

Farggi

It was early 1995 and Margarita Farga, Farggi's marketing director, was turning over in her mind the situation of her company's different businesses. The Farga/Farggi Corporation was a group of family companies, whose annual sales were expected to amount to between 2.8 and 3.0 billion pesetas in 1995 (1 U.S. dollar = 130 Spanish pesetas).

From its humble beginnings as a small traditional cake and pastry shop in 1957, its businesses had been expanded and diversified. By the end of 1994, it had three traditional cake shops operating under the name "Farga." It also manufactured and sold ice cream and frozen cakes for the catering market under the "Farggi" brand name.

However, its latest "great leap forward" had been in 1993, when it started to manufacture and market luxury ice cream for sale in "Farggi" stores—either owned by the company or franchised—and in supermarkets and other non-exclusive shops. As a result of the latter activity, their positioning was now very similar to that of the famous Häagen Dazs ice creams. In fact, it was rumored that someone had heard an unidentified Häagen Dazs manager say that, of all its competitors in the entire world, Farggi had been the one most able to adopt its concept, positioning, and way of selling premium ice cream with the greatest speed and precision.

In July 1993, the first exclusive "Farggi Tub's & Ice Cream" parlour was opened in Barcelona's upmarket Paseo de Gracia and, by the end of 1994, 13 such parlours had been opened, five owned by the company and eight franchises.

While she reviewed everything that had been achieved so far, Margarita tried to think what her company's action priorities should be, both in the short and in the medium term. Jesús Farga, her father and the company's president, insisted that all

these questions needed to be clearly defined, as the future consolidation of the company depended on it.

HISTORY OF THE COMPANY

In 1957, Jesús Farga opened a traditional food retail store on Mayor de Gracia Street in Barcelona, near Plaza Lesseps. About five years later, after attending occupational training courses in cake making, he turned his food shop into a cake shop, keeping the same name "Farga." With the cake shop operating, he married Magdalena Bertrán and had four children: Elena, Margarita, Luís and Eduard.

About five years after that, Jesús Farga opened his second cake shop, on the Paseo de San Gervasio, in a neighborhood with a higher socio-economic level, manufacturing and selling fresh cakes and pastry.

The First Diversification: "Tartas y Helados Farga"

With both cake shops operating at full capacity, in the late 1960s, Jesús Farga started to sell cakes outside of his shops, delivering them frozen to nearby cafeterias and restaurants, where they were thawed in a refrigerator or at room temperature before being served to customers.

Jesús Farga and his employees managed to perfect their formulas and processes to such a point that it was impossible for the end customers in the restaurants and cafeterias to tell that the cakes they were eating had been frozen and thawed beforehand.

The transportation and delivery service was carried out by José Manuel Garrido. In the course of time, he was to become one of Jesús Farga's right-hand men and, in 1994, he was still sales director. Also, at about that time, Farga started to make and sell ice cream.

Thus, slowly but surely, a second business activity, separate from that of the retail stores, came into being and consolidated itself under the name of "Tartas y helados Farga." Legally, both activities continued to be a single business activity owned by Jesús Farga.

The 'Farggi' Brand

In spite of the excellent performance of both activities (sales in the cake and pastry stores, and the sale of frozen cakes and ice creams by delivery to cafeterias and restaurants), close monitoring of the second of these two lines of business convinced Jesús Farga of the need to use a different brand name.

Shortly before, during a trip to Italy, his friends and travelling companions had jokingly called him "Comendatore Farggi." Jesús decided to use his own italianized name to give a distinctive identity to his second business activity.

When, in 1974, he started to use the name "Farggi," the business's name was extended to "Farggi: tartas, helados y sorbetes de lujo" (Farggi: luxury cakes, ice creams and sorbets), to prevent any connotation of a second, lower quality brand name.

The First Factory in Badalona

In 1975, Jesús moved production to a factory measuring just under 1,000 meters in Badalona. One of the innovations at that time was the production and sale of individual portions of frozen cake and ice cream, with the same "luxury" quality.¹

Jesús Farga observed with satisfaction that when he sold portions of ice cream or cake of between 100 and 150 millilitres, priced by the portion and in a market niche which he had practically all to himself, his sales revenues were substantially higher than when he sold by the litre. Although the pro-

duction process had a somewhat higher skill and labour content, his margins improved considerably.

With the opening of the new factory in Badalona and due to the sudden economic downturn as a result of the oil crisis, Jesús Farga decided to legally reform his business as a limited company under the name Lacrem, S.A. At the same time, he brought his brother-in-law into the business as financial director and minority shareholder. For many years, the company's management team consisted of Jesús Farga, Miguel Bertrán, and José Manuel Garrido.

As a result of the increase in production capacity, the company was now able to sell its products virtually throughout Catalonia, although still basically focused on the catering sector.

Farggi's products and salesmen consistently used the image of the Farga cake retail stores as their reference point, quality guarantee, and visiting card. This enabled them to gain entry in restaurants and cafeterias with relative ease, smoothing their path in a market that was coveted by many other companies. Farga's guarantee also gave them a solid argument for defending higher sales prices.

Often, the "secret weapon" used by Farggi's salesmen and distributors was to get a foot in a new customer's door by first offering him the more typical frozen cake products, i.e., apple, chocolate, almond cakes, and the like. Once the restaurant or cafeteria had become a customer for the cakes and Farggi in general, the salesmen gradually introduced new articles, particularly ice creams.

This process was also facilitated by the fact that Farggi always differentiated itself from its possible competitors in the way it did things: it offered higher quality products, with a more craftlike appearance and a more attractive presentation, a more extensive and creative collection, etc. Therefore, it was usual for restaurants and cafeterias to always have some Farggi products in stock.

Regarding distribution and logistics, Farggi had its own distribution organization, delivering directly to the restaurants in Barcelona and its metropolitan area. In the rest of Catalonia, Farggi sold through independent distributors.

¹ Individual portions of sorbet or ice cream were already common in Spain, but only in the impulse sale market segments and/or in the medium- 10" quality segments.

These distributors were almost always small local companies, enabling distribution to be fragmented into small units. The distributors were required to have their own warehouse, equipped with cold-storage chambers suitable for handling frozen products, a fleet of delivery vehicles and a minimum sales team. However, they were not required to work exclusively for Farggi, so it was common for Farggi's distributors to distribute other brands of ice cream such as Frigo, Camy, or Marisa, which targeted other market segments with less demanding quality requirements.

When it started to sell through distributors, Farggi offered them a 28 percent discount on ice creams and a 26 percent discount on cakes, applied on their own direct sales price, so that the distributor could sell to its restaurant customers at the same prices that Farggi would have charged if they had been direct customers. Following an "oil stain" strategy, distribution was gradually extended to other parts of Spain, using the same system of independent distributors.

The New Factory in Montgat and the Third Cake Shop in the Avenida Diagonal in Barcelona

In 1982–83, the new Montgat factory was opened.² With a floor area of 8,000 meters, it completely replaced the previous Badalona factory, which was closed. With the new factory operating, both capacity and service were improved.

Almost at the same time, Jesús Farga had the opportunity to rent premises on the prestigious Avenida Diagonal, in Barcelona, between the Paseo de Gracia and the Rambla de Cataluña, where it opened its third Farga cake shop, with restaurant service. A veritable flagship, it consisted of a ground floor, a mezzanine, and two basements where the kitchen and the workshop were installed. In total, it measured about 1,500 meters, in one the best locations in Barcelona.

²Small coastal town located to the north of Barcelona and adjoining Badalona.

After opening the new factory in Montgat, Farga's turnover amounted to about 400 million pesetas between the three cake shops, whose workforce now stood at 45 employees. For its part, the Farggi business was billing another 600 million pesetas, with 60 employees and 18 independent distributors. With its present distribution network, its ice creams and frozen cakes now reached cities as far afield as Madrid, Malaga, and Corunna.

The new shop, large and well-located, enhanced the reflected glory of the Farga cake shops that was projected on the Farggi brand, and increased general brand awareness.

The years until 1987–1988 were the company's period of greatest prosperity. It had excellent sales margins and was able to sell without any major marketing or advertising efforts, as it was virtually the sole player in the high quality ice cream and frozen cake segment in Spain.

Farggi was, and defined itself as, "luxury cakes, ice creams and desserts for restaurants." It utilized a single product concept, with about 250 products or stock keeping units, serving a single market: the catering trade.

