

Carvel in Beijing

In April 1995, Greg Demadis, director of business development for Carvel Corporation, was returning to the People's Republic of China to plot the next stage of development for the American company's fledgling interests in the Pacific Rim. As the representative of Carvel U.S., Demadis was already making his fourth trip to Asia in six months.

After fact-finding stops in Hanoi and Seoul, Demadis planned to proceed on to Beijing, where six months earlier the Carvel Beijing joint venture had opened its doors to Chinese consumers. Despite moderate success and growth since the venture's grand opening, Demadis felt that the company was facing its most serious challenge to date.

With summer quickly approaching, sales for the Carvel Ice Cream Bakery line would face its first upward spike in what is an inherently cyclical business. The inescapable truth in the ice cream business is that the best marketing is a hot, sunny day. Having had six months to introduce the product to Chinese consumers, Demadis felt it was crucial for the company to take advantage of its first mover status to establish the brand as the premium ice cream cake and novelty company against which all subsequent competition would be compared. Accordingly, Demadis had to defend his position to market the product as a premium ice cream demanding a premium price. Inherent in the corporate long term marketing strategy was the need to establish the brand as a premium product to which a Chinese rank and file with increasing disposable income would aspire. However, by April, retail sales remained flat and wholesale sales were

sluggish. This slow growth would deprive the company of the capital needed to fuel more regional and, eventually, national growth.

Phil Fang (yang Dengsheng), the Taiwanese general manager of the Beijing operation, faced similar pressure. Slow sales reduced the company's opportunity to break from the myriad of small brands and establish itself as the first truly national brand in China. Moreover, with Baskin-Robbins, Carvel's main rival in the United States, already with a longer, if small, presence in Beijing, and with other Western companies planning to enter the market, Fang also felt the pressure to expand the company as much as possible. Additionally, Fang must aggressively promote Carvel in Beijing.

First, as a Taiwanese manager of a three-part joint venture, Fang was pulled by each partner's differing business perspectives. Moreover, the cultural complexities of being a Taiwanese manager for an American firm in mainland China further complicated his role. Most important, though, Fang questioned the American management's decision to price and market the product as strictly an American ice cream. At times, Fang felt that the Americans did not appreciate the complexities and subtleties of doing business in China. Now, as the company faced its first summer sales period, Fang would have to make some long-lasting business decisions.

Each manager quietly felt he understood the problem. Demadis believed that the product was by far the best quality ice cream in Beijing; the company simply needed to improve the marketing and retailing of the product. He wanted Carvel Beijing to increase the products price and, in turn,

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its perceived value. Demadis feared entering a pricing spiral would establish the product as a commodity solely marketed on price. In the end, he was confident that once Beijing natives tasted and recognized the product, the brand was sure to explode in the market.

Phil Fang, however, felt that there was more to the equation than better marketing. Fang believed that certain pricing and product line changes might be needed before Chinese consumers would really take to the new brand. Time was running out for Carvel to seize its unique opportunity to establish the first national brand of ice cream in the People's Republic of China.

COMPANY HISTORY

Carvel Corporation had one of the oldest and most endearing histories of all the ice cream companies in the U.S. In 1934 Tom Carvel, a Greek immigrant, parlayed a flat tire on his ice cream truck into what would become a multimillion dollar franchise business. As the story had it, after a flat tire forced Tom Carvel into an abandoned parking lot one summer afternoon in 1934, Mr. Carvel quickly realized he could sell far more product in a stationary location than he ever could in the streets of Hartsdale, NY. Mr. Carvel soon borrowed \$100 and opened the first Carvel Ice Cream store.

Mr. Carvel used a combination of fresh ice cream and innovative products and manufacturing techniques to establish himself as the local, family-oriented ice cream parlor in the New York City area. In 1947, Mr. Carvel franchised his first store and proceeded to become one of the pioneers in fast food franchising. In fact, it was only after Tom Carvel refused his partnership offer that Ray Kroc used Mr. Carvel's store design as the model for his McDonald's chain.

Throughout the 1960s and 70s, the gravelly-voiced Mr. Carvel used his folksy and savvy style to dominate the greater New York area. By standardizing procedures and providing franchisees with exclusive product designs and marketing material, Mr. Carvel expanded all along the East

Coast. By the early 1980s, there were over 800 Carvel stores in operation along the East Coast and in some Midwestern states such as Ohio and Wisconsin. Included in the company chain were over 40 stores in California. However, by the mid 1980s, the recession and the strain on Tom Carvel to manage his business began to take its effect on the franchise. Sales and quality control began to decline, and events forced Mr. Carvel to consider changes.

In 1989, at age 88, faced with diminishing sales and increasing store closures, Tom Carvel reluctantly sold his company to Investcorp, a Bahrainian-based investment banking group. The Investcorp strategy centered on acquiring previously gainful companies whose profitability had diminished in recent years due to recession. Following that strategy, between 1988 and 1992 Investcorp had purchased Macy's, Sax Fifth Avenue, Tilecorp, and Carvel.

By infusing new capital and bringing in a new management team headed by CEO Steve Fellingham, the former president of Kentucky Fried Chicken, Investcorp focused on growth and revamping Carvel's listless image. Management was forced, however, to walk a fine line between creating a new, vibrant image for Carvel and alienating longtime, loyal customers who had grown up with Mr. Carvel's occasionally awkward but always folksy style.

In 1992, Carvel introduced the Ice Cream Bakery concept to its customers. Under this program, the company continued to offer longtime favorites such as Cookie Puss and Fudgie the Whale, but also introduced a new product line that featured specialty cakes and novelty ice cream treats for special occasions. By focusing on creating Carvel ice cream as a bakery dessert item, Carvel hoped to reduce both the cyclical sale pattern of the company and the perception that an ice cream cake was only for special occasions. To this end, Carvel instituted its current mission statement:

Working together, we will make Carvel the leading choice for unique, quality frozen desserts by consistently exceeding customer expectations.

In 1993, the company initiated its grocery store program in which Carvel displayed its own dedicated freezers in the bakery departments of supermarkets up and down the East Coast. By 1994, in the face of industry-wide declines, Carvel decided it was time to bring its Ice Cream Bakery to the People's Republic.

CARVEL IN ASIA

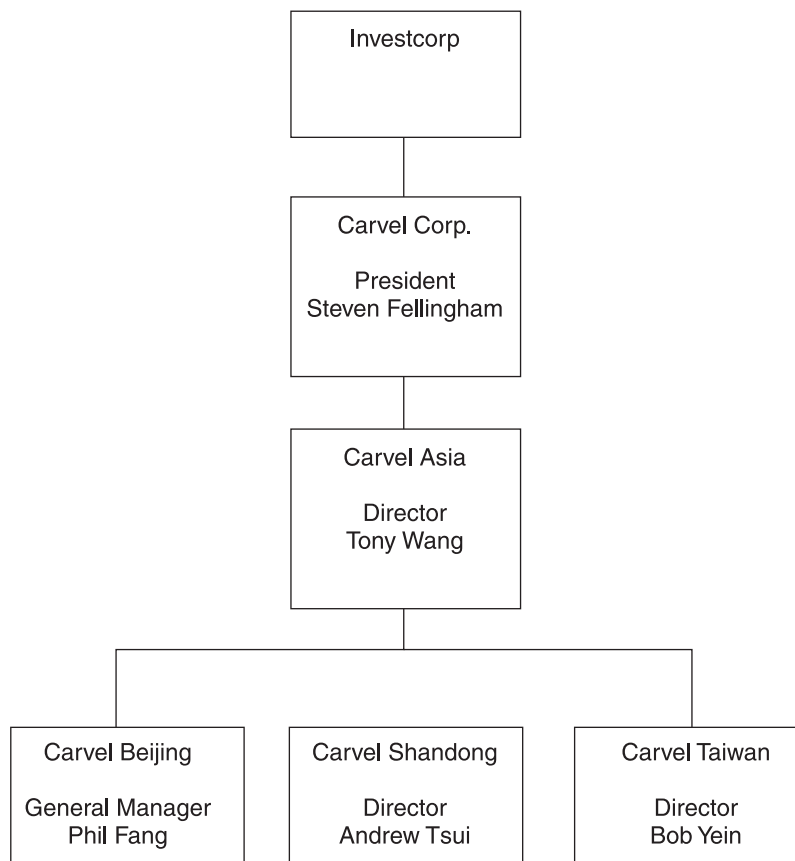
It was Steve Fellingham who decided to bring Carvel to China. Having already successfully

completed a marketing coup by introducing KFC to China in 1978, Fellingham hoped to repeat the success of the past. After an initial backing by Investcorp of \$4 million, Fellingham negotiated a joint venture in which Carvel Corporation established two new enterprises. These two new enterprises were Carvel Asia, headed by Tony Wang (Wang Da Dong), and Carvel Beijing, headed by Phil Fang. **Exhibit 1** shows Carvel's organizational arrangements in Asia.

