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**HOW LEADING INTERNATIONAL DAIRY COMPANIES  
ADJUSTED TO CHANGES IN WORLD MARKETS**

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# HOW LEADING INTERNATIONAL DAIRY COMPANIES ADJUSTED TO CHANGES IN WORLD MARKETS

W. D. Dobson and Andrew Wilcox\*

## Executive Summary

### Introduction

- The study focuses on strategic adjustments made by leading international dairy firms in response to world market developments in the late 1990s and early 2000s. In part, it describes dairy industry success stories that have implications for a broader group of dairy companies. It also shows how even successful dairy firms have adopted strategies that expose the companies to significant challenges and risks.
- Firms whose strategies were analyzed include Fonterra, Nestle, Kraft Foods, selected Western European Firms (including the Kerry Group and Parmalat), Dean Foods, Dairy Farmers of America, and Land O'Lakes.
- Strategic alliances entered into by the firms received emphasis in the analysis.

### How Leading World Dairy Firms Adjusted Their Strategies

- For the most part, the firms adjusted effectively to the economic environments in which they found themselves. Arguably, the Kerry Group of Ireland made some of the most effective strategic adjustments to deal with difficult conditions facing the firm in its early years.
- The companies, with few exceptions, pursued growth-oriented strategies that may be worthy of emulation. Acquisitions (often financed mainly by debt) were used by many of the case firms to reach growth objectives.
- Study findings were broadly consistent with those of a Rabobank report. In particular, the companies' growth strategies emphasized practices that help the firms to:
  - Become more efficient in manufacturing.
  - Open new markets.
  - Gain market share and market power.
  - Expand their brand portfolio.
  - Strengthen their innovative capacity.
  - Secure milk supply.
  - Improve their access to capital.

### Implications of the Strategic Behavior of Leading Dairy Firms

- Certain aspects of the strategic behavior of the case firms and/or the economic environment in which the firms found themselves have implications for other firms wishing to operate effectively in world markets. Strategy or market environment items having such potentially important implications included the following:
  - Growth in use of cross-border alliances.
  - A push by big firms to expand sales in developing countries.
  - Policy-related deterrents to expanded dairy trade.
  - Capital constraints facing expansion-minded producer cooperatives.
  - Importance of quality of management.
- Growth in the use of cross-border alliances was most evident in the strategic behavior of Nestle, Fonterra, Dairy Farmers of America, and Land O'Lakes. There are pitfalls associated with

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using these devices. But, with a few exceptions, the firms employed alliances in potentially beneficial ways. The firms using alliances successfully have extensive experience with joint ventures and other strategic alliances. Experience gained by U.S. firms with alliances can be put to good use when these companies gear up to enter or expand sales in foreign dairy markets.

- The push by big firms to expand sales in developing countries was most evident in the strategies of Nestle and Kraft Foods. Nestle—with more than a century of experience in foreign markets—undoubtedly is suitably equipped for such an initiative. However, even Nestle may find it difficult to reach the firm's sales goals in China. Kraft Foods, which has more limited experience in developing countries, likely will find it challenging to expand developing country sales substantially. The firm's stellar performance in developed country markets may not transfer readily to developing countries.
- The policy-related deterrents to expanded dairy trade are multi-faceted. The failure of the Uruguay Round GATT/WTO agreement to sweep open world dairy markets as much as anticipated is perhaps most important. The decision by Fonterra of New Zealand—the world's largest private dairy exporting firm—to emphasize foreign direct investment and the sale of the New Zealand dairy industry's processing, R&D, and management expertise (partially at the expense of export expansion efforts) speaks volumes about how the firm views prospects for expanded dairy exports.
- Capital constraints face Fonterra, Dairy Farmers of America, and Land O'Lakes, all of which are strongly expansion-oriented farmer cooperatives. The Kerry Group model (i.e., conversion of a cooperative into a cooperative/public limited company) will probably be of limited acceptability to these cooperatives as a mechanism for raising expansion capital.
- The importance of quality and continuity of management was apparent in the successes of most of the case firms. The strategies of the firms were mostly orthodox, but the management was not. The successes recorded by firms such as the Kerry Group, Nestle, Kraft, DFA, and Land O'Lakes are likely attributable in substantial part to the superior, lengthy service of top managers.

## HOW LEADING INTERNATIONAL DAIRY COMPANIES ADJUSTED TO CHANGES IN WORLD MARKETS

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### Introduction

*“The essence of formulating competitive strategy is relating a company to its environment.”*

M.E. Porter [29, p.3]

This definition of competitive strategy employed by Harvard Business School Professor, Michael Porter, is useful for framing problems addressed in this Discussion Paper. As will be evident, many leading world dairy firms have adjusted effectively to changes in the world market environment.

Zwanenberg, an analyst with the Netherlands-based Rabobank, argues that the most important changes and challenges driving the world dairy industry are [42]:

- Growing demand for dairy products.
- Concerns about milk supply.
- An increasing number of requirements of increasingly powerful customers.
- Changes in dairy politics.

With the possible exception of the first point, there is little that is surprising in the list of changes and challenges. According to the Rabobank analyst, world demand for dairy products is growing at about two percent per year. While growth rate might be regarded as less than spectacular, an increase in world dairy demand of this magnitude is equal to approximately the annual production of Australia, Argentina, or Poland [42]. The growing world demand for dairy products represents an opportunity for dairy companies.

The Rabobank analyst points out that the recent rapid consolidation of the world's dairy industry—manifested in a new merger, acquisition or alliance every 2.5 days—reflects adjustments made by dairy firms to deal with these changes and challenges [42]. Growth, they argue, is essential to most leading firms' strategies. Elaborating, Zwanenberg notes that the growth strategies of dairy companies generally focus on practices that would help the firms to [42]:

- Become more efficient in manufacturing.
- Open new markets.
- Gain market share and market power.
- Expand their brand portfolio.
- Strengthen their innovative capacity.
- Secure milk supply.
- Improve their access to capital.

Babcock Institute analysts have identified changes and challenges driving the world dairy industry that are similar to those appearing in the Rabobank study. Moreover, Babcock Institute studies confirm that the focus of strategies of many leading European-based, dairy-food firms, in particular, is similar to that of firms referred to in the Rabobank analyst's list. U.S., New Zealand, and Australian dairy firms also share a number of the goals specified in the Rabobank list. But there are important differences between the goals of Western European firms and those of firms in other important dairy countries. These differences are rooted in differences in resource endowments, government dairy policies, management experience and skills of the dairy companies, and probably accidents of history.

This study analyzes how leading world dairy firms have adjusted their strategies to deal with changes in world markets. The study focuses heavily on strategic adjustments made by the firms in response to world market developments during the late 1990s and early 2000s. In part, it describes

dairy industry success stories that have implications for a broad group of dairy firms. However, it also shows how even the most successful international dairy firms have adopted, or are contemplating adopting, strategies that expose the companies to significant challenges and risks.

## I. How Leading World Dairy Firms Adjusted Their Strategies

Selected strategies of Fonterra Cooperative Group Ltd. of New Zealand and Nestle of Switzerland are analyzed first. Fonterra is the world's largest private dairy exporting firm. Nestle is the world's largest food company. Both are widely regarded as formidable competitors in world dairy-food businesses. Both are growth-oriented firms headquartered in countries with small domestic markets, a characteristic that made it important for them to develop overseas markets. The strategies of Kraft Foods, the world's second largest food company, are analyzed following the Nestle segment. Strategies of selected Western European dairy companies (excluding Nestle) are considered fourth. Like Fonterra and Nestle, many of these firms expanded international sales to compensate for challenges associated with being based in small domestic markets. Constraints imposed by the European Union's (EU) milk quotas and associated high domestic raw product costs also pushed these firms toward foreign direct investments. Finally the strategies of selected U.S. dairy firms are analyzed, emphasizing the alliances that U.S. firms have entered into with foreign dairy companies.

Firms studied, with a few exceptions, appear in the listing of the 20 largest dairy firms in the world (Table 1). The figures in Table 1 represent dairy product sales and do not include sales of other products marketed by the companies. The figure for Dean Foods represents the combined dairy product sales of the original Dean Foods and Suiza Foods in 2000.

**Table 1. Top-20 Dairy Companies in the World in Terms of U.S. Dollar Sales, 2000\***

Company	Sales (\$ Billion)	Company	Sales (\$ Billion)
Nestle	\$13.0	Arla Foods	\$4.4
Dean Foods	9.0	Friesland-Coberco	4.2
Dairy Farmers of Am	6.7	Campina-Melkunie	3.6
Kraft Foods	6.1	Bongrain	3.6
Danone	6.0	Land O'Lakes	3.5
Parmalat	5.7	Meiji Milk Products	3.2
Snow Brands	5.5	Morinaga Milk	2.9
Lactalis	5.1	Sodiaal	2.8
Fonterra	5.0	Dairy Crest	2.5
Unilever	5.0	Nordmilch	2.4

\* Source: Zwanenberg [42].

