BI INTERNATIONAL CASE COMPETITION

CASE – ORKLA

BI NORWEGIAN BUSINESS SCHOOL

Orkla

Improving operational efficiency across the supply chain

This case was written for the 2018 BIICC

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Valuable inspiration, assistance and material was provided by Mikael Harder, Orkla

Introduction

The head of Supply Chain Strategy & Development, Mikael Harder, has just had a meeting with Orkla's CEO and EVP Operation regarding an emerging trend in the branded consumer goods (BCG) sector and its` potential implication for Orkla.

Activist investors (an individual or group that purchases large numbers of a public company's shares and/or tries to obtain seats on the company's board with the goal of effecting a major change in the company) has throughout 2017 increased their focus towards the BCG sector. Most recent examples are Third Points´ investment in Nestlé (demanding increased EBIT-margin from 15% to 20%, selling off non-core assets and increased balance sheet efficiency), the bid on Danone by KHC, and Nelson Peltz being appointment to the board of P&G after a months-long proxy fight.

Orkla, with an over 80 BNOK market capitalization, despite strong share performance since 2014 and hard work balancing local proximity with increased focus on Supply Chain synergy realization, still has a significant improvement potential to be captured. Looking at the BCG sector, Orkla is lagging behind its´ peers in terms of EBIT margins and balance sheet efficiency. However, so far no activists have approached the company.

During the meeting, it was concluded that supply chain has a crucial role to play securing long-term and sustainable value creation while meeting short-term increased pressure and potential bids from activist investors by:

1) **Improving margins** by reduced COGS
2) **Improve asset efficiency** by complexity reduction throughout supply chain

Mikael agreed to establish a task force to make a plan for changes and improvements for the company's supply chain to meet these challenges. The plan including estimated margin improvements is to be presented for the Board.

Mikael knows Orkla has an untapped potential on many points: Orkla generates an EBIT margin below peers in the BCG sector. Orkla has over 100 factories with 60% of its revenue generated over only four Nordic geographies. Orkla has the lowest revenue and EBIT per factory of all its global competitors.

The supply chain must be made more efficient – and that is your challenge. You are the task force Mikael has set up. He is looking forward to your suggestions; how good can we get?

Orkla – a short history

Orkla is one of Norway's oldest business conglomerates. The company's history dates back over 350 years. Orkla started out in 1654 as a purely mining company, extracting pyrite at Løkken Verk in Sør-Trøndelag County (Orkla).

The company got a major advantage of finding new large ore reserves in 1913. During first world war, Orkla became a major exporter of pyrite and also the world's largest pyrite supplier. From the 1920's, Orkla also focused on metallurgical research and industrial utilisation of ore (Rolf Bryn). In 1929 Orkla became a listed company (Orkla).

During World War II, Orkla made large investments in Norsk Hydro – a large Norwegian aluminium company – which gave a profitable return. This was the start of Orkla becoming a large financial investor in other companies. By the end of 1970's Orkla had invested in the banking, industry and shipping sectors, in companies like Elkem, Storebrand and DnC. They closed down mining plants and turned their focus to profitable hydropower that they got access to and started production of ferrosilicon and silicon carbide (the latter is now Orkla Exolon) (Rolf Bryhn).

During the 1980's under Jens P. Heyerdahl leadership, Orkla continued diversifying their business. The mining and ferrosilicon production were closed down and Orkla expanded into other industries. At the same time, Orkla continued with financial investments as one of its key activities. 1984 Orkla established a real estate company, Orkla Eiendom, and started with financial consulting and wealth management (Orkla Finans) (Rolf Bryhn).

In 1986 Orkla merged with the industrial company Borregaard, and established the company Orkla Borregaard. This was the start of Orkla´s focus on branded consumer goods. Orkla Borregaard became twice as large as the old Orkla, and the fourth largest listed company in Norway (Rolf Bryhn).

Since the late 1990 Orkla has increased its focus on Eastern Europe and the Nordic countries, and made several acquisitions. The company moved into the media sector and established newspaper activities in Poland and Eastern Europe in 1990. However, the investments in the food companies Procordia Food and Abba Seafood owned by Volvo in 1995 were the main reason for Orkla's success outside Norway (Rolf Bryhn). During the 2000's Orkla acquired several companies like Ringnes, Carlsberg, Sapa and Rieber&Søn (Orkla).

