

Free Standing Coupon Inserts: Walking or Running to Electronic Channels?

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It's late Wednesday evening. The kids are asleep and Anne Dearing is making her weekly grocery shopping plans. Unlike her mother, Anne is not looking over her collection of newspaper coupons as she makes her list. She is sitting with her home computer and wireless phone. Each week, Anne searches through a wide array of Web-based promotional offers to get the best value she can for her family's dollar. This week, Anne is preparing for a birthday party. She opens her usual weekly shopping list, adds some special items for the party and then uploads the entire list to the "coupon" site of her local grocery store's frequent shopper club. In a few moments, her grocery store has identified the coupons available for her shopping list. She also has received special offers for gift wrap and candles, items she forgot to include. Anne downloads the list into her mobile phone and heads to the store, where she will redeem her coupons by "beaming" the downloaded values at checkout. As Anne leaves for home, the grocery store's frequent shopper computers are updated with her most recent purchases and the grocery retailers and manufacturers begin planning the promotional schedule for the coming week's "fill-in" shopping and next week's major specials.

Anne Dearing's coupon-clicking life does not exist today. But new technologies are converging to change how marketers and retailers think about the role of promotional offers, such as coupons and loyalty programs. At the same time, new technology will impact the way a consumer goes about getting the greatest value both in time and money when shopping for the week. These changes will be gradual, and newspapers will need to stay abreast of the evolution of coupons and loyalty programs to monitor their impact on the newspaper's core and electronic businesses.

To help understand the future of couponing, free standing coupon inserts (FSCI's) in particular, this article will look at their importance to newspapers, marketers and consumers as drivers of change and recent experimentation with new technology alternatives. The article will conclude with a point of view of the future of FSCI's in print and via other channels, as well as identify several important strategic implications for newspapers in their core and electronic businesses.

Importance to Newspapers Today: Revenues and Readership

Newspapers have traditionally acted as the principal distribution channel for manufacturer's coupons. According to NCH NuWorld's estimates for 1999, newspaper FSCI's were used to distribute 81 percent of all coupons. For newspaper FSCI's, consumer goods marketers rely on two large marketing agencies, Valassis Communications Inc. and News America Marketing, to print, aggregate and distribute their coupons. These two agencies are the largest aggregators and represent approximately 80 percent to 90 percent of all coupons distributed through newspaper FSCI's, with an estimated combined billing of \$1.2 billion.¹

How important is this to newspapers? If we assume half of the top billings of the two agencies go for distribution in newspapers, then about \$600 to \$700 million in revenues of the newspaper industry's approximately \$13 billion in distribution products are in FSCI's. FSCI's would then represent 5 percent to 8 percent of that business.

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For perspective, this spending with newspapers for FSCI's is about the size of the combined spending of Sears, K-Mart and May Department stores in daily newspapers.

Both national and retail advertisers have developed sophisticated targeting strategies for their inserts and couponing, requiring newspapers to invest in inserting and packaging equipment to handle the increased volume of inserts and the increasingly sophisticated demands for insert distribution. According to the NAA's annual expenditure survey, newspapers will invest almost \$250 million on plant construction this year, disproportionately in post press equipment.² To the degree that incremental FSCI revenues are expected to help cover these investments, the future of couponing could very well impact newspapers operating profitability.

Coupons are also important to readership. According to the 1997 NAA study of newspaper readership, Sunday coupons and advertising circulars represent one of the most important reasons consumers buy the newspaper. If FSCI's declined overall or shifted to online media, this could diminish the benefits many consumers derive from the Sunday paper. As a result, there would be downward pressure on Sunday newspaper circulation growth, which is already slowing — and even declining — in many markets.

So the future of couponing such as FSCI's is important to newspapers, since they are a significant revenue stream — one that will be needed to help justify investments in packaging and inserting technology — as well as represent a driver of Sunday readership.

