

2003 Unsaleables Benchmark Report

By Anne Lightburn
foodBiz

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The Food Marketing Institute (FMI) is a nonprofit association conducting programs in research, education, industry relations and public affairs on behalf of its 1,500 members including their subsidiaries – food retailers and wholesalers and their customers in the United States and around the world. FMI's domestic member companies operate approximately 21,000 retail food stores with a combined annual sales volume of \$220 billion – more than half of all grocery store sales in the United States. FMI's retail membership is composed of large multi-store chains, small regional firms and independent supermarkets. Its international membership includes 200 members from 60 countries.



GMA is the world's largest association of food, beverage and consumer product companies. With U.S. sales of more than \$460 billion, GMA members employ more than 2.5 million workers in all 50 states. The organization applies legal, scientific and political expertise from its member companies to vital food, nutrition and public policy issues affecting the industry. Led by a board of 42 Chief Executive Officers, GMA speaks for food and consumer product manufacturers and sales agencies at the state, federal and international levels on legislative and regulatory issues. The association also leads efforts to increase productivity, efficiency and growth in the food, beverage and consumer products industry.

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Acknowledgments

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Companies Participating in 2003 Survey

A special thanks goes to all the companies who participated in this year's unsaleables survey. They played a pivotal role in helping create effective benchmarks that can serve to identify ways of controlling the challenging problem of unsaleables to the industry.

Distributors

Ahold USA	K-VA-T Food Stores
Albertsons, Inc.	Merchants Distributors, Inc.
Associated Wholesale Grocers	Nash-Finch Company
Big Bear Stores	Minyard Food Stores
Bozzuto's, Inc.	Price Chopper Golub Corporation
Brookshire Grocery Company	Publix Supermarkets, Inc
Bruno's Supermarkets Inc	Raley's Supermarkets
Clemens Markets, Inc.	S. Abraham & Sons, Inc.
Core-Mark International	Schnuck Markets, Inc.
CVS Corporation	Shaw's Supermarket Inc.
Fareway Stores, Inc.	Spartan Stores, Inc.
Food Lion, LLC	SUPERVALU, INC.
Grocery Supply Company	The Kroger Co.
Hale-Halsell Company	Ukrop's Super Markets, Inc.
Hannaford Bros. Co.	United Supermarkets, Inc.
Harris Teeter, Inc.	Weis Markets, Inc.
HEB Grocery Company	Winn-Dixie Stores, Inc
Kmart Corporation	Yosemite Wholesale

Acknowledgments

Manufacturers

Americas Confectionary
Alberto-Culver Company
Birds Eye Foods (formerly Agrilink Foods)
Campbell Sales Company
Chicken of the Sea, International
Church & Dwight Co., Inc.
Colgate-Palmolive Company
Con Agra Grocery Products Company
ConAgra Frozen Foods Group
Dean Foods Company
Del Monte Foods Company
Del Pharmaceuticals, Inc.
Faultless Starch/Bon Ami Company
General Mills, Inc.
GlaxoSmithKline Consumer Healthcare
Hershey Foods Corporation
Hormel Foods Corporation
Johnson and Johnson
Kellogg Company
Kimberly-Clark Corporation
Kraft Foods, Inc.
Land O'Lakes, Inc.
Masterfoods USA
Mead Johnson/Bristol-Myers Squibb
Merisant Company
Mott's, Inc.
Nestlé Purina PetCare Company
Nestlé USA
Ocean Spray Cranberries, Inc.
Playtex Products, Inc.
Quaker Food & Beverage
Reckitt Benckiser Inc
Rembrandt Division of Den-Mat Corporation
Reynolds Consumer Products/Alcoa Consumer Products
Ross Products Division, Abbott Laboratories
S. C. Johnson & Son, Inc.
Sun-Maid Growers of California
The Andrew Jergens Company
The Clorox Company
The Dial Corporation
The J.M. Smucker Company
The Minute Maid Company
The Procter & Gamble Company
UBFNA
Unilever HPC, NA
Welch Foods, Inc.

**two "declined to state" companies



Executive Summary

The food and consumer package goods industry (CPG) experienced intensified competition this past year as the economy weakened, consumers became more cautious and competition between traditional store formats and mass merchandisers increased.

