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***Doing Business in China: Mead Johnson***

1. **Introduction**

Health scares and fatalities are not new challenges for China, ranging from contamination of seafood to toothpaste, and in previous years contaminated pet food that was exported to the United States (“BBC News”). In 2008, China suffered from serious contamination in its dairy products from some if its top producing companies. Dairy suppliers are believed to have added melamine, a banned chemical that is usually used in plastic, to diluted milk in order to make it appear higher in protein. The companies were diluting the milk in order to cut costs and then injecting the banned substance before distributing the milk products. 10% of the milk from the country’s two largest suppliers – Mengnio Dairy Group and Yili Industrial Group – contained up to 8.4 milligrams of melamine per kg. Products from Bright Dairy in Shanghai were also found to be contaminated (“BBC News”). Melamine was initially discovered in baby milk powder created by the Sanlu Group, and was then found in products made by 22 different companies (“BBC News”).

More than 6,200 babies have become seriously ill after consuming milk that was laced with the toxic chemical melamine and the substance is blamed for causing severe renal problems and kidney stones. At least 1,000 children were hospitalized, of whom more than 150 were suffering life-threatening kidney failure and 3 lost their life to the battle. The melamine scandal is a prime example of China’s failure for product safety initiatives (“BBC News”).

Due to the severity of the contamination, China ordered half of its dairy producers to close down in an effort to fix China’s polluted milk industry and begin focusing on consumer safety. The General Administration of Quality Supervision, Inspection and Quarantine, China’s number one quality control company, revoked licenses from 426 different dairy producers and suspended operations for 107 other state-run producers. In their entirety, these closures and suspensions accounted for half of China’s 1,176 domestic dairy producers. After the dairy producers were back in business, Chinese consumers responded by boycotting all local milk products. According to state media, dairy imports grew from 120,000 tons in 2008 to 600,000 in 2009. Three years after the incident consumers still look toward imported dairy products assuming that they are safer, creating an opportunity for international dairy producers (Burkitt).

1. **Industry Analysis**

***Segmentation***

The dairy market consists of retail sales of cheese, chilled desserts, cream, milk, spreadable fats, yogurt and fromage frais. As depicted in the chart to the left, milk occupies 48.6% of the market’s total value and is the largest segment of the market. Yogurt and fromage frais is the second largest segment, accounting for 38.6% of the market. Of the entire Asia-Pacific dairy market, China accounts for 31.2% of the total market value and Japan accounts for 37.3% of the market (Datamonitor).

***Market Share***

Bright Food Group is currently the leading company in the Chinese dairy market, generating a 13.7% share of the total market. Bright Food Group is a China-based corporation that is engaged in manufacturing and marketing food products, including dairy, rice and wine. The company is involved in eco-agriculture and standard agriculture which involve cow milk, vegetables and aquatic products. In the food processing sector, the company focuses on developing dairy products, ice cream and beverages, canned food, sugar and candy, and honey products. Bright Dairy & Food is a subsidiary of this sector which produces milk, develops dairy products as well as nutritious and healthcare foods. Bright Dairy & Food manufactures sterilized milk, yogurt, milk powder, butter and cheese and fruit juice beverages. The company operates more than 3,300 retailing outlets (Datamonitor).

Inner Mongolia Mengniu Dairy Company accounts for 10.3% of the market. Inner Mongolia Yili Industrial Group (Yili Group) is one of the leading dairy groups in China. It operates its businesses through five different divisions, including liquid milk, ice cream, milk powder yogurt and raw milk. Yili group owns 200 livestock farms and claims to own the only dairy research center in China, which researches and develops hundreds of new breeds every year. It also provides information on dairy patents in China. The group offers over 1,000 products through its 130 enterprises, including products such as popsicles, ice cream, milk powder, milked tea powder, sterilized milk, yogurt and cheese. The company had a net loss of $246.7 million in 2008, but generated a net income of $94.7 million in 2009 (Datamonitor).

