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Slotting allowances: short-term gains and long-term negative effects on retailers and consumers

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Abstract

Purpose – The food industry is the largest industry in the world, and when considering all of the other non-food products (e.g. cleaning products, paper, etc.) that are sold through the food channel, it becomes even larger. There is one practice in the food channel that has a questionable impact on the efficiency and effectiveness of marketing of food and related products. The practice is called "slotting". Slotting allowances are fees charged by food retailers to manufacturers for the right to have products in the store. While the practice is not new, it has reached a level that has everyone questioning its appropriateness. The purpose and approach of this research is to review the arguments in the literature both for and against the practice and then to estimate the most likely amounts currently spent on slotting.

Design/methodology/approach – Estimates based on a variety of reputable sources such as AC Nielsen and government estimates were used to model current levels. Ranges as well as estimates under various assumptions are made.

Findings – Slotting seems to have led to smaller regional companies being unable to gain market access because they cannot pay the high slotting charges. Meanwhile, medium and smaller-sized global companies are having difficulty penetrating markets in which the practice of charging slotting is commonplace. Consumers are also suffering as the high slotting fees are causing manufacturers to "add on" to the prices to cover this "retail tax".

Research limitations/implications – The primary limitation to this and all previous research in the area is that no hard estimates are available as companies do not report these figures.

Originality/value – The paper assesses the short-term gains and long-term negative effects on retailers and consumers in the USA.

Keywords Retailers, Consumers, Marketing, Food products, Food industry, United States of America

Paper type Research paper

Once common primarily in the US, slotting fees, fees charged by food retailers to manufacturers for the right to have products in the store, now have the potential to be a worldwide marketing practice. While Europe, especially in countries in which chains exert the same power as in the USA (e.g. the UK, Germany, France, Holland), has various fees such as listing fees similar to slotting allowances and fees, they are not quite as developed and extensive. In countries where grocery chains are less dominant and there are more independents and regional chains, the practice of charging manufacturers fees for real or imagined services is far less common.

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The history of making various payments to retailers begins immediately before the Korean Conflict. In the US, rumors were spreading that there might be another price control situation. In anticipation, many manufacturers raised prices so that a price freeze would not leave them with a low price and little chance for increased margin during the freeze period. This was an expected result because during the prior freeze (World War II) many companies' profits fell as costs rose, but prices stayed the same. To compensate for the higher prices, manufacturers offered "rebates" or "allowances" to the retailer as payments that would bring the "real" price into alignment with the current market. Price controls never materialized, but the process of setting prices higher than market equilibrium, and adjusting via payments and rebates has continued.

A Nielsen study, reporting the total breakdown of all trade expenditures, indicated that the food industry paid out 15 per cent of sales in trade allowances (AC Nielsen, 1997). The payments were broken down as shown in Table I [1]:

In many of these cases, the implication is that the payment is related to costs associated with the retailers doing some task, but in reality, the costs are not related. For example, the advertising payment is not often related to the cost of an ad, but rather sales levels, or negotiated fees. Even in the case of damages and returns, the fees paid are often unrelated to the actual amounts or costs of returns but are usually negotiated.

Another source of funds is often called deductions. These are charged to suppliers who fail to meet some performance criteria such as making 100 per cent correct deliveries, making deliveries on appointed times, failing to send invoices in the correct form, etc. In many cases, the deductions can be equal to the other fees.

The most controversial of the above fees is the slotting allowance and/or fees. Slotting allowances are:

> . . . one time payments a supplier makes to a retailer for the initial placement of the supplier's product on the retailer's store shelves or for initial access to the retailer's warehouse (FTC, 2003).

Fees paid either as a lump sum or payments over an interval of time to maintain shelf position are often referred to as slotting fees or pay-to-stay fees (FTC, 2001). Most authors, including those in this Federal Trade Commission (FTC) report, do not distinguish between the two. Payments are also intended to secure preferential shelf space within particular stores (Boone and Kurtz, 2001; Broghesani *et al.*, 1997; Solomon and Stuart, 2003). It is difficult to estimate the actual amounts spent on slotting as it is considered confidential and competitive value. However, qualitative studies conducted

Table I.

