Taming the leviathan: how to control trade expenditures
Aidan Bocci

Trade spend is the single biggest issue affecting consumer goods marketers. In the UK, the grocery market has condensed to such a level that just a few key players dictate ever tougher terms to their suppliers. Because of this, the long-term prognosis for the fmcg sector is not good, as suppliers are forced to invest in their customers and not in their brands, and this will eventually lead to an erosion of those brands.

Retail giants, such as Tesco, now account for around 30% to 40% of suppliers' retail business, which is leaving brands with little alternative but to take their trade terms, as they have no other route to mass markets. The reality is that many companies believe they have no way of solving this problem, and trade spend is now often the single biggest cost for most fmcg manufacturers, making up between 15% and 40% of their total cost base - more than raw materials or people.

In the UK, trade spend has been the focus of the Competition Commission, which four years ago established a code of practice for fair trade terms. Sadly, this code was fairly woolly, and the Commission has recently appointed an ombudsman to review it and take a fresh look at the sector. There are similar legal battles going on around Europe, but the sector looks set to be muddied further by the introduction of EU laws that do little to protect smaller retailers.

In France there is currently legislation that stops big retailers selling certain products below cost price, which is part of the government's policy to help smaller shop owners. In fact, supermarkets in France have been able to advertise only on TV since this year, and this is only because the laws have had to be relaxed under EU rules. Other countries have different kinds of protection: in Germany, for example, certain suppliers were prosecuted recently for collusion on pricing, which is similar to what happened in the UK over dairy suppliers.

Suppliers have also been hit by the credit crunch, as retailers are approaching them and demanding more discounts, and some retailers have used the threat of reducing supplier numbers to drive discounts further. This, combined with the rising cost of raw materials, means trade spend is becoming a much bigger issue.

The current state of trade spend is leading to an erosion in the confidence of manufacturers to deliver on their own objectives in the face of the power of retail giants. Companies are worried that if they try to tackle this issue with the big chains they will simply get de-listed. So, they are continuing to increase their trade spend, thereby delivering on their customers' objectives, but not their own. Most manufacturers seem to have forgotten why they spend money with the trade - to deliver on their own objectives before anything else.

Customers should not be seen as an objective: they are a constraint, and brand owners need to deliver on their own objectives before they are dragged into delivering on anyone else's. Manufacturers need to be clear about their own objectives and concentrate their own efforts on getting their needs met within the confines of satisfying their customers. By kowtowing to retailers' whims without respect for their own needs, suppliers are simply giving money away, instead of investing in the future of their brands.

Using retailers' global power to your advantage

Part of the problem lies in suppliers' perceptions of what they should be doing: the majority try to limit the damage that retailers can cause, and to negotiate their way to lower numbers. In fact, what they should be looking at is what opportunities there are in the relationships. Companies need to be clear what their objectives are. It's not necessarily all about shifting units in the short term. For example, if a trade promotion is just shifting units but not getting any new trials, and that was a key aim of the campaign, it does nothing more than allow

existing brand users to get a good deal. It doesn't create new advocates or bring new people into the brand.

Huge opportunities exist within trade spend to build the brand and the best -most successful - suppliers work out ways of exploiting or leveraging the strengths different retailers have in different places and work that through in a coordinated way across their territories. Indeed, with the majority of the big retailers operating on an international basis, suppliers have the opportunity to create deals and partnerships to build their brands across different territories. The rationale is: 'I'm number one brand in this country, but only number two and three in these other territories; by packaging a deal for one of the big retailers I can boost my presence in these territories'. They are still going to have to pay out some money, but they get a good deal in return and fulfil their own objectives.

The concept that we try to get suppliers to understand is that retailers think of them as banks. Their objective is to find asmany keys as possible to open as many doors and avenues as possible in those banks, so that they can withdraw money. They are always trying different ways to get money from 'clients'. One French retailer allegedly has a list of 400 different routes to getting money from suppliers. This is an extreme, but we have a list of 80 ways retailers try to unlock the cash reserves available among their suppliers; these include promotional allowance, listing allowance, de-listing allowance (you get charged if your product is de-listed) and a subsequent re-listing allowance (if they decide to have you back).

By unlocking these avenues to their suppliers' wallets, retailers get themselves a licence to print money. Suppliers in turn need to be wise to this and avoid reverting to what amounts to commercial slavery. Companies that want to create and retain value in their brands have got to keep innovating and coming up with ideas; OK, some will fail, but brands can't trade on past glories - they have to keep moving forward. Suppliers that get the best results from retailers are the ones that work cooperatively and don't let themselves get bullied, while spending their money on consumer promotion and innovation.

Sadly, for most companies the temptation is to give in to the retailers and give them the money, rather than investing it in their brands, because they can generate more direct sales by giving Tesco the money than buying extra TV spots. However, if this is their only focus, their brands will become weaker and weaker, and the retailer will eventually de-list them. It works exactly the same on an international level; it's just a more complex process with bigger prizes and bigger pitfalls.

