See's Candies: Japanese Market Entry (A)

After reading the expansion proposal one last time, Charles Huggins inhaled the rich chocolate smell which filled his wood-paneled office. It was July 1991, and Charles -- known as "Chuck" to the family of employees at See's Candies -- knew that he and his management team must make a decision before the scheduled telephone call to Japan tomorrow evening. Of immediate concern was what he would tell JAL Trading Company, the import/export arm of Japan Airlines, about its proposal to import See's Candies into Japan. Their offer was one of three under serious consideration by See's senior management. A second marketing and distribution arrangement was proposed by M.A.T., a small importer of pineapples, papayas, and Hawaiian Host macadamia nut chocolates, which had grown along with the tourist trade between Hawaii and Japan. The Bank of Tokyo presented a third entry strategy, encouraging See's to replicate its dedicated candy stores in Japan with the help of a local partner. Each proposal offered unique approaches and strengths.

See's Candies was convinced that Japan represented a significant market opportunity for the company's premium quality confections. Experience demonstrated, however, that the market could be confounding. During his long tenure as president, Chuck Huggins had already spearheaded one entry into Japan in 1974. That year See's

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This case was prepared by Scott B. Bekemeyer and Keiko Tanaka under the supervision of David B. Montgomery, Professor of Marketing Strategy, Stanford Graduate School of Business.

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contracted with Nissho Iwai, one of the largest trading companies in Japan, to distribute its confections at major department stores. But difficulties with the importer led See's Candies to assume direct responsibility for its Japanese operations. See's considered replicating its American dedicated store concept, complete with black and white checkered floors, in Tokyo's fashionable Ginza district and other locations. Despite heartening consumer acceptance of the confections, it was apparent that See's operations could not be made profitable in Tolyo's high-priced real estate market, and Chuck decided to withdraw totally from the Japanese market.

Chuck Huggins was now entering his forty-first year of service as an employee of See's Candies, and he knew much had changed since that first ill-fated attempt nearly twenty years ago. Indeed, if recent distributor interest guaranteed commercial success, then See's had nothing to worry about. Unsolicited offers from Far Eastern distributors had recently been arriving on the desk of Dick Van Doren, See's vice president of marketing, at the rate of one per day. Many of these proposals addressed the complex distribution and marketing considerations which hindered See's Candies previously in Japan. Chuck pushed himself back from his desk, got up, and then followed the smell of chocolate out of his office to the production floor. There he found his favorite snack -- chocolate covered almond clusters -- cooling on wax paper in racks at the end of the production line. As he munched a cooling cluster, Chuck asked himself, "Is now the right time to expand to Japan? If it is, which partner will offer us the greatest opportunity for success there?"

The See's Candies History

Charles A. See, a recent immigrant from Canada, founded See's Candies with financial partner John Reed in 1921. The pair chose central Los Angeles as the site of their first store. From the beginning Charles and John used the image of Mary See, Charles'

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beloved candy making mother from Gananoque, Ontario, as their symbol of home-style goodness and quality. The image of Mary See continues to this day to appear on every box of See's Candies (Exhibit 1).

See's offered both candies and ice cream in its initial store. The partnership prospered in California's booming economy during the Roaring '20s, and two additional stores were added -- one in downtown Los Angeles and another in Pasadena -- in the early twenties. The twenties also saw the introduction of See's mail order service, the company's first efforts at dealing with long distance distribution. Breakage is a significant factor in a customer's perception of quality, and the partners were naturally concerned that the candy would arrive smashed or shattered. So, all mail order candy was packed in reinforced cardboard boxes supplemented with ample cotton padding. In addition, all shipments were insured so that any damaged delivery would result in a full refund. By the end of the decade, See's had more than twenty company owned stores scattered throughout the Los Angeles area.

The 1930's and 1940's presented challenges which slowed See's expansion but fortified its focus on quality without compromise. The Great Depression forced See's to reduce its prices, but California's relatively strong economy enabled the company to expand to the San Francisco Bay Area where nine new shops were opened by the end of 1936. The shops on Polk and Chestnut Streets in San Francisco remain in their original locations to this day! The Second World War brought sugar rationing and tested See's strategy of using only superior ingredients. If See's did not substitute inferior ingredients into its recipes, See's could only produce enough candies to keep its stores open two or three hours a day. See's never compromised, though, and customers were sometimes lined up around the block waiting for the stores to open during the War. See's limited purchases to a pound a person and then reminded customers that they could support the

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war effort by buying war bonds. Such a devotion to principles contributed to the company's quality reputation.

