The recession bites: fact or fiction?

Andy Hockings of Iguana Business Consultancy explores how SME food and beverage manufacturers and their customers view the economic climate.

THERE is no denying the fact that we are in recession. Unemployment is rising, manufacturing output falling, credit remains tight and the Bank of England is forecasting a decline in GDP of 4.5% for 2009.

But all is not doom and gloom. A survey by Iguana Business Consultancy – *Impact of the economic situation on the supply chains of SME manufacturers* – has specifically looked at the ability of manufacturers to understand and respond to the needs of their customers. In addition it has sought to identify changes in customer demands and how these have, or might, impact on the manufacturers' supply chains.

The results, not surprisingly, reflect the wide range of products, customer types and sector-specific challenges. Common themes stand out, some of which are due to the current economic downturn, such as availability of capital, the cost of borrowing, pressures on credit terms and bad debts. Others are part of the ongoing business environment, including the focus on reducing operating costs, demands by customers to improve service and the critical importance of product quality, although recessionary pressures appear to be focusing attention on these areas.

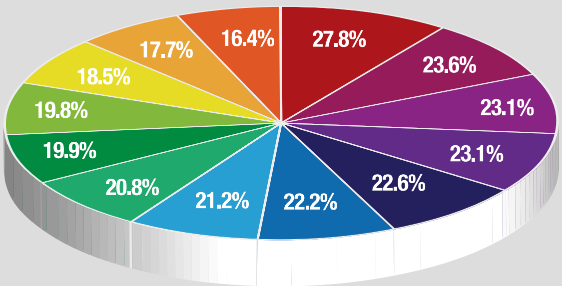
There are indicators that this is a resilient sector. This view is supported by the British Retail Consortium's latest figures which show that food and drink sales for the period February – April 2009 are 5.3% higher than the corresponding period last year, while non-food is showing a -2.9% like-for-like decline.

The Chancellor might be predicting a recovery towards the end of 2009 but this optimism isn't supported by the Bank of England or 44% of SME manufacturers, who see mid to late 2010 as a more realistic timeline; with 15% taking an even more pessimistic view of 2011 or beyond.

In your opinion, over what period will the UK economy recover?	
Within the next 12 months	7%
Over the next 12 to 18 months	31%
18 months to 2 years	44%
Beyond 2 years	15%

The suffering supply chain?

When considering the impact on supply chains, over 74% of SME manufacturers cited operating cost increases, not being paid as quickly and declining sales volumes as the main challenges.



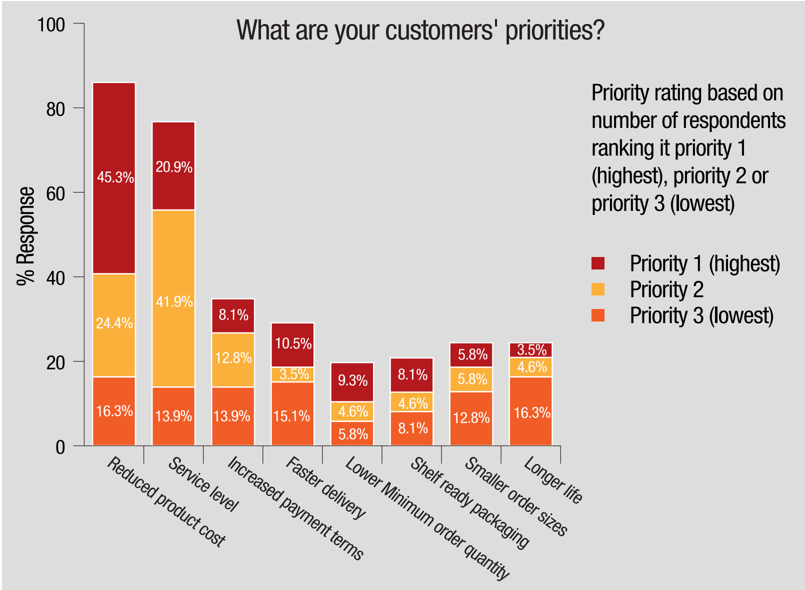
To what extent are the following inpacting your business?

