

CONSUMER MARKETS

Executive Summary: Best in Class

Insights on supply chain efficiencies in the
Canadian food and consumer products industry

KPMG IN CANADA

About the Research

This is the first major survey focused on the ambient supply chain operations of food and consumer goods companies doing business in Canada. It was conducted under the auspices of Food & Consumer Products of Canada (FCPC), the Canadian association representing the food and consumer products industry.

Total sales of the 30 companies that participated in the survey represent over 70 percent of the food and consumer goods sold in Canada, or 17 billion lbs of annual volume, or approximately 22,000 unique products.¹

Participants completed and submitted the e-mail survey in October 2009. KPMG developed and conducted the survey, analyzed the results, and prepared this report. Key executives from significant consumer goods manufacturers provided insight and advice in the survey design, administration, and interpretation of the results. The data submitted was assessed for reasonableness, and outliers were confirmed with the participants.



¹ Source: Food & Consumer Products of Canada.

Foreword



Manufacturers have risen to the challenge of serving today's consumer-driven retailers. There may be some cracks appearing in the back room, but, overall, the industry is doing an effective, efficient, and competitive job in a demanding and volatile market. A strong desire exists to collaborate with retail partners and much of the infrastructure that food and consumer products companies use to communicate with retailers is already in place.

Historically, the Canadian food and consumer products industry has developed surprisingly few industry-accepted supply chain performance metrics that are broadly tracked, which makes comparative benchmarking very challenging. The only common customer service metric is "case fill rate" — the number of cases ordered, compared to the number of cases received — and, even then, not every company reports this metric.

This lack of metrics represents a challenge to food and consumer products companies — individual companies are unable to quickly monitor whether they are keeping stride with others in their industry. But, it also represents a significant opportunity; if more metrics are established and embraced by the industry, it could provide individual companies with a better understanding of how they are meeting their customer promise and serve as a platform for greater collaboration within the industry as a whole.

This study is not meant to be definitive—far from it—but we hope that it will be a stepping stone toward providing a platform for meaningful comparisons and collaboration for the Canadian food and consumer products industry. We are grateful to have been able to participate, and commend the FCPC in undertaking this important initiative.

A handwritten signature in black ink, appearing to read 'Willy Kruh'.

Willy Kruh
Global Chairman
Consumer Markets

A handwritten signature in black ink, appearing to read 'Tom Vandeloo'.

Tom Vandeloo
Partner, Advisory Services
Performance and Technology

Executive Summary

Manufacturers of food and consumer products in Canada are between the proverbial “rock and a hard place.” Their customers are imposing increasingly onerous requirements for more responsive service, and smaller and more frequent deliveries, which drive greater costs. And competitive pressures are keeping prices in check. In addition, North American and Global sourcing strategies are driving poor inbound service levels from the plants designated to supply the Canadian market.

To help address some of these issues, Canadian food and consumer products companies see opportunities centred around collaboration—with customers, suppliers, and carriers. Participants also recognize many opportunities within their own operations to improve internal alignment, collaboration and communication, forecasting and promotion management, systems integration, and network enhancement. Outsourcing is also seen to hold promise, notably in warehousing, as is co-loading with other manufacturers.



Industry Update



The recession has impacted businesses around the world. In the past year alone, food and consumer products companies have seen volatile input costs, high unemployment rates, escalating customer demands, and fierce competition that have exerted intense pressure across their operations. However, Canadian food and consumer products businesses have a host of issues impacting their supply chains, that existed long before the recession. Top of mind concerns affecting the industry are:

The value-conscious consumer

According to the latest Nielsen Global Consumer Confidence Survey, Canadian consumer confidence continues to rise, up two index points since Q1 and ahead of many nations around the globe, including the U.S. Yet despite this increased optimism, 56 percent of Canadians continue to believe the country is in a recession. As economic conditions improve, many organizations may need to focus on aligning their businesses with changing consumer value perceptions.

