

Fast Facts on Food Processing

Grant Thornton Food & Beverage Practice Part 2 of 6

Outsourcing: Friend or foe?

Outsourcing provides options for food and beverage manufacturers to grow their businesses, fill niche product lines, and execute many functions more efficiently — from R&D to production to maintenance. Yet, new survey findings indicate that outsourcing is not favored by all, and for many, it has left a bad taste on their respective company palates.

Grant Thornton LLP, the audit, tax and business advisory firm, is collaborating with *Food Processing* magazine on a series of six bimonthly surveys — *Fast Facts on Food Processing*. The surveys and these white papers provide a snapshot of issues and opportunities in the food industry.

This second study — *Outsourcing: Friend or foe?* — examines which functions food and beverage manufacturers are outsourcing, their reasons for doing so, and their levels of satisfaction. Responses from 115 companies (see participant profile at the end of this report) received in August and September 2008 offer insights to help you evaluate your own outsourcing prospects and challenges.

Outsourcing Production

As measured by sales volume, nearly one-third of food and beverage manufacturers (32%) indicate that none of their production is outsourced. Another 54% report that one-quarter or less of their sales volume is outsourced. Just 11% have a majority of their production outsourced, and 6% outsource all production.

Firms that do not outsource often do so to maintain control of their product. As one executive says, “By not outsourcing, we control all elements of our products, quality, cost, research, etc.”

Another offers: “I believe that we can assure the quality of our products by not outsourcing,” and goes on to indicate that they currently use some outsourced warehousing but “are in the process of remedying that.”

Contact information

Dexter Manning
Partner
National Food and Beverage
Industry Leader
T 866.728.5264
E CIP@gt.com

[www.GrantThornton.com/
FoodandBeverage](http://www.GrantThornton.com/FoodandBeverage)



Among food and beverage firms that do outsource some production (“production outsourcers”),¹ a majority (58%) indicates they do so to “increase/develop production capacity.”² One satisfied food executive explains, “Contracts with outsourcing contributed to our success of expansion to gain market in other areas.”

Another adds, “We have outsourced in the past to find capacities that match the volume. For example, organic business is small, therefore smaller contractors can handle that much more efficiently, and we have been generally satisfied with the results.”

Other top reasons for outsourcing production were to gain “access to technology/equipment” (46%) and to “lower costs” (37%).

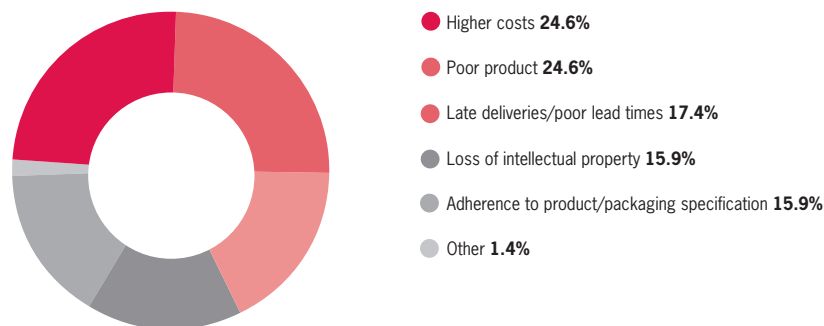
Most firms that outsource production rely on more than one vendor: 40% of food and beverage manufacturers use two to three firms, 13% use four to five firms, and 31% use more than five firms.

The dollars spent on outsourced production is likely to increase among 43% of survey respondents; 7% indicate it will increase significantly; 51% indicate no change in the volume of outsourcing and 6% report it will decrease.

Among those already outsourcing production, 53% will increase the dollar volume of outsourced production and 40% will maintain current levels.

Looking ahead to 2009, 41% of survey respondents will increase outsourcing and 49% indicate no change in volume of outsourcing. Among current production outsourcers, 46% will increase the volume of outsourced production and 41% will keep it the same.

