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Feihe: Achieving Competitive Advantage Through Strategic Transformation

Haixin Huang, Yuqin He, Haifen Lin, and Youbin Leng wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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China Feihe Limited (Feihe) was founded in 1962 in Heilongjiang Province, China. Feihe was one of the earliest infant milk formula companies established in China. In 2001, Feihe began to take the lead in building the industrial cluster in China, fundamentally ensuring food safety. Thanks to this, all of Feihe’s products were qualified when the China milk scandal broke in 2008.[[1]](#endnote-1) Feihe was one of the few companies that passed the inspection of relevant departments.

However, after the milk scandal⎯wherein several thousand infants were sickened after being fed milk powder that had been adulterated with a toxic substance (with several dairy firms implicated)⎯consumers no longer trusted the products of Chinese infant milk formula brands, as these were regarded as unsafe.[[2]](#endnote-2) After 2008, the qualified rate of Chinese brands in the test of banned additives, such as melamine, was 100 per cent every year.[[3]](#endnote-3) Even under such circumstances, the product quality of Chinese brands was still not validated by consumers. Foreign brands quickly occupied the high-end market of the infant milk formula industry in China, and Chinese brands were in trouble.[[4]](#endnote-4) The Chinese brands took various measures to regain their position, such as reducing product prices and carrying out product innovation, but these measures failed to change consumers’ negative perception of the brands.[[5]](#endnote-5)

In 2015, Feihe changed its positioning from “A Can of Good Milk Powder” to “More Suitable for Chinese Babies,” changing consumers’ negative perception of Chinese brands. In this way, Feihe successfully built its competitive advantage in the market, leading Chinese brands out of the dilemma. Feihe’s revenue growth rate was 58.1 per cent in 2017 and 76.5 per cent in 2018. In 2019, Feihe was successfully listed on the Hong Kong Stock Exchange (HKEX). However, as other brands started to imitate Feihe in an effort to develop products suitable for Chinese babies, GMT Research, an accounting research firm focused on Asia, mistakenly assumed that Feihe would lose its uniqueness and that it would be difficult for Feihe to stand out among other Chinese brands. GMT Research released a report on short selling, which caused panic among investors,[[6]](#endnote-6) who were trying to determine whether Feihe could maintain its competitive advantage. What actions should Feihe take to deal with the threat of imitation?

The development of the INFANT MILK FORMULA INDUSTRY IN CHINA

China’s infant milk formula standards were first set in 1989. Following this, the national food safety standards issued were implemented in 2010. The development of infant milk formula in the Chinese market over the past 30 years could be divided into several stages.

Expansion Period (1989–2008)

The exclusive breastfeeding rate in China dropped from 67 per cent in 1998 to 50.8 per cent in 2003. By 2008, the exclusive breastfeeding rate in China was only 27.8 per cent.[[7]](#endnote-7) As the exclusive breastfeeding rate continued to decline, the infant milk formula industry in China developed rapidly before 2008. The demand for infant milk formula constantly increased and was even in short supply. In 2008, Chinese brands, such as Sanlu and Yili, were the leaders of the infant milk formula market in China. During this period, Feihe also developed rapidly, successfully listing on the New York Stock Exchange (NYSE).[[8]](#endnote-8) In 2008, the market share ratio of Chinese brands to foreign brands was nearly seven to three (65 per cent to 35 per cent).[[9]](#endnote-9) In other words, Chinese brands dominated the Chinese market.

