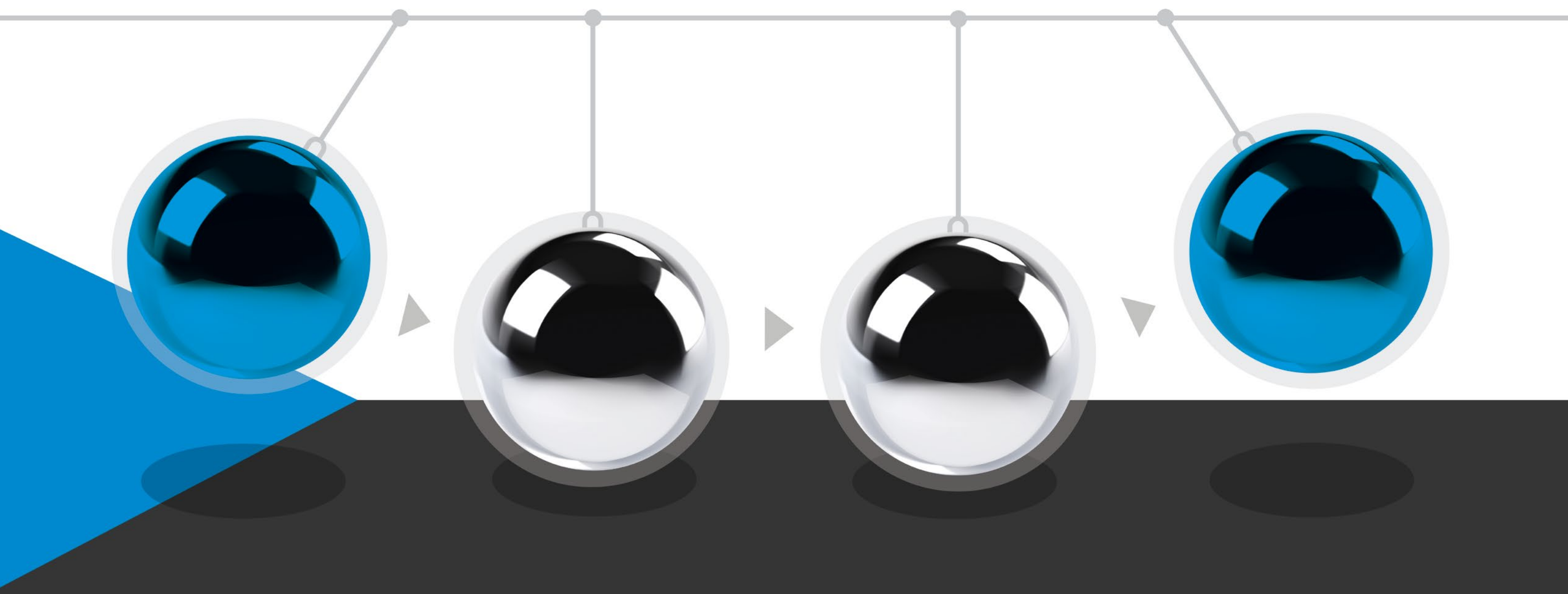
Foodservice Distribution Disruption:

Why Today's Strategies Will Not Work Tomorrow



IFMA KINETIC 12

Dear IFMA Member:

We are sharing extraordinary times and working through unprecedented challenges disrupting our businesses. As the association representing the food-away-from-home industry, IFMA works to help businesses thrive and grow by leveraging all the opportunities for success that come along, especially in times like these.

To succeed, you need up-to-date information and a guide to understanding just what emerging trends might mean for your bottom line.

This whitepaper is a direct result of our last round of strategic, long-range planning. We committed then to helping you, our members, see as far down the road as possible.

We know that gathering voices from across the ecosystem of foodservice is one way to achieve our goals. Here, those voices are from more than 30 key distributors, ranging from specialty distributors to large broadliners, as well as others that are disrupting the $271 billion foodservice supply chain. The information they shared with us can help you make sound decisions for your future.

