A Recipe for Improving S&OP in the Food Industry

Leveraging Margin-Driven S&OP to Overcome Volatility in the Food Supply Chain

Contents

Introduction 3

Competing in a Volatile Market 3

Sales and Operations Planning (S&OP): What's Working and What's Not 5

Leveraging Margin-Driven S&OP 6

Improved Predictability and Profitability 7

Introduction

In terms of overall goals, food manufacturing companies continue to be focused on higher sales and profitability. Of course, they must achieve these goals while driving innovation and ensuring food safety and product quality. Today's food companies are challenged by increased commodity and market volatility and tighter margins. The combination of more new products, more promotions and the changing supply landscape, makes it increasingly difficult to meet these goals.

Traditional Sales and Operations Planning (S&OP) practices, which attempt to address these issues using cross-functional teams, spreadsheets and limited analysis, have found limited success in the food industry. The complexity of the food supply chain and the industry's paper-thin margins require a holistic framework that allows companies to greatly enhance the accuracy, speed and robustness of their supply chain decision-making. This white paper outlines how food manufacturers can leverage margin-driven S&OP to overcome volatility in their supply chain.

Competing in a Volatile Market

It has become imperative for food and beverage manufacturers to sense changes in demand, commodities or supply so they can respond quickly to increase revenue and protect margins.

For many companies in today's market place, sales growth has declined. However, leaders have done better than laggards in the following three elements of competitive performance:

- Introduction of new products in shorter cycles
- Cost competitiveness
- Investment in retailing experience

As all companies today move past the investment phase, the competitive differentiation has come down to the how quickly they introduce new products, how the new products can be made profitable in a shorter span of time and how they respond to rising costs due to demand and commodity volatility.

According to recent studies, most of the best in class companies understand the fact that volatility and margin pressures are here to stay. The average company has seen a 1% degradation of operating margin over the last decade.

©SCA Technologies LLC

Figure 1 below shows some excerpts from annual reports of few industry leaders.

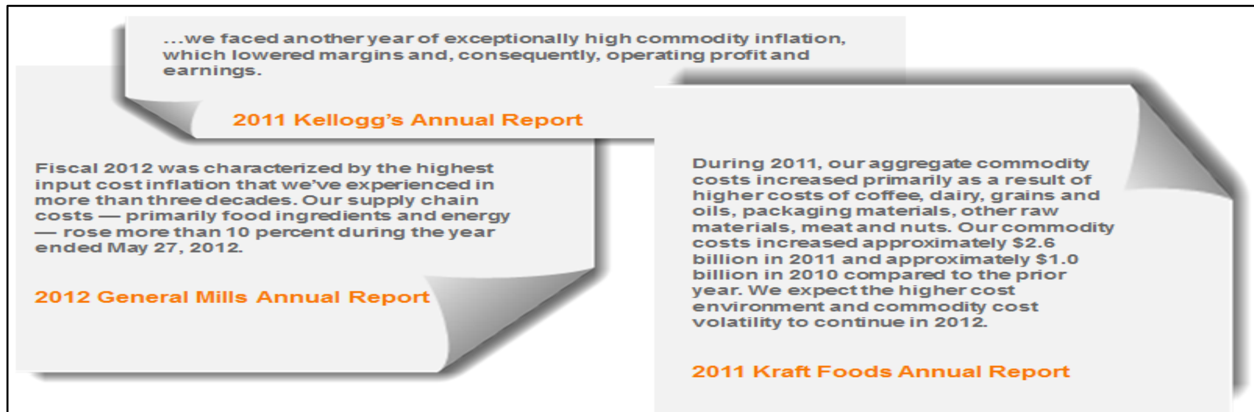

Figure 1

The same message comes through from the finance and treasury departments at these organizations. Figure 2 below shows data from a recent survey done by CFO magazine. As evident, their top priorities are to have a reliable budgeting and forecasting process and increase the accuracy in their projections. An interesting conclusion that also can be drawn is that a large majority say that as the volatility has increased, their planning accuracy and ability to project margins has gone down.

Figure 2

The question is – why? Obviously, volatility poses its own challenges; however, it should be possible to plan ahead for various situations. But this requires reliable systems and processes. According to a recent survey done by CFO magazine, only about 10% are happy with the systems and processes they have for meeting the company margin goals. Figure 3 expands upon this trend.

