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BUSINESS

Supermarkets Soured on Kraft Heinz and Its Pricing Tactics

Moves to make quick profit seen as misstep; investor Warren Buffett admits 'weaker bargaining hand' with stores



Oscar Mayer promotes its hot dogs with the Wienermobile, visited by twin girls in Minnesota last year. Parent company Kraft Heinz's decision to scale back in-store promotions and discounts is now seen as having backfired. PHOTO: LEILA NAVIDI/MINNEAPOLIS STAR TRIBUNE/TNZ/ZUMA PRESS

By Heather Haddon

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Kraft Heinz Co.'s [KHC -2.83%](#) ▼ yearslong quest for cost-cutting and profit hurt a key element for success in the packaged-food business: good relationships with supermarkets.

When the food giant made the surprise announcement last week that it was slashing the value of its Kraft and Oscar Mayer brands by \$15.4 billion, it became clear its strategy failed to

address the broader consumer shift away from processed meats and other packaged items toward healthier, more natural options.

Another problem for Kraft Heinz was its decision to scale back in-store promotions and discounts that could have helped boost sales of Kraft cheese slices, Capri Sun drinks and other signature products, according to people familiar with the industry and food sector analysts.

“We may have made a mistake in terms of trying to push hard against certain...retailers and finding out that we weren’t as strong as we thought,” said Warren Buffett, whose Berkshire Hathaway Inc. [BRK.B -0.08% ▼](#) owns more than a quarter of Kraft Heinz, in discussing the company’s troubles on CNBC on Monday. “You’ve got the weaker bargaining hand than you had ten years ago,” Mr. Buffett said.

After Kraft and Heinz’s 2015 merger, and as retailers increasingly felt competition from deep-discount chains and online sales, Kraft Heinz moved to raise prices on some items, including a 25% hike on Capri Sun drinks. Kroger executives balked at the move, arguing that price-sensitive shoppers drawn to the low-cost fruit drink would stop buying it, people briefed on the discussions said.

“We lost a lot of business for eight months,” said one of the people about the increases. “It didn’t achieve the sales that Kroger wanted. It achieved the profit Kraft wanted.”

Kraft Heinz officials said at the time that Capri Sun sales dropped due to the price increase, but that it was necessary to pay for a reformulation of the product in response to consumer trends. A drop in promotions of boxed dinners also had hurt sales.

Investment firm 3G Capital LLC, which helped make Kraft Heinz the world’s fifth largest food company through the megamerger, was aggressive about saving costs across the company.

“You had a change in personnel and mind-set,” said Don Fitzgerald, a food sector consultant and the chief marketing officer for Kroger Co.’s Mariano’s banner until this month. “There was a clear shift in focus from really working with retailers and being consumer-focused.”

The salespeople hired by Kraft Heinz and third-party contractors were armed with less leverage and ability to promote and discount Oscar Mayer wieners, Kraft slices and other key brands, Mr. Fitzgerald and former Kraft Heinz officials said.

Competition from nonbranded store products also grew in recent years, particularly in commodities such as cheese that retailers heavily discounted, Kraft Heinz officials have told investors. Kraft natural-cheese sales declined 2% last year by volume, while private-label versions grew by nearly 9%, according to data from market-research firm IRI.

“House brands, private label, is getting stronger,” said Mr. Buffett in the television interview. “And it’s gonna keep getting bigger.”

Supermarkets have greater options for their shelves today, and power has shifted to retailers in recent years as grocers gain more market data to determine what sells best. Packaged-food makers are under pressure to be more creative in arguing why their products draw customers, particularly in center-store aisles as more shoppers buy fresh food.

That has made the relationship between grocers and suppliers even more important as both try to drive sales of goods that some consumers increasingly snub.

Kraft Heinz officials say they’ve made improvements recently, including offering more discounts and distribution with retailers. Kraft Heinz spokesman Michael Mullen pointed to a retailer survey by the Kantar research firm showing that the company ranked fourth among packaged-goods companies on strategy, supply-chain and other factors last year, up from fifth in 2017.

“It was part of our commitment to have improving relationships with all our customers as we went through the merger. That has proven out,” Mr. Mullen said.

The company said its U.S. pricing outside of commodity swings was down 1.4% in the second half of its fourth quarter.

Those efforts are leading to gains in sales volume, market data show. Its processed cheese products—which includes Kraft slices, Cheez Whiz and Velveeta—saw a 6% increase in the volume of sales in the month ending in January after heavy promotions and price drops, while coffee and frozen-entrée sales also improved, according to food-industry analysts at AllianceBernstein.

The company has expanded its own sales force to distribute and merchandise its products at supermarkets. Kraft Heinz said in May that its in-store sales team for the U.S. was 80% larger than last year, which it said is helping to improve its presence with key retailers.

“Our volume improvement was also supported with a much better service level,” said Paulo Basilio, U.S. president for Kraft Heinz, in discussing the price increases last week.

Business relationships, however, take time to repair.

Kraft Heinz laid off roughly 5% of its total workforce after the merger, and job cuts have continued. Veteran Kraft employees who drove some important relationships with retailers over the years left, and were replaced by less experienced people, the former Kraft Heinz officials said.

“Our sales team really struggled,” one of the people said.

Kraft Heinz also made late deliveries to stores. The delays of shipments of products such as Ore-Ida potatoes dented their prominence on shelves, Mr. Fitzgerald said.

Total annual dollar sales for Kraft Heinz in the U.S. have fallen in the last four years, according to IRI data.

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Kraft Heinz's Mr. Mullen said that like other companies, Kraft Heinz has had periodic supply-chain issues.

Last year, Kraft Heinz began

investing more in its supply-chain and warehouse network, and executives said Thursday it had achieved industry-leading delivery metrics for rate of orders delivered on time and complete. New production lines for frozen potato, meat and other products eliminated supply disruptions, company executives said. That work was expensive, denting the company's profit.

Those in the food industry said Kraft Heinz's merchandising missteps should serve as a warning to other brands.

“The maniacal focus on cost cutting will not ultimately serve the interest of company stakeholders,” said Bob Goldin, co-founder of the Pentalllect Inc. consulting firm, in a recent note to clients. “We urge all companies to recommit themselves to growing the old fashioned way.”

—Annie Gasparro contributed to this article.

Write to Heather Haddon at heather.haddon@wsj.com

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