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ADVERTISING & PROMOTION

THE HIGH COST OF PROMOTION SPENDING

By Robert G. Brown

There comes a time when two adversaries realize that further struggle will only result in mutual exhaustion. After a 40-year battle for power between manufacturers and retailers, such a point has been reached.

The introduction of the marketing concept after World War II coupled with the explosive popularity of television contributed to significant brand loyalty and the beginning of dominance by the major manufacturers over retailers. For the ensuing two decades, the manufacturer often viewed the retailer as no more than a necessary evil to be tolerated because someone had to physically distribute branded products to the consumer. Brand growth, the success of the manufacturers and the promotion of the manufacturer's employees were based on increasing market share, which was primarily achieved through network advertising.

In the late 1960s, the foundation was laid for a new, long-term trend and a turning point in the battle for power. By that time many manufacturers had introduced the brand management system, which called for or resulted in a fast track of rapid management advancement. This rapid advancement was based on quick successes for the new elite of the branded products—the MBA graduate. In order to increase short-term sales and profits, an old, but infrequently used weapon was rediscovered: trade promotions. By employing trade promotions manufacturers could generate significant short-term increases in sales and profits, which usually resulted in the promotion of the marketing person. These increases in internally measured manufacturers' sales and profits could be accomplished by any brand, even without additional consumer sales, by just flooding the channel of distribution with additional inventory. It also is believed that sometime during this same period loyalty to major brands started to decline. Whether this is true, coincidental or caused by the increase in trade dealing and emphasis on price is open to speculation.

A Valuable Lesson

Brand managers and manufacturers quickly learned a lesson about the perils connected to the increased use of trade promotions. They discovered that if they eliminated a promotion at the end of a fiscal year, the possibility of making their annual sales and profit objectives became slim.

Many people believe that high inflation, recessions and a price freeze imposed by the Nixon Administration in the 1970s were among the most significant events leading to the heavy trade promotions that exist today. I disagree. If we look at the facts, we will see that the explosive growth in trade promotion spending started before any of these situations existed and continued long after the price freeze had ended. This is important because if we accept the explanation that factors beyond our control were primarily responsible for the situation, we will fail to search out the true causes and face the fundamental issues. Thus, we will

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continue to spend more each year.

Regardless of the cause, we do know that in the early '70s retailers began to focus on the economics of forward buying during manufacturers' promotions. At the time retailers were increasing their level of forward buying, the manufacturers' sales force was encouraging forward buying to increase manufacturers' short-term sales and profits. "A loaded buyer is loyal" was the battle cry and rationalization for many major manufacturers. This continued without interruption or interference by the financial departments or senior managers, who ultimately have to deal with the reality that the manufacturers never developed a way of knowing whether their promotional programs were effective. This inability of the major manufacturers to have even the most basic estimates of the long- and short-term impact of trade promotions on incremental sales and profits resulted in an unmanageable and out-of-control promotion budget. But the retailer now had a voracious appetite for more trade dollars, so there was pressure on the manufacturer to continually spend more. At the same time, though, there was an absence of the normal financial and management controls. Not surprisingly, spending rose at an astronomical rate.

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In the '80s, primarily because of the large amount of money being spent on trade promotions, the retailer was beginning to gain power in the channel of distribution. The more power the retailer obtained, the more he used it to force spending on trade promotions even higher. The myth that the retailer, because of increased concentration, better data or increased sophistication, first gained power and then caused trade promotion expenditures to increase is just that, a myth. In fact, it is the increase in trade dollars from $1 billion per year in the 1960s to $18 billion per year today that significantly gave the power to the retailer since he determined how the money would be spent. That has been a fundamental and primary cause in the shift of power between manufacturers and retailers.

Both the manufacturers and the traditional retailers have begun to pay a price for this change in the marketplace. Whenever there is significant economic change or upheaval, the status quo usually is destroyed by entrepreneurs who suddenly see new opportunities. Just as American industry has found itself competing against worldwide enterprises during the past 10 years, the traditional retailers suddenly have found themselves in competition with fierce, new competitors: price-oriented stores, warehouse stores, Cub-type stores, etc. One of the factors contributing to the development of these stores is the high percentage of products sold on promotion and the deep discounts offered by manufacturers when these products are on promotion. This allows many of the newer operators to buy solely at the lower prices, offering significant price savings to the consumer, while not incurring the costs of many of the traditional retailers.

