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Capturing the benefit from trade investment

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What it really takes for CPGs to “get the money”

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Executive summary

Consumer packaged goods (CPG) manufacturers have made notable steps to improve the effectiveness of their trade investments over the past several years, yet these efforts have not led to consistently stronger financial performance for most companies. In large part, this is because many of the trade initiatives are piecemeal efforts that lack a central coordinating premise. There are so many emerging options now available — particularly in analytics — that CPG companies try a little bit of everything. As a result, efforts take place at the level of organizational silos, or they rely too heavily on emerging technology without a clear sense of how best to leverage it. In other cases, the company is able to generate analytic insights through a central function, yet those insights are not actionable in the field.

Based on our work with clients, we believe there is a better, more comprehensive approach to improve trade promotion effectiveness. Specifically, this approach entails four key success factors: (1) drive coordinated transformation from the top, (2) set actionable targets tied to incentives, (3) work closely with the field to embed the new capability, and (4) diligently track the value captured.

Implementing this approach is not easy — it requires building a sustained capability and coordinating across multiple functions. However, the results justify the efforts. Our experience shows that a more thoughtful, deliberate, and comprehensive approach can help CPG companies "get the money" from trade promotion — namely, an improvement in trade ROI of 10 to 20 percentage points.

A frustrating lack of results

Consumer packaged goods (CPG) companies have long struggled to improve the effectiveness of their trade promotion spending. For many companies, trade promotion spending yields a negative ROI (*see Exhibit 1, next page*). This is not a new problem, but it is a large one — trade is typically the second biggest line item for a CPG company, after the cost of goods sold. Yet recent efforts to improve the effectiveness of trade spending have largely failed to pay off in quantitative gains that show up on the profit-and-loss statement. In our conversations with executives in the industry, this is a familiar refrain: "We have made significant investments and are trying all kinds of things, but the results never make it to the bottom line."

Why the lack of progress thus far? In part, it's because the trade promotion efforts at many CPG companies are piecemeal initiatives that lack a central coordinating premise or approach. They include the following:

- IT-led system implementations of the latest "bright, shiny objects," such as tools for trade promotion optimization (TPO) or post-event analysis (PEA), without the requisite in-house capabilities

- Individual efforts that bubble up to satisfy specific brand objectives — for example, to combat private-label sales at retailers or to increase trial adoption by consumers

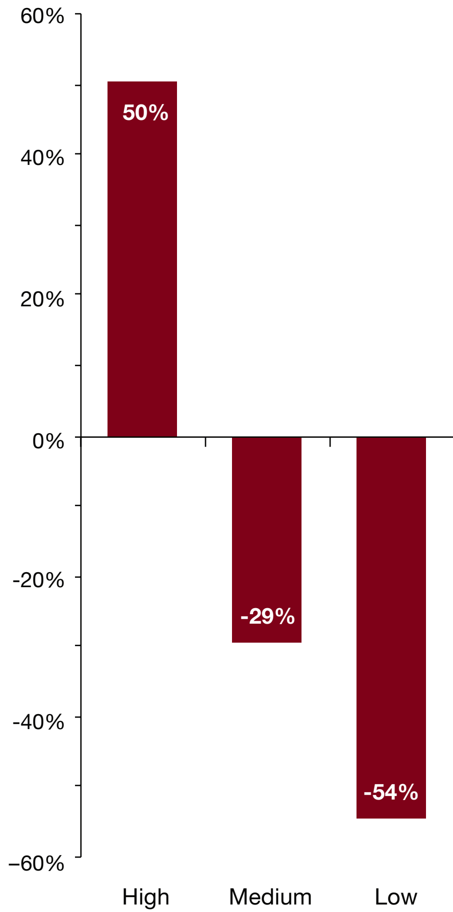
- Analytically driven efforts from centralized groups, such as the revenue management department, which generate trade-related insights that have potential but don't effectively get translated to the field

Based on our work with clients, we believe there is a better, more comprehensive approach to improve trade promotion effectiveness. Specifically, this approach entails four key success factors: (1) drive coordinated transformation from the top, (2) set actionable targets

