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Feihe Dairy: Investing in Canada

William Wei, Vicky Nie, Rongrong Zhang, and Xuewei Liu 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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It was a cold day in December of 2016. Sitting in the lounge of Toronto’s Pearson International Airport, Youbin Leng, the chairperson, chief executive officer, and president of Feihe International Inc. (Feihe), was reading a joint statement from the governments of Canada and the People’s Republic of China, which communicated an open attitude toward direct investment.

Leng was excited about the Canadian government’s desire to attract foreign investment. He and the executive team of Feihe were considering entering the Canadian market very soon. Leng was confident that internationalization would make Feihe one of the most widely known infant formula brands; however, as he considered the cultural and institutional differences between China and Canada, and the uncertainty involved in the Canadian–Chinese business relationship, he wondered what would be the best way to enter the Canadian market. Should Feihe use a greenfield investment, an acquisition, or a joint venture?

Feihe International

In Chinese, *feihe* meant “a flying crane,” a symbol of auspice, loyalty, and longevity. Feihe was founded in 1962 in Qiqihar, a city in Heilongjiang Province in northeastern China, which was famous for its habitat for red-crowned cranes. This company started as a state-owned enterprise (SOE) that manufactured milk powder. In the 1990s, Youbin Leng joined the company and found that the company was growing slowly under the planned economy. In August 1996, it was incorporated as Feihe Dairy during a period of China’s nationwide SOE asset restructuring. Leng acquired a majority of equity in the company in 1998 and transformed Feihe into a privately owned company in 2001.

Fifteen years later, Feihe was headquartered in Beijing, China. It became the largest domestic Chinese infant formula company and the third-largest dairy company operating in China (including both domestic and foreign brands). In 2016, Feihe had 16.9 per cent of retail sales in the domestic infant formula market and 7.7 per cent of retail sales in the overall infant formula market (including both domestic and foreign brands). The company earned revenue of ¥3,724.4 million[[1]](#endnote-1) with a profit of ¥406.2 million (see Exhibit 1). It mainly manufactured infant formula but also produced adult milk powders, liquid milk, and soybean powders. It provided milk powder formulated from fresh milk for infants and children under six years old. In addition to producing cow milk infant formula, Feihe was exploring the market for goat milk infant formula. Feihe’s principal products were high-end and regular infant formulas. Its high-end products included the award-winning Astrobaby premium infant formula. In 2017, Astrobaby won, for the third consecutive year, the International High Quality Trophy from Monde Selection in Belgium, which served as an endorsement of Feihe’s product safety and premium quality.[[2]](#endnote-2) More importantly, Feihe’s high-end products were very profitable. For 2014, 2015, and 2016, Feihe’s overall gross profit margin was 47.8 per cent, 55.3 per cent, and 54.6 per cent, respectively; and the gross profit margin for the high-end products was 60.2 per cent, 68.5 per cent, and 68.9 per cent, respectively.

The success of Feihe in China depended on its clear positioning in the market. Feihe had hired Junzhi Consulting to clarify its strategies as “producing the milk powder that is more suitable for Chinese babies.”[[3]](#endnote-3) More specifically, it aimed to be “standing at the top of the industry to avoid the price war, winning the consumers’ faith with the rise of brand strength, and building competitiveness by focusing on resource acquisitions and corporate strengths development.”[[4]](#endnote-4)

Aligned with the strategic positioning, Feihe successfully managed its supply chain. The infant formula industry had a long value chain, and the price and quality of the raw materials were two primary factors that affected the operation of dairy enterprises. Feihe’s supply chain gave it control over the entire production process, including choosing the raw materials, implementing its unique processing technology, enforcing its strict inspection system, and accessing diversified suppliers.

As for the choosing of raw materials, Feihe differentiated itself from most domestic brands by using fresh milk as the main ingredient in all its infant formula products. Depending on individual brands’ strategies, both milk powder and fresh milk could be used as raw materials for producing infant formulas; however, many Chinese customers believed that using fresh milk maintained the most nutrients in infant formula.

