Memorandum

Subject: Telephone Interview with [redacted]	Date: July 2, 1996 60-2096-0002

To: Files

From: William P. Jones

b7D

This morning Jill Ptacek and Cindy Alexander spoke with [redacted]

distribution: RWF, DNK, HALE, PTACEK, ALEXANDER - EAG, SWEENEY, JONES, CASE, CHRON, ARCHIVE

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Exempt under b7D

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[redacted]

one- shot, up-front payment at the beginning of the new year; and there is also an "accrual" program which serves as a payback to the retailer for sales produced, an "incentive" program. b7D

There's also an inflated fee that snack makers are charged for brand advertising. The routine has it that the retail chain demands [redacted] for the advertisement from the snack maker, but the snack maker knows quite well that the advertisement only costs [redacted] and that the retailer will be pocketing the rest. However, he plays along with the retailer and lets this gratuity factor in as part of his business. In order to get into the retailer's flyer, weekly or monthly booklet or newspaper ad, this amount of money must be paid whether all of it goes to the ad or not. [redacted]

[redacted] states that advertising can be seen as a support of a brand to help create a subliminal brand recognition in potential customers. This repeated "reinforcement" conditions the brand's virtues in the mind of the shopper and reader/watcher and generates extensive impulse buying. [redacted]

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Another aspect of advertising is the example of a pretzel sale; the item that normally runs [redacted] per bag is briefly sold at discount at [redacted] retailer's adve[redacted]

Two Types of Retailer Bonuses

[redacted] delineates two types of incentives that [redacted] and other snack makers give retailers: [redacted] comes in and says "here's your check." The result of this is that the retailer simply pockets the increase for anything he wishes. 2) There is an advertising promotional fund [redacted] allows new suppliers an opportunity to pitch new products throughout the year.

He states that they have not had any problems with allocated space not being serviced properly. He states that they expect their suppliers to keep the shelves filled constantly. One type of dollar promotion which they may have from these suppliers is a type of volume incentive for buying 100 cases. Typically, when their products are delivered to the back door of the store, the invoices are forwarded on to headquarters, where the bills are paid weekly. b7D

He explains that the overall display of the products depends on the size of the store. One suggested layout consists of [redacted] feet on one isle, used for all the pretzel items, and then [redacted] feet on the opposite side. All of [redacted] runs across at eye level. The remaining space is broken down by category sets. He believes that this procedure is most desirable to the consumers. The warehouse salty snacks are included in the drug department category and are typically displayed close to the salty snacks either across the isle or next to the salty snacks.

He explains that they view their competitors store by store. [redacted]

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area. They monitor their competitors by price checkers who compare prices. He believes that [redacted] He does not know how they rank based on sales. Sales data can be found in Progressive Grocer, from the manufacturers, newspapers, IRI, Nielsen or perhaps from their marketing department.

So/So #11854

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Frito-Lay, being so large and rich, normally creates a huge effect because of the large amount of money it hands out for incentives based on its much larger sales volume. Its incentive is based on the increment over a prior period and the resulting check is normally several times larger than its competitors' check for the smaller space the competitor controls. This dwarfing problem between Frito and all of its competitors is a problem of "scale," [redacted]

[redacted]

[redacted] Frito's check may easily stand at $100,000, and induce the retailer to be mindful of Frito-Lay's forthcoming suggestions. [redacted]

The retailer, [redacted] reports, is often caught in Frito's "trap" whereby pressure is exerted on the retailer to eliminate the small competitor's shelf space and give it to Frito in order to ensure that he will receive at year end, say, a $250,000 check which only comes from keeping Frito-Lay "growing" in his chain. Therefore, if Frito manages a takeover of, the last three [redacted] linear shelf feet when Frito already has the other 60 feet in each chain store, this does not mean that its gain will produce more or equivalent F-L sales necessarily. But the intended effect is to eliminate all other healthy competitors and thereby "control" the entire shelf space in that grocery chain, store by store and chain by chain. [redacted] argument is that the duped chain will not sell more Lays' products in the three feet as an immediate result and that the true effect <u>is</u> immediate upon both the retailer and the consumer when competition is sacrificed. The notion [redacted] expounded to us is the concept of "velocity off the shelf." This translates into the speed of consumer sales from the snack food shelf as measured visually and also in terms of the frequency with which the restocking truck must come to reset the shelves and resupply a certain snack maker's product. [redacted] states that Frito-Lay has a very clear analytically measured

