Chain

R e a c t i o n s

The strains and strengths of the foodservice supply chain

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Executive summary

This is an independent piece of research, based on in-depth interviews with executives from 40 foodservice chains and 40 food manufacturers. We spoke to these supply chain leaders, in industries ranging from pubs to airlines, to discover the current state of the foodservice supply chain.

The green shoots of economic recovery have yet to sprout and supply chain partnerships are under mounting pressure. It's no surprise that the study found that 95% of foodservice operators identified the recession as a critical issue. But it is the reactions to the recession that are worrying.

Many operators are reducing the prices of food in a bid to encourage consumers to eat out more. But they are doing so at the *expense* of the supply chain. Two thirds of supply chain leaders are taking costs out of the supply chain to maintain current prices for consumers. While over half are reducing costs to lower prices for consumers. Meanwhile, two thirds of senior supply chain leaders are planning to increase promotional activity to get diners through the doors.

These anti-recessionary measures taken by manufacturers and operators may actually be damaging to the foodservice industry. Cutting costs in the supply chain may prove a false economy, as it could reduce supply chain efficiency and impair customer service. And the scale of the action required to encourage consumers to eat out more could seriously harm business.

The study paints a picture of companies creating a balancing act between survival and efficiency. For now, the supply chain is bearing the strain. But if the recession continues unabated, there is a danger that the chain's weakest link may succumb to the pressure.

The interim solution lies with what supply chain partners can do to help the industry to reduce costs. One in five foodservice managers expressed dissatisfaction with their supply chain partner's ability to do this. Not a single supplier rated their supply chain partner's service as highly satisfactory. A quarter of respondents even described their supply chain partner as ineffective.

Keystone's solution is for supply chain partners to:

1. Deeply understand the customer.
2. Provide a truly 'great' service.
3. Collaborate to create extra value for the customer.
4. Use innovation to create sustainability and efficiency solutions.

A supply chain partner needs to be more than just 'the warehouse and the wheels.' The ultimate partner is one that is empathetic, proactive and innovative. As the world witnesses a credit crisis on a scale not seen in 70 years, the industry needs more than a lorry or a fixed selection of wholesale products on offer. It needs a flexible solutions provider. The secret is in the relationship and using it to create unique, tailor-made solutions. Collaboration is about more than products and pallets or specifying a distribution system. It's about anticipating the customer's needs through knowing their day-to-day business operations.

Introduction

Welcome to *Chain Reactions*.

This report is the result of in-depth research into how recent macro economic developments have impacted the foodservice supply chain in the UK; how operators and manufacturers have responded; and the effect on the relationships with their supply chain partners. Finally, we explore what needs to be done to strengthen those relationships – and with them, the chain as a whole.

Cost, efficiency and reliability have traditionally been the cornerstones of a successful supply chain. However, extraordinary times are presenting particular challenges – challenges that have resonated in the foodservice sector with particular force.

Escalating costs of food, fuel and energy have been followed sharply by a global economic crisis on a scale not seen for 70 years. As a backdrop to these successive crises, the sustainability agenda continues to focus thinking throughout the chain, not to mention among government policy-makers.

The foodservice supply chain has been battling to combat one or more of these threats for much of the last three years. With these unprecedented conditions in mind, Keystone Distribution UK set out to explore the impact of these challenges on the UK foodservice supply chain.

Here, we have presented a definitive study into the relationships between supply chain providers, foodservice operators and foodservice suppliers.

About Chain Reactions

Keystone commissioned Vanson Bourne Consultancy to carry out in-depth telephone interviews with senior executives from 40 foodservice chains and a further 40 food manufacturers. The interviewees had responsibility for managing the supply chain at their organisation.

The ‘foodservice operators’ in this document are all foodservice chains with a turnover of more than £1 million, including hotels, pubs, restaurants and sandwich and coffee shops. The manufacturers are all suppliers to the foodservice industry.   Supply chain partner refers to the distributors and wholesalers transporting goods and / or managing the supply chain on foodservice operators’ behalf.

PART ONE: The Strains on the Chain

A changing business environment is normal part of most industries, but the past two to three years have been marked by a succession of emerging challenges for the foodservice sector. Not surprisingly, Keystone's research found these pressures at the top of the agenda for senior foodservice managers.

What challenges do foodservice operators face?

Spiraling costs

"Dramatic price swings have created other problems because they are so instantaneous. For example, we had a product that we launched in January and by March one of the main ingredients had gone up by 70%."