COMPETITION GETS TOUGHER AND IT BECOMES NECESSARY TO INSTALL FREEZER CABINETS IN RESTAURANTS

Unfortunately for Farggi, in the late 1980s and early 1990s, the big Spanish ice cream companies, many of them owned by multinationals, started to develop their own *ad hoc* product lines for the catering segment.

Companies such as La Menorquina (previously Marisa), Frigo, and Miko started to launch products with formats (sizes and appearance) similar to those of Farggi, although without seeking to position themselves on the same high quality level. They sold at lower prices, with advertising backing, and provided the restaurants with menu cards showing the desserts.

One of the consequences of the stiffening in competition was a fashion whereby a manufacturer had

to install a freezer cabinet on deposit in the restaurant in order to be able to sell ice cream to it. Each freezer cost the ice cream manufacturer about 100,000 pesetas. The restaurants' order of priorities when buying ice cream now became freezer-price-quality-service.

Faced with this new market situation, Farggi had to invest considerable sums in installing freezers: 40 million pesetas in 1989, 70 million pesetas in 1990 and between 80 and 100 million pesetas in 1991.

An Offer to Buy Farggi

In 1989–90, Camy (Nestlé) started talks with a view to buying Farggi. At that time, Farggi was billing about 800 million pesetas and the entire group, including the cake shops, had a turnover of about 1.5 billion pesetas. It appears that the purchase offer was considerably above this figure and was therefore very tempting. Finally, it was decided to turn the offer down.

The Second Generation Joins the Company

In June 1989, Margarita Farga, the second daughter of Jesús Farga and Magdalena Bertrán, graduated in business studies from ESADE. Immediately afterwards, she went to Boston, in the United States, where she stayed until March 1990, following an extension management studies course at the renowned Harvard Business School. Margarita would be the first daughter to join the company.

In addition to her formal studies, Margarita recalled having accompanied her father on many business trips; he made her visit supermarkets and restaurants in various countries in order to find out about the prices, the products sold, who bought them and how, and other details.

First Awareness of the Existence of Häagen Dazs

When she was in Boston, Margarita first saw a Häagen Dazs ice cream parlour:

I was struck by the fact that it sold a much more expensive ice cream and that it used the word "luxury." The containers seemed very unsightly to me, but when I tried the ice cream, I realized that it tasted different, although I did not know why.

Another detail that caught her attention was that Häagen Dazs also sold ice creams on a stick. In Spain, this sort of ice folly or Popsicle had traditionally been little more than "a chunk of ice with some sort of flavoring" (usually orange or lemon), and occupied the lowest quality segments; one did not think of an ice folly as a "luxury" product.

The Häagen Dazs stores that Margarita saw seemed unappealing to her, and also fairly empty, in spite of the fact that they sold a good product which could be served with toppings. In her opinion, they lacked "a touch of European design," which would give them more class.

Margarita's reaction could be summed up by saying that she noticed and appreciated the containers³ and the presentation of the ice creams, their taste and the variety of flavors offered, the use of the word "luxury" and of the color gold in the materials and designs (although accompanied by other decorative details in black which she did not find so pleasing). At the same time, the stores, which she felt could be improved on in several respects, showed her "what Farggi would like to be when it was grown up," as a commercial mechanism for reaching the end consumer more directly (selling ice cream for consumption in the store itself, strolling along the street, or to take home).

Although Margarita felt that "it could be done even better," she was well aware that in Spain the few retailers who specialized in the sale of ice cream were almost without exception open only in

³For example, she observed that, in the United States in general, round tubs were generally accepted as indicating that the ice cream they contained was higher quality and were labeled "super premium," whereas the lower quality, lower price ice creams were sold in square-shaped packs.

summer, with inadequate fluorescent lighting, white tiles on the walls, and, as the only form of decoration, posters showing the various ice creams on sale and rows of glasses upside down on the shelves. With very few exceptions, the stores were independent, family-run businesses. Consequently, the staff usually wore no uniform or each person wore his own; and obviously, each store used its own name and had its own sign, with very poor quality lettering.

For Margarita, the concept of the Häagen Dazs-type ice cream parlour was “love at first sight.” However, if she was to introduce similar ice cream parlours in her own country, the first problem would be to find the way to make them viable throughout the year, since ice cream consumption in Spain had always been highly seasonal, falling to almost zero during the winter.⁴ Also, unlike in the United States, there was very little ice cream consumption at home.

Margarita invited her parents to visit her, among other reasons so that they could see the Häagen Dazs ice cream parlours and share with her all these opinions and concerns. Jesús Farga decided that the matter had to be looked into in greater depth and that the first thing to do was to thoroughly analyze the product. So, when he went back to Barcelona, he took several samples of ice cream with him in his hand luggage.

By then, Farggi’s ice cream was already being manufactured without stabilizers and with low air content. This was stated in the sales brochures as features indicative of its high quality.

The results of the analyses carried out in Barcelona showed that half a litre of Häagen Dazs weighed about 470 grammes, while the same volume of Farggi ice cream weighed between 300

and 350 grammes, and the ice creams of the major domestic brands weighed between 200 and 250 grammes. This was because Farggi had always sold ice cream with a low air content; in fact, every 100 litres of solid ingredients used to make Farggi ice cream yielded only about 150 litres of ice cream. From the same quantity of solid ingredients, the major Spanish brands might obtain about 200 litres of finished ice cream ready for consumption. Another significant difference was that the Häagen Dazs ice creams (and most of the North American ice creams) had a fat content of 16 percent, whereas the norm in Spain was 5 to 6 percent, including Farggi.

Margarita Returns to Barcelona

By the time Margarita returned to Barcelona in March 1990 and joined the company as “head” of marketing, Farggi’s managers had realized that, if in previous years they had grown at annual rates of up to 30 percent, now they were growing more slowly and they had to invest more to obtain that growth. Also, because of the economic recession, restaurants were buying less, which made it even more difficult to recoup the investment in freezer cabinets, which the company bought on a lease.

The first thing Margarita did was to spend six months riding in the delivery trucks, crossing Barcelona from one end to the other, accompanying the company’s salesmen and visiting distributors throughout Spain. This enabled her to acquire a certain degree of authority both inside and outside the company.

At about this time, it was also observed that the company’s mousse cakes were very popular and had relatively little competition. Furthermore, in the course of his travels to other European countries, Jesús Farga had noticed that this was a widely accepted product in many of the more developed countries’ markets. They were sold frozen in supermarkets in somewhat smaller sizes than those normally sold by Farggi to Spanish restaurants.

⁴ According to some estimates by industry sources, in 1989, 80 percent of ice cream consumption in Spain took place between May and October. The statistics indicated that ice cream consumption in Spain was about three litres per inhabitant per year, whereas in the United States it was about 15 litres.

CONCERNS IN 1991, LEADING TO THE LAUNCH OF ‘PASTIMÚS’ AND ‘CHEESECAKE,’ FROZEN CAKES TARGETING THE HOME CONSUMPTION MARKET AND SOLD IN FOOD RETAIL STORES⁵

By 1991, the entire management team in Farggi was reflecting on what seemed to them to be their chief strategic dilemma: whether to try to maintain growth in the catering market or to try to expand their market by entering another distribution channel with products for consumption in the home. All were aware that they had to find something that would enable them to achieve two objectives at the same time: to preserve and improve their image; and to sustain and improve the company's profitability.

One of the fruits of this search for new openings was the idea of launching frozen cakes targeted at the home consumption market, to be sold in supermarkets, select food shops, and the like, offering to install a Farggi freezer cabinet. They would be the first to launch this type of product in Spain.

It seemed to them that the traditional cake shop, although it continued to play a very important role, had probably entered a phase of gradual decline.

An extensive survey was carried out from the supply of frozen cakes in Europe and the United States.

While the frozen cakes made and sold by Farggi on the catering market measured 26 centimeters in diameter and 4.5 centimeters in height, the new cakes for home consumption would measure 19 centimeters in diameter and 3 centimeters in height, giving a net weight of 550 grammes. However, being mousse cakes, because they had light, airy bodies, it was considered that they were large enough to serve between six and eight portions.

⁵Throughout this case, we will call these shops non-exclusive retail stores because they sell Farggi products together with other food products, possibly including other ice cream brands.

