

Sustainable availability of brewing materials and managing volatility

Global Procurement Conference

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For procurement in the brewing industry, five main topics are crucial to manage sustainability and volatility



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1. Roland Berger Strategy Consultants

The CC Operations Strategy deals with the management of sustainability and volatility in its procurement projects

Roland Berger is a top player in the premier management consulting league

Key facts

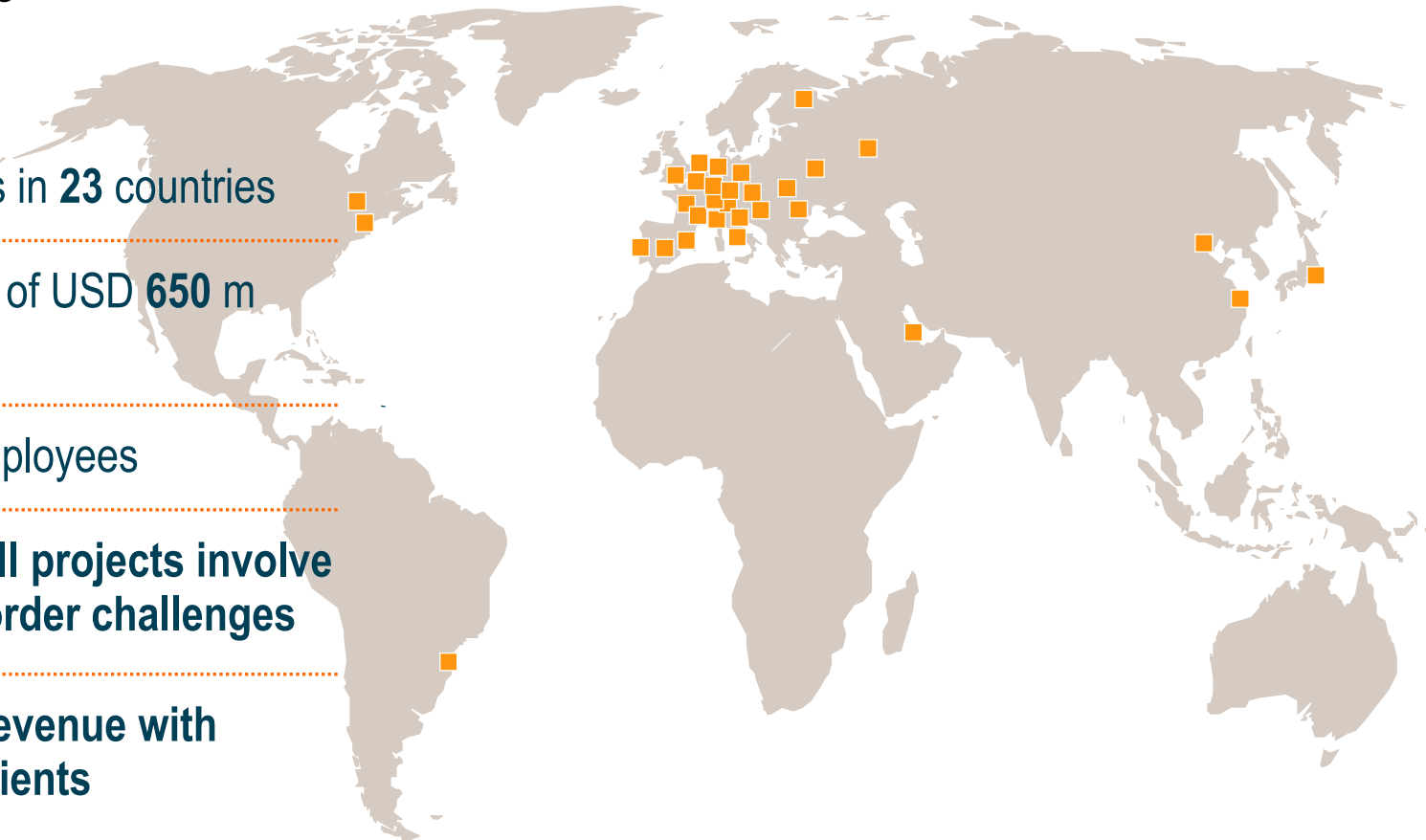
32 offices in 23 countries

Revenue of USD **650 m**
in 2005

1,700 employees

**76% of all projects involve
cross-border challenges**

**76% of revenue with
repeat clients**



We cover all relevant top management issues – 25% Operations Strategy topics

Share of strategy projects 2005 [%]

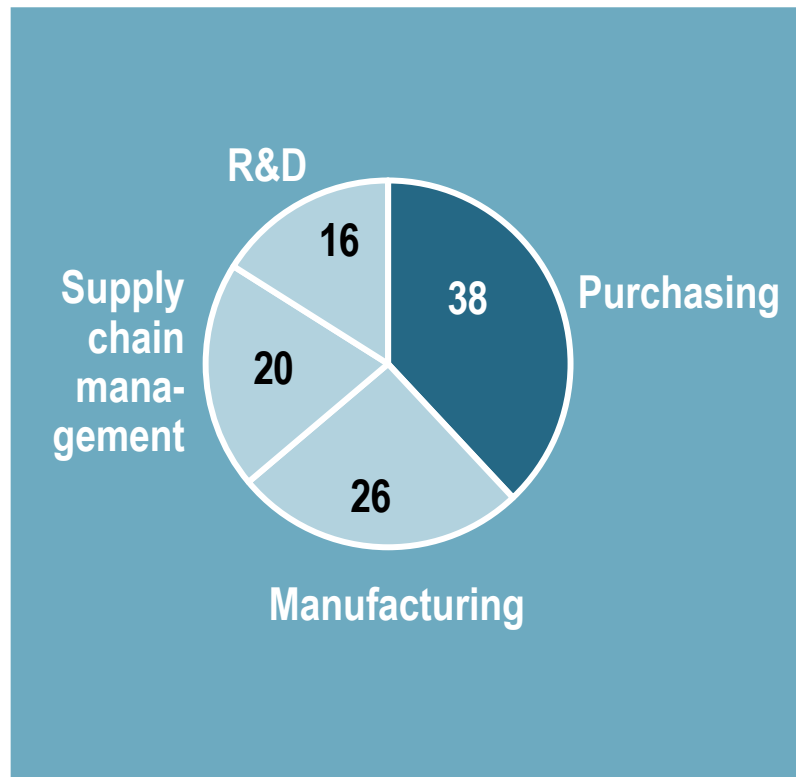


EXAMPLES of project issues

- > Sustainable growth
- > Risk management in procurement
- > Value-creating concepts
- > Decentralized organizations
- > Global footprint
- > Low cost country sourcing

In Purchasing we work successfully with top clients on challenging issues

Share of Operations Strategy projects 2005 [%]



