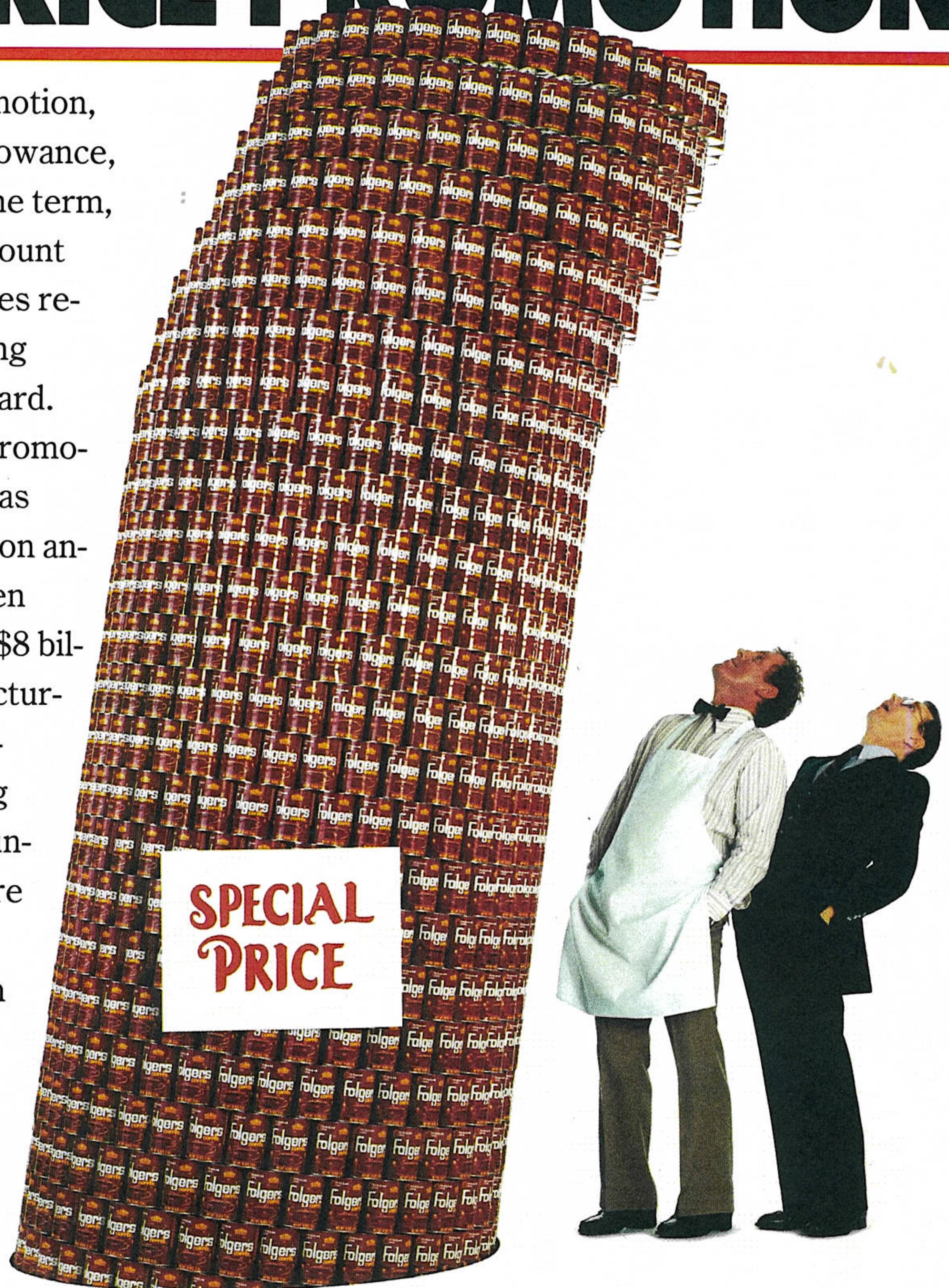
MARKETING/MONCI JO WILLIAMS

THE NO-WIN GAME OF PRICE PROMOTION

■ Call it trade promotion, push money, an allowance, a deal. Whatever the term, it's the special discount a manufacturer gives retailers for promoting his product extra hard. The size of these promotional allowances has grown from $1 billion annually in the U.S. ten years ago to some $8 billion today. Manufacturers think trade promotion is careening out of control and undermining the future of their business, but they can't seem to cut back.



