Trade Spend's Unsustainable Trajectory in the New Consumer Reality:

A Progressive Vision for Delivering Sustainable Growth

Executive Summary

The growth rate for trade promotion and its increasing share of the total Marketing and Sales, or Demand, budget is unsustainable and becoming less productive in the new consumer reality.

While trade promotion will continue to play an integral role in driving profitable consumer and customer demand creation, it will be forced to deliver similar or improved results with substantially fewer resources in the future. Consequently, a significant dose of change is required as Consumer Products (CP) manufacturers have reached a critical juncture and need to evolve their demand creation and resource investment mix models for profitable long-term growth.

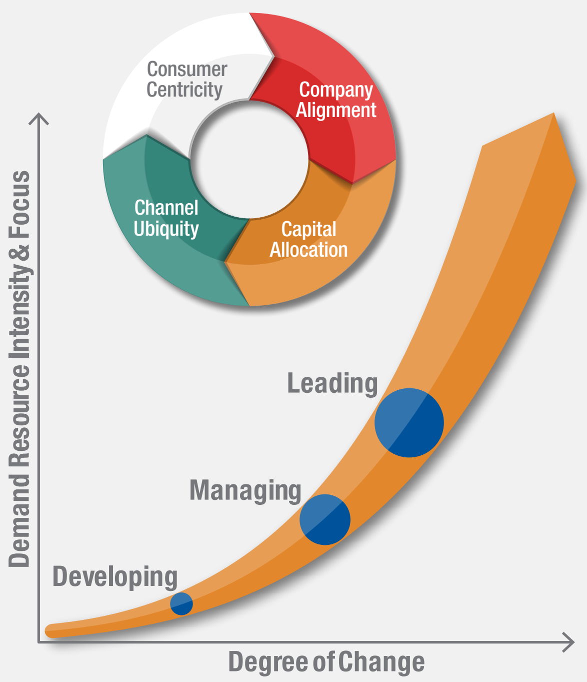
In response, we strongly encourage Consumer Products manufacturers to manage and optimize Trade Promotion Management as Priority #1 in their evolution process. CP manufacturers should escalate this change effort as a strategic business objective to drive focus and help enable success. This will require instilling leading TPM processes and a best-fit tool to drive continuous productivity improvements across trade promotion – the largest single demand related spend for most CP companies.

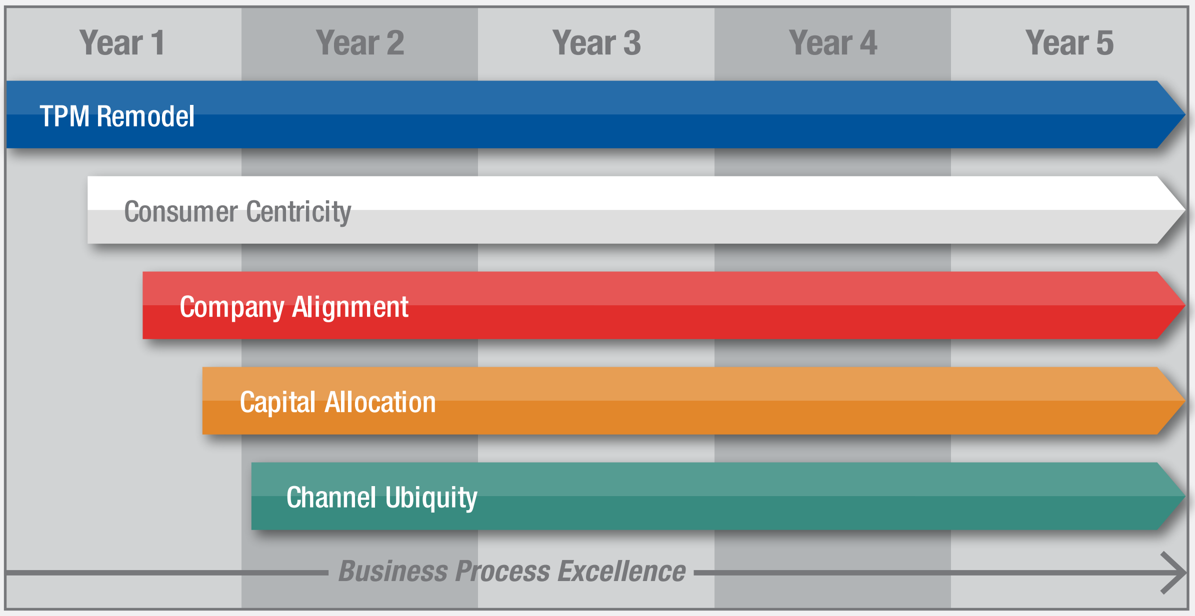
Identified savings from TPM continuous productivity improvements should be funneled to higher yielding demand creation investments within Marketing and Sales such as brand renovation, new product/service innovation and integrated consumer experience marketing.

