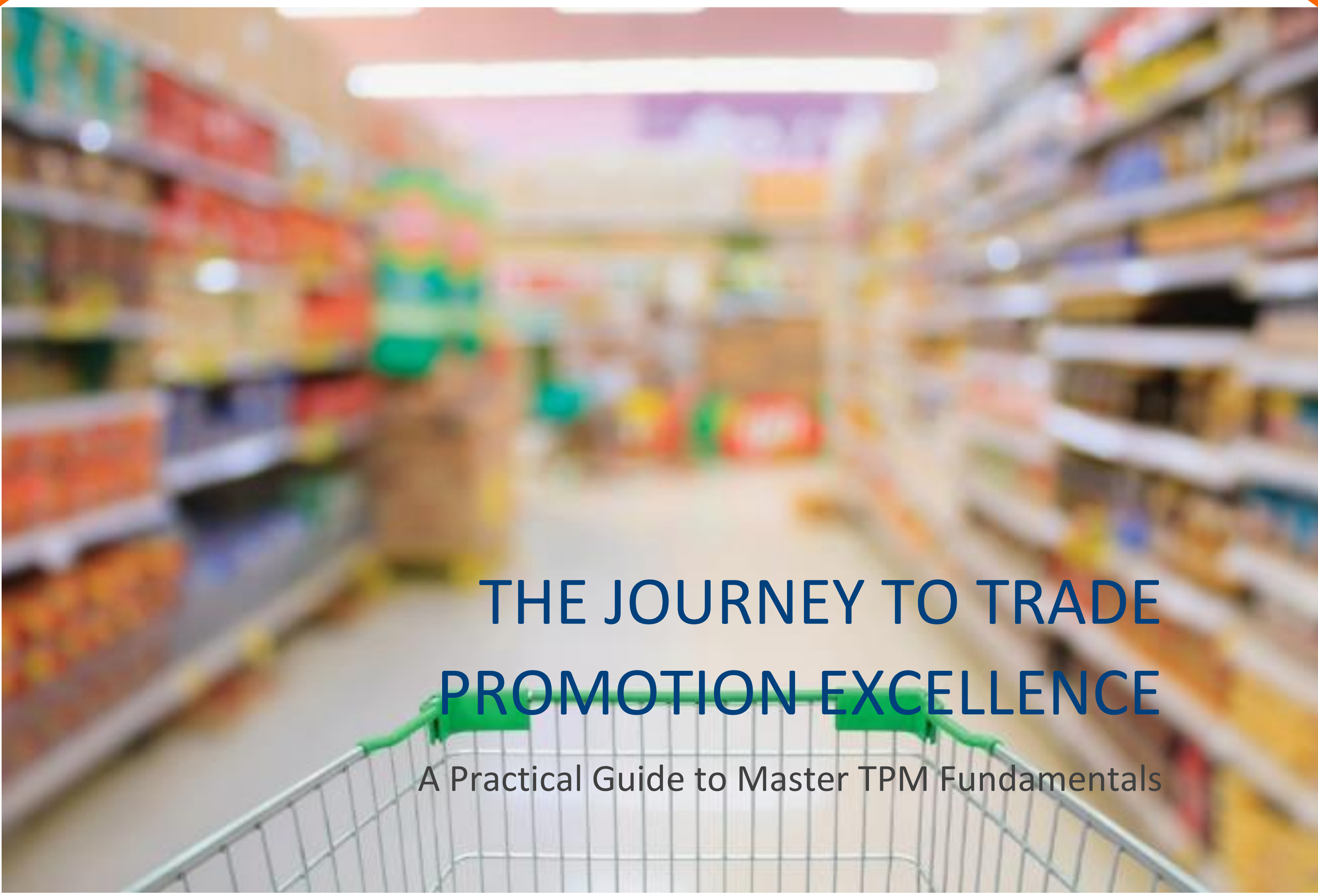


THE JOURNEY TO TRADE PROMOTION EXCELLENCE

A Practical Guide to Master TPM Fundamentals

To achieve excellence, the fundamentals must be first mastered.