- Operating costs increasing 27.8%
- Not being paid as quickly 23.6%
- Sales volume decreasing 23.1%
- Availability of capital 23.1%
- Sales order size decreasing 22.6%
- Increase in bad debts 22.2%
- Inventory levels increasing 21.2%
- Costs of capital 20.8%
- Borrowing costs of money 19.9%
- Pressure on listings 19.8%
- Need to deliver more frequently 18.5%
- Supplier defaults 17.7%
- Level of customer returns 16.4%

Responses ranked on a percentage weighted average. Responses for each question based on a choice of 'significant impact', 'some impact', 'limited impact', 'no impact'.

While operating cost pressures will remain, particularly for those with exposure to the euro or dollar, much of this was driven by the significant food price increase during 2007 and 2008 and the rapid increases in fuel and utility costs last year. These pressures are now receding and expectation of falling raw material prices into this year and the falls in utility prices are expected to feed through during 2009.

The spectra of customers extending payment terms were a recurring theme throughout the survey with 79% raising it as a concern. However, the majority (75%) had not experienced any change. When asked about their customers' priorities, 35% placed "increased payment terms" in their top three. Interestingly, while 100% of the customers interviewed said that they were not planning to extend their supplier terms, when asked about their priorities, they all acknowledged that, to a greater or lesser extent, it was on the agenda. That said, there was an acknowledgement that it was not in their interest to exacerbate the financial pressures on suppliers and as one supply chain director explained, "in some instances we are taking tactical decisions to reduce supplier payment terms particularly to those that can't be easily replaced". Ninety-two per cent highlighted the increase in bad debts but many had implemented strategies to minimise the impact such as tighter credit limits, cash on delivery and using their sales teams – as one manufacturer explained, "we are just having to work harder to get our money".



While 75% of SMEs were experiencing sales decline, there was a surprisingly high level of optimism particularly from those who supplied, for example, ingredients for home baking where there appears to be a surge in usage, or products that consumers might trade down to from more expensive alternatives. As one supply chain manager explained, "we are benefiting from the economic situation and are seeing consumers trading down from more expensive ready meals".

The research certainly indicates that the impact on SME manufacturers is dependent on the sectors in which their customers operate. Those serving the independent sector were experiencing significant pressures as outlets were being forced to close, but most have a mixed portfolio of customers with volume increase in one offsetting the decline in another.

Most respondents had experienced a significant drop off in sales during the first quarter of 2009 and this appears to be linked to customers destocked post-Christmas. However, there was broad optimism that demand is now returning to nearer normal levels.

The availability of capital (73%) and the borrowing costs of money (60%) is now impacting the plans of manufacturers, with investment often restricted to projects linked to health and safety. Views, however, tended to polarise between companies that rely on the banks for capital funding and borrowing and those that have access to independent funding such as private ownership, with the latter appearing far more optimistic.

When considering the supply chain priorities of their customers, the views of manufacturers closely correlated with those of the customers interviewed. Both identified the top three priorities as reduced product cost, service levels and increased payment terms.

Service levels

While many of the SMEs interviewed regarded their service flexibility as a key asset, for the majority, delivery accuracy (on-time-in-full – OTIF) and quality assurance was regarded as critical. However, communication rated as an essential element of service. They defined communication as advising of order shortages and issues associated with deliveries, quality and pricing. The research also indicates a correlation between the outsourcing of secondary logistics to third-party service providers and the deterioration in quality of communication, particularly regarding delivery-related issues.

Another aspect of communication is the sharing of information. While the research shows that there is a two-way flow, the information shared very much depends on the size and sophistication of the customer.

Shared information	Shared with customer	Shared by customer
Product quality	91%	88%
Sales forecasts	72%	70%
Availability & performance	66%	62%
Inventory levels	55%	51%
Raw data	51%	49%
Profitability	14%	13%

