CFA SINGAPORE INSIGHTS

By Alan Lok, CFA, Eunice Chu and Guruprasad Jambunathan

‘Please, sir, I want some more’: Understanding food producers

Any company that can manage the multiple stakeholder relationships, recognise changing customer tastes, and keep an eye on the future, will thrive

The problem of food wastage is spreading from the US and Europe to Asia: Singapore alone discards around 800,000 tonnes yearly. From an environmental perspective, it’s worth contemplating the amount of energy required to produce all this discarded food – the industry is highly resource-intensive. In addition, we have a habit of burying unwanted food, which decomposes and releases methane into the atmosphere.

That said, we may simultaneously face a future where demand outpaces supply from production hampered by a combination of change in climate, economics and demographics. Global warming could impact water and energy supplies. In terms of economics, it may no longer be profitable to produce certain crops if the numbers don’t add up. Also, the global population is expected to exceed 10 billion before the end of the 21st century, with the increase coming mainly from developing countries.

Interestingly, there are investment avenues to be explored with both over- and under-production. The waste technology industry is growing in importance, as startups seek ways to recycle unused food. Meanwhile, many companies are finding innovative ways to increase output and tackle production shortfalls.

Ingredients in the mix

Food production is a multi-dimensional stakeholder sector, with crisscrossing relationships a driving force behind innovation. Producers work with processors, who in turn liaise with distributors and, finally, retailers. Consumer power and views matter. The last thing this industry needs is a food scandal. Meanwhile, as these strands interface, the regulators are keeping a watchful eye on developments.

The role of non-governmental agencies has been added to the mix, as they monitor how companies operate in the developing world.

Innovation is another aspect to assess. Consider new product launches and their impact on the environment. How has the company made in recycling programmes or raised social and governance issues. Screen any investment in the firm has made in recycling programmes or raising consumer awareness about food wastage. Does it put profit first or make an effort to treat its suppliers fairly? What’s more, how much money is spent on minimising the release of pollutants?

Ultimately, any company that can manage the multiple stakeholder relationships, recognise changing customer tastes, and keep an eye on the future, will thrive.

We hope that the items on today’s menu have whetted your appetite for a more in-depth study of the food producers. We intend to enter new markets and understand the challenges it may face.

Food fads

With a deeper understanding of the business, delve into the structure of the market(s) within which it operates. How much competition does the company face; what are the barriers to entry and what is its overall share of the market? And how significant is the threat from private labels?

Next, find out what the firm’s customers think about its brands and products. Have their opinions been influenced by product recalls or controversies relating to health scares? Indeed, has the company ever faced regulatory action for violating any food safety practices?

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Innovation is another aspect to assess. Consider new product launches and the steps that are taken to ensure that these do not cannibalise existing volumes. Lastly, think about the health of the consumer and inquire about sugar-and-fat-related regulations. Do they exist in the company’s markets? If not, are there plans to introduce them?

Is it baked to perfection?

We have examined competition, so now look at the company’s books and see how it has performed against its peers. What are its margins and expense ratios? And do remember cash flows.

Have organic volume growth rates been achieved? Furthermore, check out the company’s investment strategy and the extent to which input cost increases can be passed on to customers. It is good to know if the company’s supply chain is vulnerable to external disruptions, such as geopolitical issues or natural disasters.

Given the energy-intensive nature of food production, we must pay particular attention to environmental, social and governance issues. Screen any investment in the firm has made in recycling programmes or raising consumer awareness about food wastage. Does it put profit first or make an effort to treat its suppliers fairly? What’s more, how much money is spent on minimising the release of pollutants?

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We hope that the items on today’s menu have whetted your appetite for a more in-depth study of the food production industry and help you to decide if the business model of a company is sustainable. If you want another helping, our complete framework is available on www.arx.cfa. Log in and feast.

This column is an excerpt from the joint research by CFA Institute, Association of Chartered Certified Accountants (Acca) and Cristal, entitled “Sector Analysis: An Investors Framework.” The excerpt is printed here with permission from the three organisations. A full version of the research will be published on CFA Institute Asia-Pacific Research Exchange at www.arx.cfa.

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