In this arrangement, Investcorp and Carvel Corporation provided 51 percent and 49 percent

EXHIBIT 1

Carvel's Organizational Arrangements in Asia



respectively of the capital financing for Carvel Asia. Carvel Asia then provided 50 percent of the equity for Carvel Beijing. Wang Meng, president and owner of New Continent Dairy, a local dairy and producer of low end ice cream in Beijing, contributed 30 percent of the capital financing for Carvel Beijing. Li Shiqing, representing the government's Beijing Food Industry Association, provided the final 20 percent investment in Carvel Beijing.

At the same time, within Carvel Asia there were two other regional franchises. First, Carvel agreed to franchise the regional rights to Shandong Province to a group of investors headed by Andrew Tsui. Second, Carvel also agreed to franchise the national rights to Taiwan to the CP Group, who in turn had named Bob Yein as general manager of Carvel Taiwan.

By creating both regional partners and joint venture partners, Carvel U.S. attempted to meet two objectives. First, in Carvel Beijing, Carvel U.S. hoped to create a training and marketing base from which to expand into other areas in China. Second, by having regional franchises in Shandong Province and Taiwan, Carvel hoped to jump start its presence in Asia and generate much needed cash flow to fuel the growth of Carvel Beijing. To that end, it was the success and Crowds of Carvel Beijing that concerned both Greg Demadis and Phil Fang.

Political and Economic Developments

After the end of the Cultural Revolution and the death of Mao Ze Dong in 1976, China had embarked on a continual but vacillating course toward free market reforms. As has been the case in China since Mao declared the People's Republic from atop Qian Men gate in 1949, China experienced intermittent periods of moderate reform and growth in the midst of hardline backlash and recidivism. Mao's Great Leap Forward, the Cultural Revolution, illustrated the tentative, and at times reactionary, road to reform the Communist government had followed. For this reason alone, business ventures in China today were far from secure.

Since the succession of Deng Xiaoping as the head of the Communist Party in 1978, however, the potential of the China market was as tangible now as it had ever been in the country's 5,000 year history. His endorsement of the "Socialism with Chinese characteristics" policy in 1978, the Communist government had taken steady but reluctant steps forward improving the business climate in China. In particular, reforms in the area of telecommunication infrastructure, business and copyright law, and financial structures led to increased foreign investment in China. The foreign investment, in turn, led to significant changes in the socioeconomic structure of China. According to a recent Gallup poll,⁹ several facts reflected this change:

- China's population was currently 1.2 billion, nearly 20 percent of the world population.
- Gross National Product reached \$410 billion in 1994 and was expected to grow at a national average of 10 percent to 14 percent in 1995. The eastern and southern regions experienced growth of 20 percent to 30 percent in 1994.
- Annual inflation averaged 20 percent, and peaked at 27 percent in some major cities in 1994. The Communist government targeted 1995's annual inflation rate at 9 percent.
- Export volume grew at an average annual rate of 12 percent between 1980 and 1993. China ranked as the world's eighth largest exporter in 1993, up from twenty-sixth in 1980.
- China attracted \$33.8 billion in foreign investment in 1994; in 1993 foreign investment totaled \$27 billion.

⁹The Gallup Organization of Princeton, New Jersey, recently completed the first nationwide survey of consumer behavior and Aches in the PRC. To complete this survey, Gallup interviewed 3,400 Chinese citizens in each of the country's provinces except Tibet. The sample represents the entire adult population 18 years of age and older. All interviews were conducted in person in the applicant's home between May 2 and September 15, 1994. The interview included over 400 questions and required more than one hour to complete.

The growth had a positive impact on increasing per capita income. The 10 cities with the highest per capita monthly income in 1994 were:

Guangthou	¥416 ¹⁰
Shanghai	¥338
Beijing	¥274
Nanjing	¥255
Wuhan	¥234
Tianjin	¥212
Chongqing	¥201
Xian	¥189
Shenyang	¥174
Harbin	¥169

In short, the apparent stability and growth in the Chinese economy continued to offer good opportunity for profitable business, but political uncertainty still clouded the future. First, the ailing health of paramount Communist leader Deng set the stage for another succession struggle in the Party. Chinese history was replete with fractious and problematic succession battles, and financial circles remained cautious about the political fallout after Deng. Secondly, while the Communist government continued to court foreign investment with assurances of improved business conditions in China, recent events reflected the inherent risk in the Chinese market. In particular, the Communist governments recent summary rescision of McDonald's lease on its celebrated Chang An Avenue store reflected this intrinsic risk. Although the government cited legal clauses in the lease agreement, the move caused shockwaves in the business community trying to establish long term commitments in China. It was under these conditions that Carvel Beijing began operations in 1994.

CARVEL BEIJING

By April of 1995, Phil Fang's operations had grown to include one factory, two retail stores, and 17 outside accounts. Fang carried out cake production at

the factory, and used the stores and outside accounts to merchandise the product and do small decorations and personalizing. **Exhibit 2** lists these stores and outlets. Fang classified his outlets according to the following schedule:

- **A-Type Stores**—These were individual retail stores that had a large holding freezer called a shock box, Taylor ice cream machines, and customer seating. A-Type stores were able to make and decorate cakes (i.e., East Four store).
- **B-Type Stores**—These store were like A-Type Stores but could not produce cakes. B-Type stores could decorate cakes, though (i.e., West Four store).
- **C-Type Stores**—These stores had no customer seating, but had Taylor ice cream machines. They were generally mini-stores found inside in the food court areas of large department stores. C-Type stores also had FPD-5s (display freezers) and could do small decorations (i.e., Chang An and Baisheng department stores).

EXHIBIT 2

Carvel in Beijing Channel Outlets

<i>Account Name</i>	<i>Account Type</i>
1 East Four	A
2 West Four	B
3 Baisheng Department Store	C
4 Chang An Department Store	C
5 Chengxiang Department Store	Counter
6 Fuxing Department Store	Ice Cream Bakery
7 Beicheng Department Store	Retail
8 Canyou Department Store	Retail
9 Chaoyang Department Store	Retail
10 Friendship Hotel	Retail
11 Landao Department Store	Retail
12 Shangan Department Store	Retail
13 Anbao Restaurant	Wholesale
14 Apollo Club	Wholesale
15 Golden Song KTV	Wholesale
16 Minzu Hotel	Wholesale
17 Songhe Hotel	Wholesale
18 Xidan Shopping Center	Wholesale
19 Xingzuo Department Store	Wholesale

¹⁰ The exchange rate as of April 1, 1995 was 8.41/US\$.

- **Counter Stores**—These sites used CMCT freezers to sell cakes and novelties. They also had menu boards and were similar to the grocery store outlets in the U.S.
- **Ice Cream Bakeries**—These sites concentrated on cake sales. They were generally located inside the bakery and food court areas of department stores and used FPD-5s and rollhards to market the cakes. Ice Cream Bakeries had the capability to decorate cakes on site. They did not have Taylor ice cream machines, however.
- **Retail Outlets**—These sites used pushcarts or small rollhards. Some of the current retail outlet sights could become Ice Cream Bakeries or C-Type stores if space permitted.
- **Wholesale Outlets**—These were large accounts which brought in huge quantities and sold the product to different vendors in their areas as well as retailed on their premises.
- **Factory**—The Beijing factory had the following equipment:
 - four Taylor 771 ice cream machines
 - two large walk-in shock boxes
 - one walk-in cooler
 - 12 PF IK 4 rollhards small ware and utensils to maintain three shifts of production

The factory was located on the southwest side of Beijing, a fact that caused delivery trouble in the dense Beijing traffic. However, the production and storage capacity of the facility was larger than most of the American plants. Moreover, the company's dairy, the New Continent Dairy, was located directly beside the factory. This created tremendous ease and integration for mix production. The potential of the factory was tremendous but still untapped.

