Processing Profitability

Improving food and beverage manufacturing margins by improving supply-chain visibility

Competition heats up, pressures grow

The food and beverage industry faces unique challenges. Narrow operating margins, rapidly changing customer preferences, and highly perishable items are but a few of the issues these firms manage daily. Although the increased application of supply-chain management (SCM) tools has added new visibility for food and beverage (F&B) executives, allowing them to quickly adapt their companies to changing conditions, today's globally competitive market demands an even fresher, more innovative approach, one that current practices and systems may not be able to handle.

Leading F&B companies are now implementing new processes, systems, and IT tools comprehensively to examine what goes in and outside of their firms in real time. They're taking advantage of new forecasting capabilities and pricing insights to improve inventory management, lower costs, and boost margins throughout the supply chain.

Understand the opportunities and challenges

Today's F&B environment is challenging for processors and manufacturers. Even as food prices are expected to rise as much as 3.5 percent in 2014,[1] any gains quickly disappear as large retailers and grocery store chains pressure manufacturers and packagers to keep prices down. Margins gained are soon margins lost. At the same time, the F&B sector has gone global, with vendors from around the world competing for space in every store and restaurant. Just as other industries have sought out low-cost country options before them, food and beverage customers now are taking a similar route. Even large manufacturers are able to exert only limited leverage in the marketplace.

Changings customer demands are only part of the profitability puzzle for F&B executives. Why? Because many of these firms haven't kept up with advances in SCM strategy and technology, leaving them with inefficient procurement, production, and distribution systems. Without visibility into all business processes — including those that extend out to furthest suppliers and producer/growers — these leaders can't optimize their revenue and profitability models — or even identify the problems that make them inefficient in the first place. All those incremental cents of inefficiency per SKU collectively contribute to a huge profit drain.

Globalization and information technology are transforming the F&B industry, but the transition to a digital business framework requires both strategy and a tactical plan.

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[1] USDA, Economic Research Service. Food Price Outlook, 2014; data for food, food-at-home, and food-away-from-home CPIs.

U.S. food imports rose from $23.9 billion in 2003 to $52.8 billion in 2013.

These problems typically affect five key areas:

- *Supplier quantities:* It's essential that agricultural products — as well as packaging and other materials — are procured efficiently. Any disruption that slows manufacturing processes leads to losses when perishable food items are involved. Business systems must better synchronize ingredient shelf life to production cycles and minimize losses due to spoilage, all while still leveraging volume discounts that make sense.

- *Product availability and delivery:* Thanks to global competition and the Internet, consumers wield more power then ever. If a product isn't available — or if competitors offer a better value proposition — consumers will switch instantly and sometimes permanently. There is no faster way to lose revenue and profit than to have an empty shelf space where your product should appear. F&B firms must analyze demand in real time in order to optimize purchasing, manufacturing, and distribution processes. They also should be using this data to get ahead of shifting consumer tastes and to feed ideation processes that deliver innovative new products.

- *Pricing:* Retailers, grocery store chains, and restaurants exert tremendous pressure on F&B companies to keep their prices down. Leading firms are using analytics and real-time data to better understand demand trends, fine-tuning their pricing models for state-of-the-art yield management. Price cuts may drive revenue and lure a new customer, but they also can drive down margins and, if overdone, leave shelves empty (*see above*).

- *Quality:* Product safety is paramount in the F&B industry. Maintaining rigorous standards requires a well-designed set of metrics and KPIs to ensure high quality throughout the supply chain. With expanding global vendor bases — U.S. food imports rose from $23.9 billion in 2003 to $52.8 billion in 2013[2]— the likelihood of quality problems also increases exponentially. F&B organizations must have integrated systems that provide visibility into remote processes and events to catch problems before they reach the market. The losses associated with food quality and safety problems is enormous.

- *New product development:* Rapidly changing consumer preferences force F&B companies to quickly reformulate products. For example, demand for healthy products has processors reformulating products and/or changing labeling to emphasize healthier ingredients. New technologies allow F&B firms to coordinate a team of vendors to help develop and deliver new products on-time and on-budget. Margins are highest for new products that accurately hit their market windows — as time passes, new-product margins typically erode.

F&B executives recognize the need to improve: 40 percent of U.S. industry executives cite operational improvements and significant cost reductions as the top strategic initiatives for their firms, and pricing concerns are seen as a significant threat to revenue growth and profit margins.[3]

[2] TradeStats Express, U.S Department of Commerce.
[3] KPMG's Food and Beverage Industry Outlook Survey, 2012.

