

September, 2009

Increasing Efficiency and Profitability in Contract Manufacturing and Packaging

Lisa M. Shambro
Executive Director, F4SS

Foundation for 
Strategic Sourcing



Answer

Standardization of Business Processes

Terminology

Customer = Marketer, Brander, Brand Owner, Branded Marketer

Supplier = Contract Manufacturer, Contract Packager, Secondary Packager, Co-Man, Co-Packer, External Manufacturer

Agenda

- Background
- CSOP – No Touch Replenishment
- Building Trust and Collaboration
 - Contract terms
- Sustainability
(up the supply chain)

What is F4SS?

A non-profit organization serving the Consumer Packaged Goods (CPG) industry,

up the supply chain between branded marketers and their external suppliers

(defined as contract manufacturers and secondary packagers)

Who is F4SS?

Our Board of Directors:

Procter & Gamble

Johnson & Johnson

General Mills

The Campbell Soup Company

The Hershey Company

Power Packaging

Marietta

Why?

The CPG Outsourcing Industry is in transition:

From: Make-Pack-Ship
to: Full Service

From: Short term execution
to: Long term relationships

From: Isolated
to: Integrated

From: Tactical
to: Strategic

What is driving this change?

Customers are outsourcing more:

- Shifting organization focus toward core competencies: Marketing, Sales, R&D
- Seeking speed to market
- Suppliers offer flexibility, capability
- Cost savings vs. internal operations

Impact

Hot off the press:

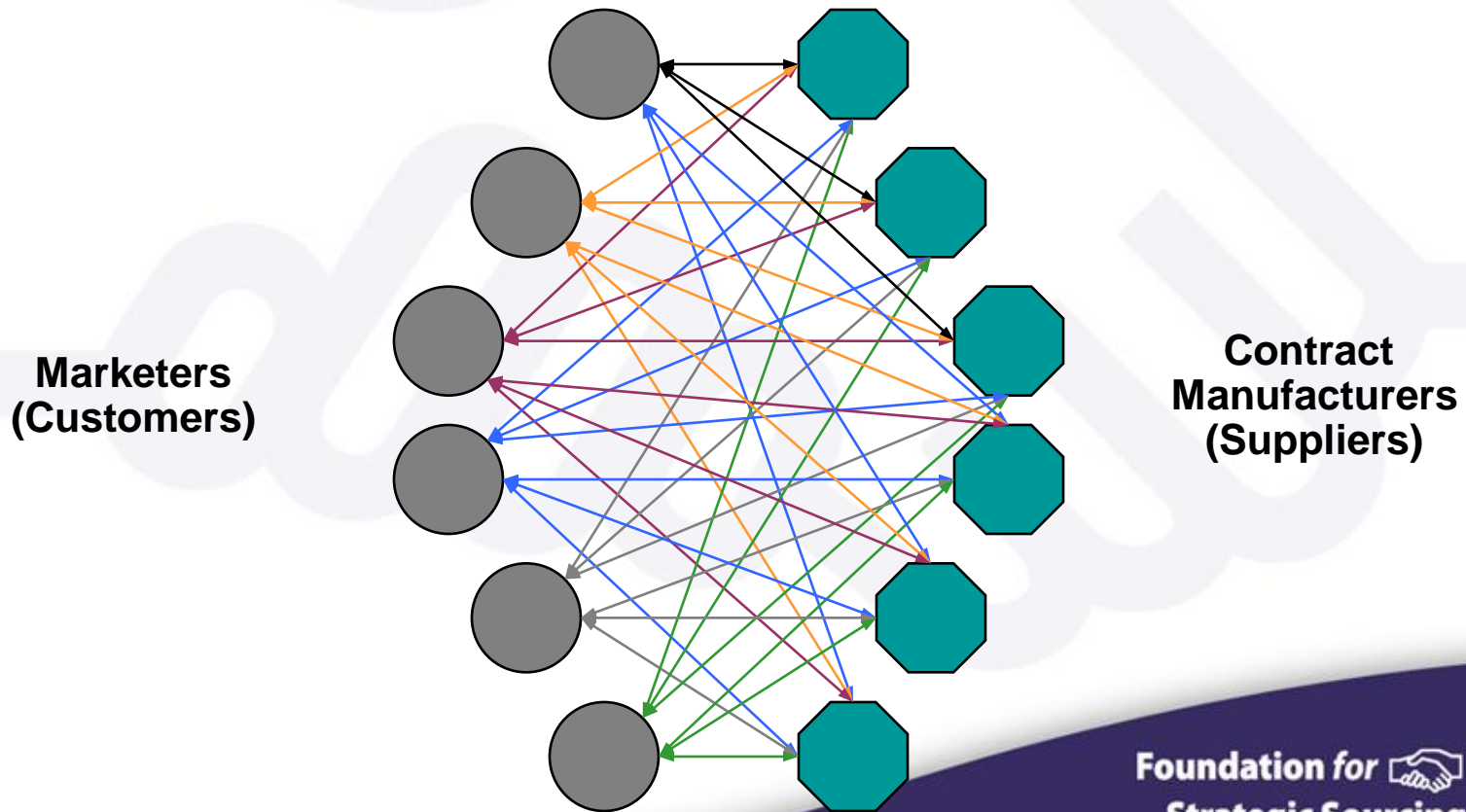
- Outsourcing is growing 15% annually¹.
- 56% of marketers outsource 11-25% of volume².
- Average savings from Outsourcing: 30% of fully loaded costs¹.

