



# controlling Trade Spend

So you have done your promotional planning, does that mean no more problems? Unfortunately not. It is still quite easy to end up with a severe overspend situation. This is because most promotions have no limit on the amount the chain may wish to buy. Why this should be so is one of those things that has become 'part of the way we do business', and has no basis in logic. It is just as illogical as extended buy periods, for businesses where there is perpetual motion and a pipeline of product! But it causes very real problems. Even with the most careful of planning, unless you monitor the trade spend during the year, you will almost certainly get a big surprise at the end of the year. Planning alone will not control trade spend. In this section we are not concerned whether the trade spend is worthwhile, only with keeping the total costs within predefined boundaries.

## Accountability

The first step in controlling overspends is to make each account manager fully responsible for his overspends, and to make severe overspends a firing offence. While it is still necessary to institute a system to oversee the spend situation, do not make the mistake of thinking you can "control" account managers. This is impossible. Rather make them own the problem. Sometimes financial accountants think that they can control Account managers via a system. They forget that all it takes to spend \$250,000 is a phone call. It does not require a system to make a phone call, so the systems that are instituted will always be at the mercy of what the Account Managers put into them. So the only solution is to put the onus on control back with the guys who spend the money.

## Commitment system

You may need some sort of commitment system, or accrual system. This means that the costs of promotions are recorded in advance of their actual date, and estimated expenditure is recorded. This can then be expensed in the month that the sales are recorded, and prior to the receipt of some of the expense claims. The commitment system is there to try to charge to the correct month the trade spend. This is because claims may well take months to arrive, and if you only expense the claim at that stage, it is likely that the sales are now very low against that product, as the retailer has not bought since the last promotion! The result is that the profitability for the month may be unfairly reduced, simply because of a mismatch between promotional sales and promotional expense. So the commitment system charges the estimated amounts against the sales in the month that the promotion occurs. Then when the claim arrives, the difference will need to be written off, but hopefully this will not be large, and it might even be a credit adjustment, if you over estimated originally. However a commitment system will still not give you control. That is because the commitment system only concerns itself with this month and the months that are past. It does not know what the future holds. And it may well be that you are heading for an overspend after only one or two months of the year, and it may be very difficult to see this, and harder to fix.

## Controllable and Fixed elements

Of the total trade spend, a portion is fixed and a portion variable. Here traditional definitions of fixed and variable can confuse the point I wish to make. The fixed portion is typically rebates and other trading term components that are tied to turnover, and irrespective of any action by the supplier, will remain as a predetermined percentage of sales.

Of course you could point out that means they are variable according to traditional definitions, but in as far as one can exercise control, these expenses are fixed in relation to sales turnover. These trading term components do not generally pose a problem in maintaining control because of this relationship.

In reporting trade spend, I often find that all components are added together, and reported in total. This can lead to the fixed components obscuring movement in the components that are under management's discretion. For example, if a company has 12.5% warehouse allowance, and 8% rebates, and in addition spends 6% on case deals during price promotions, this totals 26.5%. If case deals are out of control, and end up as 8%, the total obviously moves to 28.6%. This movement from 26.5% to 28.6% is not as severe a variation as 6% to 8%, which is a 33% overspend. It is essential to identify those components which are in this sense variable, and to ensure that they are kept under tight control. This is where the overspend will come from.



## Allocating Dollars or controlling against % spend

Since trading terms are frequently derived from a percentage to sales, it is common to find control systems that are set up that way. One may find for example, that provided trade expenses are less than 14.2%, everyone is happy.

Due to this focus with percentages, control systems have evolved where different percentages are applied at each brand, to 'generate' funds for the planning process. Obviously it is important for the generated funds to match the trading terms in total. This approach has a certain elegance, but in practice can be hard, or even impossible to execute. If the company services two different channels, like grocery and pharmacy, one rate will 'allow' excessive spending in pharmacy, but fail to cover trading terms in grocery. For this reason, while it may be a good idea to 'generate' funds, in practice it often becomes necessary to convert this to a fixed pool of money, and to treat it as a fixed amount irrespective of the level of sales that occurs during the year. However many suppliers prefer to make their account managers responsible for achieving certain percentages to sales, rather than a fixed dollar amount of trade spend.

