What Operators need to know about their Master Distribution Agreement

TERMS TO KNOW

APPLICABLE FREIGHT A freight charge for delivering products to an operator. Freight charges may include freight charges by the distributor itself, a third party supplier, and/or other charges such as fuel surcharges, cross-dock charges, unloading and restacking charges, container charges, air freight charges and others.

BROADLINE DISTRIBUTOR A distribution partner that provides a wide range of food and non-food items to a foodservice operation. An operator's broadline distributor usually ships and handles the significant majority of the operator's purchases.

COMPLIANCE Percent of total purchases that an operator has contracted to buy from their Broadliner. (Typically 80-90%)

DROP SIZE The size, usually in number of cases or dollars, of a single delivery by a distributor to an operator's receiving location.

DROP SIZE PENALTY Also known as 'Small Order Surcharge'; the amount that will be added to an invoice if an operator does not meet the minimum order size set forth in their distribution contract.

FEE PER CASE/MARK UP/MARGIN Methodology used by a Broadliner to determine the sell price of a product. An established amount of money that an operator must pay for each case that a distributor delivers, as set forth in a Master Distribution Agreement.

FUEL SURCHARGE Pricing terms set forth in a Master Distribution Agreement that outline a range of fuel prices as a Base Range and a schedule for surcharges if the fuel cost fluctuations result in fuel costs falling outside of the pre-determined range.

INCENTIVES Financial rewards based on performance. Typically these are based on growth and/or performance where the Broadliner passes on some of gained efficiencies to the operator. Incentives could be linked to drop size, growth, number of deliveries, etc.

KEY PERFORMANCE INDICATORS (KPIS) Specific targets that the operator has agreed to, such as, average dollar per delivery, average cases per delivery, Average Case Cost, etc.

MARGIN The amount added to cost to determine the sell price of an item

MASTER DISTRIBUTION AGREEMENT (MDA) An operator's agreement with their Broadline Distributor. It is often the single most important purchasing contract that the operator holds.

MARGIN SCHEDULE A data table that outlines the mark-up structure of an operator-distributor contract. This table specifies various purchase volumes or categories and their associated mark-up charges.

OFF DAY DELIVERY Any delivery that is requested by an operator for a day other than a Scheduled Delivery Day; Off Day Deliveries often result in an additional charge, as set forth in the Master Distribution Agreement.

OVERCHARGE An amount charged by a distributor to an operator that exceeds the amount set forth in a Master Distribution Agreement. Overcharges may be accidental or intentional and are often extremely difficult for operator to identify without the use of a third-party price verification resource.

PRICE VERIFICATION The act of cross-checking actual invoiced prices to the agreed-upon prices as outlined by a contract. Any over-charges identified by the price verification process are usually billed back to the distributor with the goal of rectifying the discrepancy.

PRIMARY DISTRIBUTOR Distribution partner that is guaranteed a certain amount of an operator's total purchase volume, typically not less than 80%.

ROLL-OVER The term during which a distributor contract will automatically renew, as defined in an Master Distribution Agreement.

SCHEDULED DELIVERY DAYS Designated days, typically 2 or 3 per week that a distributor agrees to make deliveries to an operator as specified in a distribution agreement

SERVICE AREA The geographic area in which a distributor is willing to deliver product to an operator, as defined in a Master Distribution Agreement.

SPECIAL ORDER PRODUCTS Products not inventoried by the distributor that an operator requests to be inventoried and delivered

SPLIT CASE FEE An agreed on charge, as listed in the MDA, that the operator pays for ordering less than a full case of product.

TRUCK LOAD An amount of product that equates to the volume of an entire delivery truck. Some pricing structures may be based on whole or partial truck loads.

TERM Length of contract as defined by a specific start and end date.

TERMINATION FOR CONVENIENCE OR WITHOUT BREACH Sometimes written into a contract that lets one or both parties out of the contract for no reason within a specific time frame (i.e. ninety days).