The East Four store was the first outlet to open in October 1994. This large store almost exactly represented an American store and was used as the showpiece of the joint venture's appearance in China. However, flat sales had yet to justify the large outlay to build the store. Because of decreasing cash flow, finances began to force Fang away from outlets that demanded large initial costs, such

as A-Type stores. Instead, Fang had begun to concentrate on C-Type stores to improve sales volume and cash flow. For the same reason, Fang had recently decided to suspend cake production at the East Four store. Instead, all production took place at the factory in order to reduce the idle capacity there. Demadis and the District Manager, Li Qunsheng, had questioned the efficacy of this decision. Although there was little doubt that the factory needed to increase production to justify costs, both Demadis and Li agreed it was better to maintain the flexibility of the East Four production.

As for the structure within Carvel Beijing, Fang had organized his staff as shown in **Exhibit 3**. Fang hoped to increase retail sales through the various outlets under Li's control. While Demadis did not disagree with this strategy, he did think that wholesale markets were underdeveloped. He felt that in order to justify the costs of the factory, more emphasis should be placed on the wholesale operations of Cao Donghui.

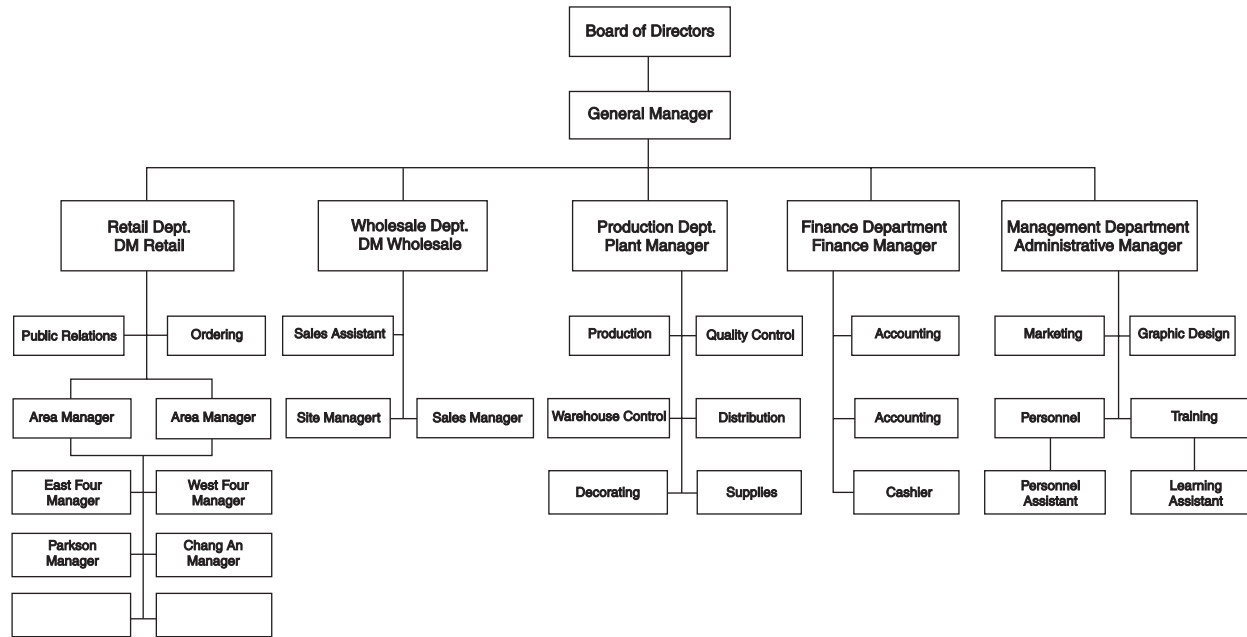
Demadis based this thinking on the success of the grocery store program in the U.S. In general, the cost of opening a retail outlet included the cost of several machines. Depending on the type of outlet, an average retail opening would include some or all of the equipment shown in **Table 1**.

Also included in the cost of retail operations were labor, rent, and a royalties fee. This fee was a

TABLE 1

<i>Item</i>	<i>Cost</i>	<i>Item</i>	<i>Cost</i>
Taylor 771 or 770 Ice Cream Machine	\$11,806	T-50 Glass-door Upright Freezer	3,460
FPD-5 Freezer Cabinet	2,760	TM-6 Display Freezer	3,850
CMCT-4 Rollhard Freezer	2,550	Hackney Bros. VC12-32 Vendcart	3,710
MasterBilt Rollhard	2,350		

EXHIBIT 3
Carvel in Beijing Organizational Structure



percentage of the gross sales that Carvel paid to the location's management and could range from 5 percent to 20 percent of gross sales. On the other hand, wholesale accounts could be established for just the cost of a T-50, TM-6, or vendcart. Moreover, since these sights took less space and were self-serving, Carvel could save on both rent and labor.

Phil Fang agreed that the sales department had to pursue wholesale accounts. However, high rent locations such as Chang An nearly doubled the sales of East Four. Such high volume locations provided much needed exposure, and he continued to pursue such additional affordable locations. In addition, Fang felt pressure trying to explain the fact that in China, the concept of *guan xi* (meaning relations or connections) went a long way in determining what sites Carvel could enter. On many occasions, it was necessary to have personal recommendations from local business or government leaders before Carvel could assume locations. Though Fang agreed that wholesale accounts were a very cost-effective way to increase sales, they might not be the most economically or politically feasible way to increase sales at this time.

Operations

The operations of running an ice cream store parallel those of any fast food chain except for the fact that product handling is more critical to ice cream production than it is for other food products. Simply stated, whereas hamburgers can be reheated, a melted cake must be scrapped. For that reason, time, temperature, and quality control are the key factors in producing ice cream products.

There are two key elements that Tom Carvel added to ice cream making, and Carvel Corporation still followed his innovations. The first was the concept of overrun. Simply put, overrun is the process of forcing air into the ice cream as it is being beaten and frozen in the ice cream machine. It is Tom Carvel's patented DL and DH ice cream machine series that first introduced this concept to ice cream production, and it is this high overrun that gives Carvel ice cream its traditional creamy

texture. In addition, higher overrun translates into lower unit costs, since adding air to the ice cream mix increases the total output of the mix.

Secondly, Tom Carvel combined creamy ice cream and various molds to create assorted shaped ice cream cakes. Such cakes as Fudgie the Whale and Hug Me Bear became standards at all Carvel stores. In fact, although Carvel always had much competition with its standard ice cream offerings of cups, cones, and fountain products, none if its major competition ever challenged Carvel's standing as the preeminent ice cream cake. For that reason, it is this concept on which Carvel Corporation capitalized to create its new line of desserts and novelties. In fact, in 1993 Carvel introduced its new "Everything Should Be Made of Ice Creams" slogan as a way to leverage its standing as the preeminent ice cream cake company.

Ice Cream Mix

The actual production of ice cream and ice cream cakes begins with the ice cream mix. The foundation of Carvel's success had always been the quality and creamy texture of Tom Carvel's patented mix formula.

There are two pasteurization processes that distinguish the mix itself. In both processes, the ingredients are the same and the processing steps are very similar. In High Temperature Short Time (H.T.S.T.) processing, however, pasteurization occurs by heating the mix to 180°F and maintaining that temperature for 20 seconds. H.T.S.T. pasteurization kills most of the bacteria and produces mix with a shelf life of 10 to 12 days.

In Ultra High Temperature (U.H.T.) processing, pasteurization occurs by heating the mix to 285°F and maintaining that temperature for five seconds. The fundamental difference between the two processes is that U.H.T. processing is an entirely closed system in which the mix is never exposed to the outside environment.

U.H.T. processing had several advantages. First, it produced mix with a shelf life of 90 days. Second, it preserved the mix's natural flavor without

causing any residual cooked flavors. At the time, the mix being produced for Carvel Beijing was H.T.S.T. mix.

New Continent Dairy produced Carvel Beijing's mix. The dairy, located directly next to Carvel Beijing's factory, used an H.T.S.T. process and produced one 75-gallon batch per week at a cost of ¥10 per kilogram.

Electricity Needs and Temperature

Clearly, the ability to maintain the product at cold temperatures was vital throughout the production process of the ice cream. Once the product begins to melt, its creaminess and smoothness are lost. In particular, placing a melting cake or novelty back in the shock box caused ice to form on the product. The result was a blander, less tasty ice cream.

In the same respect, a dependable supply of electricity was also crucial. Rollhards, ice cream machines, and shock boxes produced large surges and drains on electricity. Carvel Beijing's operations had already experienced several power problems in both its retail stores and factory.

Product Inputs

Because of the wide product line offered by Carvel, the inputs necessary to produce Carvel's product line were extensive. In particular, Carvel used a variety of food products, especially fruit fillings, flavorings, and syrups. Carvel also used an assortment of baked items, including cones, cookies, and cannoli shells. Finally, Carvel included a variety of nuts and confectionery toppings on its products.