	Per cent
Off-invoice allowances	38
Market development funds	18
Accrual programs	17
Bill-back ad allowances	13
Pay for performance	8
Slotting allowances	6
Bill-back display allowances	6
Coupon handling fees	3
Frequent shopper programs	3

by the FTC give some of the most reliable estimates. FTC estimated that for those products with slotting allowance (and not pay-to-stay fees), the average per item per geographic area (e.g. Delaware Valley, Metro NYC, Southern Florida) ranged from $2,313 to $21,768. This would translate into about $1.5-$2 million to get a new product in 100 per cent ACV[2]. However, it has been estimated that as high as 14 per cent of manufacturers pay over $3 million in slotting for a new product introduction and only 6 per cent pay no slotting (AC Nielsen, 1997). The average slotting allowance charge in 1996 had 71 per cent of manufacturers paying less than $10,000 per item per outlet, and 8 per cent paying between $50,000 and $100,000.

Estimating the actual current amount spent on slotting and other promotional expenditures is difficult because both retailers and manufacturers are reluctant to report the expenditures in part because of the ambiguous legal status of the payments. The industry has estimates, however, as the actual exact slotting fee paid by each company for shelf location and promotion has long been undisclosed (Forster, 2002). The FTC Report (FTC, 2001) agrees that estimates are sparse in that they noted that, "the few studies that have been undertaken reflect opinion rather than empirical research". Rennhoff (2002) has reported a number of studies that have estimated slotting ranging from $9 billion in 1990 to $16 billion in 2001. Sudir and Rao (2004) show estimates of $3,000-$40,000 per item for regional chains and from $1.4 to $2 million for new product introductions.

Current levels of slotting spending are difficult to estimate given that manufacturers and retailers differ on whether past spending has increased or decreased over the years. For example, AC Nielsen (2003) reported 58 per cent of manufacturers claimed that they have increased their slotting expenditures while only 8 per cent of retailers reported increased slotting dollars they received. However, given that slotting is usually reported as part of overall trade promotion spending, and given that percentage of gross dollars sales spent on trade promotion spending has varied very little from 1991 to 2002 as reported in Nielsen (2003), one might conclude that total slotting expenditures have increased by the amount that the total industry sales have increased.

Current estimates based on current industry estimates of gross sales to supermarkets (*Progressive Grocer*, 2004) and the AC Nielsen (1997) trade promotion to sales estimates can be made (Table II). Using this model, some of the current slotting estimates would be significantly less than previously estimated levels while others would be consistent with estimates of other authors[3].

On a per store basis, the slotting fees vary significantly by region of the USA (Lewis, 1996) (see Table III).

The practice of receiving slotting allowances is not uniform across retailers or across categories. In the research conducted by the FTC (2003), in some categories, "slotting allowances were charged on virtually every new product in a particular category. In other instances, no slotting allowances were paid" (FTC, 2003). One supplier was quoted saying:

> ... there is neither rhyme nor reason... (slotting fees are) pulled right out of thin air. Ten years ago, it used to be $300, or $500, or $1,000 per chain. But now, it has escalated dramatically. The problem is, the big guys are paying it, and being creative in hiding it. But slotting has really taken the art of selling out of the retail business. All you have to do now is show up with a briefcase stuffed with money (Merli, 2000).

Retailer type	2003 slotting estimate ($)
Supermarket only 14 per cent trade spending; 6 per cent slotting	3,780,000,000
Supermarkets and convenience 14 per cent trade spending; 6 per cent slotting	4,720,800,000
Supermarket only 14 per cent trade spending; 8 per cent slotting[a]	5,040,000,000
Supermarkets and convenience 14 per cent trade spending; 8 per cent slotting	6,294,400,000
Supermarket only 14 per cent trade spending; 20 per cent slotting[b]	12,600,000,000
Supermarkets and convenience 14 per cent trade spending; 20 per cent slotting	15,736,000,000

Notes: [a]The 8 per cent estimate for slotting is based on Nielsen estimates that a significant number of manufacturers reported paying higher slotting fees in 2003; [b]The 20 per cent estimate for slotting is based on the fact that the term often refers to a wider group of fees which is likely to include the bill-back display allowances (6 per cent) and pay-for-performance type fees (8 per cent)

Table II.
2003 estimated levels of slotting

	$
Northeast	69
Southeast	71
Central	36
Southwest	22
West	25

Table III.