In this challenging, complex environment, in which all companies aggressively seek efficiencies and cost reductions to give them the competitive edge, unsaleables is falling under the microscope. The industry appears to be experiencing a fundamental shift in how trading partners view reimbursement, collaboration and the shared responsibilities for unsaleables.

Industry Unsaleables Cost Up Slightly at \$2.6 Billion

This year's survey, which is marked by a sharp rise in participation from both manufacturers and wholesalers/retailers (called distributors in this report), reflects a bad news-good news scenario.

The bad news is that across all channels of distribution, total industry unsaleables for warehouse-delivered consumer package goods cost the industry \$2.6 billion last year – up slightly from \$2.5 billion the previous year. This small rise disappointed many industry companies that believed new manufacturer initiatives would cut more deeply into the unsaleables rate.

The good news is that nearly 30 percent of manufacturers and distributors reported a *decline* in unsaleables costs. (This report provides insights into how these companies succeeded and why other companies' costs increased. See Chapters 11 and 12 specifically.)

Supermarket Distributors Holding Unsaleables Costs Constant

Additional good news can be found in the fact that benchmarks and open-ended questions indicate that the supermarket channel is holding unsaleables costs down. The supermarket *industry-weighted* average unsaleables rate – the prime indicator of total channel cost – has trended down from a level of 1.17 in 2000 to 1.12.

Two of the reasons most often cited for the decline are trading partner collaboration and improved store practices.

Physical Damage Accounts for 58 Percent of Reclamation

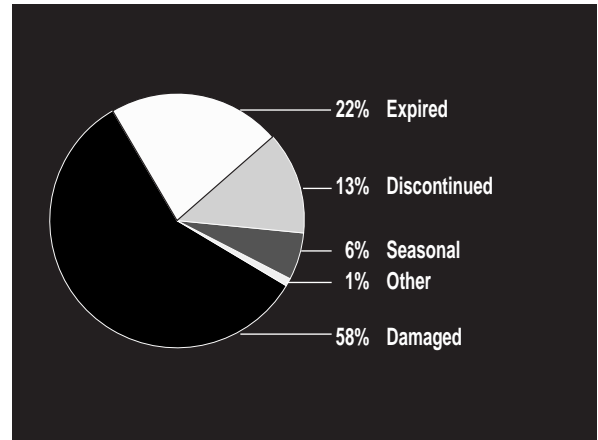
Two types of products are found at reclamation – those that are physically damaged and those that are not. The survey notes that packaging and distribution/logistics are the largest contributing factors for damaged product, which accounts for 58 percent of all reclamation volume.

**30% of Manufacturers &
Distributors Note Decline
In Unsaleables Rate**

Executive Summary

According to survey respondents, trading partner shared behaviors and inefficient practices account for those products not physically damaged – expired products, unsold discontinued items and leftover seasonal volume.

Distributors Report Damage Number One Reason for Reclamation



More than 40 Percent of Unsaleables Due to Inadequate Inventory Management

Today many opportunities for unsaleables reductions that do not require significant capital investments are clearly open to the CPG industry. This year's respondents note that 42 percent of industry reclamation volume requires only modifications or changes in trading partner behavior and practices to save the companies involved and the industry millions of dollars in avoidable unsaleables costs.

Excess volume is at the heart of the issue – from over-buying/selling to poor planning and execution of promotional and seasonal events. Other shared trading partner processes in which improvements could result in huge cost savings include product rotation, new item introduction and the product discontinuation processes.

Objective of Unsaleables Reduction: Bottom-Line Profit Growth

Readers of this benchmark study must determine whether their company's unsaleables costs can be reduced and if it makes economic sense to do so. The ultimate tests for these investment/practice change decisions include impact on trading partner, consumer satisfaction, sales growth and, of course, bottom line-profit.

Use Benchmarks Directionally – Not for Specific Company Targets

The benchmark information in this report is designed to provide companies broad industry data and trends to watch. It is not intended for specific company, retail department or SKU unsaleables targets.

Benchmarks to Watch

1

Significant Jump in Survey Participation

This is the first year that a *major* increase in the number of survey respondents has been recorded. Manufacturer participation increased 14 percent, with almost all major companies represented. Distributor participation – primarily from the supermarket channel – jumped 38 percent and includes seven out of the top 10 supermarket channel distributors.

