SUPPLY-CHAIN MANAGEMENT: IMPACT OF MERGERS AND ACQUISITIONS ON BROADLINE FOODSERVICE DISTRIBUTORS

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ABSTRACT

SUPPLY-CHAIN MANAGEMENT: IMPACT OF MERGERS AND ACQUISITIONS ON MARKETING PROGRAMS OF BROADLINE FOODSERVICE DISTRIBUTORS

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Through recent mergers and acquisitions, a sharp increase in the number of "mega" food manufacturing companies has evolved. This research studies whether these companies have effectively utilized the Efficient Consumer Response (ECR) and Efficient Foodservice Response (EFR) initiatives to achieve economies of scale throughout their foodservice supply chain. This study also focuses on whether these newly created food-manufacturing giants offer the supply chain savings, enhanced services and marketing programs they purport

to broadline foodservice distributors. Previous research has shown that sheltered income is a prime necessity for the mere survival of the broadline food distributor. The survey reveals that the amount of sheltered income previously offered by Company A and Company B does not always equal or surpass previous figures when the two companies merge to form Company C. Also examined in the study are creative programs used by foodservice distributors in an attempt to recoup lost income. Finally, the study shows whether these mega food manufacturers are able to successfully leverage their size and scale by controlling key distributor product lines, achieving line consolidations, enhancing marketing and distributor growth programs and ultimately gaining share in the marketplace.

CHAPTER I

INTRODUCTION

In the foodservice industry, margins are extremely tight for all involved. For distributors, gross margins average approximately 16 percent of sales and net profits are only hovering around 2 percent (ID: The Voice of Foodservice Distribution 1997). Food manufacturers, brokers, distributors and operators are all struggling with profitability issues. Specifically for the foodservice distributor, a distributor's adeptness at implementing Efficient Foodservice Response procedures (EFR), executing creative programs and garnering sheltered income will determine its profitability fate. Many believe that the foodservice industry has gotten off track. Instead of buying and selling products and brands, the business is now focused on buying the lowest cost of goods and selling assets through mergers and acquisitions. Since cost accounting and asset management controls operations for most distributors, supply-chain management offers the challenge of accountability. Both manufacturers and distributors are re-evaluating their corporate goals, strategies and leveragable resources to attain financial security (Llopis 1999).

A broadline distributor sells many types of products, such as dry groceries, refrigerated and frozen foods, cleaning and paper supplies and produce, to many different foodservice customers. In order to meet their own financial goals, foodservice operators are demanding lower margin deliveries from their supplying distributors. This demand asserts pressure on broadline distributors to deliver food products below their targeted sell price and endangers their own profitability picture.

In order to construct a positive balance sheet, distributors are continually seeking guaranteed income opportunities from their suppliers. Recently, there has been a rash of mergers and acquisitions among food manufacturing companies. Two examples of consolidating manufacturers are Kellogs and Keebler and General Mills and Pillsbury. In most cases these newly combined conglomerates are operating with the "one face, one company" mentally and not as separate operating divisions. In terms of shear numbers, this approach decreases the quantity of suppliers a distributor can rely upon to contribute to its marketing and sheltered income programs. Sheltered income is defined as a factor of financial incentives, such as growth programs and sales allowances, that allows the distributor to offer a program margin that is nominally well below the profit margin (Norkus and Merberg 1994). Another view is that sheltered income is payment to a distributor for access to people, product, and promotions (Civin 1993). Inevitably, these new combined companies do not always contribute at a comparable financial level as before the merger or acquisition.

Broadline foodservice distributors are also engaging in line conversions and consolidations to streamline operating costs in the supply chain. Many of the newly formed "mega" food manufacturing companies attempt to leverage their size and compel the distributor to stock and promote a particular brand in their portfolio. These vendors cite economies of scale, centralized purchasing (one stop shopping) and additional marketing and growth dollars as reasons distributors should abandon a competitive brand and replace it with the mega company brand. An aspect of this research is to determine whether the larger and more powerful food manufacturers are able to leverage their primary and secondary lines and successfully execute line consolidations at the distributor level.

Research Objectives

The objectives of this research are:

- To study whether food companies that have increased in size and scale due to either a merger or acquisition are contributing, in marketing and sheltered income, at or above the pre-merger/acquisition level.
- To determine how the distributor intends to recuperate marketing funds if post-merger/acquisition contribution is below pre-merger/acquisition level.
- To determine whether the newly merged or acquired company is able to leverage its size and control key lines and implement line consolidations.

Research Questions

H1: Manufacturers that have experienced a merger or acquisition do not continue to contribute marketing dollars and sheltered income at pre-merger or acquisition levels.

H2: Broadline distributors institute creative marketing programs to recoup lost earned income dollars from newly merged or acquisitioned manufacturers.

H3: Manufacturers that have experienced a merger or acquisition are able to leverage their size by controlling key lines and implementing line consolidations at broad-line distributors.

CHAPTER II

SUPPLY CHAIN MANAGEMENT

Supply Chain Management as defined by Kay (2001) is *the practice of coordinating the flow of goods, services, information and finances as they move from raw materials to parts supplier to manufacturer to wholesaler to retailer to consumer. This process includes order generation, order taking, information feedback and the efficient and timely delivery of goods and services.* In the simplest terms, supply chain management (SCM) lets an organization get the right goods and services to the place they are needed at the right time, in the proper quantity and at an acceptable cost.

The Boston Consulting Group found that "the entire foodservice value chain is facing profit and growth pressures and that a manufacturer's size and category does not appear to dictate destiny, meaning profitability" (Perkins 1999). Michael and Edmondson, in their March 2002 article in *Nation's Restaurant News*, contend that supply chain valuation among operators, distributors and manufacturers is low to nonexistent. They attribute this to the industry's confusion as to which exchange medium to adopt. They believe that manufacturers and distributors systems have to be able to communicate with each other in order to realize valuation in business-to-business exchanges. Michael and Edmondson highlight three exchange media, each funded by different segments, either distributor, manufacturer, and/or operators, each competing for the winning slot.

The supply chain involves the elements of location, production, inventory and transportation. Stocking and sourcing points of products determine the path along which goods will flow, while manufacturers must determine which products to produce at which plant and ultimately the route the product will take to reach the final customer. Each link in the supply chain must keep an inventory of raw materials and subassemblies as a buffer against uncertainties and unforeseen events. Finally, transporting goods from various links in the supply chain based on cost of transportation versus reliability must be weighed (Kay 2001).

Most people are unaware of the supply chain unless something goes awry. Most restaurant patrons are unaware of the distributor that delivered the food to the back door of the restaurant they are dining. Foodservice manufacturers and distributors are largely invisible to the ultimate end users, the restaurant patron. However, when the system fails, both the food manufacturers and distributors come under scrutiny (Abraham 1998).

> "...One could make a case that the phenomenal initial growth of wholesale clubs on the retail side of the food industry was evidence that the existing retail supply chain had, in a sense, broken down. The breakdown wasn't a labor strike, but rather the inefficiencies within the system that caused higher systems costs and higher prices to the consumer. This allowed the club channel to capture a significant share of the volume. A new method of distribution emerged, and consumers welcomed it, illustrating that they are generally 'value chain neutral'; they care little as to which supply chain satisfies their needs" (Abraham 1998).

The Bullwhip Effect

The traditional way of communicating demand for products or services across a supply chain is through the use of purchase orders. However, the variance between what is ordered and true customer demand can become distorted through the supply chain from both institutional and random factors. Random factors that can affect the supply chain are changing consumer preferences, weather changes and equipment breakdowns (van der Vorst et. al. 1997). Institutional factors, such as internal structures, computer systems and timetables, have a tendency to amplify the demand expressed at each subsequent upstream stage in the supply chain. Each stage becomes more cyclical and extreme in variation. This demand distortion, in which orders to suppliers have a larger variance than sales to consumers, is called the *bullwhip effect* (Lee, Padmanabhan and Whang 1997). Lee, Padmanabhan and Whang (1997) considered the *bullwhip effect* in several case studies and recognized four major causes: demand signal processing, order batching, price variations, and shortage gaming. The cost implications of the *bullwhip effect* are serious. The manufacturer incurs product shortages based on poor forecasting or excess raw materials costs, additional manufacturing expenses due to excess capacity, and overtime and excess warehousing expenses due to increased stock levels (Lee Padmanabhan and Whang 1997 and Andraski 1998). Kurt Salmon Associates (1993) suggest these activities result in excess costs of 12.5 percent to 25 percent. Eliminating the *bullwhip effect*, however, can increase product profitability by 10 percent to 30 percent (Metters 1997). However, eliminating the bullwhip effect is easier said than done. Many factors need to be closely coordinated. Following, is a brief analysis of the four major causes of the *bullwhip effect*, as it relates to the food industry sector.

Demand Signal Processing

Skepticism of supply chain management is the inability to accurately forecast sales. The ramifications of an erroneous entry level forecast in terms of timing and quantity, can be felt throughout the entire supply chain management process. A few of the consequences are that manufacturing will have to adjust to compensate for more or reduced capacity to meet customer demand, logistics expenses will be incurred and customer service levels will be affected by not having the right product at the right place at the right time. Without an accurate forecast, companies will continually deal with an exception process. Estimates are that most companies commit half of their resources to managing such supply chain error exceptions (Andraski 1998).

Forecasting and business planning typically begins in marketing. The marketing forecasts and corresponding financial projections are shared with Wall Street (Andraski 1998 and Butman 2000). Independent of the marketing forecast, the operational forecast is prepared to determine production plans and define inventory location points. The marketing and operational forecasts are rarely in sync with each other and rarely coincide with the customers planning cycle (Andraski 1998). Lee, Padmanabhan and Whang (1997) contend that forecasting is based on the previous order history of a company's immediate customers. When an order is placed, an upstream operation takes that as a demand signal about future orders. Even with exponential smoothing, long lead times, and necessary safety stocks, other factors can distort the actual volume of product needed to fill a customer's request. Over time, fluctuations in order quantities can be greater than those in the demand data. Because the amount of safety stock on hand contributes to the *bullwhip effect*, longer lead times between the re-supply of goods causes the volume fluctuation to be more significant.

Order Batching

Periodic ordering and push ordering are the two forms of order batching. In periodic ordering, a company may order anywhere from weekly to monthly. Many reasons exist for a company to order so periodically. One, it has been estimated that the cost to process an order can range from $35 to $75 and the time involved can be substantial. Therefore, it can be cost prohibitive for a company to order more frequently than once a month. Many manufacturers place orders with suppliers when they run their materials requirements planning systems (MRP). MRP are generally run monthly, resulting in monthly orders to suppliers. Also, a company with many slow moving items may order on a cyclical basis because more frequent ordering may not be warranted. The supplier now faces a highly erratic stream of orders at one time during the month followed by no demand for the remainder of the month. The variability is greater than the demands the company itself faces. This periodic ordering amplifies variability and contributes to the *bullwhip effect.*

In push ordering, a company experiences regular surges in demand by having orders "pushed" on them from customers. Push ordering occurs periodically because typically salespeople are measured regularly such as quarterly or annually. This causes end-of-quarter and end-of-year order surges. Salespeople may also borrow orders from the upcoming evaluation period in order to meet their current sales quota. For the supplier, the ordering pattern from the customer is more erratic than the consumption pattern than their customers. This situation, of course, results in the *bullwhip effect.* If orders were evenly spread out during the period, the *bullwhip effect* would be minimal. Unfortunately for the supplier, orders are likely to be randomly spread out and at worse, will overlap. Generally, order cycles will overlap around the same time. "As a result, the surge in demand is even more pronounced, and the variability from the *bullwhip effect* is at its highest" (Lee, Padmanabhan and Whang 1997).