In this white paper (the first in a series of achieving Trade Promotion Excellence), we will explore the necessary steps as the beginning of the journey towards achieving Trade Promotion Excellence.

It is intended to provide practical considerations, whether you are just beginning to formalize TPM processes, or if you are well on the way, but perhaps struggling.

I hope you find it helpful.

Contents

Introduction

To achieve excellence, the fundamentals must first be mastered. In this white paper, *primarily focused on small and medium sized CPG companies,* we will explore the necessary steps as the beginning of the journey towards achieving Trade Promotion Excellence.

It is intended to provide practical considerations, whether you are just beginning to formalize TPM processes, or if you are well on your way.

While, the discussion is on the basics of TPM, without them, there will no excellence.

Promotion Excellence

The wider CPG industry has developed numerous terms and buzz words when it comes to Trade Promotion Management, including the notion of Trade Promotion Excellence.

So, what, exactly, is Trade Promotion Excellence?

We define it as the point where trade spend goes from being a "cost of doing business" expense to an investment that generates measurable incremental profitability.

Given that definition, it is a reasonable conclusion to suggest that the vast majority of trade spend in the CPG industry today is in the cost of doing business expense category.

There is no Easy Button

We have all heard, more times than we care to remember, that trade spend is usually the 2nd largest expense on your P&L.

We have all listened to consultants and solutions providers explain how their solutions are going to magically fix all trade spend issues.

We have all heard it, unfortunately, few have actually seen this magic.

The reason: ***There is no "Easy Button"!***

Achieving excellence in Trade Promotion Management is a process that takes time, effort, and maybe most importantly, discipline. And it starts with building a solid foundation.

Start at the Beginning

Many CPG companies who implement trade solutions look to measure ROI, integrate syndicated data or optimize promotion plans immediately.

Even if you have a solution that provides that capability, the likelihood is that your data is neither complete nor accurate enough to utililze those capabilities.

You have to "start at the beginning".

There are no short cuts.

Without exception, accuracy and completeness of your trade data is mandatory to achieve Trade Promotion Excellence.

Keep It Simple

TPM in the CPG industry is extremely complex and achieving excellence requires solving the complexities.

However, solving those complexities takes time and discipline. Until the fundamentals are mastered, keeping the objectives and processes simple will provide the greatest short term results.

While promotions will be executed at indirect customers, visibility into results will not be easily available or measurable. Therefore, start by managing trade at a direct ship to customers. All budgeting, promotional plans (use promotions descriptions to highlight the actual retailer), reconciliation and reporting.

Mastering TPM Fundamentals

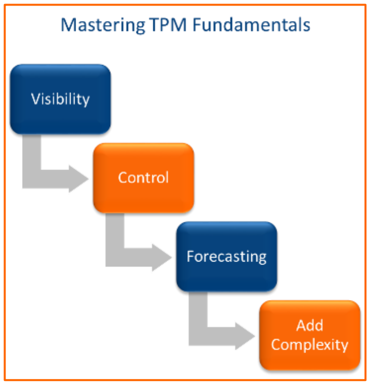
Whether an organization manages trade manually, is looking to implement a system or is currently utilizing a system, there needs to be a plan to master the fundamentals.

The overall objective of any system is to simply enable the efficient execution of existing business processes.

Even if there are formal processes in place, the fundamentals of TPM are only realized with a realistic and pragmatic execution plan.

Start with getting the basics right!

The components of a plan to master the fundamentals of TPM are illustrated in the chart below and fully explored in the following pages.



Addressing these four components as part of a plan will significantly increase the effectiveness of trade spending and will provide the foundation required to achieve Trade Promotion Excellence.

Visibility

The first logical step in achieving trade promotion excellence is to gain factual and accurate visibility into your current trade spend.

This sounds pretty basic and simple, but it isn't always so.

An organization will know, financially, what gets deducted from a customer invoice, but what is it for?

How much is trade spend versus a logistics expense?

Are the trade spend amounts valid or are there "unauthorized" amounts being deducted?

How much is being deducted as "administration fees"?

