Best Practices for Trade Promotion in Consumer-Packaged Goods

TABS Analytics

Executive Summary

Trade promotions are an essential part of consumer-packaged goods ("CPG") sales. Promotions can range from trying to boost awareness of a product, to taking advantage of times when a given product may be in high demand, to unloading inventory before it is no longer usable. However, implementing a trade promotion successfully requires a significant investment of time and money. Failing to get the desired traction that you want could result in a negative return on investment.

Compounding this issue is that many CPG manufacturers have the wrong idea of what are "successful" trade promotion metrics. Charting the wrong metrics and measuring sales of your promotions incorrectly leads to sub-optimal performance and ROI. Our goal in this whitepaper is to not only provide a data-driven look at what trade promotions perform successfully but also show how you can best measure them with your own data. Both these steps need to be combined to follow a best practices approach.

To source the data for this whitepaper, we used a combination of masked data from syndicated providers and TABS Analytics proprietary calculations, using our promotion analysis tools like AccuBase® and Promo Insights™.

Begin With a New Framework

A fundamental issue that we see with a lot of companies getting started with trade promotion analytics practices is that they adhere to an outdated framework. Right now, most conversations about trade promotions break things down into two areas:

- Trade promotion management (TPM)
- Trade promotion optimization (TPO)

However, when you take a closer look at these two processes, you see that more steps are needed to refine your promotion analysis.

For one thing, we suggest converting the two existing areas into:

- Trade promotion implementation (TPI)
- Trade promotion measurement (the new TPM)
- Trade promotion best practice (TPB)
- Trade promotion planning (TPP)
- Trade promotion optimization (TPO)

In this case, trade promotion measurement uses metrics to figure out what works and what doesn't work with a given project, category, or brand. Then, you determine the best practices of a promotion relative to said brand/category. The next step is getting data input based on software or another data collection process. The two last elements are planning and optimization. To execute these, you need to create an optimization model that your account manager or sales team can put into practice.

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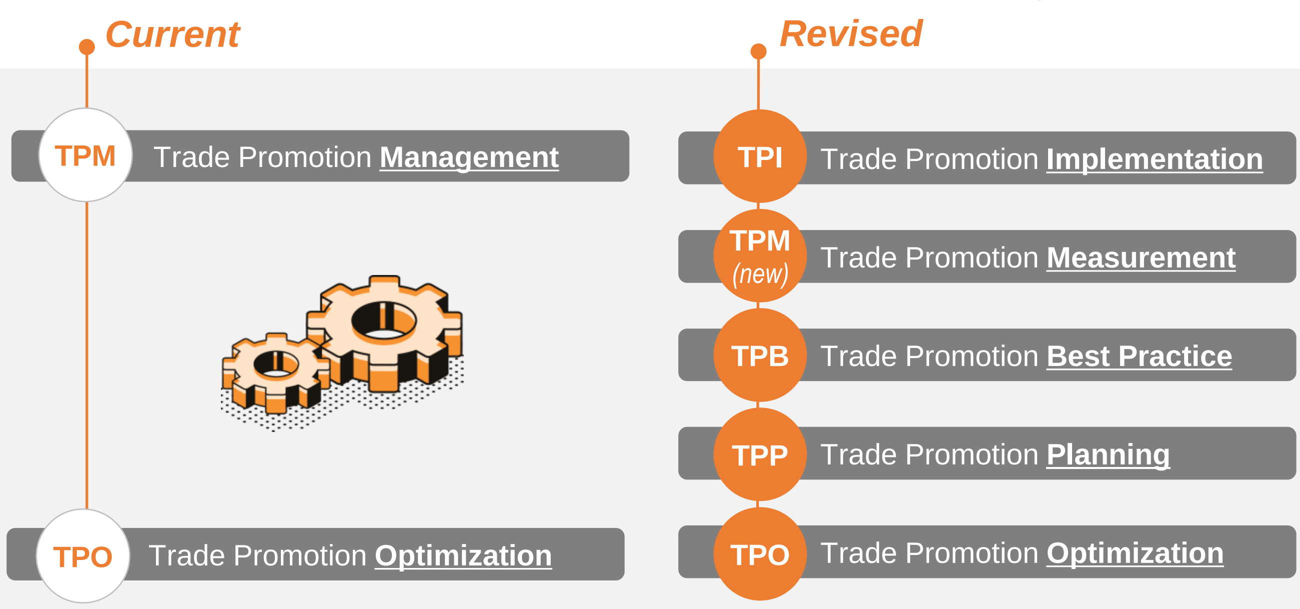
A New Paradigm For Trade Promotions

Here's the conventional mindset on trade promotions versus our new spin on things.