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PHOTOGRAPH BY NEIL SELKIRK

In many ways trade promotion is the netherworld of marketing. Scott Paper was one of several companies that refused to discuss the practice with FORTUNE. "Allowances," said a Scott spokesman, "are the kind of proprietary thing that should be left unpublished." Quaker Oats also quaked at the idea of talking; it cited "the sensitivity of the manufacturer-distributor relationship." In public, manufacturers and retailers agree that trade discounts have grown too large, are offered too frequently, and should be pruned. But in private, retailers accuse manufacturers of trying to reduce promotions and improve profits at their expense. Manufacturers counter that retailers have used the deals to fatten profits while passing little of the discount on to consumers and demanding ever-bigger deals. Few manufacturers seem willing to admit that they are mired in a swamp of their own making.

Though the $8-billion-a-year figure is a reasonable estimate, it is not precise. Manufacturers don't have to disclose the amounts spent on trade promotion and direct-to-consumer promotions like coupons and samples. Steven Kingsbury, vice president of Majers Corp. in Omaha, which helps manufacturers monitor trade promotion programs, estimates that ten years ago 20% to 30% of grocery sales carried discounts to the trade averaging 6% to 8% of manufacturers' list price. Today roughly 60% of all manufacturers' sales are accompanied by a trade deal averaging about 12%.

MANUFACTURERS often specify the kind of special treatment they would like in return for these discounts. They might want the retailer to pass along some of the discount to consumers, feature the product in newspaper ads, display the product prominently in the store—or a combination of these things. The manufacturers' sales forces, aided by outside firms like Majers, check up on whether retailers are following through on the promotion. But if they aren't, most manufacturers don't do much about it.

Coffee, tuna, soft drinks, paper products, cake mixes, margarine, salad dressings, cooking oil, deodorants, and shampoos are all promoted heavily and frequently. In these categories and others, the weaklings of the grocery shelf—products with the smallest market shares—usually get the heaviest promotion. Because marginal brands lack the "pull" of consumer demand, manufacturers figure they need extra "push" from the retailer. Procter & Gamble, whose products most often hold the top spots in their categories, spends less on trade allowances per sales dollar than, say, Lever Brothers, whose products often have smaller market shares. The allowance compensates the retailer for making room on the shelf for a product lacking powerful consumer appeal.

Trade promotion can also be a potent weapon in the guerrilla wars fought when a new product is introduced. A company may offer a 20% discount to encourage the retailer to make space on the shelf for an unproven newcomer. The established competitor, who stands to lose shelf space and market share, may then retaliate with a much bigger discount. In 1973, just before Colgate-Palmolive introduced Peak, a toothpaste with baking soda, P&G offered allowances to get retailers to stock up with Crest. Taking advantage of Crest's special price, consumers stocked up too. That's one reason you've probably never heard of Peak. It came out, sat on the shelf, and in the words of a former P&G sales manager, "just died." Colgate still struggles along with Peak; its share of the U.S. toothpaste market is 0.1%.

The escalation of deals comes as the balance of bargaining power between manufacturers and retailers has been shifting. The retailer used to serve as a relatively passive conduit for the manufacturer's goods. But the retail grocery business has been consolidating and the big retailers and wholesalers have gained buying clout. Since the mid-Seventies grocers have slowed the rate at which they've been adding space while expanding the number of products they carry. Vitamins, shampoos, greeting cards, panty hose, and dozens of other goods now encroach on the turf groceries once had to themselves. With the advent of checkout scanners and computers that supply information on how quickly products are turning over, retailers are increasingly aware of what makes money and what doesn't. They can demand discounts on marginal goods or throw them off the shelf. The relative scarcity of shelf space has, in a sense, put the retailer in the real estate business; manufacturers have little choice but to bid for territory to display their wares.

Especially fierce is competition among soft-drink marketers for in-store displays. A typical supermarket has about 50 of these at the ends of aisles and elsewhere. A single display in the front of a store can increase a product's sales sixfold. It's not unusual for buyers to entertain bids for these displays. On more than one occasion, a buyer from one of the largest U.S. chains has called Pepsi after receiving word of Coke's latest discount. His message: "You have a half hour to get back to us with yours."

Promoting soft drinks has one thing to be said for it: the discounts increase total consumption. With most products, discounts mainly shift consumption from one time period to another or from one brand to another. But when consumers who buy soft drinks, cookies, and snacks "on deal" get the stuff into the pantry, it becomes subject to impulse munching and guzzling, and the shopper soon heads back for more.

