

FMCG Industry Issues Workshop

18 March 2008

: FGC

NEW ZEALAND FOOD & GROCERY COUNCIL

AdvisorBase

Who we are ...

AdvisorBase

- FMCG industry specialists
- Decision support analysis –
 - Core capability is scenario modelling
 - Core expertise

Presenters

- Jeremy Howcroft
- Louise Williams
- Charles Wilson

www.advisorbase.com

Issues facing the industry this year – well some of them

Increased competition, not just from competitors, but customers too will increase pressure on profitability

- Optimise customer & product profitability through:
 - Cost to serve analysis
 - Route to market optimisation
 - Performance based pricing
- Increased pressure on trade spend + increasing proportion of sales on promo ~ align pricing mix and product performance
- Range rationalisation ~ pricing appropriately across range.
- Primary freight ~ a whole new ball game
- Shake out of efficiency terms
- Cost and performance pressures across the supply chain:
 - Inventory management
 - Freight rates matched to business
 - Demand planning

Objectives for the day

- Route to market
 - Illustrate outcomes of a Cost to Serve analysis
 - Demonstrate assumption rich scenario modelling process
 - Review route to market variables
- Performance based pricing
 - Review the dynamics
 - Provides insights via a case study
 - Provide list of 'red flags'
- Primary freight
 - Clarify what primary freight is
 - Illustrate some of the problems
 - Consider a possible role for the FGC
 - List factors to consider
- Sustainability
 - Assess the magnitude of the sustainability issue
 - Propose a practical method for managing sustainability
 - Review a simple example
 - Identify typical sustainability issues facing FMCG businesses

Common tools and techniques

We focus on the following tools & techniques:

- Cost to Serve:
 - Profitability by customer
 - Route to market example
 - Primary freight example
 - Profitability by product
 - Performance based pricing example
 - Sustainability example
- Scenario modelling applied to all examples
- Pricing dynamics applied to performance based pricing example

Cost to Serve

Previous seminars have covered the “How to”

This workshop focuses on using the output

Case study example is our *Beer ‘n Chip Co.*

- Applied to diverse areas of the business:
 - Freight
 - Customer profitability
 - Scenario modelling
 - Product profitability
 - Sales strategy/mix
 - Discounts and trade spend

For more info on the “How to”

Contact us: advisors@advisorbase.com

Visit of web site resource centre:

www.advisorbase.com/whitepages.htm

OR just talk to us

Scenario modelling – you just have to do it!

Answering the “what if?” questions is the key to making good decisions

- Decisions affect cost drivers
 - Order frequency = order size
 - Service levels
- Scenario modelling replaces the ‘status quo’ drivers with a new set
- To be really useful a scenario model should calculate the new drivers and replace the old – not just accept new driver values



Introducing Beer 'N Chip NZ Limited

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Beer 'N Chip is an illustrative company



We created the *Beer 'n Chip* to provide a case study vehicle that preserves all client confidentiality.

Beer 'n Chip has some interesting characteristics:

- Multi-category
- Diverse category characteristics:
 - High and low value products
 - Heavy and light products
- Products:
 - Premium beers
 - Quality chips
 - Superior dips



Beer 'N Chip is an illustrative company



We created the *Beer 'n Chip* to provide a case study vehicle that preserves all client confidentiality.

Beer 'n Chip has some interesting characteristics:

- Focused customer base:
 - Grocery
 - Grocery DCs
 - Grocery DSD
 - Mass Merchants
 - Pubs & Clubs
 - Distributors
- Diverse customer characteristics:
 - Grocery ~ unevenly split between major customers
 - Route trade ~ pubs & clubs
 - Distributors/wholesalers



Beer 'n Chip profitability by customer group

Pubs & clubs high net net margin is eroded by high cost to serve

	Total Business	Total Grocery	Total Other	Grocery DCs	Grocery DSD	Mass Merchants	Pubs & Clubs	Distributors
Gross Sales Value	100,000,000	54,750,000	45,250,000	17,200,000	37,550,000	4,250,000	23,650,000	17,350,000
Std terms	8,101,876	4,519,069	3,582,807	1,524,171	2,994,898	593,350	1,835,754	1,153,704
Promo on invoice	5,447,126	3,365,878	2,081,248	1,075,516	2,290,363	246,052	839,839	995,356
On inv. terms % GSV	13.5%	14.4%	12.5%	15.1%	14.1%	19.8%	11.3%	12.4%
Net on invoice	86,450,997	46,865,053	39,585,945	14,600,313	32,264,739	3,410,598	20,974,407	15,200,940
Net % of GSV	86%	86%	87%	85%	86%	80%	89%	88%
Settlement	2,812,500	2,005,579	806,921	623,556	1,382,023	154,025	-	652,895
Promo - co-op&rebat	3,499,079	2,855,521	643,558	902,683	1,952,838	107,750	44,971	490,837
Other terms % of GS	6.3%	8.9%	3.2%	8.9%	8.9%	6.2%	0.2%	6.6%
Net Net	80,139,418	42,003,952	38,135,466	13,074,074	28,929,878	3,148,822	20,929,436	14,057,208
Net Net % of GSV	80%	77%	84%	76%	77%	74%	88%	81%
Product Costs	44,548,634	25,040,757	19,507,877	7,665,784	17,374,973	1,644,176	10,034,002	7,829,699
Prod costs % of GSV	45%	46%	43%	45%	46%	39%	42%	45%
Net Margin	35,590,784	16,963,195	18,627,589	5,408,290	11,554,905	1,504,646	10,895,434	6,227,509
Cont. after product co	36%	31%	41%	31%	31%	35%	46%	36%
Warehousing & inwar	2,339,222	1,157,586	1,181,636	400,758	756,827	137,337	654,009	390,290
Order processing	2,005,514	1,082,068	923,446	204,117	877,950	26,307	769,909	127,231
Outwards handling W	1,793,712	776,472	1,017,241	199,739	576,732	51,588	792,817	172,835
Delivery to customer	2,979,751	1,483,402	1,496,349	318,422	1,164,981	130,290	1,035,089	330,970
Reps & Merchandise	4,767,063	2,347,112	2,419,951	32,447	2,314,666	5,705	2,262,029	152,217
Mg'ment; sales, key a	2,541,044	697,162	1,843,882	113,622	583,540	169,514	1,312,616	361,752
Financing; AR & inve	1,190,244	628,003	562,241	208,156	419,848	61,333	301,205	199,702
Total cost to serve	17,616,551	8,171,805	9,444,746	1,477,261	6,694,544	582,074	7,127,675	1,734,997
Cost to Serve as % of	17.6%	14.9%	20.9%	8.6%	17.8%	13.7%	30.1%	10.0%
Cont. after cost to s	17,974,233	8,791,390	9,182,843	3,931,029	4,860,361	922,572	3,767,759	4,492,512
Cont as % of GSV	18%	16%	20%	23%	13%	22%	16%	26%
Advertising & OH	10,891,209	5,962,937	4,928,272	1,873,288	4,089,649	462,876	2,575,771	1,889,625
other O/H % of GSV	11%	11%	11%	11%	11%	11%	11%	11%
Business contributi	7,083,024	2,828,453	4,254,571	2,057,741	770,711	459,695	1,191,988	2,602,887
Business contribution	7.1%	5.2%	9.4%	12.0%	2.1%	10.8%	5.0%	15.0%

Beer 'n Chip profitability by product group

Profit & Loss		Products			
	TOTAL	Ale	Larger	Pilsner	Wheat
Gross Sales	298,150	50,000	81,650	44,000	122,500
Trading Terms	17,680	2,500	6,390	2,420	6,370
Promo Spend	48,808	3,650	20,930	5,363	18,865
Net Sales Value	231,663	43,850	54,330	36,218	97,265
Cost of Goods	171,650	32,000	46,000	27,500	66,150
Gross Margin	60,013	11,850	8,330	8,718	31,115
Freight Costs	12,990	3,000	2,890	2,200	4,900
Net Contribution	47,023	8,850	5,440	6,518	26,215
NC % of Gross Sales	16%				

Profit & Loss - Larger		Customers		
	Total	X	Y	
Gross Sales	81,650	35,500	46,150	
Trading Terms	6,390	1,775	4,615	
Promo Spend	20,930	7,475	13,455	
Net Sales Value	54,330	26,250	28,080	
-				
Cost of Goods	46,000	20,000	26,000	
Gross Margin	8,330	6,250	2,080	
Freight Costs	2,890	1,200	1,690	
Net Contribution	5,440	5,050	390	
NC % of Gross Sales	7%	14%	1%	

***Beer 'n Chip* faces a few issues**

- Pub & Clubs channel is underperforming
- Lager beers are underperforming
- They have been invited to join retailer primary freight initiative
- The directors have asked for a review of business plan that will ensure the business is sustainable

With your help, we will work through these issues



Route to Market

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Cost to Serve – Route to market case study

Objectives of this session:

- Illustrate outcomes of a Cost to Serve analysis
- Demonstrate assumption rich scenario modelling process
 - Recognising driver assumptions
 - Recognise vested interests
- Review route to market variables
 - Selling strategy
 - Delivery strategy

A scenario model is a representation of reality ...

... it is not reality.