Can the deduction be tied back to the specific promotional event(s)?

In addition to invoice deductions, how much spending is through Off Invoice promotions and how much is being invoiced back to the company and paid through a check?

Without exception, accuracy and completeness of your trade data is mandatory to achieve Trade Promotion Excellence.

When looking to gain visibility into trade spending, there are several factors to consider:

- Funds
- Budgets
- Tracking
- Reconciliation

Funds

To maintain accuracy and to gain an understanding of how trade dollars are being spent, they need to be segregated into different funds.

Keeping in mind, the goal of simplicity, there are probably two or three separate funds to consider:

1. Trade Fund
2. Slotting Allowance
3. Administration Fees

In many CPG companies using manual control systems, there is a tendency to group trade spend into many different buckets to allow for more granular reporting against customers and products. That is not a recommended practice due to the complexities involved and the fact that there is limited visibility into spending at "indirect" retailers so true customer and product reporting will be extremely limited

Budgets

Budgeting for trade spend can provide opportunities to drive efficiencies in the overall sales and trade spend planning.

While budgeting trade spend is an integral component of any CPG company, the methods of creating the budgets is where opportunities lie.

Budgeting trade dollars based on actual and forecasted sales allows for the flexibility of allocating spending based on where it is best utilized. In order to do this however, there needs to be well established sales forecasting processes in place.

Until that point, it is sufficient to manage trade budgets as fixed dollar amounts allocated at the customer level.

To add some performance based allocation, consider determining the amount of trade spend as a percentage of sales and apply that against individual customer plans to arrive at the budgeted dollars.

Tracking

The real complexity, and therefore the challenge, in gaining accurate visibility into trade spend is the various "states of progression" of trade commitments.

It is critical to have appropriate financial controls in place to recognize and account for trade dollars at the different stages.

The stages of trade spend commitments can be summarized as follows:

- Actual spend – including Off Invoice promotions and deductions/checks that have been reconciled financially
- Current liabilities – for all promotional events that have been executed, but have not been claimed by the customer by deduction or bill back invoice.
- Projected spend – from all promotions planned to run in the future.

For the purposes of visibility of trade spending, priority needs to put on the first two areas.

Actual spend is managed through the reconciliation process (discussed after this section) and from applying Off Invoice discounts to the appropriate General Ledger accounts.

Current trade liabilities are either executed promotions that have not been deducted against or have been deducted against, but not yet reconciled.

Since there is no way to differentiate, there needs to be a process that tracks all executed promotions where the balance is relieved as deductions and or checks are reconciled. Typically this is accomplished by creating General Ledger Entries when products are shipped during a promotional window on case rate based promotions. Lump Sum promotions, for the sake of simplicity, can be accrued, in their entirety, at the start of the promotional window. There are often desires to split lump sum spend across fiscal periods (if an event crosses periods) and to split to individual products. As with separating funds, discussed earlier, the work involved against the results gained are likely not justified.

Reconciliation

The reconciliation process serves two purposes:

1. To accurately allocate actual trade spend against a company's promotional activities
2. To accurately manage the company's financials

Understanding the actual trade spend on a promotion by promotion basis is, obviously,

required to achieve trade promotion excellence. However, without a formal Trade Promotion Management system this will be difficult. Without integrated sales and trade spend process, it will be near impossible.

At this point, if trade spend can be matched against actual promotions (at the direct ship-to customer), great. If not, having accurate visibility into spend only at the customer level will be a good start.

Accurately managing the company's finances requires the appropriate processes that include finance, sales, broker partners and supply chain for logistic deductions.

In addition to the appropriate processes, financial systems must be setup to maximize the efficiencies of capturing and reporting on trade spend.

As a general rule, deductions will create a credit memo to offset the Accounts Receivables balance. The resulting deduction balance will reside as a line item on the Balance Sheet. When the deduction

is reconciled, the amount will be relieved from the Balance Sheet and applied to the appropriate expense account.

Off Invoice spend will create the appropriate expense account transaction at the time of invoicing.

Trade payments by check will follow a similar process as deductions.