BACKGROUND

The IFMA Board of Directors has directed us to focus efforts on improving the effectiveness and efficiency of Go-to-Market strategies in foodservice. The Board selected a chair and formed a committee of member companies to support those efforts. The Committee is comprised of:

- Nestlé Professional, Perry Miele (Chair)
- Hershey Foodservice, Al Adams
- PepsiCo, Heather French
- Tyson, Jerry Diekmann
- McCain, Joe Kunde
- Conagra, Scott Falvo
- Simplot, Darren Dudley
- C.H. Guenther & Son, Mauricio Santana

The Committee engaged Kinetic 12 Consulting (a leading foodservice consulting agency) to support our efforts, including the development of Go-to-Market strategies to propel foodservice manufacturers forward for years to come. The Go-to-Market Planning Program was born.

The first area of focus is Distribution Disruption. The evolution we're seeing in distribution presents both unique challenges and opportunities for foodservice manufacturers which should impact both close-in and long-term strategy.

NEXT STEPS

This whitepaper, Foodservice Distribution Disruption: Why Today's Strategies Will Not Work Tomorrow, lays out the factors causing disruption to the foodservice distribution marketplace and details the potential impact on distributors, manufacturers, and third-party players. It's step one.

Closely following this whitepaper, IFMA will publish a playbook that provides specific advice on the tactics foodservice manufacturers should consider as they confront the evolving marketplace. That's a critical step two. Understanding without action is just academics. We all know that business requires initiative.

We have plans for more research, on a variety of topics facing the food-away-from-home industry, and more toolkits for you to access. As IFMA members, know that we're listening to your concerns and developing multiple resources to address your challenges.

Thank you for your continuing membership!
Sincerely,

Herb Ring
IFMA Board Chair
The Hershey Company

Phil Kafarakis
President & CEO
IFMA

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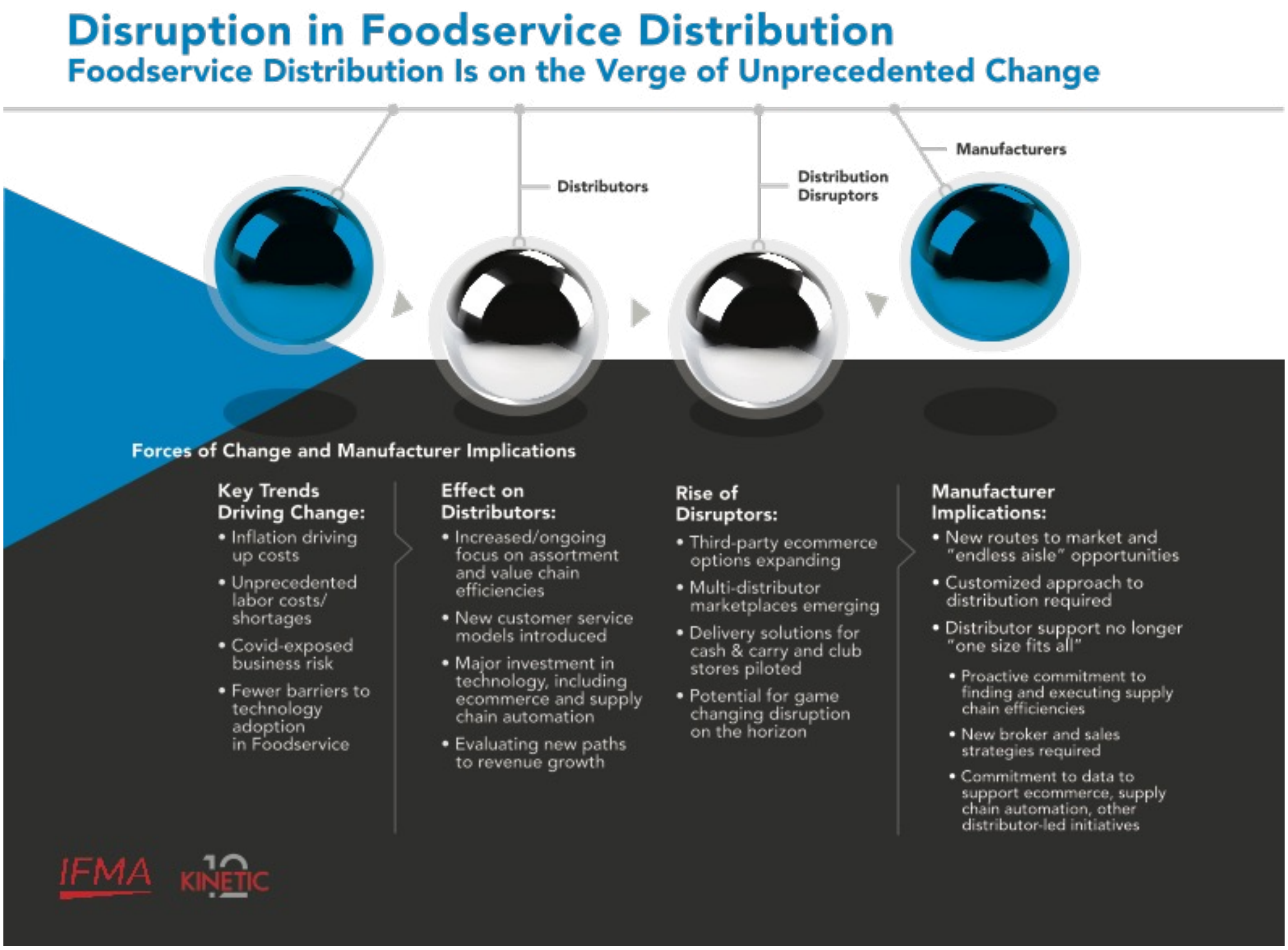
IFMA INTERNATIONAL FOODSERVICE MANUFACTURERS ASSOCIATION



