

Xue Bin Chen, PhD, MBA

My experience of doing  
business in China

Strategic  
Management  
of Lucta China

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**Part 1**

**The Strategic Management of Lucta China**

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Map of China. The labels are names of provinces.

## PREFACE

### 0.1 FROM SCIENCE TO COMMERCE

My major training or profession is science. I studied Animal Science at the South China Agriculture University in Guangzhou during 1980-1984. I won a scholarship to continue postgraduate studies in Britain from 1985. At the June 1989, I was awarded a PhD degree in Animal Nutrition from the University of Aberdeen. My PhD research work was carried out at the Rowett Research Institute, also in Aberdeen, one of the leading research centers in Animal and Human Nutrition in Europe and the world. My research work was on protein nutrition of ruminants and focussed on protein and nucleic acid metabolism in these animals. I developed a new technique which enables us to measure the protein supply status of ruminants. I was awarded in 1990 the first "Cuthbertson Award", an award given to a PhD student his/her merit research work. In 1989, I was given a job to continue my research at the Rowett institute. For the next 9 years, my heart was dedicated to science. The new technique was widely adopted by many laboratories in the world, and it was taken up by the Joint Division of FAO and International Atomic Energy Agency in one of its agricultural research programs as a tool to study how to improve the animal productivity and optimize use of local feed resources in developing countries. I had contributed over one hundred scientific publications in prestigious scientific journals. During the time, I also travelled widely for scientific conferences, lectures and technical training.



Figure 0.1. Giving a presentation in a scientific conference in Indonesia 1996

By 1995, as a senior scientist and a team leader, I spent a significant portion of time on managing projects, presenting our work to fund providers and grant application. I felt a need for management skill training. I started an Executive MBA course at the University of Aberdeen. In reviewing the course today, my main learning can be summarized by two words “competitive advantage”. In the modern date business and academic work alike, competition is getting increasingly harder, the success of a business or an academic institution, heavily depends on whether it possesses competitive advantages.

The MBA learning had been beneficial to my academic work, for example, I applied some principles of marketing in promoting our work among fund providers, and we won some grant applications. At the end of the MBA course, I was approached by Lucta S. A. though its adviser Dr K. J. Cheng, who had known me for several years. Lucta offered me a job to build a new subsidiary in China, which would use both my technical expertise in animal nutrition/feeds and the newly acquired knowledge and skills in business management.

Indeed, many of my former colleagues or friends did not understand why I quit a successful career development in science. I suppose, it was the challenge of creating something new.

## 0.2 STARTING OF A COMMERCIAL CAREER

After taking on the job, I went to China in January 1998 to research for suitable locations for the Lucta site, preparing some options. After a one-month training in Lucta headquarter in Barcelona, in March 1998, I then went together with three Lucta managers to Beijing, Shanghai and Nanjing for a brief market research and decision on the location. A decision was made to place the new Lucta subsidiary in Guangzhou Economic and Technological Development District. I stayed in China for the next a few months, overseeing the registration of the company and the renovation of the site. In July, the company was registered, under the name “Lucta (Guangzhou) Flavours Co., Ltd”. The rented premise was refurbished and ready for the start of operations from September. Six staff were appointed, including one secretary, one accountant, three salesmen and one operations manager. I was the general manager.



Figure 0.2: Photographs of Lucta subsidiary in Guangzhou (left) and the senior management of Lucta S.A outside Lucta China office (right).

The first shipment of feed additive products arrived in November of 1998, and the business started effectively from 1999. The business started from zero. Nobody in China at that time knew about either Lucta company or its products. Although Lucta's products were distributed in Taiwan and sold in China in limited amounts, those products did not bear any Lucta names. I led the three salesmen gradually to build the sales and the Lucta brand name over the coming four years (see Figure 0.2). As of today (end of 2002), the annual net sales had increased to USD 3.5 million with the initial investment recovered and profit as planned. More importantly, the Lucta's core product line, 'Luctarom' had established its position in the Chinese market as a high-quality product of feed flavours. From early 2001, we had started to prepare for local manufacturing. Manufacturing facilities had been installed, local sourcing of some raw materials completed, and production started from beginning of 2002. A team of motivated staff had also been built. Staff for the functions of technical support and quality control were in place. Sales team had increased to six people, with a total of 16 people in the company (see Figure 0.3).

The nature of my work had changed. Daily work changed to building relationship with key customers, marketing and business planning, and human resource management. As the business grew, my job focus gradually shifted towards strategic formulation and human resource management. Building a successful team had been my objective in human resource management of the company.

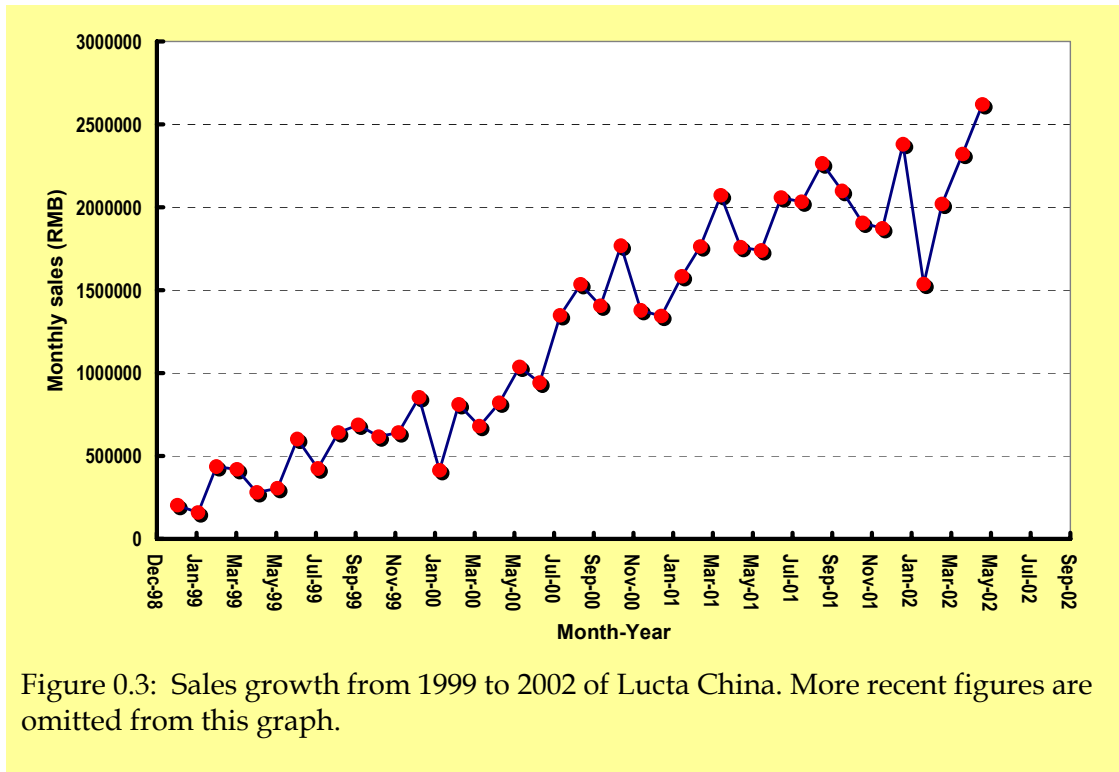


Figure 0.3: Sales growth from 1999 to 2002 of Lucta China. More recent figures are omitted from this graph.



Figure 0.3. The Lucta China team as of 2002.

### 0.3 THE CHALLENGE

For me, the challenge is to create something new. It is challenging to build a business from scratch into a successful one in the industry where it engages. Lucta China started from zero, and within five years, it was becoming a well known brand name in the feed flavour industry of China.

Even in commerce, my scientific mind is still influencing the way I do things. From the start of business, I had embarked on a grand experiment: to apply the modern business theories and models which I learnt from MBA studies to the new Lucta business. I went through a learning process: set up initial strategies - observe the results from the business - modify or reinforce the strategy - next cycle and so on. Even today, the learning process till continues.

### 0.4 OBJECTIVE OF THIS WRITING

Summary is an important step of a learning process. I write this booklet essentially as a summary of my learning process up to this stage so far. Personally, it is also for my own memory of those hard-working years.

This summary will cover how the modern theories were used in the real business: from the analysis, formulation of strategies, implementation of strategies, to the result assessment, and finally future strategies. The summary will highlight the learning experience. I believe that this learning experience might also be of interest to those who wish to do business in China. For this reason, I include in this summary also some insights of the Chinese market.

The experience is also Lucta's one. The summary may serve as the documentation of what had been achieved up to this day in Lucta China, which may become the bases for formulating future strategies of the company.

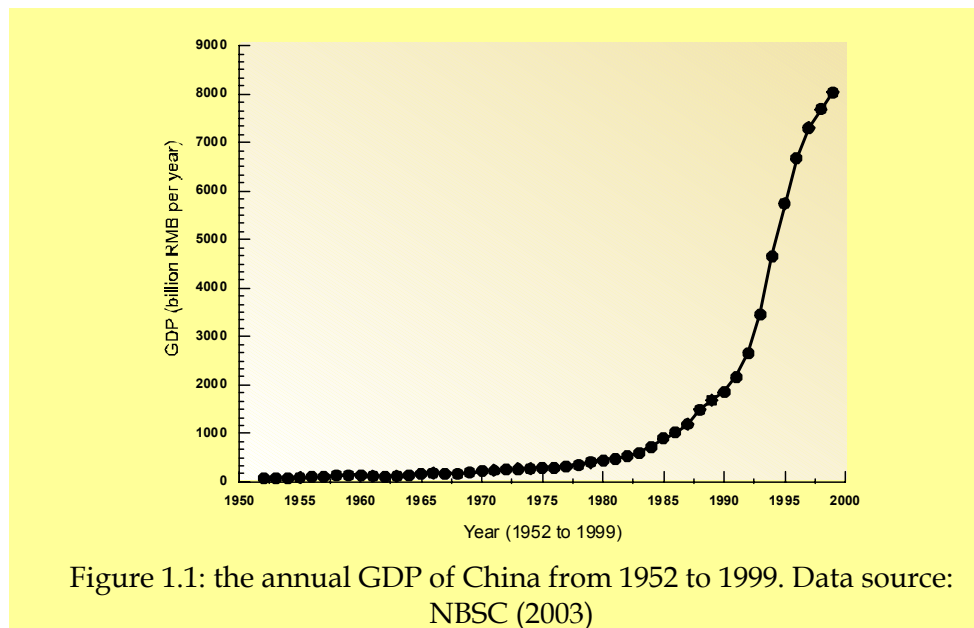
# CHAPTER 1

## LUCTA'S STRATEGY IN CHINA

### 1.1 CHINA AS AN ATTRACTIVE MARKET FOR FOREIGN INVESTMENT

Before I go into details of starting business in China, it seems useful to highlight the economic trend of China.

China as a fast growing emerging economy is well known to the world. The growth rate for the year 2002 was 7% and a rate of 9% was maintained over the past ten years. Figure 1.1 shows the evolution of GDP from 1952 to 1999. One can see that the fast growth phase started effectively from 1980. Before 1978, the country was closed to the outside world and the economy was dictated by State-planning. Private business was not allowed. It was only from 1978 that the State-control over the market was gradually relaxed. From then, farmers were allowed to choose what to plant on their own land and private businesses were allowed.



The influx of foreign direct investment has also grown as China opens its market to the outside world. Figure 1.2 shows the number of foreign direct investment companies and amount of foreign fund influx over the past 20 years. According to the statistics of Ministry of Foreign Trade and Economic Cooperation (MOFTEC) of China, as of September 2002, a total of 414,796 foreign companies were incorporated in China

and a total of 434.78 billion USD of foreign direct investment fund was actually utilized. China became a member of the World Trade Organisation (WTO) on 11 December 2001. It is expected that more foreign business will be operating in China.

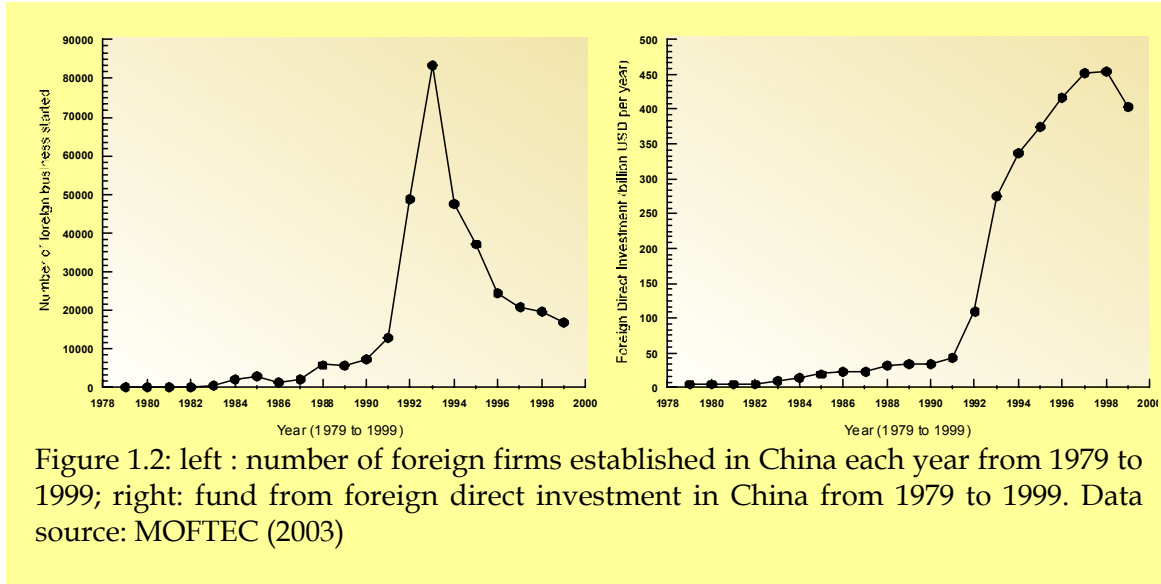


Figure 1.2: left : number of foreign firms established in China each year from 1979 to 1999; right: fund from foreign direct investment in China from 1979 to 1999. Data source: MOFTEC (2003)

Foreign companies choose to invest in China mainly for the following reasons:

- 1) Domestic market need is big. A population of 1.3 billion people created a huge need for consumer products. To provide the enough food for human, the animal industry and hence feed industry are big in scale.
- 2) Due the relatively lower cost of labour and raw materials, many companies use China as a manufacturing base. Products are exported to supply the other markets.
- 3) The political and social environment is stable, giving more confidence to investors than before.

For many companies, it is strategically important to have business in China. For some companies in Europe where business growth is already at plateau, moving to China and Southeast Asia is an option for expansion. Other companies may move to China with a longer term objective, to occupy a market stand in a country which will become the fastest-growing area in business in the future.

## 1.2 LUCTA'S INTERNATIONAL STRATEGY

Lucta S.A. is a medium-size company located in Barcelona Spain. Started in 1949, Lucta's business covers three main sectors: fragrances for industrial application, flavours for human food, and feed additives for animal feed. Lucta has wholly-owned subsidiaries with

manufacturing facilities in Mexico and Columbia, both started in 1960s. Lucta was more like a family business before despite its operations in the Spanish speaking South America. Effectively from the time when Carlos Prada became the managing director, the company started to act with a greater vision of multinational business. In 1998 Lucta China (in the name of Lucta (Guangzhou) Flavours Co, Ltd) was established. Also in the same year, Lucta acquired Agrimerica Inc. in USA, which was then the second largest feed flavour producer in North America, aiming to expand its market coverage in North America. In Brazil, the previously sales office (also established in 1960s) was reconstructed into a manufacturing plant to strength its coverage in the Brazilian market.

It was logical for Lucta to go to China, part of the reasons already stated earlier. In addition, Lucta's feed additive business had already reached a plateau in the stable market of Europe and also of Mexico and Columbia, having been in the market for 3 decades. However, business in Southeast Asia grew significantly but the products had to be shipped from Spain. Setting up a manufacturing base in China thus would create a growth point for feed additive business (and providing the experience for other sectors too in the future). Shipping products from China to Southeast Asia would also create cost-advantage. After all, quite a substantial part of raw- materials currently used by Lucta Spain were imported from China.

Lucta's China project plan was: Stage 1, to establish a sale office with warehouse space using a leased property; and to market products directly imported from Spain; Stage 2, to start partial manufacturing (only the last step of the manufacturing process) thus exploiting the cost-saving from local raw materials and labour; Some products can be exported to Southeast Asia, currently being served by products shipped directly from Spain. Stage 3, to purchase own land and premise and extend the degree of local manufacturing. The sector of business shall also be introduced one at a time. Feed additive sector was started as the business for Lucta China from its formation. The plan was that food flavour sector would be introduced when the feed additive business had had a firm market stand in China, and so on for fragrance sector.

How did Lucta's China strategy compare with the general pattern of international business? Figure 1.2 shows the different routes taken by companies to enter a foreign market. These fall under two categories: cooperative entry and direct investment. With a cooperative entry approach, a company may export and sell its products to a foreign market, indirectly e.g. by using domestic-based agents/distributors (indirect entry), or export and sell its products directly by using foreign-based agents/distributors, or its own staff and own sales office (direct entry). Cooperative entry also includes licensing and forming joint ventures with local partners. With a direct investment approach, a company may build new facilities or acquire existing facilities in the foreign market.

The different entry modes vary in the risk of losing proprietary information, in resources requirement and in the degree of control, as shown in Table 1.1. It can be seen that direct investment mode poses a low risk of losing proprietary information, gives the investor a high degree of control, but requires higher resource inputs.

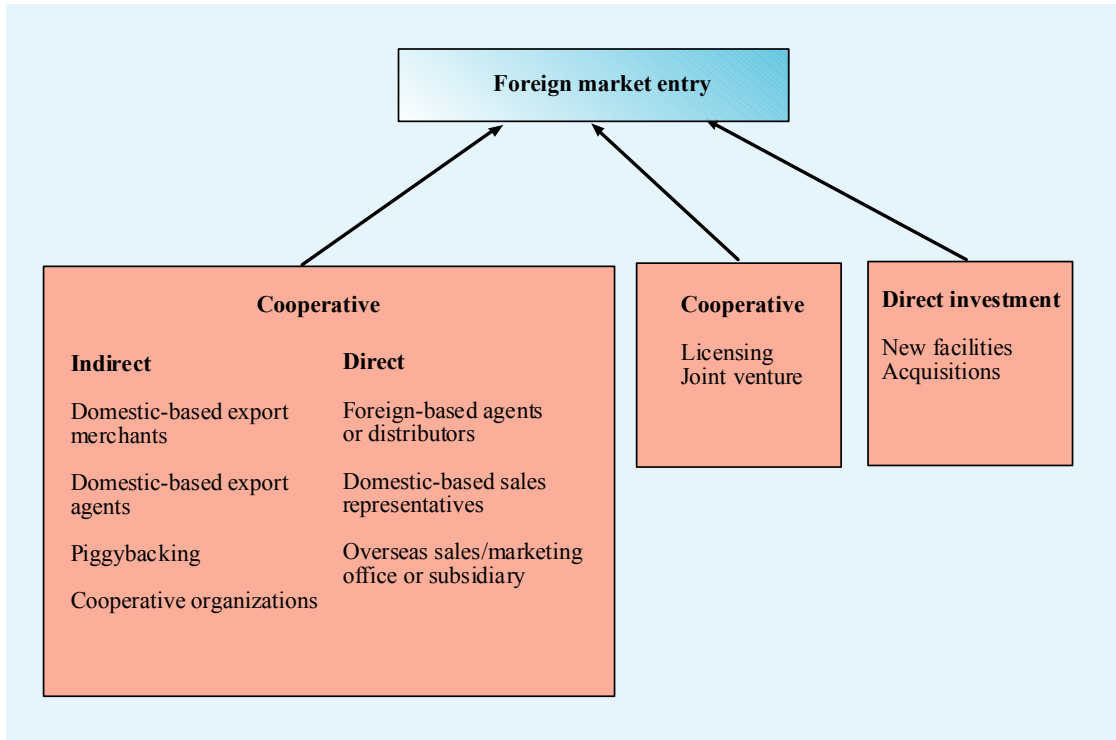


Figure 1.2. Foreign market entry strategies. From Jobber (1998)

Table 1.1: Different foreign market entry modes and levels of control, resources requirement and risk.

| Level  | Factors  |   |  |
|--------|--|---|--|
|        | Risk of losing proprietary information   | Resources requirement   | Degree of control  |
| High   |  | Direct investment   | Direct investment<br>Exporting (using own staff)         |
| Medium | Licensing<br>Joint venture   | Joint venture<br>Exporting (using own staff)                          | Licensing<br>Joint venture                               |
| Low    | Exporting (using domestic-based or foreign-based agents)<br>Exporting (using own staff)<br>Direct investment | Licensing<br>Exporting (using domestic-based or foreign-based agents) | Exporting (using domestic-based or foreign-based agents) |

The international strategy taken by Lucta in China was direct investment, but starting with direct exporting using its own sales office. It was a strategy with an objective to minimize risk and maximize control.

Talking about control, Lucta headquarter exerted control over its subsidiaries mainly in the following areas: corporate strategy (which business sector the subsidiary should be doing), financial (accounting method convergence, and daily and monthly reporting), product manufacturing (including quality control), and operations (what sales channel to use, how many people to employ). However, regarding aspects of business strategy (how to compete in the market place) and marketing strategies (how to sell the products), the decisions were really made by subsidiary managers.

### **Side Story: How Lucta China was set up**

The idea for setting up a business in China had been with the company for quite some time. The barrier preventing the step into it was the little knowledge about China. Before 1997, the managing director, Carlos Prada, got to know a Canadian professor, Dr K J Cheng, who was doing some contract research for Lucta Spain. Cheng proposed to assist Prada for starting up a business in China, since he had some connections in China, mainly previous students. Cheng became Lucta's consultant for the China project.

In 1997, Prada and Cheng visited China twice in April and August. Lucta planned to start feed additive business first, therefore the director of feed additive division, Jose Espinedo, also joined the trip. Through talking with feed mills, they had got some preliminary but first hand information about what products were sold in the market and at what price. They were convinced that there would be a market for Lucta's products and their prices would also be competitive. Prada's proposal for the China project was approved by the Board of Directors. The plan was to employ by December 1997 a Chinese professional educated in a western country to take care of the operations in China, and to start operation by May and selling of the products by second half of 1998. I was employed for the job starting from January 1998. My immediate task was to select an appropriate site, set up the company and start operation as planned.

#### **Site selection**

The question was where in China the Lucta company should be situated. The initial suggestion was Shanghai. One consideration, Shanghai had developed very fast in the past years and would soon become the business and financial centre in China. I suggested Guangzhou, for three reasons. First, feed industry in Guangdong was the most advanced in China. The output of feed mills in Guangdong province along accounted for 1/6 of total feed production in the whole country. It was where the customers were; Second, Guangzhou had a reputation for supplying feed additive products of foreign origins. Thus the image of selling foreign feed additive from Guangzhou was good. Thirdly, I had a lot of personal connections in Guangzhou (I studied there for 5 years). Thus it would be earlier to get started. In term of

logistics, both cities were good choices since port and infrastructure were the best in China.

I went to China in January 1998 to explore Guangzhou and had listed some potential choices. In end of March 1998, a Lucta team, including Prada, Cheng, and the feed additive and manufacturing division directors, visited China again. The trip included Shanghai and Guangzhou. After visiting these two cities, Guangzhou was the clear choice of the time.

Guangzhou is the capital city of Guangdong province, one of the 25 provinces in China. Because it is close to Hong Kong, Guangzhou was one of the earliest cities opened for foreign investors. Business environment was much better than other cities further inland. Guangzhou was one of the most prosperous cities in China. It had a population of 8 million.

Having decided the city, the next decision involved the choice of location. Among the choices of sites I had provided based on my previous trip, the clear choice was the Guangzhou Economic and Technological Development District (GETDD). The GETDD is a special district 35 km from the city centre created in 1985 from a plain area of banana plantation to a self-contained industry site to attract foreign investments. Apart from the basic facilities for business (electricity, water, gas, communication, transportation), the district was also equipped with container port, customs, tax bureaus etc. Transportation to the city centre, airport and rail station was convenient and fast. Within the district, there was a ferry service direct to Hong Kong. Many of the world's 500 top companies had already invested in this district, including P&G, Pepsi Cola, ICI, Nescafe, ABB, and Colgate-Palmer.

By end of March 1998, a contract was signed to hire a newly-built factory plant within GETDD as the site for the new Lucta company. The new building was about 1000 M<sup>2</sup> and was sufficient for office and warehouse. Renovation work started in 24 June 1998 and completed by beginning of August.

In reviewing this decision today, the choice of Guangzhou was still the right one. Despite its location in the southern end of China, sending goods by truck to Shandong in northern China would only take 5 days. I came across companies which made bad site decisions. Bayer of Germany, for example, set up a feed additive and animal health products manufacturing plant in Chengdu, Sichuan Province, which is located in the west part of China. The transportation of goods to other cities took longer time and cost more.