Key Takeaways

- Where possible break out trade spend
  - Promotional spend
  - New product introductions
  - Administration fees
- Get an accurate understanding of trade spend at the direct customer
- Budget in fix dollars at a customer level
- Control processes to manage all stages of trade spend progression
- Separate invoice deductions into appropriate trade spend expenses and logistics expenses
- Attempt to uncover "unauthorized" deductions
- Match trade spend to actual promotions wherever accurately possible

- Adequate financial processes to accurately and efficiently record trade spend transactions.

Control

One of the primary reasons why CPG companies struggle with understanding the effectiveness of their trade spend is due to a lack of controls over the trade promotion processes.

While a whole paper could be (and will be) written on implementing integrated sales and trade planning processes, this paper concentrates on three specific areas to increase the overall accuracy and visibility of trade spend.

These can be categorized in three areas:

1. The accuracy of promotion planning information
2. The timeliness of promotion planning information
3. The communication of promotion planning information

Accuracy of Promotion Planning

When creating individual promotional events, several pieces of information are required to simplify the process of reconciliation (against future deductions).

If this information is not included or if it is incorrect, it significantly hampers the reconciliation effort.

More importantly, it also makes future ***accurate*** analysis and optimization impossible.

At its core, all analysis attempts to use historical actual data to predict future results. So if the historical data is inaccurate, it's a reasonable assumption that the analysis being applied against it will also be inaccurate.

The following pieces of information are the minimum required to allow for future analysis and optimization:

- Customer
- Product(s)
- Payment method(s)
- Promotion tactic(s)
- Buy down rate
- Lump sum amounts as required
- Promotion beginning and end dates*
- Estimated volume*

**For the CPG companies that are more advanced in their Trade Promotion Management practice, there may be multiple dates and volume types. At the beginning, the use of ship dates and ship volumes is all that is required. In fact, they will probably be the only ones that will provide any value at the start.*

Furthermore, the accuracy of this information is also an absolute necessity. One of the largest barriers to analyzing trade promotions are that dates planned differ from the actual dates the promotions run. While this may happen for various reasons, it is critical that the controls are in place to ensure accuracy.

Timeliness of Promotion Planning

A common issue with the management of trade promotion management systems is the timing of entering promotions. *Often-times promotions are entered late, or not at all.*

While, in many cases, promotions can be created retroactively, it may still create issues with the accuracy of the required information. Without trying to sound redundant, accuracy of data is the single most critical factor in achieving Trade Promotion Excellence

It is imperative to have controls in place to identify occurrences of late or missing promotions and processes to address the frequent offenders.

Communication of Promotion Plans

Of all the business processes within a CPG company, Trade Promotion Management might the one that requires the most inter-departmental communications.

Promotions involve sales, marketing, finance, supply chain and external broker partners.

Without effective controls over communications of trade promotion planning and execution, the results of the plans will suffer, the reconciliation activities will take longer and, of course, the accuracy of the information will become less than optimal

The timing and configuration of promotion plans are important to finance for accruals and reporting. Supply chain requires the information for the planning of production.

Conversely, supply chain needs to communicate supply issues for sales to react to shortages.

Retailers will often change the dates promotions are to run, may change the products being promoted and will deduct for shipments outside the agreed dates. All of the situations need to be monitored and communicated to accurately understand promotion performance and future planning.

Actual results need to be communicated to ensure timely and accurate reconciliation of deductions.

The over spending of promotions is often of particular importance (the definition of overspend is often debated and is the subject for future articles). In many cases, CPG companies place restrictions on overspending and those dollars get applied to "dummy" promotions or separate lines on the company P&L.

Not allowing the overspent amounts to be associated with the correct promotions (if warranted), results in the promotions appearing to have achieved better results. Future planning decisions and any type of customer/product profitability reporting will be inaccurate as a result.