A scenario model assists decision making...

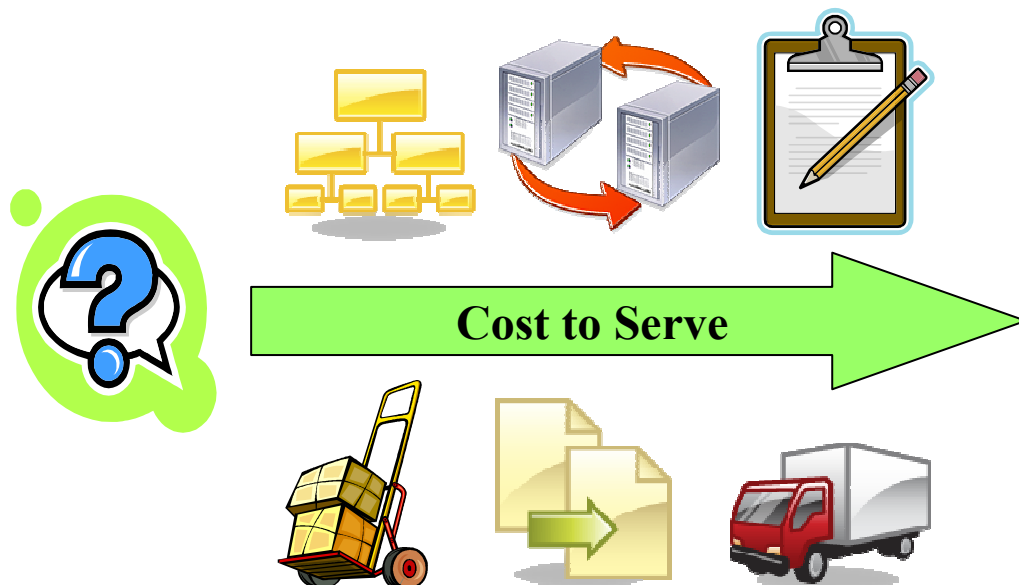
... it does not make decisions.

Cost to Serve - understanding profitability drivers

Beer 'n Chip recently completed a Cost to Serve analysis allowing them to understand customer profitability, product profitability, and customer by product.

Several questions arose from the project that needed further analysis and scenario modelling, amongst them:

- Why was the cost to serve the Pubs & Clubs channel so high?
- And what could be done about it?



Scenario	BEER	CHIPS	DI
sales	75,000,000	20,000,000	
Invoice terms	6,962,356	3,360,748	
After invoice terms	6,567,161	2,018,716	
Discounts as % of sales	18.0%	26.9%	
Net Net	61,470,483	14,620,535	
Net Net	Total Business	Grocery DCs	Grocery DSE
COGS	100,000,000	17,200,000	37,550,000
Net Mar	Gross Sales Value	8,101,876	1,524,171
Cont aft	Std terms	5,447,126	2,994,000
Wareho	Promo on invoice	1,075,516	246,052
Inwards	On inv. terms % GSV	13.5%	19.8%
Order pi	Net on invoice	86,450,997	14,600,313
Outward	Net % of GSV	86%	85%
Freight	Settlement	2,812,500	623,500
In store	Promo - co-op&rebates	3,499,079	902,000
Sales m	Other terms % of GSV	6.3%	8.9%
Key acc	Net Net	80,139,418	13,074,074
Finance	Net Net % of GSV	80%	76%
Cost to	Product Costs	44,548,634	7,665,784
Cost to	Prod costs % of GSV	45%	45%
Cont. A	Net Margin	35,590,784	5,408,290
Cont aft	Cont. after product cost % of GSV	36%	31%
Advertis	Warehousing & inwards handling	2,339,222	400,758
Direct a	Order processing	2,005,514	204,117
Busines	Outwards handling WH	1,793,712	199,739
Busines	Delivery to customer	2,979,751	318,422
	Reps & Merchandisers	4,767,063	32,447
	Mgmt: sales, key acc & categor	2,541,044	113,622
	Financing: AR & inventory holding	1,190,244	208,156
	Total cost to serve	17,616,551	1,477,261
	Cost to Serve as % of GSV	17.6%	8.6%
	Cont. after cost to serve	17,974,233	3,931,029
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	Advertising & OH	10,891,209	1,873,288
	other O/H % of GSV	11%	11%
	Business contribution	7,083,024	2,057,741
	Business contribution as % of GSV	7.1%	12.0%

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Business contribution	7.1%	5.2%	9.4%	12.0%	2.1%	10.8%	5.0%	15.0%

Closer look at Pubs & Clubs channel

Average cost to serve = 17.6%

Pubs & Clubs 12.5% higher than average

Cost to serve as % of GSV	Pubs & Clubs	Pubs & Clubs
Gross Sales Value	23,650,000	23,650,000
Warehousing & inwards handling	654,009	2.8%
Order processing	769,909	3.3%
Outwards handling WH	792,817	3.4%
Delivery to customer	1,035,089	4.4%
Reps & Merchandisers	2,262,029	9.6%
Mg'ment; sales, key acc & category	1,312,616	5.6%
Financing; AR & inventory holding	301,205	0.0%
Total cost to serve	6,826,469.3	30.1%

Cost to serve accurately allocated warehouse activities, freight, order processing etc... and drastically changed the business' view as to the profitability of this channel – so what can be done to improve?

The Cost to Serve analysis reveals the problem with Pubs & Clubs...

Cost to serve as % of GSV	Total Business	Grocery DCs	Grocery DSD	Mass Merchants	Pubs & Clubs	Distributors
Warehousing & inwards handling	2.3%	2.3%	2.0%	3.2%	2.8%	2.2%
Order processing	2.0%	1.2%	2.3%	0.6%	3.3%	0.7%
Outwards handling WH	1.8%	1.2%	1.5%	1.2%	3.4%	1.0%
Delivery to customer	3.0%	1.9%	3.1%	3.1%	4.4%	1.9%
Reps & Merchandisers	4.8%	0.2%	6.2%	0.1%	9.6%	0.9%
Mg'ment; sales, key acc & category	2.5%	0.7%	1.6%	4.0%	5.6%	2.1%
Financing; AR & inventory holding	1.2%	1.2%	1.1%	1.4%	0.0%	1.2%
Total cost to serve	17.6%	8.6%	17.8%	13.7%	30.1%	10.0%

Legacy business involved intensive service of this channel

- High frequency call cycle resulted in:
 - Frequent and small orders
 - High delivery cost
 - High cost to capture, process, handle orders
 - Low contribution

Possible solution: re-examine route to market strategies



Scenario: Re-examine route to market

Two elements to the scenario:

1. Change field selling

- Reduce rep visits but
- Supplement with outbound call centre

Cost to serve as % of GSV	Pubs & Clubs
Gross Sales Value	23,650,000
Reps & Merchandisers	9.6%
Mg'ment; sales, key acc & category	5.6%
Total Selling	15.1%

**Beer 'n Chip
average
7.8%**

2. Delivery through distributors rather than direct

	Pubs & Clubs	Distributors
Freight \$/case	1.62	0.75


**Beer 'n Chip
average
\$1.15/case**

- Distributors are currently a smaller channel but with a lower/
more efficient cost to serve
 - 10% vs. 30.1% of GSV for Pubs & Clubs

Field selling scenario variations

Several options:

1. Reduce rep costs NOT supplemented by outbound call centre
 - Reduced rep costs by 50%
 - Estimated sales decrease of 45%
2. Reduced rep calls AND supplement with outbound call centre
 - Rep costs down but call centre introduced; total reduction 40%
 - Estimated sales decrease of 15%
3. Eliminate Pubs & Clubs reps AND use only outbound call centre
 - Sole use of outbound call centre (costs down 60%)
 - Estimated sales decrease of 35%



**Sales decreases were
set at worst case
scenario levels**

Option 1: Reduce reps; no call centre

1. Reduce rep costs NOT supplemented by outbound call centre
 - Reduced rep costs by 50% in \$ terms
 - Estimated sales decrease of 45% in \$ terms

	Status Quo		Scenario		% change
	Pubs & Clubs	% of sales	Pubs & Clubs	% of sales	
Gross Sales Value	23,650,000		13,007,500		-45%
Reps & Merchandisers	2,262,029	9.6%	1,131,015	8.7%	-50%
Mg'ment; sales, key acc &	1,312,616	5.6%	910,883	7.0%	-31%
SALES LESS COSTS	20,075,354	84.9%	10,965,602	84.3%	-45%

- Total channel costs reduce by 43% in \$ terms
 - Return on channel sales is down 45% in \$ terms i.e. \$10.6m
- ... or on the bright side return on channel sales is down 0.6% as a % of GSV from 84.9% to 84.3%

Breakeven sales reduction is 6%

Option 2: Reduce reps add call centre ▼

1. Reduced rep calls supplemented by outbound call centre
 - Rep costs down but call centre introduced; total reduction in cost \$ is 40%
 - Estimated sales decrease of 15%

	Status Quo		Scenario		% change
	Pubs & Clubs	% of sales	Pubs & Clubs	% of sales	
Gross Sales Value	23,650,000		20,102,500		-15%
Reps & Merchandisers	2,262,029	9.6%	1,357,218	6.8%	-40%
Mg'ment; sales, key acc	1,312,616	5.6%	991,230	4.9%	-24%
SALES LESS COSTS	20,075,354	84.9%	17,754,053	88.3%	-12%

