

# **We All Scream for Ice Cream**

## **An Analysis of the Nestlé-Dreyer's Merger**



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## *We All Scream for Ice Cream*

### Executive Summary

In June of 2003, Dreyer's, the leading ice cream manufacturer, purchased Nestlé's ice cream division, which included Häagen-Dazs, with enough company stock to give Nestlé a controlling share of the new merged company (Reference 7). In essence, it was a Nestlé takeover, but the new expanded Dreyer's still operated as an independent unit. Consolidation was the current trend in the ice cream industry. Breyers and Ben & Jerry's had also been bought by Unilever to form Unilever Ice Cream. The Dreyer's merger had a variety of good and bad consequences. Dreyer's and Nestlé were forced by the FTC to sell key assets. The company also lost distribution agreements. However, the benefits were enormous. Operation costs decreased, buyer and seller power were brought down, and competition decreased in the industry. The Nestlé-Dreyer's merger was analyzed and a post merger strategy formulated. The conclusion was that merging the two companies was beneficial for Dreyer's.

### Background

Traditionally ice cream was produced by dairies as a secondary business to supplement their milk business. However, intense price competition led to poor quality ice cream. Dreyer's entered the market in hopes to provide a quality, brand image ice cream. It hoped innovation and technological sophistication would help keep it on top. In a highly fragmented industry, Dreyer's hoped to consolidate the market and become the leading national brand.

Consumed by 94% of households, at an average rate of 23 quarts per person per year, ice cream is a 20 billion dollar a year industry with 8.3 billion of that going to at-home consumption (Reference 6). The four major categories of packaged ice cream products are regular/economy (1.2 billion), premium (3.3 billion), superpremium (800 million), and frozen snacks (3.0 billion) (Reference 3). Regular ice cream is sold in large tubs and is targeted at parties and large gatherings. Premium ice cream is the gallon and half gallon containers sold by Dreyer's, Breyers, and private label brands. Superpremium ice cream is the pint and quart sized containers sold by brands such as Ben & Jerry's,

Häagen-Dazs, and Dreamery. Frozen snacks consist of packaged products including ice cream sandwiches and bars that are sold by brands such as Nestlé Ice Cream and Good Humor.

With all the private label brands, there were many players in the premium and superpremium segments, and “many analysts believed that the ice cream industry needed to consolidate”(Reference 1). Private label brands began to decline as Dreyer’s and Breyers grew. The intense competition led to intense promotions. This damaged the margins in the ice cream industry as even small companies were forced to aggressively promote their products. Still, by 1994, Dreyer’s surpassed Breyers in market share (Reference 1).

From 1994 to 1998, Dreyer’s strategy was to follow the “Grand Plan” (Reference 1). Dreyer’s decided to invest heavily in marketing, distribution, manufacturing, and information systems. Marketing was to increase four-fold, and new products were to be introduced. It was also going to install state-of-the-art information systems. Perhaps the most impressive, however, would be the Direct-Store-Delivery (DSD) system. Dreyer’s distributed directly to stores using refrigerated trucks; they were the only ice cream company with a national DSD system. This saved the retailers inventory costs. It also allowed for Dreyer’s to distribute certain flavors for certain stores. It was a win-win situation. To help pay for the costs, Dreyer’s distributed rival brands. One of the bigger contracts was with Ben & Jerry’s. Dreyer’s was glad to distribute this ice cream because they were not direct competitors (Reference 1).

By June of 1998, Dreyer’s and Breyers were the largest ice cream manufacturers, making up 28 percent of the entire market. Private label brands made up 23 percent, and Häagen-Dazs, Blue Bell, Ben & Jerry’s, and Healthy Choice made up 18 percent (Reference 1). The rest consisted of smaller companies. Dreyer’s had to compete with Breyers, which was owned by the large and financially strong Unilever. Private label brands had other products and could easily survive troubles in the ice cream market. Ben & Jerry’s had higher product margins because they only produced superpremium ice cream. These circumstances posed a unique set of challenges for Dreyer’s.

