



CHANGING THE
FOOD CHAIN

CEO RICK SCHNIEDERS IS
LEADING SYSCO AS THE COMPANY OVERHAULS
ITS SUPPLY-CHAIN SYSTEM.

RICK SCHNIEDERS, chairman and CEO of Houston-based **SYSCO Corp.** (SYY), began his education in the food-service industry early. He says that at age 10 he was bagging potatoes at his father's small-town grocery store, Bob's Market, in Remsen, Iowa. His first management job at the shop, at age 15, was overseeing the store's soap aisle, he recalls with a smile.

Schnieders, now 56, later worked the meat counter at Bob's Market, an experience he says helped shape his views on customer relations at SYSCO, which reports it is North

America's largest wholesale food provider by market share. "That very immediate experience with the customer — I don't think there's a better way to get it,"

he says. "We knew the customers very well. It's not unlike what we do at SYSCO: We develop relationships with our customers over a long period."





COLLEAGUES PRAISE
CEO RICK SCHNIEDERS,
PICTURED AT A HOUSTON
WAREHOUSE, FOR HIS
ANALYTICAL MIND.

Sysco says its customers include some 400,000 restaurants, hospitals, schools, hotels, cruise ships and other venues throughout the U.S. and Canada, to which it says it provides about 300,000 products, from can openers to prime rib. While SYSCO does not manufacture any of its products, it says it sells a range of items from suppliers such as **Tyson Foods Inc.** (TSN) to the smaller Red Gold and Carla's Pasta. Some 45,500 of those are products sold under the SYSCO Brand. SYSCO says that restaurants are its primary customers, accounting for 64 percent of fiscal 2004 revenues. SYSCO reports that most of these restaurants are small, but that it also supplies chains such as **Wendy's International Inc.** (WEN) and multiunit food-service providers **Aramark Corp.** (RMK) and **Sodexo Alliance S.A.** (SDX).

While it competes against other food distributors, such as **Royal Ahold NV** (AHO) subsidiary U.S. Foodservice Inc., SYSCO says its real competitor is the grocery store, since consumers must decide daily whether to dine out, take meals home or purchase groceries to prepare their own meals.

The supply-chain system is a crucial factor in the success of distributors and their customers, SYSCO says, adding that it has recently embarked on what many call an ambitious change in how it handles the movement of products within the supply chain. Although the plan was devised before he became CEO, Schnieders says, he is now spearheading this vital function. Now, SYSCO says, its 151 distribution locations in the U.S. and Canada act autonomously, making their own decisions on what products to carry in inventory and how to transport and market them. Under the new plan, the operating companies will still run as separate profit centers, but will work more cooperatively, SYSCO says. Over the next five to 10 years, the operating companies will be linked to one of five or more hubs, or regional distribution centers (RDCs), to cut transport and purchasing costs and inventory, SYSCO reports. It says that the first of these RDCs, an \$85 million facility in Front Royal, Va., will connect 14 Northeastern operating companies and begin shipping products to them in the first quarter of 2005.

A top challenge has been selling the operating companies on the economic benefits of the RDCs, for which they must now bear the operating costs, and convincing them to act more in concert with one

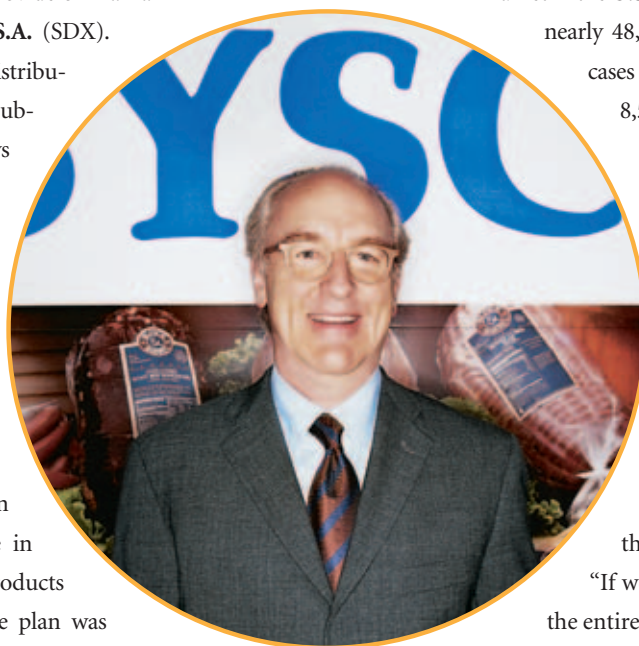
another, says Schnieders. Adds William B. Day, vice president of supply-chain management: "When you have a \$29 billion company that's been very successful, it takes a lot of courage to step out and say, 'This is a big investment we're going to make for the future.'"

