

Cadbury: porter's five forces, and pestel analysis



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In order to recommend what strategy is needed for a company to follow is essential to analyze the competitive environment where they operate. When analyzing the competitive environment of Cadbury, the factors that should be considered are both factors from the confectionery industry and factors from the macro environment, which would have an effect on the successful operation of the company. I have chosen Porter's Five Forces, and PESTEL analysis.

1. 1 Porters Five Forces

Bargaining power of buyers: Porter (2008) stated that where the product is a small fraction of buyers' costs or expenditures, buyers are usually less price sensitive.

Cadbury has two categories of buyers namely, consumers or retailer.

Retail buyers are the group that has the most effect for Cadbury and other confectionery producers. They are mainly large retailers like i. e. Tesco, Asda in UK. There is competition for shelf space and threat of backward

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integration especially with brand only products. That is a very important group, which is directly correlated with the revenue. It could have high effect.

Bargaining power of suppliers: Group that has big impact on the final product, in terms of quality and price. The main commodities used by Cadbury are cocoa, milk, and sugar. Any change in the price of those commodities will affect directly the price of the product and the profitability. Confectionery manufacturers are facing increasing cost pressures as Cocoa prices hit their highest levels for 23 years due to fall in Cocoa production (BBC, 2008). Cadbury is using commodity derivative contracts for cocoa and sugar. ' Cadbury Cocoa partnership' is established to insure sustainable supply of Cocoa by supporting Cocoa farmers in Ghana, India, Indonesia and Caribbean (Cadbury, 2008). Another way perhaps to strengthen their position would be a backward integration, where they would acquire one or more of their suppliers to ensure that they have control over the commodity price (Johnson et al, 2008). Moderate effect.

Rivalry among existing competitors: Confectionary is an industry with stiff competition amongst its players. There are five major players competing globally in confectionery industry: Nestle, Mars & Wrigley, Cadbury, Ferrero Rocher and Hershey with about 42% share of global market (Cadbury, 2008). All of the major players in the industry have very sound brands worldwide. There is a high growth rate of 5% in the developed countries, and about 10% in the emerging markets, which makes the confectionery industry very attractive. Because of the high competition, there is possibility of

competition of prices, which will cause the company to operate with lower margins. High effect.

Threat of substitute products: World Health Organization (WHO) (2008) estimates that in 2005 at least 400 million adults worldwide were obese and forecasted that this figure in 2015 will be 700 million. USA, UK, and Germany are among the countries with largest number of people that are obese, overweight, and have cardiovascular health problems on the other hand those countries are the largest confectionery markets in the world.

Consumers are becoming more and more aware of healthy eating, so the snacking habits are changing. There are numbers of substitutes emerging on the market, products like cereal bars and fruit bars are threat for the chocolate industry, as health conscious parents especially, would opt for the healthier option. Chocolatiers try to add value to their chocolate, with vitamins or antioxidants or by removing fat and sugar from the confection (Scully, C., 2006). Moreover consumers want firms to avoid e-numbers or synthetic colours and require instead organic substances In this regard many people think of the possible health benefits from the chocolate they eat. Consequently a further development will start. Special groups like diabetics or allergy sufferers will rise in importance. (Vreeland, C., 2007). The other main direction in the confection industry is the tendency to pure black and high quality chocolate. Thus, the sweet is turning into a way in which people express their selves. Candy Industry (2006) clarifies this with the headline of one of their reports ' Dark and Decadent vs. Milk and Mainstream'. The statement is underpinned by several data. In 2006 the sales of dark chocolate increased by 40%, every third chocolate released was a dark

chocolate and the premium market was foretold to grow over 20% in the next periods. The bitter chocolate has the benefit of a low sugar rate and a lot of antioxidants that makes it much more healthy than normal sweets. A dark chocolate is a bit of luxury at a reasonable price, perhaps that's a reason why this kind of sweet is so popular. The last point which supports the trend is that premium chocolate is for a multilateral use, for instance as a gift or decoration, optimally suitable (Rehan, 2007). The effect is high.