EXAMPLES of projects

- > Reorganize purchasing organization
- > Design and set-up of a KPI system for purchasing
- > Reengineer business process for central purchasing functions
- > Definition of a raw material sourcing strategy
- > Redesign large purchasing and supply chain
- > Improve sourcing in low cost countries



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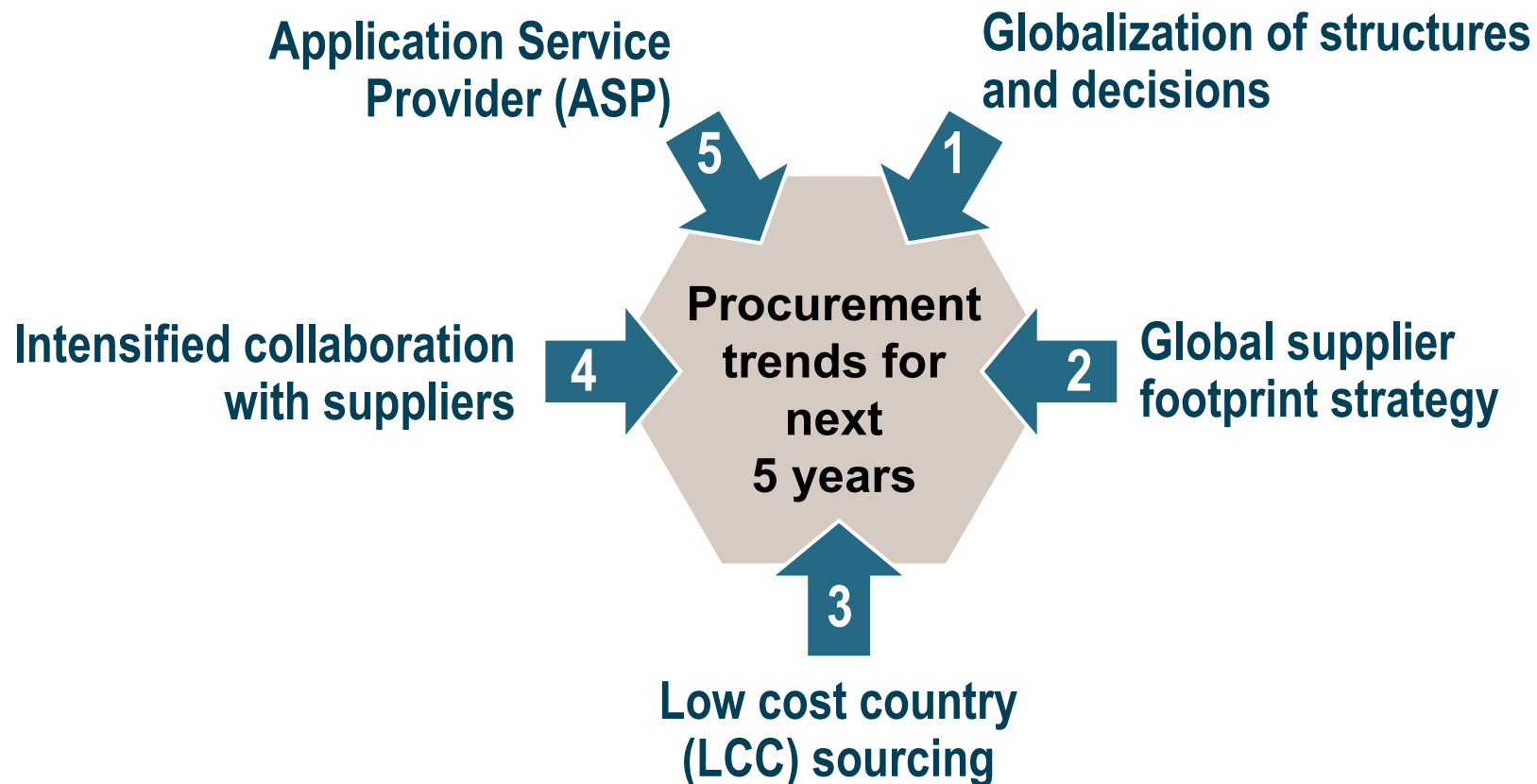


2. Procurement trends

An outlook for the next five years based on a Roland Berger study

A recent Roland Berger study revealed five major trends in procurement

Procurement trends



Procurement structures and decisions will become global to fully leverage group synergies

- > Procurement organizations are aligning their global structures to leverage group **synergies**
- > Procurement departments standardize their **processes** and harmonize their IT systems to fully leverage synergies
- > Global structures are supported by strong global **decision-making authorities** (e.g. global procurement committees)
- > Global commodity and supplier **strategies** are developed
- > Global supplier **development and evaluation** programs are applied



Global supplier footprint strategies are increasingly implemented, taking into account currency volatility

- > Companies are increasingly developing a global supplier **footprint strategy**, e.g. to hedge against currency fluctuations
- > The global supplier footprint strategy is derived from corporate **requirements**, e.g. financial needs, global production, sales projections, supply base evolution
- > A global supplier footprint strategy provides the **decision framework** for procurement and is managed cross-functionally



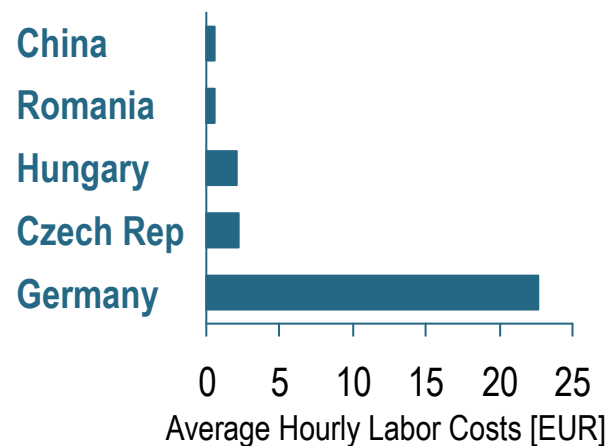
Low Cost Country sourcing will be intensified

- > **Export sourcing** follows local sourcing for local production
- > Export sourcing savings can be realized by aligning **commodity characteristics** with (low cost) country specific advantages
- > LCC supply base is developed by assisting existing suppliers to **expand to LCCs**, and by developing local suppliers
- > Increasingly, LCC sourcing will be fully integrated in the existing procurement and becomes a way of doing **daily business**
- > LCC sourcing goals need to be aligned with **corporate goals**



Eastern Europe is getting more and more interesting as a sourcing location

Attractive production location



- > Very low labor costs compared to Western Europe
- > Qualified human resources
 - Good availability of engineers
 - Good language skills

Eastern Europe is HIGHLY ATTRACTIVE



Advantages compared to China

- > Shorter transportation ways
- > Productivity often only slightly lower
- > Political stability, especially among new EU members
- > Intellectual property rights are more protected than in China

Supplier collaboration will be intensified, driven by innovation access and cost reduction