Dreyer’s began to face problems. Butterfat prices were soaring and profit margins were sinking. The “Better-for-You” segments were declining as consumers

switched to the full-fat alternatives. Dreyer's wanted to expand into the growing superpremium segment that offered higher margins. Early in 1998, Dreyer's attempted to buyout Ben & Jerry's but Ben & Jerry's refused the offer. However, in August, Ben & Jerry's announced it would no longer keep Dreyer's as a distributor, which meant Dreyer's was no longer contract bound to stay out of the superpremium segment, and Dreyer's knew it would have to fill the volume left open by Ben & Jerry's to avoid substantial losses. On September 1, 1999, Dreyer's launched "Dreamery," its new superpremium line of ice cream. It also announced an agreement with Godiva chocolates to make a line of superpremium ice cream. Godiva became a huge success. As butterfat prices lowered to previous levels, Dreyer's began to see handsome profits. In 2000, Unilever bought Ben & Jerry's and signed a new agreement for Dreyer's to distribute the ice cream. Dreyer's was on the rebound and doing great (Reference 1).

Nevertheless, the consolidations in the industry gave Dreyer's a reason for concern. Unilever now had Breyers and Ben & Jerry's. Nestlé had acquired Häagen-Dazs. These large companies could now utilize economies of scale to lower operating costs and could potentially cause problems for Dreyer's. Dreyer's knew it had to expand to rival the new Unilever Ice Cream.

On June 26, 2003, Dreyer's and Nestlé struck a deal (Reference 7). Before the merger, Nestlé owned 23 percent of Dreyer's stock. Nestlé also had its own ice cream division, the Nestlé Ice Cream Company, LLC (NICC). The NICC was involved only in the frozen deserts sector of the market. Dreyer's acquired the NICC in exchange for 44 percent of its stock, giving Nestlé a 67 percent stake in Dreyer's (Reference 8). The Federal Trade Commission required that Dreyer's, and the NICC divest certain assets. On March 3, 2003, Integrated Brands, a subsidiary of CoolBrands International, entered into an Asset Purchase and Sale Agreement (Reference 2). The "Dreamery" and Whole Fruit Sorbet brands were sold. Integrated Brands also acquired the license to the Godiva ice cream brand. Certain NICC leases, warehouses, equipment, vehicles, and other assets were sold and transferred to Eskimo Pie Frozen Distribution, a subsidiary of Integrated Brands. Dreyer's received \$10,000,000 for the sale of the brands and assets, which many believed were worth much more. The FTC issued an order that allowed Ben & Jerry's to

terminate the distribution agreement. They once again did so in October of 2003. The order also terminated Dreyer's joint venture with M&M/Mars (Reference 11).

Today Dreyer's is a \$1 billion company (Reference 1). Unilever Ice Cream (Breyers, Ben & Jerry's, and Good Humor) and Dreyer's (Dreyer's, Häagen-Dazs, and Nestlé Ice Cream) are the two ice cream superpowers with Dreyer's edging out Unilever Ice Cream as the market leader. Dreyer's has since made other smaller acquisitions as well including Silhouette and Skinny Cow. Its dedication to taste, packaging, flavor selection, price, and promotion in all its products leaves it as a company with a quality image. Dreyer's is also a leader in technological innovation and its delivery system is unmatched in the industry. Its strong culture and clever business strategy also factor in to make it the current industry leader.

### The Merger

The merger between Nestlé and Dreyer's had its good and its bad elements. The FTC imposed a number of restrictions. We assess the merger and its impact on Dreyer's position within the industry. We then propose a post-merger strategy of Dreyer's.

### Six Forces Analysis

- **Entry:** There are many entry barriers to the ice cream industry. The most significant barrier for entrants is the limited shelf space in supermarkets. The supermarkets don't have enough shelf space to carry the major brands as well as the supermarkets' own brands. Additionally, the major brands strategically offer a large assortment of flavors to protect their shelf space. Shelf space is so limited that ice cream suppliers will often pay supermarkets to place their brand in the premium shelf space locations. The ice cream industry also experiences economies of scale. The larger companies with their own sources for dairy products and other inputs can realize lower marginal costs, as can those companies with extensive distribution networks in place. The industry also has very differentiated products. The major companies offer ice cream across many different categories including premium, superpremium, good-for-you, ice cream snack products, and more. In addition, there are hundreds of different flavors of ice cream available. There is a fair amount of brand recognition within the

industry as well as established reputations for major companies. Another barrier is the limited access to major distribution channels. To be a national brand, a company needs to have the ability to keep their product frozen and distribute it. This either takes a large investment to establish, or the company can become a partner brand with a large competitor that has a distribution system in place. This allows the distributor to profit and keep the company in check with the threat of dropping them if they become too competitive. This also causes the company to become dependent on the distributor. In order to become a competitor with a company like Dreyer's, a company must overcome these entry barriers.

