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Weak Links in the Food (Supply) Chain Firms Pinched by Rising Commodity Prices Strive for Tech Efficiency

By BEN WORTHEN

It's a hard time to be in the pizza-delivery business. Cheese is up about 50% on the Chicago Mercantile Exchange since December 2006. A pound of flour costs 64% more than this time last year, according to the U.S. Bureau of Labor Statistics. Diesel fuel is approaching $5 a gallon.

"It's just astronomical," says Julie Larner, president of PJ Food Service, the subsidiary of Papa John's International Inc. responsible for delivering ingredients to the pizza maker's 3,263 restaurants. "Everything has all gone up at the same time."

Facing consumer resistance to higher menu and supermarket prices, Papa John's and companies throughout the food-manufacturing, distribution and retail world are responding to increased prices for their commodities by trying to squeeze more costs from their supply chain -- the collection of relationships that moves goods to stores from factories and warehouses. That means grappling with excess inventory, inefficient truck routes, poorly planned production schedules and the computer systems managing the process.

Papa John's is using a system it bought from Manhattan Associates Inc., of Atlanta, to centralize its inventory, warehousing and transportation planning. Previously, decisions were made at individual distribution centers, says Ms. Larner, the food-service president. The system gives Papa John's better visibility into how much food it needed to have in its distribution centers in order to keep its stores stocked, and how long it would take to receive new supplies from its distributors.

Since 2007, Papa John's has been able to reduce inventory levels by 17% and decrease the amount of outside warehouse space it needs to rent by 33%. "The more the costs go up, the more important it becomes," Ms. Larner says.

This isn't the first time that businesses have had to take a closer look at their supply chains. In the late 1990s and early 2000s, many companies in the food industry bought large software systems from the likes of Oracle Corp., SAP AG, i2 Technologies Inc, and Ariba Inc., as well as more-targeted systems from smaller vendors, to give them better insight into inventory levels and demand.

But during the last few years, "many businesses said, 'We've squeezed the supply chain as hard as we can,' " says Bill Bishop, chairman of Willard Bishop, a consulting firm that

advises food companies. Instead of investing in new supply-chain systems, businesses are using the technologies they bought earlier in the decade to look for further improvements.

Industry analysts expect that this will soon change. They predict that rising commodity costs will make it easier to justify buying new software that can help plan manufacturing cycles and optimize delivery routes.

AMR Research forecasts that spending on supply-chain software will rise to $3.9 billion by 2011 from $2.7 billion in 2007. Technology-research firm Gartner Inc. predicts that the subset of this software focused on transportation management will expand from around $500 million in 2007 to nearly $800 million by 2011.

Few businesses have managed to get new technology in place in order to deal with the current commodity-price crisis. So they are taking the same systems they have bought and enhanced since the late 1990s and early 2000s, and rethinking how they operate with them.

That is the case at Hannaford Bros. Co., the supermarket chain that is a subsidiary of Belgium-based Delhaize Group. Hannaford stores used to receive two shipments a day, a load of fresh groceries such as dairy products and meat first thing in the morning, and a load of nonperishable items like canned soup and boxed cereal at night. The split delivery made it easier for store managers to process fresh items before the store opened and let them restock the rest of the store after closing.

Rising fuel prices has made the grocer "reconsider all the rules," says Gerry Greenleaf, the company's vice president of distribution.

Hannaford used its transportation-management system and other planning software to analyze how much the split-delivery schedule cost the company and to see if there was a more cost-effective way to make deliveries. Earlier this year, Hannaford began combining the two deliveries for some of its 160 stores. It is less efficient for the store managers, but the added expense at the stores is offset by the savings on fuel, which the company says will be between $500,000 and $1.5 million chainwide this year.

Hannaford has also made other changes with the aid of supply-chain technology, such as a system that helps drivers maximize fuel efficiency that is says should save the company $500,000 this year.

Nestlé USA Inc., a subsidiary of Nestlé SA, is also changing established practices. Previously, it was cheaper for the food company to purposely overfill some bottled beverages than to spend money on the machinery, computer systems and staffing necessary to ensure that a 16-ounce bottle was filled precisely. Rising sugar, cocoa, dairy, and other food prices have convinced the company to "wage a war on waste" and make many of those investments, says Jeff Kurtenbach, Nestlé USA's vice president of supply chain.

Similarly, rising food prices have prompted Nestlé to rely on software tools to shift its manufacturing schedules. Previously, it was cheaper for a factory to spend two straight weeks making a six-month supply of infant formula, rather than to constantly clean and

retool the plant to make products in smaller batches. The company has since learned those smaller batches save the company more money by reducing inventory and food spoilage.

"Some of the things we were willing to walk by before we don't have the luxury to walk by anymore," says Mr. Kurtenbach.