A range of nine flavors was defined; five mousse flavors and four cheesecake flavors.⁶ Following the serving recommendations for the products used by the catering market, on the packs of these cakes for home consumption it was clearly stated that they should not be eaten frozen but that they should be taken out of the freezer about two hours before serving to allow them to thaw. The names “Pastimús” and “Cheesecake de Farggi” were registered as trademarks, and all the other details regarding finish, formulas, processes, packaging, etc. were defined.

Farggi's sale price to the retailer was set at 920 pesetas, plus VAT, per unit, so that retailers, in turn, could sell them to the public at 1300 pesetas per unit; that is, with a gross margin of 380 pesetas. This retail sale price was higher than that of the ice cream bars and frozen cakes sold by the major national ice cream manufacturers but significantly lower than a fresh cake bought in a traditional cake shop.

Everyone was aware that, in some way which was still not clear at that time, the mousse cakes were laying the foundations for opening the distribution channel to ice cream for home consumption. Consequently, in 1991, it was decided to build a new cold storage chamber with a capacity of 10,000 m³ on a piece of land adjoining the Montgat factory. With this decision, Farggi took a step forward, anticipating future needs, whereas in the past its decisions to increase production and storage capacity had almost always been reactive. They had not expanded capacity until they had first created the market and the need.

⁶Mousse flavors were fresh pears with truffled chocolate; fresh lemon; vanilla and Irish coffee; dairy cream and fresh strawberries; and chocolate with walnuts. The cheesecake flavors were bitter orange, cranberries, pineapple, and raspberries. In total, there were nine Stock Keeping Units (SKUs).

LUIS FARGA ALSO GOES TO HARVARD. FIRST DIRECT CONTACT WITH HÄAGEN DAZS MANAGERS

In June 1991, Luis Farga, Jesús Farga's third child and Margarita's brother, graduated in economics. Then, like his sister, he went to Harvard University to follow an extension management course. Once there, he too was fascinated by the quality of North American premium ice cream and, like Margarita, insisted that Farggi should start to make and sell it in Spain.

During a visit made by his father, they decided to make an appointment with Häagen Dazs in order to explore the possibility of doing something together in Spain. The meeting took place at the end of 1991 and was rather cold. The Häagen Dazs executive they spoke to told them that any matter related to a European market should be discussed at Häagen Dazs' European headquarters in Paris.

In January 1992, they had another meeting with a senior Häagen Dazs manager in Paris, but there did not seem to be any possibility of collaboration between the two companies. In fact, the only clear impression they got from the meeting was that Häagen Dazs had not yet decided whether or not to try to penetrate the Spanish market.

He visited the Häagen Dazs parlour in the Av. Victor Hugo, where he saw that the company had managed to improve the appearance of their ice cream parlours, giving them more class. Jesús Farga traveled on to Brussels and London, where he observed and gathered information on the Häagen Dazs parlours open there.

In March 1992, Alimentaria (Food Industry Trade Fair) was held in Barcelona. Farggi was present with a stand of its own, where they were visited by the manager responsible for Häagen Dazs parlours in all Europe. He told them that Häagen Dazs was about to open their first ice cream parlour in Barcelona and that he wished to explore the possibilities of cooperation between the two companies.

In August 1992, while the Olympic Games were in full swing in Barcelona, the first Häagen Dazs ice cream parlour was opened at number 85 in the

centrally-located and classy Rambla de Catalunya. On their packaging, it was stated that the product was manufactured in France and imported by Helados Häagen Dazs, S.A.

MEANWHILE, THE 'PASTIMÚS' PROJECT ...

A few months earlier, in January 1992, Farggi had vigorously launched the frozen cakes "Pastimús" and "Cheesecake" on the Spanish market, targeting the home consumption market.

In a period of only three months, they installed about 300 freezer cabinets in supermarkets and other select food shops in Barcelona and the surrounding area, where Farggi continued to have direct physical distribution, and a further 500 freezers, through its distributors, in the rest of Spain.

The new range of frozen cakes for home consumption was readily accepted by this kind of retailer. However, the sales volume grew at a rate substantially lower than forecast. Farggi's managers considered that this was because fresh cakes were withstanding the incursion better than expected, and that the habit of buying their cakes fresh in the cake shops, rather than in supermarkets and food shops such as bakeries, delicatessens, or frozen food shops, was deeply ingrained in the public.

In any case, the market and customer surveys seemed to indicate that the low turnover was not due to the product itself, which people liked when they bought and tried it. They thought that perhaps it was because the Farggi trademark, traditionally centered on the catering market, was not sufficiently well known and did not have enough strength to persuade the final consumers to try the new cakes.

The lower turnover of frozen cakes for home consumption led Farggi to speed up the project to launch the ice creams—which were to be displayed in the same freezers—as soon as possible in order to recoup the heavy investment made in freezer cabinets. However, it should be pointed out that, at that time, Farggi's managers had not yet decided whether the launching of ice creams through the

freezers already installed in retail outlets would be accompanied by the opening of exclusive Farggi ice cream parlours or not.

FURTHER CONTACT WITH HÄAGEN DAZS: POSSIBLE COOPERATION IN LOGISTICS

In September 1992, right after having opened their first Häagen Dazs parlour in the Rambla de Catalunya, in Barcelona, the multinational company's management took the initiative to contact Farggi again in order to explore the possibility of the Spanish company taking care of the physical distribution of its ice creams to the freezer cabinets it intended to install in supermarkets throughout Catalonia.

In the ensuing discussions, Häagen Dazs' managers provided the necessary detailed information on the number and foreseeable location of their freezers, the expected turnover, ice cream SKU numbers, restocking frequencies, etc. to enable Farggi's managers to study the foreseeable workload volumes, compatibility with their delivery schedules, etc.

For their part, Farggi's managers informed them of the areas and types of outlets that they could cover with their logistics distribution system, including the fact, which apparently seemed to be completely new to Häagen Dazs, that they were already distributing their frozen cakes in bakeries, delicatessens, and the like, in addition to selling in supermarkets.

Margarita Farga remarked:

I had my eyes and ears wide open because they were telling me the story I had dreamed of doing with our brand. The fact is that we were very unsure whether we should agree to carry out the physical distribution of Häagen Dazs. We knew that the company belonged to the extremely powerful Grand Metropolitan Group and its enormous economic potential inspired a certain amount of awe.

The talks went on, with both parties exploring the projects viability until, on a certain day in November 1992, something unexpected happened:

"We had already explored all the data and details of the proposed cooperation," said Margarita, "and we were relatively close to an agreement. But at that moment, the Häagen Dazs manager we mainly spoke with (a delightful person and very competent), possibly carried away by his enthusiasm at the way things were starting to come together, exclaimed, "Fantastic, we'll install the first Häagen Dazs freezers in the three Farga cake shops!" That sentence, no doubt uttered with the best of intentions, made something snap inside us. It came as a thunderbolt! As if suddenly a veil had fallen from our eyes and it was crystal clear to us what we should not do!"

There were at least another three reasons against closing the physical distribution agreement. First, Häagen Dazs offered to pay Farggi only 13 percent on its list price to the retailer, while the latter, just for selling the product to the public, had a gross margin of more than 38 percent on the retail sale price.⁷

Furthermore, in the event that Farggi was to physically distribute Häagen Dazs ice creams outside of the metropolitan area of Barcelona, its direct distribution area, the money received would have to be shared in some way between Farggi and its 30 independent distributors.⁸ In any case, taking into

⁷ A food shop equipped with a freezer cabinet (belonging to Häagen Dazs) bought the ice creams at 440 pesetas + 6% VAT and resold them to the public at 675 pesetas, with a gross margin of 235 pesetas per 500 ml tub. From the supermarket's point of view, this was not only an excellent gross margin in absolute terms, but was even more so when the fast turnover and small area occupied by the freezer in the shop (approximately one meter) were worked into the calculation.

⁸ The logistics process that had been designed would have been the following: Häagen Dazs would be responsible, on the one hand, for placing its ice creams (manufactured in France) in Farggi's central cold storage warehouse in Montgat, which would act as central warehouse. On the other hand, Häagen Dazs, through its own team of sales representatives, would carry out all the initial sales work with the supermarkets and would install the freezer cabinets. It would then notify Farggi of the new customer. Farggi would serve the initial order to load the freezer. From then on, Farggi's delivery/salesperson would visit the sales outlet at least twice a week. At each visit,

account the direct costs of storage, delivery, administration and control, Farggi estimated that 13 percent was not a very good rate for them.