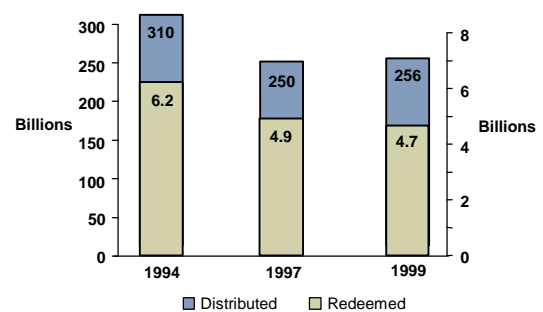
Marketers and Consumers: Drivers of Change

So why would FSCI's, the overwhelmingly dominant channel to distribute food and national advertising coupons, change?

Despite the benefits of couponing, the number of coupons distributed and redeemed have declined, as shown in Illustration A. While there are many reasons for this, perhaps the most important environmental factor has been the overall health of the U.S. economy during much of the 1990s. Consumers use coupons as a source of household savings and value. During times of increased prosperity, consumers may feel less pressure to pursue these values, resulting in lower overall redemption rates.

Illustration A

Consumer Goods Coupons



Source: NCH NuWorld, 2000

In 1999, 4.7 billion coupons were redeemed for a total of \$3.6 billion in consumer value. These coupons represented millions of combinations of face value, expiration dates and product offerings. Research has identified increasing consumer concern and frustration with the clutter and complexity of coupon offers.³ Consumers are forced to balance the potential savings from the coupons with the time required to find coupons and then to track and store them. For the regular user, coupons provide savings and value to the family, but also involve the cost and inconvenience in clipping and tracking.

During the past decade, marketers have experimented with new promotional channels and strategies, looking for greater efficiency and more measurability from their promotions. Several traditional coupon-marketing partners, such as Valassis and News America Marketing, have invested in new targeted coupon distribution programs. Valassis, for example, has developed a mailed coupon program called Aztec, which provides targeted coupon distribution as well as detailed information on the consumers who redeem the coupons. Programs such as Aztec that provide efficient coupon distribution, as well as integrate consumer information often drawn from frequent shopper programs, are an example of how marketers and retailers

today are combining the various elements of consumer promotions to yield more efficient programs. Electronic coupon networks such as Catalina Marketing also have grown as a channel for coupon distribution. Electronic coupon networks provide consumers with targeted coupons based on their current purchase for use the next time they visit the store. For instance, a consumer buys a box of Orville Redenbacher microwave popcorn and receives a coupon with a discount for her next purchase of popcorn.

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Marketers also find that coupons are costly to administer and there is significant fraud. Marcia Mogelonsky, in a Marketing Tools article on coupon reimbursement, cites the cost to manually clear coupons is \$10 to \$15 per \$1,000 in face value. In a recent Catalyst study, it was estimated that more than \$400 million is attributed to misredemption and fraud. Of course, electronic POS scanners, which can read bar coded coupons, can cut costs by as much as half, reduce fraud by confirming a purchase is made and capture customer data. According to the Food Marketing Institute, the use of electronic coupon clearing increased from 53 percent of all food retailers to 68 percent between 1995 and 1999.

In summary, coupons represent a familiar and broadly used method for marketers to encourage the purchase of their products and services. Over the past decade, the strong economy, combined with marketer efforts to experiment with new, more cost effective channels and — in some cases, completely new strategies — has lead to lower use of coupons by both consumers and marketers. Looking forward, the desire for more convenience by consumers, and the need to reduce costs to administer and target coupons will continue to drive experiments on the Internet and with other technologies over time.

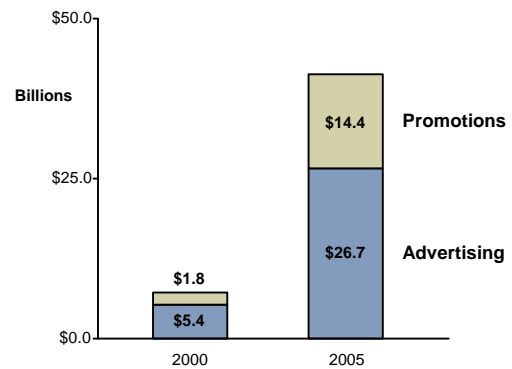
Emerging Technology

Online promotions today remain a small part of total U.S. promotional spending. Promo Magazine estimates total 1999 online spending at \$926 million, which includes spending for all online sweepstakes, couponing, loyalty programs and the fulfillment of these promotions. Spending grew 95 percent from the prior year. This spending growth is reflected in NCH NuWorld's estimates of online coupon volume. NCH NuWorld reports that the volume of online coupons grew by more than 33% in 1999 to approximately 1.3 billion coupons, still only slightly less than one half of one percent of total coupons distributed.

