ATKearney

Rethinking Supply in Food and Beverage

Global pressures on the food and beverage industry will only increase in coming years. More strategic supplier relationships will ensure you are ready for the changes.

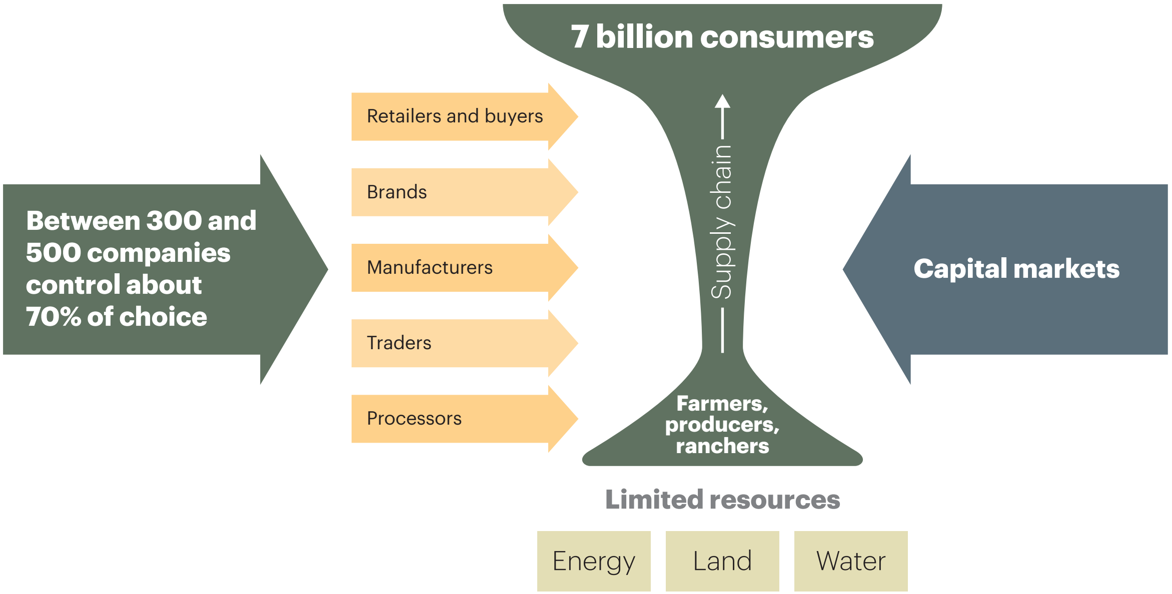
Amid rapidly transforming supply-and-demand pressures—from a growing middle class in developing markets to increasing weather volatility—the leading food and beverage companies are rethinking their supplier relationships. Are the current suppliers prepared to apply new technology, adequately control sources of supply, and respond quickly in today's dynamic, global marketplace? Do sourcing agreements favor short-term price advantages over long-term sourcing availability and security? Are supply partnerships adeptly managing increasing regulations on food safety, sustainability, and ingredient traceability? Are the right partnerships in place to deliver innovation to tomorrow's consumers?

Considering these difficult questions, the time is now to reconsider the future of your food products portfolio and assess the agricultural constraints that you might face in the coming years. Most will have to scale up or collaborate with suppliers to secure supply sources.

Supply Availability Trumps Price

As the path from farm to fork narrows, the world is moving to a global industrialized system of food production (see figure 1). In the next decade, a small set of companies will likely control the vast majority of the food supply. Key commodities supplied by a few large market players include: starch and vegetable fats and oils manufacturing, wet corn milling, soybean processing, sugar manufacturing, creamery, butter manufacturing, and dry pasta manufacturing. The world's seven billion consumers will have more than 70 percent of their choices provided by 300 to 500 companies. Farmers and producers are more likely to be corporations and consumers will likely be serviced by large global retail and restaurant chains. Future competition will not be between companies but rather supply systems. Forward-thinking operators, distributors, and manufacturers are already reevaluating their sources of supply.

Figure 1
The food value chain



Sources: Jason Clay, World Wildlife Fund; A.T. Kearney analysis

The food system's industrialization is speeding up as new market demands emerge, and regulatory and resource constraints may limit the number of companies that have the internal resources to manage supply volatility and regulatory requirements. Access to approved suppliers will become more difficult; dedicated supply systems will be required to assure adequate supply and manage costs in a volatile environment. To win the competition between supply systems, successful companies will need to ensure their sources of supply and develop strategic partnerships with suppliers that have the tools, resources, and agility to achieve a competitive edge (see sidebar: Supply-and-Demand Forces at Work).

