

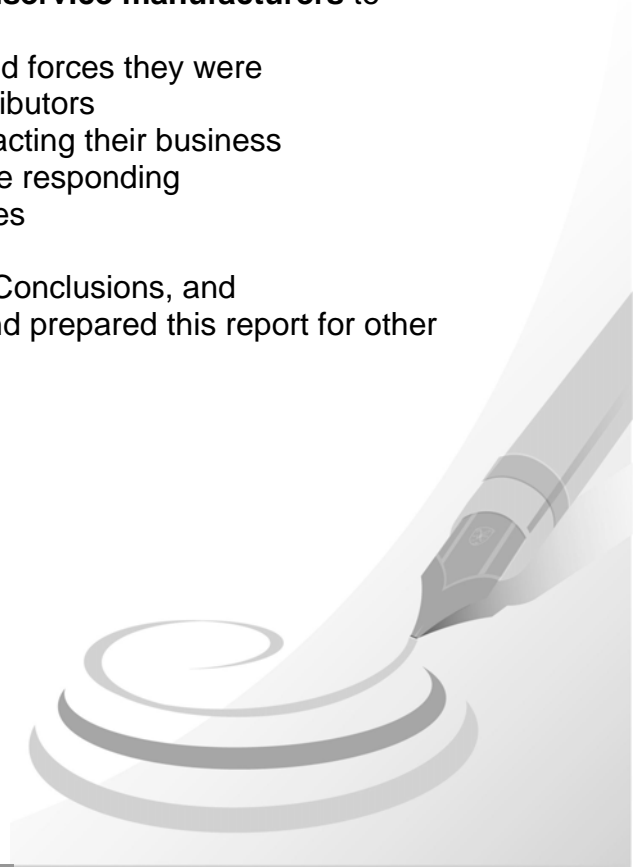
Foodservice Supply Chain Study

Distributor Inbound Initiatives and Manufacturer Responses

February, 2009

Purpose: Franklin Foodservice Solutions was retained by a major foodservice manufacturer to conduct a study of distributors' Inbound Supply Chain initiatives, and to understand how peer manufacturers are responding.

- Methods:**
1. We interviewed **Headquarters Supply Chain** people from Sysco, US Foodservice, Shamrock Foods, PFG, and independent distributors to understand their key initiatives
 2. We interviewed people from **IFDA and Dot Foods** to gain their perspectives as organizations involved with the foodservice distributor community in general
 3. Then we interviewed **6 major foodservice manufacturers** to understand
 - a. Which of these initiatives and forces they were experiencing from their distributors
 - b. How these forces were impacting their business
 - c. How the manufacturers were responding
 - d. The results of their responses
 4. We provided a report of Findings, Conclusions, and Recommendations to our client, and prepared this report for other interested parties



Overall Findings:

- Management of Inbound Logistics is a critical strategic issue for large distributors, and is receiving unprecedented attention.
- Smaller distributors were less able to articulate their Inbound Logistics strategies, and in fact seem to be preoccupied with day-to-day operational issues
- Distributor Supply Chain people at all levels express disappointment at the lack of face-to-face communication with their peers in the manufacturer community
- After our discussions with the distributors, we organized our manufacturer interviews around the following 5 topics:
 1. Distributors taking on more Inbound Logistics Activities and Costs
 2. Customer Pickup Policies and Programs
 3. Role of Redistribution
 4. Price Bracket Structure and Policies
 5. Efficiency Bracket Programs

1. Inbound Logistics Activities and Costs

The major corporate distributors are heavily engaged in understanding the activities and costs associated with moving product from the suppliers' plants to the distributors' warehouses. Sysco in particular is aggressively seeking opportunities to take on more of these activities, with a goal of "letting suppliers focus on manufacturing and letting us focus on moving products." US Foodservice is likewise exploring new ways to utilize their trucks and warehouses to improve efficiency and gain greater returns from these major assets.

While the other distributors seem to be less aggressive in this area, all described an interest in understanding the manufacturer's cost to serve the distributor. As a result, manufacturers are being asked to share cost information at an unprecedented level of detail. Most of the manufacturers we spoke with have determined that sharing this information can result in "win-win" changes to the supply chain. Several cited concerns about violating confidentiality agreements with their carriers and 3PL warehouse operators, and are careful to keep the data at a high enough level to prevent this from occurring.

Inbound Logistics Activities and Costs (continued)

The ultimate goal of the major distributors is to increase the use of “plant pickups” as opposed to deliveries or pickups at forward Distribution Centers. While manufacturers generally like the idea of eliminating forward DC’s from a cost and complexity standpoint, many report that at least some of their plants are ill-equipped to handle Customer Pickups. This is generally a result of minimal dock space for staging orders, limited warehouse space for holding inventory, and lack of case-picking capability.

Finally, several participants added that they are receiving inquiries regarding their Supply Chain costs from national chains, in addition to distributors.

2. Customer Pickup Policies and Programs

There is a high level of interest in Customer Pickups across all sizes and types of distributors. As a result, there is a lot of attention being paid to CPU Allowance rates, CPU policies, and the Price Basis used for pickups by distributors and manufacturers.

