Trends in Bidding for Rebate Contracts

This chapter examines the recent bidding history of infant formula manufacturers and some of the characteristics of winning bids from January 1998 to January 2006. The analysis is based on bid data compiled by two different organizations: the Center on Budget and Policy Priorities, and USDA's Food and Nutrition Service (FNS), the agency responsible for administering the WIC program.

Manufacturers' Bid History

During the study period, three manufacturers bid on infant formula rebate contracts—Mead Johnson, Ross, and Nestlé. Table 2 shows the bid history of the three firms during this time for the milk-based infant formula rebate contracts.[32] Examination of the data suggests that several changes took place in the rebate program during or soon after 2003.

Mead Johnson and Ross bid on the vast majority (94 percent) of contracts during the study period, while Nestlé was much more selective, bidding on less than half (27 percent) of all contracts.[33] However, Nestlé has been much more active in recent years, bidding on eight of the nine milk-based contracts awarded after 2003.[34] Furthermore, in the one State that Nestlé did not bid for the milk-based contract during this period (New York in 2006), Nestlé bid on and won the soy-based contract. As a result of Nestlé's increased bidding activity, all of the contracts awarded after 2003 (except for New York's 2006 milk-based contract) have been bid on by all three manufacturers.

In terms of winning bids between 1998 and the end of 2003, Mead Johnson won 18 contracts, Ross 15, and Nestlé 7. However, Mead Johnson has won only one contract after 2003, while Nestlé has won five, and Ross has won three.[35]

During most of the study period (1998 to January 2006), Mead Johnson won nearly all the infant formula contracts in the large WIC States, and all the contracts in the multistate alliances. The notable exception was in August 2003, when Ross won the rebate contract in California that was previously held by Mead Johnson.[36]

Along with the change in contracts won by manufacturers in recent years, there has been a corresponding shift in each manufacturer's share of the WIC market (fig. 7).[37] Mead Johnson accounted for 60 to 70 percent of the WIC market from 1998 to 2003. However, their share dropped to 49 percent in 2004 due largely to the loss of the California contract to Ross in 2003. Meanwhile, Ross increased its share from 21 percent in 2003 to 39 percent in 2004, while Nestlé's share of the WIC market increased from 5 percent in 2001 to 14 percent in 2005.

Another important change has been in the brands of formula that manufacturers are submitting bids for, that is, the designated primary contract-brand

[32]Milk-based infant formula accounts for most of the formula provided by WIC, so we focus on that here.

[33]While Nestlé bid on fewer contracts than the other two formula manufacturers, it was more likely to win a contract that it bid on. Nestlé won 58 percent of the contracts it bid on (11 out of 19), compared with 40 percent (19 out of 47) for both Mead Johnson and Ross.

[34] Four of these eight contracts were in States in which Nestlé did not bid on the previous contract.

[35]Mead Johnson did not hold the previous contract in any of the eight States won by Ross and Nestlé after 2003. That is, Mead Johnson did not lose any of the States that it previously held contracts in.

[36] California is the largest State in terms of WIC infants, with about 14 percent of the U.S. total (based on unpublished data from USDA's Food and Nutrition Service).

[37] Shares are determined by the total number of WIC infants in the States held by a particular formula manufacturer and therefore do not represent the shares of total infant formula redemptions. Interstate differences in breast feeding rates are not considered. Thus, this chart should be viewed as indicative of general trends in the share of the WIC infant formula market.