The Metrics You Need

Considering this new mindset, what exactly is the best way to measure your promotion's success when it goes into action?

A lot of well-meaning companies get things wrong here. They may try to focus on things like retail dollars or shipment dollars. The problem here is that it can be difficult to equivalize the product into volume. For example, if you are selling paper products, it may be in rolls or sheets. If you were selling a food product like candy, it may be in pounds. If you were to be working with beverages, it may be in cases.

Our recommendation, in this case, is to focus on measuring consumer units. This metric allows you to easily convert things into whatever else you need, whether it's shipments, retail, or cases. One way to convert this is into *consumed factory shipments* (CFS). We define this as our net wholesale price, or whatever you're selling the product to a retailer to, times the number of retail units generated. For example, say your product had a net cost of $3.50 to retailers and you generated 600 units. This is $2,100 in CFS. That's key when we talk about gauging ROI moving forward.

Another metric that is arguably the most important, despite its underutilization, is the idea of what we call the *incremental factor*. The incremental factor is the number of incremental units generated divided by the number of total units sold. What this does is show us if you were to eliminate promotions tomorrow on a total company basis, what percentage of business you would be at risk.

For example, let's say that you were doing three different promotions and moved 400, 350, and 600 units, respectively, during those promotions. By comparison, the baseline sales (units sold that were not on promotion) would be 100 units. Over a 10-week period, we would see 1,050 incremental units sold versus 1,000 baseline units sold. This makes the incremental factor 51% (1,050/2,050). That means if you were to stop promoting, 51% of your business would be at risk of going away.

The ROI Question

How does this translate to a best practice for measuring ROI? You can use the incremental CFS generated by a promotion dividing by what you spent on the promotion. As a result, you can see the ROI based on internal margins for your brand or category, without having to factor in all internal costs like logistical costs, cost of goods, etc. So, you'll have a metric that's easier to share and understand, which makes the profitability question a lot more accessible. The goal now becomes that for each dollar you spend on a promotion, you need to generate two dollars in that incremental retail consumption, or three or whatever threshold ROI applies.

Following our previous example, let's say we spend $1,500 on the three events and they generate $3,675 cumulatively. That generates a 2.4 spend ratio, or ROI ($3,675/$1,500), and if your internal gross margin is greater than 42%, you know you were profitable (1/.42 = 2.38). Our method saves you time from trying to find out the profitability of each event. What you need to know is whether you are making money or not and the spend ratio and gross margin comparisons will tell you this.

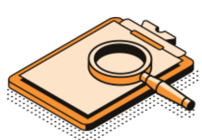
How To Gauge Trade Promotion Success

Everyone wants a successful trade promotion, but many don't understand what it takes to actually determine if something is successful or not. Here are some of the key notes to keep in mind.

Focus on consumer units:
This metric allows you to easily convert the product you are working with, whether it's food, paper goods, or anything in the CPG segment.

Use consumed factory shipments:
This metric is how much you're selling the product to a retailer for multiplied by the number of retail units generated.

Use the incremental factor to gauge ROI
This shoes how much profit you would lose if you were to halt all promotions tomorrow.



Don't get too focused on individual profitability numbers:
The main question is if you are making money on your promotions or not. The incremental factor will showcase this.

What is Data Harmonization?

So, calculating an ROI using the right metrics is a key for success, but there is another critical part of sales promotion analysis that rarely gets discussed: data harmonization. For example, a lot of companies talk about the idea of analyzing big data in terms of leveraging software tools, but that isn't nearly as effective if the data isn't harmonized properly. To do so, you should harmonize:

- Event-level spending
- Ad performance
- Ad images
- Other related data

Having data harmonized allows you to put the best practices into action and get to the critical insights. This includes understanding promotional dates, your promoted brand sizes and event-level spending.

