A Solid Framework for Trade Funds Management

BY DECK MURRAY

MOST CONSUMER GOODS COMPANIES HAVE THE OPPORTUNITY TO IMPROVE THE EFFECTIVENESS AND EFFICIENCY OF THEIR TRADE FUNDS PROGRAM.

Total trade spending among consumer goods companies exceeds $25 billion per year at today's typical consumer goods company hovering around 14% of revenue[1]. This spending is generally exceeded only by the costs of production and salaries. Within these companies, there are typically armies of analysts with an arsenal of systems focused on almost every element of the P & L. Yet that same level of analytical rigor is rarely applied against trade spending. Rigorous trade funds analysis usually only happens when it is too late – after there are dramatic overspends or volume shortfalls.

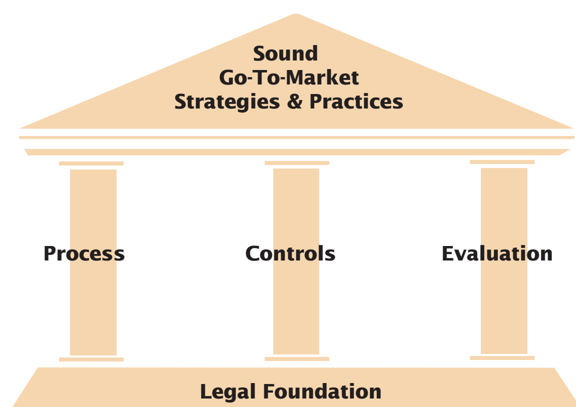
In our experience, most consumer goods companies have the opportunity to improve both the effectiveness and efficiency of their trade funds program. Unfortunately, it is very easy to defer the hard work necessary to build leading edge trade funds programs, tools and systems. This article describes a model for managing trade spending and identifies within that model how today's typical manufacturer is currently operating their programs.

Trade Fund Evaluation Model

Dechert-Hampe's model (Figure 1) for evaluating trade fund programs relies on five points:

1 *Sound Go-To-Market Strategies* – Regardless of the trade fund program's specific design or operation, it must operate under an umbrella of sound strategies and business practices. The simplest litmus test for determining the soundness of a company's go-to-market strategy is to identify if the company's business objectives are compatible with

Figure 1:
TRADE FUND EVALUATION MODEL



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TRAILING & LEADING EDGE GO-TO-MARKET APPROACHES

Trailing Edge	Leading Edge
▪ Funds are used to drive volume	❊ Funds targeted to incremental, profitable volume
▪ Funds are based on a percent of historical shipment volume	❊ Sales has accountability for determining and fielding consumer promotions
▪ Fund usage is governed by either wide discretion parameters or rigid rules	❊ Co-marketing and customization processes are routinely and efficiently deployed
▪ Little central direction on spending by product line or type of activity	❊ Trade Marketing skills are used with Sales skills to secure customer support
▪ Inventory loading is common	❊ Trade programs are synchronized with CPFR strategies

most customer's category and format strategies. A manufacturer that is constantly trying to further their own interests while ignoring the retailer's interests will have long-term challenges.

2 *A Solid Legal Foundation* – A solid legal foundation is as important as a sound go-to-market strategic umbrella. Manufacturers must have a high level, but firm understanding of all applicable laws and their trade policies must be executed in consideration of the risks involved.

3 *An Efficient Business Process* – Business process speaks to a company's operational execution. Efficient trade funds business processes include ensuring that information is available to field sales on the customer's timelines, that thorough planning principles are utilized, that funds are tracked as they move from plans to commitment to actual spending and that systems are in place to minimize the administrative burden.

4 *Appropriate Controls* – Controlling trade spending to an agreed-to budget is a fundamental pillar of any trade funds program. Controls can have many forms, including: controlling spending at either the "total spending" level or by product line, ensuring that management has accurate and timely reporting on fund activities, linking trade spending directly into an A/R or order management system, and/or routinely employing Generally Acceptable Accounting Practices.

5 *Effective Promotion Evaluation and Correction* – In order to build on promotion successes, and avoid repeating ineffective events, promotion and trade fund spending should be routinely evaluated and learnings should be shared and acted upon. Evaluation can take many forms, including measuring promotion results against the original plan, determining incremental lift, assessing % sold on deal or forward buys, calculating return on investment, and/or determining absolute and relative customer profitability.

Trade Funds Programs

As we examine a typical CPG manufacturer, we characterize their trade funds management programs in three general ways:

- *Trailing Edge* – Practices that were common during the late 1980's through the mid-1990's.
- *Mainstream* – Practices that are commonplace in today's consumer packaged goods environment.
- *Leading Edge* – Approaches that are generally progressive but are relatively rare among today's manufacturers.

