Memorandum

Subject Telephone Interview With [redacted]	Date June 27, 1996 60-2096-0002

To Frito Lay File

From Nina Hale

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On today's date, I had a telephone conversation with [redacted]

distribution: RWF, DNK, HALE, PTACEK, ALEXANDER - EAG, SWEENEY, JONES, CASE, CHRON, ARCHIVE [redacted] b7D

He said that this year, Frito Lay took a different approach than it had taken in the past years of negotiating merchandising agreements. These agreements are negotiated every year for the next year's arrangement. This year, Frito offered two proposals. The first was the traditional style of proposal, which asked for [redacted] The second proposal, which was the new type, offered an exclusive arrangement with Frito Lay. [redacted]

He told me that Frito Lay set forth three benefits of exclusivity to the retailer. First, there was the convenience of having to deal with only one vendor of the DSD variety. Second, Frito's market share was such that the space would be better utilized by giving it all over to Frito products than splitting it [redacted] Finally, the third benefit of exclusivity that Frito offered to [redacted] was the increase in merchandising payments.

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Those payments fall into two categories. One category is the space rebate which is based on what you sell and is essentially a cash payment with which the store can choose to do what it wants. The second type of merchandising payment is the flex fund, which is essentially an accrued dollar amount that is to be used by the retailer for product promotional activities. [redacted] noted that depending on the enforcement by the supplier, most of which have these kinds of arrangements for merchandising payments, the second type, <u>i.e.</u>, the flex fund would sometimes be the same as a cash payment insofar as the retailer would simply put it into its pocket rather than spending it on promotions.

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[redacted] In his view, the consumer needs to have choice and as indicated previously, his company has chosen to offer the products of at least two manufacturers of salty snacks in their stores.

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[redacted] told me that in terms of pricing, Frito Lay pricing is on the upper-end, so if he was offering only Frito Lay, he did not have the opportunity to do much with price discounts. [redacted]

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He does not think that Frito has the infrastructure to do the exclusives across the company. By that, he means that he doesn't think that Frito could basically support an exclusive relationship with all its accounts that it currently has. The reason for this is that demand in convenience stores is cyclical when it comes to snack foods. The salty snack food supplier needs to be able to service the store every other day given the limited amount of space in which the product can be stocked. When Express Mart has two suppliers of Salty Snacks, three times a week of servicing is adequate as long as the service days are worked out on a store-by-store basis. Stores that catering to a weekday clientele should be serviced on a Monday-Wednesday-Friday basis. In contrast, a store that is along the highway and is going to be attracting more of a weekend clientele, would want to have the three times a week service fall on a Thursday and a Saturday and a Monday.

This frequency of servicing issue was a matter of concern for him when it came to having only one supplier of salty snacks. He explained to me the practice that not only Frito but other dominant suppliers of product engage in when they get the bulk of the space in a convenience store. In his experience, suppliers try to sell their total market share which, for example, might be 80 percent of the category of sales. However, in convenience stores the bulk of those sales are coming from single-serve items. When these suppliers get the space justified by their dominant market share, they don't necessarily set the product on the shelf to reflect the real source of their market share. [redacted] 7D

All convenience stores sell product on a single-serve basis. But the dominant salty snack suppliers want to set the shelves with the big bags in half the space, or put out newer products to build the brand, franchise or equity. Frito Lay can afford to do this because it has, overall, enough consumer demand that its route salesmen will actually make a living off of a drop that includes half single-serve bags and half of the larger bags of new products or less fast-moving products. [redacted] In addition, at least for some of the product lines, Frito never discounts its bags and is therefore able to get the optimum profit for itself and for the retailer on those products. According to [redacted] the Dorito line is one of those products. As a consequence of all this, when Frito has an exclusive arrangement with a convenience store, it has to service the store every day in order to make sure that the single-serve products are present in sufficient numbers on the shelf to satisfy demand from that store but also to get the stales off of the shelves that have been allocated to the larger bags. For example, according to [redacted] Frito might set one of the obligatory end caps with small bags and the other with the larger bags. The end cap with the small bags would need daily service because the end cap doesn't hold enough product to survive for longer than two days.

[redacted] described an interesting situation having to do with the price and the size of the bag and how it's perceived as a

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single-serve item by the retailer versus the consumer. According to [redacted] there are three levels of single-serve products (versus take-home) from the standpoint of the retailer: size, price and in some instances, a size/price combination. For consumers, however, single-serve is simply a function of size and price. To illustrate this point, [redacted] gave the three categories of single-serve bag and price sizes that he sees in his store. The first category is the 25 cent bag, which has a low margin for both the manufacturer and for the retailer. Apparently, only the consumer likes these bags and even then they are sometimes dissatisfied with the small amount of product that the 25 cent bag contains. The second type of single serving bag is the 69 cent bag. This bag is a little bit larger and has very good profit margins for both the manufacturer and the retailer. In addition, the consumer generally likes this size bag for purposes of a single serving. A third category is the bag that [redacted] prices at [redacted] and Frito prices at $1.49. From the standpoint of the consumer the [redacted] bag is definitely a single-serve bag. The Frito Lay bag, however, at $1.49, may fall into the take-home category because of the price.

It is the consumer impact of [redacted] on Frito's $1.49 bag that [redacted] believes is the logic behind Frito's seeking exclusivity. Once Frito gets exclusivity in a convenience store, it does not have to offer the 25 cents bag any more. In addition, it doesn't have to worry that its competitor, [redacted] will be cannibalizing the Frito 69 cents bag or the Frito $1.49 bag. He said that consumers will look at the [redacted] bag and compare it to Frito's 69 cents bag and say, "hey, I get a little bit more chips and only have to pay 30 cents more." By the same token, when they look at Frito's $1.49 bag, which has the same amount of chips in it that the [redacted] has, the consumer looking for single serving often will simply go with the [redacted] and that way Frito is losing both at the 69 cents bag level and at the $1.49 bag level. But once [redacted] is gone, Frito doesn't have to worry about that.

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This point was made even more clearly to [redacted] when [redacted] introduced a bag size that fell between the 69 cents and the 99 [redacted]

[redacted] Frito, like other firms, b7D

seeks only to be competitive where it has to be.

[redacted]

[redacted]

The bottom line for Gibson was that he thought exclusivity would hurt him. He believes there should be a second supplier to keep the dominant supplier honest. In addition, he thinks that Frito is not the only one to blame for the increase in concentration of salty snack food suppliers. He believes that [redacted] as well as Frito had programs that were responsible for eliminating the competition. As a result of the small market share held by companies such as [redacted] meaning that they can't generate the sales a growth that [redacted] b7D

and Frito can, he would never consider them.

[redacted]

Finally, [redacted] did confirm for us that one of the issues that comes up for convenience stores in deciding how many suppliers to take on is the type of store that it is. Convenience stores generally are 2,000 to 4,000 square feet. The pressures of dealing with a number of direct store delivery accounts can be great. These stores are staffed by hourly workers, and theft is a major concern. If the hourly worker has to deal with two, three, four, five, DSD suppliers, that hourly worker is not going to be able to do all the other things that need to be done in the store. For that reason, [redacted] He knows of other convenience stores who have chosen to have more suppliers. And obviously there are some that have chosen simply to go with one supplier. But from his standpoint, as already indicated, the balance between the need for consumer choice and a second supplier to keep the first one honest, were more important to him than any benefits that might come from exclusivity.

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