

Slotting Allowances in The Supermarket Industry

1. What are slotting allowances?

Suppliers pay distributors slotting allowances for product placement on store shelves. Sometimes they are requested by distributors, and sometimes they are offered by suppliers. Although common, these allowances are neither uniformly requested nor offered. Well-tested, innovative products can and do reach consumers without slotting allowances. Many supermarkets waive such allowances for minority vendors and for suppliers in their communities.

The most common allowances are for new products — so-called new product introduction allowances. These may also cover premium product placements, such as on eye-level shelves or special displays; the cost to have products remain on shelves — pay-to-stay allowances; or the cost to retailers if a product fails.

Although the term has broadened in scope over the years, the term “slotting” originally referred to slots or spaces for pallets in warehouses that had to be created when products were added to the line stocked by distributors.

2. How much are slotting allowances?

The amount varies depending on numerous factors, such as whether the supplier has a proven track record, whether consumer testing has been performed, whether the product is carried by competitors in the same market, and whether the supplier has a well-conceived advertising program. The amount can be as small as several hundred dollars to have a new product introduced in a single store to many thousands of dollars for a chain-wide promotion. In some instances, manufacturers provide free cases of new products to help retailers gauge consumer demand. Since each new product introduction is unique, these allowances are typically negotiated individually and no industrywide numbers are available.

3. Why do grocery manufacturers pay such allowances — particularly for new products?

The practice may be best understood in the broader context of a major shift in how manufacturers spend their promotional dollars. In 1968, they spent 72 percent on *direct consumer* advertising and marketing, largely using the mass media of television, daily newspapers and general-interest magazines. At that time, only 28 percent of these funds were spent on *trade*

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Food Marketing Institute (FMI) conducts programs in research, education, industry relations and public affairs on behalf of its 2,300 member companies — food retailers and wholesalers — in the United States and around the world. FMI's U.S. members operate approximately 26,000 retail food stores with a combined annual sales volume of \$340 billion — three-quarters of all food retail store sales in the United States. FMI's retail membership is composed of large multi-store chains, regional firms and independent supermarkets. Its international membership includes 200 companies from 60 countries.



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promotions to help retailers influence consumers once they are in the store.

Since then, the ratios have switched dramatically: by 1998, manufacturers were spending 50 percent of this money on trade promotions, according to the *Cox Direct 20th Annual Survey of Promotional Practices* (1998). Within the consumer-direct category, spending on media advertising had dropped to 26 percent with the balance on consumer promotions such as coupons and free samples.

The reasons for this shift in promotional spending are clear. It has become much harder to reach consumers through the mass media with the decline in the market share of network television and with the proliferation of cable channels, special-interest magazines and millions of Web sites. In this age, consumers can be reached most effectively in the stores where they actually buy groceries. That process begins by having products placed on the shelf.

4. Why are slotting allowances used?

The principal reason is to cover the considerable costs to introduce a product, to remove the item that previously occupied the shelf space and to recover some of the investment in the likely event that the new product fails. Depending on how a new product is defined, the failure rate ranges up to 80 percent per year.* Suppliers do not place products in supermarkets on consignment, as they do in many other industries. Supermarkets pay for products and assume the risk that consumers will buy them. When a new product fails, the cost includes the dollars lost from the item that had to be dropped to make room for the new product.

Each year, food retailers spend an average of \$956,800 per store on new products that fail, according to a study of 1995 introductions by the market research firm Linton, Matysiak & Wilkes. The major reason cited for failures is a lack of market research. In many cases, manufacturers are using retailers to test-market new products. Through slotting allowances, manufacturers are, in effect, having the retailer conduct a live market trial instead of paying for test market research.