Traditional business models are changing

We live in a hyper-connected, technology-enabled knowledge economy. Transactions that used to take weeks are now complete in a matter of seconds. With the advent of social media platforms such as Twitter and Facebook, consumers are able to obtain and share information like never before. Social media also promotes a culture of interconnectedness between individuals, companies, and economies that has led consumers to have a much greater say in the value equation—quality, integrity, convenience, and price. Meeting these expectations will likely transform some organizations' traditional processes and practices.

European logistics models

Several of Canada's major retailers are taking a page from the successful flow-through models developed by European retailers (adjusting the models to accommodate the massive scale of Canada's geography and the low density of population). These models can reduce inventory and merchandise dwell time, but may increase manufacturer fulfillment costs and carbon footprints for smaller deliveries on case picked merchandise, metered to consumer consumption. With today's low cost of credit, the full benefits may be elusive; but, as interest rates rise, these models can become increasingly attractive.

Increased retailer sophistication

Retailers are continuing to be much more proactive and aggressive in managing supply chain costs. Many retailers are introducing programs that allow them to control the flow of goods and information more closely than in the past. Given the importance of retailers in the Canadian value chain, manufacturers are often given little choice with respect to these programs and should find ways to adapt their supply chain model to meet the increasing demands of the retail sector.

01

A View of the Industry Overall

Channels, volumes, service levels, and costs

Grocery is by far the largest channel served by the survey respondents, who represent food, pet food, beverage, health and beauty aids, and paper products manufacturers. Almost two-thirds of the volume is produced domestically.

Over 80 percent of the volume is shipped in full pallets or complete layers of one unique product or stock keeping unit (SKU); however, much of the volume is shipped to retail distribution facilities.

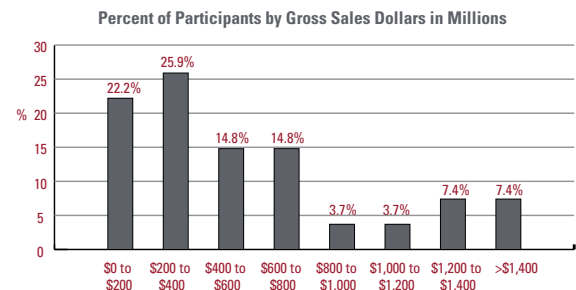
Reported service levels are quite high, but there are surprisingly few industry-accepted supply chain performance metrics that are broadly tracked, making comparative benchmarking very challenging. For example, less than half the respondents measure "line fill rate," "order fill rate," "on-time warehouse delivery to appointment," and "order accuracy." Two-thirds of the companies do track performance based on "on time to customer request date." The only common metric is "case fill rate," but not every company tracks it.

Supply chain costs span a wide range; however, the cost distribution is traditional: over half is transportation, then warehousing, half of which is labour.

KPMG: More to consider ...

Does the industry have a duplication of break-bulk capabilities between the manufacturers' and the retailers' distribution facilities?

Is there room for an industry initiative to define standard performance metrics?



02 Forecasting and Inventory Management

Better communication and collaboration is key

The majority of respondents use base plus incremental forecasting, measure forecast bias, and collaborate with their customers in some way with regard to forecasting sales and inventory requirements.

Reported forecast accuracy is poor, however, with less than 20 percent achieving over 80 percent accuracy 1 month out. As a result, inventory levels vary widely—between 3 to 10 weeks for most of the respondents. These high inventory levels are driven by long supply lead times, volatile demand, obsolete products, and slow moving SKUs.

Many respondents reported high volumes and large numbers of SKUs being imported, frequently from sister/parent companies, yet they also deplored poor inbound service levels and long lead times from these sources. While Canadian companies are taking advantage of global manufacturing strategies, they are also trying to protect their customers from the internal complexities of these strategies.

This represents an opportunity for Canadian food and consumer products companies to work and communicate more frankly with their customers about their constraints so that they can establish more realistic expectations and even increase service levels.