- > Shift of R&D **know-how** and **innovation** capabilities to suppliers puts increasing emphasis on improving the relationship with suppliers
- > Global innovation **processes** and tools are implemented
- > Cost **reduction** efforts are getting more comprehensive
- > Collaboration with cross-functions and **suppliers** is accelerated
- > Cross-functional **targets** are defined and suppliers are offered an incentive
- > Cost reduction efforts are supported by dedicated resources and a standardized **methodology/toolbox**



Internet Application Service Provider (ASP) will be used more often to save process cost and intensify competition

- > ASP enforces structured **tender process**
 - Clear and traceable staged process
 - Information on tender history readily available
- > Increased processing **speed**
 - Templates reduce time and effort in case similar tenders recur
 - Advantages of electronic communication
- > Structured **answering/quotation forms** facilitate analysis
- > Need for own **supplier research** minimized
 - Broad data base of validated potential suppliers
 - Structured information on companies provided
- > Access to very high number of **potential suppliers**



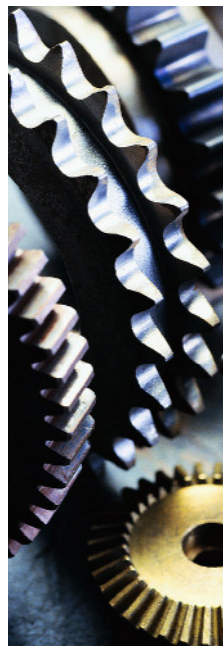


3. Managing price volatility

An example from a machinery manufacturer

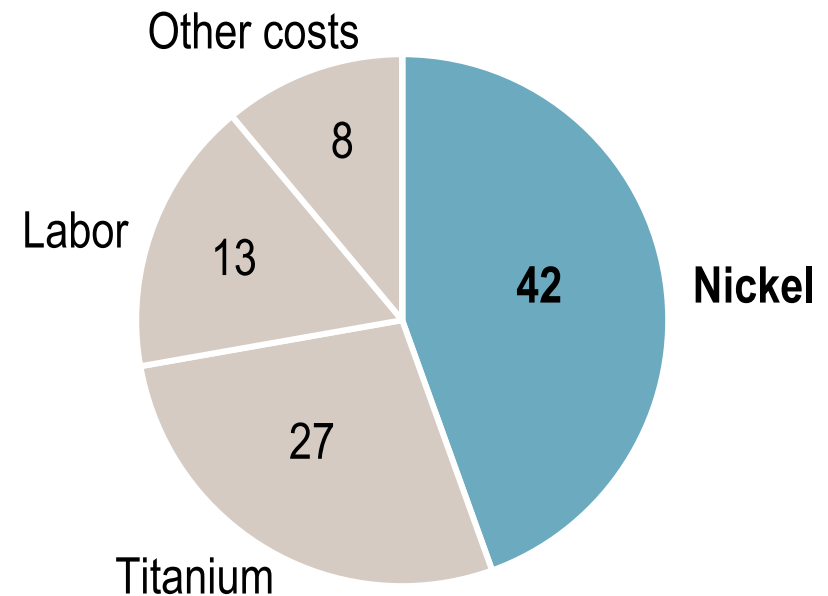
For a client in the manufacturing industry, nickel accounted for more than 40% of the cost of a typical product

Total spend for raw materials p.a.



| METAL | VOLUME [EUR m] |
|----------|----------------|
| Nickel | 25 |
| Titanium | 6 |
| Cobalt | 3 |
| Chrome | 2 |
| Rhenium | 1 |

Cost breakdown for a typical part [%]



The raw material price for nickel shows a steep increase from end of 2005 onwards

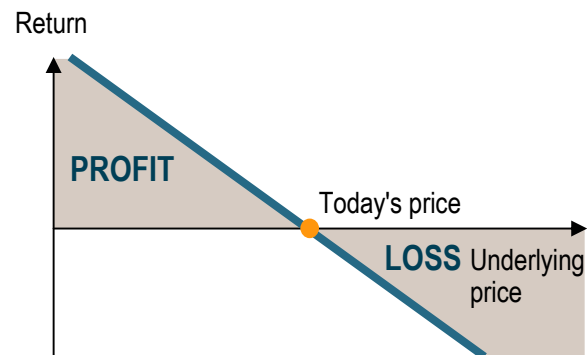
Development of nickel price 2002-2006 [EUR/t]



Different types of derivatives with different risk and reward characteristics are available to cope with the price risk

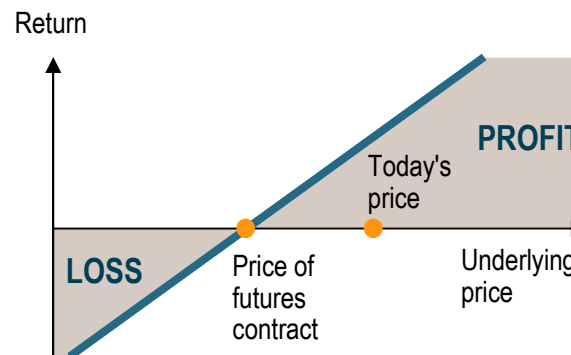
Risk management possibilities – Overview

Un-hedged position



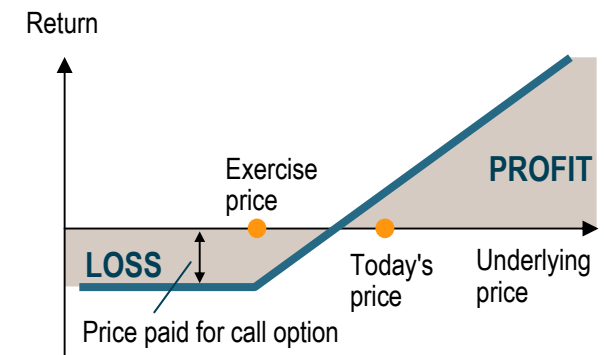
- > If price rises (e.g. nickel), un-hedged companies lose
- > If price falls, un-hedged companies gain

Futures



- > Companies lock in the price paid (e.g. nickel) at the time the futures contract is bought
- > If the price falls, the company is still obliged to buy via the future contract
- > If the price rises, the company gains

