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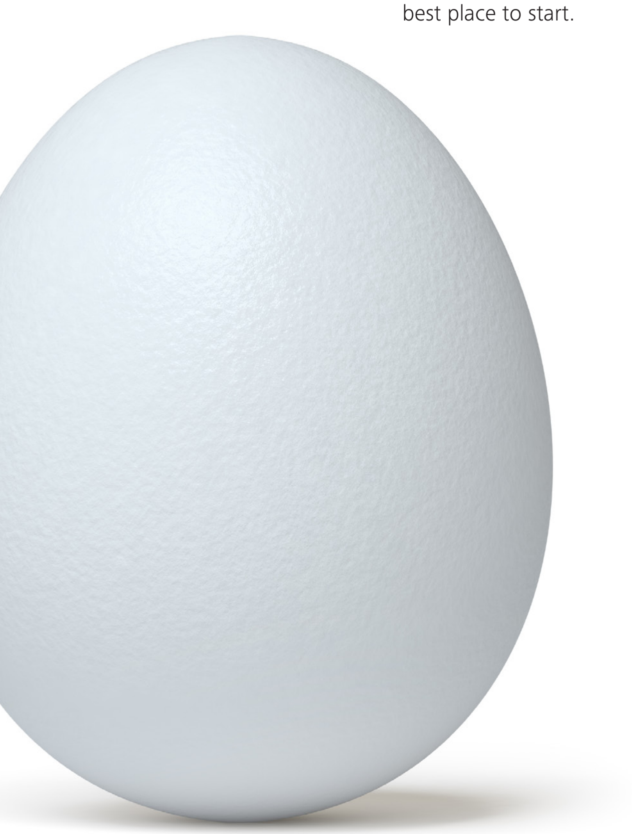
# Keep it simple.

## For companies in the foodservice industry, maintaining profitability requires keeping complexity in check. Here are eight ways to do it.

As wholesale food prices and labor costs continue to rise, manufacturers, distributors, and foodservice providers have watched their profit margins dwindle. Meanwhile, the trade environment in which they operate, and the supporting systems they have in place to manage this environment, aren't helping. They tend to get in the way of profit improvement rather than improve the situation. For those companies waiting for relief, the wait could be long, because many foresee continuing volatility and hikes in food prices. Tools like forward pricing and long-term contracts can help, but they probably won't be enough on their own. So how can foodservice companies improve their trade processes and increase profitability? For many, taking a different approach to contracts is the best place to start.

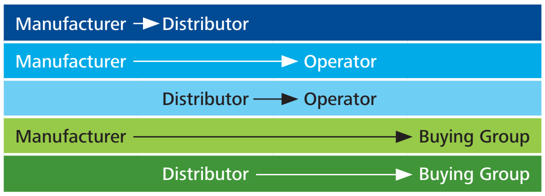


In the wholesale distribution industry, contracts are generally marked by their complexity. Compared to their counterparts in the retail industry, foodservice account managers have a much tighter timeframe in which to make important contract decisions. Plus, these contracts are typically made for longer periods of time and frequently involve multiple deals, whereas in retail, shorter promotions are more standard. There are also a host of different discounts built into foodservice contracts: off-invoice, guaranteed pricing, fixed fees, rebates on everything from growth rates to conversion fees—it's a long list. And when these discounts work in combination, as they frequently do, it can be easy for participants to lose sight of the big picture. As an example, for manufacturers, profitability sometimes simply hinges on which distributor the company is relying on most heavily—which is a function of the contract they have in place.

Scenarios like these make it clear that for foodservice operators, the ability to understand complexity in contracts can be the most important determinant of their effectiveness in achieving profitability. Here's an in-depth look at the approaches that these companies should be pursuing to gain higher profitability by mastering the mounting complexity of their contracts.

### The trouble with multilayered contracts

Lost in a sea of overlapping contracts, it can be all too easy for foodservice leaders to lose sight of profitability. Contracts overlap when one shipped case has multiple accruals and liabilities. Often, there is a contract between all parties involved:




In this environment, contract and product profitability have to be reviewed as a portfolio—not on an individual basis. It's not uncommon for foodservice distributors to have more than five contracts overlapping at any given time. In that scenario, it's important to have a system in place that can automatically review these contracts to help deliver the desired return on investment as a whole.

Figure 1 shows three overlapping contracts. The same case shipped to the distributor will generate accruals and liabilities inherent to the distributor contract. Meanwhile, when it is shipped by the distributor to the operator, accruals will also be generated due to the operator contract. This will happen yet again when the operator belongs to a buying group. It's a common scenario—and one that's loaded with complexity. Many of today's leading foodservice distributors have advanced systems in place to automatically identify these liabilities and map out the right course in the case of overlapping contracts.

How can you head off all this mounting complexity? Following are eight steps that industry leaders are already taking.

