MINH LONG I PORCELAIN CO. LTD.

Cần tắc vò ụu.

A Vietnamese Proverb: Translated: “Good watch prevents misfortune”

It was April 2009 and Mr. Ly Ngoc, Chairman and CEO of Saigon-based Minh Long I Porcelain Co. Ltd., just learned that Metro, a chain of seven department stores across Vietnam, had no intention of bringing the price of its porcelain pieces back up to the level that was agreed on in their sales and distribution agreement.

Minh Long I Porcelain had always preserved good relations with their distribution channels. The company sold the majority of their domestic output through distributors who called upon Vietnam’s rapidly developing hospitality and retail segments. Distributors had their own sales teams, and also retained a series of external agents to sell their stock. The company maintained uniformed pricing throughout Vietnam and their distribution channels had always been willing to highlight the Minh Long I products. Minh Long I had always produced to the highest quality standards and their products commanded premium prices. While the company’s distribution margins were in-line with those of competing manufacturers the high prices translated into generous per unit margins for everyone in the channel.

The global recession had created great uncertainty in Vietnam as banks tightened their lending practices. Minh Long’s sales team found that new customers were harder to come by and existing customers were timid in their purchases, postponing purchases to the last possible moment. Metro and several other retailers had begun to lower their prices below the agreed upon retail price in order to quickly move stock, boost cash flow and reduce risk. This was a clear violation of their agreement with the company, but these were not the easiest of times.

Mr. Minh was concerned that the rift with Metro could lead to an ultimatum and the timing was certainly not optimal. He did not want to lose any points of distribution at this time, but he also knew that he needed resellers that wanted to add value to his products.

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The Vietnamese Economy

The fall of Saigon (renamed Ho Chi Minh City in 1976) and the capitulation of the Army of the Republic of Vietnam in 1975 led to the country’s unification under the ruling of the Communist Party of Vietnam. Despite logistical support which the newly unified Vietnam received from China and the Soviet Union, the country found itself operating under dire economic conditions, which were exacerbated by US economic sanctions and trade embargo.

As a consequence, beginning in the 1980s, the Vietnamese government was forced to relax restrictions on private enterprises and launched an economic renewal campaign (Doi Moi). Several social and economic reforms were introduced which de facto transformed Vietnam from a centralized economy to a socialist-oriented market economy. Eventually, after considerable negotiation, the government encouraged foreign investment and the establishment of private ventures. It also removed price controls on agricultural goods, which allowed farmers to sell their goods at real market prices, further boosting the economy.

By the late 1990s, the results of the Doi Moi agricultural and business reforms were evident: the country was growing at a yearly rate of 7%. Though still a small part of the national economy, private sector growth was increasing at a multiple of its public counterpart. Thousands of new private enterprises were created every year and the poverty level, caused by four decades of wars, was reduced from 50% to roughly 29% of the adult population. In 2006 Vietnam finally became the 150th member of the World Trade Organization, an event 11 years in the making. The country’s entry into The World Trade Organization (WTO) fueled an increase in Vietnam’s already remarkable domestic growth rate to 11% and a nominal GDP per capita of $1,218. Based on a Goldman-Sachs report, Vietnam was poised to reach a nominal GDP per capita of US$4,357 by 2025 and become the 17th largest economy in the world.

In 2001, the ruling Communist Party of Vietnam approved a 10-year economic reform plan which, paired with a previously signed Bilateral Trade Agreement with the USA, propelled Vietnam into a renewed period of growth, second only to China among WTO nations. The accompanying increase in consumer purchasing power and demand led to the establishment of many private enterprises in the restaurant and hospitality industry (Refer to Exhibit 3 for data on the growth of the hospitality industry). While the hospitality sector grew rapidly, government barriers to entry in the food retailing industry made foreign franchises shy away from the Vietnamese market. International fast food, hotel, and convenience store chains had limitations on the number of outlet permits that they would be granted, compromising their operational models. As a result, locally-owned restaurants, food shops and hotels began to grow throughout Vietnam.
The ceramic and porcelain industry in Vietnam

The art of making ceramics was originally brought to Vietnam around 1300 AD, though archeological estimates are not exact. Vietnam rapidly became known for manufacturing high quality ceramic and porcelain. Vietnamese craftsmanship, abundant deposits of high quality Kaolin, and the skillful combination of traditional styles with modern design elements were the fuel of the industry. The perfection of blue cobalt colored glazing in Vietnam changed the industry so much that by the 15th century blue and white wares were the most popular in the world.

Since its inception, the Vietnamese ceramic and porcelain industry had been highly fragmented, with small producers located in craft villages around the country. Lacking scale and sophistication, few producers had been able to afford the high-tech production equipment needed for the making of hard-paste porcelain, instead sticking to ceramic products.

Vietnam’s government created barriers to entry that made it difficult for most foreign competitors to enter the Vietnamese ceramic and porcelain market. However, in 2004, several key foreign firms established a presence in Vietnam: CK and Ta Tung from Taiwan, and Giang Tay from Mainland China. These competitors did not have the technical capability of competing directly in the high quality segment with Minh Long, but rather focused on the mass markets. Giang Tay went out of business in 2007 and Ta Tung followed 18 months later. CK managed to remain afloat and slowly improved upon the quality of its porcelain products to become Minh Long’s most serious competitor. The company sold to the trade with a recommended margin for the reseller of roughly 40%, but they were free to set their prices. Overall, CK prices were typically 40-70% below those of Minh Long I for smaller items and 40-50% lower on large items such as vases and bowls. By 2011 CK had become even more price competitive.