Complementary to the use of fresh milk, Feihe exclusively used the wet blending–spray drying process to manufacture its infant formula products. Compared with a dry blending process, the resulting products were more water-soluble, the nutrients were more uniformly distributed throughout each batch, and the powder particle size and colour were more consistent. In 2016, Feihe’s fresh milk procurement costs amounted to ¥569.9 million, 33.7 per cent of the sales revenue. To ensure freshness and timely delivery, Feihe had spent 10 years building a vertical supply chain that included the cultivation of cattle feed, large-scale dairy farming, production and processing, logistics warehousing, channel control, and after-sales service. The major farms in Feihe’s supply chain were along the 47th parallel north, which the dairy industry regarded as the “world gold milk source” because of its climate conditions and natural environment.[[5]](#endnote-5)

Feihe ensured the quality of its raw materials through an overall quality control system comprising 25 comprehensive procedures and more than 300 checkpoints, from the inspection of feed in the whole production process to the delivery of finished products. The company designed highly automated production lines and procured advanced equipment and machinery to decrease risks of both contamination and human error, while increasing production.

The company’s main suppliers were dairy farms close to Feihe’s production facilities, which was aligned with the Chinese government policies to support the local, smaller-scale milk suppliers. Its exclusive suppliers included internationally accredited farms in Gannan and Kedong, which housed approximately 45,900 Australian Holstein cows. The largest supplier was YST Dairy Farm Ltd. (YST) in Heilongjiang Province. In 2016, fresh milk purchased from YST accounted for 80.1 per cent of the company’s total procurement cost, at a cost of ¥456.4 million. Although Feihe had 25 other raw material suppliers, its business and operations were highly dependent on fresh milk from YST. Besides fresh milk, Feihe also procured a variety of other ingredients for its infant formula production, such as whey protein powder and non-fat milk powder, which were generally procured from domestic trading companies and international suppliers, including powder manufacturers in Australia and New Zealand. Feihe also had its own milk collection stations, production facilities, and an extensive distribution network throughout China. Thus, the majority of Feihe’s production facilities were within a 30-minute drive of the milk suppliers, which enabled the company to process milk quickly to ensure freshness and better quality.

Feihe’s diversification of suppliers ensured the stability of raw materials sourcing. However, due to increasing costs of land, water, and labour resources, the overall costs of feed and fodder were rising in China.[[6]](#endnote-6) Thus, upstream processors such as Feihe suffered from the high costs and price volatility of raw materials.

The Chinese Dairy Sector

In 2008, a milk scandal had seriously damaged the Chinese infant formula sector. During this food safety incident, dairy products, including infant formula and other food products from China, were adulterated with melamine, which killed six infants and sickened 300,000 others. Although Feihe was not one of the brands involved, this scandal damaged the whole domestic dairy industry by eroding consumers’ trust in Chinese domestic dairy brands.[[7]](#endnote-7)

After 2008, the Chinese dairy sector had stepped into a reforming stage, when more and more domestic and foreign brands were emerging. The domestic dairy companies continuously optimized their management systems, improved food quality, and participated in global competition. Although the safety issues of domestic dairy products were eliminated, consumers’ safety concerns and trust were still the biggest challenges to the recovery of the industry. Due to the loss of consumers’ trust in domestic dairy products, China became a net importer of dairy products, and the trade deficit in this sector increased each year. China’s percentage of imported dairy products increased from 5.2 per cent in 2008, to 13.3 per cent in 2010 and 27.0 per cent in 2014. In 2016, China’s main dairy imports were milk powder products, mostly from New Zealand but also from Australia, the United States, France, Germany, and Canada (see Exhibit 2). From 2008 to 2017, China’s imports of dairy products and infant formula had increased 3.62 times and 3.80 times, respectively.[[8]](#endnote-8)

The Chinese dairy sector failed to quickly recover from the scandal not only because of safety concerns but also for three other reasons. First, the production costs of domestic milk powder were higher than the production costs for imported milk powder due to China’s limitations in terms of agricultural land, clean water, and cattle resources. At the same time, the price of the dutiable imported dairy products was significantly lower than the price of domestic dairy products.[[9]](#endnote-9) Second, Chinese consumers’ purchasing habits were being shaped by an e-commerce boom in China, resulting in more online sales and cross-border purchases, which enabled foreign infant formula to pour into the domestic market.[[10]](#endnote-10) Finally, to satisfy consumers and obtain high profits, some manufacturers chose to register their brands overseas but produce domestically, or to label their products “imported with original packaging,” or “100% foreign milk source,” which contributed to a disorderly and competitive marketing environment.[[11]](#endnote-11)