5. Why are new product introductions so costly?

The slotting practice began several decades ago as the rate and cost of new product introductions increased significantly. Today, about 100,000 grocery products are available on the market, and thousands more are intro-

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*The Prime Consulting Group came up with the 25 percent failure rate using the narrowest “new product” definition, which excluded seasonal offerings, copies of existing items and new package sizes. It also found, however, that by the 39th week, another 42 percent of the new products tracked had declining sales. It performed this research for the report *Efficient New Product Introductions — Myths, Facts & Opportunities*, a July 1997 supplement to the magazine *Progressive Grocer*. Using a less restrictive definition, Lynn Dornblaser, publisher of *New Product News*, estimates that 70 percent of new products fail. The study of 1995 introductions by Linton, Matysiak & Wilkes put the rate at 70-80 percent. A 2000 study by Information Resources, Inc., (IRI) found that 52 percent of new products fail (*New Product Trends 2000 — Beating the Odds*). IRI noted that “categories with more new product introductions, particularly food categories, tend to have higher failure rates.”

duced each year. The typical supermarket has space for only 40,000 products, and the failure rate for new products is as high as 80 percent. With so many items competing for so little shelf space, new product introductions have become a high-cost, high-risk proposition.

As many as 24 steps are needed to introduce a new item and another 10 to remove the one that occupied the space, according to a Deloitte & Touche study (*Managing the Process of Introducing and Deleting Products in the Grocery and Drug Industry*, 1990). Based on this study and current retail practices, these steps include:

- Evaluation by buyers or category managers.
- Reprogramming computers for inventory management, category management, store deliveries, labor scheduling, shelf labels and scanners.
- Providing space in the warehouse and back room and on the shelf. In many cases, the entire shelf must be reset — both physically and in computer plan-o-grams — to make room for the new product.
- Verifying that the item has been set according to the plan-o-gram and that checkout registers scan it correctly.
- Developing merchandising programs.
- Changing accounting records, including bill-payment procedures for the new item.
- Monitoring product performance.
- Modifying advertising programs as needed.
- Deleting existing items to create the necessary shelf space.

Many of these same activities are required for the product being removed, except in these cases the item must be deleted from all computer and financial records, merchandising efforts must be refocused and unsold products must be disposed of — often at a fraction of the original value.

6. Are slotting allowances offered for all products?

No. They are not offered for most established products or for new offerings that have a high likelihood of success. Manufacturers that perform thorough market research and support new products with strong advertising campaigns often do not pay allowances. Many retailers also waive such allowances for minority-owned vendors because of their increasing value in markets with high levels of diversity, and for local growers and suppliers.

7. Aren't slotting allowances unfair to small manufacturers, who say the practice makes it difficult for them to introduce their products?

Many small suppliers hold this view. A long-time critic, the Independent Bakers Association (IBA), said, "Slotting is a particularly acute problem for bakers looking to expand product lines to meet the demand for new varieties, particularly ethnic and seasonal baked goods" (Oct. 20, 1999, testimony by IBA Vice President of Legislative Affairs Nicholas A. Pyle before the House Judiciary Committee). Small manufacturers claim that they cannot afford slotting allowances. They also say that large competi-

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tors pay high allowances to keep their products off supermarket shelves.

Independent economic studies of the issue note that there are two schools of thought about slotting allowances. “One sees them as a tool for improving distribution efficiency and stimulating competition, and the other sees them as a tool for enhancing market power and damaging competition,” according to a 2000 paper published in the *Journal of Marketing* (“Slotting Allowances and Fees: Schools of Thought and the Views of Practicing Managers,” by Paul N. Bloom, Gregory T. Gundlach and Joseph P. Cannon). The first or “efficiency” school, say the authors, believes that slotting allowances:

- Signal product quality and help retailers screen products.
- Allocate the costs and risks associated with product introductions more equitably between trading partners.
- Help retailers allocate shelf space more effectively.
- Offer shelf space opportunities for valuable new products.
- Facilitate lower retail prices.