In parallel, CP manufacturers should begin a 3-5 year progressive journey aimed at reshaping Marketing and Sales into an Integrated Demand Business Function with:

- Consumer Centricity: Ensure the consumer is king and build direct, participatory relationships;
- Company Alignment: Architect, enable and align the organization to achieve the consumer centric vision;
- Capital Allocation: Manage and optimize all demand investments as a singular resource;
- Channel Ubiquity: Create compelling integrated consumer experiences across traditional and digital channels.

Our research of a cross-section of bellwether CP manufacturers indicates that firms fall into one of three segments for reshaping Marketing and Sales. Segments include Developing, Managing and Leading.





3-5 Year Journey to End State

Today's Environment

According to Clorox's incoming CEO, "We just think the defining issue for the industry and for Clorox right now is how to grow, and how to grow profitably." In the past, the answer was fairly straight-forward as trade promotion would have served as a primary lever to capitalize on volume and revenue growth opportunities.

Today an increasing number of Consumer Products (CP) manufacturers are struggling with near zero top-line growth as a nexus of forces constrain organic growth. This condition is especially true for companies that cling to traditional trade investment strategies and consumer demand generation models. To paraphrase industry leaders who have been conditioned by past successes of trade promotion, "it's easy to fall victim to price discounting as a way to get a short-term boost from the customary volume leverage, but these activities come with other costs." There are clear opportunity costs and lasting implications of such decisions.

Nexus of Forces Constraining Organic Growth

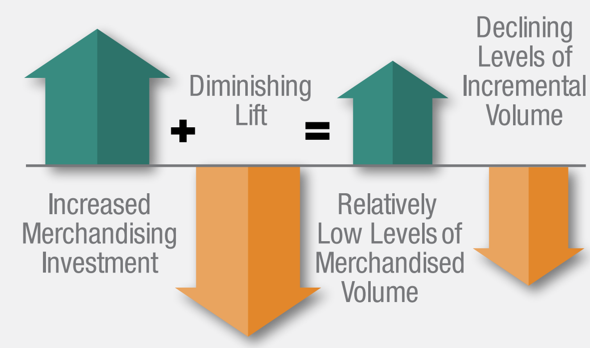
1. Deflated consumer sentiments arising from under-employment and low-wage growth
2. More informed, connected and demanding consumers
3. Fleeting loyalty to brands and banners
4. Evolving path to purchase and shopper behavior
5. Hyper-competitive retail environment

The CP industry has reached a critical juncture where the need to align growth strategies, consumer demand business models and investment decisions is crucial for long-term sustainability. Using this situation as a backdrop and as a follow-up to Navigating The Retail Revolution, where we discussed how the new consumer reality is quickly changing the face of retail and implications for all value chain stakeholders, we conducted in-depth analyses to understand how CP manufacturers are using a fleeting window of opportunity to design plans for their own transitions.

Our analytical approach focused on key demand-related issues confronting bellwether CP manufacturers from the Food, Bev-Al, Home & Personal Care and Health & Beauty industry sub-sectors. Based on our findings, the predicament confronting Clorox is the rule and not the exception across the industry landscape.

