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The End of Trade
“Spending”?
*Two New Approaches
Can Recoup This
Investment*



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CONTACT INFORMATION

Chicago

Paul Leinwand

Partner
312-578-4573
paul.leinwand@booz.com

Cleveland

Steven Treppo

Principal
216-696-1570
steven.treppo@booz.com

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The End of Trade “Spending”?

Two New Approaches Can Recoup This Investment

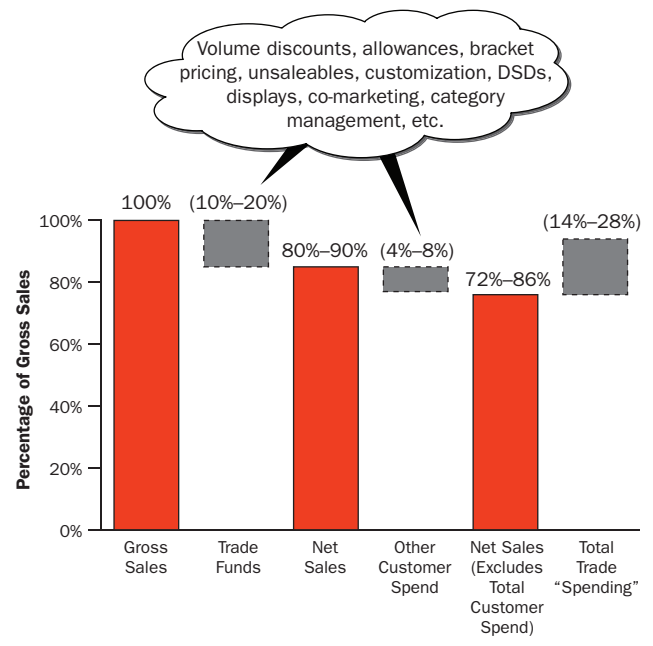
Although the end of trade spending may be on the horizon, its demise is not occurring fast enough for most consumer packaged goods (CPG) executives: Manufacturers sink a significant amount of cash into trade spending in combination with other customer spend—as much as 28 percent of gross sales (see Exhibit 1). But thanks to two specific changes in the way manufacturers are approaching their retail partners, the days of trade “spending” as a losing investment may be giving way to an era in which trade investment is a win-win.

Historically, retailers have treated trade spend as a well-deserved entitlement. CPG manufacturers have largely turned their funds into accruals, which has had a positive impact on linking investment to performance, but at the same time has been challenging in terms of providing the right investment to the right customer—especially in this era of “shelf-centered collaboration,” in which leading retailers and manufacturers must work closely together to optimize every aspect of the value chain, including trade spending¹. A truly collaborative relationship between retailer and manufacturer must address the underlying issue of how to see (and, more important, how to spend) the money as a true investment in the joint business.

There is good reason to be optimistic. Two concepts that have been incubating for some time offer the potential to bring tremendous freedom from the

historical challenges of trade spending by reducing complexity and introducing simple, fair, measurable metrics (see Exhibit 2, page 2). These ideas are now taking hold in the market, and several companies have already begun to execute elements of both. In fact, a recent benchmarking study that Booz Allen Hamilton conducted in this area showed that nearly half of the companies surveyed are considering implementing one or both of these new ideas.

Exhibit 1
Impact of Trade Programs on Realized Revenue (Typical CPG Company*)