WORRY ABOUT price controls in the mid-Seventies greatly increased the depth and breadth of deals. Manufacturers kept list prices high to protect themselves in case of a federal price freeze and used discounts to remain competitive. After fear of price controls passed, however, the discounts remained. In recent years manufacturers have been trying to signal each other—through speeches at conventions and comments in the trade press—that trade deals have been getting out of hand. But most have been unwilling to cut back for fear that the competition won't follow. They also dread retaliation from retailers. Discussions about how to reduce trade allowances are peppered with "what ifs": What if the retailer reduces my shelf space, throws out my product, or prices the competition a few cents under me? Says the division manager for a major packaged-goods company, "Everyone has been afraid to make the first move, to sustain even a short-term volume loss."

Thomas W. Wilson Jr., who heads the consumer goods marketing group of McKinsey & Co., management consultants, believes the growth in trade discounts is self-destructive. Wilson is widely respected in the food industry as the man most responsible for developing the Uniform Product Code, the ubiquitous little bars on packaged goods that checkout scanners read. He blames deals for increasing manufacturers' marketing costs and abetting the shift in consumer preference from nationally branded products to house brands and generics.

The consumer franchise for branded products has indeed been breaking down. A recent study by the ad agency Needham Harper & Steers found that the percentage of people who try to stick with well-known brands dropped from 77% to 59% in eight years. Manufacturers say that the proliferation of trade promotions has helped persuade the consumer to ignore brand and "cherry pick" products sold at deal prices. If that's true, manufacturers have plenty of reason to worry. In effect, they're undermining the billions they spend on brand-name advertising with the billions they spend on trade promotion.

Wilson has been spreading the word to manufacturers that now is the time to cut back promotions and reinvest in the consumer franchise. Some retailers and wholesalers

view him as an agent of the opposition, a hired gun for manufacturers who want to bring the discounts down. Wilson denies that accusation, saying he serves as a consultant to both retailers and manufacturers (though he won't identify specific clients) and that his public statements represent his own, not a client's, point of view. Whatever the case, the vehemence that creeps into his voice when he discusses the evils of trade promotion does indicate deep conviction.

WILSON HAS BEEN trying to put across the idea that the escalation of discounts has been costly not just for manufacturers but for retailers and consumers as well. That's because retailers and wholesalers engage in what's known as forward buying. To take advantage of trade deals, they buy more than they need for normal inventory and draw down that stock instead of rebuying at list price. Many retailers buy enough in one deal to carry them over to the next—"bridge buying," as it's called. Experts estimate that on average wholesalers and retailers "forward buy" about one-quarter of their inventory. As a result, says Wilson, as little as 30% of the manufacturer's trade promotion dollar gets passed on to the consumer. Much of the rest goes to pay interest and warehouse costs for the excess inventory. That adds costs to the distribution system. "The retailer is taking on excess inventory and storage costs he wouldn't normally have," Wilson says, "and the manufacturer is faced with uneven demand on production and distribution."

GEORGE LANGE

Message to marketers: *consultant Thomas Wilson says they're getting a raw deal on deals.*

Although the manufacturers blame the retailers for insisting on trade deals, they have come to rely on trade promotions for short-term volume gains in an industry that's growing only about 1% a year. Wilson, who also blames the retailers, concedes that manufacturers have tended "to throw money at the problem, to buy growth with dollars rather than gain it by building the consumer franchise." Brand managers now use trade promotions routinely, not just to introduce new products or defend against the competition, but to meet their quarterly and yearly sales and market-share goals. They reason that profits on the extra sales stimulated by a promotion will offset the cost of the discounts. But all too often that doesn't happen, and they wind up sacrificing profits to meet market-share and volume goals.

The manufacturer's sales force adds to the pressure for price promotions at the end of the year. John A. Quelch, assistant professor at Harvard Business School, points out that salesmen have goals to meet too. "In many companies," he says, "the salespeople have become the best representatives of the retailers' interests." Neither the sales force nor the brand manager, who is likely to be transferred in a couple of years, may have the long-term welfare of the brand at heart. Because retailers load up on deal merchandise during a promotion, the manufacturers may simply mortgage future sales to meet short-term goals. As long as they keep their sights trained on short-term targets, Quelch says, "the brand manager and sales force lack a clear incentive to reduce the level of trade promotion activity."

The focus on short-term goals goes all the way up the line. Not long ago a consultant

SECRETS BEHIND THE SPECIALS

■ Ever wonder what goes on behind the scenes when your local supermarket runs a special on canned tuna? Here's what happened at a New York City supermarket, whose May 15 flyer is at right. The price specials reflect the discounts (called allowances) that the manufacturer gave the retailer to push the product. The retailer usually pays $1.15 for a can of Bumble Bee white tuna; the allowance brought his net cost to 96 cents. In this instance he marked it up only 3 cents. But the markup can be deceiving. The retailer cuts prices for only a week or two on most products, though he usually gets the allowances for six to eight weeks. For the remaining weeks the price goes back up. The tuna was recently selling at this store for $1.39, the spaghetti sauce for $1.05, and the instant coffee for $4.79.

