Memorandum

Subject Telephone Interview With [redacted]	Date August 7, 1996 60-2096-0002

To Files

From William P. Jones WPJ

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Today, Jill Ptacek spoke with [redacted]

[redacted]

distribution: RWF, DNK, HALE, PTACEK, ALEXANDER - ECON LIT, RUFE, MIKE & HAYES, JOHN - COMP POLICY, SWEENEY, JONES, CASE, CHRON, ARCHIVE [redacted] b7D

[redacted] HEB markets from Dallas dow[redacted]

[redacted] Salty Snacks [redacted]

[redacted] planning for its different food categories is based on a "planigram" which allocates selling space to different food offerings based on an evaluation of product movement. [redacted] stated that [redacted] does no pre-established category allocation. Its advance volume-estimation is also driven by what it realizes about the size of its given [redacted] store and by the local demographics. To properly evaluate the store's category award treatment, [redacted] calculates the buying expectations of the neighborhood's customers, and assesses the historical movement of product in comparable stores throughout the chain. The same logical approach is used for products like sodas and most of the other category items. [redacted] also weighs the gross profitability and total dollar sales likelihood factors into the planigram calculation. This information, [redacted] has found, is essential to keeping its shelves filled and product selling rapidly. [redacted] also factors in historical market share/sales plus the hours of personnel utilization per category. The latter is important in terms of retarding costs by food area and category.

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[redacted] does offer satellite space to different manufacturers such as end caps and towers and sometimes the off-shelf displays are devoted to salty snack promotions as part of the marketing plan.

[redacted]

[redacted]

Frito-Lay has developed a growing market share at [redacted] adding space with Eagle's exit in early 1996. However, this growth has begun to erode because of [redacted] focus on the development of its own private snack line and the advertisement for such products. [redacted] potato chips now claim [redacted] snack sales and its tortilla chip line accounts for [redacted]

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The [redacted] revealed to us their goal of taking around [redacted] (or perhaps more) of their own shelf space in the longer term to be devoted to [redacted] private stock.

That would mean about [redacted] for potato chips and [redacted] for tortilla chips.

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[redacted] is willing to accept new small snack competitors, especially if their distribution and quality are close to ideal. [redacted] stated that [redacted] suffers from a lack of sound distribution practices and has failed to completely service the broad [redacted] retail territory. [redacted] stated a new snack maker could make a pitch since about [redacted] of [redacted] snack product category is non-Frito and another brand is feasible. [redacted] In 1996 Eagle snacks left the market, a third major competitor who no longer exists for [redacted] and its customers; so, turnover seems to be commonplace in [redacted] snack gondolas.

The effect on [redacted] retailing when Eagle snacks left the market was that the [redacted] market share went up for grabs, necessitating the reshaping of the snacks aisle and [redacted] considered the impact of possible consumer rejection when selecting Eagle's successors. The result of this shelf space reallocation was that [redacted] calculated the percentage of business of surviving snack manufacturers and provided extra space for them on a space for sales basis; however, [redacted] private line snacks also received the greatest extra space. No bids were requested of the manufacturers who found Eagle gone.

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Shelf Space Fees Charged at [redacted]

[redacted] does not charge "pay to stay" shelf space fees. [redacted] insisted that [redacted] divides its space purely based on consumer demand and not on a contractual financial payments made by snack manufacturers.

He added, at [redacted] new food items require an allowance fee to be paid to the chain if the manufacturer is offering a comparable fee to other retailers in the competing area. [redacted] policy is to let them in but corroborate that these payments are being asked at the competing retailers. He did not say how [redacted] accomplishes this. The [redacted] makes the decision of allowing new products to come into the chain based on two key criteria: whether the consumer needs to have the new item presented to him/her, and whether [redacted] will reap a suitable profit from stocking this new item. If the profit calculation is not very high, even though consumer demand seems enthusiastic [redacted] will probably not permit entry of the new product, citing a simple lack of space. [redacted] said he does recall any manufacturers gaining tacked-on shelf space through fees offered to enhance their position at [redacted] His memory is that [redacted] told all such manufacturers no in each case, and he says that it is not a profitable matter to elicit these fees on the basis of one upmanship, for either vendor or [redacted]