In the same light, Carvel also used a wide selection of cake boxes and packaging to produce the product line. Combined with the numerous cleaning products, production tools, and utensils, Carvel had a tremendous amount of inputs to manage in order to produce its product line. For the time being, most of these items were being imported from the U.S. at a relatively high cost, an issue both Fang and Demadis must address.

Product Delivery

Product delivery was the most crucial link in Carvel's production process. Because of the nature of the product, poorly designed delivery systems could negate otherwise perfect production lines and operations systems.

Carvel Beijing improved its delivery systems tremendously since the opening of operations. Currently, finished cakes were placed in Styrofoam boxes that could hold nearly ten cakes. Two small refrigerated trucks then transported these Styrofoam boxes to the accounts. However, the capacity of the trucks was only 150 cakes. As the company grew, it would need greater and more flexible delivery capacity.

Quality Control

Because of the nature of ice cream, quality control and sanitation standards are particularly important. Like milk, Carvel's mix and ice cream must be monitored at all levels of production to insure that the company provides its customers with a tasty and safe product. Unlike flour-based cakes, ice cream cakes must be kept at continually low temperatures, and they require that decoration be done in short intervals. As mentioned earlier, melting ice cream is both unattractive and unsanitary, and electrical supply and maintenance were a priority.

There are several factors in the Beijing environment that exacerbate quality control efforts. The first was the inordinate amount of dust, pollution, and coal ash found in the city. This dust made it particularly difficult to keep floors and work surface areas clean.

Secondly, the water supply in Beijing was not potable. Therefore, it must be boiled and filtered before it could be used in any products. Like its electrical needs, Carvel must continually monitor water quality.

Finally, American management had a difficult time adapting to the traditional Chinese cultural aversion to waste. Especially when working with dairy products, at times it was necessary to throw

out questionable products or utensils. Carvel also used several single use items in its production process for sanitation reasons. For their part, the Chinese resisted certain procedures and standards as too costly or wasteful.

To this end, Carvel Beijing instituted strict quality control standards and a continual internal inspection program. Weekly bacteria reports were done on the mix batches, and biweekly coliform counts were checked in the retail outlets.

Financial Review

Financially, Phil Fang did not anticipate reaching break-even sales until 1996, and the company's slow start in 1995 jeopardized even that prediction. His biggest problem continued to be slow sales growth and slow customer attachment to the high margin cakes. As the Income Statement for 1994 in **Exhibit 4** depicts, Carvel Beijing operated at a net loss of nearly (¥1,070,000) in 1994.

For 1995, Fang had requested an additional \$800,000 from the joint venture partners and set the following objectives for the year:

- Sales of ¥13 million
- 100,000 cakes sold
- 68 total sales outlets by year end

As mentioned earlier, the company's poor cash flow forced Fang to reconsider his growth strategy. He would not be able to count on large retail stores like in the U.S. Instead, he planned on operating many smaller outlets that would demand less initial cash investment. His budgeted breakdown for projected outlets by the end of 1995 underlined this strategy. By the calendar and fiscal year end of 1995, Fang aimed to have the following outlet distribution:

A & B-Type Stores	2
C-Type Stores	11
Counter Stores	15
Ice Cream Bakeries	20
Retail Outlets	20
Wholesale Accounts	10

EXHIBIT 4 *Carvel in Beijing*

Net Income Statement 1994	
Revenues	
Sales	¥320,065
Other Revenue	0
Total Revenue	0
Expenses	
Cost of Goods Sold	
Mix	98,100
Commissary	63,780
Labor	126,099
Total Cost of Goods Sold	287,979
Operating Expenses	
Administrative Expenses	407,000
Store Opening Expenses	642,456
Advertising Expenses	9,868
Total Operating Expenses	1,059,324
EBITDA	(1,027,238)
Depreciation	42,325
Net Income 1994	<u>(¥ 1,069,563)</u>

Note: The exchange rate as of April 1, 1995 was ¥8.41/US\$

Source: Company records.

These goals, however, were jeopardized by continual negative cash flow, which in February 1995 totaled (¥400,000).

Clearly, as the Projected Budget for 1995 in **Exhibit 5** showed, nearly 60 percent of Fang's investment from the joint venture partners would go toward rent and the purchase of new equipment. In fact, by April Fang had already realized that the cash crunch he was under was going to force him to revise his budget plans or to request more capital from the joint venture partners. Fang's Projected 1995 Profit & Loss Statement in **Exhibit 6** reveals several factors that contributed to this problem.

EXHIBIT 5
Carvel in Beijing Projected Budget 1995

	US\$	¥*	US\$	¥*
Outstanding Invoices				
Invoice #66586	\$ 23,288	¥ 195,619		
Invoice #66262	\$ 5,333	¥ 44,796		
Invoice #68302	\$ 1,650	¥ 13,860		
Invoice #68300	\$ 905	¥ 7,600		
Invoice #68301	\$ 35,375	¥ 297,151		
Total Current Invoices			\$ 66,551	¥ 559,025
Cash Flow Needs				
Factory Annual Rent	\$ 113,095	¥ 950,000		
Office Annual Rent	\$ 27,381	¥ 230,000		
East Four Annual Rent	\$ 26,190	¥ 220,000		
West Four Annual Rent	\$ 13,095	¥ 110,000		
Subtotal Rent	\$ 179,762	¥1,510,000		
Inventory Overhead	\$ 71,429	¥ 600,000		
Total Current Cash Flow Needs			\$ 251,190	¥ 2,110,000
Plant & Equipment Needs				
5KDC-47	\$ 10,150	¥ 85,260		
15FPD-5	\$ 42,525	¥ 357,210		
15CMCT-4	\$ 36,765	¥ 308,826		
9 Taylor 770	\$ 82,197	¥ 690,455		
Subtotal Equipment	\$ 171,637	¥1,441,751		
Custom Tax on Equipment (50%)	\$ 85,819	¥ 720,875		
Refurbishment of 9 C-Type Stores	\$ 85,819	¥ 720,875		
60 Rollhards	\$ 28,571	¥ 240,000		
2 Delivery Trucks	\$ 45,238	¥ 380,000		
Total P&E Needs			\$ 406,265	¥ 3,412,626
Total Cash Needs 1995			<u>\$ 724,006</u>	<u>¥ 6,081,651</u>

Exchange Rate = ¥8.4/US\$

Source: Company records.

EXHIBIT 6
Carvel in Beijing

Projected Net Income Statement 1995	
	(in thousands of ¥)
Revenues	¥ 13,000
Sales	
Sales Discounts and Allowances	1,170
Net Sales Before Tax	11,830
Sales Tax	1,710
Net Sales	10,120
Expenses	
Costs of Goods Sold	
Mix	2,600
Commissary	1,820
Packaging	1,170
Labor	1,200
Total Costs of Goods Sold	6,790
Operating Expenses	
Administrative Expenses	1,560
Store Opening Expenses	2,280
Advertising Expenses	180
Total Operating Expenses	4,020
EBITDA	(690)
Depreciation	540
Renovation Expenses	850
Other Expenses	30
Projected Net Income 1995	(¥ 2,110)

Source: Company records.

Customs and Import Duties

Customs taxes and regulations presented the single largest day to day problem for Phil Fang. Since nearly 90 percent of all his input products were shipped from the U.S., arranging for delivery through the complicated and fluid world of Chinese customs was critical. Currently, according

to the import license that the government had issued Carvel Beijing, Fang was only allowed to import a certain amount of products each year. In general, tariff rates averaged 50 percent of the net value of the item as listed on the original shipping invoice. However, some items such as syrups, whip topping powder, and cones could have tariff rates as high as 80 percent of their original value. For 1995, Fang faced potential tariffs of 100 percent unless Carvel could negotiate a better license or use *guan xi* to arrange a more palatable agreement.

Consequently, Fang's projected cost of goods sold as a percent of sales was roughly 48 percent. He realized he would have to reduce the man hours and capital spent to receive products from the U.S. if he were to achieve the aggressive goals he had established. Clearly, he must begin to locally source as much of his inputs as he could. He had begun to check on local producers of refrigeration equipment, and local manufacturers were already producing several new packaging materials for the cakes.

Demadis had established this priority to source goods locally, but both he and Fang were wary of the quality standards of these goods. Especially since the product was still in its introduction period, both Fang and Demadis wanted to ensure that the public's first impression of the product was one of quality.