EXECUTIVE SUMMARY

- Foodservice distribution is at the tipping point of disruptive change as traditional distributors are evolving their operating models and marketplace entrants grow.

- Four key trends—ongoing inflation, significant changes in the labor market, Covid-19-exposed business risk, and the rise in technology adoption in foodservice—are forcing established broadline distributors to evolve their business strategies and is giving rise to major disruption in the industry.

- This industry evolution presents both unique challenges and opportunities for foodservice manufacturers which should be considered when developing both close-in and long-term distribution strategy.

We conducted interviews with more than 30 key distributors across the US, ranging in size from small/specialty distributors to large broadliners, as well as other companies that are disrupting the foodservice supply chain. Additional research and industry expertise was provided by Kinetic12, a management consulting firm dedicated to the food away from home industry.

INTRODUCTION – THE NEW FOODSERVICE

While foodservice had been evolving prior to 2020, no one could have predicted the speed of change that we have seen since the start of the Covid-19 pandemic. Foodservice leaders are facing a vastly different environment as they look out over the next several years than they faced even three years ago.

One of the biggest areas of change has been in the food distribution space - the process of purchasing food products produced by the manufacturer and transporting them to the foodservice operator. The foodservice supply chain has often been defined by its complexity, number of intermediaries, and its lack of transparency.

This report serves as a fresh look at foodservice distribution and its evolution through the following four lenses:

1. **Key trends that are driving disruption in thefoodservice supply chain**
2. **The evolution of the traditional foodservice distribution model**
3. **Disruptors entering the foodservice landscape**
4. **The implications of distribution evolution and disruptors on foodservice manufacturers**

KEY TRENDS DRIVING DISTRIBUTION DISRUPTION IN FOODSERVICE

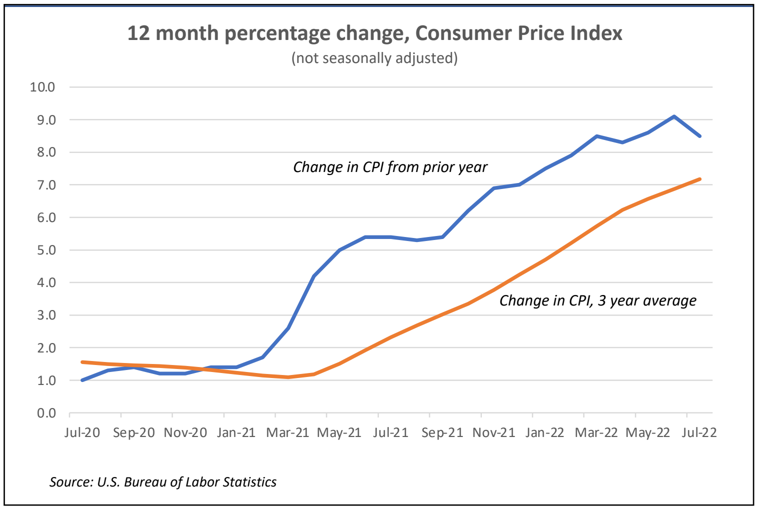
Many trends are currently impacting the foodservice industry: consumer demographics and food consumption habits are changing, channels between the retail food and foodservice sectors are blurring and sustainability is becoming a larger part of foodservice strategies. These are important trends that foodservice leaders will consider as they create their strategies for the next 3 – 5 years.