There is an exception to this suggestion that I have come across. One of our 'Icons' has a percentage of sales on promotion somewhere around 90%. At that level, it is clear that the most important issue is the average cost of the trade spend as a percentage of sales. Setting fixed dollar budgets would be possible, but the management focus would always return to the relationship to sales revenue. It seems ironic that if so great a percentage is on promotion, one should take the focus off the promotional issues, and look at the total business. In fact because the non promotional sales are so small, this approach is an effective way to monitor total spend levels.

## Sales decline

In the recent past Coles has shown sales declines in some States, and suppliers have been pressured to maintain, and in some cases to increase spend levels. If an account manager is responsible for achieving a specified spend % to sales, and sales decline, then the percentage will not be achieved. In fact there is likely to be a very large overspend, as it is likely the account manager may have spent more funds in the hope of redressing the sales drop.

If of course sales grow strongly, then the additional sales will "generate" more funds. If the trading terms are strictly monitored, as indeed they are, some of the additional monies will be deducted or claimed. Unless additional promotions are planned, this additional money will not be spent. However in most cases additional promotions will still require matching case deals, so to spend the additional accumulated funds will require the spending of more money.

The best approach appears to be setting total dollar spend levels, and to control spend in this way, rather than to slavishly follow percentages.

## Controlling Total Spend

Controlling total spend is done typically six months out. Some companies try to control trade spend but only track the costs that are involved one month before the promotion occurs. This means that they are not able to focus on the trade spend for a full six month period, never mind a full year. The only thing that they can do is try to budget spend for each month, and then plan accordingly. However the nature of promotions, the size of the expenses and the timing of the charges means that a monthly budget is all but useless, and unless you continue to focus on a full six month period, or a full year, you will not end up under control. If you only focus on a month at a time, at the end of the six or twelve month period you will be overspent, as there is no mechanism to recover overspends in previous months by cutting back in the future.

To be honest, now that promotional volumes exceed 60% on average for most companies, if you need to forecast or budget accurately by month, you will have to do the entire 12 month promotional plan before you complete the annual budget cycle! Account managers will explain that promotions are only firmed up four or six weeks out, and that depending on the market place, the promotion could be a shallow price cut or a deep price cut, and on and on. No matter, planning needs to be properly done and in detail.

If you only track the total of your actuals plus the month that is coming up, then it is very hard to know that the trade spend for either a six month period, or for a full year will end up at x% to sales.

The control system should as an absolute minimum record separately the co-op and the total case deal. Better is a product variant by product variant list of anticipated volumes and individual case deals, and the co-op amounts. It also needs to cover the full six month period, and if accounts again move to 12 month periods, it would need to cover 12 months. It must track the current actuals plus the forecast planned promotions to give a prediction of the end of period position.

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If all case deals are off invoice, and the buy periods prerecorded in the control system, the main frame can track the case deals. The co-op would normally be by a claim. There is good reason to have all case deals off invoice, rather than by claim, but with some banners getting their own promotions and buying through shared warehouses, the off invoice is not possible.

Co-op is not generally the problem, except possibly for co-op outside agreed terms. The real problem is case deals. The typical problem is a promotion planned at 2000 cases where 4000 cases are bought. If this simply ends up in the warehouse, as some of it almost always does, there has been no advantage in terms of consumer response, and the case deal which was planned has been exceeded by 100%. The ex factory sales will increase by 2000 cases, but as there was no real increase in consumer sales, but the case deal spend has increased by 100% on that promotion, and ex factory sales will decline next month. With \$30 million trade spend budget, it is quite easy to get a \$4 or \$5 million overspend. And that comes straight off the bottom line. And next year the Chain will want an increase over that overspend figure!

If the control system is reviewed monthly, the cumulative expected spend situation to the end of the planning period can be monitored, and if necessary promotions will have to be cancelled in the last few months of the period. If your peak sales period is December, as it would be for many, this is not the time to have to cancel promotions, because you have overspent. Your sales will suffer, and the trade will get very irate. Towards the end of year you have to be very careful that all, absolutely all planned promotions are in the control system. If you are not careful you will get a nasty surprise in late January when claims arrive that were not accrued.