Price Variations

From Lee, Padmanabhan and Whang's research of 1997, it is estimated that 80 percent of transactions between manufacturers and distributors in the grocery industry are made in a forward buy arrangement. In this situation, products are purchased well in advance of requirements. This forward buy purchasing is usually due to attractive pricing offered by the manufacturer, typically price and quantity discounts, rebates, extended terms and the like. Lee found that such trade deals could constitute up to 47 percent of the promotional budget for the customer. These promotions result in larger quantities being purchased than the customers' actual needs. As the customer is stocking up for the future, this forward buying wreaks havoc with the supply chain mechanics and creates the *bullwhip effect*. Forward buying can become the norm for some customers. When the price is low, more quantity is purchased than needed, then purchasing pattern causes some manufacturers to run overtime when demand is high and prices are low, but leaves them idle at other times when the price has returned to normal. The *bullwhip effect* is in full swing when the customer's buying pattern does not reflect its consumption pattern and the variation of the buying quantity is much larger than the variation of the consumption quantity.

Shortage Gaming

Manufacturers often ration their product to customers when product demands exceed supply. In some instances, if the total supply is only 50 percent of demand, customers will receive 50 percent of their order. Knowing this, customers may exaggerate their actual needs upon ordering and then they simply cancel orders when demand cools. This overreaction by customers anticipating the shortages results when organizations "game" the potential rationing. "The effect of 'gaming' is that customers' orders give the supplier little information on the product's real demand, a particularly vexing problem for manufacturers in a products early stages"(Lee, Padmanabhan and Whang 1997).

Supply chain management involves the elements of location, production, inventory and transportation. Location of sourcing points factors into the number of days inventory on hand. If product can be acquired quickly, perhaps within 72 hours, either by backhauling or shipping, inventory on hand can be reduced and turns will increase. If the product requires a lengthy lead-time in order to be received, inventory on hand must be longer to accommodate the complexity of receipt. This time lag negates the efficiencies to be gained in the supply chain. According to Jack Nevin, executive director of the Grainger Center for Supply Chain Management at the University of Wisconsin-Madison School of Business, "Firms are under tremendous pressure to cut costs, and most of those costs are just sitting there in the supply chain" (Boyle, 2001). The May 2001 issue of *Institutional Distributor Magazine* cites as an example, the case of Marriott Distribution Services revamping its logistics to increase backhaul volume from 22 percent to 60 or 70 percent of return trips. This increase is attributed to new inbound software. Although, increasing backhauling percentages seems an optimal way to gain efficiencies, i.e. lower trucking rates, best pricing for full truckload orders, reduced costs to process fewer invoices, etc., it could also fall into the batch ordering trap of the *bullwhip effect*. Lee, Padmanabhan and Whang (1997) contend that the *bullwhip effect* increases when periodic, say monthly, ordering occurs versus steady weekly ordering. The supplier faces a spike in demand once a month with no demand for several weeks. In addition, the suppliers salespeople, who may be measured on a quarterly bonus schedule, are apt to encourage the customer to "buy ahead " of schedule in order to meet their own sales quotas. This amplifies the *bullwhip effect* even more significantly.

The September 11, 2001 terrorist attacks, which wiped out the twin towers of New York City's World Trade Center, have accelerated efforts to revitalize and restructure global consumer supply chains" (Woo, 2001). For many, this restructuring has meant a particularly strenuous focus on technology as a way of driving errors, and therefore costs, out of the supply chain system. Technological advances combined with advanced forecasting systems can decrease the *bullwhip effect*.

Efficient Foodservice Response

Efficient Foodservice Response (EFR) is an industry initiative that promises to save $14.3 billion in reduced costs and provide better value to the consumer through improvements in foodservice supply chain operations (Malchoff 1996). Similarly, in the automobile industry, Chrysler and its suppliers removed over $2 billion in costs from their supply chain by utilizing SCORE (Supplier COst Reduction Effort), rather than price reduction ultimatums (Hartley, Greer and Park 2002).

The foodservice industry has not fully adopted Universal Product Codes or bar-coded cases. There were 240 million invoices generated with 80 percent of them processed manually (Abraham 1998). A task force study identified fifteen strategies for achieving the goal of reducing supply chain costs. The strategies fall into the categories of product flow, information flow and funds flow. EFR relies on the partnering of all members of the foodservice supply chain to achieve its two primary objectives - - cost reduction and greater value to the consumer. EFR enables supply chain members to capture more of the food dollar, and according to previous research, could spur $800 million in sales growth. The ultimate goal is the creation of a foodservice channel in which paperless transactions between manufacturer-distributor-operator are automated to the point where costs drop dramatically and there is only half the inventory in the pipeline as at present. Invoices, point-of-sale and other demand data, even payments, will be transmitted electronically via Electronic Data Interchange (EDI) (Malchoff 1996). Efficiently managing this process involves overseeing relationships with suppliers and customers, controlling inventory, forecasting demand and receiving constant feedback on what is happening at each link in the supply chain.

Efficient Consumer Response

In recent years, Efficient Consumer Response (ECR), "a grocery industry strategy in which distributors and suppliers are working closely together to bring better value to the grocery consumer"(Kurt Salmon Associates 1993) has helped to streamline inefficiencies in the grocery supply chain. Ideally, all supply chain participants should be integrated and focused on creating an efficient supply system. ECR was designed not only to aid in efficient replenishment, but also more efficient store assortments, promotions and new product developments (Whipple, Frankel, and Anselmi 1999). Estimates are that ECR can provide savings of up to $30 billion and dry grocery lead times can be reduced from 104 to 61 days of supply (Ibid).

Grocery supply chains are seeking new modes of freight consolidation to provide a smooth, orderly flow of smaller more frequent orders. The problem with continuous replenishment programs, aimed at reducing inventory levels and matching product supply more closely with consumer demand, is that it creates the need for smaller and more frequent orders. Frequent orders lead to higher transportation costs, more dock receipts and more product handling. Efficient Consumer Response (ECR) advocates a solution to the problem by taking advantage of natural consolidation opportunities that already exist where manufacturers ship through the same third-party warehouse. This process requires proactive communication and collaboration between the manufacturer, distributor and third party partner. The ordering process guarantees that multiple products, from multiple manufacturers will be shipped in a full truckload scenario. One key to a successful process is to ensure the loads are delivered in a cost effective, "distributor friendly" fashion. This fashion includes details such as full pallets, even tiers and stretch wrapped orders. These order parameters reduce overs, shorts, and damages. These savings are passed on to the manufacturers who in turn can lower their costs throughout the supply chain (Casper 1996). Distributors note that by combining multi-vendor loads, they do a better job of balancing inventory needs, increase turns, effectively take advantage of promotions and benefit from truckload savings. Benefits for the manufacturer include reduced transportation costs, less damage, increased productivity and the ease of doing business, which is viewed as a relationship asset (Ibid).

It is the resulting efficiencies in store assortments, promotions and new product developments of ECR that this research is concerned with. However, even with improvements in the industry, ECR has not fully realized its benefits due to a lack of integration throughout the supply chain. Inventory levels have not decreased to anticipated levels due to forward buying practices, poor communication among the supply chain members, and a lack of implementation of technologies and software that offer real-time information exchange (Whipple, Frankel, and Anselmi 1999). As in the grocery industry, the bullwhip effect resonates in the foodservice industry as well.

CHAPTER III

MERGERS, ACQUISITIONS, AND STRATEGIC ALLIANCES

In his paper, "Making Mergers and Acquisitions Work", Richard DiGeorgio (2001) found that from January 1990 to June 1, 1997, worldwide merger and acquisition deals involving over $5 million totaled $3.9 trillion. In 1999 alone, companies spent $3.3 trillion on worldwide mergers and acquisitions. This upward trend has continued through the millennium. The rise of the Internet and the resurgence of mergers and acquisitions are the two most important business trends of the last five years. In the last three years, growth through acquisition has been a critical part of the success of many companies operating in the new economy (Carey 2000).

Acquisitions are a quick way to add a product line or distribution channel that would be too costly to build from scratch. In a *Harvard Business Review* roundtable discussion, eight CEOs reported that mergers and acquisitions are attractive if they allow for speed to market, new consumer segments, new geographic markets and new products to a core category. Many CEOs feel the need for mergers and acquisitions to provide scale and scope to compete in a global economy (Carey 2000). Acquisitions do not, however, replace internal growth or alliances. The most important asset is the people, and they can walk out the door if they feel disenfranchised (Ibid).

According to Dennis Kozlowski of Tyco, "Acquisitions work best when the main rationale is cost reduction. Unfortunately, people are often too optimistic about revenues. I've seen a lot of health care businesses think that, just by virtue of having more products, they'll be able to sell more to hospitals or other medical service providers a lot quicker. But it takes a long time to train salespeople to bundle the new products with their existing ones effectively and have them accepted in the market. For one thing, the salespeople have to deal with new competitors – the people already selling the same kinds of products they've just added to their bundle" (Cary 2000).

Harry Stern, in the September 2001 issue of *Foodservice Equipment and Supplies,* believes that recent consolidations in the foodservice industry have reduced competition and been harmful to the industry. Other members of the foodservice community concur with his opinion and feel that consolidation ultimately forces many smaller companies out of business and narrows the options available to consumers. However, even distributors who are not keen on consolidation acknowledge that it is one of the best ways to reduce expenses (Lang 1994).

Mark Drazkowski, VP and COO of Reinhart Foodservice in LaCrosse, WI believes "In this climate of consolidation, operators will have fewer choices to buy from and suppliers will have fewer distributors to sell product to. And selling national-brand product to the larger distributors will be more difficult than ever as they continue to expand their private brand strategies" (ID: The Voice of Foodservice Distribution 2001).

Consolidation has seen many familiar firm names joined together or disappear completely. Creating awareness of the new brand name, and the values attached to it, is essential for attracting and retaining clients. In an industry where there is little to differentiate one product from the next, branding is the only remaining competitive edge (Rutter 2001). Peter Van Stolk, president and chief executive officer of Jones Soda Company says, "Brands do well with consolidation, not products. That's an important distinction. It's evident that it's too expensive for brands to be created today. It takes time or money. If you look at our competitors, you have to ask yourself what new brands have they created in the past 10 years that have stayed. It's easier for a big company to acquire a little company, and it's cheaper"(Holleran 2001). However, in a survey by Larraine Segil (2001), co-founder of The Lared Group, a management consulting firm, she learned that 44 percent of merged companies reported that, three years after merging, they have not gained access to new markets, increased their market share, nor added new products. This information flies in the face of the supply chain management concept of ECR, which was designed not only to aid in efficient replenishment, but also more efficient store assortments, promotions and new product developments (Whipple, Frankel, and Anselmi 1999). Segil's

(2001) findings suggest that merging and acquiring companies are still not on par of combining systems and eliminating efficiencies in the supply chain.