Laurance See, Charles See's son, became president of See's after his father's death and led the company's growth during the 1960's and 1970's. See's expanded with the population into the California suburbs, and in 1962 opened its first store outside of California in Phoenix. Successful openings in Seattle (a location the young Chuck Huggins proposed to Laurance See), Portland, Salt Lake City, and Denver followed. Each new store continued an early company tradition which continues to this day: all visitors are treated to a sample of See's candy when they enter the store. This tradition not only introduces different candies to the buying public and assures that everyone leaves the store with a smile, but it also enables See's to dispose of inventory nearing the end of its shelf-life in a way which reinforces the consumer's affection for See's.

See's Candies then discovered that Hawaii would be the next logical expansion site. Japanese merchants there had been buying See's candies on the West Coast and then reselling the confections at higher prices in their stores in Honolulu. Visitors from Japan, in turn, were buying See's candies as gifts for family, friends, and co-workers to be distributed when they returned home. See's first shop in Honolulu, the Kahala Mall store, was the first location where it was necessary to label the bulk candies in the showcase in Japanese. With the opening of two additional stores in Hawaii, See's achieved a high level of brand awareness among the increasing numbers of Japanese tourists visiting the islands.

Dawn of a New Era

See's family ownership of the chain ended in early 1972 when Harry See, who had assumed control of the company from his older brother Laurance, sold See's Candies to Blue Chip Stamps (Blue Chip Stamps was first affiliated with and then fully acquired by

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Berkshire Hathaway, Warren Buffett's corporate investment vehicle). Warren Buffett's first decision was to install Chuck Huggins as President and Chief Executive Officer, a position Chuck Huggins holds to this day. Warren Buffett wrote in 1982: I "have at least had the good sense all these last eleven years to want See's chief executive, Chuck Huggins, who has spent his working life in its business, to run the company in his and its traditional way. Chuck Huggins is a splendid man and a splendid manager. It is no minor privilege to be associated with him and the kind of quality enterprise he and his predecessors and co-workers have created."

Professional management and sophisticated ownership elevated the standards of success for See's Candies. Buffett evaluated his investments by the incremental profits they could deliver from incremental investment. Capital was available for investment in See's, but only if that capital could meet Berkshire Hathaway's hurdle rate for performance, not just the candy industry's or See's Candies'. The pressure was on Chuck Huggins to deliver superior financial performance.[1] (See Exhibit 2 for See's financial performance history.)

Buffett described some of the operating challenges which Chuck Huggins faced: "So far as we know the candy-store business continues to be terrible to mediocre for all other companies, which tend to suffer from a combination of (1) low sales per square foot of retailing space plus (2) the great seasonality of the business which requires staffing and maintenance of stores at minimum levels grossly unjustified by sales during about 90% of each year." Buffett also said, "See's seasonal sales peak becomes more extreme each year,

[1] Warren Buffett wrote in the Berkshire Hathaway 1991 Annual Report: "For an increase in profits to be evaluated properly, it must be compared with the incremental capital investment required to produce it. On this score, See's has been astounding: The company now operates comfortably with only $25 million of net worth, which means that our beginning base of $7 million has had to be supplemented by only $18 million of reinvested earnings. Meanwhile, See's remaining pre-tax profits of $410 million were distributed to Blue Chip/Berkshire during the 20 years for these companies to deploy (after payment of taxes) in whatever way made most sense."

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causing many operating problems and a growing concentration of See's net income in the single month of December.[2]"

"A Grand Scheme"

Marketing studies were conducted in 1977 to evaluate the market opportunity of major metropolitan areas which included Houston, Dallas, San Antonio, Austin, St. Louis, Cincinnati, Indianapolis, Minneapolis/St. Paul, Memphis, and Louisville. The economics of a St. Louis presence looked the most compelling initially. St. Louis would host a number of retail locations and also serve as a distribution hub for the upper Midwest. By the end of 1978, the first shop had opened in St. Louis and five others opened shortly thereafter. See's also rapidly developed the Texas/Colorado markets. Eleven shops were up and running in Texas and eight more were opened in Colorado before the close of the decade.

Over-expansion, coupled with the energy industry downturn of 1983, doomed See's Texas and Colorado operations. The St. Louis ventures also failed due to that city's lackluster economy and intense competition from Chicago-based Fannie May Candy Company. See's withdrew from all of these operations on a staggered schedule from 1986 to 1991, but the company's overall financial performance continued to shine as the core western U.S. operations became an ever stronger earnings engine. See's clearly possessed a powerful franchise among the consumers on the West Coast as continued population migration to California continued to boost sales. See's Candies corporate history summarizes the experience from this period as follows: "But the lesson learned had been a good one and strongly indicated that concentration on the operation of a highly profitable,

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[2] Berkshire Hathaway's *Letters to Shareholders*, 1977-84

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chocolate were made in the ten days around St. Valentine's Day, even though men do not traditionally purchase chocolates during this time. It is a unique Japanese custom that men who received St. Valentine's day chocolate are obliged to reciprocate with a similar gift, such as chocolate, candies and cookies, on "White Day." White Day occurs a month later on March 14, effectively providing Japanese confectioners with an extended selling period and expanded market compared to the American St. Valentine's Day's market in the U.S. A prominent industry source estimates that over 50% of Japan's premium chocolate sales -- for products such as Godiva chocolates -- occur in the months of February and March alone. The Bank of Tokyo estimates that 25% of annual chocolate sales across all categories occur during this time.