It is often a practical problem to get all claims in fast, which is why off invoice is preferable. If you only get the case deal claim three weeks after the buy period ended, you may find there was a very large buy right at the end. By the time you process that in the accrual system, it is already four weeks after the buy period ended, and with 'week after' buy periods, five weeks after the consumers saw the promotion. This makes it very hard to react by adjusting future promotions.

With promotions having generally three weeks in front as a buy period, if you have only eight weeks between promotions, you can't cancel the next one, as it is already too late. More and more people are coming round to the view that promotions should be for fixed agreed quantities, and the buy period concept should be ditched. 'Not a penny more, nor a penny less'. A good line to draw in the sand. Certainly if you are spending trade spend outside of trading terms you should insist on fixed quantities.

A favourite trick is for account managers to forget to put promotions in the control system. Or to change the promotion significantly, change the price point (i.e. go for a different retail sell price) and the case deal without updating the control system. All it takes is a phone call to book or change a promotion. One phone call can commit \$100,000 of funds. The answer is to fire those who won't follow the rules. No exceptions. You can't catch them, they have to monitor themselves. By the time you catch them it will be two months after, at least three months too late.

If a control system is to be totally successful, it has to have the following characteristics:

- Cover the full six months at all times, or even better the full year
- Split expense into sources of funding, e.g. marketing money, new line money etc
- Compare back to preset totals of funding sources, which need to recognise which are fixed, and which are related to turnover
- Be updated for actuals, and charge the greater of plan or actual until the promotion is completed

Provide a means of 'closing' out the promotion, thus releasing and planned funds where plan was greater than actual. This is particularly important in identifying potential overspends because terms are under committed, but will have to be paid anyway.

## Case Deal in Terms

A number of suppliers have negotiated quite complex trading terms, and one variant is a fixed percentage off all sales, but where one portion say 4% is co-op and another 1% or 2% is towards case deal. As a means of reducing overall trading terms, where 6% used to be co-op, this situation has some merit. But if the account talked you into moving from 4% co-op to 4+2 you got severely caught.

Controlling this also has problems, as does controlling "National" promotions. This means you now need to determine the funding source for each promotion and to keep separate cumulative balances, as well as the running total of actual and future planned. What makes this task even more difficult, close to impossible, is that some companies now end up with mixed funding. For example part of the case deal may be funded by the terms, the balance funded by marketing funds, and the co-op may itself be mixed.



Just recently some companies are running promotions with two case deals, one on purchases during the buy period and another case deal on scan sales during the sell period! No doubt this helps focus on selling out, but it substantially increases complexity, and doubles the administration costs.

I can only think that the people who agree to these complex situations do not try to figure out what will happen on a typical promotion. It is not that it is impossible to monitor, it's just that complexity increases the likelihood of an overspend. In the end a dollar overspent is the same colour no matter what it was called. The result that I have seen is commitment systems which only monitor the source of funding. i.e. is this terms, discretionary, or marketing funded. The commitment may not even tell you if it is case or co-op, as in essence it becomes a tracking system for various funding mechanisms, rather than why the money was spent. The accounting equivalent is describing depreciation of plant and equipment as being 'Barry, the production manager's cost centre expense', because he runs the plant. I have even found hybrid systems where co-op monies are funded from case deal funds and vice versa, and systems have to be designed to bend around these requirements.

The real problem comes with the Case Deal as %, where quite often the account encourages you to use 'straight monies' in the beginning of the promotional period, or money that is not part of this %. They have good, if irrelevant arguments why you should do this. One of them goes you can't spend 'Terms' till you have accumulated it, so you must first spend 'straight money'. What happens goes as follows. You first spend case deal that is outside terms, and they buy up big, getting lots of stock into the warehouse. Now you already have an overspend, although it may not yet be visible, depending on your commitment system, and all that is left are 'Terms' promotions. Then you run the 'in lieu' or 'terms' promotions, the ones funded out of 4+2. However the 4+2 is a deduction from invoice across all sales, or a claim, but either way they automatically get it, even if you cancel the promotions. So by the end of the period the account will get all the money no matter what happens on the promotion. If now these 'terms promotions' are not a big success, the account will get all the co-op and case deal anyway. If you schedule another promotion, to use up the Terms funds, you may find you need to top up the funds with straight monies. The co-op and case deal will not run out at the same time. Inevitably one or the other will run out first. This may not be apparent till the promotional period is complete, and the account informs you that you have 'underspent' or 'overspent' and here is the bill.