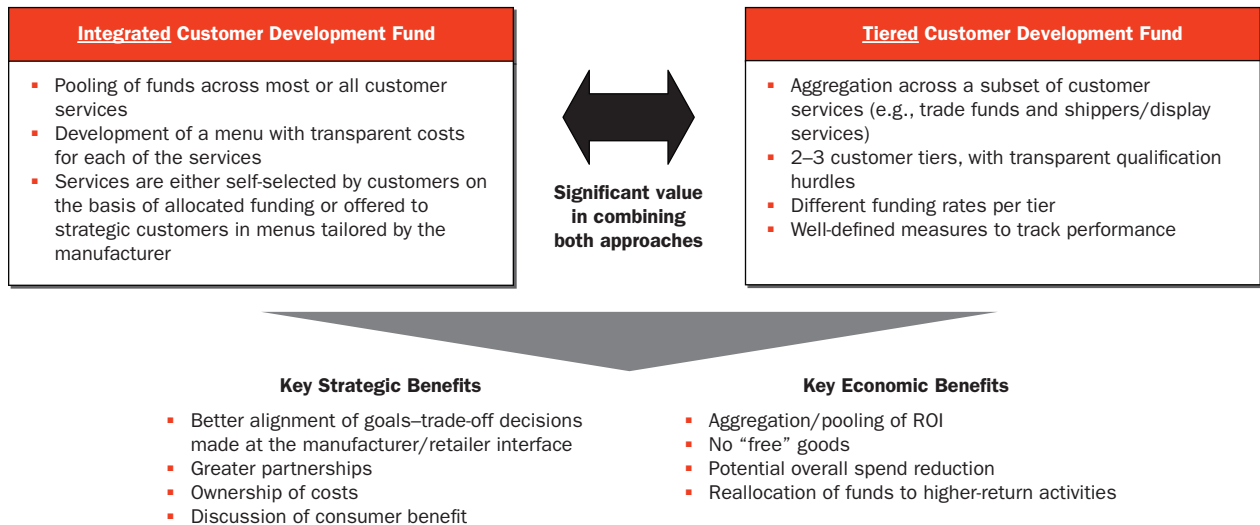


* Averaged spend of CPG companies in the following sectors: food, household products, oral care, and lawn & garden products
Source: Booz Allen Hamilton

¹ Rich Kauffeld, Johan Sauer, and Sara Bergson, "An Emerging 'Moment of Truth': The Case for Shelf-Centered Collaboration," GMA Forum, June 2007: http://www.boozallen.com/media/file/Shelf-Centered_Collaboration_GMAForum.pdf.

Exhibit 2

Two New Approaches to Trade Spending



Source: Booz Allen Hamilton

The first concept is based on eradicating “spending” and instead adopting an integrated Customer Development Fund (CDF). This may sound like a mere semantic distinction. The difference, however, is that in spending, the amount invested is determined by a narrow view of either demand or supply drivers, whereas a CDF encompasses both demand and supply drivers, and the customer and the manufacturer’s account team jointly make the call on what is the best investment. Having the people on the ground decide how to stretch the investment makes more sense than leaving that decision to a one-size-fits-all approach devised by headquarters, which was the case in the traditional model.

The second idea involves a tiered CDF with full disclosure of the criteria for incentives. Companies (and their lawyers, no doubt) have long debated the Robinson-Patman Act addressing price discrimination—and how, ideally, they would offer different incentives to customers who actually invested in the business. The idea of a fund that varies incentives but does so on an equitable basis is a breakthrough in terms of both the dialogue and the investment.

#1: Bring Partnership to Funding: The Integrated CDF

The days of a fund for every bell and whistle of

manufacturers’ go-to-market programs have tired out customers, the teams that manage the myriad of funds, and the finance staff who make valiant efforts to keep track of the mayhem. Many companies have more than five types of funding vehicles and countless other cost “buckets” that essentially are used to provide unique solutions to customers (see Exhibit 3, page 3).

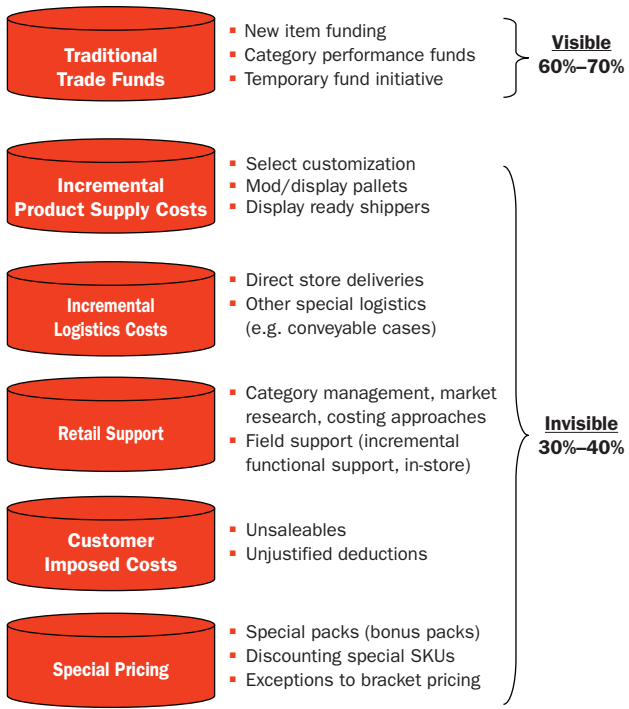
Worse, most of the decisions for what a customer “earns” are made by marketing and sales departments at headquarters, far from the customer—and with no sense of what works best for the retailer’s bottom line. In fact, a recent Booz Allen study on customization showed that more than half of retailers reported that most product customization efforts on the part of manufacturers are a waste of time².

The integrated CDF approach is simple: Bring the various funding and cost buckets together and, more important, leave it up to the customer team and the customer how that money should be invested (see Exhibit 4, page 3).