Because there is oversupply in all levels of industry, there is increased consolidation among manufacturers, distributors, and customers (Lang 1994). Consolidation in the distribution channel of an industry has occurred when the largest four firms have 40 percent or more of combined market share (Fein and Jap 1999). Consolidators in wholesale distribution tend to follow a standard strategy of building a national network, leveraging buying power with manufacturers and reinvesting profits to meet the emerging requirements of larger customers and manufacturers. Increased size yields increased financial clout to make operating decisions concerning stocked product assortments and geographic territories independently of manufacturers. Consolidation in the customer base occurs with the emergence of a few dominant customers and the exiting of smaller companies that previously formed the traditional distribution customer base. The formation of cooperative purchasing groups also yields consolidation in the customer base. The implication of customer consolidations is that distributors that cannot provide geographic reach or the level of service required by these large customers are essentially blocked from participation. This lends itself to distributors seeking growth by acquisition strategies in order to react to customer consolidations. Integrated supply agreements between the customer and distributor have recently begun to change the face of wholesale distribution. In integrated supply arrangements, customers give a single distributor, or a select few distributors, all of its business on a single product or product category. In exchange for this exclusivity, the distributor agrees to provide a high level of service at a set price on the product or product line (Fein and Jap 1999).

"For some companies, real operating results are being obscured by the rapid pace of overall business consolidation, i.e., mergers, acquisitions, etc., that are taking place at an alarming rate across all industries. Productivity gains are found in reducing headcount, closing operations, combining systems, etc., all of which have the potential to make real problems"(Andraski 1998). For this reason, many companies are seeking strategic alliance partnerships versus more complicated mergers and acquisitions. For instance, Chemical Distributors Worldwide has been forming alliances and making acquisitions at a rapid rate. The activity is driven by price declines and producers' preference for doing business with a few preferred partners (Morris 1998). "Clearly if such companies hope to protect their long-term financial health, they must make unprofitable customers profitable - - or 'fire' them. Getting rid of customers runs counter to many managers' intuition and training. However, the Life-time Value (LV) model suggests that revenue growth and market share, per se, may actually be the wrong metrics by which to gauge success"(Johnson 2002).

The concept of creating strategic alliances with fewer companies rings familiar to most foodservice distributors as well. Consolidated buying is the style of purchasing they have attempted to foster with operator customers over the past decade. Fewer vendors means improved efficiencies at all levels. It also creates the opportunity to build relationships on a broader base of vendor support in exchange for a measure of exclusivity in the distributor's marketplace (Tanyeri 1994). According to Marsha Gomez, director of purchasing for Jordano's, Inc., a $40 million Nugget distributor in Santa Barbara, California, the trend toward vendor reduction and strategic alliances is happening, but not at a pace most distributors would like. "Fewer vendors means more potential to develop partnerships that will grow the business for both sides." Gomez admits, however, that consolidating vendors is much easier said than done. "We've had some successes. We now have 30 or 40 that we classify as our prime vendors" (Ibid).

CHAPTER IV

SHELTERED INCOME AND CREATIVE REVENUE STRATEGIES

Sheltered Income

Definitions for sheltered income vary depending upon who is asked to define it. Sheltered Income is payment to a distributor for access to promotions, people and product. "Sheltered income is the easiest road for a manufacturer to take to capture a distributor's share of mind." One manufacturer views sheltered income as a green fee, the cost of getting in and playing the game [with a distributor], while another views it as an "insurance program"(Civin 1993). As defined by Norkus and Merberg (1994) of Cornell University, sheltered income is a factor that allows the distributor to offer a program margin (to the operator) that is nominally well below the profit margin. Sheltered incomes, or manufacturer's incentives, have become virtually the sole source of profit for broad-line foodservice distributors. Distributors neither pass the cost reductions on by lowering the cost of their inventory nor do they account for it in their margins. The history of sheltered income dates back to the early to mid 1980's. Multi-unit operators, who faced stiff margin pressures, began to exert pressure on the distributor for lower prices. In response, large corporate distributors began to exert their purchasing power on manufacturers (Civin 1993).

Manufacturer's Perspective

Manufacturers have come to accept sheltered income as a necessity in working with distributors. However, the use of the sheltered income funds has become concerning. Manufacturers feel they are expected to make up lacking margins distributors are not earning from operators. However, the manufacturer rarely sees an expansion in the marketplace despite their cash outlay. Manufacturers themselves have margin pressures and volume targets to achieve as well. Price increases on the manufacturers part can get controversial as they will no longer be able to compete against the distributor's private label products (Civin 1993).

"Trade promotions are the only incentive retailers have to promote a given product to the end consumer. When trade promotion is cut, retailers cut promotions to consumers, and that can really hurt market share" (Butman 2002). An example is Procter and Gamble's (P&G) move to value pricing in the mid 1990's. Previous research findings showed that P&G's deep cuts in promotion dollars actually decreased the penetration of its brands among consumers and did not improve the loyalty of the customers it did retain.

Distributor's Perspective

One distributor views shelter as the manufacturer paying the distributor to market its products through promotions and foodshows and accessibility to training its sales force. In exchange for the distributor performing this marketing function for the manufacturer, the distributor bolsters its margins and the manufacturer gains more business. Many distributors do make the effort to ensure manufacturers get a "bang for their buck" by actively pursuing marketing promotions on the product line. Other distributors just take, with no regard to volume analysis. Distributors view manufacturers as not being responsible managers if they do not evaluate the value they receive from the distributor versus the dollars they contribute (Civin 1993).

Another major stumbling block that distributors face is the reality of direct negotiations between national accounts and manufacturers. These deviated prices supplied directly to multi-unit operators, puts distributors in a squeeze position. The operator is set to receive pricing for less than the distributor can buy and the operators hold the distributors to strict cost-plus percentages. (Civin 1993) The distributor is given little or no choice if it wants the customer's business. It's virtually impossible for a distributor with a high proportion of national account business to radically consolidate its vendor list. Despite the attempts of the distributor to consolidate its lines, national accounts will not allow it. They demand the brand of product they receive the deviated pricing on.

And due to the volume a national account generates, distributors cannot turn away their business (Tanyeri, 1994). Often, chain accounts and large-scale operators attempt to secure pricing contracts with food manufacturers that typically range from six months to a year. Next, these chain accounts then look to negotiate with a food distributor who is offering the lowest margin to deliver the food items to their back door(s). This cost plus business began to loom in the foodservice industry in the 1970s. Cost plus 12 percent was the generally accepted standard (Civin, 1993). As operators began to shop for distributors willing to deliver products at lower margins, cost plus eight and even cost plus seven has become typical in today's environment. Civin (1993) indicated that any distributor knows that it needs a 17 percent margin to realize any sort of bottom line. The only conceivable way a distributor could execute cost-plus-seven chain programs and achieve this essential 17 percent would be to realize 27 percent with street customers. But this is not the case. The average margin for a down the street customer is 15 percent. At that rate, the average distributor does not reap enough margins from its principle business, delivering food, to be a profitable entity. This causes distributors to look for creative ways to pad the bottom line.

It is estimated that sheltered income contributes 100 to 300 percent of a typical distributor's pretax profit. No distributor questioned on this estimate disagrees. If it were not for the availability of sheltered income, the average distributor would, at best, break even. Without it, many distributors would go out of business (Civin, 1993). Many distributors confess to using sheltered income as "a profit center because we as an industry lack the backbone to get more margin from customers" (Lang 1994). On the other hand, many distributors view sheltered income as a partnership. In exchange for the cash that feeds the distributors bottom line, manufacturers are guaranteed slots and dominant product lines. The one thing that all in the industry agree is that the concept of sheltered income is not going away. In fact, as margin pressures tighten as the economy spins into another recession, sheltered income will become even more important to offset the real costs of a distributor doing business (Ibid).

Increasing the types of value-added service offered to customers continues to be important for distributors. But some distributors say thin margins might lead them to charge for services, as they will be less able to give these services away (Esposito 2000). The electronic component distribution industry is continually pushing for a fee-for-services model, as they can no longer sustain the cost of providing these value added services for free. The gross margins they receive on component sales have steadily eroded from 25 percent in 1990 down to 14 percent in 2002 (Sullivan 2002).

Sheltered income takes many forms. These forms include fees to participate in sales meetings and training sessions, slotting allowances, trade shows, and manufacturer growth programs. Thus the adage, "you have to pay to play," often rings true in foodservice. In their article "Food Distribution" in the

Cornell Hotel and Restaurant Administration Quarterly, Norkus and Merberg (June 1994) delve into some of the incentives offered to distributors by manufacturers. First, they examine growth programs. A manufacturer sets dollar and volume target levels for the distributor to attain over a certain time frame such as quarterly or annually. Once the target is reached, the distributor is rewarded by a refund check calculated as a case rate allowance or percentage of sales. To reach this volume target, distributors are often caught in the cycle in the quarterly or semi-annual "load," previously stated as the *bullwhip effect.* Wall Street analysts and stockholders grade many manufacturers by their ability to meet their forecasted sales projections. Falling short of the forecasted number could mean a decrease in stock price and devaluation of the company. Thus these manufacturers will offer deals or incentives for their customers to take on huge inventories of product at key measurement and evaluation times. This buying strategy can backfire on the distributor if their marketing budget and sheltered income allowances are based on a gross percentage of sales. If the distributor falls into the price variation trap of the *bullwhip effect* and buys only during times of promotional offerings when prices are lowered, then they reduce their total potential marketing and sheltered income dollars.

Sales and marketing allowances are examined next. Many manufacturers rebate a percentage of the total dollar value of purchases. Often, the intent of these funds is to be used as a marketing allowance to promote the manufacturers products. In actuality, these funds often go straight to the distributor's bottom line as income. This alternate use of marketing funds leaves excess inventory on the distributor's floor with no plan in place to push the loaded inventory out the door to wanting consumers.

In addition to the above two incentives, some manufacturers were found to offer a "'bonus on bonus' for achieving a specified growth target." In one manufacturer Norkus and Merberg (1994) examined, these three rebates together calculated to nearly eight percent of the distributor's cost of goods sold. Today, this growth target bonus is perhaps one of the largest single payouts a distributor can receive. This ghastly practice perpetuates forward buy loading of product into the distributors' warehouse at the critical measurement moment only to exacerbate the *bullwhip effect* of demand signal processing and order batching.

Pick-up allowances are often granted to distributors when they use their "own delivery vehicles to pick up the manufacturer's products at the conclusion of its delivery run" (Norkus and Merberg1994). This practice, called backhauling, often entitles the distributor "to a rebated discount for purchasing a load smaller than the volume that would normally be sold at a given discount level. The manufacturer would bill the distributor at the 'full' price for less-than-full trailer load and then grant an off-invoice rebate, commonly called a pickup allowance"(Ibid). To garner even more income, "distributors may also assess themselves a 'delivery charge' for the backhauled delivery to their own distribution center that works its way into the cost on which various program-pricing schemes are based and eventually into the food-service operator's price" (Ibid).