COMMON **QUESTIONS ANSWERED**

Today's regional and national restaurant and foodservice chains are confronted by a surplus of business and organizational challenges, but none as critical as the direct and indirect impact of purchasing and supply management.

With over 30% of revenues being spent on food supply, restaurant operators are increasing their focus and resources on developing more operational and cost effective ways of purchasing, procuring and managing supply. This trend is the logical outcome of increased managerial concern to meet specific supply objectives of quality, quantity, delivery, price, service, and competitive improvement.

Additionally, negotiations with distributors are receiving increased emphasis from operators. Now, instead of competitive bidding, longer-term contracts or master distribution agreements are replacing short-term buying techniques. This places special emphasis on strategies that ensure short- and long-term value for funds spent.In our recent interview with Barry Friends of Technomic, a research and consulting firm servicing the food and foodservice industry, Barry describes the challenges concerning restaurant and foodservice operators, while providing solutions for managing master distribution agreements. Barry spent 24 years in executive leadership roles with three of the top five U.S. foodservice distributors — Sysco, US Foods, and Reinhart — making him uniquely qualified to share his insight on the complex issues associated with distributors and distribution agreements.

Q: What are the biggest challenges facing regional and national restaurant and food service chains when it comes to supply distribution agreements?

Regional and national chains are flooded with distribution related problems. The nature of their problems and challenges vary wildly on their scale, maturity and business model. Most chains are growing, and their problems are growth related: resources, operations, and capital.

In most cases, growing chains don't have supply chain resources or a supply chain person/department. In the rare cases they do it's cobbled together or it's a shared role between purchasing and operations.

Consequently, there aren't a lot of distributors to choose from that can do a great job for growing chains across a large geography. Depending on scale and density, most chains are stuck dealing with broadline distributors — a single window approach for sourcing all food and operating supplies. However, the most critical issues that supply chains manage is disruption. Bottom line, in order to manage risk and avoid stoppage, the operator surrenders quality, quantity, delivery, price, and service to the distributor, subordinate to the broadliner's capabilities, transparency, and responsiveness to fluctuating markets.

Moreover, Barry points out that the biggest challenge regarding the operator distributor relationship is that operators "don't know what they don't know."

Barry explains that when "RFPing your business, you will get a number of offers, and you can choose the best one, but no matter how much you (the operator) know, the distributors know more; they have all the power, and they (the distributors) are excellent at making their customers feel like they have a great deal when that may not be the best they can have."

Q: What factors influence distributor costs?

There are many factors that influence distributor rates, but in most cases operators are not prepared to nor do they have the resources to analyze these influences.

To be clear, distributors do not raise costs, manufactures do. In general terms, costs are driven by the markets. For example, produce costs change daily while meat costs change weekly. Most distributors spreadsheet your supply by category and contract a fixed percent markup on top of their cost.

There are things that can be built into a distribution agreement to help smooth out price volatility, but costs are mainly controlled by the market. Once an operator comes to terms with a distributor, the distributor's primary focus becomes delivering the service end of the agreement.

Q: When does it become ideal for a chain to start thinking about doing a master distribution agreement?

In short, you should do a master distributor agreement as soon as possible. Basically, the moment an account is big enough to command the attention of multiple distributors it is the ideal time to start negotiating a master distribution agreement.

The rule of thumb is if a restaurant or food service chain has a regional and/or national presence, it should be behaving like a chain with regional and/or national authority. The chain should be buying at the very least on an honorable cost plus percent markup agreement, and it should be negotiating special pricing on its most important value added items. For example, a burger chain would be focused on fries, hamburgers and butter. As a unit of measure, most of large broadliners like Sysco consider a 5 unit chain and above a chain account.

Q: How does an operator analyze whether they are getting a good deal?

Unfortunately, operators really can't. Even after operators get their 2 to 3 proposals, at the end of the day, there's still a margin, and a backend markup that the chains are not privy to. What is the base price? What are the attached backend service costs, and how do you (the operator) analyze and compare? Aside from asking distributors how they make money, the operator is often ill prepared and ill equipped to answer these questions. The best way to know whether you are getting a good deal or not is to leverage the expertise, technology and buying power of Consolidated Concepts — the leading purchasing partner in the US for restaurants and food service organizations. They work with hundreds of chains which allows them to benchmark and compare one distribution agreement with another.