Turning Point (2008)

Sanlu had once been a well-known milk manufacturing company in China, with a brand value as high as ¥14.907 billion.[[10]](#endnote-10) According to reports, Sanlu had sold 813.737 metric tons of infant milk formula containing melamine. Products containing melamine caused serious damage to the health and safety of consumers, especially infants. As a result, the Chinese government had had to invest huge amounts of money in the medical treatment of sick infants.[[11]](#endnote-11)

Sanlu, which once led the Chinese market with an 18.26 per cent market share, went bankrupt. Melamine was also detected in 69 batches of products from 22 well-known manufacturers.[[12]](#endnote-12) However, thanks to the construction of a modern pasture and the industrial cluster, Feihe’s products did not contain melamine, passing the strict testing of all relevant departments. Specifically, the modern pasture, which was an internationally recognized area suitable for forage growth (see Exhibit 1), located at 47 degrees north latitude, ensured the safety of milk sources. The industrial cluster could monitor transportation, production, and other procedures, avoiding the risk of contamination.

In 2008, China Mengniu Dairy Company Limited and Bright Dairy & Food Co. Ltd. lost ¥949 million and ¥286 million, respectively. The Chinese-listed dairy company that lost the most money from the milk scandal was Yili, with a loss of ¥1.687 billion.[[13]](#endnote-13) Foreign brands had entered the Chinese market as early as 1995,[[14]](#endnote-14) but their high-priced products were not recognized by Chinese consumers at that time. The milk scandal gave foreign brands the opportunity to gain market share in China, with Chinese consumers preferring to pay high prices for the products of foreign brands following the scandal.[[15]](#endnote-15) Foreign brands thus quickly occupied China’s high-end market.

Recovery Period (2008–2015)

After the milk scandal, consumers no longer trusted the products of Chinese brands, which were considered unsafe. In order to promote the revitalization of Chinese brands, both the government and enterprises actively took relevant measures. According to data from the *China Dairy Quality Report*, the qualified rate in the sampling inspection of fresh milk was 99.34 per cent in 2015. After 2008, the qualified rate in the test of banned additives, such as melamine, was 100 per cent every year. In 2015, the qualified rate in the sampling inspection of dairy products was 99.5 per cent, and the qualified rate in the sampling inspection of infant milk formula was 96.37 per cent.[[16]](#endnote-16) However, the product quality of Chinese brands was still not validated by Chinese consumers, who preferred to pay high prices for foreign brands. The orders for overseas infant milk formula on Taobao, an online shopping platform, rose 118 per cent year on year following the milk scandal. In 2015, Taobao released a report on overseas shopping from 2005 to 2015. The data showed that the overseas products most frequently purchased by Chinese consumers were milk powder, and maternal and infant supplies. In addition, sales of infant milk formula were the highest. Across all categories, infant milk formula accounted for 9.1 per cent of sales but was purchased by only 1.5 per cent of the total number of consumers.[[17]](#endnote-17)

As one of the few companies not involved in the milk scandal, Feihe was recognized and supported by consumers. Feihe’s product sales maintained steady growth in the medium- and low-end markets. However, in the high-end market with high product prices, the positioning of both Feihe and foreign brands was focused on food safety. In other words, Feihe did not have a differentiated advantage compared to foreign brands. As a result, Feihe’s sales in the high-end market did not perform well in the years just after the scandal.

The process of rebuilding consumer confidence was slow and difficult. The infant milk formula industry in China was obliged to start a price war to attract price-sensitive customers who preferred cost-effective products. Beingmate, a Chinese brand that had once been a leader in the industry, reduced prices to gain market share. In response to the fierce market competition (see Exhibits 2 and 3), the Yashily brand provided a more favourable discount. According to reports, in the first half of 2015, the product prices of the infant milk formula market in China showed a general downward trend. The discounts of Chinese brands were relatively large, with the highest drop being more than 50 per cent.[[18]](#endnote-18) However, these measures failed to change consumers’ negative perception of Chinese brands, and the products of these brands were still not recognized by consumers. In other words, Chinese brands were failing to rebound. In 2015, the market share ratio of Chinese brands to foreign brands was nearly four to six (39 per cent to 61 per cent).[[19]](#endnote-19) Foreign brands dominated the high-end market, and Chinese brands had to compete in the medium- and low-end market.