An additional benefit is that this approach virtually eliminates the “free goods” that result from customers’ and customer teams’ requests for customer-specific spending, including unique SKUs, packaging, shippers, and displays—requests that create a troublesome

² Rich Kauffeld and Matt Egol, “Creating Value through Customization: Winning Through Shelf-Centered Collaboration,” http://www.boozallen.com/capabilities/Industries/industries_article/14450926?ipid=827466.

Exhibit 3
Traditional Cost Buckets



Source: Booz Allen Hamilton

good investments, they will continue to be part of the customer plan—but prioritized along with other choices.

The integrated CDF offers a significant opportunity to reduce complexity while taking advantage of a cost opportunity and deepening relationships with retail partners. For instance, three companies in our study said that they had integrated customized SKUs, shippers, and displays into their CDF. That provides real benefits to their customers while ensuring that manufacturers are not giving away the farm.

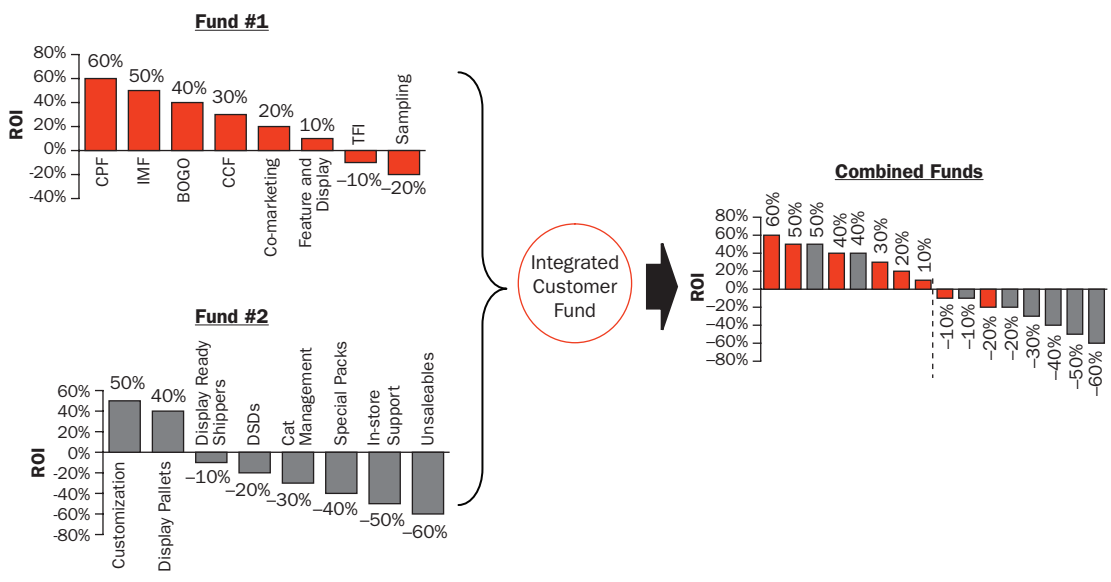
#2: Invest Where You Should: The Tiered CDF

The industry has long struggled to balance the challenge of being fair with the effort to allocate more funds to customers that provide better returns. Partly a legal issue under Robinson-Patman, partly a business process issue since it's much easier to fund everyone at the same level, the one-size-fits-all approach is one that companies have traditionally used. The problem with this approach, as most sales executives know, is that some retailers are grossly overfunded and others are starving for more investment.

number of ad hoc processes and approvals. Under the integrated CDF, if those requests are indeed

That brings us to the tiered CDF approach, in which manufacturers' trade programs are differentiated in a

