



eat *Canadian* 

CANADIAN Grocery Retail Guide

SECTION 8

Retail Programs -
What Are They?
What Do They Cost?
How Do They Work?



Saskatchewan
GROCERY RETAIL & FOODSERVICE
VALUE CHAIN INITIATIVE

*Adapting to Consumers Demands and
Capturing New Market Opportunities*

The selling price of a product, either to a distributor or directly to the retailer, is usually the only source of revenue for the majority of food companies in Canada. However, in many instances food companies set a wholesale price for their products without taking into consideration the significant costs that can be associated with participating in retail programs. The cost of these programs invariably impacts a company's cash flow, gross margins and profitability.

Once the wholesale price for a food product has been published and distributed to customers, it is very difficult, if not impossible, to increase the price to these customers in the short term. It is also extremely difficult to raise the price for a product, on an annual basis beyond the level that has been set by "the trade".

It is of critical importance that a company factor into their products margin analysis the anticipated costs of various retail programs prior to setting a wholesale price. These programs can easily cost a company up to 10-15% of the wholesale value of products shipped to a distributor or shipped directly to a retailer.



Reducing a company's operating margins by 10-15% can have significant consequences for the viability of many small or medium sized food companies.

The contents of section 8 will explore the wide range of various food retailer programs, how they work, why they are in place, what is negotiable, and how to maximize program dollars.

The Programs

There are approximately 10-15 retail programs that are used by Canadian food retailers to help control costs by reducing their "spends" in marketing, advertising, administration and distribution. Every food company that is asked by a retailer or distributor to participate in one or more of these programs has the option of declining to participate. However, the retailer also has the option of declining to purchase the company's products in favor of a company that is more willing to participate in their retail programs.

It is important to note that most retailers want to develop and maintain relationships with healthy and profitable vendors who have the resources to develop, manufacture and market new and innovative food products. That is one of the reasons why most retail programs are usually negotiable, up to a point. The retail programs can also be fine tuned to enable a small vendor to participate in some but not all of the programs.

Listing Fee

A listing fee is a fee charged by a retailer to list a company's products in the food retailers purchasing system. No product can be ordered

by any store affiliated with the major retailer until the product has been assigned the appropriate retailer specific item number, the product bar codes set up for scanning purposes, prices entered into the retailers system, ordering procedures and payment procedures put into place for the products among other things.



The listing fees are negotiable and range from a few thousand dollars per SKU to well over a hundred thousand dollars per SKU. The size of the fee is based on the ability of the company to pay, the perceived success of the product at retail, the uniqueness of the product and other factors. Many buyers or category managers are graded by their company on their ability to bring in program money such as listing fees.

Paying listing fees does not guarantee a company that the product will be purchased by the major chain stores. The purchase decision is made at the store level and each store must be approached individually to purchase the product. If the product has not been purchased by a strong percentage of a chain's stores, or the product does not perform as expected at retail, the product is delisted. No money is returned to the vendor for a delisted product. Some retail chains will delist a product within 6 months of the initial set up date if it does not get wide distribution or perform up to expectations at retail.

Note that the listing process can take up to 6 months and it may take another 6 months to get good distribution in chain stores. A vendor may not see significant cash flow from a program for up to a year after paying the listing fees.

Free Fill

In a Free Fill program, a vendor is asked to send enough free products to a store or stores to "fill the shelf". If the normal order for one store is 2 cases of product to fill the space allocated for the product, then the Free Fill is 2 cases per store.

This program is often used by major and regional chains to fill new or recently renovated stores. Care must be taken on the wording of the free fill program with a retailer. One chain tried to charge back vendors for merchandise that was purchased for stores that were renovated several years prior to the adoption of a Free Fill program.

Independent stores will often request a Free Fill instead of a Listing Fee. Free Fills can be an effective means of placing a product in an independent store. Free Fills are also used by independents in lieu of a vendor's contribution for advertising or marketing allowances. It is always wise to calculate the cost of these programs prior to agreeing to a free fill for a promotion.

