Hindustan Unilever's Cost Aggression

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Introduction

The most prominent star in the galaxy of the Indian Fast Moving Consumer Goods (FMCG) sector is Hindustan Unilever (HUL). Through years of sustained hard work, right investments, high quality research and astute strategies – this FMCG giant has built a powerful good name for itself, setting a very superior benchmark for others to pursue.

The acute competition prevalent in the Indian FMCG sector is well-known—its level intensifying further with the entry of foreign players after the economic liberalization that took place in1991. Gradually, with every market segment and all product categories becoming replete with substitutable brands, the only survival route available to these players is to increasingly appeal to the tastes and preferences of the more and more discerning customers of the times. However for any such attempt, the threshold of competitive cost and prices cannot really be crossed. Since plethora of brands exists in every product category, any unique price-rise by a brand/firm has generally been observed to be penalized grossly in this extremely value and price-sensitive Indian market. The EMI-riddled customers unhesitatingly ditch trusted brands for newer ones at the slightest inconvenience in their price-value matrix.

Hence controlling costs, curtailing costs and cost-minimisation activities occupy critical position in the 'must-do' agenda of every company seeking to set up successful business in this highly slippery FMCG marketplace. Measures to rein in costs are plenty and naturally differ with the size, nature and capabilities of the entities.

Objective

HUL—which operates in varied categories across multiple product lines—faces an overwhelming challenge to balance cost, price and quality at the face of superlative customer expectations.

Here an attempt has been made to enlist the cost-controlling measures of HUL under such testing circumstances.

Mitigating Higher Raw Material Cost

It is known that all costs are not controllable and, like any other company, rise in the prices of inputs and periodic rapid spirals therein are major de-stabilising factors for the cost and price-structures of HUL. Here, passing on the increased burden of rising input costs to the ultimate customers is the last resort and best avoided—for it is inevitably accompanied by sacrifice in market-shares in the highly competitive FMCG marketplace. This point may be substantiated from the following discussion :

The period from January to June 2008 saw a sharp upward spiral in the prices of key inputs of HUL's products such as LAB, petroleum derivatives and palm-oil. This contributed to the sharply escalating costs for soaps and detergents. Here, HUL made the strategic choice of passing on these input costs almost entirely to its customers by taking substantial price-increases spanning its portfolios.

HUL hiked prices of its products by 1-28 percent across categories such as tea, detergent, soap, shampoo and personal care from October 2008. Among the key price moves, HUL hiked prices of Lux 100 gm soap bar by 6 percent, of Surf Excel Quick Wash detergent by 5-6 percent, and of Surf Excel Blue by12-13 percent, of Brooke Bond Red Label tea and Taj Mahal tea by 8-14 percent.

Compared to its competitors, HUL took larger price increases in some of its key segments. In the January- March quarter of 2009 (which was the last quarter of the financial year 2008-2009), net profit of HUL grew by 4 percent from Rs 381 crores to Rs 395 crores. Net sales for this quarter, however, grew by 6 percent, compared to the industry growth rate of over 12 percent. Although the sales realizations had increased by 12 percent in this quarter, sales volume had gone down 4.2—percent indicating that customers had to spend more money for buying less of HUL's product(s). Consequently, the company's market-share in soaps and skincare fell from 49.6 percent and 53.1 percent in December 2008, respectively, to 48.2 percent and 52 percent in March

2009, respectively. HUL's arch rivals in the consumer products space such as Procter&Gamble, Godrej Consumer Products Limited, and Dabur India Limited, among others, managed to dent its market shares in most categories like detergents, soaps, shampoos and skincare.

The HUL management also admitted to early signs of downtrading towards cheaper brands and smaller pack sizes. And, as the analysts pointed out, HUL's focus on high-value products vis-à-vis stable pricing by its rivals made it lose market share from all fronts – established players, regional ones and newer entrants—especially in product categories directed towards the mass end of the market (" HUL changes strategy to regain market share", 2009).Between March 2008 and March 2009, HUL lost market share in key segments in which it operates, viz, personal wash (from 54.3 percent to 48.2 percent), skincare (from 55.4 percent to 52 percent) and toothpaste (from 29.5 percent to 28 percent) ["Slowing juggernaut", 2009]

In the April-June quarter of 2009, HUL's net sales fell by 8 percent to Rs 4,476 crores and, consequently, net profits dipped from Rs 558 crores to Rs 543 crores that is by 2.7 percent. The reasons attributed for such fall in net profits were as mentioned above plus a higher spend on advertisement to the tune of 26 percent in the said quarter, as well as a 15 percent rise in Minimum Alternate Tax (MAT) and lower other incomes. Foreign exchange loss of Rs 31.8 crore on open-forward contracts was also a contributor for the above-mentioned fall in net profits ("HUL June quarter net down 2.7% on higher ad spend", 2009)

