CHAPTER ONE: Introduction

On a late evening of December 15, 1999, Mr. Steel, the newly appointed general manager of the Cacao International Sdn. Bhd., staring at smoke coming out from the chimney of the processing plant, reflected the outcome of the management meeting. Mr. Steel, a MBA graduate from University of Malaysia, is totally new to the industry. He has no experience at all in handling the business. The outcome from the heated management meeting worried him.

During the meeting, the trading manager reported a very volatile raw material price movement in the last three months. The cocoa bean price has slumped to a historical low of 550 sterling pound per tonne as compared to 900 sterling pound in January 1999. Most of the raw material was bought at 800 sterling pound per tonne level. The situation was complicated by the delay in the fulfillment of contracts due to poor crops in Sabah. The company has fully sold for the six forward months but the raw material availability was just enough for the next one and half months. Extra quantity of raw material could not be bought due to most sellers not wanting to sell at this low price level.

Another issue was the heated argument between the production manager, En. Hamdan and marketing manager, Ms. Yong, on the issue of product mix. Mr. Hamdan, proposed that the company should focus on the standard range of the products to achieve higher throughput, which reduces the unit processing cost. However, Ms. Yong insists on the product customization, which is in consistent with the company policy.

Mr. Steel faces two major challenges to the success of the business. First, he must formulate an appropriate business strategy to ensure sustainability of the company. Second, he must develop an appropriate strategy in price risk management and procurement policy to tackle the scarcity of the raw material. Before any decisions can be made, Mr. Steel must understand the industry structure and the general economy situation that govern the industry. The understanding of the company's capabilities and determining the core competencies is the prime importance to him.

1.1 Company background

1.1.1. The Corporate- Kuala Lumpur Kepong Berhad

Kuala Lumpur Kepong Berhad started in 1906 when a small head office was set up in London to oversee some 1,500 acres of rubber plantation, planted in Malaya. In 1971, the founder chairman, the late Tan Sri Lee Loy Seng, initiated the move to bring its domicile back to Malaysia. From a base of 57,000 acres of rubber, oil palm and cocoa plantations, the company has expanded to over 350,000 acres located in Peninsular Malaysia, Sabah and Indonesia.

Plantation remains as the firm core business. In recent years, the recognition of the need to cushion the effects of fluctuating commodity prices has directed the Group in expanding downstream into resource-based manufacturing including cocoa processing, rubber products, the manufacture of fatty acids, glycerin and derivatives by forming joint venture with reputable concerns from Japan and Europe. In 1998, 80 percent of the company' revenue was generated from plantations and resource-based manufacturing activities (Table 1).

1.1.2. Cacao International Sdn. Bhd.

The company was founded in 1992 by the elder son of Tan Sri Lee, Lee Hoi Hean. Through forward integration, the group has ventured into resource-based manufacturing activities. Strategically located in Port Klang, the company with processing capacity of 14,000 tonnes of coca bean has expanded to 32,000 tonnes by 1998. Toady, it is the largest cocoa grinder in Malaysia and one of the largest in the Far East. Cacao International places strong emphasis on

ble 1: Kuala Lumpur Kepong Berhad Financial Performance

nancial performance	**1998** RM'000	**1997** RM'000	**1996** RM'000
rnover(, 000 RM)			
plantation	788,238	774,432	798,623
manufacturing	482,211	286,295	147,301
etailing	372,454	67,822	0
investment and other income	47,994	60,668	15,642
	1,690,897	1,189,217	961,566
ofit before deprecaition and interest	271,327	301,222	294,503
ree year balance sheet			
xed assets	1,978,002	1,799,855	1,443,111
erest in associated companies	257,898	235,042	209,824
her investment	102,600	64,265	31,858
et current assets	446,665	477,762	348,867
otal assets employed	2,785,165	2,576,924	2,033,660
antation Statistics			
l plam			
otal production (tonnes)	1,128,694	1,228,407	1,132,956
ofit per mature hectare('RM)	5,753	3,190	3,428
anted area(hectare)			
ature	55,669	54,311	50,086
mature	41,135	30,844	26,107
ubber			
otal production (tonnes)	25,301	29,283	30,612
ofit per mature hectare('RM)	1,178	1,531	2,742
anted area(hectare)			
ature	17,498	18,668	18,976
mature	9,392	9,999	8,396
ocoa			
otal production (tonnes)	2,092	5,578	4,575
ofit per mature hectare('RM)	403	614	(-183)
anted area(hectare)			
ature	4,125	6,386	6,139
mature	-	-	-