The escalating costs of many of the industry's essential inputs have undoubtedly been a key challenge for foodservice operators in recent years. When asked to identify the major sources of rising costs currently, nearly two thirds (63%) of foodservice operators cited food price inflation. Of these, an overwhelming 92% agreed that increasing food prices are having a *major impact on the business*.

Next on the list of cost pressures were rising energy prices – highlighted by 53% of respondents - and staffing costs (40%).

Of those who identified energy as a major issue, some four fifths (81%) felt that was having a major impact on their business. Among those who identified staffing costs, more still (91%) described these as significantly detrimental to their business.

When input costs are on the rise, any business in a competitive market must implement measures to protect profits and ensure a viable future. Our research examined the key actions foodservice operators had taken to combat rising costs in the supply chain.

Two fifths (40%) of directors are concentrating on reducing their own costs; half as many (20%) have put pressure on suppliers to reduce costs; while 15% indicated that staff cuts was their number one priority.

A less than favourable picture emerged when senior managers of foodservice operators were asked to rate their supply chain partner's (SCPs) ability to help them reduce costs, a little over a third (37%) expressing satisfaction.

More than two fifths (42%) were ambivalent about SCPs' contribution, while more than a fifth (21%) said they were dissatisfied with efforts to reduce costs.

A tight financial squeeze

"Rising costs is all we talk about…all the time."

Aside from rising input costs, when asked to identify the most critical issues facing the supply chain, it was hardly surprising that almost all (95%) foodservice operators cited the economic downturn.

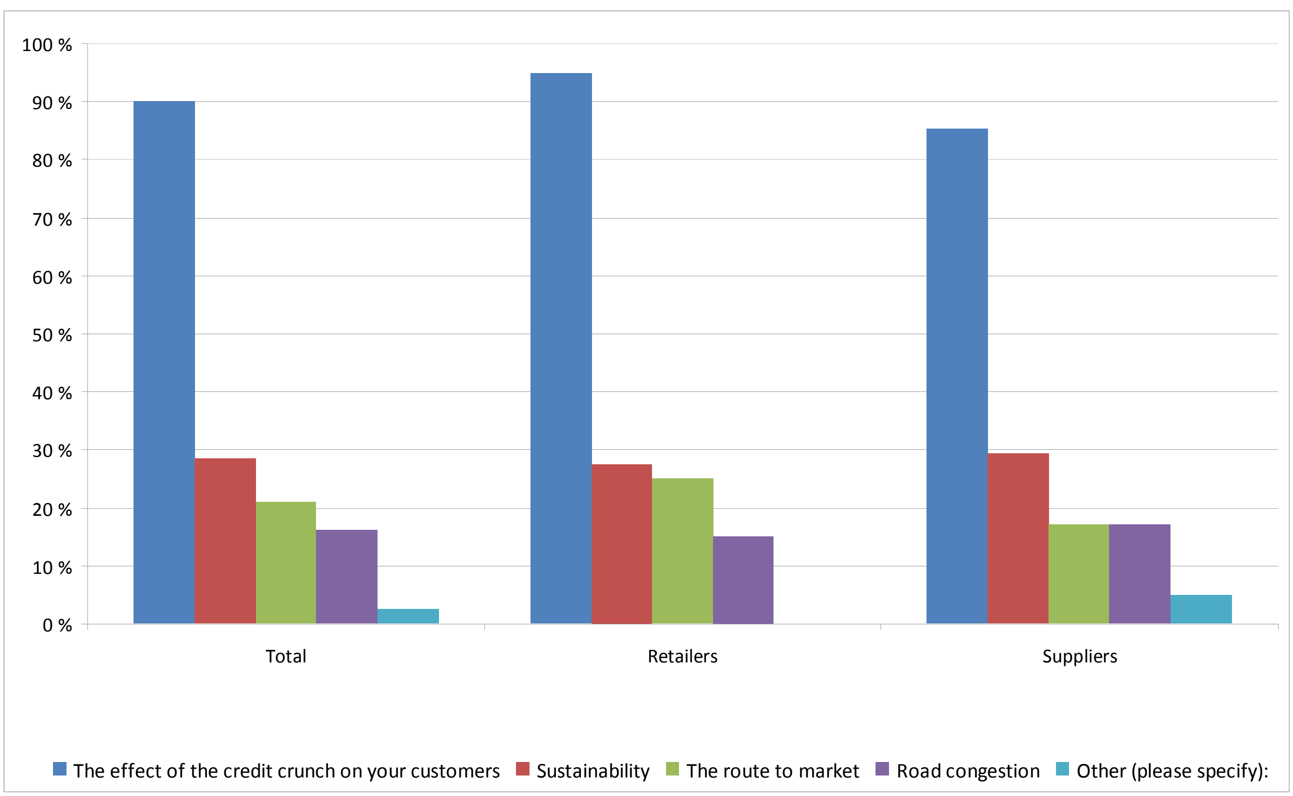
While global leaders work to resolve the economic crisis on an international scale, operators themselves are proactively implementing measures to combat the impact of recession.