Growth Period (2015–Present)

With the implementation of relevant regulatory policies, consumers gradually began to trust the products of Chinese brands again.[[20]](#endnote-20) Worthy to note was that one of the new regulations required milk powder to be regulated in accordance with drug regulatory standards.[[21]](#endnote-21) At the same time, with the rapid development of China’s economy, a new generation of young Chinese people with confidence in the nation were actively discovering the charm of Chinese brands, and more and more consumers were supporting Chinese brands. For example, it became a trend for young people to wear traditional Chinese clothing (Han-style clothes).[[22]](#endnote-22) Another example was that the prices of Chinese fashion brand Li-Ning, which had been featured in New York Fashion Week, were even higher than those of foreign brands such as Adidas and Nike.[[23]](#endnote-23) In addition, due to the rapid development of China’s economy, the national education level was greatly improved, helping consumers to understand the product’s value scientifically, rather than judging the quality of products by brand images. The new generation of young parents would think highly of the product’s value that Chinese brands could provide, rather than just consider the image of a brand.[[24]](#endnote-24)

Through strategic transformation, by 2015, Feihe had successfully achieved a competitive advantage. In this way, Feihe both helped the infant milk formula industry in China to regain recognition by Chinese consumers and led the revitalization of Chinese brands. The market share of Chinese brands gradually increased, rising from 39 per cent in 2015 to 49.95 per cent in 2019.[[25]](#endnote-25)

FEIHE’S strategic transformation process

Although Feihe maintained steady growth in product sales in the medium- and low-end market, its sales in the high-end market did not perform well because of Feihe’s lack of differentiation. In 2015, Feihe carried out a strategic transformation focusing on creating customer value, helping it to establish its brand in the high-end market and earn consumers’ validation.

Understanding Consumer Demands

Feihe identified the potential demands of consumers. According to traditional Chinese medicine, one’s diet should involve “applying proper therapeutic measure in line with [the] season, local conditions and individuality.”[[26]](#endnote-26) In other words, local people were better suited to eating local food. An emphasis on eating local food was not unique to Chinese culture; Korean medicine believed that the body and the land could not be separated, and that agricultural products produced in Korea were the most suitable for Koreans.[[27]](#endnote-27) Other cultures, Ayurvedic medicine, and research on the modern Western diet all contained views that, in order to stay healthy, it was necessary for people to live in harmony with nature and to balance the body system according to the season and local climate.[[28]](#endnote-28) The widely known macrobiotic diet also required eating local food as much as possible.[[29]](#endnote-29) It was an existing perception in the minds of Chinese consumers that local people were better suited to eating local food.[[30]](#endnote-30) In light of this, consumers were willing to buy products specially developed for Chinese babies⎯but there were no such products in the market. Thus, it became a potential demand. In 2011, Feihe co-operated with an authoritative organization to complete China’s first clinical trial of infant milk formula. The results showed that there was no significant difference in physical development between the infants who had consumed Feihe milk powder and those who had drunk the mother’s breast milk.

Feihe understood the changes in consumer demands. Chinese household income was increasing, and the purchasing power of Chinese consumers was also gradually rising.[[31]](#endnote-31) Improvement in product consumption level was usually accompanied by changes in consumption demands and in consumer perceptions. Products that had, in the past, met the basic needs of safety and health could no longer meet the needs of today’s consumers. The demand for high-end markets with low price sensitivity and high value sensitivity had increased.

Improvement of Technical and Industrial Advantages

For its strategic transformation, Feihe first assembled a high-quality research and development (R&D) team. Feihe collected data on Chinese mothers’ breast milk, in a professional and friendly way, in order to create the most professional breast milk database in China. Through its R&D platforms, the company dedicated itself to researching and understanding Chinese mothers’ breast milk composition in order to closely simulate this milk. Feihe’s formula was different from that of foreign brands. Feihe took the lead in adding OPO (a nutritional ingredient) to the formula, which aided babies’ digestion and absorption of the formula.[[32]](#endnote-32) In 2010, with Chinese mothers’ breast milk as the standard, Feihe launched the super-premium AstroBaby product series. In 2014, Feihe set up the Feihe Nutrition Laboratory with Harvard Medical School’s Beth Israel Deaconess Medical Center to engage in nutrition research.