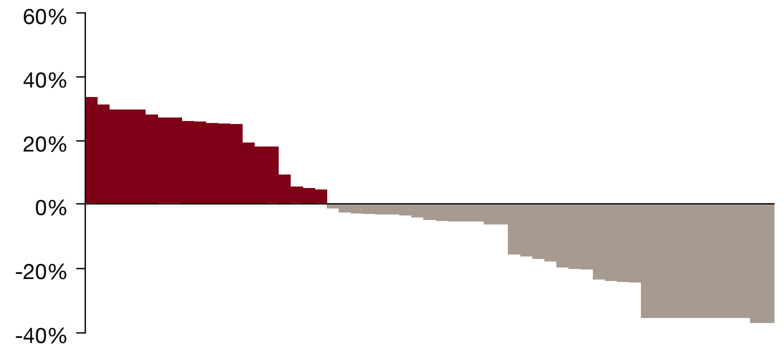
The TPE efforts at many companies are piecemeal initiatives that lack a central coordinating premise.

Exhibit 1
Overall trade promotion ROI at many CPG companies is negative

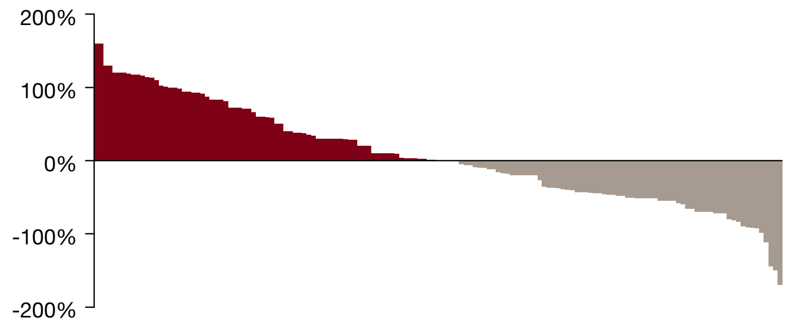
Current average return on trade spending
Return on trade dollars spent



Client A: Global food and beverage company (example)
Event ROI %



Client B: North American packaged foods company (example)
Event ROI %

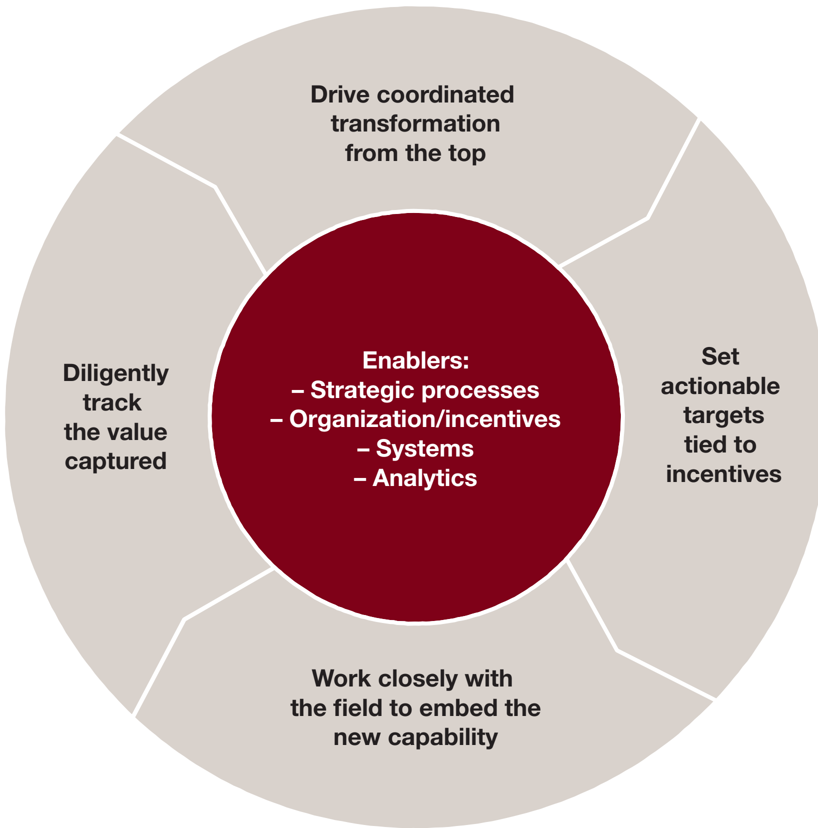


Source: Strategy& analysis

tied to incentives, (3) work closely with the field to embed the new capability, and (4) diligently track the value captured (*see Exhibit 2, next page*).