The second or “market power” school of thought argues that slotting allowances:

- Enable retailers to exercise market power.
- Undermine trading partner relationships.
- Provide a mechanism for price discrimination.
- Foreclose competitive opportunities for certain manufacturers and retailers.
- Facilitate higher retail prices.

Other studies of the practice, and even some critics, recognize the validity of both views. The true impact may depend on how the practice is applied. The Federal Trade Commission (FTC) takes the view that these issues need to be considered on a case-by-case basis as it reviews complaints. FTC officials point out that the commission already has ample authority to deal with any problems that may arise.

8. What if slotting allowances were not used?

FMI President and CEO Tim Hammonds addressed this hypothetical case in Oct. 20, 1999, testimony before the House Judiciary Committee:

Consider a world where slotting allowances are prohibited. What would it mean for the small supplier competing in a market with large, national supplier rivals? It would mean that the large companies could brand their items; advertise in all the major media in the market; drop coupons into homes; supply retailers with free signs, in-store displays and people to sample their products for consumers at the point of purchase. There would be no way for a small supplier to match this market power, and they would be forced right off the shelf in many markets.

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Slotting allowances do give small manufacturers a means to have their products placed on store shelves. If funds are limited, they can start with a few stores or niche retailers. Even as the supermarket industry continues to consolidate, the types of retailers selling groceries are expanding, including specialty and ethnic stores, gourmet stores, takeout establishments, gas stations and online shopping services.

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9. Are slotting allowances legal?

Ever since the practice began, state and federal agencies, including the FTC, have conducted numerous investigations, and none have resulted in a conclusion that slotting allowances are inherently unlawful.

The FTC has conducted a series of investigations of slotting practices searching for anticompetitive behavior that is harmful to consumers. In a 1996 staff report, it concluded, “[A]lthough the FTC heard general complaints about slotting allowances, no small manufacturer to date has provided evidence that suggests the possibility of harm to consumers . . . (Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace, May 1996, p. 6). According to Oct. 20, 1999, testimony by Willard K. Tom, deputy director of the FTC’s Bureau of Competition, before the House Judiciary Committee, the legality of slotting practices “can be determined only in light of all the surrounding facts and circumstances.” Even in cases where a small supplier cannot afford a high slotting fee, the practice can be deemed legal, he said, as long as the market remains competitive and consumers “receive the benefits of low prices and wide product selection”

After a two-day workshop with about 40 manufacturers, retailers, antitrust lawyers and economists, FTC Chairman Robert Pitofsky said that in some situations such practices “make great business sense and contribute to consumer welfare” but in others could present “competitive problems” (Report on the Federal Trade Commission Workshop on Slotting Allowances and Other Marketing Practices in the Grocery Industry, February 2001).” The FTC staff concluded that it would be premature at this time to issue guidelines on slotting allowances. The FTC reaffirmed that position on June 19, 2002, rejecting a petition to have the agency develop guidelines. The staff is conducting a study to learn more about slotting allowances and related practices

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10. Is the use of slotting allowances increasing?

The 2000 paper “Slotting Allowances and Fees: Schools of Thought and the Views of Practicing Managers” reported that it was the perception of the managers interviewed that the use of slotting allowances was increasing. At the same time, some of the nation’s largest and fastest-growing supermarket chains, along with some regional food retailers and alternative-format retailers, do not charge such allowances. Many major manufacturers have a firm policy of not paying allowances because of the extensive market research they perform and the advertising they provide to support new products.

Also some produce suppliers have complained about an increase in slotting allowances for fruits and vegetables. In the produce industry, however, the practice is limited to ready-to-eat packaged items such as fresh-cut vegetables and bagged salad, according to a 2001 report by the Economic Research Service of the U.S. Department of Agriculture (*U.S. Fresh Fruit and Vegetable Marketing: Emerging Trade Practices, Trends and Issues*). The report found that such allowances are not charged for the commodities that account for the vast majority of produce sales. It also noted that produce shippers, not retailers, initiated the practice of paying slotting allowances for such packaged items.

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