[redacted] states that when a new product is accepted at [redacted] the manufacturer's previously allocated space is used to house the product, as a customary rule. Other companies' product space isn't shorted to make room for a certain manufacturer's brand new item. Instead, [redacted] reworks and redesigns his planigram to fit the new product into the retail picture without bumping competitors. In addition, [redacted] explained that [redacted] creates no formal contracts for space allocation with manufacturers, but always leans on its planigram as the foundation for alterations at the category level. [redacted] described for us how his planigram operation takes into account individual UPC identities and SKUs which must be used to reflect category and sub-category products within [redacted] For instance, potato chips, cheese snacks and pretzels would represent "categories" in the database, while sub-categories would represent features like barbeque, onion, ridged, flavored, etc. The term SKU refers to single case pack selling units. In the event of the chain adding something really new to its (and the manufacturer's) retail line, the database indicates its placement in the manufacturer's quarters and [redacted] adjusted planigram shows the event happening "in most cases, usually coming out of the vendor's space."

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[redacted]Calculation On Snack Profitability

[redacted]said the principal component of a successful snack sales program is not the <u>number</u> of stores available to generate a certain sales figure, but instead, and certainly in [redacted]case, the prime criterion of high and steady sales volume, high enough to support and maintain the snack maker's capital investment and justify the monetary and other risks of an enterprise such as offering the public an almost complete house label line in today's market. Even if [redacted] meets its goal to fill 30 per cent

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of its retail snack shelf space which it projects as possible someday, it is sales volume that will drive its snacks program and provide the thriving level of payback to keep it going.

[redacted] Snack Shelf Management

[redacted] arranges its snack shelves by manufacturer, not by product. [redacted] which houses low-fat and no-fat snacks for the fat-discriminating shopper. Frito-Lay and other manufacturers are represented in this separate rack.

[redacted] criteria for new product placement include customer demand, historical dollar sales, and the ability of the new product to enjoy at least one "unit facing;" in grocery parlance, it must possess a [redacted] minimum space, with [redacted] and be clearly displayed to the public. Without decidedly visible placement of this sort, [redacted] said a new product is likely to fail. He continued by saying there is a chicken-and-egg puzzle in considering sufficient facing. Does a manufacturer sell more because space has been provided to make the product appear more successful, or does he acquire more space because the product jumps off the shelf and is sold regardless of its initial placement factors? [redacted] stated that this issue is pondered frequently at [redacted]

[redacted]

[redacted] stated that [redacted] does not employee category captains, per se. However, manufacturers of different product lines do provide "analysts" charged with helping to determine how best to display product categories at [redacted] and whose expertise is expected to help the grocer significantly. [redacted] and the resulting savings fund investment in critical aspects, such as buildings and related expenses, and the manufacturers contribute these services and time without seeming to tilt their own category in favor of themselves. [redacted]

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The Planigram

[redacted] performs planigramming based largely on gondola statistics and its assessment of the strategic needs for the chain. [redacted] decides what to do with different end caps which he has been assigned to parcel out. He evaluates what lines need to be promoted for maximum store profit and his decision is based on "space to sales." [redacted] admitted the adjustments [redacted] makes are an "inaccurate science," in terms of fair space assignment. [redacted] emphasized that his end cap sales are very difficult to calculate with precision and thus factor into the allocation picture. [redacted] was asked about the hand-held calculators which Frito-Lay, like Pepsico, its parent, employs to help it assess sales from secondary displays. [redacted] did not know whether Frito is much better off because of its gadgetry in terms of sales impact.

Frito-Lay's Program [redacted]

[redacted]

[redacted]

[redacted]

[redacted] considers some of its end caps to be "defensive" displays, placed for the public without any retail price discounting whatsoever, and the public may not even notice the lack of a price break. These snares are full-price, impulse-purchase secondary traps that often exceed the normal sales price for the snack products ensconced there. This is especially prevalent at [redacted] during holiday periods when impulse-buying rises. Both the snack vendor and the chain make out well.

Besides Frito's program, the promotional fees provided by vendors usually get treated as follows: [redacted]es not normally charge for display fees to its snack vendors; 2) there is a "continuing off-invoice allowance" that some manufacturers pay [redacted] These promotional, off-invoice allowance fees are not permitted to rise and fall by much to avoid confusion, especially to the shopper comparing the same product whose bag price might fluctuate greatly. So any allowance that a manufacturer gives to [redacted]is a steady number and this discount is passed on smoothly to the consumer.

