Making an IMPACT

PepsiCo prioritizes sustainability efforts throughout its own system and has high expectations for contract manufacturing partners.

By Jill Rivkin

For those involved in Purchase, N.Y.-based PepsiCo's business, there's far more expected than coming to work, getting the work done and doing it well. Working on 19 global mega brands as well as many others, there are more than 285,000 employees coming to work expected to deliver "performance with purpose" for the $60-billion food and beverage giant. When PepsiCo's chief executive officer Indra Nooyi outlined the company's "Performance with Purpose" mantra almost five years ago, she outlined the importance of performance on many levels and created a corporate strategy that resonates across the organization.

SPECIAL REPORT:
SUSTAINABILITY

Rob Schasel, (left) PepsiCo's director of energy and resource conservation and Dave Bartels, Frito-Lay's director of contract manufacturing.

"It starts with performance — you've got to make profits, put out quality products, talk to your consumers, your customers and your suppliers, and run a business to perform the way the shareholders want it to," explains Rob Schasel, PepsiCo's director of energy and resource conservation. "At the same time, you've got to make sure that you have a purpose in the way that you run that business."

This is where sustainability comes into play — on multiple levels with a three-pronged approach, Schasel says.

"Human sustainability," he explains, is the way the company's product portfolio "nourishes consumers" with a wide range of products.

"Talent sustainability" is how PepsiCo works to "cherish its employees" because "like any successful business, if we don't have good people running it, the business itself can't continue to thrive," he asserts.

"Environmental sustainability," encompasses everything the conglomerate does to "minimize the negative environmental footprint, and to the extent possible, translate that into a positive environmental footprint," Schasel says.

PepsiCo has quickly become a leader among consumer-packaged-goods companies across categories and around the globe, striving to bring sustainability to the forefront of practices for both economical and environmental reasons.

Yet while many companies approach this journey with a finite, quantitative figure in place, Schasel says there certainly are lofty goals for PepsiCo and its businesses, but "the ultimate destination is further tomorrow than where we are today. There is no stopping point. It is to always continue improving."

Though sustainability has generated news in recent years, there's nothing really new about it. PepsiCo's com-

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mitment to environmental issues has been part of the culture for decades, with many of the practices originating in its Plano, Texas-based Frito-Lay business. This foundation, Schasel points out, has "morphed" over the years to better and more fully address the current environmental issues and sustainability challenges — and ultimately save PepsiCo valuable resources and money.

A Sustainable Foundation

"Green teams" formed at Frito-Lay in the early '90s focused mostly on environmental compliance, but also explored options for the company to improve its performance, Schasel says.

The big question at the forefront: "How can we use less energy and water?"

To begin answering the question, a resource conservation program was born.

"Water and energy translate most directly into money," Schasel explains. "The less energy you use, the less money you spend. Unapologetically, in the late '90s and early 2000s, the majority of our focus was on dollar-based productivity. How could we improve payback to the company."

So with a strong foundation to build a sustainability program and increasing momentum across the consumer-packaged-goods industry to produce products more environmentally and be "green" corporate citizens, PepsiCo set out to make some meaningful changes. The company — then and now — is in a position to make a real impact, and has taken that role in stride.

Borrowing the term "BHAGS" from two authors — James Collins and Jerry Porras — executives at PepsiCo set out to create corporate-wide "big, hairy, audacious goals" that would bring sustainability to the forefront of business practices and force everyone to "get creative," Schasel says.

"Setting out to improve energy goals by 2.5 percent next year and adding it to the to-do list is not very inspiring and not very effective," he explains. "We said we wanted to improve our water efficiency by 50 percent, our natural gas efficiency by 30 percent and our electricity by 25 percent. So we had those goals and once we got our mind over the initial shock, people started to get creative."

Thinking BIG on Sustainability

PepsiCo has set big goals for its efforts…
- » 20 percent savings in water and electricity
- » 25 percent in fuels
- » Deadline 2015

But is well on the way to meeting them…
- » Water consumption down 15 percent
- » Electricity consumption down 9 percent
- » Fuel usage down 11 percent

By putting resources in place — engineers and a dedicated team at Frito-Lay headquarters — the program got off to a strong start and was implemented next at the Chicago-based businesses of Quaker, Tropicana and Gatorade by 2004 and globally by early 2006.

Although the BHAGS could have been intimidating, PepsiCo employees set out on a mission to effect dramatic decreases in water, energy and gas usage, and indeed they have.

The Frito-Lay business has almost reached the water goal, has hit the electricity goal and surpassed the natural gas goal to the tune of more than $60 million saved, Schasel says.