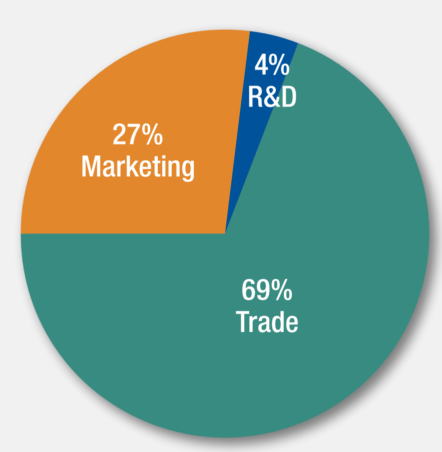
Research Take-Aways

Saturation dilutes trade productivity. CP manufacturers continue to reflexively pursue higher levels of trade promotions – varying combinations of increased frequency, longer durations or more lucrative offers – to defend share from agile competitors and to appease retail customers who are faced with unprecedented pressures brought about by the new consumer reality. The growing reliance on trade spend has both direct and indirect costs.



First, the market is becoming overly saturated resulting in declining trade productivity which can then prompt incremental trade spend on top of an already high base level of trade spend to over-compensate for diminishing returns.

Second, the opportunity costs of trade spend growth may not be fully appreciated in the near to mid-term as CP manufacturers are forced to forego longer-term investments in brand renovation, product innovation and integrated consumer engagement marketing to fund increased trade spend.



Estimated Demand Investment

In essence, the spate of challenges confronting CP manufacturers is being exacerbated by their growing dependence and often lackluster returns on trade spend – overwhelmingly the largest use of demand related investment, often consuming close to 70% of total Demand related resources.

Each sub-sector has its own unique challenges and approach:

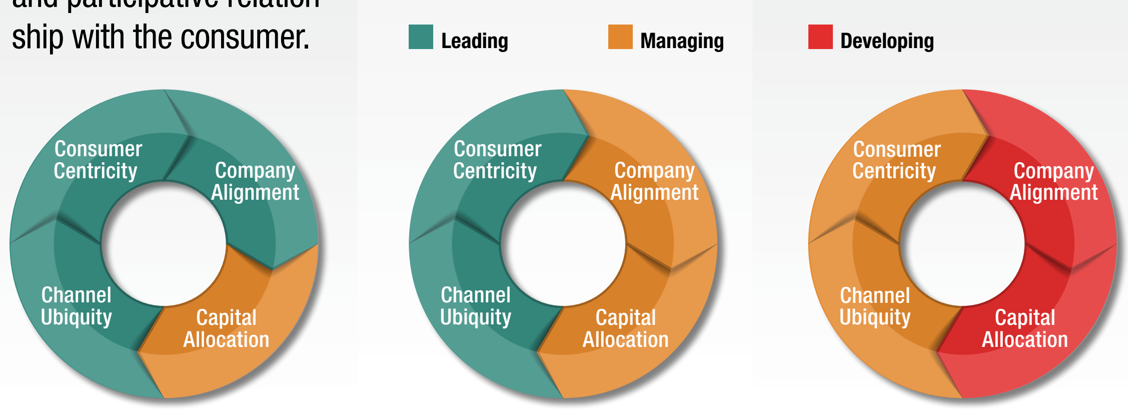
Sub-Sector	Summary	Details
Food Manufacturers *Campbell's* *Diamond Foods* *Kellogg's* *Kraft* *McCormick* *Snyder's-Lance* *JM Smucker's*	**Particularly Susceptible in the New Consumer Reality**	• Sub-sector is disproportionately susceptible to the changing consumer environment since a greater percentage of volume is sold on promotion. • Leaders are focused on developing new marketing capabilities in response to shifting consumer paths to purchase and a belief that trade spend does not drive long-term category growth.
Bev-Al *AB-InBev* *Brown-Forman* *Diageo* *Pernod Ricard* *Jim Beam (Suntory)* *Miller Coors* *Dr. Pepper Snapple* *Keurig/Green Mountain*	**Optimizing Demand Investments**	• Sub-sector is balancing investments across innovation and brand building combined with sales effectiveness initiatives to improve trade execution. • Leaders are migrating demand investments from promotional pricing to digital, account specific trade programs, and alt distribution channels.
Home & Personal Care *Kimberly-Clark* *Clorox* *Colgate Palmolive*	**Building Consumer Experience at Retail**	• Sub-sector is enhancing the consumer experience at retail via more effective merchandising coupled with consumer engagement. • Leaders are pursuing granular consumer insights to inform next generation product development to strengthen consumer bonds.
Health & Beauty *Estee Lauder* *L'Oreal, Revlon*	**Aligning with Consumers' Digital Path to Purchase**	• Sub-sector is investing substantially more in consumer marketing initiatives compared to CP industry benchmarks. • Leaders are successfully transforming their marketing models to enable participative relationships with consumers.