Manufacturers routinely offer discounts for prompt payment, such as two percent 15 Net 30. The distributor does not generally view this as a product cost reduction, but as a source of income. Norkus and Merberg (1994) found that some distributors garner additional income by assessing a two percent "upcharge" on products purchased from manufacturers who do not offer a prompt payment discount.

Brokerage fees have been found to contribute income equal to approximately three percent of sales, according to Norkus and Merberg (1994). Smaller independent broad-line distributors join together and form a buying cooperative. The cooperative "acts as a broker in arranging the sale of a manufacturer's product to the distributors in the group. Manufacturers pay the broker a sales commission for its efforts in arranging the sale. After deducting the expenses associated with running the buying group, the balance of the brokerage fee is divided up among the participating member distributors" (Norkus and Merberg 1994).

Another problem faced by food manufacturers is the loss of loyalty from the distributor and the squeeze for "more". This 'more' can take a variety of forms - - extra discounts for a particular order (even when a supplier's product has been specified), advertising and catalog allowances or unjustifiably high fees for participation in individual company shows (Stern 2000). "Distributors generate income from manufacturers in ways not related to invoices and ordering, including foodshows and controlled publications" (Ibid). The fees charged to manufacturers for participating in these events generates revenue exceeding the cost of running the foodshow or printing the publication. These activities provide another form of sheltered income for the distributor.

One of the largest money making affairs for a foodservice distributor is their annual foodshow. Typically, distributors invite manufacturers and brokers to display their products in a 10′ X 10′ booth in a convention hall or hotel setting. The fee for this opportunity can range between $2000 to $5000 per booth. From the vendor's perspective, sentiments about foodshows range from "a complete waste of time" to "a necessary evil" to "simply another distributor profit center at our expense" (Tanyeri 1999). Financing foodshows has become a real thorn in the sides of many manufacturers who feel that certain distributors are using their contributions to build a profit center rather than to help defray show expenses. Some even feel that they are being asked to provide some distributors' profit margins (Stern 2000).

> "The food distributor's price and profit margin are based on what the traffic will bear rather than any calculation of cost recovery plus profit. Relative bargaining power and market economics govern the margins that distributors can maintain. The distributor's overall margin is produced from a blend of low and high profit customers and low and high profit items. Achieving a blend that will cover the overhead and earn a profit is the distributor's challenge. It would be difficult for a broad-line

> distributor to be profitable at an overall margin below about 14 percent. Offering cost-plus programs below that level requires a balancing act of customer mix, product mix, and manufacturers' incentives. The distributor hopes that the sheltered income earned as a consequence of the additional volume will make up the difference and, indeed, provide the profit for the business" (Norkus and Merberg 1994).

When the distributor is confronted with the option of stocking Brand A versus Brand B, the decision often comes down to which manufacturer is willing to provide the most dollars in sheltered income. "Especially in the business climate that has been in effect for about 10 years now, distributors have found their margins squeezed to the point where off-invoice pricing, generally in the form of back-end rebates, often represents their entire profit at year-end" (Stern 2001). On the other hand, "dealers' (distributors') views of the consolidation trend seem to be strongly influenced by their firm's size and resultant clout. For example, before deciding to cast its allegiance with a consolidated manufacturer, one mega-dealer methodically compared its long-range plans with that of its potential supplier to determine if there was a good strategic fit. This dealer's feeling was that the rebate dollars available through this manufacturer's program, while an important factor, did not in themselves justify the formation of an expanded alliance, forcing this distributor's principals to weigh other considerations before arriving at a decision." In some instances, Stern does not believe that small percentage increases in sheltered income or additional rebates "provide enough impetus to make many dealers, large or small, switch their allegiances" to a consolidated manufacturer. Sadly, however, the bottom-line incomes, as a percentage of sales, of foodservice distributors, have continuously declined over the past three decades. Despite the elaborate sheltered income programs of manufacturers and distributors, shrinking margins continue to plague the industry (Norkus and Merberg 1994).

Tracking the Money

Despite the importance of sheltered income to a distributor's profitability, most distributors do not have systems to adequately track income due from vendors. There are an array of sheltered or earned income deals such as rebates, growth programs, buying allowances and off-invoice allowances. There are several computer software programs designed to help food service distributors maximize income from vendor promotions and allowances. Estimates are that earned income should range from two to six percent of sales for a distributor, depending on product mix (Casper 2000). Despite this crucial impact on distributor profitability, few distributors, it seems, have adequate systems for tracking all the income due from the array of deals. A few large distributors have developed internal allowance tracking programs while others use either *DealPro!* or *Earned Income Tracking System*. "Both programs, *DealPro!*, from MB Consultants, Laredo, Tex., and *Earned Income Tracking System*, from Distributor Resource Management, were designed by industry veterans who perceived a need while trying to track deal income in their own former positions at foodservice distributors" (Casper 2000). The programs are designed to "ensure distributors collect all funds due from vendors, by providing them with a detailed accounting of moneys earned through each program; and help them maximize earned income opportunities. "The programs can also be used to track rebates actually received." Tracking received rebates is useful when evaluating which suppliers contribute the most in earned income and thus considered most important (Ibid).

The programs have the ability to track both purchasing driven and sales driven rebates and allowances. Distributors need only to enter terms and time frame of the deals they want to track into their computer system and download their purchases and sales on a regular basis in order for the programs to keep a running total on monies earned for each deal. The programs can also generate invoices to manufacturers for monies due as well as monies actually received. *DealPro!* can sort deals tied to different promotions to such as feature sheet allowances versus foodshow allowances to determine which types of events are most productive (Casper 2000). The *Earned Income Tracking System* features a Growth Program Status Report, which allows distributors to check their progress against a manufacturers growth program. The Total Dollar Purchases Report ranks suppliers according to the total rebate amounts paid. These tracking features help distributors rank manufacturers by financial contribution importance and determines where future opportunities for negotiations may lie (Ibid).

Shared Ideas

Foodservice distributors and suppliers are realizing that they cannot work independently. They understand that the adoption of a total marketing strategy can help boost their operations significantly. They also agree that the driving force in the distributor-supplier partnership is not one or the other, but the operator. When the customer's needs are met, then profits begin to rise. A total marketing strategy is the optimal way to meet these needs (Seemann 1993). Managing landed cost and supplier selection are two of the most critical responsibilities of the distributor's purchasing department. In the past, most foodservice distributors built relationships with their favorite manufacturer and broker representatives and allowed them to specify products to bring into distribution. When distributors are faced with similar products, each manufactured by top-notch companies, "it is just human nature to want to do business with those you have made a connection with, those you have a 'relationship' with" (Fusari 2001). According to research by Charles Beck (1995), distributor/supplier/partnerships with a high level of communication were perceived more positively than the distributor partners than were those with low-level communication. Thus, "high level communication may be an effective tool for improving the productivity of the partnership." A distributor's allegiance to a representative and his knowledge base has caused many to question the rationale of actively consolidating manufacturers, especially if the consolidation means replacing the knowledgeable rep with one who does not know the line. However, shared values and marketing objectives between the distributor and the manufacturer are quickly becoming fundamental elements of success. The joint objective is to meet the operator's needs. This strategy translates to more profits for all. The goal of a marketing program is to increase the suppliers and distributors profitability, volume, and market share (Tanyeri 1994). While successful marketing programs consist of many components, all distributors agree that the bottom line is the financial support offered. The more marketing funds allocated, the greater the distributor's marketing power and the more direct access by the supplier to the distributor's sales force and customers (Ibid). In her research, Dana Tanyeri (1994) found various areas distributors cited as opportunities for building stronger and more effective marketing programs. A distributor's wish list would include:

- Improved Vendor Performance - on-time deliveries and accurate pricing
- Price Change Notification – advance notification of impending increases
- Quality Field Support – participation in food shows, training at sales meetings, one-on-one activities with DSRs (distributor sales representatives)
- Realistic Growth Goals – growth goals must be in line with industry growth
- Training Support – on-site plant tours, well planned sales meeting presentations, product knowledge training and relevant sales literature
- Responsibility for Turns – Suppliers must take responsibility for dead items

- Strong Sampling Program – In exchange, the distributor is willing to provide feedback as to where the sample went and what the result of the call was, sale or no sale.
- Freight Allowances – allow distributors to pick-up with their own equipment or use a third party carrier if product can be delivered cheaper than the vendor's delivered price.
- Full participation in distributor's marketing program
- Long-term thinking vs. short term spiffs
- Technological advances – product data base for laptop utilization, EDI, bar coding
- Review – most important step is to monitor, track and when necessary, adjust the programs to fit changing market conditions

From the distributor's perspective, the best marketing programs are those in which the manufacturer representatives take an active role in moving product from their the distributor's warehouse, not just laying cash on the table, shipping product in, and then disappearing until the next load period.

In a supply chain research study by Rakesh Niraj, (2001), he concluded that a small percentage of customers contribute a large percentage of total profits. In an effort to eliminate channel costs, distributors are placing new demands and multiplying service requirements of manufacturers. Market access for manufacturers is no longer guaranteed as distributors prune their supply base (Fein and Jap, 1999). "Traditional channel-management approaches rightly call for a manufacturer to identify strategies to maintain market position as value migrates down the channel. Consolidation complicated this effort, however, by creating uncertainty about the investments required to gain position if the channel structure changes." Along with supply chain solutions, such as Efficient Consumer Response, in the grocery industry, distributors face significant costs for purchasing the low cost, most frequently used items (Ibid).

> "They are attempting to minimize their purchasing costs by reducing the supplier base, shrinking internal purchasing staffs, and applying supply- chain management technologies, such as electronic data interchange, to reduce inventory. In essence, customers in these channels value the efficiency with which a product moves through the channel as much (or more than) the features and benefits of the product itself" (Fein and Jap 1999).

Because consolidated distributors can take a global view of vendors, products, and application opportunities, they are positioned to manage the entire supply chain for customers by aggregating the products from multiple industries"(Fein and Jap 1999). Fein and Jap (1999) suggest four strategic responses to consolidation. The strategies are: (1) Partner with a winner; (2) Invest in fragmentation; (3) Build an alternative route to market; and (4) Create new channel equity.

Partner with a winner - Manufacturers can partner with consolidators through "preferred supplier agreements," (or primary vendor agreements). Under these agreements, the distributor is expected to provide additional or preferred support to the brands of partner suppliers. At the limit, a distributor may refrain from carrying brands of competing manufacturers in a specific product category. In exchange for this commitment, the manufacturer offers better pricing and extra marketing support or agrees to limit its network of distributors. "If you dramatically increase the amount of materials you consume from a certain supplier, the supplier will tend to make more concessions because it becomes even more important to retain that account" (Chang 2000).

Invest in fragmentation - A manufacturer can do this by either partnering with a network of independent distributors in the channel or to developing relationships with horizontal alliances of smaller independents. From the distributor's perspective, however, the possibility of being supplanted by a manufacturer is heightened when the manufacturer's brand name is strong or the product has special attributes that make it hard to replace. When customers have little brand preference, they will give greater weight to a distributor's reputation and service quality. Fein and Jap (1999) suggest manufacturers think about additional ways to make themselves more attractive to the channel. A broad product line, for example, can help a manufacturer build countervailing power in the channel and enable it to provide package discounts and linked promotions.

