BRW - Know which way business is heading

Cereal success

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Carolyn Creswell, the woman behind the hugely successful Carman's range of muesli cereal and muesli bars, laughs that even admirers often think of her business as an "overnight success".

She guesses that it may be because of her age – she's 38 but the charismatic entrepreneur could easily pass for someone much younger. However, Creswell is no ingénue.

"There's not much I don't know about muesli," says the founder and chief executive of Carman's Fine Foods. "I've been a specialist in this field a long time and I've seen all the trends and brands come and go."

Many of her peers in the troubled food manufacturing industry – which the Australian Food and Grocery Council says is "at a crossroads" – will be watching her success with interest. At a time when the dominance of Coles and Woolworths supermarkets and the rise of private-label brands on their shelves is causing her peers much angst, Creswell is the face of successful food manufacturing.

The "overnight success" was an 18-year-old first-year university arts student working part-time in a tiny Melbourne muesli-making business when the owners decided to sell up. Creswell and a workmate, Manya van Aken, bought the business in 1992 for $2000 and renamed it Carman's – an amalgam of their first names. Creswell bought out van Aken in 1994 and has developed Carman's into one of Australia's best-loved brands.

Last year it had revenue of $50 million and it exports to 32 countries but she employs just 20 people at her Cheltenham head office and warehouse in Melbourne's south-east.

She is a foodmaker who chooses to leave the making to somebody else, indirectly employing 110 people through six contract manufacturers to produce her 15 product lines.

"For the first few years I made the product myself but I wasn't interested in managing a production line of workers," she says. "Manufacturing is not what I'm good at but there are contract manufacturers who couldn't imagine doing anything else. I respect their skills. Good manufacturers are worth their weight in gold."

All products and packaging are designed in house and Carman's specifies the ingredients and suppliers, monitors the quality of the ingredients when they arrive and ticks off on production processes.

"We drive them [the contract manufacturers] pretty crazy," she says.

That's because she knows that the quality of her products is her biggest marketing advantage. "If we get our product in people's mouths, they like it," Creswell explains.

One of the best ways to get it into their mouths has been on airlines. Her research shows that 7 per cent of Carman's customers buy the products because they've tried it on airlines – both Qantas and Virgin provide Carman's products as on-board snacks.

But her biggest sales come from supermarkets – Coles and Woolworths account for 75 per cent of sales. Coles gave Creswell her break in 1997, when 20 stores agreed to carry her muesli bars. The success of that relationship means she's not one to criticise the supermarkets.

"There is so much supermarket bashing in Australia," she says. "There are always some people who want to bag their industry. I'm a huge backer of supermarkets."

However, other food manufacturers are not as complimentary about the supermarket scene. The acting chief executive of the Australian Food and Grocery Council, Geoffrey Annison, says food manufacturers are under many of the same pressures as other industries – rising input costs, the high dollar and concern about the carbon tax. But unique to the food manufacturing industry is the impact of supermarket discounting and the growing market share of private labels.

A report by the council, *2020: Industry at a Crossroads,* calls for a federal government policy blueprint including tax incentives for investment and a cap on the market dominance of the big-two supermarkets. Without such policy action, the report estimates that the number of people employed by the industry will shrink from the current 312,000 to 180,000 by 2020.

"The food industry hasn't got its hand out for big handouts, unlike other manufacturing sectors but we're scratching our heads: how is it that car manufacturing is considered a strategic industry [by the government] but food manufacturing isn't?" Annison says.

“We want a deliberate policy focus, we’re not after handouts. We’re calling on the government to provide us with the policy settings that will assist us to compete in global markets.”

Many food manufacturers are surprised by how quickly private label products have come to dominate the grocery market. Analyst Nielsen, in a report produced in November last year, found that shoppers were spending 73 per cent more on private label goods than they were five years earlier.

Supermarket private label goods have grown in value almost three times faster than branded products during the past five years, Nielsen reports, gaining a market share of 25 per cent. It predicts private label goods will exceed 40 per cent of grocery spending in Australia by 2015.

Existing food manufacturers aren’t happy that their traditional space on supermarket shelves is being crowded out by the supermarkets’ own brands.

