

Kotchen & Low LLP



TPMA

www.kotchen.com

Presentation Outline

- Industry Trends
- Trend Implications for Manufacturers
- Business Strategies to Address Trend Implications
- Legal Issues Attendant to Business Strategies



Industry Trends



Source: Cannondale Associates, 2007 Trade Promotion Spending and Merchandising Study

Definitions

- ▶ **Trade Spend:**
Any investment made with an individual retailer, wholesaler, or distributor. Examples include: list price discounts, promotional allowances, in-store marketing investments, deductions, fixed fees, etc.
- ▶ **Gross Sales:**
List price X units sold



Industry Trends

Hypotheses for Trade Spend Increases



- Retailer Consolidation
 - Top 10 retailers account for increasing % of gross sales
 - “Winning with the winners” is paramount to manufacturer success
- Marketing Mix Changes
 - ROI of traditional marketing investments has decreased with proliferation of media outlets
 - Retailer investments have remained predictable (and measurable)
- Brand Equity Declines
 - Percentage of sales made on promotion is increasing for many brands

Presentation Outline

- Industry Trends
- ▶ Trend Implications for Manufacturers
- Business Strategies to Address Trend Implications
- Legal Issues Attendant to Business Strategies



Trend Implications for Manufacturers

Trade Spend Increases Complicate Retail Pricing



- Trade spend increases lead to lower retail prices, particularly promotional pricing by high-low retailers
- Low retail prices – particularly deep promotional discounts – often:
 - Exacerbate channel conflict – e.g., EDLP retailers often react negatively to deep promotional discounts,
 - Degradate brand equity, as consumers are trained to purchase on promotion, and
 - Compromise premium brand position, as low retail prices may be inconsistent with premium brand image



Trend Implications for Manufacturers

Trade Spend Increases Reduce Manufacturer Margins



- Increases in TS % GS yields lower net sales and, in turn, lower margins
- Trade spend increases arise in a time of input cost increases, driven largely by the cost of oil

Margin erosion is likely the single most important business issue manufacturers seek to address

Presentation Outline

- Industry Trends
- Trend Implications for Manufacturers
- ▶ Business Strategies to Address Trend Implications
- Legal Issues Attendant to Business Strategies



Business Strategies to Address Trend Implications

Manufacturer Efforts to Address Industry Trends Include

- Facilitate more predictable retail pricing by discouraging retail prices below minimum thresholds
- Focus on marketing and selling higher-margin brands and SKUs
 - See, e.g., “ConAgra Shifts Focus to Food Brands,” WSJ (10/25/06)
 - ConAgra’s Gold Store Initiative: Similar “to steps taken by Rick Lenny when he took over as CEO of Hershey Co. One of Mr. Lenny’s first moves was to instruct the sales force to focus on selling higher-margin single bars of chocolate rather than the more value-oriented multipacks. That simple change has helped fuel Hershey’s growth.”
 - According to a ConAgra executive quoted about the Gold Store Initiative, “This is not a one-year event, but part of shaping our culture... We have been heavily reliant on trade spending, but that is not a sustainable model.”

Presentation Outline

- Industry Trends
- Trend Implications for Manufacturers
- Business Strategies to Address Trend Implications
- ▶ Legal Issues Attendant to Business Strategies



Legal Issues Attendant to Business Strategies

Business strategies raise two important antitrust issues:



Can CPG manufacturers use trade funds to incent minimum retail price thresholds?



Can CPG manufacturers award trade funds to retailers on the basis of profitability rather than gross sales volume?



Legal Issues Attendant to Business Strategies



Using trade funds to incent minimum retail price points

- *Leegin** provides significantly more flexibility under federal law to influence retail prices
- Factors federal courts now must consider in assessing resale price maintenance agreements:
 - Business Justifications – e.g., assess how RPM agreements facilitate interbrand competition
 - Anticompetitive Effects – e.g., did RPM agreements lead to higher prices throughout a category



Legal Issues Attendant to Business Strategies



Using trade funds to incent minimum retail price points

- *Leegin* is spawning new strategies designed to better align retail prices with brand objectives
- “Conditional Allowance Strategy”
 - Trade funds conditioned on retailers’ maintaining retail prices above minimum thresholds
 - \$100 in trade allowances with a \$10 penalty if prices go below a floor



Legal Issues Attendant to Business Strategies



Using trade funds to incent minimum retail price points

- Before *Leegin*, in the *American Cyanamid Co.** matter, the FTC viewed a conditional allowance strategy as *per se* unlawful resale price maintenance
 - Analysis to Aid Public Comment: “American Cyanamid’s conditioning of financial payments on dealers’ charging a specified minimum price amounted to the quid pro quo of an agreement on resale prices.”



Legal Issues Attendant to Business Strategies



Using trade funds to incent minimum retail price points

- In light of prior scrutiny, conditional allowances strategies should be carefully considered and structured
 - State antitrust laws remain in effect (though most will likely follow *Leegin*)
 - Senator Kohl introduced a bill, co-sponsored by Senators Biden and Clinton, that would reinstate the per se prohibitions on minimum price agreements



Legal Issues Attendant to Business Strategies



Using trade funds to incent minimum retail price points

- Issues to consider in structuring a conditional allowance strategy
 - Potential business justifications for a conditional allowance strategy:
 - Encourage product support investments
 - Reverse base sales declines
 - Support brand positioning
 - Assessing potential anticompetitive effects
 - Market share
 - Use of similar strategies by competitors
 - Whether retailers are requesting price discipline



Legal Issues Attendant to Business Strategies



2

Allocating trade funds on the basis of profitability

- Robinson-Patman Act mandates awarding trade funds on a fair and equitable basis to competing retailers
- Attorneys have traditionally used a gross sales volume formula to assess RP compliance: if one retailer is given \$100 in discounts for \$1,000 in gross sales, a competing retailer with \$100 in gross sales should be given \$10 in discounts



Legal Issues Attendant to Business Strategies



2

Allocating trade funds on the basis of profitability

- Simple gross sales volume is flawed, as it fails to incorporate a profitability metric
 - Competing retailers that have the same cost to serve often deliver different trade spend ROI
 - One reason for ROI differences: product mix
 - One SKU may have fewer units within a pack than another SKU with the same list price – e.g., premium segments
 - SKUs within a product category can have different cost structures depending on product attribute, pack configurations or graphics, or the efficiency of the sourcing mill



Legal Issues Attendant to Business Strategies



2

Allocating trade funds on the basis of profitability

- To design an RP compliant trade program that incorporates retailer profitability, attorneys should understand reasons for trade ROI differences and then design the program accordingly
- Examples of ideas to drive profitable mix:
 - A base distribution allowance for retailers that distribute high-margin SKUs
 - Accrual rates by SKU that vary depending on SKU margin