A Tale of Two Outcomes for Food Manufacturers

Trade Promotion Spend...Working Dollars or Lost Ones?

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Trending shows that Americans are tightening belts, looking for "deals," and the best value for every precious dollar spent.

"It was the best of times, it was the worst of times". This single quote couldn't be a better description for the consumer goods landscape. Just as in robust economic times, in rough economic times there are always winners and losers. In a recent article, "Who's Winning - and Losing - in the Food Recession"[1], there is a clear consumer spending pattern these days.

Up	Down	Stable
Sandwich materials "sweet spreads"	Fine dining	Pet foods
Instant food	Organic food	(need to add)
Coffee	Coffee houses	
Salty snacks	Movie theater concessions	
Butter, margarine, oil	Bakeries	

The trending is a clear indicator that Americans are tightening their belts, looking for "deals," and seeking the best value for the every dollar spent. People are cutting back on spending, spending more time at home, and buying more products based on discounts and promotions. All of these factors make the planning, forecasting, executing and analyzing of trade promotion spend ever more crucial. This is true regardless if this is the best of times or the worst of times for your products. If it is the best of times you need to be in a position to take full advantage of the situation; and if it is the worst of times you need to be in a position to win where you can and to maximize the use your trade promotion spend to hold on to every precious consumer. More than ever, manufacturers must ensure that they get tangible benefits from each dollar spent on trade promotions and ensure that they are not exacerbating existing issues, such as stock-outs during promotional periods.

Even during the best of times, spending on trade promotion has a large impact on our profit and loss - in the form of gross sales created and the associated expense. However, an average of 39% of trade promotion spend is completely ineffective in creating "lift" in consumer spend. Does this average indicate that this spend is often looked at as a necessary evil rather than a strategic spend that provides top-line growth? True optimization of trade promotion spend will drive growth, will create demand, will improve insight on your customers and consumers and will allow for improved forecast accuracy. When this happens, the entire organization benefits!

1. The following are key ways of ensuring good trade promotion spend:

Trim the Bottom 1% and Fuel the Best Performing Promotions

Imagine if you could take the funds spent on the most ineffective promotions - the bottom 1% - and spend that money on promotions that performed better - even if they only performed at an average promotional ROI of the organization. When optimizing trade promotion spend,

[1] Anne C. Lynn, "Who's Winning - Losing - in the Food Recession", FastCompany.com, http://www.fastcompany.com/blog/anne-lee/green-room/recession-proof-foods

you identify the lowest performing promotions and begin to refocus that "wasted" spend into "more meaningful" value for your dollar.

Day-in-the-Life Approach:

For example, during each planning cycle the manufacturer reviews all promotions for the last executed cycle. This review requires each promotion to have a forecasted and actual base volume, as well as incremental volume with promotional ROI calculated based on those volumes. During the review, the ROI of each promotion is calculated and ranked. Using this ranking, t**he bottom 1% of promotions is identified** and **the remaining 99% of the promotions' ROI is averaged**. As promotion development begins for the next planning cycle, new promotions that are identical or have significant similarities to the bottom 1% are not approved. Instead, this savings is redirected to the approval of promotions that are identical or similar to those promotions that meet the average promotional ROI for the organization.

While this appears to be a straight-forward and simplistic approach, it is astonishing how many manufacturers do not have the processes or proper data to accurately assess the bottom 1% in order to redirect that spend.

The Bottom-Line Business Benefit?

To demonstrate the impact of this approach, assume a company generating $500 million in sales spends between $75 million and $125 million on trade spend. If this company runs an average of 1,000 promotions per year, this method would mean redirecting anywhere from $750,000 to $1.25 million in trade spend to better performing promotions. In today's market this is not a small amount of money and given that the money will be reallocated to promotions with stronger promotional ROIs, the result should yield measurable top-line growth. It's a compelling initiative.

