FMCG Insights

AdvisorBase

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smarter decisions, better business

The ever changing retailing landscape means suppliers must continue to challenge their ways of doing business...think of the changes (and rumours) in the last 6 months...

- The Woolworth's appeal to the Supreme Court on the purchase of The Warehouse.
- Speculation that both supermarket chains are looking at liquor retail chain, Liquorland.
- The rebranding of Foodtown to Countdown.
- Progressive's move to fully funded promotions together with increased consumer price sensitivity invalidating most existing demand elasticity data.
- Increased consumer price sensitivity leading to further increases in percentage of product sold on promotion.
- Primary freight, warehouse allowances and in-store merchandising remain on the agenda.

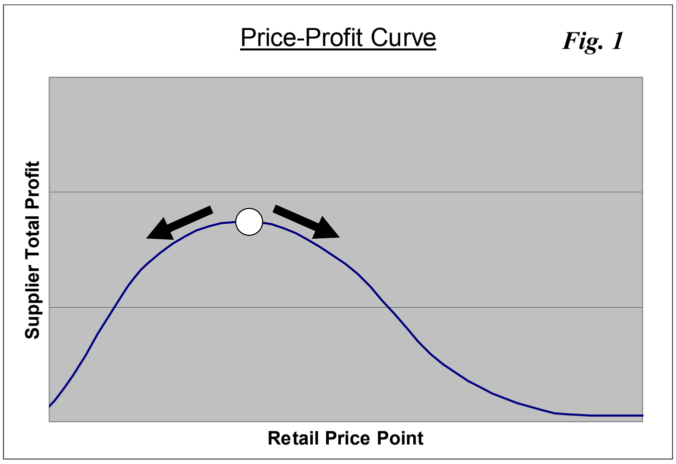
Wow! Hard to keep trade spend on target, align cost to serve, make a dollar and stay in touch with changes!

Responding to fully funded promotions … at what price?

Progressive's fully funded promotion initiative means suppliers now need to revise their Price-Profit curve for each product in order to decide how they will adjust trade spend to optimise profit. While this only applies to those products/promotions that don't make the weekly mailer the impact cannot be ignored. To manage the consequences of loss of volume, and/or contribution, suppliers are being forced to take tough decisions on product range and trade spend.

Price Sensitivity – The Theory

Decrease promotional price by 1% and sell more, *makes sense so far*, and increase contribution — *well, that depends*.
And what happens to contribution if price increases 1% instead?

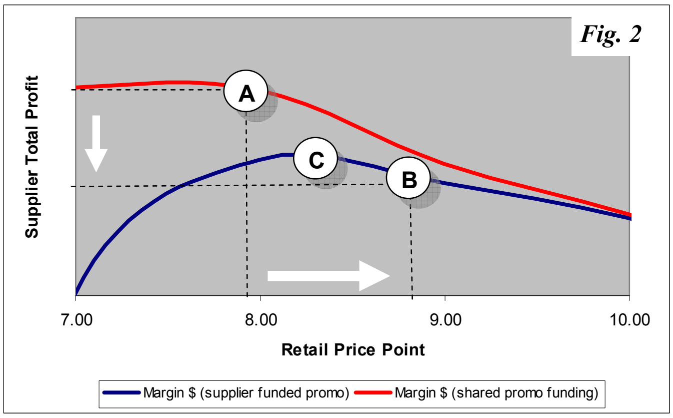


If contribution decreases with both of these movements then the product is priced optimally to maximise profit *(see Figure 1)*; if it doesn't then potential profit is being foregone. If the business can't answer these questions then product pricing and trade spend decisions are a stab in the dark.

Increased importance of the Price-Profit curve

Price inflation is suddenly becoming an issue for many categories; shoppers who were previously insensitive to prices are suddenly noticing how prices have changed. Generally speaking shoppers are becoming increasing sensitive to price points. As buying power erodes, the competition for consumers' dollar will intensify. Getting the balance between trade spend and volume right is more important in times of restrained consumer demand than otherwise.

Progressive's fully funded promotion initiative highlights suppliers need to reassess the Price-Profit curve for each product as the curve will move downward and change shape – creating a new optimal price point. Suppliers dilemma: how to change trade spend to achieve optimal contribution, or leave as is and settle for decreased volume and profit? Of course this all depends on where the product is currently priced.



