When it comes to food and beverage procurement strategy, it is highly recommended that a restaurant, hotel or food service operation consider establishing a distributor prime agreement to manage their food service distribution costs. The typical distributor prime agreement will require eighty percent of purchases to be made from the prime vendor, along with other contractual considerations that seek to address supplier costs. By working with a food service distributor to address these costs, mutual benefit can be achieved that will result in lower costs for the food service operator. Once executed, distributor prime agreements enable food service operators to focus their efforts on running the business, rather than constantly bidding out products and tracking price fluctuations. Further, a distributor prime agreement will typically improve overall operational and product consistency. There are a number of critical considerations, however, that should be addressed during the negotiation of any food service distributor prime agreement.

Pricing Structure

Obviously, one of the most important considerations in negotiating a food service distributor program is establishing an advantageous pricing structure. There are two common distributor prime agreement pricing strategies: "cost plus fixed price" and "cost plus percentage."

Under the fixed price model, the distributor adds a fixed amount to each product purchased. For example, if an operator negotiated a $2.30 per case mark up, then each case would be marked up by this amount over the distributor's cost. In other words, if an operator bought a case of canned tomatoes that cost the distributor $20.00, then the invoiced price to the operator would be $22.30. This is a very common pricing structure for national food service chain distributor master agreements, but is much more rare in street level food service programs. Sometimes, a distributor prime agreement will incorporate both pricing models; fixed price for price-stable products and percentage mark up for those products with volatile pricing. Whenever possible, Food Buyers Network recommends that operators try and negotiate a cost plus fixed price agreement. Having a fixed cost agreement has the benefit of not resulting in increased distribution costs when product prices trend upwards. Further, a cost plus percentage prime agreement creates an incentive for the distributor to sell more expensive products to a food service operator than what is necessary.

When negotiating a fixed price contract, it is important to determine the average price per case so that the effects of the proposed agreement can be better understood. Calculating the average price per case can be easily achieved by dividing the total amount spent on food for a previous quarter

and dividing it by the number of cases received during that time period. For example, if a restaurant spent $500,000 in food during the prior quarter, and the number of cases purchased during this period were 20,000, then the average price per case would be $25. Calculating the average price per case will provide a better understanding of any proposed fixed price mark up. If in the above example a distributor proposed a $2.50 fixed price mark up, then this would translate into an average 10% mark up. Unfortunately, it is not always as cut and dry when determining these figures. If a prime agreement establishes varied mark ups by product category, then the previous analysis would need to be calculated by category, rather than total spend. Once the average mark up percentage is established for each category, it is relatively easy to calculate the overall percentage mark up by looking at the category blend.

Mark Up versus Margin

While a percentage mark-up is the difference between the product cost and the invoice price, the margin is the percentage difference between the invoice price and the *profit.* This may seem very confusing, but the example below will illustrate this critical difference.

Exhibit 1.

Mark-Up Contract

Markup Percentage = Gross Profit Margin/Unit Cost

Cost	Mark up	Invoice Price
$40.00	15%	$46.00 ($6.00 gross profit margin)

Margin Contract

Gross Margin Percentage = Gross Profit Margin/Sales Price

Cost	Margin	Invoice Price
$40.00	15%	$47.06 ($7.06 gross profit margin)

As Exhibit 1 indicates, a 15% mark-up contract will be $1.06 cheaper per case for a $40.00 product than a 15% margin contract. When negotiating and reviewing distributor prime agreement contract bids, it is critical to understand whether a contract is based on a mark-up or margin. For

example, a distributor 15% margin contract may seem better than a 16% mark-up because of the lower percentage, but, in fact, the 16% mark-up contract is the better option. **Not understanding this distinction can result in a 2-3% loss in profitability.**

Defining Cost

Once the pricing structure is determined, the next big hurdle is defining cost. In almost all cases, a distributor prime agreement will define cost as the distributor's cost before deducting any off-invoice discounts they receive. These off-invoice discounts are allowances that distributors receive from the manufacturer for the specific products purchased by the food service customer. These allowances, or rebates, are "off-invoice" so that all cost plus contracts are not based on the distributor net cost after the allowances are deducted, but rather on the larger invoiced cost of the products. To help further ensure that operators do not claim stake to these allowances, Sysco has renamed these allowances "earned income" to dissuade operators from attempting to tap into this revenue stream.