- Total costs down 34%
 - Return on sales down 15% in \$ terms or \$3.5m
- ... or on the bright side return on channel sales is up 3.4% as a % of GSV from 84.9% to 88.3%

Breakeven sales reduction is 5%

Option 3: Only use call centre



1. Eliminate Pubs & Clubs reps all together
 - Sole use of outbound call centre (costs down 60%)
 - Rep costs reduce but new call centre costs introduced
 - Estimated sales decrease of 35%

	Status Quo		Scenario		% change
	Pubs & Clubs	% of sales	Pubs & Clubs	% of sales	
Gross Sales Value	23,650,000		15,372,500		-35%
Reps & Merchandisers	2,262,029	9.6%	904,812	5.9%	-60%
Mg'ment; sales, key acc &	1,312,616	5.6%	830,537	5.4%	-37%
SALES LESS COSTS	20,075,354	84.9%	13,637,152	88.7%	-32%

- Total costs down 51%
 - Return on sales down 15% in \$ terms or \$3.5m
- ... or on the bright side return on channel sales is up 3.8% as a % of GSV from 84.9% to 88.7%

Breakeven sales reduction is 8%

Comparing scenarios

Looking at the defined scenarios ...

	Status Quo		Option 1		Option 2		Option 3	
	\$,000	% of GSV	\$,000	% of GSV	\$,000	% of GSV	\$,000	% of GSV
GSV	23,650		13,008		20,103		15,373	
Selling costs	3,575	15%	2,042	16%	2,348	12%	1,735	11%
Margin on selling costs	20,075	85%	10,966	84%	17,754	88%	13,637	89%

... which option is the best choice for *Beer 'n Chip*?

Comparing scenarios

Looking at the defined scenarios ...

	Status Quo		Option 1		Option 2		Option 3	
	\$,000	% of GSV	\$,000	% of GSV	\$,000	% of GSV	\$,000	% of GSV
GSV	23,650		13,008		20,103		15,373	
Selling costs	3,575	15%	2,042	16%	2,348	12%	1,735	11%
Margin on selling costs	20,075	85%	10,966	84%	17,754	88%	13,637	89%
			This option brought a significant reduction in costs HOWEVER the sales decrease was so large it would have a negative long term impact, most telling of all return on sales was actually down!		This option did bring costs down significantly, PLUS the return on sales went up by 3.4%. With careful monitoring Beer 'n Chip thought it was unlikely that sales would decrease as much as 15%.		This option reduces costs the furthest and gives the biggest increased return on sales HOWEVER because of the huge reduction in sales, long term the Beer 'n Chips exec team worried this option would erode brand recognition.	

... Which option did *Beer 'n Chip* choose?

What if? Change to Field Sales Strategy...

Beer 'n Chip exec team favoured option 2

They would reduce rep visits and introduce an outbound call centre

- Reps limit visits to once every 2 months
- Weekly/fortnightly telesales calls in between visits
- Estimated 15% reduction in sales from change
- Estimated 34% reduction in costs
- 'Sales less costs' \$ value goes down 12% BUT return on sales goes up 3.4%

	Status Quo		Scenario		% change
	Pubs & Clubs	% of sales	Pubs & Clubs	% of sales	
Gross Sales Value	23,650,000		20,102,500		-15%
Reps & Merchandisers	2,262,029	9.6%	1,357,218	6.8%	-40%
Mg'ment; sales, key acc & ca	1,312,616	5.6%	991,230	4.9%	-24%
Total Costs	3,574,646	15.1%	2,348,447	11.7%	-34%
SALES LESS COSTS	20,075,354	84.9%	17,754,053	88.3%	-12%

- Do additional scenario modelling around growth & sales % changes...

Comparing scenarios

With different sales estimates, different questions ...

Different growth estimates for option 2

	5% reduction in GSV		No change GSV		5% increase in GSV	
	\$,000	% of GSV	\$,000	% of GSV	\$,000	% of GSV
GSV	22,468		23,650		24,833	
Selling costs	2,348	10%	2,348	10%	2,348	9%
Margin on selling costs	20,119	90%	21,302	90%	22,484	91%

In the real world we expect a sales increase from option 2

Selling is only part of the question ... delivery is also a factor in route to market strategy.

Could the Pubs & Clubs be more efficiently serviced by distributors?

Reasons for considering this option...

- Distributors:
 - Fewer orders but they would be bigger
 - Less case & unit picks
 - More centralised and fewer delivery locations
 - Less accounts (less account management needed)
 - Lower freight costs

	Pubs & Clubs	Distributors
Freight \$/case	1.62	0.75

Possible issues...

- Distributors:
 - No vested interest in selling Beer 'n Chip product ahead of competitors
 - Get bigger discounts (inc. settlement)
 - Will become largest customer group with 41% of GSV

What if? Change to Delivery Strategy...

Could the Pubs & Clubs be more efficiently serviced through distributors?

- Estimated freight cost reduction of 35%
- Outwards handling remains about the same % of sales
 - Less case & units picks
 - Distributors require pallet bases between SKUs
- Return on sales increases by estimated 2.5%

... but what about discounts?

Status Quo	Pubs & Clubs	Distributors	Overall	% of total sales
Gross Sales Value	23,650,000	17,350,000	41,000,000	
Order processing	769,909	127,231	897,140	2.2%
Outwards handling WH	792,817	172,835	965,653	2.4%
Delivery to customer	1,035,089	330,970	1,366,059	3.3%
SALES LESS COSTS	21,052,185	16,718,964	37,771,149	92.1%

All delivery thru Dist	Pubs & Clubs	Distributors	Overall	% of total sales
Gross Sales Value	-	41,000,000	41,000,000	
Order processing	-	310,882	310,882	0.8%
Outwards handling W	-	1,002,032	1,002,032	2.4%
Delivery to customer	-	891,158	891,158	2.2%
SALES LESS COSTS	-	38,795,928	38,795,928	94.6%

Delivery scenario

Cost wise the strategy to go through distributors is sound.

Discounts pose more of a problem:

- Distributors get 19% compared to Pubs & Clubs 12%
- If all Pubs & Clubs business goes through Distributors then Distributors sales could increase by 136%

Status Quo	Pubs & Clubs	Distributors	Overall	All delivery thru Dist	Pubs & Clubs	Distributors	Overall
Gross Sales Value	23,650,000	17,350,000	41,000,000	Gross Sales Value	-	41,000,000	41,000,000
All discounts	2,720,564	3,292,792	6,013,356	All discounts	-	7,928,800	7,928,800
discounts % of sales	12%	19%	15%	discounts % of sales		19%	19%

- With current discount levels there is a decrease in return on sales despite the cost savings

	\$ change	Change % of sales
Delivery related costs	-\$ 1,024,779	-2.5%
Discounts	\$ 1,915,444	4.7%
Return on sales change	\$ 890,664	-2.2%

- If Distributor discount decreased from 19% to 17% return on sales would breakeven

Final decision by *Beer 'n Chip*

After modelling the new selling strategies, the delivery strategy and both combined

Beer 'n Chip decide to wait:

- The selling scenarios were encouraging
- BUT until they renegotiate distributor discounts the new delivery strategy is a problem

They still want to streamline their business so they are scenario modelling two new options:

- Van sales
 - Since they will continue to deliver to all the Pubs & Clubs they are looking at lowering their selling costs by introducing van sales combining the delivery and sales rep roles
- Stop using distributors all together
 - Because of high discount level to distributors they are looking at the cost of doing it all themselves leveraging their current delivery to Pubs and Clubs



Performance Based Pricing

AdvisorBase

Performance based pricing

Objectives of this session:

- Look at the dynamics involved and the variables which can effect performance
- Provide insights via a case study
- List red-flag items that may indicate performance issues

What is performance based pricing?

- Pricing for customer and product performance
- Getting the most out promotional spend.

One aspect is optimising trade spend to maximise account profitability – understanding the impact of net net price on total contribution margin...

