Taking Control of Terms

Louise Williams from AdvisorBase Ltd. highlights the importance of a deliberate approach to trading terms.

What are the driving forces?

There are two reasons suppliers are moving towards cost based terms of trade. One is the ongoing call from retailers for transparent and equitable terms, the others is a drive for efficiency. In the most recent ECR report "Efficient Product Movement", the first of the recommendations made was to "*understand the cost to serve and use supply chain [efficiency/cost based] trade terms to drive efficient product movement. The distinction between commercial [promotional] and supply chain terms has been lost. Trading partners should separate supply chain terms from commercial terms, and remove obstacles for collaboration.*"

Discounts in the FMCG sector are often referred to as *Permanent* and *Temporary*, this tends to confuse their objectives. If the permanent portion becomes efficiency based terms and the temporary clearly becomes promotional terms, it is easier to drive efficient product movement and ensure the business has control over an objective driven budget. The objective of promotional terms and efficiency terms is different – the objective of promotional terms is to drive revenue through price points (top line focus); the objective of efficiency terms to is drive efficient behaviour in a sustainable way, i.e. terms that reflect cost to serve (bottom line focus).

Giving Away Money for Nothing?

Try this quick checklist. Do you:

5 *Give the same discount to customers all the time, not linked to sales or behaviour?* The question needs to be asked, what is this achieving, other than an effective list price adjustment? Could these dollars not be better spent if there was clear reasoning and targets driving them?

5 *Allocate money to customers in response to some or other pressure, with the discounts (often arbitrary and intended as a short-term solution), being locked in long term*? Again, the question to ask is what work is the money doing for you long-term – soothing ruffled feathers may not be a long-term objective.

5 *Seldom, if ever, know (and report) total discount targets by permanent vs. temporary or efficiency vs. promotional?* Being unsure of true spend and targets limits control and effectiveness.

5 *Rarely target the permanent discount portion of total spend in a way that reflects the cost to serve*? Focusing the permanent (or efficiency) terms can bring about a lower cost to shelf and savings through the supply chain that positively impact the bottom line.

5 *Try to balance the discounts to customers through temporary terms?* This may be ad hoc and result in untargeted discounts that only appear temporary.

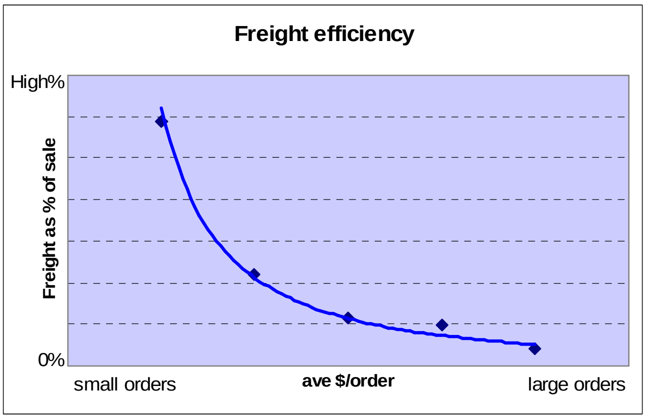
5 *Infrequently report sales results from promotional initiatives?* If so, can you be sure which $ spent works hardest for you?

Summed up, if you ticked a box chances are it can be seen as giving money away for no clear goal or gain.

Suppliers should have control of their terms. The first step to taking control of terms is to clearly split out promotional spend from the efficiency discounts.

