AN Oreo WITH CHINESE CHARACTERISTICS

By Srinivas K. Reddy

Shawn Warren reflects on Kraft's glocalisation transformation

In late 2005, Shawn Warren, head of biscuits, Asia Pacific for Kraft, was in desperate need of a quick turnaround strategy. Oreo, after nearly 10 years in the China market was facing the imminent disaster of being completely pulled from the shelves. Local retail channels, along with company headquarters near Chicago, had finally grown impatient of the iconic product's lacklustre sales.

When Warren described the turnaround in March 2012, he said, "The first step to solving a problem is to admit you have one. We are committed to have this brand and put resources behind it."

Framing the context

Oreo, first sold by Nabisco in Hoboken, New Jersey in 1912, had become a classic fixture of Americana. Over time, Nabisco built an international presence with Oreo and increased the size of that product's packaging as demand for it grew in both the United States and overseas markets.

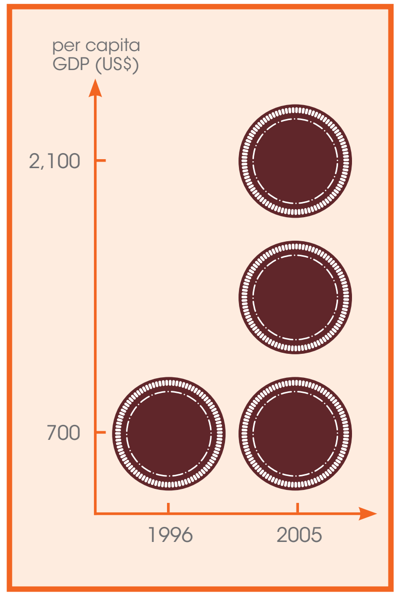
In 1996, Nabisco entered into the increasingly liberalised and rapidly-growing China market. Four years later, Phillip Morris, a U.S. based tobacco company, acquired Nabisco and merged it with several other food companies under the Kraft banner. The merged company had a diverse product portfolio of some of the most well-known brands in the world. At that time, Mary Chun, the brand manager at Oreo China, commented to Warren about the merger, "One big difference was that Kraft operated at a different pace than Nabisco. At that time, Kraft had a portfolio of products considered *back-of-the-shelf-grocery*. Nabisco had more of a fast-paced distribution model, with a product shelf life of around 12 months. Kraft products had a shelf life of more like two years. So once you changed to the Kraft pace to sell Nabisco products, it wouldn't work."

In terms of decision-making for Oreo, this was consolidated in the senior management team at company headquarters, which dictated central policy based on what worked well in established core markets. In 2004, Kraft had global revenues of US$32.2 billion, with Oreo sales accounting for some US$900 million. Impressive as these figures were, the company had experienced steadily declining profits since 2001–with the most severe drops coming from Latin America and Asia Pacific operations. A key manager at Kraft headquarters once commented, "I am not sure why the Oreo has not been a success in China. It is the most successful biscuit in the world. It has gone from a regional favourite to the number one biscuit in so many markets; surely the winning combination of taste and brand will work in China if we just give it some time."

The China market

In the nearly 10 years that Oreo had been in China, per capita GDP had risen from US$700 per person to US$2,100–a threefold increase. This rapid economic expansion was due largely to export driven growth.

PER CAPITA GDP SINCE OREO HAS BEEN IN CHINA



32%
lived in cities (1996)

50%
lived in cities (2005)

60%
living in cities (by 2020)

URBANISATION IN CHINA

There was a fair amount of integration that happened pretty quickly, which created a fairly unwieldy brand portfolio.

Favourable improvements in import policy were also occurring. Market-oriented reforms hit a milestone in 2001 when China was admitted into the World Trade Organization. A strong growing economy and the rise of the Chinese consumer in the world's most populous country had become an enticing opportunity for foreign companies.

Several foreign companies had impressive successes early on. Hypermarkets, first introduced in 1995, were well suited to take advantage of upwardly mobile Chinese consumers. More and more of these stores were opening in cities across the country. Between 1999 and 2004, their sales increased by 147 percent. This growth was expected to continue as China became more urbanised. For instance, in 1996 only 32 percent of China's population lived in cities, but by 2005 this number had reached 50 percent of the country's 1.2 billion people. By 2020, urbanisation was projected to reach 60 percent. Prospects for hypermarkets, and by extension, the packaged food category looked bright.

The issues at hand

THE MERGER

In 2005, bakery goods were the number one packaged food in China. As a bakery good, biscuits had done well—having grown by 8.4 percent annually between 1999 and 2004, with sandwiched biscuits like Oreo growing at 7.5 percent. But as the market matured, this growth had slowed down.