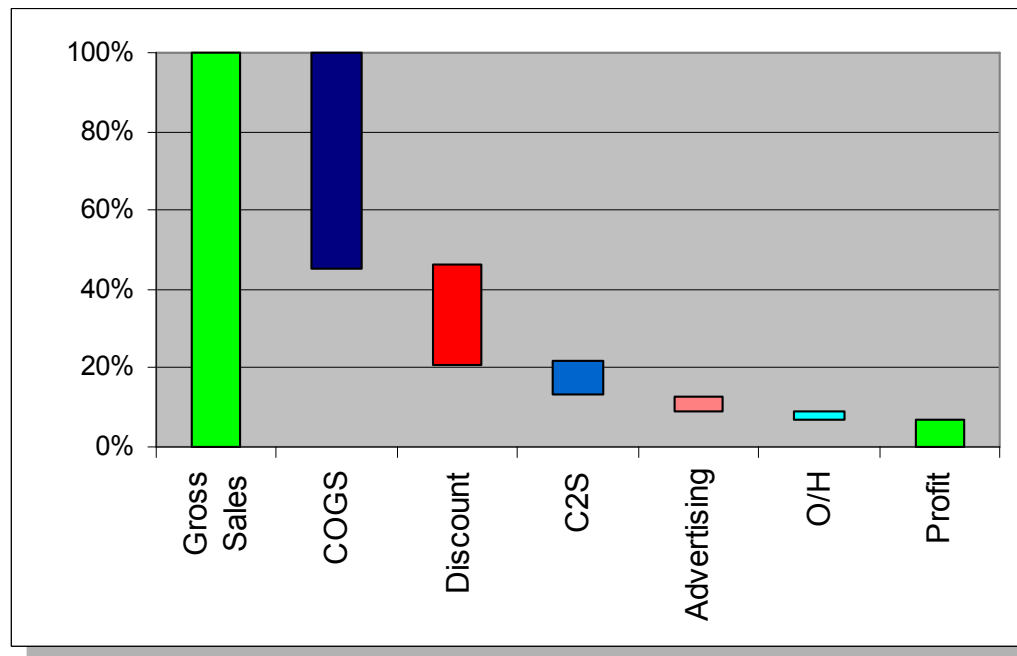
Companies with effective performance based pricing can answer the following types of questions relating to trade spend:

- Are our discounts really working for us?
- Is this the optimal deal depth?
- At this price does this line work in this customer?
- At what point is more less?
- Is this the best line to spend the money on?

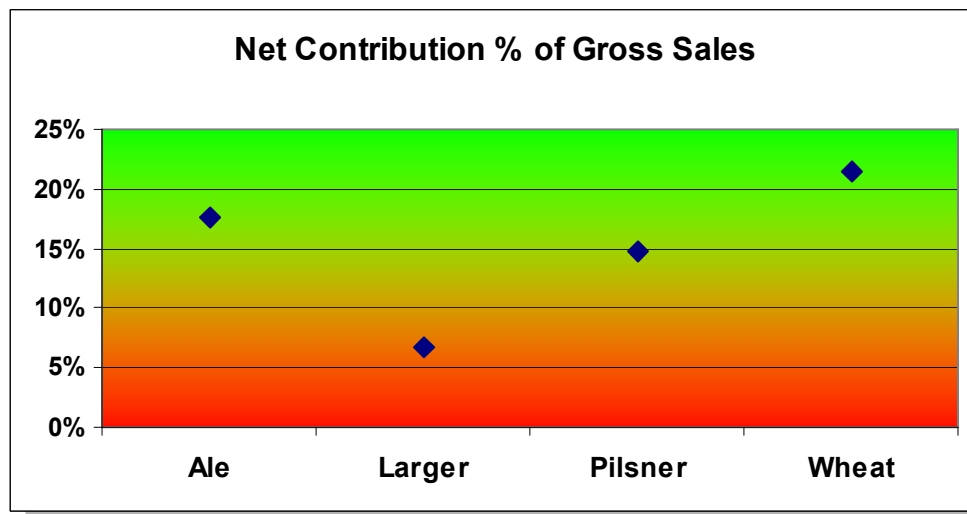
Why performance based pricing?

For many companies, expenditure on discounts is the largest cost of the business (with the exception of Cost of Goods Sold)

- Small % improvement sends \$ straight to the bottom line
- Sharpest tool for activating market and lifting volumes
- But is a 'double edged' sword...it also cuts margins.



Case Study: performance based pricing



The performance of **Beer 'n Chip's Larger** has been brought under the spotlight at the annual product performance review.

With a Net Contribution of only 7% it is not currently covering it's advertising expenses or its share of general overhead...

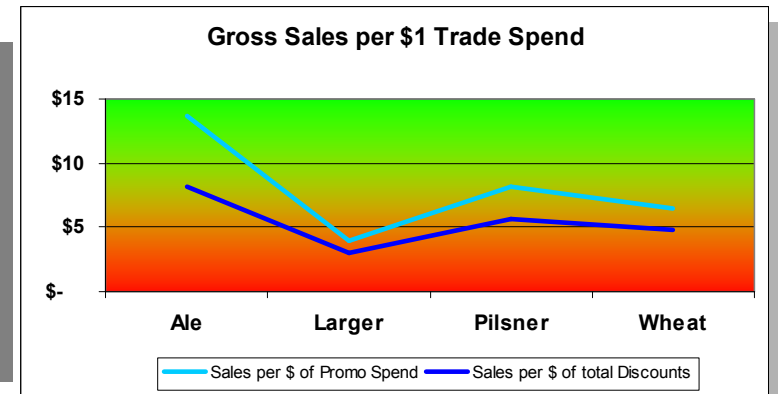
Profit & Loss		Products			
	TOTAL	Ale	Larger	Pilsner	Wheat
Gross Sales	298,150	50,000	81,650	44,000	122,500
Trading Terms	17,680	2,500	6,390	2,420	6,370
Promo Spend	48,808	3,650	20,930	5,363	18,865
Net Sales Value	231,663	43,850	54,330	36,218	97,265
Cost of Goods	171,650	32,000	46,000	27,500	66,150
Gross Margin	60,013	11,850	8,330	8,718	31,115
Freight Costs	12,990	3,000	2,890	2,200	4,900
Net Contribution	47,023	8,850	5,440	6,518	26,215
<i>NC % of Gross Sales</i>	16%	18%	7%	15%	21%

The *Larger* needs attention

Relative to the range, the Larger is characterised by:

- High volume: 1/3 of total case volume
- Low list price
- Higher discounting: 43% of total promotional spend
- Low return: 12% of total net contribution
- High proportion of product sold on promotion (79%)

Unit Rates	Total	Ale	Larger	Pilsner	Wheat
List Price/case		\$ 50.00	\$ 35.50	\$ 40.00	\$ 50.00
Cases	6,850	1,000	2,300	1,100	2,450
Trading Terms		5.0%	7.8%	5.5%	5.2%
Deal Depth/case		\$ 5.00	\$ 11.50	\$ 6.50	\$ 11.00
% on Promo		73%	79%	75%	70%
COGS/case		32	20	25	27
Freight/case		3.00	1.26	2.00	2.00



- Additionally the chart shows the trade spend as having the least return (in terms of sales)

Could the customer mix be affecting the performance?

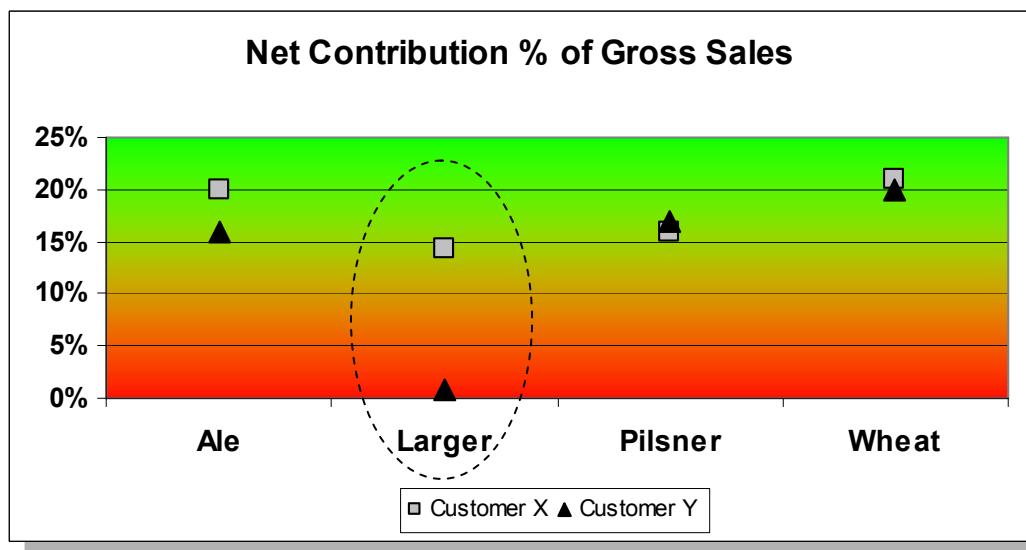
Product profitability by customer reveals an underperformance in Larger by customer Y

Profit & Loss	Products				
	TOTAL	Ale	Larger	Pilsner	Wheat
Gross Sales	298,150	50,000	81,650	44,000	122,500
Trading Terms	17,680	2,500	6,390	2,420	6,370
Promo Spend	48,808	3,650	20,930	5,363	18,865
Net Sales Value	231,663	43,850	54,330	36,218	97,265
Cost of Goods	171,650	32,000	46,000	27,500	66,150
Gross Margin	60,013	11,850	8,330	8,718	31,115

Profit & Loss - Larger		Customers	
	Total	X	Y
Gross Sales	81,650	35,500	46,150
Trading Terms	6,390	1,775	4,615
Promo Spend	20,930	7,475	13,455
Net Sales Value	54,330	26,250	28,080
-			
Cost of Goods	46,000	20,000	26,000
Gross Margin	8,330	6,250	2,080
Freight Costs	2,890	1,200	1,690
Net Contribution	5,440	5,050	390
NC % of Gross Sales	7%	14%	1%

Net contribution by customer X is at an acceptable level, but customer Y is only just contributing... what is driving this situation?