Build an alternative route to market - Manufacturers can reassert themselves in the distribution channel by bringing the functions of an independent distributor in-house. A manufacturer might also consider the Internet as an alternate channel for going to market.

Create new channel equity - Most manufacturers emphasize their brand equity. The Boston Consulting Group Report (1993) shows that higher performing manufacturers are more operator focused. Therefore, those distributors who focus on operators will be important partners to manufacturers.

"Most distributors are buying systems - they try to make a profit on the buying side of the business" says Rock Moen of CD Hartnett (Anderson 2000). CD Hartnett is one distributor that actually channels a portion of manufacturer provided marketing dollars down to the customer level. Under CD Hartnett's Loyalty program, customers earn points when they buy certain products or meet a set-buying objective. The points can be exchanged for award such as airline tickets, products or movie tickets. CD Hartnett shares the marketing monies it gets from manufacturers with its customers in order to drive the market and gain sales and customer loyalty. They will, on occasion, share this information with manufacturer supplier to demonstrate growth in the specific product lines (Anderson 2000).

"Market orientation, as defined by Kohli and Jaworski (1990), is the organization wide generation of market intelligence pertaining to current and future customer needs, dissemination of the intelligence across departments, and organization wide responsiveness to it." "The normative function of reference group theory suggests that a market oriented supplier can encourage the adoption of market-oriented behaviors by distributors interested in winning favors from suppliers, thereby increasing profits and further cementing the relationship" (Siguaw 1998).

Andraski (1998) espouses that there are four key ideas to break the existing paradigm of inaccuracies in demand planning. First, trading partners must work on a collaborative planning initiative designed to exchange information and marketing intelligence in an effort to develop a marketing specific forecast. Second, there must be intracompany collaboration such as between sales, marketing and logistics. Third, there should be a ready exchange of actionable information and a system in place to support the process. Finally, existing communications should be upgraded, such as Internet integration, to provide value added services along the supply chain.

But there are many things that can go wrong along the way of forming strategic partnerships between distributors and manufacturers. Some reasons distributors identify as causes for break down of core-vendor arrangements include:

- Lack of commitment and follow-through on the part of the supplier or the distributor on the terms of the prime-vendor agreement.

- Competitive jealously. "Distributor A" discovers that its prime-vendor partner in a given category has also been courting competitive "Distributor B" with more extensive programs and services. Trust evaporates, and the relationship dissolves.

- Sabotage. Vendors eliminated from a particular distributor's roster as a result of consolidation have been known to flood the market with promotions, funds, and marketing efforts to undermine prime-vendor efforts.

- Bad chemistry. When the relationships don't click, it's best to face it and move on.

- Personnel changes. A change on either side can sway the relationship.

- Poor tracking and inadequate communication. At least quarterly and preferably monthly status reports and review procedures should be in place.

Handfield and Bechtel (2002) believe that managers should strive to build a trusting relationship with suppliers in hopes of reducing cycle times in the supply chain. Susan Scheck, in her evaluation of *The Future of Purchasing and Supply: A 5 and 10 year Forecast*, concluded that to succeed, "companies need to achieve high-quality supplier relationships that will enable high-quality customer relationships" (Scheck 1998). In order for the relationship to continue, the supplier and distributor must meet often, share ideas, information and destinies, jointly take risks and share the rewards.

Jan Schneiderman, Vice President of K.B. Foods of Omaha, Nebraska offers a list ground rules for both distributors and primary vendors to follow in order to create a successful strategic alliance (ID: The Voice of Foodservice Distribution 1993). In her view, distributors must:

Determine the product line to be stocked: Product switching because of "hot" pricing will undermine the integrity of the program and confuse the distributors' sales reps, its primary vendors, and, its customers.

Harry Stern of Stern, president of Stern Associates, states "Manufacturers are strongly encouraged, primarily by larger dealers and buying groups, to put together compelling programs in order to become 'preferred suppliers.' It is the prevailing opinion of my sources that the common practice of giving increasingly deep back-end allowances and rebates is often simply a way of providing sheltered income to dealers. Yet despite these favorable deals, when faced with a chance to purchase their competitors' product at a slightly lower price, some suppliers feel that many dealers often bypass their 'partners'. They further belive that if a dealer truly means to deal equitably with a preferred supplier, factories will work with that dealer in situations where legitimate competition arises so as to jointly secure the business" (Stern 2000).

Limit promotional opportunities to primary vendors: Promotions and spiffs must be driven by the distributor's yearly marketing plan and be based on the selection of primary vendors.

Create a solid marketing plan and follow it: Make sure that primary vendors and DSRs are aware of the plan, and aim all efforts toward follow-through.

Spell out financial expectations to the primary vendor: The expectations must be realistic in keeping with the distributor's position in the local market. Proper budgeting and a sensible plan will provide the vendor with clear-cut direction. Request marketing monies once a year so that time is more effectively spent cultivating the plan toward achieving success for all.

Ensure that all departments in the distributorship are aware of and adopt the plan. Construct a "seamless system."

Equally important, according to Ms. Schneiderman, the primary vendor must:

Offer value by visiting the distributor's facility. It is not enough to load DSR mailboxes with point-of-sale materials, and take repeat orders from buyers.

Make the effort to become acquainted with all DSRs, not just the top two or three. The better the vendor rep knows the DSRs and their territory, the better the chances for accomplishing goals.

Make sure vendor representatives have the ability to impart knowledge to the DSR, as well as to the customer.

Follow through on all commitments. If it is not possible to meet the distributor's expectations, it is better to be honest and up front about it at the outset.

Be innovative – Modify promotions from time to time, and recognize that not all "national" programs will be appropriate to every distributor's marketing plan. Be flexible, and be prepared to negotiate to make the program work for each individual distributor.

CHAPTER V

METHODOLOGY

Sample Selection

An aggregate of broadline distributors from Sysco Corporation, US Foodservice and Performance Food Group were used as the targeted population of broadline foodservice distribution locations. No independent foodservice distributors were included in this study. A proportionate stratified sampling process was employed to ensure an equal opportunity for the three subgroups participation. This process yielded 138 distributors selected to receive the survey.

Survey Instrument

Initial information for the survey instrument was gathered through interviews with three Vice President's of Marketing. Appendix A summarizes their comments. This information was used to develop the final survey instrument.

A seven question survey was developed. Question one used a multiple choice multiple response scale. Questions two and three consisted of a two-part multiple choice single response scale. Question four was a simple dichotomous category scale. Question five used a multiple choice multiple response scale. Questions six and seven used the Likert Summated Rating Scale. Critiques and comments were solicited from faculty of several Texas Universities who teach research related courses. Only minor revisions were required of the survey instrument. See Appendix B for the survey.

Survey Administration

The survey was made interactive and web viewable and placed on a Southwest Texas State University web page. Selected recipients were e-mailed a message requesting their participation in a foodservice survey. The message included a disclaimer statement and directions to click on an attached link to complete the survey. See Appendix C for disclaimer statement and link to the survey. One hundred thirty-eight e-mails with links to the survey were sent out. Three weeks were allowed for responses from the date the surveys were initially e-mailed. Distribution of the survey included foodservice distributors across the continental United States.

Sixteen electronic mails were returned due to incorrect addresses. Follow up electronic mails were sent out the second week to the remaining 122 participants. The electronic communication thanked those who had already participated and reminded those who had not to please take a moment and complete the survey. Thirty-three surveys were received within the deadline period, however three were unusable. Thirty completed, usable surveys remained for a response rate of 24.5 percent.

Data Analysis

Data were received and analysis was performed using SPSS® statistical software. Data entry was checked twice for accuracy and to eliminate mistakes. The analysis of the questions on the survey included frequency analysis for all questions, Chi-square tests and cross tabulations.

Limitations of the Study

- With US Foodservice's recent acquisition of Alliant Foodservice, some electronic mail addresses were outdated and several personnel changes had been made. Consequently, sixteen surveys were returned due to incorrect e-mail addresses.

- The targeted population yielded a relatively small sample since the study focused only on national broadline foodservice distributors. Smaller, regional independent broadline distributors were not included in the study. The results of the study may be skewed as the national distributors may have the ability to command more lucrative corporate deals from manufacturers than smaller distributors.

- Many distributors refused to answer the survey because of corporate policies against disclosure of such information. Two responses were received by e-mail where the selected survey recipient indicated a desire to discuss the survey with the graduate student before completion. The respondents felt the questionnaire was extremely specific to the foodservice industry. Their concern was that if their specific house could be identified based on their response, confidential information could be made public.

- The survey did not require the respondents to provide actual dollar amounts of earned and sheltered income provided by the manufacturers. Their responses were subjective based on memory and what they believed to be the amount contributed recently versus pre-merger and acquisition contributions.

CHAPTER VI

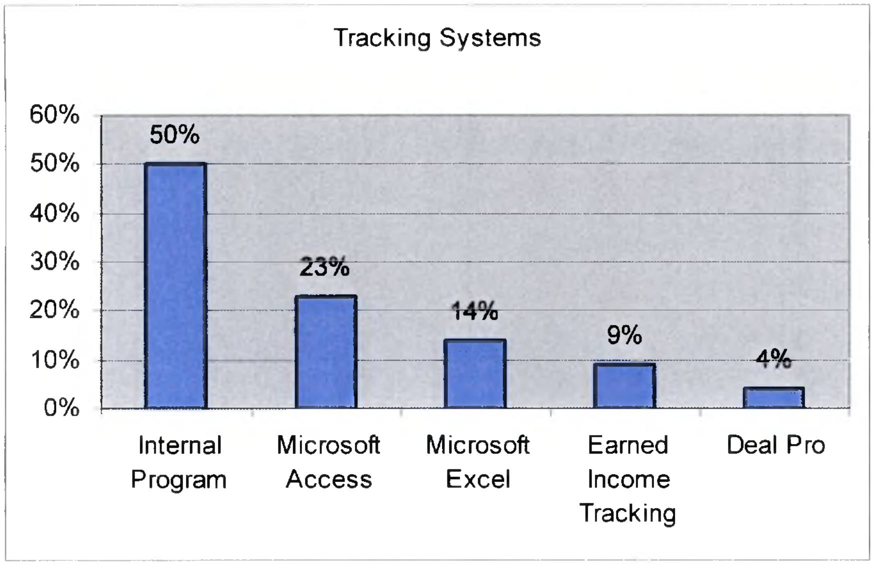
ANALYSIS OF RESULTS

Following is a discussion of each survey question and a summarization of results. Frequencies for all survey questions are summarized in APPENDIX D.

Question one: "What tracking system(s) do you use to capture all forms of earned and/or sheltered income?"

