

PATATI

Turnaround
Food & beverage

Medium difficulty
Interviewer-led case

This case discusses how to turnaround the declining profitability of a food product in the UK market.

All elements of the case interview scorecard are tested.

Problem definition

Patati is a French company that sells raw material for potato fries. They have a global presence and they are known for manufacturing potato fries of different varieties.

Three years ago, they launched a new type of potato wedges product into their top 3 markets: the UK, USA and Japan. Since the launch, while the product has performed well in Japan and the USA, profits have declined in the UK

The CEO of Patati is concerned about the declining profitability of the UK potato wedges business and has called on you to analyze the situation and advise the company on how to turn things around.

How should the client go about solving this problem?

Additional information

If asked, please share that:

- The client sells only one variety / brand of potato wedges
- Profitability has only declined in UK market; all other markets are performing well
- The CEO will consider the turnaround successful if Patati can take profits of the UK operation back to the same level as 3 years ago

Question 1 (Structuring)

How would you structure your approach to the question?

Possible answer

1. *Revenue*
 - a. *Volume: are we selling fewer potato wedges?*
 - *Is the market for potato wedges shrinking in the UK?*
 - *Within the market, are proportionally fewer customers buying our wedge products?*
 - b. *Pricing: has our unit price gone down?*

2. *Cost: are our costs rising at any point in the value chain?*
 - a. *Raw material*
 - b. *Production cost*
 - c. *Distribution costs*
 - d. *Sales and marketing*

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Question 2 (Judgement & Insights)

The client shares revenue data from the last 3 years [share Exhibit 1].

What insights can you draw from this data?

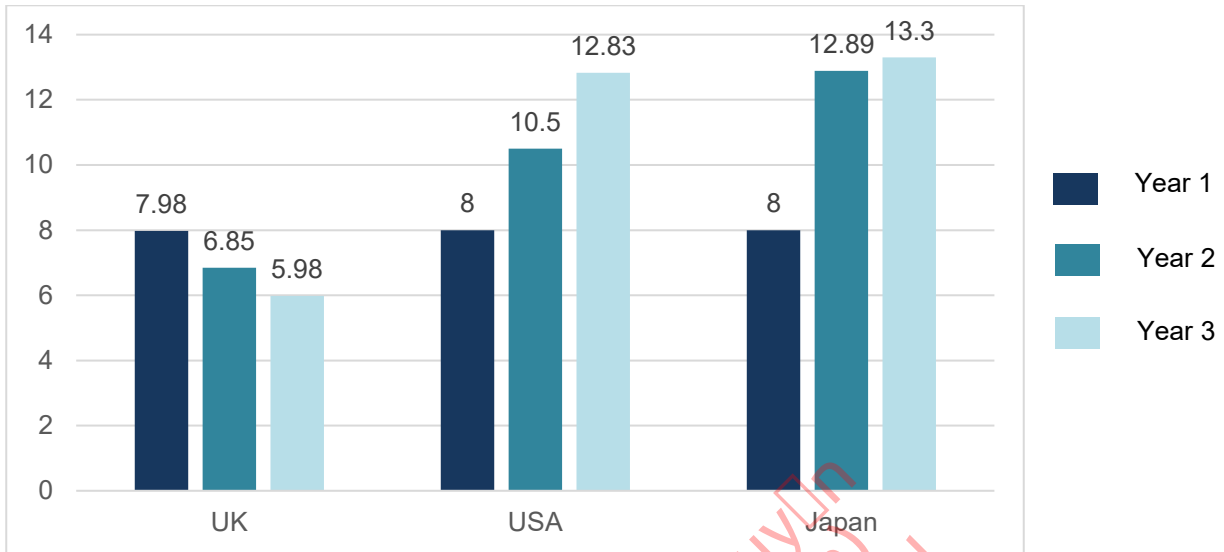
Additional information

- A candidate will naturally be able to comment on the steep decline in the UK versus other markets, but they should also capture the point that the launch year was very successful – and that something must have changed since then

Possible answer

- *UK revenue has fallen by 25% from year 1 to year 3*
- *Sales in year 1 were almost equal in all 3 markets, even though the UK market was likely the smallest of the three. Therefore, the UK business does not seem to have had any issues at the time of launch*
- *However, from year 2 onwards the UK appears to have some problems whereas other markets are growing rapidly. It's likely that something changed for the worse after launch, such as strong discounting by competitors driving down prices*

Exhibit 1: Patati's potato wedges revenue (\$m)



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Question 3 (Structuring)

The client tells you that our product's price has not changed. **What therefore could be the reason for the decline in revenue in the UK after a strong launch year?**

Possible answer

If price hasn't changed, units sold must have decreased. There are several potential reasons for this volume decrease:

Changes in customer preferences:

- *Customer preferences may have shifted away from potato wedges, e.g. towards regular potato fries*
- *Customer preferences may have shifted towards a type of wedge that our client does not offer, e.g. low-fat wedges*

Increased competition:

- *Competitors have launched superior products or compelling alternative products (e.g., crinkle-cut fries)*
- *Competitors have decreased their prices*

Issues with distribution:

- *We have lost some distributors*
- *We have lost some shelf space within our distributors (for instance if they have started to distribute competitors' products)*

Issues with our product:

- *Change in perceived or real product quality. For example, perhaps the product received negative reviews or press coverage after year 1*
- *Change in portion size making the product less attractive vs. competition*

ineffective marketing:

- *Spend on marketing post-launch may have been too low maintain the interest of customers*
- *Spend on marketing may have been focused on the wrong channels, e.g. on TV when social media would have been more effective*
- *Promotional and marketing content may have been ineffective. For example, the client's marketing messaging may not have been adapted to the local market*

Question 4 (Judgement & Insights)

Research suggests that competitors have reduced the per portion prices of potato wedges from \$6 in year 1 to \$4 in year 3, without significantly losing profitability. Over the same period, our client's prices have remained the same at \$6.