When the Norwegian investor Stein Erik Hagen became head of the board in 2004, he started the process of cultivating Orkla as a brand company, mainly within the food industry (Rolf Bryhn). New acquisitions were made and today the company is a leading supplier, with a diversified product portfolio of branded consumer goods in the grocery, out-of home, specialised retail, pharmacy and bakery sectors. The Nordic and Baltic regions and selected countries in Central Europe are Orkla's main markets. The Orkla Group also holds strong positions in selected product categories in India (Orkla Annual Report).

Orkla (http://www.orkla.com/About-Orkla/History/History-in-brief)

Orkla Annual Report 2016
http://annualreport2016.orkla.com/assets/orkla/pdfs/en/Orkla%20Annual%20Report%202016.pdf

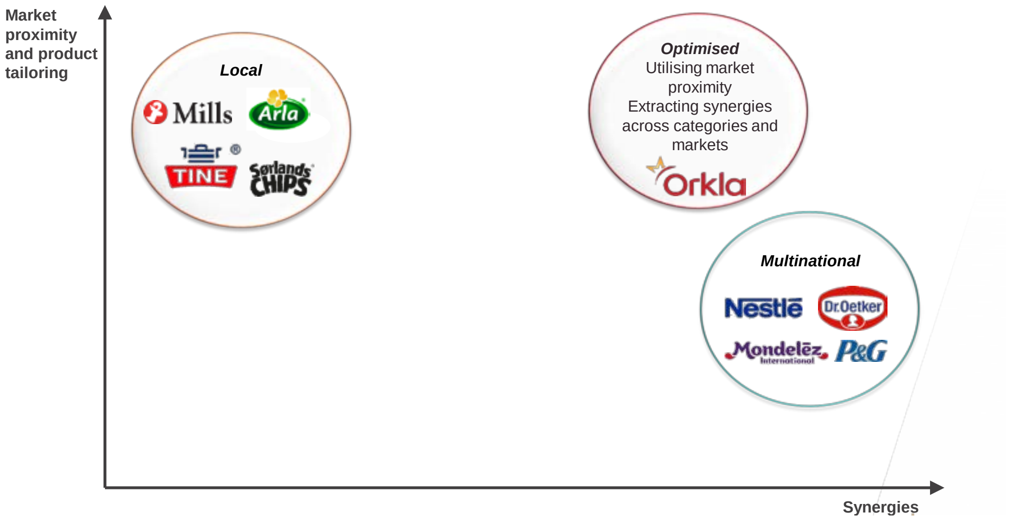
Rolf Bryhn - Store Norske Leksikon https://snl.no/Orkla_ASA

The market situation

Orkla's Branded Consumer Goods (BCG) currently comprises of four business units – Orkla Foods (40%), Orkla Food Ingredients (23%), Orkla Confectionery and Snacks (17%), and Orkla Care (17%) [% of sale].

In the Nordic countries Orkla is dominant with 42% of its sales coming from categories in which it has the number 1 position in terms of market share, and 73% of its sales coming from categories where it has first or second position. An example of this is Frozen Pizza. Frozen Pizza makes up for 5.5% of Orkla Food's sales, 92.4% of these sales from the number 1 position and 100% if we include second position. (Ask any Norwegian about the Grandiosa Frozen Pizza). This dominance is important when negotiating with retailers, giving Orkla more say in how its products are displayed on shelves.

With its numerous production plants, Orkla has a proximity to the market, allowing it to tailor its products to the local Nordic and Baltic markets. Consumers show a high degree of loyalty to Orkla's products. In its further development, Orkla needs to maintain these advantages while creating a more efficient supply chain. See illustration below:

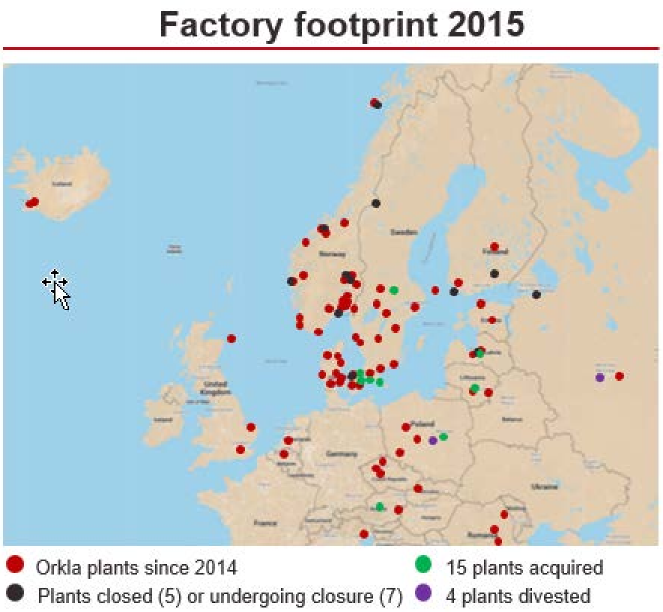


The supply chain

Orkla has relative its peers a large improvement potential, and this makes it a likely target for activist investors. An activist investor is an individual or group that purchases large numbers of a public company's shares and/or tries to obtain seats on the company's board with the goal of effecting a major change in the company. They target companies they believe could be run more profitably thereby making the company more valuable.

Orkla generates an EBIT margin below average for an international Brand Consumer company. Orkla has over 100 factories with 60% of its revenue generated over only four Nordic geographies. Orkla has the lowest EBIT per factory of all its global competitors.

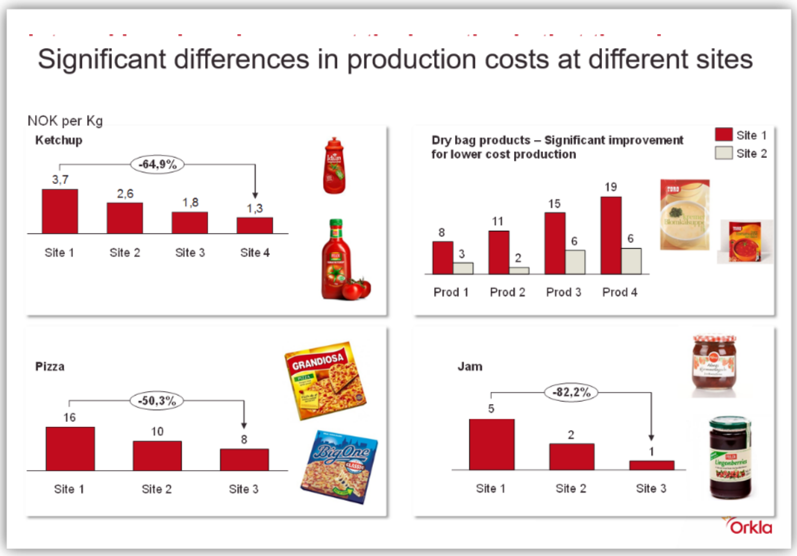
Orkla currently has 103 factories; the figure below shows their locations:



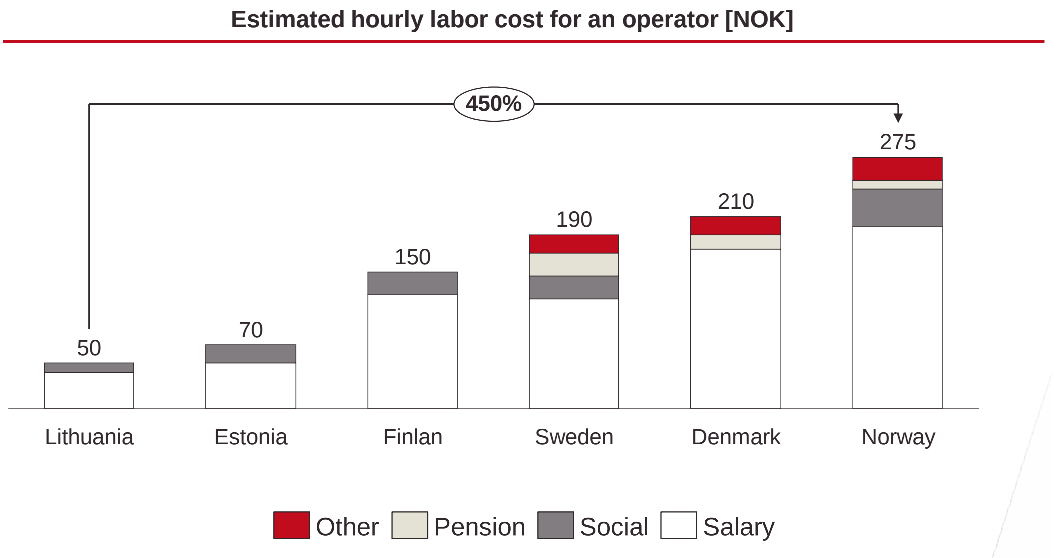
Increased complexity over time:
- Acquisitions have added complexity.
- Few structural changes have been made to enable operations across countries.