Second, Feihe spent more than 10 years building the first industrial cluster of China’s infant milk formula industry. All of the procedures in the formula creation process, from forage grass planting to after-sales service, were controllable (see Exhibit 4). Fresh milk could be delivered to Feihe within about two hours for processing, which preserved the freshness of the milk and minimized pollution risks. The products of foreign brands, on the other hand, took three to six months to enter China, and they had to go through the equatorial zone with a temperature of more than 50 degrees Celsius; at such high temperatures, it was difficult to ensure product quality. In addition, these products were affected not only by temperature but also by humidity and other environmental factors during long-distance transportation, so it was difficult to maintain the products’ original taste and smell. After mixing with water, the oil and other substances in the milk powder would change with time, and the smell would also change. In order to mask the change in smell, some brands added flavouring substances, such as vanillin, to their products. In contrast, in its goal to closely simulate Chinese mothers’ breast milk, Feihe never added any flavouring substance to its products.

Third, Feihe had the modern pasture and advanced technology. Feihe had built the modern pasture at 47 degrees north latitude, the internationally recognized area suitable for forage growth.[[33]](#endnote-33) The soil of the modern pasture was rich in nitrogen, phosphorus, and potassium, making it very suitable for the growth of forage grass and silage. In addition, Feihe used the wet processing method combined with the spray drying method to produce milk powder, which ensured the freshness of the milk powder to the greatest extent (see Exhibit 5).

Finally, Feihe’s employees had confidence in the company. Feihe’s Beijing headquarters featured a wall composed of photos of nearly 100 babies’ smiling faces. These babies were children of Feihe employees, including the two daughters of Feihe’s chairman and chief executive officer, Youbin Leng. All of the babies of Feihe employees used Feihe’s milk powder and were the company’s “brand spokespersons.”

Repositioning

Before 2015, the Feihe brand had been positioned as “A Can of Good Milk Powder.” In 2015, Feihe strategically repositioned itself as “More Suitable for Chinese Babies,” conveying its unique product value to consumers. In this way, “More Suitable for Chinese Babies” became the new value of infant milk formula products, and the “safety” represented by foreign brands became the basic value of these products.

After repositioning, Feihe made corresponding changes in all aspects of its process. In terms of products, in order to build a high-end brand image, Feihe no longer sold low-end products. In terms of delivery, relying on Internet e-commerce platforms, it took only nine to 28 days from milking cows to delivering products to consumers, ensuring the freshness of the milk powder. In contrast to this, the transportation of foreign products took a long time—usually three to six months. In terms of marketing, Feihe launched face-to-face “Mother’s Love” seminars to enhance brand awareness through educating consumers. In terms of advertising, Feihe chose the Internet media that was popular with young consumers.

After repositioning, Feihe’s sales increased significantly (see Exhibits 6 and 7). The compound annual growth rate of the revenue for the super-premium AstroBaby was 168 per cent from December 31, 2016, to December 31, 2018. Feihe’s revenue growth rate rose from 58.1 per cent in 2017 to 76.5 per cent in 2018.[[34]](#endnote-34) On November 13, 2019, Feihe was successfully listed on the HKEX.

future challenges for feihe

After Feihe repositioned itself as “More Suitable for Chinese Babies,” other brands started to imitate Feihe, developing products specifically for Chinese babies. Yili, for instance, advertised that it had “focused on Chinese mothers’ breast milk research for 13 years and was committed to developing milk powder that was more suitable for Chinese babies.” Beingmate brand products were advertised as being “specifically for Chinese babies.” The slogan introducing Happy Prince’s products was “Happy Prince developed a better milk powder for Chinese babies.”[[35]](#endnote-35) Even the German brand Bebivita mentioned Chinese babies in its slogan: “Bebivita made a change to be more suitable for Chinese babies.”[[36]](#endnote-36)