While approximately 150 domestic manufacturers compete within the Japanese confectionery market, 75% of the market is controlled by five companies. The following chart outlines the chocolate sales and market shares in 1990 of the five dominant domestic producers. Refer to Exhibit 3 for company descriptions.

Figure 1:

Domestic Japanese Confectioners -- 1990

	Sales (mil. yen)	Share(%)
Lotte	53,000	19.8
Meiji Seika	49,500	18.5
Morinaga Seika	42,600	15.9
Fujiya	31,300	11.7
Ezaki Glico	26,500	9.9

The general increased demand for imported chocolates has stimulated Japanese makers to develop new products though the confectioners have been loathe to engage in

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price competition. Instead, active technological development has led to improved product quality while marketing attention is focused on tailoring offerings and flavors to Japanese consumers' emerging preferences. Mixed nuts, nut chews, and bitter truffles with a moderate sweetness are flavor combinations which are gaining the most widespread acceptance. Technological and marketing efforts have resulted in the introduction of a variety of new products and the expansion of traditional product categories, including gourmet chocolates, creme-filled chocolates using new technology, and dessert chocolates.

Import Trends

Foreign chocolate manufacturers have found the Japanese market exceedingly difficult to penetrate ever since chocolate bars were introduced there over a century ago. The key obstacle had always been a stiff tariff, which at one time reached 35%. Chocolate, however, has become the best-known type of imported confection. The import market grew quickly to about 7 billion yen in 1979. After annual sales dropped to the range of 5-6 billion yen in the early 1980's, the market began to expand again, reaching 7.7 billion yen in 1986, 10 billion yen in 1987 and 15.3 billion yen in 1990. The U.S., the largest chocolate exporting country to Japan, held 42.9% of 1990 sales, followed by Switzerland at 9.5% and Germany at 7.8%. However, import volumes dropped for the second consecutive year to 15,310 tons in 1990, down 16.5% from the previous year's volume. The lower end segment (chocolate bars, etc.) competing directly with Japanese manufacturers sold particularly poorly.

Despite the recent fall-off, high-quality truffle-type chocolates given as Christmas and St. Valentine's Day gifts appeared to enjoy increasing demand (refer to Exhibit 4 for positioning diagram of import and domestic brands). Prestigious brand image, high price points and gorgeous packaging are proving to be important for success in this market segment. Belgian products, typified by the popularity of Godiva, have been selling

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particularly well. In terms of taste preferences, Japanese consumers are becoming more accustomed to the taste of imported chocolate as more Japanese traveled abroad and ate richer chocolate. That is not to say that consumers were wholly satisfied with imported confectioneries. Typical consumer dissatisfaction focused on some candy's inferior quality, a taste which was too sweet (a problem Kentucky Fried Chicken also encountered with its coleslaw in Japan and subsequently solved by nearly eliminating the sugar from its secret coleslaw recipe), absence of product descriptions in Japanese, no indication of production dates and anxiety about chemicals and other additives. Quality inspections and continual product improvements appear to be necessary components of a successful sales program in Japan.

See's Candies' Experience in Japan

In 1968 See's was approached by Nissho Iwai, one of the largest Japanese trading companies, to distribute the See's product line in Japan. Nissho Iwai proposed selling See's Candies in the Tokyo branches of Takashimaya, a prestigious department store with a reputation in Japan similar to that of Harrod's of London or Nieman Marcus in the U.S. See's typically controlled the point-of-sale through its company-owned stores, so this new format represented a break with tradition. The proposal nonetheless received serious consideration, and during See's routine due diligence process a trademark search revealed that Nisho Iwai had already registered the See's Candies name in Japan. It was not until 1974, after regaining the company's trademark rights[6], that Chuck Huggins signed an exclusive distribution agreement for Japan with Nissho Iwai. But the venture brought little

[6] The discovery that third parties could register the See's Candies trademark in international markets spurred See's to register its name in other likely export markets, including Mexico. In general, international law stipulates that a trademark will be maintained if it is used lawfully and continually within a country. Interestingly, See's trademark lapsed in Mexico after trade restrictions made it impossible to export candy there. By the time the trade barriers were reduced and Mexico became an attractive export market, an opportunistic entrepreneur had reregistered the See's trademark for his own use and then proposed a joint venture with See's. In 1993, despite their precautionary measures, See's Candies again found itself in a legal battle to regain its trademark rights in a foreign country.