BUMBLE BEE white tuna

List price per 48-can case:	$55.43
Allowance:	$9.50
Net cost per can:	96 cents

RAGÚ spaghetti sauce

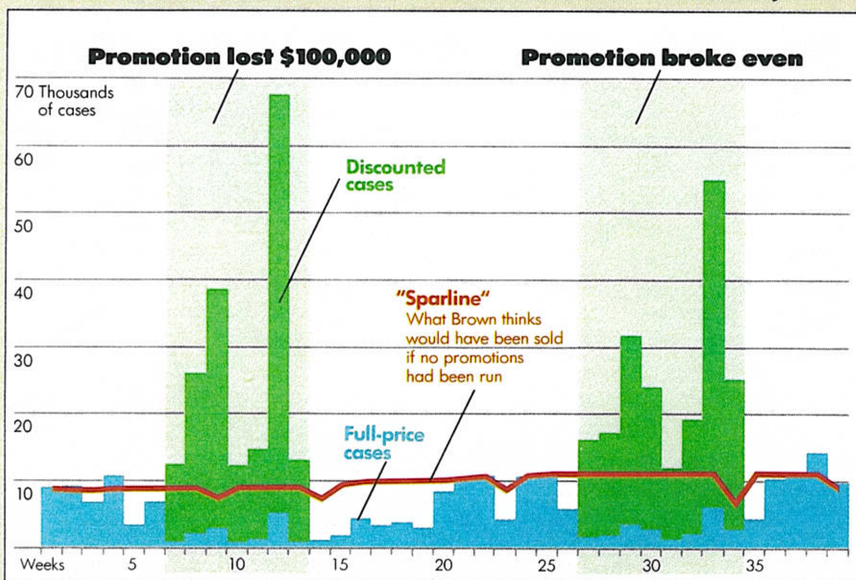
List price per 12-jar case:	$9.50
Allowance:	96 cents
Net cost per jar:	71 cents

MAXWELL HOUSE instant coffee

List price per 18-jar case:	$83.72
Allowance:	$13.50
Net cost per jar:	$3.90

Picnic And PantryBon
CHUNK IN OIL OR WATER
BUMBLE BEE WHITE TUNA
6½ OZ. CAN 99¢
BUMBLE BEE SALMON 1.99
SAN GIORGIO MACARONI
2 99¢
RAGU SAUCE
15 OZ. JAR 79¢
MAXWELL HOUSE COFFEE
10 OZ. JAR 3.99
TASTER'S CHOICE COFFEE
1 OZ. JAR 79¢
YOO HOO SYRUP
22 OZ. BTL. 99¢
CORNED BEEF HASH
GREEN GIANT

Price-promotion guru *Robert Brown tells marketers which deals make money.*



A TALE OF TWO PROMOTIONS

■ Manufacturers who promote their products with discounts don't always make money on the deal. That's because retailers and wholesalers stock up on discounted merchandise near the end of a promotion and may not buy at list price for weeks. Robert Brown, 40, invented the Sales Promotion Analysis Reporting (SPAR) system to help marketers fine-tune promotions for profitability. He developed it for Hershey Foods 16 years ago, and his SPAR Inc. in Elmsford, New York, now counts P&G, Pepsico, Dow Chemical, and Dart & Kraft among its clients.

For the two pet food promotions charted above, the red "Sparline" is Brown's estimate of what sales would have been if no promotions had been run. In the first promotion, a 26% discount encouraged retailers and wholesalers to stock up heavily; they took almost two months to work off the inventory and return to normal buying levels. Netting out the sales lost after the promotion ended, the company still sold an extra 86,000 cases of pet food. But it lost $100,000. In the second deal, the company lowered the discount to 21% and policed the retailers' promotional activities more vigilantly. Retailers and wholesalers returned to normal buying levels two weeks after the promotion ended; the company sold an additional 108,000 cases and broke even.

completed a study on trade promotions for a divisional vice president of sales at a major packaged goods manufacturer. "It was four weeks before the end of the last quarter," says the consultant. "He wanted to find out if he could make his numbers by upping the deals. The point of the study was to find out how much product the trade could absorb. It's not exactly consonant with your image of a well-managed company."