After Feihe’s listing on the HKEX, a report from GMT Research caused investors to question whether Feihe could maintain its competitive advantage. GMT Research focused on analyzing the financial data of listed companies in Asia, especially corporate debt and cash flow issues. Limited by data thinking, GMT Research had failed to find a convincing reason to explain the success of Feihe’s rapid transformation. In fact, the phenomenon of other brands changing their positioning in an effort to imitate Feihe precisely showed that Feihe’s strategic transformation had been successful and was worth learning from. However, based on that phenomenon, GMT Research suggested it would be difficult for Feihe to distinguish itself from other Chinese brands. Although its report had raised doubts about Feihe’s rapid revenue growth and profitability, GMT Research also admitted that its report did not indicate that Feihe had spurious revenues.[[37]](#endnote-37) In response to GMT Research’s doubts, Feihe published tax certificates, bank deposit certificates issued by multiple banks, and market share data provided by Nielsen Corporation, all showing that Feihe was in good business condition.

Although Feihe claimed that the doubts expressed by GMT Research were unfounded,[[38]](#endnote-38) Feihe also accelerated the progress of determining the direction for its future development. After all, Feihe was indeed highly dependent on its high-end infant milk formula products—namely, AstroBaby; in 2019, sales of high-end infant milk formula products accounted for 68.6 per cent of Feihe’s total revenue.[[39]](#endnote-39) With the increasing competition in the market, relying on a single product line to make profits could affect Feihe’s future performance. To avoid losing its competitive advantage again, Youbin, chairman of Feihe, was considering two options.

Option 1: Product Diversification Strategy

Feihe could focus on consumer demands and reposition itself again, transforming from an infant milk formula manufacturer to a health food manufacturer dedicated to health management. In 2018, Feihe acquired the health care business of Vitamin World USA Corporation, which was engaged in the retail business of vitamins, mineral substances, vegetable medicines, and other dietary supplements. This acquisition could help Feihe implement a product diversification strategy. With a rising aging population throughout the world, middle-aged and elderly people were a group with huge consumption potential that had not yet been tapped into by brands. Like newborns, they also needed to take in more nutrients for everyday health maintenance. Traditional products for middle-aged and elderly people were mainly characterized by high calcium content, and other special needs of this group, such as the need for products that were low in sugar and kept blood-sugar levels steady, had not yet been met. Feihe could continue to focus on technological innovation and provide special milk powder and dietary supplements for groups that suffered from diseases. In addition, the market demand for adults aged 20−40 had also not yet been met. It was not difficult for adults to find other foods, such as fish, shrimp, and nuts, to replace milk powder and dietary supplements. Therefore, Feihe could attract this customer group by improving the taste of milk powder and dietary supplements.

Option 2: International Strategy

As early as 2003, Feihe took the first step toward internationalization. Feihe was officially listed on the Nasdaq in the United States, becoming the first Chinese infant milk formula company to be listed overseas. In 2005, Feihe was listed on the NYSE, which provided the foundation for resource globalization. In 2007, Feihe was exporting its ground raw material to dozens of countries and regions, including Asia, Africa, the Middle East, and Europe. Its export earnings exceeded ¥300 million, which helped Feihe accumulate experience in international business. In 2014, the Feihe Nutrition Laboratory, jointly established by Feihe and Harvard Medical School, was carrying out research not only in the field of infants and young children but also in the field of human nutrition and health. Based on this, Feihe realized R&D globalization to a certain extent, which was sufficient to support the expansion of overseas markets through R&D innovations. Feihe could focus on the characteristics and needs of babies in different countries and provide babies in various countries with different infant milk formulas suitable for them, establishing a differentiation advantage for entering the international market.

