How manufacturers can increase ROI by moving to performance-based trade terms

By Sane Mdlalose

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For any consumer goods manufacturer, the topic of trade terms and trade investment is often an uncomfortable one. Over time, trade terms have increased but the relative returns for the manufacturer have not been felt, therefore resulting in terms that don't drive strategy.

Sane Mdlalose

In the past it was easier to justify keeping trade terms the same because there was almost guaranteed growth. However, today, the pressure to change terms could mean the difference between surviving or folding.

The big question on everyone’s lips is how to move from legacy-based trade terms to profit-driving ones. Trade terms in the past were non-conditional and were not necessarily linked to driving business. Everything is about return on investment (ROI) and yet every year manufacturers feel short changed in their trade terms.

A way of life

Manufacturers need to be able to move trade terms from being an annual event that is dreaded, to a way of life every month and every day. This means tracking the effectiveness of their investment daily to ensure their strategy is enabled. It is critical to know what this trade investment looks like in declining categories or where disposable income is declining. If they can’t track their ROI, they will be at the mercy of the trader when negotiating terms.

Today the real issue is about moving towards a performance-based trade investment and here's how:

- By reviewing the total basket of trade terms. What was relevant in the past and the component of terms has not really evolved. What has happened is that elements have been added but not reviewed. A full review that takes account of the entire picture is needed and this includes examining multiple categories and multiple trade structures;

- By ensuring that there is strategic alignment between the trade terms and business strategy. Due to the historical nature of terms, they are often not aligned with the changing needs of the manufacturer's business. Manufacturers need to find a way to fuel growth through an efficient trade investment strategy and then restructuring terms to reflect their business drivers. This means ensuring that their investment gives greater volume or revenue growth and optimising their ROI;

- By making sure processes and systems are in place to track and manage the effectiveness of terms regularly. They don't need ultra-sophisticated IT to do this, an Excel document could be just as effective. The key is to link sales data into volume and revenue data and set up systems so junior managers are able to do it. If tracking is done, then it is about managing efficiencies and optimising trade terms that can move companies to performance-based or conditional terms – even of the base terms. If this is managed correctly, benchmarking across categories is far easier; and

- By making sure that when you launch a new product, the trading terms are in the profitability analysis. This includes examining what the new product will do to the rest of the business and asking whether that is a good thing from a trade term perspective.

By focusing on the above, brand owners are better able to manage an evolving trade structure so that trade terms remain relevant, effective and competitive for their business. Other benefits include being better positioned to understand category drivers, positioning and brand strategy as well as having cross-functional working, which means budget discussions are now more holistic.

When manufacturers do it right, it will normally be the right strategy for the retailer too, and their credibility should increase. While the trade terms discussion is a difficult one, if it is backed up by insights and analysis it should drive growth for both parties.

ABOUT SANE MDLALOSE

Sane Mdlalose is an associate consultant at Aperio, a business consulting company focused on accelerating growth of FMCG brands in South Africa and Sub-Saharan Africa.

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