### **Company registration and formation**

In Western Europe, UK for example, the procedure for registering a new company is simple and this can be delegated to a solicitor. Registration will be made directly with the Company House, i.e. one authority deals with all companies nation-wide.

In China, the system is completely different. Company formation needs to pass through the approval of several government authorities. Application for a business license is made with the "Industrial and Commerce Bureau (ICB)". There are many ICB, one for each level of administrative hierarchy. In China, the administrative hierarchy is: state 国家- province 省- municipal city 市- county 县- township 镇. There are practically tens of thousands of ICB, with no communication between them. Depending on the location and the name of the company required, registration should be made with the appropriate levels of ICB, and subsequently the annual renewal of license made at the same ICB. For example, a company called "Guangzhou ABC Ltd", should be registered with the ICB at Guangzhou municipal city level; and a company called "ABC (China) Ltd" should be registered with

the State ICB, i.e. the company formation should be approved by the central government. Thus, small and medium size companies are not able to use the word "China" in their names. In the past 20 years, the government had a policy to encourage foreign investment. Regional CIBs had room to interpret the central government policy differently. Some regional CIBs gave special privileges to investors in order to attract investment to their regions. Accordingly, the requirements for forming a company and the registration procedure could vary with different ICBs.

At the time of registration, as a foreign investment, Lucta was given s privilege of first 3-year profit tax exemption following by 2-year 50% reduction in tax.

For a foreign company wishing to establish a company in China, the first government authority to contact is the local "Economic Development Bureau (EDB)". Like the ICB, there are different levels of EDB. The EDB assesses the feasibility of the investment project and check that this project is not within the areas prohibited by the government. If the project is within the encouraged business area, approval for the project takes less time. China welcomes foreign direct investment in the form of manufacturing and not trading. If a foreign investor wishes to open a manufacturing firm, a local EDB can decide whether the project can go ahead or not. However, if a foreign investor wishes to open a trading firm, the decision has to be made by the state level EDB.

The next stage for Lucta was to go through the paper work required for the company formation. The officials of the EDB in the GETDD suggested that we could ask a Chinese consultant company within the district to help with the registration work. However, the Baker & McKinsey company situated in Hong Kong was employed instead. The latter did not have an office or representative in Guangzhou. Baker & McKinsey spent the next two months working on two documents, the Article of Association and the Report of Feasibility Studies. It took so long, because the template they used for the Article of Association for company in Hong Kong did not suit the requirement for China. The time was spent on tossing the printed documents between Hong Kong, Guangzhou and Barcelona with correction and re-correction. By end of May 1998, seeing that no papers had been submitted to the EDB and ICB, the EDB official of the GETDD offered to appoint an internal company to do the work at no cost to Lucta. With the help of the Chinese company, most paper work was completed within the next 2 weeks. On 15 June, application was submitted to the ICB and a provisional business license was granted on 2 July. The registrations with several other government authorities were subsequently made. The final business licence was granted in November 1998. The new company "Lucta (Guangzhou) Flavours Co., Ltd" was finally established.

The original plan for starting operation by the second half of 1998 had to be delayed due to the delay in company registration. Initially Lucta was planning to appoint Baker & McKinsey as the company's legal consultant, the plan was cancelled and later a Chinese law firm was appointed instead.

### **Legislative procedures after registration**

For the interest of readers who may wish to do business in China in the future, here I highlight some procedures that may be different from other countries.

The business license needs to be renewed annually, usually before May in Guangzhou. With companies registered as a foreign-investment company or joint-venture, the procedures are more tedious and can take the major part of one person's one month of work, since there are many forms to fill.

Accounting reports need to be submitted to the local tax bureau before the 10th of each month. Annual audit is of course also needed.

In China, fund transfer out of the country is controlled. Permission from the 'Foreign Currency Administrative Bureau' is required in order to send money out of China to pay for non-merchandise purposes, whatever the amount. Each payment requires separate permit. Of course earning from profit can be taken out of the country without problem. In Lucta, subsidiaries are required to pay loyalty fee to the head company. It has been a big problem for Lucta China to pay in time as the procedure to apply for permission to send money out is very tedious. The application required materials such as contracts, evidence for use of trademarks, technologies and management support etc. which need to be scrutinized also by the tax bureau, as the loyalty fee is to be treated as cost.



Figure 1.3: Scene of Lucta China on the day of opening ceremony on 15 March 1999. It was a large event, more than 200 guests were invited.

## CHAPTER 2

### KEY ISSUES IN STRATEGIC MANAGEMENT

The success of a company relies on three prerequisites: 1) the company must be operating in an attractive market (or industry) for long term profitability; 2) it must have certain competitive advantages over its competitors within the selected market; and 3) it must be able to communicate the advantages to its customers, thus transforming the advantages into profit. These three areas can be regarded as the key issues for business strategic management.

Relevant to these areas, many questions may be asked:

What kind of markets is attractive and who assess the attractiveness of a market? When we have different products which are engaged in different markets, how are we going to prioritize? Finding answers to these questions is a process of corporate strategy formulation.

Once the market is chosen, how should we compete in that market place? What advantages do we need to possess in order to win the customers? Are we going to compete by achieving the lowest cost, or are we going to compete by being unique in certain areas? These questions fall in the area of setting business strategy. The business will have to be conducted differently depending on the chosen strategy.

Finally, but not the least important, how do we implement the business strategy in the actual business operations, in respect of product, price, promotion, and place (sales channel)? This is the scope of marketing strategy.

The key issues of strategic management are also embedded into the market positioning of a company. The “market” for a particular product is composed of potential customers who have needs for the product and are willing to pay money in exchange for satisfying their needs. “Potential customers”, “needs” and “satisfy needs” are the three key elements. In market positioning, there are accordingly three key questions which we need to ask all the time:

*Who are our target customers?*

*What are their needs?*

*What, and how, should we do in order to win the customers preference?*

Companies should have clear answers on these questions from the start of, and throughout, the business.

Indeed, some of the questions above had been raised and answered in the course of Lucta China business. Questions relating to corporate strategy and business strategy even had to be answered from the start.

This chapter serves as a general introduction to the next four chapters to come. In Chapter 3, I will discuss making corporate strategic decisions regarding choice of priority for different products or markets. In Chapter 4, I will discuss the formulation of business strategy and in Chapters 5 and 6, the setting and implementation of marketing strategies.

## CHAPTER 3

### STRATEGIC CHOICE ON MARKET (PRODUCT)

#### 3.1 INTRODUCTION

Lucta China had three product lines: Luctarom, Luctacid, and Luctamold, the trade names for products of feed flavours, acidifiers and mould inhibitors respectively (more details about these products are given in section 3.3.2). Although three products are within the feed additive industry, they address different needs and so they could be taken as different markets. The first question was: what product should our company be best known for?

It is necessary for a company to make a clear statement, “We sell feed flavours.”, or “We sell mould inhibitors.”, etc.. By doing so, it is easier for customers to create an association between the company and that product group. It is easier for the company to establish dominance in one sector than many sectors. “We sell feed additives” would be too blur, since there are practically hundred types of feed additives.

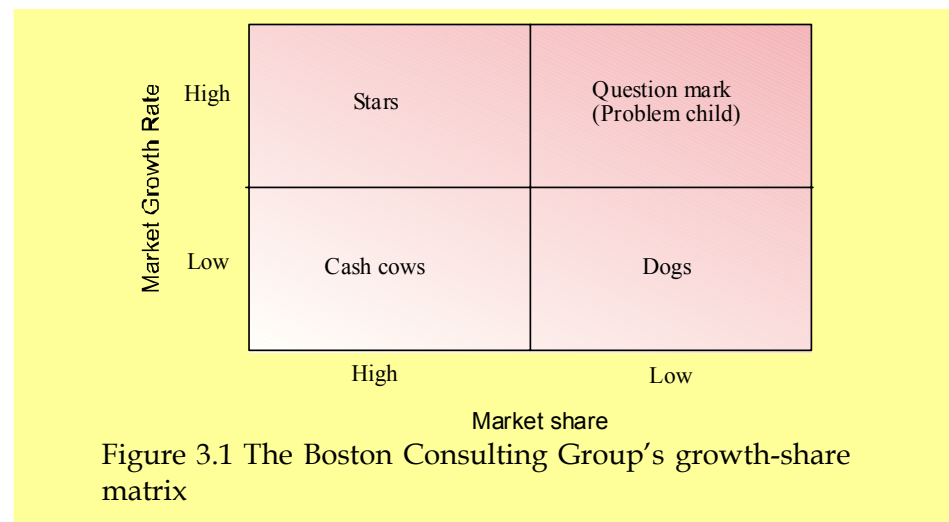
In this chapter, I will discuss the application of the principles of two most widely used models, the Boston Consulting Group’s growth-share matrix and the General Electric market attractiveness-competitive position matrix, to the analysis of the market attractiveness and competitive positions of each product line. From the analysis, it was concluded that Luctarom should be our core business while the other product lines were secondary products. This decision then steered the subsequent business operations.

#### 3.2 MODELS FOR CORPORATE STRATEGY SETTING

##### 3.2.1. *The Boston Consulting Group’s growth-share matrix*

The Boston Consulting Group (BCG) growth-share matrix is the most widely-used model for product portfolio or strategic business unit management. It is used to evaluate the significance of each individual product (or service) produced by a company in relation to all the others, in order to establish future priorities and needs. Effectively, it is a tool which companies can use to decide which industrial sector or market to engage in. Moreover, the BCG matrix can also be used to evaluate the current position and future potential opportunities for a product within the particular market or industry in order to establish the appropriate marketing strategy.

The BCG matrix is consisted of annual market growth rate as y-axis and product's relative market share as x-axis. The relative market share refers to the market share of the product relative to its largest competitor in the market. For example, a value of 0.25 means a market share 25% of that of the market leader. Relative market share is divided in to high and low using 1.0 as dividing line. An annual market growth rate above 10% is considered to be high. There are four positions in this matrix, which are named as "stars", "cash cows", "question mark or problem child" and "dogs", as illustrated in Figure 3.1.



1) A *star* is a product which has a high market share in a growing market. It is a market leader but requires substantial investment to maintain its growth (e.g. product facility) and to meet competitive challenge from competitors. Cost reduction may be possible through economies of scale and through learning (experience) curve effect. A company at star position is likely to be profitable.

2) A *question mark* (or *problem child*), is a product also in a growing market but its market share is low. The company will have to invest a lot of money to gain the market share. It is not likely to be profitable for a short run. A question mark is drain of money.

3) A *cash cow* is a product which has a high market share in a mature market. Because the growth is low and market is stable, there is no need for heavy investment. Cost is likely to be the lowest since the learning curve is finished. It is thus a profitable business and a cash provider.

4) A *dog* is a product which does not have high market share in a static or decline market. It will be costly to increase its market share. It would produce negative cash flow and negative profit.

The four positions can loosely be related to the product life cycle, with question mark representing the introduction stage, stars the growth stage, cash cow maturity stage, and dogs saturation and decline stage.

The appropriate strategic actions depend on the locations in the matrix.

- 1) Star: a) build sales and market share; b) invest to maintain or increase leadership position; c) repel competitive challenges.
- 2) Question mark: a) build selectively; b) focus on defendable niche where dominance can be achieved, but harvest or divest the rest.
- 3) Cash cow: a) maintain sales and market share; b) defend market position; c) use excess cash to support stars or selected question marks and new product development to extend product life cycle.
- 4) Dog: a) harvest or divest; b) focus on defendable niche only.

### 3.2.2 *The General Electric market attractiveness – competitive position model*

This model was developed by McKinsey & Co in conjunction with General Electric (GE) Company in the USA. It is more complex than, or an improved version of, the BCG matrix model.

On the y-axis of the matrix, instead of just one single variable of market growth rate used in the BCG model, the GE model considers five variables:

- a) market volume (V)
- b) market growth rate (g)
- c) strength of competition (C)
- d) profit potential (p)
- e) social, political and legal factors (F)

The five variables, weighed with appropriate factors, are summed to give an index of “Market Attractiveness (MA)”

$$MA = 0.15 V + 0.20 g + 0.30 C + 0.30 p + 0.05 F$$

where each of the variables can be given a score of 0-10. Based on the weigh factors, MA is least sensitive to F (social, political and legal factors).

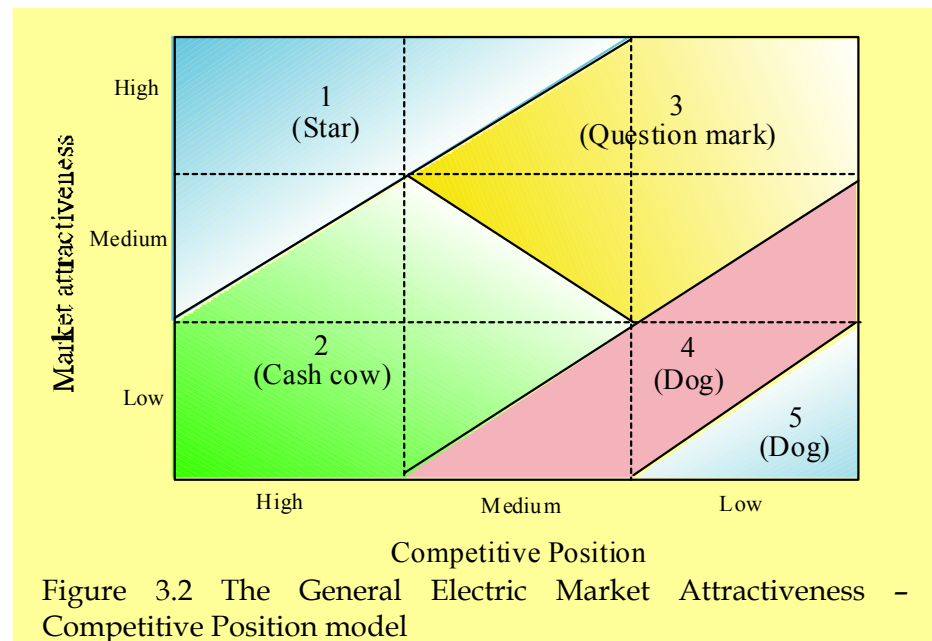
On the y-axis, instead of just one single variable of market share used in the BCG model, the GE model considers 5 variables:

- a) market share (S)
- b) potential to develop a differentiation advantage (A<sub>d</sub>)
- c) opportunities to develop cost advantages (A<sub>c</sub>)
- d) reputation (R)
- e) distribution capabilities (D)

These variables, weighed with appropriate factors, are summed to give an index of “Competitive Position (CP)”:

$$CP = 0.20 S + 0.40 A_d + 0.05 A_c + 0.10 R + 0.25 D$$

where each of the variables can be given a score of 0-10. From the weighing factors, one can see that CP is more sensitive to  $A_d$  (potential to develop a differentiation advantage) than to  $A_c$  (potential to develop a cost advantage).



The MA-CP matrix has five zones which correspond to the positions in the BCG matrix. The zones are shown in Figure 3.2.

- Zone 1: This is a *star*. Strategic action: build – increase sales and market share since the market is attractive.
- Zone 2: This is a *cash cow*. Strategic action: maintain market share and profit while the competitive position is high.
- Zone 3: This is a *question mark*. The strategic action depends on the strength of the competitor. Build if the competitors are weak. Hold or harvest if the competitors are strong.
- Zone 4: This is a *dog*. Strategic action: harvest for cash with minimum input.
- Zone 5: This is a *dog*. Strategic action: divest – improve short term cash yield by dropping or selling the business.

The GE model is more comprehensive than the BCG model, because it takes into account more factors that determine the attractiveness of the market and the company's competitive position in the market. However, it requires more information or data. While the BCG model is useful for assessing the situation of existing products in the market, the GE model can also be used for assessing the potential situation of products before entering a market.

### 3.3 PRODUCT DECISIONS AND STRATEGIC ACTIONS FOR LUCTA CHINA

#### 3.3.1 Feed industry in China in 1999.

Lucta China's customers are feed mills. It is therefore necessary to have a look at the feed industry in China. Feed additives are a group of ingredients to be applied to feed in small quantities in order to improve the performance or certain attributes of feed products. Feed industry in China is a big industry, since it has to support the animal husbandry to provide animal origin food to feed China's 1.3 billion people. The forms of feed manufactured commercially are: 1) pelleted compound feed, 2) protein concentrate, and 3) premix of minerals and vitamins. In simple terms, a *compound feed* (or *complete feed*) contains energy, protein, minerals & vitamins and other additives; A *protein concentrate* equals to a compound feed without the energy ingredients and normally accounts for 15% volume of the complete feed; A mineral & vitamin *premix*, which also contains other minor additives, only accounts for 4% volume of the complete feed.

The production of commercial feed in China increased very rapidly in the past 20 years, from zero in 1980 to 51.8 million tons per year in 1995, making China the second largest feed producing country in the world (see Figure 3.3). By 1998, the annual yield was 55.7 million tons, accounting about 10% of the total feed production in the world (575 million tons). The annual growth rate was 7.5%, 43.0%, and 26.6% for compound feed, protein concentrate and premix respectively.

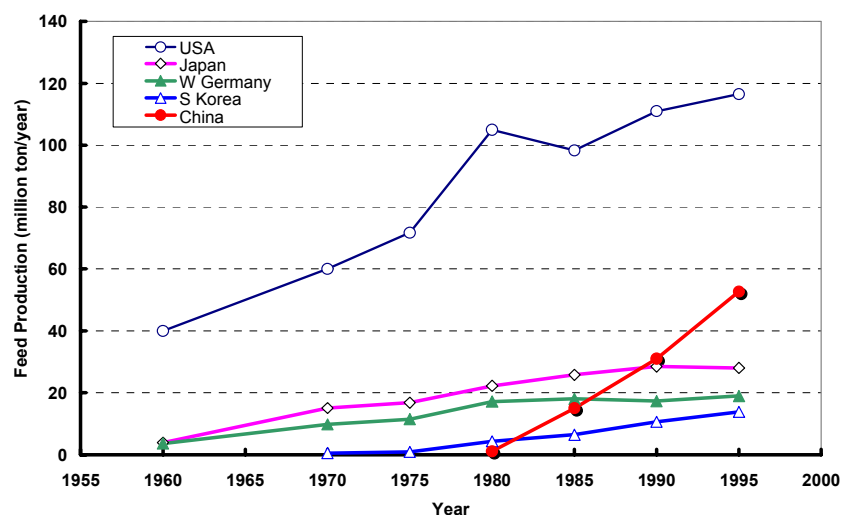


Figure 3.3: The compound feed productions in USA, China, Japan, Germany and South Korea 1960-1995. Data: China Feed (1999)

There is still a large room for growth, as the market potential is much greater. According to the statistics of 1995, the total consumption of feed (by mainly pig and poultry, and to smaller extent, fish) was

299.7 million tons per year, of which only 51.8 million tons were made commercially (17.3%), and the rest (82.7%) were prepared by farmers themselves using raw materials available. The latter part would be replaced by commercial products. In other word, the commercial feed production can still grow by five times in volume.

The feed additive industry exists and grows side-by-side with the feed industry. In fact, feed additive (or feed ingredients) - feed industry - animal husbandry, as part of the supply chain, are tightly bound together. When the market price of pig meat fluctuates, or when there is a disease outbreak with animals, both the feed business and feed additive business are affected.

From the models of BCG and GE matrix which consider market growth rate determinant, we can see that China feed industry, and thus feed additive market, is very attractive for manufacturers of feed additives.

### 3.3.2 Description of Lucta's product lines

Lucta China's feed additive business has three main product lines under the trade names of "Luctarom", "Luctacid" and "Luctamold". The customers are primarily feed manufacturers, and to a small extent animal husbandry farms.

1) Luctarom is a group of products called "*feed flavours*", i.e. flavouring substances, made of a mixture of aromatic compounds. Under the trade name of Luctarom, there are many individual products varying in their sensory profiles, e.g. milky, fruity, spicy etc, or varying in the concentration of essence. Luctarom is used mainly in piglet diets to lure suckling piglets to start eating solid feed. It is also used for improving the palatability of feeds when low quality raw materials are used. These applications are for the purpose of "intake boosting". Because flavours are used so extensively in feeds that buyers (farmers) get used to buying feeds with an intensified flavour. Therefore, some feed manufacturers add flavours to their feed products just to please their buyers. The purpose of this application is "marketing enhancing". Flavours can be added to compound feed, concentrate and premix. Although it is primarily used in pig feeds, it can also be used in feeds of other animals for marketing purpose. Unlike vitamins or amino acids, flavours are not essential to the nutrition of animal and can be dispensable. Under the pressure of low profit margin, feed manufacturers may do without the use of flavours if they can be sure that no damage in sales is caused.

2) Luctacid belongs to a group of products called "*acidifiers*", containing a mixture of inorganic and organic acids. It is intended mainly for piglets feeds, with a function to increase the acidity of stomach and the benefit is reduced occurrence of diarrhea and increased protein digestion in young animals. Acidifiers are not

essential to the nutrition of animals although it improves feed values. Its use lies on its performance relative to cost.

3) Luctamold belongs to a group of products called “*mould inhibitors*”, used to inhibit mould growth in feed, its use is particularly necessary in places where ambient temperature and humidity are high. In South China, between March and September, mould inhibitors should be added in feeds. Some feed mills use mould inhibitors all year round. In North China, being cooler and less humid, the period when mould inhibitors are applied is shorter than in South China.

Based on the market size of the intended feeds, we estimated the total market size of our three product lines to be 32.6, 19.6, and 61.0 million USD respectively (see Table 3.1 for parameters used for the estimation).

Table 3.1: Estimated market size for feed flavours, acidifiers, and mould inhibitors.

|  | Feed flavours | Acidifiers | Mould inhibitors |
|--|---------------|------------|------------------|
| Feed treated (million ton/year) <sup>1</sup> | 8.96          | 3.36       | 33.60            |
| Product sold (ton/year) <sup>2</sup>         | 8,960         | 6,720      | 50,400           |
| Assumed price (USD/kg)                       | 3.64          | 2.91       | 1.21             |
| Revenue (million USD/year)                   | 32.6          | 19.6       | 61.0             |

1. Assuming 16%, 6% and 60% of the total compound feed (56 million ton/year) use flavours, acidifiers and mould inhibitors.

2. Based on dosage of 1.0, 2.0 and 1.5 kg/ton feed treated for the three products respectively.

### 3.3.2 Use of a modified GE model

In Lucta, a modified version of the GE matrix was used as a tool for market selection (product portfolio choice). The difference lies in the calculation of the index for market attractiveness (MA) and competitive position (CP). The MA is calculated from the equation below and expressed as sales revenue in US dollar.

$$MA = V \times p \times (g^2) \times F$$

The variables used are:

1). Market volume (V), refers to the size of real market of the product in US dollars. Here we should distinguish total market, potential market, captive market, and real market. As part of total market, potential market refers to the market segments who can use our product. But not the entire potential market can be taken by us, part of this is captured, e.g. self-supply, or has already been locked up by competitors. Thus the remaining part is the real market. The real market is our target market.

2). Gross profit margin on sales ( $p$ ), is a factor of 0 - 1. It can be simply calculated as:

$$p = 1 - \% \text{ raw material cost} / 100.$$

Here  $p$  is equivalent to the profit potential variable used in the GE model.

3). Market annual growth factor of the real market (g).

$$g = 1 + \text{percentage growth}/100.$$

If the market is expanding,  $g > 1$ , and if the market is shrinking,  $g < 1$ . For example, if the annual growth rate of the real market is 10%, the growth factor is 1.10.

4). Barrier factor (F): a number between 0-1. If the industry has a high barrier of entry, the F would be close to 1 if we are inside the industry and close to 0 if we are outside the industry. Evaluation of the industry is based on understanding of the business and the industry, and the characteristics of the industry: regulatory requirements, size of entry investments required, access to customers, and how easy to exit. The barrier factor is equivalent to the variable of "social, political and legal factors" used in the GE model. In the case of our products, a value greater than 0.5 was used since we were also ready inside the industry (the entry required manufacturing license for local products and registration license for foreign products).

Similarly, CP is calculated from the following eight factors:

- 1) Image (I): the image of the company and the brand recognition
- 2) Quality (Q): quality of products
- 3) Service (S): quality of service including delivery, technical support
- 4) Price (P): price and terms of payment of our products relative the competitor's
- 5) Technology (T): technology of product, manufacturing and R&D
- 6) Knowledge about the market ( $K_m$ ), also includes knowledge about the market of customers
- 7) Knowledge about the customers ( $K_c$ ), including customer needs and relationship with customers
- 8) Commercial skills( $C_s$ ): sales network and capability of sale team to convince customers to buy.

$$CP = I \times Q \times S \times P \times T \times K_m \times K_c \times C_s$$

A competitive position is classed as "weak" if the index is lower than 1 million (i.e. each variable has an average value below 5.5); "medium" if the index ranges 1-10 million (i.e. each variable has an average value between 5.5 and 7.5); and "strong" if the index ranges 10-100 million (i.e. each variable has an average value between 7.5 and 10). As can be seen from the equation, the index is equally sensitive to all variable.