DECENTRALIZING THE MODEL

For fiscal 2004, which ended July 3, SYSCO reports its sales exceeded \$29 billion, giving it a 14 percent share of the fragmented \$207 billion wholesale food and related products market in the U.S. and Canada. The company reports it has nearly 48,000 employees and ships over 4 million cases of products per day on approximately 8,500 trucks, which it describes as the largest private truck fleet in the U.S.

SYSCO says its decentralized business model was created by John Baugh, now 88, who formed SYSCO (Systems and Services Co.) in 1969 when he merged the frozen-food supply business he had started in 1946 with eight other food-service companies. "Local operating companies understand the idiosyncrasies of their particular markets," says Schnieders. "If we decided to choose one bacon flavor for the entire U.S., it would be a self-defeating process because of all the different flavors people like. There is no imperial wisdom coming out of Houston."

SYSCO's operating companies say they also choose their own processes. Many employ a system under which every inbound pallet gets a bar-coded decal, or license plate, SYSCO says. As a pallet of products is received, a forklift operator can scan it and a computer mounted to the forklift will tell the operator exactly where in the warehouse to store the pallet. As the product selector is picking products for an order, says SYSCO, he or she is directed to a slot that matches the license plate number of the stored product. The selector will then scan the bar code on the slot, with a reader that attaches to the finger, to confirm that the product is actually the one the customer ordered. Over the past five years, this real-time inventory process has cut errors at the SYSCO Food Services of Houston subsidiary to one in 2,500 cases of products from one in 400, says Keith Miller, president and CEO of that operating company.



Still, says Schnieders, “55 percent of the items we purchase for customers can be handled more efficiently.” The solution, he says, will come in part from the RDCs.

Highly trafficked items such as french fries will continue to ship straight from suppliers to the operating companies, explains Day. The new system is aimed at items such as Tabasco sauce that an operating company generally orders in quantities of less than full truckloads, he adds. RDC system software will calculate how much Tabasco sauce all the operating companies in a region need, then send a single vehicle to bring it to the RDC, he explains. From there, full truckloads, with Tabasco sauce and other products that have similar movement characteristics will be sent to those operating companies in a pallet configuration that can be stored immediately without any rearranging, he says.

The RDCs, Schnieders predicts, will cut by at least half the 80 to 90 days it now takes products to go through the supply chain. With more items filling a central warehouse, the operating companies will have a wider variety of products “essentially available overnight,” he adds.

“It has been complicated,” Schnieders concedes, dealing with operating company merchandising departments’ concerns such as: “You’re telling me that a computer can do what I’ve been doing for 25 years?” Getting all the operating companies onboard has been a gradual process, with an emphasis on open communication, says SYSCO. Senior management undertook a feasibility study of the RDC concept from October 2000 to May 2001, keeping the operating companies informed as it progressed, Day says, and shared final results in June 2001. SYSCO management says it called a series of both group and one-on-one meetings with operating companies and put together change-management teams at the top and at each of the distribution companies.

“This redistribution model has been done in places such as **Wal-Mart Stores Inc.** (WMT), but it hasn’t been done in a food-distribution environment in the U.S.,” says Andrew Wolf, an equity analyst with **BB&T Corp.**’s (BBT) Capital Markets. “It will create efficiencies and give SYSCO further procurement and selection advantages.” Adds Miller: “This is going to put us many years ahead of our competition.”

ANALYZING THE SITUATION

When I went to college I swore I’d never be involved in the food business again,” Schnieders says. “I graduated [from the University of Iowa] with a bachelor’s degree in mathematics, and there’s just about nothing you can do with a bachelor’s degree in mathematics,” he jokes. So, the CEO recounts, he gravitated to a grocery chain in the upper Midwest, where he was a meat manager until he joined Malone & Hyde Foodservice in 1979. (Malone & Hyde is the predecessor of **AutoZone Inc.** [AZO]. See story on page 40.)

In 1982, Schnieders, then 35, joined SYSCO’s Memphis subsidiary as part of the executive-development program. Rising through the company, he was named president and chief operating officer in 2001. In early 2003, in a succession planned for several years, he says he assumed the chairman and CEO titles from Charles Cotros.

Schnieders, who plays classical guitar, says his math degree was a plus. “We have copious amounts of data,” he relates. “The challenge is, how do you make sense of it?” Schnieders’ colleagues say that one of his greatest strengths is his analytical mind. “He’s also very marketing savvy,” adds SYSCO President and COO Thomas Lankford. “He understands what trends are coming.”