Table 2

Bids for milk-based infant formula rebate contracts by manufacturer, 1998-2006

	Mead	Ross	Nestlé	Number of bidders
NY 7/1/1998	Winning bid	Did not bid	Did not bid	1
CA 8/1/1998	Winning bid	Losing bid	Did not bid	2
GA 8/1/1998	Losing bid	Winning bid	Did not bid	2
CO 10/1/1998	Winning bid	Losing bid	Did not bid	2
MO 10/1/1998	Winning bid	Losing bid	Losing bid	3
PA 10/1/1998	Losing bid	Winning bid	Did not bid	2
TX, MN, IO 10/1/1998	Winning bid	Losing bid	Did not bid	2
FL 2/1/1999	Losing bid	Losing bid	Winning bid	3
KY 7/1/1999	Losing bid	Winning bid	Did not bid	2
ND 7/1/1999	Losing bid	Winning bid	Did not bid	2
TN 7/1/1999	Losing bid	Winning bid	Did not bid	2
IN 10/1/1999	Winning bid	Losing bid	Did not bid	2
LA 10/1/1999	Winning bid	Losing bid	Did not bid	2
NJ 10/1/1999	Losing bid	Losing bid	Winning bid	3
OK 10/1/1999	Winning bid	Losing bid	Did not bid	2
SD, NE 10/1/1999	Winning bid	Losing bid	Did not bid	2
SC 4/7/2000	Losing bid	Winning bid	Did not bid	2
AL 10/1/2000	Losing bid	Winning bid	Did not bid	2
AR, NM, NC 10/1/2000	Winning bid	Losing bid	Did not bid	2
WI 1/1/2001	Losing bid	Winning bid	Did not bid	2
IL 2/1/2001	Losing bid	Winning bid	Did not bid	2
VA 6/29/2001	Losing bid	Losing bid	Winning bid	3
KY 7/1/2001	Losing bid	Losing bid	Winning bid	3
ND 7/1/2001	Did not bid	Losing bid	Winning bid	2
NEATO 10/1/2001	Winning bid	Losing bid	Did not bid	2
WSCA 10/1/2001	Winning bid	Losing bid	Did not bid	2
MI 11/1/2001	Did not bid	Winning bid	Losing bid	2
OH 6/20/2001	Did not bid	Did not bid	Did not bid	0
FL 2/1/2002	Losing bid	Losing bid	Winning bid	3
GA 10/1/2002	Winning bid	Losing bid	Did not bid	2
OH 10/1/2002	Losing bid	Winning bid	Did not bid	2
TX, MN, IO 10/1/2002	Winning bid	Losing bid	Did not bid	2
CO 1/1/2003	Losing bid	Winning bid	Losing bid	3
OK 1/1/2003	Losing bid	Losing bid	Winning bid	3
LA 2/1/2003	Losing bid	Winning bid	Losing bid	3
NY 7/1/2003	Winning bid	Did not bid	Did not bid	1
CA 8/1/2003	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	Did not bid	2
AR, NM, NC 10/1/2003	Winning bid	Losing bid	Did not bid	2
IN 10/1/2003	DHA&ARA (Winning bid)	DHA&ARA (Losing bid)	Did not bid	2
MO/NE/SD 10/1/2003	DHA&ARA (Winning bid)	DHA&ARA (Losing bid)	Did not bid	2
PA 10/1/2003	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	Did not bid	2
TN 7/1/2004	DHA&ARA (Losing bid)	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	3
AL 10/1/2004	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	Losing bid	3
LA 10/1/2004	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	DHA&ARA (Losing bid)	3
NJ 10/1/2004	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	DHA&ARA (Losing bid)	3
SC 4/7/2005	DHA&ARA (Losing bid)	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	3
ND 7/1/2005	DHA&ARA (Losing bid)	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	3
OK 10/1/2005	DHA&ARA (Losing bid)	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	3
WI 1/1/2006	DHA&ARA (Losing bid)	DHA&ARA (Losing bid)	DHA&ARA (Winning bid)	3
NY 1/1/2006	DHA&ARA (Winning bid)	DHA&ARA (Losing bid)	Did not bid	2

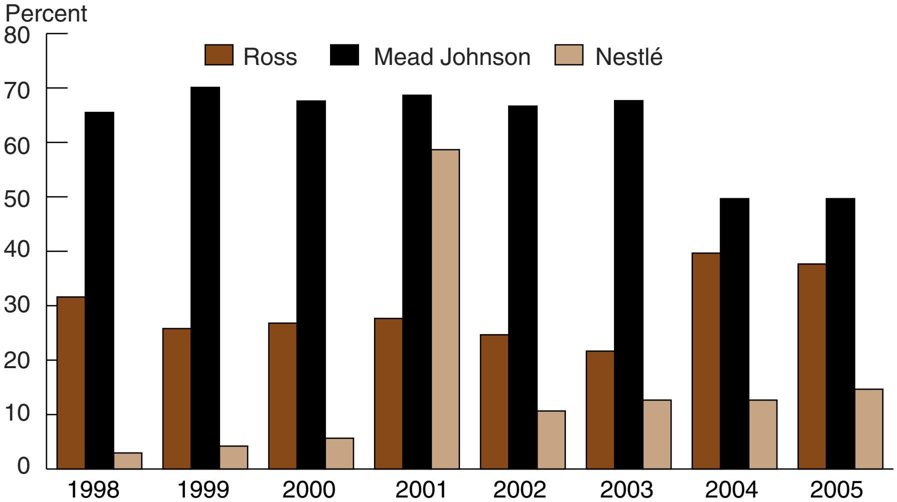
Legend

Winning bid	Losing bid	Did not bid

Source: Compiled by USDA's Economic Research Service based on formula manufacturers' bids.

