

# Coping with rising costs

## The surge in the cost of raw materials and commodities is expected to continue into next year. Manufacturers are taking steps to cushion the impact

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MANUFACTURERS for a broad base of products are grappling with rising costs and are coming out with strategic plans to weather the challenging times.

This follows a surge in the prices of commodities, especially crude palm oil; energy (crude oil and gas); raw materials (steel and cement); and food (rice, wheat and milk).

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Malaysia's largest bottled water producer Spritzer Bhd, has embarked on initiatives to mitigate the impact of rising costs of raw materials involved in the manufacturing of bottles.

Executive Director Dr. Chuah Chaw Teo said one of the measures adopted was economies of scale in purchasing. "We are able to purchase raw materials at discounted prices. We are also stepping up efficiency via our state-of-the-art production lines that run with high efficiency and minimum rejection rate."

"We can reduce environmental impact and also save cost on the polyethylene terephthalate (PET) resin - the raw material used for the production of bottles by using our lower weight bottle design."

## Tough times for firms dependent on commodities

THE issue of rising raw material prices is impacting Malaysian businesses.

Even commodity as well as oil and gas-related firms that have benefited from buoyant crude palm oil and energy prices have not been spared from the current business environment.

TA Securities research head Kalalther Govindan, in his analysis of the first quarter (Q1) results, said companies that were relying heavily on commodities as raw material input were facing margin pressures.

"The operating margins for the basket of companies that has announced results so far has reduced to 27.5% in Q1 this year from 27.9% and 29.7% in Q4 and Q1 of 2007 respectively. The affected sectors are consumer, power and industrial," he told StarBiz.

Kalalther said the current escalation in inflationary pressure was just the tip of a widespread phenomenon that would eventually permeate into all other sectors.

"Some oil and gas players like Scomi Marine Bhd are already facing the impact of rising crude oil prices in the form of higher bunkering charges," he said, adding that consumer players like Nestle (M) Bhd also saw some margin erosion at gross profit level due to rising prices of

commodity prices. The country's largest tobacco manufacturer British American Tobacco (M) Bhd (BAT) has in place an integrated and responsive supply chain that is able to optimise efficiency and enhance productivity.

Operations director Datuk Chan Choon Ngai said: "We achieved this through constant chalking up of the status quo to achieve breakthroughs in management, improvements in work practices and at the same time, minimise any holding stocks beyond requirement in the short term."

Women undergarment maker Grand Bell Trading Sdn Bhd chief executive officer Joseph See said some of the notable steps to combat costs was reducing wastages and excess stocks during manufacturing. It enhanced productivity and efficiency by implementing systems for better stock control, upgrading staff technical know-how.

See said the company would also continue to provide value for money products and invest in research and development programmes.

The company planned to explore the market for more competitive products without compromising on quality and to expand its export markets.

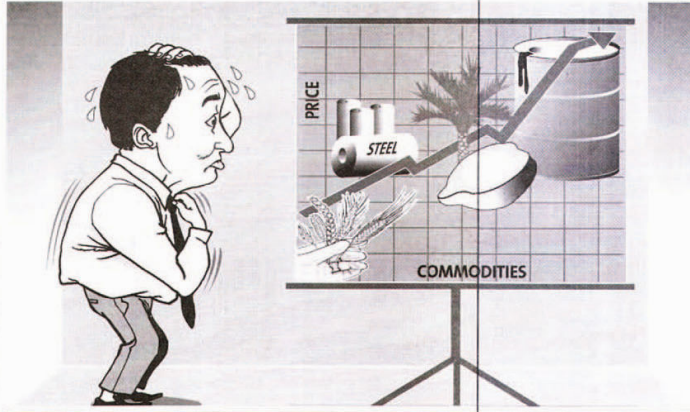
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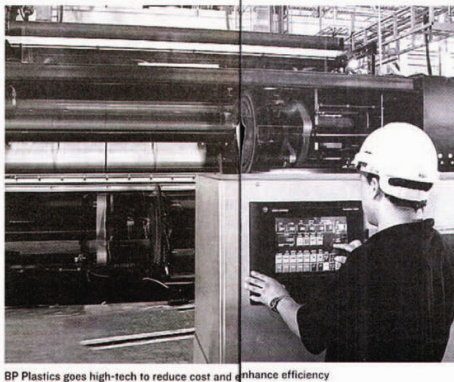
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BP Plastics goes high-tech to reduce cost and enhance efficiency



Datuk Chan Choon Ngai  
Operations Director  
British American Tobacco (M) Bhd

BAT Malaysia, like many other local manufacturers, is faced with increasing cost of operations due to the rising cost of raw materials.