The second, and perhaps most important and decisive reason against a logistics cooperation between Farggi and Häagen Dazs, was that José Manuel Garrido, Farggi's sales director, was never quite sure that the distribution of Häagen Dazs products was really compatible with the delivery of Farggi products, from the commercial and image viewpoints (signage on the vans, etc.).

Finally, Farggi's managers also thought that, if they acted merely as a logistics service for storage and delivery, any time that Häagen Dazs received a more attractive offer from another logistics company, they could decide to discontinue their relationship with Farggi, which could leave Farggi with excess storage and transport capacity, which it would not be easy to reoccupy.

In the end, the negotiations were broken off and, almost without giving it a second thought, Farggi's

management team took the momentous decision: "We must open our own Farggi parlours as soon as possible!" Initially, the plan was to open five Farggi-owned ice cream parlours, the first of which had to be open by June 1993 to gain maximum benefit from the summer season. They knew that they would need bank financing for this. Consequently, right from the start, they planned and executed the entire project on the understanding that subsequent growth of the number of exclusive Farggi parlours would be by franchising.

Farggi's managers were well aware that both Farggi, through its Farga cake shops, and Häagen Dazs created and developed their image through establishments that bore their name. Thus, one of the key success factors would be to get customers to buy the luxury ice creams in the supermarket thanks to the memory and image they took away from their visit to the exclusive ice cream parlour.

A FEW MORE MONTHS OF FRENETIC ACTIVITY: THE DESIGN OF 'FARGGI TUB'S & ICE CREAM'

Once the decision to open their own parlours had been made, there began a frantic race against time. Numerous operational details concerning the new ice cream parlours and the range of ice creams had to be decided.

They designed a new logo with the "Farggi" brand name and considered different names for their new establishments (they did not want to call them "ice cream parlours"). They did not know what name to give their ice cream containers either.

Finally, they decided that the formal name would be "*Farggi Tub's & Ice Cream*."⁹ Generally, they referred to them as their "shops."

In addition, they had to resolve, decide, and define a large number of operational details, such as:

he would verify stock status, replace the sold articles (placing the ice creams inside the freezer), and obtain the retailer's signature on the delivery note, which detailed what had been delivered. Farggi's delivery person would not collect payment, but would hand in the signed delivery notes at his operations base at the end of the day's work for verification, control, and subsequent dispatch to Häagen Dazs, who would issue the corresponding invoice and take care of collecting payment. (Apparently, it was Häagen Dazs' intention to issue only one monthly invoice, summarizing everything that had been delivered to a particular shop during each calendar month.) In return for its cooperation in this process, Farggi would receive 13 percent of Häagen Dazs' selling price to the retailer. It was estimated that the average order per visit and delivery would be at least about 12–14 "pints" (500 ml tubs). In autumn 1992, Häagen Dazs' selling price to the retailer was 440 pesetas (+ 6% VAT) per "pint." Consequently, Farggi's average revenue per visit would have been 13 percent of this amount, or about 744 pesetas per visit made by its own delivery personnel (13 pints sold per visit x 440 pesetas/pint x 13%). Obviously, the more successful and better accepted Häagen Dazs's ice creams became, the higher the average sale per visit. At that time, Häagen Dazs had installed only three freezers, but it intended to initiate an aggressive sales and freezer installation campaign as soon as it had solved the physical distribution issue.

⁹"Tub's" is a registered trademark of Farggi.

1. Find a container manufacturer who could supply food-quality printed cardboard tubs. Apparently, there was no such manufacturer in Spain. It was also difficult to find a suitable supplier of plastic lids for the tubs. Then, the tub had to be “dressed.” Its decoration had to be designed so that it conveyed the idea of “luxury ice cream,” using gold and navy blue, which became the “corporate livery.”

However, there was another problem: the tub manufacturer (which was not a Spanish company), stipulated minimum runs of 100,000 units for each model or type of decoration. The solution was to print and manufacture a standard or universal tub model, a preprinted base to which two labels would be added: one on the tub front or side, with the name of the flavor (and stamped with the outline of the object defining the flavor, for example, a strawberry), and another with the barcode, which would be stuck on the tub base. Likewise, it was decided to buy lids made of white plastic, to which a round sticker was added. Initially, on a temporary basis, these labels would have to be stuck on by hand, which would slow down and increase the cost of the production process. The primary goal was to get the product on the market as soon as possible. These production details could be improved at a later date.

2. Define the range of ice cream flavors to sell. Then, develop the corresponding formulas and production processes. For this purpose, besides using the knowledge and experience of Farggi’s production and management team, numerous trips were made to the United States to make contact with various manufacturers of machinery for making ice cream. Jesús Farga also contacted experts in formulas and production processes for North American-style ice cream.

During these months, Farggi’s management team and technical and production staff, with outside help when necessary, developed the

formulas and processes for the 25 flavors¹⁰ that made up the new range of ice creams for sale both in Farggi’s exclusive ice cream parlours and through the 800 freezer cabinets that were already installed in supermarkets and other non-exclusive food shops to sell the “Pastimús” and “Cheesecake” frozen cakes.

Establishing the formulas and production processes for the new range of ice creams involved serious technical difficulties because Farggi wanted to use only absolutely natural ingredients and because the new ice cream had to meet the following specifications: about 16 percent fat content (instead of the 5 to 6 percent that was usual in Spain, even in the ice cream previously manufactured by Farggi), a very low air content, and no stabilizers or artificial coloring.

In fact, so great were the technical difficulties that the formulas and processes were not considered to have been finalized until June 1993, when the opening of the first Farggi ice cream parlour was imminent.

These formulas produced ice creams that were very similar to those of Häagen Dazs. On the other hand, both companies’ premium ice creams were clearly different from any other ice creams manufactured at that time in Spain.

3. It was necessary to purchase, install, and start up a number of new machines in the Montgat factory in order to manufacture and/or package the new types of ice cream.
4. It was also difficult to find a manufacturer who could supply the 9.5-litre cardboard cylinders that were required as bulk containers for use in the glass-fronted freezer cabinets in the Farggi parlours, for serving to the public in individual scoops. In Spain, the

¹⁰Of these 25 flavours, at least three were typically Spanish and therefore had no Häagen Dazs counterpart: milk meringue streaked with cinnamon, mandarin sorbet, and Spanish nougat.

normal size was five hires, but Farggi's managers wanted them bigger, so that they would not have to be changed so often and so that they would fit better in the freezer cabinet.

5. Much to their surprise, they also found that there was no Spanish manufacturer capable of supplying freezer cabinets with the machines and thermostats needed to keep the ice cream precisely between -18°C and -20°C . This was an essential detail, not only to keep the ice cream in perfect condition (manufactured with a high milk solids content), but also to ensure that the consumer would find it cold enough when he ate it. Finally, after a hard search, they managed to locate a manufacturer of freezer cabinets in the United States, to whom they sent their first orders.

However, a surprising incident occurred: when these freezer chests were ready, the North American manufacturer shipped them to Europe. When Farggi's managers asked for the address and telephone number of the collection point, they discovered to their horror that the North American manufacturer had assumed that they were Häagen Dazs licensees and had sent the freezer chests to the Häagen Dazs warehouse in Paris! So, in March 1993, Häagen Dazs found out that Farggi was planning to open its own ice cream parlours.

6. The interior of the freezer cabinets installed in the retail outlets where the frozen cakes were being sold had to be redesigned so that they could also be used to store the new tubs in such a way that customers could help themselves directly from the freezer.
7. A large number of decisions had to be made regarding the range of products to be sold in the Farggi ice cream parlours, the functional design of the parlours, and their decoration. For example, one of the key decisions was whether only ice creams would be served, as seemed to be the case in Häagen Dazs, or whether coffee, soft drinks, and pastries would also be served. If coffee was to be served, the

establishment's decoration depended, among other things, on whether the coffee machine would be located in a place where it was visible to the public, as in most bars and cafeterias, or not. If they served coffee and pastries, would the typical bar counter be installed or would they only be served to be taken away or to be eaten sitting at the tables?

There was never any doubt that portions of Pastimús and Cheesecake would be served in Farggi's parlours, and this feature would clearly differentiate them from Häagen Dazs.