Survey respondents indicated they recognize that forecasting accuracy could be improved with better internal Sales & Operations Planning (S&OP) process discipline, including formality, consistency, and commitment across functions, but they also highlighted the poor state of collaboration between manufacturers and retailers as a key culprit, and they believe this stems from a shortfall in the retailers' capabilities.

Respondents are therefore very eager to have constructive conversations with their retail clients at an operational level. While they can build on robust Electronic Data Interchange (EDI) feeds and point-of-sale information, more effort must be focused on making sense of this ocean of data so that they can use it more successfully to improve forecasting accuracy and inventory levels.

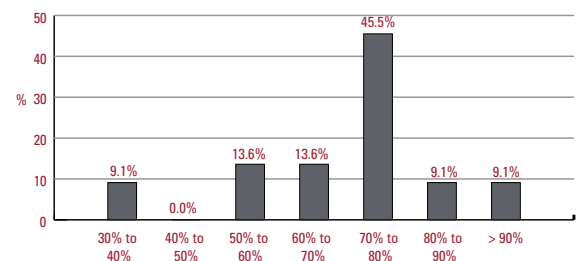
KPMG: More to consider ...

What will it take to foster true retailer-manufacturer collaboration?

Is there scope to squeeze inventory out of the chain, through improved demand and supply visibility, and more responsive plant parameters?

Is the stage finally set for supply chain analytics to reach mainstream application status?

Percent of Participants by Forecast Accuracy 1 Month Ahead



03 Orders and Customer Service

Enhancement through investment

Normal order-to-ship lead times are 2 days for most companies. Most orders are received by EDI, followed by fax and then e-mail. Payment terms remain reasonable, mostly within 15 to 30 days.

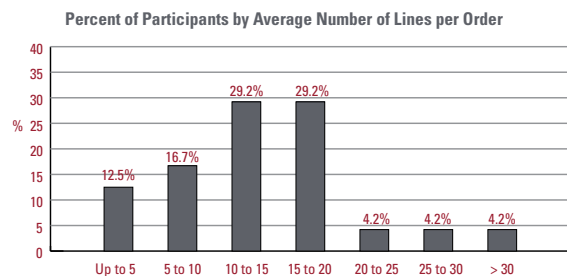
Survey respondents ship almost 3 million orders per year. While more than half of respondents offer between 250 and 750 SKUs, and the median annual number of products introduced or removed from the market (churn) is about 10 percent, retail customers rarely order more than 20 SKUs, indicating that retailers are generally ordering the same fast-moving items time and again.

The number of customer service representatives each company staffs varies widely—from 2 to 73—with an average of 16. Purchase order processing is the task that occupies most customer service staff, followed by demand planning and inventory management. Customer service remains a Canadian function; over 90 percent is Canadian-based, while almost 90 percent is bilingual.

Respondents indicated that the role of customer service is in flux, resulting in misaligned processes and policies, and requiring management attention. Rich opportunities exist to enhance customer service levels through customer collaboration, but it will require investments in staff, management time, and systems—on both sides. Making this happen may require incentives, procedure standardization, and enforcement by food and consumer products companies.

KPMG: More to consider ...

Can greater collaboration between manufacturers and retailers enhance customer service performance on both sides?





04 Warehousing, Distribution Centres, and Transportation

Focusing internally to improve efficiency



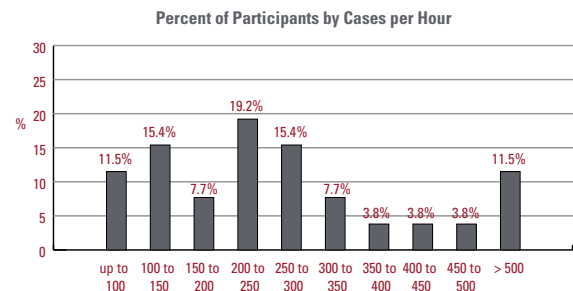
The respondents' total permanent warehouses occupy more than 15 million square feet and provide storage for over 1.2 million pallets. One-third of the facilities are owned and/or managed by a third party. Twelve of the respondents have only one distribution centre (DC) and all are located in Ontario. When they have two, the second DC is typically in Alberta. Companies with three or more DCs frequently have several in one province and at least one in the East and one in the West.

