However, with promotions, this is rarely the case.

Direct promotional cost

These costs vary per industry and across the value chain. However, they can include any direct cost for the promotion to take place including slot fees, display fees, and any advertising costs.

Return on investment

The return on investment of promotion is the sum of all promotional costs (direct and indirect) divided by the profit generated from the promotion.
Paying attention to this key KPI ensures that the promotional spend is going into the right promotions and that the business is not running promotions that are damaging to the bottom-line.

Volume gain does not necessarily mean profit gain - in fact, it can hurt the business if it is not driving promotions with the full picture in mind. Investing in promotional analytics can get the company where it needs to be in terms of driving successful promotions.

Additional benefits of a centralised system

Consumer behaviour: Is the business pushing the correct products at the right time, stores, or price and is it pushing the right type of promotions to really change consumer behaviour? A company can answer all these questions if it applies the correct analytics. Creating a consumer-centric view of historic data provides direction into what promotions to do when, where, and how. Promotional success is based on meticulous planning, monitoring and analysis of many different factors.

Data-driven forecasting: Without the correct supply, a company will be unable to reach the full potential of a promotion strategy. Using analytics, it can consider the future (investment and inventory forecasting), helping it to plan accordingly and not lose out on sales.

ABOUT THE AUTHOR

Ina Oosthuizen is a data scientist at Decision Inc.