Regardless of the actual amount of money spent on slotting allowances, it should be clear that it is significant and enough, at even the low estimates, to create a controversy.

The controversy

The controversy stems from potential anti-competitive aspects of the payments. The issues have only recently been addressed in the courts because historically, no individual manufacturer wanted to be associated with a suit against their customers. They fear that they will lose any relationship they may have with the retailer if they pursue actions to stop the payments. Furthermore, there has not been the "retail power center" that has controlled so much of the industry. In the past, outrageous requests by retailers could be balanced against manufacturers' branded power. Equally important is that there are minimal amounts of data available to truly assess the impact of fees and allowances on competition and prices because no one wants to produce the evidence and take their customers to task. The FTC reported in June 1996 that:

> ... although the FTC heard general complaints about slotting allowances, no small manufacturer to date has provided evidence that suggests the possibility of harm to consumers, although this agency remains open to receiving such evidence (Skitol, 1997).

Additionally, a more recent FTC study provides quantitative data, but only on a very limited number of stores and categories (FTC, 2003).

Another aspect of the controversy is whether there are potential contractual relationships providing category exclusivity. If, in fact, a firm enjoys an exclusive category distribution in a chain in return for slotting fees, it could represent "exclusive dealing". It was reported that the FTC has found direct evidence in some of their investigations (Harps and Thayer, 1997).

Advantages and disadvantages to the industry

The concept of the slotting allowance came from the retailers and/or wholesalers incurring additional costs of providing warehouse space, additional paperwork, added training, and other indirect costs. Some estimates range as high as $4 million annually to evaluate and prepare new items for possible introductions. The manufacturer would suggest that these costs are normal costs of doing business. The retailer would argue that under conditions of a reasonable introduction of new products, it would be normal expected costs, but manufacturers have established an environment of consistently introducing new products. Some estimates of new items are as high as 40,000 per year. Even this would not be a problem if most of the new products were successful, or if they replaced existing products in the product line. Neither of these conditions is true. Most new products fail. They fail because they are generally line extensions that offer nothing new to the consumer, but instead represent a way to either get more shelf space, or offer potential new trial sales (getting little repeat purchase). Estimates of new product failure rates vary from 70 to 85 per cent depending on how you define a "failure". Some estimates are as high as 90 per cent (FTC, 2001).

Supermarket Business reported that 47 per cent of retailers agreed (strongly and somewhat) that slotting allowances are a way to penalize manufacturers for inadequate market testing (of new products), and 79 per cent agreed that manufacturers are flooding the market with too many new products (Partch and De Santa, 1997). The FTC has reported that slotting may "help reduce the retailer's risk by compensating for real, out-of-pocket costs involved in new product introductions" (FTC, 2001). If there was a competitive balance among retailers (i.e. a large number of equal retailers), then the issue of slotting might be moot. The retailers demanding slotting could be ignored by the manufacturers who did not want to pay the fee. However, concentration by large retailers, or "power buyers", has created a situation in which the dominant retailer makes it impossible to ignore the "request" for slotting[4]. In the US, the top five grocery retail chains account for roughly 40 per cent of the industry sales (FMI, 2003).

Furthermore, slotting is purely negotiated by many retailers and different amounts are charged to different manufacturers. Retailers indicated that 70 per cent did not charge everybody the same slotting fee (Partch and De Santa, 1997). This may appear to be discriminatory and, in effect, permits manufacturers to give different net prices to retailers based on the slotting fee. Some argue anonymously that large suppliers can use slotting as a way to keep small companies out of the stores. While slotting is expensive for the giants, it is still cheaper than fighting competition on the shelf. One executive of a small company said:

> Slotting allowances have just about killed our national consumer frozen food business. It is a very depressing thing, since the consumer frozen food business has been a genuine source of challenge, effort, and reward over the years. It is very sad to tell this to our younger people in the business. The frozen food business is a business we loved. There is no incentive now to create new products, new concepts, improvement, programs, anything. Slotting allowances

> are an absolutely vicious business. They're just a killer. They've killed innovation. They've robbed manufacturers of any incentive. Slotting allowances are anti-small business. They're anti-medium business. And, for the record, they're a restraint of trade (Merli, 2000).