Warehouse efficiencies vary significantly in picking productivity, from just over 20 cases to over 700 cases per hour. The companies that reported large proportions of full layer, full pallet, and display-ready pallet (DRP) shipments tended to have higher warehouse productivity. The most productive warehouses shipped significant volume in full layers, full pallets, and DRPs.

Respondents indicated they have experienced increased pressure by retailers to reduce order sizes, lead times, and workload regularity, which represents an opportunity for food and consumer products manufacturers to enhance efficiency and productivity by aligning the facility layout and organization of their permanent warehouse space with these new requirements.

KPMG: More to consider ...

As customer requests for smaller and more frequent deliveries increase, are there opportunities for manufacturers to improve internal efficiencies before pursuing comparatively complex initiatives, such as sharing facilities and co-loading with other companies?



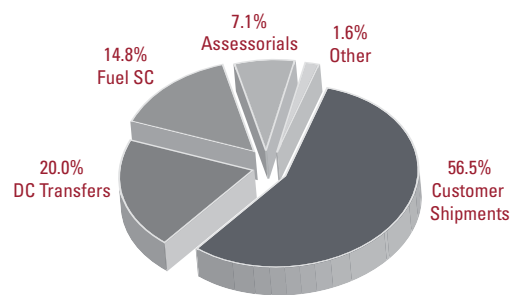


Typical for transporting goods across Canada's expansive geography, almost 75 percent of volumes are shipped by full truck load; 12 percent use intermodal transport (a combination of more than one shipping method). During the survey period, freight, typically about half the supply chain costs, was impacted by fuel price volatility by up to 25 percent more cost in fuel surcharges and assessorial charges, and the economic pressures driven by the recession. Reported freight costs varied widely, however, suggesting supply chain managers have had uneven success in managing what has been a highly volatile and significant cost.

Food and consumer goods companies are also seeing increased operating costs associated with retailers' demands for smaller and more frequent deliveries, and the industry would like to see customers assume a share of these

increased costs. Many companies are also very interested in some form of joint logistics with other food and consumer goods companies to help reduce operating and transport costs.

Components of Transportation Costs



05

KPMG's Final Thoughts

Five must-dos

Enhance the distribution network – Food and consumer product manufacturers should determine if they still have the right facilities in the right places, given the different growth patterns across the country and the rising sophistication and concentration of Canada's retailers. This is also a good time to baseline the distribution network's carbon footprint, as sustainability will no doubt be receiving more and more attention in the future.

Flesh out performance metrics – This survey is an excellent baseline for Canadian supply chain operations, and shows the way towards meaningful performance measurement with both metrics and current performance levels.