Notes: DHA&ARA=bid based on DHA- and ARA-supplemented formula.
NEATO=New England and Tribal Organizations (CT, ME, MA, NH, and RI).
WSCA=Western States Contracting Alliance (AK, AZ, DE, HI, ID, KS, MD, MT, NV, OR, UT, WA, DC, WV, and WY).

Figure 7
Estimated share of the WIC infant formula market by manufacturer, 1998-2005



Source: USDA's Economic Research Service.

formula. Beginning with the California contract that became effective in August 2003, nearly all the submitted bids have been for DHA- and ARA-supplemented formulas.

Characteristics of the Winning Bids

The net wholesale price and rebate (per can) of the winning bids (both powdered and liquid concentrate) are shown in figures 8 and 9. Note that the net wholesale price plus the rebate equals the wholesale price.[38] Differences in can sizes and reconstitution factors for powdered formula across both manufacturer and time period make comparison of rebates and net wholesale prices across contracts difficult. As a result, this discussion focuses on the winning liquid concentrate contracts (all the liquid concentrate contracts awarded during the study period were based on a 13-ounce can that reconstituted to 26 ounces). However, the same general conclusions hold for the powdered contracts.

Rebates varied greatly by State and time period, ranging from $1.82 to $3.37 per can of liquid concentrate during the study period (fig. 9). Net wholesale price also varied, ranging from 7 cents to $1.07 per can. The percentage discount rebates (i.e., the amount of the rebate expressed as a percentage of the wholesale price) were generally large, ranging from 65 percent in New York (effective July 2003) to 98 percent in South Carolina (effective April 2000). In other words, the infant formula purchased through WIC cost the South Carolina program only 2 percent of its wholesale cost, plus the amount of the retail markup.[39]

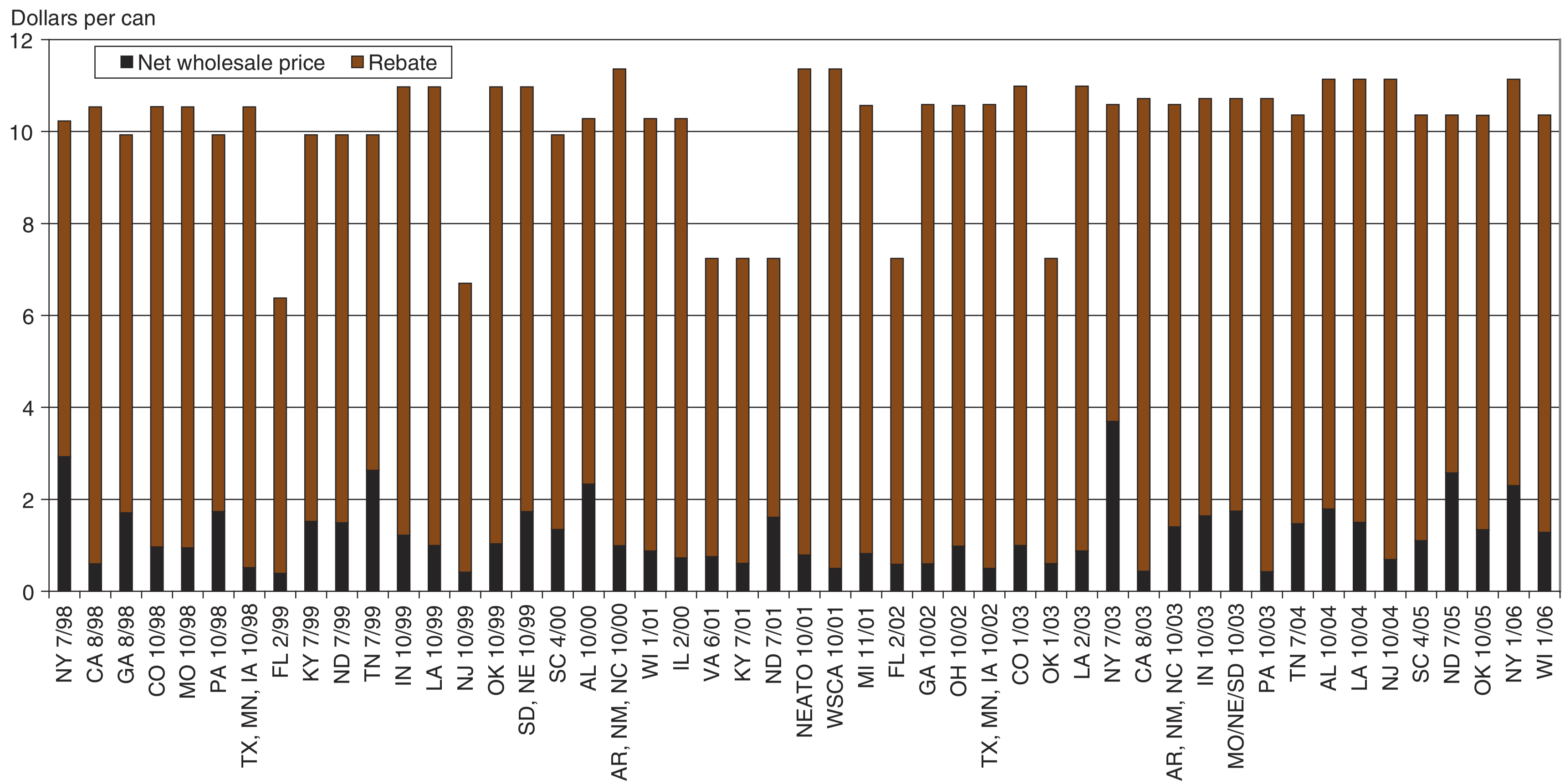
Both supply-side and demand-side characteristics of the infant formula market help to explain why WIC State agencies receive such large rebates. On the supply side, the formula market is highly concentrated, a factor which is often associated with higher profit margins. This, in turn, gives