2. Get a More Accurate Sales Forecast, The First Time

What would it be like if your organization could get a better sales forecast the first time out? Companies struggle with developing sales forecasts that provide proper insight, for the demand and supply planning processes, into the forecasted base and incremental volumes to be created by promotions. Organizations often spend extra time in validating or adjusting sales forecasts and there are some demand planners that have no faith in sales forecasts at all. While improving sales forecasts may only seem to improve other functional processes, the best practice of doing so intrinsically optimizes your trade promotions. Potentially the greatest improvement is through the use of statistical models in the development of sales forecasts. Incorporating statistical models into the sales forecasting process will provide base and incremental volumes based on the entry of promotions and their associated customers and products. These statistical models and process provide quantifiable support to the experience and knowledge of the sales team; create better data for key planning processes that impact production and logistics; and limit the number of revisions and questions in the forecast process itself. In essence, it saves time and money spent on rationalizing the sales forecast.

In the end, this improvement in trade promotion development and modeling generates visibility for production planning and scheduling requirements for planned promotional volumes, which ultimately, improves visibility and drives lower out-of-stocks during important promotion periods. Thus, the emphasis and focus is on peak revenue periods and on the efficient use of working capital through proper management of inventory levels.

Day-in-the-Life Approach:

Many manufacturers still develop sales volume forecasts and promotional plans via separate processes, data and technologies. In this new approach each planning cycle contains a single process, data and technology to accomplish both the sales volume forecast and promotional plan. Based on the promotions entered by the sales team a statistical engine provides the initial forecasted base and incremental volumes that become the sales volume forecast.

Step 1: Teams review product base volume by customer as generated from statistical forecasting models, and make adjustments if market factors have changed in any way.

Step 2: They then begin developing promotions. Incremental volumes are provided to them based on timing, products, price points, and tactics. The combination of this statistical base and incremental volume is the sales forecast. Since the sales forecast is based on statistical models and experience instead of gut, intuition or "hope" alone; **there is quantifiable support for the forecast**.

This approach reduces the number of revisions needed in the forecasts that impact demand, supply, and S&OP and drives greater visibility, providing improved inventory levels and lower out-of-stocks during promotional periods.

The Bottom-Line Business Benefit

In addition to the savings achieved from reduced process cycles on refining forecasts, an organization carrying $100 million in inventory that realizes a 1% improvement in forecast accuracy will generally free up $1M of working capital. Industry standard states that 1% forecast accuracy equals 1% of inventory reduction; up to 80% accuracy and then a diminishing percentage afterward. **$1 million in working capital would be available for more strategic spend. $1 million in working capital!**

In a recessionary market where credit is tight and revenues are down, the ability to better manage cash reserves becomes even more critical. How much money do have tied up in unnecessary spend like this? Do you even know? Does anyone?

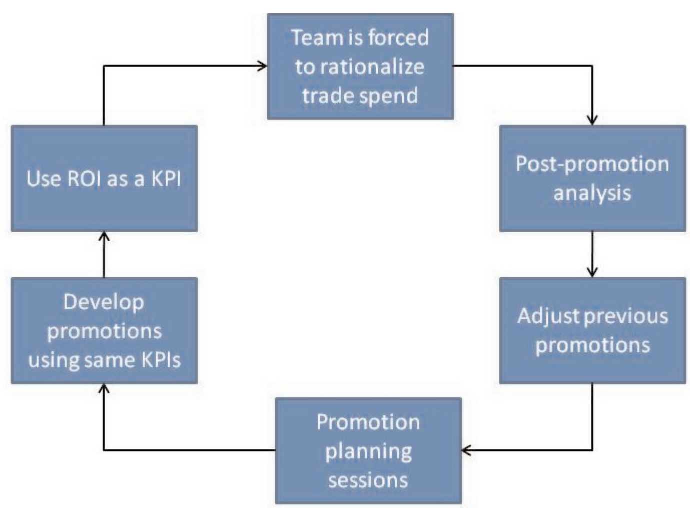
3. Information is Power

A common attitude in trade marketing and sales is that customers simply get the promotions they want and they dictate terms to the manufacturers. "The customers have all the power." Like most myths, there is some truth in that belief. **In reality, customers have all the power because they have better data and analysis than what is being presented to them. There is a lack of information, analysis, and ultimately quantifiable "proof" to support the benefits of alternative trade promotions.**

A core principle of optimizing trade promotions is to provide organizations the ability to demonstrate quantifiable proof of what promotions have the best impact. This support combined with consumer insights allows the manufacturer to create more compelling win/win/win scenarios for the manufacturer, the customer and the consumer.