### Fonterra Cooperative Group Ltd.

This firm represents the 2001 union of the New Zealand Dairy Board (NZDB) and two large New Zealand cooperatives—Kiwi Cooperative and the New Zealand Dairy Group. The NZDB was established in 1924. In the early years, the NZDB served as the single-desk (monopoly) exporter for scores of small cooperatives. In 1960/61, for example, the NZDB functioned as the exporting arm for 180 New Zealand cooperatives [12]. As a result of rapid consolidation, the number of New Zealand dairy cooperatives declined to four in 2000. Farmer-members of two of the four remaining cooperatives—Kiwi Cooperative and the New Zealand Dairy Group—accounted for about 95% of New Zealand's milk production in 2000.

When Fonterra was created, the organization relinquished the government-granted monopoly exporting privilege possessed by the NZDB. However, Fonterra retained privileges that allow the firm to capture dairy import quota rents in the EU, U.S., and other markets for six years [1, p.N3].



The strategies of the NZDB and Fonterra have evolved in ways that have important implications for the world dairy industry.

***Core and Subsidiary Strategies of the NZDB, Late 1980s and Early 1990s:***

- 1) Lift the 30% to 40% of milk sold as value-added (differentiated or partially differentiated) products to close to 100% as soon as possible [34].
- 2) Subsidiary strategies [26]:
  - a) Expand the Board's global own-brand consumer products business.
  - b) Grow the value-added food ingredients business.
  - c) Further develop the Board's international food service business.
  - d) Increase dominance of the UK consumer butter and cheese markets.
  - e) Continue to take advantage of opportunities created in Europe by the Uruguay Round GATT/WTO agreement.
- 3) Superimpose the core and subsidiary strategies onto a strategy of being supplied by the world's lowest-cost milk producers.

***NZDB Strategies, Circa 1999-2000 [13]***

- 1) Create a global dairy business four times larger than the New Zealand dairy industry of 2000 within 10 years.
- 2) Create value for New Zealand's dairy farmers by manufacturing and marketing products in the following categories:
  - a) Value-added dairy products and dairy commodities made from New Zealand milk.
  - b) Dairy products made from milk from other countries using the New Zealand industry's skills and know how.
- 3) Use local milk where shelf life restrictions rule out use of New Zealand product and be prepared to do business in countries where tariff barriers price New Zealand products out of the market.
- 4) Establish targets of 15% minimum return on the total gross assets of the New Zealand dairy businesses, 15% annual growth in revenues, and a four percent annual improvement in productivity from farm to consumer.

***Fonterra Strategies, 2001-Present [31]***

- 1) Integrate the manufacturing and marketing arms of New Zealand's major firms to allow the industry to compete more effectively in world dairy markets.
- 2) Seek coordinated acquisitions of, and joint ventures with, companies already operating in inaccessible parts of the world dairy market—94% of the market.
- 3) Obtain scale economies in R&D and brand development.

In early 2001, Mr. John Roadley, then Chairman-Designate of Fonterra, explained the rationale for points 2 and 3 in the Fonterra Cooperative Group's list of 2001-present strategies as follows [31]:

While we have been successful in achieving a third of international dairy trade (mainly through operations of the NZDB), the lion's share of the global dairy business is not traded across borders. The part of the market that is accessible to us is as small as six percent of world dairy production. Ninety four percent of the market is largely inaccessible to us because of trade restrictions...(We must continue) to work closely with government on international trade liberalization. *But far more immediately, we need to seek acquisitions and joint ventures with companies already operating in the inaccessible part of the market (emphasis supplied).* And we need to continue to invest in leading-edge research and development; manufacturing technologies, and brand development.

Roadley's comment speaks volumes about how the world's largest dairy exporting firm views the current environment for dairy exports. It represents implicit recognition by New Zealand's dairy

industry that the Uruguay Round GATT/WTO agreement failed to produce expected world dairy market liberalization. Secondly, it underscores the advantages to Fonterra of foreign direct investment versus dairy exporting. Third, the statement identifies the importance that the firm attaches to alliances with dairy companies in largely inaccessible markets. Thus, Roadley's policy statement provides a rationale for the joint ventures between Fonterra and firms such as Dairy Farmers of America and Nestle (discussed later). Finally, the statement recognizes limits to the expansion of milk production in New Zealand. The country's milk production increased by an average of 6.2% per year during 1995 to 2001 via establishment of dairy farms in the South Island of New Zealand, the conversion of sheep and beef farms throughout New Zealand to dairy, and productivity improvements [37]. However, this rate of increase in milk production probably is not sustainable for an extended period.

Fonterra's strategies (and those of predecessor firms) evolved from orthodox efforts to expand product differentiation to a more nuanced strategy that emphasized seeking profits by applying the industry's management expertise in the dairy industries of other countries via alliances or foreign direct investment. This change, of course, does not mean that Fonterra will stop being the world's leading dairy exporter. It simply means a change in emphasis. There is also emphasis on growth of the firm, e.g., a fourfold expansion in 10 years that will require substantial capital. Whether Fonterra has access to the needed expansion capital is unclear.

### **Nestle**

Headquartered in Vevey, Switzerland, Nestle is world's largest food company, boasting sales of U.S.\$49.7 billion in 2001 [24]. The company traces its origins to the Anglo-Swiss Condensed Milk Company founded in 1866 in Cham, Switzerland. Over the years, the company has developed or acquired such well-known brands as Carnation, Klim, Nescafe, Libby's, Friskies, Stouffers, Kitkat, and Perrier [15]. These brands understate Nestle's worldwide brand presence. The company has about 8,000 brands, but only about a tenth of the brands are registered in more than one country.

In 2000, Nestle had about 230,000 employees, more than 500 factories, and 17 R&D facilities with a combined budget of about U.S.\$600 million [40]. The company is the world's largest seller of powdered/condensed milk, non-dairy creamers, soluble coffee, mineral water, and chocolate and confectionery products [40]. The firm is the No. 2 seller of ice cream, behind Unilever.

Once considered to be a "sleeping giant," Nestle is regarded as a model firm by many other international dairy firms. Helmut Maucher, CEO of the firm from 1981 until the late 1990s, is credited with awakening the firm from its slumber. The business literature is replete with examples of Nestle's strategies. A few of the firm's strategies, many of which are associated with foreign direct investment in dairy and other food businesses, include the following:

- 1) Focus on the long-run and balance sales between low-risk and low-growth countries of the developed world and high-risk and high-growth markets of Asia, Latin America, and Africa [36].
- 2) Keep brands local and people regional. Only technology goes global [30].
- 3) Deepen the pool of Asian and other developing country managers to acquire a cadre of autonomous regional managers who know more about the culture of local markets than Americans or Western Europeans [30].
- 4) Selectively strike strategic partnerships in instances when this will clearly produce advantages for the firm.
- 5) Engage in continuous improvement and nearly constant cost cutting. Discover the root causes of competitive advantage for the firm [40].
- 6) Seek to achieve four percent per year real internal growth [40, p.117].

These are orthodox strategies that would hardly qualify the firm as a model. However, these strategies have contributed to the firm's successes. It is useful to "flesh out" the strategies and provide background on how Nestle's strategies have evolved.

Nestle appears to follow a practice similar to Unilever in staffing foreign units. Unilever began filling local executive and technical positions in the early 1940s through a process that company insiders refer to as "ization." Thus, there was "Indianization" of subsidiaries in India, "Brazilianization" of subsidiaries in Brazil, etc. While Nestle does not give its staffing the same name, the firm follows staffing practices similar to "ization" for its numerous foreign units.

Early in its development, Nestle established production facilities outside of Switzerland [25, p.8]. By 1986, Nestle had plants in 60 countries. In determining whether to set up production facilities in a particular country, the company considered several factors, including the availability of raw materials, the overall economic climate, and consumer tastes and purchasing power. "The company is guided...by longer-term goals and not by short-term objectives [25, p. 8]."

Helmut Maucher revealed the importance that Nestle attached to China in the following comment [5, p.11]:

In spite of free market reforms, ..China (continues to be) a difficult and uncertain place to do business. Yet, even with the risks, the potential gains are so great that no major food company can afford *not* to enter the market.

Maucher's comment regarding China's importance appears consistent with the company's strategy of growing its share of business in an area in proportion to the region's contribution to world GDP [5, p.9].