For the overall PepsiCo business, the BHAGS set were "slightly less ambitious," but still big, hairy and audacious — 20 percent savings in water and electricity and 25 percent in fuels, Schasel says. The hope was that these company-wide goals would be accomplished by 2015, and the current pace indicates success long before then. PepsiCo water consumption is down 15 percent, electricity consumption is down 9 percent, and fuel usage is down 11 percent already, according to the company. "We're well on track to hit the targets," Schasel asserts.

Only Part of the Solution

Though PepsiCo's accomplishments thus far have made a big impact, the company itself is only part of the equation.

"When you look at the life cycle of one of our products, it involves growing agricultural raw materials, bringing them to a plant, manufacturing and packaging a product and delivering it to a consumer who eats it and throws away the package.

Less than half the environmental footprint is ours," Schasel explains. "If we're going to make a strategic commitment to improve sustainability, and we're only focused on us at the center, we're not impacting a majority of the footprint."

With this in mind, PepsiCo executives have implemented the company's Supply Chain Outreach program intent on influencing partners and helping many of them achieve better sustainability programs. This includes contract manufacturing and packaging partners.

"We've already done a lot to improve our environmental sustainability in our plants, and we're going to show our contract manufacturing partners everything that we've done so that they, too, can improve in their plants where they're making product that has our brand on it," Schasel says.

As a result, PepsiCo's strategic approach to supply chain outreach is: "What do we control, what practices can we mandate and where can we influence our partners," Schasel explains.

The Contract Manufacturing Component

There are 38 contract partners working with the U.S. food divisions of PepsiCo — 25 for the Frito-Lay business, operating in 38 facilities; and 18 for the Quaker Foods and Snacks business, operating in 19 facilities. For Frito-Lay North America, outsourcing accounts for about 25 percent of the business.

And while this percentage is expected to grow as the market evolves, PepsiCo has not set a targeted goal. Rather, it has established a keen focus on making the best choices for protecting its brands and intellectual property while of course making the best choice for the bottom line.

"There isn't a corporate initiative with a target percentage of outsourcing," says Dave Bartels, Frito-Lay's director of contract manufacturing. "But our activity with contract partners has grown during the last 10 years, and that's a common practice with other CPG companies."

The growth at PepsiCo and in the industry at large primarily is attributed to the hefty cost of capital, flexibility of our partners, the ability to leverage PepsiCo raw material scale, and necessary speed-to-market capabilities, Bartels says, also pointing to the importance of flexibility. The contract manufacturing model has been and will continue to be a key ingredient to the success of PepsiCo.

The make-vs.-buy decision are systematic and are managed by a cross-functional headquarters team of operational, technical and financial resources, Bartels explains,

"The contract manufacturing group here is essentially a self-contained Fortune 50 company in terms of the dollars that we spend on contract manufacturing and the volume," Bartels says. "Our team is a self-contained group of 40 people that oversees all the components — quality, cost, service, transportation and sustainability."

Pepsi's Contract Manufacturing Component

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- 25 for Frito-Lay, operating in 38 facilities
- 18 for Quaker Foods and Snacks, operating in 19 facilities.

As to what goes into the make-vs.-buy decision, Bartels says some brands and products are sacred while others may be the perfect fit for outsourcing. "There are certain products we consider core competencies that we would never consider having someone else make on our behalf — Lay's potato chips, Cheetos, Doritos — these products brought us to where we are today, and they are off-limits," he says. However, there are projects that fit nicely into the contract manufacturing model.

Where PepsiCo doesn't have capabilities or the technical expertise — areas such as dips and meat snacks, for example — Bartels says contract manufacturing is a great solution. And then there are those that are "in between" if it is the right business decision and the company can "lock up any intellectual property or proprietary trade secrets."

Bartels says the team evaluates the total landed cost, including manufacturing costs, distribution costs and required capital costs, to make a final make-vs.-buy decision. But where it gets a bit more complicated and less defined is when the team has to seriously consider strategic considerations.

The ever more competitive nature of the food and beverage industries gives even giants like PepsiCo cause to consider. "If we were to buy industry capacity and then bring it back in house, that would leave industry capacity to compete with us," Bartels says. "We look at that as a potential issue down the road and have to decide what we take out to the industry in terms of innovation."

New ideas, new packaging or a completely new product launched internally is much easier to protect, Bartels adds, and eliminates the need to so fiercely protect intellec-

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tual property. Analyzing whether or not the new project is short or long term is the key because Bartels knows that launching with a contract partner can be the fastest way to market."