However, there are four key macro trends we believe are primarily responsible for driving the dramatic change we are seeing in foodservice distribution: ongoing inflation, significant changes in the labor market, Covid-19 exposed business risk, and the rise of technology adoption in foodservice.

Inflation Driving Up Costs

In June 2022, the Consumer Price Index (CPI) grew by its highest level since 1981 – 9.1% in the month - up from 8.6% in May - exceeding the 8.8% gain economists had expected during the month. This continued increase, driven by higher gasoline, shelter and food costs, suggests that inflation remains elevated but may not have peaked yet in the US and is creating enhanced margin anxiety throughout the industry*.

*Source: U.S. Bureau of Labor Statistics



The New Labor Reality

According to Pew Research, the Covid-19 pandemic set off nearly unprecedented employment churn in the US. Early in the pandemic, widespread job losses led to tight labor markets in 2021, driven in part by the Great Resignation of 2021.

In April of 2022, even with growing recession fears, a near record 4.4 million Americans quit their job.* This ongoing churn indicates shortages in the labor market are likely to persist for a long time: the jobs vacated by older, seasoned workers who retired early during the pandemic are not quickly being filled by younger workers; those that are available to fill jobs are shopping around, looking for better salaries, better benefits and more flexible hours and work locations. The labor shortage has hit all players in the foodservice value chain, with distributors, operators and manufacturers all feeling the impact of fewer skilled workers.

*Source: US Bureau of Labor Statistics

Foodservice Industry Risk is Real

The pandemic laid bare the fragility of the foodservice industry and how quickly business profitability could unravel: during the pandemic, more than 8 million restaurant employees were laid off or furloughed* and consumer spending in foodservice declined -25% from 2019-2020, with restaurants making up almost 70% of those declines**.

*Source: National Restaurant Association. **Source: Datassential

The Pandemic's Effect on the US Foodservice Industry

-$280B	How much the industry as a whole lost in total sales during the first 13 months of the pandemic
10%	The total number of restaurants in the US that remained temporarily or permanently closed at the end of 2021
-25%	Decline in consumer foodservice spend, 2020 vs. prior year
-1M	Fewer restaurant employees than before the pandemic

Sources: National Restaurant Association, Datassential

The bulk of these casualties fell on independent operators, the most lucrative customer segment for distributors. As a result, distributors lost billions of dollars in revenue during 2020 and into 2021. These unprecedented losses put at least one distributor, Maines Paper & Food, permanently out of business. This experience served as a wake-up call to many distributors who scrambled to de-risk their business models to stay vital during the pandemic and are determined not to experience this magnitude of business decline ever again.

Fewer Barriers to Technology Adoption in Foodservice

While the pandemic created its share of difficulties for the industry, it also proved to be the tipping point into ecommerce by holdouts in the industry. As independent operators pivoted to food delivery and fewer face-to-face sales calls were conducted by distributors, leveraging ecommerce was immediately normalized across the industry.

And ecommerce is here to stay. IFMA SCOPE notes that over half (55%) of all foodservice supply orders are placed online today; the number of operators ordering online is expected to rise to from 50% to 70% by 2025*.
*Source: FSR Magazine www.fsrmagazine.com/expert-takes/how-e-commerce-changing-supply-chain-ordering

THE EVOLVING BROADLINE DISTRIBUTOR

Broadline distributors had started to evolve well before the pandemic hit. The industry has seen consolidation, with previous top ten distributors Reinhart and FSA purchased by Performance Food Group and US Foods, respectively, and larger broadliners acquiring small broadliners and specialty distributors. US Foods and Performance Food Group also joined Sysco as publicly traded companies.