Going forward, Forrester Research, Cambridge, Mass., predicts that growth will continue until online promotions represent a significant part of total promotions. Forrester has forecast promotional spending growth to double in 2000, resulting in total spending of \$1.8 billion, growing to \$14.4 billion in five years time. By 2005, Forrester estimates that promotional spending online will represent a third of total online marketing (advertising and promotion) and between 10 percent and 12 percent of total promotional spending in all media. (See Illustration B.)

But while growth has been dramatic, marketers, for the most part, have allocated only a small portion of their budgets to online promotions. Promo Magazine's annual survey of marketers and promotions agencies found that 41 percent said that the Web had no impact on their current marketing spending. More than 65 percent of respondents spent 5 percent or less of their marketing budget on online promotions. But the same survey also forecasts strong growth for online

Illustration B
Online Promotional and Advertising Spending

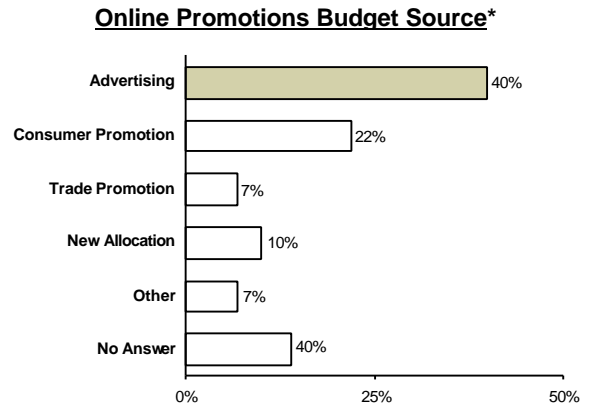


Source: Forrester Research, 2000

promotional spending in 2000. Asked to predict their 2000 budgets, more than 50 percent of respondents expected to spend 6 percent or more of their marketing budget on online promotions and over 20 percent expected to spend 10 percent or more.

According to Promo Magazine’s Annual Survey and shown in Illustration C, marketers will add online promotions to their marketing mix by reallocating their budget away from more traditional promotional vehicles, including newspapers. Forty percent of respondents expect to reallocate budgets from traditional advertising and 29 percent expect to divert funds from existing trade and consumer promotional vehicles. Only 10 percent expect to increase budgets to allow for online promotions.

Illustration C



*According to a survey of brand marketers and marketing service companies. Source: Promo Magazine, 2000

Why the dramatic moves? Online access has rapidly become a mass-market phenomenon, and online consumers have quickly adopted online coupons. Today, more than 39 million U.S. households have online access. By 2004, online access is expected to exceed 60 million households. Among these Net-enabled consumers, online coupon awareness and usage have grown dramatically. According to the NPD Group’s Electronic Coupon Survey, approximately half of all online users are aware of online coupons, and 27 percent have actually redeemed an online coupon. More than 11 percent of online consumers have used an online coupon for offline grocery shopping. According to CMS, the largest U.S. provider of promotional settlement services, redemption rates for online coupons in 1999 were 29.3 percent versus 1.1 percent for the traditional Sunday FSCI. Adoption by online consumers has been so rapid that by March 2000, NPD Group reported that online coupons represented 10 percent of total coupon usage among online consumers. The strength and speed of consumer acceptance suggest that the online coupon satisfies many of the consumer’s needs for shopping information and planning.