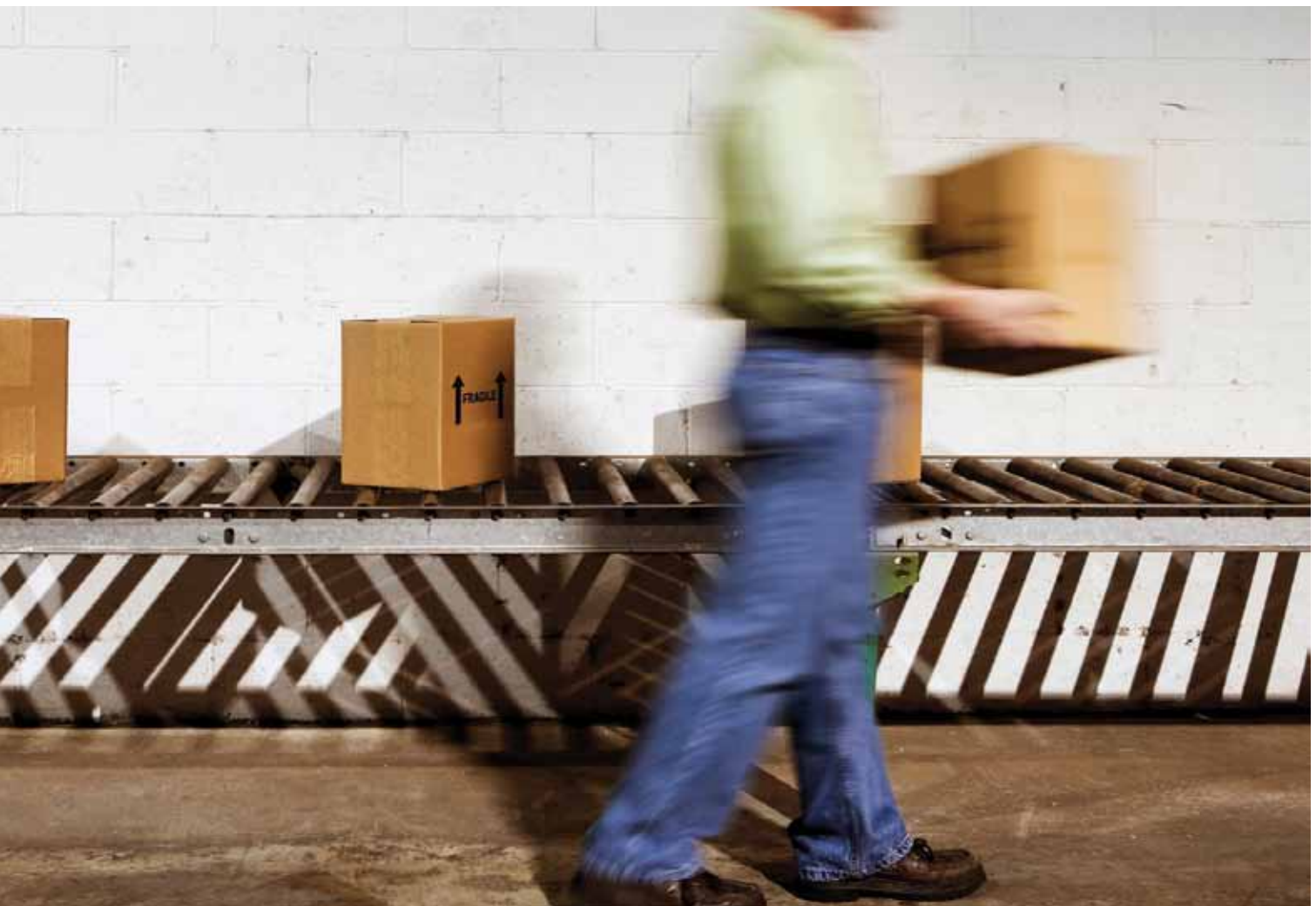
Metrics and the goals associated with them must be SMART—i.e., be defined specifically and unambiguously, measure meaningful issues to the business (i.e., to the supply chain, but also to the customer and the business it serves), be aligned with the strategy to drive constructive behaviour and emphasis, be relevant to the goals and to their stakeholders and be reported in a timely manner.

High-level “dashboards” are seeing a lot of success, but robust analytics can make the difference between interesting data and useful, actionable information. Strong analytics are a skill that will likely be in increasing demand in tomorrow's outsourced and global reach organizations.

Reinvest in the S&OP process – Many organizations can improve the relevance of the S&OP processes—i.e., make insightful demand prognostications important for the salesforce, and make the consensus meeting the one meeting where senior management understands how the business will meet the plan and how the risks are being managed. Taking S&OP to the next level can require strong analytics and good data, in particular from trading partners.

With the stage set for strong internal planning, collaboration with channel partners can be built on a robust foundation. Companies should not perfect their own capabilities before reaching out to trading partners; great results can be achieved between two willing participants who are average performers and will treat each others' shortcomings with indulgence. Reaching perfection takes a lot of time and effort, and too great a skill and capability mismatch may make collaboration with less proficient partners difficult.