The pandemic created a whipsaw effect for foodservice distributors as they shifted from having too much inventory when the country went into lockdown in 2020 to not having enough inventory as consumers returned to restaurants en masse in 2021 and 2022.

This experience has led us to believe that traditional distributors will be more aggressive in evolving their operating models to become more adaptable should future unforeseen circumstances arise. Some of the changes we see them making include:

Increased Focus on Assortment and Value Chain Efficiencies

While foodservice distributors have undertaken efficiency initiatives in the past, we believe that the learnings from the pandemic will push them to make efficiency a key component of their business model going forward. Commonly mentioned efficiency opportunity areas included:

- Streamlining the number of products stocked in their distribution centers
- Pallet and packaging standardization to enable warehouse automation
- More accurate forecasting and inventory management tools
- More strategic use of redistribution to support their distribution centers

New Customer Service Models Introduced

Distributors are also shifting the way they think about servicing customers. While distributors we spoke to all recognized the enhanced need to support their customers during this time, they described how they will execute this support in very different ways.

Digital Engagement Approach

Because independent operators are becoming increasingly tech-savvy, a number of key distributors are investing heavily in ecommerce and other digital support. Distributors pursuing this tech-centric strategy view the digital engagement approach as a highly efficient and effective way to connect with and sell to their operators and as a result, many are reducing their investment in traditional DSRs.

Consultative Selling Approach

Other distributors are seeking to expand their positioning as an accessible, local partner to independent operators. Although many are also leveraging ecommerce to reduce sales' involvement in low value tasks such as placing orders, these distributors are maintaining and/or strategically growing their number of DSRs to provide what they believe is a competitive point of difference: more value-added services and stronger local connection to the operator. Distributors that employ this strategy are more likely to invest in local products and actively support community events.

Realistically, all distributors will deploy elements of both of these customer service models. It is best to think of evolving customer service models as a continuum, with digital engagement on one end and consultative selling via salespeople on the opposite end. Distributors will position themselves along this continuum based on their overall business strategy, financial strength and their customer strategy.

Additionally, when developing customer strategy, we expect distributors will continue to tier their customer bases to determine what value-added services they are willing to bring to each of their customers.

Increasing Investments in Technology

The use of technology is exploding across the foodservice landscape. With the new reality of decreased labor supply and increased labor expense, the foodservice industry, typically slow to adopt cutting edge technology, is scrambling to modernize its supply chain through tech development and deployment.

One of the foremost areas of technology investment is ecommerce. Distributors we spoke to are minimally leveraging ecommerce to provide easy access to product information, while many are allowing and encouraging operators to place and manage orders digitally. Ecommerce allows distributors to efficiently place and track orders with fewer errors, and can be utilized to enhance operator communication regarding delivery times, out of stocks and product substitutions.

Additionally, tech-savvy distributors are automating existing processes to achieve efficiencies, including investing in CRM tools and inventory management systems to allow better visibility to product across the network. Predictive analytics and investment in artificial intelligence tools help cut waste by allowing for data-driven product assortment decisions to be made regarding and inventory levels across facilities. Inventory management systems and applications that better communicate product availability are being tested and deployed as a response to ongoing supply chain disruption, and food safety systems that allow product to be traced back to the origin source were mentioned as closer-in tech investments.

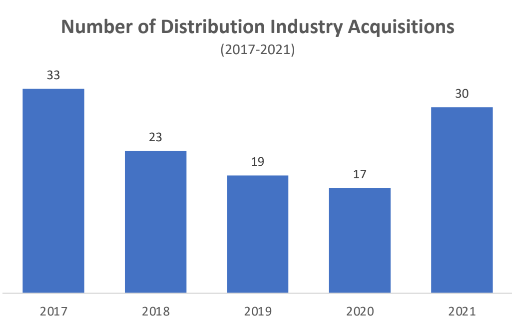
Longer term, many distributors we spoke to see larger tech investments as a way to offset issues created by an unsustainable labor model. New technologies such as on-floor warehouse robots and investment in Internet of Things (IoT) applications to remotely monitor and control warehouse and truck environments and autonomous vehicles were some of the tech applications identified as potential long term distributor investments.