Despite the endorsement of some of the biggest Bollywood stars viz, Shahrukh Khan, Aiswariya Rai-Bachhan, Priyanka Chopra, HUL's beauty soap Lux saw the biggest dip of 2.1 percent in value market share in the 12 month period ended June 2009. Similarly, HUL's germ-protection brand Lifebuoy's value market share dropped from 17.9 percent to 16.6 percent during the same period.

However the prices of key raw materials such as palm oil, LAB and packaging materials started to ease during 2009, dropping by about 25 to 40 percent below 2008 levels. (However, the sharp correction in input prices has another dimension also. It helps to resurrect regional and local competitors in the staple FMCG categories. Since urban consumer spends continued to be under pressure during 2009, the threat of consumers' downtrading to cheaper local as well as national brands continued to loom for HUL.)

From early 2009, HUL cut prices of its key soaps and detergents by 4 percent to 20 percent. The price-cuts have been undertaken through a combination of increase in weight of some packs or a reduction in MRP. For instance, HUL increased the weight of its popular Lifebuoy toilet soap from 115 gm to 120 gm, but kept the price unchanged at Rs. 15. This translated into an effective price-cut of 4.2 percent. HUL also reduced the MRP of 200 gm Wheel Active Blue detergent cake by 20 percent from Rs 10 to Rs 8. For the quarter ended September 2009, operating profit grew 16.48 percent to Rs. 605.72 crores from Rs. 520 crores while operating margins improved by 140 basis points, with tight cost management and operating leverage.

Vegetable oil prices, which had dropped to extremely low levels in 2009, began rising in 2010 and increased steeply towards the end of 2010. Crude oil prices increased significantly. This adversely impacted the price of laundry chemicals, packaging cost and freight cost. The practice of extra-fill in the form of consumer promotion and higher grammage packs was discontinued. Moreover, the business was managed dynamically with increased frequency of cost and pricing review, and aggressive cost saving programmes, which helped to minimise the impact of escalating input-prices.

However HUL has not always passed on the burden of rise in input costs to final customers – devising ways to circumvent such cresis to maintain stability in its costs and prices in the highly competitive market that it operates. So HUL here takes advantage of cost variations by seamlessly changing product formulations without any difference in the end-use experience through value–engineering which is enabled through its supreme capacity of research and innovation.

In 2003, there was tremendous rise in oil prices and firming up of international cargo rates which impacted the costs of HUL quite adversely. Use of alternative materials, tight control of indirect costs and other cost effectiveness programmes helped mitigate the impact of cost increases. Savings generated through these initiatives were re-invested in superior quality and competitive pricing. Operating margins were lower in 2003 compared to 2002. Relentless focus on cost reduction programmes resulted in significant benefits. Several breakthroughs in factory efficiencies were achieved, resulting in significant productivity gains and conversion cost optimisation.

In 2005, again there was steep increase in petroleum (there was major diversion of oils for production of bio-fuels) and petrochemical costs leading to substantial rise in raw material, packaging material and distribution costs (freight). HUL employed 'Best Practises' and leveraged Unilever's relevant global and regional strengths to mitigate such cost pressures to a considerable extent. Significant buying cost advantages were generated and strategic alliances with many international and local vendors for key raw and packing materials, led to development of new technologies, new materials and joint cost reduction programmes (through reduction of input costs, locational synergies, and import substitution) – the benefits of which were shared between HUL and the concerned vendors. This was part of the 'Ten Point Programme' that HUL initiated in 2003 where the company sought to leverage its scale fully in supply chain, logistics and buying to drive lower costs. Global buying of some of the ingredients across different geographies obtained better economy of scale for HUL. For e.g., in case of display containers—instead of every country doing its own buying, it is being singularly done at the European level under a global procurement officer. Moreover, through Vendor Certification Programme several vendors were certified for implementation of quality systems and zero defect track record. The buying function of the company focused on reducing lead time and procurement costs and developing reliability in the supply of raw materials and PM by fully leveraging benefits of scale and synergy through Unilever's global buying network.

Several small scale industries and ancillary units were developed to support HUL's operations. HUL also undertook a 'Partner in progress' initiative, under which more than 500 managers visited about 65 suppliers to develop meaningful ways of improving the quality of the supply chain through mutually rewarding partnerships.

