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BUILDING REAL ADVANTAGE IN A RECESSION

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HOW MARKETERS CAN MANAGE PRICE INFLATION

By John Quelch on June 4, 2008

When driving these days, do you look at the prices every time you pass a gas station? Do you notice yourself paying more attention to the prices of everything you buy? You are not alone. Consumers everywhere are more price aware. People who've been indifferent to price increases for years are suddenly amazed at what things now cost. How can marketers cope not just with inflation but with consumer sticker shock?

1. Understand Your Customers. There are at least four ways in which customers can respond to higher gas prices: downgrade from premium to regular; take fewer trips by car, consolidate errands, switch to public transportation; take the same number of trips but reduce the miles driven per trip by, for example, vacationing closer to home; drive more economically and less aggressively to improve miles per gallon; and buy a specific dollar amount of gas rather than filling up every time, even though this may mean more visits to the pump. Some consumers may even trade in (at a loss) the SUV for a hybrid, an example of how price inflation on one product can cause demand shifts in a second, related, category.

2. Invest in Market Research. You must discard your existing customer segmentation assumptions and segment consumers around product usage behavior and price sensitivity. You must get out into the marketplace yourself and talk to consumers directly to understand their pain points and how they are changing attitudes and behaviors in response to price inflation. You must then quantify these shifts and develop product and pricing strategies that balance the need to maintain both profitability and market share.

3. Redefine Value. Customers buying soft drinks can think about price in three ways: the absolute cost per can or bottle, the cost per ounce, and, less common in this category, the monthly consumption cost. Customers short on cash will focus much more on the absolute price. They'll go for the 99 cent soft drink rather than the $1.29 container with 50% more volume. To motivate cash-poor consumers, marketers must reverse engineer products and packaging to hit key retail price points. This may mean downsizing package sizes, something the candy industry always does in response to inflation.

4. Use Promotions. If you've always passed through raw material price increases to the end consumer, you don't necessarily need to change that policy. However, lagging competitors in passing on price increases can have the same effect as a temporary price promotion. More customers than usual will be looking out for price promotions, but don't give away the store to those who don't need the discount, and cut prices not across the board but only on items selected as your inflation-busters. For cash poor consumers, these promotions should hit the key price points on small pack sizes. For cash rich consumers, encourage multi-unit purchases ahead of the inevitable next price increase.

5. Unbundle. Customers who previously welcomed the convenience of buying product, options, and services rolled into one may now ask for a detailed price breakdown. Make it easy for your more price-sensitive customers to better cherry-pick the options and services that they truly need by giving them an unbundled menu of options.

6. Monitor Trade Terms. Beware of powerful distributors paying you more slowly than they turn the inventory they buy from you. In an inflationary environment, they're making money on the float by stretching their payables. Manage your inventory on a last-in, first-out basis to insure that increases in your realized selling prices do not trail the increases in your input costs.

7. Increase Relevance. You need to persuade customers to cut back their expenditures on other products, not on yours. In tough times, consumers more than ever need and deserve the occasional treat. So, if you are Haagen Dazs, tell the consumer to substitute private label peas for the name brand but to not forego the comfort of curling up on the sofa with a tub of her favorite ice cream. Strong brands can hold consumer loyalty while increasing retail price points. Weaker brands risk private label and generic substitution.

Clearly, not all marketers are equally affected by price inflation. Commodities like gasoline, where the manufacturer adds little value before the product reaches the end consumer, are more vulnerable, while sales of the most exclusive global luxury brands hold up pretty well regardless of price. Especially challenged are marketers of goods and services for which consumers don't necessarily understand the input costs: decorative candles, for example, are highly sensitive to oil prices and the purchases are discretionary. The key here is to educate the consumer, apologize for the uncontrollable price increases, give price-sensitive consumers some promotional options, and reemphasize product benefits.

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FINDING THE SILVER LINING

Key Lessons for Marketing in a Recession, by Will Galgey, Alastair Morton, Andy Stubbings and Tom Ding.

With much of the world's economy in the grip of the worst financial crisis for decades, here's a round-up of thinking on how the marketing community can respond. An exclusive bibliography of sources on 'coming out on top' is also available, see details below

12 things you and your clients need to know about marketing in times of economic and financial turbulence

"Brands continue to have value in turbulent times. They can lose value if there is not sufficient marketing investment in them, but can also gain under the right circumstances, and with the correct understanding of the opportunities open to them." That is the key message summed up by the authors of Key Lessons for Marketing in a Recession, a new special report recently commissioned by WPP from The Futures Company, designed to guide thinking throughout WPP's agencies on how to help a client's business and inform their marketing strategy. In addition, the study presents an extensive bibliography of sources on the topic of marketing in a recession. The study is based on assimilation of some 150 articles, books, reports and case studies on marketing and business practice in a recession, from all over the world, and including references and examples from as far back as the 1920s. The 12 key points are summarised right.

Recessions: the 'facts'

Recessions are uncertain and unpredictable, what we do know is that: they happen; they're short (usually); they are inequitable; and no two are the same.

Consumers' values are up in the air

In hard times, consumers are forced to re-evaluate how they consume, providing opportunities and challenges as loyalties change.

Uncertainty reigns

Recessions are uncertain times for consumers; brands can build trust by showing sympathy and engaging emotionally with consumers.