The situation today:
- Many small factories.
  25 in Norway, 50 in Scandinavia
- Several plants producing similar products.
  5 plants producing potato chips
  6 plants producing ketchup
  7 plants producing “ready-meals”
- Low level of cross country sourcing.
- Underutilised production capacity.
- Fragmented investments in new technology.
- Significant cost differences between sites.

The figure below illustrates the problem of differences in production costs excluding raw material for different production plants: (from Orkla)



Labour costs also differ in in the different countries where Orkla operates. See figure below:



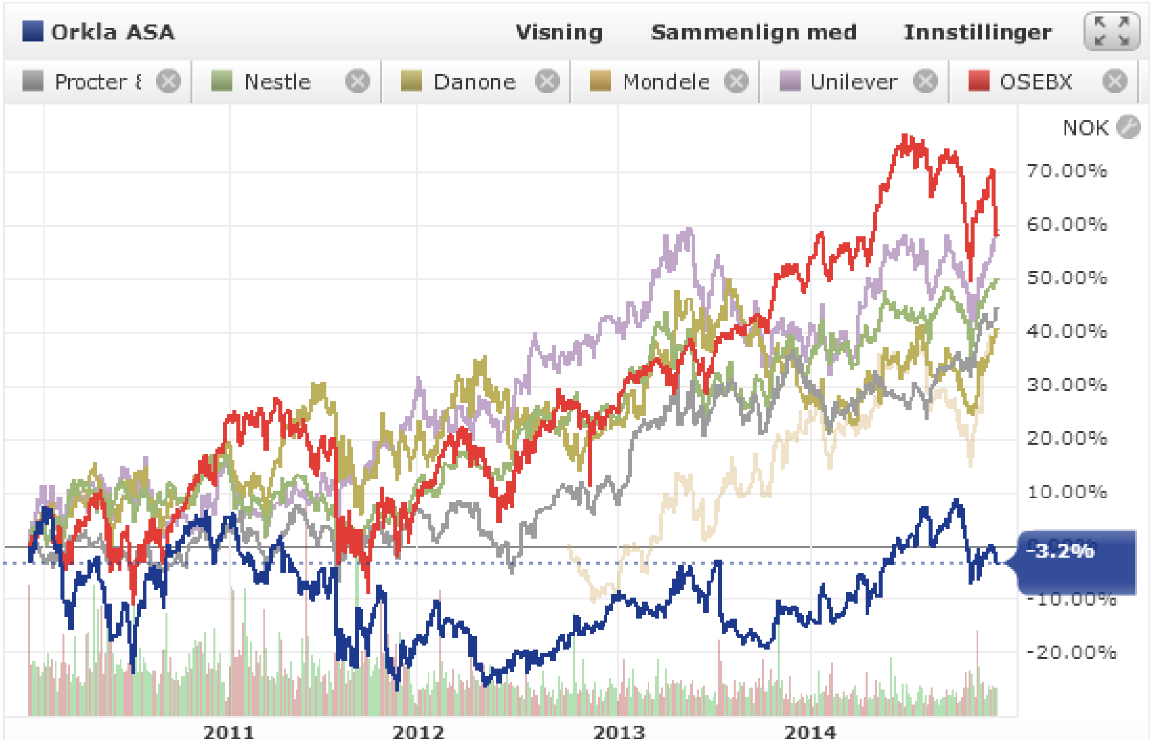
The Orkla plants are lagging behind industry peers in terms of capacity utilization and efficiency. The Orkla plants generate a revenue of 309 MNOK/factory, while Heinz generates 982 MNOK/factory and Nestle 1317 MNOK/factory.

