

WHITE PAPER

Contract Packaging: Success Built on Partnerships and Know-how

Introduction

Today, contract packaging makes a \$20 billion statement in the marketplace. And it punctuates that statement with a 10 percent growth rate. “The use of contract manufacturing and packaging services is surging, and the brakes will not be applied anytime soon,” declared Jim George, editor in chief of *Contract Packaging* magazine. “Many large and small consumer packaged goods (CPG) companies plan to increase their use of these services.”

Along with retailers, suppliers and consumer packaged goods manufacturers (CPGs), contract packagers traffic in everything from personal hygiene products to popular food items to life-enhancing pharmaceuticals. But the traffic moves efficiently only when it moves together. As the IBM Institute for Business Value has observed, the retailer recognizes that serving increasingly savvy consumers requires thinking and working in concert with CPGs. The CPG seeks the services of contract packagers for obvious reasons: the cost advantages inherent in outsourcing, enhanced speed to market and the multiplier effect gained by relying on specialists to move products to shelves. Co-packers, in turn, look to reliable, innovative suppliers to ensure that the chain keeps consumer goods moving to that demanding market.

Teamwork is indeed paramount. IBM Institute consultant Sean O’Neill said “collaborative planning, forecasting and replenishment [CPFR] was one of the first shared processes in which CPGs and retailers have engaged. While current CPFR initiatives have yet to achieve full integration of CPG and retailer processes, they have yielded some promising results, helping to make the case for even closer collaboration between trading partners across a greater variety of processes in the future.” That collaboration is certain to include contract packagers and their suppliers more and more.

And what in particular do CPGs seek in their co-packers? Here are the criteria most often cited:

- Proven experience in a particular market
- A strong track record in terms of controlling costs
- The size and flexibility to handle projects

- A cost-effective location in relation to the customer
- An unwavering commitment to quality assurance
- A reputation for financial stability
- A commitment to innovation and customer service
- The willingness to partner for extended periods

ACH Food Companies Inc. is a leading manufacturer of edible oils, spices and syrups. It uses a number of co-packers to assist it in meeting supply needs to customers. “We will seek a co-packer that has the internal manufacturing capacity and capital equipment capable of handling a particular product, explained John Hougendobler, the company’s director of corporate purchasing. For example, we may identify a market segment that offers potential for growth. We, however, may not have the current capabilities of manufacturing this product internally. We will select a co-packing partner from a pool of 2 or 3 qualified manufacturers. In many cases we will use a co-packer for product start-ups until we are certain that the product will be successful and then bring production internally if the anticipated volumes warrant the capital investment.”

As the Contract Packaging Association advises CPGs, “a...packager must be able to complete the project at a competitive cost aligned with your time schedule with quality assurance. [It] may also solve common problems in start-up businesses, limited production facilities, concerns about equipment investments, physical facilities, personnel training and more.” The demands can be great, but the opportunities for the co-packer are well worth the effort.

What about the co-packer?

Naturally, to ensure that opportunities translate into genuinely profitable partnerships, the contract packager needs to place the highest value on communications. Expectations, processes, decision making and consequences must be understood by the parties from the start.

Typically, it’s the co-packer’s responsibility to fashion the specific agreement for a job, starting with a clear understanding of which party — the retailer, the co-packer or the CPG — is responsible for each particular step in the packaging process.

While some co-packers focus on a narrow skill set — notably the providing of manual labor for packing products — others may offer a range of services that include, but aren’t limited to, such services as capping, assembly, boxing, auto bagging, drop-sealing and sealing RFID chips into clamshell packages. Still others further broaden their value to customers by broadening their services with everything from bar coding to fulfillment to warehousing. Depending on the particular need, some customers may seek out contract packagers with refined skills such as FDA regulation knowledge or advanced logistical expertise.

“There are several key factors,” says ACH’s Hougendobler. “First is price. Everybody must have an understanding of what the market will bear from an introductory cost standpoint. We have to blend the co-packers toll charges with our internal costs to define a cost of goods and ultimately a price point with which we can go to market.”

