

An Insider's Guide to Co-manufacturing

Co-manufacturing, or the use of a third party to manufacture or package a product, is an increasingly common strategy for food companies



For a co-manufacturing arrangement to be truly successful, it must be beneficial both to the contracting client company and the company that is doing the manufacturing.
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to reduce assets, speed time to market, and, often, reduce costs.

Some large food companies, such as Sara Lee, Downers Grove,

Ill., have an avowed policy of shedding assets and relying on third parties for much of their manufacturing. Others use the approach more selectively, typically either for new products or well-established ones that do not require unique facilities.

There are firms, such as Power Packaging, St. Charles, Ill., that exist exclusively to perform co-manufacturing for other companies. The assumption at Power Packaging is that the company can design, build, and operate food plants more quickly and at lower costs than large, public companies can. The reasons are that Power Packaging, and other firms like them, do not feel bound by corporate engineering standards that have a tendency, over time, to become unwieldy. (Having helped design facilities for Power Packaging and large food corporations, I can affirm this observation.)

Co-manufacturers often are smaller, privately held companies and so may accept lower profit margins than publically held corporations feel obliged to achieve. In reality, co-manufacturing can be quite satisfactorily profitable because costs, such as labor and marketing, are often less than those for client firms.

How to Find a Co-manufacturer

In general, a desirable co-manufacturer for a specific product or family of products has in place appropriate and available assets for most, if not all, of the required process. Frequently, some investment is

needed, especially for new products, and who bears that cost, and how it is recovered, must be negotiated.

Often, there are options for processing a new product. For example, a beverage might be cold-filled, hot-filled, aseptically processed, or post-filling pasteurized. Usually, packaging is intrinsic to a new product, but not always. If packaging is novel, new equipment might be required, which involves some lead time. Packaging material also has a lead time, especially if the form is unique. Savvy partners might suggest use of an off-the-shelf bottle, for instance, that is easily available and known to run well on existing equipment.

Companies that primarily manufacture private label products often are candidates for co-manufacturing similar products. Private label typically refers to products carrying a store brand rather than a major consumer product company brand. Some store brands are made by major firms, but most are made by smaller companies that can offer economies because they do not spend much money on research and marketing. The customers of private label manufacturers typically bring a formula or prototype to be duplicated and bear most of the marketing cost themselves. Many private label manufacturers belong to the Private Label Manufacturers Association (PLMA), New York, N.Y. (www.plma.com), and exhibit at PLMA's annual trade show in Chicago.

Extension professors of food science at land-grant universities with a food science department are usually well-acquainted with the

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local food industry and often will know of firms that are capable and interested in co-manufacturing.

Getting a lead to a firm that is known to make products similar to a candidate for co-manufacturing is only part of the challenge, of course. One must evaluate the candidates and then negotiate an arrangement that is advantageous to both parties.

Evaluating a Co-manufacturer

Here is a partial list of questions to consider, recognizing that every case is unique and that any given firm may have its own criteria.

- What assets are available?
- What assets are missing?
- What alternative processing or packaging might work?
- Is space available for additions?

For storage?

- How is confidentiality assured?
- What technical resources are available? What kind of product/formula/packaging development is offered? What about quality assurance?

- What is the firm's reputation?

Are references to customers available?

- Is the company financially stable?
- What about information technology? Is it compatible with the customer's systems?
- Is the culture compatible?
- What are the labor relations considerations?
- Is the firm environmentally sound, sustainable, and energy efficient?
- What are the cost elements?
- How are standards developed?

Where are the risks of waste and defects?

Obviously, there can be many more details that need discussion.

Experienced customers often have a network of co-manufacturers with whom they do repeat and continuing business, while others may be just starting to use the strategy or embarking on a new path.

Keep in mind that a candidate firm may be considering performing co-manufacturing for the first time. For example, many restaurant chains have captive commissaries that may want to utilize spare assets or capabilities. In such cases, both sides need to anticipate as many issues as possible, but realize that new ones can appear. The key approach is to establish a relationship that is a mutually beneficial partnership in which challenges are resolved with integrity.

