Stop Feeding the Bear!

Trade Funds Management is Part System, Part Process, and a Whole Lot of Rigor

By Ben Ball and Rod Brown

Step inside a management team meeting at just about any CPG manufacturer today and you are likely to hear one of the following phrases:

"We've got to stop feeding the bear."

"We've got to pull the needle out some time."

"The mountain of deductions just keeps growing."

What all of these phrases refer to, of course, is the growing concern manufacturers have with the level of trade spending. The 2007 A.C. Nielsen survey reports that trade spending represents 60% of the overall marketing budget, or roughly $70 billion; obviously, the stakes are huge.

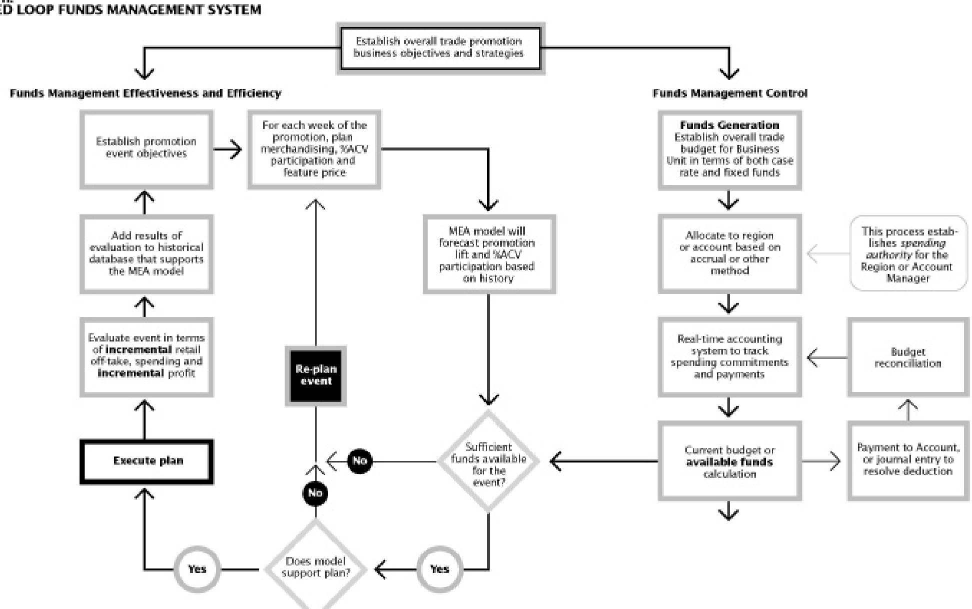
Is there efficiency to be gained in trade spending? Absolutely. But it is more than just reducing deal rates or cutting promotions. Successful trade funds management is part system, part process, and a whole lot of rigor.

System

Successful trade funds management requires a "closed-loop funds management system," a concept analogous to using an ATM, along with a database of actual performance. This system ensures that funds are allocated within available limits, and that accurate tracking and reconciliation information is available to all key users in a timely manner. Like an ATM, good trade funds management systems are fast, have a minimum of manual processes that could introduce error into the equation, and give instant feedback, such as current balances.

The database of actual performance can be used by both management and account managers. Management uses the database to drive strategic plans that will accomplish stated objectives. Account managers use the database at the account level to plan actual events. Having both parties work off of a common database is essential.

Exhibit H:
CLOSED LOOP FUNDS MANAGEMENT SYSTEM



Having a common database gives management the ability to quantitatively answer the following basic questions of strategic planning and management:

Where am I now? Is trade promotion accomplishing my stated objectives? How much is it costing me to do that?

Where do I want to be? Can I grow volume with a reasonable investment? Do I want to sacrifice volume for profitability?

How do I get there with some reasonable assurance of success? Should I shift spending to certain SKUs? Can I eliminate some forms of promotion?

The potential power of this information is best illustrated by a food client who had a brand that was heavily trade dependent. The company wanted to know if it could "pull out the needle" enough to bring the brand up to an acceptable level of profitability. The unknown that kept executives awake nights was whether they could reduce spending in ways that would not drop volume below breakeven levels.

In this case, the targeted trade spend reduction was about $20 million. Dechert-Hampe built a flexible strategic modeling tool, using the MEA database, that allowed management to play out "what if" scenarios in less than 24 hours. The resulting roadmap showed that a number of changes in activities, price points and geographic emphasis could actually deliver the targeted savings with only a 5% reduction in volume. This more than met their profitability goals.

Process

An effective trade funds management process involves some key decisions involving *spending objectives, funds generation*, and the allocation of *spending authority*. In all of the surveys Dechert-Hampe has done in this area, no one has ever responded that their primary objective for trade spending was to lose money. Unfortunately, the vast majority of programs do lose money when strictly measured. If company executives were truly holding themselves to the standard of the popular mantra "to drive profitable incremental volume," there would be no trade spending issues – almost everyone would quit spending!

So what are reasonable spending objectives? The most common is to drive marginal or "incremental" volume. The truth is, however, this volume is usually the "margin" necessary to beat last year's total volume numbers. Other reasonable objectives are to maximize brand exposure, defend shelf position and/or market share.

The next big choice is the method of funds generation and the allocation of spending authority. *Fixed budgets* have the appeal of certainty to the controller, but delivering the planned volume from which these targets are derived is generally not a fixed occurrence. Of course, based on the commitments made by field sales reps, you can bet that the spending of the funds will be fixed.

Live accruals are popular because of the "if you don't sell it, you don't get it" philosophy behind them. Unfortunately, most businesses are seasonal. That means that the sales force must have the freedom to "deficit spend" with an account or risk going into the peak selling season without competitive programming. Unfortunately, the forecasted volume to cover those funds is not always sold.

The root of all evil in trade funds generation is the "incremental spending request." Most often associated with fixed funds programs, this is what we refer to as *"on-demand"* spending. When a headquarters' function such as Marketing, Trade Marketing or some other department, is given responsibility for approving funding while Sales is held accountable for volume, disaster often strikes. The classic scenario is in the company that has established some sort of hurdle rate evaluation process based on "payback." Incremental programming requests from the field always generate the required volume to pass muster on paper. When the cases are counted at the end of the year, Sales made quota and earned its bonuses, but the company is left holding the bag with spending that exceeded the budgeted rate per case.

Rate per total case funds generation is the only method that truly transfers total accountability to the field. In this method, the field must make the business decisions that encompass total promoted volume versus base sales. In addition, the vested interest in critical evaluation of the incremental volume likely to be generated by higher spending rests in the field.

The problem with this method is that the sales force does not always have the business management skills necessary to make these decisions. Furthermore, most companies do not have the tracking and reporting systems to get them the information required in a timely manner.

Rigor

What is most amazing is the level of sophistication and effort many companies put against successfully managing what is often their biggest expense after cost of goods. The principles of trade funds management are not terribly complicated, but measuring and managing these dollars is a complex process. Think of it this way: managing media and consumer promotion dollars is like riding a well-trained saddle horse. They go when you say go and they stop when you say stop. By contrast, managing trade dollars is like herding wild horses. Once you let them out of the corral, you have to constantly ride herd on them just to keep them under any kind of control.

To be successful in trade funds management, companies need to adhere to a disciplined approach such as the traditional management process loop. Trade funds managers *analyze* past performance, *plan* for future action, execute the plan, *control* spending through careful monitoring, assess the results, and then start all over again. Following the proper decision-making process, and using a proven system, such as the MEA process illustrated on page 6, can lead to more effective trade funds management.