### 3.3.3. Analysis of the product positions in 1999

Using the modified calculation methods, the MA and CP for the three product lines as of 1999 were estimated (see detailed variables in Table 3.2). The real market size was taken as 30%, 10%, and 10% of their respective total market for Luctarom, Luctacid and Luctamold respectively. As for the barrier factor, a value of 0.7 was used for Luctarom and 0.5 for both Luctacid and Luctamold. Luctarom had a higher value because this product was more difficult to imitate. Other variables were estimated with consideration of our position relative to competitors.

Table 3.2: Assessment of market attractiveness (MA) and competitive position (CP) for Luctarom, Luctacid, and Luctamold (situation in 1999).

| Variables  | Luctarom  | Luctacid  | Luctamold |
|--|-----------|-----------|-----------|
| Market volume (V), USD                           | 9,775,000 | 1,955,000 | 6,109,000 |
| Gross margin on sales (p),                       | 0.50      | 0.65      | 0.20      |
| Market annual growth factor (g).                 | 1.09      | 1.09      | 1.09      |
| Barrier factor (F)                               | 0.7       | 0.5       | 0.5       |
| Image (I):                                       | 8         | 6         | 5         |
| Quality (Q):                                     | 8         | 7         | 6         |
| Service (S):                                     | 5         | 4         | 4         |
| Price (P):                                       | 3         | 4         | 5         |
| Technology (T):                                  | 8         | 5         | 5         |
| Knowledge about the market (K <sub>m</sub> ),    | 6         | 5         | 5         |
| Knowledge about the customers (K <sub>c</sub> ), | 6         | 6         | 6         |
| Commercial skills (C <sub>s</sub> ):             | 7         | 6         | 6         |
| Market attractiveness (MA), USD                  | 4,064,600 | 754,900   | 725,900   |
| Competitive position (CP)                        | 1,935,360 | 604,800   | 540,000   |

Figure 3.4 shows the positions of the three product lines in the MA-CP matrix. Luctarom was located in zone 3, market attractiveness was high and competitive position was medium. The other two product lines were located in zone 4.

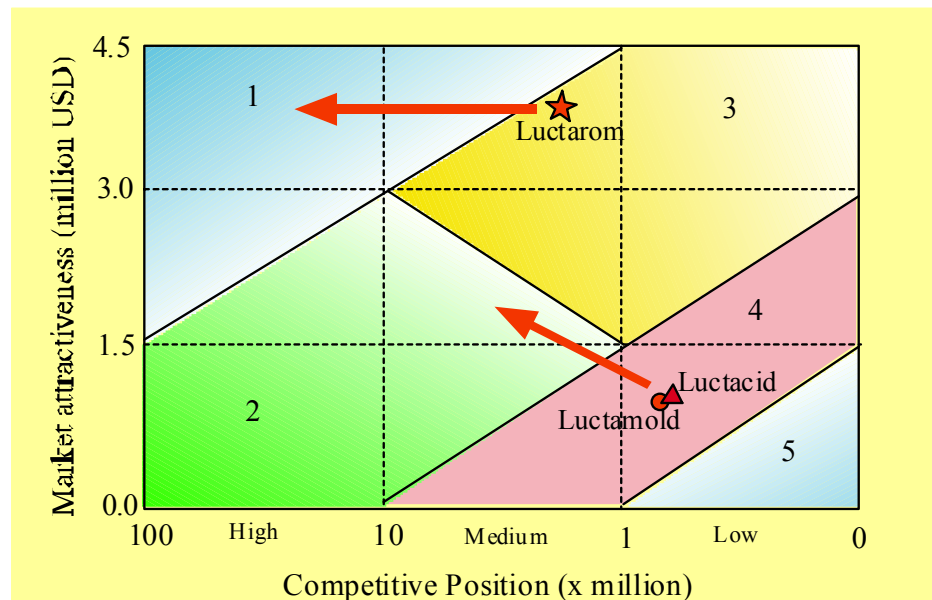


Figure 3.4 Positions of Luctarom, Luctacid and Luctamold in the GE MA-CP matrix (situation in 1999). The arrows indicated the direction for future positions.

The strategic options for the three product lines:

1) *Luctarom*: It was located in a question mark situation. According to the BCG and GE models, the strategic action would be either to grow if the competitors are weak and harvest/divest if the competitors are strong. Considering that at the time Lucta was new to the Chinese market, it would not be a surprise to have a low initial competitive position. However, there were opportunities for improving to a better competitive position, by gradually improving the scores for I, S, P,  $K_m$ ,  $K_c$  and  $C_s$ . Moreover, Lucta elsewhere, e.g. in Europe, was in a leadership position. Therefore, the strategic actions for Luctarom should be to grow by expanding its market share through improving its competitive position in the market.

Feed flavour market was an attractive one, because it had a reasonable market size, and because the product required more technology than acidifiers and mould inhibitors, and its market had higher entry barriers for competitors. Lucta is strong in the technology and manufacturing capabilities of flavours.

2) *Luctacid and Luctamold*. Based on the model of GE matrix or BCG matrix, the logical strategy would be to harvest with minimum resource input. In the unconsolidated market, there were many minor products, each had occupied certain market share. Since Luctacid and Luctamold possessed competitive advantage over some competitor products, there should be revenue to gain from grasping the market from those products. After all, Luctacid and Luctamold shared the same customers as Luctarom. Keeping these two lines were useful to facilitate sales of Luctarom, since they would act as sales leads for Luctarom.

#### 3.3.4. The final strategic decision for 1999

The chosen corporate strategy was as follows:

Luctarom was set as the core product, this being consistent with the core business of Lucta group. We should strive to increase our competitiveness in flavour market to grow the sales of Luctarom. On the other hand, Luctacid and Luctamold were not the core products, and as a principle, we should not invest much resource to promote these products. The competitive positions of Luctacid and Luctamold may be improved through better knowledge of the market and of the customers and through a good image of the company.

The strategy had been followed for the past four years. Internally, we focused our resources on the sales of Luctarom. Even salesmen's salary scheme was related with the proportion of various products sold. Higher commission rate was given to Luctarom than to Luctamold. In fact, because Luctamold's profit margin was low, a restriction was imposed on the sale of Luctamold so that our effort would not be dispersed. Externally, we focused our communication with the market

on the concept: “Lucta – the leader for feed flavours”. The objective was to build an association between “Lucta” and “Flavours”. This was done through the corporate image positioning, to be described in details in Chapter 5. At end of 2001, the 63% of total sales came from Luctarom, and 16% and 20% from Luctacid and Luctamold respectively.

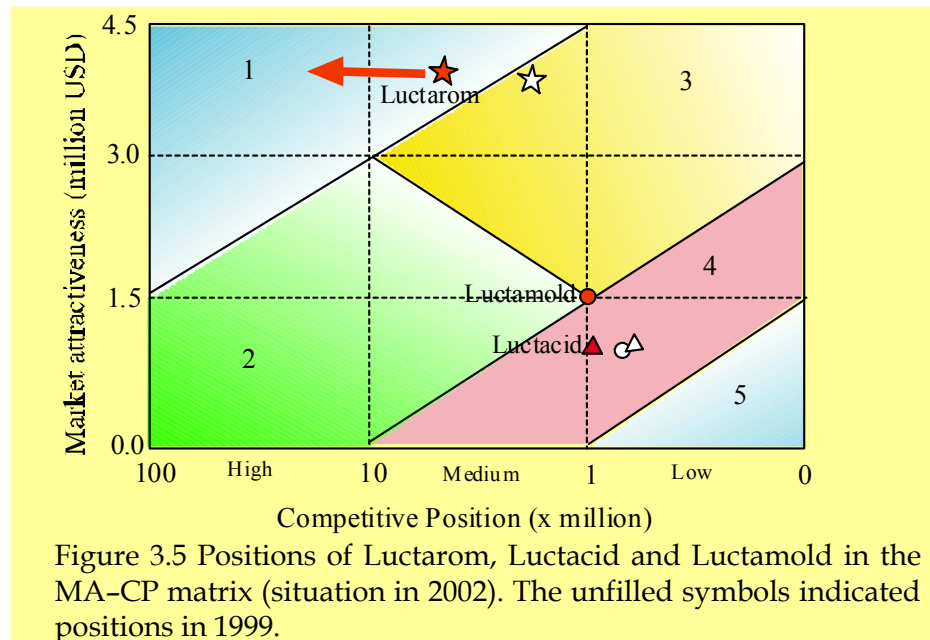
### 3.3.5 Strategic analysis revisited in 2002.

Our business results for the next four years showed that the strategic direction which was set out in 1999 was a correct one. This strategy is still being carried forward to the present date.

During this time, the market had changed and our company had also improved in many aspects. The Luctarom line became more competitive in price and service, mainly through local manufacturing, and updates of new products. Local manufacturing had also made Luctamold market more attractive since the margin had increased (product cost and operational cost reduced while sale price maintained relatively unchanged). An increased degree of competition, due to entry of more local producers, had driven the market price for acidifiers low. Thus Luctacid’s profit margin was not increased despite lower cost due to local manufacturing. In order to compare with the 1999 situation, the MA and CP positions of the three lines were recalculated using the variables listed in Table 3.3. The plot is shown in Figure 3.5.

Table 3.3: Assessment of market attractiveness (MA) and competitive position (CP) for Luctarom, Luctacid, and Luctamold (situation in 2002).

| <i>Variables</i>                         | <i>Luctarom</i> | <i>Luctacid</i> | <i>Luctamold</i> |
|--|-----------------|-----------------|------------------|
| Market volume (V), USD                   | 9,775,000       | 1,955,000       | 6,109,000        |
| Gross margin on sales (p),               | 0.50            | 0.65            | 0.40             |
| Market annual growth factor (g).         | 1.09            | 1.09            | 1.09             |
| Barrier factor (F)                       | 0.7             | 0.5             | 0.5              |
| Image (I):                               | 8               | 6               | 6                |
| Quality (Q):                             | 8               | 6               | 6                |
| Service (S):                             | 7               | 5               | 5                |
| Price (P):                               | 6               | 5               | 5                |
| Technology (T):                          | 8               | 5               | 5                |
| Knowledge about the market ( $K_m$ ),    | 6               | 6               | 6                |
| Knowledge about the customers ( $K_c$ ), | 6               | 6               | 6                |
| Commercial skills ( $C_s$ ):             | 7               | 6               | 6                |
| Market attractiveness (MA), USD          | 4,064,600       | 754,900         | 1,451,700        |
| Competitive position (CP)                | 5,419,000       | 972,000         | 972,000          |



We can see from the Figure that Luctarom's competitive position had improved and now in star position. Luctamold and Luctacid competitive positions had also improved although not to same the extent as Luctarom. In terms of product portfolio strategy, the direction remained the same. 1) Luctarom should still be the core product, which required resource input to grow market share. 2) Both the market attractiveness and competitive position for Luctamold had improved, and the restriction imposed on the sales of Luctamold may be removed because the profit margin had increased. 3) Luctacid was still a problem. Acidifiers in the market were gradually sold as a commodity. Major changes may be required in order to improve the competitiveness of Luctacid. One of the options could be to lower the price further in exchange for greater sale volume (greater market shares).

### 3.4 RESULTS OF THE CHOSEN CORPORATE STRATEGY

The feed industry provides a big market and many opportunities for manufacturers of feed additives. Most feed additive manufacturers, have a range of products to offer. Product categories include: amino acids, vitamins, organic trace elements, enzymes, flavours, acidifiers, mould inhibitors, antibiotics, pigments, and animal health products (vaccine, drugs etc). Because many of these products share the same customer base, many suppliers attempt to do as many products as they can, with an objective to maximize their sales revenue. This is a very common thinking in China business at this time. Based on my observation over the past five years, the type of companies who were successful doing so was only distributors (i.e. intermediary or traders), but not manufacturers. It is important for manufacturers to be perceived as specialists, not so for distributors. Bayer (Sichuan) Animal Health Co Ltd, a joint venture in China of Bayer, was a company taking

this approach. Bayer is generally considered to be relatively strong in animal health products and disinfectants, but the joint venture company produced and marketed tens of feed additive products without much focus -- practically covering all categories of products, thus spreading their marketing resources. The company could not gain high market share from each product category/sector in face of more-specialized competitors. Apart from failure in gaining the expected sale revenue, the cost of manufacturing so many product lines made the company unprofitable. In a conversation in May 2002, the newly appointed General Manager of the company told me that he considered the 'un-focused' strategy of the company as a failure, and they had decided to withdraw many product lines, including feed flavours, which had been in competition with Lucta China. The "failure" of Bayer strategy was that it did not have a focus, i.e. a strong sector that the customers can associate the company with. Many customers asked "What does Bayer do?". It was difficult to answer. In this context, other similar companies in the Chinese feed additive market included: Rhone Poulenc Animal Nutrition (a French company) and Alltech (an American company). Both company were unable to establish a clear positioning in any sectors of feed additive market. However Roche (for vitamins), BASF (for amino acids and enzyme phytate), ADM (for amino acids), Alimet (for liquid methionine), Zinpro (for organic minerals) had been successful in establishing their names as the leader in their respective core sectors.

Lucta China could be considered successful in that the Lucta name had already been established in the market, as a specialist producer of feed flavours and becoming a leader in this sector. This is credited to our strategy to focus on Luctarom. Although Luctacid and Luctamold were also marketed, they were non-strategic and supplementary. The key word was "focus".

### Side Story: Should Lucta China have started selling Luctaplus in 2000?

"Luctaplus" is a product line, developed by Lucta, which combines feed flavour, acidifier and protease enzyme in one single product. Thus when this product is applied, there is no need to buy the flavour, acidifier, nor the enzyme. Lucta did not have the technology to produce the enzyme mixture but brought it from a major producer.

In 1999-2000, Lucta carried out extensive in vivo trials on the efficacy of Luctaplus for the target animals (piglets), and found it to be effective. This product had been marketed in Southeast Asia and other countries. In 2000, there were some temptations to start promoting this product in China. I did not take on this product at the time (although registration for manufacturing and selling this product locally was later made), for the following reasons:

1) Luctaplus sales would replace Luctarom sales. At the time, we were working hard to position Lucta as the leader for feed flavours. The marketing of Luctaplus would counteract with our positioning efforts. Even if we were to be successful in selling Luctaplus, when customers ask "what does your company do?", we could not offer a clear statement. It would not help the company to build an image of specialist/leadership in one sector. Moreover there would be a danger of losing competitive edge when compared with specialists of enzyme/acidifier/flavours. For example, Lucta would not be able to compete with companies like Finnfeeds and Nova Nordis in enzyme sector, if we were to claim our product was an enzyme preparation.

2) Practically, the product would be difficult to sell under that market condition. At a treatment dosage of 5 kg/ton feed, and a price of 35-50 RMB/kg, that product would not sell in the price-conscious Chinese market.

In reviewing that decision today, I still think the decision made at the time was a correct one. However, it may be appropriate, in several years time when the image of Lucta being the leader of feed flavours has been firmly established, to introduce Luctaplus, as a variant or new development of our Luctarom. This would not be counteractive to our market positioning objective. Thus, it would be appropriate for Lucta S.A. to promote Luctaplus in Europe since Lucta's name in feed flavour section is firm.

## CHAPTER 4

### SELECTION OF COMPETITIVE STRATEGIES

#### 4.1 INTRODUCTION

The feed industry in China showed a phase of rapid development from 1980, particularly between 1990-1996 (also see Figure 3.3). This development was in line with the rapid expansion of pig production. Feed additive industry grew accordingly. During this period, the demand was in general greater than supply and the profit margins for feeds and feed additive products were high. By 1998, the growth had slowed down. A slump of pig price in 1999 had caused a difficult time for the feed and feed additive industry. Supply was greater than demand and profit margins were generally reduced. Prior to Lucta's entry, the Chinese feed additive market had already been filled up with a full range of products, - there was no empty segment. New comers had to compete with the existing ones. Moreover the market was dominated with low price-low quality products. The market itself was not consolidated; the feed mills were small in size but large in number, so were suppliers. Many competitors resorted to lowering prices in order to snatch market share. Lucta entered Chinese market at this market situation.

The key concern was: how do we compete in this market? In this chapter, I explain the application of the widely-used Porter's generic strategies model and the "strategy clock" model in answering this question, thus setting the business strategy for the company.

#### 4.2 MODELS OF BUSINESS STRATEGY

##### 4.2.1 Porter's generic strategies

In the highly competitive market place, how do companies compete? Porter's model of generic strategies (Porter 1980, 1985) provides three directions (Figure 4.1): cost leadership, differentiation, and focus.

1) Overall cost leadership: The company strives hard to achieve the lowest cost of production, distribution and overhead, so that it can charge prices lower than its competitors to win a large market share. In other words, the company sets out to be the low-cost producer in the industry. Companies pursuing this strategy have to be very good at engineering, raw material purchasing, manufacturing, and physical distribution, in order to give the lowest price without affecting profit. The risk of this strategy is when the cost leadership can not be sustained, due to, e.g., competitor imitation, technological changes, and

the bases for cost leadership eroding, or when cost focusers achieve even lower cost in certain segments.

2) Industry-wide differentiation: The company concentrates on achieving uniqueness in its industry along some areas that are widely valued by customers. It selects one or more attributes that a large number of customers in the industry perceive as important, and uniquely position itself to meet those needs. It is rewarded for its uniqueness with a premium price. The means for differentiation vary with different industry. The risk of this strategy is when the differentiation (i.e. uniqueness) is no longer sustained, due to, e.g., competitor imitation, the bases for differentiation becoming less important to buyers; or when differentiation focusers achieve even greater differentiation in certain segments.

The company that can achieve and sustain differentiation will perform above average in the industry if its price premium exceeds the extra costs incurred in being unique. Porter cautioned that the company pursuing differentiation strategy should not ignore its cost position, because its premium prices will be nullified by a markedly inferior cost position. The company thus should aim at cost parity or proximity relative to its competitors, by reducing cost in all areas that do not affect differentiation.

3) Focus: The company focuses on one of more narrow market segments, and pursue either cost-leadership or differentiation within the narrow target segments, depending on its strengths. Thus, there are two variants: cost focus and differentiation focus. The focus strategy rests on the promise that the company is able to serve its narrow strategic target more effectively or efficiently than competitors who are competing more broadly. The advantage of effective focus strategy is that it may reinforce market position in the perception of segment customers, and elevate segment protection against entrants. The risk of this strategy is when the targeted segment becomes unattractive, when the broadly-targeting competitors overwhelm the segment, or when the new focusers sub-segment the industry.

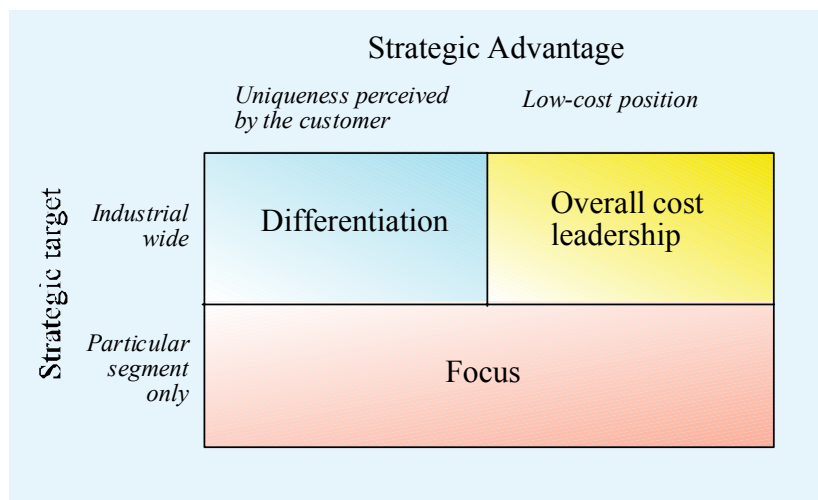
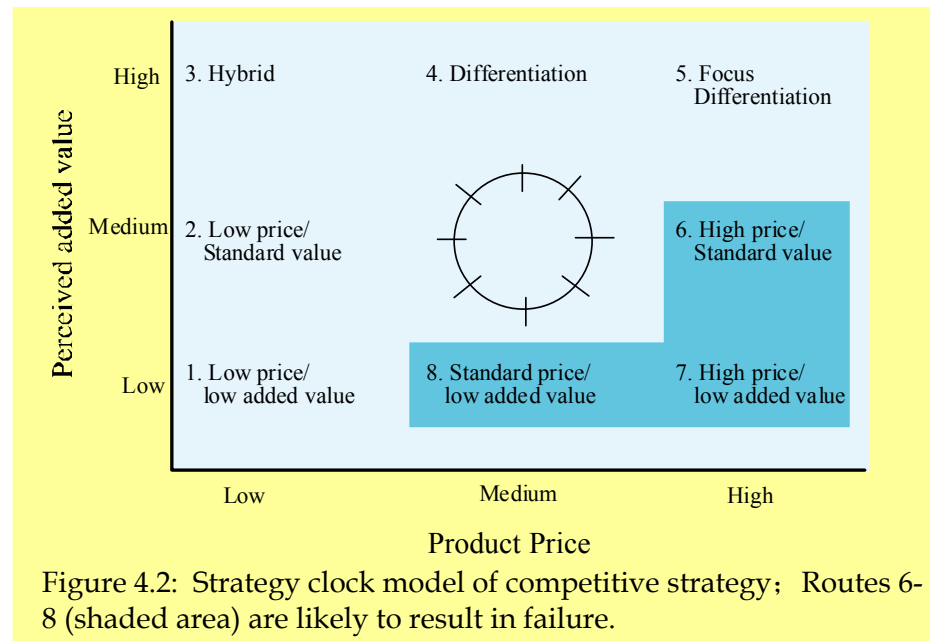


Figure 4.1: Porter’s model of generic strategies.

#### 4.2.2 The strategy clock model

Johnson & Scholes (1989) discussed the “strategy clock” model, which in effect, is the Porter’s generic strategy model viewed from the market angle, instead of from the company angle. The generic strategy model looks from the company’s strength and cost, whereas the strategy clock model looks from the view of customers: added value and price of the product, as perceived by the customers.



In the strategy clock, there are two dimensions: price and added value. Depending on the price level and on the level of added value the product has, as perceived by customers, there are eight possible situations or routes (Figure 4.2):

1) *low price/low added value* (price-based strategy): This “cheap and basic” option is to reduce price but also lower added value and focus on the very price-sensitive market segment.

2) *low price/medium added value* (price-based strategy): This option attempts to seek advantage over the competitor by reducing the price while maintaining the quality of the product. It is likely to be successful if a company has lowest cost bases and is prepared to enter into a sustained price war.

The price-based strategy as in Routes 1-2 is not equal to cost-leadership strategy. Price-based strategy may be successful and sustainable only if the company can achieve a cost-leadership aimed at lowest cost of sourcing, manufacturing, logistics etc.

3) *low price/high added value* (hybrid strategy): It is possible to provide added value in customer terms whilst maintaining lower prices than the competitor, i.e. differentiation strategy and cost-leadership strategy at the same time. In order to succeed, it is necessary to provide low costs of purchasing, manufacturing and distribution, and to aim for a volume sale to maintain the profit margin.

4) *medium price/high added value* (differentiation strategy): The aim of this strategy is to achieve greater market share by offering 'better' products at the same price as the competitors. This can be achieved through the power of brand.

5) *high price/high added value* (focused differentiation strategy): In this case the company will compete by offering perceived higher value to the customer at a significantly higher price. This usually entails targeting in a particular niche segment.

6) *high price/medium added value*: The route suggests that the company may attempt to charge high prices for an average product or service, only possible in the event of a near monopoly. It is considered to be unsustainable in the long term.

7) *high price/low added value*: Similar to Route 6, and it may result in earlier failure.

8) *medium price/low added value*: Reducing the value whilst maintaining price is again a risky strategy. The company may not suffer much if the market share is strong enough to hold the product's dominant position. The option risks losing market share to competitors.

Routes 6-8 are likely to result in failure sooner or later, because only when the customer's perceived value is greater than the price that a continuous sales can be sustained.

#### 4.2.3. Choosing a competitive strategy

A strategic choice must be clear cut: differentiation, cost leadership or focus. Companies that do not make clear choices tend to lose competitive edge and would result in a below-average performance. According to Porter (1985), a company engaging in each generic strategy but fails to achieve any of them is "stuck in the middle". It possesses no competitive advantage. A company that is "stuck in the middle" may compete at a disadvantage because the cost-leader, differentiators, or focusers will be in better position to compete in any segment.

In many cases, becoming "stuck in the middle" is often the result of a company's unwillingness to make clear choices about how to compete. It tries different means and achieves none, because achieving different type of strategy requires different, but consistent, actions.

#### 4.2.4 Different ways to differentiate

The use of differentiation as a strategy implies the building up of a market perception of difference or uniqueness, and this difference or uniqueness must have a benefit by the target customers. The sources of differentiation which can be used are listed in Table 4.1, in the categories of product, service, personnel, channel and company and brand image. The variables can also be grouped using the marketing mix structure as shown in Table 4.2. The latter approach stresses benefits to the customers. Which variable should be used? The key is whether the improvement of the said variable provides more benefit to the target customer.