Evaluating New Paths to Revenue Growth

While continuing to adapt their current business models, lessons from the pandemic left distributors with the understanding that further revenue diversification is necessary. As a result, distributors are expanding into the following areas:

Expansion into Adjacent Segments and Specialty Areas

Large foodservice distributors are accelerating their entry into adjacent channels and specialty foods. Last fall, two years after it acquired the Eby-Brown company, PFG acquired Core-Mark to consolidate their strength under their Vistar segment and accelerate their diversification into the growing convenience store channel, while also expanding their geographic reach. Sysco acquired Greco & Sons in 2021 to make them "more credible and more relevant within a specific cuisine segment" per Kevin Hourican, Sysco CEO. US Foods also expanded their presence in the cash and carry retail segment with their 2020 acquisition of Smart Foodservice Warehouse Stores to complement their Chef'Store cash and carry model. We expect additional acquisition and industry consolidation will be required to sustain the large distributors' aggressive growth goals.



Type	2017	2018	2019	2020	2021
Produce	6	7	10	6	10
Broadline	9	5	5	2	5
Protein	13	6	2	3	2
Specialty	0	1	1	1	8
Seafood	2	2	0	2	2
Other	3	2	1	3	3
TOTAL	**33**	**23**	**19**	**17**	**30**

Source: Keiter Advisors: https://keiteradvisors.com/industries/foodservice-industry

Buy-Side Revenue Generation: Digital Marketing and Data Services

With their large investments in technology, many distributors now view themselves as marketing and data service providers to the manufacturer community. We expect to see distributors offer more of their data to manufacturers to help them better target specific operators and then offer marketing access to these operators via their ecommerce platforms.

RISE OF DISRUPTORS

As traditional distributors evolve their operating models to adjust to the new foodservice reality, we are also seeing an explosion in new, technology-focused companies that are entering the foodservice supply chain. These organizations are well funded - according to Pitchbook, 2021 was a “banner year” for foodtech funding - and they’re translating best practices learned in other industries into foodservice.

Some of the key disruptors entering the industry include:

Third-Party Ecommerce-Only Distributors

Although technically not new to foodservice, ecommerce acceptance has fueled exponential growth at companies like FoodServiceDirect.com or Chef’s Warehouse – companies that sell a large variety of items exclusively through ecommerce, have no sales organization and ship direct to the operator.

> **Why is this disruptive?** *Since launching its new ecommerce platform in September 2018, FoodServiceDirect.com, says it has seen B2B sales and new customer acquisitions each increase 40%, and repeat purchases jump 110%*. Although not a replacement for all of an operators’ supply needs, fast direct ship options make these ecommerce-only distributors an increasingly convenient alternative and their endless aisle approach to inventory makes them a good source for more niche or specialty items that aren’t usually bought by operators in large quantities.*
>
> *Source: www.digitalcommerce360.com/2020/05/06/unilevers-online-food-service-a-timely-shift-to-b2b-and-b2c/

Cash and Carry and Warehouse Stores, Redefined

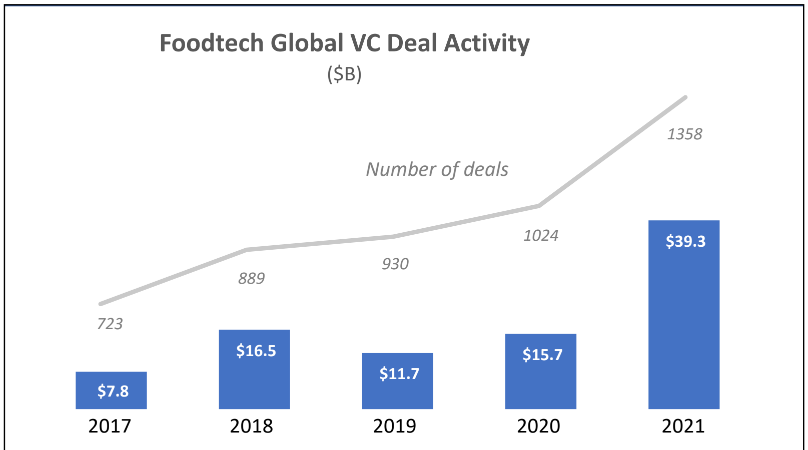
Cash and Carry, which has long been utilized by local operators to “fill in” needed items, gets a facelift with the addition of ecommerce and crowdsourced local delivery through services like Instacart. Warehouse stores like Costco and Sam’s Club are also now offering delivery through these third-party delivery services.

