****

9B21M064

FEIHE: STRATEGIC ADJUSTMENT UNDER a PANDEMIC CRISIS

Haifen Lin, Xiangli Xuan, Yunqing Ma, 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.

This publication may not be transmitted, photocopied, digitized, or otherwise reproduced in any form or by any means without the permission of the copyright holder. Reproduction of this material is not covered under authorization by any reproduction rights organization. To order copies or request permission to reproduce materials, contact Ivey Publishing, Ivey Business School, Western University, London, Ontario, Canada, N6G 0N1; (t) 519.661.3208; (e) cases@ivey.ca; www.iveycases.com. Our goal is to publish materials of the highest quality; submit any errata to publishcases@ivey.ca. i1v2e5y5pubs

Copyright © 2021, Ivey Business School Foundation Version: 2021-06-23

Since 2015, when its “more suitable for Chinese babies” strategy was proposed, Heilongjiang Feihe Dairy Co. Ltd. (Feihe) had entered a period of high-speed development and become a leader in the dairy industry, with a rapid increase in revenue. However, the outbreak of COVID-19 in early 2020 disturbed Feihe’s expansion.[[1]](#footnote-1) In response to this emergency, Feihe actively adjusted its strategy and adopted various activities to ensure its regular operation and to provide rations for hundreds of millions of Chinese babies. However, in the context of the global pandemic, Feihe still had a long way to go: Although it had successfully gained a share of the high-end market, which had been dominated by foreign brands, its proportion of the high-end market was still not high. At the same time, the competitive landscape for domestic milk powder brands had quietly changed, and companies such as Shijiazhuang Junlebao Dairy Co. Ltd. (Junlebao) and the Yili Group’s Jinlingguan brand had seized the opportunity and had grabbed significant market shares by June 2020. Leng Youbin, the chair of Feihe, needed to decide how Feihe should further adjust its strategy to properly handle its competitive relationship with other brands: Should Feihe continue to compete with foreign brands and fully seize the first- and second-tier markets, or should it slow down its pace of confronting foreign brands and focus on restraining the rise of domestic brands?

DEVELOPMENT OF the MILK POWDER INDUSTRY IN CHINA

Beginning in 1978, China’s reform and opening-up policies[[2]](#footnote-2) had injected fresh vitality into the country’s milk powder industry beginning. The milk powder market had gradually become centralized, and the leading milk powder brands tended to be regional. Domestic demand was rising steadily, but while there was a strong need, there was a limited milk supply. The imbalance between supply and demand resulted in many companies adding the chemical melamine to their milk powder. This poisoned milk powder made many children sick, and, inevitably, the domestic milk powder market entered a period of difficulty. After the melamine incident in 2008,[[3]](#footnote-3) consumers’ trust in domestic milk powder dropped to a “freezing point,” and a large number of domestic consumers turned to foreign milk powder. Many countries banned imports of Chinese dairy products, and China’s milk powder industry fell into a crisis. Before 2008, domestic milk powder brands had accounted for about 65 per cent of China’s milk powder market share and had occupied a dominant position. However, by 2015, domestic milk powder brands accounted for only 31 per cent of this market, and foreign milk powder brands dominated the market. At the same time, the sales growth of domestic milk powder brands was sluggish (see Exhibit 1). After 2015, the government, industry associations, and milk powder companies worked together to guarantee the safety of domestic milk powder, and milk powder brands gradually recovered. Consumers also developed an objective and rational understanding of the quality and safety of domestic and foreign milk powder, and they gradually regained confidence in domestic milk powder. According to a report from China National Radio, as of December 13, 2019, national food safety supervisors from the State Administration for Market Regulation had sampled 2,358 batches of infant formula milk powder. Out of 1,721 batches of samples from 114 domestic enterprises, 100 per cent qualified or met expectations. There had been no melamine detected in domestic infant formula milk powder for 11 consecutive years.[[4]](#footnote-4)

THE DEVELOPMENT OF FEIHE

Feihe was founded in 1962 in Qiqihar, a prefecture-level city in Heilongjiang Province. For 58 years, it had focused on researching the nutritional needs of Chinese babies and the nutritional makeup of breast milk, and had created various technologies, formulas, and processes to improve the fitness of milk powder for Chinese babies.