Responses to the New Consumer Reality

From our analysis, Consumer Products companies can be divided into three primary groups based on their degree of change in response to the new consumer reality. The segments, Leading, Managing and Developing are based on how companies are evolving their approaches into Integrated Demand Models to achieve desired levels of Consumer Centricity, Company Alignment, Capital Allocation and Channel Ubiquity.

Leaders are transforming their organizations to achieve and sustain long-term volume, share and profit objectives without compromising their ability to compete and win in today's promotion intense environment. Trade investment is, and will continue to be, an integral component of consumer and customer marketing. Leaders differentiate by pursuing Trade Promotion Optimization through TPM process excellence coupled with best-fit system implementations and integrated business management. This focus tends to impel continuous productivity improvement across trade investment which enables marketing mix optimization. In addition, Leaders exhibit higher degrees of Consumer Centricity which is used as the basis to inform all tenets of Demand Strategy creation, fulfillment and organizational alignment, especially where insights and innovation are concerned.

Leading	Managing	Developing
• Recognize the need for change early in the cycle and are successfully transforming their Demand creation and fulfillment practices. • Experiencing positive results across the New Marketing Model due to early adoption and experiential growth, but have opportunities to further optimize investment mix. • Desire to "own" a direct and participative relationship with the consumer.	• On-board with necessary changes and in the process of catching-up with industry leaders. • Increasing marketing investments and accelerating innovation based on consumer, category, and customer insights. • Focused on improving trade execution by expanding direct sales force and trade coverage.	• Positioned in the formative stages of their Demand transformation journeys with over-use of often tactical, less productive Demand practices perhaps to the detriment of long-term strategy. • May have encountered a mixed degree of success across the New Marketing Model via "fits and starts" and/or not adequately addressed each dimension.



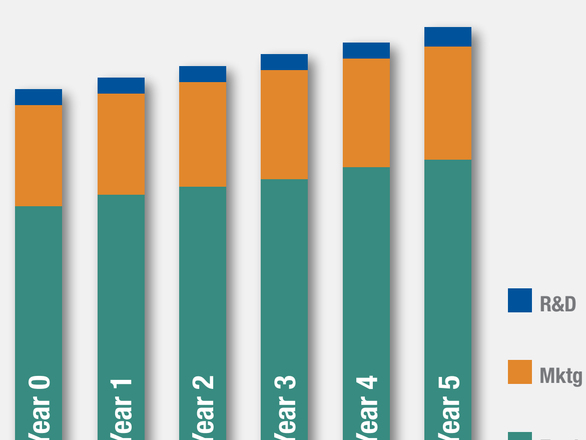
A Progressive Approach

Kraft's CEO recently stated, "In some ways we have to unlearn what we believed worked in the past and relearn what will make a difference today." This is exactly what must happen for CP companies where trade investment is concerned. Given the environmental shifts rendering the perpetuation of current trade spend practices unsustainable, what changes should CP manufacturers make to achieve and sustain profitable growth in the new consumer reality? And, how should it be funded?