For critical commodities, price-based relationships will evolve into more strategic relationships, in order to counter the disruptive changes affecting supply-demand dynamics. Over the next decade, it is very likely that supply *availability* will trump *price* as the crucial factor in supply decisions. Ensuring availability requires rethinking current criteria for supplier evaluation, identifying the right set of suppliers, and selecting suppliers that can offer a complementary set of capabilities to improve a company's overall position. These suppliers will also be integral to achieving value beyond cost—this value could simply be securing supply, or it could be other factors such as innovation or improving capital return.

Supply-and-Demand Forces at Work

Demographic trends are colliding with availability challenges, leading to a global transformation of both supply and demand for the food industry. Let's look at some of the most important trends going forward.

Changing demographics in the developing world. **Per-capita food consumption in developing markets is moving closer to developed countries, particularly as a new "middle class" continues shifting from grains to proteins. This new consumer group will drive significant industry growth and alter the dominant taste preferences, and technology will change the way they access information and shop. Consumption changes have already disrupted supply and demand of many commodities. For example, since 2003, cocoa consumption is up 279 percent in China and 158 percent in India—all while limited acreage, poor weather, economic policies, and social tension have increased raw ingredient costs of cocoa in West Africa.**

Weather volatility. **As the world faces more droughts, floods, and famines in its most important agricultural regions, the effects on prices are huge. For example in the United States, the 2011 drought drove up corn and feed prices, drove down beef profitability, and led to a historic drop in beef production.**

In particular, water stress and scarcity will intensify and expand. By 2025, 1.8 billion people will be living in areas with water scarcity, and two-thirds of the world population could be under stress conditions. Water usage has been growing at more than twice as fast as the population, with agriculture accounting for 70 percent of withdrawals from freshwater sources. The current rate of withdrawal from underground aquifers is considered unsustainable. With pressures from industry and urban centers, water scarcity will increase and agriculture will be facing significant challenges as it seeks to produce more food with fewer water resources.

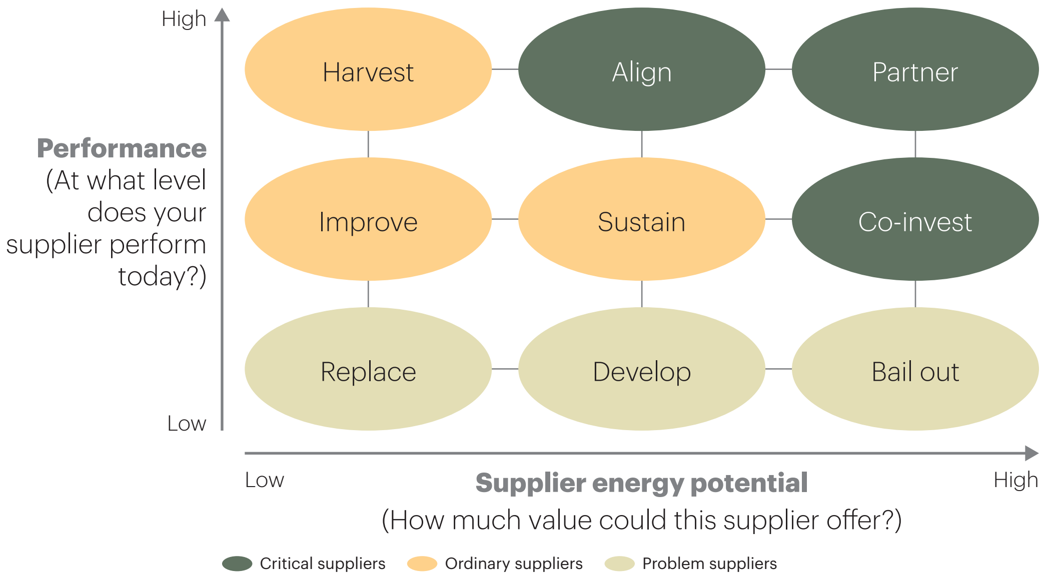
Arable land scarcity. **For now, the world's food supply has sufficed, despite periodic droughts, floods, and famines. However, since 1950, the amount of arable land per capita declined from the traditional 1.2 acres per person capacity to approximately half an acre per person today. New arable land is becoming a scarce resource. Across both developed and developing economies, prices for staples such as corn, soybeans, wheat, and rice are increasing while agricultural productivity growth is declining.**