In the end, it was decided that coffee, soft drinks, and pastries would be served, in addition to ice creams and cakes. There were at least two reasons for this decision: on the one hand, Farggi's managers were continually concerned about ensuring their parlours' commercial and economic viability during the winter months, when ice cream consumption drops off considerably. In fact, the thought process followed by Farggi's management team had been the following: "Our growth will necessarily depend on granting franchises. Therefore, inevitably, the exclusive Farggi parlours must be profitable for our future franchisees. Consequently, the parlours and the range of products served in them must be designed so that they make good business sense in their own right, even if we stay with the idea that most of their sales should be ice creams."

Secondly, by offering and serving combinations of scoops of ice cream with portions of cake (possibly with toppings, such as whipped cream, melted chocolate, caramel sauce, or other fruit sauces), the aim was to inspire consumers to imitate them and prepare similar dessert combinations in their own homes, after purchasing the ingredients in the Farggi parlours or from the freezers at the supermarkets. As Margarita Farga added "... by this means, we wanted to get the final consumer to identify with the sweet world of Farggi."

8. It was also decided that they would manufacture and sell three varieties¹¹ of premium ice cream on sticks, to be called "batonets," a name that was unique in Spain.
9. Having established the products and services to be sold in their own parlours, menus were printed so that customers wishing to consume the products sitting at the establishment's tables could choose in complete comfort and ask the waiters to bring them what they wanted.
10. Regarding the decoration of the first Farggi parlour, it was necessary to contact a number of contractors and interior decorators. One of the prerequisites was that these companies should be organizations large enough to be able to fit out and decorate other exclusive Farggi parlours (either owned by Farggi or franchised) in any part of Spain. Also, right from the start, there was a serious and persistent effort to define designs that used standard measurements and specifications, so that they could easily be reproduced in other premises of a different size, in different locations and with different floor layouts.
The idea was that Farggi parlours would have two parts: the entrance had always to be "very Farggi," with a more striking and direct style of decoration, lighting and signage. Further inside, on the other hand, in what Farggi's managers called the "tea room," the style of decoration would be softer and more flexible, and could vary from one parlour to another, although they would always use fine materials such as marble and wood.
11. The last three important decisions were, first, to run a number of blind tests of the ice cream developed at the Montgat factory, comparing them with Häagen Dazs' ice cream. Farggi's managers reached the conclusion that, at least when the test was carried out blind, when the

customer did not know which brand of ice cream he or she was tasting, the result was a draw between the two companies. In actual fact, what happened was that with certain flavors there was a preference for the ice creams of one manufacturer, while in other flavors there was a preference for the ice creams of the other manufacturer. There was a third group of flavors where there was no significant preference in either direction.

Encouraged by this result, Farggi's managers then decided that their ice creams would be sold at exactly the same retail price as Häagen Dazs' products, both in their parlours and in the freezer cabinets installed in supermarkets and other sales outlets. First, this would give them the same (substantial!) unit margins that Häagen Dazs enjoyed. Second, selling at lower prices could have been interpreted by the consumers as an indication that Farggi's ice creams were lower quality. Finally, they did not have any wish or intention to start a hypothetical price war with Häagen Dazs.¹²

The final decision concerned the location of their first parlour. After considering various options as regards site, size and rent, it was decided that their first parlour would be at number 94 of the stately Paseo de Gracia, a few yards along the street from Saundis world famous building "La Pedrera" and a few blocks from Häagen Dazs first parlour on the Rambla de Catalunya.

THE FIRST 'FARGGI TUB'S & ICE CREAM' PARLOUR IS OPENED

The first Farggi parlour opened its doors to the public in July 1993, almost one year after Häagen

¹¹Swiss chocolate with black chocolate, vanilla with mild chocolate and almonds, and vanilla with milk chocolate.

¹²This price policy would be continued during the following months: Farggi accepted a role as price "follower" with respect to Häagen Dazs, so that when Häagen Dazs took the initiative to increase prices, Farggi followed suit, raising prices by the same amount.

Dazs opened its first parlour. A few months later, in November of the same year, the second Farggi parlour was opened in the Rambla de Catalunya, barely three blocks away from the first Häagen Dazs parlour and on the same side of the street. A few weeks later, on 2 December, the third parlour was opened in the "L'Illa Diagonal" shopping centre, on the Avenida Diagonal.

These three parlours were owned and operated by Farggi.¹³ The necessary investments had been made by the company itself and they were run by Farggi personnel. Responsibility for the day-to-day management and supervision of the parlours was assigned to Marcos Serra. Eduard Farga was made responsible for planning and initiating relationships with franchisees: identification of future franchisees, negotiation, implementation, start-up and monitoring.

On his return from the United States, Luís Farga had also joined the company as assistant sales director, with direct responsibility for the distribution of Farggi products in supermarkets and other types of non-exclusive food shops. His first task was to study the performance of each of the freezers where frozen mousse cakes were sold. Any freezer that did not reach certain minimum sales levels was reinstalled in a different shop.

The opening of these first three Farggi-owned parlours—true flagships for "Farggi Tub's & Ice Cream"—attracted a lot of attention and the company started to receive unsolicited requests to open franchised Farggi parlours.

This fitted in perfectly with the company's intentions and plans, since they had all been aware, right from the start of the new project, that franchises would be indispensable if they were to continue

growing at a high enough rate. Indeed, opening the first three parlours had required an investment of about 140 million pesetas, which the company had financed with bank loans.

Therefore, in early 1994, on the basis of the experience acquired during the first months of operation of the three Farggi-owned parlours and other sources of information, Margarita Farga drew up an operating manual running to more than 200 pages detailing, from A to Z, the operation of a Farggi parlour.

THE FIRST FRANCHISED FARGGI PARLOUR IS OPENED; THE OTHER PARLOURS OPENED IN 1994

With the manual now available, in February 1994 the owner of a restaurant that was a customer for Farggi products opened the first franchised Farggi parlour in Vilanova i La Geltrú.¹⁴

The agreement initially took the form of a pre-contract, while Elena Farga, who had a degree in law and worked in a law firm unrelated to the company, worked against the clock to draw up a highly detailed franchise contract that eventually ran to over 40 pages.

In May 1994, the fourth Farggi-owned parlour was opened in the Port Olímpic in Barcelona. A trial run had been carried out beforehand by opening a corner franchise, almost a window franchise, in "El Túnel del Port," one of the many restaurants in the area. In view of the enormous success of the window, it was decided to open the parlour while maintaining the corner franchise. This "double sale" in the same area was still operating at the time of writing this case.

In May 1994, the seventh exclusive sales outlet was opened (the third of the franchised outlets) in Conde de Penalver Street in Madrid, near the El Corte Inglés department store. In this case, the licensee was Farggi's own distributor in Madrid.

¹³ All Farggi parlours are exclusive, that is, they only sell products made by Farggi. In this text, we use the expression "Farggi-owned parlours" to refer to the parlours in which the investment and operation are Farggi's responsibility, using the expression "franchised parlours" when the investment and operation are the responsibility of an independent licensee, although always under Farggi's control and supervision.

¹⁴ A coastal town with about 40,000 inhabitants located about 40km south of Barcelona.

In June, the fifth Farggi-owned parlour was opened in the heart of Barcelona: the Plaza de Cataluña. Located between El Corte Inglés and the head of the Ramblas, Barcelona's most famous boulevard, this parlour would benefit from high visibility and high pedestrian traffic. With this parlour, Farggi's management team had a certain sensation of having achieved, in barely one year and a half, the objective that they had set themselves in November 1992 of opening five Farggi-owned parlours. They were frankly pleased with the impact they had in Barcelona and on the ice cream market.

In the same month, the fourth franchised parlour was opened in Salou, a well-known coastal town located a few kilometers to the south of Tarragona. Finally, in the next few months, another three franchised parlours were opened: in the port of Mataró, in Malaga, and in Calella de Palafrugell, on the Costa Brava.

Thus, the first full year of activity of Farggi Tub's & Ice Cream (July 1993–July 1994) ended with 12 parlours open: five Farggi-owned in the city of Barcelona, and seven franchises (one corner franchise in Barcelona's Port Olímpic, four in towns on the Catalan coast, one in Madrid and another in Malaga). After the summer, in September 1994, a second franchised parlour was opened in Madrid (Pintor Sorolla–Santa Engracia).