Key Takeaways

- Ensure promotions are accurate and complete
- Plan and communicate promotional events well in advance
  - Have corrective actions for missing promotions
- Monitor and control changes to promotions that are already planned
- Over communicate between departments
- Ensure all spending is allocated to the corresponding promotion

Sales & Trade Spend Forecasting

Once there is accurate visibility to trade spend and the appropriate controls are in place ensuring the accurate and timely promotional plans, look to expand processes to include the integrated forecasting of sales and trade spend.

As a CPG company, there will already be a forecast for sales and projected trade spend. However, these are often completed independent of one another and usually represent a snap shot in time.

There are two key pieces to consider:

1. Create an integrated sales and spend forecast
2. Forecast is managed on a "Latest Estimate" basis

Integrated Sales and Spend Forecast

An integrated sales and spending forecast

brings all the relevant departments together to review and agree upon the path forward.

The components of an effective integrated sales and spending forecast include:

- Revenue
  - Prior Year
  - Annual Plan
  - Actuals/Forecast
- Volume (usually cases or pounds)
  - Prior Year
  - Annual Plan
  - Actuals/Forecast
- Trade Spend
  - Prior Year
  - Annual Plan (Budget)
  - Actuals/Projected
  - Balance
- Sales to Spend Ratio
  - Prior Year
  - Actuals/Forecast
  - Expressed as spend as a % of sales, or as a cost per shipped case/pound

An integrated sales and spend planning process will evolve over time and complexity can be added as appropriate.

The plans and reporting needs to be completed at a customer and product (ideally, promoted product group) level.

Admittedly, organizing this level of detail with manual systems may be difficult, specifically when looking at the trade spend component. However, if trade spending is to evolve from an expense to an investment, it is absolutely necessary.

The benefits of creating an integrated sales and spend forecast are that it creates a formal communication process that forces the organization to "hold hands" and agree on the path forward. It enables visibility into what is working and what isn't. It creates accountability across the organization for planning and execution.

"Latest Estimate" Forecast

When managing the company plans and forecasts, it is important to manage on a latest estimate basis. Simply put, latest estimate is the actual results year to date and the forecast for the remainder of the year.

The objective when managing an integrated sales and spending plan is to always have visibility to the projected end of year results.

Utilizing a latest estimate process is the only way to ensure the organization always has that visibility.

It is especially important in managing the trade spend results. Trade spend budgets are usually uniform when annualized. Whether created as a fixed dollar allocation, a percentage of sales revenue or as a case rate. However, the promotion planning and individual promotional buy down rates will vary across the year, creating variances between budget and forecast on a period by period basis. The only way to ensure accurate visibility into annual projections is through a latest estimate approach.

Key Takeaways

- Institute integrated sales and spend planning
- Managed forecasts on latest estimate basis
- Manage trade spend against an annual projection and not period by period

Addressing CPG Complexity

The basic fundamentals are in place. There is an accurate visibility into trade spending, the necessary control processes are in place, integrated forecasting has been establish with an accurate view of projected year totals.

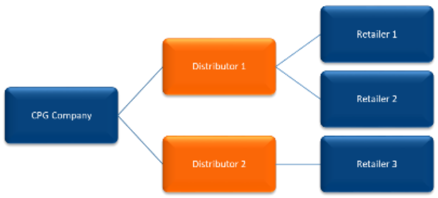
It's time to enhance the effectiveness of trade management through addressing the complex nature of the CPG industry.

The primary complexities affecting Trade Promotion Management in the CPG industry can be summarized as:

1. Indirect customers
2. Consumption based promotions
3. Performance based budgeting

Indirect Customers

As discussed earlier, much of CPG sales go through 3rd party distributors/wholesalers. For small CPG companies, it is virtually all sales.



In addition to a lack of visibility into indirect customers, these customers are not part of a financial system (since there are no financial transactions against them). That adds a component of needing separate customer masters that need to be managed. The use of a TPM solution will help with that.

Indirect customers will add costs to the overall sales expenses. Payments for promotions are usually managed through the distributor, for which, they add an administration fee. That fee is often greater than the amount of the deduction.