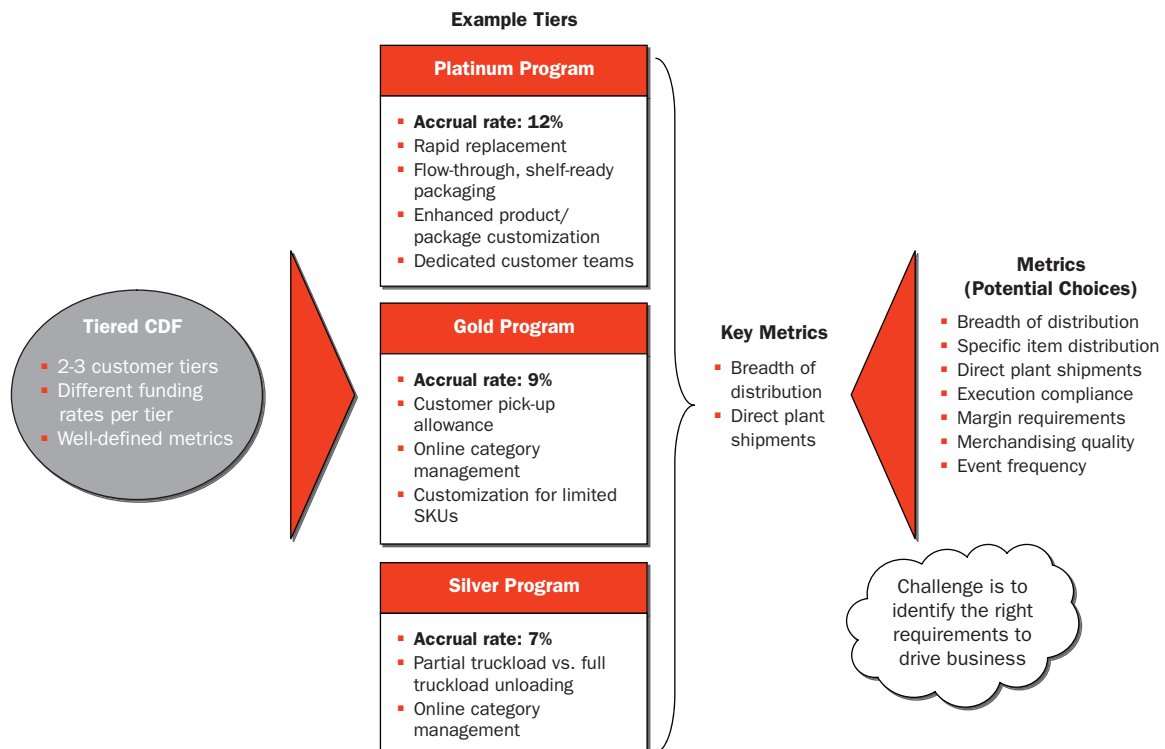
Exhibit 4
The Integrated CDF Takes a Holistic Approach to Spending



Source: Booz Allen Hamilton

Exhibit 5

The Tiered Funding Approach Rewards Increasing Performance



Source: Booz Allen Hamilton

transparent manner with simple but powerful metrics, such as breadth of distribution, that drive the overall business (see Exhibit 5). Tiers motivate customers to move up and earn more—and if the metrics are chosen intelligently, manufacturers are actually thrilled to spend more.

The benefits are significant, since manufacturers drive the behavior that both they and their customers want, while taking trade dollars out of some accounts and offering other accounts the opportunity to earn more. Better yet, the program is completely equitable and fully disclosed.

The key to getting the tiered CDF approach right is ensuring that the metrics are simple, fair, and measurable. One company, for instance, made ROI its key metric—and then ended up mired in discussions of how to accurately measure ROI.

Getting the Details Right

Essentially, both CDF ideas are simple, and although they can be pursued independently, companies are

more likely to reduce complexity and achieve optimal results by pursuing them together. Manufacturers can bring all customer funds, visible and invisible, together to create one optimal master fund. Alternatively, they can start with current funds and tier them to drive the right customer behavior. Ideally, they would integrate all their funds and then introduce tiers into that one fund.

The ideas are clear, but the execution is not easy. The hardest work for manufacturers is making the tough choices on how to structure the solution based on the profile of their business, their strategy, and the nature of the partnerships they want to build with customers. For instance, a company with a lot of business that's driven by customer marketing—incorporating TV, radio, and in-store signage—would find that including marketing in the integrated CDF and providing incentives related to it would be very helpful. In another example, a company whose profitability is driven by base distribution can use the tiered CDF approach to provide incentives to retailers that provide the right distribution for key SKUs.

In contrast to trade spending projects of the past, these programs offer good news to customers—so

the implementation challenge, while never easy, has a happy ending (see Exhibit 6).

Exhibit 6
Key Questions and Challenges in Implementing an Integrated and/or Tiered Fund

Key Questions	Challenges
<ul style="list-style-type: none">▪ What are the right levers to include in the customer development fund?▪ What should the tiering levels be?▪ What measures drive performance but do so in a simple manner?▪ What would be the estimated impact of such a change?▪ Are the right processes and systems in place to monitor performance and track progress?▪ How should the program be piloted to ensure success?▪ Is the organization ready for such a change?	<ul style="list-style-type: none">▪ Picking the right customers to start with<ul style="list-style-type: none">– Ideally, this program would be implemented across all customers, but...– ...to maximize impact, the program could be rolled out across specific channels/ customers that are winning in the market▪ Aligning incentives within the organization<ul style="list-style-type: none">– Typically funding sources vary by type of fund (sales vs. operations) and incentives vary by organization– Success in this approach will require both sales and operations to be incentivized by customer-level profitability– Senior management involvement is necessary to reset expectations across functions

Source: Booz Allen Hamilton

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