On related points, Nestle's current CEO, Peter Brabeck, said that the firm is not "...made for quick ins and outs. It took my predecessors years to build a profitable business in countries like Japan and Korea; the invaluable experience we have acquired in emerging countries took decades to develop. Now we are harvesting the fruits of those long labors...[40, p.116]." Decentralization is also an untouchable. Brabeck notes that "...people have local tastes based on unique cultures and traditions...Therefore decision making needs to be pushed down as low as possible in the organization, out close to the markets. Otherwise, how can you make good brand decisions? A brand is a bundle of functional and emotional characteristics. We can't establish emotional links with consumers in Vietnam from our offices in Vevey [40, p.116]."

Nestle has participated in the development of infrastructure necessary to build markets, as it did in China's Heilongjiang province in the late 1980s by constructing "milk roads," training farmers in basic animal health and hygiene, and organizing collection points for fresh milk to help establish its operations and ensure high quality supplies [5, p.9]. Nestle has done similar things to increase the company's access to higher quality milk supplies in the Mexican tropics. These grass-roots efforts encouraged local dairy farmers to increase production.

There is ambiguity relating to one of Nestle's strategies. Helmut Maucher, Nestle's former CEO, initiated a number of major joint ventures with powerful partners such as Coca-Cola and General Mills. However, a Harvard Business School case indicates that Maucher "...is not as big an advocate of joint ventures as these actions might imply. He generally believes strategic alliances to be 'last resorts' but remains open to opportunities where the objectives are clear, the partners share a philosophy, and where progress in a given sector might otherwise be extremely slow or costly [5, p.2]."

### ***The Fonterra-Nestle Alliance***

In March 2002, Fonterra and Nestle signed an agreement to set up joint ventures in North, Central, and South America, creating Dairy Partners Americas (DPA). The joint ventures will be managed by senior executives from both partners. Immediate priorities for DPA are to expand Alliance sales in Argentina, Brazil, Paraguay, and Venezuela. According to the partners, the joint ventures for these markets were expected to be operational by about mid-2002. Agra Europe described the joint ventures as follows [4, pp.3&4]:

The alliance...will operate in all the countries of the Americas and will cover branded chilled products and liquid milk, ingredient milk powders and milk management. First year

turnover will be in the region of US\$1.4 billion and the alliance will have an initial staff of approximately 10,000. Fresh milk for the venture will be sourced in the Americas and dairy ingredients from New Zealand. Joint venture companies will have access to brands of both companies...John Roadley...added that the Fonterra board was confident that the alliance was the best path forward to build Fonterra's position in the America's US\$100 billion annual dairy market.

The Fonterra-Nestle joint venture materialized after Peter Brabeck assumed the duties of CEO of Nestle in the late 1990s. It is not clear whether this action represents a generally more favorable attitude on the part of Nestle toward strategic alliances. However, arguably this alliance would meet Maucher's criteria for a potentially successful joint venture where objectives are clear, the partners share a philosophy, and where progress in a sector might otherwise be slow or costly.

On the surface, it appears that Nestle's current strategies differ in one major respect from those of the Kerry Group/PLC, Dairy Farmers of America, Dean Foods, Parmalat and other international dairy firms that continue to grow substantially via acquisitions. In this connection, Peter Brabeck commented as follows [40, p. 117]:

The only objective I have publicly stated is the goal of 4% real internal growth. Now I haven't done this for the financial world. I've done it for Nestle's employees. If all I wanted was growth, I could do that myself with a banker through a negotiator, through acquisitions.

However, Nestle's performance and actions during 2001 suggest that the company's growth strategy is not as monolithic as Brabeck's comment suggests. Nestle did record real internal growth of 4.4% during 2001, on sales of 84.698 billion Swiss francs (U.S.\$49.7 billion) in 2001 [17, pp.6 and 24]. But Eurofood notes that Nestle went on an acquisition spree in 2001 that continues in 2002, describing the acquisitions as follows [17, p. 6]:

Nestle made several key acquisitions last year, with the likes of **Ralston Purina**, sole ownership of **Ice Cream Partners USA** and the purchase of **Schoeller Holding**, as well as several key acquisitions in water, all joining the Nestle stable...This recent spree has continued into 2002, with the Swiss concern announcing the purchase of Brazilian chocolate and confectionery manufacturer **Garoto**.

In summary, Nestle's strategies generally exhibit consistency over time. The firm has shown ambivalence in recent years toward growth through acquisition. Hence, Nestle appears to have adopted a mixed-mode growth strategy, featuring both internal growth and acquisitions. The strategic focus on the long-run, of course, is different from that of many U.S. firms. Important advantages possessed by Nestle include early mover advantages, access to capital, an ability to attract superior management, knowledge of a host of foreign markets, and the staying power of a large, publicly-held firm. These advantages appear to allow the firm to prosper without sweeping changes in strategy.

### **Kraft Foods, Inc.**

Kraft, headquartered in Northfield, Illinois, is a Philip Morris Company. Philip Morris (soon to be called the Altria Group) had sales of \$88.1 billion in 2001. Emphasis in this section is on Kraft's dairy businesses.

Kraft Foods traces its origins to the early 1900s when J.L. Kraft and Bros. Co. became a successful Chicago cheese distributor. Founder J.L. Kraft's vision for the company was to bring to retailers a variety of cheeses of consistent quality and with longer shelf life. An early contribution of the company was development of processed cheese in 1916 [15].

Kraft Foods was acquired by Philip Morris in 1988. This acquisition was sandwiched between Philip Morris' acquisition of General Foods in 1985 and the company's acquisition of Nabisco Holdings in 2000. The major companies acquired by Philip Morris had themselves acquired many smaller companies during their years as independent organizations. For example, the Oscar Mayer Company was previously part of General Foods and eventually became a prominent part of Kraft Foods.

Following an \$8.4 billion initial public offering (IPO), Kraft Foods began trading as a public company on June 13, 2001. The firm's stock price has exhibited a strong upward trajectory from the date of the IPO to the time of this writing (mid-June 2002). Sales revenues of Kraft Foods totaled \$33.9 billion in 2001, making the company the largest food company in North America and second only to Nestle worldwide [20]. Six of Kraft's brands generated global revenues of more than \$1 billion and 61 generate revenues exceeding \$100 million. Kraft brand products are sold in about 145 countries. The company has operations in 68 countries.

Kraft's cheese revenues totaled \$6.3 billion in 2001 [20]. The firm's cheese brands include Philadelphia—Kraft's most global brand, Cracker Barrel, Kraft Singles, Shreds and Cubes, Velveeta, Cheez Whiz, Dairylea, and El Caserio. Kraft's cottage cheese brands include Breakstone and Knudsen Cottage Doubles. Sold in over 30 countries, Philadelphia Cream Cheese is a leader among Kraft's brands that have sales exceeding \$100 million in sales per year. In the late 1990s, Philadelphia Cream Cheese had leading market shares in Germany, Italy, the UK, Belgium, Spain, Austria, and Australia [15].

Kraft Foods' sales were concentrated fairly heavily in North America in 2001 (Table 2). The firm has indicated that Asia represents a potential growth market for its cheese products and other foods and beverages [8].

**Table 2. Kraft Foods' North American Sales by Business Segment and International Sales by Country Aggregates, 2001\***

	Sales	% of Sales
<b>North American Sales by Business Segment</b>	<b>(\$ billions)</b>	
Cheese, Meals & Enhancers	\$10.3	30.4%
Biscuits, Snacks & Confectionery	5.9	17.4
Beverages, Desserts & Cereals	5.4	15.9
Oscar Mayer & Pizza	3.6	10.6
Subtotal:	\$25.2	74.3%
<b>International Sales by Country Aggregates</b>		
Europe, Middle East & Africa	\$6.3	18.6%
Latin America & Asia Pacific	2.4	7.1
Subtotal:	8.7	25.7%
Total Kraft Food, Inc. Sales	\$33.9	100.0%

\* Source: Kraft Foods Annual Report, 2001 [20].

### **Core Strategies**

Kraft Foods in its 2001 Annual Report describes its strategies as follows [20]:

- 1) Accelerate growth of core brands.
- 2) Drive global category leadership.
- 3) Drive world-class productivity, quality and service.
- 4) Build employee and organizational excellence.

Kraft provided noteworthy rationales for two of the core strategies. Thus, the rationale given for *acceleration of growth of core brands* was specified as follows [20]:

To drive growth, we're leveraging one of the industry's most powerful portfolio of brands to address the marketplace's most compelling trends. We're focusing new product innovation on four high-growth consumer needs: snacking, beverages, convenient meals, and health and wellness. We're capturing a greater share of the fastest-growing distribution channels, including supercenters, convenience stores, mass merchandisers, drug stores, club stores, and food safety away from home. And we're developing customized products and marketing

programs to reach rapidly expanding demographic segments such as the African-American and Hispanic populations in the U.S.