As we reviewed various trade funds management programs we were cognizant of a company's size. It would be unreasonable to assume that a small organization would have put an elaborate software system in place. Likewise, it would be uncharacteristic to see a multi-billion dollar company managing trade funds with paper forms.

For the purpose of this article we have focused only on mid-size consumer goods companies and we have detailed below "mainstream" trade funds management practices. In addition, we have also highlighted some of the more traditional and leading edge practices that are also in current use by other companies of similar size.

Sound Go-To-Market Strategies & Practices

Today's mainstream trade fund management strategies have four major attributes:

1 *Brand objectives are translated into category management terms* – Two maxims sound so simple: "Think like the customer thinks" and "create a win-win situation." Of course, it is harder to do than it is to say, but those companies that can think like a category manager as they bring their products to market will have the greatest long-term success.

2 *Spending is targeted to specific product lines and types of activity* – It has always been difficult to execute a balance between brand specific funding and a single, universal fund. Most companies are now beginning to implement a single, flexible fund with guidelines to direct appropriate spending levels to individual elements of the brand's portfolio. These funds also provide guidelines on the types of retailer performance that have proven to deliver the best financial return.

3 *Funds are generated based on live accruals, not history* – Most mainstream companies have shifted away from generating funds based on historical shipments to funds based on live accruals. These companies have also developed tools and systems to manage funds on this basis as well. A live accrual approach enables the manufacturer to more closely align its trade funds spending with growing customers and prevents over-investment in declining customers.

4 *Customers receive their funding in the manner they choose* – The sales organization can efficiently disperse funds either via lump sum payments, off-invoice allowances or pre-authorized deductions. Importantly, Sales can also create Everyday Low Pricing Contracts, with the negotiated price executed through the manufacturer's order management/invoicing system.

Solid Legal Foundation

Today's mainstream consumer goods manufacturer generally has a solid legal foundation for their trade funds program. Robinson-Patman (see next article) and other appropriate laws are clearly understood, the company's trade policies are de-signed to encourage significant compliance, and there is adequate knowledge of the risk factors involved with non-compliance. Additionally, there is an active effort underway to address issues that fall outside the company's policies.

TRAILING & LEADING EDGE APPROACHES TO APPLICABLE LAWS

Trailing Edge	Leading Edge
▪ Adherence to Robinson-Patman is either rigid or loosely enforced ▪ Spending attributed to "meeting competition" was often overused ▪ Some Tier III customers do not receive proportional funds because activities are focused only at fast growing customers ▪ Management is unaware of level of compliance except at only the largest of customers	❊ Total customer controllable costs (including customization, unauthorized deductions, unsalables and other sales and logistics related costs) are factored into funding levels

An Efficient Business Process

If there is a single common issue with today's mainstream companies, it would be that most continue to have business process inefficiencies and lack systems to effectively support their go-to-market approach. Although the vendors of leading trade funds management technology have made significant progress in developing complete and integrated trade funds management systems, there remains significant room for improvement. In a recent Trade Funds Technology Assessment conducted by Dechert-Hampe, we found that while each of the major vendor systems excelled in certain areas, no vendor's trade fund management system excelled in all areas. As a result, most CPG companies are still wrestling with a combination of manual forms, patched processes and system disconnects.

Despite these shortcomings the business processes of today's mainstream companies do share the following attributes:

1 *Management focus is placed on planning, not spending* – Actual spending analysis is helpful in preventing the "He who does not learn from history is doomed to repeat it" syndrome, but this knowledge is actually only helpful to the account manager. At most companies, management is instead focused on the planning of trade spending and rightly so. In this way they place themselves in the best position to shape the business before it occurs.

2 *Transactions (actual spending) are automated, but planning and commitments are still managed by spreadsheets* – Systems that integrate historical shipments, scan data, base and incremental volume calculations, promotion history, and include what-if capabilities and links to key corporate systems exist only in the rarest of cases. As planning is still somewhat more of an art than a science, it remains an island of limited automated support.

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TRAILING & LEADING EDGE BUSINESS PROCESS EFFICIENCY

Trailing Edge	Leading Edge
▪ Administrative burden on field sales is large and funds are managed by forms ▪ Deductions for spending are considered the norm ▪ Funds are managed by actual spending, not plans or commitments ▪ Fund amounts are issued to the field after planning has begun ▪ The level of funding available to the field changes to meet corporate needs	❊ All processes are supported with automation and the systems are interfaced with financial, order management, account planning and forecasting systems ❊ Deductions are pre-authorized and closed automatically ❊ Key Performance Indicators are generated automatically

3 *Ad hoc analysis are used to track Key Performance Indicators (KPI's)* – Because there are often inadequate systems to support the planning, commitment and tracking processes, management generally has low visibility to the status of the funds at any one particular point in time. As a result, efforts to analyze promotions, to assess customer performance or to measure progress against KPI's must be done via ad hoc analysis.