Mix

After labor, mix production represented the largest expense Fang faced. Currently, mix production represented 45 percent of the cost of goods sold and nearly 20 percent of total projected sales. New Continent Dairy, a partner in the joint venture, charged Carvel Beijing ¥41.81 per gallon of mix, and was averaging batch rounds of 3,000 gallons per month.

Fang predicted that as sales increased with the weather, he would be using 12,000 gallons in July and 30,000 gallons total for the first six months of the year. This fact, combined with the fact that New Continent still produced mix for its own ice cream

brand, led Fang to believe there were economies of scale in the mix production cycle that could lower his mix expense. In short, Fang would like Wang Meng, president of New Continent, to share those scale economies with Carvel Beijing. However, because of the political nature of the issue, Fang had few options to pursue in this matter.

Fang and Demadis were planning the conversion of New Continent's Dairy facilities from H.T.S.T. to U.H.T. In order to convert the plan, Carvel Beijing would have to purchase a new filler, holding tank, and vacuum pump at a cost of nearly \$100,000. Fang was searching to defray some of this cost by locally sourcing some of the pipe fitting and tank assembly parts. Once completed, Carvel's U.H.T. system would be the first in China, and would have tremendous potential as Carvel expanded in the region. By creating 90 day mix in Beijing, Carvel could centralize mix production throughout its chain and potentially create other lines of mix for other companies. Fang was hopeful that this conversion would allow him to work with Wang Meog to reduce the cost of Carvel Beijing's mix.

Labor

Another of the financial restraints facing Fang was labor. Oddly enough, although relatively inexpensive labor was one of the chief reasons firms expanded into China, labor was not the leveraged competitive advantage it first appeared to be. First, although the average employee at Carvel Beijing earned ¥800 per month, there were other hidden costs involved. In particular, for each employee, Carvel Beijing must pay a 17 percent government payroll tax; also, the government also required the company to set aside an additional 32 percent of each employee's salary in a special account for health care, training, and child care costs. Ultimately, these costs raised labor expense to 149 percent of their actual cost.

Secondly, the government imposed a "Luxury" payroll tax of 5 percent to 20 percent for each employee earning over ¥1,000 per month, of which

there were four at Carvel Beijing. With inflation running at 16 percent in 1994 and projected at 9 percent in 1995, Fang must consider ways to reduce labor cost.

Finally, the fact that Carvel Beijing was a foreign joint venture in China encouraged employees to expect relatively higher wages than domestic companies offer. With over 60 employees to manage, Fang often found himself busy with this wage issue. He often questioned the validity of the advantage of Cheap Chinese labor.

Sales

Sales growth continued to be a major problem for the new franchise. By beginning operations in October, management had run the risk of starting the new venture in what was traditionally the slowest period of the year for Carvel. Consequently, Fang and Demadis were still unable to identify the cause of the slow sales with any real certainty. As the sales figures in **Table 2** demonstrate, sales were actually increasing both in gross and relative terms. However, the true potential for the operation remained unclear.

These sales figures followed the traditional sales cycle of the American stores. Except for several spikes around the six major holidays (Valentine's Day, Easter, Mother's Day, Father's Day, Thanksgiving, and Christmas), weather had historically driven sales volume in the U.S.

To combat this cycle, Carvel U.S. introduced various measures to dispel the notion that ice cream

TABLE 2

<i>In ¥</i>	<i>December</i>	<i>January</i>	<i>February</i>
East Four Store	57,222	73,424	77,305
West Four Store	24,127	30,421	35,585
Chang An Dept. Store	79,351	128,147	119,167
Parkson Store Dept. Store	N/A	44,609	78,320
Wholesale Accounts	73,360	94,455	72,040
Total:	234,060	371,056	382,417

cakes were only for special occasions and warm weather. The success of the grocery store program in the U.S. reinforced the theory that a push-oriented sales program would help remind customers that ice cream cakes were a tasty treat all year-round.

Demadis felt this was exactly the strategy to apply in China. Solid marketing could introduce Carvel's traditional American ice cream experience to unfamiliar Chinese consumers. An aggressive push campaign for outside accounts would create brand awareness and drive sales.

Fang, however, felt that there were other market forces at work. In particular, Fang believed that the conventional Carvel approach did not appeal to the traditional Chinese consumers. Such cakes as rainbows and baboon cakes did not attract the typical Chinese consumer who expected a more elaborate, Chinese design on cakes. According to Phil Fang it was a reluctant, unfamiliar consumer, that was behind the slow sales.

Both Fang and Demadis agreed that slow sales and negative cash flow limited their options to grow the business. Analysis of the accounting information confirmed the difficulty the retail stores had on covering their costs. On the other hand, the success of the Chang An and Parkson stores confirmed the fact that Carvel could produce a profit in Beijing. Furthermore, despite continuing losses, Fang and Demadis both agreed that the East Four and West Four stores were necessary for the chain to project a positive image in the city of Beijing. What remained to be determined was how best to improve their performance.

Meanwhile, Wang Meng presented Phil Fang with a new option to increase wholesale sales. Recently, he had constructed 6,000 new vendcarts in order to merchandise his product in Beijing and Tianjin. These carts closely resembled the color and design of the Carvel vendcarts, and Wang Meng was willing to let Fang use the 4,000 Beijing carts to sell Carvel novelties with New Continent ice cream. It was a tough decision for Fang to make.

On one hand, Fang could not argue with the economies of this proposal. Wang Meng bought his

carts domestically at a cost of ¥4,000 per cart. Currently, Fang was importing Carvel carts from the U.S. at a cost of ¥35,000 plus the added cost of ¥15,000 in customs tax. Wang Meng expected a return of nearly ¥30,000 per month per cart. Faced with such tight cash flow, even a small percentage of these sales offered Fang the opportunity to meet his budget and concentrate on plans for the rest of the business. On the other hand, Fang faced harsh opposition from Demadis on this point. Besides the apparent conflict of interest and appearance of impropriety, Demadis strongly argued that selling Carvel products alongside cheaper quality New Continent products would severely harm the long term status and positioning of the product. Especially with so many first time buyers during the summer, Demadis felt selling Carvel alongside New Continent would confuse customers and jeopardize his strategy to develop the line as a premium product from America. This was an issue that both had yet to agree upon.

Finally, part of the problem centered on the lack of any centralized cost accounting and transfer pricing systems. This lack of accurate and centralized information hampered efforts to determine the cause of high costs. One of the goals Fang set for 1995 was to improve the internal and corporate reporting of information.

Product Line

Carvel Corporation offered a wide variety of ice cream products. The company's fundamental product, though, remained its soft serve ice cream and fountain line. Included in this category were:

- cups and cones
- shakes
- floats
- sundaes
- hard ice cream—soft ice cream that is frozen in the shock box in tubs so that it can be scooped and served as traditional ice cream.

In order to promote the everyday nature of the business, though, management had introduced

numerous new products over the last three years. Included in this category were novelty ice creams.

Carvel classified novelty products as an individual ice cream treat which was more premium than the traditional soft serve and fountain offerings. The following is a sample of Carvel's novelty line:

- **Flying Saucer**—Carvel's original round ice cream sandwich
- **Brownie**—a cube of chocolate ice cream with layers of chocolate fudge and walnuts
- **Ice Cream Cannoli**—a real cannoli shell filled with soft serve ice cream and toppings
- **Truffle**—a ball of vanilla ice cream filled with cherries, almonds, and chocolate chips inside a chocolate shell.
- **Mint Chocolate Chip Cake**—mint and chocolate ice cream with a chocolate cookie crunch middle decorated with mint frosting, fudge, and chocolate chips
- **Sinfully Chocolate Cake**—chocolate ice cream with a fudge and cookie crunch center decorated with chocolate mousse topping, hot fudge, and chocolate candy shards
- **Strawberry and Cream ATOP**—strawberry and vanilla ice cream with a vanilla cookie crunch center topped with vanilla frosting and whole strawberries
- **Cappuccino Coffee Cake**—coffee ice cream with a chocolate crunch center topped with mocha frosting, walnuts, and vanilla cookie crunch

Management felt that these novelties would greatly renew and invigorate the brand's name and image, but Carvel's traditional cake line remained the high margin product that had the greatest impact on sales. Carvel's traditional line of cakes all had the same recipe. Each cake was made with one layer of vanilla ice cream, one layer of chocolate ice cream, and a chocolate crunch cookie center. The cakes were frosted with a vanilla whip frosting and decorated in several fashions, including roses, balloons, and rainbows. Cakes differed, however, in size, shape, and weight. In particular, Carvel's traditional cake line included:

- **Dessert Cake**—a 6" round cake weighing 21 ounces
- **Small Round Cake**—an 8" round cake weighing 43 ounces
- **Large Round Cake**—a 10" round cake weighing 66 ounces
- **Small Sheet Cake**—an 8" × 12" square cake weighing 85 ounces
- **Large Sheet Cake**—a 10" × 14" square cake weighing 156 ounces

It was Carvel's cake line that distinguished it from all the other offerings in Beijing. In particular, Carvel's classic cake line aimed to offer customers more variety than the traditional chocolate and vanilla cakes. This line included:

These cakes continued to sell well in the U.S., particularly in the grocery store program. Carvel also offered various shaped cakes, including the following:

- **Cookie Puss**—a clown shaped face with an ice cream cone nose and cookie eyes
- **Fudgie the Whale**—a chocolate whale cake with fudge frosting
- **Hug Me the Bear**—chocolate and vanilla ice cream bear cake with a cookie crust
- **Holiday Cakes**—including Santa, heart shaped cakes, and turkey cakes

Finally, Carvel offered both sugar-free and fat-free frozen yogurt and a fat-free ice cream. To date, however, these products had not been introduced to China.