Call options

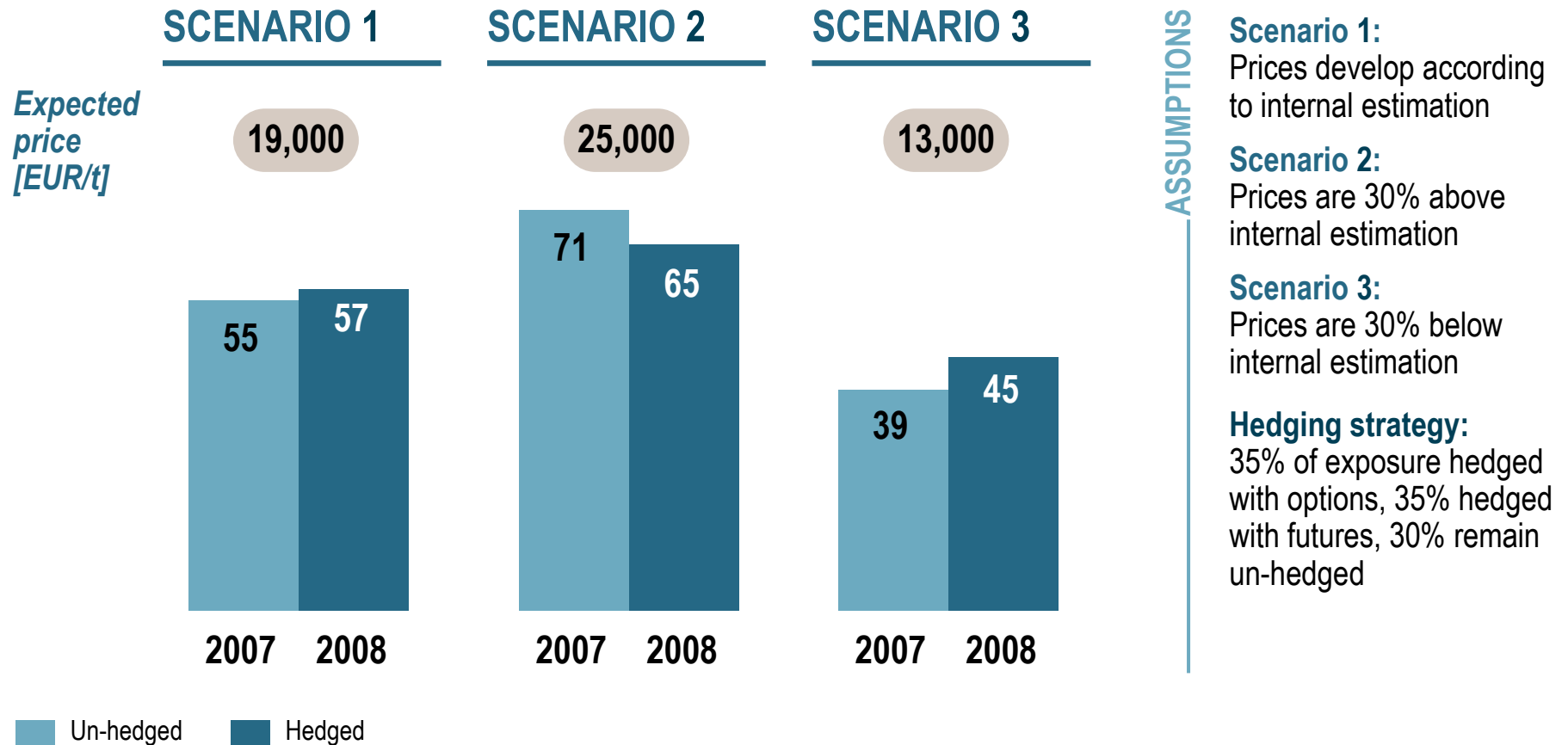


- > Company caps exposure to upward movements in prices for a pre-determined cost (the option price)
- > Company benefits from a price fall
 - Pays the lower prices
 - Does not exercise the call option
 - Has to bear the option premium

Hedging is an insurance to manage raw material price volatility

Hedging saves money if raw material prices increase further – But money will be lost if prices decrease

Simulation – Hedging scenarios for nickel [EUR m]

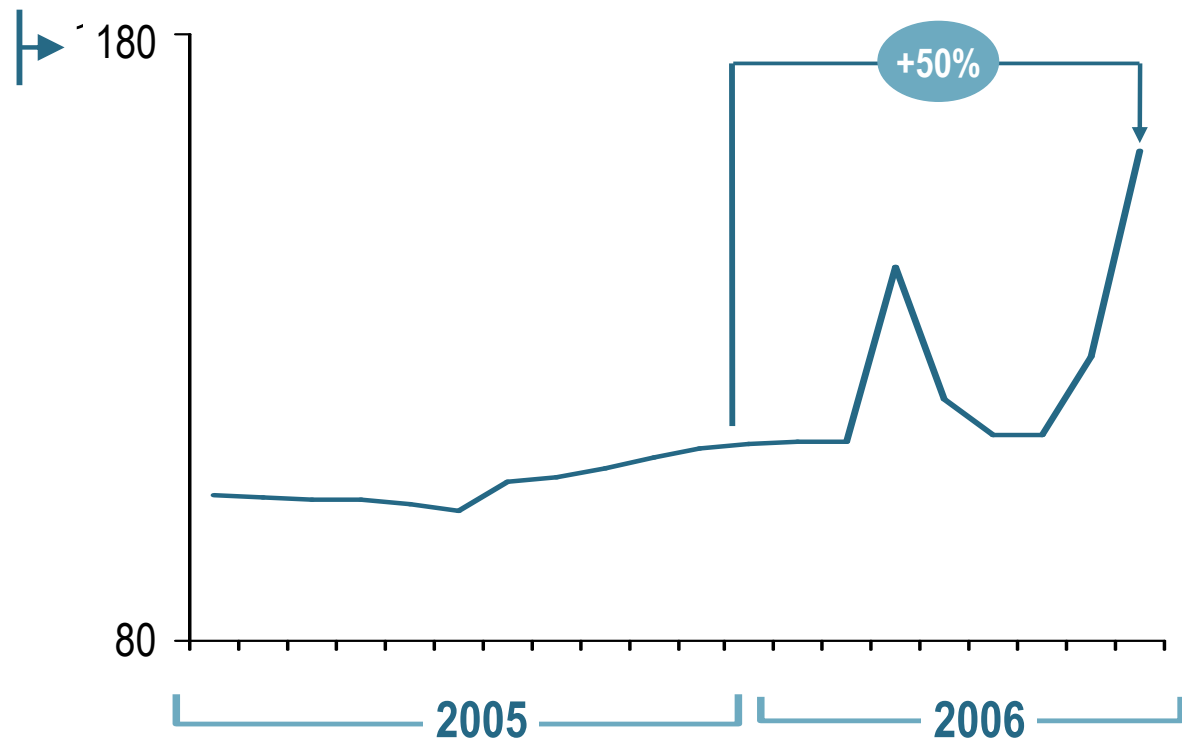


Hedging could be intensified in the brewery industry to cope with price volatility

HEDGING OPPORTUNITIES

- 1 Malting barley
- 2 Malt
- 3 Hop
- 4 Aluminum for cans

MARKET PRICE GERMAN MALTING BARLEY [EUR/t]¹⁾



1) Production price for immediate delivery



4. Procurement organizations

Alternatives to the Lead Buying organization

Companies are facing a number of challenges when globalizing their procurement organization

Communication alignment

- > Organizational structure/responsibilities
- > Common IT platforms/commodity codes

