SAP White Paper
SAP for Consumer Products

TAKING CONTROL OF YOUR BUSINESS

Best Practices for Survival in the Food Industry

THE BEST-RUN BUSINESSES RUN SAP™

CONTENTS

EXECUTIVE SUMMARY

It's no picnic in the food industry these days. Companies in all segments – from fresh, frozen, and canned fruit and vegetables to meat, dairy, grain, pasta, and baked goods – are facing pressures from every side. Issues around food safety and security, evolving consumer tastes, increasing retailer power, financial compliance, and corporate responsibility are combining to create a challenging and often volatile business environment.

Plagued by low revenue growth, fierce competition, and industry consolidation, food companies are under enormous pressure to cut costs. Meanwhile, increasingly sophisticated consumers are demanding constant and rapid product innovation, while shareholders – and governments – call for greater levels of corporate accountability. These forces are causing food companies to search for new ways to improve margins, increase asset efficiency, and manage food safety risks, all while introducing the new products that can help grow revenues.

How can a food company remain competitive while pressed from all sides by the government, consumers, competitors, retailers, and suppliers? It can employ leading best practice solutions to gain control over every aspect of the business and move from a reactive to a proactive business stance. This paper will detail how food companies can enable process efficiencies that reduce operating costs, support rapid product innovation, increase visibility across the supply chain, and effectively track and report on their compliance in order to remain competitive in a difficult market.

MARKET PRESSURES

Today's food company is experiencing unprecedented market pressures, ranging from eroding margins and requirements for faster innovation to issues around food safety and security. Let's take a moment to look at these factors in greater detail.

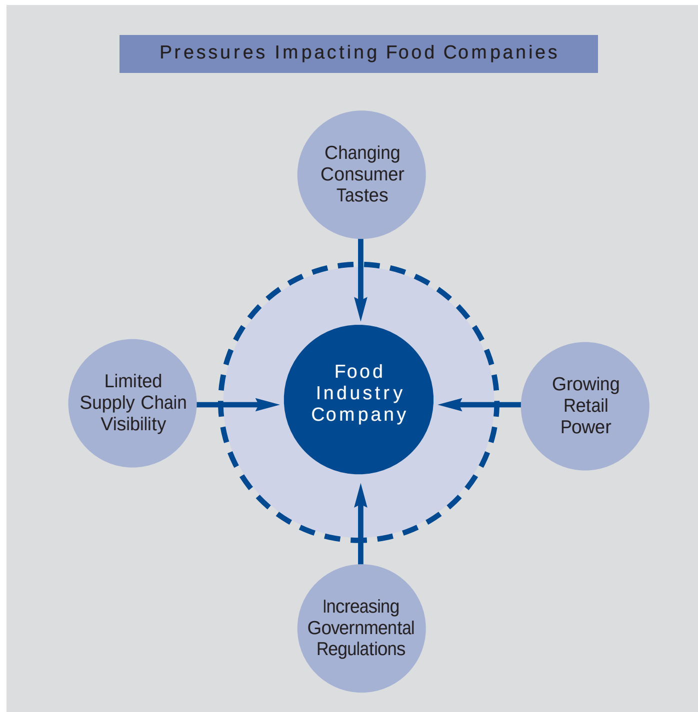

Figure 1: The Pressures Impacting Food Companies

Growing Retail Power

As illustrated in Figure 2, more than 50% of total retail sales are generated by the top ten food retailers, including Wal-Mart, Carrefour, Tesco, and Ahold. Because retail buying power is highly concentrated in these few key accounts, food companies find themselves in a reactive mode, always trying to respond to the latest round of demands from retailers. These demands often include the following:

- Lower prices in an already low-margin business. An astounding 72% of the respondents in a UK–based *Food Manufacture* survey of readers claimed that "pressure from retailers to cut costs risked compromising quality." One respondent noted that "much of the industry is running at a marginal level of profitability." Another blamed retailers "with the eradication of true partnerships and emphasis on cost, not quality." At the same time that retailers are mounting significant price pressures, the cost of doing business continues to rise, further squeezing the profit margins of food companies. The food and beverage segment of the consumer products industry has been particularly hard hit by rising commodity prices, as Figure 3 indicates.