A new Price-Profit curve emerges as fully funded promotions are introduced *(see Figure 2)*. The product moves from the red curve (co-funded) to the blue curve (new price curve).

For example, a product that is co-funded to a particular price point (point A), will to move to point B on the new Price-Profit curve when the retailer removes their funding support. The result: a higher price point, less volume and less profit to the supplier.

The new Price-Profit curve that emerges is less attractive to the supplier and requires more investment to hit previous price points. Faced with this situation the supplier is left with several options:

Responding to fully funded promotions continued...

- Allow the price point to rise leading to reduced volume and reduced profit *(point B)* on the new curve.
- Target the existing price point to maintain volume but with substantial increase in trade spend and, on the new curve, a significantly reduced profit.
- Target a new price point *(point C)* that provides the new best return at an acceptable market share/volume.

With the current pressures on supplier bottom lines there is no room for "misplaced" trade spend.

Leveraging the Price-Profit curve in dialogue with retailers

Understanding the Price-Profit curve is important for jointly structuring promotions with retailers. A well informed supplier can demonstrate how the share, or distribution, of profits is impacted at different price points and different levels of joint funding.

Suppliers can use the Price-Profit curve to enlist retailers to share the promotional burden. It can be used to demonstrate that the volume potential of the promotion at the lower price will deliver more contribution for both parties, in spite of a lower margin percentage for the retailer. The historic focus on percentage rather than dollar totals gets in the way

Take action

With pressure on margin, suppliers will benefit from performance based pricing analysis as a platform for:

- A range review
- Setting price points
- Targeting trade spend by product by customer
- Mutually beneficial contribution increases for retailers and suppliers through jointly targeted and funded price points.

The last point may be idealistic, but the first three rate as survival tactics in the current market.

For more information on establishing product profitability by account, price optimisation and the Price-Profit curve, contact **Jeremy Howcroft** on 021 434 082 or **Charles Wilson** on 021 899 161 Or email: Advisors@Advisorbase.com

Valid decisions need valid data …

Simplistically there are two key elements to business decision making — knowing which decisions to make when, and having the relevant information to make the smartest decisions.

Change often brings hidden challenges

Among the consequences of rapid change in an industry is that we lose many of our reference points.

Rapid and significant changes in consumer behaviour and industry cost structures cause historic data to lose its relevance and validity for comparison purposes, target setting, and for decision making. Consider the impact of recent changes on:

- Financial performance data
- Demand elasticity curves
- Cost to Serve
- Selection of KPIs
- Customer profitability
- Product profitability.

Impact of some current trends on business performance	Downturn in consumer spending.	Increased portion of sales on promotion.	Retailer range reviews.	Fuel prices & RUC charges.	Change in products (mix, value, packs).	Fully funded promotions.	Primary freight.	Ingredient costs.
Gross Sales Value	■	■	■		■	■		
Std terms				■			■	
Promo on invoice		■	■		■	■		
Net on invoice								
Settlement & std rebates							■	
Promo - co-op/rebates		■	■		■	■		
Net Net								
Product Costs (COGS)	■		■		■			■
Net Margin								
Logistics & Supply Chain	■		■	■	■		■	
Transaction processing								
Selling costs					■	■		
Customer service							■	
Capital funding costs			■		■		■	
Cont. after cost to serve								
Advertising & Sustaining			■		■			
Business contribution	■	■	■	■	■	■	■	■
Strategic & Tactical Impact								
Discounts (efficiency based)	■			■	■		■	
Product profitability management	■	■	■			■		■
Private label supply	■	■			■			■
Trade spend and revenue discounts	■	■				■		
Customer value management	■	■			■	■		
Route to market strategy				■	■			
Marketing mix	■	■			■	■		
Customer service strategy	■	■			■	■		

We used to be able to use, say, Cost to Serve data for up to two years, that is no longer a safe option. There is less room than ever for a "she'll be right" approach to decision making.

The table above illustrates some of the areas of impact that recent changes have had on business performance and related decision making. We hope it provides a useful checklist to help to assess the impact of change on your decision making.

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