The best way to avoid that expense, with considerations for cash flow, is to manage indirect customers on a pre-paid basis. Issue an amount of money to the indirect account on a periodic basis and record that balance on the Balance Sheet. When an indirect customer runs a promotion, they will invoice directly, avoiding the distributor, and therefore, the administration fees. Along with their invoice, they also need to provide proof of performance. This can be either warehouse withdrawals form the distributor or Point of Sales data.

This provides a few benefits:

1. It avoids the expense of the distributor administration fees (which are almost always higher than the cost of borrowing money)
2. It provides shipping information from the distributor to the indirect, which is required for any promotional analysis
3. It allows for a more accurate understanding of the trade activity at the indirect customer and not just at the ship to distributor

To get a more accurate view of sales and spend at an indirect customer level, actual sales data from the distributor is necessary. That information is available from many distributors, for a cost. An evaluation will be required to determine the cost-benefit ratio. For all but the largest indirect customers, the benefit isn't justified. Concentrate on the top accounts and prior to buying any data, make sure you have adequate systems to integrate the data for management and analysis.

Estimating projected spend for indirect customers also requires special consideration. Typically, the only information available is what gets shipped to the distributor. Therefore, the estimated cases on a promotion will represent the cases shipped (which is required in order to forecast sales), but will not accurately represent the projected spend at the indirect. This requires an additional volume estimate to separate the actual shipments and

the anticipated volume to the indirect customer for projected spend calculations. This might be a separate volume field on whatever system you utilize, or a calculation to estimate the percentage of the shipped volume to be applied to the specific promotion. In either case, it is not an exact science and care will need to be given during the reconciliation process.

Another option for this scenario, as well as consumption based promotions is to have the ability to have an "updated estimate" ability. Often times, information becomes available after the promotion that gives a better idea of the true projected spend (POS, warehouse withdrawal, information from the broker etc.)

Consumption Based Promotions

Similar to the last piece on indirect customers, consumption based promotions also require additional volume estimates to accurately forecast spend. Either an additional volume estimate, or a redemption rate on the shipped case estimate. The concept of utilizing an "updated estimate" can also work.

When selecting the start and end dates for promotions, dates other than the shipping dates will be of value in the reconciliation process. Performance dates will provide dates that the promotion actually executes. If actual consumption data, or warehouse withdrawal data is available, that can significantly increase the accuracy of the projected spend. However, it is not often available, so utilizing redemption ratios becomes the next best option.

Performance Based Budgeting

Once there is an integrated sales and spend planning process, utilizing a performance based budgeting process allows for trade spend to be targeted where it is being used most effectively.

In this scenario, trade budgets are "accrued" (not to be confused with financial accruals. This process simply determines the trade budget for sales) based on actual and forecasted sales

(sales LE) by customer and product. A percent of sales or case rate ration is applied to customers and/or product. That ratio then calculates against the sales LE to determine the overall trade budget. If actual sales are higher than forecast, the trade budget increases and vice versa.

That number can then be compared, on an ongoing basis, against the actual and projected spend (spend LE) to determine if there will be a projected overspend.

Key Takeaways

- Manage to the indirect customer if data is available
  - At a minimum, gain visibility to indirect spend
- Use Pre-paid option if cash flow permits
  - Avoids distributor administration fees
  - Provides indirect purchase information
- Utilize additional "volume estimates" or redemption ratios to increase accuracy of spend projections
- Create budget accruals to determine trade budgets

Summary

The ultimate objective of Trade Promotion Management is to take trade spend from a cost of doing business expense to an investment that generates measurable incremental profitability.

To achieve that objectives the fundamentals of TPM must be mastered and that requires a pragmatic and executable plan.

Adopting an approach to gain accurate visibility into trade spend, incorporate the appropriate controls to ensure accuracy and timeliness, promote effective communication processes, implement an integrated sales and trade planning method will assist in mastering the fundamental.

Address complexities as the organizational capabilities develop and the journey to Trade Promotion Excellence will be well under way.

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About the author:

Keith has more than 20 years of experience in the CPG industry, developing, implementing and consulting on Trade Promotion Management solutions.

In all those years, ignoring the basics of TPM has been the number one behavior that has caused TPM systems to fail to meet expectations.

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