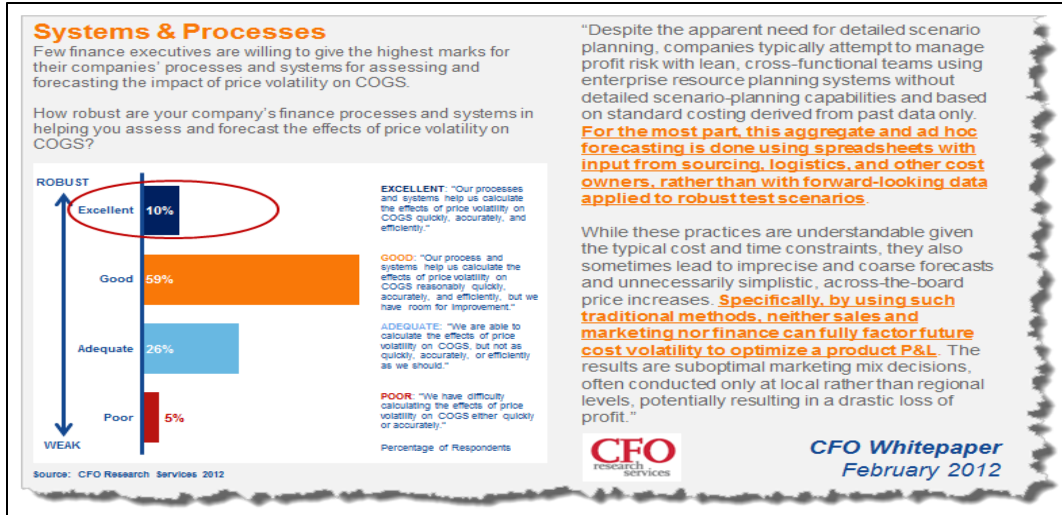

Figure 3

So clearly, from an industry background, a few things are preventing companies from meeting margin goals. They need better visibility to good quality data at the right time, predictive analytics and a more collaborative process for managing margins and costs.

Sales and Operations Planning (S&OP): What's Working and What's Not

Today the majority of food companies have instituted Sales and Operations Planning (S&OP) in order to meet with demand variability, maintain margins and control costs. S&OP brings together the operations and demand plans, and aligns them with the business plan for a given company. Every company conducts its S&OP process differently, but they all serve the same purpose. Figure 4 shows a schematic representation of a typical S&OP process and its key elements.

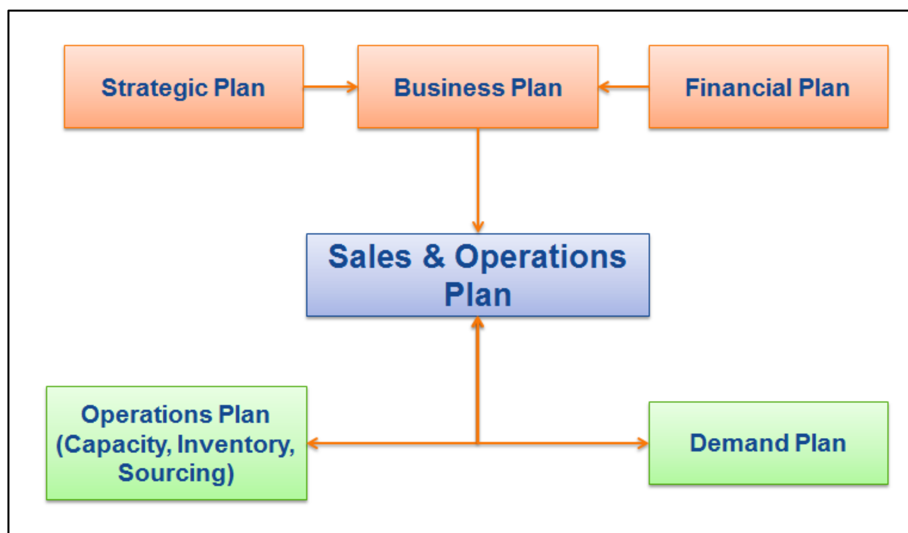

Figure 4

According to our studies across the food and manufacturing industries, most of the companies that have implemented an S&OP process today, however not many have automated the process. Perhaps more troubling, the focus has been mainly on balancing supply and demand, rather than on improving company margins.

Challenges to effective S&OP include:

- Managers are spending a great deal of time getting the data. And when they do get it, it is not the right data.
- Limited ability to plan and evaluate alternative scenarios.
- The process is set up today to align supply and demand – so often it is not aligning with the overall financial goals, especially the margin and profitability goals.
- Finally, there is no ability to test the effectiveness of the actions taken.

If we look at these gaps in the context of the increased volatility, the picture is even worse. Today's S&OP processes are simply not built to manage the volatility, whether in commodities, production or distribution. Most people today do not really have a notion of a cost-optimal S&OP plan. Additionally, the speed at which supply and demand change, one must analyze and plan alternatives essentially in real-time, which is lacking.