All brands can provide value

Value for money is especially important during a recession; 'value' brands as well as premium brands can provide value.

A caveat: spending more is in itself no guarantee of success

There is a frequently expressed view that increasing spending on advertising during a recession causes a company to be more successful afterwards. This simplistic view should be approached with caution.

Maintain brand equity

Companies must continue to exploit and nurture to the best of their abilities the brands that they have.

Response 1: Exploit

If you are in a position to do so, there may be considerable opportunity to exploit versus competitors during a recession.

Response 2: Hold firm

Holding firm to your brand strategy can pay significant dividends in terms of long-term shareholder value.

Response 3: Shape up

In recessionary times it is more crucial than ever to ensure that operations and marketing are effectively streamlined and optimised.

Opportunities in the new media landscape

This recession is unprecedented in occurring at a time when the penetration of the internet worldwide is high, creating new challenges and opportunities.

A ripe time for innovation

Recessionary periods are rich in innovations. Consumers are willing to adopt new products, and companies are forced to innovate to survive.

Heed your own words…

Agencies would do well to heed their own advice, by protecting their own assets, and by partnering with their clients over the long-term.

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WHY ADVERTISING PAYS IN A RECESSION

Options and Opportunities for Consumer Businesses: Advertising During a Recession, by Alexander L.Biel and Stephen King.

Back in 1990 Stephen King, who passed away in 2006, published a pioneering study on advertising spend during a downturn. His conclusion: that businesses which cut advertising would be long-term losers

KING STARTED out by defining a recession in a specific market as a time when short-term growth lags the long-term trend by at least four percentage points. With this definition in hand, he looked at data from some 749 companies in the Profit Impact of Market Strategy (PIMS) database, provided by the Strategic Planning Institute, covering four years or more for each company.

The first conclusion was the predictable one that companies increase their Return on Investment (ROI) when the market expands, while their profits fall when the market contracts.

During recession, the data showed that only a third of companies cut their advertising spend – by an average 11 per cent – while two thirds increased it; Around 60 per cent of those increasing spending did so modestly, by an average 10 per cent; the remaining 40 per cent made a big increase, average 49 per cent. All the businesses saw a reduction in their ROI during the recession, albeit it was slightly greater (-2.7 per cent) for the big spenders, than for those who cut their advertising (-1.6 per cent). This caused King to note: "… businesses yielding to the natural inclination to cut spending in an effort to increase profits in a recession find that it doesn't work."

However, when he looked at market share, King found that marketers who cut their spending lost an average of 0.1 per cent of the total market, while those that made a significant increase in advertising spend saw their market share rise by an average of 0.5 per cent of the market. And the implication of this is that their profits would be greater in future.

King summed up these findings as follows: "In general, virtually all businesses see reduced profits when their market is in recession. But businesses that cut their advertising expenditures in a recessionary period lose no less in terms of profitability than those who actually increase spending by an average of 10 per cent.

In other words, cutting advertising spend to increase short term profits doesn't seem to work. More importantly, the data also reveal that such a moderate increase in advertising in a soft market can improve share. There is a substantial body of evidence showing that a larger market share generally leads to higher return on investment.

For the aggressive marketer, the data suggests that a more ambitious increase in expenditure, although reducing profit short term, can take advantage of the opportunity afforded by a recession to increase market share even further.

The PIMS data indicate that consumer marketers increasing their spending by an average of 48 per cent win virtually double the share gains of those who increase their expenditures more modestly. While this aggressive increase in advertising is associated with a drop in ROI of 2.7 per cent in the short-term, it may nevertheless be acceptable to the marketer looking ahead to post-recession growth."

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INDEX OF ANXIETY

From Feeling the Pinch? by Karen Kidson

THE FUTURES Company has carried out research among 2,000 UK adults to find out what has happened, and is likely to happen, as consumers feel their finances squeezed. The report, Feeling the Pinch? provides forecasts for the coming five years; whether or not the UK economy technically experiences a recession, the impact of this bleaker landscape on consumer confidence and behaviour will be significant. The first part of the analysis explores consumers' levels of anxiety regarding their personal financial situations, the UK economy and, more specifically, 22 issues affecting them such as the cost of petrol and their level of debt. Consumers are segmented by an anxiety index: The Placid are barely worried at all, while The Panicked are very worried about many of the issues facing them.

The second part seeks to understand precisely how consumption behaviour is likely to change in the coming year. Using a factor analysis, The Futures Company identified eight themes of trade-offs that consumers may make in the coming year given their personal financial concerns, including one around ethical and environmental consumption. Some key findings include:

• Actions around spending wisely, cutting back and no frills consumption are those most likely to increase over the coming year.

• The more anxious consumers are, the more likely they are to make specific changes to their consumption behaviour in order to save money.

The report concludes by exploring in detail the marketing and strategic options that companies should consider in the face of the cooling economic climate.

We hope you have found this paper both interesting and useful. A number of the tips contained within these articles suggest how research can assist businesses to ride the recessionary wave successfully.

Innovation & NPD

With consumers reassessing their product needs, take the opportunity to innovate your way through hard times. Research International can help you identify unmet needs, create solutions and take them through to launch. Click here

Pricing & Retail Solutions

Almost all economic commentators agree offering value is crucial in a recession. Research International can help you price your products correctly and optimise your retail strategies. Click here

Market Strategy & Structure

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