The Guise of Generics

For the manufacturers, the economically unjustified and unreasonably high list and shelf prices needed to subsidize the deep deals and "hot features" contributed to the substantial growth of private labels and generics. I disagree with those who would argue that it was the recession that caused a significant increase in generics. If we look carefully at those categories in which generics grew the most, in almost every case their strength increased after the total category had reached a level of unjustified everyday shelf/list prices coupled with an unrealistic and unsustainable level of excessive and deep dealing. When the level of dealing and unrealistic pricing decreased in a category, the growth of generics in the categories generally stopped or reversed itself. Both the manufacturers and retailers, with short-sighted programs, contributed to the rapid growth of generics.

These days, however, we are witnessing perhaps the most serious attempt to clamp down on trade promotion spending in 20 years.

For example, some manufacturers are experimenting with the notion of converting promotional dollars into "street money." Whether they are called local marketing funds, tactical funds, accrual money, etc., they are funds to be spent in a local market to meet local retailer needs. If these expenditures are funded by manufacturers selling a lower percentage of their cases on promotion to traditional retailers, the short-term trend of increased retail competition by the price-cutter type of store will intensify. This is because the manufacturer realizes that many of these price retailers will only buy when the brand has sufficient promotional incentive. To make that sale they always will have to attach an economic incentive.

At the same time, if the traditional retailer starts buying a higher percentage of product at list price, he will find himself at even more of a competitive disadvantage, vis-a-vis his price-cutting competitor.

As difficult as the impact of trade promotions were for the manufacturer to measure when money was spent equally across all retailers, it is going to become even tougher when trade promotion money is applied locally. Just the addition of something as simple as accrual funds across multiple brands, but applied by the retailer against only one brand, makes it nearly impossible to measure the impact of trade promotions using manufacturers' current accounting systems. If the switch toward street money continues, the trade promotion fire is liable to leap completely out of control and consume both the traditional brand manufacturers and the traditional full-service retailers.

The switch to street money is yet another example of the manufacturers' policy of change and motion for the sake of change and motion. The manufacturer has not set up any management controls to determine the effectiveness of how the street money is to be spent. In the future, manufacturers, pointing the finger of blame at either retailers or the economy, probably will bemoan the waste of street money and start to switch back to more

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I do not believe the street-money promotion has to be doomed. It could be effective if the manufacturer determines the short- and long-term effects of spending money in different markets in different ways. By then eliminating unprofitable programs and running effective ones, a sound program could be developed.

Unfortunately, there is no evidence that the manufacturers are making an attempt to execute street money any better than they have executed any of the new programs of the past 20 years.

Cooperate or Perish

Industry leaders representing both sides recently have come to realize that if they are to survive and prosper, something must be done to solve the trade promotion problem. It has become increasingly clear to both parties that neither can solve the problem alone.

By most estimates, one-third to two-thirds of a manufacturer's expenditures on trade promotions are wasted or unjustified. At the same time, I estimate that around 40% of the promotions run by retailers result in a lower profit than the retailer would obtain if he did not promote that item to the consumer. In many cases, the brands that result in losses for the manufacturer are the same that result in incremental losses for the retailer.

The following criteria are guidelines to help solve the problem:

1. If trade promotion money is to be spent differently, both retailers and manufacturers must believe any new approaches are fair and that the data used to measure the results of these new approaches is accurate.

2. Any dialogue must be based upon retailers and manufacturers both having full access to the same data from which the decisions are made.

3. Only if retailers and manufacturers are able to get the true incremental sales and profits by brand, size, retail account and geographic area will a change last over time.

4. The retailers and manufacturers who participate in new programs must gain immediate short-term sales, profits or other advantages against their competitors.

5. A solution must be seen as having a long-term strategic impact to be embraced by industry leaders on both sides of the channel of distribution.

6. It must be simple to administer, measure and execute.

7. It should not pose any significant short-term risk to any of the participants, and manufacturers and retailers must be able to test the programs easily.