2

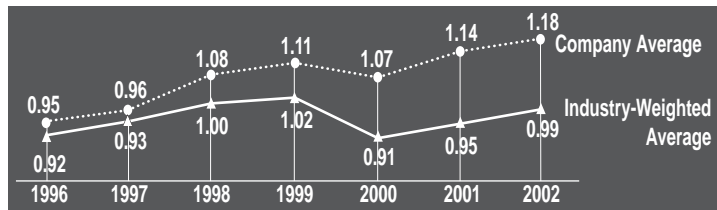
Manufacturer Weighted-Average Rate/All Channels Jumps to .99 Percent

Over the past nine years, manufacturers unsaleables cost as a percentage of sales has increased steadily to an *average company rate* of 1.18 this year – the highest rate in the nine years of tracking. The most often cited cause for this year’s jump from 1.14 percent the previous year is high product discontinuation.

Of greater importance for measuring over-all industry trends is the *industry weighted-average*, which is based on volume. This average has, in the past, increased at a slightly slower rate than the average *company rate* and shows a widening gap between the larger and smaller companies.

Last year, however, this larger company rate advantage was not experienced, since the average company rate increased at a slightly lower pace than the industry-weighted average – thus narrowing the gap between large and small companies.

Manufacturer All-Channel Unsaleables Rate



Historically, the reasons for lower rate increases in larger companies may be due to the significant capital investments being made in packaging and distribution/logistics, the implementation of swell and adjustable rate policies, and gaining product listings with the low-unsaleables rate mass merchandiser/club store channels.

3

Drug Channel Again Has Highest Rate; Club Stores Lowest

Drug stores continue to register the highest rate of manufacturer unsaleables at 2.57 percent – up from 2.35 percent the previous year.

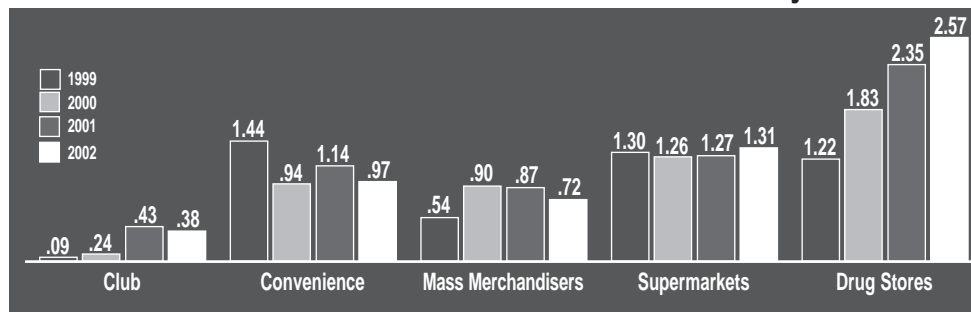
Club stores have the lowest rates (0.38 percent) while mass merchandisers place next lowest with a 0.72 rate of unsaleables.

Executive Summary

The manufacturer unsaleable rate for convenience stores was .97. The supermarkets rate was 1.31.

The significantly lower unsaleables rates for the mass merchandise and club channels may be due in part to lower product assortments, fewer new item acceptances, and different distribution/logistics, reclamation and store-stocking practices.

**Manufacturer Unsaleables Rate
By Retail Channel**



**Largest Single Drop in
Store Credit Payment Rates**

4

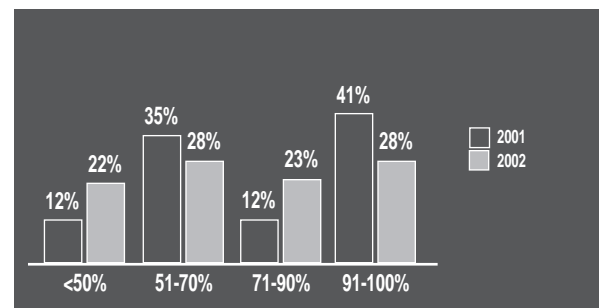
Distributor Unsaleables Store-Credit Rate Drops to Lowest Level in Four Years

During the past several years, a slow but steady decline in the rates that distributors credit stores for unsaleables has been seen.