Highlighting areas for improvement

So how can companies make sure they aren't bullied into submission by retailers? First, they need to look at what they are spending, what their profit is and how and where they are going to spend. From this they can determine how they are going to cut - or at least actively manage -their trade spend. By working through their objectives, brand owners will start to build a picture of where cuts can occur. There are four key areas that brands need to concentrate on to get the balance right: fund allocation; promotions; pricing; and terms.

Fund allocation

Brand owners need to define the optimal way of assigning resources and funds across geographies, customers and categories by understanding brand priorities, trade priorities, segmenting the customer base and clarifying customer strategies. To do this, some targeted analysis can be carried out on available data to understand where the bulk of trade investment is being spent and identify trends. It is important to understand if money is being spent in the appropriate proportions to grow the right brands and the right customers. We created an investment vs share matrix to help brand owners answer some basic questions:

Low Share/High Investment: 'Can investment be reduced without affecting share?'

High Share/High Investment: 'Can share be maintained with less investment?'

Low Share/Low Investment: 'How can share be increased?'

High Share/Low Investment: 'Are there opportunities to optimise?'

Promotion

The areas brands need to focus on here include: reallocating promotion budgets based on brand and customer strategies; cutting ineffective promotional activities; and improving ROI on agreed promotions. ROI is typically measured over the short term and is not a true indicator of profit. As a result it's more important to establish whether or not the activity is delivering the brand objectives (a truer view of profits) and is aligned to the customer strategy. We have developed significant unique intellectual property to help organisations break the short-term analysis habit, and consider promotional effectiveness in a more strategic context.

We find that, on trade investment, 'the answer lies within'. Essentially, although the board of a company sets budgets and objectives, it's down to individual brand managers to spend the money and execute on the objectives, setting their own personal promotions. It's the job of the board to control this spend at the macro level, but on the ground, brand managers know the market and can see where decisions are to be made. What boards need to do is empower these people to make their own informed decisions, but they need to be assured that this is being done as well as possible. This requires training on how we make decisions as a group.

Pricing

In looking at pricing, companies need to clarify the rationale behind current pricing and terms, and determine logical and defensible pricing architectures across brands and for stock-keeping units (SKUs) within a brand. Brands need to ask themselves: are we exposed to significant risk, and how do we make our pricing more defensible? If people within the company are concerned about pricing defensibility, it is important to model pricing across customers and relativities between brands to identify where current pricing is not aligned to your trading strategy. The overall decision process for the development of a defensible .pricing and terms structure consists of three sections, as follows. Determine the 'anchor point' - identify the market, establish internal minimum and external maximum prices, and define the base list price for the 'anchor' SKU. Calculate base list price relativities within the brand - model the relativities between SKUs within a brand using the anchor as a base, and define base price list for the brand.

Calculate pricing and terms across customers - determine the level of investment required for the brand to reach its objectives, identify the behaviours to reward in return for the investment and attribute discounts to each potential customer behaviour.

Terms

To establish an appropriate terms approach to encourage and reward desirable customer behaviours in alignment with business goals, companies need to address the following questions. Are we driving the right customer behaviours? And, how do we ensure pay for performance? Defining a terms strategy by customer or channel that would drive the right behaviours will help clearly identify areas where behaviour is not currently linked to performance.

By following this four-step process, companies can gain a greater insight into where they need to make changes in their retail policies. The advice we would give is to straighten out your terms, cut out any thing that's unprofitable and be brave enough to do it. How suppliers handle their relationships with retailers is for the most part in their own hands; but they need to keep creating ideas about how they want to develop the sector, the market or the category they are in, and how that creates value for retailer and the brand.

Just say no

More often than not, retailers are very happy to see people working together and the supplier doing a lot of the work. Admittedly, in some countries this is easier to do than others: for example, in the UK it's quite easy to work cooperatively, whereas it's harder in France because the buyers are generally more brutal. In Germany it's hard to work with retailers in this way because most of them are discounters. Spain lies somewhere between the two. Italy is divided north and south, with the north being more like France and Spain, and the south being very old-fashioned.

In general, suppliers who are more inventive, know what they want to do, can bring something to the party and are good at managing the retail relationship, will, 90% of the time, do better than those who just think that life is terribly unfair. Fifty years ago you'd have had to go tramping round 100,000 stores to get them to take your product; now you just deal with a centralised team, so it's much easier and takes away a huge financial burden, which is now just diverted elsewhere.

But this doesn't mean that you can just do a couple of head office deals and then sit back. It gives you an expensive but clear path to your market. You still have to keep working at it: innovate, manage well, treat relationships as partnerships, have your eyes open, produce imaginative and creative ideas, but most of all, be brave.

Retailers know that if they try to push their suppliers to give them more discounts or deals, about a third will blindly agree, another third will negotiate around it and a third will say 'no' outright - you don't have to be in the third that just agrees with everything.

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