China Mengniu Dairy Company Ltd. accounts for 8.6% of the market, which manufactures and distributes dairy products in China. The company manufactures many different products, including liquid milk, yogurt, ice cream and other dairy products. The company is located in Hong Kong and employees about 23,500 people. Its products are marketed throughout China, including Hong Kong and Macau. In addition to the liquid dairy products that are produced, other dairy products that are manufactured and distributed by China Mengniu Dairy Company include milk powder and cheese products. The company had a net loss of $138.7 million in 2008, but had a net income of $163.1 million in 2009. Other companies occupy 67.4% of total market share (Datamonitor).

***Market Value Forecast***

As shown in the graph to the right, the Chinese dairy market is predicted to have a value of $25,238.2 million in 2014, which is an increase of 53.4% since 2009. The annual growth rate between the periods of 2009 and 2014 is predicted to be 8.9%. Considering the fact that the dairy market is going to improve within the next few years, it is a feasible market for international dairy producers to enter (Datamonitor).



1. **Rationale**

There are three main drivers that create a perfect market niche for a milk company to do business in China. First, since 2006, the Chinese government has launched a campaign to promote dairy consumption in an effort to enhance citizens' nutrition with their slogan stating, "A glass of milk every day can make people stronger." By associating milk with health, the demand for milk increases. Second, several local baby booms throughout China took place, which in turn led a momentum to the formula milk sector (Coonan). Finally, the number of Chinese citizens that consume milk is only 300 million of the 1.3 billion. This amount leaves a vast untapped market to be explored by dairy companies and infant formula producers that are internationally based.

One of the biggest concerns for domestic dairy companies in China is the lack of consumer faith in their products. This is primarily due to the melamine contamination scandal in 2008. The scandal was a food safety incident where milk, infant formula, and other food materials were adulterated with melamine, an organic base that contains 66% nitrogen and is harmful when swallowed. As a result of melamine usage in dairy products, there was an estimated 300,000 victims including six dead infants from kidney stones and another 860 babies hospitalized (China.org.cn). Since the scandal, the Chinese government has made some public steps to punish those involved in the production of poisoned formula or dairy products; but unfortunately, there are still lingering doubts about the safety of domestic milk powder and the reliability of Chinese dairy companies.

The destruction of the public image for the Chinese dairy industry allows for other international companies to meet the need of the Chinese consumer. Chinese Marketing Manager of Wellcome Supermarket said, "Milk powder has been in short supply in recent months, and the amount of customers are increasing. There is a significant gap between supply and demand" (China Economic Net). For example, citizens of the People’s Republic of China have recently bought out and even smuggled Hong Kong’s supply of infant formula. The Hong Kong Tourism Board chairman James Tien said, “During the 2001 Spring Festival Golden Week this year, the Chinese mainland visitor arrivals hit a record high. It recorded a total of 662,928 visitors within seven days of trips, increasing 15.7% from last year’s attendance” (ChinaHourly). Supermarkets in the central district can often see the Mandarin-speaking mainlanders carrying up to 56 cans of milk powder (ChinaHourly).

The result of the Chinese milk powder craze comes from the many factors that have been mentioned above. First, the main drivers that create a market niche for milk promote the product. For example, the Chinese government is promoting health through milk making the average consumer want and demand milk. Second, the fact that the milk is tainted due to local Chinese companies injecting melamine into milk to create the illusion of higher protein causes a lack of consumer faith in domestic product. Finally, the milk powder craze was created by an interest in foreign products because of the negative public image that was established by Chinese dairy companies. For example, the Chinese dairy companies currently have such a bad image that thousands of Chinese consumers travel to Hong Kong to obtain their share of milk powder. All these factors clearly establish an opportunity to create a well secured market niche for an international company to do business in the Chinese milk industry.