Factors contributing to the variation in performance



Some fundamentals differ between the two customers:

- Trading terms vary between customers (Y receives an additional 5% for promoting the product)
- A common promotion structure exists – \$11.50 ensures a price point can be met that is competitive
- Customer Y sells a large proportion on promotion - frequently going below brand standards and sacrificing some of their margin.
- Customer Y has the largest share of volume.

Larger		Customers	
		X	Y
Fixed Trading Terms		5%	10%
Price Support (case off deal)	\$	11.50	\$ 11.50
% sold on promotion		65%	90%
List Price (per case)	\$	35.50	\$ 35.50
COGS (per case)	\$	20.00	\$ 20.00
Volume (cases)		1,000	1,300

Several options are put forward, what is the best course of action?

- 1. Stop supply to customer Y and push the product through customer X.** It is forecast that Customer X would increase volume by 20% in this scenario.
- 2. Reduce promotional spend (reduce case deal).** This should increase the margin on each case but is expected to result in a decline in volumes.
- 3. Implement an EDLP (everyday low price) strategy.** Provide a set promotional spend to the retailers (that provides an acceptable return to the business) and allows retailer to promote as desired.
- 4. Increase List Price.** As the lowest priced product in the range, the option exists to increase the product price. It is thought that a 2.5% increase would have around a 10% reduction in volumes.

Option 1: Stop supply to customer Y and push the product through customer X

This option seeks to cut loose the underperforming customer and convert some volume to the favourable channel.

Analysis suggests that due to product loyalty and favourable treatment because of exclusivity Customer X's volume will increase by 20% if *Larger* is no longer ranged in Customer Y

Variable Changed	Customer	
	X	Y
Forecast Volume	1,200	-

Option 1 (Forecast)		Customer	
	Total B	X	Y
Gross Sales	42,600	42,600	-
Trading Terms	2,130	2,130	-
Promo Spend	8,970	8,970	-
Net Sales Value	31,500	31,500	-
-			
Cost of Goods	24,000	24,000	-
Margin	7,500	7,500	-
-			
Freight Costs	1,440	1,440	-
Net Contribution	6,060	6,060	-
NC % of Gross Sales	14%	14%	0%

Assumption that:

- Deal depth remains as is
- % sold on promotion remains constant.

>>> \$620 improvement in Net Contribution

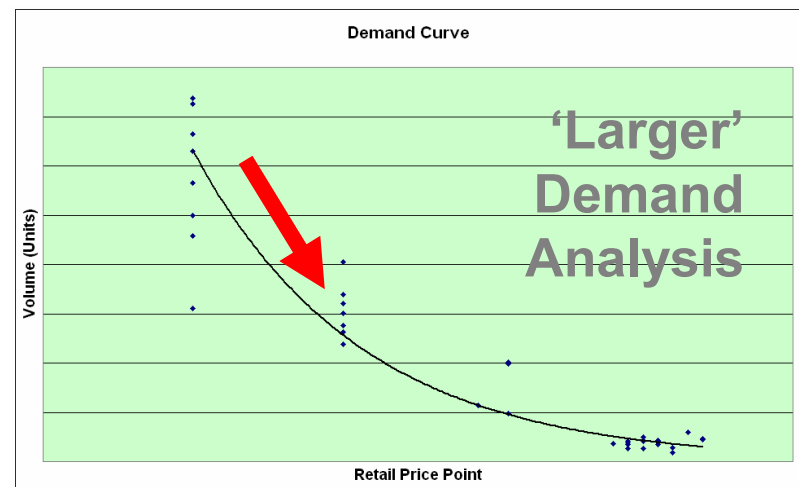
Option 2: Reduce promotional spend

This option seeks to return the product to an acceptable performance level by reducing promotional expenditure.

Analysis of demand curves (derived from scan data) across the two customers' banners indicates volumes at various price points and therefore what alternative deal depths may be possible.

- Deal depth reduced to \$8.00
- Volume down 50%
- But contribution margin improvement – less investment spend chasing diminishing returns...
- Assume % sold on promotion remains constant.

>>> \$465 improvement in Net Contribution



Variables Changed	Customer	
	X	Y
Deal Depth/case	\$ 8.00	\$ 8.00
Forecast Volume	500	650

Option 2 (Forecast)	Customer		
	Total B	X	Y
Gross Sales	40,825	17,750	23,075
Trading Terms	3,195	888	2,308
Promo Spend	7,280	2,600	4,680
Net Sales Value	30,350	14,263	16,088
-			
Cost of Goods	23,000	10,000	13,000
Margin	7,350	4,263	3,088
-			
Freight Costs	1,445	600	845
Net Contribution	5,905	3,663	2,243
NC % of Gross Sales	14%	21%	10%

Option 3: Implement an EDLP strategy

This option is to implement an EDLP price (to retailer). It provides a set promotional spend to the retailers (that provides an acceptable return to the business) and allows retailers to promote as desired.

The deal depth is reduced (from \$11.50) to \$6.00 and is given away on all ex/factory sales, rather than just scan sales during promotional periods.

As with Option 2, volumes are likely to reduce dramatically as price points increase under this option.

Variables Changed		Customer	
		X	Y
New % sold on Promotion		100%	100%
Deal Depth/case		\$ 6.00	\$ 6.00
Forecast Volume		500	650

Option 3 (Forecast)		Customer	
	Total B	X	Y
Gross Sales	40,825	17,750	23,075
Trading Terms	3,195	888	2,308
Promo Spend	6,900	3,000	3,900
Net Sales Value	30,730	13,863	16,868
-			
Cost of Goods	23,000	10,000	13,000
Margin	7,730	3,863	3,868
-			
Freight Costs	1,445	600	845
Net Contribution	6,285	3,263	3,023
NC % of Gross Sales	15%	18%	13%

>>> \$845 improvement in Net Contribution

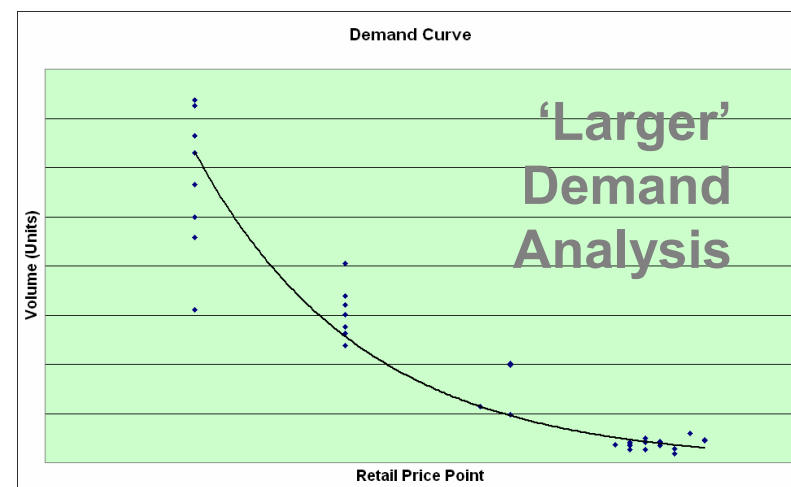
Option 4: Increase List Price

Being the lowest priced product in the range the option of a list price increase could lift revenue.

Analysis of consumer demand curves suggest around 10% reduction in volume would result from a 2.5% price increase.

Variables Changed		Customer	
		X	Y
List Price		\$ 36.39	\$ 36.39
Forecast Volume		900	1,150

Option 4 (Forecast)		Customer	
	Total B	X	Y
Gross Sales	74,594	32,749	41,846
Trading Terms	5,822	1,637	4,185
Promo Spend	18,630	6,728	11,903
Net Sales Value	50,142	24,384	25,759
-			
Cost of Goods	41,000	18,000	23,000
Margin	9,142	6,384	2,759
-			
Freight Costs	2,575	1,080	1,495
Net Contribution	6,567	5,304	1,264
NC % of Gross Sales	9%	16%	3%



>>> \$1,127 improvement in Net Contribution

Option Change Summary

Option	1	2	3	4	
	Current	Stop Selling to Y	Reduce Support	EDLP Strategy	Increase Price
Net Contribution (NC)	5,440	6,060	5,905	6,285	6,567
Change	-	620	465	845	1,127
NC % of Gross Sales	7%	14%	14%	15%	9%
NC per Case	\$ 2.37	\$ 5.05	\$ 5.13	\$ 5.47	\$ 3.20
Volume (cases)	2,300	1,200	1,150	1,150	2,050

What option should be adopted by *Beer 'n Chip*?

Assessment of the Options

Option 1: Stop supply to customer Y and push the product through customer X

Positives

- Only option that attempts to fix the problem solely where it is occurring (ie, Customer Y)
- Does not interfere with Customer X's good performance

Negatives

- 2nd smallest financial improvement
- Loss of share in customer Y – loss of future opportunity?

Option 2: Reduce promotional spend

Positives

- Slight improvement in current financial performance

Negatives

- Common deal sheet means contribution \$ from Customer X deteriorates
- Lowest return of the four options.

Assessment of the Options *cont...*

Option 3: Implement an EDLP strategy

Positives

- 2nd best financial return
- Removes ongoing promotional management of a poor performing product
- Return known – making for easy future planning

Negatives

- Applies fix to product rather than underperforming customer Y
- Surrenders promotional control and therefore brand equity to retailer – maybe difficult to reverse.