Threat of a new entry: -as the confectionery market is dominated by well established brands, as stated while analyzing the rivals, and they are Nestle, Mars & Wrigley, Cadbury, Ferrero Rocher and Hershey, with 42% of the market (Cadbury, 2008) for a new company is very difficult to enter the market, unless they come up with new interesting product, something to go in line with the healthy lifestyle perhaps, as discussed above. However, it will be difficult to take a considerable market share, as they would be competing against very well established companies, with also established brand names, distribution channels and high capital investment. Other barriers for new entrants are economies of scale and experience of major operators in production and distribution (Johnson, et al 2008). On the other hand those barriers might not be effective for a company that is diversifying, like Nestle, they used their strong position of the confectionery market to enter the ice cream market (Reader, 2006). The effect on Cadbury is low.

1. 2 PESTEL Analysis

Political: Only 10 countries in the world produce more than 90% of the world's cocoa (World's Coco Foundation, 2007). The major problem in those countries is poverty. The main concern for the companies trading with those

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countries is political stability, as instability can have effect on the price, and the supply.

Economic: Recent fall in the value of the pound, is one economic factor that affects all the companies that operate in UK, and have business connections with other countries. Cadbury operates in more than 60 countries in the world. Cadbury' suppliers of their main commodity cocoa are not British, as outlined above. The depreciation of the pound makes the prices of cocoa more expensive; even though Cadbury had future contracts to hedge against situations like that it will still affect the operation in longer run, when new future contracts need to be made.

On the other hand interest rates are very low in England at the moment. The base rate is only 0. 5% (Bank of England, 2010). Companies can benefit with lower interest borrowing.

Social: Fair trade with cocoa farmers is a social factor, as affects how the company is perceived by the consumers. Fair trade means that a company buys a tone of cocoa at the market price and pays a social premium for the commodity. This benefits the planter because of a steady income stream, which is more independent from the volatility of the market price.

Furthermore a company with a fair trade label pays a percentage of the selling price to the centralized fair trade organization. Corporations try to redeem these disadvantages through a higher quality of cocoa beans (Westen, 2006). Furthermore an enterprise could gain a competitive advantage because of their social commitment. The customer can see a fair

trade certification on the package and this is becoming more and more important.

As outlined above Cadbury operates in more than 60 countries in the world. When a company operates in more than one country potential problems are conflicts between different cultural groups, language difficulties, stereotyping, and mutual misunderstanding (Greenhouse, et al, 2010).

Technological: Availability of high-tech machinery enables the company to produce high quality product at lower prices, which helps the company to gain competitive advantage. Another point is the widespread of the internet and satellite television, makes it easier to advertise to bigger audience of potential consumers.

Environmental: The cocoa plant needs a stable climate. But the ideal conditions in Africa and South America are in danger because of global warming. The weather will be unpredictable and natural disasters are possible. Consequently the plants get hurt and the productivity decreases. Moreover disease destroys over 20% of the cacao beans that should be use for chocolate production every year (Ogodo, 2006). Therefore companies should search ways to secure a steady flow of cocoa in the required amount and quality. Cooperation with the World Cocoa Foundation could be a solution. Confectioners like Ferrero, Lindt, Thorntons and Nestle realise this potential and try to improve future expectations (World Cocoa Foundation, 2007)

Legal: Affecting the industry are two new legislations that came into force in 2003 in UK. Regulations concerning contaminants in food and organic

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products force firms to obey and perhaps change their own practices (Baxter, 2006).

The company had a very strong financial position with sales revenue growth of 14.6% compared with the previous year, which was due to increase in price, rather than increase in volume of sales, (Bonfield, 2009). Increasing price with no increase in the quality results in higher margins, however it is a very risky strategy to follow as the consumers might not agree with it, the company can lose market share (Johnson, et al 2008). The profit margins have increased from 5.41% in 2007 to 7.43% in 2008, and are higher than the average which stands at 6.42%. That is an indicator of successful cuts in cost. Main reason for that is cutting the number of employees, in 2007 the number of employees was 50,465, and in 2008 was nearly 4000 less down to 46,517. ROCE was nearly doubled in 2008 rising from 3.78% to 7.29%, and was much higher than the average ROCE for the industry, which was 5.53%. This increase in part can be from divestment of Americas Beverages in 2008 during 2008 that had lower ROCE than other companies in the group. According to Cadburys annual report (2008) In July 2008 Company issued new £350m sterling bond with a coupon of 7.25% and underlying interest rate for Cadbury in 2008 was 6.5%. This means that Cadbury is not producing ROCE much more than its current cost of capital. On the other hand Nestle's ROCE is an impressive 21.5% that indicates that the operating costs in UK are much higher, like wages, rent, administrative expenses etc. Current ratio which indicates the company's liquidity is 0.86% for 2008 for Cadbury, which is an improvement from previous year when it was 0.58%. That indicates that their liability has decreased during 2008. Compared to <https://assignbuster.com/cadbury-porters-five-forces-and-pestel-analysis/>

the competitors is obvious that they are not as liquid as Nestle, with current ratio of 1%, however their performance for 2008 compared with the industry average which is 0.72% indicates that they are doing better than the majority.

