Practice Case 4 (Chemical Manufacturer)

Question

A major chemical manufacturer produces a chemical product used to preserve foods in containers. Despite an increase in market share, the manufacturer has experienced a decline in profits. The CEO of the company is worried about this trend and hires you to investigate.

Recommended Solution

<u>High Level Plan of Attack</u>

- The first thing we need to figure out is what does "an increase in market share" mean? Remember, the term "market share" is a percentage, and not an absolute number. It could imply that the company has increased its share of the market by beating out the competition, or the competition exiting the market. It could also mean that the market is actually shrinking, but the sales of the company are decreasing by less than those of its competitors.

<u>Lay Out Your Thoughts</u>

- Use the Profitability Framework. Lay out factors that you feel would help from the Value Chain analysis, 4Cs, and 4Ps.

<u>Dig Deeper: Gather Facts</u>

- Has the company experienced any significant increase in cost in the last couple of years related to any additional fixed or variable cost? *No, costs have been steady.*
- On the revenue side, has there been an increase in the volume of output? *Slightly, a little bit higher than the industry average.*
- What about the competition. Have there been any new entrants on the scene? *Actually, competition has decreased. A number of players have exited the industry.*
- Why has that been the case? *They were losing money. They felt that the industry had gotten saturated, so they left.*
- Has sales decreased for the industry overall? *Yes, there has been a general negative trend in the last few years. There certainly has been less demand for the product.*
- Are substitute products being used? *Not really. Preservatives in general are being used less in foods. Fresh food is now the preferred choice for many consumers.*

- What about the makers of food? Are they experiencing decreased volume? *Yes, the entire industry has been slowing.*
- Are they forced to lower their prices to survive? *They certainly are. Additionally, to lower costs, they are using their leverage to renegotiate price structures of raw materials.*
- So is the company in question forced to lower its prices? *Yes. They are gaining market share, but it's because of a number of competitor fallouts.*
- But costs have stayed the same? *Yes.*

Key Findings

- The industry overall is shrinking. To survive, the company in question has been competing on price. It has gained market share at the expense of it competition, forcing some to exit the industry.
- Its sales have only increased slightly.
- The decrease in price has caused the company to lower its profits, despite the increase in market share.
- Profit margin has been lower on a per volume basis.

Recommendations

- Focus on cost reduction. If price is the only way to compete, then costs must decrease.
- Collaborate with the competition to increase leverage in negotiation.
- Diversify into other chemicals that are in demand. Reduce the risk of market trends via a portfolio of products.