Putting them into place is not easy; however, we believe that the rewards justify the effort. With careful implementation and follow-through, manufacturers can typically improve their trade ROI by 10 to 20 percentage points. (*For an example of how this approach looks in the real world, see "One company's comprehensive approach pays off," page 19.*)

Exhibit 2
The four-part approach for CPGs to improve trade spending effectiveness



Source: Strategy& analysis

Drive coordinated transformation from the top

A comprehensive approach to improving trade promotion effectiveness — one that can generate real financial impact — starts with the right senior leadership. Typically, such efforts are led by the head of sales, the chief financial officer, or the head of the specific business, as these individuals possess the clout needed to galvanize the organization around a shared objective of improved trade performance.

Scope and time line

In addition to this senior oversight, the company needs to structure the program by identifying the customers and categories that it aims to address, along with a clear time line for working with customer teams. Many companies start by focusing on a subset of customers and categories to demonstrate the potential value and then expand more broadly to cover a greater portion of the business.

Several key factors should be considered when selecting in-scope customers and categories for analysis, including the following:

- **Improvement opportunity:** Customers and categories with significant trade spend and historically poor ROI
- **Availability of data:** Easy access to consumption data (syndicated, point-of-sale), shipment volume data, promotion details (tactics, time frame, price), and master data (prices, cost of goods sold)
- **Capability of sales team:** The ability to grasp key analytical planning concepts, which can help in rolling out the capability more broadly in future phases
- **Diversity of accounts:** Various types of accounts — retailers with a traditional high-low pricing model, everyday-low-price retailers, and hybrids — to maximize the breadth of learning

Team

Leaders also must put the right team in place, with a clear delineation of roles and responsibilities. One model that is increasingly effective is a trade promotion task force staffed with representatives from multiple disciplines and functions. The task force can work across brands and business units, applying a deep knowledge of retailers, and house all required institutional expertise, particularly for analytics. The task force needs to bring cross-functional capabilities, including the following:

- **Brand and category strategy:** Deep knowledge of brand objectives and goals for the categories and products.

- **Sales planning:** The ability to translate brand and business unit strategies into retailer-specific plans. This entails an understanding of retailer strategies, the CPG's market position, and how retailers position competing products within their stores.

- **Trade analytics:** A thorough understanding of promotion data, syndicated data, and analytical approaches to derive insights that shape future events.

- **Trade planning:** On-the-ground knowledge about promotion planning and retailer dynamics. Companies must be able to adjust plans as competitive dynamics change and respond to retailer requests.

- **Trade performance:** Knowledge of trade metrics, drivers of trade performance, and the ability to measure and track metrics.

Key advantages of this structure are that it helps embed the enhanced capabilities within the organization, serves to stress-test and drive plans, and allows different brands and business units to share best practices.

Due to the breadth and depth of the skills required, most organizations seeking to drive this type of change choose to work with an outside partner. The right partner brings deep trade experience, analytical skills blended with business acumen, the discipline to successfully hit target objectives, the ability to embed change within the organization, and the capacity and bandwidth to help drive such an initiative.

One effective model is a trade promotion task force.

Enabling tools

Once the scope, time line, and team have been established, the company needs to decide which enabling tools it will use, and the level of sophistication for each. Below is a summary of the key tools that support trade value capture and the range of options for each:

- **PEA tool:** This provides insights on the performance of historical trade events to help companies understand what worked and what did not. Most companies do not have automated PEA tools, even though such tools are in development. In such cases, a manual Excel-based approach can be leveraged to provide a point-in-time snapshot of historical performance.

- **Predictive analytics:** This tool uses statistical analysis to predict how an event will perform before it runs. Options range from sophisticated trade promotion optimization tools with advanced modeling capabilities to more basic price-elasticity-based lift coefficients that estimate a change in volume based on a change in price.

- **Planning tool:** This provides the ability to specify a full-volume plan that separates the base business and its drivers from the promotion-driven incremental business. Some organizations have this type of planning capability embedded within their trade promotion management (TPM) tool. However, in many cases, TPM systems are focused on financial transactions and do not enable this type of planning. In such cases, companies can use Excel-based planners.

- **Tracking and performance measurement tool:** This tool captures the overall planned improvements in sales, volume, and profits. It allows teams to measure plan performance as actual data becomes available and gauge the variance with the plans. Creating this tool ahead of time allows companies to incorporate the drivers of performance while the plans are created and track the results.