A Free Fill is not free to the company supplying the product. Assume for example that a food company makes a net margin of 10% on its food products. For each case of product that is given away it takes 10 cases of "incremental" product sales to make up for the lost margin.

The “opportunity cost” of the money used in the Free Fill can be very high and the pay-back period can be quite long so companies are advised to use this program with caution.

Guaranteed Sale Program

In this program the vendor guarantees the retail sales of a product up to an agreed upon percentage over a set period of time. For example, a product may be guaranteed to sell out 90% of the inventory in 2 months or the retailer can send the balance of the product back and only pay for the product that sold in that 2 month period. If the product only sells out at 60% then the retailer can send back the remaining 40% and pay for the 60% sold within a set period of time. The effective dating on a program like this can be up to 120 days from the ship date.

The dating and terms of this program are totally negotiable. For example, the program can be run on a declining guarantee basis. The first order is guaranteed to sell out 100% in 30 days, the second order is guaranteed to sell out 50% in 30 days and the third order has no guarantee.

This program is used by both majors and independents for new products and to introduce new programs. It is important to put a cap on the guarantee period and to have a written program that is mutually agreed upon by all parties so that there are no misunderstandings as to the terms of the program. Note that the program has opportunity costs for both the retailer and the vendor. The retailer is giving up valuable real estate to test a product and the vendor is giving up cash flow.



Marketing Allowance

Many retailers will ask for a marketing allowance of 1-4% based on the net wholesale purchases of the product over a specified period. The period can be one month, one quarter or annually. The allowance can be deducted automatically off invoices, rebated by credit note, or paid by cheque. The payment terms are often negotiable.

The fund is often used by the retailer to increase “traffic” or “footsteps” into the retailer’s store or stores. The fund is also used to increase the retailer’s brand awareness under the assumption that the more people who enter the store the more product will be sold by each brand.

Often the vendor has little or no control over how this money is spent so many vendors decline to participate in these programs. However, specifically targeted marketing programs can be very beneficial to both parties. For example, participation in a retailer’s magazine or support for specific initiatives can be beneficial to a brand. Many retailers issue publications on health and family issues and support initiatives like camps for children. These initiatives are usually socially orientated and may be considered for support.

Advertising Allowance

Vendors will often be asked to commit to an advertising allowance either in specific dollar amounts per period of time, as a rebate based on a percentage of sales over a period of time, or for a specific promotional event. The most effective use of these funds is to drive retail sales (the pull) of the companies brand by way of a targeted spend on store flyers, in store promotions, in store demonstration, end cap spends or cross promotions with other products.

Vendors will be asked to participate in targeted flyers by way of offering a discount on products sold for a specific period of time (usually 1 to 2 weeks). Funds spent in this manner are carefully targeted to achieve specific sales objectives and increase brand awareness. Many retailers refer to these programs as “reward promotions” meaning they have a dual objective: to reward regular users of the product with a discount and to encourage new users to test the program.

Programs to avoid: those programs that permit the retailer to deduct a percentage off invoice, up to a set amount of funds, with no commitment to use the funds to drive traffic for the vendors’ brand.

Programs to participate in: target spends with clear objectives, and clear spend amounts.

Volume Rebate

Volume rebate or VR is a standard program in the food industry that requires a vendor to rebate back to a retailer a percentage of the annual wholesale shipments to the retailer. A VR program is based on a percentage of sales ranging from 1%-5% of net wholesale sales (after deductions off wholesale shipments for freight, returns and allowances). It is important to ensure that the VR is based on wholesale, not retail sales of product. Clarify this point in all VR discussions and agreements.

A typical VR program is usually either “base 0” or “incremental”. In an incremental program, the increase VR percentage paid is based on achieving a set volume level, and only applies to the level of shipments. It does not apply to all previous shipments.

A “base 0” program is one in which once a new shipment plateau is reached in the VR program, the higher VR percentage applies to all the shipments up to that point. The “base 0” program is the most costly to a vendor but the most attractive to a retailer.