But were the above-mentioned options feasible? And would competitors’ imitation cause Feihe to lose its competitive advantage? Youbin had to resolve these two issues as soon as possible.

EXHIBIT 1: The Modern Pasture

Volcanic Lava

(Original Ecological Environment)



The Internationally Recognized Area Suitable for Forage Growth

Soda Water

Holstein Cows

Black Soil

Forage Grass

Basaltic Layer



The Pasture

The Farm

Source: Company documents.

EXHIBIT 2: Infant Milk Formula MARKET in China

Note: ¥ = CNY = Chinese yuan; US$1 = ¥6.8166 on September 25, 2020.

Source: “Analysis on the Market Situation of the Infant Milk Formula Industry in China in 2020” [in Chinese], Forward - The Economist, October 21, 2020, accessed December 23, 2020, https://www.qianzhan.com/analyst/detail/220/201021-5c027584.html.

EXHIBIT 3: Market Concentration Rate of Infant Milk Formula Industry in China

Note: CR = concentration ratio.

Source: Zhiyan Consulting Company, “Analysis on the Development History, Market Size, Competitive Pattern, and Sales Channels of China’s Dairy Industry in 2019” [in Chinese], China Industry Information Network, April 3, 2020, accessed April 20, 2020, <https://www.chyxx.com/industry/202004/848768.html>.

EXHIBIT 4: The industrial cluster

Source: Created by the case authors based on company documents.

EXHIBIT 5: High-Quality Raw Materials and Product Freshness

|  |  |  |  |
| --- | --- | --- | --- |
| **Main Contents of Fresh Milk** | **Feihe** | **Chinese Standard** | **European Standard** |
| Protein | ≥3.4% | ≥2.8% | ≥3.2% |
| Fat | ≥4.2% | ≥3.1% | ≥3.7% |
| Aerobic Plate Count (per ml) | ≤10,000 | ≤2,000,000 | ≤100,000 |
| Somatic Cell Count (per ml) | ≤200,000 | … | ≤400,000 |

Note: ml = millilitre.

Source: China Feihe Limited, *The Share Prospectus*, 169, November 27, 2019, accessed April 10, 2020, <http://img1.feiheimg.com/pdf/CWF06186.pdf>.

EXHIBIT 6: CHINA Feihe LIMITED⎯Revenue and gross margin after Repositioning

Note: ¥ = CNY = Chinese yuan; US$1 = ¥6.8166 on September 25, 2020.

Source: China Feihe Limited, *Annual Report 2019* [in Chinese], 3, April 15, 2020, accessed December 23, 2020, https://img1.feiheimg.com/pdf/20200415/report2019.pdf.

EXHIBIT 7: Major Brands in the Infant Milk Formula Market in China

|  |  |  |  |
| --- | --- | --- | --- |
| **Brand Name** | **Headquarters** | **Market Share in 2015** | **Market Share in 2019** |
| Beingmate | China | 9% | ＜5% |
| Yili | China | 6% | 5% |
| Yashily | China | 4% | ＜5% |
| Feihe | China | 4% | 13% |
| Mead Johnson | United States | 15% | 6% |
| Abbott | United States | 7% | 7% |
| Wyeth | Switzerland | 13% | ＜5% |

Source: Zhiyan Consulting Company, “Analysis on the Development History, Market Size, Competitive Pattern, and Sales Channels of China’s Dairy Industry in 2019” [in Chinese], China Industry Information Network, April 3, 2020, accessed April 20, 2020, https://www.chyxx.com/industry/202004/848768.html; China Industry Information Network, “Analysis on the Market Situation and Development Trend of the Infant Milk Formula Industry in China in 2015” [in Chinese], China Industry Information Network, October 19, 2015, accessed April 20, 2020, https://www.chyxx.com/industry/201510/350458.html.

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