

A woman in a dark business suit is shown from the chest up, looking down and counting several US dollar bills. She is holding a stack of money in her hands. The background is slightly blurred, showing what appears to be a retail or office setting with some yellow flowers.

INSIGHTS

Turning Unrestrained Trade Promotion Spending Into Profitability

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Executive Summary

Trade Promotion Spending continues to dominate the Consumer Products Industry as manufacturers spend out of control on marketing efforts with few tangible ways to measure the benefits of this spend. Trade Promotion Spending comprises well over 50% of consumer goods manufacturers' marketing budgets, and an average of 13% of manufacturers' total sales, yet only a small portion of those trade dollars delivers a profit.¹ Similarly, only a small portion of retailers—the recipients of trade promotion dollars—perceive tangible benefits from this spending. Manufacturers and retailers are well aware of this problem. According to an AC Nielsen survey in 2000, 98% of manufacturers and 95% of retailers ranked promotion efficiency and effectiveness as a critical issue.² Despite these ominous findings, consumer product manufacturers still funnel billions of trade promotion dollars to demanding 800-pound retail partners. And there appears to be no end in sight to this trade spending. According to a Cannondale Associates survey, Trade Promotion Spending has increased 33% in the past 5 years.³ Without significant change, the spending cycle appears destined to continue its steep incline.

And significant change is necessary. It is essential that manufacturers regain control of this spending problem by targeting valuable Trade Promotion Dollars at the right

customers. This means that manufacturers must understand who their most profitable customers (retailers, distributors, and in some cases, direct consumers) are, tailor Trade Promotion Programs around retaining and growing their most profitable and most potentially profitable customers, and measure Trade Promotion effectiveness around customer profitability metrics. This article is going to delve into the current issues preventing successful Trade Promotion Management, and then discuss how changing spending habits, based on customer profitability and measuring Trade Promotion effectiveness, can radically change Trade Promotion Spending for the better.

The Current Problem

It's important to first review some background information regarding Trade Promotion Spending, and how this money is spent. Manufacturers allocate Trade Promotion dollars to their retail partners to improve their own competitive positioning through tactics such as temporary price reductions (coupons, two-for-one deals, and consumer rebates) and stronger in-store brand presence (special end-of-aisle displays and premium shelf positioning). Additionally, manufacturers leverage Trade Promotion dollars to build a stronger retail partnership by offering friendly payment terms, off invoice allowances, and rebates.

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Trade Promotion affects all aspects of the value chain between the manufacturer and the retailer, which translates into tremendous annual costs. According to one study on Trade Promotion, the Total Annual Costs amount to approximately \$30–33 Billion in the grocery channel alone.⁴ This staggering cost is comprised of \$25 billion on Trade Promotion (the number two P&L item, second only to cost of goods), and another \$6 billion on inefficiencies due to supply chain volatility resulting from Trade Promotions.

And yes, manufacturers do receive some benefits from Trade Promotion. According to IRI, 15% of total volume for promoted categories is incremental (volume above the baseline average generated by the price reductions, two-for-one deals, ads, etc.), but this percentage translates into incremental sales, not increased profits.⁵

Because retailers rely heavily on Trade Promotion Dollars, they have become quite savvy on (legally) taking advantage of the system. Retailers profit from end-of-month price reductions from manufacturers by buying additional quantities for future months. This is a clear example of a manufacturer measuring success by an incorrect metric (volume). Retailers, in turn, build infrastructure (additional warehouses, labor, transportation) to accommodate for the volume surge and uncertain future demand, which accounts for additional costs and increased inefficiencies.

Some retailers are really taking advantage of Trade Promotion Dollars. According to a Cannondale Associates survey, 17% of Trade Promotion Dollars contribute to the retailer's bottom line,⁶ which means that manufacturers are spending billions of dollars to retailers for the relationship alone. Though seemingly inexplicable, this may occur because the balance of power is firmly entrenched with a few large retailers (the six largest supermarket retailers control over 50% of U.S. food spending⁷) who happen to control shelf space, and because manufacturers feel the need to remain competitive in the eyes of these giants. Its legality continues to be brought into question; executives at General Mills, Coca-Cola, and several other companies are under investigation by the Securities and Exchange Commission for using Trade Promotion Dollars to illegally pay their customers (retailers and distributors) to order more than they really need.

Theoretically, the end result of Trade Promotion Dollars is to build consumer loyalty for the retailer, and brand loyalty for the manufacturer. However, when manufacturers and retailers celebrate over the news that 59% of trade spend is passed through to the consumer—meaning that the consumer directly benefits through price discounts—loyalty is typically a casualty. A loyalty “program” consisting of only brand price discounts will risk alienating a consumer once the manufacturer or retailer removes the price discount. In other words, the con-

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sumer will likely defect to another competitive brand that is offering price discounts, therefore it's a no-win situation.

Solution: Focus Spending on Profitable Customers

The concept is not difficult to comprehend—common sense should dictate that throwing money at a problem (yes, unprofitable retailers are a problem) is not going to provide a solution (i.e., yielding profit). But to alleviate this problem, manufacturers must be able to determine who their most profitable retailers are, as well as customers who have the potential for profitability. It's crucial to note that the sales, foot traffic, or volume (i.e., number of cases moved) that a retailer generates is a less significant metric than a retailers' profitability. Understanding who is profitable and who is not—and why—enables a manufacturer to make financially-rooted, fact-based decisions on which retailers a manufacturer should truly invest in to collaboratively strengthen the consumer-manufacturer-retailer relationship. Retailer profitability metrics also allow a manufacturer to further investigate why a customer is not profitable, and what needs to be rectified to make the retailer profitable. And lastly, hopelessly unprofitable and high maintenance retailers (the heart of the problem) can be jettisoned from a manufacturer's Trade Promotion program.