There are two messages here. First if you have this sort of arrangement, all 'over & above' or 'Straight Monies' promotions must be for fixed order quantities. The overspend is caused by the excessive buy of Over & above monies before the Terms monies are used. Secondly the "terms" promotions absolutely must be scheduled first, and if they are a success, 'straight' or 'over and aboves' may be scheduled, or if they are not a success, cancelled. This will be resisted by buyers, because they know the score.

The point they conveniently forget is the 4+2% is the supplier's money, held in trust until activity is scheduled. It is not their money till they have delivered the promotions it funds. In reality it is too difficult to try to manage both a fixed cost like co-op and a variable like case deal out of another variable, the 4+2. The co-op is manageable, as the six monthly promotional plan handles this, but first prize is to withdraw the 2% case deal from terms, and to make it discretionary. Another line to draw in the sand!

## A manual Control System

Most companies now have computer systems to track trade spend. But if you have to do it manually, you need two things. Firstly create a numbered set of 'PAF' forms (Promotional Advice Form) This has the following data on it:

- Promotion Number
- Date of Promotion
- Type of Promotion
- Objective of Promotion
- Account
- Buy Period
- Co-op Charge
- Products, quantities and case deals
- Extended Case Deal costs
- Expected Revenue (List Price x quantity)
- Cost as a percentage of revenue (Co-op + Case Costs)
- Payment mechanisms - Off Invoice, By Claim, Co-op by Cheque etc

These should all be filed, awaiting the claims verification.

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The next part of the system is a spreadsheet set out promotion by promotion, and account by account which adds up the case deals planned, deducts any actual case deals paid and shows a balance if the actual is less than planned. As claims are received, they should be verified against the PAF, and entered in the spread sheet. Every month review old promotions to see those that are possibly three months old, so that you can close the promotion, by setting the balance of planned expenses to zero.

## Key Steps in Control of Trade Spend

Work out how much co-op your trading terms will generate. Make sure you know if this is off net or gross sales.

Find out if there is any other co-op or new line monies expected to be spent, and finally decide on the total co-op figure that you will use in the initial promotional program. It is often a good idea to hold a bit back, and it is also important to be able to convince the Account that the figure is realistic.

Decide on the mix of products and promotional vehicles. You will need input from marketing, as you should align programs to their media schedules. Also decide on the objective of each promotion, and the appropriate level of case discount to achieve that objective. Ensure there is adequate separation between promotions, as you do not need to encourage investment buying. You need to know if pension weeks are better for your products etc. Scan data can help here.

Work out the cost of each promotion, including case discounts and co-op. Make sure each promotion individually has reasonable financial evaluation, but also bear in mind that some products will be more expensive than others. Buyers will happily 'give' you additional "free" promotions just to get the case deal, so these are not free promotions. You need to know whether you really want to use up all your co-op, or whether you should be trying to minimise the number of promotions. (Which will upset the buyer) Work out the total spend expected for the full six months, (and possibly 12 months) as a percentage of total sales expected. Make sure this is within management guidelines. Enter all promotion details on a 'PAF' form or something similar.

Negotiate with your buyers for the slots needed. If necessary readjust the program and if necessary recalculate any promotions that have changed structure.

Build a control system yourself using a spreadsheet if your company does not have a satisfactory system. Enter all the planned promotions from the PAF forms.

When each claim is received, allocate it to one of the promotions, which are all numbered. Each month update the planned expense values with actual case deals, and enter the actual sales achieved. Make sure that there is a balance of expected expenses, unless actual is greater than planned. As soon as practical, close promotions, which means setting any planned balances to zero. Also adjust any upcoming promotions where you have decided to increase case deals, or change promotional types, or add products etc. Make sure that your % to sales for the whole period is always within guidelines. On a month by month basis, you may spend more or less, due to the timing of claims and sales, but you must ensure the total for the six month or twelve month period does not exceed your management guidelines.

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