¹F4SS Research, 2009

²F4SS Research conducted by McGill University, 2008.

Challenge: As Customers expand their supply base and Suppliers expand their customer base, the level of oversight (and system cost) multiplies

Today's Environment



Vision – Transform the CPG Industry

Develop and unleash the CPG industry potential by creating a world class external supply network via collaborative engagement, establishment of industry standards and sharing of best practices to promote healthy, sustainable growth of the total industry and each member company.

The economic development will retain and attract talent needed to challenge business processes thereby supporting a fundamental shift in the CPG industry to one characterized by long term, trusted customer/supplier relationships.

Intervention

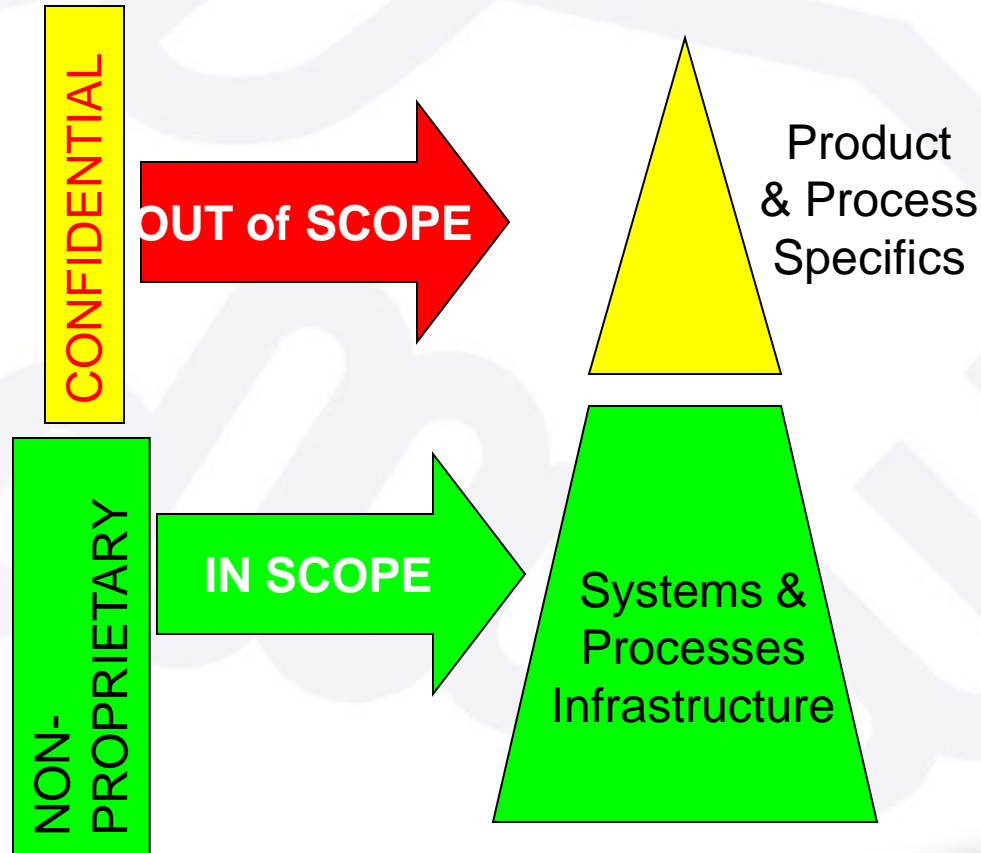
Based on analysis of data collected from F4SS Member Companies, estimated industry savings resulting from standardizing business processes is:



