PENTALLECT™ POV

GPOs Targeting Independent Operators: Impact, Critical Strategic Issues and Outlook

Pentallect's perspective on Group Purchasing Organizations and their expansion with independent operators: The fight for the foodservice "sweet spot."

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Introduction

The foodservice supply chain is a complex ecosystem of aligned and competing interests. Producers/sellers want access to users/buyers and vice versa, but between them reside distributors who mediate the exchange, and, in many cases, keep the B2B market opaque, especially for independent operators that are not part of a group. There are at least 15,000 foodservice distributors, but the market is concentrated among a handful of industry-leading companies like Sysco, US Foods, Performance Food Group, Gordon Food Service, and Reinhart.

There are two ways for operators to gain enough purchasing power to reach suppliers directly and negotiate more favorable prices for the products they buy:

- **Large, homogeneous consortia or "systems" of buyers,** such as restaurant chains or the military, have uniform needs, collective buying power, processes, and purchasing expertise. They negotiate contracts with manufacturers and distributors alike and reap the benefits of low prices, excellent service and a competitive position to advance their interests.
- **Group purchasing organizations (GPOs)** reproduce this advantage of scale among heterogeneous buyers by replicating the uniformity that occurs naturally with "systems" buyers: members must adhere to brand and volume commitments if the GPO is to maintain its credibility and leverage with manufacturers. GPOs originated in foodservice segments such as hospitals, school districts, colleges and hotels, and their success has led to high penetration in most of these channels. Over time, some successful GPOs merged to achieve greater scale. A few "source" GPOs such as Foodbuy and Entegra, extended their contracts to channel partners. This has led to channel blurring as members of many types—increasingly including independent operators—seek to take advantage of group purchasing power.

Pentallect estimates that **approximately 35,000 independent operators (including "non-restaurants") are currently affiliated with GPOs.**

These numbers have grown over the past two years and **will continue to grow** as long as the balance of power in the foodservice supply chain disfavors independents.

- The convergence of GPOs and independents is still in the early stages**; 85-90% of independent operators have not yet been touched.**
- **Double-digit annual expansion rates in GPO affiliation will likely continue** until the balance of power is realigned.

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Independent Foodservice Operators: A $100 Billion Market with Little Clout

Together, systems buyers and group purchasing organizations account for more than 60% of total industry purchasing volume. However, in sheer customer numbers, these buyers are vastly outnumbered by non-aligned independent operators who collectively spend over $100 billion annually on their purchases. High-volume individual locations and small chains, known as local leverage operators ("LLO's"), are big enough to wield some purchasing clout, and mom-and-pop restaurants can take advantage of newer alternative supply sources—cash-and-carry stores, warehouse clubs, and internet buying.

Most **independent operators continue to depend primarily on distributors** who are able to charge what the market will bear. Because they have higher costs to serve and lack competitive leverage, these operators pay far more per SKU than chains or GPOs. While some of the extra price/margin reaches all the way upstream to manufacturers and processors, most of it benefits the distributors. Not surprisingly, distributors devote resources to differentiating themselves and competing for as much business as they can get from these independents. For broadline and local market specialty distributors, independent operators are a critical target customer base, greatly influencing distribution economics and profitability.

For manufacturers, too, independent operators represent an attractive population, although one that's challenging to reach. A large percentage of a manufacturer's sales, marketing and trade spend is devoted to reaching independent operators, especially LLOs.

For GPOs that have already penetrated noncommercial segments such as healthcare, education and business & industry**, independent operators offer huge potential for growth and revenue.**

This is true for both source GPOs (large national organizations that negotiate and manage deals) and access GPOs (segment or regional GPOs that tie into source GPO deals). National and regional GPOs have intensified their focus on independent operators, and local "I-GPOs" (typically in a single metropolitan area) may be devoted primarily or exclusively to independent restaurants.

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Independent Operators' Reported Experience with GPOs

Independent restaurant operators who belong to a GPO generally report a high degree of satisfaction with the organization due to perceived cost savings. They often have difficulty quantifying their savings, but believe these savings would not exist if not for the GPOs. And they appreciate the peace of mind they gain by having a third party monitor their pricing and purchases.

Independent operator "compliance" with sponsored products and brands recommended by GPOs remains relatively low compared with compliance in highly-penetrated noncommercial segments. Some operators are fully on board with their program, while others feel the incentives are not compelling enough to warrant any material change in their purchasing behavior. Oftentimes product assortment offered by distributors does not align with GPO-sanctioned SKUs. A few operators even report belonging to multiple GPOs to gain access to more items, compare prices or otherwise optimize deals.

Even after joining a GPO, **many independents are reluctant to change brands**. They also need to "get along" with their distributors whose private label strategies are largely incompatible with the mission of most GPOs, causing friction between trading partners.

Push vs. Pull

To gain favored market access, foodservice manufacturers provide distributors with financial "push" incentives to stock, catalog and promote their brands. Distributors negotiate vigorously for these incentives, which often generate more profit than margin on sale.

Operators attach themselves to GPOs to take advantage of discounts and rebates - "pull" strategies on the part of manufacturers designed to ensure loyalty.

A manufacturer that invests in a "pull" strategy with a key customer (a chain, GPO or LLO) may balk at paying "push" dollars to a distributor on the same purchases. The collision of "push" and "pull" strategies raises the question: **Who owns the customer?** Who has greater leverage and who deserves the incentive: the operator, distributor, or both?

When GPOs expand into a new segment, especially if the segment is not contemplated in the manufacturer's "pull" spending plan or is already supported with a "push" strategy, the question of leverage quickly arises.