Most significant problems encountered when outsourcing production
% of respondents identified as outsourcers



Production outsourcing does not necessarily solve production ills; in fact, it can create a variety of problems for food and beverage manufacturers. Approximately one-quarter of firms that outsource indicate that their most significant problems are higher costs (25%) and poor product (25%). Another 17% cite late deliveries/poor lead times as the most significant problem.

“Outsourcing brings a loss of product control, dilutes/eliminates brand integrity, and opens the door to product recalls and/or contamination,” says one food and beverage executive.

Yet others are ‘very satisfied.’ “[Nearly all] product is delivered when requested. Overall quality is consistent and meets specification requirements. Suppliers are very cooperative and easy to work with. [We] have had very few problems.”

Another executive says the company is so happy with their contractor that they “intend to move all of our production to them.”

Many food and beverage manufacturers are implementing best practices to better manage their contract manufacturers, even when they no longer control actual production.

Common best practices in place at a majority of outsourcers include: “certify contract manufacturer prior to contracting” (65% of production outsourcers); “testing of product by your company” (64%); and “testing of product by contract manufacturer” (56%).

One food and beverage executive says, “Due to our strict and thorough preapproval auditing practices, we usually have few problems with contract manufacturers. Most issues arise as a result of cultural differences when dealing with off-shore suppliers.”

“Production outsourcing does not necessarily solve production ills; in fact, it can create a variety of problems for food and beverage manufacturers.”

¹ Production outsourcers identified here and for the rest of this report based on question of percentage of production outsourced: i.e., those indicating some percentage of production outsourcing while those that answered 0% or failed to respond to the question are counted as non-outsourcers. For questions where “We do not outsource production” is an option, that answer is omitted in reporting the data.

² For many questions, respondents were allowed to select more than one answer.

R&D and Product Development Outsourcing

The vast majority of food and beverage manufacturers choose to keep their R&D/product development activities in-house: 68% report they do not outsource product development (as measured by percentage of SKUs), and another quarter of respondents outsource between 1-25%. Only two percent of survey respondents outsource all of their R&D/product development.

Among those food and beverage manufacturers currently outsourcing some R&D/product development, 56% indicate they do so to gain “access to technology/equipment” and 47% hope to find “access to new ideas.” Additionally, 44% of R&D outsourcers look to “increase R&D capacity.” Only 21% outsource R&D to “lower costs.”

Most firms that outsource R&D rely on a cadre of vendors: 68% use more than five firms, and 53% report that they outsource the function to ingredient suppliers.

That situation can create some unexpected outcomes: “As an ingredient supplier to the food industry, we are feeling the outsourcing in two different ways. First of all, our customers are expecting us to deliver all of their R&D work. Second, we are then asked to problem-solve their outsourcing contractors.”

One executive reports that he uses a consultant firm to manage all the R&D work. “They perform tremendously to save my company a lot of revenue. And since they work out of their own location, my company is not bothered with taxes, employee benefits or providing offices.”

Yet, not all praise their R&D contract providers: “We have not been impressed with the outside vendors/flavor houses showing new products/ideas. The last time a major flavor house showed us new product ideas, we painfully told them we already had similar products on the market! They don’t do their homework.”

The SKU volume of outsourced R&D is likely to increase among 24% of survey respondents (3% of those indicate it will increase significantly); 71% indicate no change in the volume of outsourcing and 5% report it will decrease. Among R&D outsourcers, 56% will increase the dollar volume of outsourced production and 38% will keep it the same.

Looking ahead to 2009, 20% of survey respondents will increase outsourcing and 75% indicate no change in SKU volume of outsourcing. Among R&D outsourcers, 49% will increase the volume of outsourced production and 46% will keep it the same.

R&D outsourcing is not without its problems: Approximately one-third of firms that outsource R&D (36%) indicate that their most significant problem is loss of intellectual property, and another 27% cite late deliveries/poor lead times.