“Number two,” he continues, “is that they have to meet stringent quality requirements that our quality assurance group and our R&D group set forth. We have a very rigorous process of vetting which includes reviewing their internal capabilities. Have they been inspected by organizations such as AIB (American Institute of Baking)? What kind of recall and traceability process do they have in place? Do they record lot numbers of ingredients and packaging so they may be tracked back to finished products? What type of microbiological testing is done? What types of clean-ups are done (CIP, Allegen)? We have a very comprehensive process in place to insure our co-packer’s processes meet the standards we set for our own internally manufactured products”

Once expectations and duties are clearly established, market experts say, defining a reliable and robust two-way communications process is important so that problems are identified early and resolved quickly.

At the operational level, co-packers use the contract to identify the contact who clarifies specifications. Moreover, that person acts as the referee for problem solving. Such contracts may also identify in writing how serious problems are resolved.

A trend now seen among CPGs is the addition of agreements to utilize the skills of third-party experts who leverage not only industry knowledge and managerial expertise but also an unbiased view in terms of making the co-packing agreement work efficiently. “With CPG companies focused on internal operations and contract packagers tasked with ever-growing responsibilities,” says *Contract Packaging*’s Jim George, “a third-party perspective provides external insight into alternative methods to augment existing processes and help uncover new ways to increase efficiencies.”

Without question, the co-packer’s responsibilities continue to increase because of market trends. Consider, for instance, the impact of private-label brands. *Contract Packaging* magazine noted that “data show that private label is growing not only in dollar volume but also in product value. Retailer brands are competing with national equivalents and, increasingly, in the perception of being upscale. How? By improving their packaging both graphically and structurally and shifting to formats like stand-up pouches and incorporating convenient closures, slider zippers and other ‘add-ons’ available through contract packagers.”

A 2007 report from the business consultancy McKinsey & Co. said the private-label strategies of high-performance retailers could move annual sales from national brands to private labels by as much as \$55 billion. For contract packagers, that’s a distinct market advantage, given the fact that they can offer national brand equivalents in smaller quantities than other manufacturers. At the same time, though, retailers’ expectations are high: they expect contract packagers to go beyond providing the breakfast supplement or the beauty product and add value to the process with product forecasting and inventory control.

Further, the co-packer, the retailer and the CPG must address any additional expectations attached to the project. For example, how will sustainability be addressed in the particular job? Large companies such as Wal-Mart have taken the initiative to ensure that sustainable packaging is part of its corporate stewardship and have demanded as much from their suppliers in eliminating toxic constituents, using less material and making packaging more reusable. Other companies, including Weatherchem, are making the same commitment by including sustainability into their corporate charters.

Sustainability is part of being at the forefront of technology, ACH's Hougendobler insisted. "That's where the customer wants us to be," he says, "and that's where the consumer wants us to be."

The suppliers' role

With expectations so high, contract packagers have no choice but to look to suppliers as key allies in bringing new and innovative ideas into the process. It's no surprise that successful leaders in the market seek suppliers with outstanding credentials for innovation or with track records regarding success in joint product development.

As a company that designs, develops and delivers innovative dispensing closures, Weatherchem has a well-tested appreciation for being able to leverage its research, design capabilities and market know-how on behalf of the overall success it shares with the contract packager. Whether its applying the functionality of its senior-friendly Nutra closures or applying its extensive research to a specific market challenge, Weatherchem looks at the co-packer-supplier relationship as the whole not only being greater than the sum of the parts, but also being the surest way to product acceptance and success in the marketplace.

That sentiment is also shared in the packaging market. At a 2007 roundtable sponsored by *PL Buyer*, Mike DeCory, brand manager of Wegmans Food Markets, pointed out that the most important trait in the manufacturer-supplier relationship is trust. "You need to trust the folks that you work with — trust that they will work in the best interest of you and your customers," he said. "Also, the willingness to try new things around innovation is important...and not necessarily product-based innovation, but also in the business process. There has to be trust and they have to be willing to try new things."

A roundtable colleague, James D. White, echoed DeCory's thoughts. Speaking from the perspective of being senior vice president of consumer brands for Safeway Inc., White observed: "Our key partners and co-packers provide category expertise, consumer insights, and market and product-development know-how."



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