- **Buyer Power:** The main buyers that Dreyer's is concerned with are the supermarkets. The supermarkets have strong buyer power as they can replace Dreyer's on their shelves with any of a number of competitors who would love to steal Dreyer's shelf space. The buyer power is evident in that the ice cream companies will actually pay the supermarkets to be stocked in the best shelf space. Other buyers that have less, but nevertheless still strong buying power are club stores, convenience stores, restaurants, movie theaters, hotels, and other retailers. Still, stores cannot replace the portfolio of products offered by large companies such as Dreyer's. This serves to decrease the buying power of the supermarkets.
- **Supplier Power:** The supplier power really depends on the input being supplied. Supplier power is fairly weak for inputs like sugar, fudge, baked goods, and other ingredients that can easily and quickly be obtained from other sources. The supplier power is a bit stronger for the dairies, because it is in both companies' best interest to have a long term relationship. However, supplier power is strong for trademarked candy and cookie ingredients. Having a brand name ingredient like Reese's, Snicker's, Oreos, or Girl Scout Cookies, among others, is in the best interest of the ice cream company; the trademarked brand ingredient could choose to sell to any ice cream manufacturer so the price could be quite high. Mergers of ice cream companies with conglomerates helps eliminate this problem because they can use the conglomerates' other brands as ingredients in the ice cream. The merged companies can also leverage their new size to increase their buying power for common inputs.

- **Substitutes:** There are many substitutes for store bought ice cream. These include sherbets, gelato, frozen snacks (popsicles and ice cream bars), soy based ice cream, ice cream parlors, and the make your own ice cream at home machines. While market trends may cause the substitutes to vary in popularity over time, the ice cream industry is fairly mature and the market for store bought ice cream does not see large swings either up or down.
- **Rivalry:** Rivalry in the ice cream market is rather high. This is evidenced by intensive price competition within each of the individual categories. The rivalry is decreased somewhat by the amount of product differentiation. Stores will also tend to not order the same or similar flavors from different companies, except for the main flavors, due to their limited shelf space. This helps decrease the amount of direct competition within flavors. Due to the threat of replacement in stores by incumbents and the competition among the top firms to be market leaders, there is a fair amount of rivalry within the industry. The trend of consolidation has helped to decrease this rivalry.
- **Complements:** Some examples of fairly weak complements are the hot weather and ice cream cones. Perhaps the strongest complement is birth rates, as households with children tend to purchase more ice cream, especially in the frozen snacks category.

### Pros and Cons of Merger

The Six Forces Analysis shows how the six forces relate to mergers in the ice cream industry in general. We now take a look at the synergies and problems created by the merger between Dreyer's and Nestlé.

As mentioned in the background, Dreyer's and Nestlé had to divest certain assets. Dreyer's lost its "Dreamery," Whole Fruits, and Godiva brands to Integrated Brands. The NICC lost many assets to Eskimo Pie Frozen Distribution. Furthermore, they did so at what many would consider a substantial discount. Because Dreyer's and Nestlé were forced to give up assets, they were not in a position to bargain for a good price. This was definitely a downside of the merger. On top of that, Dreyer's was forced into an unfavorable distribution agreement with Integrated Brands. Dreyer's had to manufacture the divested brands for a period of up to one year. It also had to provide certain transition

services to Integrated Brands and Eskimo Pie. It had to deliver the divested brands for up to one year. Eskimo Pie also had to use its newly acquired distribution assets to deliver the brands licensed to the NICC for up to one year, but this was inconsequential to Dreyer's. A very devastating aspect of the merger was the termination of the distribution agreement with Ben & Jerry's. Dreyer's was once again in a situation where it would have to fill the void. The termination of the joint venture with M&M/Mars was also damaging.

Anytime two companies merge, culture clash is a major concern. The two company cultures could have trouble integrating if not managed well. This is especially a concern with Dreyer's strong culture. The merger definitely had its downsides.

Of course the merger also had its benefits. We look at each of the six forces and how the merger shows benefits in the different areas.