USD \$9+ Billion

Opportunity

Focus on the 80/20: Non-Proprietary Systems



Members



ConAgra Foods®



Elizabeth Arden



Roskam Baking Company

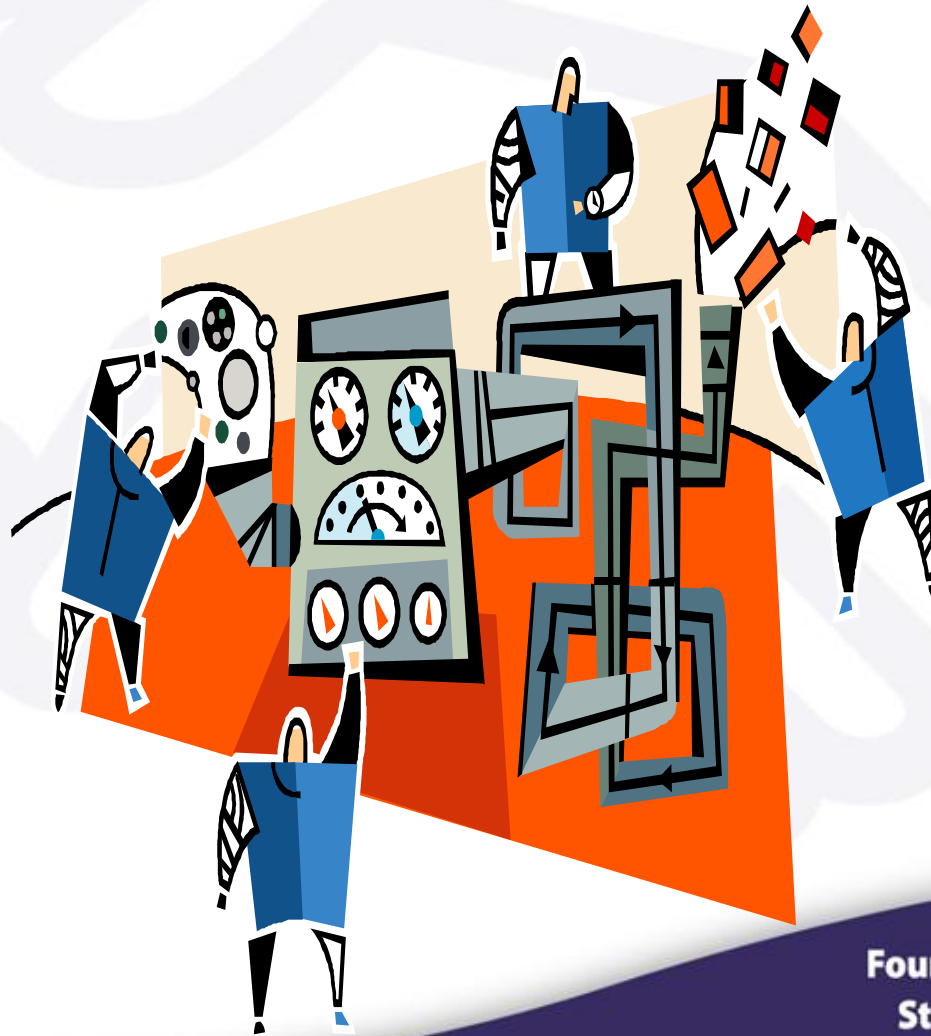


Initiative Teams

- CSOP - No Touch Replenishment
 - Scorecard Harmonization
- Quality Assurance
- Building Trust and Collaboration (TAC)
 - Contract Terms
- Capital Expenditure Options
- Sustainability (SIT)