To encourage consumers to part with dwindling discretionary spending, over two thirds of senior industry leaders (68%) were planning to increase promotional activity. Two thirds (66%) of operators are looking to take costs out of the supply chain to maintain current prices for customers, while well over half (58%) aim to reduces costs out to *lower* prices.

A significant proportion claimed they would be sourcing cheaper food products (42%), as well as increasing customer loyalty schemes (39%).

However, despite the anti-recession measures, the economic crisis remains a source of deep concern. With fewer customers eating out, 87% of operators have found that lower turnover has reduced funds to invest in the business. More than half (53%) fear that reducing supply chain costs further could result in lower efficiency and poorer customer service.

The bar chart below shows the other key concerns of the senior supply chain executives.



The question of sustainability

"At the end of the day we have to work closely…to ultimately achieve what needs to happen."

While the recession and rising costs are the key worries keeping senior foodservice executives awake at night, the sustainability issue is continuing to shape thinking.

Over a quarter (28%) of operators cited sustainability as one of their top two supply chain issues – the second highest response rate.

The supply chain is a major influence on the sustainability of the foodservice industry. Yet, almost half (46%) of all operators claim that that their SCP is *ineffective in helping them to improve the sustainability of their business*. Only 15% were satisfied with their SCP's efforts in this regard.

Senior managers identified two key routes through which to address sustainability issues: government action and industry collaboration. Almost three quarters (73%) of operators called for the government to introduce initiatives to encourage the industry to develop sustainable business practices and improve green credentials. An equal number said that the industry must also take responsibility – a worrying conclusion in the light of operators' judgment on SCPs' ability to contribute.

There is further cause for pessimism when it comes to industry collaboration. Almost two thirds (64%) of operators claim that *reluctance to work together* is a major barrier to the creation of a sustainable industry. More than half (55%) highlight prohibitive costs as a barrier to the implementation of sustainable solutions.

Other challenges cited by senior leaders include individual companies not taking the issue seriously (36%) and persistent concerns about collaborative partnerships leading to loss of competitive advantage (36%).

What challenges do foodservice suppliers face?

Spiraling costs

"Raw materials and utilities (have gone up in price by) 5 or 6%. The end user - our customer and the end customer - is resistant or is not strong enough to take on this increase. We are getting creative in a number of ways including managing relationship with our customers and re-engineering ingredients. This is all that we talk."

When asked to identify the two most significant sources of rising input costs, fuel and transport price was most frequently cited by senior managers of foodservice suppliers (59%). And for over half (52%) of this group, this was having a significant negative effect.

Energy costs were highlighted by 54% of supplier businesses, three quarters (77%) of which were experiencing a major negative impact.

The rising price of food was a key concern for 44% of respondents. More than three quarters (77%) of those felt that rising food prices are having a significant detrimental effect.

Reducing internal costs was the primary strategy to combat rising input prices for nearly half of suppliers (46%). The second most frequent measure was passing costs onto customers - 15% of suppliers said this was their main tactic, while 10% were pushing the responsibility onto *their* suppliers to reduce costs.

Like their counterparts in foodservice chains, suppliers were less than enthusiastic about SCPs' contribution to cost-cutting efforts, less than half (45%) responding positively. Close to a third (30%) of suppliers gave a lukewarm response, while a quarter described their SCP as ineffective.

A tight financial squeeze

"With variable food and fuel costs, it used to be that we'd make as much as we'd lose but now things are different. There is a totally different dynamic."

Just as for foodservice operators, the economic situation dominates the concerns of suppliers. An overwhelming 85% cited the recession among their top two issues in the supply chain aside from rising costs.

Taking costs out of the supply chain to maintain prices for customers was a primary tactic for getting through recession for almost three quarters (74%) of suppliers, while close to two thirds (63%) will do so to *reduce* current prices.

To a lesser degree than for operators, promotions will also play a role. Almost half of suppliers (49%) will increase promotional activity in order to boost sales. A similar number (46%) will enhance customer loyalty schemes, while 43% will source cheaper foods.