Table 4.1: Differentiation variables. From Kotler (2003).

| <b>Product</b>         | <b>Service</b>            | <b>Personnel</b> | <b>Channel</b> | <b>Image</b>   |
|------------------------|---------------------------|------------------|----------------|--|
| Form                   | Ordering ease             | Competence       | Coverage       | Symbols,<br>colours,<br>slogans,<br>special<br>attributes<br>Physical plant<br>Events and<br>sponsorship |
| Feature                | Delivery                  | Courtesy         | Expertise      |  |
| Performance            | Installation              | Credibility      | Performance    |  |
| Conformance<br>quality | Customer<br>training      | Reliability      |                |  |
| Durability             | Customer<br>consulting    | Responsiveness   |                |  |
| Reliability            | Maintenance<br>and repair | Reliability      |                |  |
| Repair-ability         | Other service             |                  |                |  |
| Style                  |                           |                  |                |  |
| Design                 |                           |                  |                |  |

#### 4.2.5. Quality and the PIMS principle one

The PIMS (Profit Impact on Marketing Strategy) database has often been used to provide directions for strategy planning. PIMS started off as a research program initially carried out in the USA in 1970-1983 by the US Strategic Plan Institute. This initial research program compiled a data bank of information on 3000 strategic business units of 200 different companies in order to analyze market performance and marketing strategy. The database has been maintained ever since. Using the data from PIMS, the research of Jacobson (1988) indicated that:

- 1) Companies emphasizing quality tended to be more profitable.
- 2) Companies with higher market share had higher profitability than their competitors with smaller market shares.
- 3) Companies can achieve cost saving through economy of scale, ability to bargain with suppliers, or backward integration. Low cost heightens profitability.

Buzzell & Gale (1987) in their "PIMS Principle One" concept state that: " in the long run, the most important factor affecting a business

units performance is the quality of its products and services, relative to those of its competitors.”

The PIMS data showed that products perceived to be of the highest quality achieved greater market acceptance, and yielded a significant better percentage return on investment (ROI) than their competitors. Quality, therefore, is a critical source of competitive advantage by which to differentiate a product or service; or by which to achieve niche dominance in a specific market segment.

Table 4.2: Differentiation variables in the perspective of marketing mix and their benefit to customers. From Jobber (1998).

| Marketing mix | Differentiation variables                      | Value to the customer                                      |
|---------------|--|--|
| Product       | Performance                                    | Lower cost; higher revenue; safety; pleasure; status       |
|               | Durability                                     | Longer product life, lower cost                            |
|               | Reliability                                    | Lower maintenance and production cost; fewer problems      |
|               | Style  | Good looks, status   |
|               | Upgradability                                  | Lower cost; prestige                                       |
|               | Technical assistance                           | Better quality product; closer supplier-buyer relationship |
|               | Installation                                   | Fewer problems; easy to start                              |
| Distribution  | Location                                       | Convenience; lower cost                                    |
|               | Quick/reliable delivery                        | Lower cost; fewer problems                                 |
|               | Distributor support                            | More effective selling; more support                       |
|               | Delivery guarantees                            | Peace of mind  |
|               | Computerize reordering                         | Less work; lower cost                                      |
| Promotion     | Creative/more advertising                      | Brand personality; status                                  |
|               | Creative sale promotion                        | Direct added value   |
|               | Co-operative promotion                         | Lower costs  |
|               | Well trained sale force                        | Problem solving  |
|               | Demonstration, trials, Fast complaint handling | Less risk of purchase                                      |
|               |  | Fewer problems; lower cost                                 |
| Price         | Lower price                                    | Lower cost of purchase                                     |
|               | Credit facilities                              | Lower cost; better cash flow                               |
|               | Low interest loans                             | Lower cost; better cash flow                               |
|               | Higher price                                   | Price-quality match  |

### 4.3 SELECTION OF COMPETITIVE STRATEGY FOR LUCTA CHINA

#### 4.3.1 *Analysis using Porter's generic strategy:*

As a decision at the corporate level, how do we compete in the market? This was a key decision to be made at start of Lucta China business. From the Porter's generic strategy model, there were three choices: overall cost-leadership, differentiation and focus. How would each option match our company situation?

Overall cost-leadership strategy: This strategy would not suit the company, for the following reasons: 1) Our cost was higher than competitors, in raw materials (we used high quality materials) cost, product cost and management overhead; Our products (at the beginning of the operation) were imported products. We employed highly-qualified staff at a cost; 2). Competitors were willing to operate with very low margins, whereas as a foreign company, we could not. 3) Our strength was not the lowest cost but the capability of the company to create good quality product and of our staff to create added value. Therefore industry-wide cost leadership was not compatible to our company.

Industry-wide differentiation: It may not be suitable because: 1) Lucta's products would not be able to offer outstanding benefits to all or a majority of customers industry-wide at the time. It may offer outstanding benefits to some specific groups of customers but not to all customers. 2) In order to pursue industry-wide differentiation, for example, superior product performance to be accepted by all customers, it may be too costly in terms of resources input.

Focus: This would be the most suitable option for the company. Some product lines could offer outstanding differentiation in selective segments while others could offer good cost leadership in other selective segments. A combination of focused differentiation and focused cost-leadership may be taken for different product lines.

The following sections assess the strategy for different product lines: Luctarom, Luctacid and Luctamold.

#### 4.4.2. *Strategy for Luctarom*

Luctarom is a feed flavour. Flavouring products are easy to make but difficult to make well. The creation is an art, and is heavily dependent on the skills and experience of the manufacturer. Moreover, there are no industrial or explicit technical standards. The product is more difficult to imitate. The assessment of the quality of the product is also rather subjective, and is influenced by the market preference as well. The dominant products may have the advantage of setting the trend in market preference. Naturally, this group of products has a potential for differentiation.

We had chosen the focused differentiation for Luctarom. The differentiation was quality. In 1999, Luctarom entered the market with a target segment of “high quality and high price” (see Figure 4.3 and 4.4), thus, a high price/high added value route in the Strategy clock model. In this segment, there was relatively little competition (and also limited number of customers) since most of our competitors were in the mid-low and mid-high quality and price segments.

By 2002 when we had a reasonable market share of the high quality segment, we decided to expand into the mid-high segment through introducing new products. Again, in the new segment, we took the “focus differentiation” strategy: medium price/high added value route. The original high quality segment was remained as a niche market (this group of customers was looking for quality and less sensitive to price). Figure 4.4 shows the target segments in a strategy clock model grid.

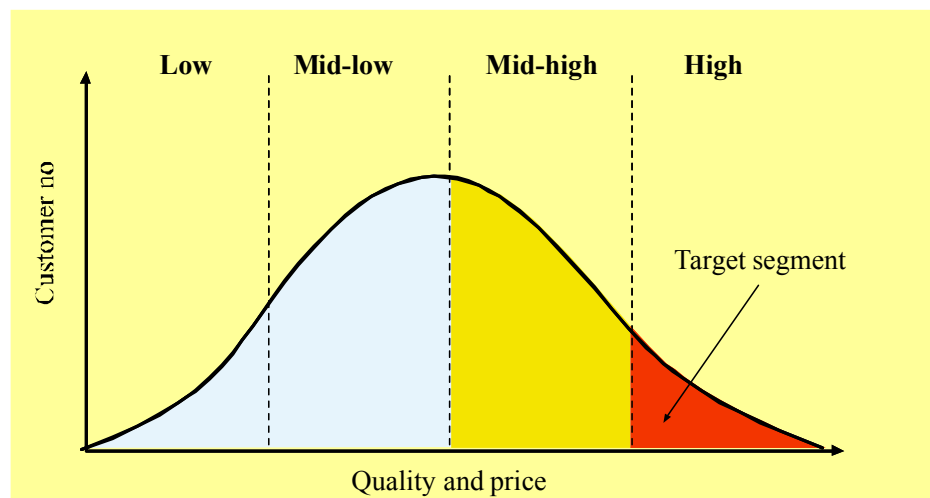


Figure 4.3: Market segments. Customer distribution across the axis of quality and price, dividing into 4 segments. The target segment of Luctarom in 1999 was the “high quality and price” segment. In 2002, a new “mid-high” segment was also targeted.

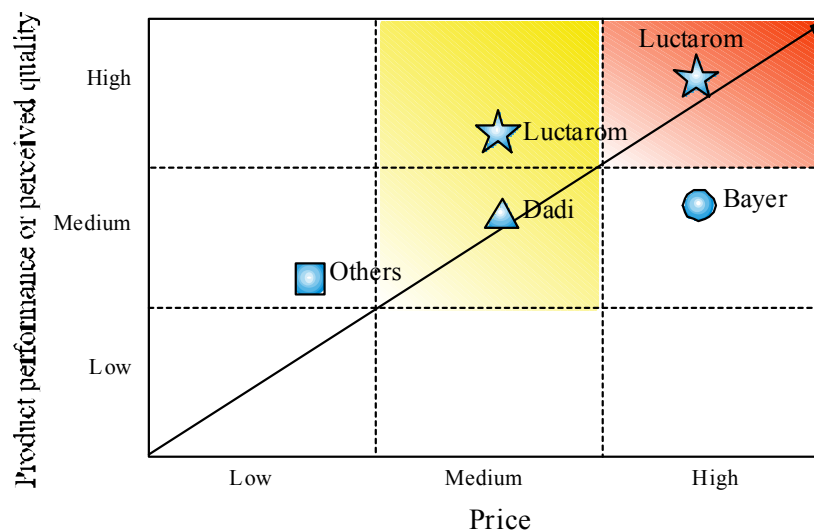


Figure 4.4: Luctarom’s target segments (in shaded areas) in perspective of the competitors.

### 4.3.3 Strategy for Luctacid

Luctacid belongs to a category of products which are easy to produce and imitate. Between 1999-2001, there were relatively fewer competing products in the Chinese market. Two major ones were : Digestacap (from IPSA of Spain) and Stacidem (by Pfizer of USA), both were foreign products. Digestacap had a large market share with a price of about 28 RMB/kg. Stacidem had a smaller market share with a price of 35 RMB/kg. Both products were sold through distributors. Stacidem's market was mainly in Guangdong province where it enjoyed a better quality image than Digestacap. Luctacid entered the market (with product Luctacid HC33720) targeting the Stacidem customers at the high price segment and offering a price (30-32 RMB/kg) lower than Stacidem while maintaining product quality. It offered a focused cost leadership (see Figure 4.5), because we sold directly to final users cutting off the cost of middle steps. Stacidem was sold through at least two levels of distributorship each adding to the final price. Our tactics was to compete and win Stacidem by lower cost to achieve our initial market stand, and then the same with Digestacap at a later stage.

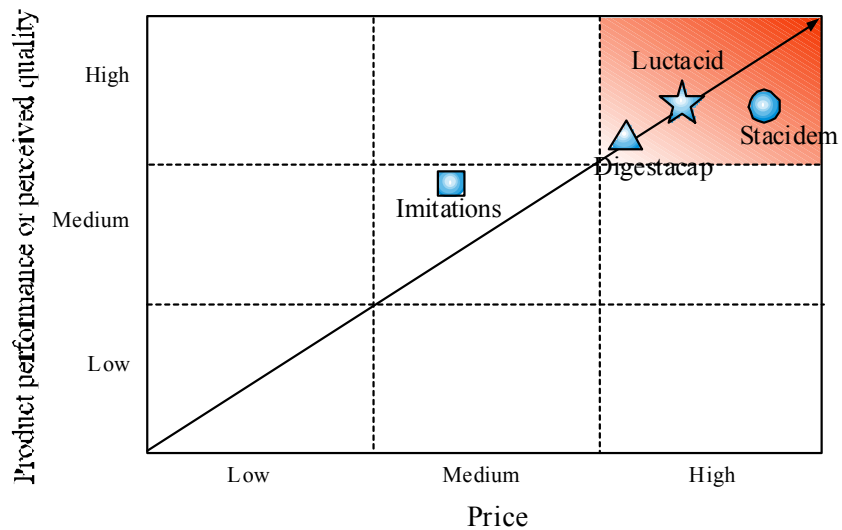


Figure 4.5: Luctacid's target segments (in shaded areas) in perspective of the competitors in 1999.

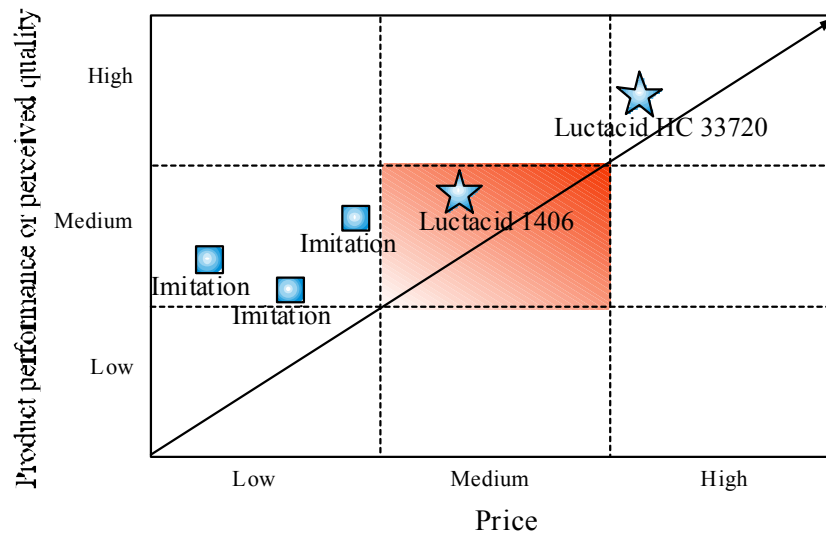


Figure 4.6: Luctacid's target segments (in shaded areas) in perspective of the competitors in 2002.

By 2002, the market had changed to a completely different situation from that of 1999. The price for acidifiers had been driven down by many new entrants of local producers and imitations. The price for most local products was 10-20 RMB/kg. Stacidem and Digesta had practically lost market share and disappeared from the market. Luctacid HC33720 sales volume was dropping despite subsequent readjustment of price to 26-28 RMB/kg. At the time, it was also difficult for any single brand to gain market dominance since there were many competing products. In 2001, we introduced a lower concentration version Luctacid 1406 targeting at medium-price segment. The strategy was a focused differentiation of quality and brand, since the price for the new Luctacid 1406 was still higher than many local products (price for Luctacid 1406 was 16 RMB/kg). Considering that acidifiers are easy to imitate and low in technological discretion, it is difficult for quality and brand differentiation to offset large difference in price. Therefore, the gap in price must not be too large, our products were priced higher than the average market price, but the difference must not be too large.

#### 4.3.4 Strategy for Luctamold

Mould inhibitors are sold more like a commodity than flavours. Customers are looking for lower application cost (price per ton feed treated) irrespective of the technology of the product. As far as the product protects the feed from becoming moldy, technological differentiation does not seem to present much an added value in the eye of customers. In 1999, the main players in the market were Luprosil salt (from the German BASF), Monopro (an imported product from USA) and some localized less-known names. Luprosil was sold in the market at 8.5 RMB/kg requiring a dosage of 2 kg/ton feed, through at least two levels of distributorship. Luctamold entered the market at 12 RMB/kg at half the dosage (through its product technology), thus offering lower application cost (price per ton feed treated) to Luprosil

customers. Luctamold did not compete with local products. However, Luprosil had been in the market for a long time and the brand image was strong. Moreover, many customers would not risk damaging their reputation due to moldy feed as a result of changing mould inhibitor. Luctamold's target market segment was Luprosil customers, offering them a large cost-saving over Luprosil, large enough to motivate some customers to change. The strategy had been a focused cost-leadership: we had a cost advantage because of direct sales to the target customers. At the same time, efforts were made to continuously improve competitive position by brand image and better service, with an objective to increase Luctamold's "safety" perception by customers, to improve our competitiveness with sustainability.

Situation in 2002: The market conditions for mould inhibitors were rather stable and less influenced by the entry of local producers, because one of the main raw materials "propionic acid" had to be imported. Thus the price of mould inhibitors had been rather stable since 1999, unlike acidifier market. Monopro had been out of market due to its unsustainable high price/low value (performance). However, Luprosil could still be considered as the overall market leader. Thus for Luctamold, the target market segment remained the same, i.e. customers of Luprosil; and the strategy remained the same: focused cost-leadership. By this time, local manufacturing had enabled us to reduce product cost; and the cost of learning curve had also reduced. Moreover, the corporate image of Lucta, other areas of competitive advantage, had been improved. The competitive position of Luctamold had been better in 2002 (also see analysis in Chapter 3).

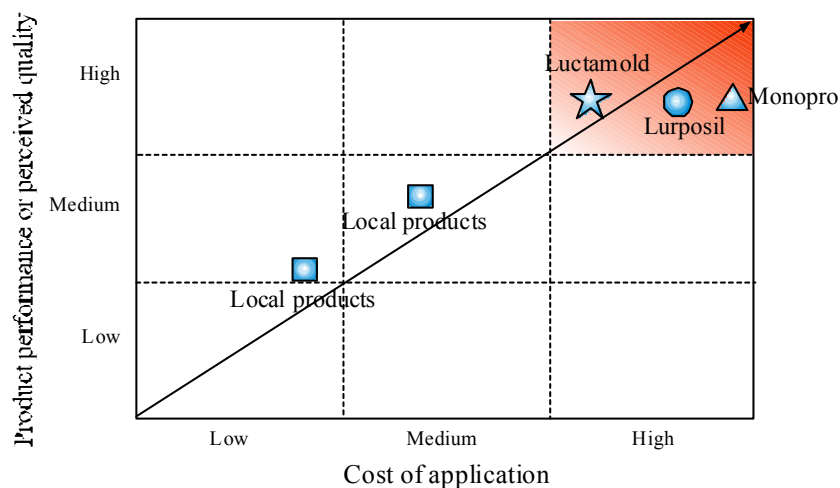


Figure 4.7: Luctamold target segments (in shaded areas) in perspective of the competitors.

#### 4.4 RESULTS OF THE CHOSEN BUSINESS STRATEGY

The results of the business (i.e. growth of sales and company's position in the market place) indicated that the focused strategy was a correct choice.

With Luctarom, when we targeted at the high-quality and high-price segment using a focused differentiation strategy, a considerable success had been achieved: we estimated that Luctarom occupied 30-40 % of the market share in this segment. But the size of this segment was small, thus leading to the coverage of additional mid-high segment from year 2002. Here products with medium price-high added value were offered: the products becoming more competitive price-wise. The question was whether this would affect our sales of high-price segment. To avoid this effect, we would need to attach more differentiation to our high-price segment, for example, by further improving quality or other factors. Another question was whether addressing a broader segment would blur our quality differentiation strategy and thus lead to the “stuck in the middle” situation. There may be a danger of losing differentiation focus when we go too far in offering lower price basic products. The company should be aware of this danger, and should constantly check its developing track and pursue further differentiation.

With Luctacid, the initial strategy was a correct one and so was the choice of target segment. However, in general, sales growth for this product was not really satisfactory, as can be seen in Figure 4.8, the growth was small for two years. Moreover, the product did not really achieve a position in its target segment. The problem was the rapid change in the market. The target segment ceased to exist. It would be expected that Luctacid HC 33720 (the product targeted at the high segment) may suffer further drop in sales, until major changes (e.g. major improvement in quality, or major price cut) are made. We may have to drop this segment and focus on Luctacid 1406, a lower price version, and concentrate on competing with local products through differentiation in quality image, company reputation, people and service.

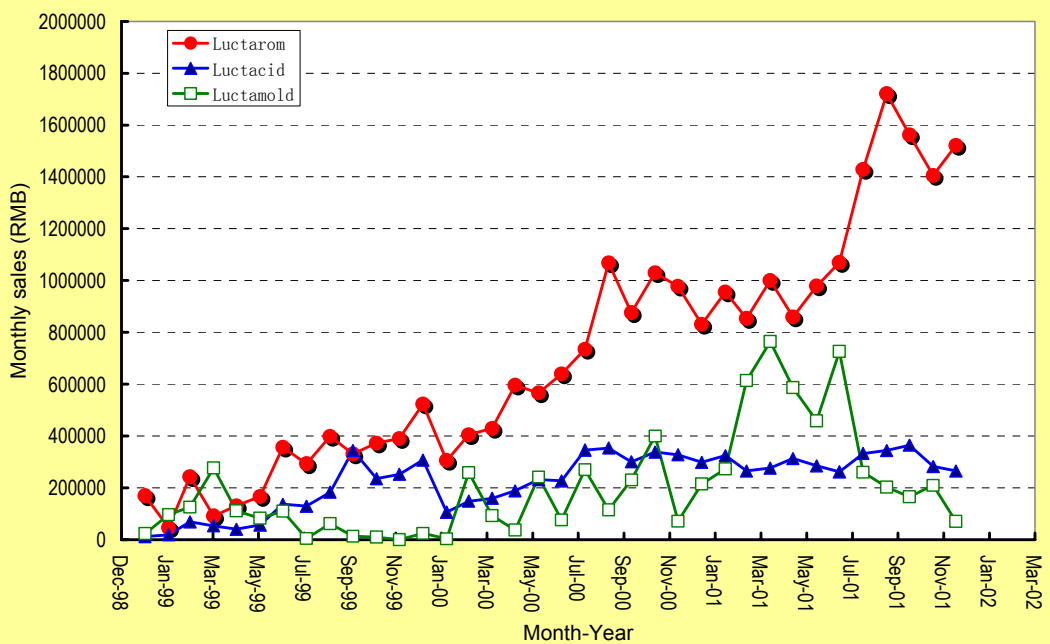


Figure 4.8: The sales evolution of three product lines from 1999-2001. Please note, Luctamold sales is seasonal.

We can see from the ongoing discussion so far, strategic direction had been useful for guiding the development of this company.

I have noticed that there is an increasing need in the feed industry in China for strategic thinking and planning, as competition gets stronger. Many medium to large size feed mills are facing the problem of strategic blindness. In the past, feed mills enjoyed large profits with high profit margin and the business grew without the need for strategic planning. But the situation has changed. There are more competitions and the margin is low (the profit margin for one ton of complete poultry feed could be as low as 50 RMB). The natural response to competition is dropping prices. Many owners or managers are troubled by what they should do. In Putian county of Fujian Province, there are four medium-large size feed mills within 2 km radius. The owners, all without even a university education, are increasingly concerned about which strategic direction the business can take (As a supplier, I often offered advice to our customers as part of our service.) In feed flavour industry, there are several competing suppliers who resorted to price reduction as a competition measure. Viscous price war can only be detrimental to the companies in the long run. I believe we have to stay competitive by differentiating ourselves and not by entering into the price war.

I have also seen many successful companies. Hope Group, a feed company producing 3 million tons annually of complete feed through over 140 feed mills, has been very successful in pursuing an industry-wide cost-leadership strategy. They manage to reduce cost through economies of scale, direct purchasing power, stringent overhead cost control. Liuhe, a company based in Shandong province producing 1 million ton feed annually from over 30 feed mills, offers territory-focused cost-leader strategy and gains dominance in the Shandong province. Tanrensheng, a company based in Hunan province producing 0.5 million ton a year feed, grows rapidly in recent years by differentiation, by adopting a customer-focus corporate culture.

### Side Story: How did our competitors sell acidifiers

"Acidifier" is used in piglet starter feeds to compensate the deficiency of gastric acid secretion in the first a few weeks of the animal so to reduce occurrence of diarrhoea. Its use as feed additive started from 1980s. At the beginning, mostly single acids, for example, citric acid, fumaric acid, phosphoric acid were used. Gradually, more research showed that a mixture of organic acids (lactic acid, citric acid, etc) and inorganic acid (phosphoric acid) was more cost effective. Most acidifiers are mixed acids. The use of acidifiers became more common in recent years after the EU banned some antibiotics as growth promoters. Also in China, there were more acidifier products in the market in the last two years than ever before. Majority of them were local products, as the information about its composition was becoming more transparent.

The price of acidifiers had been driven down due to tough competition. Some smaller suppliers were prepared to sell at a small margin due to low overhead. Recently one of our competitors started selling their acidifiers by giving the feed mill customers an open formula and open costing. Basically, the formula could be provided by the customer, or the supplier, for example, x% of phosphoric acid, y% of lactic acid z% citric acid, and so on, then the price of the product offered to the customer was calculated openly as the raw material cost plus a 2 RMB/kg net margin. For example, one of our customers was offered a product at a price of 8 RMB/kg.

When the product is being sold in this way, it is very difficult for others to compete, particularly foreign products, unless the competing products have the technology differentiation. For acidifiers, it is difficult to find technology differentiation. However, one area for technology differentiation is to make the acidifier non-reactive to mineral premix so that the product can also be included in the premix without reaction.

Kemin's acidifier is called "Acidlac". It was almost disappearing from the Chinese market (it was sold at more than 35 RMB/kg before). Recently it had tried to come back with a significant reduction in price (about 20 RMB/kg) because the product started to be manufactured in China. However, Acidlac had a lot of setback and did not come back as easily as expected, due to the pressure of local products.

## CHAPTER 5

### CREATING AND COMMUNICATING DIFFERENTIATION THROUGH CORPORATE AND PRODUCT IMAGE

#### 5.1 INTRODUCTION

As has been discussed in earlier chapters, Lucta China's business strategy was "focused differentiation". Corporate image and product image are important variables of differentiation. A good corporate and brand image can be perceived by customers as added values to the product.