Similarly, Kraft's rationale for part of the *drive for global category leadership* was described in these terms [20]:

Managed effectively, category leadership is a compelling advantage...We are intent on driving growth in developing markets. More than 80% of the world's population lives in developing countries, yet only 9% of Kraft's revenues are sourced there. Our rapid expansion in these markets will continue by broadening our brand portfolio in current categories, bringing new categories to current geographies, expanding to new geographies, and building distribution in all geographies where we operate.

The comment relating to the importance of expanding sales in developing countries is broadly similar to one made by Helmut Maucher of Nestle. However, Kraft's experience in foreign markets—especially developing country markets—is less than Nestle's. For example, as noted in Table 2, Kraft made nearly three-fourths of its sales in North America in 2001. Thus, the drive for global category leadership—particularly as it relates to developing countries—may be a significant challenge for Kraft Foods. The firm will encounter competition from the likes of Nestle, Unilever, and increasingly strong local firms when it undertakes this initiative.

### **Secondary Strategies**

Other strategies gleaned from literature on the Kraft's operations (especially the firm's dairy operations) include the following [15]:

- 1) Packaging and advertising are tailored specifically for each country. This is contrary to the strategies employed by certain other multinational packaged goods companies, which are moving to a single, international package design.
- 2) The company encourages a free exchange of ideas and products across international boundaries.
- 3) New product development is a key element of the firm's marketing strategy since it enables the firm to maintain a diversified portfolio of brands, and permits development of products for specific ethnic or cultural groups that can be employed in other regions.
- 4) Kraft Foods North America purchases the majority of its cheese for further processing, rather than processing cheese from raw milk. Thus, the firm focuses on the value-added cheese segment.
- 5) The firm divests itself of product lines that face stiff competition from well-established local brands and offer limited opportunity for rapid growth. The strategy manifested itself in the firm's divestiture of several dairy operations in Germany and Australia during the 1990s.
- 6) The firm has developed and promoted value-added products that provide higher-than-average profit margins, while avoiding commodity products such as fluid milk.
- 7) Kraft aims for high market share for many categories and brands.

Kraft's strategies have evolved in ways that permit the firm to secure rapid growth in high margin markets. For the most part, the firm's core and secondary strategies are orthodox. This suggests that the firm's generally high profit margins have stemmed substantially from excellent management. A challenge will await the firm as it seeks to expand sales substantially in developing country markets.

### **Western European Dairy Firms (Excluding Nestle)**

In the mature dairy-food markets that exist in much of Western Europe, leading dairy firms in recent years have faced the basic choice of diversifying at home or expanding core businesses abroad [15]. For a host of reasons, many Western European firms chose the latter.

Many factors—especially the existence of milk quotas in the EU—influenced such decisions. The EU quotas, initiated in 1984 and likely to remain in operation until at least 2008, constrain milk supplies available to growth-oriented EU dairy firms. The desire of well-known European dairy-

food firms to expand sales of branded products—a strategy that was constrained by the supply restraints and high domestic prices associated with the quotas—also encouraged them to develop markets outside of Western Europe.

Accordingly, it is not surprising that many Western European firms have expanded sales in the U.S. [15]. Examples of firms that have increased or maintained substantial dairy-food investments in the U.S. in recent years include Danone (France), Lactalis (France), Diegeo (UK), the Kerry Group (Ireland), Glanbia (Ireland), Unilever (UK-Netherlands), and Parmalat (Italy).

### **The Kerry Group/PLC**

While not among the largest of the European dairy-food firms, the Kerry Group of Ireland provides a dramatic example of successful strategic adjustments to a sometimes hostile economic environment.

Headquartered in Tralee, County Kerry Ireland, the Kerry Group/PLC is a diversified food ingredients and consumer foods company. The firm grew from a small dairy cooperative that had sales of about U.S.\$50 million in 1974 to a multinational company with sales of 3.0 billion Euros (about U.S.\$2.7 billion) in 2001 [15, 16, p.3].

Much of Kerry's growth was achieved by acquisitions of food-ingredients firms. The firm began acquisitions in the U.S. in 1987, and by 1995 had made 43 acquisitions in a host of countries—actions that doubled the firm's size in each of the previous five-year periods. By the end of the 1990s, Kerry had operations in Ireland, the U.S., continental Europe, Canada, Mexico, Brazil, Argentina, Chile, New Zealand, Australia, and Malaysia. About two-thirds of Kerry's revenues were obtained from food ingredient sales at the end of the 1990s.

An accident of history appears to have shaped the strategies of the Kerry organization in important ways. In the early 1970s, a brucellosis eradication program reduced the milk supply of Kerry Cooperative (parent of the current organization) by about 20%. Facing this situation, the Kerry Cooperative's management and board of directors concluded that, if the firm was to grow, it needed to reduce its reliance on commodity dairy products and diversify into differentiated products. Accordingly, the firm embarked on a path that produced the following strategies [15].

- 1) Emphasize production and sale of food ingredients.
- 2) Acquire firms selling branded food products.
- 3) Beginning in 1986, exchange the assets of Kerry Cooperative for a majority holding in a public limited company, mainly to obtain capital for growth.
- 4) Emphasize quality and continuity in management.
- 5) Increase expenditures on R&D to 2-3% of sales in order to remain competitive in the food ingredients business.
- 6) Emphasize growth through acquisitions, especially of profitable food ingredients businesses.
- 7) In the early 2000s, seek 15% per year earnings growth—10% from organic growth and 5-6% from acquisitions [38].

Implementing these strategies propelled the firm into a world leadership position in food ingredients. Simultaneously the implementation caused sales of Irish-based dairy products to decline to about 11% of the firm's total revenues in the late 1990s.

While Kerry's strategies involve more than a response to EU dairy policies, management of the firm made clear their reluctance to acquire dairy businesses that were subject to the growth-inhibiting effects of the EU's Common Agricultural Policies. Thus it was surprising that in the last quarter of 2001, Kerry acquired Golden Vale dairy and prepared meal business (an Irish cooperative), paying 391 million Euros (about U.S.\$350 million) for the firm [2, p.11]. Kerry reports that it will be 2003 before the business will begin to yield the 5.9% average margins of the other parts of Kerry's food business. While Kerry has spun off part of the acquired cooperative, the reason for acquiring the Golden Vale cooperative in the first place remains unclear.

One of the firm's noteworthy strategies was the exchange of Kerry Cooperative assets for a majority holding in a public limited company. This was done in hopes of obtaining capital for growth. Through sales of Kerry's shares on the Dublin and London exchanges, the firm was able to raise expansion capital. Kerry's successes might encourage capital-short farmer cooperatives in other countries to pursue a similar strategy for raising expansion capital. However, it should be noted that Kerry made heavy use of debt for its numerous acquisitions. The firm was able to manage the heavy debt loads associated with the acquisitions partly because of its superior management. Indeed, retaining superior management probably accounts for much of the firm's successes.

### **Parmalat**

Headquartered in Parma, Italy, Parmalat Finanziaria SPA (Parmalat) grew from a small cold cuts and preserves firm in 1961 into one of the world's largest dairy firms in the late 1990s and early 2000s. The firm's dairy sales in 2000 totaled about U.S.\$5.7 billion [42, p.3]. In 1999, Parmalat had over 41,000 employees in 33 subsidiaries in Europe and 61 subsidiaries in other parts of the world [15]. Products produced by the firm include milk (UHT and pasteurized), cream, yogurt, desserts, fruit juices, tomato-based sauces, tea-based drinks, vegetable soups, biscuits, and cakes.

Parmalat is a world leader in UHT milk sales. UHT milk is Parmalat's strongest branded product and accounts for about 90% of the firm's milk sales (55% of total sales) [15]. This product, which has a shelf life of about six months in the unopened container, represents the bulk of the firm's sales in South America and half of the firm's sales in Europe. Parmalat's sales of UHT milk in developing countries were fostered by the following developments:

- 1) Governments in developing countries promoted consumption of UHT milk as a safe alternative to poor quality tap water.
- 2) Government programs to combat malnutrition included UHT milk.
- 3) The longer shelf life and no refrigeration costs led retailers to prefer to carry shelf-stable UHT milk rather than regular pasteurized milk.

Reflecting an aggressive acquisition strategy, Parmalat expanded its presence from six countries to 31 countries during the 1990s. The company's total sales grew by about 800% from 1990 to 1999—two-thirds of the sales expansion was accounted for by acquisitions. Mainly as a result of acquisitions, the company established a major presence in Brazil and also acquired plants in Argentina, Uruguay, Paraguay, Mexico, Chile, Spain, Portugal, Germany, France, Hungary, China, Russia, the U.S., Canada, and Australia.

Parmalat's acquisitions were expected to decline in the early 2000s while the firm focused on integrating new businesses into the company and paring operating costs. The lull in acquisitions was short-lived. Parmalat was quiet for the first three quarters of 2000, but closed the year with five deals in dairy [42, p.4].