Who are these online coupon “clippers”? While not precise, the demographics of the online coupon user approximate the demographics of the traditional consumer user. According to a March 1999 NPD Survey of online consumers, 55 percent of online coupon users are women, 55 percent are between 25 and 44 years old and 33 percent earn more than \$75,000 per year. These consumers resemble the stalwarts of coupon users in the offline world.

Illustration D

Promotional Offers Online*

	Usage	Most Effective
Price discounts	64%	11%
Coupons	64	11
Free merchandise	60	31
Sweepstakes	53	20
Free shipping	36	16
External points program	24	2
Referral program	20	0
Gift certificates	20	2
Internal points program	11	0
Contests	11	4
Rebates	7	2

* Survey of 45 online marketers; 15 online retailers, 15 offline retailers, and 15 product manufacturers. Respondents were asked which online promotions he/she used and which of these types of promotions did he/she believe to be the most effective. Source: Forrester Research, 2000.

The combination of an increasingly mass audience and familiar user base has led to a quick introduction to the Web of traditional coupon and price-off offers. Marketers continue to rely on traditional types of promotional offers to drive online consumer behavior. Forrester’s “The Promotion Commotion,” issued in April 2000, reports that marketers are most likely to use coupons, price discounts, giveaways and sweepstakes (see Illustration D). These traditional offline promotional offers are also felt to be the most effective with online consumers.

While the nature of the online promotional offer remains basically the same, the distribution vehicles have become increasingly direct, often relying on both online e-mail and offline vehicles, such as direct mail, as shown in Illustration E.

Given the very familiar demographic group, it is no surprise that couponing leaders in packaged goods, fast food and new online retail categories are driving current online couponing. Across these categories, consumers are redeeming their coupons mostly in the retail store for traditional consumer goods and fast food categories, and on the Web for online retailing categories such as books and music (See Illustration F.).

At this early stage, online promotions still mirror many of the attributes of offline promotions. They rely heavily on price-off coupons, discounts, direct e-mail and similar executions. But the nature of the distribution vehicles has given rise to experiments with more complex executions, combining both online and offline promotional tools. In one example, Sports Authority distributed 1.5 million game pieces through its stores, sending contestants to their Web page to check for winners. Today, the majority of coupons in a typical Sunday FSCI will include a Web site reference to other offers.

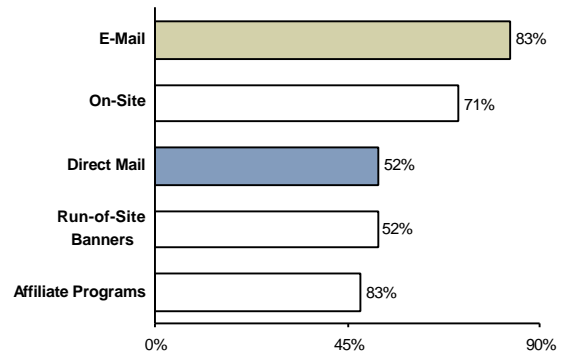
As online promotion becomes more sophisticated, marketers are looking for ways to use customer information gathered from online promotions to develop retention marketing plans, shifting attention from the immediate sales transaction to the value of a long-term relationship. In fact, Forrester estimates that as much as 85 percent of online promotional spending today is for acquisition of new online customers. But marketers plan to refocus on customer retention, almost doubling their commitment to retention efforts in the next five years.

Although online technology has been around now for several years, the combination of direct communications, consumer information and the evolution of both new online standards yields new models every year. In the case of online promotions, three areas bear close attention. The volume buying “name-your-own” price services are an alternative to coupons for stretching the family dollar. Shopping bots, such as My Simon, also offer consumers a way to save on their weekly purchases without the investment in searching, clipping and tracking. And finally, peer-to-peer computing, the technique underlying Napster and Gnutella, may have applications for consumers who want to place their shopping lists online not for other consumers to share, but for grocery chains and manufacturers to compete over.