- Shorter order-to-delivery cycle times, which introduces a whole set of logistical implications. On one end of the spectrum, convenience stores are remerchandising multiple times during the day, requiring replenishing throughout the day rather than daily. On the other end, a traditional supermarket may need to replenish stock more frequently than the usual weekly cycle.

- Rapid removal of under-performing products, which represents a particular challenge to branded products. Because of the growing popularity of private labels, retailers are less inclined to reorder branded products that are not meeting sales expectations, forcing packaged food companies to constantly adjust their product lines.

- The ability to act as a global "super supplier," a new category created as a result of the largest food retailers consolidating their supply bases. As a super supplier, a single food company can supply a complete product category for a very large retail account, but only if it has systems and infrastructure in place to support an effective, agile, and responsive supply chain.

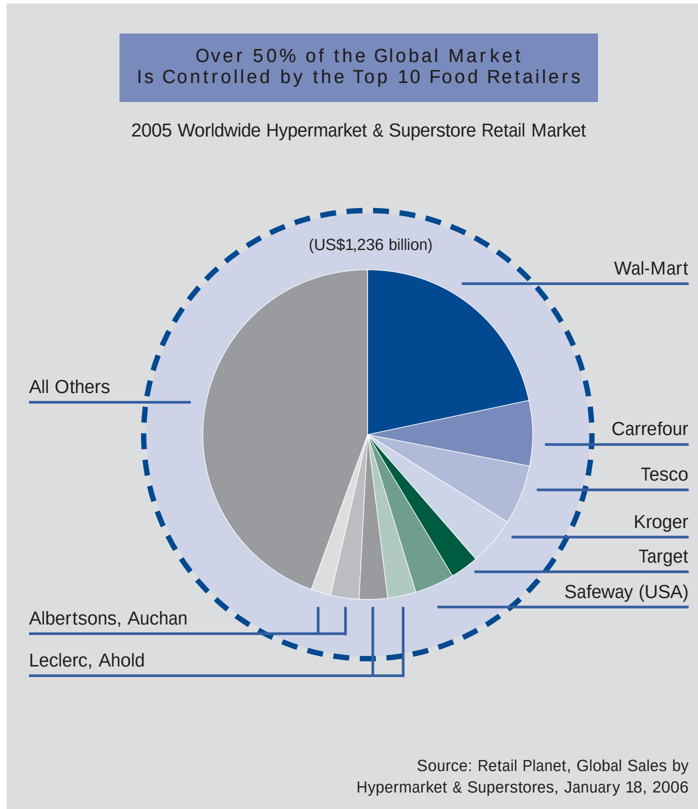

Figure 2: Food Retailers That Control the Global Food Market

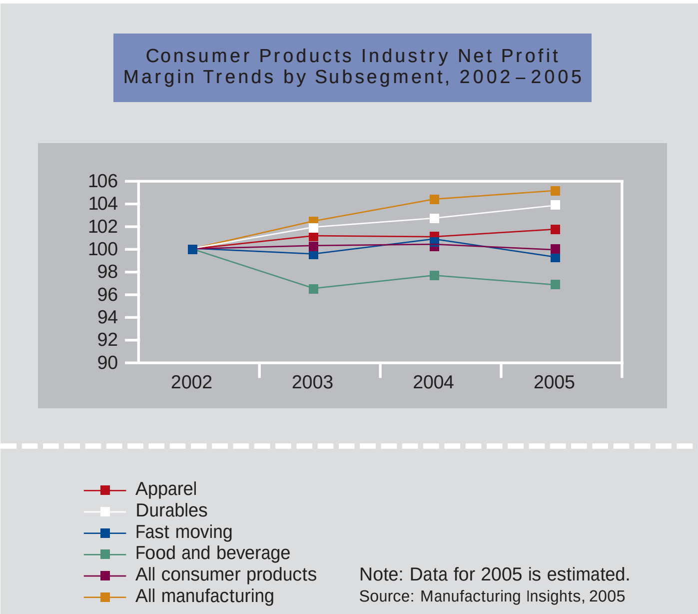

Figure 3: Net Profit Margin Movement in the Consumer Products Industry

If food companies are going to meet these retailer demands, they must adopt effective planning methods and streamline operations. A food company that is able to remain flexible and responsive to retailers is better positioned to become a preferred supplier – giving it the opportunity to grow revenues and gain market share as its retailer partners grow.