Option 4: Increase List Price

Positives

- Best financial return
- Maintains highest volume

Negatives

- Applies fix to product rather than product for just customer Y
- Real consumer reaction to price change hard to predict.

What course of action should one take?

The decision is mathematically straight forward but requires tools:

- Calculator, Excel or Trade Promotional Management Software
- Key account manager.

But variables considered have been limited and often reality is not so simple.

Often reactions are even harder to predict:

- Consumer response to price point change
- Consumer response to change in gap between everyday price and promotional price
- Competitor response to price point change
- Retailer response to price support reduction.

What Industry assumptions are valid?

Is the existing way of doing business holding you back?

- Common deal sheet across accounts no longer seems valid given different trading terms
 - Optimising deal depth required for each retail banner within an account.
- Trading terms previously transparent ...now equitable is more important
- % sold on promotion effects performance
 - Some categories at 90%+
 - These types of product – ‘promo’ price should be treated as ‘list price’
 - Does retailer run at recommended price point – if they reduce margin further – it can affect the % sold on promotion.

Final decision by *Beer 'n Chip*

After assessing the options

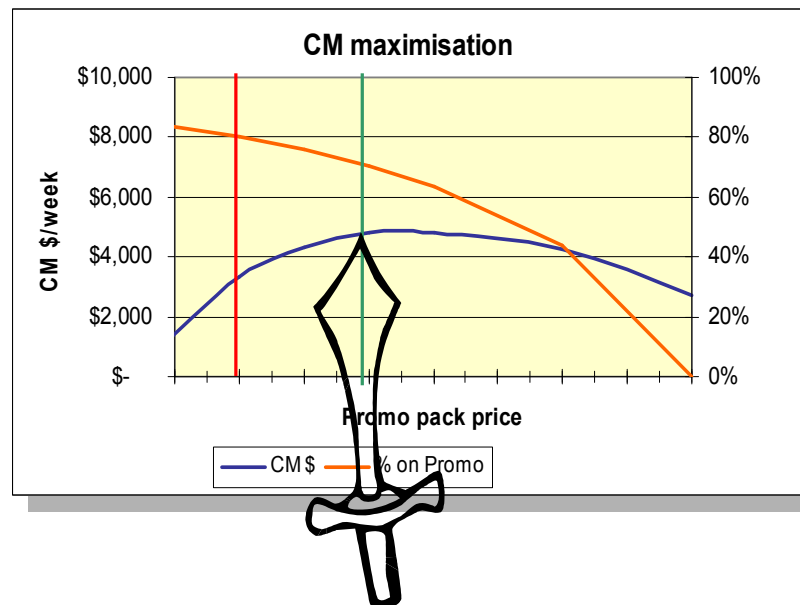
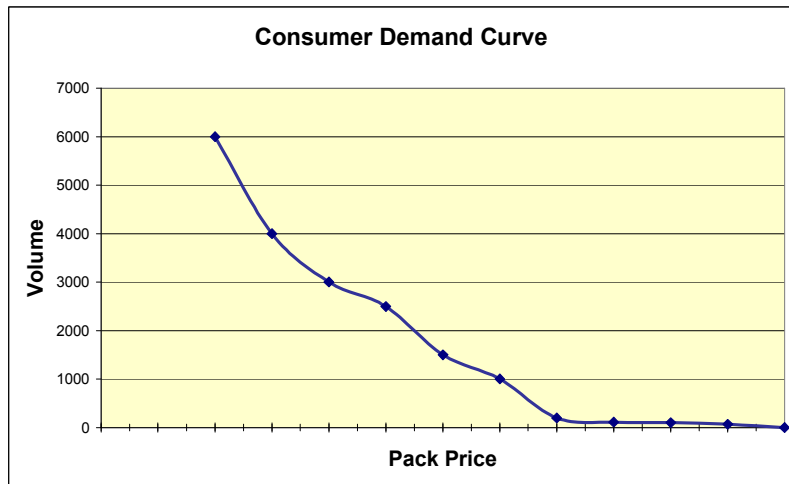
Beer 'n Chip decided to raise list price by 2.5%

Was the forecast achieved?

- A list price increase was implemented
- Retailer Y increase everyday price **BUT** “requested” their deal depth price support be increased to hit pre-price increase retail price point
- Threatened deletion from promotional programme if request not met... *Beer 'n Chip* obliged
- Gap between High and Low increased...
- ...causing volume to increase slightly and % sold on promotion increase from 65% to 70%.

Option 4: Price Increase				
		Current	Forecast	Actual
Net Contribution (NC)		5,440	6,567	6,054
Change		-	1,127	614
NC % of Gross Sales		7%	9%	8%
NC per Case		\$ 2.37	\$ 3.20	\$ 2.79

Option 2 showed optimal deal depth was not in place – promotional pricing should maximise contribution



Many companies base promotional pricing on demand elasticity curves

- Analysis of Nielsen data is an essential input ... but ...
- Analysis should extend to:
 - Contribution margin = profit after all discounts and trade spend and COGS
 - Individual product price groups – aggregated category data is of little value
 - Impact of retailers' internal price support

Pricing should focus on CM not volume alone ...

... less may be more.

Trade spend management requires a top down assessment of performance... is your spend performing as expected?

Performance based pricing reports should be produced regularly (if not have an external pricing audit completed)

1. Based on ex/factory sales, trade spend and product data
 - Identify problematic customers or products
 - Identify the leverage points and sub optimality
 - Size the opportunity and address

2. Increase return on spend using dynamic price modelling (develop deal sheets) from scan data
 - Reflect product life cycle
 - Target customer – product mix
 - Optimise contribution (not maximise sales?)

**The market has a way of exploiting pricing errors ...
... if it's under priced they will buy it big ...
... not only that, they may even push it hard!**

We have compiled a set of 'red flags' to look for

- High proportion of sales (& increasing) at promo price
- Increase in sales without corresponding increase in contribution
- Marketing complain that retailer pricing breaks brand standards
- Fixed portion of total discounts & trade spend high or increasing
- Big gap between list and promo price
- Lines selling well where not expected to, or vice versa
- Promotional plan does not align with product by customer strategy
- Diminishing return on trade spend investment
- Not hitting expected contribution targets.



Primary Freight

AdvisorBase

Primary freight

Session objectives:

- Clarify what primary freight is and how it may work
- Illustrate some of the problems in arriving at a primary freight rebate with a case study
- Outline retailer potential benefits
- Identify some supplier concerns
- Consider a possible role for the FGC
- Assess the benefits of a co-operative approach
- Draw attention to some possible downstream issues
- List factors to consider when setting primary freight charges/prices/rebate

Terminology

Retailer primary freight:

- Supplier warehouse to retailer DC
- Retailer provides and manages freight carrier

Factory gate pricing (FGP):

- Primary freight to retailer account;
- Delivery and ownership to retailer at supplier warehouse
- Supplier price reduced to reflect nil freight
- Discount structure and trading terms likely to change
- Retailer controls freight efficiency and pays accordingly
- Supplier future proof for retailer strategy and cost changes

Primary freight arrangement (PFA):

- Supplier reimburses retailer for freight costs
- Delivery and ownership to retailer at retailer DC
- Price list unchanged
- Discount structure and trading terms likely to change
- Retailer controls freight efficiency and supplier pays accordingly
- Renegotiated for retailer strategy and cost changes

Terminology

Australia adopted 2 versions of PFA

- Freight rebate deducted from remittances
- Coles & Woolworths use different methodologies
 - Woolworths - Primary freight rebate
 - Rebate is route based
 - Coles collect – Factory gate rebate
 - Rebate is national SKU based

Neither retailer adopted FGP

- FGP or PFA is not a neutral choice for retailer or supplier
- Suppliers should care which model is adopted

Case study – the problem

Beer 'n Chip has been approached to provide a national \$per case rebate to **Retailer B** as a PFA.

The supply chain manager soon had the figures:

	Total Business	Total Other	Total Grocery	Retailer A	Retailer B
Gross sales (\$,000)	100,000	45,250	54,750	17,200	37,550
Supply locations		National		National	National
Delivery method		DC & DSD		DC	DSD
Cases (x1000)	1,503	432	1,071	304	768
Freight (\$,000)	2,980	1,496	1,483	318	1,165
Freight \$/case	1.98	3.47	1.38	1.05	1.52

Options	A	B	C	D	E
Freight Rates	1.98	3.47	1.38	1.05	1.52

So the question is ... which rate to use?

Case study – possible outcomes

Ignoring the rates for “Other” and “Total Business”

- Why?

The overall impact of adopting the different rates is:

Freight cost using rate for	Freight rebate \$/case	Change in freight \$,000 Retailer B
Total Grocery	1.38	-102
Retailer A =DC	1.05	-360
Retailer B =DSD	1.52	0

The obvious preference would be to use the Retailer A's DC rate

... but why would B accept that?

... would they accept the grocery sector average rate?

Case study – possible outcomes

The ‘reasonable’ choice is Retailer B rate (\$1.52)

... but what if ...

