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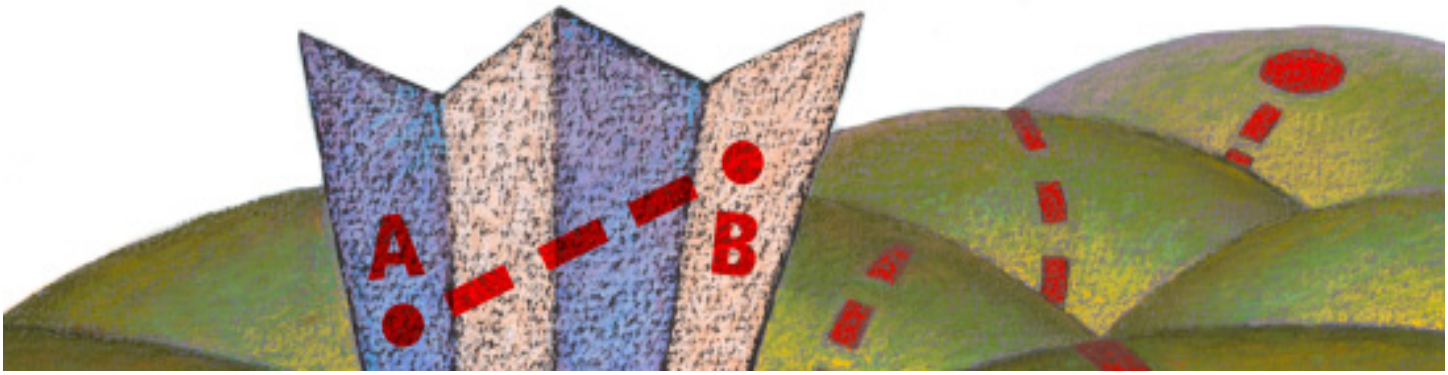
Strategic Initiatives

Mapping Success in The Food System:
Discover. Analyze. Strategize. Implement. Measure.



ELEVATING YOUR GAME
FROM TRADE SPEND TO TRADE INVESTMENT

Foodservice manufacturers allocate, in 2010, nearly 18% of each sales dollar generated on trade spend. While trade spend is the largest single spend item on their P&L after COGS, yet it is approached as "table-stakes," tactical and largely without performance expectations. Successful manufacturers will move trade spend from a tactical level to a strategic investment. They will raise their level of planning and execution – elevating their game.

Introduction

This second Foodservice Trade Investment Survey was conducted jointly by The Hale Group and MarketIntelligence in the spring/summer of 2010 polling a larger group of foodservice manufacturers. The first survey was conducted in 2008-2009 by MarketIntelligence.

Looking back and ahead, trade has and continues to evolve in foodservice.

> **1950-1974 Institutional Era:** Simple programs were directed exclusively by the manufacturer consisting of "label allowances" and participation in selected food shows. The industry was immature and the institutional business was an afterthought to most retail companies. Most distribution was local and most of the operators were independents.
>
> **1975-2008 Growth Era:** Foodservice was in a growth cycle; manufacturers offered "Earned Income and Shelter" programs to distributors, rebates and deviated pricing to National Accounts and LLOs to drive sales. The industry evolved as national distributors and chains began to grow. Trade spend became a cost of doing business and, until later in the 2000s, was manageable.
>
> **2009-2015 Trade Investment Era:** The industry enters a period of slower growth; however, distributors and operators continue to look to the manufacturer for lower prices and deals. Contracted business and GPOs are capturing a larger portion of the higher margin street sales. Commodities are fluctuating and inflation is being held in check. Today, market share growth is increasing in importance, and the vehicle to capture it is prudent trade investment. Manufacturers will need to utilize their trade dollars more efficiently and effectively.

Historically, manufacturers have looked at their spend with, and on behalf of, distributors and operators as "Trade Spend." The results of this second survey indicate that moving forward, spend will be redefined as "Trade Investment" with associated, expected performance outcomes.