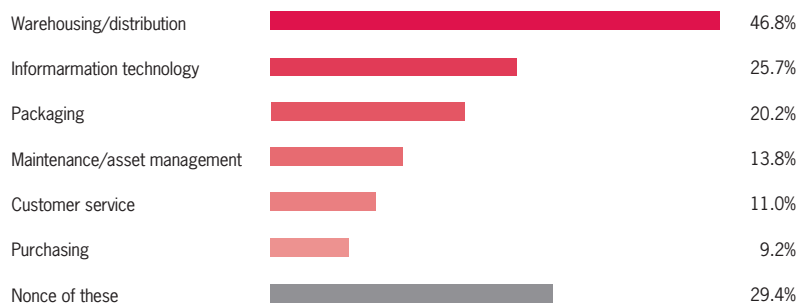
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Other Outsourced Functions

Highest among other outsourced functions is warehousing and/or distribution (47%). One-quarter (26%) outsource information technology and 20% outsource packaging.

The percentage of outsourcing among food and beverage manufacturers for these categories is significantly higher than what’s found across all U.S. manufacturing: Just 16% of U.S. manufacturers report they outsource information technology, and only 7% outsource staging and/or packaging.

Other outsourced functions % of survey respondents



³ R&D outsourcers identified here and for the rest of this report based on question of percentage of R&D outsourced: i.e., those indicating some percentage of R&D outsourcing while those that answered 0% or failed to respond to the question are counted as non-outsourcers. For questions where “We do not outsource R&D” is an option, that answer is omitted in reporting the data.

The outsourcing of warehousing and/or distribution is dramatically higher than the percentage found among all U.S. manufacturers (14%). Some of this gap may be because food and beverage firms perceive the category to also include “transportation” (half of all U.S. manufacturers report outsourcing transportation).

Still, some in the food and beverage industry outsource nothing, and seem quite proud of it: “We don’t outsource anything. It is all done in-house — buying ingredients, book keeping, baking, cooking, packaging and shipping.”

Outsourcing of production, R&D or any function by food and beverage manufacturers should be done in a strategic, corporate context. One executive says, “Outsourced solutions have to work at the right price,” and that is certainly true.

But, savvy food and beverage manufacturers take a more rigorous approach that analyzes multiple factors beyond price to ensure that outsourcing is the right decision. Examples of this approach include:

1. Assess business operations and functions; develop measures by which to evaluate core competencies.
2. Understand and prioritize corporate strengths and weaknesses before deciding what should be outsourced (top concerns can include intellectual-property and brand-identity).
3. Commit to decisions and execute an outsourcing “strategy.” Invest in core competencies that are kept in-house.
4. Manage the in-house and outsourced functions as a single, continuous and highly productive chain of activities that serves customers.

By applying a thorough and holistic approach to your company’s outsourcing strategy and execution, the ensuing experiences and bottom-line effects can make for some very appetizing results. •

Profile of Participants

A diverse group of food and beverage manufacturers are represented in the results of the second survey. More than one-third of survey participants (36%) report annual revenues greater than \$500 million, and another 17% report revenues of \$100 million to \$500 million. Approximately 44% of companies produce processed foods, the largest food group represented, followed by miscellaneous/other (34%), bakery products (29%), snacks (29%) and meat, poultry and seafood (29%).

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About Grant Thornton LLP

Grant Thornton LLP is the U.S. member firm of Grant Thornton International Ltd, one of the six global accounting, tax and business advisory organizations. Through more than 100 countries, including 50 offices in the United States, the partners and employees of Grant Thornton International Ltd member and correspondent firms provide audit, tax and advisory services to public and private clients around the globe.

About Food Processing

Established in 1940, Food Processing is the premier publication for the packaged foods industry. Food Processing writes for the entire management team about the critical issues in bringing a product successfully to market, exploring the latest trends in new product development, marketing, process optimization, packaging and workforce management.

