Moving up the value chain

PETER CUNNINGHAM LOOKS AT TRENDS AND CHALLENGES IN THE CONSUMER SECTOR AND HOW COMPANIES ARE RETOOLING FOR THE FUTURE.

The past two years have seen the consumer sector face significant headwinds. Elevated borrowing costs, restricted access to traditional funding, unstable supply chains, volatile commodity prices and a depressed demand for products limiting the possibility of passing elevated costs on to the end consumer have all made their mark. Yet the consumer sector has emerged relatively unscathed compared with other sectors. After all, people still need to eat, drink, clothe their families, and maintain hygiene.

Access to public debt markets has returned at lower pricing levels and companies are looking for the right opportunities to deploy cash stockpiles amassed over the past two years. But consumer demand remains fragile, particularly in OECD markets facing sluggish growth and austerity packages, with private deleveraging further dampening demand. Many companies are looking to Asia, Africa and Latin America (with 75% of the world's population, rising to 90%) and an emerging middle class as drivers of growth.

The market is rewarding companies that can grow the top line and unleash improved operating leverage by stripping costs and running leaner operations (90% of earnings per share (EPS) growth among non-financials in the MSCI World Index was derived from cost-cutting) even at a cost of reduced margins. A range of themes are shaping the consumer sector, triggering opportunities to capture new growth, streamline operations and unlock working capital, as summarised below.

PREMIUMISATION AND EM GROWTH OPPORTUNITY Growth in disposable income levels within the emerging market (EM) middle class has a positive margin effect as people transition from economy to premium brands. The ability of consumer companies to create a portfolio of brands that can move with the consumer as their income rises ensures they continue to capture this (higher margin) spend. Indeed, as consumers reduced expenditures through the economic downturn, this brand range protected some of this spend from moving to private-label alternatives as consumers traded down to value range branded products.

Consumer companies recognise this "premiumisation" is prevalent

in EMs, driven by a middle class with growing disposable income, urbanisation and population growth. Companies are positioning to serve these regions by building new near-shore manufacturing capabilities and establishing local/regional brands aligned with demographic and spending patterns.

The high cash levels of consumer companies could fund the required capex to support this. Besides traditional forms of external funding, companies can use export agency financing (EAF) to deliver competitive funding. EAF draws on financing programmes of national export credit agencies (ECAs) and development finance institutions (DFIs) so companies can diversify their funding base, preserve bank lines, and access a stable, tax-efficient funding source. Citi has relationships with 65+ agencies globally.

OPERATIONAL EFFICIENCY Driving operational efficiency is realised in different ways, not only in payment factories, in-house banks, shared service centres (SSCs) and legal entity rationalisation, but recently also in "payment-on-behalf-of" structures using technological innovation and market developments such as SEPA, which lays the foundations for more rationalised and centralised account structures.

Through our work with 750+ SSCs, we understand the drivers and challenges of establishing centralised and streamlined structures. We have developed integrated payment platforms, data analytics and reporting, liquidity management structures, and guidance on solution alternatives, considerations, peer comparisons and market best practices. Furthermore, our SSC Forum enables clients to discuss relevant topics and best practices with practitioners across sectors.

MARGIN PRESSURE AND COST MANAGEMENT Increased production input costs (raw materials, packaging, transportation) on the supply side and customers with depressed income and negative economic outlook on the demand side have led to acute margin pressures for consumer companies. To maintain top-line performance, companies have sold on discounts and promotions (44.8% of US food and 53% of US beverages in 2009). However, recently we have seen these increases passed on to consumers, particularly in the food and household sub-sectors.

Often the first cost lines to be cut back are marketing budgets, non-strategic procurement, and T&E. We have seen regional and global corporate credit card programmes turn to a single provider with wide card acceptance so that companies can gain greater visibility and control over group spend. And as companies focus on reducing costs and improving operating leverage, we have seen a continued drive for efficiencies in existing payment factories and SSCs and for geographical and functional expansion.