“Name Your Price”

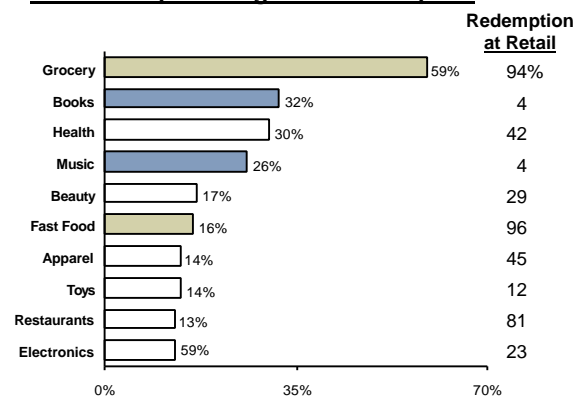
Priceline’s troubles lately have been well covered in the press. Its WebHouse Club affiliate that was designed to offer savings to consumers on grocery, gasoline and other household items has folded. But it is still unclear whether the underlying model was flawed, or if the problem was poor execution and bad timing. WebHouse Club competed with manufacturer’s coupons to offer savings to the consumer.

Illustration E
Vehicles for Online Promotion*



* Survey of 45 online marketers; 15 online retailers, 15 offline retailers, and 15 product manufacturers. Source: Forrester Research, 2000

Illustration F
Online Coupon Usage and Redemption*



* Table reads that 59% of all online coupon users gathered grocery coupons and that 94% of those online grocery coupon users redeemed them at a retail store. Source: NPJ Group, 2000

WebHouse's model linked together the consumer, the retailer and the manufacturer. The consumer paid a nominal monthly fee (\$3) to participate. The consumer payment established the backbone of a consumer database. The retailer agreed to honor the WebHouse Club price for the given items. The manufacturer diverted some of their trade and consumer promotion efforts to WebHouse Club to subsidize the discount on the products that the consumer buys. WebHouse Club could have become an alternative to traditional couponing, couponing on-demand, name your own offer and expiration date.

Where did WebHouse Club run into trouble? The consumer was clearly better off. Three dollars was a small price to pay for the chance to name your own price on thousands of grocery items. The retailer received free store traffic without incurring incremental marketing costs. For WebHouse, the problem was the packaged goods marketer who did not sign up to subsidize the discount. According to a report by The Industry Standard, a survey of the top eight consumer packaged goods manufacturers found that six were not honoring the discounts and two refused to comment.⁴ Without the consumer goods marketing companies' participation, WebHouse Club was left to subsidize the discounts themselves. WebHouse clearly had a big idea, but the costs were too great to carry, and consumer goods marketers were reluctant to create another powerful intermediary between themselves and the consumer. Although WebHouse Club may have failed, online technology will continue to allow entrepreneurs to challenge traditional models of consumer and trade promotions.

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Shopping Bots

Intelligent search services — shopping bots — may also lead to new promotional forms. Shopping bots, such as the CNET subsidiary My Simon (mysimon.com), satisfy many of the needs of consumers. The shopping bot searches across the Web, all sites or just member sites, depending on the business model, to find the lowest price on a particular item. For the consumer, the technology could potentially comb through all offers, the grocery retailer, the consumer goods manufacturer, online competitors, as well as coupon sites. The technology provides the consumer with savings and value across multiple online couponing vehicles. It also simplifies the cumbersome paper-based process, providing a savings and planning tool on demand.

Shopping bot technology and business models are still evolving. None has yet to provide searches of all the potential promotional offers in the product categories that drive today's coupon and promotional spending. My Simon is an example of an online-only comparison shopping service that illustrates some of the potential for this technology. Consumers come to My Simon and follow a search for a particular deal on the desired product. My Simon's intelligent search agents explore the Web in search of online merchant with the lowest price. Search results display merchant, brand, price and other particulars such as shipping costs. The consumer then links to the online merchant and conducts the transaction.

My Simon receives income from on-site advertising. My Simon cannot perform a cross-Web site search for promotional deals, but its technology could develop in this direction. A shopping bot service across all retail and promotional offers could either complement or compete with aggregators such as Valassis and News America Marketing. As a complement, the retailers and marketers would continue to use third-party companies (Valassis, News America, Treasure Chest Advertising) to publish and distribute their coupons. Or retailers and consumer goods manufacturers could publish their own coupons and rely on consumer's shopping bots to find the promotion. This technology will continue to evolve providing new models and opportunities for online promotions.