Parmalat's key strategies included the following during the 1980s, 1990s and early 2000s [15]:

- 1) Invest in countries with more growth potential than Western Europe.
- 2) Employ debt as a major source of funding for acquisitions.
- 3) Transform the firm from a commodity food company into a nutrition company, offering functional foods that have special health benefits.
- 4) Expand the firm's R&D capability to support the increased sales of functional foods and other differentiated food products.
- 5) In developing countries, use commodity dairy products to generate cash and provide a distribution platform. As incomes increase in these countries, push higher-valued products through the same channels, build brand awareness for the firm's products, and ultimately introduce a range of value-added products.



With a few exceptions, Parmalat's strategies and their pattern of evolution are familiar. Like the Kerry Group, Parmalat used debt as a major source of funding for acquisitions. Parmalat's efforts to expand sales of differentiated products and develop the R&D capacity to support product differentiation are familiar adjustment strategies for big European and Australasian firms. Key strategy No. 5 is broadly similar to a generic (and successful) strategy employed by Nestle for expanding developing country food product sales in response to changes in income levels in developing countries.

However, there is one noteworthy difference between Parmalat's strategies and those of other major international dairy firms. Parmalat implemented strategies to gain profits from consolidating the still fragmented global fluid milk business—mainly by acquiring or building UHT milk businesses. As noted below, Dean Foods and Suiza employed strategies to profit from consolidating the U.S. fluid milk business. Parmalat did a similar thing on an international scale.

### **Dean Foods**

The new Dean Foods Company is the product of the December 2001 merger of U.S.-based Dean Foods and Suiza Foods. This merger produced a firm with annual sales of \$9.0 to \$10.0 billion and approximately a one-third share of the U.S. fluid milk market.

The original Dean Foods company traces its origins to 1925 when Samuel L. Dean Sr. founded the Dean Evaporated Milk Company [33, p.7]. Suiza is much newer, beginning as a single Puerto Rican dairy in 1993 [14]. Both companies acquired a large number of fluid milk companies during the 1980s and 1990s, and both profited from consolidating the fragmented U.S. fluid milk business. Wilcox described the gains from consolidating the U.S. fluid milk businesses as follows [41]:

...In 1996 there was significant noncompetitive excess capacity (in U.S. fluid milk processing). This coupled with the fact that milk processing was inherently a high fixed-cost business created depressed earning throughout the industry. The opportunity to combine the processing and distribution systems of recently completed acquisitions provided significant opportunities for significant cost savings. Volume at poorly performing plants was moved to more efficient plants to ensure assets were operating at full capacity. Most fluid milk processors have typically earned operating margins of only 3 to 5% on (annual) sales of a couple hundred million dollars. Because of low margins, just a few basis point improvements in the operating margins could create a fairly favorable swing in the consolidator's profits...By creating a larger company with higher profitability (stronger cash flow) and access to outside capital, a company could take advantage of many investment opportunities that have been neglected in U.S. fluid milk processing for decades.

Insights on the strategic choices that will face the new Dean Foods Company can be obtained from information on practices of the parent companies.

### ***The Original Dean Foods Company***

Dean Foods moved into the fresh fluid milk business in the mid-1930s. In 1947, the firm began expanding geographically by buying regional dairies outside the midwestern U.S. The regional expansion accelerated in the 1980s when Dean acquired such profitable regional brands as *T.G. Lee* in Florida, *Reiter* in Ohio, and *Mayfield* in Tennessee [33, p.7]. In July 2000, Dean Foods entered into a noteworthy "...50% joint venture with Land O'Lakes to market and license fluid milk and cultured dairy products nationally, extending the popular Land O'Lakes brand. At this time, Dean also purchased Land O'Lakes' fluid milk operations, which added \$310 million in revenues [33, p.10]."

The company also diversified into the pickle and/or vegetable business in the 1960s, 1970s, 1980s, and 1990s. Further diversification occurred in 1999 when Dean acquired a 25% interest in *White Wave*, a producer of soymilk and other soy products.

In 2000, the firm had become the second largest U.S. fluid milk processor, with total dairy and other food product sales of \$4.1 billion [11]. Prior to the merger with Suiza Foods, Dean Foods had a 14-15% share of the U.S. fluid milk market.

Dean Foods made relatively small dairy product sales in foreign markets. However, the firm did sell fluid milk in Mexico in recent years from its Texas fluid milk plants.

Selected strategies of the original Dean Foods Company relating to fluid milk included the following [33]:

- 1) Grow primarily by acquiring profitable, well-managed regional dairies.
- 2) When seeking acquisitions, target dairies close to those already owned by the firm. If the acquired companies are profitable, let the dairy keep their brand name, management, and decision-making power. If necessary to gain efficiencies, close the plant of the acquired dairy and process the milk at a nearby Dean plant.
- 3) Do private label milk processing for supermarkets such as Albertson's and Wal-Mart in order to get Dean's branded milk into their stores.
- 4) Seek higher margins by product packaging innovations such as the *Chugs* container.
- 5) Increase margins by reorganizing the firm to include a National Refrigerated Products (NRP) division. The NRP division would handle extended shelf-life *Chugs*, dips and refrigerated dressings, *White Wave* soy products, and would develop new cultured products using the Land O'Lakes brand.

Prior to the merger with Suiza, Dean Foods' management clearly regarded the challenges facing the firm in the fluid milk business as daunting. Howard Dean, CEO, described those challenges as follows [33, p.11]:

Consolidation of the retailers and the food service business is driving a lot of what we are doing. Business is getting tougher, margins are getting smaller, volumes are very important... We're all seeing what Wal-Mart is doing...Wal-Mart is forcing the industry to change. They want the gallons and half gallons, the bulk items—that's 80% of its dairy sales—delivered right to their door. We can pull up a whole truckload of milk and drop it off, the volumes are so big there. But they want more extended shelf-life products that they can run through their warehouses.

The narrowing of margins spoken of by Howard Dean presumably was of particular concern to Dean Foods because the firm's dairy operating margins were smaller than those of Suiza, as noted in Table 3 [33, p.10].

**Table 3. Dairy Operating Margins of the Original Dean Foods Company and Suiza, Selected Years\***

Company	Dairy Operating Margins		
	1997	1998	1999
Dean	5.8%	5.6%	3.5%
Suiza	7.7	7.3	7.0

\* Source: Slack, HBS Case No. 9-901-007 [33].

Wilcox's research showed that Suiza's dairy operating margins for 1996 through 2000 averaged 6.2%, while those for the original Dean Foods Company averaged a percentage point lower at 5.2% for the same period [41]. Free cash flow generated by Suiza was also substantially larger than that of the original Dean Foods during 1996 through 2000. Among other things, the differences in operating margins and free cash flow undoubtedly encouraged Dean Foods to rethink the basis for competing in the industry.

Dean's president, Richard Bailey, described the challenges and the need for the company to depart from its traditional strategies as follows [33, p. 11]:

The only way you're going to grow this company is to look outside the regional approach that Dean's has used to market milk. We're not going to [maintain] double-digit growth because acquisition opportunities will run out...The [retail] trade is consolidating, and they're looking for leaders that will provide services on a broader scale than the regional approach. They want fewer trucks pulling up to their store or warehouse, they want one invoice and one sales person from a company. The other way to grow is to develop new products. Because of our acquisitions, we've got to go to the trade with new products and get them on the shelves.

### ***Suiza Foods***

This firm was a fluid milk company that grew rapidly and successfully, mainly through acquisitions, to record sales of \$5.76 billion in 2000. In its 2000 annual report, the company described its growth strategy as follows [35, p.6]:

We have built Suiza Foods on the vision of acquiring strong regional companies, empowering them to manage their businesses locally and providing the centralized resources they need to run their operations efficiently. We have completed 43 dairy acquisitions since 1993, and continue to manage our company on a decentralized, regional basis to capitalize on the established success of the businesses and brands we have acquired and the experience of our management teams in the field.

Prior to the acquisition of Dean Foods, the largest of Suiza's acquisitions was the 1999 purchase of the Southern Foods Group, whose brands included Borden, Meadowgold, and Schepps. Suiza acquired the Southern Foods Group from Dairy Farmers of America (DFA) under an alliance arrangement whereby DFA would supply raw milk to the Southern Food Groups plants. The acquisition of the Southern Food Groups pushed Suiza's share of the U.S. fluid milk market to about 18%.

The Southern Food Group acquisition increased the number of dairy plants operated by Suiza by 30, increased the number of employees by 5,500, and expanded sales by \$1.3 billion per year. Suiza's management claimed that [35, p.2]:

The most profound change brought about by the Southern Foods acquisition was that it provided us with the infrastructure needed to enable us to serve customers with virtually any product in the dairy case almost anywhere across the United States and Puerto Rico.