The merger provided further barriers to entry in the ice cream market. Dreyer's now had a more extensive line of frozen dessert products, especially with the acquisition of Häagen-Dazs. Its many differentiated products left little room for entering companies to differentiate themselves to avoid competition. Moreover there was little overlap between the conglomerates' parts. Nestlé had focused on frozen snacks, while Dreyer's focused on premium ice cream. In addition, Häagen-Dazs was a leader in the superpremium market. The diversity of products also prevented current companies from entering different ice cream markets. The many varieties of ice cream served to take up shelf space. Combining the two operations resulted in improved operating efficiencies as well. Consolidation of manufacturing plants, marketing, administration, sales, and distribution added up to huge savings. The distribution was a particularly strong area now that Dreyer's could fill its Direct-Store-Delivery system with more products. This would be a particularly difficult mountain for others to climb, as Dreyer's had the most extensive distribution system of any ice cream manufacturer. Entering companies and smaller companies would have a hard time competing with such a large operation in all areas of operating costs. The creation of a larger company made it tougher for other companies to enter.

The merger decreased the buyer power of the supermarkets. While supermarkets can easily replace specific ice creams with others, it would be very difficult and probably

less cost effective to replace an entire line of ice cream products such as Dreyer's provided after the merger. Supermarkets would have less negotiating power, so their buying power was severely decreased by the merger, which led to more profits for Dreyer's.

Although supplier power was not necessarily decreased by the merger, the merger provided a convenient solution. Supplier power is generally strong for trademarked candy and cookie ingredients. Dreyer's had to pay a handsome sum for use of Godiva chocolate, for example. Upon the merger, Dreyer's could use Nestlé brand names such as Butterfinger, Crunch, and more in its premium ice cream without paying a substantial sum just for the name. This was a very beneficial synergy.

The merger did not have much of an impact on substitutes or complements. As mentioned earlier, the ice cream market is mature and fairly stable overall.

Clearly the merger improved the major problem of rivalry. In an industry with intense competition, any merger works to alleviate the competition. Dreyer's and Nestlé no longer had to worry about each other as potential threats. Also, Dreyer's main competitor, Unilever Ice Cream, would recognize that they and Dreyer's now dominate the large supermarket ice cream industry across all the major product categories. Unilever and Dreyer's would realize that it is in both of their interests to decrease their rivalry.

### Conclusion on the Merger

Given the pros and cons of the merger, the merger was a good idea for both parties involved. The pros heavily outweighed the cons. The most convincing argument is the economies of scale in the ice cream industry. The two companies were able to drastically reduce their operating costs. The improved situation regarding buyer and supplier power further supports the claim. The decreased competition was another huge benefit. The synergies are overwhelmingly beneficial.

The cons to the merger are not very devastating. Dreyer's lost brands that were not necessary for its success that were replaced by arguably better brands. It had always focused on the premium ice cream industry and lost nothing in this area. The loss of NICC assets was offset by the improved efficiency in operations. Though Dreyer's lost

these for little compensation, the increased profits due to the merger made it worth the hit. The unfavorable distribution agreements with Integrated Brands were only temporary. The loss of Ben & Jerry's was not as crucial as the first time. Dreyer's would easily be able to fill the distribution void with Nestlé and Häagen-Dazs products and new Dreyer's products. Ben & Jerry's business was not necessary. The severance of the venture with M&M/Mars was a minor inconvenience compared to the new joint venture created. The downsides were temporary and minor in comparison to the rewards.

Dreyer's is now the number one ice cream manufacturer. It holds 24 percent of the market while Breyers holds 20 percent (Reference 5). Its profits are soaring, and it is in a position to remain at the top for years to come. Also, during this period of major consolidation from 1998 to 2003, the ice cream industry grew by a remarkable 24% in revenues (Reference 10).

### Post-merger Strategy

As a larger, merged ice cream company, Dreyer's will have to make changes and adaptations to realize the full benefits of the merger. Within the structure of the larger company, they have the challenge of aligning the employees based on business objectives and company cultures. They must utilize all the potential synergies and economies of scale created. They can consolidate resources such as equipment, property, talent, and delivery methods just to name a few. They must step into their new leadership role signaling to Unilever that they are ready to decrease industry rivalry. The new expanded line of products should be marketed to supermarkets so that outlets that carried Dreyer's but not Häagen-Dazs for instance would have an incentive to add those products and kick competitors off the crowded shelves. Flavor selection and product variety should continue to expand as well to further crowd up the shelf space and decrease competition by greater product differentiation. One possible way of doing this would be to add Nestlé candy bar flavors to the Dreyer's premium ice cream product. Also, they should phase out unpopular and overlapping brands. In these ways the merger can be utilized to add value to the combined company.