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success. One problem was that the arrangement did not circumvent the multiple layers of distribution within the Japanese market. Independent freight forwarders delivered the product from the airport to the Nissho Iwai wholesale distribution warehouses. Deliveries were then made to the retailers who distributed the candy from their warehouses to their retail outlets. This multi-tiered structure had two serious pitfalls. First, the costs of distribution were too high, resulting in high retail prices and lower-than-expected demand. Second, central control of the whole distribution chain was extremely difficult. Given the fragile nature of the product and its need for consistent refrigeration, mishandling damage was unacceptable.

Two other factors contributed to the failure of the See's/Nissho Iwai venture in Japan. Tariffs on imported chocolate products remained stubbornly high at 35%. In addition, no effort was made to tailor product packaging and assortment selections for Japanese consumer preferences. See's provided its Japanese partner with the same products and packaging that served the U.S. market.

Due to the disappointing progress of Nissho Iwai's market introduction, See's decided to explore the possibility of opening its own stores in Japan, replicating its successful distribution and retailing strategy in the U.S. market. Land costs and lease rates at the time were exorbitant, however. Given the exchange rate of $1: 300 Yen, no economic argument could be made for a direct investment in dedicated Japanese stores.

In 1978, the Fujiya Confectionery Company of Japan approached See's about licensing production of its candies, thus circumventing the tariff on imported confections. Fujiya, one of the largest confectionery producers in Japan, would distribute the candies through its network of 1,800 company-owned stores. The owner's son, Shunichi Fujii, had studied in the U.S. and was well acquainted with See's products. Fujiya had a distribution arrangement with U.S. ice-cream manufacturer Baskin-Robbins, a relationship which had proven to be highly successful. Fujiya suggested that they were uniquely placed

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to repeat this success with See's Candies. Fujiya's history with Baskin-Robbins and their solid distribution network prompted interest in this proposal, and Chuck Huggins traveled to Japan to meet the Fujiya management team. His optimism soured, however, when it was learned that Fujiya marketed a line of confections that was "based on the good old-fashioned home cooking" of a fictional American matriarch similar to Mary See, using very similar packaging, products and promotions. It appeared that Fujiya's licensing proposal was really a ruse designed to acquire See's proprietary production techniques. Even See's quality manager had been approached in an apparent effort to learn trade secrets. Obviously Fujiya's objectives did not match See's, and the proposal was dismissed.

See's Current Proposals

See's failed domestic expansion eastward beyond the Rockies weighed heavily on Chuck Huggins, Dick Van Doren and Chip Huggins, Vice-President for Purchasing (and Chuck's son) as they contemplated the dynamics of the Japanese confectionery market. The company had supposedly learned to restrict its efforts to within its core western region. However, the population mix in the Western states was changing. Immigration of Hispanics and Asians, particularly in Southern California, was transforming the demographics of See's traditional buying core. Huggins, Van Doren, and Huggins were spending increasingly more time trying to market to foreign cultures at home. Perhaps establishing a Japanese operation, and gaining the associated market knowledge from developing tailored language displays, packaging, and flavor assortments, would enable See's to target Japanese consumers in the U.S. more effectively. And the Japanese market looked financially compelling in its own right. The tariff on imported chocolate was still a relatively low 10%, See's assortments could be sold at a premium relative to U.S. prices, and companies such as Jacob Suchard of Switzerland and Godiva Chocolates of Belgium were continuing to increase their market share there.

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The three managers knew that if See's Candies did export to Japan, then it would partner with JAL-Trading, M.A.T., or The Bank of Tokyo. Chuck Huggins had been studying each company's proposal intensively for the last four months. JAL-Trading offered a professional presentation and seemed to leverage its distribution experience from its many other import ventures wisely. JAL-Trading would act as an intermediary for See's to the local distribution and retail chains. Its superior reputation and extensive network of partners ensured that high quality retailers would be attracted to the venture. Huggins and Van Doren had met with representatives from the trading company and were impressed by their financial sophistication and thorough knowledge of the Japanese confectionery market. Their monthly sales forecasts foreshadowed an aggressive marketing campaign which would immediately capitalize on the expanding premium gift chocolate market.

The second Japanese trading company, M.A.T., operated on a smaller scale than JAL-Trading and had bootstrapped its way to success as an importer. M.A.T. was a division of Hawaiian Host, and the first product the company represented in Japan was Hawaiian Host chocolate-covered macadamia nuts, already popular with vacationing Japanese as gifts to bring home to family and business associates. M.A.T. methodically developed the Japanese market for its candy, increasing distribution piecemeal as word of mouth expanded the Japanese market. Chocolate covered macadamias remained the company's sole offering until after Mr. Takitani, the founder, died. He was succeeded by Sachie Nomura, an energetic and engaging lady who is credited with expanding the company's offerings to include pineapples and papayas. M.A.T.'s storage and distribution facilities were well suited for these perishable commodities, even though fruit represented an entirely different consumer market for the company. M.A.T. is able to deliver directly to its retailers, bypassing the wholesaler intermediaries, so its products reach the consumer more quickly and with less handling. Spoilage and damage are therefore minimized.