Suiza, like the original Dean Foods Company, made few investments in foreign dairy firms. However, in February of 2000, Suiza acquired a 75% interest in Leche Celta, the fourth largest dairy in Spain with annual revenues of about \$150 million [35, p.4].

In summary, Suiza's strategies for the firm's fluid milk operations have evolved as follows in approximately the past decade:

- 1) Aggressively acquire strong, regional fluid milk companies to develop a national processing and distribution system.
- 2) Employ substantial financial leverage in the acquisitions.
- 3) Vigorously pursue efficiencies to obtain profitable operating margins.
- 4) Reap the profits associated with consolidating the fragmented U.S. fluid milk business.

### ***Strategic Options for the New Dean Foods Company***

In recent years, both the original Dean Foods Company and Suiza Foods pursued acquisition-based strategies that helped the firms profit from consolidating the fragmented U.S. fluid milk business. But presumably the challenges that the original Dean Foods Company faced prior to the merger with Suiza will not disappear. While the new Dean Foods Company undoubtedly can acquire additional profitable regional fluid milk firms, the pickings will be slimmer. Indeed, Richard Bailey's comment about the exhaustion of profitable acquisitions in the fluid milk business is likely to prove prophetic. These challenges probably will encourage the new Dean Foods company to pursue strategies aimed at obtaining additional processing and distribution efficiencies, and to seek ways to expand profit margins through new product development and product

differentiation. Diminishing returns can be expected from pursuit of additional efficiencies, and returns from new products and product differentiation efforts are likely to be costly and uncertain. The new strategic environment will require skills different from those that made Suiza Foods exceedingly successful.

Faced with these less-than-promising strategic options, the firm might opt to expand internationally in the fluid milk business. The clearly excellent skills that Suiza applied to consolidating the U.S. fluid milk business might be employed to advantage internationally.

### **Dairy Farmers of America (DFA)**

DFA is a dairy cooperative that recorded sales of \$7.9 billion in 2001 [32]. The cooperative marketed 45.6 billion pounds of milk (34.5 billion pounds for member farmers) in 2001. The 45.6 billion pounds represented about 28% of the U.S. milk supply. The firm is a national cooperative with a fairly balanced presence across the entire U.S.

A product of mergers that began in the 1960s in the U.S., the cooperative acquired its present name and a large addition to membership as a result of a merger in 1998. Mid-America Dairymen (the dominant parent of the present DFA), representing about 12,600 farmers in 30 states, merged with three other cooperatives to form DFA on January 1, 1998. In addition, to Mid-America Dairymen, the DFA cooperative included Milk Marketing, Inc. (Ohio), Western Dairymen Cooperative, Inc. (Colorado), and the Southern Region of Associated Milk Producers, Inc. (Texas). The new DFA cooperative represented 12,600 milk producers in 42 states [14, p.5]. By 2001, DFA had grown to represent about 15,100 farmer-members and picked up several additional percentage points of national milk supply.

DFA has a complex organizational structure that employs an affiliate network in connection with its strategy for building market access. DFA describes the affiliate network employed for expanding the cooperative's fluid milk sales, in part, as follows [32, p.3]:

- 1) The objective of DFA's fluid milk group is to maximize the distribution into the highest value fluid milk channel. Joint venture investment in fluid milk processors is an essential part of the DFA strategy:
  - DFA enters into equity partnerships with bottler management teams.
  - The bottling affiliate network provides access to the highest price for commodity milk.
- 2) Given the perishable nature of fluid milk and the cooperative's geographically diverse membership base, it is important to establish relationships with fluid milk processors with facilities close to membership areas.
- 3) DFA makes non-controlling equity investments in affiliates in exchange for a share of the profits and the right to be the bottler's preferred supplier.
- 4) The bottling network distributes milk to end users such as grocery chains, food manufacturers, and restaurants.

DFA's bottling affiliates represent a virtual who's who of fluid milk processors across much of the U.S., including the new Dean Foods Company. DFA's largest joint venture is with National Dairy Holdings, LP—the second largest dairy processor in the U.S.

The Cooperative's recent joint ventures in milk manufacturing include the following [32, p.6]:

- 1) Keller's Creamery
  - A leading distributor of branded butter products sold into northeastern U.S. retail and food service markets.
  - Provides DFA with a branded strategy for butter.
- 2) DairiConcepts
  - Combines DFA's manufacturing capacity with Fonterra's innovation and advanced R&D.
  - Manufactures dairy and cheese ingredients for industrial customers, including McCormick, Nestle U.S.A., Frito-Lay, and Cumberland Packing.

- 3) Greenwood Valley Cheese
  - Joint venture with Fonterra.
  - Manufactures dried and grated cheese for the retail, food service, and industrial markets.
- 4) Melrose Dairy Proteins
  - A cooperative to cooperative joint venture for cheese production in the Upper Midwest.
  - Fifty percent shared ownership that maintains existing customers and product mix.
  - Commits DFA and Land O'Lakes to providing members in the Upper Midwest with secure dairy markets.

### ***The DairiConcepts Joint Venture***

Two of DFA's recent manufacturing alliances involve Fonterra of New Zealand. Created in 2000, the DairiConcepts joint venture is a 50-50 limited partnership between DFA and NZMP, the ingredient business of Fonterra. A noteworthy initiative under the joint ventures involves the production of milk protein concentrate at a DFA plant in Portales, New Mexico. Mr. Craig Norgate, Fonterra's CEO, described milk protein concentrate production under the joint venture as follows [39]:

The New Mexico plant will feature the first commercial production of milk protein concentrate (MPC) in the United States. It will also produce other dairy ingredients for many market applications in the fastest growing food sector in the U.S.—convenience foods.

Mr. Gary Hanman, DFA CEO, said that establishing a domestic source of high-end milk protein products is an important step for DFA's farmers, noting that [39]:

Domestically produced MPC will offset imports now being used by many of our customers as an economic and efficient ingredient in the processing of many dairy-based food and beverage products. It is time for DFA members to share in the market of this valued ingredient and, ultimately, utilize more DFA-produced milk.

Both CEOs agreed that the expanded DairiConcepts relationship represented a "key strategic move."

### ***Implications of DFA's Strategies and Practices***

Growth of the cooperative has increased its political power, enhancing the firm's ability to influence changes in federal milk orders, dairy price supports, and dairy trade legislation. Second, the cooperative, which has long used joint ventures, has expanded the use of these devices. DFA apparently has avoided major problems with these potentially risky devices. Indeed, the firm's long and apparently successful experience with the alliances produced the "11 Tips for Cooperative Mergers, Joint Ventures and Alliances" appearing in the Appendix. Third, expansion of the DairiConcepts joint venture to include production of MPC in New Mexico represents an import substitution measure. The MPC to be produced at the New Mexico plant will be destined for high-end products—otherwise the product would not be competitive with imported MPC. Finally, expansion of the DairiConcepts joint venture implies that DFA has a high regard for Fonterra's R&D and technical prowess.

To date, DFA's aggressive growth-oriented strategies, emphasizing mergers and alliances, appear to have evolved successfully. The strategies have increased the firm's political and market power. Reflecting scores of mergers and alliances, the firm's organization chart has grown exceedingly complex. Because of the sheer complexity of the firm, it would not be surprising if DFA found it difficult to manage the organization successfully at some future time.

### **Land O'Lakes, Inc.**

Like DFA, Land O'Lakes is a national food and agricultural cooperative. The cooperative recorded sales of \$5.97 billion in 2001 from its operations in dairy foods, feed, seed, swine, agronomy, and other items [23]. Approximately 60% of the firm's sales came from dairy foods. Land O'Lakes is the number one marketer of branded butter and deli cheese in the U.S.

Headquartered since its founding in 1921 in Minnesota in the upper midwestern U.S., Land O'Lakes became a national dairy cooperative in 1998 when it merged with Dairymen's Cooperative Creamery Association in Tulare, California [14]. The California merger came on the heels of the firm's merger with Atlantic Dairy Cooperative of Pennsylvania a year earlier. The California merger positioned the firm to take advantage of the rapidly increasing milk supplies in this western state. The two mergers increased Land O'Lakes' milk supply from four billion pounds to about 12 billion pounds per year.

Land O'Lakes' President and CEO, Mr. John Gherty, and Mr. Jim Fife, Chairman of the Board, described the strategic transformation of the cooperative during the past five years, and challenges associated with making the transformation, as follows [23]:

Over the past five years, Land O'Lakes has transformed itself, in a very strategic way, from a strong regional company to a national, farmer-owned organization with necessary size and scale in key businesses...As a farmer-and local cooperative-owned organization, we recognize the unique challenges we face...For example, cooperatives have a more limited access to capital than many of our private and publicly held competitors. At the same time, focused, profitable growth remains essential to our success long-term. And we have taken the initiative in pursuing strategic growth.