In some cases, operators will be able to negotiate a prime agreement that defines cost as the net product cost after these allowances have been deducted, but this is very rare for restaurant street level agreements. Because of the impact that these back end allowances can have on distributor profitability, prime agreements will also typically state that operators are not eligible to take advantage of supplier rebate programs. This is because the rebate allowance earned under these supplier programs will typically reduce the supplier allowance received by the distributor. Operators can typically get such a clause removed from a prime agreement during the negotiation process, however.

Market Basket

Determining only the prime agreement pricing structure is not sufficient when evaluating the overall strength of a particular distributor prime agreement contract. Two competing prime agreements that have the same mark up and the same cost definition will not result in the same product pricing. Each distributor is able to negotiate different manufacturer pricing based on their overall product purchasing volume. Because of this, certain distributors may be strong in some categories and week in others, based on the specific purchasing profiles of their food service customers. Therefore, it is important to ensure that a potential supplier is positioned best in the market for the specific product needs of a restaurant or food service operation.

The best way to determine this is by requiring a market basket report during the negotiation process. A market basket report will look at your top twenty to thirty products and provide the theoretical pricing under the proposed contract for a historical time period (usually the last complete month). It is important to ensure that each distributor submitting contract bids completes the market basket for the same historical time period so that accurate pricing comparisons can be done. Using these reports, operators can compare the value of competing contracts, as well as compare the contracts to past pricing.

Drop Size Thresholds

Negotiating a valuable prime agreement is only possible when a food service operator considers the food service distributor costs, as well. By lowering supplier costs, operators are able to achieve additional value. One of the most effective ways that an operator can reduce distributor costs is by managing the delivery drop size. This often means that an operator will agree to order less frequently to increase the amount of each delivery. In other words, a restaurant that was ordering three days a week prior to the prime agreement may agree to limit deliveries to only two days a week. Further, it is common for a prime agreement to create drop size bracket incentives which lower the mark up of products based on the drop size of each delivery.

Supplier Deviated Prices

It is absolutely critical that any prime agreement provide a restaurant or food service operation with the right to negotiate pricing directly with manufacturers, and that any negotiated manufacturer pricing will be respected by the distributor and invoiced as deviated prices. By negotiating pricing directly with suppliers, operators are able to get product pricing on key products that is often better than the distributor cost (before backing out the off-invoice allowances). Because these deviated prices often reduce or eliminate the off-invoice allowances that a distributor receives from the manufacturer, a standard prime agreement will not allow this practice unless an operator negotiates for it.

Audit Privileges & Data Rights

It is important that any distributor prime agreement include audit privileges by the restaurant or food service operator. In a standard audit privilege clause, an operator will be able to provide notice to the distributor that they wish to audit the cost of specific products to ensure that the restaurant is

being billed properly. Often, the distributor will provide a limit to the number of products that can be audited.

As technology advances in the food service industry continue to be made, it is important to include a data rights clause that will require a distributor to provide your purchasing data to any third party that you engage to audit your invoices. Specifically, several companies, including Food Buyers Network, provide invaluable services to operators by automatically auditing each invoice line item to ensure proper billing. To enable this process, distributors must provide the purchasing data via an EDI feed to the third party contract monitoring company. Even if you are not sure whether you will utilize such services, it is important to include this clause in the contract so that you have the flexibility to use such services in the future.

Term/Out Clause

It is our recommendation that every prime agreement have a thirty or sixty day out clause that enables the termination of the agreement for any reason. That being said, you may be able to get a better contract with out such a clause. If you are willing to lock in for a period of time without the option of switching distributors, our advice would be to negotiate the best agreement you can with the out clause in place, and then ask for a better deal at the end if you agree to strike the clause.

Payment Terms

Understanding the cost of extending credit to a restaurant needs to be taken into consideration by the food service operator. Agreeing to shorter payment terms will typically result in the ability to achieve a reduced mark up on your products. Further, it is recommended that an operator negotiate an incentive for payments made quicker than the contracted payment terms call for. For example, a contract that requires the payment of invoices within thirty days should have an incentive clause that reduces the mark up should the business pay specific invoices within fourteen days. Having this incentive enables a business the flexibility to pay faster when cash flow allows and reduce the cost.

Special Orders & Slotting

The prime agreement should require the distributor to stock particular products required by a restaurant that are not normally stocked in the distributor warehouse. Typically, there will be minimum usage requirements that an operator will need to abide by for such products. Twenty cases per month is a typical threshold.

Substitutions

It is recommended that the distributor prime agreement address the substitution policy for products that are out of stock. Typically, operators will require notification prior to delivery of substituted products when the cost of the product exceeds a set threshold, such as two percent. Further, it is not uncommon to set an acceptable threshold for how often products can be substituted.