Realization of commodity synergies

- > Global lead functions
- > Commodity strategies

Efficient decision making process

- > Global procurement committees
- > Cross-functional meetings

Procurement process alignment

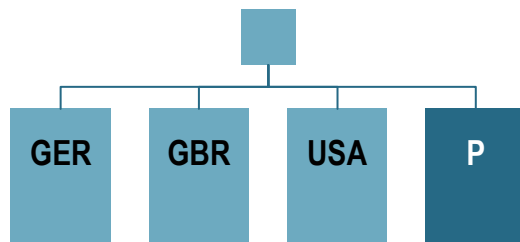
- > Common procurement processes
- > Alignment of interfaces

Strategic supplier management

- > Supplier development
- > Systematic supplier evaluation

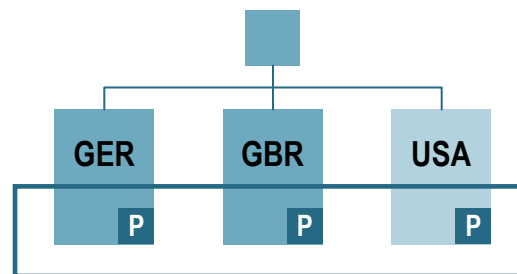
Three organizational concepts provide basic options for global procurement organizations

A Centralized PROCUREMENT



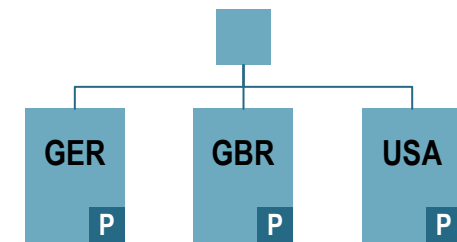
- > Centralized strategic and operational procurement
- > Locations are obliged to make use of central procurement
- > Examples industries: retail, financial services

B Coordinated PROCUREMENT



- > Consolidation of categories, suppliers, information, etc.
- > Coordination on group level
- > Examples industries: automotive, aviation, construction

C Decentralized PROCUREMENT



- > Decentralization of procurement for all categories/ suppliers
- > No coordination of procurement
- > Examples industries: cement fabrication, food ingredients and flavors

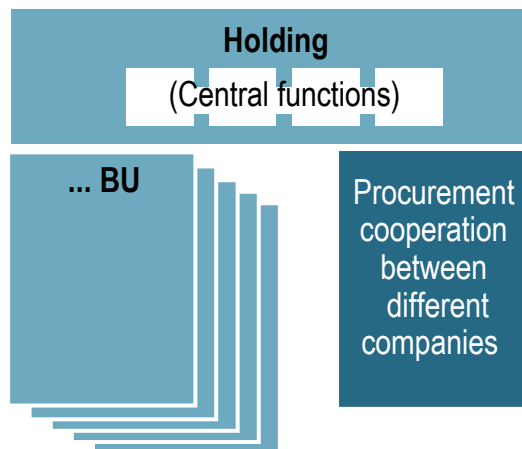
P = Procurement department

□ = Coordination

■ = Business unit/location

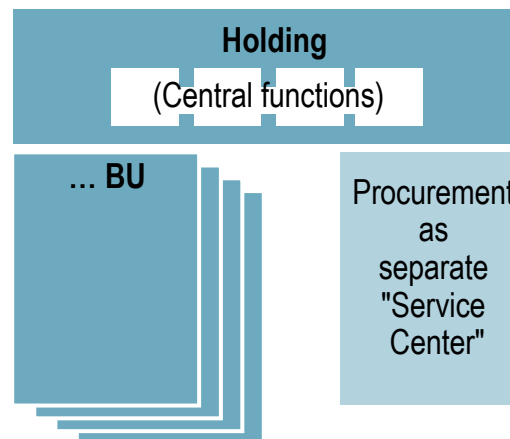
Centralized procurement concepts require a dedicated entity or function to support all business units

A.1 Cooperation



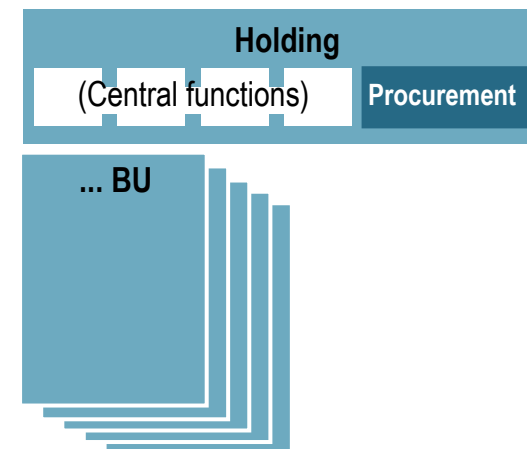
- > A procurement cooperation is owned by different companies
- > Bundling of procurement services across companies

A.2 "Service Center"



- > A separate legal entity offers procurement services to all locations
- > Business units are forced to use the "Service Center"

A.3 Central procurement

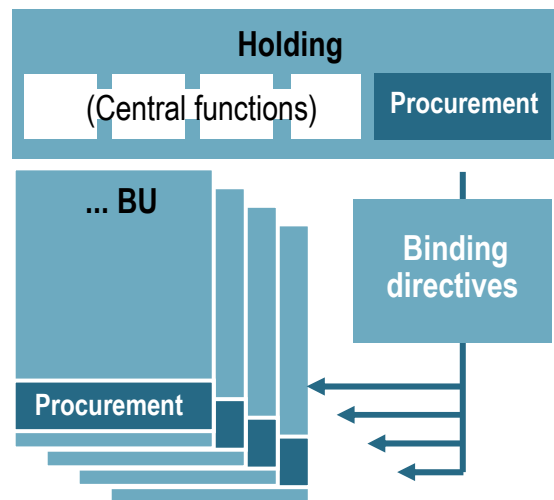


- > A central operational and strategic procurement takes over all procurement tasks
- > Central procurement owns process and tools

■ = Business unit/location

Coordinated procurement builds on local know-how while leveraging group synergies

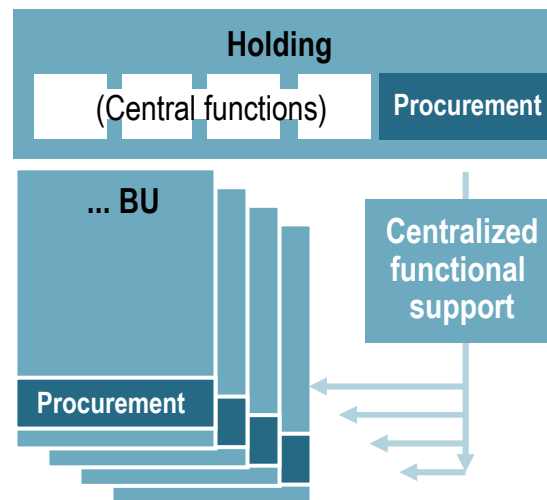
B.4 Central procurement with local satellites



- > Central procurement has full authority and can even issue directives
- > Small procurement departments implement directives