Being a Good Co-manufacturer

The key to being a successful co-manufacturer is to remember why the customer came to you in the first place. Most likely, the critical reasons were cost, speed, and quality.

The element of cost that often gnaws at the customer is the tolling charge or co-manufacturer's markup for overhead and profit. Most other costs are easy to understand and evaluate. For example, raw materials are dictated by the formula, and then are affected pretty much by the same factors the customer experiences— volume, seasonality, type of delivery, and yield. Energy costs are usually small and only affected by location and efficiency. Labor costs in most food manufacturing are usually relatively small and are affected by location, degree of automation, and local rates. Co-manufacturers' facilities may be less automated than some larger, specialized plants because they typically value flexibility. On the other hand, many



Co-manufacturing, which is the use of a third party to provide a company with manufacturing or packaging services, can allow the company to reduce assets, increase speed to market, and lower costs.

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Sourcing a Co-manufacturer

There are websites that list candidate co-manufacturers or co-packers (the terms are synonymous, mostly). Some examples include the following:

- <http://www.specialtyfoodresource.com/page/page/4205553.htm>,
- <http://www.findacopacker.com/>, and
- <http://www.contractpackaging.org/custom/directory/membership.cfm>.

co-manufacturers achieve lower hourly rates by remaining non-unionized and locating in areas where the wage rates are low.

One negotiable element of cost is the allowance for waste and who bears the risk. An incentive for the co-manufacturer is created by setting a reasonable allowance for yield and then having the co-manufacturer bear the risk of exceeding the allowance. *continued on p. 80 »»*

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The tolling charge or markup includes the co-manufacturer's recovery of the cost of his assets, indirect labor costs, and profit. To the degree that assets deployed are already in place, their book value is likely to be less than the cost of equivalent new equipment, which the customer would have had to buy if the company did its own manufacturing. Thus, this element of the charge should represent a savings. Likewise, because co-manufacturers are typically leaner than their customers, their indirect costs are also usually less than the corresponding charges for self-manufacture. Finally, the co-manufacturer tries to earn a return on his assets, just as the customer would want to do. So long as this is "reasonable," there should be no issue. What is reasonable? It certainly is not zero! Customers sometimes forget, conveniently, the costs they are avoiding.

Speed to market is one of co-manufacturing's best advantages and so should be emphasized. This requires a sense of urgency at every level of the organization. Some compromise between running lean and being ultra-responsive must be struck, with favor given to responsiveness. This may mean

extra engineering staff or good relations with an outside firm to expedite procurement and process modifications while keeping an existing operation running smoothly. Trials are usually required to confirm feasibility of any new assignment. These might need to be performed on evenings and weekends. The responsive firm makes those sacrifices. Firms focused on co-manufacturing may maintain open space to facilitate additions of new capabilities and often have a reserve of general purpose equipment, such as tanks and pumps, that can be deployed quickly.

Finally, quality and food safety must dominate operations. This means maintaining a well-trained quality function, keeping a well-designed facility clean and safe, and having a well-equipped laboratory. Beyond the important goal of keeping food within specifications and safe, a good co-manufacturer can often add value by assisting in product development. He or she might suggest alternative ingredients, raw materials, processes, and packaging. These might be products with which the co-manufacturer has experience or to which they have access at a good price. The same might apply to processes and

packaging. The risk is the Cinderella effect—trying to force a product into a process that does not apply just because it is there.

A good co-manufacturer offers the assets he or she has, knows the capabilities of the existing equipment, is willing to modify the process or facility as needed, but will not compromise the quality or critical characteristics of the customer's product, declining the assignment if the assets are not appropriate and cannot be adapted.

In summary, co-manufacturing can be a valuable business strategy for both the customer and the co-manufacturer, but it requires considerable skill on both sides to execute successfully. A common progression is to introduce a new product through co-manufacturing, then to bring it in house if it is successful. There have been long-running arrangements, but more typically, co-manufacturing of any one product is shorter term. **FT**



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