Redefining this process of harmonization is also important. Many manufacturers believe in starting with their implementation before optimization. Our counterpoint is to go to the measurement step right away. This lets you figure out exactly what your impact on sales is compared to what you are spending. After that, you can combine planning and optimization, and implement software to manage all these promotions. A lot of companies are starting backward by buying software to manage the data rather than learning how the data works, then using software to do the job at scale.

Busting Myths On Tactics

Many companies may already have trade promotion tactics that they favor, and on the surface, they feel that they're successful. However, as the prior sections point out, a lot of companies are basing their understanding on faulty metrics and measurements. When we apply our methodologies to the data, what trade promotion tactics show up as the best? Here's a rapid-fire look at our insights here.

- Displays aren't particularly effective if there are no price discounts available. Designing them, implementing them, and managing them comes with a high dollar cost and time toll that rarely pays off. The one exception is the consumables sector. One side benefit of displays is the ability to hold extra inventory for a hot promotion, but that's hardly worth it.
- Bonus packs generally do not pay out. Even with well-paired items, you're rarely going to get a lot of sales, and will likely end up with many "no shipments" after the end of the promotion. If you want to do a variant of this method, BOGO is the best option. However, you absolutely can't over ship.
- Loyalty cards don't equal loyal shoppers. In fact, it's just the opposite. Shoppers that buy these are willing to go to many different stores in order to pursue the best deals. With this said, they are also heavy shoppers by nature, so if you have the best deals, it can work.
- BOGOs can work well to generate lift, but percent off generally works better. This is especially the case when we talk about higher price points. Note that if you do go for giving a percentage off, it needs to be above 20% to get significant traction.
- Buy 2, get 50 (BOGO50) generally doesn't work well. In the retail drug channel, this is common, but it doesn't give the customer savings that BOGOs or percent off do. Customers are savvy to this and pass these promotions by.
- It is better to do fewer, deeper discount promotions versus more moderate ones. You will be more efficient on your fixed ad costs this way, and the demand curve steepens the deeper the discount.

The Facts On Trade Promotion Tactics

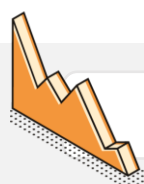
We analyzed masked data from providers to see how different trade promotions stacked up against each other. Here are some of the winners and losers from our findings.

Winners:

Percentage off:
Customers respond best to these types of deals, but you need it to be above 20% to get customer interest. This is especially important if you are selling a product like supplements at a higher price point.

BOGO:
BOGO is also effective for customer lift, but gets less useful the higher the price point gets.

Loyalty cards:
Success here is a bit of a tossup. Loyalty card owners are the least loyal shoppers, but they are also heavy shoppers. If you have the best deals, they will make good customers for you.



Losers:

Bonus packs:
You can come up with a smart combination, but the customer interest just isn't there. Use BOGO or percent off instead.

No-price displays:
The added inventory space is nice for a hot promotion, but there's generally too much work for not enough gain.

Buy 2 get 50:
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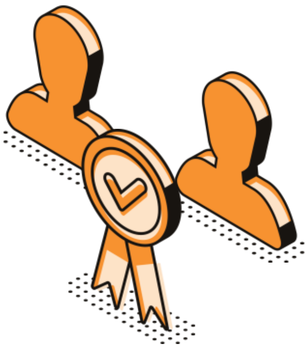
Executing Trade Promotions

At this point, we've been focusing on the planning stage. Now, we need to talk about best practices for execution. One common concept that a lot of retailers buy into is either asking to hold their penny profit or margin on a regular basis. The problem is this isn't realistic and is a bit of a pessimistic view. Lowering the price will make it more difficult to get the lower margins you need to maintain your profits. The end goal should be to get a break-even scenario to guarantee making money in the total value chain. Manufacturers know the costs of the goods, so they have more information than retailers do.



When that step is taken, how do you end up distributing the discounts? There's a real struggle here in ensuring that the manufacturer and retailer make money this way. Our formulas show that a manufacturer subsidizes a discount in a proportion to the profit they have in a value chain. So, if a manufacturer makes 75% of the profit in said chain, they cover 75% for each dollar's discount. This means they may need to:

- hold the margin
- create a larger margin to the retailer
- have the retailer accept a lower margin

The key in executing trade promotions is to make it a win-win proposition for both retailers and manufacturers.