Alongside an over-dimensioned factory footprint, Orkla has a complex and scattered set-up of warehouses and distribution as the figure below shows:

101 Warehouses:

- There are 73 warehouses in the Nordic and Eastern Europe serving the 50 different factories
- Around 50 % of the warehouses are owned and operated internally in Orkla
- More than 50% of the warehouses are used for ambient storage
- Comparison between the internal and external warehouses indicates that Orkla needs to improve efficiency at their internal warehouses

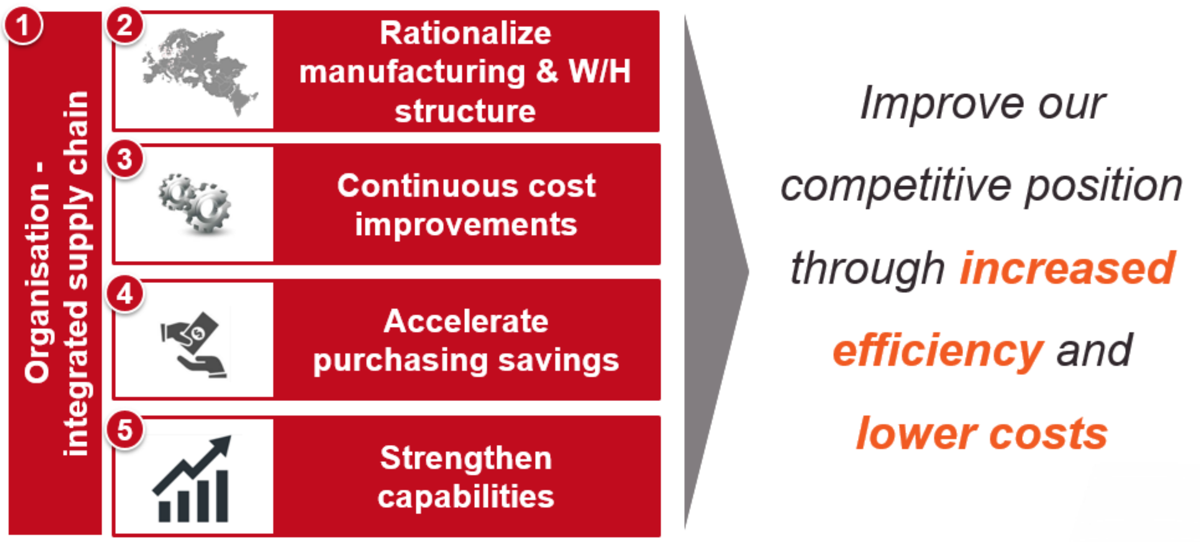
The challenges in the supply chain is reflected in Orkla's market performance. The figure below shows Orkla's share price performance 2009-2015 compared to key competitors with a stronger supply chain performance in terms of inventory turnover, return on asset and factory footprint (see e.g. Gartner Supply Chain Ranking 2015).



Creating a more efficient supply chain

The Orkla supply chain produces eight million consumer units daily with its 5 500 supply chain employees and 103 production plants. This is enough volume to ensure the economies of scale if the supply chain is operated wisely.

Orkla has set the following priorities for their supply chain:



The top priorities are an integrated supply chain within the organisation and rationalising the manufacturing and warehouse structure. Your task will be to supply a plan for this process.

Conclusion

Orkla needs to improve its` margins to secure long-term value creation while fencing off potential activist investors buying shares and demanding short-term changes. To meet this challenge Mikael Harder has hired you to come up with a plan for improving Orkla's supply chain.

When compared to its industry peers, Orkla is lagging behind in terms of supply chain performance. They have a large footprint of factories (103) and warehouses (101) covering a relatively small geographical area. The factories are less efficient than their competitors, as is their distribution system.

However, the fact that Orkla has a unique proximity to the market through its many factories, allows Orkla to tailor its product for the Nordic and Central European markets. This strength, with a great number of their brands holding the number one or two position in these markets, gives Orkla leverage when negotiating with retailers and loyal customers.

How then to improve the efficiency of the supply chain, and benefiting from the synergies being created, while maintaining a degree of market proximity and product tailoring?
This is your task.

Good luck.

Some of Orkla’s brands:

Beauvais
Stabburet
TAFFEL
Vitana
KiMs
POLLY
FELIX
Zalo
Idun Mors hjemmebakte
OLW
SPILVA
Kalev ANNO 1806
Abba KUNGSHAMN
MTR
Jordan
Laima 1870
Odense
MÖLLER'S TRAN
Nutrilett
Salvequick
Pierre Robert

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