Q: What's the difference between a fee per case and percent markup?

Either one is fine. Generally speaking, the distributor will like the percent markup better, and as the product inflates, the distributor's profit increases. It prevents them from coming back to the operator and saying they need a rate increase because their percent markup will float in respect to inflation.

Commonly, the higher the price volatility, the riskier the security. For example, 15% markup on produce during a tomato shortage can raise the price per case from $25 to $50. However, either option is still better than autonomous pricing from the DSR (Distributor Sales Representatives).

All in all, it comes down to what the distributor is willing to offer and what you are able to do to rationalize that offer.

Q: What factors should an operator consider when terminating a 3 to 5 year distribution agreement?

Even if the broadliner agreement is sound and the service level is excellent, a chain experiencing significant growth should be checking the validity and currency of their agreement with some regularity. MDA's have something called an "exit clause," or common language that says with 60 or 90 day notice, for no cause, the operator can terminate the agreement.

For instance, a 25 unit chain on a 5 year MDA has grown to 50 units in the last 2 to 3 years and has doubled their purchase volume or added a third purchasing volume under their broadliner. In this case, there is no clause that forbids the chain from shopping their current MDA; in fact, Consolidated Concepts highly recommends shopping for new pricing with an agreement currently in place.

Q: A lot of operators fear losing a good relationship with their broadliner...why should they consider shopping their current agreement even if they have good relationship with their distributor?

This is a clear case of a mutually valuable relationship where the distributor does a good job and is honorable and diligent. The relationship is built on more than price. In our society, it's natural to feel the risk emotionally when threatening to break up with a distribution much like initiating a divorce with one's spouse.

However, this is business, and operators have a responsibility to themselves, their employees and their shareholders to do the best thing for their organization. If the goal is to increase profits by reducing supply costs, operators should consider the value of quality service, because the cost associated with replacing product, missing product, broken product is huge.

In the end, if an operator builds an exceptional relationship with a distributor, they should be comfortable enough in their business to back that distributor and negotiate fair pricing and vice versa. If the distributor values your relationship, they will find a way to retain your business the while upholding their standards of quality service.

Q: What common triggers cause an operator to renegotiate their distribution agreement? What sets them off?

There are many triggers that start the distribution agreement negotiation process. Usually this is triggered by something that causes the operator to lose trust in their incumbent distributor. It could be a matter of price or it could be how the distributor is administered.

Another factor that compels renegotiation is the chains own external state of affairs. Unfortunately, sometimes the problems associated with growing pains transfer to blame on current purchasing practices.

Q: If an operator is unhappy with their level of service, should they give their distributor a chance to fix the problem?

As mentioned before, operators have a responsibility to themselves, their employees and their shareholders to do the best thing for their organization.

A good deal or distribution agreement is only as good as their level of service (the quality and delivery of product). The costs associated with missing or broken product affects a chains profit margins just as much as the amount they spend on supply.

At the end of the day, an operator must ask themselves "what's best for my business?" The answer will be clear.

Q: If a chain is happy with their service level and the distributor offers sufficient transparency, how do they know they have a good master distribution agreement?

One of the most valuable activities an operator can do to benchmark their agreement is to network and compare their deal with similar size organizations.

Unfortunately, this rarely happens. On the other hand Consolidated Concepts works on hundreds of master distribution agreements. This is a huge advantage because it allows you to validate your agreement.

You can always RFP your business to multiple distributors in different markets, but you will never truly know if you've improved your deal as much as you could, unless you have a means of benchmarking. Without benchmarking, operators are essentially flying in the dark.

Q: What is compliance and why is it important?

Compliance is designed to add strength to the agreement by assuring that both distributors and customers are adhering to the agreement. For example, if a customer doesn't pay on time, or is not purchasing at the frequency or volume described by the key performance indicators in the agreement, the distributor has the right to call that customer to the carpet.