This past year, distributors reported the *largest single* drop in the retail-price basis for crediting stores. This method is used most frequently by more than 50 percent of companies.

Today, less than 30 percent of these companies are crediting stores at the 91-100 percent level, and more than 20 percent at less than 50-percent level. This significant shift to lower store credit rates has negatively affected store gross margins and increased store awareness and accountability for unsaleables — helping reduce the incidence of store-level unsaleables.

**Retail Price Basis for Unsaleables
Store Credit**



EXECUTIVE SUMMARY

5 Swell & Adjustable Rate Products Account for Nearly 25 Percent of Sales

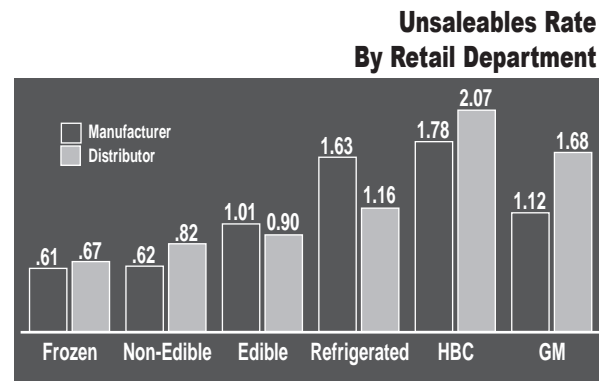
On average, distributors report participating with 20 trading partners (22 percent of sales volume) on swell and adjustable rate allowances.

Several distributor respondents report these programs are having a negative impact on their bottom-line profits because allowances do not cover the full costs of unsaleables. Many distributor companies report taking positive steps to deal with these financial pressures, including increased analysis, improved collaboration with trading partners and reduction in the rate that stores are credited for unsaleables.

On the bad-news side, respondents also report a decrease in their willingness to accept new items, an increased use of mark-down bins, a discontinuation of problem SKUs, and/or a change of suppliers.

6 HBC Department Has Highest Unsaleables Rate

Health and beauty care products have the highest rate of unsaleables of any retail department for both manufacturers and distributors, due in part to high levels of assortment, heavy product introductions, full-line changes and associated discontinuations and resets. This year, frozen product had the lowest rates, followed by the non-edible dry grocery department.



Partnership for Better Supply Chain; Benchmark Success Stories Show the Way

The issue of unsaleables is an extremely complex one with multiple players and a venue that covers the entire supply chain.

Simplistically, manufacturers strive to make product shelf-life and packaging durable for the entire journey to the consumer’s pantry. Distributors seek to make the journey a continuous safe FIFO (first-in, first-out) one. Many things can and do go wrong along the way. There will always be some unsaleable product – no matter how efficient and effective the industry becomes.

However, the question facing the industry is: “Can trading partners improve shared and individual responsibilities to manage the inventory flow more efficiently to improve product freshness and appearance while lowering unsaleables?” The Joint Industry Unsaleables Steering Committee believes the answer to that question is YES. This report contains numerous company success stories for unsaleables reductions that prove that many companies are now also saying YES.

Executive Summary

Companies report success due to trading partner collaboration; packaging and distribution/logistics improvements; reduction in unsaleable store-credit rates, increased training; improved store practices; improved measurement and focus. When a simple thing like focus is demonstrated as reducing unsaleables, more companies should take up the challenge.

Unsaleables Resources Available

The Joint Industry Unsaleables Steering Committee recommends sharing this report within your company, especially with staff responsible for managing unsaleables, and with your trading partners. Industry experts say that the unsaleables issue is not an easy one to tackle due to its shared nature and its complexity, liability and the variety of solutions available. They suggest, however, that companies can best achieve unsaleables reduction by working with trading partners to find solutions that address root causes, assign accountability and monitor performance.

Expertise and valuable assistance are also available through the industry relations departments of GMA and FMI. Also, please note in the Appendix a listing of publication resources on unsaleables available through these trade associations.

All companies are encouraged to access the *Unsaleables Update* newsletter, published several times throughout the year by GMA and FMI. The newsletter contains the latest research reports, news accounts and success stories on unsaleables in the industry and is available on www.gmabrands.com and www.fmi.org.