- Retailer A adopts primary freight and wants the same rate
 - The current cost to deliver to A is only \$1.05 (vs. \$1.52 to B)

Freight cost using rate for	Freight rebate \$/case	Change in freight \$,000 All grocery	Change in freight \$,000 Retailer A	Change in freight \$,000 Retailer B
Retailer B =DSD	1.52	142	142	0

... Should we have used the grocery sector average rate?

.... but then what if...

- ... Sales to Retailer A build to match retailer market share (46%)

For Retailer A Beer 'n Chip sales up to overall Retailer A market share				
Freight cost using rate for	Freight rebate \$/case	Change in freight \$,000 All grocery	Change in freight \$,000 Retailer A	Change in freight \$,000 Retailer B
Total Grocery	1.38	195	297	-102

Case study – ... what if

The issues just keep coming... what if ...

- ... Beer 'n Chip pack size changes from 24 to 12 ... \$390k pa
- ... existing freight carrier rebalances rates to reflect volume change – say an average increase of 10% Another \$150k pa
- ... product mix shifts to high case/pallet
- ... both retailers are currently DC (with different freight rates?)
- ... retailer currently takes direct container delivery
- ... retailer decides to cross-dock individual store orders

Is a \$per case rebate an acceptable rebate structure?

Why are retailers wanting to adopt primary freight?

The initiative to adopt Primary Freight in NZ follows similar moves by retailers in Australia.

Potential benefits:

- Economic benefit – lower cost to shelf - may be difficult
 - Suppliers have very competitive freight rates
 - Principal benefit from use of pre-paid backhaul capacity.
- Other retailer benefits include:
 - Better utilisation of loading dock capacity at DCs
 - Visibility of the primary freight component of product costs.
- Route-to-shelf strategy & costs further under retailer control.
- Improved in-stock-on-shelf. Not automatic or specific benefit.
- Strategic value – the supply chain is perceived to be a core competitive competence

Not withstanding different supply chain dynamics in NZ retailers have seen the \$ signs ... so ...

Why are suppliers concerned?

With a new freight provider ‘for life’ suppliers see potential drawbacks:

- Operational issues.
- Impact on NZ freight sector.
- Impact on suppliers’ residual freight arrangements and pricing.
- Extension of primary freight to other retailer(s)
- Lack of transparency between retailers.
- Effect on terms of trade (e.g. volumetric discounts, ullage) and possibly on national pricing.
- Extension of primary freight to a secondary distribution charge or warehouse allowance claim on suppliers.

Realistically, if the retailers want primary freight, they will have it.

Suppliers’ interests lie in the successful implementation of a robust and stable primary freight model.

Suppliers can benefit from FGC involvement

Industry body involvement may benefit at an industry level and individual supplier level.

At an industry level benefits include:

- Advocating for the primary freight model that is most equitable.
- Development of costing/rebate setting methodology acceptable to retailers and equitable to suppliers.
- Address retailer internal charging and possible impact on National Pricing.
- Address issues regarding possible adoption of primary freight by PEL/Woolworths as well as Foodstuffs.

Industry body could smooth individual suppliers' path

Industry agreement on process issues avoid each supplier having to 'reinvent the wheel'.

Plus suppliers would benefit from the enabling of:

- A confidentiality shield to avoid the stress of suppliers being asked for confidential freight contracts and sales data.
- Honest broker to attest to the validity of supplier pricing and rebates in accordance with agreed methodologies.
- Economic access to professional advice for members to reduce the economic and operational risk of what amounts to a fundamental business model.
- Implementation 'check lists' and support.
- Problem resolution procedures and protocols.

Such an approach will minimise supplier resource commitment to the process and the risks associated with implementation

Advantages of co-operative approach

A co-operative approach between the retailer(s) and suppliers offers real advantages and is more likely to produce an outcome that:

- Produces a result that is at worst cost neutral to suppliers and preferably results in a sharing of benefits.
- Uses a common methodology and approach for suppliers, but produces individual solutions. This would mean minimum cost and resource commitment by suppliers and ensure that individual suppliers (in particular smaller members) are not disadvantaged.
- Allows time to establish a mutually beneficial arrangement – time to get the numbers right.
- Delivers a future proof solution – avoiding re-negotiating at every turn.
- Incorporates KPIs for performance of retailer freight operator.
- Pilots the introduction with co-operative suppliers to iron out problems.

Some concern about downstream effects:

National pricing

- There need be no impact on supplier national pricing
- An opportunity for suppliers to try to adopt regional pricing
- Internal retailer charging may establish de facto regional pricing.

Secondary distribution

Retailers may seek to recover downstream supply chain costs downstream of primary freight:

- Retailer warehouse costs.
- Retailer inventory holding costs.
- Retailer inter-warehouse freight movements.
- Retailer delivery to store.

The methodology used and the structure of PFA or FGP is critical as it determines how suppliers can respond

Establishing primary freight rebate/charge is complex ...

... with considerable associated risk.

There are a number of factors to be taken into account when establishing FGP or PFA terms, including:

- Calculation methodology - robust and acceptable to retailers.
- Supplier confidentiality to be protected.
- Maintain transparency or equity in treatment of retailers.
- Rebate IS NOT automatically equivalent to list price reduction
- Incorporate addressing future changes in freight charges.
- Recognise potential to migrate to the other major retailer.
- Possible impact on national pricing.
- Ability to extend primary freight to secondary distribution.
- Differentiation between DC and DSD retail operations.
- Future proofing for changes in product mix.
- Differentiation between single or multiple supply points and economics of retaining multiple supply points.
- Impact on residual supplier freight contracts and route to market model economics.

Operational issues are important, but financial considerations dominate

Negotiating and implementing primary freight is resource hungry and involves finance, sales and supply chain.

Operational factors to be appreciated include:

- Operational constraints and considerations of retailer management of primary freight access to supplier DCs in areas such as:
 - Warehouse pick pack and dispatch planning co-ordination and cost implications.
 - Warehouse loading dock operating times.
 - Inventory management (supplier warehouse and retailer DC).
 - Vehicle fleet utilisation.
- Residual freight (non-retailer primary freight) pick pack dispatch and load efficiency.
- Dynamics and costs of product or container returns.

Best advice is “be prepared!”

Primary freight: technically challenging, financially significant, resource intensive and not quick.

Preparation involves an in depth appreciation of the:

- Role of freight in cost to serve and the drivers of freight costs.
- Composition, interaction between and value of the components that make up the existing discount and rebate structures applied to retailers.
- Implications for existing freight contracts of retailer primary freight.
- Drivers of freight costs and their variability.
- Impact of changes in some primary freight arrangements on all route to market costs and service levels.
- Impact of retailer primary freight on the economics of multiple supplier warehouse locations.
- Mechanism for maintaining price points across regions with changes to discount, pricing and rebate structures.



Sustainability

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Sustainability

Session objectives:

- Asses the magnitude of the sustainability issue
- Propose a practical method of placing sustainability issues within a manageable framework
- Look at a simple case study

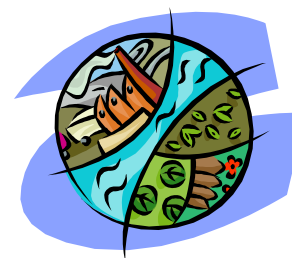
Sustainability

Two questions often asked:

- What is sustainability?
 - In simple terms sustainability relates to the notion that the business should do no enduring harm to us or our environment – Is it sustainable in the medium/long term?
- How does it impact our business?
 - This is the BIG question...

Many companies already subscribe to a sustainability index but they want to render the issues into terms they are better able to deal with.

- This usually means financial...



Are the risks real?

The short answer is YES.

- In the US most consumers, 93%, operate in everyday life with varying degrees of what we have come to think of as 'sustainability consciousness'.
- Research for the US Grocery Manufacturers/Food Products Association found an emerging 17% of consumers – coined as LOHAS (Lifestyle of Health and Sustainability) – are willing to shift their brand loyalties to 'green' companies.
- Another 21% of US consumers ('Naturalites') focus on natural/organic products. New Zealand research shows similar results.

The people our businesses rely on want to change their buying patterns, and will when they get the opportunity. *Beer 'n Chip* want to future-proof their business by positioning themselves to provide that opportunity.

So What?

OK, the risks are real but what does that mean?

- You've got a sustainability index of 103 – so what?
- World will run out of 'x' in 'y' years – so what?
- Petrol prices go up by 40% – so what?
- 30% of your customers are LOHAS – so what?
- No enough usable water – so what?
- Restrictions on import/export – so what?
- Price increase on raw materials – so what?



What does it mean financially for your business?

What steps can you take to protect the profitability of your business?

Where does reality fit

The sustainability issues are by their nature hard to get to grips with.

What is the scope of sustainability issues for us?

- In the worst case scenario the global eco-system implodes and business survival may become a moot point as the human race dies out
- Or in the simplest case change pressure is gradual and business adapts along with it

Reality is likely to be somewhere in between with only those companies that have a good grasp of the issues and their implications able to thrive on the changes.

Business still faces the “*So what do we do about it?*”

How to get to grips with sustainability?