Gearing Ratio has decreased from 123.69% to 89.66% in 2008 mostly because of the demerger with the Americas Beverages which was financed by debt. At 2008 their gearing was lower than the average that was 106.6. That is an indicator that if the company needs to borrow, it will not be difficult to find a lender, as they are outperforming the average.

Return on shareholders' funds is 11.36% nearly doubled compared to year before when it was 6.10%. Nestle's return is again much higher at 14.76%. However Cadbury's Return on Shareholders' funds is again better than the average for the industry which sits at 8.73%. (Weetman, 2006) (Nestle, 2008) (Fame, 2009)(Cadbury, 2009)

CORPORATE STRATEGY CURRENTLY BEING PERSUED

Vision into action is the name of the strategy pursued by Cadbury. The main outcome of the strategy is to achieve mid teen margins by 2011, alongside with 4-6% organic revenue growth, and improved return on capital employed. If all of that is achieved Cadbury PLC is going to be in an excellent position financially and marketwise, and would deliver outstanding return for their shareholders and become the largest confectionery company in the world. Cadbury's priorities stated in the strategy were: growth, efficiency, and capability (Cadbury, 2009).

In order to achieve the priorities cost reduction was very important, which resulted in increase in profit by 2.02% the de-merger of US Beverage happened in May 2008, as it was difficult for a British company to compete against American giants such as Coca Cola and Pepsi Co (Market Watch, 2008). And because it was an unrelated diversification from Cadbury's main focus on chocolate, gum, and candy. Originally Cadbury wanted to sell the business, as Colley et al. (2002) suggests that a company may not have the time or resources to focus on particular division. Selling the units that lack long term prospects would bring in cash that can be used in what would be considered more advantageous ways. However a lack of interest from "cash shy" investors forced it to split the business instead. Instead of adding value to the Parent Company, if that given unit adds in management costs, adds to bureaucratic complexity and obscure financial performance, it is not feasible to continue with their operation (Johnson et al, 2008). The recent acquisition of Adam business is of immense benefit to Cadbury having gain number two position in gum business. They are focused in Integrating these recent acquisitions for sustainable growth.

In order to implement strategy successfully there should be match between strategy and organisational structure. Roquebert et al. (1996) argue that in essence the structure of the organisation and its fit to environment determines the relative degree of profitability. Alfred Chandler (1962) concluded that 'structure follows strategy'. New group structure of seven business units instead of four was introduced and de-layering organization for faster decision making and reduction in administrative cost. " Strategic business unit is a part of an organization for which there is a distinct external

market for goods or services that is different from another strategic business unit SBU" (Johnson et al, 2008). The definition for SBU by CIMA, (2006) adds that SBU has a significant degree of autonomy, typically being responsible for developing and marketing their own product. In the case of Cadbury there is no evidence that shows these business units will have any autonomy in developing their own markets and products.

Alongside what I have mentioned several other activities had been carried out in order to implement the strategy, such as the reconfiguration of production in Australia and New Zealand to reduce complexity of production, and the closure of the nonperforming plants i. e. Barcelona and Turkey Gum plants and Somerdale Chocolate plant (Cadbury, 2009).

Cadbury is a large company that only concentrates in one industry. In a study carried out by Schmalensee in 1985 was found that the industry effect is very significant and accounts for at least 75% of the variance of industry rates of return on assets, which is directly correlated with the profit of the firm. He also found that market share effects exist it share has positive relation with profitability but its effect is negligible and industry and market share effects are negatively correlated. Within the industry this is competitive advantage that accounts for profitability of company. Cadbury at the moment does not have competitive advantage over its rivals. Profit target set for 2013 that is operating margin of 16%-18% (11. 9%for 2008) shows that understanding this fact managers are trying to gain competitive advantage over other global players by focusing on performance and increasing profit (Hill and Jones, 2007).