Product Line Sales

With such a wide product line, Fang tried to introduce as many items as he could to the Beijing customers. However, he soon realized that certain products were not selling. **Exhibit 7** illustrates the breakdown of product sales over the course of the first four months of operations.

Fang drew several conclusions from the sales data. First, some cakes such as the Sinfully Chocolate and Strawberry and Cream cakes had

EXHIBIT 7
Carvel in Beijing Sales Breakdown (in units sold)

<i>Item</i>	<i>November</i>	<i>December</i>	<i>January</i>	<i>February</i>
Small Round Cake	14	123	162	186
Large Round Cake	1	520	17	94
Small Sheet Cake	0	121	64	37
Large Sheet Cake	2	21	10	2
Small Heart Cake	14	74	148	162
Large Heart Cake	9	118	102	68
Dessert Cake	27	134	237	335
Hug Me Bear Cake	42	180	304	265
Fudgie the Whale Cake	8	29	13	33
Cookie Puss Cake	6	22	21	29
Santa Cake	13	89	48	20
Football Cake	0	0	0	0
Bunny Cake	0	0	32	39
Carvel Log	0	0	29	49
Sinfully Chocolate Cake	20	144	293	228
Fudge Drizzle Cake	27	61	132	85
Strawberry and Cream Cake	21	62	123	132
Mint Chocolate Chip Cake	16	33	72	41
Cappuccino Coffee Cake	0	1	72	43
Truffle	0	0	96	343
Brownie	370	744	878	739
Dream Bar	274	592	751	651
Neapolitan	18	819	757	582
Blondie	320	538	637	501
Chocolate Flying Saucer	59	106	134	921
Vanilla Flying Saucer	56	76	89	82
Strawberry Flying Saucer	19	79	93	78
Deluxe Flying Saucer	73	103	147	110
Vanilla Mini Sundae	98	1,388	2,635	1,927
Strawberry Mini Sundae	88	1,407	720	0
Van-Straw Mini Sundae	102	1,853	3,616	4,627

Source: Company records.

strong sales, while the Cappuccino Coffee cakes and Mint Chocolate Chip cakes had very slow sales. Fang felt that such relatively exotic cakes simply did not appeal to Chinese who were accustomed to traditional vanilla, chocolate, and strawberry flavors. Demadis, on the other hand, continued to assert that consumer awareness was the issue, not consumer taste. Second, Fang also noticed that Hug Me Bear cakes continued to show

strong sales numbers, but Cookie Puss and Fudgie the Whale cakes were sluggish. Again, he concluded that traditional Chinese shapes such as the bear were inherently strong sellers, while American style cakes such as Cookie Puss simply seemed too exotic and too foreign. Third, Fang had to face frequent comments from customers that the ice cream, and, consequently, the ice cream mix, was too sweet. Fang knew that Chinese traditionally did

not like very sweet desserts, and he feared that traditional American tastes might not appeal to the broad spectrum of Chinese consumers. Changing the mix formula might increase sales, but Demadis strongly opposed tampering with the traditional success of the company in any form.

Finally, Fang felt that pricing was both driving strong cup and cone sales and inhibiting relatively slow cake sales. For this reason, Fang had serious doubts about the pricing strategy established last October.

Pricing

Before Carvel Beijing opened its doors in October, Demadis and Fang had to discuss the pricing strategy for the company. Demadis argued that prices should be at least as high as, what he considered, the company's chief competitor, Baskin-Robbins. Demadis based his rationale on the fact that Carvel was virtually unknown in Beijing, and consequently, management had the unique opportunity to create whatever image and market position it wanted for the company. He argued that Carvel Beijing should be seen as a premium ice cream that was not priced out of the range of the typical Beijing resident; nevertheless, it should be priced high enough to make people consider it a product of quality and prestige.

Fang, however, maintained that such a long term approach to pricing would suffocate short term sales and consequently nullify the long term benefit of such a strategy. Fang considered his chief competition Walls and Bud's, both of whom offered novelty cups and cones throughout the city for roughly ¥4.

Both men presented their arguments in an early October meeting. Demadis argued that since Baskin-Robbins presented the most significant long term threat to the Beijing ice cream market; Carvel had to price its product in line with them. At that time, Baskin-Robbins was asking ¥9 for an ice cream cone. Demadis felt that pricing Carvel's product below that would send the wrong, initial signal to the customers.

Fang argued that the future of the Beijing market lay in understanding the Chinese consumer, who was not ready to purchase ice cream cones that represented, on average, nearly 25 percent of a day's pay. Fang contended that Carvel should price more in line with Walls and Bud's, both of whom had been in the market longer than Baskin-Robbins and had experienced annual growth and profits.

In the end, the two decided on a cost plus strategy that considered the following costs:

Mix cost	4¢/oz.
Duty on commissary	50% to 80%
Freight charge	10%
Carvel surcharge	10%
East Four rent	¥210,000 per year
Taxes	17%

Ultimately, Fang and Demadis agreed that Carvel's standard small cone in the East Four store should be priced at ¥9. However, they disagreed on the issue of soft and hard ice cream prices. Fang wanted to price soft serve cones at ¥7 and hard ice cream cones at ¥9. Demadis felt that pricing one higher than the other gave customers the impression that one ice cream cone was better than the other, when in fact they were both made from the same soft serve ice cream. In the U.S., Demadis argued, hard and soft serve ice cream were always priced the same.

As for the rest of the product line, Fang again applied a modified cost plus strategy. However, since his cost accounting system had not been established, he had to use the cost information he had with the production costs that Carvel U.S. had determined for American production. Although both men agreed they would have to review these prices once Chinese cost figures were available, they were willing to go along with the above approach to determine prices. **Table 3** lists the available cost and retail price information for Carvel Beijing.

By April, however, Fang had to reconsider his costs and sales prices. It was clear that he had to reduce costs. This he could accomplish by continuing to source inputs locally and increase volume and his economies of production.

TABLE 3

<i>Item</i>	<i>Production Cost</i>	<i>Retail Sale Price</i>
Large Heart Dessert	¥30	¥130
Hard Ice Cream Cone (scoop)	¥12	¥49
Small Cone	¥1.5/¥3.0/¥4.5	¥8/¥15/¥20
Small Cup	¥1.5	¥7
Hug Me Bear	¥23	¥10
Cookie Puss	¥25	¥69
Fudgie the Whale	¥32	¥99
Sinfully Chocolate	¥18	¥69
Strawberry & Cream	¥17	¥69

What was uncertain, though, was whether these prices made Carvel products unreachable to Chinese consumers. After six months, Fang felt that slow sales had forced him to examine the decision whether to stick with the original pricing strategy, or redefine his product through price cuts.

Advertising

The basic drive behind the advertising campaigns both in China and the U.S. was to use fountain and novelty products to drive cake sales. Cake sales by far had the most margin, and it was in cake production that Carvel had its most leveraged competitive advantage. Clearly, if Carvel was to succeed in China, it had to do so on the back of cake sales.