Map processes and gain a 360-degree view

Globalization and information technology are transforming the F&B industry, but the transition to a digital business framework requires both strategy and a tactical plan. The first step is a business-systems assessment — an analysis of SCM gaps and problem points that drain cash and diminish performance, with an eye toward improving them via new practices and technologies. Savvy executives focus first on internal improvements, including:

- Development of production schedules and the capability of processes to meet those schedules;
- Rationalization of product portfolios, including optimization of SKUs for profitability;
- Digital coordination of sales and marketing efforts to maximize revenues while collecting data on changing consumer preferences; and
- Managing a global supply base.

External factors especially demand SCM visibility. As product distribution goes global, it's often difficult to forecast demand across different markets and customer segments. The introduction of new or reformulated products further complicates matters as companies coordinate new suppliers, new ingredients, different materials, and a variety of process changes. Effective systems drill down to data specific to each SKU's suppliers, production lines, and distribution channels.

Another key assessment issue is materials tracking and the timing and integration of deliveries. Varied raw materials and ingredients make supplier-performance and quality tracking difficult. Many F&B companies are moving from two-dimensional barcodes to electronic product codes (EPC) and RFID tags, in which sensors measure temperature and other factors to ensure quality.

All these factors contribute to a level of complexity that can escalate costs and damage margins. For example, organizations without visibility may miss vendor price variances and fail to take advantage of buying opportunities. Conversely, they may also miss signals of falling demand, leading to overproduction and product spoilage.

Improved ERP functionality also provides an advantage in recruiting, leveraging, and retaining talent. As manufacturing professionals retire, the younger workers replacing them bring heightened expectations for enterprise software: easy-to-use tools that encourage continuous improvement and learning, and immediacy in decision-making and action. They want the speed of texting, the clarity of instant photo-sharing, and the intuitiveness of an app.

Benefits of the digital business model

Effective use of SCM tools within your ERP or as a standalone application can help an enterprise control a wide range of variables — purchasing costs, quality controls, pricing, speed to market. The right mix of information technology and processes ultimately contributes to a healthier, higher margin business — and one that's better equipped to see and deal with unexpected changes throughout the supply chain:

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- *Customer and market visibility:* One of the biggest benefits of SCM tools is access to accurate, real-time data from a disparate array of IT systems, databases, and even social media feeds. Plugging all this data into robust analytics tools offers insights that could not have been imagined just a few years ago. As coordinated forecasts and supply-chain systems take shape and data gaps disappear, forecasts become more precise and dependable. What's more, the information is available on an anytime, anywhere basis — in whatever manner managers require.

  Nearly two-thirds of F&B executives cite analytics as a key to gaining customer insight, and 57 percent describe them crucial for brand and product management, according to KPMG. A majority of U.S. F&B executives also indicate that they're important for pricing decisions. Yet only 17 percent of the executives say that their firm has a high level of data analytics literacy, and 25 percent admit that they're lagging or don't know.[4]

- *Vendor visibility:* Supply-chain visibility and analytics also improve the management and performance of suppliers, giving manufacturers confidence to implement just-in-time materials and ingredients deliveries that reduce spoilage and waste. This also allows purchasing and procurement to take place based on the best supplier, goods, and price at any given moment. Executives can confidently select from a broader array of suppliers based on speed, quality controls, delivery systems, payment terms, etc.

  F&B firms armed with data are also in a position to negotiate better pricing and payment terms from suppliers. They can standardize product attributes and recipes, further reducing inventories and waste. And they are able to improve their knowledge base and construct a more intelligent and connected supply chain and enterprise. The end results are better products and an ability to react to changing vendor conditions more quickly.

[4] KPMG's Food and Beverage Industry Outlook Survey, 2012.

Design an end-to-end vision

Today's F&B manufacturing and distribution environment is remarkably complex. Businesses must have a deeper understanding of market trends, consumption patterns, distribution models, and sourcing opportunities — and *collectively* analyze these factors across markets, regions, demographic groups, and more. Only by clearly seeing in real time how all pieces of the supply-chain function — cost, quality, speed, etc. — can F&B businesses drive down costs of all supply-chain pieces; streamline handoffs from piece to piece, externally and internally; and drive up margins.

Obtaining this three-dimensional view of the business requires an SCM system and IT tools that synchronize with constantly improving business processes. Organizations that can capture information, leverage advanced data analytics, and gain an end-to-end view of their business and supply chain are positioned to transform today's industry challenges into opportunities — and to tap the full potential of today's fast moving business environment.

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