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To truly measure customer profitability, manufacturers must measure the costs incurred by a retailer. The costs resulting from Trade Promotions is the first and most obvious place to incorporate Cost-to-Serve metrics. This requires a manufacturer to break down each retailer interaction to determine the return on investment (ROI) from the interaction, thereby revealing unprofitable interactions, and ultimately enabling a manufacturer to provide remedies to repair the interaction.

Customer Loyalty Equals Profitability

According to Frederick Reicheld, noted author, if a company increases customer retention by 5%, this can result in a "possible profit increase by as much as 50 to 100 percent."⁸ Additionally, Reicheld lays out in statistical detail that acquiring a new customer can cost 5–7 times more than retaining a customer. With these facts in hand, why does a manufacturer spend billions of dollars on Trade Promotion to acquire its customers? In the world of consumer products, customers are the retailers, as well as the end consumer. The retailer's goal is to build a relationship with consumers so that consumers return to the store, and continue to spend at that store. The goal of the manufacturer is to compel that consumer to buy its brands at that store by building a consumer-brand relationship. In-

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stead, a majority of trade promotion spending entices customers through coupons, discounts, and rebates—tactics which are typically reserved for customer acquisition, and most certainly reduce profitability. However, any customer (retailer or end consumer) who demands subsidies of their purchases through coupons, discounts, and rebates is an unprofitable—and undesirable—customer.

Refocusing trade promotion spending on retaining existing consumers through targeted loyalty programs, rather than simply acquiring customers through price reductions and eye-catching store displays, would completely revamp the manufacturer-retailer relationship. Manufacturers and retailers would be forced to collaborate in order to achieve both store and brand loyalty. Examples of this joint collaboration are Collaborative Planning, Forecasting and Replenishment (CPFR) and co-marketing strategies. Both the manufacturer and retailer would share the promotional costs involved with attracting consumers to buy the manufacturer's brand in the retailer's store. With both of these examples, manufacturers and retailers are jointly focusing resources toward a common loyalty goal.

Instead of blindly throwing Trade Promotion dollars to retailers in the hopes that consumers will buy their brand, targeted promotional dollars should be used to reward the most profitable consumers who continue to buy their brand, and grow their profitability by introducing cross-selling and up-selling promotions. Targeted in-store advertisements aimed at a manufacturer's Most Valuable Customers or targeted discounts (discounts that encourage up-selling and cross-selling allow a manufacturer to reward and simultaneously grow a profitable customer) given only to a manufacturer's Most Valuable Customers are controlled, measurable, and effective ways of spending Trade Promotion dollars on a retailer.

Measuring Trade Promotion Spending Effectiveness

Even with a sound loyalty strategy that targets retaining and growing profitable retailers and end consumers, Trade Promotion spending can only be controlled by measuring the efficacy of a trade promotion. If the Trade Promotion is not working, then fix it or scrap it. If it is working, use it as a model for future promotions.

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Establishing the infrastructure for measuring Trade Promotion effectiveness starts at the very top of an organization and requires tremendous resources, but the benefits are immediate and immense. The penultimate example of a program that measures Trade

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Promotion effectiveness is Anheuser-Busch's Budnet program. Budnet is a data network driven by Anheuser-Busch and its 700 distributors (Anheuser-Busch's customer), where the distributor's sales reps and drivers serve as the eyes and ears of Anheuser-Busch by tracking sales, shelf stocks, and in-store displays of the thousands of stores that sell Anheuser-Busch brands. All of this data, which is reported back to Anheuser-Busch, allows Anheuser-Busch to tailor Trade Promotion campaigns based on the data collected, and immediately determine the efficacy of that Trade Promotion. By crossing the collected data with demographics data from AC Nielsen and the U.S. Census, Anheuser-Busch is able to determine which product will garner the most sales, and what type of promotion will work most effectively based on the combined demographic and store data. Because of Budnet, Anheuser-Busch has enjoyed increased market share while its competitors struggle to maintain their positioning.

Conclusion

Trade Promotion Spending is clearly an issue that is high on the list of every consumer products manufacturer. While Trade Promotion Spending is currently out of control, targeting spending dollars on profitable retailers and end consumers can curb the spending habit. Through loyalty programs, a manufacturer's most profitable (and most potentially profitable) customers can be rewarded, while targeted promotions can grow these customer profits even further. Lastly, combining a loyalty strategy with a program that measures Trade Promotion effectiveness will transform the relationship between manufacturer and retailer into a more collaborative partnership.

Notes

1. "The Daunting Dilemma of Trade Promotion," Accenture, 2001.
2. AC Nielsen, Tenth Survey of Trade Promotion Practices, 2000.
3. 1999 Trade Promotion Spending Survey, Cannondale Associates, 2000.
4. "The Daunting Dilemma of Trade Promotion."
5. Ibid.
6. 1999 Trade Promotion Spending Survey.
7. "Food Companies Quietly Give \$100 Bn Cash To US Retailers," *Minneapolis Star Tribune*, 2004.
8. Reicheld, Frederick F. and Thomas Teal. *The Loyalty Effect: The Hidden Force Behind Growth, Profits, and Lasting Value*. Harvard Business School Press, 1996.

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