In order to make sure that the franchisees properly complied with the conditions contained in Farggi's manual, the services of an independent company that specialized in the control and monitoring of food franchises were hired. This company used the "mystery buyer" method, which basically consists of visiting the establishments without any prior announcement or identification to verify the level and quality of service to customers, the establishment's cleanness and appearance, and other details.

New Parlours that Would Be Opened in 1995 and After

In February 1995, the third Farggi franchised parlour would be opened in Madrid. A further nine

new franchised Farggi parlours were scheduled: in the "Maremagnum" shopping and entertainment complex in the port of Barcelona; in the Calle del Pi, also in Barcelona; in Vic (province of Barcelona); in L'Escala (province of Gerona); in Benidorm (province of Alicante); in Puerto Banús (province of Malaga); in Marbella (province of Malaga); in Lloret de Mar (province of Barcelona); in Corunna; in Las Arenas, near Bilbao; and in Ciutadella, in Menorca

In short, if these plans worked out, by the end of 1995, Farggi would have a chain of 25 exclusive ice cream parlours, five owned by the company itself and located in the city of Barcelona, and 20 franchises.

By the end of the fifth year of operations, Eduard Farga expected to have about 100 exclusive Farggi parlours open, of which 90 would be franchises and perhaps 10 Farggi-owned.

EVOLUTION OF THE SALE OF FARGGI PRODUCTS IN SUPERMARKETS AND OTHER TYPES OF NON-EXCLUSIVE SHOP FOR HOME CONSUMPTION

The first Farggi products for consumption at home had been the "Pastimús" and "Cheesecake" cakes, which were distributed and sold frozen, but were to be eaten after thawing. They had been introduced in early 1992 by installing about 800 freezer cabinets in supermarkets and other types of retailers.

Even back then, Farggi's management team had guessed that this range of cakes would eventually be complemented with another range of ice creams to be eaten at home, possibly taken from or based on the range of Farggi ice creams sold to restaurants.

Unfortunately, sales of this range of frozen cakes were growing at a much slower rate than expected. Margarita Farga attributed this slowness to the need to induce and allow time for a double change in the end customers' purchasing and eating habits, since, in Spain, it was not the custom for people to buy frozen cakes in the supermarket. Normally, people either ate fresh cakes bought in a traditional cake shop, or ice cream bars and frozen

cakes bought in supermarkets and eaten while still frozen.

In spite of this difficulty, Farggi had never advertised its frozen mousse cakes in the mass media.

As a result of all this, sales of the Pastimús and Cheesecake range in some of the freezers were just above 100,000 pesetas per freezer per year, at Farggi's selling prices to the retailer. Although this was a minimum figure, the company's managers admitted that the project would only have been profitable in the long term. There were even cases where some freezers had to be relocated, installing them in restaurants and cafeterias.

Throughout 1992, these freezers were installed in various kinds of sales outlets. From November 1992 onwards, the attention of Farggi's management team was concentrated on preparing the launch of "Farggi Tub's & Ice Cream," so little attention was paid to the Pastimús and Cheesecake range during that period.

Of course, these cakes were included in the range of products to be sold in the Farggi ice cream parlours.

However, once the first Farggi parlour had been opened in Paseo de Gracia, modifications were made to the freezers' shelving to be able to display the ice cream "Tub's" in them, starting with the freezers installed in Barcelona. At the same time, Farggi's sales teams reopened negotiations with some supermarket chains with a view to relaunching the installation of new freezer cabinets which would sell the ice cream "Tub's" and the Farggi frozen mousse cakes right from the start.

Like Häagen Dazs, Farggi's policy was first to open an exclusive Farggi parlour in a city, to create the product's image, and then start distributing ice creams in supermarkets through the freezer cabinets. Of course, Farggi had the advantage of the fact that a large number of freezers had already been installed.

Consequently, all that was needed in order to expand the product range was to change the inside shelving and obtain the retailer's agreement, which was relatively easy as the sales turnover of a Farggi freezer cabinet increased very substantially, almost

always to about 500,000 pesetas per year, at Farggi prices to the retailer.

Although both Farggi and Häagen Dazs maintained a discreet silence regarding their costs and margins, a number of experts in ice cream manufacture indicated that, even taking into account the fact that both brands used only top quality natural ingredients, the cost of the raw materials and packaging would probably not be more than 35 percent of their sale price for "Tub's" and "pints" to retailers.

Generally speaking, although both had started in Barcelona, there was relatively little confrontation between Farggi and Häagen Dazs. First, because both were still in an early phase of market entry.

Second, because Farggi already had a large installed base of freezer cabinets. Third, because both realized that they could coexist perfectly, sharing presence in many supermarkets and even in smaller shops.

In spite of this, there were a few clashes. For example, Farggi managed to be present in all the Caprabo supermarkets (55 points of sale), whereas Häagen Dazs would only be present in the 15 largest, sharing presence with Farggi. In those supermarkets where both brands' freezers were installed side by side, their sales volumes were very similar.

On the other hand, in the Pizza Hut chain, even though Farggi had managed to get its foot in first, in March 1994 Häagen Dazs became the sole supplier of ice creams. However, Farggi remained as a cake supplier for Pizza Hut, so the business relationship was not broken. Much the same thing happened in the Pans & Company sandwich chain, which bought ice creams from Häagen Dazs and cakes from Farggi.

In August 1993, Farggi signed a contract with the Barcelona Football Club for the exclusive sale of ice creams in its sports facilities. The purpose of this contract was to create brand impact and enable a large number of people to taste Farggi's products. "Mini Tub's" (100 ml) and "Batonets" were sold from 25 carts at 350 pesetas each. The contract would run for three years, with Farggi paying 15 million pesetas/year.

MEANWHILE, HÄAGEN DAZS ...

Farggi's managers believed that, by the end of 1994, Häagen Dazs had about 25 parlours operating, of which two were actually owned by the company: one in the Rambla de Catalunya in Barcelona and the other in the centre of Madrid.

Regarding distribution, it was estimated that they had about 600 freezer cabinets installed in Barcelona and a further 400 in Madrid, mainly in relatively small outlets, but with presence in some supermarket and hypermarket chains. The physical distribution in the Barcelona area was carried out by La Menorquina, although this relationship seemed to have ended by the end of 1994. In other parts of Spain, they used the services of professional frozen product logistics companies.

In June 1994, Häagen Dazs had introduced a range of four varieties of ice cream under the name "Extråas," which it sold in its parlours but not in supermarkets. This range had a distinctive presentation and seemed to have achieved a relative success.

By the end of 1994, one or two Häagen Dazs franchisees had raised the possibility with Farggi of changing flag and joining its chain.

MAIN STRATEGIC DILEMMAS FACING THE FARGA/FARGGI GROUP IN EARLY 1995

In early 1995, Margarita Farga, as Farggi's marketing director, was reflecting on what had been done so far and what had been achieved.

To help her organize her thoughts about the Farga/Farggi Group's business activities, she sometimes used the following "branch system:"

Farga/Farggi Group:

1. Farga traditional cake shops
2. Farggi businesses
 - 2.1 Farggi products sold to restaurants
 - 2.2. Farggi products sold to retail shops
 - 2.2.1. Sold to non-exclusive shops (supermarkets, etc.)
 - 2.2.2. Sold to the exclusive Farggi parlours
 - 2.2.2.1. Farggi-owned parlours
 - 2.2.2.2. Franchised parlours

Some of her thoughts and concerns about each of these "branches of the Farga/Farggi tree" were the following:

On the one hand, the three Farga cake shops (item 1) were carrying on as usual, with 37 years of professional and trade experience, as upmarket establishments making fresh cakes and high-quality pastries, sold directly to the public either for consumption on the premises or to take home. There did not seem to be any intention of modifying their activities or increasing the number of such establishments.

On the other hand, there were all the Farggi products (item 2).

First among these, both for historical reasons of "order of appearance" and because of its basic economic importance, was the sale of ice creams and frozen cakes to restaurants and cafeterias (item 2.1), which was still the group's largest business in terms of sales: excluding sales by the Farga cake shops, it had accounted for 60 percent of total ice cream and frozen cake sales under the Farggi brand name in 1994.

Margarita was aware that, since November 1992, this "business 2.1" had been somewhat neglected as a result of the strategic priority given by all the company's personnel to designing and starting up the "Farggi Tub's & Ice Cream" project. Consequently, it seemed to her that the time had come to redefine and refocus it strategically, both as a brand and as its product range or collection.