On the other hand, this variation in the fee charged permits the retailer to reflect issues such as the past success rate of new products from each manufacturer, the amount of work done in the store such as DSD[5], and whether the product has a regional or local franchise. Others have argued that there are three ways that slotting may actually be pro-competitive: signaling, screening, and increasing incentives.

Signaling assumes that manufacturers have better information than retailers about the success of a new product. When a manufacturer believes that its new product is highly apt to succeed, it will be more willing to pay a significant slotting fee believing that it can recover the costs through future sales. Under the signaling theory, it is assumed that slotting allowances actually make the channel more efficient by helping to ensure that the greater the likelihood that a new product will succeed, the greater the likelihood that it will be stocked by the retailer (Chu, 1992).

Screening theories focus on the selection process of new products. By having slotting fees, it is assumed that suppliers will agree to the fees on only those products that they believe have a high likelihood of success. By explicitly allowing the manufacturer to compete for shelf space with dollars or, in effect, an auction for limited shelf space, the retailer is using the fees for efficient allocation (Sullivan, 1997).

The "increasing incentive," the most complex of the pro-competitive theories, suggests that the higher costs for the manufacturer encourage the manufacturer to enhance the brand (the value of the brand to the consumers as much as the value is in terms of brand image) and therefore, increases consumer welfare (FTC, 2003). In some cases, slotting may be a more serious violation of the law in that 83 per cent of retailers agreed with the statement that "slotting fees represent an 'under-the-table' form of payment to the distributor", and 14 per cent have indicated that they have been paid in cash for the slotting fee (Broghesani *et al.*, 1997). In fact, the retail buyers are often evaluated on the basis of not only gross margin (the difference between for what they purchase a product and for what they sell a product), but also how much additional money they can get for fees and allowances. This practice has created a situation in the retail food industry that bodes poorly for the future. By placing so much emphasis on the value of "buying right", a euphemism for getting fees and allowances, it has created an industry that makes money from buying, not selling.

Before a supermarket opens its doors in the morning, it has made its likely profit for the day. One may argue that this is good for consumers, as they are the recipients of lower prices. However, this is not the case. While not true of all supermarkets as may be argued by supermarket executives, many supermarkets put little value on serving the customer. Look at the checkout lines that still exist in many stores. In addition, there are other instances such as failure to move quickly into the prepared food markets, failure to provide clean and easily accessible restrooms, failure to provide basic services for specific target groups such as special parking for expectant mothers or mothers with small children, or benches in stores for older shoppers.

The impact that the slotting fee practice has on the manufacturer varies depending on the size of the manufacturer. The largest manufacturers, while quick to complain about the various fees they pay, actually use these as barriers to entry. Large food processors can maintain and protect their shelf space position by paying the fees that

other smaller competitors cannot afford to pay. The FTC fears that the slotting fees could decrease competition because the smaller manufacture cannot often afford a "slot" on the shelf (Teionwitz, 2001).

This is more of a concern for categories that have a significant amount of competition from small regional companies. *The Wall Street Journal* reported that the Justice Department investigated Frito-Lay's practices of "purchasing shelf space in grocery stores and securing exclusive promotions to improperly lock out competitors" (Skitol, 1997). The article noted that Frito-Lay commands more than half of the nation's entire salty snack market. In another case, the Federal District Court held that "discriminatory" payments of slotting fees may violate Sections 2(a) and 2(d) of the Robinson-Patman Act. The fees are imposed by retailers and, while they may be viewed as an advantage because the larger firms can pay, should they (the manufacturers) choose not to pay, they would be de-listed the next day. No manufacturer would encourage the use of slotting for a competitive advantage as there are many more efficient and effective ways to compete than making payments to retailers.