Yet sometimes a contract partner has the expertise but not the equipment, and in that case, PepsiCo can invoke the practice of backstopping capital investment. The company has the supplier buy the equipment and get paid over time by PepsiCo, which will own the asset in the end.

"We pay the supplier back principal plus a negotiated interest payment over time, and at the end of that time, we own the asset and typically won't allow the supplier to produce any other products using those assets," Bartels explains, adding that about 50 percent of PepsiCo's capital relationships are handled this way.

Teaching Partners to Fish

PepsiCo wants its contract partners to be best-in-class suppliers, but Bartels says there is a very fine line he and his team walks almost every day: "We walk a fine line between having industry knowledge, proprietary technologies and trade secrets," he says. "We want our contract manufacturers and partners to be as profitable as possible,"

Helping contract partners function as efficiently as possible to deliver the best products is critical to successful business, however, Bartels says, "we don't want to put them in a position to be formidable national competitors."

Finding the right approach is a big challenge, Bartels says, even more so now when even CPG giants as strong as PepsiCo face new competition from private label.

However, PepsiCo is committed to working with strong partners on innovation and is "slowly opening up to two-way innovation," Bartels says. And the company certainly wants its partners to achieve better sustainability performance.

"We haven't used the same BHAG concept with them, but we've asked for continuous improvement and a goal of 4 percent per year," Schasel says.

Bartels adds that while PepsiCo isn't making strict performance demands, the message over the past three years has evolved from sharing best practices with partners to expecting them to perform and have it show on a supplier scorecard.

"Sustainability is part of our Supplier of the Year scorecard," Bartels points out. "Suppliers are ranked on their cost performance, service performance, quality performance, partnership, innovation and sustainability. It's part of the measure for us to say whether a supplier has won or not and also a measure for future business and growth."

Schasel says that while his team's resources are concentrated on the PepsiCo-owned facilities — it's a small team so his approach with partners is based on "education rather than direct project management" — the company will work with contract partners, especially those that put in the time and effort on their own.

"If they're willing to support all of the practices and still can't drive down the numbers, we'll give them extra help and spend time with them," Schasel says. "We want to help those that want to help themselves."

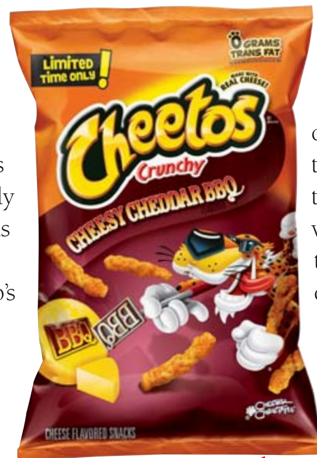
Pepsi's Three-Pronged Approach to Sustainability

- Human sustainability = the way the company's product portfolio "nourishes consumers" with a wide range of products.
- Talent sustainability = how PepsiCo works to "cherish its employees"
- Environmental sustainability = everything the company does to minimize a negative environmental footprint and translate that into a positive environmental footprint

A Genuine Approach to Best Practices

Though the contract manufacturing and packaging industry was once more elusive than any other, today's CPG environment has trended toward slightly more open dialogue. And sustainability efforts, for one, are a great place to share best practices.

"There's some best practices sharing within this environment that is unique because it doesn't really exist across any other functional boundary," Bartels says, pointing to an example such as a water-reduction symposium that brought some of PepsiCo's chip, dip and nut co-packers together.



For PepsiCo, this transparency has translated to a strong educational program for its network, which has proven to trickle down throughout the industry to everyone's advantage.

PepsiCo's ReCon events — resource conservation — happen regularly throughout the year and bring contract manufacturers and packagers under one roof to learn from PepsiCo and brainstorm applicable practices for their own sites. There are five ReCon events scheduled this year, and Schasel says many plant visits are scheduled to help partners with program implementation.

Both Schasel and Bartels say educational outreach has been a success so far within the company's contract partner community. Next, however, is to "push out" to raw ingredient suppliers. "We're taking the same approach — inviting them to ReCon sessions, following up with scorecards, doing audits and monitoring performance," Schasel says, recognizing that CPG companies don't have the expertise needed to guide agricultural suppliers, but they do have the influence and strength to initiate improvement.

"In the CPG industry, we're certainly not the only company out there focused on water and energy efficiency," Schasel says. "All of our big competitors are. But I don't think all programs are at the same stage of evolution or maturity. We all need to continue pushing out those boundaries." ‖