Fang had several avenues to explore to promote his product. Among the options and costs to consider were:

- **Television**
 - 5 second commercial 3 times per day for 7 days—¥4,000
 - 15 second commercial 3 times per day for 7 days—¥10,000
 - 30 second commercial 3 times per day for 7 days—¥15,000
- **Radio**
 - 5 second commercial 3 times per day for 7 days—¥1,000
 - 15 second commercial 3 times per day for 7 days—¥3,500
 - 30 second commercial 3 times per day for 7 days—¥5,000
- **Billboards** —¥10,000 per month
- **Bus placards** —¥40,000 for one bus on one bus line for six months
- **Newspapers**
 - 150 word ad—¥2,000 per month
 - color ad on front cover—¥5,000 per month
- **Magazines**
 - local biweekly magazine—¥3,000
 - local monthly magazine—¥5,500

Before making his decision, Fang wanted to examine media-related information, as shown, in **Exhibit 8**, available from the Gallup Poll.

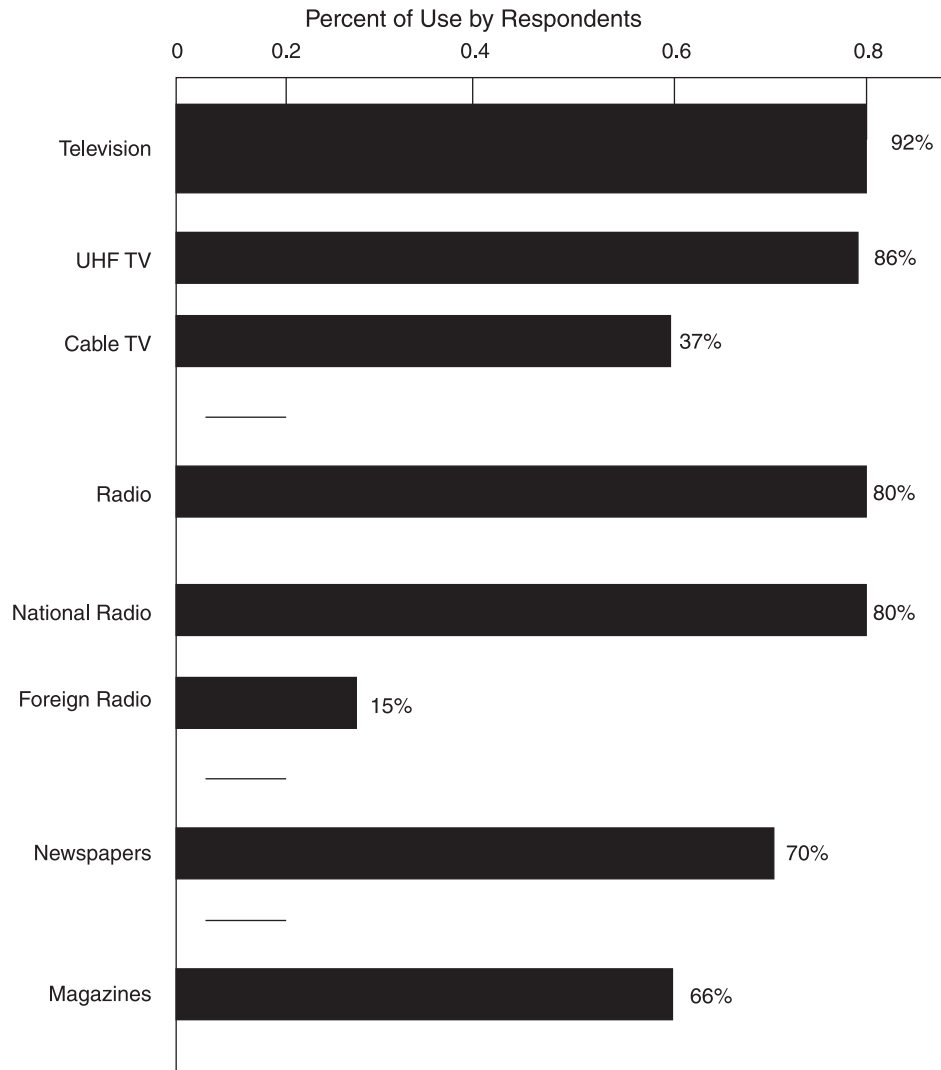
CONSUMER MARKET IN CHINA

The recent Gallup Poll provided interesting insights into the burgeoning consumer market in China. The most striking fact to emerge was that Chinese consumers were very intelligent shoppers who valued quality and long life in their purchases. For example, only 29 percent of consumers bought on price alone, whereas 63 percent bought on quality.

As for consumer tastes in food, the survey revealed that, as expected, rice, tea, and pasta were the most common foods in the Chinese household. However, 17 percent of those polled had dairy products in their house, and 13 percent regularly kept frozen foods at home.

The Gallup Poll also indicated that Chinese were very well aware of foreign brand names. The respondents were read a list of over 100 brand names and were asked whether they had heard of the names. Forty-four of the names were those of American-based companies or brands, 25 were Japanese, 17 were European, and the other 14 were

EXHIBIT 8
Carvel in Beijing Media Usage¹



¹ This is based on the results of a Gallup poll in response to the question: Which of the following did you read, see, or listen to yesterday?

Source: Company records.

from other nations. **Exhibit 9** lists the 30 most popular brand names in China, of which 14 are Japanese, 8 American, 5 European, 2 Korean, and only 1 Chinese.

Exhibit 10 shows the Gallup Poll information relative to fast food and soft drinks. Kentucky Fried Chicken was the most widely recognized fast food chain in China; McDonald's, Burger King, and

EXHIBIT 9
Carvel in Beijing

Popular Brand Names in China					
Rank	Company	Percent	Rank	Company	Percent
1	Hitachi-a	65%	16	Nestle-c	40%
2	Coca Cola-b	62%	17	Mitsubishi-a	40%
3	Panasonic-a	60%	18	Mercedes Benz-c	39%
4	Toshiba-a	58%	19	Head and Shoulders-b	36%
5	Qing Dao Beer-e	56%	20	Gold Star-d	36%
6	Toyota-a	54%	21	Sharp-a	35%
7	Mickey Mouse-b	51%	22	Philips-c	34%
8	Marlboro-b	47%	23	Sony-a	33%
9	Suzuki-a	44%	24	Volkswagen-c	33%
10	Honda	42%	25	Hilton-b	33%
11	Pepsi Cola-b	42%	26	Samsung-d	31%
12	Kodak-b	42%	27	Nissan-a	26%
13	Sanyo-a	42%	28	NEC-a	26%
14	Boeing-b	42%	29	Casio-a	25%
15	Fuji-a	41%	30	Peugeot-c	22%

Legend:

- a = Japanese companies
- b = American companies
- c = European companies
- d = Korean companies
- e = Chinese companies

Source: Company records.

Pizza Hut were also very recognizable throughout China. However, as the survey concluded, the most telling fact about these findings was:

As has been the case for almost every measure, urbanization is the factor most affecting brand recognition levels. Those living in urban areas are much more likely to recognize brand names than are people nationwide, and residents of the largest 9 cities are still more able to recognize brand names than are urban residents in general.

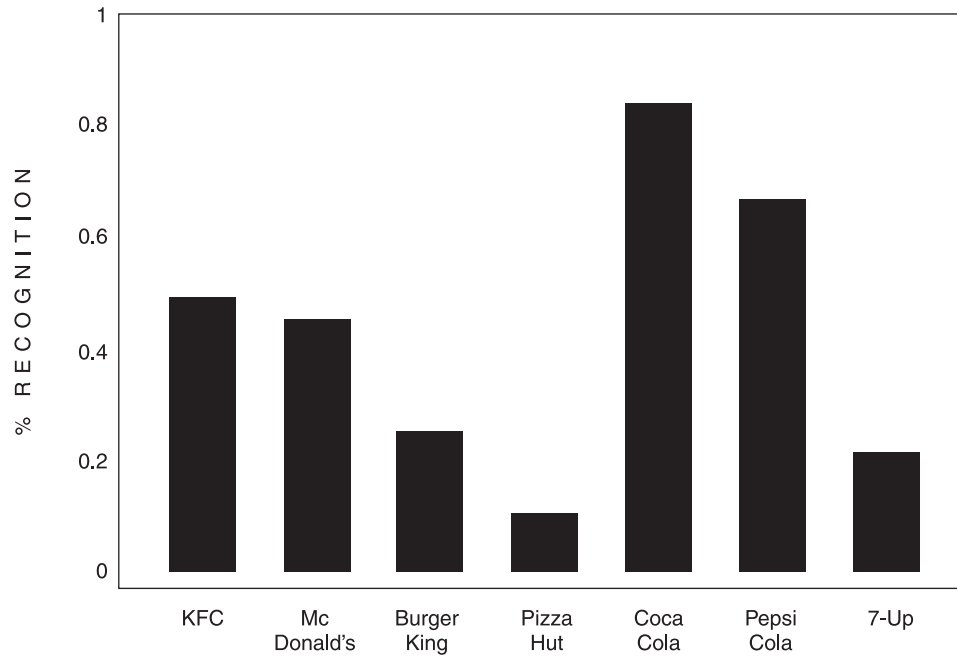
Finally, the Gallup Poll revealed some telling information on buying habits in China. For example, in response to the question: "On average, about how much do you and your household spend per

month on the following items?", considerable differences were found between large cities, urban areas, and the country as a whole. (See **Exhibit 11.**)

COMPETITION

Carvel Beijing faced a very fragmented market in Beijing. Generally speaking, several domestic and international companies had penetrated the market and achieved moderate brand awareness. However, no brand had yet to break from the pack and establish itself as the market leader in ice cream. The following breakdown describes the most dominant of these fragmented players:

EXHIBIT 10
Carvel in Beijing Brand Recognition of Fast Food and Soft Drinks



Source: Company records.