Peer-to-Peer and Wireless

The newest technology on the Net is peer-to-peer computing, the model that drives Napster. Peer-to-peer provides an exchange between two computers without a substantial intervening server. Accounts of peer-to-peer have focused on the threat to traditional media and entertainment business models, especially in the music business. But the technology could provide an entirely new way for consumers, marketers and retailers to come together. The consumer's shopping list becomes a request for coupons and promotional offers that marketers and retailers then match and provide directly off of their computers. The many uses of peer-to-peer computing are still evolving, but large companies such as Bertelsmann and Intel have made important investments to understand and develop peer-to-peer business models that may impact the way consumers, marketers and retailers use coupons and promotional offers.

Additionally, wireless technology promises the next major step in interactive marketing. According to research company IDC, there were 3.6 million individuals in the U.S. with Web-enabled wireless devices in 1999. These mobile services are expected to grow exponentially over the next few years, reaching as many as 40 million by 2003. While somewhat cumbersome today, the advent of new wireless standards — the 3G, third generation services — will bring broadband “always-on” access to mobile devices throughout the U.S. Many of these mobile services will debut in Japan early next year and will roll out quickly afterward in Europe followed by the U.S. In addition to speed, the 3G services will provide location-based and “wallet” services. These two features will add new dimensions to marketers' promotions.

Peer-to-peer technology could provide an entirely new way for consumers, marketers and retailers to come together.

In 3G wireless services, the provider and its marketing partners will be able to pinpoint the location of an individual mobile device. Marketers armed with this additional information will be able to design promotions that take advantage of the impulse buy. A consumer driving toward a local gas station during off-peak hours could receive a wireless coupon for 10 cents off a gallon of gas. This e-coupon could be stored on the wireless device as a small XML document that contains encrypted information detailing the terms of the offer. The e-coupon could only be used by the intended recipient, and would include the ability to “expire in the next 30 minutes.” The gas station manages its capacity and the consumer gets a discount. Spending on these services as well as other opt-in e-mail and push advertisements by one estimate will reach \$16 billion in 2005.⁵

Finally, wireless devices with increased memory and interactive functionality will be able to function as an electronic wallet. This feature allows consumers to dial a number, enter a pass code and charge items to their cell phone. For example, a consumer checking out of the grocery store will be able to transmit a payment from their mobile phone.

Simple forms of these features already have been deployed in Scandinavia and Central Europe, where mobile phone users can pay for vending machine purchases by dialing a couple of numbers on their mobile phone. The potential uses of high-speed, wireless services are just beginning to be identified. As they are deployed in Japan and Europe, you can be sure that astute marketers will be looking for new promotional opportunities.

Point of View and Strategic Implications

The forces of change will drive couponing, including FCSI's, to non-core newspaper channels. Manufacturers are experimenting with new technologies, from online and wireless to ATM's to reach customers more efficiently. Marketers and retailers are searching for ways to reduce the complexity and cost of distribution and reimbursement of traditional paper coupons. Consumers clearly like and use

coupons, but dislike the searching, clipping and storage, all of which can be simplified via non-traditional channels.

How long will it take for electronic couponing to have a meaningful impact on the FSCI business? On the consumer side, the timing will be driven by the penetration and use of online and wireless devices. Once these become pervasive, marketers will be able to reach large audiences electronically. From the retailer and manufacturer perspective, the timing will also be driven by the availability of in-store technology to facilitate electronic clearing of coupons. These steps could extend the life of print coupons by reducing the cost and increasing the effectiveness of a print coupon, as well as enhance the use of electronic coupons. Taken together, we believe it will be five to seven years before we see a major shift away from FSCI couponing, given the current rate of acceptance of these technologies.

What does this mean to newspapers? On the defensive side, the revenue stream of \$600 million to the print business is relatively safe near term. Newspapers, however, should be cautious in their forecasted FSCI revenues to cover investments in post press operations.

