

Raw materials sourcing

## Increasing bottom line contribution ...

*Raw materials sourcing of FMCG/CPG companies, and in particular soft commodities sourcing has been challenged by market conditions. Price volatility has been high, financial markets have been somewhat illiquid complicating hedging activities. Accounting guidelines have been restrictive.*

*Sourcing practices are advancing, and markets continue to mature. Hence, it could be worthwhile to review raw material procurement program and close potential value leakages.*



## Performance pressure is increasing

FMCG and CPG companies are under increasing pressure. It is much harder to ensure top line growth and profitability compared to previous years.

- **Market conditions are becoming fiercer** and premiums of branded goods are under pressure
- **Portfolio restructuring** takes time and comes at a cost
- **Digital transformation** requires management attention
- **The creation of online channels** is difficult; some firms struggle to implement them successfully
- ...

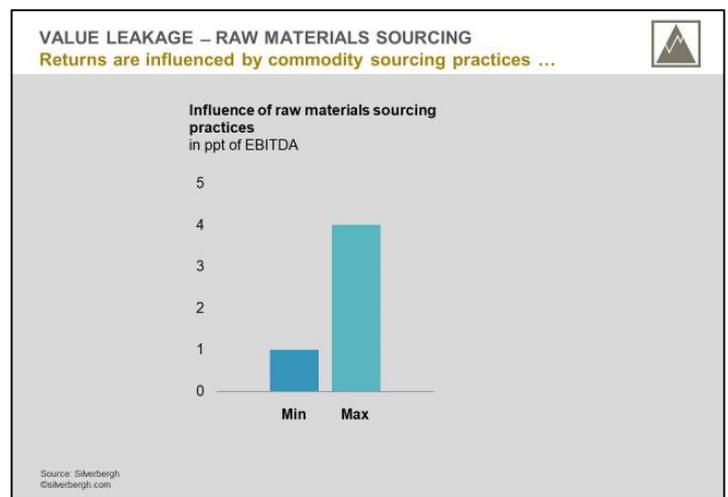
These are some of the reasons which are frequently being discussed.

For several FMCG and CPG firms' raw materials and especially soft commodities are an important cost component. Could raw materials sourcing contribute more strongly to bottom line profitability?

## Today, value leakage in commodity sourcing is significant

In several firms physical procurement rationales dominate commodities sourcing practices. Some markets have however developed into traded markets with significant volatility. Additionally, several markets are USD denominated and hence add currency exposure. Financial markets are not as developed as the underlying physical markets. Therefore, financial hedging opportunities are limited.

The influence on company profitability can be significant. A key issue is also a lack of synchronization between sales, manufacturing and sourcing. This is influenced by different dynamics in raw materials markets and product markets. How can these differences be bridged and how can an agile organisation contribute to make amendments to the system



to deal with e.g. seasonality, weather influences, competitive pressure, changing demand patterns?

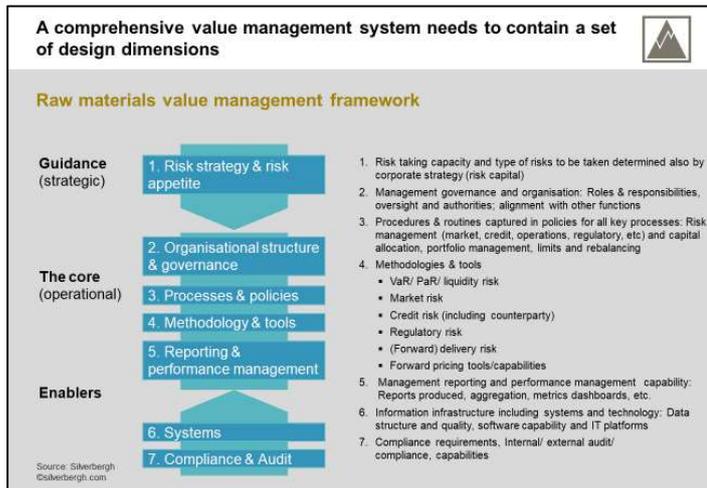
## Procurement practices are being upgraded

Companies are exploring a broad range of value levers to improve bottom-line profitability. In this effort, commodity sourcing practices are moving into the focus. A few value levers companies experiment with are ...

- **Hiring of commodity traders** to manage commodity procurement operations
- **Accounting treatment of hedges** (in IFRS and FASB)
- **Timing of shipments**
- **Market timing** respectively over- and under-hedging to contribute profitability
- ...

## Strengthening raw materials procurement practices ...

Some of the above activities might be justified. Experience shows that in some instances isolated initiatives could backfire and achieve the opposite. In this case the value leakage increases.



It is very important that the procurement activities are closely integrated into the company's overall financial and operating framework. In several companies this integration can be improved.

It needs to be ensured that there is clarity of the respective value levers and roles and responsibilities to manage these value levers.

The raw materials value management framework guides the review of current practices as well as the comparison with

adequate practices of other organisations. A comparison would also need to reflect the business model employed. Otherwise any comparison would be flawed and would lead to misinterpretations.

The business model is embedded into a strategic rationale which is assigned to raw materials procurement.

- According to which pattern is the procurement function supposed to source volumes?
- Which degrees of freedom to amend/ change procurement volumes and patterns exist?
- How is the procurement functions performance being measured and assessed?
- Which functions interfere with procurement activities?
- ...

## ... will contribute to higher company earnings and enterprise value

Strengthening the raw materials procurement functions set up will improve bottom line profitability and stability of earnings. A more sustainable company performance will directly translate into a higher enterprise value.

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