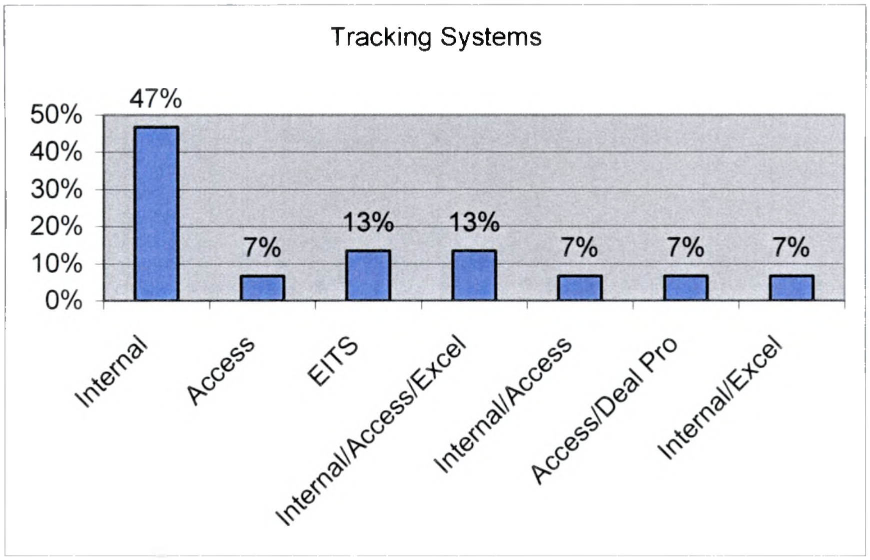
The respondents could select as many forms that applied. The purpose of this question was to determine if distributors are actively tracking earned income deals and if so, by what means. A total of forty-four responses were provided for question one. Figure 1 summarizes the results by category. Internally developed software/computer program garnered 22 responses from the participants for 50 percent of the responses. Microsoft Access received ten responses for 22.7 percent of the responses. Microsoft Excel received 13.6 percent or six responses. Earned Income Tracking System from Distributor Resource Management received four responses or 9 percent of the total responses. Finally, Deal Pro! From MB Consultants received two responses or 4.5 percent of the total responses.

Figure 1



Four respondents indicated that they used a combination of an internally developed program, Microsoft Access and Microsoft Excel. Two respondents indicated they used a combination of an internally developed software program and Microsoft Access. Two respondents indicated utilizing Microsoft Access and *Deal Pro!* from MB Consultants. Two respondents indicated using Microsoft Excel along with an internally developed software program. Figure 2 summarizes the multiple responses. No respondent indicated they either manually tracked earned income or did not track earned income in any manner. Also, no respondent checked other and wrote in a tracking method.

Figure 2

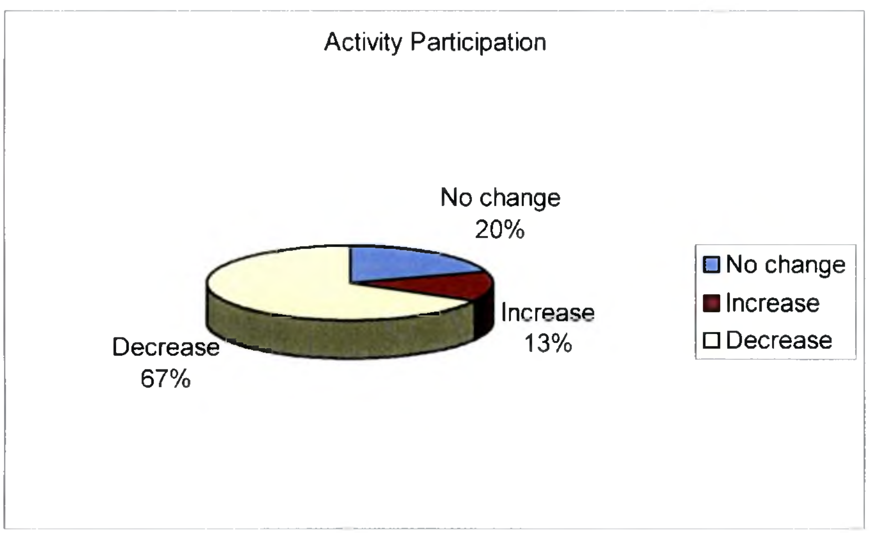


Although each respondent indicated using a computerized method of tracking earned and sheltered income, less than 15 percent of the sample utilizes the latest software developed specifically for the foodservice industry to aid in the billing and tracking of earned and sheltered income.

Question two: "How have the recent mergers and acquisitions of several food manufacturers such as Kellogs/Keebler, Pillsbury/General Mills, Kraft/Nabisco, affected the activity participation level in your distributor marketing programs?"

The respondent could select no change in participation, increased participation or decreased participation. If increased or decreased participation was selected, the respondent was asked to indicate what percent increase or decrease was incurred in the activity participation level by the merged companies. Due to the small number of respondents, some categories where combined. Forty percent of respondents indicated a decrease in activity participation of 29 percent or less. A decrease of 30 percent or more was indicated by 26.7 percent of the respondents. No change in activity was indicated by 20 percent of the respondents and only 13.3 percent indicated an increase in activity of 29 percent or less. Figure 3 summarizes the results. Two-thirds of the respondents cite a decrease in activity indicating that most manufacturers that have merged or consolidated do not continue to participate at the same pre-merger or acquisitioned levels.

Figure 3



A chi square goodness of fit test was calculated comparing the frequency of occurrence of each response of no change, increase and decrease in activity participation. The frequencies are summarized in Table 1. The hypothesis was that each value would occur an equal number of times. A significant deviation from the hypothesized values was found (chi square(2) = 15.20, $p<.05$). Therefore, from the table, it can be concluded that consolidated companies exhibit a marked decrease in activity participation.

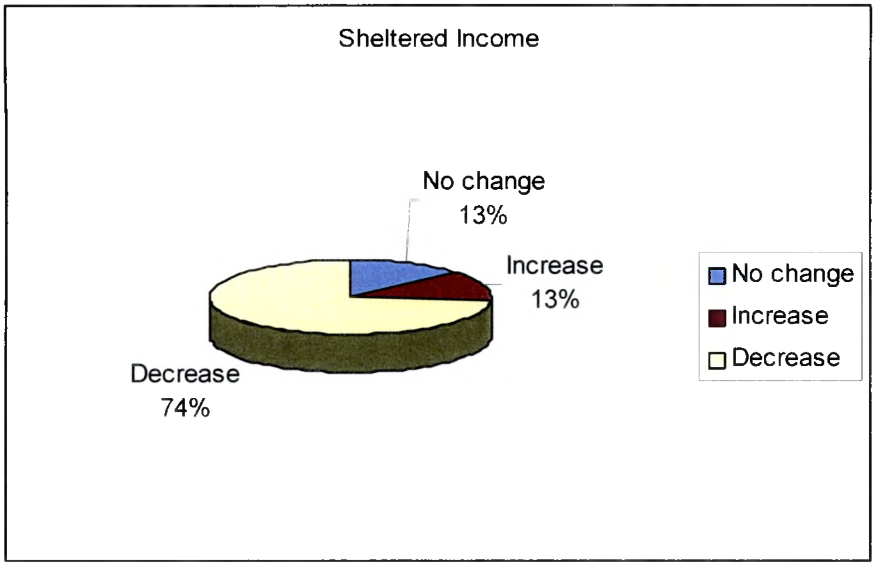
Table 1

Activity Participation	Responses	Percentage
No change	6	20%
Increase in participation	4	13%
Decrease in participation	20	67%

Question three: "How have the recent mergers and acquisitions of several food manufacturers such as Kellogs/Keebler, Pillsbury/General Mills, Kraft/Nabisco, affected the amount of sheltered income and deal money obtained against your distributor marketing programs?"

The respondent could select no change in participation, increased participation or decreased participation. If increased or decreased participation was selected, the respondent was asked to indicate what percent increase or decrease was incurred in the amount of deal money and sheltered income contributed by the merged companies. Figure 4 summarizes the results. A decrease of 29 percent or less was indicated by 53.3 percent of the respondents whereas another 20 percent indicated a decrease of 30 percent or more. No change in the amount of deal money and sheltered income contributed was indicated by 13.3 percent, while another 13.3 percent indicated an increase in funds contributed by 29 percent or less.

Figure 4



A chi square goodness of fit test was calculated comparing the frequency of responses of increase, decrease and no change in the amount of sheltered income contributed at pre-merger and acquisition levels. Table 2 summarizes the frequencies. The hypothesis was that the majority of respondents would cite a decrease in the amount of contributed sheltered income. No significant deviation from the hypothesized values was found (chi-square(2) = 5.44, p>.05. This test confirms Hypothesis 1.

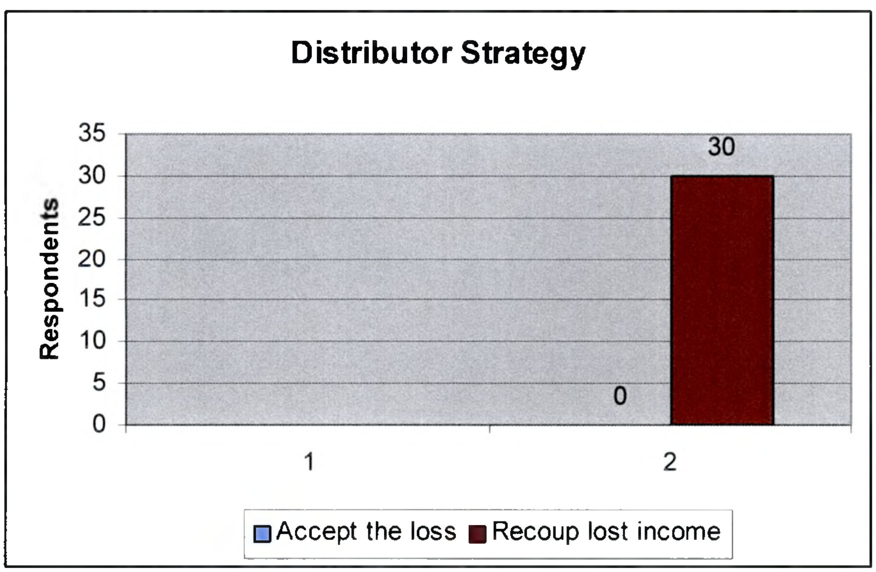
Table 2

Sheltered Income	Responses	Percentage
No change	4	13%
Increase in participation	4	13%
Decrease in participation	22	74%

If a respondent indicated "No change" or "Increase in income" in Question 3, they were directed to skip to question 6. Four respondents indicated no change in funds contributed and six respondents declared an increase in funds contributed. For the remaining participants who indicated a decrease in sheltered income contributions, Question four asked,"How do you handle the decrease in income from newly merged or acquisitioned manufactures?"

The options were to either "accept the loss of income, with no attempt to recoup lost income" or "attempt to recoup the lost income". All respondents indicated an attempt to recoup sheltered income lost from companies who have recently merged or consolidated through acquisitions. Figure 5 summarizes the results.