Online and other technologies will also offer new opportunities for newspapers. For consumers who value convenience, the Sunday coupon package has become the one-stop source for manufacturers' coupons and sales circulars. To date, no national or network of local online sites has developed a one-stop reputation. According to a 1999 NPD Group study, of those consumers using online coupons, most found them through general browsing or pointer ads, as shown in Illustration G. Locally driven newspaper Web sites still have the opportunity to continue their traditional role online. If local Web site operations can establish themselves as the source for local savings, the presence of a rich set of online consumer promotions will provide an important benefit to bring users to the site for savings, as well as news and other local information. The use of e-mail for personalized coupons and messages is emerging as more powerful than banner ads. A second opportunity for local online players to consider is harnessing this technology for advertisers for the local market.



Online clearly opens the competitive floodgates and threatens the traditional newspaper's revenue from distribution products, but the competition has just begun. Local Web sites can still capture a significant role in the online promotions and couponing market.

Managing the threat to print while simultaneously cultivating the online opportunity will require careful planning and execution of consumer, advertiser and capital planning strategies. Shifting revenues, shifting consumers and increased competition will make the future of promotions difficult to forecast with certainty. But print response should not be ignored. As newspapers evolve to offer household-specific delivery products, it can attract some of the monies being invested in experiments with more targeted coupons. The desire for more information on consumers and their behavior pose a challenge to local databases. The key challenge: how the online information can be integrated with offline data in a privacy-sensitive, but sound, approach.

Newspaper companies and their local Web sites need to stay abreast proactively of developments in couponing and online promotions. Here are a few hot spots to watch for trends, threats and opportunities.

1. Watch your traditional local competition, TV and radio. They have the sales forces to sell local promotions and coupons and the Web sites to distribute them.
2. Monitor volume and potential competitive threats from coupon and preprint aggregators such as Valassis and News America Marketing. They have relationships with national marketers and regional retailers. They have invested in online technology, but they have not yet been able to create an audience for their coupon sites.
3. Make sure your Web sites are developing online promotional capabilities and have the sales talent and resources to sell them.
4. Distribution products will be around for a long time, but the growth rate will be more moderate. When calculating the ROI on new packaging equipment, do not assume that future volume will reflect past trends. Chances are it will not.
5. Prepare for wireless. If there is another digital revolution coming, it will be in here. Keep an eye on Japan and Europe for innovations that may apply to the U.S. in the future.
6. Keep abreast of new technologies such as peer-to-peer, because new business models will continue to emerge.

Emerging online promotional models will put pressure on newspapers and their Web sites to innovate. While there is no need to panic now, a careful eye on trends in consumer, retailer and marketer needs and behavior will keep newspapers out in front of developments in online couponing and promotions.

Footnotes

1. Advertising Age, "FSI's Build on Niche," May 8, 2000.
2. Editor and Publisher, "Repackaging the Packaging Center," August 21, 2000.
3. American Demographics, "Cereal Drama," July/August 1996.
4. The Industry Standard, "The High Cost of Name-Your-Own-Price," February 14, 2000.
5. WiredNews, "Consumer Coupons Going Mobile," July 19, 2000

Digital Links

Bertelsmann	http://www.bertelsmann.com
Catalina Marketing	http://www.catmktg.com
CNET Networks Inc.	http://www.cnet.com
Food Marketing Institute	http://www.fmi.org
Forrester Research	http://www.forrester.com
Gnutella	http://gnutella.wego.com
The Industry Standard	http://www.thestandard.net
International Data Corp.	http://www.idc.com
Intel	http://www.intel.com
MySimon.com	http://www.mysimon.com
Napster	http://www.napster.com
News America Marketing	http://www.newsamerica.com
NPD Group	http://www.npd.com
Promo Magazine	http://www.promomagazine.com
Priceline.com	http://www.priceline.com
Sports Authority	http://www.sportsauthority.com
Treasure Chest Advertising	http://tcadvertising.com
Valassis	http://www.valassis.com/

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