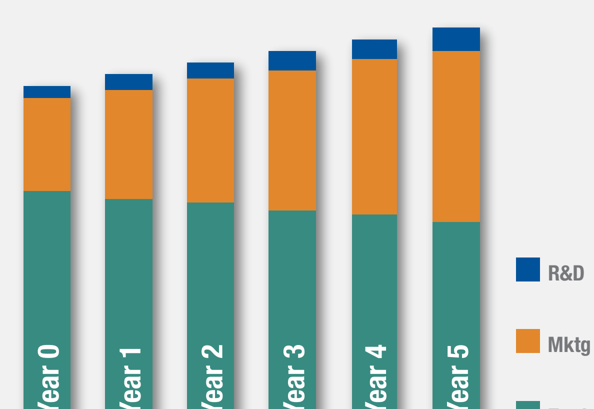
Consumer Products manufacturers can leverage lessons learned of leading industry players to chart a differentiated course designed to facilitate competitive advantage and sustainable growth. The transformation journey is a 3-5 year marathon, not a sprint, and should start now with a mindset change – "maniacal focus on the consumer" to embed Consumer Centricity as a central organizational tenet. In addition to Consumer Centricity, CP manufacturers can bolster performance by adopting a new marketing model concentrated on optimizing Company Alignment, Capital Allocation and Channel Ubiquity.

To drive sequential improvement and lasting change, CP manufacturers should underpin the transformation with leading TPM business processes augmented by best-fit tools and Integrated Business Planning. As a function of scope, scale and relative performance, trade funds will be a "net" donator to higher yielding demand creating investments throughout the optimization process. This requires consolidating the demand resource envelope as a singular budget across brand, consumer, customer/trade and innovation and then identifying underperforming spend using "Relative Performance" and "Relative Business Impact." Companies must eliminate elements of ineffective spend and reallocate to drive continuous productivity improvements.

Companies should strive to decrease trade's share of the total demand budget by 25% to 30%. On average, this would take trade spend from consuming approximately 70% of the budget today to about 50% within a five year window. These are averages; significant differences will exist between individual companies and industry subsectors depending on their unique business models and relative performance between marketing programs.

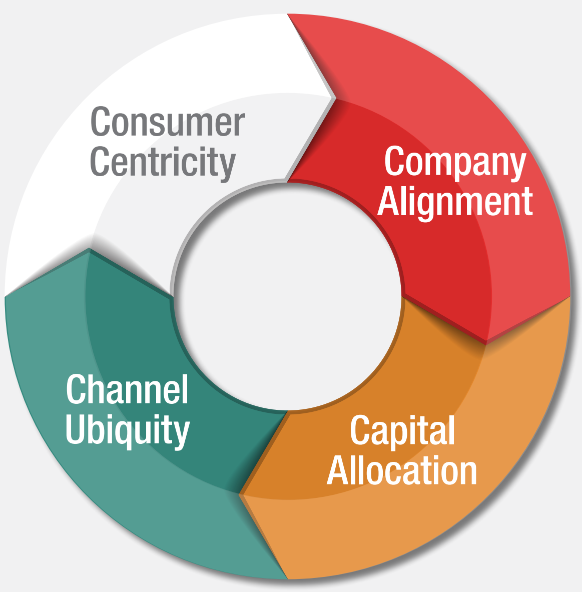


Base Case



Remix Case

In parallel, CP manufacturers should embark on a transformational journey reshaping their organizations into Integrated Demand Models. This journey requires taking a progressive approach to all four elements in the Integrated Demand Model – Consumer Centricity, Company Alignment, Capital Allocation and Channel Ubiquity. Strategy is about making choices, trade-offs; it's about deliberately choosing to be different.



Consumer Centricity

As Sam Walton once said, "There's only one boss. The customer. And he can fire everybody in the company from the Chairman on down simply by spending his money somewhere else." It all starts with the consumer. Differentiated consumer experiences build brand, market share and competitive advantage and produce insight into purchase behavior that further informs demand strategies.