Changing government policies. **Governments are limiting agricultural research even as the U.S. Food and Drug Administration pushes for enhanced food safety rules (such as Foreign Supplier Verification and Accredited Third Party Certification). The push for nutritional literacy is increasing, and consumers are actively demanding transparency within the food industry, using social media to advance their causes.**

Segmenting Suppliers into Specific Categories

What are your strategic suppliers? The ones that show high levels of both current performance and long-term potential (see figure 2). These suppliers provide high value in business-critical areas, often represent a majority of category volume, participate in the planning stages of category ideation, and allocate dedicated resources to their clients. Strategic suppliers share mutual objectives and often have had a long-term relationship with the client. And they excel at delivering what we call "supplier energy"—a high level of resources, skills, capacity, and goodwill that help their clients achieve their broader strategic objectives.

Figure 2
Supplier energy segmentation framework



Source: A.T. Kearney analysis

Segmenting suppliers based on their level of strategic importance allows food manufacturers to capture current opportunities within supply networks, to get in line for future ones, and to strengthen the most valuable ones.

After identifying potential strategic suppliers, the next step is working to create a mutually beneficial partnership based on shared goals, ownership, and risk. Three types of distinct supplier interaction models offer the best chance for success:

- **Influence.** Tap into supplier technology to develop and launch new products or services jointly. Exclusivity is typically not a requirement.
- **Integrate.** Enter a multi-year relationship with the objective to shape the market. There is often an opportunity to change the rules of the industry across a sizeable portfolio. Exclusivity may be an option to allow for game-changing moves.
- **Invest.** Jointly build competencies and commit resources on both sides to develop game-changing portfolios.

While the preferred partners would be highly motivated to become strategic suppliers, and thus ready to agree to reasonable terms of transparency, collaboration, governance, and risk, some buyers may need to make cost tradeoffs in order to secure supply resources from these preferred suppliers. Over time, these costs prove worth it, as strategic supply partnerships unlock competitive value, retain expected benefits, secure supply, and lower risk exposure.

Moving Supply Systems in the Right Direction

Building strategic supply relationships today can give companies a disproportionate advantage as global forces impact resource availability, commodity availability, and pricing and consumer tastes. Engaging in strategic partnerships brings benefits across the portfolio in areas of growth and innovation, sustainability, risk management, product quality and safety, and long-term costs (see figure 3).

Figure 3
Strategic supplier opportunities

1	Growth and innovation	• Collaborating on supplier-driven innovation • Managing innovation and R&D
2	Sustainability	• Establishing a sustainability strategy • Assessing and driving a sustainability agenda across entire supply chain
3	Risk management	• Establishing a commodity risk management strategy • Reducing supply risk
4	Product quality and safety	• Increasing transparency through collaborative sourcing • Applying tighter control, from upstream raw material input to downstream delivery to end-consumer
5	Long-term cost advantage	• Shifting from sourcing to category management • Applying advanced strategies outlined in the Purchasing Chessboard[1]

[1] For more on the A.T. Kearney Purchasing Chessboard, see www.purchasingchessboard.com.
Source: A.T. Kearney analysis

The following examples show companies that are moving in the right direction.

Growth and innovation: Frito-Lay and Taco Bell. The 2012 deal between PepsiCo's Frito-Lay and Taco Bell to bring Doritos-flavored taco shells to Taco Bells led to the restaurant's most successful product launch in its 50-year history. A year later, Doritos unveiled two new chip flavors replicating the flavors of the Doritos Locos Taco, helping bring some of the restaurant's success into grocery aisles.

Sustainability: General Mills and AgroMantaro. General Mills' four-year, $1.1 million sustainability sourcing program with supplier AgroMantaro in Peru is designed to help smallholder artichoke farmers in that country increase their crop yields and improve profitability. General Mills will share its knowledge of supply chains and the agricultural economy with farmers, while AgroMantaro will provide technical assistance and engineering support. As Augusto Fernandini, general manager and partner at AgroMantaro, described it, the plan "created a rich business model that fosters world-class value throughout the entire supply chain—for the farmers, our company, our clients, and the end-consumers."[1]

Risk management: PepsiCo and Anglian Water. Potatoes require an abundant water supply to successfully produce. PepsiCo, seeking to ensure a solid, long-term supply of this critical ingredient for its potato chips, partnered with Anglian Water to identify the impacts of climate change on potato suppliers and to develop a strategy to tackle the potential risks. PepsiCo and Anglian Water have succeeded in reducing water use among farmers (through tactics such as drip-feed irrigation), identifying where they need to introduce new species of crops, and installing sensors to monitor and update suppliers on changing climate conditions.

