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SPECIAL EDITION: DEALING WITH HIGHER COMMODITY COSTS

Weathering the commodity price storm: Winners and losers

By Elaine Watson, 22-Nov-2011

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***"I'm not sure I can give you a prediction on 2012 that will really mean anything"*, responded Coca-Cola's chief financial officer Gary Fayard when asked by an analyst for some 'color' on the 2012 outlook for commodity prices last month.**

Indeed, the only certainty facing the beleaguered buying departments at the nation's leading food and beverage manufacturers is continued uncertainty when it comes to the prices of raw materials and other input costs.

Winners and losers

But some have certainly proved more successful than others at weathering the storm, according to analysts contacted by FoodNavigator-USA for the second part of our series on handling higher commodity costs.

As a rule of thumb, says Morningstar analyst Erin Lash*, "Firms that operate with a portfolio of strong brands have been more successful* [both at passing on higher costs – and not taking a massive volume hit] *than those that possess a lackluster brand portfolio.*

"Firms that operate in categories where consumers tend to consider price rather than brands when making purchase decisions have been disproportionately impacted relative to firms that compete in categories where brands matter."

But either way, *"The combination of elevated commodity costs in a soft consumer spending environment has been a challenge."*

Private label manufacturers meanwhile, have benefited as shoppers have traded down to save cash, but are in turn disproportionately affected whenever commodity costs rise as raw materials account for a greater proportion of their overall budget compared with big brands, who spend far more on marketing, points out Edward Jones analyst Jack Russo.

Price goes up by x, volume goes down by y... or does it?

As to whether there is a clear correlation between an x% rise in price on the shelf and a y% drop in volume, it all depends on the category, says Lash.

"Price/volume elasticity varies based on product type and the level of competitive pressure and ultimately the degree of private label penetration in respective categories."

In some categories, people will simply consume less if the price goes up, in others they will continue to buy the same amount, but switch brands or switch to private label. But there is no hard and fast rule, says Sanford Bernstein analyst Alexia Howard: "*It's been all over the place, segment by segment*."

She adds: *"In a sector such as coffee where people can be quite particular about brands, things have held up pretty well, but in a category such as cheese, we've seen more trading down to cheaper brands or private label."*

The art of buying

When commodity prices first started to go through the roof in 2007/8, some firms did not have sufficient flexibility built in their pricing arrangements with retailers to move quickly enough, and took a big margin hit, she says.

This time around, however, they have managed to get price rises through more quickly, although there was still a time lag at the beginning of the year that dented margins for many companies, she notes. *"They have definitely been on a learning curve."*

One thing is for certain, notes Edward Jones' Jack Russo: "*Being a buyer has become a lot more difficult in recent years. Hedging is all very well but I'm not sure anyone wants to lock in the price of anything for too long in the current climate as it's so hard to predict where prices are going.*

"I think things will calm down as we go into 2012 but I don't think anyone is predicting a reversal."

So what does 2012 look like?

The Food and Agriculture Organization's (FAO's) food price index has been dropping in recent weeks. However prices are still 5% higher than they were this time last year and remain very volatile.

"As manufacturers do not want to stand up and tell their customers that everything is getting easier, they are still saying that things will be up in 2012," notes Howard.

"But the point is, it is going to get easier. Input cost inflation is getting back to the low single digits and so in the first half of the year you're going to see a bit of carry over and margin expansion."

Read FoodNavigator-USA tomorrow to find out how specific manufacturers have dealt with rising commodity costs and what they have factored in for 2012.