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Managing
profitability
when raising
your prices is
not an option

Whitepaper



Managing profitability when raising your prices is not an option

From the merging of grocers to the decreasing options in food distribution channels, industry consolidation puts downward pricing pressure on food manufacturers. The recent trend has been consistent and shows no sign of slowing down.

When faced with decreasing profits due to pricing pressure, it's common for food processors to turn to internal costs and processes looking for efficiencies that may restore lost margins.

Usually, the focus turns to the labor force and how to decrease the number of direct laborers on the line in order to decrease the direct cost to produce. There are rational reasons why management typically looks there. Mainly, it's because labor is easy to see, identify and target. It's easy to say you made an impact on costs: there were 12 workers on the line yesterday and there are 10 today, so we decreased our cost to produce. It's hard to argue with. However, legendary basketball coach John Wooden had a famous saying, "never mistake activity for achievement." And it can be argued that focusing on decreasing the "unskilled" labor force on the line as a meaningful and sustainable way to reduce costs and increase profitability is exactly what John Wooden is talking about: activity without achievement.

An analysis of the data provided by the *USDA Economic Research Service* illustrates the point. The study isolates the percentage of overall costs associated to food production in North America.

The implications are clear. Focusing on reducing the direct labor component of your operation, while not a total loss, can only yield so much. In this case, putting your attention on the most *visible* source of production costs can be detrimental to your overall cost-saving goals. The real potential for cost savings is in raw materials and maintenance.

Managing those costs effectively can have a far greater impact on your bottom line than can ever be achieved by cutting direct labor costs. There are a few best practices common to the industry leaders, all based on leveraging software technology to do the tracking, allocating and reporting that humans aren't well suited for.

North America food production costs

Component	Percentage of total cost
Raw materials	54%
Maintenance and utilities	15%
Direct labor	8%

Source: USDA Economic Research Service

Expiry management

The basic principle is to make sure the right product is being used, which industry leaders accomplish by maintaining a close watch on soon-to-be expiring products. By monitoring and using inventory with an impending best-by date, companies significantly reduce raw material spoilages and write-downs.

The best place to start expiry management is right at the loading dock. Top industry performers check raw materials while they're being received, looking to see how much useful life is left. Make sure you get what you bargained for.

Shelf life management

Next to making sure the right raw materials are used at the right time is making sure the right products are sent to the right customers. Different customers have different requirements when it comes to shelf-life, and some make very specific demands on their producers. Good shelf life management means fewer credits and returns.

Unfortunately this is often easier said than done. Manual checking, Excel tracking and other ad-hoc solutions can work for a while, but industry leaders universally rely on software to make shelf life management easier for them.

Typical software features include automatically allocating inventory to sales orders on a first-expire-first-out (FEFO) basis and generating reports that help management monitor trends and consequently reduce the amount of inventory that's allowed to approach its expiry date in the first place. The best systems also incorporate a means of optimizing shelf life by tracking the expiration dates of individual ingredients and scheduling them for production accordingly. By leveraging those features, industry leaders benefit from shelf lives that aren't just managed better — they're actually longer.



Automatic inventory allocation on a FEFO basis helps food and beverage companies reduce waste and rework and achieve an optimized shelf life

Recipe management

Along with production scheduling that takes ingredient expiration dates into account, the software frequently used by food and beverage industry leaders offers real-time monitoring on the production floor. Again, the aim here is preventative: if a near-expiry ingredient can be intercepted before it becomes part of a batch with a long expected shelf life, the result is fewer batches that need to be destroyed or reworked.

Using modern technology to manage recipes also makes some other benefits possible: companies that use it can let the software select the most cost effective ingredients according to flexible guidelines they provide. Costing reporting, computation of nutritional information and allergen management are also popular features that give production floor workers and management the data needed to catch errors and make intelligent cost-cutting decisions, respectively.

Production and yield reporting

Top companies are always analyzing expected versus actual yields and costs so they can make continual improvements to their bottom lines. If the expected yields aren't materializing, the problem needs to be identified and solved before any more raw material or effort is squandered.

A helpful concept from outside the food and beverage industry

Airline pilots and computer programmers have one thing in common: they both work with extremely complex high-tech systems that are inherently difficult (or impossible) to keep completely error-free. The stakes are somewhat higher for pilots, but in either case the incentive to catch errors before they lead to disaster is high.

That explains why in both disciplines you'll find the concept of **error trapping**. It may seem obvious to try to stop errors before they happen, but the principle of error trapping goes beyond mere attentiveness and other common sense approaches to getting things right. Error trapping means setting up the *system* so that inevitable errors are caught before they do damage.

Sophisticated modern airliners will alert their crew if they detect the aircraft in a landing posture with the landing gear handle still in its "up" position. Similarly, computer programmers build in error traps so unexpected exceptions can be caught and handled effectively rather than just crashing the program.

The principle is the same: anywhere there is human involvement, accidents will happen. Setting up the system to recognize and deal with inevitable oversights is as important as working to prevent them in the first place. Modern software solutions can support this type of sophisticated error prevention in a number of industries, including food and beverage producers. The airline industry has found that, as long as airplanes are piloted by humans, this is the best way to save lives. You can apply the same thinking in your own business.

Without accurate and frequent yield reports, it's easy for your true production costs to stray from where you think they are. In an industry where margins are slim to begin with, food and beverage producers can't afford to let a couple of points slip away because yield isn't being managed aggressively.

When asked how they do it, leaders and many of the top companies respond the same way: technology makes it possible. Frequent, timely, accurate reports are what's needed here. Top performing companies rely on software to deliver the critical data to where it can do the most good.



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John Wooden

Maintenance management

Among the necessary evils in a food production facility is that of maintaining equipment so that it delivers its best performance. Much like tracking expiry dates, this is an area where manual tracking can work for a while, but when the stakes of having a poorly performing (or broken) machine get high, it pays to put a more robust system in place.

The introduction of maintenance management software can help to reduce downtime by scheduling the appropriate maintenance activities at the most desirable times. The demands of the machine and the demands of the production line can be balanced to arrive at the economically optimal scheduling. Naturally, the functionality for scheduling regular preventative maintenance is there, but where this kind of software really delivers is in how it takes the impact to your business into consideration before scheduling the downtime. If that planned belt maintenance can wait until the current order is complete, then that's when it will be scheduled.

A common theme

Perhaps unsurprisingly, as market prices are driven down and margins get smaller, the most savvy food and beverage producers are turning to technology to squeeze a little more margin out of their operations. Approached in a thoughtful, systematic way, the application of software to your cost reduction efforts can yield results unobtainable using traditional methods, and certainly more prudent than merely reducing headcount — a highly visible but usually self-defeating activity.

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