For a progressive Consumer Centricity approach:

- Take an outside-in perspective of the business, through the eyes of the targeted consumer. Apply insights derived from consumer empathy to inform every aspect of the business model including products/services, brands, markets, channels, resource intensity and mix, organizational architecture, competencies and alignment.
- Note how L'Oreal has built a culture centered on achieving a direct and participatory relationship with their consumers on a 1:1 basis.
- Invest more resources in building capabilities in this space.

Consumer Alignment

Consumer Products companies need to transform their organizations by integrating around the consumer to drive enterprise-wide alignment.

For a progressive Company Alignment approach:

- Break down organizational silos across consumer touching functions such as marketing, sales, IT, consumer insight, and innovation.
- Establish consumer experience teams and staff with expertise in consumer insight, brand, product, retail, digital, and social to create integrated consumer experiences and new product launch plans.
- Support organizational transformation through training initiatives, process improvements, new tools, and perpetual focus on reinforcing consumer-centric culture.
- Create a well-equipped trade planning and development team to drive cross-functional collaboration and process excellence.
- Mimic the success of CP leaders such as McCormick who develop great cross-disciplinary teams, especially between IT and Marketing, and then benefit by generating compelling consumer insights for digital activations.
- Invest in a good organizational change management plan to expedite benefits realization.

Capital Allocation

Companies need to create pressure to reduce "traditional" trade spend. Ideally, companies should reduce this spend from 15% - 20% of gross sales to low double digit for re-allocation to more productive investment opportunities in brand differentiation, innovation and technology-enabled 1:1 consumer interaction.

For a progressive Capital Allocation approach:

- Treat brand, consumer and trade investments holistically.
- Plan, execute, monitor and optimize as a comprehensive Demand Resource Envelope.
- Ensure trade processes, infrastructure, analytics and tools are capable of identifying and eliminating waste.
- Craft a 3-5 year roadmap with risk mitigation strategies to minimize business disruption and sustain trade relationships.
- Carefully navigate the drawback on trade spend as it can often be deeply entrenched and sacrosanct with both your sales team and retail customers.
- Establish sound financial thresholds and then eliminate spend on least productive brands, promotion types, customers and channels.
- Reinvest in customer relationships by introducing new products, services and promotions built on meaningful consumer and customer insights.
- Establish stretch targets related to new product introductions (e.g., % Net Revenue from New Product Innovation) and invest accordingly to deliver upon your targets.
- Invest in pricing analytics. The strategic pricing process and subsequent application to base pricing is the most accessible marketing lever for

managing profitability. For example, all else being equal, a 1% price change with a 10% Operating Margin structure equates to 10% change in margin per unit sold whereas a 1% change under a 25% Operating Margin structure delivers a 4% change. The lower your margin structure, the greater the relative impact of a pricing change.

- Follow Colgate's lead and use trade investment to create compelling integrated consumer experiences at retail as opposed to discrete exercises in price discounting.

Channel Ubiquity

In the "new consumer reality" shoppers make informed purchase decisions in a non-linear, multi-channel fashion where credibility and loyalty are earned – not bought. Companies must now use direct to consumer and mobile generated in-store promotions to offer new ways to interact with and engage consumers in the buying moment while also helping to drive post-purchase advocacy.