The market's future leaders are challenging their own thinking and **pursuing solutions to take advantage of global opportunities** while mitigating global risks.

Product quality and safety: Dole and Matanuska Africa. In January 2014, Dole Fresh Fruit Europe entered a long-term partnership with Matanuska Africa (a subsidiary of Rift Valley Corporation) whereby Dole assumed all sales operations and became the sole distributor of Matanuska's Mozambique banana production in the Middle East, Europe, and Africa. It also agreed to assist Matanuska logistically and supply technical support in its farming operations. The deal gave Dole a supply base close to its Middle East customers, while Matanuska obtained expertise to improve its product and increase production.

Long-term costs: Procter and Gamble and Amazon. E-commerce giant Amazon has begun co-locating in P&G warehouses, letting Amazon direct-ship orders for P&G products, eliminating the typical transportation and warehousing steps. For Amazon, co-locating reduces the space needed to store bulky items; for P&G it reduces logistics costs while allowing faster delivery for customers. Amazon is now inside at least seven P&G distribution centers worldwide, including in Japan and Germany, and if it's successful, expansion to other suppliers is likely.

Preparing for the Next Decade

In the next decade, increased consumer demand, changing consumer tastes, increased regulations, limited availability of arable land and water, and consolidation within the commodity industry will put pressure on sources of supply. The market's future leaders are those that are challenging their own thinking and pursuing solutions to take advantage of

[1] General Mills news release, "General Mills launches $1.1 million sustainable sourcing program in Peru," 5 September 2013

global opportunities while mitigating global risks. They are collaborating with key suppliers to drive innovation, establish sustainability strategies that reach across the entire supply chain, manage their supply risk, ensure product quality and safety, and create long-term cost advantages based on strong category management.

Rethinking supply requires all levels of food and beverage leadership to ask the hard questions, to make choices between suppliers based on future potential, and to influence, integrate, and invest where appropriate in sourcing initiatives with longer payoff horizons. Marketing strategies need to anticipate rapid changes both in consumer tastes and ingredient availability. The future is bright for companies that know their strategic suppliers and develop relationships that achieve innovation, share risk, and provide for ongoing product security, sustainability, and long-term advantage.

Authors

Dave Donnan, partner, Chicago
dave.donnan@atkearney.com

Joy Peters, partner, New York
joy.peters@atkearney.com

John Piatek, consultant, Chicago
john.piatek@atkearney.com

Abe Thomas, consultant, Chicago
abe.thomas@atkearney.com

A.T. Kearney

A.T. Kearney is a leading global management consulting firm with offices in more than 40 countries. Since 1926, we have been trusted advisors to the world's foremost organizations. A.T. Kearney is a partner-owned firm, committed to helping clients achieve immediate impact and growing advantage on their most mission-critical issues. For more information, visit www.atkearney.com.

Americas	Atlanta Bogotá Calgary Chicago Dallas	Detroit Houston Mexico City New York Palo Alto	San Francisco São Paulo Toronto Washington, D.C.
Asia Pacific	Bangkok Beijing Hong Kong Jakarta Kuala Lumpur	Melbourne Mumbai New Delhi Seoul Shanghai	Singapore Sydney Tokyo
Europe	Amsterdam Berlin Brussels Bucharest Budapest Copenhagen Düsseldorf Frankfurt Helsinki	Istanbul Kiev Lisbon Ljubljana London Madrid Milan Moscow Munich	Oslo Paris Prague Rome Stockholm Stuttgart Vienna Warsaw Zurich
Middle East and Africa	Abu Dhabi Doha	Dubai Johannesburg	Manama Riyadh

For more information, permission to reprint or translate this work, and all other correspondence, please email: insight@atkearney.com.

The signature of our namesake and founder, Andrew Thomas Kearney, on the cover of this document represents our pledge to live the values he instilled in our firm and uphold his commitment to ensuring "essential rightness" in all that we do.

A.T. Kearney Korea LLC is a separate and independent legal entity operating under the A.T. Kearney name in Korea.

A.T. Kearney operates in India as A.T. Kearney Limited (Branch Office), a branch office of A.T. Kearney Limited, a company organized under the laws of England and Wales.

© 2014, A.T. Kearney, Inc. All rights reserved.

ATKearney

Rethinking Supply in Food and Beverage

Global pressures on the food and beverage industry will only increase in coming years. More strategic supplier relationships will ensure you are ready for the changes.