Also, to remain the industry leader, Dreyer's needs to continue to do several things well. They must continue to innovate in taste, packaging, and flavor selection.

Nestlé synergies may be utilized to aid this. Dreyer's should push forward to maintain competitiveness and efficiency. They should be sure to keep up quality in all three segments of the ice cream industry in which they compete. While doing this, they must optimize the cost structure and continue to build leadership positions in all channels where ice cream products are sold. By focusing on quality, innovation, and efficiency while maintaining a positive brand image, Dreyer's can continue to be the number one ice cream company in the United States.

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# Appendix A

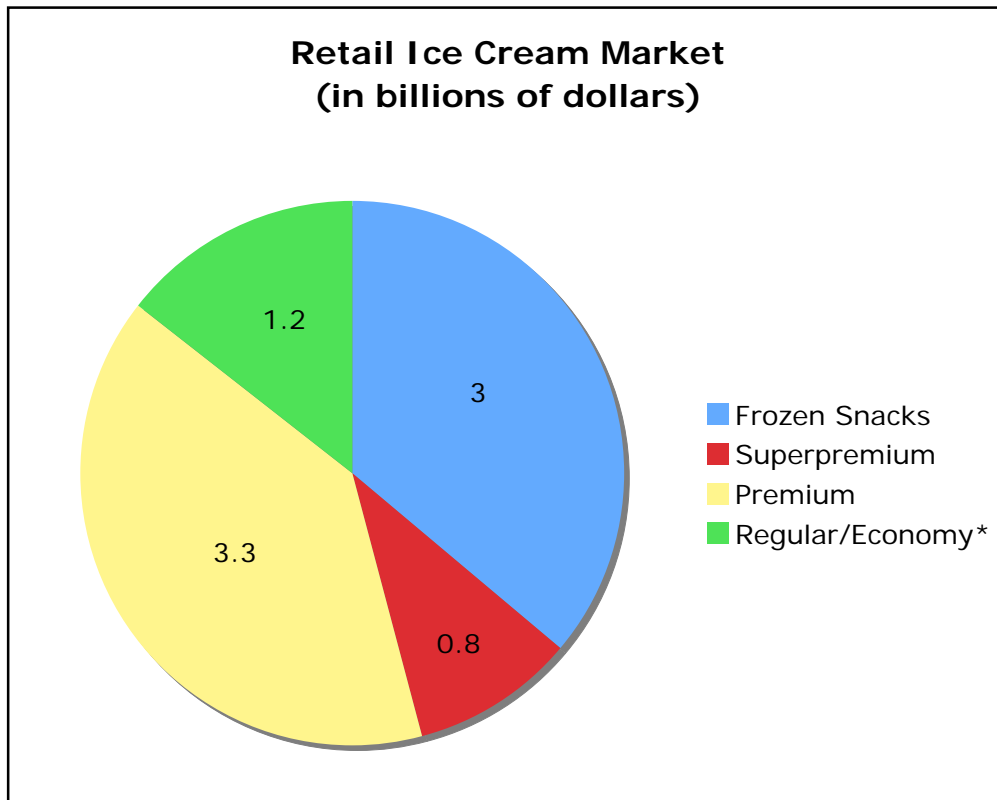
## Ice Cream Industry Profile

### Product Categories

- Regular/Economy\* – lowest quality category of ice cream typically sold in sizes of 1 gallon or larger.
- Premium – low overrun and higher fat content than regular. Typically sold in 1 gallon and half gallon sizes.
- Superpremium – very low overrun and high fat content with highest quality ingredients. Typically sold in pints.
- Frozen Snacks – snacks such as ice cream sandwiches, drumsticks and Bon Bons that are frozen.

### Facts

- Total ice cream market is over 20 billion dollars.
- Total retail ice cream market is 8.3 billion dollars.
- 94% of US household consume ice cream.
- The average American consumes 5.6 gallons of ice cream per year.



