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How Food And Beverage Companies Can Deal With Inflation’s Impact On Margins

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Every company wants it. Every CEO works for it. Every shareholder looks for it. Growth is the goal, but there’s a shift in focus in the “growth is good” equation. Carrefour, for instance, in 2022 reported sales rose 8.5 percent, with a little help from inflation, expansion and a favorable impact on currency. Top lines often are rising, but there’s a second side to this story. Carrefour’s margins slipped slightly to 20.0 percent of net sales and operating margins narrowed from 3.1 percent in 2021 to 2.9 percent in 2022.

While inflation is often helping nudge revenues upward, managing margins may be the biggest challenge and the biggest story for many F&B companies today. The top line may be growing, but what about margins? Amid inflation, rising interest rates and growing labor costs, maintaining margins can be challenging. Carrefour, for instance, has identified growing margins as a priority. In the battle to restore and grow margins, businesses are reducing waste, increasing private label, shifting sourcing and, of course, raising prices so that margins stay healthy – or get bigger.

The proof, as the saying goes, is in the pudding, but when it comes to profits, it may be in the margins. Nestlé CEO Mark Schneider at the end of 2022 said, “margins continued to be resilient,” but added that 2023 would bring “a focus on restoring our gross

margin." Growing margins isn't magic, but there are strategies and steps you can take to boost margins and grow profits, even if that doesn't always mean growing sales.

The big picture

First, let's look at margins for the F & B industry. The industry often has tight margins, although beverages often have better margins than other F&B sectors. Alcoholic beverages have a 44 percent gross margin, while soft drinks have a 53 percent gross margin, according to research done at NYU's Stern School of Business. Food processors' gross margin is typically 25 percent, while farming and agriculture has a 13 percent gross margin.

When you get to food retail and wholesale, margins often start to narrow, making any loss a potentially big issue. Food wholesalers' gross margin is 14 percent, while retail grocery and food is at a 25 percent gross margin, according to the study. If margins are tight to begin with, there just isn't much space to shrink.

Raising prices

One way to maintain margins, of course, is to increase prices to keep up or outpace cost inflation. The F&B industry often has been doing that very nicely. Many F&B companies hiked prices 15 percent as costs rose about that much, according to the Food Institute. Despite higher prices, F&B companies were still able to "maintain relatively stable volumes and even improve their gross profit margins," according to the Institute. Nestlé, in 2022 hiked prices 8.2 percent, "reflecting significant cost inflation." That didn't seem to hurt overall revenue, which rose 8.4 percent. Pumping up prices, to pass on growing costs, can preserve margins. But at some point, companies can feel the squeeze of the customer demand curve.

Private label

Growing private label is another way that many companies are maintaining or growing margins. Companies can buy the same private label product at a cheaper price than branded products and get almost the same margin. While customers often like good deals with private labels, so do companies. Carrefour at the end of 2022 reported private

labels accounted for 33 percent of food sales but is aiming for 40 percent by 2026. Growing the portion of private label in your mix of sales can boost margins.

Sales dilutions and not so many happy returns

Discounting can grow sales, but it can also eat away at margins.

One way to reduce costs is to better manage promotions, discounts, and rebates. The retailer is looking for some type of rebate and the customer wants a deal. Sometimes reductions from gross to net sales can amount to 20 to 30 percent. Depending on who you are, a distributor or manufacturer, you can experience significant reductions from your selling price due to promotions, discounts, and rebates. Making sure your products are good through top-notch quality control reduces returns and handling returns efficiently can also help boost margins.

Supplier struggles

Suppliers also often have been hiking prices, boosting their earnings while prompting manufacturers to raise prices, but there are signs that some are feeling the impact and pinch of inflation. Ingredion'sINGR 0.0% margins initially lagged compared to the prior year as of 2022, but soon rose as the company hiked prices. Suppliers' margins aren't always recovering, however. International Flavors and Fragrances' Nourish segment felt margin pressure in the second half of 2022, according to the Food institute. Management attributed possible 2023 weakness to inventory "destocking" which could lead to lower sales and make it harder to raise prices and achieve robust margins.

Material and input costs

Although inflation is hitting nearly everything, F&B companies are seeing inflation's impact due to the cost of materials. Carrefour said margins were impacted by increases in costs for services, energy, and materials such as paper. "Pricing, growth leverage and efficiencies "helped to partly offset the impact of cost inflation, according to Nestlé, which added that administrative expenses as a percentage of sales benefited from "disciplined cost control." Reducing waste and tightening costs can boost margins.

Input inflation

In looking at input costs, companies can find opportunities to save. Higher interest rates, supply chain disruptions and tariff problems are taking their toll on input costs and how a company manages those costs is important.
Hedging, which can be tricky, can help manage input costs by setting a contract up a year in advance and fixing the price of a certain quantity of goods. If the price drops, however, you’re committed to a higher price. With supply disruptions, having a good alternative supply relationships also helps.

Labor pains

Labor is very difficult to get these days and very costly. Minimum wage is going up around the country. Benefits often are higher. Remote work is affecting companies. There may be high turnover as workers look for more money and better jobs. That’s the real challenge. The better companies know how to manage their labor, retain employees, and reduce turnover.

The delivery dilemma

Delivering product is making it tougher to deliver strong margins. Restaurants pay outrageous fees to delivery companies. And companies are being affected by the trucking situation and driver shortages. Offering free delivery, however, means companies either raise prices or take a margin hit. Major players are eliminating that perk after seeing delivery take its toll. Even AmazonAMZN -2.1% Fresh as of February 28 ended free grocery delivery for Prime members on orders under $150. Amazon had offered free delivery on orders above $35, and $50, in New York. "We're introducing a service fee on some Amazon Fresh delivery orders to help keep prices low in our online and physical grocery stores," Amazon spokesperson Lara Hendrickson said in a prepared statement.

When more is less

While growth is good, smart companies are focusing more on growing profits than the top line. I recently spoke to a hospitality company that, because of labor shortages and inflation, shifted from seeking to sell 100 percent of their rooms to 75 percent. They could staff and price that better, so they increased prices and offered more amenities.

They're making more money. It's psychological. You may be able to do, and make, more with less. Nestlé found that with higher prices it could boost total revenue, even without having to grow the number of units sold. It is possible to do more, and make more, with the same or less.

Technology time

Technology, such as having a good system to monitor sales, labor, and costs, and a good accounting and inventory management and warehousing system all can help. Companies that don't employ good technology get hurt. And artificial intelligence can reduce costs, by better aligning inventory with demand. Companies with good tech can do a much better job of monitoring and managing margins. It's not about top line or bottom line; it's about what's in between. There's a lot of meat in between those numbers. And technology helps you better manage margins and react. Smart companies are looking at margins daily. If you have proper technology, you should know your margin on every sale, every day.

Maintaining and growing margins remains the most important focus for F&B companies, past, present, and future. And growing interest rates and inflation only make margins, even if they're tougher to maintain, that much more important.