Memorandum

Subject Interview with [redacted]	Date May 15, 1996 60-2096-0002

To Frito-Lay File

From Neeli Ben-David NB

b4, 7D

Jill Ptacek spoke with [redacted]

BACKGROUND

[redacted]

REVENUE

[redacted]

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

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Exempt under b4, b7D

[redacted]

[redacted]

[redacted]

However, calculations are made to determine whether the high expense is justified by the probable return. In addition, retailers may take away shelf space if the product is not creating enough revenue.

PROMOTIONS

Promotions are an everyday issue with [redacted] competitors. The vendors need to get this right to have a sales promotion or a retail price reduction in order to sell their product. Space allocation is usually determined either once a year when a retailer does an overall sales analysis, or in reaction to an unexpected event (for example, Eagle going out of the market). There is no daily allocation of shelf space.

Usually vendors deal with retailers regarding group promotion packages, but this depends on the time frame the retailer wants to work with. These promotions can be as limited to as little as four weeks and can last up to two months. In recent years the

competition has created promotion packages for a full year which lock themselves in and other competitors out of promotions. For example, if they enter into a contract for a one year promotion type package, they may demand to be promoted on the biggest consumption days, such as the Super Bowl, Fourth of July, Memorial Day.

As far as [redacted] knew, retailers have not requested one-year plans from the vendors. It has only been the largest competitors who go to retailers with full year program and then give the retailers incentives to set up the products and get the top promotional opportunity. While [redacted] has attempted to discuss doing this with its retailers, it has found it difficult financially to create one-year promotions packages. 7D

[redacted] 7D

[redacted]. The reason for this is that cost of production of corn chips and tortilla chips is much lower. Corn has a consistent quality and there are rarely corn shortages because they can be stored for long periods of time, which results in fewer price fluctuations.

Frito has generated huge market shares in tortilla and corn chips and uses the funds to handle its large promotions. [redacted] b4, 7D

[redacted] Frito can sell below manufacturing costs because it can absorb the loss with its large profits from the other areas, in other products.

[redacted] admits that Frito may have some efficiencies of scale which allow it to do this but [redacted] 7D

[redacted] that is, the amount the potato and corn crops cost each respective vendor is the same. Frito constantly engages in undercutting, according to [redacted] strictly to build market share, so that it can go to a retailer and demand more shelf space.

One year long term contracts by the big retailers are very frequent and influence the allocation of shelf space. These are referred to as calendar merchandising or marketing agreements. Vendors will give retailers the huge chunk of money up front, if they are promised a larger number of promotions or promotions on

holidays and high consumption days. [redacted] may still be able to get into the market, its sales will be reduced significantly. A retailer is unlikely put out an ad [redacted] Instead, he chooses one or the other -- usually Frito -- with the aim of increasing product sales with Frito-Lay. The low price of Frito allows retailers to sell more of its product. They then turn around and give Frito bigger displays.

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DATA SERVICES

Frito has also invested in software which organizes Nielsen and IRI market data. This enables it to give shelf layouts to retailers. It will offer to manage the snack food section of the retailer's store, using the data it has accumulated and analyzed. It can then enter into a partnership with the retailer and assume the title of the category manager. Often retailers allow this practice because it cuts down on their own costs of management.

[redacted]

As a result of its involvement in shelf management, Frito can make recommendations based on the data regarding who gets what

and how much shelf space. It can then get the best displays for itself. Using these displays, Frito is able to increase its sales further which then allows it get more shelf space from its retailers. It is difficult for retailers to identify which products are being sold because of popularity and which are being sold because of advantageous displays. They tend to just accept the data that Frito offers them.

According to [redacted] allocation of space is rarely based on sales. Rather, it is influenced by Frito's data and the additional incentives Frito gives to retailers. This practice is primarily used in regional stores which cannot afford to collect and analyze the data themselves, and must depend on vendors to do it for them. It is rarely used with big chains such as Safeway and Kroger.