Changing Consumer Tastes

Consumer tastes are constantly evolving, putting pressure on food companies to continuously introduce new products. Consumer brand and product loyalty continues to diminish as a result of shifting demographics, life-style changes, and the growing popularity of private-label food products. Because it is more difficult than ever for food companies to retain customers with traditional product offerings, rapid new product introduction is critical to capitalizing on consumers' changing tastes. Let's take a look at what is motivating these shifting consumer demands.

Consumer tastes and demands are being shaped by health issues, changing life styles, diverse cultural backgrounds, and awareness of worker and animal treatment, particularly in the testing process. Aversion to genetically modified (GM) food in Europe has already forced food companies to label their products as being GM-free. Concern over unhealthy fat content in processed foods has spawned a "0 trans fat" labeling trend in the United States. Other lifestyle changes are leading to the emergence of categories such as organic, gourmet, quick-to-prepare, ethnic, and healthy foods. These new categories are fueling the need for continuous food product innovation. Consider the organic food category, which has grown between 17% and 21% each year since 1997, compared with total U.S. food sales, which grew at an average of 2% to 4% a year.[1] No longer considered a fad, organic food retail sales were expected to top US$20 billion by year's end in 2005.

In addition to consumer-led changes, retailers are helping to shape consumer tastes by investing heavily in improving both the marketing and quality of their private-label brands. As a result, private-label products continue to grow in popularity, taking market share away from branded packaged foods. As shown in Figure 4, a 2005 study conducted by ACNielsen found that within private labels, refrigerated foods (containing such categories as milk, cheese, and complete "ready meals") grew at more than triple the rate of the perennial leader in private labels: "paper, plastic, and wrap." The rise in refrigerated food

1. Organic Trade Association, "2004 Manufacturer Survey," May 2004.

confirms a steady trend in the private-label strategy of retailers worldwide, pushing private-label products into premium segments that go beyond the low-price, high-volume commodity-driven practices of the past.

"Strategically, retailers worldwide seem to be placing more and more emphasis on branding and marketing their private-label wares to match the lifestyles and values of their shoppers," noted Jane Perrin, managing director of ACNielsen Global Services. "From the Tesco Healthy Living range of products to Loblaw's President's Choice expansion into organics and health-oriented lines, retailers are expanding their brands far beyond a singular focus on low price points."[2] Because of these trends, consumers expect higher-quality products at the lowest possible prices, creating additional pricing pressures even on unique food brands.

	Product Area	Private-Label Share	Private-Label Growth
1	Refrigerated Food	32%	9%
2	Paper, Plastic, and Wraps	31%	2%
3	Frozen Food	25%	3%
4	Pet Food	21%	11%
5	Shelf-Stable Food	19%	5%
6	Diapers and Feminine Hygiene	14%	-1%
7	Health Care	14%	3%
8	Nonalcoholic Beverages	12%	3%
9	Home Care	10%	2%
10	Snacks and Confectionery	9%	8%
11	Alcoholic Beverages	6%	3%
12	Personal Care	5%	3%
13	Cosmetics	2%	23%
14	Baby Food	2%	13%

Figure 4: Private-Label Shares and Growth Rates by Product Area (Based on Value Sales)

Responding to these changing consumer tastes has been challenging for many food companies, especially midsize food companies. Midsize companies usually lack the IT and market research resources to adequately track and monitor changes in consumer demand, let alone to respond to them. This shortcoming will ultimately result in lower revenues and further market share loss.

Limited Supply Chain Visibility

The constant price pressures applied by leading retailers has forced food companies to look for areas in which they can reduce operational costs – such as streamlining their processes for quicker order fulfillment. An example is using electronic data interchange (EDI) to execute advanced ship notifications for retailers and receive the notifications from suppliers. However, limited visibility across the supply chain often impedes these efforts to decrease costs and optimize operations. For midsize food companies this challenge is exacerbated, because they have less volume to absorb or compensate for lower prices and fewer areas for which they can effect cost reductions.