However, domestic producers also had opportunities. First, with the relaxing of the one-child policy, the demand for infant formula was increasing. According to AskCI Consulting Co., Ltd., the retail sales value of the infant formula market increased from ¥63.7 billion in 2012 to ¥84.4 billion in 2016, and its sales volume increased from 375,000 tonnes in 2012 to 465,800 tonnes in 2016.[[12]](#endnote-12) Observers estimated that the market growth would continue as a result of the government supports for the dairy sector, increasing industry concentration, and the implementation of the universal two-child policy.[[13]](#endnote-13)

Second, the demand for goat milk infant formula was increasing in China. One reason was that some Chinese infants suffered from lactose intolerance or other cow protein allergies so that the parents preferred to source goat milk powder for their babies. These parents were willing to pay a premium price for goat milk infant formula.[[14]](#endnote-14) Many domestic infant formula milk producers, including Feihe, were trying to develop their goat milk production lines after 2013, and some industry experts estimated that goat milk infant formula would be the next high-end star product in the Chinese infant formula industry.[[15]](#endnote-15)

Third, in 2016, China announced a new regulation that required all infant formula manufacturers to register the ingredients in their brands before selling in China.[[16]](#endnote-16) The regulation aimed to increase the market concentration of the infant formula market, and would likely drive some small brands out of the market, while the major domestic dairy companies would benefit from this new policy.

Fourth, supported by the Chinese government, the dairy sector had entered into a period of rapid revolution after 2008, with massive mergers and acquisitions and internationalization. The leading domestic dairy enterprises began to invest in farms and plants and to collaborate with strategic partners overseas. Through this internationalizing approach, domestic firms introduced high-quality foreign milk products into China to meet domestic consumer demand and improve their brands’ reputations and competitiveness. Internationalization strategies became an important part of the Chinese dairy sector’s market expansion.

The Internationalization of Chinese Infant Formula Companies

In 2016, China had a total of 103 infant formula companies, which produced approximately 725,700 tonnes of powdered infant formula.[[17]](#endnote-17) Major domestic infant formula brands grew to 45.5 per cent of the Chinese infant formula market in 2016 from 41 per cent in 2012, and were estimated to reach 48 per cent by 2021. The industry was dominated by 10 big players that together held a concentration ratio of almost 80 per cent. Among them, eight companies—Yili Inc.; Mengniu Dairy Co., Ltd.; Bright Dairy & Food Co., Ltd.; Want China Holding Limited; Shijiazhuang Junlebao Dairy Co., Ltd.; Nestlé China; Feihe Dairy; and Beijing Sanyuan Foods Co., Ltd.—accounted for 51 per cent of the infant formula market’s total production and 54 per cent of its sales (see Exhibit 3).

All of these major Chinese dairy companies had started to expand overseas. Yili Industrial Group Co. Ltd. (Yili), from Inner Mongolia, which was one of the forerunners among the Chinese dairy enterprises, began internationalization in 2007 and accelerated the process after 2013 by seeking high-quality, low-cost destinations. Within two years, Yili had successfully established a global supply chain covering Europe, Asia, America, and Oceania. Yili’s production plant in Waimate, New Zealand, was the company’s flagship international innovation project. The plant was the world’s largest integrated dairy facility to date; it included research and development (R&D), production, deep processing, packaging, and manufacturing facilities, and represented an investment of US$600 million—a new record for economic co-operation between China and New Zealand.

China’s Mengniu Dairy Co., Ltd. (Mengniu), another leading dairy enterprise in China, moved relatively slow. In June 2013, it acquired Yashili International Holdings Ltd. for HK$12.4 billion,[[18]](#endnote-18) obtaining two infant formula brands, Yashili and Scient. Yashili, a wholly owned subsidiary, expanded overseas as part of Mengniu’s internationalization strategy. Construction of Yashili’s New Zealand plant—a NZ$220 million[[19]](#endnote-19) investment—began in July 2012. The plant was expected to have an annual output of approximately 47,174 tonnes of infant formula. In April 2017, Mengniu signed an agreement with several large farms in New Zealand to supply its Deluxe milk line; it aimed to develop a joint strategy that would include its supply chain and dairy processing.[[20]](#endnote-20) Mengniu also entered into strategic co-operative arrangements with several leading international dairy enterprises, including Arla Foods, based in Denmark, and Danone, based in France.