However, two thirds of suppliers (66%) fear that reducing supply chain costs further will reduce efficiency and impair customer service.

The question of sustainability

"From an environmental point of view, it makes sense to have consolidation – with one vehicle that delivers many suppliers' products to one location."

Echoing the concerns of operators, sustainability is the second biggest issue for suppliers aside from rising costs, cited by well over a quarter (29%). Of these, an overwhelming 83% are calling for government to introduce initiatives on sustainable business practices.

An encouraging two thirds (67%) believe that the industry has a responsibility to collaborate to improve sustainability – though this is a lower response rate than for operators.

Significantly, the same proportion agrees that foodservice companies will need to work *only with green suppliers* to improve the industry's record – a much more convincing response than the 45% of operators who hold this view. Half of the suppliers also believe that firms have *failed to take the sustainability agenda seriously.* The same number again agree that costs are a barrier to implementation of sustainable measures – over half (58%) of them highlighting industry's reluctance to work together.

Much like their operator counterparts, suppliers reserve a damning assessment of their SCP's ability to help improve sustainability in the supply chain. Only 8% of suppliers claimed that their SCP was very effective at addressing sustainability issues, while a third described their SCP as ineffective in this respect.

PART TWO: The Strengths of the Chain

As the emerging challenges examined in Part One have put pressure on the foodservice supply chain, how has this impacted on relationships within the industry? Our research examined in detail the relationships between supply chain partners, operators and suppliers.

In a perfect world, all three partners would work in close harmony to resolve the issues facing the industry. However, in difficult times, the links in the chain may be stretched.

How strong is the chain?

Must Do Better

"Supply chain partners need to visit the depot, talk to the hotel, café or restaurant and to the head chef. They need to find out the exact needs and whether the deliveries can be amended to lower costs and improve efficiencies. It may be that historically chefs have always requested morning deliveries, when in fact, a multi-drop afternoon delivery may suit them."

Nearly a fifth of all operators (19%) and suppliers (18%) outwardly expressed dissatisfied with the overall level of service from their SCP. A rather surprising statistic was that only *5% of operators were highly satisfied* with the service they received.

Not one single supplier rated their SCP's service as highly satisfactory.

To what do the operators and suppliers attribute this lack of satisfaction with the service from their SCP?

Their principle complaint was a lack of proactive approach. Almost two fifths of operators (38%) and suppliers (39%) complained that their SCP merely *reacted* to problems, rather than taking a proactive approach.

Similar numbers highlighted their SCP's failure to take full responsibility for supply chain issues – cited by 35% of operators and 37% of suppliers. An additional gripe was a lack of innovation, highlighted by a fifth (20%) of operators and some 37% of suppliers.

Critical Success Factors

"We really need (a supply chain partner) to be proactive to help provide systems and processes and disciplines that will improve performance."

To analyse relationships within the foodservice supply chain in further depth, Keystone asked senior industry leaders about the qualities they were looking for in a SCP, and assessed SCPs' performance against these qualities.

Flexibility, low cost and a long-term partnership approach were the top three qualities foodservice operators demand from an SCP.

Perhaps surprisingly in the light of rising input prices, cost did not top the agenda for operators. More than half (53%) listed flexibility among their top three requirements from an SCP. 59% of these felt their partner delivered this, while just 8% were dissatisfied.