In most cases, the process of clarifying these aspects — scope, timing, team, and tools — will indicate that the company must make meaningful investments in the transformation. Though many executives have an understandable hesitancy to make these investments (especially in the wake of earlier efforts that failed to pay off), our work with clients has found that the right investments, along with a structured approach to leveraging them, more than pay for themselves. For early results, the tools need not be automated systems — standardized Excel models can get the optimization rolling, as well as help define the business requirements for the implementation of future systems.

The right investments more than pay for themselves.

Set actionable targets tied to incentives

The second major component of improving trade promotion effectiveness is to establish enterprise-wide targets. Companies must determine whether the overarching goal is to reduce trade investment, improve operating income, or some other target. In most cases, companies seek to drive profitable growth while making appropriate trade-offs between sales growth and profits. It's relatively easy to cut trade spending and increase profit margins with reduction in volume. The real benefit comes from realizing the sales growth objective while improving profits.

With the overarching enterprise targets in place, senior leaders need to allocate them down to an actionable level — e.g., the intersection of category and customer — to drive ownership. Critically, the targets need to be aligned to incentives in order to make the change stick, particularly among the key stakeholders (field staff, analytics, brands). In our experience, this simple change can make an amazing difference.

In one case, we worked with a company to help drive significant operating income improvement from its trade investment. Although everyone in the organization agreed that this was an important objective, account teams did not take direct responsibility to drive the effort. That changed when leadership modified the incentive structure for account teams, tying a significant portion of their bonuses to hitting their individual targets. Prior to this shift, teams had dismissed recommended changes that would improve the profitability of their plans, claiming, "That's an interesting idea, but it would never work with my retailer." Afterward, they began proactively reaching out for help in identifying improvement opportunities. Simply put, the right incentives can convert trade initiatives from a "push" effort driven mostly by senior leaders to a "pull" effort in which employees step up to see it succeed.

Companies often set out to reduce trade spending instead of strategically optimizing their spending to drive profitable growth.

Work closely with the field to embed the new capability

The third component entails change management and working hand in hand with the field teams to embed the change. Worth noting is that many organizations have already established some of the required capabilities for improving trade promotion effectiveness — such as PEA and/or TPO. However, these capabilities are often built in a centralized group like revenue management, without an explicit connection to customer and category teams. This step formalizes that connection, and ensures that the teams not only understand the change but see the process firsthand and can drive subsequent efforts on their own.

Working with the field teams includes the following steps:

Evaluate historical performance

The company should start by establishing a baseline for its current trade performance. This entails conducting PEA to understand the performance of trade spending at the level of individual events for the prior year and the current year to date. Drilling down one level, companies must also identify key themes behind both superior and poor performance, along with underlying drivers and the dynamics at play for individual customers and categories.

Typical areas for analysis and improvements include the following:

- Everyday low price (EDLP) support
- Promotion event design
- Execution within retail locations
- Terms and margin
- Shifting trade dollars within a category

- Value leakage (through diversion, forward buy, scan fees)
- Shopper or co-marketing funds
- Category trade rates
- Major changes in retailer priorities and strategies

Optimize customer/category plans

Once the insights are clear, companies should model scenarios to identify optimal plans that balance manufacturer and retailer criteria and hit required targets.

A library of historical events, captured as part of the PEA exercise, serves as the initial foundation for developing future plans. CPG companies can then augment these historical events with innovative new events, which they construct based on insights about superior performance. Events are then combined into multiple plan scenarios and modeled via a predictive tool to estimate the overall plan performance. These scenarios should include both base and stretch plans to ensure that teams are truly pushing their thinking. Teams should evaluate these scenarios against key manufacturer and retailer criteria (e.g., manufacturer ROI, volume, and gross revenue, and retailer gross margin dollars and percentage) to select the optimal plan.

Sell-in plans to customers

Once the plan is in place, the company needs to develop sell-in strategies for individual retailers. This requires a deep understanding of the retailer's strategy and how the new trade promotion plan aligns to it. Manufacturers also need to shape the way they communicate the new approach, through a holistic "story" that puts individual events into context. Retailers should be shown how the pieces fit together — digital initiatives, advertising, new product innovations, and customer and category insights — along with the key metrics that establish potential benefits that will accrue to the retailer as well as the manufacturer.

This is particularly crucial for high-risk plans and major strategic changes, where senior leaders may need to get involved during sell-in discussions (rather than miss opportunities by leaving the communication to junior field staff). In addition, companies that are changing their trade funding structure, in particular — and potentially reducing their year-over-year trade spending — should be prepared for some tough discussions with retailers.

