AMARALIA (A)[1]

In January 2007, Manuel Cortez, the General Manager and shareholder of Amaralia, was in a thoughtful mood and made the following reflection on the future of his business over a coffee in his office with his good friend Gabriel Dolá:

> *"Gabriel, what I don't want to do is lose control. I'm less interested in increasing revenues and more interested in maintaining the profitability of the firm, living relatively peacefully and not having any problems."*

Management had to decide on which sectors to focus activities in the coming years, after having grown from an ice cream distribution business into a small diversified company. Manuel thought it was time the company had a clearer strategy to follow. Until then he thought this strategy was clear, but then he realized that it had to be put down in writing and developed in more depth, defining which measures had to be adopted in order to keep the business profitable and guarantee the company's future development.

THE COMPANY

Amaralia was a family business. It began operations in 1970 when Rafael Cortez and his wife Matilde Amaral won a contract to distribute "Alacant" ice cream in a number of towns on the Gerona coast[2]. It was a low risk business with few overheads (rental of cold storage and five employees) that had operated reasonably well for fifteen

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[1] Case study prepared by the Research Division of IESE Business School and Instituto Internacional San Telmo, Spain. Prepared by Professor Alberto Fernández Terricabras of IESE Business School and Professor Raúl Ibáñez Trianteno of Instituto Internacional San Telmo, for use in the classroom and not as an example of the correct or incorrect management of a specific situation.

[2] From Gerona, a province in Spain, in the Autonomous Community of Catalonia.

years, allowing them to live peacefully and build up a little capital. By 1984, the company already had a turnover of around one million euros. In 1985, Rafael Cortez acquired a warehouse on the outskirts of Roses in the province of Gerona and Amaralia began producing and distributing white label ice cream, in addition to retaining the distribution business for Alacant ice cream.

The ice cream business was very successful during the 1980's and even in the early 1990,s. At that time, total sales amounted to 3.5 million euros, of which 60% corresponded to the company's own ice cream, which gave it a greater margin. Around 70% of its production capacity was used, but the cold storage rooms worked at full capacity from April to September, meaning that it was sometimes necessary to rent additional cold storage space.

During the nineties a slight crisis began in the tourism sector on the Catalan coast. This, coupled with stiffer competition, caused sales and especially margins to drop significantly and prompted the company's management to consider diversifying into other lines of business (see Exhibit 1).

The company had always obtained good results. In 2006 it made a profit of 300,000 euros on sales of nearly 7 million; the return on equity was around 13%, although it was declining; new business operations had required the company to make new investments but these additional profits had not yet been consolidated.

The ice cream business

In 2006, the company manufactured and marketed white label and Amaralia ice cream, and also distributed Alacant and Häagen-Dazs ice cream. Its clients were mainly companies operating in the hotel, restaurant and catering sector.

The company's traditional white label and Amaralia brand ice creams were largely cheap to produce, offering low margins but acceptable quality. The quality of the ice cream depended on the raw material used, the amount of air it contained (the less air, the better the quality) and the type of oil used, vegetable oil being better than animal oil (see Appendix 1 for a more detailed description about the making of ice cream). Amaralia had analysed its ice creams and those produced by its competitors and felt that its products, within the low-priced ice cream range, were of very good quality, especially due to the raw material used.

In addition to distributing Alacant ice cream, in 1992 the company began distributing a much more prestigious brand, Häagen-Dazs, in a move to improve customer service by broadening its range of ice creams. The distribution of Helados Alacant ice cream had always yielded reasonable margins, although sales had declined in volume over the previous decade due to stiff competition and the loss of exclusivity in certain areas, resulting in a substantial downturn in margins. The initial idea behind distributing Häagen-Dazs ice cream was to offer a higher quality product, although both sales volume and margins were always relatively low.

In 2002, Amaralia began manufacturing and marketing Italian-style ice cream, which was creamier and better in quality (with more milk and less air) and with greater value added. It was targeted at the same traditional ice cream customers but those who valued a higher quality and more visual product. With this goal in mind, Miguel Cortez, Manuel's brother and the company's Sales Manager, had worked on the design of Italian-style ice cream, creating a range of different products and adding three new flavours (lemon, tangerine and peach) to the five traditional flavours (vanilla, chocolate, strawberry, cream and coffee). The average selling price to customers was €1.60 per average unit, compared with only €1.05 for traditional ice cream.

Revenues from the ice cream business had been falling gradually in relative terms since the early nineties, and stood at approximately 3.7 million euros in 2006. This accounted for approximately 50% of the company's total revenues[3]. In terms of margins, in recent years pressure from hotels and restaurants to maintain or even slightly lower prices had also pulled revenues down (see Exhibit 2).

The chocolate business

In 1999, as part of its diversification process, Amaralia started making chocolate figurines, which were sold at bakeries; these were mainly Easter cakes or *monas de Pascuas* as they are called in Catalonia. This is a seasonal product, designed primarily during the last quarter of the year and made and sold from January to Easter.

First quarter production accounted for 80% of annual sales of the chocolate business. During the rest of the year, production remained at a low level and products were sold to order and for special events (e.g. children's First Communions, parties and, in particular, for King Balthazar's gifts for children at Christmas).

The company offered excellent quality products. Since the cost of chocolate was not a significant part of the total price of the product, there was little sense in lowering the quality of the raw material.

The company produced to order for bakeries, which sold the company's products as their own. Manuel Cortez believed that bakeries ordered chocolate figures from Amaralia for two reasons: firstly, because they were unable to cater for demand with their own products during periods of high demand; and secondly, due to the high-

[3] The consolidated business included the ice cream, chocolate and cafeteria segments, as described below.