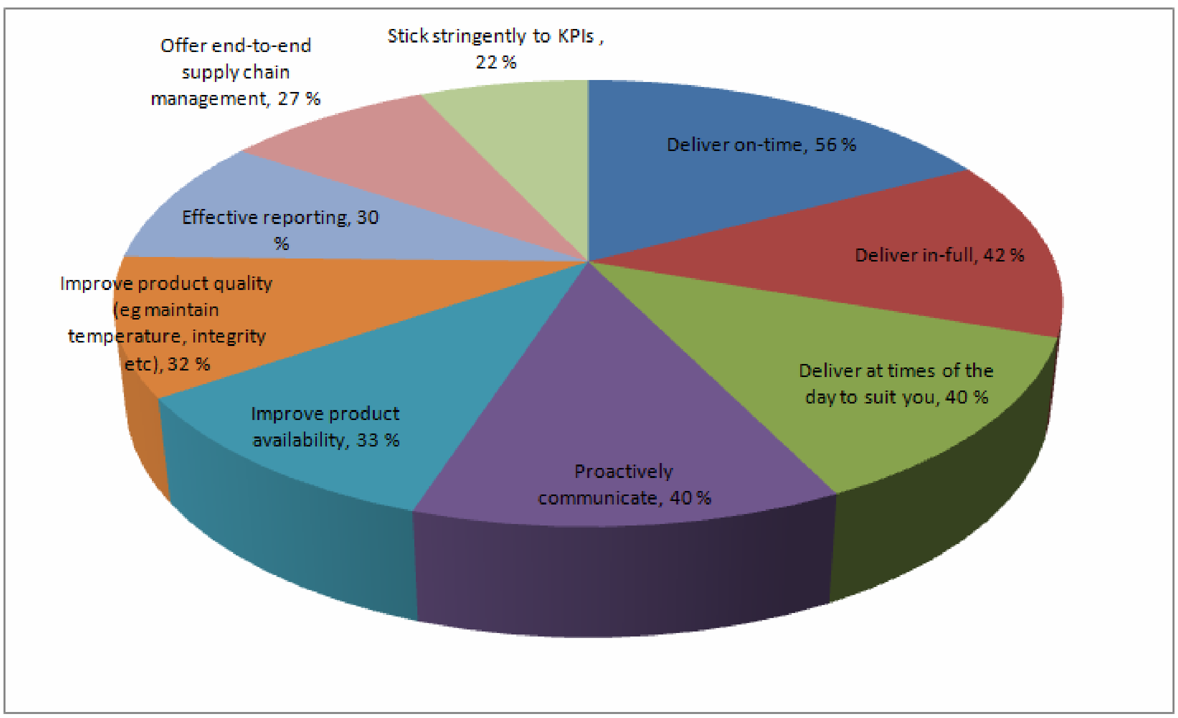
Cost came in second among operators' demands on an SCP, cited by less than half (45%). An encouraging 70% of these are satisfied that their SCP offers a low-cost service, testament to a competitive marketplace. Again, only 8% of operators were not satisfied they were receiving a low-cost service.

Changing a supply chain partner is a huge undertaking for a foodservice operator. As such, long-term partnerships are valued by two fifths of operators, of whom almost two thirds (61%) are satisfied that their SCP is committed to the long term. Only 11% were not satisfied in this regard.

For suppliers, this long-term partnership approach was the most highly valued attribute in an SCP, cited by 59% of suppliers. Two thirds of these (66%) are happy with the long-term approach of their SCP, although close to a fifth (17%) are not.

Being low-cost is valued by almost half (49%) of suppliers – three quarters (75%) of whom are satisfied with their SCP in this respect. Of the 39% of operators who list flexibility as a key quality, over half (59%) are satisfied that their supply chain partner achieves this.

The pie chart below outlines the qualities of an effective supply chain provider.



At the Sharp End

"The key is the relationship between the distributor and the end customer. (It's important to) act longer term and treat partnerships as a relationship where there are aligned incentives to driving down costs and sharing benefits. I think it's about relationships and how you can move forward to more open, transparent relationships that (will then also) drive down costs".

"*I would expect anyone who is interacting with the customer – driver, telesales, customer services, a supply chain manager – to have at least worked on an operator site so they have some empathy and understanding of what the day-to-day issues are. I would expect them to be briefed on what the demands of that style of business are, what the key objectives of that business are – the difference between running a hotel and running a subway."*

When asked to rate their SCP's customer service to the end user (such as the individual pub, restaurant or hotel) around two thirds (61%) of foodservice operators claimed to be satisfied overall.

However, digging a little deeper into this aspect of the operator-SCP relationships unearthed some room for improvement.

Over a fifth (21%) of operators expressed dissatisfaction with their SCP's track record of on-time deliveries - only 8% were highly satisfied with this. Half claimed that their SCP needed to improve on-time delivery to outlets.

Operators also urged more proactive communication from their supply chain partners, two fifths (40%) citing this as an area for improvement.

The same number complained that their SCP needs to demonstrate greater flexibility of delivery times, and provide a schedule to suit the operator's needs. Close to half 46% of operators interviewed by Keystone are only given 'a.m.' or 'p.m.' delivery time slot; just 18% are offered one or two hour slots, while 5% enjoy the luxury of 30 minute delivery windows.

Finally, our research explored what operators felt SCPs should do to strengthen working relationships.

A third (33%) of operators felt that improved availability would enhance service to outlets. Nearly a fifth (18%) were dissatisfied with SCP's performance on availability – *only 3% were highly satisfied*.

To provide better availability, SCPs need to enhance stock management, according to 45% of operators. Close to half (48%) called for real-time visibility while over a quarter (28%) urged SCPs to increase collaboration and transparency across the supply chain.