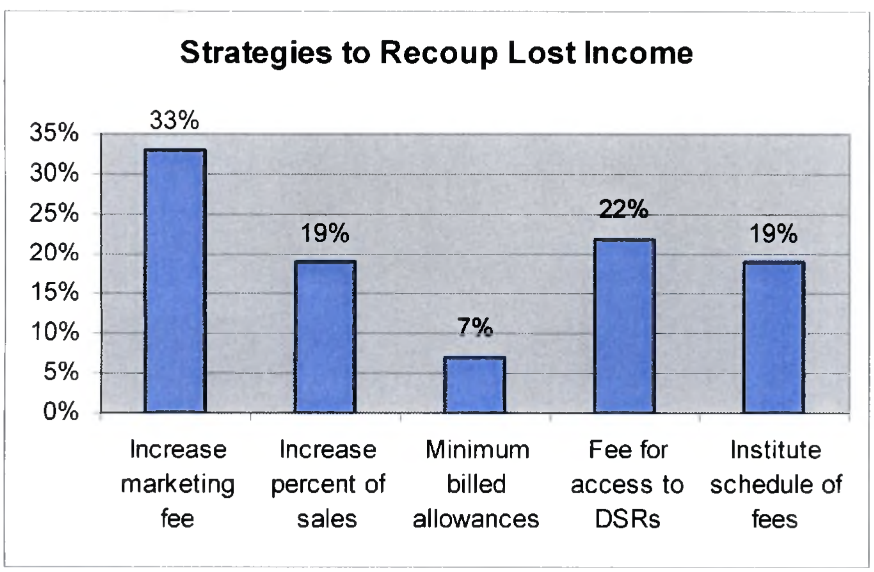
Figure 5



Question five: "How do you attempt to recoup lost income? Check all that apply."

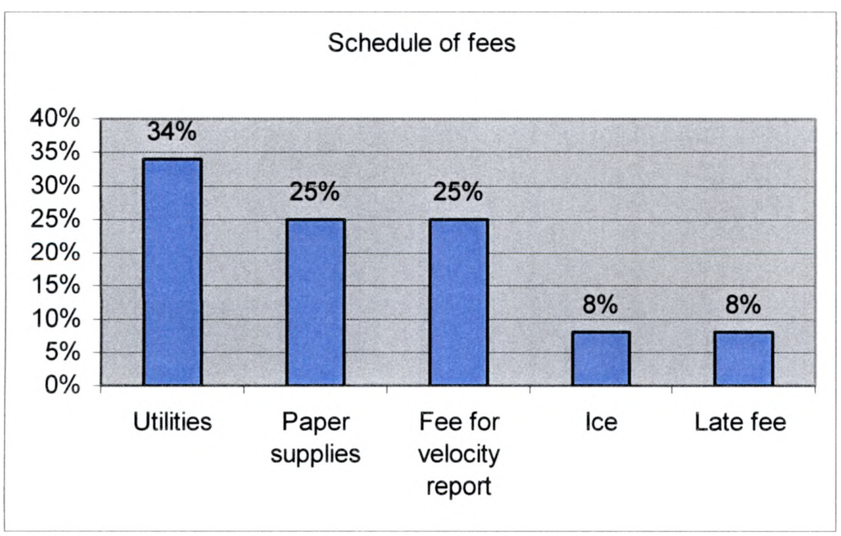
The purpose of this question was to determine the creative methods broadline foodservice distributors use to capture all or some of the income they believe they have lost from consolidated manufacturers. In total, fifty-four responses were collected. Figure 6 summarizes the results. Thirty-three percent indicated that they increased the base fee amount for their marketing program participation. Increasing the percent of sales required for local program participation was indicated by 18.5 percentof respondents. Only 7.4 percent chose to set a minimum for billed allowances. Twenty-two percent charge a fee for access to DSRs such as training sessions, ride-withs and sales meetings.

Figure 6



Another 18.5 percent of respondents indicated they instituted a schedule of fees to recoup costs. Respondents who indicated they instituted a schedule of fees were asked to check all that applied from a list of five fees and an option to type in a fee where "other" was indicated. Twenty-four responses were received for this sub section of Question five. Figure 7 summarizes the results. One-third indicated that vendors were required to pay for their own utilities (electrical and water connections) at foodshows. Twenty-five percent indicated that vendors were charged for paper goods at foodshows. Another 25 percent charged fees for velocity reports requested by vendors. Only 8 percent indicated they charged vendors for ice used at foodshows and only 8 percent charged a late fee for promotional allowance sheets turned in after the due date.

Figure 7

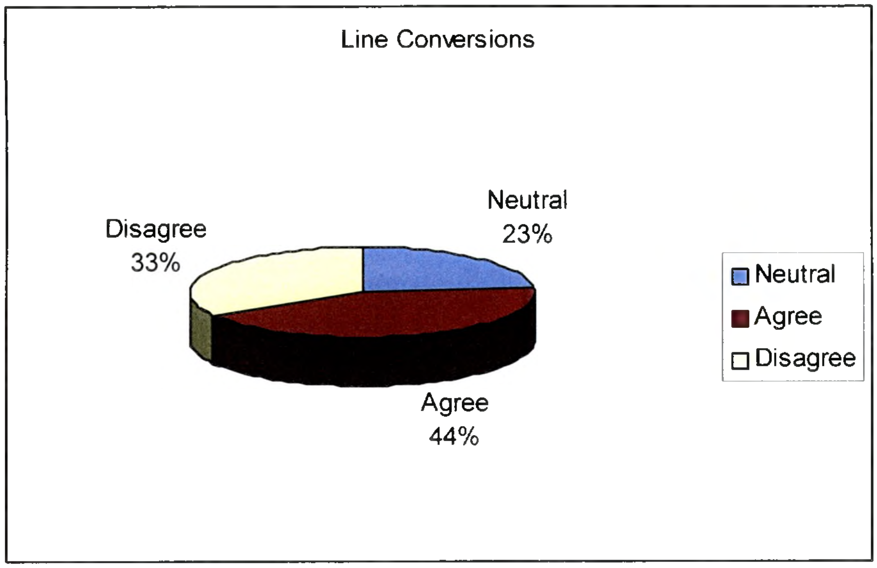


Per the responses from question four and question five, hypothesis two is accepted and it is concluded that distributors institute creative marketing programs to recoup income lost from consolidated manufacturers.

Question six: "Consolidated companies leverage their size and scale and successfully obtain line conversions from other manufacturers within your house."

The purpose of this question is to test Hypothesis Three. Figure 8 summarizes the results. Due to the small number of respondents, the categories of agree and strongly agree were combined and disagree and strongly disagree were combined. Forty-three percent of respondents do not agree that consolidated companies are able to successfully leverage their size and scale to obtain line consolidations in broadline foodservice distributors. Another 33.3 percent agree that merged companies are able to obtain line conversions in foodservice distributors and the remaining 23.3 percent remained neutral on the subject.

Figure 8



A chi square goodness of fit test was calculated comparing the frequency of each response. The frequencies are summarized in Table 3. It was hypothesized that a majority of respondents would agree that consolidated manufacturers are able to leverage their size and scale and successfully obtain line conversions from other manufacturers. A significant deviation from the hypothesized values was found (chi square(2) = 12.019, $p<.05$. Therefore it cannot be concluded with statistical certainty that consolidated manufacturers are able to leverage their size and scale and successfully obtain line conversions from other manufacturers within a distributor house.

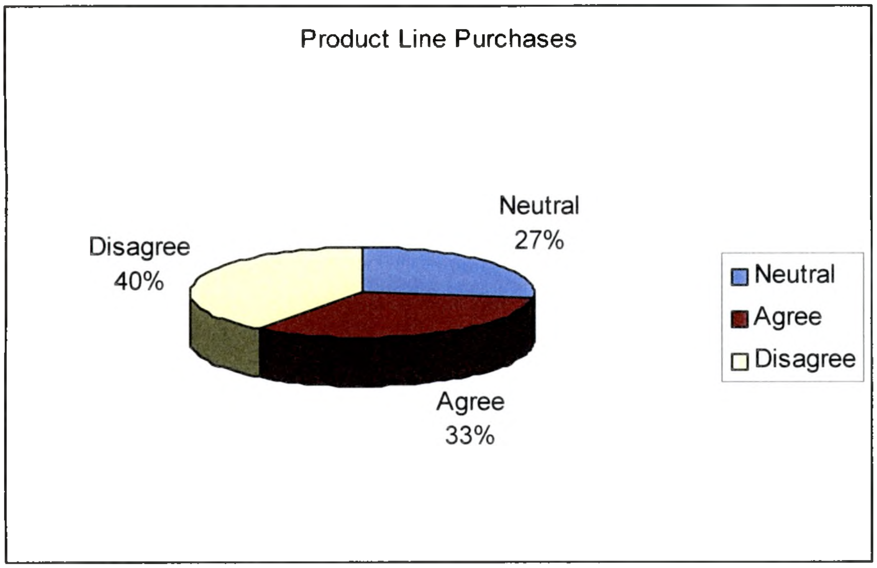
Table 3

Line conversions attained	Responses	Percentage
Disagree	10	33.3%
Neutral	7	23.3%
Agree	13	43.3%

Question 7: "I am more likely to purchase more lines of a merged and consolidated company, versus single line manufacturers."

Due to the small number of respondents, the categories of strongly agree and agree were combined and strongly disagree and disagree were combined. Forty-percent of the respondents disagreed with the statement that they are more likely to purchase more lines of product from a merged manufacturer. Thirty-three and three-tenths of respondents agreed with the statement while 27 percent were neutral. Figure 9 summarizes these results.

Figure 9



A chi square goodness of fit test was calculated comparing the frequency of occurrence of each response. Frequencies are summarized in Table 4. It was hypothesized that the majority of respondents would indicate agreement with the statement that they are more likely to purchase more product lines of a consolidated company, versus single line manufacturers. A significant deviation from the hypothesized values was found (chi square (2) = 8.908, p<.05). Therefore, it cannot be concluded with statistical certainty that distributors are more likely to purchase more product lines of a merged and consolidated company versus single line manufacturers.

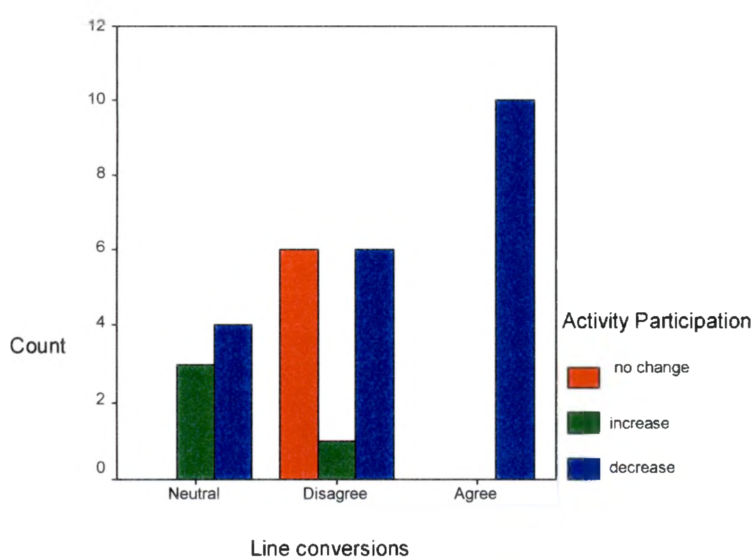
Table 4

Product lines purchases	Responses	Percentage
Disagree	12	40.0%
Neutral	8	26.7%
Agree	10	33.3%

Due to the low number of respondents, cross tabulation and Chi-Square analysis between line consolidations and activity participation is not recommended. However, Figure 10 illustrates that all distributors who agree that consolidated manufacturers are able to leverage their size and scale and convert product lines within the distributor's house, also noted that the activity participation level for these manufacturers has decreased due to their consolidation.