> **Why is this disruptive?** *Labor-constrained operators can now order critical items and have them delivered within an hour or at a prescribed time with zero disruption to their business.*

IFMA INTERNATIONAL FOODSERVICE MANUFACTURERS ASSOCIATION

Rise of Venture Capital-Backed Distributor Marketplaces

In 2021, venture capital investment activity reached $39.3B across 1,358 deals* - the biggest year yet for foodtech funding, doubling the value of the prior year's deals. Investment in food ecommerce has been rising over the past decade, and the trend accelerated significantly after Covid-19 required companies to build out new infrastructure to meet consumer demand.



Source: 2021 Annual Foodtech Update: Pitchbook. Includes both foodservice/retail ecommerce

Of these VC-backed initiatives, several business product and service providers received funding, including a class of new entities that act like distributor marketplaces: digital "one-stop shops" that allow operators to order from all of their distributors/suppliers through one ecommerce-based interface. The tech companies behind these platforms, like Cut + Dry, Choco.com and Rekki.com, have helped smaller and specialty distributors get into the ecommerce game with little to no investment. These tech companies can develop a full ecommerce catalog for a distributor in just a few weeks, at no cost to the distributor, eliminating the need for the distributor to build their own system from scratch, as many larger broadliners have done.

> **Why is this disruptive?** *These distributor marketplaces allow operators to source products from multiple distributors in a single order and enables them to look for key products across multiple distributor portfolios.*
>
> *Manufacturers on the platform can directly engage with the operators via digital marketing initiatives to promote products, collecting and analyzing operator data to aid in customer targeting and program development. While this is a benefit of any ecommerce-enabled solution, distributor marketplaces are unique in that they present multiple distributors, adding breadth to a manufacturer's marketing approach.*

Potential for Game Changing Disruption on the Horizon

Beyond the disruptors identified above, there is potential for game-changing disruption within the industry should any one of the following two events occur:

Amazon Enters Foodservice

It has long been said that Amazon, if it chose to, could knock out the biggest distributors in the industry, either by competing more efficiently against them or by acquiring them. Ever since Amazon entered B2C grocery delivery with their acquisition of Whole Foods in 2017, the industry has been anticipating their move into foodservice. In fact, the large investments in ecommerce by major distribution players are widely seen as a defensive strategy should Amazon decide to move into the foodservice space.

Foodservice industry participants should review Amazon's entry into other industries to inform their understanding of what could happen should they move into foodservice. As Amazon grew as a provider within other industries, traditional pricing models were challenged and algorithm-based pricing models were instituted. Amazon also redefined customer expectations regarding how and when they receive their purchased products. While we don't know and can't predict the exact approach Amazon would take if they were to enter foodservice, it is recommended that manufacturers stay abreast of any new Amazon developments in ecommerce.

Business Strategy Change Within a Key Food Industry Player

During the pandemic, Sysco and US Foods both pivoted to supplying grocery stores which experienced a surge in demand, and Sysco worked employee "swaps" with large grocery retailers. Now one of the largest US grocery retailers, Kroger, is getting into foodservice distribution: in April 2022 they announced the launch of a restaurant supply business that offers free next day delivery for orders of $250 and above to businesses in the greater Dallas area. Kroger Restaurant Supply offers an alternative to ordering in large quantities on a set schedule and offers "competitive wholesale pricing" by the case or unit for delivery seven days a week. Should this experiment prove successful, expansion is likely outside of the Dallas market, where Kroger is positioned as an additional resource for restaurants facing supply-chain constraints, and could pose a threat to established foodservice distribution.*

*Source: https://foodinstitute.com

Staying well-connected to the broader foodservice ecosystem will be critically important to better understand the role of disruption in the industry. Even among traditional foodservice participants, it is important to look for industry leaders that are evolving their strategies – especially leaders who have scale to influence broader change across the industry.

Sources of Distribution Disruption

Growth of **third-party ecommerce** supported by **direct ship or crowdsourced last mile delivery** provide alternative routes to market for manufacturers

Venture capital backed **distributor marketplaces** provide manufacturers direct access to the operator

Change in business strategy of large existing industry player could pose significant threat to established industry ways of working

MANUFACTURER IMPLICATIONS

All of this change/disruption presents both unique opportunities and challenges for foodservice manufacturers and should be considered when developing both close-in and long-term distribution strategy.