#### 1. Recapture rebates from distributors

When manufacturers recapture money from distributors for volume they agreed to but did not generate, it is broadly referred to as "street volume." But determining which volume is considered street volume can be tricky, especially when volume is pulled by operators that have direct agreements with manufacturers. This is yet another area where having the right system in place can make all the difference to help contracted parties clearly identify exactly which volume is which, and make sure everyone is compensated fairly.

#### A guide to our terminology

The *foodservice industry* generally includes manufacturers, distributors, and operators that are responsible for any meal eaten away from home. Companies that supply foodservice operators are foodservice distributors. Commercial foodservice operators include full-service restaurants, fast-food outlets, cafeterias, hotels, casinos, catering, supermarkets with ready-to-eat sections, and many other formats. Noncommercial operators are those that prepare meals as a supportive service to hospitals, day care facilities, and schools. Some foodservice companies manufacture products for both retail and foodservice channels. Products destined for the retail channel usually come in smaller sizes and have colorful packaging. Meanwhile, products for the foodservice channel come in larger sizes and may be packed with different labels.

#### 2. Plan for redistributors

When manufacturers, distributors, and operators deal with redistributors, complexity can multiply. Redistributors are essentially distributors acting as wholesalers that can ship products to other distributors and operators. Most started shipping products to customers who bought less than full truckloads, since those customers are more expensive to serve and were frequently underserved as a result. Today, national distributors rely on redistributors to supply products when manufacturers run dry or cannot meet demand.

Figure 1.

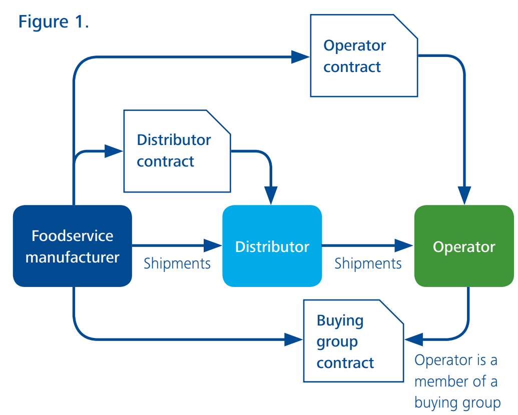


Figure 2.

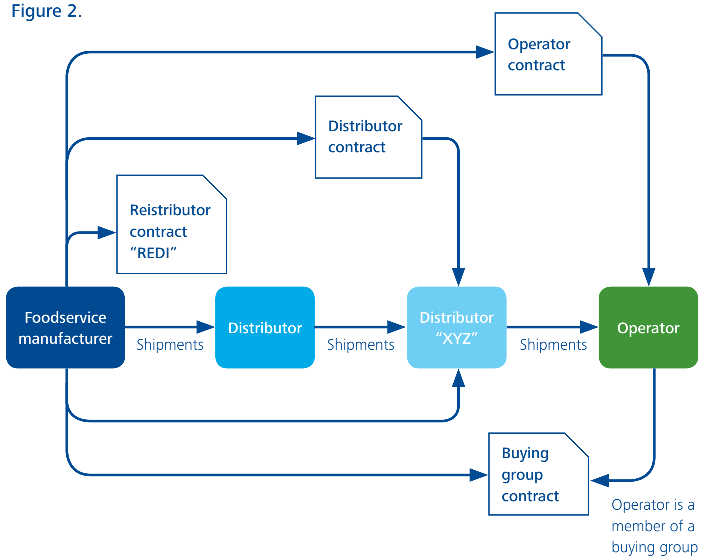



Figure 2 shows a scenario in which a manufacturer ships directly to a distributor or through a redistributor. In this scenario, the complexity is apparent: manufacturers can have guaranteed pricing with the operator and off-invoice discounts with the distributor which is then claimed by different parties.

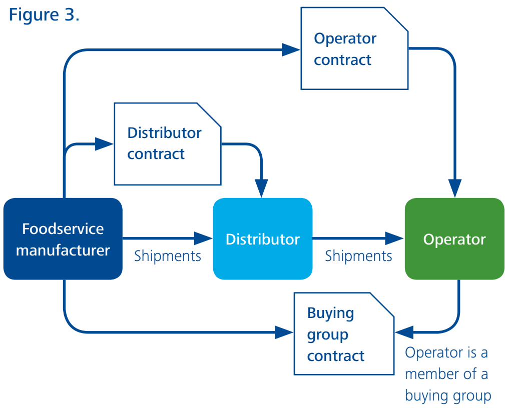
In this scenario, if a foodservice manufacturer provides a $1.00 off-invoice discount per unit of its product to the distributor, and ships products directly, the invoice will automatically reflect the discount. Today's systems can identify whether a redistributor ships the same product to the same distributor and accrues for the $1.00—an important trail to follow since the redistributor will claim back that amount or the distributor will deduct from direct payments.