[38]The wholesale prices shown in figures 4 and 5 differ across contracts due to both variation in the wholesale price by manufacturer and changes in each manufacturer's wholesale prices over time.

[39]Rebate contracts contain inflationary provisions. In the event of an increase in the wholesale price after the date of the bid opening, there is a cent-for-cent increase in the rebate amounts. Thus, once the wholesale price increases (e.g., near the end of the contract), the cost to an individual State WIC agency will be an even smaller percentage of the new wholesale price.

Figure 8

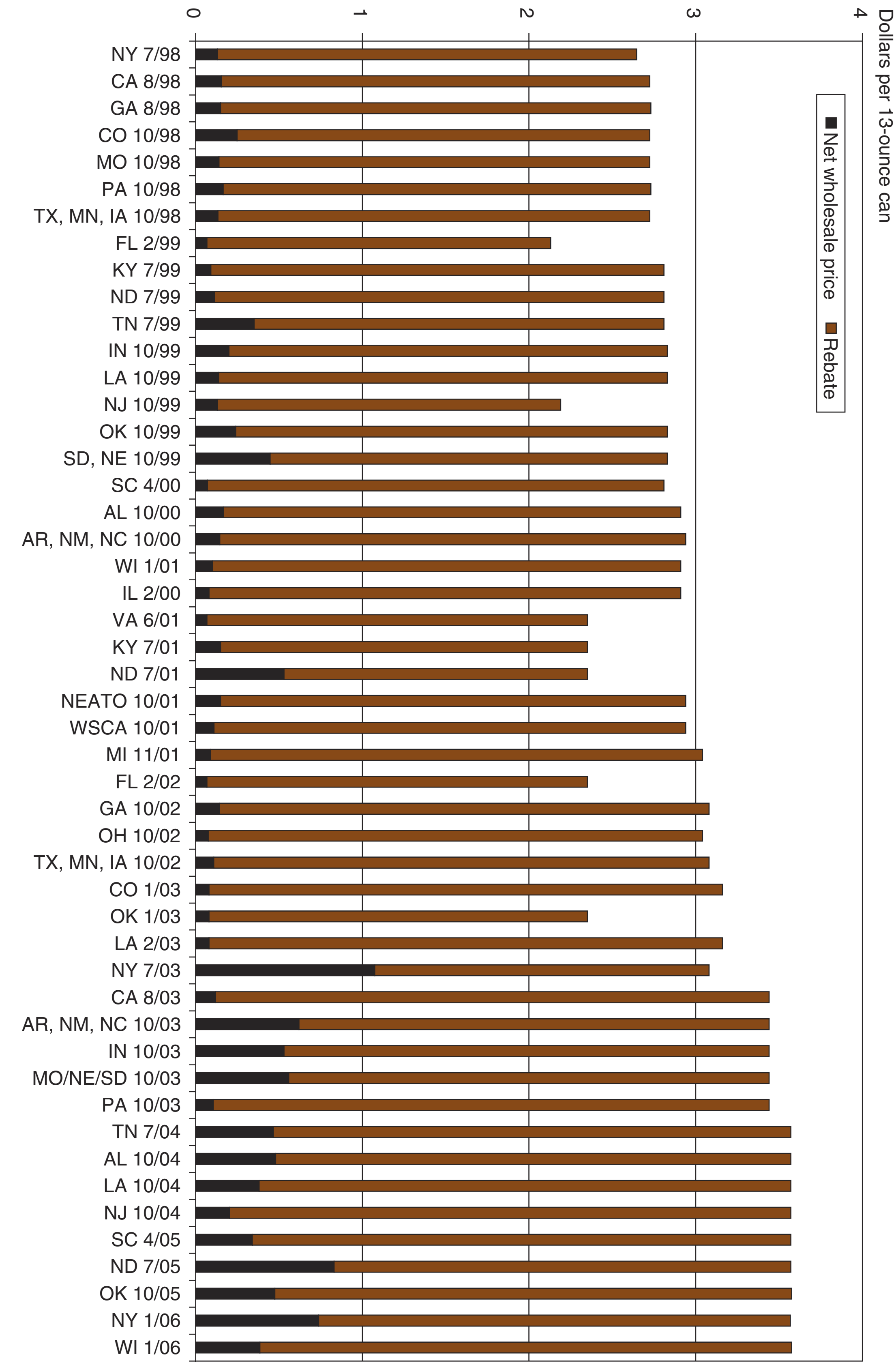
Rebate and net wholesale price of milk-based powder by State, 1998-2006



Note: Can sizes are not standardized.

Source: Compiled by USDA's Economic Research Service based on formula manufacturers' bids.

Figure 9
Rebate and net wholesale price of milk-based liquid concentrate by State, 1996-2006



Source: Compiled by USDA's Economic Research Service based on formula manufacturers' bids.

manufacturers the cushion to offer high rebates.[40] On the demand side, WIC participants purchase over half of all infant formula, assuring large sales for the contract-winning manufacturer. In addition, manufacturers may realize spillover benefits of winning a WIC contract: retailers may devote more shelf space to the WIC contract brand, which may spur sales to non-WIC consumers. Sales may also rise if hospitals and/or physicians recommend the WIC contract brand to non-WIC mothers.[41]