Efficiency Terms

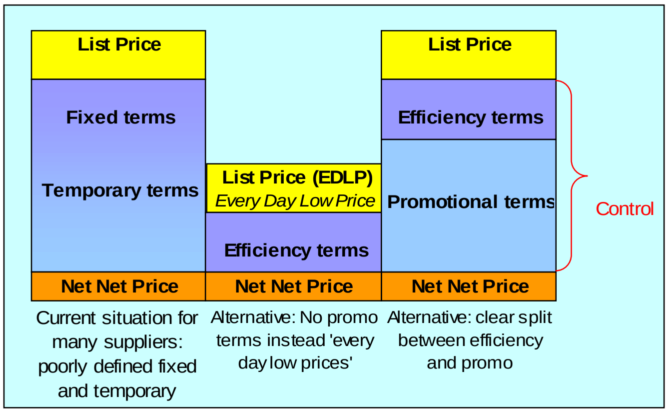
Efficiency terms make visible the steps in the supply chain which enables effective decision making by customers for lowest cost to shelf. Setting appropriate efficiency based terms will drive beneficial customer behaviour, triggering savings through the supply chain due to more efficient product movement.



Typically, efficiency comes from size and frequency of orders. This impacts handling in the warehouse, order processing, and freight. For instance, an appropriately structured freight contract can bring about big savings as order size and frequency improve. The graph illustrates a typical freight cost to order size profile. Small order freight is a much higher percentage of overall sales value. If customers can be encouraged to change ordering patterns so they are less frequent, and the orders therefore larger, reductions of freight as a percentage of sales can be seen.

Setting clear efficiency based terms is a signal to customers that they have a choice. They can balance the costs/benefits of continuing to behave as they do against the savings/costs, reflected in the product price, generated by the discounts.

Promotional Spend



By splitting out efficiency and promotional spend there is more control over the money, it can be targeted and results of the spending better measured. Unlike the present split between permanent and temporary terms, in all likelihood the efficiency discounts will make up a smaller portion of the discount budget. This means less of the available money is locked and the remainder can be used for more flexible and responsive promotional spend.

The fundamental objective of promotional spend is reaching a desired price point (net net price to retailer). Once efficiency terms have been subtracted from list price the difference between that and net net price is the available promotional terms. Our work with a variety of different NZ supplies indicates that approximately 10-20% of sales turnover is spent on trade promotions. With that kind of money in play it is crucial that it be used strategically. For instance, what portion of the money goes to isle ends or scan-back, or even shifted into the alternative avenue of consumer advertising. In the “PPA Retail Promotional Spend Study 2004” report conducted by Wessenden marketing in the UK, they observe that it is important to monitor promotional effectiveness and to beware of undermining long-term brand values in the pursuit of short-term sales increases. It is important to remember that promotional spend can be linked to performance for example, if x% is spent on promotion then a result of y% increased sales turnover is expected. If this is not achieved, review is needed.

Money, But Not for Nothing

FMCG suppliers have plenty of opportunity to benefit their bottom line by utilising efficiency based terms of trade to bring about savings in the supply chain, and using the greater flexibility this gives promotional terms to target specific goals.

Louise Williams is a consultant with AdvisorBase Ltd. working mainly in the area of business modelling and developing efficiency based terms of trade for some of New Zealand's leading FMCG suppliers.

What is the current state of play regarding the introduction of efficiency based terms of trade in the industry?

Charles Wilson of AdvisorBase comments "while a lot of work has been done over the last year or two we have seen relatively few companies concluding the introduction of new terms.

"While some suppliers are pressing hard to implement new terms, others are feeling daunted. One cannot help but feel a measure of sympathy for suppliers trying to introduce equitable efficiency based terms. On the one hand, they have been urged towards this goal by their own business sense and by the retailers – indeed they have seen other suppliers being sanctioned by retailers for not introducing these terms. On the other hand, when they do front up they are sometimes met with reluctance and delaying tactics from retailers seeking to maintain or negotiate a deal of special advantage to themselves.

"The essence of the new approach to terms of trade is that they reflect costs and are equitable. It is the 'equitable' part that seems to be the stumbling block. Equitable terms imply that there are likely to be winners and losers as non-cost related terms are eliminated. Suppliers have to face the possibility of delivering some very difficult explanations in this regard and retailers have, in some cases, to face up to losing past privileges in the interest of equity, transparency and efficiency across the industry"

Charles Wilson is a director of AdvisorBase Ltd. and has a long association with the FMCG industry, working on business modelling, supply chain, and trading terms assignments.