Oreo had a successful initial launch in China and within three years, by 1999, had established a strong foothold. After Kraft acquired Nabisco, the merged company with its expanded product line had become the largest biscuit company in China, with a 10 percent market share in the category. Warren commented, "There was a fair amount of integration that happened pretty quickly, which created a fairly unwieldy brand portfolio." It soon became apparent that the expanded portfolio was a collection of distinct brands, with non-complementary sales efforts.

Warren worried that this larger portfolio was not being branded and distributed effectively. The company lacked the focus and sufficient spend on any one brand, and by attempting to concentrate on all brands they ended up concentrating on none.

After the merger, sales of Oreo had been flat–growing at just over four percent annually. Warren recalled, "When it was launched, we used the U.S. product, the U.S. formulation, and the U.S. advertising strategy, which was very much the global practice. But growth between 2000-2004 was stagnant. Four percent is not good enough in China; anything below 10 percent is not growing at all."

This was extremely frustrating for the local office, which felt they had little say in major decisions about Oreo. In particular, decisions about pricing and product innovation were completely centralised.

A UNIVERSAL PACKAGE

From 1996 to 2005, Oreo's primary sales channel in China continued to be the medium-size grocery stores and foreign-chained hypermarkets such as Tesco and Carrefour. The biscuits came in the standard packaging that was used in other geographies—which was based on the U.S. packaging that contained three partitioned rows of 12 Oreos. Chun discussed the package size with Warren, "The current production is manufacturer-driven as they prefer producing packaged rows of all the same length, since it gave better efficiency and output. But if we need to satisfy the customer, we might need to change."

Kraft would also run bonus pack promotions with extra Oreos in the standard package size. This had been a highly successful strategy in the U.S., where having additional Oreos in the package strengthened the consumers' perceived value.

COMPETING COOKIES

Across China, competition in the biscuit market was strong. Despite Kraft's overall number one position, the company was trailing behind the competition in regions outside the north. Oreo's sales began to erode as competing biscuit sales grew. Chun remarked, "When Oreo was first introduced in China, the types of biscuits in the Chinese market were limited. The majority of the market was in sweet or savoury plain crackers. At its launch, Oreo was considered a good innovation as it was in a sandwich cookie format. But as we got into the later years, we started to see all different forms of biscuits appearing on the market. Some of these products did quite well, like sandwich biscuits introduced by Taiwanese companies."

Taiwan-based Master Kong led the sandwich biscuit category with two brands that together held a national share of 32 percent of the market, well ahead of Oreo's 19 percent. Master Kong brands were less sweet than Oreo, and more to the taste of the average Chinese consumer's palate. It was also offered in smaller packaging than Oreo, and contained just three biscuits. However, since most packaging in China contained only two biscuits, Master Kong packages were perceived by consumers to be of good value.

SELLING AT A PREMIUM

Oreo was priced at a premium and noticeably more expensive than competing brands on a per biscuit basis. On a per package basis, the absolute price of buying Oreo was dramatically higher because of the large package size. Distributors believed that the higher price and larger package size was a key factor behind the poor sales. There were other concerns too.

DISTRIBUTION

Premium biscuits, like Oreo, generally contributed a smaller share of the final sale to the distribution partner. Kraft estimated that 60 percent of Oreo's final sale price went to the distributor, whereas value biscuits, such as Master Kong brands, gave 70 percent of the final sale price to the distributor.

In stores, Oreo was given shelf space in proportion to how well it sold. Unlike the U.S., where companies could pay for more favourable shelf space, most grocery stores and hypermarkets in China would arrange their shelves based on their own sales data. Although they would sell end-cap space or prominent one-time displays, the most desirable shelf space in the aisles was reserved for best sellers – which did not include Oreo.

In 2004, 50 percent of all biscuit sales came from super/hypermarkets. Although corner stores were the fastest growing sales channel for biscuits, nonetheless, internationally-chained hypermarkets were very important to Kraft's distribution strategy as they maintained an expansive network of locations. Whereas 65 percent of locally owned grocers had only one location, 60 percent of foreign chains had locations in at least five cities, with 30 percent present in more than 16 cities.

INVENTORY WOES

Kraft was not sitting idly as their biscuit sales tanked. In 2003, the company increased marketing and communications spend by 40 percent in China–but the consumers did not respond. By 2004, shipments for their entire biscuit line were down 12 percent. Moreover, higher than expected inventories were driving up storage costs, and much of the stock had to be thrown out.