Much of the concern about a possible trend toward reduced rebates and higher net wholesale prices was prompted by the rebate contract for New York that took effect in July 2003. This contract specified a rebate that was only 65 percent of its wholesale price (on January 1, 2004, a contract amendment changed the rebate in New York to 75 percent of its wholesale price). The percentage discount rebates specified in previous contracts were usually 90 percent or more (i.e., in 31 out of the 34 previous contracts). Only one manufacturer—Mead Johnson—bid on the New York contract. This was seen as particularly significant because New York contains the third largest number of infants in WIC. States with large numbers of WIC infants are presumably able to negotiate larger rebates from infant formula manufacturers, other factors being constant.[42] Although no contract awarded since New York's has as low a percentage discount rebate, net wholesale prices in general appear to have risen.

[40]For a fuller discussion of market power and prices, see Prell, 2004.

[41]To win a WIC contract, a manufacturer may choose to offer infant formula at low net wholesale prices or even at a loss in the WIC market by bidding a high rebate. To be profitable to a manufacturer, such a below-cost strategy requires that increased sales in the non-WIC market offset the loss in the WIC market.

[42]It has been speculated that one factor behind only one manufacturer bidding on the New York contract was California soliciting bids for their contract at about the same time (the California opening date for bids was December 2002, versus March 2003 for New York). Concerns regarding Ross' capacity to fulfill the WIC contract in two of the largest States may have prevented it from bidding on both contracts.