Last year’s runup in fuel costs undoubtedly contributed to the activity around pickups, and our participants often spoke of having to defend their prices, policies, and allowances in light of current fuel costs. Although fuel prices are not as much of an issue at present, there is lingering disagreement between distributors and manufacturers regarding what constitutes “fair” pickup policies.

As an example, some manufacturers use the appropriate bracket price (based on order size) as a starting place from which the CPU Allowance is deducted. A corporate distributor may place 4 orders totaling 40,000 lb, destined for 4 different warehouses, but pick them up as a single Truckload order. The manufacturer’s policy (and system) treats this as 4 separate orders, with pricing and CPU Allowances calculated accordingly. But the distributor argues that from a cost and pricing standpoint, this should be treated as a single Truckload pickup.

Study participants agreed that there is no single “right” solution to these issues, but expect continued debate and negotiation on the future.

3. Role of Redistribution

All distributors and manufacturers report that redistribution will continue to play an important role in their Supply Chain Strategy. As Sysco continues to roll out its RDC network, manufacturers have adapted their networks and pricing policies accordingly. Manufacturer attitudes toward the RDC program range from “it’s a win-win program” to “it’s the way Sysco wants to do business, so why argue?” to “at least it doesn’t appear to be a negative on costs.” Even the most cautious respondents acknowledge that the RDC program has streamlined and simplified their supply chain, even if the cost benefits are not immediately apparent.

Some manufacturers are working with US Foodservice on “internal redistribution” programs, wherein USFS uses existing facilities to consolidate truckloads of inbound products, then break them down into mixed loads bound for their branches. These new ordering patterns are causing manufacturers to review and revise their systems and policies.

All of the manufacturer participants are using redistribution as part of their Supply Chain strategy, via Dot Foods and in some cases other local redistributors. Several are in the process of reviewing their programs, with an eye toward increasing their minimum order size and moving more small-order volume to redistribution. The manufacturers cited the importance of understanding all of their costs across various order sizes, as a means of making a sound decision about the role of redistribution.

4. Price Bracket Structure and Policies

With all of the attention being paid to Supply Chain costs, we expected manufacturers to be fielding a lot of distributor questions about their Price Bracket Structure. We found, however, that this is generally not the case.

While bracket definitions and price premiums across brackets are generally understood to be a reflection of logistics costs, it is possible that Supply Chain people recognize that actual invoice prices are affected by many other factors. Trade programs, allowances, billbacks, and negotiations probably have equal or greater impact on the ultimate price.

That said, distributors seem to be interested in the “FOB Plus Freight” structure as a means of clearly separating product costs from logistics costs. But at least one manufacturer respondent said he would “avoid that at all costs” due to the resulting high prices for distant customers, and the risk of losing volume to regional competitors.

5. Efficiency Bracket Programs

We discussed the concept of Efficiency Bracket Programs, whereby a distributor receives “better than Truckload” pricing in return for providing efficient orders. This has become common practice among many Retail manufacturers and customers. Typically, the customer receives favorable pricing by adhering to such practices as:

- Full Truckload orders
- Full pallets (1 sku/pallet)
- Appropriate lead time
- Full use of EDI for Order Management and invoicing
- EFT payment
- No deductions
- Etc.

While the large distributors express interest in the concept, it is not in wide use in foodservice. Both distributors and manufacturers feel that in most cases the foodservice business is too fragmented to support this type of ordering, and that suppliers who do have this type of business already have pricing that reflects the efficiencies.

It was also stated that most smaller distributors are in a “day-to-day execution” mode, and would not be in a position to take advantage of this type of program.

Summary:

Large distributors are pursuing a new era of transparency, information-sharing, and collaboration on Supply Chain issues. Their interests in some cases conflict with those of smaller distributors, and manufacturers may find that policies which help one set of distributors may hurt the other. Manufacturers must therefore be careful to balance their responses to distributor pressures.

All sizes of distributors will continue to investigate opportunities to pick up products, as opposed to taking delivery. These pickups may be backhauls using the distributor's own equipment (for distributors located near plants and DC's), or simply a transfer of responsibility for booking and paying for transportation. Manufacturers need to prepare by reviewing and adjusting policies; longer term, it may be wise to reconfigure plant warehouses to support customer pickups wherever possible.

Redistribution in all of its forms is growing in importance. Sysco will continue its rollout of the RDC model, with the ultimate number and location of RDC's yet to be determined. US Foodservice and other corporate distributors will seek to implement "internal redistribution" by consolidating demand from multiple locations and taking in products to a single warehouse. Again, manufacturers must be prepared to adjust policies and systems to accommodate these new order patterns.

And both distributors and manufacturers are making increasing use of redistributors such as Dot Foods to manage smaller, high-cost orders and as an efficient means of moving products to hard-to-serve distributors.

Finally, all of these forces will have a bearing on manufacturer price structures, policies, and supply-chain based programs such as CPU Allowances. Manufacturers are advised to stay on top of both distributor initiatives and their own costs in order to ensure that prices and policies address distributor needs while delivering profitable sales.

Thank you for your interest. Please call or email me if you have any questions or comments.

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