

Meat Processing

[McKinsey Style Case]



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What We Will Cover Today

- Meat Processing Case
- Round 1, McKinsey and Co.
- Question & Answers From The Audience

Meat Processing

Our client is a meat processing company. They buy livestock, process and then sell to major retail supermarket chains. In early 90's, the industry went through consolidation and now there are only 5 big players in the market. During this time our client bought about 8 regional/local players in the market who were not doing well and had old assets that had depreciated.

The CEO has called McKinsey because their profitability is declining and they want to understand what they can do.

[Question #1]

- What are the key areas you would look into?

[Question #1]

On the revenue side, I would look at the changes in the two drivers of revenue – price and quantity. Before that, I want to understand how the overall market is doing – is it growing or shrinking (however, I think this would not be a problem). The next thing I would look into is what the competition is doing – are there new competitors in the market – have they reduced the prices or stolen share from us. I would also look at customer trends – for instance, end consumers could be moving towards healthy foods or vegetarianism. Further, the customers i.e. the supermarket chain, might not provide enough shelf space since their bargaining power might be higher or might squeeze our client on the price. These factors would affect the price and quantity we sell.

On the cost side, I would look at the fixed costs and variable costs of the facility.

Fixed costs:

- Plant/Facility – Rent
- Equipment for processing
- Insurance
- SG&A

Variable costs:

- COGS
 - o Direct materials such as birds (quality of birds/type of birds) and chemicals needed for processing
 - o Direct labor
 - o Production costs
- Transportation cost (was told that each facility is independent and complete so no transportation is required within facilities)

[Question #2]

Interviewer: The processing costs are high for the client. We did competitive benchmarking of our “birds” division with King Chicken. Data provided.

| | Client | King Chicken |
|---|---------------|---------------------|
| Average quantity of birds processed each year in each plant | 300,000 | 500,000 |
| Average processing cost/bird | \$30 | \$20 |

Interviewer: What do you think?

[Question #2]

- King Chicken sells more chicken and has reached economies of scale, and therefore has lower fixed cost per bird.
- King Chicken has better capacity utilization which leads to lower overhead per bird.
- King Chicken has more efficient or cheaper processing due to newer equipments or more advanced technology.
- We process different types of birds that might require extra care or more specialized process or more specialized labor leading to higher costs
- We have a better skilled labor force as we deliver premium products.
- Since our average processing cost is higher, it could be that some of our plants have a lot higher processing costs which bring up the average cost.

[Question #3]

Interviewer: One of our Associates came running in and told us that one of their plants (out of 10) processes turkey instead of chickens, whereas King Chicken only processes chicken. The processing costs in that plant are a lot higher. He found out that it costs twice the amount to process a turkey than it takes to process a chicken. Can you find out what the costs for processing a chicken and a turkey are in our plants?

| | Turkey | Chicken |
|---|---------------|----------------|
| Quantity of birds processed each year in each plant | 600,000 | 266,000 |
| No. of plants | 1 plant | 9 plants |

[Question #3]

Interviewee should do the calculation:

I would just take the actual costs of processing of both turkey and chicken, and equate it to the total average costs of processing (which we know from the data earlier) in all 10 plants.

Lets say the processing cost of chicken = \$X

Then, processing cost of turkey = \$2X

$$600,000 * \$2X * 1 \text{ plant} + 266,000 * \$X * 9 \text{ plants} = 300,000 * \$30 * 10 \text{ plants}$$
$$\Rightarrow X = \$25$$

The cost of processing chicken is \$25 and that of turkey is \$50. The cost of processing chicken is still higher than our competitor's cost of \$20.

[Question #4]

- Why do you think this is true? What would you think of doing?

[Question #4]

The cost of processing is still higher by \$5 than our competitors. That might not be good. If we produce the same type of meat as our competitors, given the commodity nature of this type of meat we have to take lower profit margin to stay competitive. If our competitors decide to reduce price to gain more market share, we will be very vulnerable.

If we produce premium product, the supermarket chains might not be willing to pay much higher price to buy our product as I would think that \$5 might be a significant % of the total cost of meat's tag price.

If our client's product is a branded premium product and consumers are willing to pay the extra dollars for better taste, packaging or healthy meat (whatever is the criterion that differentiates it), higher cost structure may be fine. However, I am not sure how much extra price consumers will be willing to pay for premium chicken or turkey meat. Let's say that one bird produces two pounds of meat, which means consumers will have to pay \$2.5 extra per pound. It seems very high. Therefore, we should still find ways lower costs. If our product has the same quality as our competitors', it's even more important to look at ways to reduce costs.

To reduce both fixed costs and variable costs,

- We could look into consolidating the plants, especially if they are underutilized. That might bring down costs as we can consolidate both facilities and equipments.

[Question #4]

- If we haven't don't so, we could look for opportunities to maximize synergies as we acquired so many players, such as consolidating purchasing to have better price from suppliers
- We could share best practices across different facilities.
- Improve labor productivity or hire cheaper labor without affecting quality of work
- Find better suppliers to lower material costs.
- Buy cheaper equipments or lease them instead.
- Expand to other markets such that capacity utilization increases, or lease/sell the unused capacity.
- Stop processing turkey to reduce average processing cost.

Q&A Session – Any Questions?



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Q&A Session – Any Questions?



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