Rationalisation of Advertisement and Promotion Expenses

Operating multiple product-lines in highly competitive categories, HUL is India's largest advertiser, accounting for about 18 percent of total spend on advertisement in the country. India's largest media-buying house Group M manages HUL's media buying. HUL works with media agencies like Lowe, O&M and McCann-Erickson. According to rough estimates, HUL's ad-spends are placed at around Rs. 1,300 crores on an annualized basis.

Lord Leverhume—one of the pioneering leaders of Unilever—had said 'I know half my advertising is wasted. I just don't know which half.' But the present management is extremely conscious to plug any inefficiency in its promotional spends. In 2009, HUL revised the terms of its contract with its advertising agencies with a view to derive more value for its money.

Aligning its policy with the global 'performance-based' payment package of Unilever, HUL sought to reimburse its agencies the cost for the advertisement, topping up by a bonus if certain performance targets are achieved. However, if the campaign falls short of the target, the company will only cover the costs incurred by the agency. The advertising agency business margins were also slashed from 10 percent to about 5 percent. This is quite unlike the earlier system where upfront commissions were guaranteed. Under the earlier system, creative and media agencies were compensated either on a monthly retainership fee or on the basis of commissions which could vary between 8- 12 percent of their media budgets.

Here the concept of 'Return on Marketing Investments' (ROMI) has been used to drive continuous improvement. ROMI is about optimizing the effectiveness of advertising, promotional and trade investments. HUL has developed advanced marketing mix modeling techniques that allows assessment of all the marketing levers to drive growth and superior yields from marketing investment. For example, the media elasticity of each of the brands have been identified which helps HUL to optimize its advertising spends.

With increase in rural consumption in certain FMCG categories like hair oils, toothpaste, shampoo, skin creams and lotions, HUL seeks to judiciously break down its massive advertisement budget among print, electronic and below-the-line activities to raise its effectiveness pertinent to relevant geographies.

To enhance the effectiveness of advertisement and promotional expenditures, world class quantitative tools such as Advertising Budget Guidelines, Minimum Invest Levels, Market Activities Costing and Dynamic Resource Allocation were used and fully leveraged through unlimited access of Unilever's such outstanding Intellectual Properties.

Productivity Augamentation

For example, in some of HUL's detergent factories 'twin track' is deployed on single production lines. This helps in nearly doubling of the production thus improving operating efficiencies and cutting down cost. Apart from this, today most of HUL's production lines have developed the capability of quick changeovers to meet the market demand mitigating to a large extent the risk of obsolescence and providing for long-term cost-efficiency.

Elimination of Wastes

At HUL, cross-functional teams identify and put in place actions to eliminate wastes and hidden costs from all facets of the business. TPM (Total Productive Maintenance) is employed in factories to continuously reduce business waste and eliminate losses in the supply chain to meet zero error, zero loss. Through application of TPM, appropriate capital expenditure investments are executed in creating capacity to enable future growth, and to de-bottleneck existing assets to run them efficiently. These result in increase in asset productivity levels improving 'throughput' from existing assets generating savings which are ploughed back into the products. It helps in delivering top-quality products with world class service at a competitive cost.

From 2009, HUL has sought to downsize the number of SKUs in its portfolio of over 35 brands extending to 1,200 SKUs. By eliminating and rationalizing the tail-end SKUs, HUL is in the process of substantial simplification and cost-savings.

Empowered teams led initiatives to reduce specific energy consumption and also piloted the use of sustainable alternative biofuels at several sites, resulting in appreciable savings in energy costs.

HUL has sold several residential and commercial properties across India to cut costs and raise cash. It has shifted its headquarters to Mumbai's Andheri western suburb and leased out its former headquarters in South Mumbai to either corporates or banks after refurbishing it.

Citadel strategy is pursued for certain specific brands (usually premium ones) for concentrating on specific geographies where most of the demand is generated. For example, in the ice-creams business, 20 major cities have been focused upon. It helps in protecting the turf and growing these specified markets for the company. At the same time, it also conserves the resources by not spreading out on equal strength across varied geographies.

Cutting down on travel of executives and using video-conferencing instead.

The traditional model is essentially about cost + margin=price. In the bottom of the pyramid, the same model cannot be applied. So the price is first set. Here price minus desired margin equals the desired cost. And the target cost is the end-to-end cost of the total business system. So, to arrive at better efficiencies in managing costs, the factories are closer to the point of sale that allows reductions in freight costs—both inwards cost for materials and outward cost for despatch to the customer. The costs are reduced—both at back-end as well as point-of-sales through across-the-board innovation.