Due to limited capital resources, past IT purchases at these companies were usually based on price and the need to solve short-term problems – placing little emphasis on long-term functionality. As a result, they may have multiple nonintegrated legacy systems that make it difficult, if not impossible, to produce the cross-organizational information and supply chain insight they need to make educated decisions and adequately adjust to changing market conditions.

Increasing Governmental Regulations

Strict governmental regulations on food safety and financial reporting can result in complicated and expensive compliance programs that further inhibit food companies from making the cost reductions necessary to remain competitive.

2. ACNielsen, "Growth of Private-Label Continues Worldwide," press release, September 27, 2005.

Food Safety and Security

Food security has become a hot topic, what with the rise of massive food recalls and threats of deadly diseases. Protecting consumers and businesses against the consequences of safety-related failures and mitigating the risk of bioterrorism is now a top priority for many food retailers and manufacturers.

In response to these threats, food safety requirements are becoming more stringent. This has translated into a mandate for food companies to have track-and-trace capability for all products, as well as the ability to recall a defective batch. Specifically, it is necessary that they be fully compliant with food regulations, such as EU Article 18 of Regulation 178/2002, the U.S. Bioterrorism Act of 2002, and Hazard Analysis and Critical Control Points. The net result is that food companies need end-to-end ingredient transparency and traceability – at an accurate and detailed level – for all products they produce, process, and distribute.

Financial Compliance

Many food company executives must certify that their financial reports have been reviewed, contain only true statements, and do not omit any material facts. For example, the U.S. Sarbanes-Oxley Regulation Section 301 requires that management certify internal controls, while Section 404 requires that management annually assess the company's internal controls and procedures for financial reporting. Other companies comply with International Financial Reporting Standards (IFRS) requiring transparent and comparable information for all general-purpose financial statements.

Complying with these increasing government regulations is an imperative, but it also drains resources necessary to meet market demands. The problem is compounded for midsize food companies, which have the same compliance requirements as larger companies but lack the IT and financial resources to effectively address them.

BEST BUSINESS PRACTICES IN THE FOOD INDUSTRY

In order to mitigate the external pressures from retailers, consumers, and the government, a food company must alter its stance from reactive to proactive. By following best practice approaches, management can take control of financial and operational activities and make the forward-thinking decisions that will help the company maintain and gain market share. Based on 30 years of experience working with over 900 companies in the food industry, SAP has developed an understanding of how progressive food companies institute best practices to maintain a competitive advantage. These industry best practices include the following:

- Establishing processes to respond quickly and effectively to increasing retailer demands by **using technology to improve process efficiencies and ultimately reduce operating costs**
- Ensuring the ability to quickly address changing customer tastes **through rapid product innovation and a streamlined product development cycle** – from recipe through rollout
- Helping to optimize operations by **improving visibility across the extended supply chain** – from supplier to consumer
- Ensuring **compliance with government regulations** using a coordinated compliance program

Using Technology to Improve Process Efficiencies and Reduce Operating Costs

In order to respond to the increasing pressures from retailers to reduce costs, food companies must implement process efficiencies and trim operating costs – all while maintaining product quality. Technology solutions are often the key to meeting these challenges. Specifically, food companies must implement technology that supports an integrated order-to-cash process; inventory management and direct store delivery; and the ability to load, dispatch, and track deliveries efficiently.

An integrated order-to-cash process can eliminate manual processes and lower IT costs. Moving toward an integrated order-to-cash process requires food companies to connect their disparate point solutions and increase the accuracy of critical business information. Process efficiencies such as shortening order-cycle times, meeting on-time and in-full delivery targets, and providing customers with preferred payment methods need to be the focus of these improvements. To effect these changes, food companies must be able to meet retailer requirements for variable pricing, delivery, invoicing, and payment automation. EDI capability and the ability to handle consignment sales and support foreign trade are also important to improving operating efficiencies.