Step 1: Qualitative

- Identify the full scope of sustainability issues that may impact the business ... e.g. For *Beer 'n Chip* ...
- Reduce the list to those likely to impact the business in the next 3, 5 and 10+ years

Step 2: Quantitative - Business thinks in financial terms

- Link the issues to drivers of business performance
- Acquire a wide scope scenario model of the business
- Test the sensitivity of the business to the various drivers and hence sustainability issues

Step 3: Build impact scenarios

- Workshop the range of scenario variables
- Model the potential impact of the sustainability issues one at a time and then (where appropriate) collectively
- Identify the issues/scenario that need the most attention

How to get to grips with sustainability?

Getting to the solutions is the important bit

Step 4: Develop and test response scenarios

- Devise strategies to counter the impacts
- List the assumptions that underpin the strategies
- Establish a practical range (best, likely, worst) for the scenario variables
- Model the scenarios, focus on the big issues – keep it simple

Step 5: Implement and monitor

- Decide on the strategise to implement
- Establish a monitoring regime to track the causal drivers and key assumptions
- Periodically update the model and compare scenarios with reality to build understanding of dynamics involved

For *Beer 'n Chip*

There are a number of sustainability issues in the minds of the *Beer 'n Chip* team.

Foremost is the possible rejection of their current beers by the market.

Let's look at this in simple terms:

- The possible threat to their market from the new 'natural' beer from a major brewery and the possibility of new craft brewers producing natural products
- The growing number of LOHAS (Lifestyle of Health and Sustainability) consumers
- Possible backlash by LOHAS on the current chemical treatment of hops.
- The high water use/waste in current beer production
- The high energy use/waste in current beer production

The market for the existing original recipe product is at stake

Sustainable beer

***Beer 'n Chip* has decide to develop an 'eco' beer of their own to address this sustainability issue**

The new beer incorporates the following elements:

- Fair trade hops
- Organic ingredients
- More water and energy efficient processes

Not only is it going to be better for the environment it is going to appeal to the LOHAS consumers (and with it's great taste it'll still appeal to their existing customer base)

Scenario: convert all beers to a 'eco' recipe

The 'eco' recipe is adopted.

What should the list price be set at?

- New beer has 20% higher COGS
- What change in volume (growth) is expected at introduction?

As Is				GM % of sale
cases	1,785,714	GSV	75,000,000	
COGS/case	20.27	COGS	36,202,051	
\$/case	42.00	GM	<u>38,797,949</u>	51.7%

Option 1				GM % of sale
growth	15.0%			
list change	0.0%			
cases	2,053,571	GSV	86,250,000	
COGS/case	24.33	COGS	49,958,830	
\$/case	42.00	GM	<u>36,291,170</u>	42.1%

Option 2				GM % of sale
growth	10.0%			
list change	5.0%			
cases	1,964,286	GSV	86,625,000	
COGS/case	24.33	COGS	47,786,707	
\$/case	44.10	GM	<u>38,838,293</u>	44.8%

Option 3				GM % of sale
growth	0.0%			
list change	7.5%			
cases	1,785,714	GSV	80,625,000	
COGS/case	24.33	COGS	43,442,461	
\$/case	45.15	GM	<u>37,182,539</u>	46.1%

Option 4				GM % of sale
growth	-20.0%			
list change	20.0%			
cases	1,428,571	GSV	72,000,000	
COGS/case	24.33	COGS	34,753,969	
\$/case	50.40	GM	<u>37,246,031</u>	51.7%

Option 5				GM % of sale
growth	-25.0%			
list change	26.0%			
cases	1,339,286	GSV	70,875,000	
COGS/case	24.33	COGS	32,581,845	
\$/case	52.92	GM	<u>38,293,155</u>	54.0%

- NB: industry ave. growth = 5% per annum
Expected to be higher for 'eco' & lower for original product

Scenario options:

No change (As Is) and options 2 & 5 show most promise

- Option 2 gives highest GM\$
- Option 5 has highest GM%
 - Significant negative growth to make up
- Option 4 list price decrease matches cost increase so GM% unchanged
 - GM \$ still lower

scenario	As Is	Option 1	Option 2	Option 3	Option 4	Option 5
growth	0%	15%	10%	0%	-20%	-25%
list change	0%	0%	5%	8%	20%	26%

1 year after introduction:						
	As Is	Option 1	Option 2	Option 3	Option 4	Option 5
GM \$	38,797,949	36,291,170	38,838,293	37,182,539	37,246,031	38,293,155
GM %	51.7%	42.1%	44.8%	46.1%	51.7%	54.0%

What option should *Beer 'n Chip* go for?

Or should they just stay with 'As Is' for now?

5 year projection

Slowly declining growth for original beer recipe as consumers move to 'eco' beers

Growth	year 2	year 3	year 4	year 5
eco' beer	7%	10%	18%	27%
original beer	5%	4.5%	3.5%	2%

All options have higher GM \$ than original recipe because of better growth

- Options 1-3 still showing lower GM %
- Option 4 showing break even GM %
- Option 2 has highest \$ return
- Option 5 has the highest GM %
 - This option is also highest risk because of the price increase

Options 2 & 5 show the most promise going into the future

After 5 years:						
	As Is	Option 1	Option 2	Option 3	Option 4	Option 5
GM \$	44,942,258	64,012,260	68,505,009	65,584,504	65,696,495	67,543,465
GM %	51.7%	42.1%	44.8%	46.1%	51.7%	54.0%

➤ NB: no price change beyond the initial change included

Decision

After running scenarios *Beer 'n Chip* management are faced with 3 choices:

- 1.** Leave product offering as it is for now and opt to change recipe in a few years as market changes
 - Risk that competitors will corner the market if they are late entrants
- 2.** Convert all product
 - Risk of loss of market share because of price increase
- 3.** Slowly/rapidly replace original recipe with eco beer
 - Risk that they will be neither one thing nor the other

Knowing the financial risks/opportunities involved this strategic decision will be backed up by numbers they know and understand.

Sustainability has become just another business decision.

Importance of scenario modelling

Scenario modeling allows evaluation of different options involved in making a change

- The difference between GM% and GM\$ can have a big impact
- The one year time trap
 - Initial pain (decrease in sales) – growth in sales in future years as the % of LOHAS exponentially increase means the business starts to really shine
- Impact when other suppliers turn away from conventional products to fill the gap in the market.

The scenario model can also illustrate the down side of not making a change

- e.g. loss of sales of conventional beer as other brewers shift or a new market entrant.

Time is not on our side – we need to act NOW

Change will be swift.

- Changes in consumer attitudes and behaviour regarding sustainability issues suggest accelerating change.
 - Research in New Zealand in 2007 classifies 33% (c.f. 38% in the US) of consumers as LOHAS/Naturalites, 26% more than two years ago.

The time between recognising the problem and responding before it is too late decreases every month. Some companies already face the challenge of getting ahead of the problem in order to address it.

Tackling sustainability today

Approach

- Identify the causal drivers of profitability that sustainability issues impact
- Quantify the risk – put a dollar figure on the threat or opportunity
- Develop the response scenarios and evaluate them
- Monitor developments – check assumptions.

Reality is a lot more complex than our example

The old chestnut that ‘change is inevitable’ is certainly true, but equally true is that only some are prepared for it.



Wrap up

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Issues facing the industry this year – well some of them

Increased competition will increase pressure on profitability

- Optimise customer & product profitability through:
 - Cost to serve analysis
 - Route to market optimisation
 - Performance based pricing
- Increased pressure on trade spend + increasing proportion of sales on promo ~ align pricing mix and product performance
- Range rationalisation ~ pricing appropriately across range.
- Primary freight ~ a whole new ball game
- Shake out of efficiency terms
- Cost and performance pressures across the supply chain:
 - Inventory management
 - Freight rates matched to business
 - Demand planning

Objectives for the day

- Route to market ✓
 - Illustrate outcomes of a Cost to Serve analysis
 - Demonstrate assumption rich scenario modelling process
 - Review route to market variables
- Performance based pricing ✓
 - Review the dynamics
 - Provides insights via a case study
 - Provide list of 'red flags'
- Primary freight ✓
 - Clarify what primary freight is
 - Illustrate some of the problems
 - Consider a possible role for the FGC
 - List factors to consider
- Sustainability ✓
 - Asses the magnitude of the sustainability issue
 - Propose a practical method for managing sustainability
 - Review a simple example
 - Identify typical sustainability issues facing FMCG businesses

Cost to Serve

Previous seminars have covered the “How to”

This workshop focuses on using the output

- Case study example is our *Beer ‘n Chip Co.*
- Applied to diverse areas of the business:
 - Freight
 - Customer profitability
 - Scenario modelling
 - Product profitability
 - Sales strategy/mix
 - Discounts and trade spend

For more info on the “How to”

- Contact us: advisors@advisorbase.com
- Visit of web site resource centre:
www.advisorbase.com/whitepages.htm
- OR just talk to us

***Beer 'n Chip* had a few issues**

- Pub & Clubs channel was underperforming
- Lager beers were underperforming
- They had been invited to join retailer primary freight initiative
- The directors had asked for a review of business plan that would ensure the business was sustainable

With your help, we worked them through for them

From *Beer 'N Chip*

Any questions?

**Thank you for
working with us!**

**Approach us with
anything you would
like more
information on**