\* Dreyer's does not compete in this segment

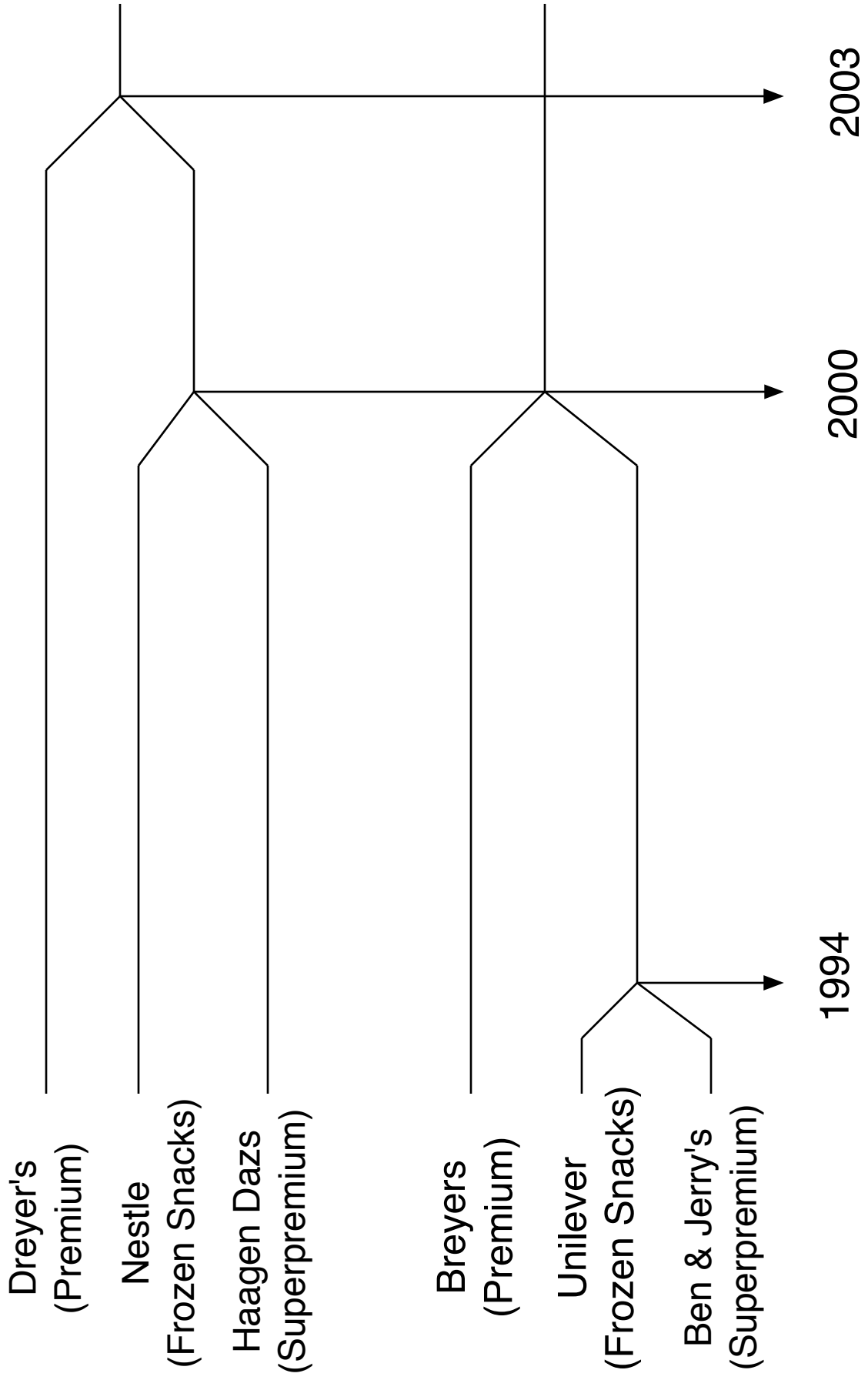
## Appendix B

### Dollar Share of Premium and Superpremium Packaged Ice Cream Market

	<u>1994</u>	<u>1998</u>	<u>2004</u>
Dreyer's and Haagen Dazs	15.7%	20.3%	~24% ( $\pm 5\%$ )
Breyers and Ben & Jerry's	15.1%	18.1%	~20% ( $\pm 5\%$ )
Private Label and Small Regional Brands	64.3%	53.8%	~49% ( $\pm 1\%$ )

During the merger period from 1994-2004 we see a consolidation of the ice cream market as market share gained by Dreyer's and Breyers was mostly taken from private label and small regional brands.

## Appendix C: Mergers Timeline



# Appendix D