Slotting fees, as a method to reduce the competitive impact of competition, are a very effective marketing method. In theory, an effective barrier to entry would require superior, innovative products or economies of scale to reduce price, etc. In this case, competitors can be kept out, without any changes in the product or the process, by a mere payment to the retailer. Frito-Lay is only an example, and the government might not find a problem with their marketing practices. The small or regional manufacturers suffer the most from the practice of charging slotting fees. An example of this might be Farrara, an Italian cafe and bakery in New York's Little Italy. The company dismissed the idea of Farrara entering into the frozen dessert market. They said it was not worth the effort to get involved in paying slotting allowances while still having no guarantee that the retailer would go out of its way to support the product (Anon, 1997).

The final issue revolves around how this practice affects consumers. The major question is "how do slotting allowances affect price?" It should be clear that, in order to finance the payments to the retail trade, the whole and retail price must be increased. In fact, based on anecdotal evidence, it has been reported that the price of a product may be 10-30 per cent higher than it might have been if no additional payments were made to the retailer. A manufacturer must include the costs of allowances and fees in the calculation of a retail price. Suppliers have about a 40 per cent increase in the price to the retailer just to cover the retailer fees (but not exclusively slotting allowances). Some evidence to that effect can be seen in Wal-Mart's prices. While not rigorous proof of the impact of retailer-based fees on retailer prices to the consumer, Wal-Mart accepts absolutely no fees or promotional payments and, in general, its prices are lower than comparable supermarket prices. This net-net pricing (the practice of not accepting fees, etc.), as well as other distribution economies, is what permits Wal-Mart to maintain such a low-cost structure, and therefore, offer a low price. This is not to imply that Wal-Mart does not have methods to increase revenues from suppliers while not using a slotting approach. The supplier side frequently complains privately that Wal-Mart is a slow payer, and a major user of deductions.

There are also other added costs, often indirect, of these systems. The most obvious is the added staff needed to keep track and account for these payments. A typical sales

office will have a number of full-time people whose sole job is to make certain that payments are made in a timely and accurate fashion. In many cases, conditions are placed on the fee or allowance (e.g. the product must have so many facings in the store for each SKU). While this might not be an incremental cost, as it can be done by salespeople, it removes them from their selling function.

Slotting fees also divert money away from communicating with the consumer as to the benefits of a new product, or from other equity-building advertising for existing products. A marketing plan that must build in money for slotting is not using money for other marketing activities. A study by Cannondale Associates indicated that food manufacturers were spending 44 per cent of their total marketing budget on trade promotions, and only 23 per cent in traditional advertising. Now, this figure may not be ominous, except that in the same survey, manufacturers indicated that they felt only 46 per cent of promotional dollars paid out or generated incremental sales (Pollack, 1997b).

Another study by Cox Direct found that 47.7 per cent of the dollars were spent on trade promotion (Tenser, 1997). AC Nielsen's (1997) survey of trade spending estimated trade spending to be 54 per cent of the promotional dollars. Notwithstanding the variation in the percentages, it is clear that a significant portion of the marketing budget is going to trade spending. One CEO, Anthony O'Reilly of Heinz, called slotting allowances, "debilitating" (Pollack, 1997a).

One final disadvantage is that, unless the industry comes to grips with all of these aforementioned issues, the government will step in and regulate this aspect of the industry. We believe that any system the industry devises, that is reasonably fair and equitable considering all of the interested parties' needs, will be better than government regulation.

Future issues

The issue for the continuation of slotting allowances and other retailer-charged fees in the US is likely to be settled in the courts only. However, it will be almost impossible for retailers to voluntarily end the practice regardless of the disadvantages of it. A retailer told one of the authors that the annual budgets now have the fees firmly embedded. The retailer said that, in some cases, 75 per cent of the corporate profit could be attributed to the manufacturer fees paid to his firm. There is almost no other source of income that could be relied on to replace the slotting. On the other hand, Wal-Mart pricing models never built-in these fees to the budget so it is not an issue.

The critical issue is whether the rest of world will develop the practice of slotting fees and allowances to the extent that it exists in the US and Western Europe[6]. There will typically be trade promotion money available everywhere in the world. Retailers, unfortunately, have relied on this source of money to build up their bottom line rather than stimulate demand. Buyers in the US and Western Europe have been instructed to "get as much as they can" from the manufacturer. In general, this system is not good for anyone: retailers, manufacturers, or consumers. Retailers are relying on handouts for profits, manufacturers are not getting resources to affect consumers, and consumers are paying too much for products. There is no doubt that as the food retailers in other countries become more concentrated and larger, they will be enticed by the large payments that can be demanded from manufacturers.