For example, assume that in the following program that the shipment target of \$40,000 per annum has been achieved, the total incremental VR paid would be \$2,000.00. A base “0” program would pay \$2,700.00 because once the level is achieved then the highest percentage, in this case 3%, is applied retroactively to all shipments.

| Shipment Dollars | VR Percentage | Incremental Rebate \$ | Base “0” Rebate \$ |
|---------------------|---------------|-----------------------|--------------------|
| \$0 - \$20,000 | 1% | \$0.01 - \$200.00 | \$600.00 |
| \$20,001- \$30,000 | 2% | \$40.02 - \$600.00 | \$900.00 |
| \$30,001 - \$40,000 | 3% | \$90.03 - \$1,200.00 | \$1,200.00 |
| Total Rebate | | \$2,000.00 | \$2,700.00 |

The VR is negotiable and can be used to drive volume by inserting volume triggers into the agreement. As shown in the example there is a clear incentive in both the “Incremental” and “Base 0” program to drive shipment volumes to the next level.

Payments of VR are negotiable. The usual practice is for the vendor to pay the VR quarterly by cheque. Some retailers request the right to deduct the VR off invoice on a quarterly or even monthly basis. This practice puts the VR payment in the control of the retailer and volume disputes can be difficult to resolve, particularly if the shipments are made by a distributor on the vendor’s behalf. It is the distributor who has the deduction made off of their invoice to the retailer. The situation can get complicated, particularly if the distributor has an additional VR program with the retailer that covers all the lines sold to the retailer.

Return Allowance/Defective Merchandise Allowance

In the food industry, there will always be products returned to the retailer for a number of reasons which range from the product taste was off; the product smelled bad, the package was leaking; the product was off code or past the best before or foreign material inside the package such as visible insects, etc.

In addition to consumer returns, there are store returns. A store return is when a store determines that the product is not merchandisable or not fit for sale. The reason for this can be such things as dirty outer cases, broken cases, shopworn packaging, leaking product etc. Depending on the category of product, consumer and store returns can range from 0.5% of retail sales to 4%-5%. The return

is charged back to the distributor or vendor at wholesale. Returns can sometimes take 6 months to process at retail.

It is not unusual for retailers to request a monthly percentage off invoice to accommodate returns. Often 2% is used as a starting point. This type of program can turn into a profit center for the retailer if the returns are less than 2%. It is usually best to issue credits to the distributor or retailer for the actual products returned.



It is also necessary to monitor all returns as both a quality assurance mechanism and to keep track of any distribution or warehousing issues with products. It is not uncommon for some retailers to request a credit for products that are not defective and for some retailers to request store credits for products that have been over purchased.

It is also not uncommon for some retailers to use returns as a form of guaranteed sale program. Large amounts of inventory are ordered and the unsold inventory in a set period of time is returned as defective. The cycle is repeated until the company catches on and monitors the orders to prevent abuse of the return policy.

Watch and monitor returns very carefully as they can also be an early indicator of quality issues with ingredients, processing, packaging, and distribution.

Prompt Payment Discounts 2/10 net 30 or 3/7/EOM

Many retailers will request a discount for prompt payment. A standard 2/10 Net 30 is 2% discount off invoice if paid in 10 days or net 30 with no discount. The cost of money can be high, in this case 24% per annum, but the discount generates rapid cash flow if the payments are received as agreed.

The programs can get complicated and misunderstandings can occur unless everyone is very clear as to the terms, discounts and precise payment dates. For example a 3/7 EOM program can mean 3% discount if paid in 7 days or payment at the End of Month.

The EOM can be interpreted as a fiscal month (closing at the 20th or 25th day) or a calendar month. It can also mean End of Month following after the close of the fiscal month. That can mean 60 days dating.

It is recommended that the terms be very carefully spelled out in the Prompt Payment Discount program as there have been many cases of retailers taking the discount and paying on extended terms. Remember the old accounts payable adage: 120 days is as good as cash.