CSOP - No Touch Replenishment



CSOP - No Touch Replenishment

REALITY

Replenishment is Core to Customer/
Supplier Relationships



ISSUE

- Every customer manages the process differently, causing complexity
- When disruptions occur, tensions escalate until resolved
- When resolved, business as usual
- Vicious cycle, no long term process improvement

CSOP - No Touch Replenishment

Phase I

Prevent supply chain disruptions and improve
Supplier/Customer Interface



➤ Provide for recurring management discussion regarding long range forecast & business plans



➤ Provide for regular review of selected KPIs & business performance



➤ Provide a CSOP Handbook standardizing the processes.

Recommended process has been and continues to be piloted by Unilever, General Mills, Kenra, Marietta and Best Sweet.

CSOP - No Touch Replenishment

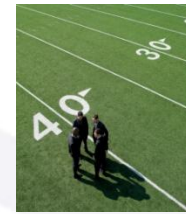
Phase II

“Low Touch Replenishment”

Reduce cost further and standardize business processes

- Establish standardized Business Models
- Establish standardized Business Processes
- Establish standardized Data Exchange Processes

Low Touch Teams



Standardized Business Models

- PO Based
- Traditional
- Full Service
- Vendor Solution
- VMI (Vendor/Supplier Managed Inventory)

Standardized Data Transactions

- EDI, X12 – XML, Exchange Service
- Demand Plan
- Supply Plan
- Production Plan
- Component PO's
- Production Execution
- Shipment confirmation
- Invoice

Standard Business Process Development

- Capacity to Demand Management
- Purchase Price Variance Management
- Demand Supply Management
- Age Management
- Change Management

No Touch Replenishment

1. Significant benefits derived from Phase I
 - Process savings = 6%
 - Reduction in lost sales/working capital = 1%
2. Expected savings from Phase II to be \geq Phase I
3. Pilots continue to validate savings. Big win = elimination of duplicate planning functions

CSOP Summary

This process has the potential to make the single biggest impact on the industry to:

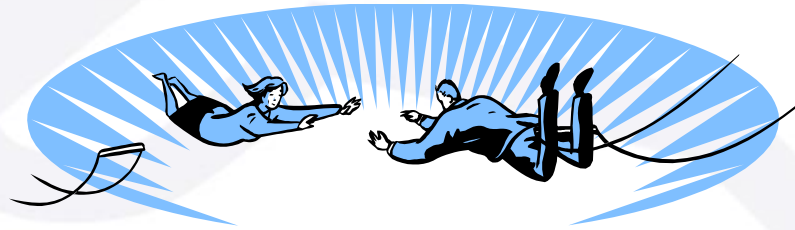
- ✓ Significantly improve supply chain reliability
- ✓ Save A LOT of money ($\geq 10\%$ of service revenue for both parties)



Building Trust and Collaboration



Building Trust and Collaboration



REALITY

Trust is core to constructive business relationships

ISSUE

- Very difficult to achieve in the CPG industry
- Suppliers believe customers will move their business for a half of a penny.
- Customers don't believe suppliers act in their best interest

Building Trust and Collaboration

Established Industry “Vision 2012”

Conducted Gap Analysis:

Root issue is lack of trust between customers and suppliers.

Costs:

Potential Costs	Explanation
FG Inventory - Holding Costs over optimal	Safety Stock - check points slow the process, can also lead to higher inventories.
Raw & Pack Inventory - Holding Costs over optimal	Duplicate inventories for common products due to having to use Customer's source
Obsolescence - Components	Remnants destroyed due to forecast miscommunications
Contracts - Outside Legal costs	Adversarial contracts lead to contract negotiations
Contracts - In-house Legal costs	Adversarial contracts lead to contract negotiations
Duplicate Functions: Planning, Finance, Quality, Audits, Security, EH&S, Transportation, R&D, Product Development	Both Supplier and Customer maintain staff for same functions
Procurement	Common supply purchases potentially handled by Supplier or Supplier having to use Customer's source in addition to their own
Travel	
Measurement systems/scorecards	Costs to capture, consolidate & report
Flexible bandwidth (c to d ratio)	Cost of flexible capacity to the supplier
Redundant IT systems	Maintaining data in 2 systems (supplier needs common system for all its customers)
Organizational efficiency resulting from operating with FT employees (vs. temps).	Wide swings in volume necessitate temp labor resulting in operational inefficiencies
Supplier Insolvency	When businesses fail - transition costs, step-in
Supplier Change	Transition costs - Inventory, Remnants, Moving Equipment, etc.