The Biostime International Holdings Ltd. (Biostime), another major infant formula producer in China, had a long history of collaborating with French strategic partners in seeking milk resources. In 2013, Biostime and Isigny Sainte-Mère, a leading French dairy brand, signed an agreement to expand their infant formula production capacity. On June 12, 2015, the company’s French infant formula plant became operational through a €65 million investment; Biostime’s investment accounted for €20 million.[[21]](#endnote-21) The 40,000-square-metre plant was designed to process approximately 45,359 tonnes of infant formula by 2018.[[22]](#endnote-22)

Another Chinese leading infant formula producer, Beingmate Baby & Child Food Co., Ltd. (Beingmate), invested ¥170 million to set up a subsidiary in Ireland in 2013 for R&D, production, and sales of infant formula and related products. In 2015, Fonterra Brands (Australia) Pty. Ltd., the dairy giant from New Zealand, acquired Beingmate, which enabled Beingmate to acquire 51 per cent equity in Darnum, another processor under that group’s umbrella. The company thus formed an unincorporated joint venture with Fonterra and established an infant formula production plant in Victoria, Australia.[[23]](#endnote-23)

Acquisition was a widely used strategy in the Chinese dairy sector. Bright, a leading brand in southeast China with a 100-year history, divided its international acquisition and strategic alliance strategy into three steps. First, it acquired 51 per cent of the New Zealand New Wright Dairy in August 2010, for NZ$82 million. Second, it started a strategic co-operation with the Australian Pactum Dairy Group in April 2014. Third, it acquired full control of Tnuva, the largest integrated food enterprise in Israel, in June 2015.[[24]](#endnote-24) Another high-end brand, Ausnutria Dairy Corporation Ltd. (Ausnutria), used a similar strategy by acquiring 51 per cent equity in the Dutch company Hyproca Dairy Group (Hyproca) with equity exchange and cash in 2011. This acquisition provided stable milk resources and production plants in Europe and thus developed Ausnutria’s experience in farm management, resource control, R&D, technology, and quality system design, which improved the company’s operation. In July 2013, Ausnutria acquired 100 per cent equity in Hyproca and aimed to develop its production capacity further in the high-end market.

But internationalization could be risky. For example, in 2012, another infant formula producer, Synutra International, Inc. (Synutra), signed an agreement with Sodiaal International SA, the largest French dairy company, and invested €90 million to build a new modern infant formula plant with an annual capacity of approximately 90,718 tonnes.[[25]](#endnote-25) However, in 2016, it was reported that Synutra was unable to pay its bills because of its undesirable sale of French products in China.[[26]](#endnote-26)

Canada’s Dairy Industry

Canada’s dairy sector was an important and growing part in the Canadian economy (see Exhibit 4). According to the Canadian Dairy Commission (CDC), the dairy industry was Canada’s third-largest agricultural sector (behind grains, oilseeds, and red meats) and contributed significantly to the Canadian economy. It employed approximately 221,000 people in 2015, contributed about CA$19.9 billion each year to Canada’s gross domestic product, and remitted CA$3.8 billion each year in federal, provincial, and regional taxes.[[27]](#endnote-27) In 2016, it generated CA$6.17 billion in net receipts, and employed approximately 22,900 workers in dairy processing alone.[[28]](#endnote-28)

Canada had developed a system to ensure the quality of dairy products, and its strict quality standards resulted in the great reputation of Canadian dairy products.[[29]](#endnote-29) A wide range of institutions, including the federal government departments, regulatory bodies, and advocacy groups, supported the implementation of these standards. For example, the Canadian Food Inspection Agency was responsible for ensuring the safety and quality of dairy products, both exported from and imported to Canada, through the establishment of dairy product standards and grades, dairy plant inspections, packaging and labelling requirements regulations, animal health programs, and product safety monitoring.[[30]](#endnote-30) Agriculture and Agri-Food Canada worked with farmers and producers to enact dairy policy, conduct research, assist market and rural development, and help with the livestock improvement.[[31]](#endnote-31) The Dairy Farmers of Canada also developed the Canadian Quality Milk Program, which provided guidance for dairy producers to improve food safety management in dairy farms.[[32]](#endnote-32)