WORKING CAPITAL MANAGEMENT Managing working capital to fund the production cycle has always been a consumer company focus. This has been sharpened by the financial crisis (where companies sought internal sources of capital to replace smaller, more expensive external capital pools) and by supply chain pressures causing trading partners to seek better payment terms and ways of securing liquidity.

There are significant differences between sub-sectors in working capital performance – for example, hotels, restaurants and leisure versus household durables. The same divergence in performance occurs within consumer sub-sectors. This indicates a significant scope

Procter & Gamble case study

Best-practice management of cross-currency cash

Procter & Gamble is a major brand and the world's leading maker of household and personal care products. P&G has annual sales of $80bn and 127,000 employees working in about 80 countries.

THE CHALLENGE In Western Europe, P&G has multiple currency accounts in 15 currencies. Historically these accounts were managed individually with draw-down and investment on an individual currency basis. This led to operational challenges in centralising excess cash to the global company and increased FTE to manage accounts on an individual basis. The company's goal was to optimise group liquidity, enhance visibility and control over cash, and drive operational efficiency in daily company funding and cash repatriation.

THE SOLUTION P&G determined that the structure of Citi's multicurrency notional pooling offering was the optimal solution for the cross-currency cash management of one of its most important multicurrency WE legal entities. The solution benefits Western Europe and its relationship with the global cash pool.

The solution delivers liquidity efficiency across a basket of currencies, replicating the effect of entering into back-to-back FX swaps through an automated solution. It allows P&G to continue to manage its currency balances individually, but facilitates the automatic offsetting of long and short positions across all currencies, delivering financial, liquidity and operational efficiency.

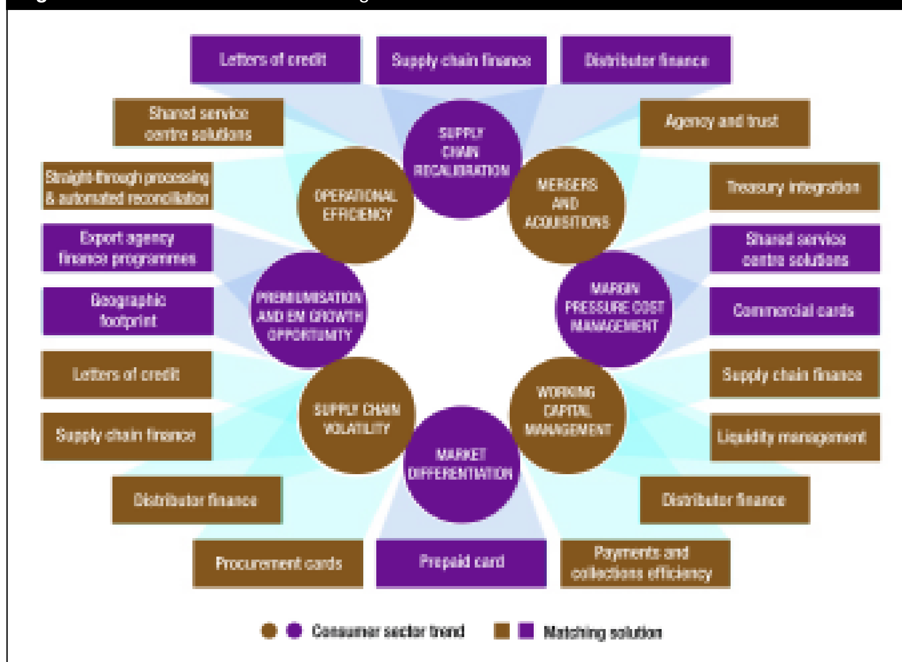
The implementation of this solution was smooth and straightforward. P&G already had bank accounts with Citi London for 12 of the 15 currencies covered by the solution. To implement the multicurrency notional pool, new accounts were opened for Central European country currencies. Local currency accounts in London were linked to local Citi branch accounts with an automatic funding mechanism in place to meet P&G's needs.