In January, United States-based food manufacturing giant HJ Heinz closed its tomato sauce manufacturing plant in Girgarre, northern Victoria, with a loss of 146 jobs. The plant has been relocated to New Zealand. The decision was announced in 2011 as part of a global review of Heinz’s manufacturing operations but in an extraordinary outburst, Heinz chief executive William Johnson placed the blame at the feet of the supermarkets.

“In Australia, we are confronting a combination of weak categories, relentless promotional pressure and [the supermarkets’] growing private label [business],” Johnson told US analysts.

But Creswell argues that manufacturers should have been more awake to the potential of private labels: in Britain, private label products have a 42 per cent share of the grocery market.

“Some businesses aren’t being realistic about the current situation. Everyone knew the push of private labels was coming but a lot of manufacturers did nothing about it – they presumed private labels were not going to do well,” she says.

Like it or not, for the $108 billion food and grocery manufacturing sector, the stark reality is that Coles and Woolworths are the principal conduit to customers. Business being business, many branded manufacturers are adjusting their models to comply with that reality – even if it means contract manufacturing private label brands that will compete with their own.

Listed NSW cheesemaker Bega Cheese, for example, has struck an agreement with Coles to manufacture and package the entire range of Coles-branded cheese products. The five-year contract will add 19,000 tonnes of cheese production to the company’s annual output.

Fruit and vegetable processor SPC Ardmona has signalled its intention to go down the same path. The company has felt the pressure of the strong Australian dollar, cheap imported packaged fruit and vegetable products and private label competition. The high dollar has been particularly devastating, resulting in exports falling from 30 per cent to 5 per cent of its output since 2005.

Last year, SPC Ardmona, which is owned by listed food and beverage giant Coca-Cola Amatil, closed one of its three manufacturing plants in Victoria's fruit-growing hub in the Goulburn Valley. Managing director Vince Pinneri says the key to "turning our business around" is innovation, including the development of new ranges of its branded fruit and vegetable snacks. However, Pinneri recognises that "house brands are a growing reality of food retailing".

As part of the restructure of SPC Ardmona, the company plans to complement its portfolio of premium brands with private-label manufacturing.

"We currently do manufacture some retailer brands and it is our intent to work collaboratively with all retailers across multiple categories which will ensure we leverage our current manufacturing capacities and capabilities more effectively," Pinneri says.

Warrnambool Cheese & Butter, like Bega, has also signed a five-year manufacturing deal with Coles but unlike Bega's private label contract, this agreement is for the development of a new brand of cheese and milk products that will be sold exclusively in Coles supermarkets.

A listed dairy company based in Victoria's south-west, Warrnambool Cheese & Butter will manufacture the Great Ocean Road range of products for Coles starting in May. But in a special twist, at the end of the five years, the company will retain ownership of the brand.

Warrnambool chief executive David Lord says developing a new consumer brand with guaranteed distribution through Coles' 742 supermarkets is critical to creating what will become Warrnambool's premier brand. (The company now has branded cheese, butter and milk products, which it sells through independent supermarkets and small retailers.)

"There are many examples in the fast-moving consumer goods [FMCG] market where good products and good brands fail because they can't achieve the right level of distribution," Lord says. "This agreement guarantees us the sort of distribution that's required to make the brand successful. It also gives us the certainty to invest in greater manufacturing capability."

Warrnambool Cheese & Butter, which had revenue of $504 million in 2011, exports half of its output, including milk powders and whey protein concentrate, to wholesalers and food manufacturers. It also supplies local wholesale customers and does some contract manufacturing. The Coles agreement will boost production volumes 10-15 per cent a year.

“We recognise that private labels are a reality of today’s marketplace,” Lord says. “If we are to grow our FMCG presence over time, there’s no doubt that we have to enter into these relationships with retailers.”

The AFGC’s Annison says the food manufacturing industry is in for a period of consolidation, with local manufacturers having the most to lose from the growing dominance of the supermarkets and their private label brands.

“For the [foreign] multinationals there will be some head scratching about the benefit of maintaining a manufacturing base in Australia,” he says. “The bigger companies, the multinationals with stronger brands, have the flexibility to ask, ‘Do we reinvest in new plant in Australia or can we make these products in our Thailand factory or New Zealand factory?’

“As the market gets tighter, it’s the weakest who will feel the pressure, companies that are less innovative and have weaker brands. The companies that remain fleet of foot, that are truly innovative and who back their own brands are likely to be the most successful.”