In late 2005, while Warren was wondering how to salvage the Oreo in China, he went back to a market research study that had been completed earlier that year in July. The study tested a new Oreo product, LightSweet Oreo against the regular Oreo, and it revealed what the local team members already knew -- that Chinese consumers preferred a less-sweet biscuit.

32%
Master Kong's share

19%
Oreo's share

SANDWICH BISCUIT CATEGORY

CUSTOMER WANTS

The study, however, could only estimate a preference for LightSweet at a 90 percent confidence interval. Policy at Kraft required a 95 percent confidence to launch a new product line, and several new product launches had recently already been cancelled. Convincing headquarters to go ahead with LightSweet Oreo would be difficult. Warren elaborated on the company's reluctance, "If you look back at it from 1912 to 1975, we did not have a single variant of the Oreo, just the black and white cookie. Even in 1975, when the Double Stuffed came out, the only change was the extra amount of crème. The next actual flavour took almost 100 years and came out in 2001, which was chocolate. The original Oreo is what got us here."

Regardless, something had to be done quickly if the Oreo was to stay in China. A debate ensued–should the company focus on the core brands that had been underperforming, or spend a lot of time and money on launching new flavours and varieties? Warren recalled Chun's comment, "We need a mind-set shift and to place a foundation for future success. We have to decide what we want to achieve as the Oreo brand in China and how we can reset our strategies to get there."

Recognising the problem

The Oreo was too sweet for most Chinese consumers and the packaging too large to appeal to purchase occasions. The promotional strategy was no-good either. The Oreo was still a new product for many people in China, and they were not interested in buying a month's worth of Oreos, having never tried them. Yet, the large size of the Oreo package presented exactly this dilemma.

The problem, as Warren put it, "was that we were looking for American consumers in China". The Oreo in China simply focused too much on the global market, and not enough on the local market. It essentially had its name translated into the local language and dropped into China. Market research may have helped address these problems early on, but by no means would it have guaranteed the biscuit's success.

By 2005, it was apparent that there were so many challenges that needed to be addressed, that for a turnaround to work, a number of interrelated problems had to be solved at the same time. Addressing only a few of these would not yield the dramatic results that the company needed.

Many of the issues that Kraft experienced in China originated from central policy and decision-making that took place in the U.S. Senior managers, who had never even visited the countries where Kraft was operating, were the ones developing strategy for those places. This was, in fact, a Kraft-wide problem. Moreover, the team in China too was not very local, and comprised many expatriates and Westerners.

There was also a strong culture in place that felt the formulation of Oreo was untouchable.

Oreo in China needed a vision shift, but these factors made for a hard sell. Nonetheless, it was becoming evident that a change in Oreo in China's marketing and communication strategy, along with an adaptation of product innovations to the local market, was the need of the hour.

A transformative solution... nothing is sacred

In 2006, the CEO and Chairman of Kraft were replaced and a new management team was brought in. This, along with the poor sales in China, helped Warren convince central leadership to give him enough leeway to make changes. He said, "Giving empowerment to local managers made a big difference... If you looked at the board of management for Kraft China in 2006, there were a lot of expatriates and western folk around. If you look at the organisation today, almost 99 percent of our staff is Chinese, which makes sense. The brand was at risk of elimination, and in the face of that, we were humble enough to listen to the consumer, put resources around it, and change."

Kraft China refocused on six core brands in their biscuit line, including Oreo. The vision for Oreo was adjusted from the number one sandwich biscuit to the number one sweet snack in China. This paved the way for improved product innovation that catered to local tastes, which included an expansion of the Oreo brand into the wafer category and the launch of LightSweet Oreo.

Distribution was also expanded beyond Kraft's limited network in northern China. This would enable Oreo sales to grow alongside the booming hypermarkets. As Warren said, "[The Oreo] was too expensive... we didn't have the right distribution capacity and the manufacturing and cost structure were not very attractive."

Packaging decisions were shifted from the manufacturer's prerogative to local offices that understood customer wants and perceived value. In addition, customer trials were boosted by a subtle campaign around in-store samples.

Looking back

Oreo in China became a huge success. After the changes, the brand took off. Warren looked back, "When I first came to China in 2005, Oreo sales were US$20 million in China, and today (March 2012), seven years later, it's almost US$400 million–growing nearly 20 times in that time."

He added, "We changed the business from the ground up, to move away from headquarters. The price point, for example, was being decided from Chicago. The company also made a significant change, and now key decisions are being made from managers who are closest to the company."

These experiences changed the way Kraft operated as a company into a truly Glo-Cal (global-local) enterprise.

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