In order to make this shift, individual companies and the industry as a whole will need to take a highly analytical approach to developing measurement criteria and systems. As everyone competes for the consumer's attention, and margins continue to be under pressure, the amount of spend on trade will become a distinctive tool, not a line item.

Survey Background

- Over 68% of the companies surveyed sold both branded and private label products
- The survey included a representative sample of product categories
- Both private and public companies were included in the survey
- 70% of the respondents had foodservice sales of $250 million or more
- Most respondents (90%) sold to both foodservice and retail

Trade Investment: "Above the Line"

We have worked to define trade investment with a group of foodservice manufacturers.

- Compromised of various types of spending that can be considered a "reduction in revenue" according to the Financial Accounting Standard Board's interpretation, defined after the Sarbanes-Oxley Act of 2002.
- Includes monies paid by the manufacturer to a distributor, wholesaler, customer or operator as payment for consideration of various promotional, merchandising and/or product, brand or category-building activities for the manufacturer.
  - Bids
  - Rebates
  - Off-Invoice
  - Price Allowances
  - Market Pricing
  - Deviated Pricing
  - Distributor Food Shows
  - Earned Income / Shelter
  - Corporate Growth Programs
  - Local Growth Programs
  - Corporate Marketing Programs
  - Local Marketing Programs
  - Distributor Sales Spiffs
  - Local Blanket Bids

Trade Survey Takeaways

1. **Trade investment increased in 2010.** Although the industry experienced negative growth, the spend on trade went up; manufacturers desired to shift to more operator spend; but, the survey results show that this did not occur in a significant manner.

2. **Trade is not measured.** Trade is considered "table stakes" or pay-to-play by many of the respondents and is currently not measured for effectiveness due to a lack of actionable information or a lack of analytical resources / systems.

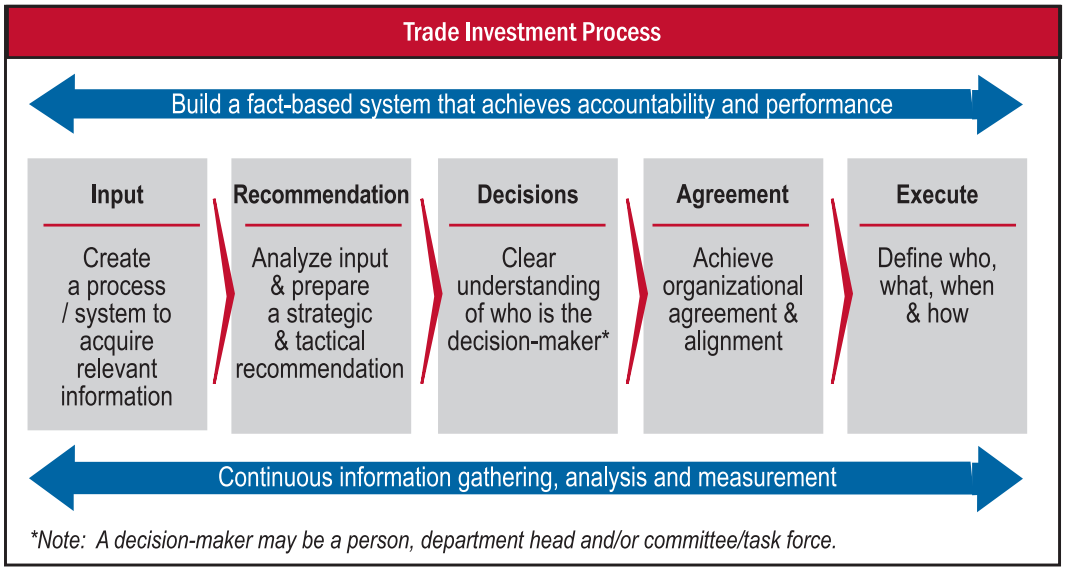
3. **Trade investment is institutionalized.** Over time, the spend on trade has become part of the margin equation for distributors and part of the gross margin calculation for operators.

4. **Trade management will need to be an integrated process.** The challenge for the industry is to utilize the investment that is made in trade to grow market share. This may lead to closer relationships between distributors, manufacturers and operators – working together to maintain and grow share. Manufacturers will participate, but will need to understand the linkages that exist or will exist.