RECOMMENDATION

Based on the findings regarding the competitive environment where the company operates, and on Cadbury's financial performance and current strategy, I can give recommendations for a strategy to be followed, supported by a Balanced Scored Card provided in Appendix 1. The main goal as it was outlined in the existing strategy is Increase in Shareholders' Value. For the goal to be achieved every department in the Company should be involved. I will explain the implementation of the strategy starting from implementation in the process of learning and growth, than the implementation across the internal processes, followed by what would the strategy mean to the customers, finishing with how will the strategy affect the financial perspective.

In order for a company to be successful the most important asset are the employees. Very important part of any strategy is how happy the employees are? Are they driving the business towards the goal set by the management? In order to achieve the points made is very important that the team fully understands the strategy and the underlying assumptions. The employees should work as a team with a successful communication between them, which contributes to faster decision making. For best results Cadbury should employ and retain high performers, for example high performing managers, or specialists in the field of R&D. Once those employees are on board is very important to retain them, by appropriate pay, safe conditions, training and development to achieve their full potential. After the Kraft take over, and numerous job cuts, the team morale is low (BBC, March 2010), and it is very important that they get the support needed, and understand the big picture.

Another crucial area of successes is investing in R&D. As outlined by the analysis using the Porter's Five Forces, there is a threat of substitutes, to develop products in line with the changing consumer habits (WHO, 2008) healthier variety of snacks should be introduced. Consumers are becoming more health concern, and are happy to pay higher price for a good quality, example of that is Innocent, focused on healthy food and drink, 100% smoothies, packed fruits and vegetables, which in the nine years they exist has grown from just a three employees to 268, and is one of the fastest growing companies with revenue of over 120 million pounds (Innocent, 2009). As explained by Ansoff's Matrix possible growth opportunities are found in this particular case by introducing new products in already existing markets (Richardson, et al, 2007). I think that Cadbury PLC should be one step ahead and introduce similar products as well. However, introducing new products is very costly and it will relate in lower growth prospects. There are two factors that the power of substitutes depends on: Relative Price/Performance; and The extent of switching costs (CIMA, 2007). By using Porter's Five Force was found that the competition in the confectionery industry is fierce; in order for Cadbury to maintain their market share, or better to enlarge it, constant improvements of the products should be maintained. Black and Green line should be developed further, as the demand for dark chocolate is growing (Rehan, 2007). As Porter (1980) says "the goal of a competitive strategy for a company is to find a position in its industry where these competitive forces, will do it the most good or the least harm" The Cadbury's brand is large and global. Kraft had done a lot of acquisitions in the past where the brand has been kept intact like Jacobs Coffee in Germany. The company should continue that with the Cadbury

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Brand, as that is key to success. In the long run that will result in improved sales revenues, and better profit margins.

In the Balanced Score Card I have outlined that Cadbury should be environmentally friendly. Ogogdo, (2006) had pointed that there is a threat to the cocoa trees in the long run, by the global warming. Cadbury should do their part and be involved in projects helping the environment, like using fair trade, or following their competitors examples. Nestle USA is helping to safeguard the environment through pollution prevention and control, energy conservation and recycling/solid waste management practices (Nestle Global, 2010).

Entering new markets is a way of driving the business forward. By acquiring Cadbury, Kraft had positioned themselves on the Indian market where Cadbury has a very strong position, on the other hand Kraft can help Cadbury to penetrate the Chinese market, where they have a solid position, and use their distribution channels (Riches, 2010). Being global as referred to in the PESTEL analysis comes with its negative sides. To overcome that Cadbury should work towards minimizing conflicts and have procedures in place to supplement the strategy.

Even though the current liabilities had decreased from the year before, there are still high. Restructuring the debt to a lower interest loan, would result in substantial savings. The interest debt on the existing debt is 6.5% (Cadbury, 2009).

As outlined from the financial analysis, the performance had been stronger year after year, where almost all of the ratios had improved. If all the

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recommendations outlined above are followed the financial performance can only get stronger. When all standards are met for quality and the product meet and exceed customer expectations, there are possibilities for higher margins and increase in profit. On the other hand when the profits increase after interest and tax, the shareholder's return would increase as well, which makes the final goal achieved - increase in shareholder value.

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