Solution: Building Trust and Collaboration Kit



Four Key Areas:

1. Governance
2. Collaborative Relationships.
3. Measurement/Benefits
4. Contract Terms



Governance:

- Governance Structure

 - Top to Top Sponsorship

 - Joint Steering Committee

 - Functional Working Teams

- Governance Process

- Ethical Code of Conduct

Governance Structure & Process



The Governance Structure & Process Worksheet is intended to establish the Senior Leadership team from both the Customer and Supplier with the responsibility and authority to ensure functional teams have the proper resources and support to meet their business objectives with the other party. After a successful initial implementation, the same committee could meet on a regular basis as agreed between the parties. In most cases, at least several meetings per year would be required to ensure results are achieved.

How to use the Governance Structure & Process Worksheet:
1. Assign a senior leader to both the customer and supplier

2. Assign desired individuals to each category on the functional working teams for both the customer and the supplier

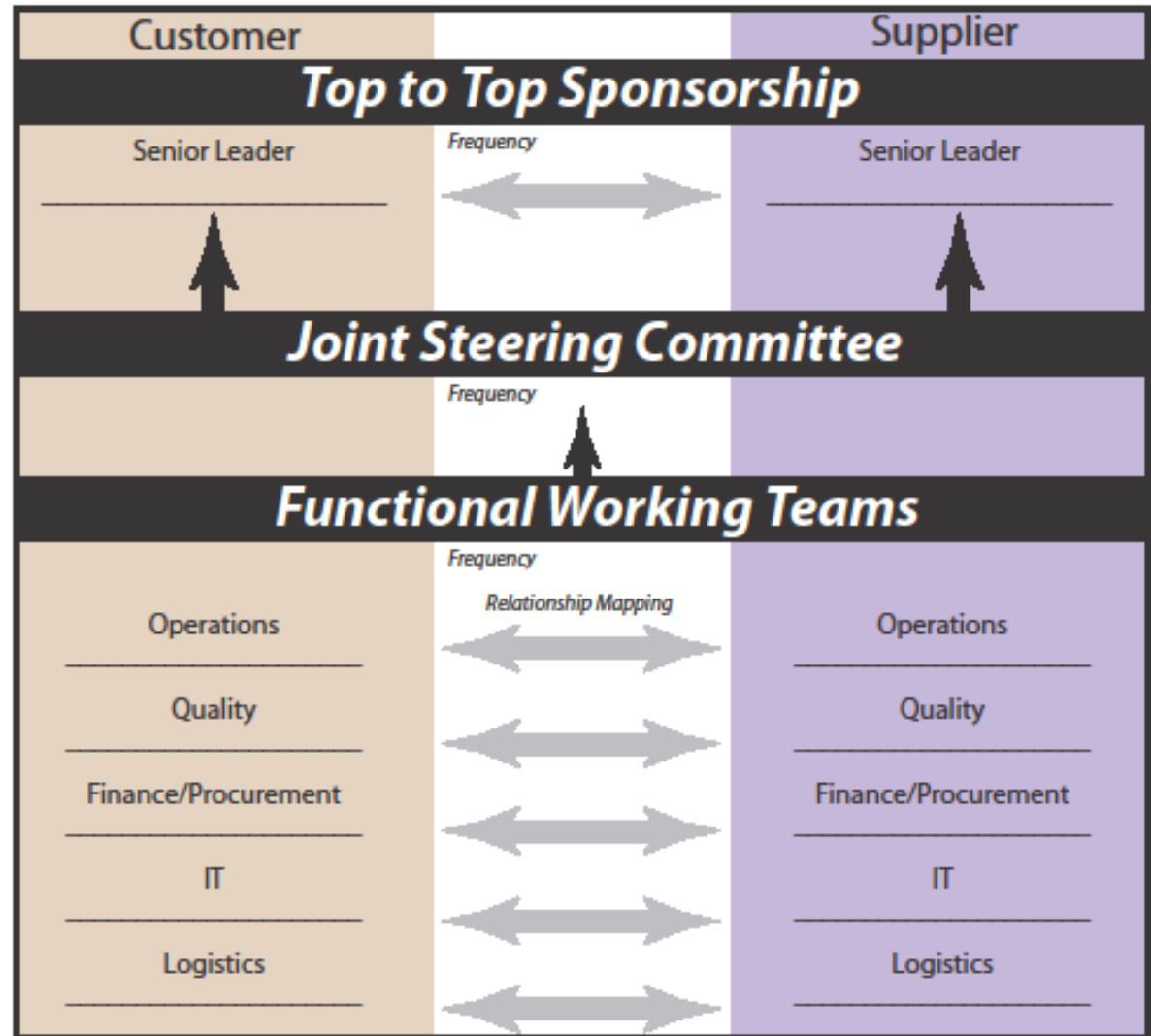
Customer Company: _____

Team Leader: _____

Supplier Company: _____

Team Leader: _____

Team Members: _____



Collaborative Relationships:

- Relationship Mapping - Expectation Process
- Relationship Health Check
- Relationship Drivers Summary
- Transparency Model – Stages & Flow in development





Customer Supplier Relationship Health Check

The Customer Supplier Relationship Health Check is intended to assist customers and suppliers in determining the effectiveness of their working relationship. The form is designed to provide specific descriptions and attributes to help team leaders both recognize the synergies between trading partners as well as identify and address areas of the relationship that have opportunity for improvement.

Customer Company : _____ **Supplier Company:** _____

Team Leader: _____ **Team Leader:** _____

Team Members: _____ **Team Members:** _____

How to use the Health Check:

1. For each success criteria, read the attribute checklists under each rating.
2. Check the boxes of the attributes that accurately describe your relationship.
3. To rate the relationship, determine the average rating of the attributes you selected.
4. Mark the appropriate rating in the rating column for each success criteria (e.g., Leadership Commitment, Team Members):
 1 = Poor; 2 = Fair; 3 = Good; 4 = Very Good; 5 = Excellent
5. Customer and Supplier team leaders share their completed Health Checks and discuss an appropriate development plan.

Success Criteria	Rating	1 – Poor	3 – Good	5 – Excellent	Comments
<i>People</i>					
Leadership Commitment		<input type="checkbox"/> The relationship is viewed and treated as a tactical project by <u>one or both</u> organizations. <input type="checkbox"/> The relationship is not viewed or treated as a high priority – inaction and delays are not effectively addressed by leadership. <input type="checkbox"/> It is unclear who is sponsoring the relationship. <input type="checkbox"/> Sponsors are not available or not involved when needed.	<input type="checkbox"/> The relationship is valued by the leadership of both organizations as a contributing factor in long-term success. <input type="checkbox"/> Sponsors are known. <input type="checkbox"/> Sponsors are available and involved when needed.	<input type="checkbox"/> The relationship is viewed and treated as strategic by the leadership of both organizations. <input type="checkbox"/> Sponsors have clearly made this relationship a priority. <input type="checkbox"/> Sponsors ensure effective action and timeliness to support the relationship. <input type="checkbox"/> Sponsors have clearly articulated their expectations for progressive performance.	

Collaborative Relationships:

- Relationship Mapping
- Relationship Health Check
- Relationship Drivers Summary
 - Key Drivers Worksheet
 - Relative Assessment Scale
 - Operating Parameters
 - Process/Resource Requirements
- Transparency Model

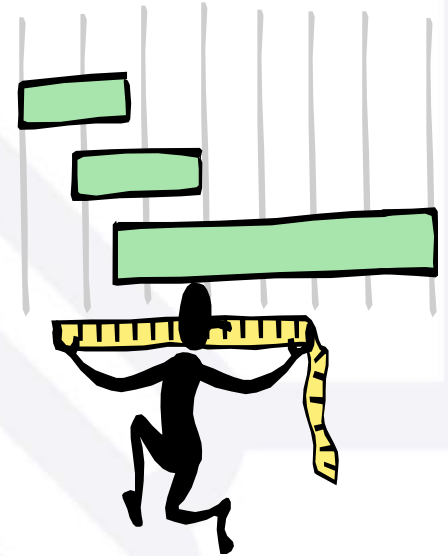


Measurement/Benefits:

➤ Dual Accountability Scorecard -
White Paper

➤ Dual Accountability Scorecard -
Example Completed

➤ Collaborative Cost Savings Opportunities



SUPPLY CHAIN	Completed by:	Accountability:	1Q 05	2Q	3Q	4Q	2005 YE	2006 YE
Case Fill Rate	Customer	Customer/Supplier	98.33%	99.63%	100.00%	99.88%	99.50%	98.60%
Case Fill Rate (Platinum Accts)	Customer	Customer/Supplier	98.11%	99.35%	100.00%	99.90%	99.30%	98.17%
Financial DOS	Customer	Customer/Supplier	89	76	74	41	70	68
Schedule Attainment	Supplier	Supplier	24%	22%	37%	31.00%	28.00%	na
Forecast Accuracy (MAPE)	Customer	Customer	28.6%	27.20%	19.00%	26.90%	23.90%	21.70%
Schedule Changes	Supplier	Customer		11	20	15	46	85
Monthly Capacity - Filling	Supplier	Supplier	CS&OP	55%	88%	70.40%	75.23%	66.33%
Annual Capacity - Filling	Supplier	Supplier	CS&OP	65%	71%	55.55%	55.55%	61.55%
Monthly Capacity- Batching								55.85%
Annual Capacity- Batching								25.00%
Raw Material Supplier Quality	Supplier	Supplier	0%	0.04%	0.16%	0.17%	0.09%	1.77%
Raw Material Supplier Delivery	Supplier	Supplier	pichney	Pumps	Silgan tubes	no majors		
Raw Material Supplier Payment	Supplier	Supplier	48	53	48	49	49.750	52

QUALITY & COMPLIANCE			1Q 05	2Q	3Q	4Q	2005 YE	2006 YE
cGMP Status	Customer	Supplier						
National Holds	Customer	Supplier	1		0	0		2
Mfg. Complaints	Customer	Supplier						
Non-Conformance	Customer	Supplier	1	3	3	98.80%	98.7%	99.48%
Microbiological Design	Customer	Supplier						
Microbiological Results	Supplier	Supplier			0.6	1.2%	0.92%	0.9%
EH&S Compliant	Customer	Supplier	marginal	marginal	marginal	marginal	marginal	
QA Release Time	Supplier	Supplier			Q1 '06	Q1 '06	Q1 '06	na

TAC Summary

1. Critical and Complex
2. Required for Strategic Relationships
3. To Create Value in relationships, must have a Structured Development plan.
4. Consistent Execution is Key.

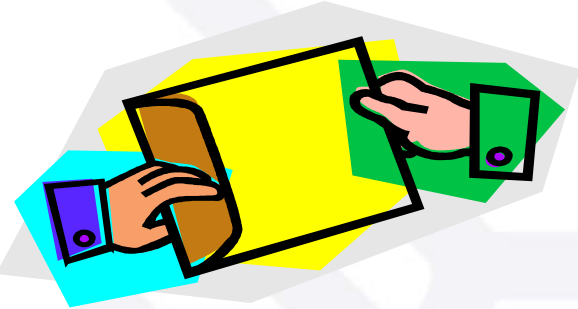
Contract Terms



Contract Terms

REALITY

Contracts are part of many Customer/Supplier relationships



ISSUE

- Negotiations can be time consuming on both sides
- Goodwill built during award process can dwindle in negotiations
- Contract Similarity

Contract Terms

Analyzed current industry contracts.

Reviewed terms and conditions.

Currently working on recommended standard industry language.



*Ultimate goal:
Industry Boilerplate Contract*

Contract Terms – Demand Visibility/Horizon

- Customers supply 12-18 month rolling forecast
- 3 month firm
- Frozen period is 21-90 days for materials
- Frozen for 3 weeks – 2 months \ (average 30 days)
- Allow for some variation (5-10%) in the frozen period.