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We should also begin to talk about some of the self-defeating tendencies that hamper the ability to really make money off a promotion.

First, is the concept that trade promotion spending is an inherently bad thing that is going to tarnish the image of a brand. However, effective trade promotion spending can increase profits, as some of our earlier examples have shown. The main issue here is manufacturers not caring about what their retailer partners make. This is a self-defeating mentality to have.

There are also barriers on the retailer's end. For example, some retailers are unwilling to be flexible with margins. Others take deductions and apply them across the board to all manufacturers. This is a mistake because there are some brands that just inherently get low responses. It doesn't really make sense to promote these. Instead, those promotional dollars should be deducted from larger or more responsive brands.

However, this mentality can go too far in the other direction as well. Some retailers decide not to promote smaller sales brands because they believe that these won't help them meet the goals of creating a set amount of volume via a given block of ads. However, this doesn't account for incremental ad blocks. As a result, larger manufacturers throw all their brands into an ad block, but the "kitchen sink approach" doesn't create a lot of lift.

What Does It Take For Your Trade Promotion To Succeed?

Let's sum up a basic roadmap that you need to take in order to create a successful trade promotion for your business.

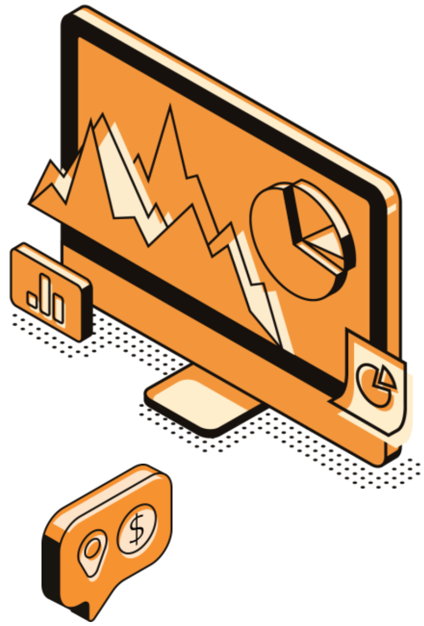
Adjust your frame of thinking:
Our model for trade promotions is more complicated for a reason. There are a lot of steps companies are missing when it comes to iterating and improving their promotions.

Using the right metrics:
Concepts like incremental factor and consumed factory shipments are easily translatable to different products, rather than needing to create a new metric for each type of product your company sells.

Being data-forward but not using software as a crutch: Eventually, you will need data software for long-term promotion efficiency and proper data harmonization. However, it's important to learn how the data you have works first before making this investment.

Trendy does not equal successful:
There are plenty of concepts like buy one, get 50 or bonus packs that may be popular, but don't actually show meaningful success. The same applies to models like live accrual.

Working with your partners:
Retailers and manufacturers can't afford to be selfish. Transparency and trust are key to creating promotions where both sides benefit.



Shifting Your Trade Promotion Paradigm

Our findings show that trade promotions are an important part of creating profits across the board CPG manufacturers. However, a lot of manufacturers are holding onto outdated or false tenets when it comes to their overall strategy. Our recommendation is a two-part shift to:

- Ensure that manufacturers and retailers are working together to create the most profit possible.
- Change from conventional metrics of success to more accurate figures, using data at every step of the way.

While your specific goals for a promotion may differ, the ultimate endgame is increased profits for your business. The practices outlined in this whitepaper are key for getting to that point and being able to analyze the sales and promotion data more effectively.

About TABS Analytics

Tabs Analytics, founded by Dr. Kurt Jetta in 1998, is a technology-enabled analytics firm servicing the consumer products industry. Our mission is to simplify and improve the way analytics is conducted through analytical innovation, which translates into a competitive advantage for our clients. TABS is the leading outsourced sales and marketing analytics firm in the consumer-packaged goods (CPG) industry.

For more information about TABS Analytics services or this white paper, please contact Robert Baldwin at robertbaldwin@tabsanalytics.com.