The establishment of a good corporate image and product image in the eye of customers is a long process. But the process must be started as soon as possible, since once a bad image has been formed in the mind of others, it would take several times the effort to correct it. So at the start of the company life, I had started the long-term program to shape the company image and product image. The work required the concerted efforts from everyone and from all activities of the company.

#### 5.2. CREATING AND POSITIONING COMPANY IMAGE

##### 5.2.1 *The target image*

Corporate image lives in the mind of people. Here 'people' can be customers, potential customers, suppliers, employees, potential employees, etc. The image is a composite reflection of many aspects of the company, including products, people, and the way of conducting business. For Lucta China, strategically we wanted the target image to deliver two messages:

- 1) who we are: We are a reliable supplier, with who you can do business with trust.
- 2) what business we do: We are a specialist and a leader in feed flavours.

Accordingly two short phrases were used to reflect the messages:

*"Your Reliable Supplier"*

*"Lucta - the name for flavours"*

"Your Reliable Supplier" had already been used in Lucta group-wide. Therefore, the policy was consistent with the Lucta group policy.

### 5.2.2 Implementation

For ease of understanding and implementation, the “Reliability” strategy was detailed in three major areas: reliability in products, reliability in people, and reliability in the way of conducting business.

a) *Reliability in products*: Firstly product functionality or quality should be realistically conveyed to customers. Salespeople were not allowed to overstate the quality of the products so as to mislead our customers. Exaggerating of product quality can only lead to higher expectation by the customers and later greater disappointment. Repeated sales can not be given by misled customers. We trained our salesmen to be honest with our products. Secondly, product quality must be maintained constant. The product quality, which includes not only the functional aspects but also the physical properties and packaging, should be kept constant with time. In order to do so, a strict quality control system (raw materials quality, production process, finished product quality, packaging) was in place. We put a lot of care in maintaining a good image of our product quality to the smallest details, e.g. labels must be neatly put. Thirdly, reliability also means that products should be delivered in time. A sufficient stock of goods was kept in our warehouse. When stock was depleted too fast risking disruptions of supply of products to existing customers, the product in shortage was shipped by air freight from Spain at the last resort. The operations department had worked out a good logistics system for tracking the delivery of goods until they reached customer’s warehouse. In some cases, when large customers placed unexpectedly urgent orders, we also sent the goods by air cargo at no extra cost. Those customers were impressed by our extra effort to insure uninterrupted supply, and they knew that we were reliable.

b) *Reliability in people*. Honesty and sense of responsibility were the foremost requirements. Customers do not want to do business with people or companies whom they cannot trust. Internally, the trustworthiness quality of our people is equally important because the company can not guarantee to deliver reliable products or service if staff members do not act with responsibility. Thus in our company, staff members were carefully selected, and continuously trained, for these qualities in addition to their capabilities.

c) *Reliability in the way of conducting business*. Professionalism was very important. This was implemented as follows: a) only people with good qualifications were employed to the company; staff were given continuous training on professional knowledge required for their work; b) Standard operating procedures (SOP) were developed for the daily routine work so as to reduce probability of making errors; c) Every communications (including letters, faxes, technical materials, reports etc) with the outside (including customers), must be prepared and typed with a professional finish. Any staff (sales, technical, or managerial) in business contact with customers, must be dressed appropriately. d) Keeping ones’ word was also an important

demonstration of reliability. Thus, we aimed to respect the contracts, agreements or even appointments made with customers, suppliers or others.



Figure 5.1: Staff training is important for implementation of corporate image positioning. On many occasions, outside trainers were brought in to train our staff.

In Lucta China, I devoted an enormous effort to shape this 'Reliability' image through details implemented into the different processes of company operations. The foremost importance of implementation was that this strategy to be known and understood by all staff members, including new recruitments. The motto, "Your Reliable Supplier", was even displayed on the screen facing the entrance of the company. After five years of continuous implementation, internally the pursuit for 'reliability' had become part of the company culture.

The "reliability" corporate image positioning was implemented mainly by internal measures and discipline, but the message was delivered to the target customers through our products and other physical materials, our staff, and the interaction with the customers. Contribution was also made from marketing activities, such as advertising the company as a technology-based multinational company; and from the technical capabilities and support given to our customers. These activities together added to the confidence of customers in us.

# ISO9001 质量认证

## 国际品质

ISO9001 certification  
International quality

- 卓越的品质  
Superior quality
- 稳定的质量  
Consistent performance
- 可靠的供应厂家  
Your reliable supplier



# 乐达独创的香料设计体系

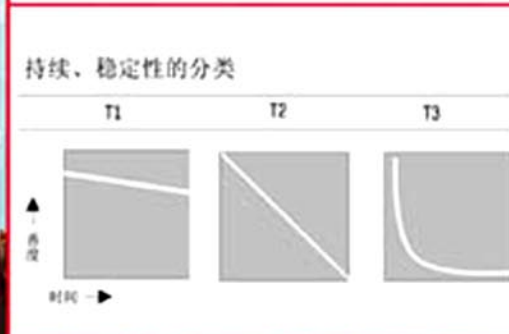
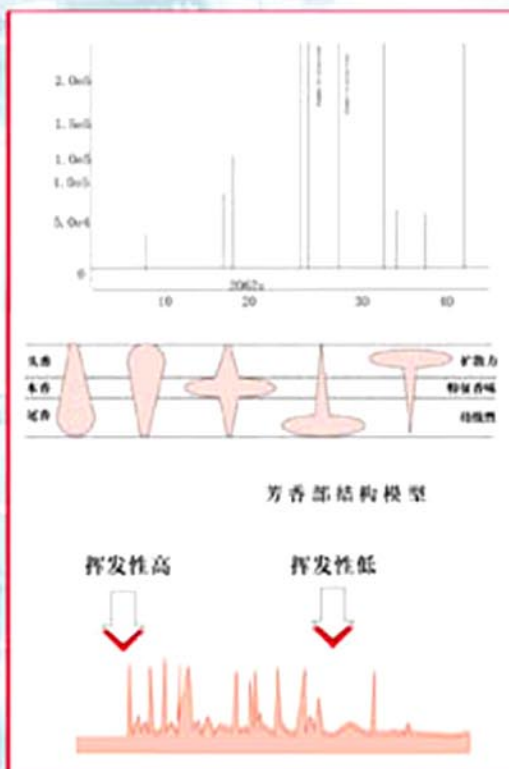
Lucta's innovative flavour design system



色谱图

芳香部结构模型

持续、稳定性的分类



The “flavour specialist company” image positioning was, however, implemented mainly through communication with the market and supported by our business capabilities. The activities of communication with the market went side-by-side with those used for product image positioning. Details are described in the next section. As integral parts of a brand, corporate image and product image can not be separated.

### 5.3 CREATING AND POSITIONING PRODUCT IMAGE

As had been defined before, the target segment for our products was the “high quality/high price”. We targeted at those customers (feed manufacturers) looking for quality in their products and thus willing to purchase high quality and differentiated raw materials at an average or higher than average price. Their primary concern is quality and not price.

In line with the market targeting, our products must be positioned accordingly. The position of the product is the place the product occurs in the target market relative to the competitors, as perceived by the target customers. Again, product position or product image lives in the mind of the target customers.

#### 5.3.1. *The desired image*

We wanted our products, particularly the “Luctarom” line, to be perceived with the following attributes:

- 1) high quality foreign products;
- 2) manufactured by a specialist company with technology and experience.

The word “foreign” was included, since the general perception in China was that foreign products were better in quality than local products. Thus why not use the inborn advantage of our products being made in Europe.

#### 5.3.2 *Implementation*

##### a) Through product design and labeling

When we first launched Luctarom, we started with products which ranged in quality on the high end of the market, but with a high price. At the time, the usual prices for feed flavours of local manufacturers were 20-35 RMB/kg. Our products ranged from 50 to 60 RMB/kg. The striking pricing difference made customers think of our products differently. The general impression from customers of Lucta’s flavour products was “very good in quality, but expensive”. For me, it was important that customers found it good, and not so important that they did not buy because the products were expensive, since I believed I could find a product in the right price for them in the future.

In order to enhance the image of a foreign product, we carefully designed the labels for our products. The main product names were in English with only Chinese translation in smaller prints. All the other text legally required (name, ingredients, direction for use, etc) was

given in four languages (English, German, Spanish and Chinese) to enhance the image of an international product. When later the products manufactured in Lucta China, the general design of the labels was still maintained.

#### b) Through communication with the market

Advertising, trade exhibitions and seminars played an important role. Advertisements were made in three national trade magazines (*China Feed*, *Animal Husbandry in China*, *Animal Science and Technologies Abroad*) and two regional trade magazines (*Guangdong Feed*, *Hunan Feed*) within the feed industry. With the magazines which had nationwide circulation, our message was about the corporation, stressing Lucta group as a multinational with 50 years' expertise and technology and as the world leader in feed flavours. With advertisements in regional magazines, however, individual products were promoted. To be compatible with our quality image, we always advertised in reputable magazines and in full pages in colour.

We also had outdoor advertisements, in a form of large poster located on the roof of feed markets in two provinces. Internet has become the new media for marketing. We used internet website (see Figure 5.2) as a window to communicate with customers (giving information about the company and products). It gave our customers (and prospective employees) an image of us being a modern and progressive company.



Figure 5.2: A snapshot of Lucta China's website, featuring products. Internet is an increasingly important window for communicating with customers.

We did not advertise in newspapers, TV and other media which target consumer mass, since our customers were specialized business unit (feed mills). In reviewing the efficacy of advertising, I would consider in our case, trade magazines gave the best result and other media were not successful. On many occasions when I visited customers first-time, I often heard customers saying that they had known Lucta from certain magazines already.

Attending trade shows or exhibitions had been important means of communication with customers, giving opportunities to convey to customers message about our products and image of our company. In the past four years, we had 3-4 trade shows every year, and we always attempted our best to give a good image at the show. It was important to be present at trade shows, because customers considered your presence as you still being active in the business. Therefore, we tried not to miss trade shows at national level.

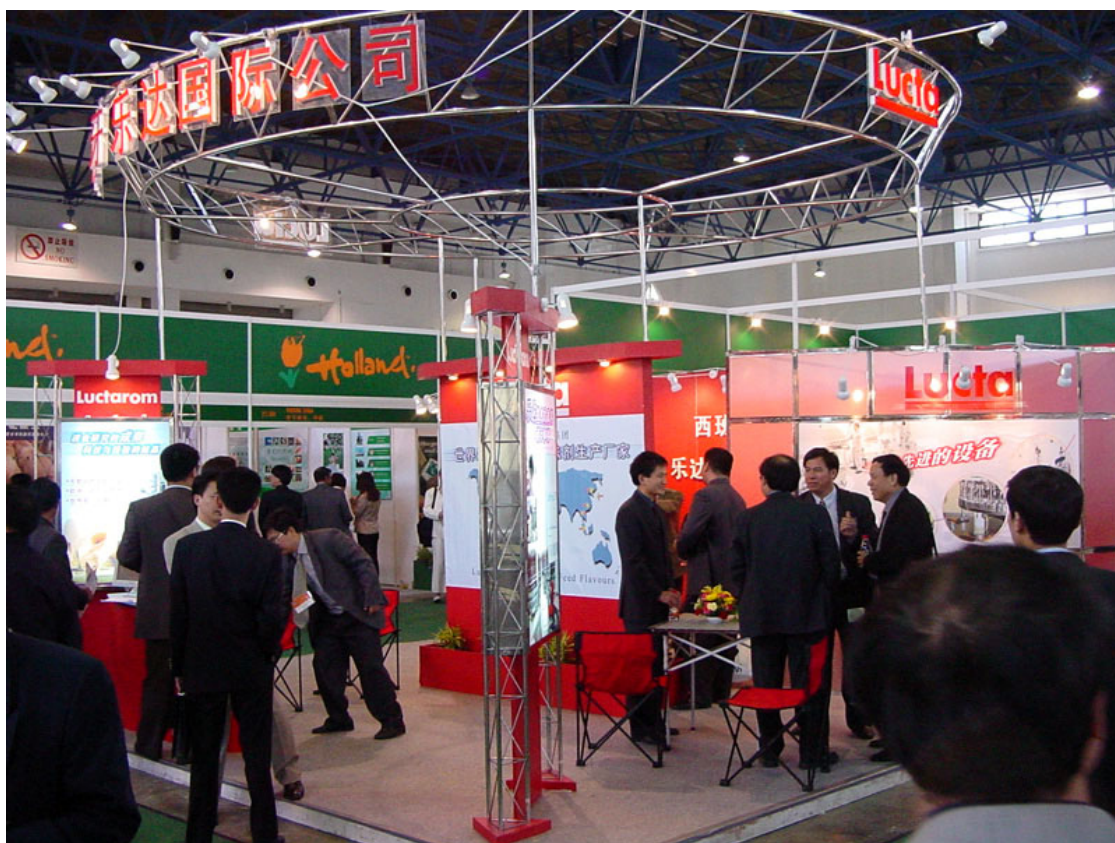


Figure 5.3: Lucta China exhibited in VIV 2002 in Beijing. VIV is internationally the largest scale trade exhibition for the feed industry. In the past four years, we had 3-4 trade shows every year.

The image of our products being “technology products” had to be nurtured by more than just advertisements and trade shows. Significant contribution also came from technical promotions. Each year we organized 4-5 technical seminars in different parts of the country. Small groups of targeted customers were invited to the seminars. The seminars focused on demonstrating the technologies used to make the products and the technologies for applying our products in the customer’s products. Publications in technical magazines/scientific journals were also made. To enhance association with the technical or academic circle, the company also sponsored scientific conferences, and encouraged staff to attend scientific conferences. Lectures were also given at well known universities to under graduate and postgraduate students, and to feed association as the way to train (and get known to) future customers.



Figure 5.4: A technical seminar on feed technologies organized by Lucta China to target customers. Each year we organized 4-5 technical seminars in different parts of the country.

In consistent with the corporate strategy, our market promotion activities always concentrated on Luctarom, the core product, and little on other products (Luctacid and Luctamold). “Lucta – the name for feed flavours” , the slogan was promoted with an objective to create an association between “Lucta” and “Feed flavours” in customers’ mind, and to deepen in the customers’ mind the image of Lucta being the specialist in feed flavours.

c) Through the performance of products

Of course, the manifestation of the high quality product image also came from the products themselves. If the products were poor in performance and unstable in quality, all the messages we attempted to give from our marketing activities would be void. Thus we took additional care of the product quality and its stability through stringent quality controls.

d) Through technology capabilities of the company

The technology capabilities of the company, in designing customer solutions, providing the right products to solve customers' problems, and in delivery of technical support after sales, further demonstrated that our products had "technology-backup".

e) Through good handling of complaints made by customers

When a valid complaint is made by a customer, how it is handled can affect the company's image. If this is not done correctly, a good image painstakingly nurtured may be lost overnight for that customer. We would not only lose that customer, but also other customers due to the word of mouth. If the complaint is dealt with well, the loyalty of the customer is enhanced. Customer's complaint must be handled promptly, being just and fair and with sincerity to correct for the error.

#### 5.4 RESULTS OF THE CORPORATE AND PRODUCT POSITIONING

The reward for our strategy and effort in corporate position and product positioning was good. From the words of mouth, I had feedback directly and indirectly from people in the market that Lucta China's image was good. By 2002, "Luctarom" had been regarded as a high quality feed flavour in Chinese feed market. One very obvious difference was, at the beginning of our business, our salesmen needed to explain to customers what Lucta company was, but now they did not normally need to do so because the customers had already heard about the name or Luctarom before. Most importantly, many customers were willing to buy our products at a slightly higher cost than our competitors because they trusted our products would perform and give constant quality. In the market, some suppliers used low price to gain customers at start but reduced quality later to regain profit. It was obviously an unwise thing to do, but in a developing market, this thing could happen.

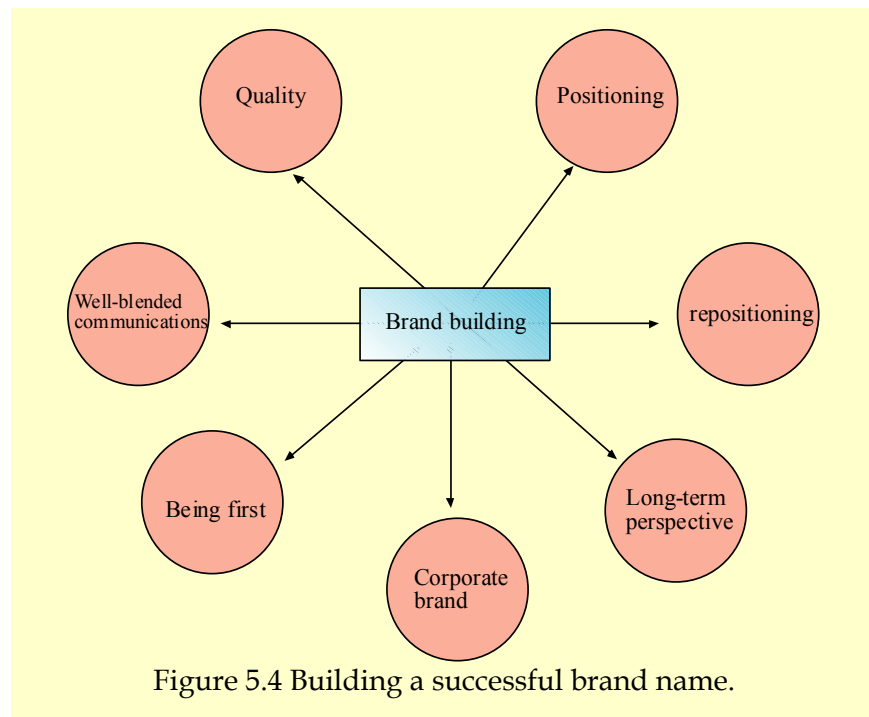
In summary, the good corporate and product images offered differentiation, and had helped enhancing the competitive position of Lucta China.

## 5.5. IN THE CONTEXT OF BRAND BUILDING

Successful brand can have many benefits; among them are premium prices and sustaining of stable sales. A brand is created by augmenting a core product with distinctive values that distinguish it from the competitors. For examples, in the case of “Luctarom”, it is not just a substance that gives smells — it is a product that helps the customers make better feed products and hence better sales. The technical know-how of our company means that the customer can get extra benefit from our expertise, and our reliability commitment means that the customer can have a more stable and constant-quality product of their own (a good brand name of their own).

As discussed by Doyle (1989) and King (1991), successful brand building requires a combination of some of the seven factors (Figure 5.4).

- 1) Build quality into the core product;
- 2) Position the brand in a clear well defined segment;
- 3) Reposition if the market situation have changed;
- 4) Being the first in the market is more successful than followers;
- 4) Well-blended communications to the target customers;
- 5) Build corporate brand (some brands are, in fact, corporate brand);
- 6) Have a long term perspective.



In fact, what we did with the corporate image positioning and product image positioning in the past five years can be regarded as part of the brand building process. The corporate image of “a reliable company” and “specialist for feed flavours” is consistent with the brand image of a high quality product. This branding process is an ongoing and long term process.

### Side Story: A case of solving a customer's complaint

In 2000, a complaint was made by one of our largest customers, Hualong Group in Fujian province. The customer reported that Luctarom 1806 which is a milky flavour gave a spicy smell. Some bags of the product had already been used in their feed and had caused rejection and return of their feed by their customers. It had caused a serious damage to our customer. In tracking the source of problem, we discovered the error was on us. In that shipment of one ton of Luctarom 1806, there was mistakenly two bags (20 kg) of another product Luctarom 38063 (which is a spicy flavour) mixed inside. Since the colour of the labels for the two products were the same, the workers of the customer's feed mill did not detect the product code and used 38063 as 1806.

Due to the importance of this customer, I dealt with this complaint myself. I knew that talking on telephone would not solve the problem. I flew to Fuzhou and talked to the group general manager and group technical director in head office. The direct complaint was made by one of their subsidiaries about 500km away in the mountainous region. There was only train to get there. Accompanied by the technical director, I took the train overnight and arrived to the station at 3am in the morning. At 7:30am I was in the feed mill waiting for the general manager of that feed mill to come to work. When the general manager saw me coming a long way to listen to his complaint, he was moved by my sincerity. He was not as angry as he would be otherwise. I explained the reason for such error to occur and promised that the same error would not happen again. At the end I also offered 200 kg of the product free of charge as compensation. The customer continued to use our product. The complaint seemed to have been dealt with successfully.

The error happened due to several events occurring at the same time: 1) Products were normally shipped from Spain in 600 kg pallets. When we ordered 2 ton of a product, for example, one of the pallets would contain at least two products. In this case, Luctarom 1806 and 38063 was put in one pallet. Since the labels for these products were similar (the colours of the labels were the same), it was difficult to distinguish them apart visually. 2) products were normally placed into carton boxes before shipment (3 bags into one box). It happened at that time that the packaging worker was new to the work. So Luctarom 38063 was packed as 1806 for delivery. In order to ensure that the same error would not repeat in the future, preventive actions were taken: 1) When ordering products from Spain, the amount for each product would always be a multiple of 600 kg so that each pallet will contain only one product; 2) different coloured labels were used for different products so that different products can be distinguished visually. The same type of error did not happen again since.

In reviewing this case, being fast, fair and sincere was the key in handling complaints. Appropriate compensation was also importance. A complaining customer would never feel happy without being given appropriate compensation, however good the excuse may be. I found that often a more generous compensation was worthwhile to delight the customer, and also to show to the customer that I could not afford to do this all the time!

## CHAPTER 6

### MARKETING FEED FLAVOURS IN A DYNAMIC MARKET

#### 6.1 INTRODUCTION

In Chapter 4, I have discussed how Lucta China had arrived with the business strategy of “focused differentiation”, i.e. to develop areas of uniqueness in our products which can be considered as added values or benefit by the customer of our target market segments. The implementation of this business strategy was carried out in two parallel levels: one, to create and communicate differentiation in corporate and product image, as reported in Chapter 5; two, to create differentiation in our products and communicate it at sales operations. The latter is described in this chapter in greater details. I will recall the process of how we actually marketed the product Luctarom, the core product of Lucta China business. Areas of marketing, such as market segmentation and sales channels, are also discussed.

#### 6.2 THE FEED FLAVOUR MARKET IN 1999

Flavours for animal feed were introduced to Chinese market in early 1990s. Agrimerica (from USA) entered China indirectly through its distributor in Hong Kong and started off the concept of adding flavours to feeds. However, in 1999, feed flavour products available in the market were practically of local brands. There was few imported brands or no foreign suppliers directly manufacturing in China. Local manufacturers included: Harse (Guangzhou of Guangdong Province), Dadi (Chengdu of Sichuan Province), Hongda (Zhaoqin of Guangdong Province), Jiamei (Chongqing), Lixiang (Guangzhou of Guangdong Province), Mudan (Xiamen of Fujian Province), Mingtai (Chongqing). Some other smaller manufacturers are not listed here. Among those named above, Harse and Dadi had the biggest market shares at the time.

Harse was the earliest manufacturer to produce feed flavour in China. After Agrimerica had introduced to China the concept of using feed flavour, Harse imported part of their flavour nucleus from Agrimerica to make the final products. In their marketing campaign, Harse always branded their products as an achievement of “technical collaboration with Agrimerica in USA”. Harse’s peak time was in 1990s, with a market share greater than 50%. However, because of problem of internal management leading to loss of several key staff members to become their own competitors (e.g. Tiandi of Beijing, Jiamei of Chongqing, were formed from Harse’s staff), and because of

the instability of their products leading to loss of customers, its Market share shrunk significantly. Harse in 1999 was already a company whose business was sliding. By 2002, Harse had practically disappeared from the market.

Dadi however was a steadily growing company. Its products could be considered as the highest in quality among the local products at the time. Quality stability was also good. Dadi company was started up in mid 1990s by a then MSc student who was experimenting the use of a flavour for a feed manufacturer for his MSc project. When he finished the project, the time was the fastest growing period for the feed and animal industry and the demand for raw materials was greater than supply. So he started, at the right time, to market his feed flavour product to the industry. The company grew rapidly. By 1999, Dadi had already had distributors in most provinces of China. Dadi had two flavour products at that time which were being sold well, at the unit price of 28 and 35 RMB/kg.

In order to understand the competitive products in the market, we collected samples of 12 typical products from the market and sent them to our HQ laboratory in Lucta Spain. Based on gas chromatographic analysis and expert panel test, the results showed that all products were rooted from one product called "Piglet Milky Flavour" originally introduced to China by Agrimerica Inc. of USA, and all other products were derivatives of the Piglet Milky Flavour by addition of some top notes such as fruity (e.g. bananas) or more commonly woody and spicy notes. The analytical results also showed that all products were low in concentration of essence and thus required high dosage when applied to feed (typically 1-2 kg/ton feed).

With some initial knowledge about the products in the market, it was considered Lucta product should be able to compete in the market with quality and even price advantages.

