Increased Wheat Prices and its Impact on the Supply Chain

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Wheat prices have hit an all-time high. The International Grain Council claims that prices will remain volatile due to supply uncertainties and developments in financial, energy and other commodity markets. The stock to use ratio is at an all-time low, as the risk of not keeping up with demand increases; it has recently been reported on UK BBC radio 2 that there is only an estimated 9-10 weeks of buffer stock remaining.

So what has caused these depleting stock levels?

Climate
The biggest wheat exporters include the US, Canada, Russia, Argentina, Kazakhstan and Australia. Last year’s drought in Australia and Canada had a considerable effect on annual yields, as did an April freeze and excessive rainfall in the US. In Australia alone, the wheat crop last year was just 10 million tons, less than half that of the year before (Source: The Grain Drain: 3 Reasons For The Current Wheat Shortage).

Import and export changes
The poor yields have caused producing countries to become concerned and safeguard their domestic supplies. Bloomberg reported that Kazakhstan has recently put export restrictions on their supplies which are having a ‘knock on’ effect to importers, such as Turkey, that are offering lower import taxes in order to attract new suppliers. Such shifts in price and export/import change can encourage stock piling and panic buying which will of course exacerbate the situation further.

Changing diets
Emerging markets such as India and China are buying far more wheat then ever. Diets are changing throughout the world as the East becomes more westernised. As prosperity increases in Asia, diets are shifting from vegetable based diets to more meat being consumed; adding pressure to the wheat based animal feed market. This has caused an increase not only in wheat based food products, but also the cost of meat worldwide. In the UK turkey prices hit an all time high at Christmas 2007.

Increase in food waste
The Love Food, Hate Waste organisation estimate that “6.7 million tonnes of food is thrown away by households in the UK alone every year, or, to put it another way, around a third of all the food we buy ends up being thrown away, and most of it could have been eaten. Some of the waste is made up of things like peelings, cores and bones, but the majority is, or once was, perfectly good food.” This has an impact on the rising levels of demand for food production. There has been much debate over what the supermarkets have done to increase this waste, for instance attracting us to buy more than we need with buy one get one free offers, and only selling some products pre-packed in quantities that are too large for the average household. A shorter shelf life has also been placed on some products and consumers have become more cautious about consuming food after its recommended use by date. This had led not only to increased demand in food, but also in food packaging.
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Alternative uses for wheat
For some time wheat has been used to produce plastic bags, packaging etc., and demand for these products has also increased considerably. Although some stores are working towards reduced packaging and encouraging shoppers to re-use plastic bags, demand is still on the increase.

Bio fuels are also ever more popular and some countries have been setting targets to encourage their use. It has become more apparent that they do not offer the solution we initially thought as an alternative to fossil fuels, and they are unlikely to increase fuel security because of the fossil fuel required for their production. Also, by building a biofuel industry, wheat stocks are depleted, food prices have risen and there is a risk of jeopardising food security in developing countries.

How does this affect P&SM professionals?
Firstly, the increased prices have put pressure on organisations to try not to push these costs on to the consumer - some products will remain resistant to price fluctuations while others fail in the market. P&SM professionals will be under pressure to reduce costs in as many other areas of products’ make up and production.

Process and production costs
This could include implementing lean manufacturing and process improvements, to cut out any unnecessary ‘waste’ and therefore cost in the process.

Alternative ingredients
It may be the case that an alternative to wheat is used. Weetabix cereal producers have recently launched a new variety of oat based products. This could have been a reaction to the increasing wheat costs. This is an example of a product that would probably not tolerate much price increase before consumers switch to an alternative breakfast cereal.

Stronger supplier relationships
Where no alternative is available it will be ever more important to build a strong relationship with a wheat supplier or producer to ensure (as much as possible) a consistent supply. Supplier development programmes or joint venture and risk arrangements can help to build stronger relationships and also decrease the risk of another poor yield.

Hedging and stock levels
By closely monitoring the fluctuating price of wheat, P&SM professionals can forward buy or bulk buy wheat when it is at its lowest price. This decision needs to be carefully calculated and the cost of holding stock and opportunity costs of spending more than you have to at once, need to be considered.

Summary
Monitoring market fluctuations in order to assess the impact on the supply chain has become one of the major strategic roles for P&SM professionals. These market factors can have a
negative and positive impact in both a direct and indirect way. By keeping abreast of market trends, we can create more informed planning and forecasting schedules to minimise the impact on the organisation.

Thinking outside the box at the bigger picture is also necessary where the impact is indirect. In this example plastic and packaging buyers were probably not as quick to realise the impact as those buying wheat directly. Another example is when foot and mouth disease caused much of the UK’s cattle to be destroyed. Then Clark’s, the shoe manufacturer had not anticipated the knock on effects of the lack of available cow hides; most of the cattle were incinerated.

Knowledge is king and thorough research can help mitigate against supply chain risk or at the very least, reduce the impacts. Further information can be found on risk management and supply chain vulnerability in our Knowledge Works documents on the professional practice pages of the CIPS website.