In addition, food companies need **inventory management and direct store delivery (DSD) capabilities** to attract and retain key retailers – and to be considered a potential super supplier. Managing inventory levels efficiently – maintaining low inventory levels while avoiding out-of-stock situations – is a high priority for food companies and their customers. A best practice is to optimize both inventory levels and storage space based on inventory planning and turnover – an effective method for reducing working capital and inventory carrying costs. At the same time, quality checks can be performed in combination with warehouse and transportation management, helping reduce administrative costs associated with the order-to-delivery cycle.

For those retailers that require DSD, food companies must have a way to **load, dispatch, and track any number of deliveries efficiently.** With route-planning tools optimizing the entire approach to deliveries, food companies can eliminate redundant trips by dispatching the appropriate vehicles and drivers to their customers. This will allow them to shorten order-to-delivery times, a key metric tracked by large retailers.

By adopting technology solutions that facilitate an integrated order-to-cash process, improve inventory management, and help support effective DSD, food companies can be more responsive while lowering costs. In short, moving away from multiple, disparate systems and processes to integrated, functionality-rich systems will enable food companies to regain control of business processes and better meet the demands of retailers.

Supporting Rapid Product Innovation and Streamlined Product Development

In order to shorten the product life cycle and better meet the rising consumer demand for innovation, it is essential for food companies to control the entire multistep product development, procurement, manufacturing, and promotion process. They need an integrated solution that can track, analyze, and manage individual product profitability from recipe to rollout to promotion.

For example, **new product development** can be managed more efficiently by allowing for structured, reusable product specifications. These product specs can be used to cast an initial bill of materials that is then automatically integrated into the procurement and manufacturing planning process. By doing this, food companies not only reduce their development cycle times for faster time to market but also ensure consistent product information on a company-wide scale. These improved efficiencies can release monies to fund important projects, for example, in research and development. R & D is essential to sustaining product innovation and increasing brand equity – two strategies that are especially important for responding to the growth in private labels.

For **procurement**, your technology solution should support automated vendor pricing and contract comparison to improve price negotiations and vendor selection. It should provide tools that offer greater spend visibility in the procurement process – from managing quotes, contracts, batches, and quality to automating operational tasks.

In the area of **manufacturing**, food companies should strive to postpone final packaging as long as possible. This allows the greatest flexibility in meeting retail requirements and changing consumer preferences. Final packaging flexibility can help support changes related to seasonal or promotional packaging, sizing, and packaging innovations.

A closed-loop process is needed to track the five major steps in **trade promotion**: planning, accounts planning, sell-in and negotiation, retail execution and validation, and pre- and post-event evaluation and analysis. This structured approach to trade promotions can provide a food company with the ability to react to and effectively execute planned promotions. In addition, a closed-loop process will reduce the out-of-stock situations caused by mismatched supply and demand that results from poor promotion planning.

Increasing Visibility Across the Extended Supply Chain

To support a global food supply chain and meet stringent food safety requirements, food companies need to establish business processes and an underlying system consistent with retailer demands for cost-efficiency, good service, quality, and traceability. In other words, food companies must increase visibility into the extended supply chain from sourcing of materials to production, distribution, and consumer purchase.

As a starting point, companies can utilize EDI to better understand the delivery and receipt of raw materials. As traceability requirements become more sophisticated, companies may need to adopt radio frequency identification (RFID) methods that improve handling efficiencies and supply chain performance. With new technologies that utilize RFID and scan-based trading, food companies can view and analyze more types of information. When used strategically, these technologies allow the food company to track and report on individual products, resulting in better managed and more profitable products.

Food companies also need the flexibility to manage multistep manufacturing processes. This ability should incorporate in-process and post-process quality management and automatic batch determination based on expiration date. By defining product inspection and related usage rules, food companies can quickly identify lots that do not meet quality standards. In addition, automated batch-number generation can help manage expiration dates. An integrated solution also includes cost-object controlling, such as preliminary costing, simultaneous costing, and period-end closing, for more accurate calculation and monitoring of production costs.

Effectively Tracking Compliance

As food safety compliance becomes more stringent, the ability to support food ingredient–lot genealogy tracking and batch recall is mandatory. In order for a midsize food company to be compliant it must be able to capture all costs, batch details, and quality metrics as well as facilitate the prompt reporting of potential abnormalities. This includes tracking ingredients from the point of procurement to finished product and the ability to identify and recall a defective batch at any point in the process. In addition to meeting industry requirements, a company can minimize the risk of losing customer trust and confidence when it can professionally manage a possible recall of a defective batch and process batch-specific returns rapidly.