THE RESULT From day one, P&G benefited from its multicurrency pooling structure, which provided the company with a platform conducive to reducing overall credit lines. The company has enhanced yield, lowered costs and created a better relationship with its global treasury cash pool as a result.

What's more, this structure allows P&G to optimise its transaction processing costs throughout its Western European businesses, with local payments made locally, and concentrate excess liquidity. This enables the company to minimise, and potentially eliminate, bank overdrafts and maximise its yield on group cash, which is moved to a global level. P&G has also been able to reduce or eliminate overnight borrowing as operating cash balances are upstreamed and all payment activity is centrally funded through the multicurrency notional pool in London.

This pooling solution enables the company to use cash where it is most needed, irrespective of internal cut-off times between regional operations and group treasury.

Figure 1: Consumer sector: retooling for the future



to drive further working capital efficiencies within supply chains. A one-day improvement in the average consumer sector multinational's working capital releases $22m ($200m+ for larger multinationals).

Consumer companies continue to reduce cash conversion cycles via payables- or receivables-led initiatives and financing structures that deliver liquidity where it's needed and improve balance sheets.

MERGERS AND ACQUISITIONS Many consumer companies are right-sizing product portfolios, targeting core competencies, disposing of peripheral assets, and making strategic acquisitions that strengthen go-to-market value propositions. There's a focus on capturing growth opportunities in EM and high growth categories such as health and well-being through acquisition and joint venture, partly due to local restrictions on foreign ownership (43% of cross-border deals for Chinese targets and 52% for Indian targets involved minority stakes).

Whether in acquisition or disposal mode, transactions need smooth execution. Often the financial settlement of the acquisition or disposal is left to the last minute, from finding a paying, tender or exchange agent to co-ordinating shareholder communication and so on. The acquisition complete, much effort is applied to integration to extract economies. Here transaction banking partners are instrumental, whether in restructuring accounts and group funding mechanisms or revamping operational processes and systems integration.

SUPPLY CHAIN VOLATILITY Volatile commodity prices, combined with instability in supply, have hit consumer sector supply chains, triggering concerns over security of supply and counterparty strength. Many companies have sought solutions to mitigate these risks and inject liquidity into the supply chain.

We have worked with many consumer sector clients on LC issuances and confirmations – for example, to substitute supplier counterparty risk with that of the bank – and have also launched a Direct Presentation capability to help clients upload trade documents online, accelerate discounted funds flow and reduce days sales outstanding (DSO).

We have also structured supply chain and distributor finance programmes to drive working capital and margin improvements and inject liquidity into the supply chain, ensuring a more stable supply of production inputs and distribution networks to boost sales.

MARKET DIFFERENTIATION In a competitive environment with improved perceptions of private label alternatives, consumer companies must differentiate. Some are harnessing social media to build a community and affinity around their brands while others are making forays into direct online sales.

For certain consumer sub-sectors, we have witnessed sales incentivisation and consumer reward schemes to build top-line sales and customer loyalty. Our Citi Prepaid Visa card has helped here, reducing the cost of reward fulfilment and providing a significantly more impactful reward mechanism: linking reward and company through a branded card and redirecting spend back to the company through up- and cross-selling.

SUPPLY CHAIN RECALIBRATION Most consumer companies' supply chains have evolved over time, driven by an impetus to reduce material input costs with less regard to associated risks (counterparty, sovereign, currency) and lead times so as to fulfil orders quickly and manage inventories but resulting in unwieldy supply chains. Given the volatility in commodity prices, FX, increasing regulatory oversight of carbon emissions, and an increasingly fragmented and complex customer base, supply chains are likely to go through a process of recalibration to counter these risks and shift the focus from just-in-time to just-in-case.

As these physical chains are attuned to new market dynamics, it is important to ensure the financial supply chain is adjusted to drive stability and working capital efficiency.

FINAL THOUGHTS While challenges remain, there are opportunities for consumer companies in the form of increasing demand and the composition of that demand transitioning to premium brands as household income levels continue to rise, particularly in EMs. Companies that recognise these opportunities and retool to overcome challenges position themselves for sustained growth.

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