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Grocery Trade Promotions: How Important is “Pass-Through?”

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It is argued in academic research that a critical issue associated with manufacturer trade deals to grocers relates to how much of the promotion will be passed along to the consumer. The "pass-through" is defined as the percentage of the trade deal that is given to consumers (see Grocery Trade Review, January 2000). According to the limited amount of research on the topic, the following conclusions have been made regarding pass-through (see the book Sales Promotion Concepts, Methods, and Strategies by Blattberg and Neslin):

- a high percentage of manufacturer promotions do not receive any retailer support
- a brand's position is critical to the effectiveness of the trade promotion
- leading brands are more likely to receive pass-through than a weak brand
- factors influencing pass-though are:
    a. Promotional elasticities
    b. Item importance
    c. Manufacturer incentives

With regard to "pass-through", as with all aspects of trade marketing, it is important to understand the reasons behind the retailer's actions. In the Canadian grocery industry, in most cases it is far more complicated than the grocer simply pocketing a manufacturer's hard earned marketing budget in return for nothing. Fundamentally, the amount of pass-through is impacted by everything from the role of the product within the retailer's defined category strategy through to the role of the product in establishing a retailers pricing strategy (ie. EDLP vs Hi/Lo)

Not surprisingly at the highest or broadest level, Canadian retailers assert that of all the deals and rebates received, all are passed on to the consumer. The cursory evidence would be that while trade deal amounts have increased over the years, margins have remained stagnant. Beyond that broad level however, it is claimed that with regard to the high profile items, those 20% of the items that drive 80% of the business, all allowances/rebates are passed on to the consumer. In fact, relative to the allowance, often much more is "passed-on" to the consumer. That extra investment is in order to price the item competitively, drive dollar sales requirement and to drive customer traffic requirements. A retailer almost always must over-invest in these high profile items. That is to say, the economics on those high profile items almost always does not "mix-back" to a desired profit level.

As such, Canadian grocers then look to the other 80% of the items to "mix-back" the desired profit requirements. This involves an examination of the levels of discounts available from manufacturers, frequency of discount, volume projections based on retail discounts, resulting profit opportunities and other strategic variables. At that point the retailer will then determine the role of that item as it relates to its contribution to the "mix back" equation as driven by the high profile, severely discounted items.

In essence then, the top volume categories are the ones most prone to discounting and over investment by the retailer. The secondary categories and secondary brands are the ones that are "milked" to mix back profit and fund the investment in the top tier.

Understanding a retailer's practice for determining the amount of "pass-through" on allowances and rebates requires one to understand the overall pricing strategy taken by that retailer. For instance, an EDLP or every day low price position may mean a strongly discounted retail on an item all the time. In that case, the pass-through percent would be low but constant on all sales. This contrasts to a High/Low or deep discount strategy where top profile items are frequently advertised at very deep discounts generating large unit sales. In those cases, pass-through are often greater than the individual item deals and rebates made available. These deep discounts are funded by "mix-back" opportunities as generally provided by the secondary items in the ad or in the store.

A recent and very great contributor to mixing back profits has been private label items. Private label can serve to slow the deeply discounted items sales by shielding them from purchases and reducing the national branded items overall penetration in the category. Of course, simple cross merchandising of private label items around the deeply discounted national brand item can drive incremental private label sales and profit contribution. In some of these cases the amount of effective shielding or incremental sales is very much reliant on a retailer's in-store execution of the merchandising effort. This is as simple as putting private label fabric softener beside the money losing national brand laundry detergent for customers to purchase as they purchase the laundry soap.

A few years ago Coke openly complained about retailers putting cheaper private label soft drinks in front of the Coke displays literally causing customers to trip over the store brand in order to be able to reach the Coke they wanted. That was an extreme but not altogether inaccurate position noted by Coke. The reason was to slow the money losing sales of Coke by trading-off those purchases into the more profitable private label offering. Only at times of severe discounts would it make sense to shield the profit draining national brand item in this way.

The level of retailer investment or pass-through is not related to the size of the manufacture but more to the size and position of a brand or item within a category and

by the consumer. Manufacturers that have a broad base of items may well be doing their own "mix-back" within their own product base to fund their top brands. That may appear to suggest that retailers correlate the degree of pass through by manufacture size but that is not the case. With that said, however, it is a very large challenge to a small manufacture who has a top brand and little internalized opportunity to mix back products to support the top brand.

Store Level Execution

The retailer does what he can afford to do by the definition of strength and support found from the discounts, profit from secondary brand mix-back opportunities and profit from control label products and the individual retailers ability to execute in store merchandising practices.

Historically the placement of an item in an ad reflected the depth of discount and the levels of trade support. Now these criteria of measurement have shifted to a retailer's ability to execute a sales plan for the right reasons at store level. So once again important store level performance criteria play a larger role in determining the amount of discounts and rebates being made available and ultimately the amount of pass through. Furthermore, with recent reductions in out of store or mass media advertising by retailers, not to mention frequency reductions and total ad item count reductions, more and more investment in execution of a merchandising strategy is at store level. That is to say ad size, position, and frequency is far less determined by the size of discount. Instead these factors are determined by the retailer strategy as it relates to the retailer's profit and sales objectives.

Recent years have seen the focus of discounts and rebates return to the grocery floor once again. These are increasingly played out in shelf space and positioning decisions, display activity and frequency, signage and a number of store level direct consumer marketing executions. As such, the ability of a retailer to execute a strategy at store level and thus drive tonnage for the manufacture will and should once again be part of the qualifiers for deterring the level of or type of discounting available.

Less frequent ads and fewer items in these flyers generates fewer opportunities to pass through the discounts and rebates made available. That is unless something else can be done. This puts the responsibility back on store level merchandising done with direction from a category manager. With execution done at the store level it increases the opportunity that each store can be more locally responsive to that store's clientele.

In summary, the issue of "pass-through" is really not the issue at all. Instead, serious

trade and consumer marketing programs should focus on the important factor: execution at store level in the right market for the product. Manufacturers should be prepared to move with individual retailers who are flowing with the change. In fact manufacturers should be encouraging retailers to move in this direction as advanced marketers continue to dial into micro marketing, ethnic opportunities, brand regionalisation and much more.

Canada's Agriculture and Food Think-Tank

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