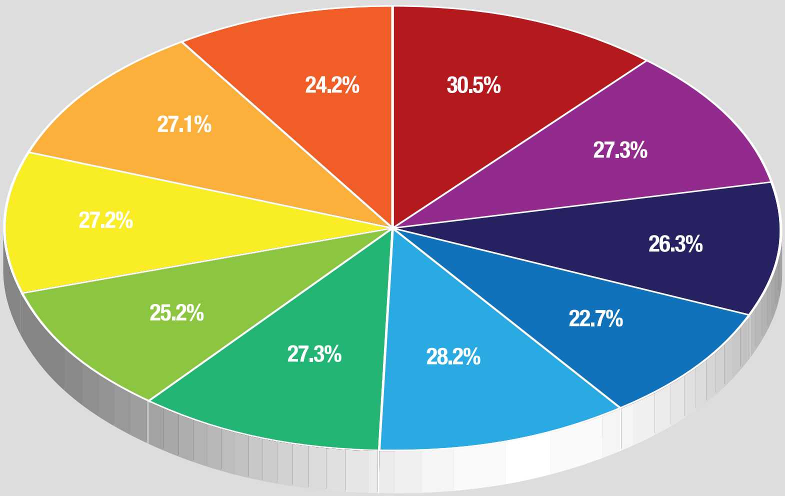
Changing customer demands?

Less than half of manufacturers (45%) were experiencing changes in the demands of their customers and while some may be directly linked to the recession, others are part of ongoing strategies. Larger customers have been looking further down the supply chain for some time in order to manage cost and availability, with the increasing move to backhaul and PCCs being examples. As the supply chain director of a major customer explained, "we are looking further down the supply chains of our suppliers in order to manage inbound transport costs and performance"

But as customers seek to reduce inventory and manage margins, the research indicates increased demand for shorter order to delivery lead times (28%), smaller order sizes (24%) and more frequent delivery (28%). Longer product life (24%), shelf-ready packaging (21%) and lower minimum order quantities (20%) are also increasingly on customers' agendas.

Where to focus?

The level of supply chain error was a frequently raised issue, as expressed by an operations director of a major customer - "there is a need for manufacturers to reduce supply chain errors which are creating planning and forecasting issues impacting availability". This view was broadly recognised by manufacturers and improving the planning processes was regarded as an area of focus amongst an overwhelming majority (98%). This aligned closely with the views of customers who regarded planning process improvements and the development of appropriate performance measurement tools as priority areas for their SME manufacturers.



Impact of initiatives on the performance of the supply chain

- Improving planning processes 30.5%
- Improving manufacturing flows 27.3%
- Improved warehouse flows 26.3%
- Supply chain benchmarking 22.7%
- Reducing order to delivery lead time 28.2%
- Performance measures 27.3%
- Improved inbound logistics visibility 25.2%
- Improving inventory management 27.2%
- Improved systems process 27.1%
- Improved secondary logistics 24.2%

Responses ranked on a percentage weighted average. Responses for each question based on a choice of 'significant impact', 'some impact', 'limited impact', 'no impact'.

Linked to improvements in planning processes are several other initiatives including: the impact of reducing order to delivery lead times (93%); improving inventory management (92%); and improving manufacturing flows (94%).

While most manufacturers recognised the need to improve their planning processes, there was less clarity on how this might be achieved. There was limited understanding of, for example, how to incorporate customer demand into the supply chain planning and material ordering processes or how improvements in the forecasting processes could aid production efficiencies and inventory management leading to better availability. Certainly there were indications that much of the planning, particularly where spreadsheet based, tends to be error prone, and moves to invest in more sophisticated systems may now be delayed due to the current restrictions on investment.

To conclude

While the recession is clearly impacting SME food and beverage manufacturers the data suggests that the sector is likely to be more resilient than most. While, sadly, there will be inevitable casualties amongst manufacturers, there was a great deal of determination and optimism amongst those surveyed which may stem from the fact that successful SMEs tend to be experienced in running a 'tight ship'.

When understanding the preparedness of SME manufacturers to understand and meet the demands of their customers, the answer to the former is probably 'yes' and the latter 'maybe'.

The pressure to reduce product cost, manage payment terms and improve delivery service is well understood and a focus for most businesses. What appears to be less understood is how to sharpen service through improved communication and the impact of under-developed planning processes on the supply chains of customers.

So, where do you start? This article alludes to a number of solutions from finessing your communication with customers to reducing supply chain error through greater emphasis on planning processes. Suffice it to say, those who make their move now will be in pole position to exploit the recovering market we all hope to see during 2010. End

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