For a progressive Channel Ubiquity approach:

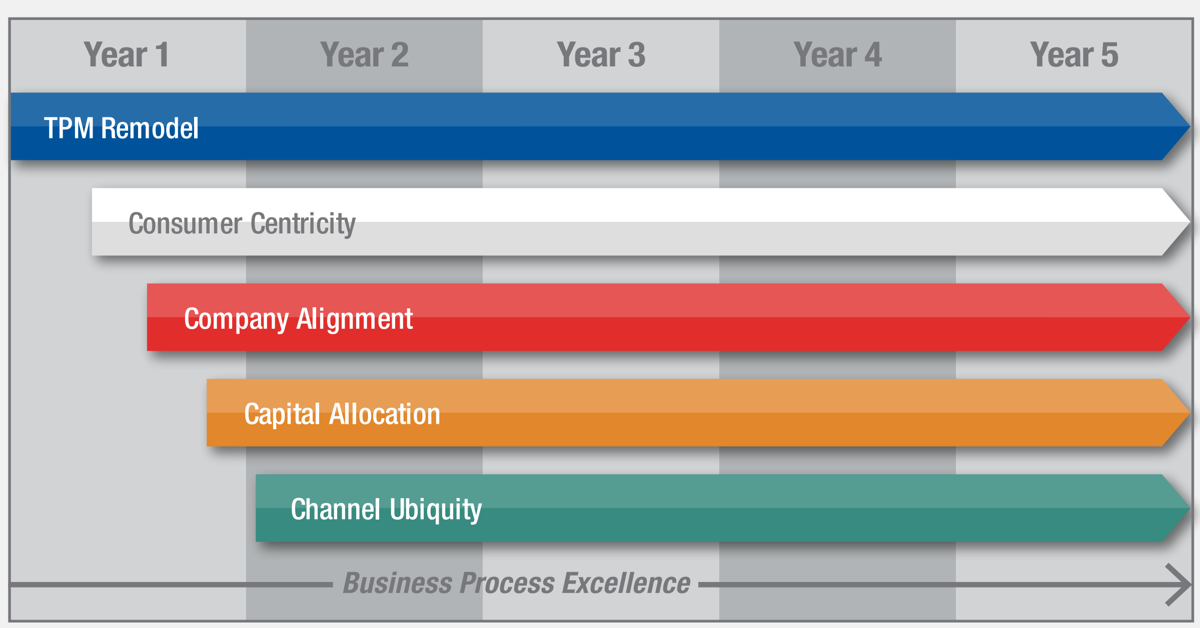
- Revise traditional playbooks to ensure proper share of voice, brand representation and personalized offers at key intersection points along the shopper's digital path to purchase.
- Evolve trade spend tactics by capitalizing on the collective impact of mobile and social to influence shoppers at the shelf.
- Leverage in-store mapping, augmented reality and integrated loyalty programs.
- Consider Kraft's transformation to "Agile Marketing" where data, infrastructure and content are laying the foundation for channel agnostic, personalized 1:1 consumer dialogue.

Getting Started

The transformation journey is a 3-5 year sequential marathon with staggered initiation periods informed by priorities and dependencies to promote organizational focus.

To get started, Consumer Products companies should:

1. Focus on effectively managing and optimizing TPM given its scope and business impact.
2. Begin adapting and aligning company culture and organizational architecture with the consumer at the core.
3. As capabilities, processes and tools sufficiently mature, manage the demand resource holistically and optimize spend across investment types to align with the "new consumer reality."
4. Augment the transformation with business process excellence such as Integrated Business Planning to sustain an aligned culture of continuous productivity improvement.



3-5 Year Journey to End State

About the Author

Steve Rogers is a Principal with Clarkston Consulting with over 20 years of experience in Consumer Products. He has served in leadership positions across a wide spectrum of demand related functions including Consumer Marketing, Brand Marketing, Trade Marketing, Sales Planning and Field Sales. He's passionate about helping clients build strong brands that resonate with consumers.

References

1 CP Manufacturers' Annual Reports, Quarterly Earnings Calls, Investor Presentations: Campbell's, Kellogg's, Kraft, McCormick, Snyder's-Lance, JM Smuckers, Brown Forman, Diageo, Pernod Ricard, Jim Beam, Miller Coors, Dr. Pepper Snapple, Keurig, Kimberly-Clark, Clorox, Colgate Palmolive, Estee Lauder, L'Oreal, Revlon

2 Navigating the Retail Revolution

3 Energizing Trade Promotion Optimization