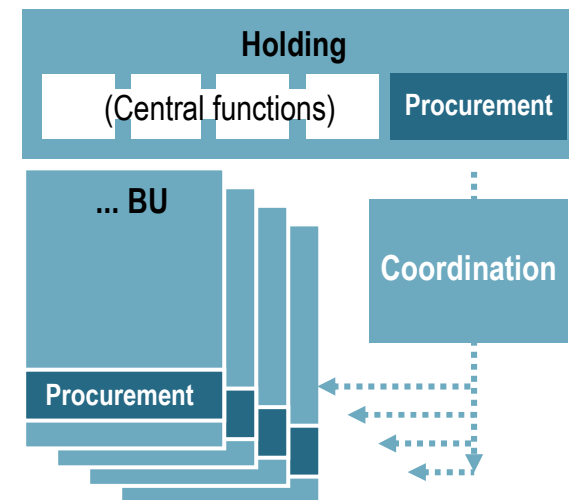
■ = Business unit/location

B.5 Decentralized procurement with centralized functions



- > Central procurement consolidates actively volume and negotiates prices
- > Decentralized self-responsible procurement departments

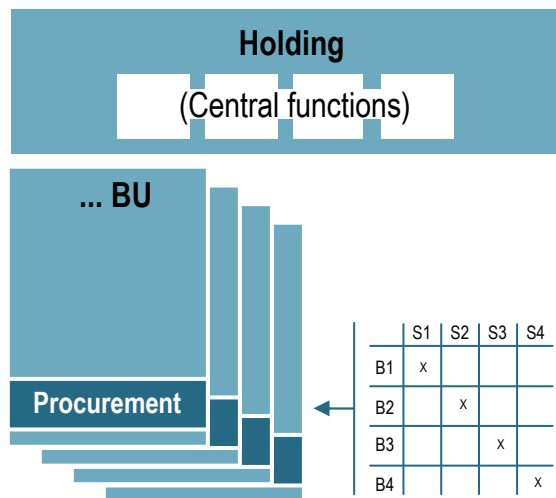
B.6 Decentralized procurement with centralized coordination



- > Decentralized self-responsible procurement departments
- > Central procurement ensures coordination between business units only and cannot issue any directives

Decentralized procurement concepts face the coordination complexity within a matrix organization

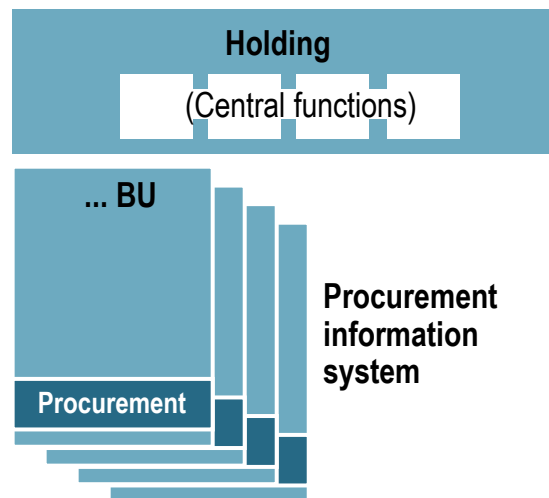
B.7 Lead Buying



- > No centralized procurement
- > Local buyers take on responsibility for group-wide coordination

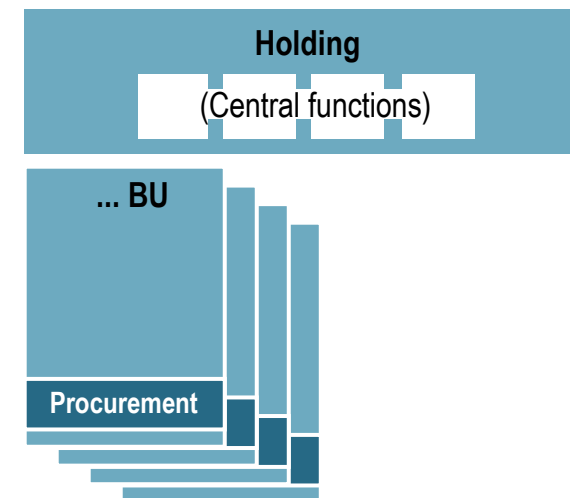
■ = Business unit/location

C.8 Virtual Central procurement



- > A central information system provides the basis for coordination
- > Decentralized self-responsible procurement departments