In 2009, Polman had frozen executive bonuses (executive directors and senior management) and linked them to performance, instilling a sense of aggression and performance culture in Unilever globally. Such freeze which insiders refer to as the policy of deferred bonus, have been lifted—at least in India. HUL has witnessed double digit volume growth for at least two quarters now after a year of single digit growth (5% in volume terms for the year ended March 2010). Consequently, senior and middle-level managers have earned bonuses up to Rs. 40 lakh and Rs. 20 lakh, respectively. However, Polman has implemented targets for executive bonuses based on sales volume instead of earnings.

HUL has either shed or reassigned managers as part of a plan to link revenue and profits to headcount. In 2009, some staff including managers with 5-10 years' experience in the company has been redeployed to functions such as research and development, while the rest have been given a severance package and laid off. These jobs were mostly in supply-chain management; where the company undertook a massive restructuring identify redundancies ("30 HUL managers face layoff or redeployment", 2009).

In order to optimize resources in an increasingly competitive scenario, HUL offered VRS to about 200 people. The VRS is being offered to its staff in clerical and field sales offices. The eligibility criteria will be for people over 40 years of age who have spent more than 15 years with the company ("HUL offers pink slips to 200 staff, 2009).

HUL had divested a 51 percent stake in the BPO business (earlier known as Unilever India Shared Services) in October 2006 in line with its strategy to focus on core businesses such as home and personal care.

Revamping Distribution Network vis-a-vis Improving Efficiency and Cost

Distribution efficiency happens to be an area of core competence for HUL. Apart from its wide and unmatched distribution network, HUL has strived to augment the quality of coverage through cutting-edge technology and made substantial investments in I-T for the purpose.

Since 2001, through RS-Net which is a web enabled stockist management system, HUL has established two way connectivity with its stockists. Using this infrastructure, HLL has implemented a Continuous Replenishment based ordering and selling system that sought to eliminate inefficiencies in stockist inventory holding—both in terms of quantity and quality. All Redistribution Stockists who are key elements in HUL's country-wide distribution framework are under a Continuous Replenishment System, leveraging the internet. An end-to-end technology solution has been deployed which helps reduce inventory cycles while enabling optimum service levels—ensuring freshness of stock, reduction in wastage and less working capital blockage. Before Continuous Replenishment System was implemented, stock levels of as high as10 days to 2 weeks were maintained with the suppliers, which after its implementation has come down to 5 to 7 days.

Backing this up was the 'Internal Network Planner and Optimiser' which helped in ascertaining the daily stock positions at each point in the supply chain, project stock requirements at these points, plan for replenishment — and do so with complete transparency across the supply chain. Instead of planning for every month, the company was thus facilitated to plan for every day, and even for every shift, in line with an overall optimisation strategy. The underlying objective was to move to making today what was sold yesterday.

The physical distribution set-up has also been continuously stream-lined. The hub-and-spoke method on which the rural distribution framework was built up (comprising Redistribution Stockists, ReDistributors and Star Sellers) was dismantled by HUL in 2009 across India, as connectivity to rural areas had improved. SSs who were responsible for supplying HUL's basket of products to the kiranas in the nook and corner of the hinterland were eliminated and the RDs were directed to supply the products directly to the kiranas. The SS partners have been absorbed to a large extent by HUL in its wholesale channel. In the process, its entire distribution process was streamlined; to do away with unnecessary layers in distribution and thus improve efficiency and reduce cost

During 2010-11, the Supply Chain team worked on a strong Cost Effectiveness Programme to deliver savings throughout the supply chain, by various means including identification of further opportunities for waste elimination. This has facilitated the business to achieve a significant cost reduction (around 6% of supply chain costs), the highest ever in the recent past.

Continuous improvement to develop consumer-led, agile value chain through leveraging scale and improving efficiencies by rapid deployment of appropriate technologies has resulted in reduction in inventories, improved product freshness and time-to-shelf, which has resulted in significant reduction of working capital.

Conclusion

HUL's strategy on costs has been succinctly summarized by Harish Manwani, Chairman, HUL, at the company's 76th Annual General Meeting ("HUL to rationalize costs, prices", 2009) where he declared that for his business 'It will be business as usual on growth but business unusual on costs.' The FMCG behemoth seeks to be extremely cautious on its cost front—deploying it to generate and sustain growth and this stand of the company has been vindicated from the above discussion. Each and every aspect of the organization has been considered here, which is the very essence of an effective cost minimization programme. ❐

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