Although the Canadian dairy industry occupied an important position in Canada, its output was relatively low compared with that of other major countries. In 2016, Canada’s milk production was approximately 8 million tonnes,[[33]](#endnote-33) which was significantly lower than production in New Zealand (approximately 21 million tonnes), the European Union (approximately 221 million tonnes), or the United States (approximately 96 million tonnes).[[34]](#endnote-34) Because of its relatively small population, Canada was able to meet its domestic requirements with its milk and dairy production, but the country was not very active in the international dairy trade (see Exhibit 5). From 2007 to 2016, Canada’s exports and imports of dairy products both increased, but imports were consistently higher than exports, leading to a deficit each year. In 2016, the country imported 233,560 tonnes of dairy products valued at CA$969.4 million, representing an 8 per cent growth rate; it exported 98,758 tonnes valued at CA$235.3 million, representing an 11 per cent growth rate.[[35]](#endnote-35)

The Supply Management System

One important reason for Canada’s smaller scale of dairy production and deficit was the unique Canadian Supply Management System, monitored by Dairy Farmers of Canada. This system aimed to stabilize producers’ revenues and consumer prices and to avoid costly product surpluses through “three pillars,” namely, setting production quotas, managing minimum prices, and controlling imports.[[36]](#endnote-36) Every year, the Canadian Milk Supply Management Committee looked at yearly demand to determine the production and supply quotas of milk for each province, and to set a minimum price for milk. This system led to three notable outcomes: it kept foreign products out through its high tariffs, beyond the quota;[[37]](#endnote-37) Canadian producers and consumers avoided unpredictable price fluctuations; and the sustainability of this sector was ensured so that producers did not need a government subsidy, as producers did in other countries.[[38]](#endnote-38)

However, this system was also criticized for trade protectionism. Since the dairy industry was not covered by the North American Free Trade Agreement (NAFTA), it became a target of the NAFTA renegotiation between the United States and Canada.[[39]](#endnote-39) The Canadian government also attempted to expand similar protections to other milk ingredients by implementing a new price class, Class 7, to lower the price paid by domestic producers, which angered not only the US producers but also producers from Australia, the European Union, Mexico, and New Zealand, who were driven out from the Canadian dairy market by this policy.[[40]](#endnote-40) As an opinion piece from the University of Calgary’s School of Public Policy noted, such protection had “resulted in low Foreign Direct Investment to the Canadian dairy sector. Of the [US]$21 billion invested globally into the dairy sector, Canada attracted a minuscule amount—less than one per cent.”[[41]](#endnote-41)

Dairy Industry in Ontario

The majority (approximately 82 per cent) of Canada’s dairy farms were in Ontario and Quebec, approximately 12 per cent were in Western Canada, and just over 5 per cent were in the Atlantic provinces.[[42]](#endnote-42) Ontario’s share of the total Canadian milk market was approximately 32.0 per cent, with 2.77 million litres of milk produced in 2016. Ontario had 3,705 dairy farms and 72 dairy processing plants[[43]](#endnote-43) that supplied and processed not only raw milk but also all the other milk products. Ontario was also a major goat milk production base, with 52 per cent of Canada’s goats and 36 per cent of Canada’s goat farms. According to *Ontario Farmer* magazine, “There were 240 goat milk producers licensed by the Ontario Ministry of Agriculture, Food and Rural Affairs in 2015. The Ministry licenced 22 new producers in 2014 and 35 in 2015. There were already 24 new producers ‘pending’ in 2016 ‘in all ranges of farm size.’”[[44]](#endnote-44)

Feihe’s INTERNAtionaLIZATION

The Chinese customers’ awareness of product quality and safety had been increasing since the milk scandal in 2008 that had involved Sanlu, the producer responsible for the tainted infant formula. Many Chinese customers were willing to buy foreign products to ensure food safety for their babies. As a result, the Chinese market was currently dominated by international brands, but domestic brands, including Feihe, were attempting to catch up by increasing their investments in raw material sourcing and technology.