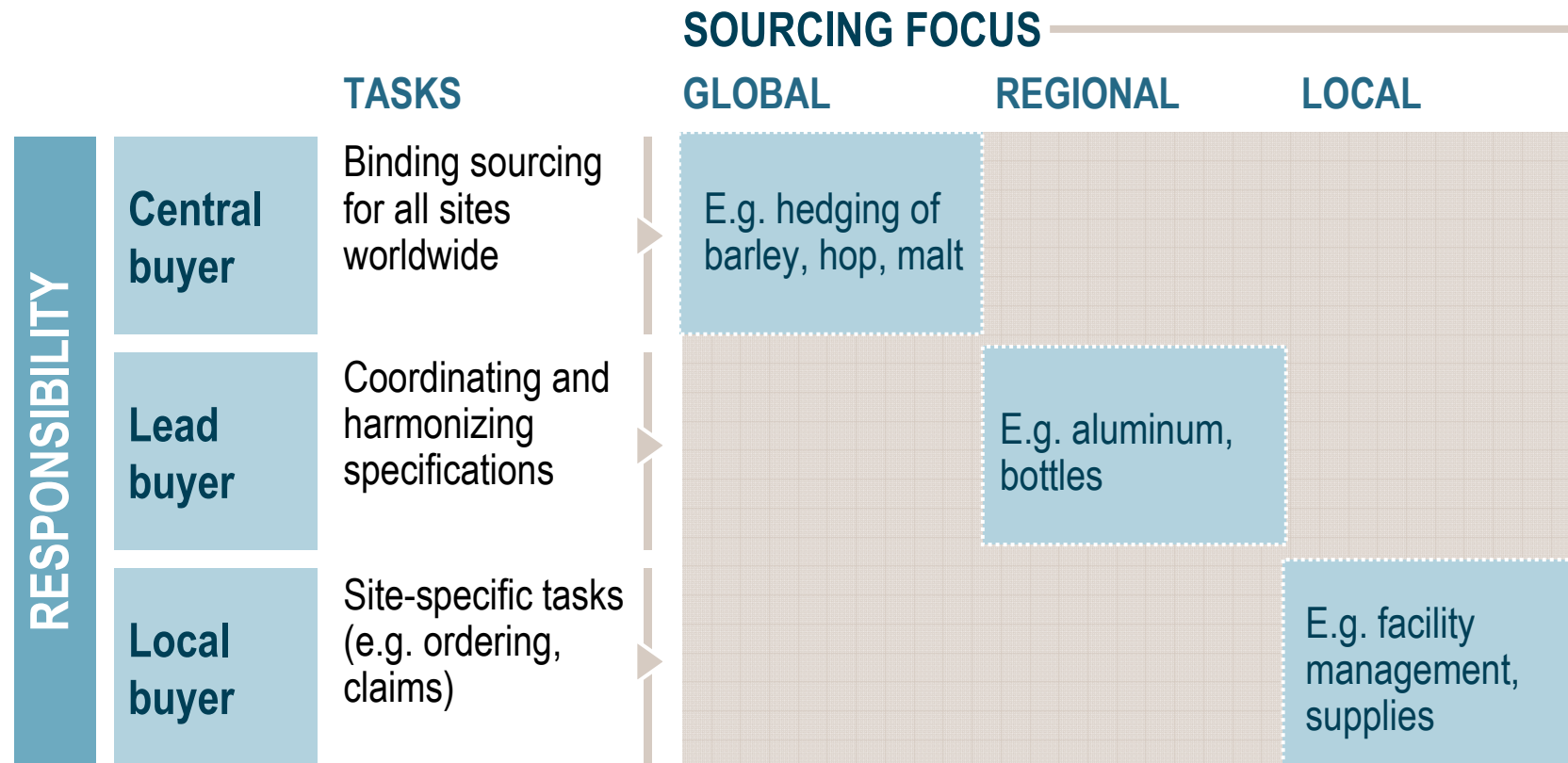
C.9 Decentralized procurement



- > No centralized procurement functions
- > Decentralized self-responsible procurement departments

If the lead buying organization is selected, it needs to be fine-tuned to the brewery industry

Detailing of the (selected) lead buying organization



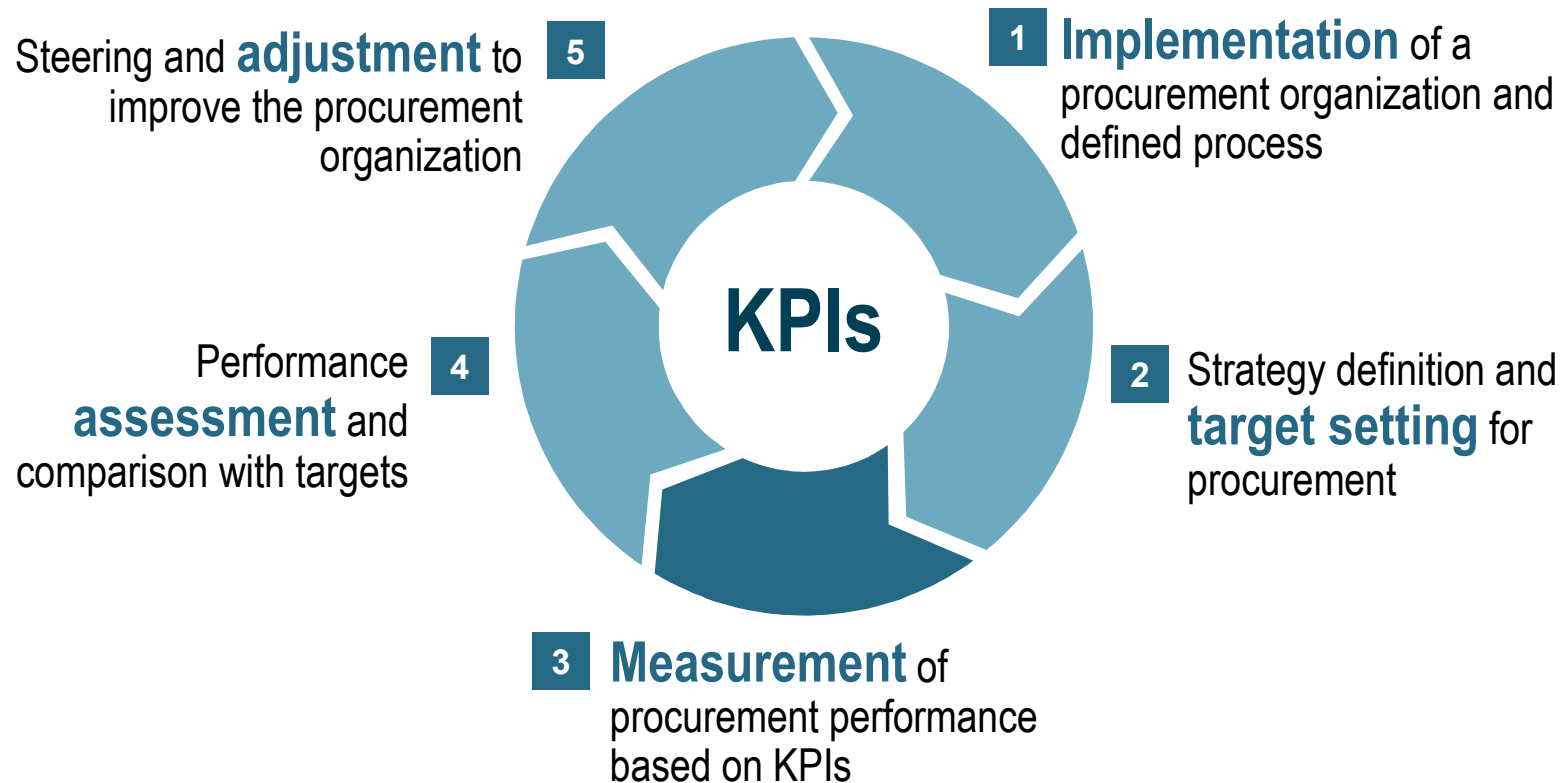


5. Key measurement criteria

Identifying and tracking success of procurement

Key performance indicators (KPIs) are required to track the success of procurement organizations

The need for key performance indicators



Roland Berger follows six guiding principles to define KPIs for procurement organizations

Key guiding principles

- 1. Strategic relevance** > Deduction of KPIs from strategic **objectives**
- 2. Focus** > Limitation to few KPIs with large strategic business **impact**
- 3. Applicability** > Development of **generic indicators** for all categories
> Specific indicators for particular requirements
- 4. Continuity** > Long-term **availability** of indicators to ensure comparability
- 5. Availability** > Availability of relevant data in the **IT system**
> Availability at all **business units**

**KEY
PERFORMANCE
INDICATORS**

The key performance indicators can be structured along four axes of performance

Axes of performance analysis

1. Financial performance perspective

How does a procurement organization contribute to a company's profitability?

2. Customer satisfaction perspective

How does a procurement organization fulfill identified customers' needs and expectations?

4. Organization development perspective

How can the procurement organization leverage the potential of its employees?

3. Business process perspective

How are the business processes/ tools provided used by the procurement organization?

