Memorandum

Subject Meeting with Frito Lay	Date July 29, 1996 60-2096-0002

To Files

From Tara Sweeney

DOJ: Nina Hale, Attorney
Jill Ptacek, Attorney
John Hayes, Economist
Michael Rufe, RA
Tara Sweeney, Paralegal

Frito Lay: Mark Fritz, VP & Assoc. General Counsel (Pepsico)
Mark Schechter, Counsel (Howrey & Simon)
Roland Colman, counsel (Howrey & Simon)

On Friday afternoon, July 26th, we met with representatives of Frito Lay to begin a dialog concerning our investigation of Frito Lay. Mr. Fritz's territory of responsibility is the eastern United States. His legal responsibilities include promotions, distribution, and sales. He explains that he deals with issues in sales operations, field sales, logistics, transportation, manufacturing, and personnel. He reviews contracts and programs, and gives presentations to employees.

Mr. Fritz explained that since the 1965 merger of Frito-Lay and Pepsico, several strategic decisions have set them apart from their competitors.

distribution: RWF, DNK, HALE, PTACEK, ALEXANDER, RUFE, HAYES, SWEENEY, JONES, CASE CHRON, ARCHIVE

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DNK

1) **National snack brand** - Some competitors attempted to create a national brand however they were unable to carry it all the way through. Whereas Frito-Lay originally started with national sales, Borden began as a regional company and tried to grow into a national distributor.

2) **Full line product** - Other companies tended to focus on niche products. Keebler, for example, focused on potato products.

3) **DSD distribution** - They have company owned route vehicles throughout their distribution system. Proctor and Gamble and Nabisco use warehouse delivery.

4) **Availability** of their products. They operate in all channels of distribution from grocery stores to vending, bars, and military.

Another important factor for their success is that Roger Enrico, CEO, implemented several changes to revitalize the industry when he joined the company in 1982. At this time the industry was significantly less competitive and he attempted to make it more so. [redacted] b4 Secondly, he redirected their focus on quality. At this time, Frito-Lay products were testing well below their competitors. Enrico focused on bringing quality up to the level of their brand value and tradition. Thirdly, he also improved the efficiency of plant operations and research and development. They have developed patents on new potatoes, seasoning, and equipment, and have become the industry

leader in innovation of low-cost production. He also tried to make their pricing more competitive and refocused marketing on the consumer.

Jill questioned whether their product innovation has caused cannablization of their own products. Fritz explains that this is something that they worry about but they have been successful in offering meaningful changes. Another critical concern of product innovation is the affect on space allocation. Because of the deluge of new products into the stores every year (despite limited space), they need to have a proven track record.

They became more aware of the superb quality of their facilities during the Eagle acquisition. He says they typically need to turn down acquisition possibilities due to the conditions of the facilities. [redacted] b4

[redacted]

Methods of Distribution

Frito-Lay's principle distribution is DSD. While the DSD distribution may not be unique to Frito-Lay, some aspects set their system apart from their competitor. First of all, Frito-Lay focuses on individual service. Anheuser-Busch, for example, combined their beer and snack distribution, which created a split focus and lack of synergy.

Another important aspect of Frito-Lay's distribution is the product shelf life. Frito-Lay makes sure that the code is available and guarantees that everything will be sold. He explained that in accounts where products may be slow-moving, the products are rotated from the slower store to faster-moving stores. This ensure that the products are sold by their code date. The accounting is produced by hand-held computers. The computers allow the distributors to access the current programming and to produce invoices on the spot.

Frito-Lay also tries to offer guidelines for product displays, however they believe their key to success is to be flexible and react to the customers needs. They may offer a planigram, which shows their preferred arrangement based on their internal review, however, the placement of the products varies

according to location. Products may be displayed on secondary displays such as FEMs (front-end merchandiser), bread tables, and end caps.

Product Inclusion and Shelf Allocation

[redacted]

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[redacted]

Their department is broken down to 22 geographic areas which represent the sales orientation. All areas have at least of one of Frito-Lay's 42 plants. The Area Vice President is responsible for the Zone Managers, who are responsible for subdivisions or

cities or zones. The zones are broken down to districts, which are divided into routes. He explains that route people do not pick up products directly at the factory. They will usually pick up from trailers at the distribution centers or from bins located throughout the geographic areas.

They emphasize that the plant service area (PSA) is separate from the geographically defined sales area. PSAs are constantly changing boundaries. It is always a question of whoever can deliver at the lowest cost. It is the salesperson's responsibility to know where products are produced and what the best source for products would be. Baked Lay's are being distributed nationally but they still having difficulty meeting demand. He says limits on shipping include cost and variety of products. Pretzels, for example, can be shipped further distances than chips. Likewise, Proctor and Gamble only has one plant, but they can distribute Pringle's nationally. [redacted] b)(4)

Channels of Distribution

Frito-Lay sells their products in supermarkets, convenience stores, club stores, UDS (up and down the streets), and mass-

merchandisers (K-mart, drug stores). Other channels of food service include vending machines and military. He states that they also have some sales to food brokers. A national account comprises the accounts for which they are expected to call upon headquarters and deal with the national sales force. Frito-Lay sends national account representatives to handle a account for all of the chain's outlets. They try to serve they store according to the customer's preference. He explains that most supermarkets are decentralized and require stops to both headquarters and the local divisions.

[redacted]

Shelf Fees

They explained that they would prefer not to pay for shelf space because they want their payment programs to promote performance improvement. Similarly, they do not pay for exclusivity or condition the payments that are made. They believe that exclusivity does not necessarily promote growth in sales. They typically try to make an objective case by using IRI data and discussing how a store can improve their own sales by further promoting Frito-Lay. It is their policy not to pay just for space. Ultimately, it is up to the retailer to decide how shelf space will be used. If Frito-Lay can convince them that they will make more money by using the space differently, they may be able to get their products promoted. Fritz states that it is unlikely that a grocery store would carry a product exclusively. Convenience store, however, may decide that one supplier is beneficial to limit traffic flow in the store.

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[redacted] They believe that the extra space is going to private labels and to their competitors. They use this

data to show the stores how to maximize their space. They also state that it is not their policy to request stores to carry certain bag sizes. Their presentations typically compare Frito-Lay's sales and services with their competitors.

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[redacted] With the departure of Eagle, there was a clear opportunity for Frito-Lay to access additional space. The question at this time, however, was whether that extra space would be reallotted to the salty snack category.

Fritz states that some supermarkets may demand payment for shelf space. In these circumstances they will pay, however, they may try to reduce their programming funds or they may attach additional performance criteria. Ultimately, it is the store's decision of whom to place in the store. He states that there is always a fear that a store can influence their brand value. He emphasized that their programs attempt to reflect the stores' needs and to focus on growth to their shares.

So/So # 12016