Major acquisitions made and/or alliances entered into by Land O'Lakes during the last few years to achieve growth objectives included the following:

- 1) Completed the acquisition in 2000 of Madison Dairy Produce company in Madison, Wisconsin—the region's largest private-label butter manufacturer.
- 2) Acquired the Beatrice Group cheese plant in Gustine, California in 2000, bringing increased mozzarella and cream cheese production capacity to the firm and expanding Land O'Lakes' presence in West Coast markets.
- 3) Broke ground in 2000 on a new, world-scale joint venture cheese and whey plant. This project, with Japanese partner Mitsui, was designed to increase Land O'Lakes' domestic market cheese sales and expand dried whey product sales in the Pacific Rim.
- 4) In 2001, purchased Purina Mills, Inc., one of the nation's biggest makers of livestock feed, for about \$230 million and the assumption of about \$130 million of debt [9]. This added Purina's strong horse-feed production to Land O'Lakes' dairy and beef-feed business.
- 5) Formed a cheese marketing joint venture with Alto Dairy Cooperative in Wisconsin in 2001.
- 6) Formed an alliance in 2001 with Davisco Foods International. Under this alliance, Land O'Lakes will supply the milk for and market the cheese produced at a soon-to-be-constructed cheese manufacturing plant in South Dakota.

The \$310 million sale in 2000 of the firm's fluid milk operations to Dean Foods was described earlier. That action—an important redeployment of assets by Land O'Lakes—was consistent with the moves of many other U.S. dairy cooperatives that have exited from the highly competitive U.S. fluid milk business.

Land O'Lakes considered entering into an alliance with Alto Dairy Cooperative of Wisconsin in 2000-2001 that would have produced a large, new cheese plant in Wisconsin. For a host of reasons—e.g., concerns about milk supply and failure of Wisconsin's state government to provide subsidies—the two firms chose not to pursue this initiative.

In 2001, Land O'Lakes management pursued strategies to enhance the value of the Land O'Lakes brand and increase its value as a platform for growth. Gherty and Fife described the initiative as follows in a letter to stakeholders[23]:

We spent a good portion of the year evaluating our brand...documenting its existing strengths, and determining how best to further separate ourselves from the competition in the eyes of the consumer...we are defining the Land O'Lakes brand in a way that builds on our long-standing reputation for purity, quality and freshness and responds to the consumers' documented desire to 'rediscover a simpler, less complicated, back-to-basics lifestyle, anchored in simpler foods.' In the spring of 2002, we will launch an aggressive public

relations, marketing and advertising campaign to position Land O'Lakes as the leader in fresh, pure and natural products that make 'Simple Goodness Living' possible.

Land O'Lakes strategies have produced a firm with a more diverse portfolio of enterprises and product line than that of many U.S. dairy firms. In addition to the mergers, acquisitions, alliances and brand enhancement efforts, Land O'Lakes has stressed efforts to achieve manufacturing and distribution efficiencies. Most of the firm's strategies are consistent with a robust, growth orientation.

### **The DairyAmerica-NZMP Agreement**

A federated marketing company, DairyAmerica is an association of seven U.S. producer-owned dairy cooperatives: Dairy Farmers of America, California Dairies, Land O'Lakes, Agri-Mark, United Dairymen of Arizona, O-At-KA Milk Producers, and Maryland and Virginia Milk Producers. DairyAmerica markets 100% of the milk powder produced by the member cooperatives.

In 2001, New Zealand Milk Products (NZMP) signed agreements with DairyAmerica to become the major exporter of U.S. nonfat dry milk (NFDM) [10]. NZMP, an operating unit of Fonterra of New Zealand, is responsible for the entire cow-to-customer value chain, including milk collection, manufacturing and logistics operations, transportation, manufacturing and the marketing of ingredients to customers around the world. Under the DairyAmerica-NZMP agreement, NZMP will receive a commission from DairyAmerica for NFDM sold on behalf of the federated marketing company.

NZMP has unquestioned ability as an exporter of NFDM. In most situations, NZMP probably can secure the highest price available for DairyAmerica's NFDM. However, since NZMP also exports NFDM for New Zealand farmers, there is a potential conflict of interest.

A situation could arise where New Zealand NFDM and DairyAmerica NFDM would compete for the same market outlet. What assurance will DairyAmerica have that NZMP would attempt to market the federated cooperative's NFDM as effectively as New Zealand NFDM? The potential for a conflict of interest is lessened by the fact that the New Zealanders are reducing NFDM production (while increasing whole milk powder production), making the New Zealanders less dominant in world NFDM markets. This development has made it important for NZMP to sell export marketing services and maintain the satisfaction of customers for those services. However, New Zealand's dairy industry in recent years has still accounted for about 20% of world NFDM exports [37]. This level of world market presence suggests that the potential for a conflict of interest still exists. Perhaps more important, DairyAmerica's use of NZMP as the exporter of NFDM deprives the federated marketing company of exporting experience.

## **II. Implications of the Strategic Behavior of Leading Dairy Firms**

For the most part, the findings regarding the strategies of the leading dairy firms are consistent with those listed by Zwanenberg of Rabobank as drivers of the growth-oriented strategies of the firms. However, certain facets of the strategic behavior of the firms and/or the environment in which the firms found themselves have important implications for other firms wishing to operate effectively in world markets. These items summarized below warrant additional discussion.

- Growth in use of cross-border alliances.
- Push by big firms to expand sales in developing countries.
- Policy-related deterrents to expanded dairy trade.
- Capital constraints facing expansion-minded producer cooperatives.
- Importance of quality of management.

### **Growth in Use of Cross-Border Alliances**

This development was evident in the strategic behavior of Nestle, Fonterra, DFA, and Land O'Lakes, all of which had entered into cross-border alliances.

Goals of firms entering into strategic alliances vary but frequently the devices are used by a company to gain the skills needed to enter new businesses and improve the strategic position of existing businesses [6]. Gomes-Cassers claims that three types of strategic goals frequently drive a firm's decision to collaborate with another firm: product exchange, corporate learning, and market positioning [19].

While common in many global industries, alliances are controversial. Kenichi Ohmae argues that "Globalization mandates alliances, makes them absolutely essential to strategy [27]." Michael Porter differs, claiming that "Alliances as a broad-based strategy will only ensure a company's mediocrity, not its international leadership [28]." Controversy surrounding alliances arises, in part, because an improperly structured alliance frequently has a relatively short life.

Bleeke and Ernst described how differences in initial strengths and control of distribution channels can doom a strategic alliance, illustrating the point using the Borden-Meiji Milk Products alliance [6, p.99]:

When the balance of power is tilted at the start, the stronger partner usually becomes the eventual owner. In the alliance between Meiji Milk Products and Borden to sell premium dairy products in Japan, Meiji originally controlled the relationships with the retail outlets, and Borden supplied the products. When the partnership was phased out between 1990 and 1992, Meiji retained control of the distribution and manufacturing facilities and introduced its own products in the premium ice cream, cheese and margarine segments. Borden subsequently exited the Japanese market after its sales and market share declined.

Drawing from case studies, Bleeke and Ernst analyzed the effectiveness of cross-border alliances for different industries and concluded the following [7]:

- Acquisitions work well for core businesses and existing geographic areas, while alliances are more effective for edging into related businesses or new geographic areas.
- Alliances between strong and weak companies rarely work.
- The hallmark of successful alliances that endure is their ability to evolve beyond initial expectations and objectives.
- Alliances with an even split of financial ownership are more likely to succeed than those in which one partner holds a majority interest. The 50/50 alliance produces a situation where each partner has a stake in mutual success.

In the case study entitled, *Managing International Alliances*, Gomes-Casseres suggests the following procedure for managing alliances in stages (Table 4). DFA's experience with alliances and mergers has generated a set of guidelines, which are broadly consistent with the points in Table 4.

**Table 4. Managing Alliances in Stages\***

<b>Stage in Process</b>	<b>Key Management Concerns</b>
1) Strategy Formulation	Define Logic of Collaboration
2) Partner Search	Match Goals and Capabilities
3) Negotiation	Allocate Roles and Design Structure
4) Start-up	Invest and Build Trust
5) Operation	Contribute and Receive Capabilities
6) Adjustments	Monitor Changes in Environment and Partners and Renegotiate as Needed

\* Source: B. Gomes-Casseres, HBS Case 9-793-133 [19].

Helmut Maucher of Nestle, it will be recalled, said that strategic alliances are a "last resort" but remained open to opportunities where objectives are clear, the partners share a philosophy, and where progress in a given sector might otherwise be slow or costly [5, p.2].