When it came to availability on promotional items, operators were clearly unhappy with the level of service they were receiving. Around a third (34%) called their SCP's performance on promotion availability unacceptable, while only 11% rated this highly effective.

Conclusions

The current economic climate has played a large part in shaping the content of this research. The study shows that companies are taking costs out of the supply chain and increasing promotional activity in an attempt to redress the balance. However, this could be detrimental to businesses as it results in lower funds being available for investment. The research suggests that the rising cost of food and rising energy prices are two key factors behind cost increases but the real impact on business success is staffing costs. Supply chain leaders see the solution as reducing staffing costs and cutting the number of deliveries.

Current supply chain partners are successful at helping their customers deal with road congestion and the route to market issue, but little help is offered around the credit crunch concern. The recurring themes on the executives' wish lists were empathy and partnership. A successful supply chain partner needs to show plenty of both. Some supply chain relationships are failing because suppliers are reactive rather than proactive; lack innovation and do not take full responsibility for all supply chain issues. When asked how customer service could be improved at the outlet level, the key areas seem to evolve around delivery, communication and product availability. To improve product availability, suppliers need to improve stock management, provide real time information and increase collaboration and transparency across the supply chain.

In difficult financial times, savings have to be found somewhere. Taking short cuts in hygiene, warehouse staff, vehicle maintenance, training or temperature control can be damaging in the long term. Instead, collaboration is the best cost saving mechanism. Working together to find ways to save those pennies and pounds means that supply chain partners, operators and suppliers can all become more streamlined and efficient. It may not seem a dramatic move but the cumulative effects can be startling.

In summary, Keystone's findings point to four pillars of supply chain success.

To lessen the effects of the financial crisis, supply chain partners must:

<u>1. Deeply understand the customer</u>

Getting to know managers and understanding their working life on a day-to-day basis is the best way to deeply understand the customer. Supply chain partners need to visit the restaurant, hotel or bar and spend a day working in the customer's role. Understanding is about more than products and pallets or specifying a distribution system. Warehouse employees and drivers need to experience service at the point of delivery to provide a truly empathetic distribution service.

<u>2. Provide a truly 'great' service</u>

A supply chain partner needs to be more than just the warehouse and the wheels. The foodservice industry is looking for more than a good service that delivers according to the specifications. Instead, supply chain partners need to aim to provide a truly 'great' service: one that anticipates the customers' needs and goes the extra mile.

Collaborating with other companies is an effective way to hone business performance. For instance, since 2008, warehouse managers from Keystone and John Lewis have swapped jobs for a week at a time in order to share best practice. Swaps can be more effective than training. They enhance the managers' understanding and awareness without having to leave the business.

3. Collaborate to create extra value for the customer

Communication with the customer is key. Effective communication can lead to simple solutions such as rescheduling deliveries to off-peak times. A supply chain partner can optimise in-bound transport by making sure that every pallet is full and that the pallets effectively fit in the truck. But the service needn't end once the goods have been delivered.

4. Use innovation to create sustainability and efficiency solutions

It's vital to work with the customer to create an agenda that adds measurable value to their business. Being innovative in creating sustainability and efficiency solutions can arise when you have long term partnerships with your customers; understand their needs and work together to create mutually beneficial solutions.

The overriding message is that supply chain partnerships need to be more than a marriage of convenience. Solutions must be dispensed with a long-term view and be carefully tailored to the needs of each organisation. Supply chain partners must be empathetic with customers' needs to ensure that supply chains remain intact and are able to weather financial storms.

Foodservice operators and suppliers must aim to emerge from the recession with a strong supply chain that acts as a business asset – one that adds increasing value. Post recession, it will be essential that supply chain partners have a clearly laid out sustainability and environmental agenda, as this will become a fundamental element of distribution. Smart, long term moves are needed. Otherwise, the foodservice industry could be nursing a nasty hangover that lasts long after the economic crisis has ended.

About Keystone

Keystone Distribution UK is a world leader in the end-to-end supply chain business. Keystone uses purpose built, multi-temperature trailers to deliver frozen, chilled and ambient products so that each foodservice outlet receives a complete order in one delivery.

About the author

Paul Pegg is the Vice-President of Keystone Europe. He joined Keystone Distribution UK Limited in 2005 and has spent his entire career in logistics and supply chain, including 3rd party logistics service providers and consultancy.

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More information

To find out more about keystone visit www.keystone-distribution.co.uk

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