The melamine incident in 2008 had dealt a fatal blow to the domestic milk powder industry, and consumers’ trust in domestic milk powder had fallen to a freezing point. For a time, foreign milk powder flooded into the domestic market and was sought by domestic consumers. Although Feihe had attached great importance to the quality of its product to survive this disaster, the impact of this incident was more far-reaching than imagined. Domestic consumers perceived domestic brands with invisible labels to be of low quality. The market was crowded with foreign brands, while domestic milk powder brands were struggling. From 2013 to 2015, with increasing competition among domestic brands and the continuous expansion of foreign brands in China, Feihe’s growth appeared very weak. It was a challenging time to enter the mainstream market.

By chance, Leng met with Xie Weishan, the chair of Shanghai Kmind Enterprise Management Co. Ltd. (Kmind), a strategic consulting company dedicated to helping companies beat the competition. At Leng’s invitation, Kmind conducted a comprehensive survey and evaluation of Feihe and of China’s milk powder industry. After surveying nine provinces in northern China, Kmind found that babies with different physiques had different nutritional requirements during development, while the core of foreign brands was a global brand, global quality, and global formula. Foreign brands monopolized the markets in Tier 1 and Tier 2 cities, while domestic milk powder brands occupied the Tier 3 and Tier 4 cities. In the minds of consumers, foreign brands were high-end brands and domestic brands were low-end brands. So, while foreign brands were Feihe’s main competitors, Feihe could not yet confront them directly. The current priority was to enhance Feihe’s brand value. Based on this information, Feihe identified a competitive opportunity and proposed the strategy of being “more suitable for Chinese babies.”[[5]](#footnote-5) This strategy highlighted the corporate characteristics of Feihe, which for many years had been based on identifying the differences between Chinese and foreign breast milk and developing and producing milk powder specifically for Chinese babies. In 2016, Feihe began a strategic allocation that implemented this “more suitable” strategy in production, research and development (R&D), brand image, and other areas of the company.

Since implementing the “more suitable” strategy, Feihe had achieved revenues of ¥3.724 billion,[[6]](#footnote-6) ¥5.887 billion, and ¥10.392 billion in 2016, 2017, and 2018, respectively, and had made profits of ¥406 million, ¥1.160 billion, and ¥2.242 billion, respectively, in these years (see Exhibit 2).[[7]](#footnote-7) In 2019, Feihe achieved an operating income of ¥13.722 billion, a year-on-year increase of 32.0 per cent, and realized a net profit of ¥3.935 billion, a year-on-year increase of 75.5 per cent. According to data released by Nielsen Corporation at the end of 2019,[[8]](#footnote-8) as of September 30, Feihe had surpassed all foreign brands and become the number-one brand in China’s infant milk powder market in terms of sales. Feihe had also taken the opportunity to announce that its sales were far ahead in China, delivering the signal that Feihe had surpassed foreign brands in the market.

STUCK IN THE pandEMIC

The sudden outbreak of COVID-19 was a shock to all enterprises. The Spring Festival holiday, which was supposed to be a peak consumption season, plunged into a cold winter for a while. People conscientiously stayed at home. The bustling commercial streets were no longer busy, and off-line shops were empty. Sales slides, store closures, and even corporate bankruptcies occurred every day. The resumption of work and production was difficult. The shortage of personal protective equipment had forced many companies to continue to postpone work when they could not protect their employees’ physical and mental health. National traffic control continued to strengthen, and employees could not return to their posts on time to undertake work. At the same time, the pandemic had disrupted Feihe’s operational rhythm. Under the impact of COVID-19, many companies’ supply chains had been interrupted, and companies could not resume production. Besides, for most companies, a variety of off-line campaigns were forced to stop, and all kinds of marketing activities were affected to varying degrees. The marketing effect of advertisements placed in public places such as movie theatres was significantly reduced during the pandemic.

Feihe was also profoundly affected. At the beginning of the outbreak, consumers around the country stayed at home (many had been infected and then forced to quarantine, and others chose to stay home to assist the government in the fight against the pandemic). Feihe’s operations in major supermarkets, maternal and children’s stores, and other sales outlets became increasingly bleak. The pandemic had also disrupted Feihe’s off-line rhythms, affecting employees’ resumption of work, logistics distribution, and other links. It was also difficult for Feihe to carry out ground promotions, which was an essential part of its marketing campaign.[[9]](#footnote-9) With the shutdown, Feihe had lost the opportunity to interact with consumers face to face.