In the past 12 months a number of retailers and manufacturers have started to participate in test programs that meet these criteria. Since many of these programs have just begun, we cannot tell what the final outcome will be. However,

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what is significant is the fact that leading retailers and manufacturers have begun to cooperate and test out programs that will be mutually beneficial over the long run. What we are now seeing is simply the tip of the iceberg and, if successful, will represent the beginning of a new trend that within five years will change the way trade promotion money is spent. The leveling off, and in some cases reduction, in traditional trade promotion spending now occurring across many categories is one of the early results of fundamental changes that have started to take place. Those manufacturers and retailers who ignore these fundamental changes and believe that they can continue to do business as they have for the past five years surely will lose short-term advantages to their more perceptive, innovative and forward-thinking competitors.

Who Wins? Who Loses?

Unfortunately, despite a great deal of rhetoric and lip service, these changes will not result in wins for all parties. The American system of distribution is at such a level of efficiency and maturity that for every winner there must be a loser. Other than very nominal changes, American consumers are not expected to significantly increase, in real terms, their per capita grocery spending during the next decade. At the same time, there is no reason to believe that the margins made by the retail trade or the manufacturer are going to increase measurably in the next 10 years. As a result, when somebody increases his profits, somebody else's profits probably will decrease. If branded products increase their sales and market share, the low-price brands will see a corresponding decrease. If the traditional retailers increase sales, and the top 10 chains grow in real terms, other retailers will suffer. If one manufacturer, working in cooperation with retailers, gains more retail support for his brand, he will do so at the expense of other brands in the category. If a retailer, through sound policies and forward thinking, attains a greater share of the manufacturer's trade dollar, the retailer he is competing with will suffer by getting a smaller share.

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In my estimation the winners will be:

- Brands that are undersupported by retailers in proportion to the support that they should be given based on their promotion potential.
- The traditional retailer, who will find that a reallocation of manufacturers' promotion money on a more rational basis will help him vs. retailers who sell almost exclusively on price.
- Retailers who have developed loyal consumers or those who have found reasons for existing other than just being able to sell at the lowest possible price.
- Progressive retailers and manufacturers who recognize the changes that are occurring and take advantage of them before their competitors do so.
- Manufacturers who know the true incremental profits and sales that they are getting from each of their promotions by retailer and who begin to reallocate their promotional money from unproductive promotions to productive ones. This will help manufacturers who shift money not just from promotions that are unprofitable for themselves, but who also shift money away from promotions that are unprofitable for the retailer.
- The first manufacturers and retailers who successfully cooperate to increase the effectiveness of their promotional programs.
- Retailers who stop asking for promotions that are unprofitable for manufacturers, and who run promotional programs that are profitable for the manufacturer.
- Brands that when promoted generate true incremental category profits or increased traffic for retailers.
- Retailers who give agreed upon support to manufacturers' promotions and

also deliver the incremental sales and profit that the manufacturer really expects in return for his promotional payments.

The elements of the the losers are:

- Brands that currently are oversupported by retailers relative to their true promotion potential.
- Retailers and manufacturers who sell solely on price.
- Retailers who don't perform fairly in return for promotional money.
- Manufacturers who run promotions that are unprofitable for retailers.
- Retailers who want to run promotions that will be unprofitable for manufacturers.
- Brands without any consumer base.
- Manufacturers and retailers who don't cooperate and allow their competitors to build promotional programs with their partners in the channel of distribution.

Many retailers and manufacturers whom I have spoken to ask why they should participate and encourage these changes when they believe the current system is working quite well for them. It is true that the current system is working well for many people, and if it could be maintained, would probably be to their advantage. However, change is inevitable. Those retailers and manufacturers who try to maintain and continue the old systems will find themselves in a new environment in which the old ways of doing business are gone.

The Future

Many manufacturers and retailers will realize that the current practices in the channel of distribution—excessive trade loading, high list/deep deals, excessive emphasis on price, etc.—are counterproductive to the health of the industry in general and their own business specifically. Many of these practices have resulted in higher consumer prices and over the long run will erode their own brand or retail image. While the final result of the specific programs currently being tested by manufacturers and retailers cannot be predicted with certainty, when we talk about the future cooperation of retailers and manufacturers, two things are certain. One is that manufacturers and retailers who continue to waste, spend ineffectively or lose money on a high percentage of their promotional programs will definitely lose market share and competitive positioning. The second certainty is that manufacturers and retailers who run promotional programs without any consideration for whether their partner in the channel of distribution is making a profit from these programs will find the amount of people willing to cooperate and lose profits with them shrinking. Only those manufacturers and retailers who develop a long-term strategy that allows both parties to benefit will become stronger, bigger and survive in the future. ■

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