FROM FARM TO FORK



“When the sun comes up tomorrow in Salinas Valley, Calif.,” says SYSCO CEO Rick Schnieders, “we’ll have seven people in the fields making sure that this particular field of lettuce or strawberries is good for the SYSCO Brand.” These seven people are part of a team of 180 quality-control workers who monitor SYSCO Brand food “from farm to fork,” to make sure it is safe, consistent and high in quality, notes Craig Watson, vice president of quality assurance. “These efforts contribute to building cus-

tomers confidence in our company and our brand,” says Watson.

Before SYSCO enters into business with a SYSCO Brand supplier, a SYSCO quality-assurance professional will conduct a plant audit to make sure that quality-control and food-safety measures are in place, says Watson. After that, the supplier must undergo an annual audit by a third-party inspection firm, he adds.

SYSCO and its suppliers’ upper management also agree on checklists for every product, says Watson. When it comes to boneless ham, for example, SYSCO says it has age and

weight requirements for the pigs, ingredients for the flavor solution added to the product and rules as to how the product is processed and cooked. SYSCO inspectors also spot-check each production run of the ham, Watson adds.

Watson says that all these efforts increase brand integrity, although this is difficult to quantify. “Companies can measure it when they have a brand recall — like the sales they lost due to a quality, ingredient or safety issue,” says Watson. He explains that at SYSCO, “It’s harder to measure effects on brand integrity when you don’t have a problem.”

A key trend from which SYSCO has benefited is the growth of the “meals prepared away from home” category, says Schnieders. “In 1972, 37 cents of the consumer food dollar was spent away from home,” he points out. “Last year it was about 50 cents of every dollar.” That figure should increase as Americans become more strapped for time and less skilled at cooking, he adds.

Schnieders estimates that there are 900,000 potential food-service customers, but he says SYSCO focuses on finding high-potential businesses to work with, through internal research or referrals. Once you find the right customers, don’t let them down, the CEO says: “Ten percent of our customers generate 52 percent of our gross profit. You want to stay very close to that 10 percent.”

Just as SYSCO’s main competitor is the grocery store, its customers don’t so much compete against other restaurateurs as they do against supermarkets, says Lankford. “If we give our clients actionable data,” he adds, “we can help develop marketing programs to convince customers to have one more meal a month at their restaurant.” This data is relayed by SYSCO’s 8,000 marketing associates, or salespeople, who also help customers develop strategies and rework menus, he says.

Marketing associates are also trained to analyze customers’ menus. Once SYSCO estimates what products a customer uses and in what quantity, it can deduce which items the customer purchases from competitors, says John Stubblefield, executive vice president of finance and administration and CFO. SYSCO can then assess which products to try to sell to the customer, he adds.

SYSCO says its scale also helps when it comes to working with national companies. “SYSCO gives us continuity and consistency across the U.S.,” says John Orobono, Aramark’s senior vice president, supply-chain management. “There’s a lot of value in that, as opposed to developing a network of independent distributors and trying to weave together a logistics platform,” he explains.

Schnieders adds that scale has allowed SYSCO to build its own brand over 25 years. SYSCO says it makes its brand more desirable by developing specifications for products that

suit its customers’ needs (such as cleaned and chopped salad mixes), then working closely with suppliers that will make those products. It also cites its rigorous quality-control process. (See “From Farm to Fork,” previous page.)

FOCUSING ON GROWTH

SYSCO is now focused on internal growth, but acquisitions still play a role in its expansion, according to Stubblefield. When SYSCO buys a business, Schnieders points out, “we build in five-year earn-outs for the management team to encourage them to remain instrumental in the company’s success. They know their local marketplace or specialty business much better than we do.”

Indeed, the average tenure for current top executives is more than 20 years, SYSCO reports. This lends to a warm, family atmosphere, the CEO says. Founder Baugh, although no longer involved in day-to-day operations, still has an office at headquarters, SYSCO says.

Schnieders says good corporate governance also improves spirits at the company. “I

would define corporate governance to be the organization’s relationship with all of its constituencies — employees, customers, suppliers, investors and the communities in which we work,” he explains. One example of governance that Schnieders gives is the company’s emphasis on safety. The company reports that through training programs, video presentations and safety reminders posted throughout SYSCO facilities, it has cut accident frequency to 7.25 annual incidents per 100 employees from more than 18 in 1997.

“We have fewer accidents and a much more efficient workplace, and employees’ attitudes are much better,” says Schnieders. “It’s just a wonderful environment to work in and be a part of.” □

“YOU’RE TELLING ME THAT A COMPUTER CAN DO WHAT I’VE BEEN DOING FOR 25 YEARS?” WAS ONE CONCERN CEO RICK SCHNIEDERS HAD TO ADDRESS IN SELLING SYSCO’S NEW SUPPLY-CHAIN SYSTEM.

*As of Aug. 24, 2004, Andrew Wolf, an analyst at BB&T, was not an officer, director or member of an advisory board at SYSCO. Neither he nor BB&T owns a position in SYSCO.