A closed-loop planning process that aligns brand strategy with bottom-up retailer plans unlocks the value from trade.

In rolling out the plan, companies should create a playbook with multiple options for pricing and promotion, allowing field sales to be nimble in responding to retailer demands as part of the negotiation process. Plans that have little room for negotiation can result in reducing benefits significantly. Depending on the situation, the impact can be high — as much as half of the planned benefits for a certain lever or account. To combat this, companies should incorporate potential ranges in the targets up front, mitigating the impact of benefit leakage from sell-in discussions.

Diligently track the value captured

Fundamentally, measuring improvements from trade is difficult. The challenge is that companies need to pull data from multiple sources, aggregate it in a way that makes methodological sense, and then analyze it to ensure that it accurately reflects what actually happened during the promotion — and what drove changes in performance.

The first step is gathering the right data. Companies can start tracking the results of their customer business plans shortly after they begin to receive actual performance data (mainly consumption/sell-out, shipment/sell-in, and trade payments). However, incremental volume is often syndicated data, while spend is in the TPM system, and they must be linked correctly. In addition, companies need to understand and overcome complexities like the layering of events, bad data, unconventional deal structures, and other factors. Similarly, companies may need to control for external factors such as weather, recalls, new product performance, the actions of competitors, and any other outliers that impact sales. In many cases, much of the data aggregation can be automated, but it still requires human oversight.

A bigger challenge, however, lies in the "wiggle room" inherent in calculating incremental sales and profitability. For example, on the volume side, some people in the organization may disagree on the base volume assumption, or how sales at EDLP retailers can be linked to trade promotions. On the profitability side, the cost of goods sold and value-chain management expenses are difficult for retailers to estimate, and many manufacturers don't have an approach to allocate the costs to assess retail-level margins. Additionally, the challenge of wiggle room gets compounded when companies aggregate results at higher levels (e.g., for categories instead of products).

Companies can minimize these challenges through a consistent approach to estimating base and incremental volumes for EDLP and promotions, supported by profitability data by retailer and

product. Since event-based tracking gets difficult and is not easy to scale, plan-level tracking tools are required to measure actual results. The tracking tools capture the pre-event performance drivers and allow for comparisons once actual data becomes available. The encoding of the original assumptions that went into plan creation enables teams to validate the results using consistent methods and also adjust for external factors (for example, changes in commodity costs).

Conclusion

The retail environment is becoming more dynamic and complex, due to emerging new technology, evolving consumer behavior, changes in distribution channels, and a need to increase margins. In such an environment, CPG companies need to improve the effectiveness of their trade investments. Although they are acutely aware of the problem — and are trying to address it — their current efforts are falling short.

Our client experience has shown that a more comprehensive approach — implemented carefully and thoughtfully across brands and functions — can lead to gains that make it to the bottom line. Though this approach almost certainly requires an investment, it will lead to a stronger trade promotion capability, with improvements that build on one another over time. As a result, CPG companies will finally “get the money,” through sustainable gains of 10 percent to 20 percentage points in trade promotion ROI.

One company's comprehensive approach pays off

A U.S. food manufacturer needed to improve its trade promotion effectiveness to remain competitive. To that end, it completely transformed its sales and trade capabilities, with new processes, organization, and enabling tools.

Processes: The company implemented a simplified and flexible planning process, with an annual plan that ties in brand strategy, sales strategy, analytical insights, field planning, and a sell-in approach built around opportunities for shared gains between the manufacturer and its retail customers.

Organization: The company built an analytics center of excellence (COE), which could not only derive analytical insights from individual events but also integrate them with brand strategies, and translate it all into plans that would resonate with retailers. Critically, the COE was the foundation for a more collaborative planning and execution process among the brand teams, sales support teams, and field sales force.

Enabling tools: A new TPM/TPO tool helped build trade planning capabilities, what-if scenario analysis, and an integrated PEA tool, which helped the organization automatically capture performance data and use it to shape future trade events.

Results: Overall, the measures have driven an improvement of 10 to 15 percentage points in ROI on in-scope trade spending. The company realized roughly one-third of its target improvement in the first year of the initiative, was on track to capture another third in year two, and will realize the rest in year three. Along with the improvements in trade ROI, the company developed collaborative relationships between the analytics COE and sales and built a repeatable process to realize continued year-over-year savings.

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