1. **New Routes to Market and "Endless Aisle" Opportunities.** New players in the industry mean new and expanded routes to market for manufacturers. Manufacturers can now explore alternative distribution channels as an entry point for innovation or specialty items. These ecommerce sales vehicles may provide a cost-effective way to test-market products utilizing promotional techniques that can be adjusted on the fly and capturing data to aid in the eventual placement of these items in traditional distribution channels.

As manufacturers, distributors and even operators become increasingly focused on SKU optimization, manufacturers can leverage other distribution methods to ensure important lower volume items are available to operators. With the endless aisle, important niche or specialty items may be made available through a distributor's catalog even if the item is not formally stocked in the distributor's DCs. We expect the concept of the "endless aisle" will continue to grow within foodservice as the use of ecommerce technology continues to increase.

2. Customized Approach to Distribution Will Be Required. With traditional distributor partners evolving and new distribution options increasing, it is imperative that manufacturers reassess their distribution strategy. Manufacturers should review their current routes to market, including analyzing cost to serve and benchmark against best-in-class supply chains. This assessment should be customized for each manufacturer, taking into account category/product type, food safety protocols, brand strategy and operator targets.

3. Distributor Support No Longer "One Size Fits All". As distributors evolve their operating models, manufacturers will be required to support different distributors in different ways. After determining which routes to market make the most sense, manufacturers will need to assess their distributor support strategies to help them be most successful with their mutual operator customers.

When developing distributor support plans, manufacturers should focus on the following key areas:

- Proactively commit to finding and executing supply chain efficiencies in partnership with key distributors
- Identify new sales and broker strategies with a focus on local execution
- Develop a data strategy to support distributor ecommerce initiatives
- Assess current marketing strategies and tactics including investments in digital marketing

4. Flexibility/Adaptability Required. One thing the pandemic has clearly taught us is that change is inevitable, and most distributors we spoke to believe we are entering a time of unprecedented change in foodservice. Foodservice leaders need to cultivate a culture of adaptability to embrace this change and ensure future success.

Key areas that manufacturers should develop to cultivate a more adaptable business model include:

- Listen to and collaborate with operators and distributor partners
- Provide a forum for employees to communicate their industry observations and thoughts on impact to the business
- Experiment with new technology: automate existing processes, capture business intelligence and invest in marketing automation tools
- Understand and share best practices internally and with other industry partners where appropriate

CONCLUSION

It is clear the foodservice distribution industry is on the verge of unprecedented change brought about by current financial and labor conditions, the effect of the Covid-19 pandemic on industry players and the widespread adoption of technology across the industry.

It is critically important that foodservice leaders embrace this change, and evolve their distribution, sales and customer strategies to thrive in this changing environment. Manufacturers that embrace this change will find new opportunities to sell their products, will be better partners to their distributors and will achieve a level of flexibility so critical to survival and growth over the next several years.

IFMA's Go-to-Market Planning Program is committed to helping its members better understand these changes and optimizing their go-to-market strategies. In addition to this full report, Go-to-Market Planning Program members will receive the Distribution Optimization Playbook which will provide tools that will complement many of the learnings found in this report.

If you are interested in becoming a subscriber to IFMA's Go-To-Market Planning Program, please contact Charlie McConnell, IFMA Sr. Director of Insights & Best Practices at charlie@ifmaworld.com.

Thank you from IFMA to Kinetic 12 Consulting for their partnership in creating this whitepaper.

LEADING FOODSERVICE TOGETHER

About International Foodservice Manufacturers Association (IFMA)

The International Foodservice Manufacturers Association (IFMA) is a trade association that has served its industry for 70 years. IFMA's mission is to equip food-away-from-home manufacturers with the tools needed to navigate the future with confidence. By providing insights, fostering best practices, and developing networking and educational opportunities through events, IFMA enlightens its members and motivates change that improves both individual member organizations and the $1.17 trillion food-away-from-home industry at large. For more information, visit IFMAworld.com. Follow IFMA on LinkedIn, Twitter, Facebook and Instagram.