### 6.3 INITIAL SETTING OF MARKET STRATEGY

Before launching our flavour products, "Luctarom", we conducted a good market study. Collection and analysis of competitor products were one way. We also studied their prices and performance: price ratio. The price range for competitors' products was 25-35 RMB/kg with a dosage of 800-1000 g/ton feed. We decided to launch products in the range of 50-60 RMB/kg. Luctarom 1806 (a milky vanilla flavour) was introduced at 58 RMB/kg and Luctarom 37661 (a fruity-milky flavour) at 50 RMB/kg. Why did we launch the products at that price range? At the time, there were already too many companies actively promoting flavours to feed mills so that many technical managers refused to receive visits of salesmen from flavour companies. But we wanted to be seen different and not as "another flavour company". We intended to use the striking difference in price to make people stop and

think: perhaps this company's product is different! Of course the dosage of our product was lower, at approximately 50% of the dosage of competitor products, so the cost per ton feed treated was rather similar to competitor products and thus we should be still competing with quality. The "high unit price and low dosage" approach was useful to us in two aspects: 1) low dosage and thus high essence concentration would give the products a high-technology selling point. Luctarom used multi-pore silica as absorbent giving not only good physical appearance and flow-ability but also high absorption capacity. All existing products however used corn-cob meal as the absorbent, resulting in poor physical appearance and limitation of absorption capacity. 2) At a low dosage, it was a cost-saving for us since the freight cost from Spain to China could be reduced. Anyway, the pricing tactics was part of our focused differentiation strategy: high quality product and hence high price, as discussed in an earlier chapter.

Of course, a high price per se was not a selling point, we must tell our customers how our products were different from the competitors. When we studied the market at the time, we observed the view of many users on existing products in the market, which can be summarized as: 1) poor resistant to high temperature required for making the mixed feed into pellets; 2) short duration of flavour intensity: most flavour only lasted for typically 20-30 days after application; 3) there was little knowledge about flavours. After several rounds of brain storming among our sales team, logically we decided to highlight the technical and performance advantages of Luctarom as its quality differentiation points. That was: 1) technology of slow release used in Luctarom; 2) heat resistant and long lasting flavour persistence feature of the product (able to remain 70% of its original intensity at 70 days after pelleting); 3) the system developed by Lucta for flavour design and the assessment of flavour performance. In supporting this marketing strategy, a two-page colour advertisement was placed in *Guangdong Feed* (a regional industrial magazine published quarterly). A technical article entitled "A system for the characterization and evaluation of feed flavours" was also published in the journal. The paper described the Flavour Information System developed by Lucta, which covered topics such as the profiling of aromatic structure, standards to assess resistance to time and temperature, sensory evaluation and animal feeding trials to determine animal's preference. Several technical seminars were also arranged to convey message of Luctarom's technically advanced features. Sales activities were directed to persuade prospective customers to conduct comparison trials in their feed mills, to benchmark Luctarom against their existing products.

How successful was this marketing strategy? After about one year's practice in 2000, we found that the quality differentiation strategy was overall a correct one, however, the tactics of using technical attributes as quality differentiation point for Luctarom did not give good result in sales, and thus could be regarded as a failure. I remembered receiving a phone called from a salesman who was working very hard to

convince a customer to try our product, “According to the technical datasheet, I recommended the customer to carry out a pelleting trial at a dose of 250 g/ton feed. There was barely any flavour smell from the pelleted feed produced.”. Despite of large effort made, we did not succeed with that customer because our product had failed. There were many similar cases where our products did not live up to expectation. It was very frustrating to our sales staff.

The possible reasons for failure can be summarized as follows:

1) We did not really understand our products, particularly the performance and particularity of individual products. This was partly because we had little experience and partly due to the fact that, the information given by Lucta Spain was too simple and was not explicit to the detailed differences between products. Technical and marketing data were incomplete. It was half a year after product launch that only we were given information that Luctarom 1806 contained 20% sweetener thus customers would not need to add sweetener any more. Some of the recommendations were not applicable to the Chinese market, for example, 250 g/ton dose appeared sufficient for customers in Europe but not in China.

Although in general the claims (about heat resistance and lower dosage) we made about our products were true, there was indeed large differences between individual products. Luctarom 1806 had a high resistance to heat and thus good durability, but it had a low head note and thus the flavour intensity was low. Particularly when recommended to use at 250 g/ton, the intensity would be inadequate for most Chinese customers, who wanted the flavour to powerfully strong. On the contrary, Luctarom 37661 had a very powerful head note, but it was not really heat resistant. One of our customers in Guangxi made complaint about the product being unstable since the flavour intensity was lower at one time than before. Although the real cause was that their temperature controller of the pelleting machine was out of order giving an unobserved higher temperature and thus greater loss of flavour essence during the pelleting process, the customer’s confidence in our products was affected.

2) Later we discovered that, because we placed a lot of emphasis on the technical features, such as heat resistance and low dosage, we had raised customer’s expectation on our products. Once a product was not that excellent in one aspect or another, it easily failed the customers’ expectation. That product then became “not as good as claimed, and not worth the high price”.

In fact, we should not have placed the emphasis too much on the physical and technical attributes which can be immediately measured. These attributes are “*tangible*” traits. We should have placed the emphasis on those *non-tangible* traits which the customers can not see, touch or measure easily. Non-tangible traits could include: benefits to the animal and to the feed mills themselves. There is a general

tendency for people to promote the non-tangible traits if the product is tangible, or vice versa. Typical examples are: car advertisers would emphasize the feeling of status and success that their cars would give the owner etc. Fashion clothing is using the similar tactics. On the other hand, hospitals would place emphasis on their tangible advanced facilities and profiles of their doctors, because their service is not tangible (the customers can not see the result before engaging the service). Understanding this principle, we later decided that we must explore more on marketing the benefits of our products, shifting from the technical and physical attributes.

Luctarom 1806 is a pure (genuine) milky flavour. The sensory intensity is not powerful, but the product is the best for attracting young piglets to start eating solid food, thus a good transition from liquid milk to solid food. "Intake boosting" is its strong point. The market at that time had changed as well. It was rather messy as local flavour suppliers multiplied by number and all were promoting products with a sensory intensity stronger and stronger, regardless whether they offered any benefit to animals. The result was that feed manufacturers started to develop a negative feeling against flavour use. Therefore, under these circumstances, it would be to our disadvantage if we continued to promote the "low dosage and heat resistance" feature, as this would lead the customers only to judge our products only using the intensity of smell, and this trait may be inferior to competitor products. Luctarom 1806Z did not sell at all in Guangxi province where the market was seeking strong and powerful flavours. Based on this analysis, we finally placed the selling point of Luctarom to its "feed boosting" benefit. We no longer painstakingly stressed the heat resistant advantages of our products — let the customers find out the feature themselves, and let this feature become a bonus. The benefit of intake boosting could not be seen right away (because most feed mills would not conduct animal experimentation on their feeds), and is a non-tangible feature.

#### 6.4 DIFFERENTIATION BY PRODUCT BENEFITS

From the year 2000, our marketing tactics was shifted towards emphasising the "intake boosting" benefit of Luctarom as a differentiation point. Business strategy remained unchanged: to compete by focused differentiation of product quality and service. In accordance with this new market tactics, the content of our advertisements were also modified to deliver the message "Luctarom – your solution for improving feed palatability". A new article entitled "Animal's feed selection behaviour and the use of flavours" as published in a well-known scientific journal. More importantly, 4-5 technical seminars or symposiums each year were delivered across the country educating customers how to apply the principle of animal's food selection behaviour to create good prestarter diets to achieve early feed intake by young pigs. The responses from seminar attendants were good, as judged from the business with the attendants. Even

those who did not proceed to buy our products, they had formed a good perception of Lucta products.

Luctarom 1806 was the representative of the group of products featuring 'intake boosting' performance. For this product, we focused the advantage on the benefit of increasing feed intake. We warned customers that this product may not give strong sensory intensity, but was the best for the animal preference. In this way, we avoided customers forming high expectations on the flavour intensity of our product. In the end the product often performed better than expected and the customers were delighted.

The result of this change in marketing strategy was good. At the beginning, it took painstaking work to convince feed mills to choose a weak flavour albeit its benefit of improving animal intake, while at the time the majority of feed mills and feed buyers were used to strong flavours. However, the effort was in the end well-rewarded. Luctarom sales increased steadily for the coming years (see Figure 6.1). More importantly, many of the major feed or premix manufacturers were already among Lucta's customers. By 2002, Luctarom had become a well-known brand for high quality feed flavours of China. Association with good quality itself became a differentiation point. Many smaller feed or premix manufacturers bought Luctarom to create top quality products in their product range.

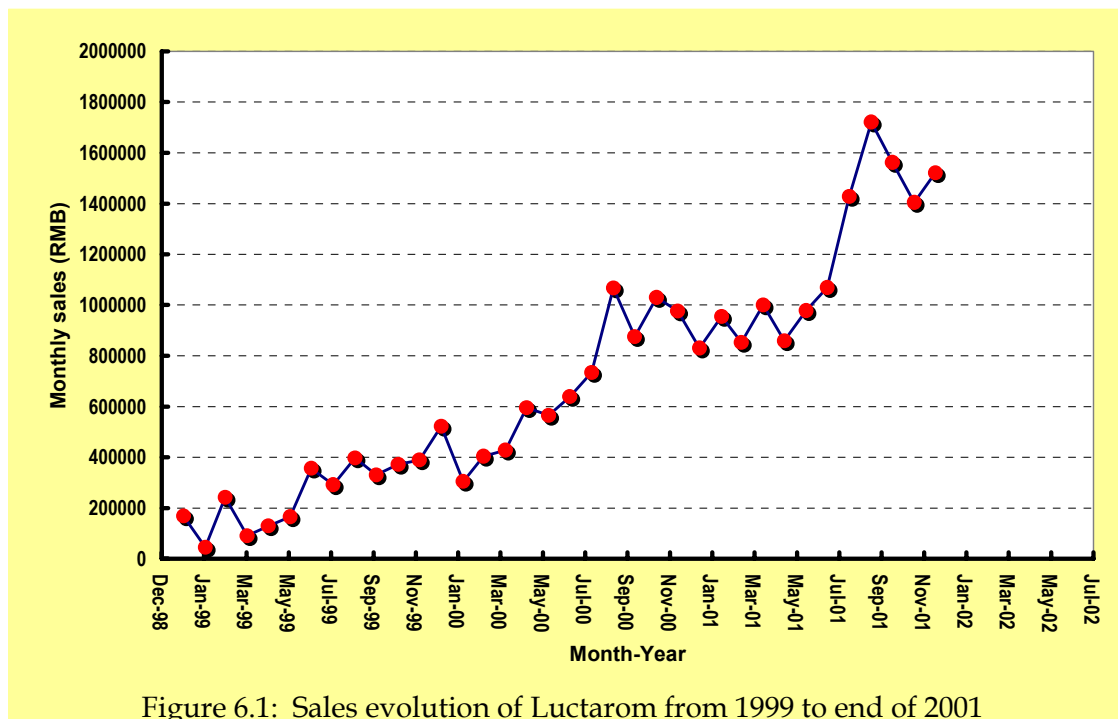


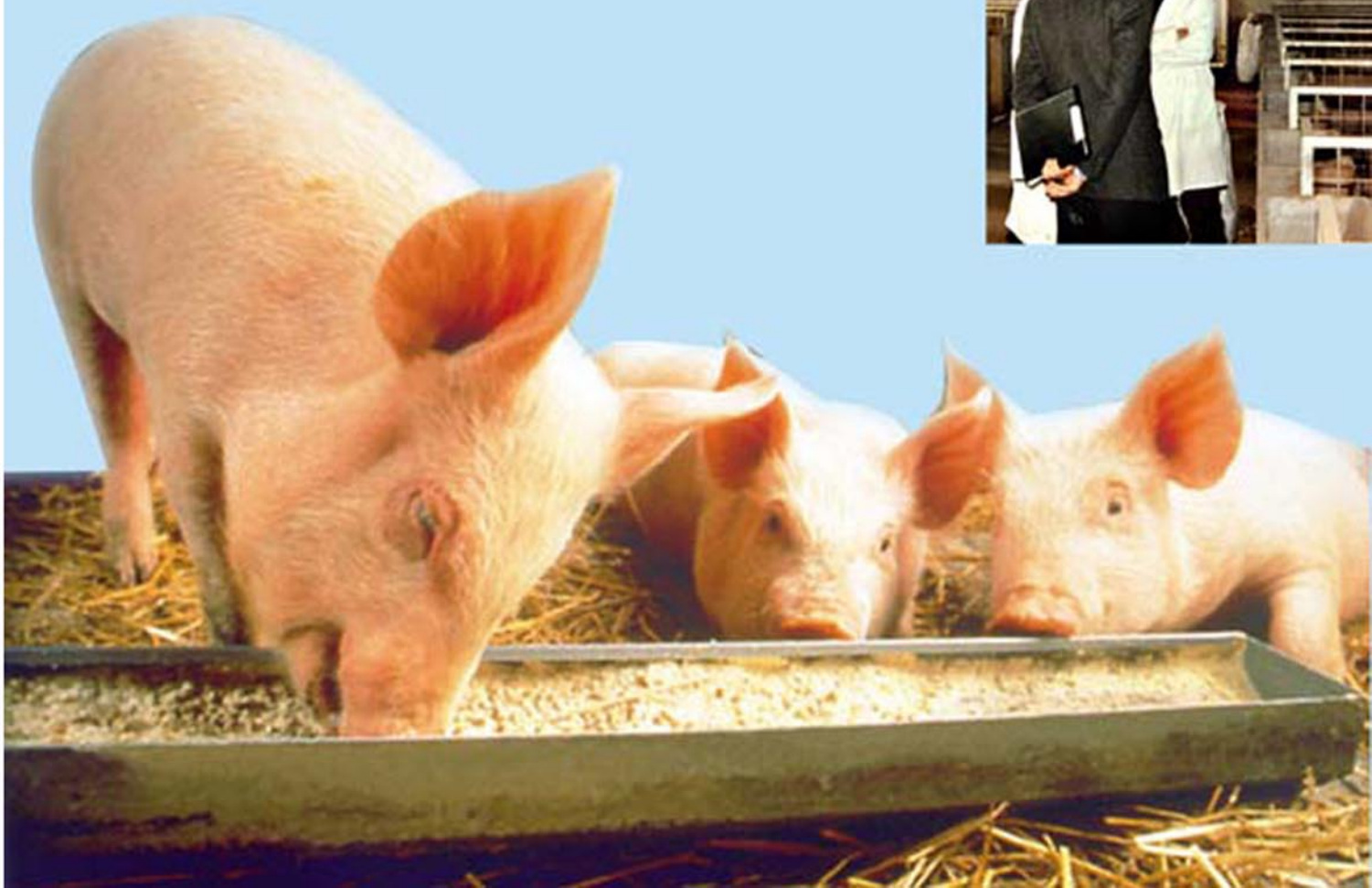
Figure 6.1: Sales evolution of Luctarom from 1999 to end of 2001

# 诱食研究的成果

## 科技与经验的结晶

Proven animal performance  
Product of technology and experience

- **无数动物试验证实**  
Performance tested by animal trials
- **欧洲三分之一市场**  
One out of three piglets in Europe consumes
- **世界第一品牌**  
World's No1 name in feed flavours



## 6.5 DEVELOPING PRODUCTS SPECIFICALLY FOR CHINA

Creating products specific to the market requirement had been a key determinant of success or failure. Up to the year 2000, Lucta Spain sent to China several products (see Table 6.1) which were best sellers in Europe. The assumption was that these products may also sell equally well. The reality however was very disappointing. We found most products did not suit the Chinese market. The sensory profile (i.e. the smell) of Luctarom 1806 was well received and liked by customers but its intensity was too weak for many customers. Even though there were buyers of this product, the volume was small. The sensory profiles of other products however were too far different from what the market regarded as normal. Feed manufacturers were unwilling to try flavours with smells too different from the norm in order not to risk a drop in sales in fear that feed buyers (e.g. farmers) may reject the new smells. As a result, little of the 37661 and 38063 were sold, and none of the 37794, 37795 and 37787 was sold at all.

Table 6.1: The list of products first sent to Lucta China

| Product Code | Characteristics                                   |
|--------------|---|
| 1806         | Milky vanilla flavour used for piglets            |
| 37661        | Fruity (strawberry) flavour                       |
| 38063        | Spicy flavour used for adult pigs                 |
| 37787        | Sensory the same as 37661 but lower concentration |
| 37794        | Fruity (honey and cherry) flavour                 |
| 37795        | Strong anise flavour                              |

Practically all our customers were feed manufacturers, producing complete feed, protein concentrates and mineral & vitamin premix. In China market at that time there were a large number of feed mills but most were small in scales. In Nanning of Guangxi province, a street called "Wuyi Road" accommodated more than 50 feed mills, and those feed mills with a monthly production of 2000 tons feed would be considered as large plants. But in Guangdong, there were larger feed mills with production yield of greater than 10,000 ton per month. There were marked differences between regions in the feed industry. However, their sales channels were rather similar irrespective of the size. Majority of feed manufactures did not sell their feed products directly to the final users but through distributors or feed traders. The distributors were typically family-owned shops where farmers came to buy a bag (40 kg size) or two to take home for feeding. The distributors may sell products from more than one feed mills and thus the outlet point created competition among different feed brand names (see Figure 6.2). Unable to see its quality, farmers may select the feed purely based on its smell. There was a tendency of preferring stronger smells.

This market preference drove the feed mills to use flavours which were increasingly strong in intensity and in pleasing the buyers. When the profit margin was down, feed mills would squeeze out expensive feed additives and look for cheaper raw materials. There was a weakness with this type of sales channel for feed mills. The feedback on the product quality from the end users was slow and was sometimes incorrect via the relay of the distributors.

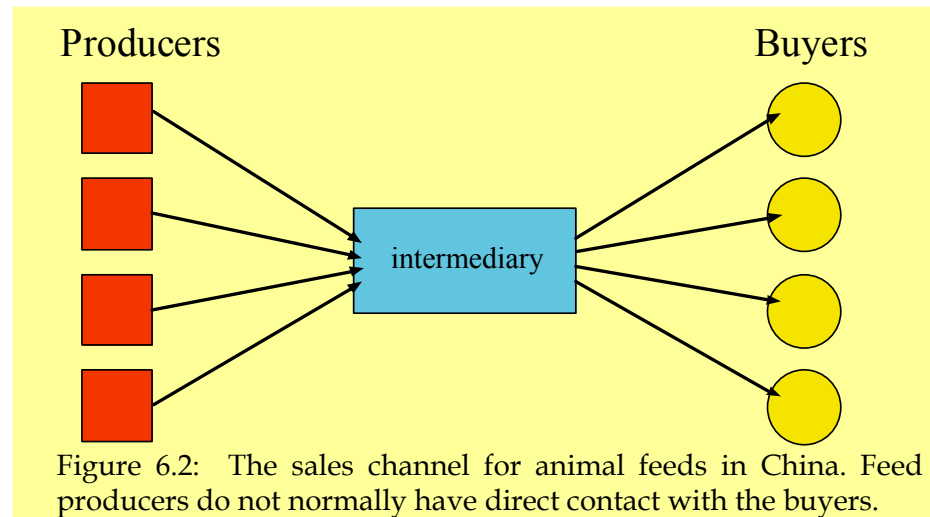


Figure 6.2: The sales channel for animal feeds in China. Feed producers do not normally have direct contact with the buyers.

As can be seen from this analysis, Lucta at the time really lacked products that could meet the needs of the market. Such products should have the following features: 1) powerful in sensory intensity with good durability; 2) modest price and 3) sensory profile (the smell) acceptable and preferred by the buyers of feed. Through market studies and collaboration with Lucta Spain, finally we created a new product with a sensory smell similar to the then leading product in the market, but better in performance (the smell, the intensity and durability). The product went to market in October 1999. This product, Luctarom 38972, was priced at 50 RMB/kg with a dosage of 50-60% of competitors' products, thus the real cost to feed mills was 20-25 RMB/ton feed. It was competitive cost-wise, compared to its target competitor, a leading product from Dadi which was priced at 30-35 RMB/kg with a dosage of 800 g/ton (24-28 RMB/ton feed). The profit margin for this product was low, but this product was meant to compete with a price advantage as well. My rationale behind this move was to grasp some market share from our competitors. Through letting more customers use Luctarom and experience its quality, we make Luctarom name known, particularly because dominant products set the market trend. Only when our products have a considerable market share that we can start to slowly lead the market preference to our own direction. As an analogy, selling Luctarom at the time was like selling the colourful clothing of United Colour of Benetton in China of 1970s when every one was wearing blue worker-uniforms, or like selling suits then when every one was used to blue Zhangshan uniforms. We should produce blue colour garments, and let people accept the products and the brand name first. Once the brand name is well accepted and has established as a trend, other colours clothing can come in and lead the market.

The introduction of Luctarom 38972 was a success and the sales of this product increased significantly in the recent 2-3 years. It had grasped an apparent size of market share from our competitors. In Fujian province, feed industry was concentrated in Putian county. All four largest feed mills switched to Luctarom 38972 from a product by Dadi. Many smaller-size feed mills also wanted to adopt the same flavour product. The feed smell given by Luctarom 38972 became the best preferred one by farmers (the feed buyers). In other provinces too, Luctarom 38972 was well accepted in smell, heat resistant property, and intensity. The acceptance for the price also maintained for a while until the market situation changed.

By August 2000, we introduced a mid-price product, Luctarom 40797 and the product was also successful. This was a lower concentration version of Luctarom 38972 thus requiring higher dosage. It was priced at 30 RMB/kg. The cost of application (cost per ton feed treated) to the customers was effectively the same as 38972. This product was created because there was an enlarging segment of customers who did not like “expensive” (i.e. high unit price) products. This is a price-sensitive segment. The product of 30 RMB /kg may appear more acceptable while that of 50 RMB/kg too expensive. The owners of some private feed mills, who would receive report of feed additive raw materials purchasing prices without knowing the actual dosage, may question their technical manager why their flavour cost 50 RMB when the usual price was only 20-25 RMB. Luctarom 40797 was just to address this niche and was successful. The sales increased steadily and became one of the major selling products (see Figure 6.3).

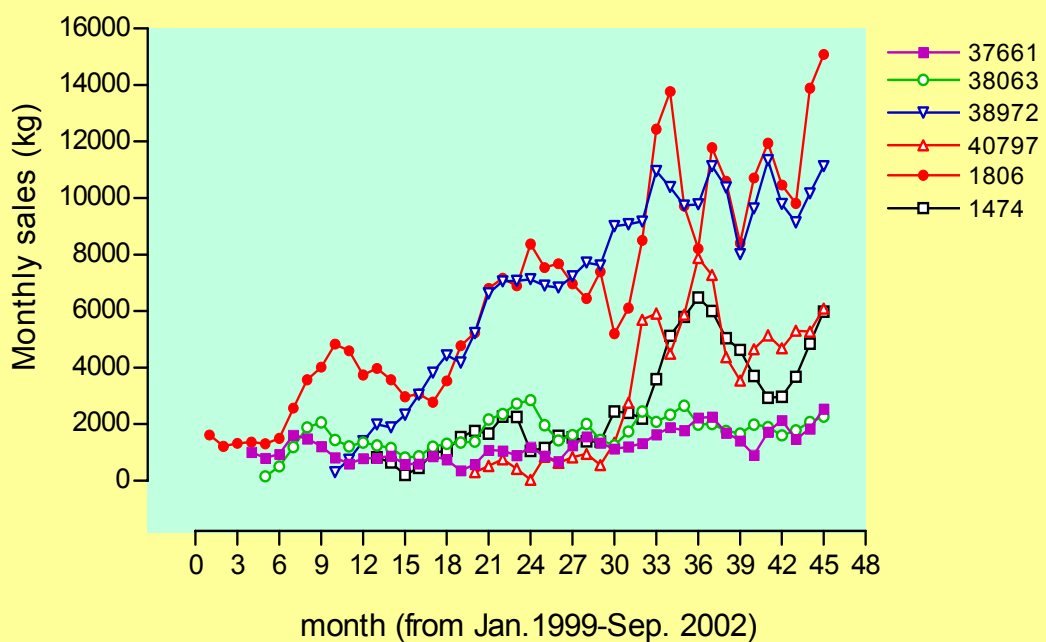


Figure 6.3: The sales evolution of different Luctarom products (data are moving average of 2 months). Luctarom 38972, 40797, and 1474 were created for Chinese market. Sales of 1474 was affected by fishmeal market price.

From the success story of 38972 and 40797, which were created specifically to fit the Chinese market, we can see the importance of matching products to the market needs. This is particularly true for products like flavours, because the preference for smell is subjective and influenced by many local factors. For instance, a “biscuit flavour” referred to by most Chinese was that based on vanillin since for a long time in the past biscuit contained ethyl vanillin as a flavouring ingredient, whereas a “biscuit flavour” referred to in Spain would be totally different, it may be fruity or chocolate. Moreover, there were marked differences in market characteristics between different geographical regions. Even within the same region, market characteristics and demands can vary. This was true with the feed flavour market in China. Therefore it was necessary to continuously align our products with the market needs. I will also elaborate this topic in the next section.