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Given a choice, **manufacturers would prefer to pay the party in power.** They are sometimes willing to support both the distributor and the GPO/operator, just as they might contribute to both of two rival political campaigns. They want to hedge their bets but also want to prioritize the winner. If a group purchasing organization does not have the power of disciplined member purchasing, manufacturers may opt to financially reward the "distributor party."

What's a manufacturer to do when it is supporting a GPO with discounts or rebates and a GPO signs up an operator who is buying products from a distributor that is receiving "push" funding? Surely, **both the operator and a distributor have a case that they have earned compensation** if they have lived up to their commitments.

But what if the GPO's requirements are loosely defined and there's little expectation for purchase behaviors? Who should be expected to hold up his end of the deal—and **what is the deal, anyway?** It needs to be better understood by stakeholders up and down the supply chain, and steps must be taken to make it a "good deal."

The Supply-Chain Challenge: Changing GPO-Distributor Dynamics

There is no such thing as "one size fits all" when it comes to GPO-distributor relationships and strategies. Since the 1990s, large distributors have had distribution agreements with the large national source GPOs and foodservice management companies like Aramark. They therefore shared the most in GPO business expansion over the last 20+ years as the source and access GPOs have grown and penetrated their targeted, primarily non-commercial, market segments.

Other, primarily independent, foodservice distributors who elect to work with GPOs, have developed their own marketplace strategies which in most cases include working with independent local market GPOs (IGPO), Access GPOs and other entities such as cooperatives (ex: Pan Gregorian). Some distributors and distributor co-ops even created their own "alternative" GPO (ex: IMA), an idea that is experiencing a resurgence of interest as evidenced by UniPro's current efforts to launch such a program.

However, now that high non-commercial segment GPO penetration rates have been achieved, independent operators and K-12 are considered opportunity areas ripe for expansion by large source and access GPOs. With independent operators being such an important customer group for distributors, the targeting of independents and K-12 has led to conflicting business objectives between the trading partners. Reportedly, some Source GPOs have even asked their distributor partners to convert all/most street/independent operators to GPO membership, which to date has been politely declined.

Lest we forget one other critical element, distributor shipment data is the lifeblood of GPO billing and to date appears to have been "commoditized." Data management is expected to take on greater significance in the future as trading partners look to use data more strategically. This strategic conflict between GPOs and distributors will continue to play out as we go forward. Therefore, the critical but difficult, questions for manufacturers as they focus their resources will continue to be; "which trading partner provides the most marketplace leverage" and "how do we best manage resources to achieve strategic objectives?"

Anticipations & Expectations

Based on interviews with trading partners (manufacturers, distributors, GPOs and independent operators), Pentallect has identified trends, issues and conflicts likely to arise over the next few years:

- GPOs are expected to gain further penetration of independent operators, especially higher-volume full-service operators with complex menus and broad value-added SKU requirements.
- We expect operators' level of purchase compliance with GPO-sanctioned products will grow modestly. As the pursuit of product/brand penetration and compliance evolves, trading partner roles especially that of direct sales/brokers, may change to further support compliance.

GPO Penetration of Independent Operators

	2017	2022
Number of members	35,000	55,000
Manufacturer compliance	10 – 15%	15 – 20%

- GPOs themselves, many of which support large sales/service organizations of their own, are likely to expand their sales/marketing resources devoted to independent operators.
- GPOs will work even harder to satisfy their independent operator members by looking beyond savings on food and supply costs to add-on services, such as technology or training assistance.
- Distributors will continue to introduce counter-strategy "GPO-type" programs to protect their positions with independent operators.
- GPOs will continue to push cooperative distributors to sign up independents on their programs.

- GPOs will continue to push manufacturers for price "extendibility" to independents
- Manufacturers will pursue more "pull" spending and will intensify their operator sales focus using better data and analytics.
- Data and advanced analytics will continue to improve manufacturers' ability to focus efforts where greater return on trade investment can be achieved—with distributors, GPOs and/or operators.
- As alternative purchasing options evolve (Amazon, WebstaurantStore, Restaurant Depot, Cash & Carry) there will be increased focus on transparency in pricing (delivered cost of goods) as well as incentives and other benefits that independent operators receive.
- While GPO penetration of independent operators is expected to grow, distributors are expected to still be the primary influencer for the majority of independent operators.
- Operators receiving duplicate "pull" benefits through multiple channels ("double-dipping") will receive increased scrutiny and "pull-back" from manufacturers with the aid of improved software and tracking mechanisms.

Considerations & Recommendations

- Manufacturers should determine which trading partners offer mutually advantageous alignments—distributors, GPOs, chains or a delicately managed combination—and decide where and how to best allocate/invest their trade budgets. Deciding who most influences the operator purchasing process will be of paramount strategic importance. The answer may be different for each manufacturer.
- Manufacturers should prioritize development of their strategy for gaining greater market share with independent operators, including their most effective trade spending strategy and which trading partners bring the most incremental business.
- To enable positive outcomes for all trade participants, manufacturers should take advantage of software tools (such as those from Blacksmith Applications) that analyze massive amounts of difficult-to-manage transactional data. The manufacturer establishes a relationship with the operator, and the data associated with that relationship can inform the seller of competitors' offerings and/or incremental sales opportunities.

- Manufacturers should seek to further develop their sales strategies so they may drive reach, penetration and compliance to achieve growth and improve return on trade investment.
- Manufacturers hoping to grow profitable market share will need to take full advantage of the tools and resources at their disposal to make fact-based choices about their business approaches.

Want to learn more about this important strategic issue; the battle for independent operators: "the foodservice sweet spot"?

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