All of this means that while today's S&OP process is quite successful at its original goal, i.e. making sure that a company meets the demand for its customers, it misses the mark in terms of improving the margins and handling the volatility.

Leveraging Margin-Driven S&OP

Food manufacturers are under pressure to increase sales and preserve margins despite demand and supply volatility. They need to quickly develop and optimal supply plan and integrate that plan with customer opportunities in real-time. Traditional S&OP falls short of these requirements.

In order to maximize margins, companies need three key elements in their S&OP process:

- Have the right information at the right time
- Use the right kind of analytics to evaluate opportunities to mitigate volatility, reduce costs and meet margin goals
- Bring all of this together in an end-to-end, in-line, automated, dynamic process for cost and supply management.

So what does this dynamic process look like? It needs to cut across all these various functions, from revenue or pricing or channel management, to procurement, to sourcing and manufacturing, all the way to the suppliers and contract manufacturers. The process itself is dynamic and continuous. It starts with the companies' current plans and actuals, and synchronizes all these decisions, which then flow into a forward looking forecast for the business. This process repeats itself at a set frequency, ideally once a month, more often if the business is experiencing high amounts of demand and commodity volatility. Figure 5 below shows a schematic representation of the redefined process.

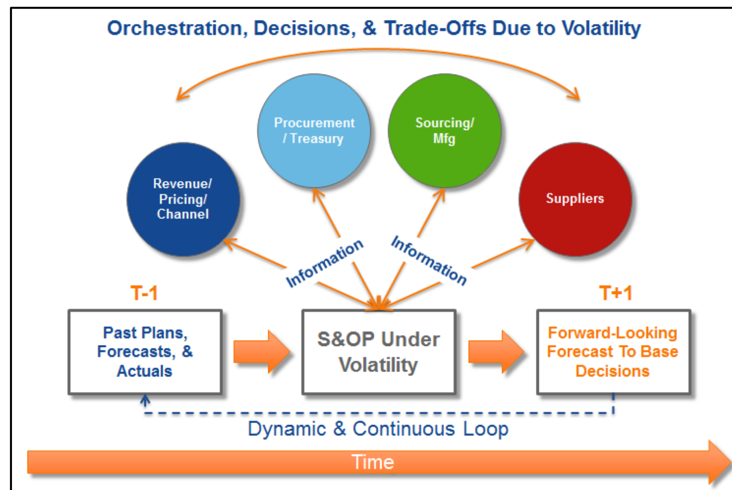

Figure 5

Improved Predictability and Profitability

The benefits are real, and can add up very quickly. Companies that have adopted this approach have seen lower cost of goods, an increase in the predictability of prices and margins, and a responsive supply chain that can handle more new products and promotions.

It all begins with the orchestration. Companies that do this well end up with a system of record and standard process for many of their core activities – sourcing, capacity planning, pricing, promotions and commodity management. The processes are collaborative within their departments as well as with suppliers, and it allows them to build meaningful partnerships with their suppliers so they can manage the supply, reduce costs and share the risks and rewards.

Secondly, it improves the resiliency. Most food companies today are selling more products than ever before. Promotions have increased, while there is more volatility in the supply base. Despite all of this, companies that have followed this novel approach have seen more reliable margins, and are able to put through more products and promotions. All this has some significant impact on the bottom line, typically in the order of 3-5 % in cost reduction. It also reduces the decision making time substantially. What used to take 2-3 months now takes a week. What used to take a week now can be done in minutes or hours.

Lastly, companies have managed to substantially increase forecast accuracy. They begin the year with a projected food and paper cost, and come in very close to it by the end of the year, thereby establishing the faith of the investors.

By working with SCA Technologies companies implement sourcing best practices that improve supply chain visibility and streamline cross-functional processes for planning, tracking and optimizing direct materials costs and prices. To learn about how you can reduce risk and better manage volatility contact SCA technologies today.

About SCA Technologies

For over a decade, SCA Technologies has provided category sourcing and cost management solutions that help industry leaders maximize profits by better managing market, supply and demand volatility. Supply chain, procurement, finance and corporate social responsibility professionals use the unique cross-functional approach of the SCA Planner™ suite to make better decisions for billions in category spend each year. With our patented technology, customers can finally address the tough challenges of volatile commodity prices, extended supply chain networks and corporate social responsibility tradeoffs in a coordinated manner. Our innovative, cloud-based solutions deliver increased visibility and quicker response, leading to an average 3-5% reduction in the cost of goods sold on an annual basis.

Learn more at www.scatech.com