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M.A.T.'s proposal might never have been considered if it were not for a mutual business contact's introduction. Chip Huggins purchased See's packaging materials from Standard Box Company, a Japanese-owned paper packaging manufacturer in Southern California. Standard Box also supplied Hawaiian Host's packaging materials. When the president of Standard Box gave Nomura his highest personal recommendation, Chip arranged for formal introductions and a presentation which would receive full consideration. At their meeting in South San Francisco Nomura impressively demonstrated her company's capabilities, but she was also regarded as somewhat of an anomaly. For example, her presentation to See's did not include any sales and volume forecasts. When about the lack of projections, Nomura replied that she purposefully did not make any. She feared that they would create short term performance expectations which might compromise the venture's long-term goals.

Finally, The Bank of Tokyo's research on the Japanese confectionery market highlighted the marketing opportunities that See's Candies presented while focusing less on transportation and distribution issues (they advised locating a distribution partner). The Bank of Tokyo noted that there was no precedent for "a widely sold, upper-middle market American-made chocolate. Because there is not precedent, however, there is great potential to position See's Candies as the 'original homemade American chocolate'." An early American style image would capitalize on the "fond, almost nostalgic memories of the Little House on the Prairie television series which ran for many successful seasons on NHK (Japan's National television station)." Their report also advised using the name "See's Chocolates" in Japan rather than See's Candies. Traditionally "candy" referred to just hard candy in Japan, though most Japanese candy stores carry cakes, ice cream, cookies, and confections in addition to hard candy. The Bank of Tokyo recommended that See's expand its product line to include premium ice cream, just as See's had in the 1920's. By retaining the traditional facade, interior, and crisp, white employee uniforms of their U.S. stores ,

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See's could sustain dedicated stores in Japan by selling "the image of old-fashioned quality and nostalgic late 19th Century with its chocolate."

The Decision

See's Candies' revenue and earnings growth had been more than acceptable to date, with sales per square foot of at least two to three times that of its competitors. However, price increases reflecting increasing operating costs[7] accounted for most of this growth. Total volume of shipped chocolates had been essentially static for years. These real price increases deterred general year-round personal consumption, further concentrating the company's sales to the December gift market. That, in turn, heightened the issue of underutilized capacity for much of the year.

Chuck Huggins focused on ensuring continued growth, even as the dynamics of See's principal market changed. Dick Van Doren had recently spent time designing a Spanish-language advertising campaign for use in Southern California and, possibly in the near future, Mexico. Hispanic consumers were identified as a priority because of this group's growing purchasing power. Should See's establish export operations to Japan now, even as exporting to Mexico appeared imminent? If so, should See's establish its Japanese operations independently or should See's entrust the marketing of its confections -- and indeed a quality image cultivated over seventy years -- to JAL-Trading, M.A.T., or the Bank of Tokyo? How would See's Candies have to adapt its current products and processes in order to support operations on two sides of the Pacific Ocean?

Chuck broke off a chunk of Victorian toffee and chewed it absent-mindedly as he considered See's options.

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[7] Raw material costs had actually declined, but all other operating expenses including rents and labor were increasing.