In other cases, a red flag may be raised against a distributor who doesn't call out a customer who is not in compliance with their key performance indicators. For instance, a distributor accepting 100 cases when 150 cases are in the agreement is an indicator that the distributor figured out how to profitize that business to their satisfaction without the 150 cases. This can be a sign that the operator is paying for something they may not be aware of and did not agree on. This is why compliance is important for both sides.

Q: What qualifies a chain to ask for additional incentives?

The number one thing that qualifies a chain to ask for incentives or an improved deal is when a chain starts consistently out performing or overachieving the parameters of their agreement.

A good example of a chain that deserves a better deal is a 10 unit chain (paying cost plus 2 dollars and 40 cents a case with a requirement of 80 cases minimum order and 4 million dollars worth of supply per year) that grows to 15 units (paying 7.5 million dollars a year and 124 cases per order) during the term of their agreement.

In this case, the operator should reach out to the distributor to negotiate better pricing.
At the end of the day, the distributor will be competitive in situations that make sense. It's your job as the operator to get the distributor to think of you as a 15 unit chain with 7.5 million dollars in business. They won your business once; make them win it again.

Q: What's the difference between gross profit per case and gross profit per drop?

Looking at any one metric without it's relation to the other is a meaningless metric. GP per drop is more of a metric for averaging than it is a stand alone metric for a contract. When assessing your deal on a GP per case or GP per drop basis, you want to focus on the combination of the two. To be safe, you want to know the number of cases and how much GP per case.

5 HIDDEN FACTS IN YOUR MDA

AND HOW TO NEGOTIATE AROUND THEM

Most operators who have scaled in size to multiple locations have found the benefit of pursuing a Master Distribution Agreement, or MDA, with their main broadline or grocery distributor. This vital contract offers the operator the opportunity to lock in pricing terms on their order guide items and avoid drastic swings in costs and terms from their primary distributors.

However, these contracts often carry terms that may cause an operator to lose money in the long run. I spoke with former Broadline President and MDA Expert, Randall Knopf about the pitfalls that may be hidden in an MDA and how to avoid them. According to Knopf, an MDA "is a lot like a home mortgage. Many people sign them, but few actually read all the way through to find the clauses that can be the difference between a great deal and one that is not necessarily so strong."

FREIGHT COSTS AND FUEL SURCHARGES

"Freight costs were originally put into MDA contracts during the 90's when gas prices were more volatile", says Knopf. "Today, however, with fuel costs at next to nothing, there really isn't much of a need for these surcharges." Many contracts will include a chart of 'strike points' that indicate that if the price of diesel goes over a certain fee, the distributor can raise the price, either by total invoice or on a per-case basis.

Operators and consultants who are skilled at negotiating MDA's will aim to remove fuel surcharges from the contract altogether or make the strike points so high that they would never actually be enacted over the life of the contract. "You'll never see credit given back to the operator on the flip side if diesel prices drop. It's only ever one way," says Knopf. This is just one of the many ways in which distributors may try to increase their margins via an MDA.

RENEWAL NOTICE

One of the highest-dollar impacts for operators when it comes to Master Distribution Agreements is renewals. Operators must be aware of when their contracts ends in order to take advantage of the opportunity to re-negotiate their MDA and maximize their contracts for their next 3-5 years.Typically, MDA's will contain language that the distributor will automatically renew the contract for a 12-month period if the operator does not notify the distributor within 180 days of contract termination. Knopf advises that operators never miss an opportunity to negotiate a new MDA that is tailored to their most current needs. "It's a lot like buying a car," he explains. "Most people don't just go to one auto dealer. They shop around to see what is available and try to pit the dealers against each other for pricing.

Operators should do the same thing with their distributors whenever they can. Especially if your operation has grown its locations over the life of your previous contract," Knopf adds, "You're going to get a much better deal than in the past."