Contract Terms - Length

Term

Long Term Relationships

➤ 5 years

Short Term Relationships

➤ 1-3 years



Contract Terms - Termination

Termination can be based on material issues

- Breach
- Bankruptcy
- Product discontinuation



Contract Terms - Specs

- Customer provides specifications
- Supplier produces to spec
- Changes to specs affecting price to be negotiated



Contract Terms - Warranty

Supplier will produce according to specifications

Will be in compliance with all Laws

Merchantable and fit for Customers use

Supplier held harmless for design patent or trademark if article supplied by Customer

If Customer owns formula and specs; Supplier not liable



Contract Terms – Breach of Warranty

A supplier who fails to meet specs is responsible for:

- Replacement or rework at no cost
- Retrieval cost
- Disposal cost
- Transportation cost



Shared responsibility to the extent liable

Contract Terms - IP

Customer owns the Intellectual Property

- Customer indemnifies Supplier
- No rights transfer



Jointly developed IP

- All rights transfer to Customer

Contract Terms



Stay tuned

Clauses still in development

Boilerplate available: end of 2010

Sustainability



Sustainability



Top 10 reasons to “green” your supply chains*.

- Increase Profitability
- Asset Utilization – by incorporating greater eco awareness into transportation and inventory practices
- Risk Mitigation – environmental, social, and market risks.
- Innovation – catalyst for supplier innovation.
- Alignment - across the supply chain.

*Taiga Co 3-12-09

Sustainability



Top 10 reasons to “green” your supply chains* (cont).

- Continuous Improvement - A common understanding provides a platform for continuous improvement.
- Customer Service - will standardize operations and allow for improve customer service.
- Regulatory Compliance - ensure regulatory compliance.
- Product Differentiation – Creating uniquely different green supply chain practices will differentiate the company
- Enhance Reputation – promote business sustainability and enhance company reputation.

Sustainability

REALITY

Most Customers have defined Sustainability Initiatives “down” the supply chain.

ISSUE

There is little industry discussion on Sustainability “up” the supply chain.

Sustainability

REALITY

Sustainability will be of long term importance to the industry moving forward.

ISSUE

Where do we begin???



Sustainability

Definition of Terms (everyone has a different approach):

1. Social, Economic, Environmental
2. The 3 P's – People, Profit, Planet
3. ESG – Environmental, Social, Governance



Sustainability

CONCLUSION:

3 drivers: Consumer, Customer, Cost

Definition:

Responsibly act to build a regenerative, profitable business cycle which is driven by consumer demand, customer demand, and cost.

Sustainability

Four primary focus areas:

Economic

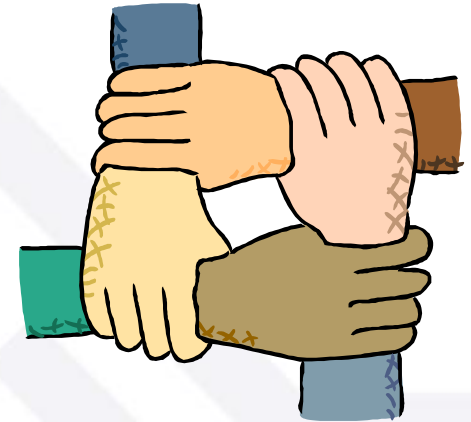
- Increased revenues
- Reduced costs



Sustainability

Social

- Diversity
- Agricultural Impact
- Community Service
- Fair wage
- Safety
- Human rights
- NGO Engagement
- Employee Engagement
- Philanthropy



Sustainability

Environmental

- Packaging
- Water
- Energy
- Solid Waste
- Transportation
- Agricultural Impact
- Materials



Sustainability

Governance

- Reporting
- Measurement
- Mission/Value Statement
- Top down
- Executive compensation



Sustainability

An almost endless list of possibilities...

How do we start the process



Sustainability

Suggested CPG Upstream Metrics:

- Packaging
- Water
- Energy (all forms)
- Solid Waste



Stay tuned – metrics to be shared in
February 2010

Summary

- The industry is in transition
- Industry Leaders now recognize the benefit of collaborating on upstream, non-proprietary business processes.
- Adopted “standards” drive industry efficiency to the benefit of all industry participants.

Thank You



Presentation available at
www.f4ss.org under Library section

Twitter: F4SSLisa

Foundation for 
Strategic Sourcing