Feihe aimed to compete with international brands on both quality and price. It seized a chance to grow in the domestic market after the falling of Sanlu in 2008. In 2016, it beat foreign brands in 10 provinces of China.[[45]](#endnote-45) Also, the company noticed that since 2012, the high-end infant formula segment in China had increased from a sales value of ¥19.9 billion (31.2 per cent of the overall market) and was expected to reach ¥66.4 billion by 2021. Although Feihe had begun its internationalization strategy as early as 2005, when it was listed on the New York Stock Exchange, it did not have any foreign manufacturing plants. Further, it delisted from the New York Stock Exchange in 2013 to free more capital for domestic mergers. However, Feihe needed more suppliers of low-cost, high-quality raw materials to satisfy the growing demands in China.

To support its internationalization strategy, the company positioned its brand as “more suitable for Chinese babies” and spent ¥13.8 million in R&D in collaboration with international research institutions, including the Feihe Nutrition Laboratory at Beth Israel Deaconess Medical Centre at Harvard Medical School in 2016. Feihe then filed its initial public offering application with the Hong Kong Stock Exchange in May 2017, which indicated that the company was trying to obtain more capital and secure its leading market position in China.[[46]](#endnote-46) However, since this company had not yet been listed, it still lacked sufficient capital for a large investment.

In November 2015, Feihe announced a plan to invest US$100 million in building an intelligent plant with an annual output of approximately 45,359 tonnes of milk powder in California.[[47]](#endnote-47) However, it soon found that due to the local laws and policy restrictions in the United States, it might not be the perfect match for Feihe.

Kingston’s Ambition

The year 2016 was a milestone in the history of China–Canada relations. Canadian Prime Minister Justin Trudeau attended the G20 leaders’ summit in Hangzhou, China; and, only a couple of weeks later, Chinese Premier Li Keqiang visited Canada, for four days—the first Chinese Premier to do so in 13 years. The two leaders issued a joint statement to encourage more co-operation between their countries.[[48]](#endnote-48)

It was exactly at this time—“a time to nurture cooperation”[[49]](#endnote-49) between these two countries—that Feihe targeted the Canadian market. Canada’s three largest dairy processors—Saputo Inc., Agropur Cooperative, and Parmalat Canada—processed approximately 80 per cent of Canada’s raw milk and did not have a clear strategy on infant formula or tapping international markets. To attract more capital and diversity, the CDC started to search for an infant formula processor in Europe or Asia. Kingston, a city on the eastern end of Lake Ontario, was chosen as a potential location. In June 2016, Feihe invited a small delegation from the Kingston Economic Development Corporation (KEDCO) to China to help celebrate its anniversary, and this trip provided an opportunity for the city to forge a new relationship with this potential investor.[[50]](#endnote-50)

Kingston was recognized by the London (UK) *Financial Times* 2017–2018 publication on “American Cities of the Future;” was the winner of “Small Cities in North America for Foreign Direct Investment Strategy;” and was rated sixth in the category of “Small City for Human Capital and Lifestyle.”[[51]](#endnote-51) While economic growth in 2016 was more robust outside the Kingston metropolitan area, Kingston had a population of 167,965 and a well-educated labour force of approximately 91,000.[[52]](#endnote-52) It had access to an effective transportation system composed of highways, railways, and air transportation, integrated with US networks, which enabled passengers and cargo to conveniently arrive at major North American cities. Kingston also had four well-organized business parks with complete facilities, infrastructure, and was close to major highways and downtown.[[53]](#endnote-53)

Another advantage of Kingston was that it had the support of KEDCO. Established in 1998, KEDCO was a not-for-profit agency providing sales and marketing for the City of Kingston. It facilitated investment and job creation. In its 2015–2020 strategic plan, KEDCO aimed to reposition the city as an agri-business centre by focusing on food processing, technology, and sustainable agriculture.[[54]](#endnote-54)