5. **Trade management requires a technology solution.** Technology in foodservice is rapidly reaching a point where the impact of price or promotion can be understood at the operator unit level. The relationship and interdependence of operator and distributor trade programs will become more tightly aligned and ROI can be measured.

Recommended Next Steps: What Should I Do?

Based upon survey results and migration from a tactical to a strategic response, a straight forward approach to the issue is illustrated below.



The Current Situation – Survey Results

Trade investment is currently averaging 18.01%; this is a combination of both distributor and operator programs and we believe that this level may be reaching a peak. If nothing else, the survey results indicate that manufacturers are seeking to shift their investment towards the operator.

Strategically, this response is on target, yet this effort must be integrated with the needs of the distribution community. There is greater pressure on the manufacturer to provide the operator with a margin improvement. This is evidenced by the growth/expansion of buying groups. In an era where volume retention is growing in importance, the balance between lower margin or lost volume has become more critical.

- Trade investment is one of the largest items on a manufacturer's P&L. The 2010 survey average was 18.01%, higher than the 16.65% in the 2009 survey. This is second only to COGS on a manufacturer's balance sheet.
  - The vast majority of respondents (80%) stated that their T:S ratio stayed the same or increased from the previous year.
- This area is managed at multiple levels, yet it lacks strong analytics.
  - It has evolved over time and, in many cases, without a central focus. Who "trade" reports to is a mix between sales (56%), finance (25%) and marketing (12.5%) and the majority of the respondents did not have a trade planning group (62%).
- Trade investment is not directed at growth; a large portion of trade is to retain either volume or slots.
  - Program dollars are used as a base to negotiate current year plans.
- There appears to be a shift in the balance between operator and distributor trade investment.
  - GPO's spend is increasing; 56% of respondents admit to increased spend.

The Issues Around Trade Investment

Trade planning and trade management are underdeveloped areas in most organizations.

- Most organizations (90%) manage trade internally, but do not have a dedicated group focused on this area.

- Trade investment / trade planning does not have a "home." Organizations reported that trade could report to finance, marketing, or sales. While this in itself is not an issue, the integration and planning of trade spend across functions is a requirement.
  - In over 36% of the cases, trade spend and trade management may report to more than one area.

- Trade investment management administrative costs are generally below the previously estimated 3.2% (Technomic survey 2009) and fall within a range of 2.25% to 3.25% of sales.
  - Relative to the amount spent on sales efforts through brokers or a direct sales team, trade investment is approximately 100% of what is spent on a brokered sales process or 30% of a direct sales effort (estimated by THG at 6.5 – 7.0%).

- While field sales is involved in setting promotions and calendars with key accounts (88%), they are not compensated or rewarded for savings or improvements in trade spend (less than 40% have any program based on this).
  - There is no clear methodology for setting the trade spend budget.
    - It is an equal split between bottom up, top down, and some combination.

- Trade investment is often set once a year (50% of respondents reported); and 30% either set budgets quarterly or revise them every quarter.
  - The process of setting and revising budgets is done as an expense item, not as an investment vehicle.

Defining Trade Investment Has Become More Difficult

Over time, the trade bucket has expanded to include all sorts of operator and distributor-based programs, contracted volume, and spending on unique trade initiatives (trade shows, etc.). We believe that as the focus on the role of trade investment grows, it will begin to achieve clarity. The use of analytical tools and structured approaches to planning will re-allocate the funds and have the potential to incent share growth.

- Approximately 50% of trade spend is directed at distributor programs in order to achieve placement and retention.

- Approximately 50% of trade spend is going to operator programs.
  - This is increasing (over 45% of the respondents) due to increased payments to GPO's.
    - While we see this increasing, we do not see distributor programs being reduced. So, this is not a re-allocation, it is an additional cost.
  - Although GPOs are relatively small at this time as far as total manufacturer trade spend, they are a growing group.
    - Operator programs are increasing; 54% of respondents said that they increased in the last year.