The solution will not be from government action. The manufacturers will not take a chance on being involved in a lawsuit against their customers, and without their help, it will be very hard to prove price discrimination or unfair trade practices. The most likely outcome is that manufacturers will just refuse to pay more as there is a limit to what they are willing to pay. At some point, the requests for "welfare" will be so great that even the large manufacturers will not be able to pay.

The move away from slotting and the lack of proliferation in the countries not currently using these programs will be exacerbated by two important facts. First, there are so many alternative channels of distribution that do not rely on slotting. Wal-Mart and other mass merchandisers are not as involved, but many new formats, like dollar stores, speed markets, catalogue sales, QVC/HSN, etc. will remove some of the concentration now resident within the traditional supermarkets. For example, Kellogg launched a new product (15 oz frosted flakes) with its debut on QVC (Pollack, 1997c). In addition, Campbell Soup Company is testing a direct-to-consumer (via mail) frozen food product. This Campbell's tactic is a test of the possible effectiveness of getting the product to the consumer without the traditional method of using retailers. While these channels currently are small relative to the grocery channel, they are growing; and while almost non-existent in the less developed markets, the diffusion speed will be faster once the channel is developed.

Second, technology is making it possible to have promotions focused more on movement out of the stores as "pay for performance" programs over "buying" programs. The technology also makes it possible to have better information on the real costs of maintaining a slot. Wal-Mart is using the technology to better understand where the costs are in the distribution system, and consumers have voted with their money to make Wal-Mart the largest retailer in the world, and the largest food retailer in the world. Retailers in the *Supermarket Business* survey overwhelmingly agreed (55 per cent) that the supermarket industry can never be competitive with alternative formats as long as present trade practices continue (Partch and De Santa, 1997).

Retailers in countries that do not currently have the practice of slotting allowances may find it very attractive to have manufacturers simply give them money, but it is a false promise. It is similar to illegal drug use! A retailer will try the drug called "slotting" because it seems so good. But soon, the retailer's life becomes distorted by it. Retailers begin cutting costs that affect the quality of service because their real money is made by the buyers not in the stores. Retailers then lose the incentive to do the best job in stores and find their best people want to be buyers, and not line store personnel. After all, they understand where the power is in the chain. After some time of "drug/slotting use", the store will realize that it must kick the habit, but it is too late. The budgets have grown to "rely" on it to get through each week.

The most compelling reason not to start the practice of slotting allowances is that the retailers believe it has impacted negatively their ability to conduct efficient and effective business. In the *Supermarket Business* survey, 67 per cent of retailers indicated that "slotting fees limit the true effectiveness of (shelf) space management", 64 per cent of retailers agreed that "slotting fees limit the full implementation of category management," and 58 per cent of retailers agreed with the statement that "slotting fees hamper a retailer's ability to maximize the effectiveness of product assortment".

Notes

1. Other costs not mentioned here include damages and returns, co-op advertising, and de-listing.
2. ACV, or all category volume, is a weighted average of the number of stores in which a product is located. It is more valuable to be on the shelf of a store that sells 5 per cent of all the product than a store that sells 1 per cent of all the product. It implies all stores are not equal.
3. *Progressive Grocer* estimates total supermarket sales at approxiamtely $449 billion for 2004 and $112 billion for conveneince stores. Mass merchants and warehouse clubs do not traditionally accept slotting fees.
4. Retailers refer to the fact that they request slotting allowances as opposed to demanding them. Demanding might have anti-trust implciations. Retailers say that suppliers could, of course, decline to pay.
5. DSD, or direct store delivery, refers to the practice of the supplier delivering the product directly to the stores and not through the warehouse. Not only is the product delivered, but shelves are also stocked and maintained by the supplier. This delivery system usually has the lowest cost to the retailer to maintain the product in the stores.
6. While not documented in this paper, the use of "listing fees" and other retailer fees are common in most of Western Europe where chains are more concentrated.

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