To achieve this goal, KEDCO assisted enterprises in applying for funding and determining which programs and services would best meet their needs.[[55]](#endnote-55) The funding programs were supported by both provincial and federal governments, and included two five-year federal programs to improve the competitiveness of the agriculture, agri-food, and agriculturally based product sectors in domestic and international markets, which were in operation until 2019, with total funding of CA$391.3 million; a CA$5 million funding program offered by the Ontario provincial government for food and beverage processing; a development fund for economic development in eastern Ontario; and an innovation fund to help the agriculture sector adapt to the global and domestic market environment.[[56]](#endnote-56)

Next Steps

Most of Feihe’s competitors had invested in New Zealand and Australia; Canada was not a traditionally popular investment destination for the Chinese dairy giants. In addition, Canada had not had an infant formula processor in the country in the past 20 years. Kingston was fuelled by the investment and ready for its ambitious plan. Any major dairy country would envy a large inward foreign direct investment in the competitive global market. At the same time, Feihe was already on track for internationalization and was highly interested in investing in Canada. The question was: How could Leng formulate a best entry strategic plan for Feihe?

Exhibit 1: Feihe Financial Data For the year ended December 31 (in ¥ thousands)

|  | **2014** | **2015** | **2016** |
| --- | --- | --- | --- |
| **Revenue** |  |  |  |
| **Infant Formula Products** |  |  |  |
| *High-End Infant Formula Product Series* |  |  |  |
| Super Premium (Astrobaby) | 294,413 | 438,107 | 711,464 |
| Premium (Super Feifan) | 693,206 | 861,708 | 874,552 |
| Subtotal for High-End Infant Formula Product Series | 987,619 | 1,299,815 | 1,586,016 |
| *Regular Infant Formula Products Series* |  |  |  |
| Mid- to High-End | 1,864,997 | 1,601,032 | 1,469,128 |
| Others | 231,478 | 296,653 | 125,784 |
| Subtotal for Regular Infant Formula Product Series | 2,096,475 | 1,897,685 | 1,594,912 |
| **Subtotal** | 3,084,094 | 3,197,500 | 3,180,928 |
| **Other Products** | 499,173 | 417,891 | 543,453 |
| **Total Revenue** | **3,583,267** | **3,615,391** | **3,724,381** |
| **Cost of Sales** |  |  |  |
| **Raw Materials** |  |  |  |
| Fresh Milk | 629,098 | 567,188 | 569,915 |
| Packaging Materials | 189,076 | 189,864 | 237,558 |
| Whey Protein Powder | 173,295 | 150,083 | 111,576 |
| Mixed Vegetable Oils | 52,157 | 43,415 | 57,728 |
| Non-Fat Milk Powder | 59,308 | 40,086 | 43,945 |
| Alpha-lactalbumin | 36,678 | 29,334 | 27,902 |
| Others | 565,803 | 395,071 | 393,244 |
| **Subtotal** | 1,705,415 | 1,415,041 | 1,441,868 |
| Manufacturing Overheads | 91,349 | 115,932 | 146,638 |
| Labour Costs | 40,457 | 38,217 | 56,005 |
| Others | 34,586 | 46,334 | 45,910 |
| **Total cost of sales** | **(1,871,807)** | **(1,615,524)** | **(1,690,421)** |
| **Gross Profit** | **1,711,460** | **1,999,867** | **2,033,960** |
| Other Income and Gains, Net | 216,789 | 300,187 | 359,235 |
| Selling and Distribution Expenses | (756,244) | (1,173,936) | (1,369,520) |
| Administrative Expenses | (251,114) | (256,435) | (230,858) |
| Other Expenses | (53,331) | (194,005) | (171,097) |
| Finance Costs | (31,602) | (30,818) | (26,773) |
| **Profit before Tax** | 835,958 | 644,860 | 594,947 |
| Income Tax Expense | (335,991) | (263,226) | (188,795) |
| **Profit for the Year** | **499,967** | **381,634** | **406,152** |
| **Attributable to:** |  |  |  |
| Owner of the Parent | 485,461 | 411,880 | 416,988 |
| Non-Controlling Interests | 14,506 | (30,246) | (10,836) |
| **Profit for the Year** | **499,967** | **381,634** | **406,152** |

Note: ¥ = CNY = Chinese yuan renminbi; US$1.00 = ¥6.94 on December 30, 2016

Source: Company files.