Assess inventory health – Companies at the high end of inventory coverage may be carrying more inventory than is necessary, and giving their consumers a stale product experience. Worse, they may be tying up valuable cash that could be used to fund the initiatives outlined above. Assessing inventory coverage by SKU is the first step, then the replenishment parameters at each stocking stage of the supply chain can often reveal some of the reasons—wrong lead times, arbitrary safety stocks, inaccurate bills of materials, or inappropriate minimum order quantities.

Review physical distribution operations – 2009 was a very difficult year for the trucking industry, and we have seen some highly esteemed carriers fail. Others are in precarious shape. It has never been more important than today to know the shipping profile and who you can count on to get your products to your customers.

It is worth buying some stability, but shippers should also get accurate billings and fair fuel surcharge and assessorial charges. There are also ways to squeeze deadhead miles and poor vehicle cube utilization that can be effective when the industry works together.

With an abundance of DCs and storage capacity, plus outsourced overflow storage and trailers in the yard, the industry uses a lot of warehouse space. Rational layouts can boost storage density and improve facility productivity at relatively modest costs.

With the backdrop of retail flow-through models inspired by successful European retailers, getting your physical distribution operations aligned with the changing market demands can be of paramount importance.

Industry Insights

Providing new information and perspectives related to trends, issues, and opportunities is a vital part of our role as advisers. At KPMG, we share knowledge with our clients through on-going communications, research-based publications, and professional development seminars.

Some recent publications include:



A Global View of M&A in Consumer Markets *2010 and beyond*

This report is based on interviews with senior KPMG M&A professionals around the world. They were asked to share their outlook for M&A activity in the consumer markets sectors over the next 18 months. The report also covers some of the key drivers of M&A deals, the role of Private Equity and expected buying trends for 2010 – 11.



Beyond Purchasing *Next steps for the procurement profession*

This research report is based on the responses of almost 600 senior executives, including procurement and supply chain professionals from a cross-section of industries. It provides insights into procurement trends and practices from both procurement practitioners and procurement specialists in the field and from within KPMG.



Competitive Alternatives 2010

Published every 2 years, *Competitive Alternatives 2010* compares business locations in North America, Europe, and Asia Pacific. It contains valuable information for any company considering their international business location options.



ConsumerCurrents – Issue 8

This edition of *ConsumerCurrents* addresses the challenges that consumer companies face in an environment robust with both geographic and consumer behaviour shifts.



New on the Horizon

Revenue recognition for food, drink and consumer goods companies

This edition of New on the Horizon considers the proposals in the ED from an IFRS perspective, with additional focus on the potential impact on food, drink and consumer goods companies.



New Dynamics, New Directions: Steering a New Path

The underlying volatility in the food, drink, and consumer goods sector shows little sign of abating as companies wrestle with the sting of higher costs, shrinking consumer spending, and working capital constraints. This publication describes an industry in the midst of potentially disruptive change, led by accelerating technological, social, and economic shifts.



Procurement Fraud in Consumer Companies

This paper focuses on some of the risks associated with procurement fraud, including how companies can reduce their exposure to losses resulting from the fraud and error that can occur throughout the procurement process, the use of technology to detect losses, and the conducting of supplier audits to recover them.



Shipping Insights: Insights arising from the economic downturn

Shipping insights: Insights arising from the economic downturn is the second issue of the publication. This issue, which is focused on IFRS, looks at how the financial reporting of the shipping industry has responded to the economic downturn and what lies in store for the future.



The Evolution of Retailing: Reinventing the Customer Experience

This publication examines the rising influence of today's global consumer on traditional industry retail models. Changes taking place in the retail sector reach deep into the industry's structural foundations, rocking everything from how the industry sources its products, to how it markets to an increasingly fragmented demographic.



Cash is back in fashion, but is it here to stay?

This publication delves into today's economic conditions in which companies have pushed cash generation up the agenda, responding to the changing demands of analysts, lenders, and ratings agencies.

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