4 *Funds may be reallocated among customers and/or markets and/or product lines* – Although funds are typically generated on a per customer basis, policies have been established that give field sales the ability to reallocate and offer them equally to different customers. This practice has created enormous flexibility for the field sales force and has enabled the sales organization to shift funds away from customers that are not supporting the company's programs to those that are. However, executing these transfers has also brought about a large administrative burden. As Sales has typically not shown the discipline to appropriately debit and credit relevant customer accounts to reflect the reallocations, this area represents either a weakness in controls, or a weakness in process efficiency for most companies.

TRAILING & LEADING EDGE TRADE SPENDING CONTROLS

Trailing Edge	Leading Edge
▪ Period-end accruals are unsubstantiated estimates ▪ Total fund spending is regularly over budget ▪ Some sales regions have overspent, some have underspent ▪ The size of the trade budget is developed subjectively, not through quantitative analytics	❊ Cross-functional teams self-regulate the planning, commitment and spending process ❊ Activity based costing methodology is in place to accurately measure cost to serve

Trade Spending Controls

Anyone with enough experience in the industry can recall at least one sales manager who made their number, was paid their bonus, and then started having deduction troubles. Since many sales organizations have faced this situation, most companies have by now implemented adequate controls to prevent this from recurring. They have established processes to base year-end accruals on accurately reported spending commitments. Some additional controls that have been instituted by most mainstream companies include:

1 *Sales management routinely reviews proposed promotion plans of subordinates* – Mainstream consumer goods companies are adequately disciplined such that they have regular manager-subordinate reviews of planned expenditures.

2 *Major account plans and performance are reviewed by senior sales management, marketing and finance functions* – Senior management from various functions gets involved with major customers and stay "close to the business" through this review process.

3 *Spending is controlled at each management unit of the sales force and on a "case rate" basis* – Controlling trade spending to budget levels is a key management responsibility and is a critical element in effectively managing the P&L. Companies are moving away from controlling spending at the "total spending" level to controlling the "total case rate". Why? If sales utilizes the entire trade budget, but does not deliver the annual sales target/quota, spending has, in effect, been higher than budgeted and the P&L is adversely affected. If, however, sales must manage to a "case rate", then total spending "moves" with volume. This requires a business process that collects sales commitments as those commitments are being made to the customer. The same process that collects those commitments is able to report on spending by salesperson and at each level of management (territory) from the bottom to the top. This spending is captured at the total dollar level, but ad hoc analysis is generally required to determine spending per case.

Evaluation is Effective

Just as it does with business processes, today's typical mainstream company also has some room for improvement in the way it evaluates promotions.

1 *Post-promotion evaluations are performed* – The most critical element of evaluation is that it regularly occurs. The organization culturally accepts that self-evaluation is an important element of improving results over the long-term and that learnings will show both "good news" and "bad news."

2 *Reviews of expenditures vs. plan are not widely communicated* – Although the typical mainstream company regularly evaluates promotion performance, the learnings are not proactively communicated on a wide-scale basis. As a result, key learnings are often missed.

3 *Pilot programs are in place* – Today's mainstream company has pilot programs in place to evaluate customer profitability in the absolute, as well as in relation to other customers. A second area of evaluation is the integration of scan data with shipment and trade spend data. This pilot program will have invested in systems that support automating the integration of separate data categories.

TRAILING & LEADING EDGE PROMOTION EVALUATION PRACTICES

Trailing Edge	Leading Edge
▪ Promotion performance is rarely evaluated vs. plans or objectives ▪ Spending within budget and quota achievement are the primary measurements of sales performance	❇ Promotional learnings are widely available through knowledge management practices ❇ Promotional spending vs. investment is evaluated as part of a total customer investment

Conclusion

Given the relative size of the trade funds budget line, it certainly makes sense to operate your trade funds program with excellence. Since trade fund expenditures are projected to increase, and since trade funds should be used as an investment in generating revenue and building customer relationships, it becomes critical to "get it right."

With so much on the line, it is incumbent upon today's senior sales management to have an effective trade funds management plan (and act upon that plan) and to continuously improve the use of their trade funds so that these funds become a strategic and tactical competitive advantage for the company. V

[1] ACNielsen – 12th Annual Trade Promotion Practices And Emerging Issues Study - 2002