Restaurants and cafeterias were a mature market, but one in which some fast food chains were growing rapidly. However, during 1993 and 1994, Margarita had not had the impression that Farggi's customary competitors in this field (Frigo, Camy, Menorquina, Avides, etc.) were introducing any striking novelties.

In third place was "business 2.2," the sale of Farggi products in shops and parlours for consumption at home, on the premises, or on the street (impulse sale). It seemed clear to Margarita that Farggi's management team's chief achievement during the previous three years (1992-1994) had been the creation of a relatively complex strategic

platform for the sale of Farggi ice creams and frozen cakes for consumption in Farggi ice cream parlours and at home. Over a period of three years, they had taken this business from zero to 40 percent of the total sales of Farggi products, "business 2" in 1994.

According to a market survey carried out in September 1994, their only competitor in this "business 2.2," in the opinion of a sample of final consumers in Barcelona, was Häagen Dazs. It seemed that Farggi and Häagen Dazs were the only two ice cream brands that had really succeeded in positioning and consolidating themselves in the high quality, premium price segment of the ice cream market in Spain. However, at the same time, it seemed obvious to her that both "luxury" ice cream brands competed with the major brands, such as Frigo, Camy, Avides, Miko, etc., given that the consumer, when buying ice cream, had to decide whether he wanted high quality ice cream at a high price or medium quality ice cream at a medium price.

Regarding sales in non-exclusive shops (item 2.2.1), by the end of 1994, Farggi was distributing its ice cream "Tub's" and frozen cakes (Pastimús and Cheesecake) in Catalonia, Madrid, and Malaga through 800 freezer cabinets installed in supermarkets and other retail sales outlets. Farggi's management team were of the opinion that, in these three areas, the market was still a long way from being saturated and that in Catalonia, Madrid, and Malaga-Costa del Sol, they could install up to a maximum of 6,000 freezers.

It was also their intention to expand the distribution of "Tub's" and frozen cakes as new exclusive Farggi parlours were opened in other locations; the parlours would create the brand image in each location, paving the way for sales in non-exclusive shops. The brand image was also needed to justify the price premium of Farggi ice creams, which were sold to the public in supermarkets at 675 pesetas for half a litre, whereas the usual price for Frigo, Camy and Miko ranged between 400 and 450 pesetas per litre, although they often ran promotions during which the price could be reduced to as little as 350 pesetas per litre.

By the end of 1994, Farggi had about 80 applications to open new franchised Farggi parlours, so Margarita was sure that there would be no obstacle to growth due to lack of parlours. However, depending on the rate at which new parlours were opened and the market size and potential of each town or city in which they were to be opened, a limiting factor might be their financial capacity to invest in the purchase of freezer cabinets. By the end of 1994, each freezer cost 150,000 pesetas. The upside of this was that, thanks to the sale of "Tub's" and cakes in the same freezer, sales figures exceeding 600,000 pesetas per freezer per year were being achieved, at Farggi's sales prices to the retailer. In a large supermarket, the figure could easily be double this amount. When Farggi sold to retailers through its local distributor, it granted the distributor a 20 percent discount, giving a net billing for Farggi per freezer of 480,000 pesetas/year. Even so, with such figures, it was possible to depreciate a freezer over a reasonable period of five years, financing them by credit lines or leasing operations.

Finally, regarding sales in exclusive Farggi parlours (item 2.2.2.), a distinction had to be made between Farggi-owned parlours and franchised parlours.

As stated earlier, by the end of 1994, Farggi had five parlours of its own (item 2.2.2.1), all of them located in the city of Barcelona. The parlours in Paseo de Gracia, Rambla de Cataluña and L'Illa had been operating for barely a year. Port Olímpic and Plaza de Cataluña, which were opened in mid-1994, had only been going for a few months and had yet to pass the acid test of the winter season.

In Margarita Farga's opinion, these five Farggi-owned parlours were "perfect as flagships," to create the necessary Farggi image: (a) to sell "Tub's" in the supermarkets; (b) to promote sales of new franchises; and (c) to generate a good image, in general, with a very broad range of groups and audiences, such as gastronomic journalists, retailers, financial institutions, etc. Their profitability was in some cases "very high," while in others she considered it to be "satisfactory."

The company's immediate plans were not to open any more Farggi-owned parlours, except in cities or streets which might be considered "strategic," necessary for the process of creating or strengthening the company's image.

There could perhaps be a middle road, consisting of having part-owned parlours, in which Farggi would share ownership of the parlour with a local partner.

Regarding the franchised parlours (item 2.2.2.2), one point that had to be remembered was that some of them were seasonal, open to the public for only about six months. Such was the case of the parlours in Salou, Calella, Mataró... It appeared that the seasonal parlours, located in coastal resorts, were "extremely profitable." Other parlours were open all the year round: Madrid and Malaga. The key profitability factor for these parlours would be their performance during the difficult winter months.

At least until the end of 1994, these franchised parlours did not pay any royalties nor had they made any initial down payment to buy their franchising rights when they signed the contract. Farggi obtained its profits from the captive sale to its franchisees of five products or groups of products:

1. Ice cream, in 9.5 litre packs ("bulks"), which they resold "by the scoop."
2. Ice cream in "Tub's" for taking away.
3. "Pastimús" and "Cheesecake" frozen cakes for taking home whole.
4. Frozen cakes for selling in the parlour in portions.
5. Various complementary articles, such as paper napkins, cone wafers and paper cups for serving the balls of ice cream, toppings and sauces, uniforms, etc....

The margin, the difference between the purchase price from Farggi and the selling price to the public in the parlour, was very high, about 65 percent of the retail price. To put it the other way round, the cost of the products sold to the public was 35 percent of the selling price. Of course, the parlour owner had to pay the rent, wages and social security, financial expenses (if any), electricity, water, amortize the machinery and facilities, etc.

Farggi required that parlours which were to be open all year round should have a minimum surface area of 100 meters. A parlour of this size required investments of about 20–25 million pesetas in machinery, equipment, and decoration.

In the case of parlours that were open only during the summer season, Farggi allowed them to be smaller, with a minimum of about 50 meters. The investment to fit out an ice cream parlour of this size usually ran to between 12 and 15 million pesetas.

SOME FINANCIAL INFORMATION

Being a family-owned company, Lacrem, S.A. did not publish its balance sheets. Traditionally, it had always made a profit which had enabled it to finance its growth from self-generated funds. Exceptionally, in 1993, the company had recorded a negative cash flow. However, cash flow had been moderately positive again in 1994. The economic forecasts for 1995 and 1996 were for a strong increase in cash flow, which would enable the company to progressively decrease its level of indebtedness, open new Farggi-owned parlours, or buy more freezer cabinets.

As marketing director, Margarita had a relatively modest budget of about 25 or 30 million pesetas, which she used to carry out typical marketing activities, such as local promotional events when new parlours were opened, tasting events, preparing the new menus for the company's parlours, a number of public relations activities, etc.

The Group's turnover, which consists of Lacrem, S.A.'s turnover plus the final turnover (sales to the public) of the five Farggi-owned parlours, less Lacrem, S.A.'s billing to these five parlours (so as not to count twice), was expected to double between 1993 and 1995, as follows:

	1992	+5%
	1993	-15%
	1994	+40%
Forecast	1995	+30%
Forecast	1996	+30%

The investments in the factory had amounted to about 350 million pesetas. Total investments in Farggi-owned parlours and freezer cabinets had amounted to another 350 million pesetas.

By the end of 1994, for all its sales activities, including sales to restaurants and cafeterias, the company had an installed base of about 3,000 freezer cabinets and a further 2,000 top-opening freezer chests, used by restaurants and cafeterias to store their stocks of Farggi products.

SOME QUESTIONS ABOUT THE FUTURE

Faced with this situation, Margarita Farga was turning over a number of questions in her mind. For example:

- Who were they really competing against? Against Häagen Dazs? Against the traditional big ice cream companies: Frigo, Camy, etc.? Against the traditional cake shops? Were they perhaps expanding the market, expanding consumption among people who would not otherwise eat ice cream?
- How quickly should they grow? In which cities or geographical areas? Farggi was already receiving a large number of franchise applications from outside of Spain. Should it start to internationalize itself? If so, which countries should it go to first? Should they open directly in other countries or reach an agreement with a master franchiser who would be given exclusive rights for an entire country?
- Were five Farggi-owned parlours enough or should they try and open more? Should they maintain a certain percentage or proportion of Farggi-owned parlours out of the total number of exclusive Farggi parlours?
- Would it be enough to open exclusive parlours to create the necessary image or should they also run advertising campaigns in the mass media? In the case of the latter, what should be their positioning and message? It was clear that such advertising would have to promote high quality, premium price products, but should

they aim for an “adult” positioning like Häagen Dazs? Would a more family-style positioning be better, with advertisements showing children with their parents and/or grandparents or perhaps a “for gourmets of all ages” positioning?