The prices of imported tobacco leaves and cigarette wrapping materials have risen significantly over the past few years. Labour costs in Malaysia, one of the highest in the region, have also escalated over the years. The reason for the surge in prices of imported tobacco leaves is due to supply shortage caused by bad weather. Wrapping materials have been hit by ascending prices of oil and other commodities like paper pulp and plastic. Inflation is the main factor driving labour costs.

With commodity prices and inflation on an uptrend, further increases in raw materials and labour costs are expected.

We are trying our best to manage these price hikes through operational efficiencies. The problem is further exacerbated by growing competition from our Asian neighbours as they are able to produce cigarettes at a lower cost. This is because all cigarettes made for consumption in Malaysia must contain at least 70% domestic tobacco leaves, which is the most expensive in the region.



Dr. Chuah Chaw Teo  
Executive Director  
Spritzer Bhd

THE raw material used in the production of bottles is polyethylene terephthalate (PET) resin, which is polyester derived from petroleum base. The continual surge in crude oil price has resulted in an escalating PET resin price.

The major increase in PET resin price came in the last few years when crude oil price started to climb over US\$100 per barrel. We see this upward trend to continue until next year, especially if the US dollar continues to weaken and if the issue of food shortage is not resolved quickly.

Currently, we export 10% of the company's production. Spritzer is still very focused on the local market with its brand now becoming a household name.

We are aggressively participating in trade shows organised by Matrade, aimed at penetrating markets such as Australia, Japan, the Middle East and Southeast Asia.

We have recently succeeded in venturing into Australia and we hope to enter the other markets soon. Spritzer natural mineral water, for the 10th consecutive year, has won The Most Trusted Brand Platinum Award from Reader's Digest magazine last week.



polyethylene prices have been increasing for the last three to four years.

However, with the anticipated mega global polyethylene capacity coming on stream towards the year-end, polyethylene resin prices are expected to decrease towards end-2008.

To cushion the impact of rising costs, we are exporting about 70% of our products now compared with 60% last year, particularly to Europe and Asia's emerging markets.

Our lean and efficient organization will help us withstand the current economic turmoil.



Most of the cost increases are due to a surge in raw material prices, especially chemicals, which are petrochemical derivatives. In addition to that, freight expenses have also increased.

As more than 60% of our turnover is from exports in US dollar terms, there is significant exchange loss. Obviously, the increase in oil prices has directly impacted us, but the falling value of the US dollar is not helping.

The hike in costs has been going on for over two years now and we expect this increase to continue into the following year. With exports accounting for over 60% of total turnover, we are now looking to expand into other new markets. We plan to venture into the Middle East and will participate in a trade fair to be held in June. We also hope to make inroads into Pakistan, India and Bangladesh. Besides, the rising cost of living is an issue we will have to address sooner or later. This could include wage adjustments, which would increase our costs.

I would like to suggest that the Government address the issue of the rising cost of living in the coming Budget. Companies that make the effort to relieve these rising costs should be granted double tax exemption.



Joseph See  
Chief Executive Officer  
Grand Bell Trading Sdn Bhd

The production of Skiva undergarments has been affected by a surge in production, operational and retailing costs.

Our manufacturing costs increased by about 10% due to higher raw material prices while labour cost was up 5% for the company's entire operations. Retailing expenditure jumped by almost 15%. The higher manufacturing cost was due to rising raw material prices and logistics costs. Rising labour cost is unavoidable as we have to help employees cope with the escalating prices of essential goods.

Retailing cost was due to increases in the sales margins of consignment counters for major retailers such as hypermarkets and departmental chains.

We experienced rising cost pressures in early 2007, particularly in retailing. Owners of hypermarkets and department chains will review their consignment counter sales margins on a yearly basis. This practice reduces the profit margin of local manufacturers of home grown brands. We anticipate the increase in costs to continue until next year. Given such a scenario, we would have no alternative but to review our selling price and pass on some of the rising costs to consumers at a later stage.



William Arul  
Chief Executive Officer  
Flavor Inn Corp Sdn Bhd

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