Exhibit 2: 2016 China’s Milk Powder Imports, by Country of Origin

| **Origins** | **Imports**  **(in Tonnes)** | **Percentage** |
| --- | --- | --- |
| New Zealand | 503,562 | 83.34% |
| Australia | 26,687 | 4.42% |
| United States | 16,195 | 2.68% |
| France | 13,441 | 2.22% |
| Germany | 11,735 | 1.94% |
| Canada | 2 | 0.00% |
| Others | 32,587 | 5.39% |

Source: Ministry of Agriculture and Rural Affairs of the People’s Republic of China, *The Chinese Dairy Yearbook 2017* [in Chinese] (Beijing, China: China Agriculture Press, 2017), 436–437.

Exhibit 3: Top 15 Dairy Companies in China

| **Name** | **2016 Sales Revenue**  **(in ¥ Billion)** |
| --- | --- |
| Yili Inc., Inner Mongolia | 606.1 |
| Mengniu Dairy Co., Ltd., Inner Mongolia | 517.8 |
| Bright Dairy & Food Co., Ltd. | 200.2 |
| Want China Holding Limited | 197.0 |
| Shijiazhuang Junlebao Dairy Co., Ltd. | 79.6 |
| Nestlé China | 65.2 |
| Feihe Dairy, Heilongjiang | 59.3 |
| Beijing Sanyuan Foods Co., Ltd. | 56.0 |
| China Huishan Dairy Holdings Company Limited, Liaoning | 55.9 |
| Mead–Johnson China Limited | 53.2 |
| Wondersun Dairy Co., Ltd., Heilongjiang | 52.1 |
| Yinqiao Dairy Co., Ltd., Xi’an | 39.4 |
| New Hope Dairy Holdings Co., Ltd. | 39.0 |
| Synutra International Inc. | 35.1 |
| Beingmate Baby & Child Co., Ltd. | 27.6 |

Note: ¥ = CNY = Chinese yuan renminbi; US$1.00 = ¥6.94 on December 30, 2016.

Source: Kungang Song, “The Dairy Industry Review in 2016 and Focus in 2017,” [in Chinese] *China Dairy Industry Newsletter*, September, 2017, accessed October 4, 2017, www.cdia.org.cn/down.php?name=uploads/pdf/1510292756.pdf.

Exhibit 4: Canada Milk Production, 2007–2016

| **Year** | **Production (Hectolitres)** | **Growth Rate** |
| --- | --- | --- |
| 2007 | 75,891,672 | – |
| 2008 | 75,926,096 | 0.05% |
| 2009 | 76,627,816 | 0.92% |
| 2010 | 76,731,527 | 0.14% |
| 2011 | 77,771,092 | 1.35% |
| 2012 | 79,801,292 | 2.61% |
| 2013 | 78,197,966 | −2.01% |
| 2014 | 78,259,854 | 0.08% |
| 2015 | 81,766,876 | 4.48% |
| 2016 | 84,704,919 | 3.59% |

Source: “Milk Volumes and Components,” Canadian Dairy Information Centre, Government of Canada, February, 23, 2018, accessed Oct 10, 2018, www.dairyinfo.gc.ca/index\_e.php?s1=dff-fcil&s2=msp-lpl&s3=hmp-phl&page=histprod.

Exhibit 5: 2016 Canadian Exports of Dairy Products by Region

|  |  |  |
| --- | --- | --- |
| **Countries** | **Value**  **(in CA$)** | **Percentage** |
| North America | 121,648,585 | 51.70% |
| Central America and West Indies | 10,759,835 | 4.57% |
| South America | 10,347,487 | 4.40% |
| European Union | 2,723,820 | 1.16% |
| Other Europe | 3,278 | 0.00% |
| Middle East | 15,724,626 | 6.68% |
| Africa | 28,225,941 | 12.00% |
| Asia | 41,778,597 | 17.76% |
| Oceania | 4,063,657 | 1.73% |
| Total | 235,275,826 |  |

Source: “D033Y Canadian Imports / Exports of Dairy Products (Year),” Canadian Dairy Information Centre, Government of Canada, accessed October 10, 2018, aimis-simia-cdic-ccil.agr.gc.ca/rp/index-eng.cfm?action=rR&pdctc=&r=166.

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