Day-in-the-Life Approach:

As an example, all promotions should be developed using a standard set of KPIs to evaluate effectiveness. Specifically, the promotion components and KPIs not only include the standard total volume, start and end dates, and products and tactics; but also base and incremental volume, promotional ROI, manufacturer profit, customer profit, and category effect. By incorporating these additional KPIs, the team is



forced to rationalize trade spend up front from both the manufacturer and customer perspectives.

With the proper planning, you are now able to enter into planning and review sessions with the customer to evaluate both recent and future promotions. The reviews are conducted using the results of the KPIs that were established during the creation of the promotion including promotional ROI, manufacturer and customer profit and category effect. Pre- and post-promotion analysis force both, the manufacturer and the customer, to rationalize re-use of past poor performing promotions and/or underperforming new promotions. This continual review closes the loop on post-promotion analysis, planning, promotional modeling, and pre-promotion evaluation.

As a part of the review process the manufacturer and customer can assess underperforming promotions through modeling and **"what-if"** analysis and determine the feasibility of making changes in order to run the promotion again or to not run the promotion again. In instances where the promotion did not hit price, ad or display performance targets, you can apply the same tools and KPIs that the manufacturer used in the creation of the promotion to demonstrate to the customer **what** the impact would have been if the targets were met. Further, the manufacturer is now able to also model the effect that any changes would have on future promotions.

All of this pre- and post-promotion analysis and modeling provides the quantitative data and insight to support the manufacturer's position and suggested promotions. This provides both the manufacturer and retailer improved promotional performance and encourages better collaboration; ultimately putting some of the power back in your hands because you now have better data and analysis to offer.

The Bottom-Line Business Benefit

The ability to work in sync with a customer provides boundless opportunity in any market condition. Moreover, these steps provide the tools to rationalize underperforming promotions, past or future, and the basis to redistribute that money - just as you did in **making better use of the bottom 1% of promotions**. The bottom line is ultimately to maximize the use of your trade promotion spend.

- Trim the bottom 1% and fuel better performing promotions
  - Analyze the average ROI of 99% of the promotions and isolate the bottom 1%
  - Create criteria that drive the approval process to ensure that the bottom 1% is not repeated

- Establish a continuous improvement mindset around the bottom 1%, establishing this processes as ongoing, and not a onetime "project"

▶ Get a more accurate sales forecast, the first time

- Integrate traditional sales forecasting and volume sales forecasting with promotional development and modeling. The forecast is then based on statistical models and not just intuition and experience alone, providing quantifiable support to the forecast.

- This impacts the performance of your plan, source, make, and deliver processes.

▶ Information is power

- Providing customers with quantifiable information, analysis, and proof of performance beyond traditional high-level measures is powerful. This facilitates collaborative decision-making and changes on future promotions based on quantifiable analysis.

- It shifts the power based on facts

Ultimately, the best of times and the worst of times are opportunities for change and growth. Use this time to "tighten up" trade spend...shake off the old attitudes and grab the opportunity NOW, so when the market picks up, you are truly ready to capitalize on it.

As indicated in the Wall Street Journal the article, "*Food Firms Cook Up Ways to Combat Rare Sales Slump,"* In the last quarter of 2008, consumer spending on food fell by an inflation-adjusted 3.7% from the previous quarter - it's the steepest drop in 62 years, the commerce department said. So food giants are racing to adapt to what they believe is a lasting shift in eating and sleeping habits."

How has your organization responded? Time is of the essence... the question is not if you can afford to change...can you afford not to?

To learn more, contact the supply chain specialists at Spinnaker
Call **877-476-0576** or visit
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About the Author

Blake Watts is the practice director of Spinnaker's Trade Promotion Optimization practice. He has more than a decade of experience working with CPG and food and beverage companies with much of that time dedicated to trade promotion optimization and pricing effectiveness. An active member of the Trade Promotion Management Association (TPMA), Blake has contributed to the development of over 50 best practices and a maturity assessment approach that effectively identifies opportunities for trade promotion optimization and savings. Blake is considered a "hands-on" industry expert in maximizing trade spend.