Performance management frameworks have traditionally focused on metrics related to cost and service. However, given the challenges posed by new regulatory compliance, measurement frameworks can be leveraged and expanded to encompass supply chain integrity and other compliance-related metrics. This can include quality, environmental, ethical, and assurance metrics. For example, quality metrics can include freshness at the point of purchase and temperature compliance throughout the chill chain. Environmental metrics can be used to track the creation and disposal of excess packaging.

In addition to maintaining food safety compliance, midsize food companies must also address financial compliance in an efficient and effective manner. A best practice for financial compliance is to utilize an integrated financial system that not only manages financial requirements and enterprise profitability but also tracks regulatory compliance. An enterprise resource planning (ERP) system such as this should be fully compliant and continuously updated with local and fiscal regulations. Ensuring compliance with Sarbanes-Oxley, IFRS, and other regulations will allow companies to focus on mid- and long-term operational goals and regain control over their business processes and profitability.

BUSINESS BENEFITS OF USING AN SAP® SOLUTION IN THE FOOD INDUSTRY

SAP offers a comprehensive, world-class solution that includes ERP and is uniquely tailored to the processes of the food industry. The SAP® solution can be implemented at a defined price in as little as 12 weeks, depending on specific requirements. This preconfigured solution, when implemented by an SAP partner and our network of food industry experts, can reduce costs by more than 50% (compared to traditional approaches). A survey of leading manufacturers shows that SAP solutions achieve real results, improving labor efficiency by as much as 40%, reducing inventory by an average of 30%, and cutting financial closing times in half.[3]

Specifically, SAP offers software and services that help midsize food companies improve operational efficiency, support rapid product innovation, increase visibility across the supply chain, and address regulatory compliance issues. SAP provides a food industry solution that focuses on key business processes, creating a baseline for future growth, delivering immediate benefits by solving the problem of system heterogeneity, and enabling significant business-process automation.

Tracking key performance measures such as gross profit, net case growth, inventory turns, purchased raw material volume, production schedule adherence, and warehousing or distribution costs, the SAP solution helps food companies target specific areas for improved performance. From managing the supply chain, logistics, and operation to providing financial control and corporate services, the SAP solution for the food industry provides a single integrated platform that solves the vexing problems posed by multivendor, heterogeneous IT environments.

The SAP solution for the food industry provides baseline ERP functionality that supports nearly every aspect of food manufacturing and distribution from production planning and warehouse-logistics management to commercial and back-office functions such as pricing, promotions, contract management, and finance.

CONCLUSION

Midsize food companies face several daunting challenges that can impede their ability to remain both competitive and profitable. Consolidating retailers have greater power and wield it with a strong hand, demanding lower prices, rapid product delivery and removal, and supply chain efficiency. Fickle consumers constantly change their tastes, putting pressure on companies to innovate quickly. Old technology has hampered visibility along food supply chains, a reality that is no longer acceptable given the demands of retailers and consumers – not to mention the growing list of government requirements and regulations. Food safety and bioterrorism are huge concerns that impact how food companies must track their products and all of the ingredients that go into them. Furthermore, new fiscal regulations, such as Sarbanes-Oxley, demand a new level of financial accountability that is putting immense strain on resources.

To survive and ultimately thrive, food companies must rethink the way they do business. They must adopt best practices that streamline their operations and provide increased visibility into every aspect of their business – from product innovation and manufacturing to operations and finance. Companies that continue to be reactive to industry, market, and government pressures will fall behind. Those that take a proactive approach – and adopt the technology needed to support it – will ultimately take control of their business and come out ahead.

Taking a proactive stance requires food companies to implement an integrated technology solution that reduces IT complexity while helping to improve business processes, asset utilization, and cash flow. With an integrated solution, food companies gain the timely, accurate insights they need to make proactive business decisions that drive profitability and performance.

3. Martin Selchert, SAP Press, “Enhanced Project Success Through SAP Best Practices,” International Benchmark Study, 2004.

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50 078 531 (06/03) Printed in USA.