What is one to conclude about the effectiveness of the strategic alliances used by leading world dairy firms? For the most part, the firms using them have extensive experience with joint ventures and other strategic alliances. Most are aware of the pitfalls and benefits associated with these devices. Nestle, as noted, has extensive experience with alliances, which has steered the firm toward selective use of the devices. The New Zealand Dairy Board (now a component of Fonterra) used joint ventures for decades as a risk management tool for entering new dairy export markets. Frequently the Board ended up buying out the joint venture partner in the foreign market. DFA (and predecessor cooperatives) has used domestic joint ventures for decades to obtain preferred markets for members' milk. While this has provided valuable experience for the firm, a caveat appears in order for DFA. The extensive use of domestic and cross-border alliances has created an exceedingly complicated organizational structure that almost certainly makes the organization complex to administer. Land O'Lakes also has ample experience with domestic alliances, which presumably will be valuable in dealings with Mitsui in the California cheese plant alliance.

The DairyAmerica federated marketing company presumably represents a useful alliance for marketing member cooperatives' NFD. However, DairyAmerica's entry into an agreement with NZMP whereby the latter will market NFD in foreign markets for DairyAmerica carries risk. Among other things, it deprives DairyAmerica of the potentially valuable experience of exporting NFD.

Questions can be raised about why U.S. dairy firms have not made greater use of alliances for entering foreign markets. The domestic experience gained with the devices should be useful when such initiatives become more important.

### **The Push by Big Firms to Expand Sales in Developing Countries**

This push was most evident in the strategies of Nestle and Kraft. Recall that Nestle has the strategy of growing its share of business in an area in proportion to the region's contribution to world GDP. Referring specifically to China, Helmut Maucher of Nestle said that "... even with the risks, the potential gains are so great (in China) that no major food company can afford *not* to enter the market [5]."

Kraft laments its small presence in developing country markets, noting that "More than 80% of the world's population lives in developing countries, yet only 9% of Kraft's revenues are sourced there [20]." Kraft believes that Asia, where demand for cheese remains minimal, could be its biggest growth opportunity [8].

Nestle, with more than a hundred years of experience in foreign markets, perhaps is best equipped for further expansion into developing country markets. However, even Nestle may find it difficult to reach target sales growth rates in China. China, in recent years, has expanded its GDP by 6 to 8% per year, implying a substantial increase in its share of global GDP. It may be difficult even for Nestle to expand sales in proportion to that country's increase in global GDP.

Ghemawat, in a *Harvard Business Review* article entitled, "Distance Still Matters: The Hard Reality of Global Expansion," suggests why China is such a tough nut to crack. He first points out that distance between two countries can manifest itself along four basic dimensions [18, p.4]:

- Cultural;
- Administrative;
- Geographic;
- Economic.

Relating China to these basic dimensions, he notes that many businesses, at their peril, focus on the economic benefits of serving over a billion Chinese customers. He argues that cultural and administrative factors represent a serious deterrent to sales in China, noting that [18, pp.8-9].

- Culturally, China is a long way from everywhere. First, the many Chinese dialects are notoriously difficult for foreigners to learn, and the local population's foreign language skills are limited.

- The well-developed Chinese business culture, which is based on personal connections, often summarized in the term *guanxi*, creates barriers to economic interchange with Westerners who focus on transactions rather than relationships.
- Chinese consumers are home-based, indicating less preference for foreign brands than, for example, Indian customers.
- Corruption is common in China, which is reflected in both cultural and administrative dimensions of doing business there.

Ghemawat supports his arguments with results of a survey of 100 multinationals. Of these firms, 54% said that their total business performance in China has been "worse than planned," compared to 25% reporting "better than planned." The survey indicated that 62% of the respondents overestimated the market potential for their products and services.

These considerations may not deter Nestle, which focuses on the long-run. But Kraft, with modest sales in developing countries and a penchant for divesting itself of under-performing units, may find China a hostile market in which to operate.

### **Policy-Related Deterrents to Expanded Dairy Trade**

The early 1990s featured optimism regarding prospects for expanded world dairy trade. The Uruguay Round GATT/WTO agreement reduced export subsidies and expanded market access for dairy exporters. The U.S.—long protective of the dairy industry—even indicated that it would end the dairy price support program after 1999. Given this development, it was no stretch to assume that the U.S. would be interested in freer world dairy markets and expanded dairy exports.

The optimistic prospects for expanded world dairy trade proved to be partially illusory. The U.S. decided not to end the dairy price support program. The U.S. and EU did reduce dairy export subsidies; however, overall the U.S. and EU dairy industries remained protectionist. Moreover, the EU only reluctantly agreed to negotiate for additional dairy trade liberalization under the Doha WTO Round that began in late 2001. Market access gains supposedly provided under the Uruguay Round GATT/WTO agreement also proved to be smaller than many dairy exporters expected.

Fonterra's strategic behavior in the late 1990s and early 2000s says a lot about the dairy trade environment. The decision by Fonterra—the world's largest private dairy exporting company—to emphasize foreign direct investment and the selling of New Zealand's dairy expertise (partially at the expense of export expansion efforts) provides a lesson for the world's leading dairy companies: world dairy markets have failed to open as much as many anticipated in the aftermath of the Uruguay Round GATT/WTO agreement.

### **Capital Constraints Facing Expansion-Minded Producer Cooperatives**

The ambitious growth plans of Fonterra may be affected most by capital constraints. However, DFA and Land O'Lakes also appear to be embarking on strategies that will require large amounts of capital. These cooperatives have access to debt capital but likely not in the quantities that will fully serve their growth objectives.

The Kerry Group converted to a public limited company in order to raise expansion capital. Fonterra doubtless will explore opportunities to gain access to additional equity capital; however, New Zealand's farmers will wish to do so in a fashion that will allow them to retain control over the organization. Whether the latter consideration will be compatible with the firm's desire to acquire the amounts of equity capital needed to produce a fourfold expansion in the size of New Zealand's integrated dairy industry in 10 years is unclear.

For a host of reasons, efforts to convert large U.S. cooperatives into cooperative/public limited companies have met with substantial opposition. Thus, the Kerry model may find limited use by expansion-minded U.S. dairy cooperatives. Expanded use of debt will be part of the answer for DFA and Land O'Lakes. Actually, such a strategy would be close to Kerry's practices. Kerry was

able to acquire and service heavy debt loads by acquiring firms that made large amounts of cash available for debt service.

**Importance of Quality of Management.**

A careful reading of the strategies of the leading firms reveals much orthodoxy. Most leading dairy firms appeared to develop strategies that effectively addressed the challenges and constraints facing the firms. It is entirely possible, of course, that key proprietary data (not available to the authors) would reveal strategies that were highly out of the ordinary, but we believe that this is unlikely.

In addition to gifted management, continuity of management appears to be important. The stellar performance of the Kerry Group appears attributable to the stellar performance by long-time CEO, Denis Brosnan, and his top lieutenants. Helmut Maucher of Nestle, despite his protestations to the contrary, appears to have been substantially responsible for awakening this sleeping giant during his 15 plus year tenure as CEO. The administrative skills and long tenure of Gary Hanman of DFA and John Gherty of Land O'Lakes have also contributed to the growth and successes of these two cooperatives.

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## Appendix. DFA's 11 Tips for Cooperative Mergers, Joint Ventures, and Alliances\*

- 1) Answer the "Big Four." Getting to the final yes always boils down to answering a few good questions:
  - What is the new name and logo?
  - Where will the new headquarters be located?
  - Who will be the CEO?
  - Who will be the Chairman of the Board?
- 2) An outside facilitator provides balance.
- 3) Define the terms. Make certain everyone is using the same terminology and definitions up front.
- 4) Do due diligence.
- 5) Do the rating game. Are the financial numbers comparable? Are you using the same assumptions? Is equity...equity?
- 6) Settle the internal politics early.
- 7) Cultures can kill you. Recognize that all businesses have an internal and external culture. The culture drives the business' identity and position in the marketplace. It is critical to understand whether the cultures are similar.
- 8) Plan first. Use a detailed strategic plan that directs the process. Make certain that the right people are plugged into the developmental process and the process, once it is agreed to, is communicated and followed by everyone involved. This plan must include:
  - An agreed-to set of bylaws and board structure.
  - A plan that establishes the internal structure for member participation and governance.
  - A transitional period process.
  - An action plan that includes a comprehensive communication plan.
- 9) Timing is everything. Establish a firm timetable and stick to it.
- 10) Negotiate options for mutual gain. Identify strengths and weaknesses. Carefully consider options in which both parties benefit. Be realistic about the weaknesses. Can your business overcome them quickly and economically?
- 11) Develop a capital plan for implementing the change.

\* Source: Schriver [32, pp. 12 & 13].