In a recent project, Roland Berger defined 32 procurement KPIs for a company in the beverage industry

Organization Development

- 26. % of procurement spend managed by Procurement Organization (locally and c
- 27. Overall spend Glaverbel pr
- 28. Overall spend procurement
- 29. Average num
- 30. Average spe
- 31. Cumulative r buyer
- 32. Average con

Business Process

- 18. Number of suppliers representing each less than X% of total spend as % of overall number of suppliers

Financial Performance

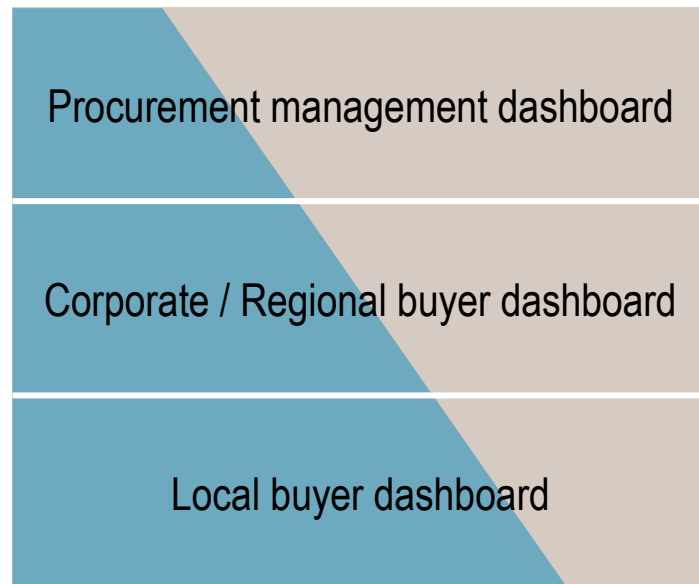
Customer S

- 13. % of spend r quantity and
- 14. Supplier bas of overall nur
- 15. Article base : overall numb
- 16. Average inte
- 17. Average grat

1. Average payment term for supplier
2. Inventory coverage
3. Inventory value
4. Spend versus budget / last year figures
5. Investment spend versus lowest spend offered by supplier
6. Unit price versus budget / last year figures / market figures
7. Unit price versus budget / last year figures using base 100
8. Current product reception figures versus budgeted figures
9. Current consumption figures versus budgeted consumption
10. Yearly cumulative gains and losses for category hedging
11. Yearly price surplus paid on prices
12. Inventory turns

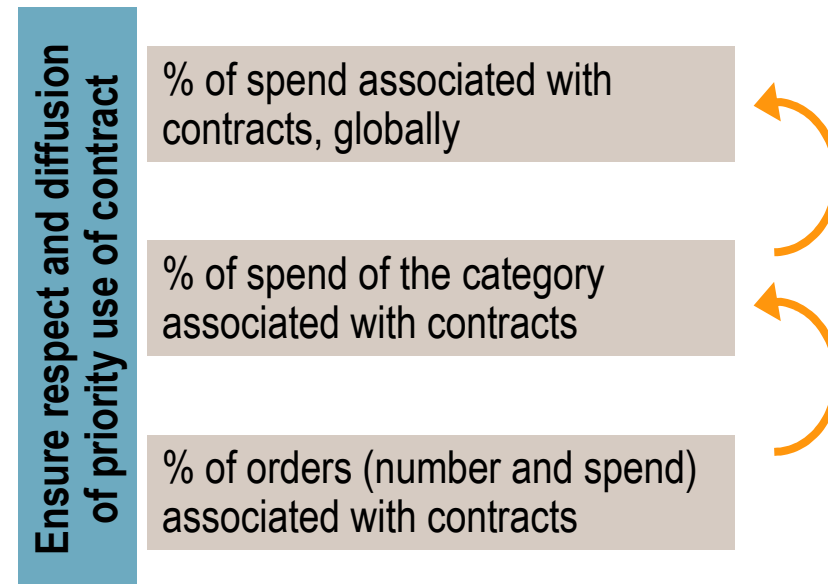
Dashboards were created on all levels of the procurement organization to track the achievement of objectives

Dashboard defined for each procurement organization level



■ KPIs ■ Operational indicators

Declination of objectives and KPIs





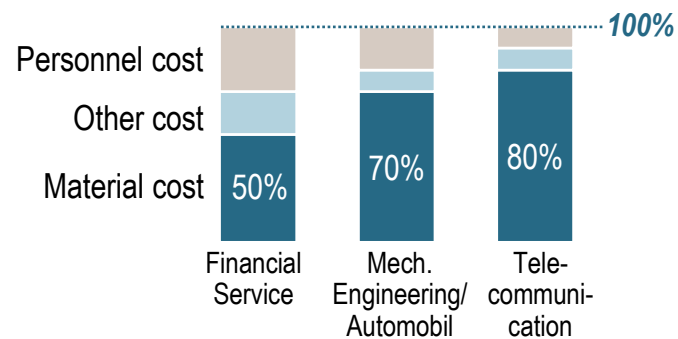
6. Value creation

Reaching the next level in procurement

The discrepancy between relevance and effective role means potential in procurement might not be realized

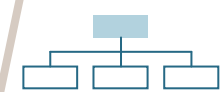
Value driver in procurement

RELEVANCE of procurement division



- > Procurement is a big lever to influence cost structure and profits
- > Positioning of procurement within company according to relevance

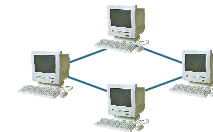
ROLE of procurement function



Insufficient organizational positioning



Inefficient process connection and process implementation



Insufficient implementation and utilization of system



Insufficient capabilities and competencies of employees

Realization of all existing potentials in procurement in risk

Early involvement is the most important measure to optimize procurement spending

Benefits of early involvement procurement

Early INVOLVEMENT in the R&D process



Early INVOLVEMENT in the Sales process



Early INVOLVEMENT in investment decisions



Early INVOLVEMENT in Global Footprint design



Benefits of an EARLY INVOLVEMENT

- > Avoid log-in effects with supplier due to design constraints and/or specifications
- > Enable procurement to be involved even in the design phase (e.g. design-to-cost)
- > Allow standardization of parts and raw material (e.g. by involving procurement in the sales process)
- > Capitalize procurement by managing also non-traditional procurement spend (e.g. investments)

Strategic and operational procurement activities have to be clearly separated – Trend towards strategic procurement

Strategic sourcing

- > Supplier relationship management
- > Supply chain management
- > Linear performance pricing
- > ...

FOCUS _____

Savings

Operative procurement

- > Efficiently running procurement processes (Order Request)
- > Ensure availability of material needed
- > ...

FOCUS _____

Transaction cost

Procurement organization today (time)



Procurement excellence (time)



Required development



Towards strategic procurement

Challenges in the brewery industry can be managed with the right know-how

Management of sustainability and volatility

- 1** Integrate upcoming trends in procurement
- 2** Transfer volatility best practices from other industries into your own
- 3** Assess alternative procurement organizations
- 4** Manage the organization by using KPIs
- 5** Act immediately for future value creation



Creative strategies that work!

Roland Berger
Strategy Consultants