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perception of the velocity off the shelf calculation necessary to resupply Frito products to any given chain or store. He says that we should find out from F-L their set of calculations which have to do with route frequency and the like. He knows that they buy space from the chains, eliminating other competitors in order to add velocity to their sales; this gambit also pushes store sales of Frito to the reward threshold culminating in the obligatory periodic mega-check awaited by the cooperating retail corporation. [redacted] says Frito-Lay is "hungry" and basically wants to "control" the shelf space, which is simply its number one goal for the retail segment of their operation. When F-l finally achieves the goal, it can easier make the determination of how to reset the shelves, "tweaking" the retail space to increase Frito's "velocity" and profits by adding a new product or some other ploy after the exiled competitor has been taken off the shelf. But [redacted] says that even after Frito does its changes, post-takeover, the net increase of say, 63 feet versus 60 feet will not yield extra Frito sales of much measure, unless it introduces a new product in that 3-foot spot. [redacted]

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[redacted] says that Frito believes bumping its competitors will create much greater visual impact in F-L sales potential, and so it fights for all the space it can get and thereby achieve the "velocity off the shelf" effect to the maximum.

[redacted] states that he is "the last one to be critical of Frito-Lay; how they operate is remarkable." He states that in walking a grocery aisle, one always finds an end display filled with Frito-Lay products with maybe one or two displays on each end aisle that are permanently Frito. In a sea of products, he adds, this creates both a great brand recognition and the opportunity to sell both single serve size bags and larger bags which Frito understands well and has started to program into its presence. These end aisle displays "hit you boldly," and Frito has realized for some time that this affords its products much greater visibility and is a great boost to sales potential. Keebler had little impact in the end aisle segment during its salty snack marketing.

Frito's Message to the Retail Community

Frito's central message to the retailer is that, basically, "you need Frito-Lay products, your private house label products and perhaps one small regional snack maker on your snack food shelves." That, Frito says, will give the customer adequate variety and will maximize sales for the retailer. In actuality, b7D [redacted] says that Frito controlling the shelf space and having most of it will not necessarily mean greater revenues for the grocery chain. [redacted] however, [redacted] concedes, he has no access to retailers' sales numbers. [redacted] adds that the only effect that can be seen for certain is that the customer is worse off by not having a choice like [redacted] and ultimately the retailer will suffer too. Even if the Frito volume incentive is reached, this will not make up for the absence of a variety of product the shopping public can choose. In trying to remain polite about retailer shortsightedness, that the normal grocer is often unskilled at understanding future trends and that by the time the chain understands its position, "Frito has got you by the proverbials." Very often, Frito will produce a spread of advertisements in hopes of making up dollar losses when it has just annihilated a chief competitor at a store chain and it will manipulate the retailer by telling him that "you're that close" to making the appropriate amount of sales to get that huge year-end check from Frito-Lay.

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Gondola versus End Aisle Space

The Frito-Lay end aisle program often ties up the end cap in a store chain for an indefinitely long period. [redacted] asserts that if he had the choice between six feet of gondola shelf space versus one end cap, he would always choose the end cap because it produces a 30-40 percent sales increase just by its position; [redacted] So the end cap is a tremendous booster of sales in a snack food retail environment.

[redacted]

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[redacted] reports that Frito-Lay gained more shelf space through Eagle's departure than anyone else although some regionals also picked up shelf space. Frito's general offer was [redacted] per linear foot of shelf space. [redacted]

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We asked whether [redacted] had a strategy for competing in a Frito dominated world. [redacted] no plans to promote their products directly to consumers. Thus, the company will have to rely on instore displays to create customer awareness of their products. In order to effectively promote their product in this way, they need to get their product displayed on the endcaps and other satellite display areas in the stores. Thus, our conversation seemed to come full circle -- in order to gain or hold market share, [redacted] needs to display their product in areas of the store of which Frito has taken control. [redacted] said some stores do rotate the vendors displayed on the endcaps (which I guess means that Frito has not negotiated exclusivity for that space). b7D

In addition, [redacted] intends to make a verbal assault on retail outlets that are considering increasing Frito's share of salty snacks. He will remind retailers that if they give space to Frito today, they will suffer in the long run, I assume because the incentives from Frito may be less sweet and prices higher. He would point out to them the California and Nashville markets where Frito is the only major manufacturer and has 70% of chip sales. Of course, [redacted] noted that it is unclear whether once Frito has captured a significant share of the market, they will make the incentive hurdles more difficult for stores to achieve.

He said that it may be that Frito will adjust the hurdles in order to counter the threat of entry by other manufacturers. b7D

[redacted] said that he has not heard of any instances where Frito has threatened to withdraw its product from a store if its requests for sales or promotional support were not met. He did say that some retailers have threatened to stop selling Frito because they felt they had been treated unfairly with respect to pricing, advertising, etc.

So/So #11690