
CASE 10: PAINT MANUFACTURER PROFITABILITY**Firm:** McKinsey (1st round)**Category:** Profitability

Question (posed by the interviewer):

Your client is the CEO of a paint manufacturing company. One McKinsey team has previously worked on optimizing their cost structure. The CEO wants to further improve their profitability. How would you analyze the situation?

Information to be given if asked:

Industry Structure

- The industry growth rate is same as GDP growth.
- Client has 30% market share.
- 2nd competitor has 35% market share. There are number of small regional and local paint manufacturers as well which serve the rest of the market.

Customers

- The customers are of 2 types: PROFESSIONALS (CONTRACTORS) and PRIVATE CONSUMERS.
- The customers are not very loyal (recognize this as an issue to be addressed later if time permits).
- They have multiple brands and have good basic quality paint.

Firm's Economics

- The total revenues are 1B.
- There are 3 sales channels as follows:
 - Company owned stores: 600M in sales. Focuses on contractors (professionals).
 - Consumer division: 300M in sales. Sold through mass merchandises.
 - Independent dealers: 100M in sales. Sold to local mom & pop stores. The client maintains a separate set of warehouses to serve this channel.
- Make the candidate calculate the Profitability numbers as below:

<u>Channel</u>	<u>Revenues</u>	<u>Return on Sales</u>	<u>Profitability</u>
1. Company owned stores	600M	5%	30M
2. Consumer division	300M	3%	9M
3. Independent dealers	100M	1%	1M

- The target for the firm is \$80M.

Competition

- The competitors also have 3 distribution channels. There is no data on competitor's profitability.

Solution:

- The candidate should recognize that company store channel, which focuses on contractors (professionals) have the highest ROS (return on sales). The company needs to focus on this segment.
- The independent dealer channel has the lowest ROS. The company needs to re-evaluate their strategy/presence in that channel.
- The client needs to focus on their sales force and strengthen their relationship with the contractors. Since loyalty is an issue, introduce switching costs. Some techniques are order automation by establishing web presence, which will allow the contractors to quickly and easily re-order.
- Re-evaluate the sales force compensation and their commission structure.

CASE 35: GAS MANUFACTURERFirm: McKinsey, 2nd roundCategory: Market Entry Analysis

Question (posed by the interviewer):

Your client is a gas manufacturer. Currently the client owns and operates its gas plants nationwide. They have hired McKinsey to investigate whether they should enter into the business of running 3rd party gas plants. How will you structure the analysis of this case? Should the client enter or not enter into this business?

Information to be given if asked:*Customer Information*

- The client manufactures hydrogen, oxygen etc.
- The customers are other industrial goods companies which use gas for producing steel, waste treatment etc.
- Some of the steel mills and waste treatment agencies own their own gas plants. For instance, a steel mill can have its own gas plant, which is located right next to the steel mill. These are the gas plants that the client wants to operate (not buy them, just provide operations service!!)
- The client has highest market share in the market (about 30%).
- The market grows pretty much along with the GDP (1-3%).
- The cost of the gas for the customers is a small % of their total direct production costs. It is extremely important for the customers to have an uninterrupted supply of gas, since their steel plant shutdown is extremely expensive for them.

Firm's current economics

- The product is a commodity, so the firm is a price taker. The firm's revenues grow with GDP.
- Client's cost structure is the lowest in the industry.
- Think about how the gas plant's cost structure will change if the client operates it:
 - Direct Material (DM) – raw material is air, which is free
 - Direct Labor (DL) – very lean operation. One gas plant can be run by 1-2 persons. There will be no change.
 - SG&A – Some reduction due to client's scale
 - O/H – Some reduction by centralized monitoring and repair crew. Possible due to client's large scale of operations.

Client's resources/capabilities

- They have perfected the technique of monitoring the gas plants (using remote monitoring) and have the minimum average plant downtime/breakdown in the industry.
- By being the largest producer of gas, the client has achieved the highest economies of scale.

Competitive landscape and current issues

- There are 3 other national firms that manufacture and provide gas. Their market shares are smaller than that of our client.

Solution #1:

The client can create value by operating 3rd party gas plants by lowering the operational cost somewhat. More importantly by minimizing the downtime of the gas plants they can add more significant value. Therefore, based on the value proposition, the client should enter into this business.

The client then needs to consider barriers to entry for other firms and implementation strategy.

Barriers to Entry

- The client's capabilities are unique in the industry. They can sign exclusive long term contracts with 3rd party clients to operate the gas plants.
- The client also needs to consider their pricing very carefully.

Implementation

- Evaluate the capital investment of this market entry.
- Since the client's infrastructure is well established, the capital cost will be minimal.
- The client could offer to operate 3rd party gas plants which are located reasonably close to their own plants. This would allow the client to go up the learning curve while ensuring uninterrupted gas supply to the customers.

Summary

- **The client should enter this market since there is value to be captured and the capital investment is low.**

CASE 36: VITAMIN MANUFACTURER ENTRY INTO CHINAFirm: McKinsey, 1st roundCategory: Market Entry Analysis

Question (posed by the interviewer):

Your client is a chicken vitamin manufacturer. The vitamin helps increase the size of chicken breast and reduce fat content. Should they enter China?

Information to be given if asked:*Chicken Industry in China*

- Chinese chicken industry is twice as large as US in terms of amount of chicken consumed.
- Growth trends are similar to those of US.

Customers

- The customers in US consist primarily of large corporate farmers e.g. Tyson, Purdue.
- The customers in China can be segmented into 3 categories:

<i>Customer Segment</i>	Current Market Size	Growth (last 5 years)
Family poultry farms	80%	1%
Village farms	10%	19%
Corporate farms	10%	80%

Competition

- There is no direct competitor at the moment in China. There is one substitute product which sells for 47cents/lb.
- The client's product is superior in performance and has no side effects compared to the substitute product.

Firms Resources

- Magnesium is an important ingredient used to manufacture the vitamins.
- The firm has one mine in Florida which is operating at max capacity.
- There are mines in other parts of the world, which have a cost structure as follows (includes transportation of raw material to China):
 - 2 in Europe- 39cents/lb
 - 1 in Africa – 35cents/lb
 - 1 in India – 37cents/lb
 - 1 in China – 38cents/lb

NOTE: These are prices if the client were to acquire the mines.

Solution:*Economics of entry decision*

- Draw a basic Value Chain for the vitamin manufacturing/distribution process.
 - | |
|---|
| Raw Material → Manufacture vitamin → Sales and Marketing → Distribution |
|---|
- The cost of raw material is given above for different mines. The additional cost beyond the raw material is 10cents/lb.

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- Which mine will you choose? The one in Africa.
 - Now that the cost structure is established, the client should perform an NPV analysis based on certain project sales volume.
 - The NPV analysis was positive.

The client should enter China for the following reasons:

- The corporate market is growing rapidly (80% growth in 5 years). The corporate farms are more likely to use vitamins than the small family farms.
- The client should acquire the mine in Africa.
- There is no significant competition. The client's cost (45cents/lb) is less than that of the substitute product (47cents/lb).