EXHIBIT 11
Spending Habits in China

Item	National Response	Urban Response	Largest 9 Cities
Food, including eating out	\$22.10	\$38.00	\$53.10
Family savings	\$11.40	\$17.00	\$20.50
Clothing	\$5.60	\$9.00	\$10.00
Child's education	\$4.70	\$7.00	\$9.10
Home, rent, & electricity	\$4.30	\$8.20	\$9.80
Daily goods (non-food)	\$3.50	\$4.80	\$5.60
Entertainment	\$1.30	\$3.20	\$4.50
Medical	\$2.30	\$4.00	\$4.00

Source: Company records.

- **Walls**—Walls was a Holland-based company and one of the market leaders in Europe and Australia. In Beijing, Walls' product line was limited to cups, cones, and various other novelty treats. Mainly, their distribution was limited to roughly 3,000 rollhards from which they sold novelty ice creams, namely cups and cones. Walls was also available in several supermarkets.

As one of the first western ice creams in Beijing, Walls still enjoyed the benefits of its first mover status. Beijing customers still considered Walls to be the preeminent Western ice cream in Beijing, simply due to breadth and duration of its presence. On average, Walls sold its products for ¥4, but recently it had raised its prices to ¥5. It was estimated that Carvel had taken much of its market share from Walls.

- **Bud's**—Bud's was a San Francisco-based ice cream company that enjoyed a wide presence and brand awareness in Beijing. Although only a regional brand in the U.S., in China, Bud's enjoyed the reputation of being the preeminent American brand because it was the first American brand to appear in the PRC. To date, in a country where consumers still prized a company's tradition and longevity, both Baskin-Robbins and Carvel had not yet been able to dispel Bud's image.

Like Walls, Bud's did not have any retail store outlets. Instead, Bud's sold only from nearly 600 rollhards scattered throughout Beijing's markets and supermarkets. Bud's only produced cup and cone products, and its prices matched those of Wall's. Small cups were ¥4.2, hard ice cream was ¥6, and pints sold for ¥23.

- **Baskin-Robbins**—Baskin-Robbins represented the most significant long term competition to Carvel Beijing for several reasons. First, Baskin-Robbins was Carvel's chief rival in the U.S. and its products enjoyed a more national brand awareness than Carvel's. Secondly, Baskin-Robbins was the only competitor in Beijing that produced an all ice cream cake and had retail stores in which to promote them. Finally,

Baskin-Robbins had a longer and broader presence in Beijing and appeared to have the positioning strategy that Carvel had targeted.

Baskin-Robbins' presence was mainly limited to its two retail stores. Like Carvel, Baskin-Robbins offered its customers a true ice cream parlor experience. While Carvel's cakes were of better quality, Baskin-Robbins relied on its tradition of hard ice cream cones and fountain products to drive sales. Currently, Baskin-Robbins charged ¥9 for a single scoop ice cream cone and ¥107 for a cake comparable to Carvel's small round. Baskin-Robbins did not have any wholesale outlets at this time.

- **Meadow Gold**—Meadow Gold was a locally produced product with high market saturation. Meadow Gold's product quality was much lower than the above competitors, but the company's rollhards were in twice the outlets than Walls and the company sold its products through a number of channels: local stores, supermarkets, and on the street. Concentrating on only novelty products, Meadow Gold charged only ¥2 to ¥3 for its product line of cups and cones.
- **New Continent**—As a venture partner in Carvel Beijing, New Continent was also a strong domestic player in the novelty side of the market. Generally speaking, New Continent competed alongside Meadow Gold for market share and sales, and produced novelty products in the same factory that produced Carvel Beijing's ice cream mix. Most of New Continent's prices were ¥2 or lower.

New Continent, though, had clearly used its partnership with Carvel to project itself deeper into the Beijing market. The company had come out with awning and vendcart styles that closely resembled the colors and logos of Carvel. Also, with nearly 6,000 vendcarts on order, New Continent would clearly redefine the lower end of the ice cream market in Beijing.

Finally, New Continent had also begun to open mini stores along the same lines as

Carvel's Chang An and Parkson outlets. The company was also considering bringing out a new line of ice cream cakes that would compete on price with Carvel's and Baskin-Robbins' products.

SUBSTITUTE PRODUCTS

Beijing residents enjoyed a wide variety of dessert products. Besides ice cream products, there were numerous bakeries that offered a variety of traditional Chinese-designed cakes and pastries. These flour-based cakes were richly designed with traditional Chinese figures and styles and sold on average from ¥100 to ¥250 for an ornate wedding cake.

Other traditional treats included pastries with a sweetened jelly or fruit paste filling. Chinese also enjoyed various types of traditional dried fruits, and they often ended each meal with a platter of fresh fruit and tea. There were also many styles of Chinese and Western candies. Furthermore, a traditional sweet treat called *suan niu nai* (literally meaning sour milks), a yogurt-like product, was sold throughout the city for ¥1.5. Chinese of all status enjoyed *suan niu nai* at all hours of the day, but it was more closely associated with the less affluent segments of society.

Finally, the growth of McDonald's, Burger King, and Kentucky Fried Chicken had presented Carvel with other possible substitute products. More and more consumers were trying these fast food giants' own desserts, such as apple pies, shakes, and their own ice cream cups and sundaes.

In short, there were a wide variety of dessert and snack treats from which Chinese consumers could choose. What concerned Phil Fang, though, was that all these alternative treats were cheaper and more widely recognized than his product line.

CONCLUSION

On April 30, 1995, Phil Fang gathered his management team together to perform a SWOT analysis of Carvel Beijing. They concluded that Carvel Beijing was operating under the following conditions:

• Strengths

- Carvel had the best ice cream cake in Beijing and one of the best ice creams.
- Carvel had received positive reviews from its customers.
- Training and operations had progressed well and the company was ready to increase production.

• Weaknesses

- Vaguely defined management roles and objectives hampered definitive marketing policies.
- Inability to source inputs locally continued to hamper the bottom line.
- Too many potential customers still did not know of Carvel Beijing.

• Opportunities

- Carvel was looking into involving the foreign embassy community in its sales promotions as a means of increasing both sales and potential outside business contracts.
- The approaching summer allowed Carvel to have a seasonal grand opening to reintroduce the brand to first time customers.
- Wang Meng's offer to use 6,000 New Continent vendcarts offered Carvel the opportunity to increase greatly the brand's exposure at minimal cost.

• Threats

- The cash flow and sales problems threatened to scuttle the proposed business plan for 1995.
- The competition, including Wang Meng, were quickly realizing the potential of ice cream cakes in Beijing, and Carvel's competitive advantage in this area would be challenged.
- The dynamic political and economic environment in China presented inherent uncertainty.

Having done this analysis, Fang had to plot his strategy for the rest of 1995 and beyond. More important, he had to make some very tough decisions on where he wanted to position Carvel

Beijing as it entered its first and, arguably, most important summer in Beijing. Among the most pressing issues he had to face were:

- how to price the product: competitively or as premium product
- how to design and position the cakes: as American products or as more traditional Chinese products
- how to confront the financial problems: with short term or long term policies
- how to respond to Wang's vendcart proposal
- how to produce the mix: as the original American mix or as a less sweet mix more appealing to traditional Chinese tastes

What complicated these decisions were the problems associated with a multinational joint venture: issues of personality, culture, and the joint venture agreement itself. In the end, though, it was Phil Fang who would have to overcome these challenges and seize upon the unique chance to create the first truly national brand of ice cream in the People's Republic of China.