Accounting for Trade Investment Has Improved Somewhat

Industry leaders have made investments in the tools required to evaluate and direct the return on trade investment. These tools require a significant initial investment and on-going analysis in order to achieve the necessary clarity for action. Making the information available throughout the go-to-market system (internal and external), defining the objectives, and measuring the results can be achieved through systematic approaches.

- Respondents reported that internal audits have increased (over 60% of respondents).
- More promotions (operator) are accounted for at the summary customer level (76%), not the unit level invoice (ULI). This needs to change.
- 93% accrue at either the customer or product level for promotions.

Measuring Effectiveness of Trade Spend Is Limited

Overall, trade investment is accounted for. Increasingly, manufacturers are looking at developing a detailed analysis which will provide a basis for measuring performance versus objectives. The current situation is such that:

- Distributors
  - 70% of the respondents either did not measure effectiveness or did so on a random and infrequent basis.
  - 65% of respondents do not always analyze proof of performance on deviated pricing.
  - The most likely level of evaluation is at the summary level.

- 81% of the respondents said that they receive less than 50% of their distributor Proof of Performance (PoP) claims in a usable electronic format.

- Operators
  - At the operator level, over 77% of trade spend is analyzed, but only at the headquarters summary level.
  - 43% of the respondents said they receive less than 10% of their operator claims in a usable electronic format.

- Both
  - Only 16% of the manufacturers share data on past performance with distributors and operators; therefore, the annual agreement is not likely to be a fact-based negotiation.
    - Less than 50% of claims are regularly validated.
    - Only 16% of those surveyed are able to measure the impact of multiple programs (operator and distributor combined) to develop a true P&L.

There Is No Clear Technology Solution

There is a number of different companies who provide technology platforms for documenting trade dollars. However, the most widely used technology continues to be "home grown." There is a shift towards a standard platform / approach.

- Claim details are not saved in usable formats, so there is no real history for post-promotional analysis.

- Manufacturers are turning to Commercially Off the Shelf (COTS) Software versus internally developed software to manage trade investment.

- Trade investment systems are increasingly integrated into a manufacturer's Enterprise Resource Planning Systems (ERP) versus stand-alone systems.

- Electronic claims and PoP are increasing, albeit from a smaller base, allowing more automated claims processing. The IFMA/IFDA GS1 project initiative will accelerate this trend.

- Increased electronic PoP data is beginning to allow for visibility into the unit level detail of an operator versus summary level.

- Leaders are beginning to measure, utilizing existing data sources, the true P&L of programs.

Looking Ahead

Trade investment is a major element of the industry P&L. It is estimated to exceed $15 billion in total; in many cases, it is the difference between profit and loss for industry participants. As the industry matures, evaluating trade investment will become more important, and will come under greater scrutiny.

> Utilizing a structured approach to understanding the current base of trade spend is the start of the process of converting it to trade investment.

The pressure to reduce trade investment will shift to focus on managing and measuring. The use of technology and coordination throughout the go-to-market system will allow for greater transparency. This will begin to open the door to utilizing trade investment as a way of reaching the ultimate consumer through the operator.

Summary

The survey was conducted in 2010 by the joint efforts of MarketIntelligence and The Hale Group. The objective of this white paper is to galvanize organizations to rethink the role of trade – shifting from spend to investment. If you have observations which you believe should be included or shared, please contact us; in addition, if we can assist your organization to develop, analyze, and engage, we would welcome the opportunity.

About Us

MarketIntelligence, LLC is a business strategy consulting firm focusing on foodservice trade investment and pricing optimization. Our extensive foodservice industry background provides clients with a unique perspective of the complex supply chain. For more information about MarketIntelligence, please reach out to us at 704.562.9794 or at jimklass@marketiconsulting.com.

The Hale Group provides strategic counsel to the food system focusing on mapping and navigating opportunities for profitable growth. The underlying philosophy of the firm's efforts on behalf of its clients, and in collaboration with them, is to formulate strategies that enable clients to break through the market clutter to identify platforms for growth. For more information about The Hale Group, please reach out to us at 978.777.9077 or at hale@halegroup.com.