Flex Funds

[redacted]accumulates flex fund amounts, also known as "promo allowance" funds, which are taken from virtually all manufacturers and also have the name, "market development funds." These dollars are used by the manufacturers and the store to promote and push specific products. [redacted]described Proctor & Gamble as a strong and clever market development fund user and its funds are earmarked intelligently for "specific" named products. Their program is easy to follow. Other manufacturers offer money too, but do not specify when and how that money should be used at [redacted] How[redacted]uses the money to enhance sales of the disorganized firm's products is normally far less successful.

In the salty snack food category, sales are driven by product movement figures alone. [redacted] asks promotional fees and the result is greater profit for the chain and much larger consumer sales from those salty snack shelves.

Jill asked [redacted] what the result would be if Frito-Lay and [redacted] requested the same end caps for their potato chip lines at [redacted] The question came down to which would generate the most sales and justify the awarding of that end cap. [redacted] stated that stimulation of incremental sales would be critical in this matter and if both parties were able to generate, for instance, 2 times normal sales in this space, the issue would resolve thus: [redacted] selling [redacted] units versus Frito selling [redacted] units -- Frito would definitely win because [redacted] profitability would depend on that decision for a far superior payback. The matter of units sold would dictate who would come out with the satellite space in this and in almost all cases. However, if [redacted] were to sell [redacted] worth of product in that space and Frito-Lay were to sell [redacted] might lean toward [redacted] getting the end cap if its combined dollar sales volume plus bag margin could outdo Frito. It would not be question of who had a better market share or reputation in snacks. [redacted] stated that he would never be able to sell a new item if its inclusion were a matter of just market share percentages. [redacted] will take a chance on anyone's product if the calculations look right. Figured into an end cap award would be the ultimate factors of the net return margin (volume times bag margin), plus the end cap fee presented to [redacted] as an additional cash payment that sweetens the profit returns to [redacted] In short, the total volume sales generation, including the revenue stream and end cap payment would determine [redacted] final decision on who gets end caps. b7D

[redacted] does its end cap and other planning 12 weeks ahead of the activity to be staged, with continuous updating until that time. A manufacturer will come to [redacted] and offer his program and be evaluated by [redacted] staff. [redacted] looks for maximization of sales and profitability and creates its master plan to reflect those issues. Normally the manufacturer comes in to [redacted] with a one-time yearly plan and follows up with about three updates during the year for the partnership to stay on track. [redacted] stated this is not a "re-bid" process, but just a timely correction effort. [redacted] does frequent reconsideration of its programs with manufacturers and can overturn a running program if actual sales come up short or other matters fail to materialize correctly. [redacted] is always reevaluating how its operation is living up to the agreed-upon program made with vendors. Those agreements are mutually worked out as a contract of sorts with goals that both parties are to adhere to. If a rebate (growth program) is dangled, [redacted] will accept this and operate in ways to ensure that increasing amount which would be triggered by greater sales on a sliding predetermined volume scale. The current program that Frito-Lay offers for [redacted]

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[redacted] Another aspect was the exit of Eagle Snacks contributing to Frito's slight 1995 increase that aided the growth of other small manufacturers as well as [redacted] pointed out that over the last several years Frito-Lay has been generally gaining ground in market share and sales, and that the entire salty snack category has been growing at [redacted] over the last few years.

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Treatment of Frito-Lay Shelf Space Versus Sales Volume

[redacted] explained to us that at [redacted] Frito-Lay has been "under-spaced" compared with its market share so other companies could have critical and sufficient "facings" in what he insisted is a limited amount of snack shelf space in his chain. The bottom line factor, he proclaimed, is consumer choice, and it's emphasized throughout [redacted]

To meet Frito's growth urges, [redacted] has been dealing out satellite space and advertisements on its behalf to generate public interest in Frito. The chain has found creative ways to push this promotional program and does not intend to limit Frito. Jill asked if Frito-Lay is being "capped" at [redacted] and, if so, why. [redacted] answer was that [redacted] does not manage its snack vendors according to a market share arrangement but looks to store sales alone to dictate how vendors will be allocated empty selling space. When the next planigram is produced, Frito might get more or less space, but bumping another vendor to please F-L would probably upset some consumers and [redacted] prefers variety over growth program inducements anyway.

