Manufacturers getting snared in the 'trade promotion trap'

U.S. MANUFACTURERS are falling into a "trade promotion trap" that is reducing profit margins and spurring the growth of generics, according to Robert G. Brown, president, SPAR Inc., Elmsford, N.Y.

"Everyone knows that the short-run impact of a deal is increased manufacturer sales," said Brown, whose firm specializes in analysis of trade promotions.

"Unfortunately, very few have developed the tools to determine what are the true sales increments after both pantry and trade forward buying are removed. In fact, a promotion-forced increment this year often undermines next year's performance and even the long-term viability of the brand."

Indiscriminate dealing became a problem in the food industry 3-4 years ago, he said, and the same pattern is appearing in other industries. When offers of a deal become the norm, distributors and retailers cease to place orders when a deal is withdrawn, resulting in production inefficiences and higher shelf prices.

As much as 90% of sales in some categories are on deal, Brown said. If the category is inelastic and consumption cannot be expanded, manufacturers eventually are forced to raise their prices.

"Practically everything is being sold on deal in the grocery trade," he said. "As a result, manufacturers have restructured their pricing."

FOR EXAMPLE, A manufacturer may decide to hype sales by offering a $5 per case deal on a product normally wholesaling for $10 per case. Competitive pressures eventually will force retailers to wait to place orders until a deal is in effect, so the manufacturer is forced to increase the wholesale price to $15.

As a consequence, the manufacturer begins producing and shipping the product one month while the deal is in effect, then doing virtually nothing the next month when the deal is not in effect.

"That's a very disruptive and inefficient way of doing business," Brown said. "Ultimately, who pays?

"Certainly not the grocery trade. The manufacturers are not absorbing the loss from their profits. Instead, it's resulting in on-average higher shelf prices.

"We believe that is the major cause in the growth of generics. The recession has played a role in the expansion of generics, but it is not the main reason."

Robert G. Brown

THE HEALTH AND BEAUTY industry also is falling into a trade promotion trap. A new type of businessman called a "diverter" has cropped up, he said, creating unexpected competition for the manufacturers' representatives.

Diverters are purchasing health and beauty products at discounts of 20% and more, then turning around and selling it to the trade, not consumers.

"They are underselling the manufacturers' reps," Brown said. "It's the same, identical products, and the guy is selling it for 10% less than the rep can.

"It's becoming a very serious problem in the health and beauty industry, and it has come about because the manufacturers have put into place policies that allow it to happen."

Airlines and auto makers are other visible examples of the promotion trap.

"What consumer is going to go out and buy a car when he knows the same car is going to have a $1,000 discount in a month?" he asked. "If auto makers continue that practice for another year or two, they're going to have the same problem as exists in the food industry."

NOT ALL PROMOTIONS hurt incremental sales, of course, but the problem is identifying which ones are working and which are not.

"The only way the manufacturers can resolve the problem is if they get a handle on the impact of the promotions they run," Brown said. "Companies can cut back their dealing significantly without suffering losses. It's not easy, but policies can be instituted.

"The difficulty is that until the president knows how much he is losing on a program, he can't cut it. A lot of companies have product lines that are profitable because of deals. If you cut in the wrong area, your share will go down and profitability will be hurt."

Beneficial deals vary from market to market, and the implication of total trade promotion policy on sales, share, and profit in each market must be evaluated.

Chain policies, distribution systems, competitive practices, and other factors bear scrutiny, he added.

Brown claims to have developed a system which can pinpoint the incremental sales effect of each promotion in each market, whether the promotion is a case allowance, a combination of allowance with ads, point-of-purchase displays, or coupons.

The system has evolved over 15 years of analyzing "600,000 promotions" by the country's leading food manufacturers, he said. The groundwork for the system was laid in 1973, when the federal wage and price freeze was instituted.

"When the price freeze hit, we were able to study the impact on the same product in on-deal and off-deal markets," he said. "We had an instant laboratory, and that's the kind of thing that comes along once in a lifetime."