This section touches the subject of international strategy for product. On this subject, Keegan (1995) distinguished three adaptation strategies of product to a foreign market:

- 1) *straight extension*: introducing products in the foreign market without any change
- 2) *product adaptation*: altering products to meet local conditions or preference
- 3) *product invention*: creating new products to meet the need. Product invention is a costly strategy, but the payoffs can be great, particularly if a company can move product invention into the target foreign country.

Lucta’s experience showed that straight extension of product was a failure, product adaptation, e.g. the creation of Luctarom 38972, 40797 to meet the local preference, was essential for the acceptance of product by local market.

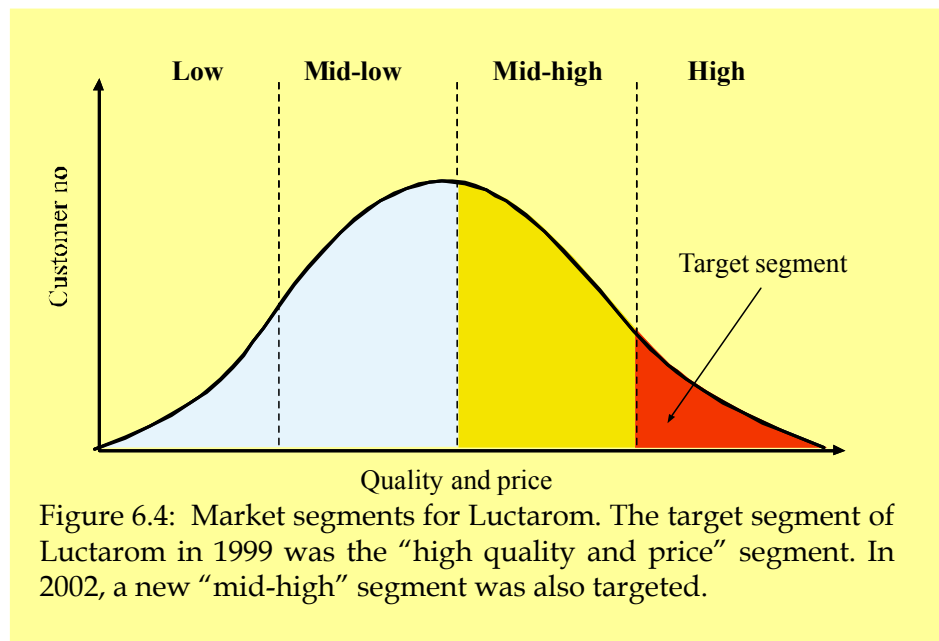
There was also a case of product invention. In central and north China the major form of feed produced was protein concentrate, containing fishmeal as the protein source. Therefore, there was no need for adding milky or fruity flavouring to protein concentrate. In fact, our customers wanted a fishmeal flavour to enhance the “rich in fishmeal” impression of their products (farmer would buy protein concentrate with a strong fishmeal smell assuming it had a high protein content). As the prices of fishmeal increased, a lot of feed manufacturers also wanted to replace fishmeal with other protein sources, but the absence of fishmeal smell may not be accepted by buyers. Thus there was a need for a flavour that gave fishmeal smell, and the market potential was large because this flavour was not restricted to piglet feeds (i.e. it may also be used in poultry feeds, thus the market would be greater). However, Lucta did not have a fishmeal flavour in its product library, and had no experience of working with fishmeal flavour raw materials.

This was because in Europe fishmeal smell was the one to be masked and not to be enhanced. This product had to be created brand-new or invented. It took two years of work, though not intensively, to create three versions of fishmeal flavour product (Luctarom 1474). Although further improvement was needed, the products had gained a reasonable success. At 2002, the fishmeal flavour product as a whole ranked 4<sup>th</sup> place in the sales of all Luctarom products (see Figure 6.3).

## 6.6 NEW TARGET MARKET SEGMENT: MEDIUM-PRICE PRODUCTS

From 2000 to 2001, the sales of Luctarom increased steadily. The company's sale revenue increased from 13 million RMB in 2000 to 23 million in 2001. Market share had also increased. Within the territories (provinces) where we operated, most of the major feed manufacturers had become Lucta's customers. However, we found that some of them did not purchase to their potential, i.e. their order size was much too small relative to their buying potential. The reason was that: they limited the use of our product in their top product range because of the apparently high cost of our product, and used other cheaper products from other suppliers in their big volume medium and low-price product ranges.

So far, our product was positioned at the high end of the quality range, i.e. good quality but high price. The market segment was those customers who cared more about quality than cost. In fact we had occupied a very good market share in this market segment (estimated to be 30-40% share). However, the total volume in this high price quality product market segment was small (see Figure 6.4). The medium price market segment was much bigger in volume. In sales experience, we also noted that large feed mills (for example, producing 10,000 tons feed per month) did not normally use much flavour at all, because they believed their products did not need to use flavours to please their buyers; the big users of flavours were, in fact, those medium to medium-small size feed mills producing around 2000 tons pig feed per month. They could buy 1 ton/month of our flavour, much more than large feed mills would normally order (300-500 kg/month). However, this segment of customers were very sensitive to price and would not pay higher prices. Our products at unit price of over 50 RMB/kg were difficult to be accepted. At the time, the competitive situation had changed too. The general market prices for flavours from local suppliers had reduced to 15-25 RMB/kg, and the performance to price ratio of local products had been significantly improved. Since the profit margin of feed industry was reduced, feed mills were increasingly more cost-conscious and would squeeze out expensive raw materials. This imposed a threat to us.



As the market requirements changed, our strategy had to be modified accordingly. Despite the fact that Luctarom’s “high quality-high price” brand image and product position had been established, we needed to get into the “medium quality- medium price” market segment in order to get enough market share to consolidate our position in the market. Our new strategy was to strengthen our leadership position in top range market segment by creating even better performing products, and at the same time, extend to the medium-high range market segment (see Figure 6.3). New products to target on the medium range market segment would be around 25-30 RMB/kg, with an application cost of around 15 RMB/ton feed. The launch of Luctarom 40797 at mid-2001 (priced at 30 RMB/kg, application cost 18-20 RMB/ton feed) was the first step in this strategy. In March 2002, a new product, Luctarom 44971, was launched. Subsequently, a series of new products were also developed with different sensory profiles. Specific products were also developed for premix applications within this price range.

## 6.7 DIFFERENTIATION BY CUSTOMERIZATION AND SERVICE

By 2001, competition in the feed flavour market of China had become more and more intensive. Although some of the previously active brand names, such as “Hongda”, “Lixiang”, “Harse”, had gradually lost their market stands in the market; “Dadi” had grown stronger in market position and was the largest in terms of volume of product sold. A new local company “Meinong” (from Shanghai), recruiting a flavourist who previously worked for Jiamei, entered the market with a vigorous marketing campaign aiming ambitiously to become the No.1 supplier in feed flavours. Bayer Sichuan, a German company joint venture, had started its feed flavour production in Sichuan and shared the similar target market segment as Luctarom. Foreign products from Feed Flavours (USA) and Pancosma

(Switzerland) had also entered the Chinese market. Local products had also improved in quality, particularly in the physical appearance of the products. Some competitors started to use the same type of carrier for their products as that used for Luctarom. The differences in the physical attributes became smaller. By now, Luctarom had become one of the significant brands of feed flavours in the China market. As its market share increased, it had attracted the attacks and imitation by its competitors. Dadi and Meinong had been working on imitating Luctarom 1806 and 38972 and offered cheaper alternatives to Lucta customers.

In face of the tougher competition, at a meeting of the board of directors held in May 2001, two important decisions were made: 1) start manufacturing of Luctarom, Luctacid and Luctamold in China; 2) start providing tailor-made solution to customers as a point of differentiation. The first installation of production facilities had been in place by end of 2001. At earlier 2002, we started to import essence nucleus in liquid form from Lucta Spain, and other raw materials were sourced locally. The final products were thus made in China. Local manufacturing had enhanced the competitiveness of Lucta China, lowered cost and lowered stock of finished products; moreover, it had also made it feasible to provide customerized products to customers. In our customerized approach, we provided products to customers with labels such as “for the exclusive use of XXX company”. Our target was to supply to our customers products of “individuality” based on their choice. Working together with the flavour creation department of Lucta Spain, we created a system which would enable us to provide a range of products based on a smaller set of product nucleus.

Our sales activities were also refocused. More emphasis was now placed on differentiation by service and by our capability to provide customer-driven solutions. The mode of our sale activities was changed from selling products to providing service and customer-solutions. Sales personnel job nature was also changed, from “sale executives” to “customer service executives”. Further and regular training was provided to our sales staff to improve their capability and skills for their new role.

There were two key elements in our service differentiation strategy. One element was to provide solutions to meet our customer needs. For some of these requirements, the work could be accomplished at sale staff level. Each of our sales staff was equipped with a notebook computer, and was trained to be able to make professional presentations to customers and formulate a “Customer Solution Report” to be delivered to customers either by email or in well-presented printed format. For some more complex requirements, the work had to be accomplished with the participation of our technical department and the product application laboratory. With this type, normally the customers needed to provide samples of their products for use as substrates in our laboratory tests. Different solutions were

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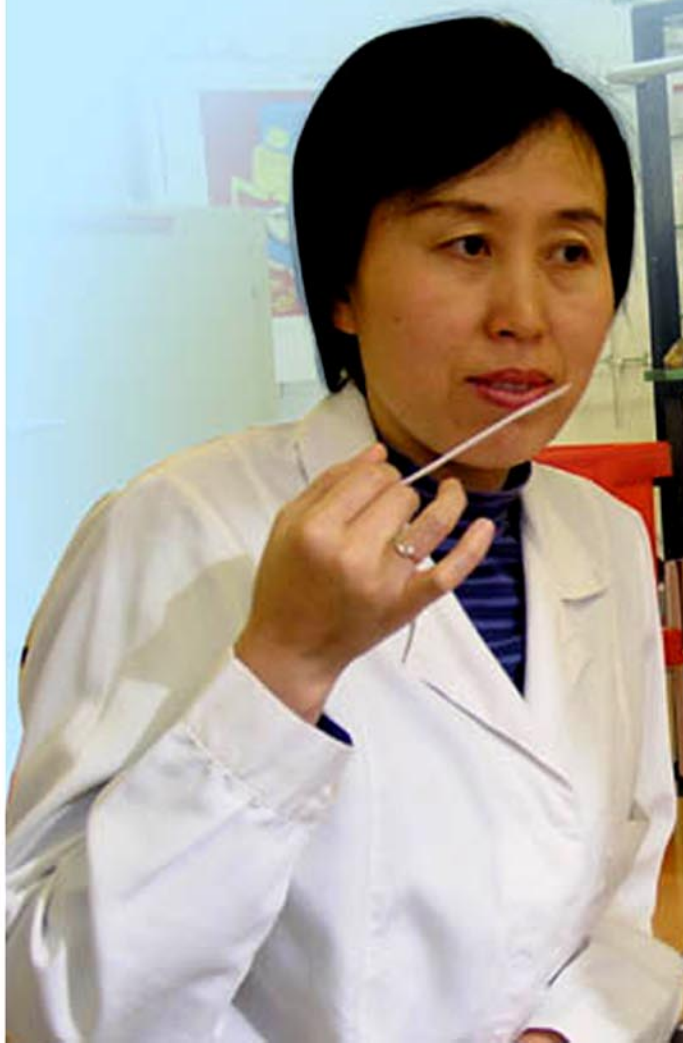
Design customer-required sensory profile

- 推荐使用方案

Provide solutions addressed to customers problems

- 提升饲料品牌

Increase brand name recognition with the help of Luctarom



tested and screened before selecting two or more solutions for submission to the customers for evaluation.



Figure 6.5. Training sales staff in computing skills to meet the demands of the new strategy which was based on service differentiation.

The second element of our service differentiation was to provide training to our customers. The training subjects may include technologies related to the use of feed additives, general aspects of animal nutrition and feed formulation, sales management and selling skills. Sales skill trainings were given to customers' sales team. The owner of one of our largest customers in Shanghai said to me: "The collaboration between our two companies in the past two years has been fine. The quality of your products is very good, but there are many other products which are superior in price than yours. Many suppliers often come to me to promote their products. If you can help us to train our sales staff so that our company can improve our competitiveness, there is no need to talk about price anymore." This view was shared by many of our customers, particularly those medium size feed mills with a product scale of over 2000 ton feed per month. Most of the feed mill owners in this group had limited levels of education. There was a gap between the demand for management knowledge by the business and what the owner could offer. When our service was given to these companies, the feedback was good.

Backham & Vincentis (1999) classified business buyers into three groups, each requiring different type of selling:

- 1) price-orientated customers (transactional selling): they want value through lowest price
- 2) solution-oriented customers (consultative selling): they want value through more benefit and advice
- 3) strategic value customers (enterprise selling): they want value through the supplier co-investing and participating in the customer business.

In the feed additive business in China, we had seen groups 1 and 2. Although group 1 was by far the biggest in number, there were an increasing numbers of customers in group 2. This group of customers were the ones addressed in our service-based strategy. I have not yet come across customers of group 3, perhaps because the industry is not yet consolidated.

Preliminary results indicated that the service differentiation strategy was successful in improving the competitiveness of Lucta China. The service we offered in fact was the technical know-how of our staff. In a developing country like China, where the technical competency of the industry is still relatively low, the provision of additional knowledge and technical know-how can be an added value to the products.

In accordance to the approach of providing customerized product solutions and service to customers, internally, the company also adopted a "customer focus" philosophy. The objective was to enhance the loyalty and thus retention of value customers. We put more importance on building customer-relationship. A Customer Relationship Management (CRM) software system was also implemented to support our key accounts management.

## 6.8. SUB-SEGMENTING THE MARKET

Market for a particular product/service is composed of all potential customers who have needs for the product/service and are willing to pay money in exchange to satisfy their needs. "Potential customer", "needs" and "satisfy needs" are the three key elements. In marketing, there are accordingly three questions which we need to ask all the time: Who are our target/real customers? What are their needs? What and how should we do in order to win the customers preference? Only when we know clearly the answers to these questions that we can direct our limited resources to create successful sales. Potential customers have different needs. The grouping of customers according to their needs or other certain criteria is the process of market segmentation.

Market segmentation is a useful means to help us identify who are our real potential customers which we can target on. Many factors can

be used as criteria for grouping, including: geographic location, industry, nature of business, size of company, technological capability, purchase size, quality or cost orientation, personal factors etc. The choice of criteria obviously varies with industry and individual company.

When applying to our business, we had segmented the feed flavour market using the quality and price variable, for the purpose of business strategy setting. This has been discussed already in Chapter 4. However, for the purpose of marketing operations, we had sub-segmented the market of Luctarom using several variables (or criteria). Details and results are listed in Table 6.2. Below I highlight the characteristics of some market segments.

1). Geographical areas: We used “province” as a unit of segment. Neighbouring provinces were treated as blocks for ease of sales management. There were large differences in the degree of feed industry development between provinces even within a block. Guangdong was the most developed, where feed mills were bigger in size, and pig production were most intensive. In contrast, in most other provinces, feed mills were much smaller in size. For this reason, in Guangdong, we sold our products by direct sale, but in some other provinces we had to use distributors. There was also a difference between the south and the north in the type of feed products manufactured. In the southern and southeastern provinces, complete mixed ration was the main product; whereas in the north, where energy feed (typically corn) was grown, protein concentrate was the main feed product (farmers could prepare the complete feed simply by adding corn to protein concentrate).

2). Production scale of customers: Our earlier strategy was just to concentrate our sales activities on feed mills of large production scales. However, we later found that large feed mills did not necessarily buy big volume of flavour products. Some big feed mills did not use flavours at all. Chia Tai feed mills, the agro-industry business of the Thai conglomerate Charoen Pokphand (CP) Group, were examples. They did not use flavour up until recently because their nutritionists considered that flavour was used only to compensate poor quality of raw materials. In fact medium-size feed mills used more flavour in their feed products.

3). Customer’s products: Depending on the type of feed products feed mills made, different flavours should be recommended. Moreover pelleted feed also required more temperature resistant flavours.

4). Purpose of using flavour: Different flavour products should be recommended depending on the purpose. For instance, Luctarom 1806 should be recommended if the purpose was “boosting feed intake”; while Luctarom 38972 or others may be recommended if the purpose was “pleasing the buyers”.

5). Sales channel: If the feed mill's sales of product was through distributors, in our experience it would be more suitable to recommend stronger flavours, even though the customers may think that feed intake improvement was what they needed. Their market needed stronger flavours instead.

6). Customer's product positioning: Those feed mills whose products were low-cost orientated were less likely to buy high quality and expensive raw materials. For instance, Hope Group, which positioned as cost-leadership would not be our customer yet despite its size and huge potential (producing 3 million ton feed a year). We could only waste our time and resources trying to work on it unless we had suitable products to offer.

7). Ownership of business: We found it easier to work with foreign-owned and privately-owned companies than state-owned companies. Foreign-owned companies were easier to accept our products since most of these companies positioned their products by quality differentiation and were thus willing to use high quality raw materials as well. Decision makers in state-owned companies often did not put product performance and price in their consideration. Personal interest was often the prior consideration. Private business cared more about benefit from the product and would be workable if our product really delivered benefits.

8). Age of technical manager: Technical manager was the main decision maker on the choice of feed additive in most feed mills in China. We repeatedly found that those who were older than 50 years old tended to be conservative, unwilling to accept new things and difficult to communicate in technical matters (people of this age group had their education before or during the Cultural Revolution.). The chance of getting business was significantly lower. Very often, this group of technical managers were unwilling to younger, though more knowledgeable, people for the sake of not losing face.

9). Qualification of the technical manager: Technical managers with high qualifications (MSc or PhD degrees) were more ready to adopt new things and try new raw material products. But doing business with them required people of similar or higher qualifications to interact with them. If the technical manager did not have a university degree, his readiness/willingness to learn and to adopt new things declined with age. We found that technical managers under 30 year, even without university degree, were also easy for us to taking in our products, but this group required a lot of technical assistance.

Through market segmentation and analysis of the needs of the different groups of customers, we were able to identify clearly who were our target customers (whose needs matched our products offerings). Our target market segments, had the following characteristics: 1) large to medium size feed mills, foreign or privately owned, located within the geographical areas (provinces) where we

operated; 2) they were quality orientated and not low-cost orientated. 3) their technical managers should be below 45-year of age and had university or postgraduate degrees. Depending on the feeds they produced, the type of sales channel they use for their feeds, and their specific needs for our product, different Luctarom products should be recommended.

Table 6.2: Criteria used for the segmentation of feed flavour market in China.

| Criteria                              | Segments   |
|---------------------------------------|--|
| 1. Geographical areas                 | <ul style="list-style-type: none"> <li>a) South China (Guangdong, Guangxi, Hunan, Fujian)</li> <li>b) East China (Shanghai, Zhejiang, Jiangsu)</li> <li>c) Southwest China (Sichuan, Chongqing, Yunnan)</li> <li>d) Central-North China (Hubei, Henan, Beijing, Tianjin)</li> <li>e) Northeast China (Shandong, Liaoning, Heilongjiang)</li> </ul> |
| 2. Size of customer                   | <ul style="list-style-type: none"> <li>a) Large size: complete feed &gt;10000 ton/month or premix &gt; 500 ton/month</li> <li>b) Medium size: complete feed 1000-10000 ton/month or premix 200-500 ton/month</li> <li>c) Small size: complete feed &lt;1000 ton/month or premix &lt;200 ton/month</li> </ul>                                       |
| 3. Customer's products                | <ul style="list-style-type: none"> <li>a) Complete feed (pelleted mixed ration)</li> <li>b) Concentrate</li> <li>c) Premix</li> </ul>  |
| 4. Purpose of using flavour           | <ul style="list-style-type: none"> <li>a) To improve animal feed intake</li> <li>b) To improve feed marketing traits</li> </ul>  |
| 5. Sales channel                      | <ul style="list-style-type: none"> <li>a) Product sold direct to pig farms</li> <li>b) Product sold through distributors</li> </ul>  |
| 6. Customer's product position        | <ul style="list-style-type: none"> <li>a) Low cost orientated</li> <li>b) Quality orientated</li> </ul>  |
| 7. Ownership of business              | <ul style="list-style-type: none"> <li>a) Privately-owned</li> <li>b) Foreign venture or joint venture</li> <li>c) State-owned</li> </ul>  |
| 8. Age of technical manager           | <ul style="list-style-type: none"> <li>a) Old (&gt;50): conservative, afraid of trying new things</li> <li>b) Young (&lt;40): willing to take in new things</li> </ul>   |
| 9. Qualification of technical manager | <ul style="list-style-type: none"> <li>a) No university education</li> <li>b) BSc</li> <li>c) MSc or PhD</li> </ul>  |

In terms of targeted geographical areas, we progressed from South China in 1999 to East China and Central China provinces in 2001, and

to North China in 2002. Gradually the area would expand to Northeast China in 2003.

In our experience, the keys for success of sales activities were: identify the right target customers, formulate the right marketing mix (which consists of product, price, promotion and place), and focus all the resources on those targets. Focusing was the means for reducing selling cost and getting better results.

## 6.9. SALES CHANNELS FOR FEED ADDITIVES

Feed industry in China started effectively only in 1980 when Thailand's feed giant Chia Tai (or CP) Group set up feed mills in China. Within the short span of development, the industry had not reached its maturity. There were two characteristics: 1) feed manufacturers were large in number and small in size. Table 6.3 showed that in 1998 there were 13742 feed mills with production capacity greater than 1 ton/hour (equivalent to 300 ton/month). Only 13% had a production capacity greater than 5 ton/hour (1500 ton/month). These feed mills spread over a large geographical area (Each of the over 25 provinces of China could be a size of a country in Europe). 2) Collection of payment from the goods sold could be a problem for all business in China. In the feed industry, feed manufacturers owed their suppliers money, and were owed by their distributors, who in turn were owed by the animal producers (e.g. the pig or poultry farms). Any problem occurred to any node of this chain could easily result in a risk of dead payments for the front part of the chain, the suppliers. Collection of debt took a substantial part of business time (for Lucta China, up to 30-40 % of our sales time).

Table 6.3: The number of feed manufacturers in China from 1990 to 1998.

| Year | Production capacity*    |                         |
|------|-------------------------|-------------------------|
|      | Greater than 1 ton/hour | Greater than 5 ton/hour |
| 1990 | 6045                    | 555 (8% of total)       |
| 1995 | 12678                   | 1424 (10% of total)     |
| 1996 | 12107                   | 1503 (11% of total)     |
| 1997 | 11301                   | 1567 (12% of total)     |
| 1998 | 11950                   | 1792 (13% of total)     |

\* Production capacity of 1 and 5 ton/hour are equivalent to 300 and 1500 tons per month per shift assuming 10 hours per day. Data: China Feed (1999).

With the feed additive business, with customers being feed manufacturers, the most common sales channel is the "product manufacturer - distributors - users" type. International business such as Roche, Pfizer, BASF, Finnfeeds, ADM, Bayer, and Zinpro, and more local feed additive manufacturers (including our competitor Dadi, and

Meinong), used this mode of sales distribution. Typically, one province is regarded as a sales territory unit; and one distributor is set up in each unit. The use of distributors in this sale channel has the following advantages:

- 1) Benefit of using the existing sales network (including sales resources) of local distributors and the customer relationship for faster market coverage.
- 2) Better control over accounts receivables and thus less risk. It is easier to control one distributor than to control hundreds of individual feed mills.
- 3) Reduced sales expenses, since part of the cost of sales is taken up by distributors.

However, there are also disadvantages of using the distributors:

- 1) Lower profit margin
- 2) Loss of direct contact with the final customers
- 3) Relies heavily on capability of the distributor and the amount of resources the distributor allocates to your products (distributors often also market other companies', but not competitors', products). If the relationship with the distributor goes wrong, there is a risk of losing the network of customers already established.

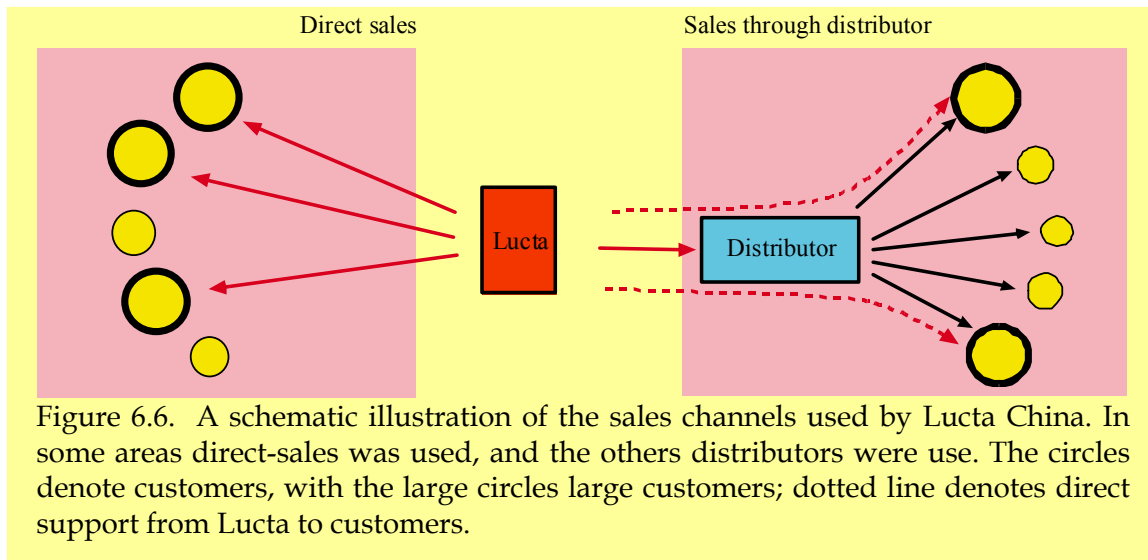
In order to overcome the disadvantages of 2) and 3), feed additive manufacturers usually provide the direct service to key customers while the goods are still supplied by their distributors. In this way, the direct connection between the manufacturer and the final users is enhanced.