Figure 10

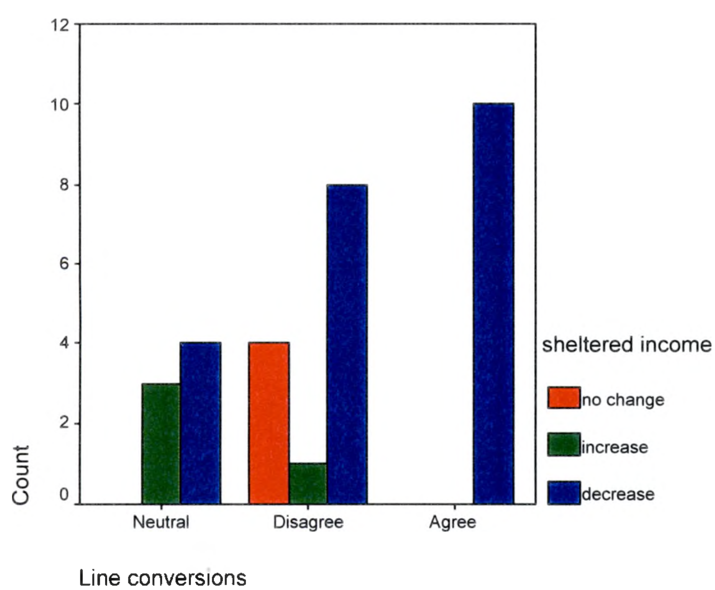
Successful line conversions versus activity participation



Due to the low number of respondents, cross tabulation and Chi-Square analysis between line consolidations and sheltered income is not recommended. However, Figure 11 illustrates that all distributors who agree that consolidated manufacturers are able to leverage their size and scale and convert product lines within the distributor's house, also noted that contributed sheltered and earned income has shown a marked decrease for these manufacturers due to their consolidation. Therefore, it cannot be concluded that the amount of sheltered income contributed has any bearing on whether the consolidated manufacturer is able to secure more product lines within the distributor house.

Figure 11

Line Conversions versus sheltered income contributions



CHAPTER VII

CONCLUSIONS AND RECOMMENDATIONS

From the survey responses, it can be concluded that Larraine Segil's research of 2001 still holds true. She found that even after three years of consolidation, consolidated companies do not gain access to new markets, increase their market share or add new products. This study demonstrated that most distributors see decreased participation in local marketing programs and a decrease in the amount of sheltered income contributed to the local distribution house. The survey responses did confirm that distributors are actively attempting to track sheltered and earned income, although not with the latest software programs designed specifically for foodservice tracking. The survey also confirmed that distributors are instituting creative programs and fee schedules in an effort to recoup the lost income they face from newly consolidated manufacturers. Finally, the researcher concludes that consolidation does not guarantee that a manufacturer is able to leverage its size and scale and gain new product lines, nor does it guarantee that distributors are more persuaded to purchase more product lines from the consolidated manufacturer versus a single line manufacturer.

Based on this study, it is recommended that foodservice distributors utilize the latest earned income tracking software to ensure they are capturing all of the earned and sheltered income they are due. It is recommended that consolidated manufacturers make the foodservice distributors aware of, and assign a monetary value to, the supply chain savings the distributor receives based on the consolidation of the manufacturers. Examples of savings includes backhauling opportunities, full truckload orders at lower pricing versus less than truckload orders and fewer purchase orders to generate and process. These savings should be presented as earned income to the distributor in lieu of decreased sheltered income contributions. Presentation of the savings in this manner could assist the manufacturers in gaining new product lines at the distribution facility.

A recommendation for future research would be to secure a larger sample inclusive of both nationwide broad line distributors as well as regional independents. A larger sample would allow for more statistical testing as well as cross tabulations between contributed sheltered income and product line leverage. In addition, future research should consider requesting actual dollar amounts of sheltered and earned income provided pre and post consolidation. Reporting actual contributed income would ensure accuracy of whether the dollar amount actually increased, decreased or remained unchanged. A final recommendation for future research is to survey the consolidated manufacturers and compare their response to similar survey questions to those of the distributor. From the literature review, many manufacturers consider cost saving enhancements in the supply chain earned income to the distributor, whereas the distributor does not always recognize it as such.

APPENDICES

APPENDIX A

Summarized results from one-on-one interviews with three Vice President's of Marketing.

What are the relevant issues in determining a marketing strategy and developing an annual marketing program for distributor participation?

The marketing program is designed to be a partnership between the manufacturer and the distributor. Both sides need to take ownership of the program and be responsible for maximizing their investment. The goal of the marketing program is to grow sales volume and contribute to the profitability of the distributor house. The distributor's dilemma is allocating the manufacturer's dollars against marketing campaigns versus sheltered income to the bottom line.

What tracking systems are utilized to capture all forms of earned or sheltered income and what percent to sales or profit do you strive for?

The distributors indicated use of a locally developed tracking program, Microsoft Excel and Microsoft Access to track earned and sheltered income. Each Vice President indicated that they are accountable to a dollar amount, which is split between marketing income and sheltered income. The Vice

Presidents strive to capture five to ten percent of manufacturer purchases but in reality only capture three to four percent. The vice presidents had conflicting comments on the profitability of foodshows. Some felt that foodshows are the best money maker, resulting in double the profits than the average promotion. Another felt that foodshows result in more income out than in when the cost of entertaining customers is factored in.

How have the recent mergers of several food manufacturers affected the amount of sheltered income obtained? (Kellogs/Keebler, Pillsbury/General Mills, Kraft/Nabisco, etc)

Merged manufacturers are seeking economies of scale while maintaining sales growth. Unfortunately, from the distributor's perspective, mergers lower the percent of sales they are able to capture. Two of the vice presidents do not believe that mergers are an automatic advantage to get more business. The third vice president felt that more consolidation meant more solidarity between manufacturers and distributors. This movement toward an alliance between the distributor and manufacturer could spell trouble for smaller manufacturers.

APPENDIX B

Impact of Mergers and Acquisitions on Distributor Marketing Programs

Disclaimer: You have been selected to participate in a survey conducted by a graduate student at Southwest Texas State University. The purpose of the survey is to determine the impact of mergers and acquisitions, if any, on local distributor marketing programs. No attempt will be made to attribute survey responses with specific respondents.

Instructions: Please click on the box next to your desired response. Upon completion, please press "Submit." Completion by 3:00 p.m. CST, Friday, February 14, 2003 would be greatly appreciated. Thank you.

1. What tracking system(s) do you use to capture all forms of earned and/or sheltered income?

☐ Non-computer based tracking system

☐ Internally developed software/computer program

☐ Microsoft *Access*

☐ Microsoft *Excel*

☐ *Deal Pro!* From MB Consultants

☐ *Earned Income Tracking System* from Distributor Resource Management

☐ None

☐ Other (please specify)

2. How have the recent mergers and acquisitions of several food manufacturers such as Kellogs/Keebler, Pillsbury/General Mills, Kraft/Nabisco, affected the activity participation level in your distributor marketing programs?

□ No change in participation

□ Increased participation

By what percent? □1%-9% □10%-19% □20%-29% □30%-39% □40%-49% □50%+

□ Decreased participation

By what percent? □1%-9% □10%-19% □20%-29% □30%-39% □40%-49% □50%+

3. How has the recent mergers and acquisitions of several food manufacturers, such as Kellogs/Keebler, Pillsbury/General Mills, Kraft/Nabisco, affected the amount of sheltered income and deal money obtained against your distributor marketing programs?

□ No change in participation

□ Increased participation

By what percent? □1%-9% □10%-19% □20%-29% □30%-39% □40%-49% □50%+

□ Decreased participation

By what percent? □1%-9% □10%-19% □20%-29% □30%-39% □40%-49% □50%+

If you answered "No change" or "Increase in income" in question 3, please skip to question 6.

If you answered "Decrease in income" in question 3, please answer the following:

4. How do you handle the decrease in income from newly merged or acquisitioned manufacturers? Please check one.

□ Accept the loss, with no attempt to recoup lost income

□ Attempt to recoup the lost income

If you marked "Attempt to recoup the lost income," please answer the following:

5. How do you attempt to recoup lost income? Check all that apply.

☐ Increase the base fee amount for marketing program participation

☐ Increase the percent of sales required for local program participation

☐ Set minimums for allowances billed

☐ Charge a fee for access to DSRs (distributor sales representatives) such as training sessions, ride-withs and sales meetings

☐ Institute a schedule of fees such as:

- ☐ Fee for velocity reports
- ☐ Late fee for promo allowance sheets
- ☐ Vendors pay for ice at foodshows
- ☐ Vendors pay for paper goods at foodshows
- ☐ Vendors pay for utilities (electrical and water) at foodshows
- ☐ Other (please specify)

6. Consolidated companies leverage their size and scale and successfully obtain line conversions from other manufacturers within your house.

☐ Strongly Disagree

☐ Disagree

☐ Neither Agree nor Disagree

☐ Agree

☐ Strongly Agree

7. I am more likely to purchase more product lines of a merged and consolidated company, versus single line manufacturers.

☐ Strongly Disagree

☐ Disagree

□ Neither Agree nor Disagree

□ Agree

□ Strongly Agree

Thank you for completing this survey!

If you prefer to mail your response, please address to:

Dr. Cecilia Temponi

Southwest Texas State University

601 University Dr.

San Marcos, TX 78666-4605

Or you may fax your responses to Dr. Cecelia Temponi at (512)245-3189.

Appendix C

You have been selected to participate in a survey conducted by a graduate student at Southwest Texas State University. The purpose of the survey is to determine the impact of mergers and acquisitions, if any, on local distributor marketing programs. No attempt will be made to attribute survey responses with specific respondents.

Please use the following link to participate in the survey. Thank you.

http://www.swt.edu/~mn1003/

APPENDIX D

Tracking System	Responses	Percentage
Internally Developed Program	22	50.000%
Microsoft Access	10	22.727%
Microsoft Excel	6	13.636%
Deal Pro!	2	4.545%
Earned Income Tracking Sys	4	8.889%
Activity Participation	Responses	Percentage
No change	6	20.000%
Increase in participation	4	13.333%
Decrease in participation	20	66.667%
Sheltered Income	Responses	Percentage
No change	4	13.333%
Increase in participation	4	13.333%
Decrease in participation	22	73.333%
Strategy to handle decrease in income	Responses	Percentage
Accept the loss of income	0	0.000%
Attempt to recoup income	30	100.000%
Programs to recoup lost income	Responses	Percentage
Increase base mktg fee	18	33.333%
Increase percent of sales	10	18.519%
Minimum billed allowances	4	7.407%
Fee for access to DSRs	12	22.222%
Institute a schedule of fees	10	18.519%
Schedule of fees	Responses	Percentage

Utilities at foodshows	8	33.333%
Paper supplies at foodshows	6	25.000%
Fee for velocity reports	6	25.000%
Ice at foodshows	2	8.333%
Late fee for allowance sheets	2	8.333%
Line conversions attained	Responses	Percentage
Disagree	10	33.333%
Neutral	7	23.333%
Agree	13	43.333%
Product lines purchases	Responses	Percentage
Disagree	12	40.000%
Neutral	8	26.667%
Agree	10	33.333%

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VITA

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