### 3. Clearly identify and accrue for off-invoice discounts

Accrue for off-invoice discounts? Isn't that an oxymoron? In fact, foodservice companies often need to accrue for off-invoice discounts, especially when a distributor buys a product from a redistributor. In this case, they're entitled to receive an off-invoice discount for the product, as if they had bought and sold directly from the manufacturer. Sometimes, either the distributor or the redistributor will claim the amount back to the manufacturer, who in turn needs to record the liability and expense in the proper manner. Only advanced systems can clearly identify if an off-invoice discount applies between a distributor and manufacturer if the redistributor ships the product.

### 4. Capture competitive data for RFPs, quotations, and bids

Another area of opportunity for foodservice companies is to gather competitive data around bids, requests for proposal, and price quotations. Every year, schools issue bids for companies to supply products. Companies can increase their likelihood of winning if they can capture and analyze more information for each bid year after year. To help with this, Deloitte offers a seamless and integrated system from quotation creation all the way through contract approval. Companies can then analyze the percentage of bids they win and lose to competitors and at what price points, providing an advantage for next season's bids.




### 5. Plan for price deviations in contracts

Contracts that create deviations—the difference between the procurement price paid by a distributor to a manufacturer and the distributor's selling price (as shown in Figure 3)—add complexity to the process, since they force distributors and operators to submit claims for the price deviation.

The complexity comes in calculating the correct amount, since manufacturers provide multiple prices, FOB manufacturer location, FOB distributor location, and more. All these layers create different procurement pricing points, so basing the deviation on one number may not be feasible.

### 6. Increase automation for more accurate claims processing, validation, and payment

Distributor claims—which indicate the price at which they bought the product along with the amount and price sold to each operator—are frequently submitted in electronic formats, such as electronic data interchange (EDI) and spreadsheets, or they are downloaded directly from websites. Some are even paper-based, creating difficulties for the manufacturer when it comes to validation and processing. As part of the validation process, each manufacturer has to determine whether the distributor acquisition price defined in the claim is correct. The difference in pricing between manufacturers and distributors, and between distributors and operators, is the source of deviated type claims.

Increasingly, distributors have the ability to transmit claims electronically, which can open the door to significant automation. By making automatic claim transmissions to manufacturers, distributors can receive payments more quickly and reduce the costs of manual processing.

Deloitte has implemented many systems built around the use of EDI transmissions to capture claim information and automatically submit relevant information, effectively removing all users from the task of processing data. When distributors cannot send EDI information, data loads from spreadsheets can help automate the data entry process.

Some examples of claims validations include:

- Distributor acquisition price
- Historical volume bought in pounds, cases, catch weight, pieces, etc.
- Deviated pricing
- Operator (drop-ship location)
- Contract dates, rates, and product validation for
  - Distributors
  - Operators
  - Buying groups
  - Professional service organizations
  - Foodservice cooperatives

For companies that have implemented automatic claims validations, Deloitte has helped achieve between 3 percent and 5 percent savings of the total claim amounts.

### 7. Convert fees more effectively

While new products are constantly introduced into the foodservice industry, most are never displayed on retail shelves—so fees are often paid differently from the retail conversion fees. New product fees are commonly paid as conversion fees, which are used by the distributor or operator to "convert" (that is, they stop buying one given brand and start buying one from another manufacturer).

For conversion fees to be effective and efficient, they should be tied to a given volume and profit. The amount of the conversion fee should be dictated by volume and profit, along with the mode in which the conversion fee is paid. Deloitte often advises companies to tie product conversion fees to distributor and operator profits—so they pay only for real conversions.

8. Spell it out

Since manufacturers have relationships and contracts in place with operators and distributors, the contracts should spell out the details for operators. These details can range from guaranteeing a fixed price of a product to an operator (even though the distributor may buy the product at a higher price) to specifying which of the operator's private label products cannot be sold to other operators.

Manufacturers need to know the amount and invoice price for products shipped from distributors to operators. In fact, they should always request that daily invoices be sent through electronic communications (EDI, XML, etc.) directly to their own back end systems. This will guarantee that the manufacturer can easily reconcile any charge-backs done by the distributor when selling product to operators that buy it at a guaranteed price. By having this information, the manufacturer can identify the volume that is generated by the distributor as new business (street volume) and distinguish it from the volume generated by the manufacturer directly.

## Be ready for what's next

Complexity is just part of doing business for companies in the foodservice industry. But today, many of these companies have settled for far more complexity in their contracts and trade operations than is necessary. Plus, many have overlooked major advances in technology that could make their contracts significantly easier to manage.

One thing is certain: in the foodservice industry, nothing is going to become any less complex. From regulatory changes to shifting market conditions, there are plenty of reasons to expect increased complexity in the coming years. That's one reason it is important to rein in complexity today before it overwhelms your business.

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