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Exhibit 1

Mary See

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Exhibit 2

See's Candies' Perfomance Data

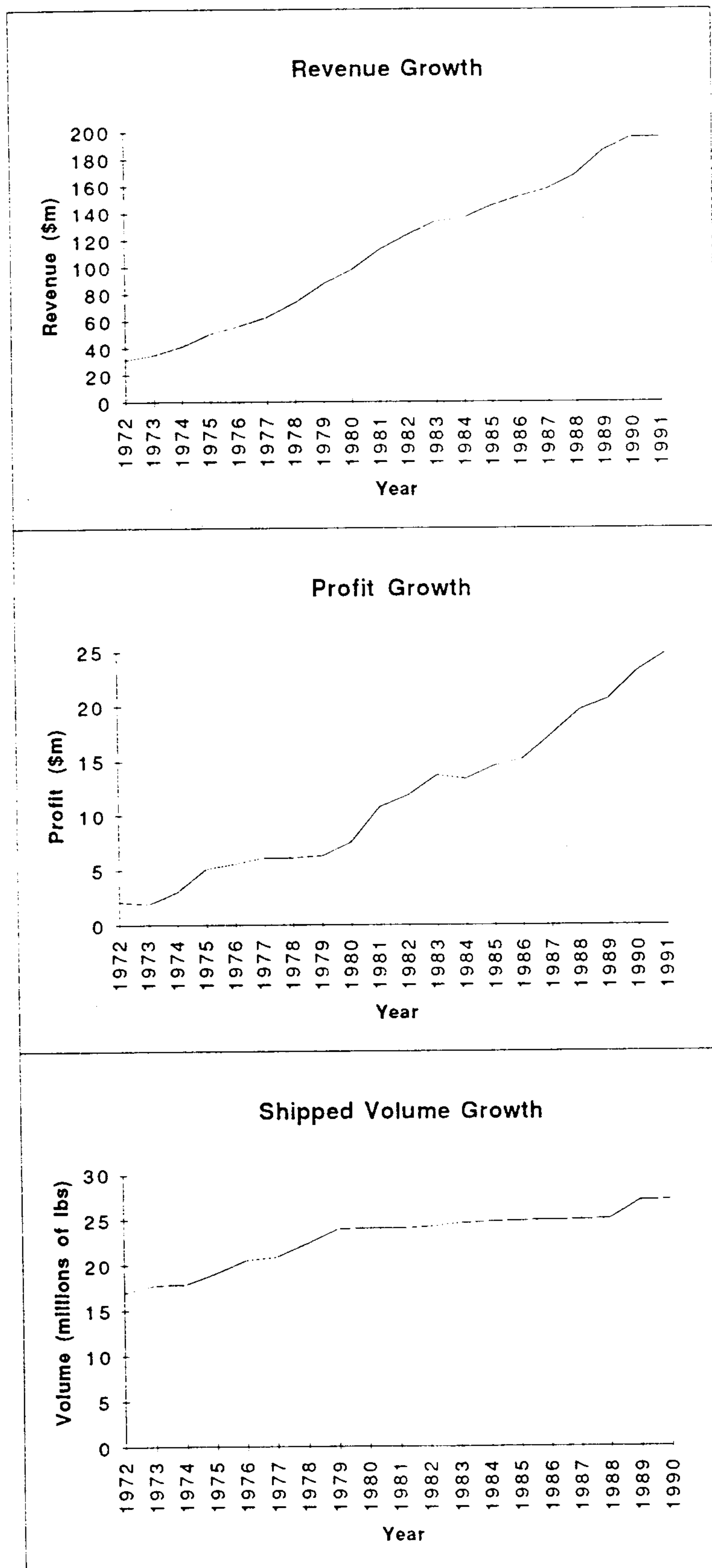

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Exhibit 3

Japan's Domestic Competitors

Lotte Co., Ltd.

One of the largest confectionery companies, Lotte offers a wide product range and is the largest manufacturer for chewing gums and chocolates. Lotte has been pursuing a diversification strategy into real estate and the restaurant business. The company also owns a professional baseball team and is controlled by the Shigemitsu Family. Lotte's total 1991 sales were 225 billion yen with chocolate representing 35% of sales, followed by chewing gum (35%) and ice-cream and others (30%).

Meiji Seika

The company is the overall leader of the confectionery industry. Pharmaceuticals account for 40% of the company's sales and approximately 50% of its profit. Meiji has technical ties with Merck & Co., and others in both confectionery and pharmaceuticals. The company has been engaged in local production in Southeast Asia. Sales were 236 billion yen in 1991.

Morinaga & Co.

Morinaga is a well-known general confectioner with a long history. The company enjoys traditional strengths in caramels and biscuits, but it is now branching out into health foods and pharmaceuticals. It also owns a subsidiary devoted to restaurant operations. Morinaga also has a cross-holding relationship with Fujiya. The company has been producing Sunkist-brand products under license. The total sales from the most recent fiscal year were 152 billion yen.

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Fujiya

Fujiya operates 1,800 Western-style bakery shops and restaurants under both a direct management and franchise system. In addition, the company has joint ventures with Nestle for importing confectionery and with Baskin-Robbins for its ice cream shop chain. The company is controlled by the Fujii family, and last year's sales were 134 billion yen.

Ezaki Glico

Glico has been growing into an integrated food maker and places an increasing emphasis on its chocolates and related sweets businesses. The company is influenced by the Ezaki family which retains a sizable stake in the company. Glico also manages almond farms in the U.S. and has a joint venture in France. Sales were 166 billion yen in 1991.