DROP SIZE PENALTY

"The best thing a chain can do for themselves is to improve their drop size penalties," says Knopf. A drop size penalty relates to the minimum delivery size that an operator must hit in either dollars or cases. If the minimum drop size is, for instance, $1000, the operator will pay a flat penalty if a single order falls below that minimum. As a former broadline distribution executive, Randall Knopf knows that "distributors think about their business primarily in terms of drop sizes, whereas operators tend to think in terms of margins. The burden is on the operator to negotiate an appropriate drop size penalty and to then manage their order guides, their storage space, their forecasting and their order frequency in order to avoid an operator is finding themselves paying that penalty on a regular basis, Knopf advises that the operator might be spreading their business among too many distributors, which is not ideal for efficiency, security, nor pricing. Plus, managing to a good drop size will help keep the client on good terms with the distributor and provide leverage with the distributor that will help in future negotiations.

MARGIN INCREASES

Margin Increases are a fairly straight-forward part of an MDA, but one that operators need to watch out for. Often, when contracts roll over, there may be an automatic increase or cost-of-living increases that can wind up costing operators more money and providing extra margins to distributors.

"It's a point that you have to negotiate," says Knopf.

"Try to make sure there are no increases and that your margin schedule and fee structure remains stable over the life of the contract."

AUDITING

Lastly, Knopf advises that an MDA ever having to pay that fee. If should always have language that allows for auditing on a regular basis by either the operator or an outside party in order to ensure that all pricing is correct. A distributor might add stipulations to their contract language that says that the operator can only conduct an audit once or twice a year or only after giving 8 weeks' notice.

Knopf's recommendation is to establish a provision for electronic invoice auditing and hire a third party with the software capabilities to conduct those audits on an ongoing basis.

"We recommend that our clients NEVER accept an MDA without an open audit clause," says Knopf. Knopf advises that a proper MDA negotiation is a 4-6 months process and that an operator should consider the complexity of their specific situation.

When an MDA contract is expiring, a full RFP is necessary so that the operator is not only comparing the fee per distributors, but also comparing the cost of each individual product across each distributor. "We've seen many cases where the bid with the lowest fee-per-case is not necessarily the best bid. A distributor might have the lowest margin, but they actually have a higher cost," says Knopf.

If an operator has the internal structure and expertise to properly manage the RFP and the negotiation themselves, then they should try, but it is likely that an outside professional is going to get a better deal if there is a lot of regional considerations, proprietary items, unique items or other individual factors.

SUPPLY CHAIN CASE STUDY

Below is a snapshot of what was found for a 100+ location brand

The CEO wanted an audit done to evaluate all facets of their supply chain. A critical discussion took place between the clients' key personnel (CEO, CFO and VP of Supply Chain) and the Consolidated Concepts team and partners. Information was exchanged about the brand and key items which were open for review and those that were "off limits". The audit then took place at three locations and involved the clients' VP of Supply Chain, Director of Culinary, Director of Operations and included the store's managers.

Item	Opportunity	Suggestion
EGGS	Using Grade AA eggs for scrambling	In this application Grade A eggs do not effect guest experiencde but will provide significant cost savings
TOMATOES	Using a 4x5 tomato for chopping/dicing	Plums are lower cost option in this format and provide better presentation/color
BACON	Using a traditional size bacon for sandwiches/burgers	Bacon cut from a smaller pork belly leads to wider pieces, meaning wider coverage, better presentation, and cost savings for this application
SHRIMP	Using a lower count shrimp size to give perceived bigger product	61/170 count shrimp cooks down to a comparable size of the 51/60 count providing savings that will not affect the guest's experience

ABOUT CONSOLIDATED CONCEPTS

Consolidated Concepts optimizes the foodservice supply chain and provides savings and solutions for multi-unit restaurants and their partners. Clients leverage our contract negotiation, spend management, and supply chain expertise to reduce costs and gain valuable insights into their business. Our data and technology are designed to identify areas where emerging, growing, and established restaurants may unlock additional opportunities to save money and increase profitability.