Current market trends also prove that entering the Chinese milk industry is a viable option and intelligent business move. According to Dairy Australia, China’s whole milk powder imports are likely to “remain strong” this year after increasing dramatically in 2010. As previously stated, domestic dairy production was having a difficult time keeping up with demand growth due to the preference for imported products (Pugh). This creates a significant opportunity for the U.S dairy industry. United States dairy suppliers had record export volumes in 2010, reaching 3.04 billion pounds in 2010 and overseas shipments were 63% higher than in 2009. Dairy has become a fundamental part of the diet in many emerging markets, including China, India and Southeast Asia. Purchasing power in these nations has grown and individuals there are now more able to buy the products that they want. There are 43 million babies born every year in China and India, and these infants will start drinking milk-based formula earlier than they have in the past. Out of all of the growing dairy markets in 2010, none of these markets impacted global demand more than China. China imported 326,000 metric tons of whole milk powder which was seven times its total imports in 2008. The nation also imported 89,000 metric tons of skim milk powder, which is a 64% increase over the past two years. These increases in global demand create direct opportunities for U.S suppliers of milk powder, whey, lactose and cheese in China. According to the U.S Dairy Export Council, “To compete in an increasingly globalized market, our suppliers must move to the next level of sophistication as international players, toward the role of consistent suppliers” (U.S Dairy Export Council). It is evident that there is a huge opportunity for success for U.S dairy suppliers in the Chinese market.

1. **Mead Johnson Nutrition Solving the Milk Crisis in China**

Mead Johnson & Company is a company which was majority owned by Bristol-Myers Squibb after an acquisition in 1967 but in 2009 was spun off as an independent firm. Mead Johnson is a major manufacturer of infant formula both domestically and globally with its flagship product being Enfamil—infant formula. The company dates back to a firm created by Edward Mead Johnson, one of the co-founders of Johnson & Johnson, who created his own business in 1895, which was renamed as Mead Johnson & Company in 1905 (Dorfman).

Although Mead Johnson was founded in the United States and continues to maintain its worldwide headquarters in Evansville, it is a global company with more than 70 products in over 50 countries (Our History). Not only does the company use existing products to expand into new markets but also adapts to product innovation by creating market-specific goods to meet customers’ needs in individual countries. Today, Mead Johnson's global growth progresses, as the company continues to pursue innovation in science-based nutrition on behalf of infants, parents, and health care professionals throughout the world.

With recent events in the Chinese dairy industry, it is obvious that the best international company to fill the needs of the Chinese consumer is Mead Johnson Nutrition. The credibility and prestige of a brand such as Mead Johnson Nutrition will easily attract the Chinese consumer. For example, the consumer in China would rather invest and purchase foreign milk products because of the recent events in China, such as the melamine scandal, that created a lack of faith for domestic product. Furthermore, “the next couple of years will be good for foreign brands such as Mead Johnson's Enfamil A+ series..,” said Shaun Rein, managing director of CMR China, a market research group. "They have close relations with the pharmaceutical sector and the better hospitals use them" (ChinaDaily).

A company such as Mead Johnson Nutrition will eliminate the Chinese milk powder craze by conducting a thorough transition in to the market. With their reputation and their high quality product such as Enfamil, Mead Johnson Nutrition will solve the problem that the Chinese milk industry has. In addition, their reputation and financial leverage gives them a greater competitive advantage to transition into the Chinese market over any other international company (Our History). An effective strategy for Mead Johnson Nutrition would be to create a subsidiary directly located in China that follows governmental procedures and produces an infant formula similar to Enfamil. Even with the reluctant Chinese consumer, Mead Johnson Nutrition should be able to market themselves as a corporation properly and rebrand the Chinese milk industry.

1. **Conclusion**

In conclusion, both the Chinese milk industry and Mead Johnson Nutrition will benefit from the incorporation of Mead Johnson Nutrition into China. Mead Johnson Nutrition’s sales and market share will rise while China’s milk industry will fix its reputation.

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