[redacted]

Most salty snack manufacturers at [redacted] are considered "niche" vendors. Asked whether [redacted] would consider a company like [redacted] which might be interested in marketing through [redacted] said it would be a matter of defining [redacted] profitability and accepting such a company would be evaluated each year, application-style, for bottom line value. The company could come in each year and see whether vendor status would be a mutually worthwhile venture. The impression was that [redacted] would likely strike out, repeatedly. b7D

What the Salty Snack Consumer Really Wants and Needs

[redacted] stated that most salty snack consumers really look for three kinds of snack quality varieties: (1) a high quality/ high priced line of snacks such as Frito-Lay; (2) a high quality/ lower priced line of snacks like that of [redacted] private brand; and (3) a medium to low quality chip snack with a medium to lower price, such as [redacted] added that in finding [redacted] as a private brand supplier to its chain, it met the criterion of competing with Frito-Lay both in quality and then in pricing.

Criteria for New Snack Vendors [redacted]

[redacted] said that the factors that determine whether a new snack competitor could enter [redacted] would be a "long litany of things," which might swing his decision. He added that a new manufacturer's characteristics would have to include and represent guaranteed sales, a sound advertising scheme and a flavor profile which matches his market areas' demographic tastes. He said that some of this information would not be a black and white decision but instead would be generally worked out.

Another [redacted] consideration in bringing aboard a new snack maker is whether the category would be able to grow incrementally or whether the entire snack line would simply trade dollars from one vendor to another (the new one and maybe just temporarily) because the products would be roughly the same. But if someone with a genuinely new product were to come in and help grow the whole category by fresh sales leaps, that would be another matter. Another factor is [redacted] finite space for snacks, resulting in the possible necessity of taking an established vendor's shelf space in order to permit a new snack company to come in and field its products.

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The final major factor [redacted] emphasized was that a new company might depress [redacted] private brand long term profits by being the newest product "on the block," as it were. This would quite possibly nix the prospect of a new company coming soon to [redacted]

Current Snack Maker Performance at [redacted]

At the current moment, [redacted] is experiencing good taco chip growth and volume expansion. Also, [redacted] private brand is doing satisfactorily and Frito's Baked Lays chips are [redacted]

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Frito-Lay's Growth Program Specifics

[redacted] stated that Frito-Lay's growth program does not include a specific amount of space to be utilized for its growth needs. No physical space was factored into the F-L/[redacted]/incentive agreement; however, the growth program does envision a specific amount of advertisement and end cap and satellite space options for Frito during special periods of the year.

[redacted] Concern About Future Frito Marketing & Market Share

[redacted] stated that they would consider the arrival of a successfully monopolistic Frito to be unlikely in the future. Such a development, they felt, would lead to a lack of consumer choice and unrest with reduced variety and would definitely result in Frito pricing rigidity down the line which would clearly hurt the consumer. [redacted] likened this kind of development to being a shopper for a new car and having to go to seven dealers who offered him the very same car no matter where he stops. This unsatisfactory situation would not work in the salty snack category, they added, and [redacted] would always be looking for other manufacturers to offer variety to the public [redacted] b7D named now defunct [redacted] in terms of balancing Frito in marketing snacks. If [redacted] were to look around for a useful surviving regional snack maker today, [redacted] which is not sold normally in supermarkets, but does a good business in convenience stores, could perhaps rise to fill the role as a future competitor for Frito in [redacted] and be a reliable player in supermarkets. When the bids to become [redacted] private chip manufacturer in 1995 went out, [redacted] was also asked to submit numbers, but was not interested.

As for Frito-Lay becoming monopolistic in [redacted] is watching to see that Frito-Lay's list price for its line does not change upward (which it has not done for some time even with the departure of Eagle Snacks). This is being closely watched by [redacted] and its fellow retailers. Another factor that might keep Frito honest and "competitive" is the [redacted] private brand which the chain intends to continue pushing to the public.

[redacted] private brand chips, both potato chips and tortilla chips, now collectively account for [redacted] per cent of the chips market share at [redacted] Its tortilla chip has been around for several years and is [redacted]

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