Initially Lucta did not wish to use distributors and decided that only direct sales would be used in China. It was agreed however, by end of 2000 to experiment with one distributor in Henan province, and subsequently three other distributors at end of 2001.

In China the use of distributors seems necessary. The reason was that there were marked differences between China and Europe in the feed industry structure: 1) In Europe, feed mills are large in scale and small in number. For instance, in the UK, there are fewer than 10 feed mills in total. The feed industry is mature. 2) In Europe, generally speaking, there is no problem of collecting payment for good sold to customers. Thus the risk of bad debt is much lower. 3) The geographical span of each country is small, making it possible for direct sales with reasonable expenses.

The Chinese situations have been discussed earlier in this section. In order for us to conduct direct sale, we must own a large team of sales staff and technical support. Conti Beijing company used this approach of direct sales, but the company had 22 sales offices, over 100 sales and technical staff and 8 warehouses.

Considering the Chinese specific conditions and our company situations, I believe that the sales channel suitable to Lucta China should be the one based on distributors in most areas, yet combined with direct sales in some other areas. Currently, we carried out direct sales in Guangdong, Fujian, Beijing and East China provinces, and had one distributor (exclusive distribution) in each of the four provinces of Guangxi, Hunan, Sichuan and Henan. The distributors were not left alone. Training was given to distributor staff twice a year. One of our sale staff was allocated to support one or more distributors, to facilitate sales into key customers. For larger customers, successful sales may require the technical department and product application laboratory participated in providing solutions. To enhance the relationship with customers in the distribution areas, technical director, sales manager, and even general manager may also visit the customers although they were receiving our products through distributors. Figure 6.6 schematically illustrates the sales channels used by Lucta China.



Our criteria for selection of distributors were: the candidate should:

- 1) be highly reliable so to reduce the risk of bad debt;
- 2) have existing network of customers;
- 3) have certain level of technical capability, since Lucta products required technical sales;
- 4) have certain size of sale team. On the other hand, the distributor does not need to be very big since a big company may not market our products as its main business.
- 5) not market competitors' products.

Whether the sales channel using distributors is successful or not, the key lies in whether one can effectively manage the distributors. Our experience was:

- 1) Always safeguard the interest of the distributors; increase their share of profit when possible. Treat the distributor as a staff member of our own, given him target, and reward for achieving the target.
- 2) Having distributors does not mean that one can take a rest. The manufacturer should now take of the role of support and management.
- 3) There must be a suitable pricing system so that there is not price inconsistency between direct sales and distributor sales.

The use of distributors in our sales channel could be regarded as successful. At 2002, distributors sales ranked in the first 6 places of our total sales. In Hunan province, the sales revenue was 50,000 RMB/month with direct sale by one dedicated salesman in 2001; when the sale was carried out through a distributor in 2002, the revenue increased to 500,000 RMB/month yet without our input of one dedicated sales staff.



Figure 6.7. Training of salesmen from distributors. In order to get the most out from distributors to sell our products, it is necessary to train them.



## 6.10 SUMMARY

The story described in this chapter illustrated a business in real life, a process of try and error, failure and success. At sales operations level, the keys used as the differentiation point started from tangible attributes, shifted to benefits and intangible attributes, and finally changed to company's capability in providing customer-tailor-made solutions (Figure 6.9). The strategy set out initially had to be modified accordingly as the business developed and as the market situation changed.

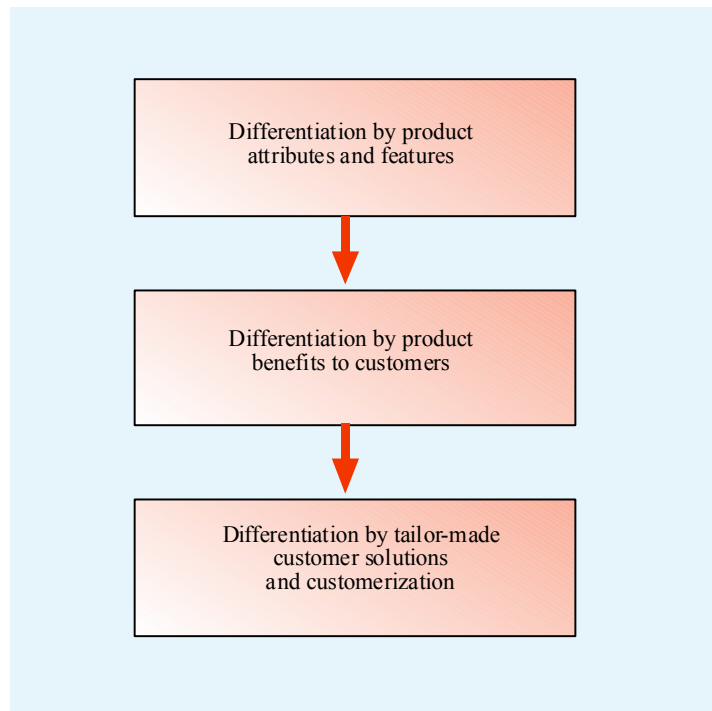


Figure 6.9: The evolving emphasis of differentiation of Luctarom.

The key to the success of doing business is to stay in line with the market conditions and requirements. In a rapidly developing economy like China, the needs are changing rapidly, and competition conditions are also changing rapidly. One should be prepared to response quickly. Products may need to be redesigned; and strategy may need to be modified. Moreover, differences in country characteristics do exist either in the market or in culture between China and Europe. These need to be taken into account in making business strategy and decisions.

### Side Story: Competing in customer relationship building

Building relationship with customers in China is exceedingly important not only for opening doors to sales but also maintaining the sales. In Fujian province, people feel particularly obliged in returning kindness and favours given by others.

Putian county was concentrated with feed mills. Four of the biggest feed mills were located in this city. They all used Luctarom, and three of them also used Luctacid. Because they were big buyers, our competitors also put an eye on them constantly. We managed to maintain these customers in Luctarom despite competitor attacks. Our salesman working with these customers had been very good in building relationship with them. He was born in a neighbouring county, thus able to speak the local dialect. Importantly he was able to communicate with those customers at personal level, listening to their problems. Very often, he also helped our customers in the sales of their premix products (prior to working for Lucta, he was selling premix in the province).

Despite our close link with the customers, a determined salesman from a competitor still found the way to break in. Although he was not local to Putian, this competitor salesman rented a room from the target customer. In this way he had all the opportunities to get close to the customer and to do things to delight him. After some time, the customer finally decided to buy his acidifier. The customer told our man: the guy had given him a lot of help and he offered a product at such a good price that he would feel bad to reject him. So the customer stopped ordering Luctacid, but he promised to stick to our Luctarom and closed his door for other flavour competitors.

In this case, the customer felt emotionally obliged to return the favours or kindness he received from others. This is very common in Chinese society, and this characteristic is being used daily for business.

We did very well with most customers by devoting time to maintain the relationship. But this was very time consuming, and there was a limit to how many customers one sales person could look after.

## Side Story: Dropping Hope Group without hope

Hope Group is the second largest feed manufacturer in China, producing about 3 million tons of compound feed with a sales revenue of RMB 6 billion in 1999, from the over 140 feed mills located throughout the country. Started by four brothers in a village in rural Sichuan with an initial capital of RMB 1000 (USD 125) in 1982, by 1999, the net assets of the Hope Group had reached USD 800 million. Liu Yongxing and his brothers made the list of the 500 richest people in the world, as published by the American Magazine "Forbes".

In 1998 even before Lucta China was formally established, Lucta had listed Hope Group as the target potential customer. In March 1998, Jose Espinedo (director of Feed Additive division), KJ Cheng and I visited Hope's head office in Chengdu, Sichuan province and proposed to create feed flavour for their need. Despite the company's large asset, the head office at the time was very basic, - in fact, simple farm houses. A young purchasing director (graduated from a university of political studies) and an old technical manager (a retired researcher) met us. They said that Hope purchased a total of about 50 tons of flavours per month for the whole group. Without showing much enthusiasm, they proposed that Lucta analysed the feed flavour samples from them. Later, 12 feed flavour samples were sent to Lucta China and forwarded to Spain for analysis. About 3 months later, Jose Espinedo and I went to Sichuan again, presenting the results of analysis and proposals of new products from Lucta. A cool feedback was given without rejection but without acceptance either. For the next a few months, I kept consistently pursuing this Hope project. The purchasing director asked me to deliver samples for trial in two of their feed mills, in the countryside of Shanghai and Beijing. Considering the importance of Hope group as a whole, I specially flew to these places to visit both feed mills, hoping to make a presentation about the product. Their managers did not even look to have a university education. They were not interested in technical details of the product. The first question I was asked "How much does it cost?". My understanding from those visits was Hope was looking for very cheap products. At the point, I was convinced that Hope at the time was not our target customer. I dropped it from that point. The reasons were:

- 1) Lucta China at that time did not even have appropriate product suitable to meet their need. Viewing this from today's experience, none of the products, even those supposedly created for Hope, were able to meet their need. They were looking for very strong flavours, at a cost about 10 RMB/kg. The products for Hope project would cost 70-100 RMB/kg.

- 2) For flavours, the company did not purchase centrally, but leave to individual feed mills to make their own choices. The initial information that Hope group ordered centrally was incorrect. My visits to the two feed mills confirmed that we would need to convince and deal with the feed mills individually.

In 2000, I had a conversation with the Sales Manager of Dadi (also based in Chendu), who was one of the suppliers of feed flavours to Hope. She told me Dadi knew every thing that Lucta did with Hope: they had even read our analysis report! Our competitor had already formed an intimate link with decision makers in Hope, how on earth could we have broken this relationship by simply flying there over 1000 km for a meeting once in a few months?

This side story illustrates two points: 1) A customer may sound very attractive in terms of the potential volume of purchase, however, it may not necessarily be a target customer. Hope pursues a lowest-cost strategy. It squeezes the cost of raw materials to a level giving little margin for suppliers. Dadi could do it because they were willing to accept low margin. 2) Building a close relationship with customers is very important for winning business. For us to operate in a different province, we would never be able to form a close relationship with our customers as well as local competitors. Different provinces of China have different cultures. The use of local distributors may provide a solution.

In 2001, Hope (Eastern Hope) moved its headquarter to Shanghai. Whether Hope may become our target customer in the near future needs to be reviewed.

## CHAPTER 7

### GENERAL ISSUES AND FUTURE STRATEGY

#### 7.1 CHARACTERISTICS OF FEED ADDITIVE MARKET IN CHINA

##### 1) *The market is dynamic and speed is important*

Chinese market is very dynamic. Market needs and competitors' status can change very rapidly. Market niches or segments can disappear while new ones appear. Differentiation factors previously perceived as valuable may no longer be of value, resulting in loss of the company's competitive advantage. Imitations of products by competitors can turn up fast. Product life cycle is shorter. These have impacts on product innovation. Thus strategies have to be dynamic too. They need to be constantly reviewed and revised.

In the fast changing market of China, speed is a source of competitive advantage. Companies, however successful that they might have been, are likely to be knocked over by innovative competitors or imitators if they stand still.

This specific characteristics of the market brings up the importance of having a critical market share (or customer mass), in order for the company to stay firm in the market. There are many examples of those minor names (i.e. products with small market share) losing their market stand as local competitors overwhelmed them. Monopro, the mould inhibitor product from USA, completely disappeared from the market due to growth of local mould inhibitors. Stacidem was engulfed by local producers. Earlier, Agrimerica's feed flavours also gave way to local suppliers, despite that Agrimerica flavours were to first to enter the market. In this dynamic market, if a company stays still, it will lose out eventually, unless it is offering products no one else does.

Feed additive business is a volume business. The large profit margins enjoyed some 10 years ago have already disappeared. Most suppliers or manufacturers are getting used to accepting lower margins. Accordingly, the strategy is to achieve bigger volume sales. Most companies will be striving hard to expand their market share.

Lucta has been conservative about the pace of expanding market coverage in China. There is no doubt about the need to grow business in solid steps. However, in the fast-moving market like China, faster pace of action is needed. Luctarom's market share is still low in general. When flavour market is attractive and Luctarom still has a competitive edge, we should strive to gain a better market share faster before competitors catch up. There are several reasons for do so: 1) The market stand would be insecure if the company has only a few customers, since competitors could easily offer them a better deal. Lucta China had this experience with several big customers, to whom

competitors offered a price we could not match and we lost. 2) If the company does not grow and turn out new products fast enough, the technical advantages of the products would be lost since the competitors are catching up faster than the company could move ahead. There had been already such threats, as discussed in Chapter 6. In the recent one year, more foreign competitors were operating in China market. They were also competing for market share. 3) In the flavour business, the major market players have the benefit of setting the trend of market preference for flavours.

#### 2) *Personal relationship means business*

Personal relationship (in Chinese word “*Guanxi*”, meaning “relationship”) is exceedingly important in doing business in China. Your product may be very good, but the purchasing manager or the technical manager may not want to try it, because he is happy with the friendship from the existing supplier. He may have been enjoying some personal benefits from his existing supplier and does not want to make a change. It is still very common in China for under-the-table paybacks. If a company wants to survive and grow, adaptation of business operation to the environment or culture is needed. Many foreign companies in the feed additive business use the resources of local distributors to compensate their weakness in the ability to build close personal relationship with customers.

#### 3) *Unconsolidated industry and vast differences between regions*

In general, many industries in China are characterized by the presence of large numbers of companies but small in scale. The feed industry, for example, there were over 12,000 feed mills in 1998, and 87% of which had a product capability of 300 ton per month. The industry is not consolidated. Thus selling feed additives or other raw materials to these feed mills in China would require completely different market approaches, at least in the distributor channel.

The country is geographical so huge that different regions or provinces have marked differences in the industry structure, market needs and business behaviors. For example, if you do business in Northeast China, you should be able to drink, but you do not need to be so in the South. In fact, China market should not be treated as one market, but as many markets. Each has to be treated differently when it comes to formulating marketing strategies. Different marketing mixes may need to be offered. For example, in the case of Lucta China, different sales channels suited different provinces. While direct sales was good for some provinces, “sales through distributors” was necessary for other provinces.

#### 4) *Technical know-how as an added value*

Service in a form of providing technical know-how to customers is very important in China feed industry. Many feed mills buy from foreign companies because they want to benefit from the foreign know-how. The success of Lucta in China was in part due to the fact that

Lucta staff were able to give customers foreign know-how, through providing technical assistance or advice. The latter was not limited to Lucta's products, but also included knowledge of animal nutrition and business management. A certain proportion of existing customers chose to buy from Lucta not because of the product superiority but because of the foreign know-how we were able to offer. More and more customers value this kind of service and are willing to pay higher (to a certain extent) prices.

For this reason, many suppliers, including local suppliers, in the feed additive industry of China have technical support staff with PhD degree. More feed mills have technical managers with PhD degree. A salesman with a BSc degree may find it difficult to approach and make technical presentation to those customers. This is also about personal status.

At this point, I should highlight "personal status". Status is cared about a lot by people in the East. Customers would normally appreciate visits by general manager or a PhD, more than visits by a salesman. When working with CP (the Thai feed manufacturers), the status-matching is extremely important. Most of their nutritionists are high in position in their companies, and would not be happy to receive visits by suppliers with a lower position.

In summarizing this section, many specificities of the Chinese markets have been highlighted. It is important that these specificities are taken in account when making business decisions. One should always be prepared to accept that some business methods which are proven successful in Europe or other countries may not be so at all in China.

## 7.2 FUTURE STRATEGIES FOR LUCTA CHINA

Strategies for Lucta China today have already been discussed in details in the previous chapters. These strategies will continue for some time to come. Review and revision can be made based on the business results in the near future. Some points that need particular development in the future are discussed below.

### 1) *Corporate strategy*

The corporate strategy of pursuing a leadership in feed flavour sector should be continued. Luctacid and Luctamold continue to be secondary products, but they may serve as a cash cow if sales volume can be achieved. In the Luctarom business, more resources must be put into it to develop market share and to enhance competitive stand. The business in feed flavours could be grown faster, but the immediate task is to build a sales network.

For the future product development of Luctarom, flavours for concentrate and premix would be an interesting market segment, for the following reasons: 1) based on the trend of 1990-1998 (see Figure 7.1), concentrates and premix production have been expanding steadily. In the future, concentrate will account for a much greater proportion of

the total commercial feed produced. 2) flavours for these two groups of commercial feeds are more difficult to create than those for compound feed. More importantly, there is relatively less competition in this segment than flavours for compound feed. Lucta China should develop in this segment with greater thrust.

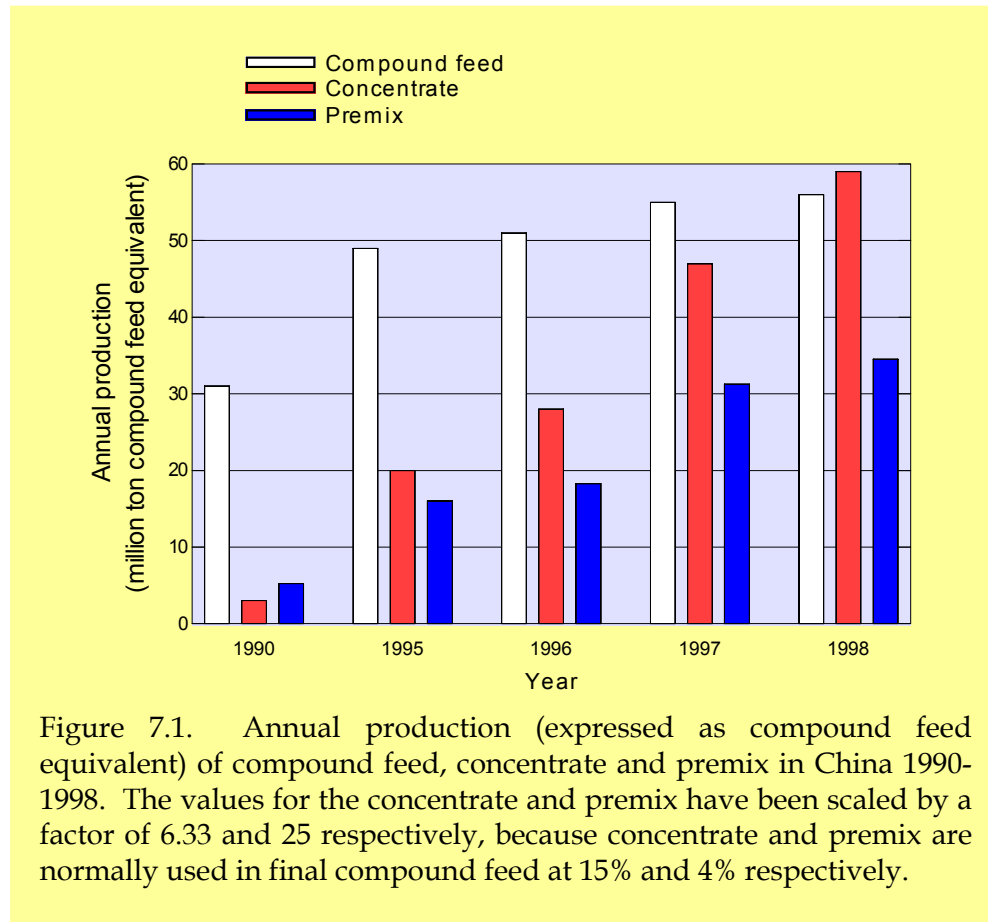


Figure 7.1. Annual production (expressed as compound feed equivalent) of compound feed, concentrate and premix in China 1990-1998. The values for the concentrate and premix have been scaled by a factor of 6.33 and 25 respectively, because concentrate and premix are normally used in final compound feed at 15% and 4% respectively.

Luctacid and Luctamold are volume products. They can already be regarded as commodity products. The Luctamold is still quite competitive at the moment and the margin is reasonable. The margin can be increased by local production of the liquid nucleus (currently the liquid nucleus is shipped from Spain). Thus the sales of Luctamold should be developed. Luctamold will become a cash cow if the volume of sales is good.

Luctacid at the moment is a problem child, as discussed earlier. It has lost its initial target market niche. To readjust the target market, i.e. to compete with local producers, the price has to come down. Nevertheless, the margin for this product is still very high. There is space for reducing the margin, and thus selling price, to boost the sales volume, with an objective to increase net profit revenue. The tactics would be to launch a new product with a lower price (Existing products remain unchanged). Without taking this measure, this product will lose its market stand soon. As a commodity product, this product should be competing with price. In the acidifier market, there is also opportunity for differentiation by product innovation. At the

moment, acidifiers are not suitable for adding to mineral premix products as it can cause reaction. There is a need for non-reactive acidifiers by the premix manufacturers. There are no products in the market. Lucta has been working on this project, but products are ready. Successful solution requires a compromise of performance and price.

## 2) *Business and marketing strategies*

Business strategy shall continue to be a “focus – differentiation”. We must strive to outperform our competitors in certain areas, through which we maintain existing customers and gain new customers. The following areas need to be strengthened:

a) Speed in product innovation. Just being able to turn out new products is not good enough, the key here is speed. Lucta has a core competence in flavour creation, but the speed of turning out new products has been slow. At the moment, it takes about 6 months for Lucta Spain to provide the first sample of a new product. By the time it is tested and shipped to the market, 12 months has passed. The reduction of this response time will require a major change in the organization of work. Some of the R&D work would have to be conducted in China in order to improve responsiveness. Moreover, Lucta group may develop more on product innovation, i.e. to develop new products using new support technologies for better performance.

b) Providing tailor-made products and customer’s exclusive use products shall be the development for the future. Again this will require major changes in the organization of work. Technical capabilities have to be developed locally.

c) Building a long-term supplier-customer relationship. The objective is to enhance loyalty from value customers through providing them service, care, better complaint handling and collaboration in certain areas. Increasingly more and more customers will prefer suppliers who can sell and deliver a set of coordinated products/services, who can quickly solve problems and who can work together with customer teams to improve products and processes.

There will be new requirements on salespeople, and thus training. Salespeople working with key customers must do more than calls when they think the customers might be ready to make orders. They must be able to visit the customers at other times, take customers to dinner, and make useful suggestions on their business. They should monitor key accounts, knowing their problems and be ready to serve them in a number of ways.

It is not just salespeople who should focus on customers. Everyone in the company should be thinking about how they can contribute toward customer satisfaction within their own duties. Changing the

corporate culture to the one focusing on customer-satisfaction shall bring long- term fruitful return to the company.

Further pursuit of this direction must be strengthened, although Lucta China is already moving towards this direction. Plan to start implementing customer-focus culture from 2003 has been formulated. To assist key account management, a CRM software has been implemented. It will provide a powerful tool to monitor in real time changes in customers needs, and their feedbacks (satisfaction or complaints) to our products and service. Changes in customers' ordering status are indicated in time for prompt actions.

Following the changes in technology and economy, business beliefs and practices are changing too. Kotler (2003) summarized the changes in business beliefs and practices (see Table 7.1). Focus on customer satisfaction and customer retention is the new approach in doing business in modern days.

Table 7.1 The shifting of business belief or practices from the old economy to the new economy

| Old economy                           | New economy                                      |
|---------------------------------------|--|
| Organized by product units            | Organized by customer segments                   |
| Focus on profitable transactions      | Focus on customer lifetime value                 |
| Look primarily ay financial scorecard | Look also at marketing scorecard                 |
| Focus on share holders                | Focus on stakeholder                             |
| Marketing people do the marketing     | Everyone does the marketing                      |
| Build brands through advertising      | Build brand through performance                  |
| Focus on customer acquisition         | Focus on customer retention                      |
| No customer satisfaction measurement  | Measure customer satisfaction and retention rate |
| Over-promise, under-deliver           | Under-promise, over-deliver                      |

This booklet has covered some important issues of strategic management of Lucta China. It covers the process from strategic analysis, strategy formulation, implementation, and result evaluation. It covers the experience of learning by trial and error. The experience and business results have shown the importance of having a clear strategic bearing in modern business management.

To end this chapter and this part about strategic management, I quote the words of Liu Yongxing, chairman of Hope Group: "China has gone through five business cycles since it began opening its markets to the outside world in the early 1980s. The first phase required bravery; the second, technology; the third, capital; the fourth, marketing, and the fifth, modern management." Readers can contemplate on what modern business needs.

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