Companies might be less tempted to use trade promotion if they knew what it cost them. McCormick & Co., the $720-million-a-year spice manufacturer, was dazzled by the illusion that promotions would eventually pay for themselves. Managers in McCormick's grocery products division began offering promotional allowances to meet their profit goals. They soon found that the promotions didn't generate the profits they were supposed to, so they deferred the costs to later quarters. After nearly five years of this the SEC moved in. "As the level of those expenses increased," McCormick said in a document filed with the commission, "the grocery products division planned further deferrals, always with the hope that it would have an extraordinary quarter in which it could absorb the expenses." When the SEC filed a complaint last year alleging improper accounting practices, McCormick settled (without admitting or denying the charges) and restated 19 quarters of earnings by some $4 million.

Since the late Seventies P&G, Kraft, R.T. French, Texize, and others have been setting up planning and analysis systems that weigh the incremental sales and profits from trade promotions against the costs (see box at left). But few manufacturers use such a system companywide, and the industry as a whole has a long way to go.

ONE REASON promotions fail to pay off is that manufacturers have trouble targeting them geographically. Retailers and wholesalers can sabotage a manufacturer's efforts by buying merchandise on deal in one market and reselling it where the manufacturer is trying to get full price. They may sell to another chain or wholesaler—"diverting," the trade calls it. Or in the case of companies doing business in several markets, they may transfer the product from one branch to another—a form of diverting called transshipping. People in the business guess that both forms of diverting add up to over $1 billion worth of coffee, tuna fish, health and beauty aids, and other products being shipped around the country each year.

The diverter is a shadowy figure. Just who diverts is a matter of fascination in the indus-

try, but retailers, wholesalers, and manufacturers are reluctant to name names. In the mid-Seventies, General Foods test-marketed new packaging for Maxwell House coffee with tighter-fitting plastic resealable lids that were supposed to keep the coffee fresher. The lids could be identified by a blue ring around the rim. The coffee was introduced with a fat promotional discount in Syracuse, New York. Before long the blue-ringers were turning up in Los Angeles, Portland, Oregon, and Jacksonville, Florida. In a Federal Trade Commission case touching on the matter, General Foods testified that companies transshipping coffee around the East and Midwest ranged in size from a $120-million-a-year Brattleboro, Vermont, wholesaler to Grand Union, the nation's eighth-largest supermarket chain, with annual sales of $4.1 billion.

Manufacturers have been trying to persuade distributors that selling deal merchandise to diverters or buying it from them is unethical and possibly illegal, since distributors are prohibited by the Robinson-Patman Act from accepting promotional allowances if they don't run the promotions. Perhaps surprisingly, some buyers seem more troubled about the ethics than the legality. Alfred Walsh, director of purchasing for Affiliated Food Stores in Little Rock, Arkansas, explains: "We have a relationship with a salesman. We see him once a week, he knows us. I don't like buying the product he sells from some salesman in New Jersey I never saw." William Deskins, who buys for a family-owned chain in North Tazewell, Virginia, agrees, but feels forced to buy diverted merchandise when it comes his way. "If the guy across the street gets a product from a diverter," he says, "and he sells it cheaper than I can, I'd be stupid not to buy from a diverter too."

IN THE PAST YEAR or so, P&G and Coca-Cola have taken tentative steps to cut trade discounts on a few products. In the hope of offering consumers more stable prices, and thus lowering the incentive to shop around, the companies reduced both deal rates and list prices. Coke made the move with Hi-C fruit drinks and Minute Maid instant and frozen lemonade, P&G with Bounty paper towels, Charmin and White Cloud bathroom tissues, and Duncan Hines cake mixes. Despite widespread belief that the moves would hurt market share, the products have held their own. Still, the movement has hardly swept the industry.

Looking at the inefficiency of trade promotion, many manufacturers think that putting price cuts directly into the hands of consumers makes more sense. They have been turning increasingly to cents-off coupons distributed by mail, in newspapers and magazines, and packed with the products themselves. Over the past several years coupons have enjoyed phenomenal growth; a record 120 billion were circulated by manufacturers last year, over 1,400 for every American household. But coupons only compound the problems manufacturers have created for themselves with trade promotion: they encourage brand switching and reinforce the consumer's inclination to shop not for brand but for price.

■ The recent history of trade promotion illustrates the dangers of adopting short-term tactics that collide with long-term goals. A company can't keep hawking its wares at cut rates and expect consumers and retailers to come back later and pay full price. The marketing addiction to price promotion looks like a habit that's almost impossible to kick. Manufacturers seem destined to shuttle back and forth among various short-term volume-building tools, all the while putting the value of their brands in greater jeopardy. ■

GEORGE LANGE

Here's the end-of-aisle real estate *soft-drink marketers bid for. Up to 90% of what they sell to supermarkets is discounted.*