**FINDING A WAY OUT**

In this particular period of the pandemic, every move of Feihe’s was significant, so Leng asked his old partner at Kmind for help. Through multi-market analyses, Kmind found that customers were paying more attention to safety and health issues during the pandemic; customers’ consumption patterns had shifted from off-line to online; and customers’ patriotism was soaring to support domestic brands. Based on this information, Feihe decided to take advantage of customers’ attention to domestic brands to confront foreign brands more directly. The company adjusted its brand appeal from saying that sales were far ahead in China to saying that *high-end* sales were far ahead. The adjustment delivered to consumers was that Feihe was a high-end milk powder and more popular than foreign brands. Feihe made this change not only in its brand appeal but also in its strategy.

Strengthening Exclusive Industrial Cluster Control

As early as 2001, Feihe had established its first complete and exclusive industrial cluster in China’s infant milk powder industry within the World Golden Milk Source Belt, an area located 47 degrees north latitude with abundant sunshine and rich pasture resources, which were important for ensuring quality milk.[[10]](#footnote-10) At the beginning of the pandemic, Feihe had actively linked upstream and downstream partners in the industrial cluster, ensuring full control over all links—from source forage planting and large-scale dairy cattle breeding to production and processing, logistics and storage, channel control, and even after-sales service. Feihe further strengthened its quality control over raw materials by arranging sampling and testing immediately after the raw materials arrived at the factory. Feihe also formulated more stringent processing control and evaluation standards based on the production process. These were coupled with automation of the entire process; each link was visualized and digitized, and a real-time temperature measurement system was implemented by employees every four hours. All of these processes guaranteed the safe and orderly production of milk powder from all aspects. Feihe broke with routine to show consumers its exclusive pasture and intelligent factory in the form of live broadcasts, so that more people could see the production conditions of the pastures or factories 24 hours a day. Feihe’s approach demonstrated transparent management during the pandemic and allowed consumers to be more at ease, which was something foreign brands could not achieve.

Implementing a Logistics Distribution Plan

With stricter traffic controls across the country, logistics and distribution became difficult. Feihe quickly took action. On the second day of the Spring Festival, Feihe’s logistics team communicated with its base to dispatch 117 transport vehicles to load the goods. On the third day, the company arranged for all vehicles to go to six storage warehouses across the country and to shuttle non-stop to Zhengzhou, Suzhou, Huangshi, and other cities. All of Feihe’s front-line logistics employees had resumed work: work such as communicating with carriers, allocating inventory, and contacting warehouses was still going on in an orderly manner during this extraordinary period.

At the same time, Feihe took the initiative to connect with e-commerce platforms such as Tmall, JD.com, and Suning, and coordinated with distributors across the country in advance of resuming work to ensure smooth product transfer. In response to a situation where customers could not go out, Feihe provided contactless home delivery services from more than 3,600 stores. Nearly 10,000 terminal personnel across the country ensured that consumers’ milk powder could reach their homes safely. All of these actions reflected Feihe’s high-end service.

Accelerating Digital Transformation

In response to the dismal in-store sales and the suspension of off-line activities, Feihe took many measures to shift from off-line to online platforms and expanded digital methods to its off-line business, opening up a cloud channel that enabled consumers to interact directly with Feihe (see Exhibit 3).

Over 1,500 off-line event assistants from Feihe participated in live broadcasting during the pandemic. They helped off-line store managers invite customers, through WeChat groups, to support selling goods in stores and to make the sluggish off-line market “live” again. To achieve in-depth interactions with consumers, Feihe used platforms such as Weibo, WeChat, and TikTok to invite psychologists and nutrition experts to share scientific knowledge with parents about milk powder feeding and preventing COVID-19 infections. Feihe also co-operated with professional online medical platforms such as WeDoctor and Ping An Good Doctor to open a channel for 24-hour online consultations to answer parents’ questions. Feihe broke through physical space limitations with comprehensive and considerate online services, narrowing the distance between itself and consumers.