There are more partnerships every single week. Many individual retailers sell a portion of their stores to wholesalers who then have more influence on the allocation of shelf space. [redacted] estimates that approximately 99 percent of category managers come from Frito-Lay.

The data that Frito uses provides each company's pricing and sales within each individual product in a given state as well as the increase and decrease in volume of certain products in

certain brands. While all vendors have equal access to this information if the retailer decides to sell its information to Nielsen or IRI, only the partnering companies can get the information that is not sold and not generally available. [redacted]

[redacted]

EXCLUSIVITY

One common practice with small accounts in rural areas are exclusive trading agreements between Frito and the retailer. Frito will approach a retailer and offer to pay a set amount if the retailer will remove its competition from the store. This tends to happen primarily at single store locations but also in chain stores and convenience stores. Every week, [redacted] claims to hear of another instance of an exclusive dealing contract; either such a contract is being entered into or an offer is being made by Frito.

[redacted]

[redacted]

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[redacted]

Some retailers turn down exclusive dealing offers because they fear that in the long run they might not be able to sell as many snacks or that customers will complain about lack of product diversity. In addition, retailers are worried that as soon as competition is eliminated, Frito will no longer have the incentive to offer the large promotions and payments to retailers. However, those stores that are experiencing financial difficulty, especially in rural areas, may want the short-term benefits of entering into an exclusive sales arrangement.

Independent stores have also forced vendors or certain vendor products to be eliminated because the vendors could not pay for shelf space or because of exclusivity contracts. For example,

Frito's has engaged in exclusivity contracts regarding one particular product of their line of salty snack food. Small packages of one to one and 3/4 ounce potato chip bags are an important source of revenue but Frito has provided incentives for retailers to only carry their small bags.

EXPANSION INTO NEW MARKETS

[redacted]

[redacted] it is virtually impossible to expand into a new geographic niche because the entry cost is prohibitive. A new vendor in the area must invest almost all of its sources just to get on the shelves and as a result it cannot reach consumers in the new market with promotional allowances or other means of advertising. Since these payments have to be made repeatedly, rather than just an initial investment, and it makes it very difficult for a new entry in the market to ever make a profit.

One illustration of this problem can be seen with Eagle, which underestimated Frito's ability to undercut and influence retailers. Eagle had two options in dealing with Frito: it could

have built up its market share or it could have made a profit. Eagle decide to forgo its profit in order to create a viable market share and, as a result, it went out of business.

Often when the vendor wants to increase its market line and introduce a new product, the retailer will require that another one of the vendor's products be taken out of the supermarket so that there is no overall net gain for the vendor. This adds an additional disincentive to expanding into new markets.

FRITO'S STRATEGIES

[redacted] offers as proof of what Frito is doing (i.e., undercutting other competitors) the different prices that Frito places on its products from one location to another. Wherever Frito has a significant regional competitor, its prices are much lower and wherever it operates almost completely on its own its prices are higher [redacted]

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[redacted] also discussed Frito's manipulation of the potato market. [redacted] However, Frito has increased over 50 percent of its market share in potato chips nationally. Frito has been known to buy up the potato crop that has been allocated to other vendors so that the other vendors would be forced to buy potatoes at a higher price in the open market. Frito has also been known to encourage early harvesting which has decreased the potential yield, forcing all manufacturers to go into the open market to buy at a higher price.

Regional processors have suffered from this maneuver much more than Frito for two reasons: (1) Frito does not depend as much on its potato chip product as the other regional competitors [redacted] do, and (2) Frito has a lot more capital to burn on higher prices of potato products than its competitors do.

Frito's alleged actions are difficult to prove. [redacted] says Frito's activity is common knowledge in the

market. In one case, a broker was paid by Frito to sell more potatoes to Frito than Frito had originally contracted for. [redacted] described the process in which the vendor contracts for a certain amount of potatoes and the farmer allocates a reasonable acreage to meet the contract needs. When a growing season is bad, the vendor does get the full amount of potatoes. [redacted]

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So/So # 10811