ource: Kuala Lumpur Kepong Berhad 1998 Annual Report) maintaining high quality standards to meet the stringent requirement, commanded by the premium market. It's parent company, KL Kepong Berhad, is well known for its consistent and high quality cocoa bean supply and is the constant source of Cacao International's need to satisfy premium customers.

Cacao International adopted Total Quality Control concept as a part of the company-wide continuous quality improvement. The company has accredited with ISO9002 certification by SIRIM since 1995. The company assures its customers with a product consistency, reliability and product safety.

1.1.3. Current Strategy

Marketing strategy is low cost leadership. Thus the raw materials were bought prompt to the actual production to lower inventory holding cost. Lower inventory turnover rate coupled with higher capacity resulted 7 millions ringgit profit in 1999 as compared 1997. Hedging of cocoa bean purchase has been widely used as a tool to reduced price risk. Actual sale must hedge back to back to the raw material purchased. Thus the profit gains shall be from the operating activities (Table 2).

Production has to be customer driven. Customization became the key factor of short production cycle, high switching process cost and non-standardized products. However, due to strategy of low inventory holding in the company, complex and tedious analysis required from the Quality Assurance department. Quality status as well as logistic control becomes the prime importance factors to be competitive.

1.2. Purpose and Significance of the Study

In view of the intense globalization, one's strength or core competency might change or destroy by the external forces. The core competency one enjoys might become core inertia. The purpose of this study is to put our selves in the shoe of

able 2: Cacao International Sdn. Bhd. Financial Performance

inancial performance	**1997**	**1998**	**1999**
urnover(, 000 RM)	**157,144**	156,933	202,018
rofit before deprecaition and interest	12,187	8,894	14,931
rofit after taxes(,000 RM)	3,801	2,586	7,069
iquidity			
urrent ratio	1.77	4.92	16.84
rade debtor turnover period	1.31	0.74	0.71
rade credit tornover	2.20	0.47	0.08
vetury turnover	3.10	0.60	0.53
everage			
ebts to equity ratio	0.60	0.00	0.00
ebts to total asset ratio	0.34	0.00	0.00
roduction performance			
lant capacity (mt of cocoa bean)	25,000	25,500	30,500
nit processing cost(RM)	923	902	814

ource: Cacao International 1999)

Cacao International's General Manager, to analyze the industry structure of cocoa industry, determine the capabilities and core competencies of the company, and develop an appropriate business strategy that match the current economic and business environment.

Besides generic business strategies, price risk management becomes the major issue faced by manufacturing sectors. The old days of earning above average returns through economies of scale does not guarantee the success of a company in today's business environment. Commodity price movement have been complicated by the advancement of financial instruments. Future and option market influence the raw material prices beside the fundamental of commodity trading. An appropriate procurement strategy shall be established to manage this unforeseen risk.

1.3. Scope Of The Study

The study will focus on Cacao International. The Industry structure of the cocoa will be analyzed. The scope of the study will be focus on the local environment, and South East Asia in general. The investigation on the managerial obstacles faced by Mr. Steel will be the objectives of the study.

1.4. Limitation Of The Study

Data collected for the case study is mainly secondary data from trade publications, Internet and Cacao International's library. Some of the data might be solely the view of the company, which may distorted the actual market scenario. The data might not be comprehensive to explain the world scenario but it might sufficient for decision-making based of local context.

As the cocoa industry is highly competitive, primary data is not widely available. Trade data complied by the trade body such as Malaysia Cocoa Board was historic data, which cannot be utilized for immediate strategies and responses to the changing market are not available.

Primary data collected through the company's balance sheet, profit and lost account, cash flow account, technical and market survey report are used in the case study.