Freight Allowance

Retailers will often request an allowance to offset ever increasing freight costs. The allowance can range from 1%-3% of the wholesale cost if the



terms of sale are FOB plant or vendors warehouse. The allowance can be used to help secure programs. However, make sure that the allowance actually reflects the freight costs of the products. In some cases the allowance is actually higher than the cost of the freight, particularly for low weight but high value products.

Freight costs are one of the highest cost centers for most food companies and they must be very closely monitored. Freight costs can reduce operating margins by 10%-25%.

Trade Discount

Many retailers, particularly independents, will request a Trade Discount. This discount has several interpretations; it can mean a buying group discount that is given to members of organizations such as Distribution Canada or the Health Food Association. It can also mean a discount that is based on the fact that it is one way an independent can compete with the majors. This discount can override and replace other discounts and allowances such as volume rebate, marketing, freight and advertising. The range on this discount varies from 3-10%.

Distribution Fee

Many medium to large retailers "run" different types of products through their warehouse. The vendor or distributor will ship products to the retailer's warehouse or distribution center and the retailer will distribute products to their stores.



There are two fees involved in this program: a one-time set up fee of approximately \$500.00 per SKU and a warehouse distribution fee of 4%-8% of the wholesale value of the shipments to each store.

It is useful to note that many retailers view their warehouse or distribution center as a profit center and operate on a cost plus basis.

Seasonal Discounts

Retailers will often request a seasonal discount on products that are either seasonal in nature or have peak selling periods such as holiday periods, back to school or are tied into a special retail promotion around a one of a kind event. These discounts can range from 5%-15% or even up to 50% off the regular wholesale price.

In-Store Demo Program

These programs are not strictly speaking a discount program but they are often tied into in-store promotions. An in-store demo program can cost \$200 per hour per store (minimum 3 hours) if contract demo personnel such as In-Store Focus are used. It is best to use company personnel where possible and where permitted.



Over and Above Allowance

This is an allowance that is charged over and above all other discounts and allowances. It is usually a dollar figure rather than an allowance and is deducted off an invoice to a distributor or a vendor. These allowances are often charged at the end of a quarter by major retailers or the end of a fiscal year.

Manufacturer Charge Backs – MCB

In most instances where a company works with a food distributor, the distributor will request an MCB on promotional programs and allowances. The distributor charges back the vendor for the costs of the allowance or program.

Retail Program Overview

All retail programs are negotiable and retailers rarely ask small vendors to participate in all the programs. However, it is expected that even small vendors will participate in one or two of the programs. Usually Volume Rebate, Guaranteed Sale or Free Fills are requested by independents. Listing fees, volume rebates, advertising allowances or programs are requested by majors as a minimum entry point into their programs.

It is important to pay close attention as to how and when payments are made for the various programs. It may be tempting to reduce administration costs by agreeing to have all programs deducted off invoice, however it does get complicated for some programs that are tied into distribution agreements. Work closely with the distributor to monitor the results of these programs and to reduce the administrative and accounting errors that can creep into these programs.

Distributors can often “bundle” different vendors together to create an incentive for retailers to introduce new lines or increase the volume in all the lines. Work with distributors to develop bundle programs using volume rebate, advertising allowances, or promotional allowances to drive volume.



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The Agriculture Council of Saskatchewan (ACS) Inc. has developed this electronic guide for the Canadian Grocery Retail Industry as part of its continuing efforts to support the agriculture and agri-food industry and develop the capacity and tools for food growers and processors to enter the Canadian Grocery Retail Industry.

The purpose of the guide is to provide food growers and processors with a better understanding of the Grocery Retail Industry and how to tap into business opportunities within it. ACS has engaged Ackerman & Associates, consultants to the Grocery Retail Industry, to help create this powerful reference tool. Ackerman & Associates is an alliance of senior consultants focusing on business strategy support – research, value chain design and implementation – for the Grocery Retail Industry.

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