Promoting Product Upgrades

The pandemic had made everyone pay more attention to health and the safety of food, especially baby food. The National Dairy Science and Technology Innovation Alliance, together with Feihe Infant Formula Whole-Industry-Chain Innovation Center, had established four R&D centres in two countries,[[11]](#footnote-11) which gave Feihe access to extraordinary technological innovation. In March 2020, Feihe upgraded its core product, Xingfeifan formula, and officially launched it on the market in May. The newly upgraded Xingfeifan adopted a new generation of a patented ingredient, OPO, which was similar in structure to human milk, to meet babies’ all-around nutritional needs and to help strengthen babies’ immune systems. Feihe was also actively deploying and launching high-end children’s and adults’ milk powders so that fresh, safe, high-quality milk powder could help more people.

Next Steps

Thanks to its concrete foundation and rapid response capability, Feihe’s business operations during the first quarter of 2020—including raw material supply, production, distribution logistics, and sales—had not been negatively affected by the pandemic. According to company statistics, from the beginning of February to March 15, 2020, Feihe had held nearly 90,000 interactive online events for more than 2.1 million consumers. The company’s e-commerce business had increased by 200 per cent during the pandemic, which had also driven sales of more than 100,000 off-line retail stores. The company’s March 23, 2020, financial report showed that Feihe’s revenue in the first two months of 2020 would still maintain rapid growth; its revenue growth rate in the first quarter of 2020 was estimated to be not less than 30 per cent. While it had been affected by the pandemic, Feihe was confident in its business development in 2020. Leng was quite pleased with the results that Feihe had achieved in the early stage of the pandemic, but the market situation would not allow him to rest for a while.

While Feihe was fully committed to fighting the pandemic, the milk powder industry’s competitive pattern had also changed quietly. Under the influence of COVID-19, the sales of foreign brands had tended to decline, while those of domestic brands had increased steadily. On the one hand, Junlebao had followed up a victory with a hot pursuit: public data showed that Junlebao’s growth rate in 2019 was 10 times faster than the industry, and Junlebao began to employ the slogan “Leading sales in the country” at the end of 2019, taking advantage of the overwhelming publicity and marketing during the pandemic to successfully create an industry-leading image.

On the other hand, Jinlingguan closely followed Feihe’s value appeal. During the pandemic, Jinlingguan had continued its previous national sentiment of devoting itself to researching human breast milk in China. At the same time, Jinlingguan had also comprehensively upgraded its brand appeal of “Chinese patent formula, the inheritance of maternal love,” which had endowed Jinlingguan with the brand meaning of a “national treasure.” Jinlingguan had attracted numerous fans.

Length knew that the development of these other domestic milk powder brands should not be underestimated. He needed to make another decision as he faced these changes in the competitive pattern during the pandemic: how should Feihe further adjust its strategy to properly deal with its competitive relationship with other brands? The company had two distinct options: it could continue to compete with foreign brands and fully seize the Tier 1 and Tier 2 cities, or it could slow down the pace of confronting foreign brands and work to restrain the rise of domestic brands.

Option 1: Compete with Foreign Brands in Tier 1 and Tier 2 Cities

Tier 1 and Tier 2 cities had excellent market potential and development space. Since it had implemented its strategy of being “more suitable for Chinese babies,” Feihe’s market share in Tier 1 and Tier 2 cities had increased from about 2 per cent to 15 per cent. Although these results were good, foreign brands still monopolized the Tier 1 and Tier 2 cities. If it could not fully open Tier 1 and Tier 2 cities to domestic products, the competitive space for domestic brands would become narrower and narrower, and competition among domestic milk powder brands would fall into a vicious circle.

Option 2: Work to Restrain the Rise of Domestic Brands

Business circles were like battlefields, and the slightest mistake would ruin all previous efforts. Through thousands of ups and downs, Feihe had gone from obscurity to being number one in the industry. If Feihe did not counter the attacks of other domestic brands and instead allowed them to erode the market and disrupt consumers’ perceptions, its long-standing image of having sales far ahead in China would become fuzzy. Directly competing with domestic milk powder producers and suppressing their expansion would help Feihe maintain its position as number one in the industry.

In this particular period, every move of Feihe’s would be infinitely magnified. Leng needed to think carefully about the next strategy. As the industry leader, which option should Feihe choose?

EXHIBIT 1: MARKET SHARE OF DOMESTIC AND FOREIGN MILK POWDER Brands, 2007–2019

Source: Created by the authors based on data from Euromonitor and Qianzhan Intelligence Co. Ltd., *Analysis on Market Status and Competition Pattern of China Infant Milk Powder Industry in 2021* [in Chinese], April 22, 2021, accessed April 24, 2021, https://www.sohu.com/a/462256854\_473133.