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Exhibit 4

Positioning Diagram for See's Candies in Japan

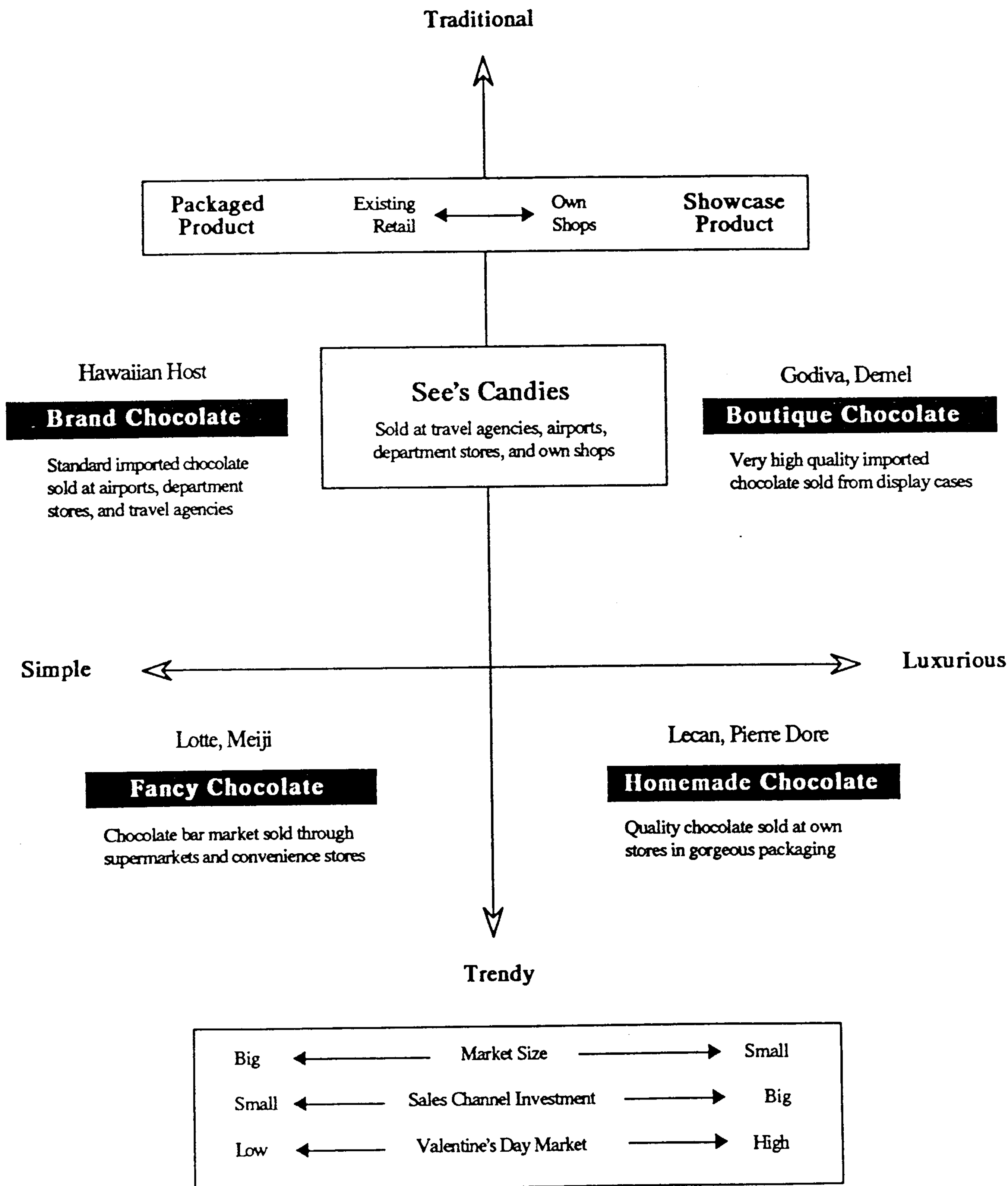

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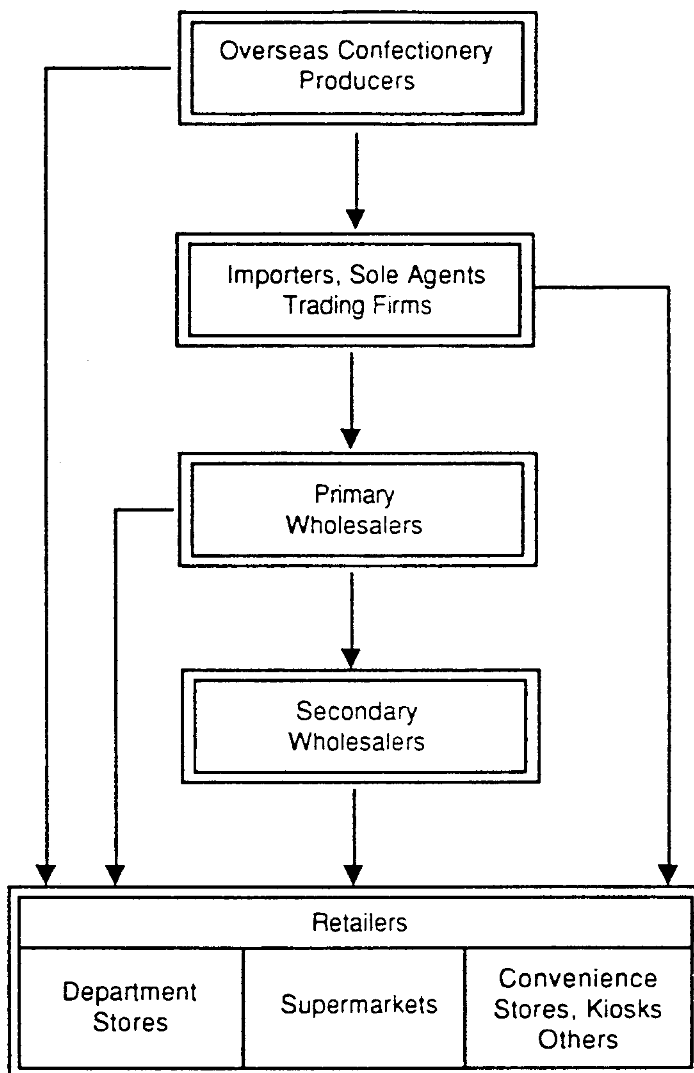
Exhibit 5