And that is someone like Carolyn Creswell. She expects to double turnover in the next three years and Coles and Woolworths will be critical to achieving that target.

For her, “private label is one of the best things that’s ever happened to our business”. Her positioning of Carman’s at the premium end of the market has assured her top-shelf space as the supermarkets reduce the variety of products to make way for their own private labels.

But she also understands all too well that relying on two cornerstone clients is not without risk. “There are two people who can send my business under tomorrow: my Coles buyer and my Woolworths buyer,” she acknowledges.

Creswell says she’s an optimist but she’s also a risk manager. “We spend a lot of time talking about risk and strategy and reviewing where the business is,” she says. “We’ve asked ourselves, what happens if we get delisted by the supermarket chains? What’s our strategy?”

But that’s not going to happen, she insists: “We trust each other. I always make sure that I deliver on my promises and so do they.”

Online market

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Adelaide food distributor Robert Falzon believes it has become too hard for independent food suppliers and retailers to compete with Coles and Woolworths and “their incredible duopoly”. He believes small players are overshadowed by the dominance of the big supermarkets, so he wants to bring these businesses together as an online wholesale and retail market.

Falzon intends to do this with his new internet venture, Food Traders, to be launched in July. The site will enable food industry participants to share information as well as allow consumers to buy directly from suppliers and retailers.

“As a distributor for 12 years, I was finding it very hard to source the products I needed – it was almost impossible to locate specialty manufacturers around the country,” he says.

The venture has attracted investors from the food industry, including mushroom grower Adelaide Mushrooms and Sydney smallgoods manufacturer Pendle Ham and Bacon. The investors, including the Falzon family which will own 60 per cent of Food Traders, have tipped $250,000 into to the business.

“I would like to see existing manufacturers come on to the site to provide information about their products but I hope that new businesses will also use the site to create and build their own brands,” Falzon says. Site listings will cost $10 week and 2 per cent of online sales.

Falzon unashamedly wants his business at the very least to be an irritant to Coles and Woolworths.

“The more we push small manufacturers’ own brands, perhaps Coles and Woolworths will start changing their minds about what they’re doing [with private label products],” he says.

Private label Australia

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- Shoppers are spending 73 per cent more on private label products – brands owned by retailers – than they were five years ago, which is $1 of every $4 spent on packaged grocery products.

- Private label goods have a 25 per cent share of the grocery market.

- Researcher Nielsen expects private label products will grow to 40 per cent of grocery spending by 2015. IBISWorld has more modest expectations: it forecasts a 30 per cent share by 2016.

- As a proportion of sales, Coles sold more private label products than Woolworths in 2011: 23 per cent and 18 per cent respectively.

- German-based budget supermarket chain Aldi has just 5 per cent of the grocery market but it can teach Coles and Woolworths a thing or two about private label products: 95 per cent of products stocked on Aldi shelves are private label, often specially contracted "pseudo brands" that consumers tend to mistake for European brands.

- The Australian Food and Grocery Council wants legislation to limit private label goods to 30 per cent of space on supermarket shelves.

Contract manufacturer

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Contract food manufacturer Chris Diver is happy to leave brands to his customers. As owner and managing director of Melbourne-based Joy Foods, Diver employs 100 people and has $30 million in annual revenue, all from manufacturing the products of others, including Carman's muesli bars.

Diver comes from a food manufacturing background and started the business eight years ago when he took a calculated punt that contract manufacturing would play a more prominent role in the food and grocery market.

"We saw that some of the branded manufacturers out there, even the major groups, were going to an outsourced model and investing more on the sales and marketing of their brands rather than manufacturing," he says. "We also could see that the market was going private label."

Initially, Joy's business was to manufacture branded muesli and snack bars for some "reasonably well-known names" in addition to Carman's, "but I'm not going to tell you who they are". In the past four years, however, manufacturing private label products for supermarkets has grown from 0 to 40 per cent of sales.

Diver expects private-label manufacturing to keep growing and is moving to a larger factory. He plans to spend as much as $7 million on new plant equipment and technology in the next two years.

"I feel sorry for those businesses whose brands have been hit because they've spent time and money building those brands but the marketplace is changing," Diver says.

“When you get change of this magnitude, you have a choice: you can either embrace it or resist it. Private label is here to stay. That’s the way the world is going and you just have to adapt.”

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