- What things should they, try and do like Häagen Dazs and what things should they do differently in order to achieve a distinct, differentiated image? For example, on the subject of ice cream flavors, should they make “international flavors” or should they differentiate themselves by creating flavors more in tune with the Spanish palate?

In short, what were the key success factors of “Farggi Tub’s & Ice Cream?” What things could Farggi do that Häagen Dazs could not or did not want to do? Looking at it the other way round, what things could Häagen Dazs do that Farggi could not do, or at least could not do so well? What things could both of them do with more or less equal cost-effectiveness, without any differential competitive advantages on either side?

- Finally, Farggi’s management team was aware of a significant dilemma: (a) They could either go on alone, self-financing their growth, in which case they might not be able to keep up with Häagen Dazs and other competitors might appear in the same segment;¹⁵ (b) or it might be better to allow a non-family investor to come in with a view to accelerating their market penetration at home and abroad.

No doubt, this list of questions was not exhaustive and what most worried Margarita was the possibility that she might have left out some key decision in this maze of decisions and opportunities.

¹⁵ On 5 February 1995, the newspaper *Expansión* published an article stating that the North American ice cream company Ben & Jerry had recruited Robert Holland as its new CEO. The article closed by quoting Holland, an ex-McKinsey consultant, as saying, “We will be in Europe next year.” According to the same article, Ben & Jerry’s sales in 1993 totaled 140 million dollars, with a net income of 7.2 million U.S. dollars.

EXHIBIT 1***FARGGI The Spanish ice cream market***

The Spanish ice cream market had a total volume of almost 182 million litres (some 48 million U.S. gallons) in 1994.

According to industry sources, this figure includes only "industrial" ice cream, manufactured by companies which were members of the Asociación Española de Fabricantes de Helados. Therefore, to obtain the real total market volume, one should add a further 20 to 25 million litres of ice cream homemade or made by small artisan-like manufacturers, plus some 20 to 25 million litres manufactured by small industrial companies which were not members of the Asociación.

Bearing in mind that Spain has a permanent population of some 40 million, the annual consumption of ice cream would be around five litres per person. It may be even less than that, bearing in mind that Spain received some 60 million tourists and visitors in 1994.

According to industry sources, the total market may be broken down in the following manner:

1. Some 42 percent of the total market would be made up of products classified as "impulse," sold in individual portions, individually packed or wrapped, frequently sold by street or beach stand vendors, or from ice cream freezers located at the door of bars, supermarkets or miscellaneous food retailers. The most common products in this category would be pre-packaged ice cream cones, small cups, and ice lollies or Popsicles. It may be necessary to clarify that this classification refers to product categories, and not to how or where it is consumed. In other words, whether an "impulse" product, is bought at a bar or in a restaurant, if it is a product in an individual portion, individually packaged, it continues to be classified as "impulse."

In the last few years, formats of "impulse" products have appeared in the market, such as ice cream sandwiches, or small ice cream bars, such as Crunch by Nestlé, or frozen Mars bars.

2. A further 11 percent of the total market is made up of "home" consumption products. These are frequently packaged in one litre packs, such as the product ranges of "La Cremería" (Nestlé), "Carte d'Or" (Frigo), or "Etiqueta Negra" (Miko). We

would also find in this group the large ice cream bars or blocks which have to be cut into smaller individual portions for consumption, as well as frozen cakes or confections, such as "Gala," "Comtessa," crocanti, or whisky frozen cakes. We also find here multipacks containing several portions usually sold as "impulse," but in a special multiple pack to be sold in supermarkets and food stores, to be consumed at home.

3. A further 11 percent of the total market is made up of products sold in "restaurants," cafeterias, and food service outlets. This product category is made up of larger ice cream bars or blocks for restaurants (intended to be cut into individual portions just before serving), and ice cream prepared by the manufacturer in individual portions to be sold in restaurants, mostly as desserts: individual portions with fruit or packaged in ceramic terrines, bonbons, tartuffi, small cartons or plastic cups for food service cafeterias, etc.
4. Finally, the remaining 25 percent of the total market is defined as "blocks and bulks." This product category would be made up of ice cream in large bars or blocks, sold directly to consumers using the same freezers out of which "impulse" products are sold to the public. We would also find here the large ice cream carton cylinders of 2, 4, and even 6 litres each, out of which ice cream parlours or restaurants serve cones or cups by the ball. These ice cream balls will be eaten at the restaurant or walking in the street. These portions are never individually packed and are meant to be consumed immediately. Maybe as much as 50 percent of the volume sold in this way is really an "impulse" purchase, bought and consumed without any previous planning on the part of the consumer.

Industry sources estimated that ice cream consumption by impulse and in restaurants and cafeterias amounted to some 75 percent of the total market, while ice cream consumed at home would account for only around 25 percent of the total volume. These same sources expected that consumption at home would increase in the immediate future, attaining maybe 40 percent total market volume by the year 2000.

EXHIBIT 1***FARGGI The Spanish ice cream market (continued)***

Some observers said that the Spanish market had witnessed a significant improvement in the average quality of ice cream. The traditional water-based ice lollies or Popsicles had given way to richer and more nutritive products. It was estimated that maybe 50 percent of the total Spanish ice cream market was now manufactured with milk fats, while the other 50 percent was manufactured using modern and advanced vegetable fats.

Regarding the main competitors and their products, Frigo (Unilever) had been the traditional leader in the Spanish ice cream market for many years, with a market share of around 30 percent (*Source: El Pais-Negocios*, 2 July 1995, page 5). In 1993, Frigo had a total turnover of some 27,780 million pesetas (1 US\$ = 130 Spanish pesetas), of which 87 percent had been by its ice cream division, while the other 13 percent had been in frozen foods (*Fomento* magazine, October 1994, page 260). According to "IP mark" magazine (16–30 September 1995, page 45), Frigo was said to have spent around 1,100 million pesetas on media advertising in 1994.

However, Frigo's leadership had just been lost to Nestlé. After a premature announcement in August 1994, in March 1995 Nestlé-Camy had finally bought Avides and Miko. According to Carina Farreras (*La Vanguardia*, July 22, 1995, *Economía y Negocios*, page 7), Nestlé would now be the new leader of the Spanish ice cream market with a total market share of around 40 percent, with its three brands Camy, Avides, and Miko. According to the same issue of *IP mark* magazine, Nestlé spent some 900 million pesetas on media advertising to promote their ice

cream in 1994 (presumably, just to promote their Camy brand). However, sources close to Nestlé indicated that their media spending in that year was close to 350 million pesetas.

In other words, some 70 percent of the total Spanish ice cream market would now be jointly held by Nestlé (Camy + Avides + Miko) and Unilever (Frigo). TLC Beatrice-La Menorquina would be the third contender, with a total turnover of some 12,800 million pesetas in 1993 (*Fomento*, October 1994, page 259). This turnover was slightly less than the 13,950 million pesetas sold in 1993 by Helados y Congelados, S.A. (Conelsa-Miko), recently acquired by Nestlé. However, Beatrice Foods and its partner Mr. Delfín Suárez also owned Intergrás, S.A. (Kalise), which had a turnover of 7,800 million pesetas in 1993, including yoghurt.

Finally, the U.S. market was estimated to be worth between 3.2 and 3.3 billion U.S. dollars. Out of these, the "super premium" segment had a share of about 11 percent. In the last few years, the total U.S. market was said to have grown at an annual rate of about 3.5 percent, while the "super premium" segment would have grown faster.

The two major competitors in the "super premium" segment were Häagen Dazs and Ben & Jerry's with some 40 percent each. The remaining 20 percent was in the hands of other "super premium" brands such as *Frutsen Gladge*, *Steve's Homemade*, some "ethnic" brands such as *Goya*, or private brands such as *Dag's Select*, owned by D'Augustino supermarkets.
