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DE-STRESS TO DELIVER

A folly called trade promotions

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Depending overmuch on traditional trade promotions for generating sales is unwise. But this folly is generally apparent only in hindsight.....

Companies vie with each other to spend more and more in BTL activities and schemes with the hope that these will fructify into sales. Sometimes the anticipated sales happen but unfortunately more often than not, sales do not keep pace with exorbitant promotional budgets.

The carrot and stick approach

One of the most expensive headers in the budget for marketing and promotions in a typical consumer goods company is 'trade partners'. Trade partners – retailers, wholesalers, resellers – are targeted with as much as 20% to 60% of the total budget! Most of this spend is in the form of discounts which can take various forms – foreign trips, gifts like gold, appliances, bonus pack deals or even cash. Needless to say, most of these doles are limited-period-offers that run till targets are met. Companies dangle these carrots before their channel partners under the assumption that the channel partners need to be incentivized to sell more.

The companies also use the stick – blocking the channel partners' capital in stock – under the assumption that the partners will be then forced to sell more to release their own capital. But are these realistic assumptions? Do fat schemes and blocked capital really help grow sales? Do these truly motivate them? Or is this just a cherished industry myth?

Let's first consider what happens to the hard won margins or price discounts that channel partners wrangle from companies. Do they keep them? Nope; it's passed on - it is used as a lubricant to flow goods down the channel and to increase inventory turns. Obviously they value inventory turns more than margins. Moreover for either the carrot or stick to work, the retailer ultimately has to have the clout to convince customers to pick brands of his choice-i.e. the retailer should be taking every opportunity to promote the products that he has thus been incentivized to sell. Many companies genuinely believe that if they corner their partners' stock and/or retailers are incentivized with competitive margins- directly or through discounts and schemes, they (retailers) will naturally in their selfish interest (to make more money or to unlock their working capital) sell more of their product. But do retailers really behave this way? Do they have the power or will to influence customer decision?

Putting a Myth to Rest

At Vector Consulting Group, we decided to study retailer behavior in the field. Typically, products of leading brands fly off the shelves but margins for such products are lower. They also tend to have the least number of schemes and discounts. Similar products of new or relatively unknown brands are likely to have higher margins. So apparently it is in his best interest to sell more of these higher margin products provided he can convince the customer.

An experiment was conducted on 1200 small and large mom and pop (kirana) stores where the buyer has a chance to directly interact with the seller. Only those shops where brands of both leading and non-leading brands were available were chosen for the study. To create an ideal opportunity for the retailers' to push a brand of their choice-the researchers approaching the

shops asked for a product without specifying a brand; thus they cede complete control over their buying decision to the retailers. They insisted that the retailer make the choice for them. The result expected was that the retailers would 'push' a high-margin brand to these brand indifferent customers.

To ensure that the level of involvement the customer had in the decision making does not bias the results, the experiment was conducted for both low-involvement products (like toothpaste) and high-involvement products (e.g. auto components). Interestingly, the results were always the same- inevitably the opposite of the predicted effect. 97% of retailers sold the researchers products of established brands (with low-margins) despite having stocks of high-margin brands!

This experience and the retailers logic for this behavior has been described in detail in the book I have co-authored called 'Apparent in Hindsight' but many other studies on retailer behavior have also revealed that retailers prefer to offer products of established brands to customers as it has a positive influence on the consumers' image of the retailer which can then translate into more business. Essentially, the retailers' attempt is to make a "safe" decision on this occasion that will ensure that the customer is not unhappy and will continue to patronize him. Faced with the choice between possibly losing a customer by making him unhappy (but gaining a little more money on one sale) and possibility of keeping the customers patronage (but by sacrificing an opportunity to make a little money), the retailer clearly choses the latter.

Particulars	Instances	Instances as a % of total
No. of test runs	1200	5%
Bought leading brand	1164	97%
Bought non-leading brand	36	3%
Both brands available – Effective test runs	1091	91%
Bought leading brands in effective test runs	1047	96%
Bought non-leading brands in effective test runs	44	4%

Table 1: Results of the experiment

Source: Research@Vector Consulting Group

In the light of these findings, can we really argue that retailers who don't even push high margin products to "pansy" customers would actually expend time and energy in converting customers' with actual preferences, for either margins or schemes?

In addition to the fact that schemes and discounts have no positive impact; the propensity of companies to push products with "irresistible" schemes and discounts actually has a sure shot negative impact. Many retailers pick up stock under these schemes in bulk and since they cannot liquidate these, they end up with a lot of slow-moving stocks- hurting the trade partners ability to pick up more stock from the company in the future. Instead, the company and trade partners can actually have a win-win if the inventory in the channel could be significantly reduced!

Reduce Inventory and Increase Rotation

Most companies in India have established stocking points close to traders' warehouses. It takes no more than 10 days to transport goods from the former to the latter. Traders can comfortably manage with 15-20 days' stock. In reality, however, they carry 40-60 days of stock! So, slashing inventory by even 50% isn't as far-fetched. Most companies are aware of this but what they believe is that with fall in inventory, availability will also crash, hurting sales.

But this is not necessary –if they work towards ensuring that all their SKUs are present in the traders stock on a daily basis, it is possible to have high availability at low inventory. This can be achieved if companies build a rapid response supply chain that operates on pull-based replenishment. With this, the gains for the trade partners are far higher than if the company offered a significant increase in margin (say 10%). It cannot be denied that higher ROI can be an unbeatable motivation for channel partners to invest more in the same business.

		Current	With 10% increase in margin	With 50% reduction in stock
Total Margin	a	5	5.5	5
Operation Exp.	b	2	2	2
Cash in stock	x	10	10	5
Net market credit	y	10	10	10
ROI	(a-b)/(x+y)	15%	18%	20%

Table 2: Simulation of the effect the changes in margins and inventory on the ROI of the channel partners' business

Source: Research@Vector Consulting Group

Customer should indeed be the king

It is clear that higher margins to channel partners do not significantly impact the profitability of his business and therefore motivate him to sell more. So the only entity that can push sales growth is the customer. Therefore, we can argue that all the funds earmarked for promotional activities should be used to create real demand from the customer. One of the ways this could be done is by organizing in-shop activities to help the customer appreciate the features of the products.

Funds could also be better used to directly motivate the key influencers in the buying process. A shining example for how this can be done effectively is Fleetguard Filters, a leading manufacturer of heavy duty air, fuel and lube filters. Rightly recognizing that it is not the retailer but the local mechanic who has the power to recommend a filter to the customer, the company launched a lifetime loyalty programme for mechanics. Enrolled mechanics gain points for every filter they recommend. Sales skyrocketed! Following the success of the programme, the company has diverted all funds hitherto set aside for incentivizing retailers and distributers to strengthen its ties with mechanics. Distributors and retailers continue to thrive in the business, too, thanks to high ROI. A similar loyalty programme has also been launched by Pidilite for carpenters.

It is past due that we took a hard look at the role of trade promotions in motivating trade partners and analysed whether it truly helps build strong channel partnerships.