How do you think competitors have made this possible? Feel free to ask for more information as we discuss this, to help you come to a judgement

Additional information

This question is intended to be a discussion where the candidate suggests and debates ideas before the interviewer provides the following information:

- 75% of the cost is raw materials, transportation cost to the factory, and import duties for potatoes. Production, distribution and marketing makes up the remainder
- Potato wedges are made from a specific variety of potato which is broad in the middle and has less starch. This variety mostly gets imported into the UK from nearby countries
- Competitors have invested in greenhouses in the UK where they have started growing this variety domestically, reducing their costs significantly as the import duties and transportation cost is saved
- There is no other significant difference in how Patati makes potato wedges vs competitors

Possible answer

I would expect competitors have done something different to reduce their costs vs Patati. I suspect the major costs for producing and selling potato wedges are:

- *Raw materials (potato, frying oil, seasoning, packaging)*
- *Production (cooking and packaging)*
- *Transportation (field to factory, factory to store)*
- *Marketing and sales (advertising, store promotions)*
- *Overhead (staff, rent and rates, insurance, etc)*

To reduce cost to this extent, our competitors likely changed their cost structure significantly with regard to the most expensive cost components.

Given that raw materials and import costs make up the largest component of cost, it seems likely that competitors have done something differently in potato sourcing or production – perhaps buying from lower-cost suppliers and countries, or perhaps even growing domestically.

Overall, it seems like our client's use of imported potatoes vs home-grown potatoes is the key contributor to higher costs at Patati.

Question 5 (Numeracy)

The R&D investment to start farming potatoes in the UK is \$3m. Once the company starts the usage of home-grown potato, the price can come down \$1 per portion each year until the price reaches the lowest possible point of \$4.

With every drop of \$1 in price, Patati is confident it can sell an additional 500,000 units per year. We can assume the profit margin will stay a constant 20% as cost will reduce in line with price.

Do you think Patati should invest \$3M into growing potatoes in the UK?

Additional information

If the candidate starts calculating the net present value of future profits, guide them to ignore time-value of money and to focus on whether the additional profit will be sufficient to cover the initial investment.

If asked, please share that:

- The client wants to focus on the next 4 years when evaluating this question
- Patati can be expected to decline at c.15% per year if it maintains the current price point

If the candidate requires help, suggest that:

- Before making further calculations, the current sales volume can be established by taking the \$6m sales in Exhibit 1 and dividing by the current price of \$6 (to reach a volume of 1M)
- It can be helpful to sketch a table to complete these calculations, and rounding can be used to complete calculations in a reasonable timeframe

Possible answer

To answer this question, we should compare a scenario where Patati makes the investment against a scenario where they choose not to invest.

Scenario 1: Patati invests in growing potatoes in the UK.

Calculating the increasing sales of 500,000 units and \$1.00 price drop every year, Patati would sell potato wedges worth \$37m over 5 years, until the time the price reaches \$4:

| Year | 0 | 1 | 2 | 3 | 4 | Total |
|---------------|------|------|------|------|------|-------|
| Price (\$) | 6.00 | 5.00 | 4.00 | 4.00 | 4.00 | |
| Units (M) | 1 | 1.5 | 2 | 2 | 2 | |
| Revenue (\$M) | 6.0 | 7.5 | 8.0 | 8.0 | 8.0 | 37.5 |

At 20% margin this reflects c. \$7.5m profit

Scenario 2: Patati does not invest and continues

It is likely that with the current delta in price point vs competitors, Patati's market share will reduce and they will continue to decline. Taking a decline rate of 15% (which approximates historical decline so far), at \$6 Patati will sell c.\$22.3m over the 5 years:

| Year | 0 | 1 | 2 | 3 | 4 | Total |
|---------------|------|------|------|------|------|-------|
| Price (\$) | 6.00 | 6.00 | 6.00 | 6.00 | 6.00 | |
| Units (M) | 1 | 0.85 | 0.72 | 0.61 | 0.52 | |
| Revenue (\$M) | 6.0 | 5.1 | 4.3 | 3.7 | 3.1 | 22.3 |

At 20% margin this reflects c. \$4.5m profit

Based on this, a \$3m investment in R&D to grow potatoes in UK is an attractive option – the client more or less breaks-even on the investment in the period. If we were to consider a longer time horizon, the case becomes even stronger: the alternative will be continued decline until most likely Patati has to exit the wedges market in the UK.

Question 6 (Synthesis)

What do you recommend to Patati?

Possible answer

I recommend Patati invests in R&D and grows its own potatoes to produce wedges in the UK. This is for three main reasons:

- All competitors are doing this successfully and have developed a cost advantage as a result
- Patati has a large price disadvantage due to the imported potatoes, and this is causing customers to choose competitors over Patati potato wedges
- The investment is clearly attractive versus the alternative of continued decline, assuming our assumptions are correct

As a next step, I suggest that Patati considers the additional capability and expertise that is required to make the investment a success and builds a plan to source or develop this.

If we had more time, I would like to investigate what Patati could do to attract more consumers in the short-run to increase sales, such as running an innovative advertising campaign.