Distribution of Imported Confectionery



Source: Dodwell Marketing Consultants, BCG Analysis

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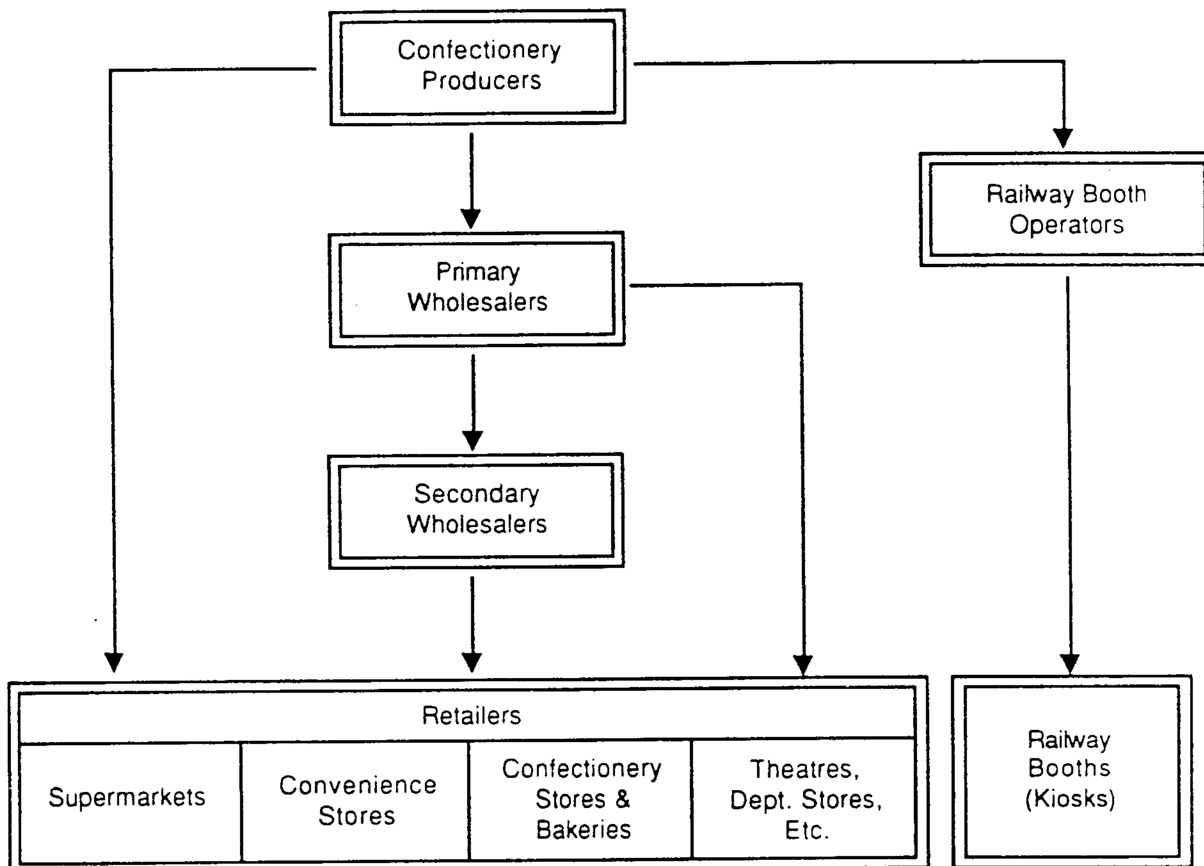
Exhibit 6

Confectionery Distribution in Japan



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