EXHIBIT 2: FEIHE REVENUE AND PROFIT, 2016–2019 (¥ Billions)

Note: ¥ = CNY = Chinese yuan renminbi.

Source: Created by the authors based on data from Heilongjiang Feihe Dairy Co. Ltd., *2019 Annual Report* [in Chinese], 3, April 15, 2020, accessed April 24, 2021, https://img1.feiheimg.com/pdf/20200415/report2019.pdf.

EXHIBIT 3: Feihe’s Online service platform

Weibo

WeChat

TikTok

Ping An Health

Weiyi

Online Medical Platform

Live Platform

Note: Weiyi is an online medical service platform that provides medical consultation, online appointment registration, diagnosis, treatment payment options, and more.

Source: Created by the case authors.

1. Penghui Zhang, “WHO Listed the 2019-nCoV as a Public Health Emergency of International Concern” [in Chinese], *People’s Daily Online*, January 31, 2020, accessed January 5, 2021, http://world.people.com.cn/n1/2020/0131/c1002-31565415.html. [↑](#footnote-ref-1)
2. Reform and opening up were two basic points in China’s primary stage of socialism. The policy of domestic reform and opening to the outside world was implemented in 1978. [↑](#footnote-ref-2)
3. Melamine was commonly used to manufacture strong and durable laminates, plastics, adhesives, and flame-resistant textiles. It was deliberately added to food and animal feed to boost the appearance of protein content, which caused an outbreak of kidney stones and renal failure in Chinese infants. Meanwhile, China reported a total of six child deaths and 296,000 cases of children affected by consumption of contaminated formula and milk products. Health effects included discoloured urine, kidney stones, acute renal failure, and subsequent death. Because milder cases were often asymptomatic, many more children may have been affected both in China and abroad. China Daily, “Dairy Farmers ‘To Blame’ for Poisoned Milk” [in Chinese], *ChinaDaily.com*, September 13, 2008, accessed April 23, 2021, www.chinadaily.com.cn/china/2008-09/13/content\_7024619.htm. [↑](#footnote-ref-3)
4. Shen, “In 2019, the Qualified Rate of Infant Formula Milk Powder Sampling in China was 99.7%” [in Chinese], China National Radio, January 12, 2020, accessed January 5, 2021, <http://health.cnr.cn/jkgdxw/20200112/t20200112_524934480.shtml>. [↑](#footnote-ref-4)
5. The following saying is used in Chinese traditional culture: “Yi fang shui tu yang yi fang ren [in Chinese].” The translation of this sentence means “The water and soil of an area foster the persons of the area,” or “Local food is more suitable for local people.” “More suitable for Chinese babies” is based on that saying, which aims to remind consumers that Feihe is a Chinese brand. [↑](#footnote-ref-5)
6. ¥ = CNY = Chinese yuan renminbi; US$1 = ¥7.1277 on June 1, 2020. [↑](#footnote-ref-6)
7. Heilongjiang Feihe Dairy Co. Ltd., *2019 Annual Report* [in Chinese], 3, April 15, 2020, accessed April 24, 2021, https://img1.feiheimg.com/pdf/20200415/report2019.pdf. [↑](#footnote-ref-7)
8. Economic Daily, “Chinese milk powder enters the "Feihe's moment" after the first earnings release after listing [in Chinese],” www.ce.cn, March 23, 2020，accessed June 12, 2021 http://www.ce.cn/cysc/sp/info/202003/23/t20200323\_34544439.shtml [↑](#footnote-ref-8)
9. Feihe held 500,000 off-line events every year and had a great deal of talent promotion and marketing experience. [↑](#footnote-ref-9)
10. Well-known livestock areas concentrated near this latitude included dairy regions near Hokkaido, Japan; Wisconsin, United States; and Alberta, Canada. [↑](#footnote-ref-10)
11. The four R&D centres of the two countries were the Feihe Nutrition Laboratory at Beth Israel Deaconess Medical Center at Harvard Medical School, an R&D centre at the University of Vermont, a Beijing-based R&D centre, and a laboratory based in Qiqihar. [↑](#footnote-ref-11)