Data released by the Hanoi government showed that the ceramic industry in Vietnam was highly-export oriented, with more than 50% of suppliers sending their entire output overseas. The US was the largest export market, accounting for in excess of 25% of total exports. Other important export markets were the EU, Japan and Korea.
Minh Long

Company history

At Minh Long I, the love for ceramics has been handed down for more than three generations. Mr. Ly Ngoc Minh’s paternal grandfather was born in Fujian, China and moved to the Binh Duong province in southern Vietnam where he lived for many years. Upon his death, he left Minh’s father several kilns. Minh’s father passed away when all of the children were still young. At 16 years of age, Minh became responsible for the kilns and the economic welfare of his family.

He began to make porcelain, (Refer to Exhibit 1 for a summary of the porcelain making process) initially, for use in the electrical insulation business. Along with his brother Duong Van Long\(^1\) they founded the Minh Long company, built laboratories, created innovative designs and patterns, and found new recipes to make brighter (though more expensive) colors, eventually moving from insulation into chinaware and figurines. In 1971, in the middle of the USA-Vietnam war, the family business was booming and customers were shocked when they realized that two “20 some-things” owned the Minh Long Porcelain Company (later to be renamed Minh Long I).

The brothers built new kilns and increased capacity to satisfy an ever-growing demand for their products. While sales of insulation products were increasing, demand for figurines and vases with high quality textures and colors was experiencing explosive growth. Minh Long’s hand-painted figurines were becoming highly sought after in foreign markets (which by this time generated the lion’s share of company sales.)

While the company enjoyed great prosperity, there were bumps along the road. In the aftermath of the 1998 Southeast Asian recession and resulting trade policies, distribution channels were so disrupted that porcelain goods were virtually impossible to export. With little access to foreign markets the company was so restricted that Mr. Minh turned to farming until a close friend advised him: “The government now allows everyone to do business. You should return to making porcelain, because that’s who Minh Long is.” Upon Minh’s return to the business he established Minh Long I Porcelain Ltd., while his brother continued in the insulation business, operating the business as the Minh Long II company.

Encouraged by the returning strength of company exports, Mr. Ly Ngoc Minh decided to focus on the domestic market and revive a Vietnam tableware industry which had been dominated by inferior quality Chinese goods. He started a domestic technological revolution, making what was widely regarded as the best quality porcelain in Southeast Asia. The company developed new

\(^1\) Five years later, Mr. Ly Ngoc Long spun off a second company called Minh Long 2 that to this day builds porcelain electric insulators.
firing techniques and were able to achieve a brilliant array of colors, facilitating their ability to find the perfect color to suit each product.

Between 1990 and 1998, Mr. Minh spent a considerable amount of time in Europe, where he learned emerging techniques for making higher quality porcelain. Additionally, during his time in Europe, he gained insight into the market needs of Europeans, and forged solid distribution arrangements. As a result of his efforts, new orders from the French and German markets brought a steady 10% yearly revenue growth.

Always a family business, Mr. Minh’s children grew up around the factory floor and the showroom shops. Starting in 2001, Mr. Minh rearranged his company’s management structure to include his three elder children into the nucleus of corporate leadership.

As 2009 began, Minh Long was the largest producer of high-quality porcelain in Vietnam, with roughly 2,200 full-time employees, production of 35 million pieces per year and annual sales in excess of US$15 Million (Refer to Exhibit 2 for historical financial sales of Minh Long). By comparison, the next largest porcelain-maker, by size, Hai Duong, was state-owned and heavily subsidized, with 500 full-time employees, a production of 12 million piece/year and annual sales of US$4 Million, across all of its product categories.

**Minh Long’s Market Approach**

Minh Long had two main product lines: tableware and figurines. Tableware and cookware production at Minh Long started in 1996 and it eventually became the company’s main focus as domestic demand from restaurants and hotels grew. Tableware also had a 30% higher profitability margin than figurines.

Hand painted figurines had always been positioned for export markets, which comprised nearly 75% of total figurine sales. With low labor rates compared to France and the natural trade ties between Vietnam and France, the company began selling to the French market beginning in the mid 1970s. Figurines were being affected by increasing labor, distribution and sales expenses leading to lower margins than tableware, slowly marginalizing their importance in the company portfolio. In 2008, 97% of company exports, mainly to France and Germany, were figurines.

Distribution in Vietnam was logistically very complex as nearly three quarters of the country’s 85 million plus population lived in rural areas. AT Kearney estimated that Vietnam had over 500,000 traditional shops selling consumer packaged goods. Despite the 2008 economic downturn the segment was witnessing 16% year-on-year same store sales growth. Even more
impressive, the number of modern trade outlets looked as though it would grow 45% in 2009, and per store sales were increasing at over 65% yearly.\(^2\)

Minh Long sold 20 million pieces of tableware and cookware in 2008, with its volume steadily increasing in the years 2002 to 2008. Overall gross profit margins were roughly 30% (Refer to Exhibit 4 for a breakdown of Minh Long’s tableware and cookware cost structure.)

Minh Long distributed through its three national distributors, geographically located in Hanoi (North), Ho Chi Minh City (South) and Danang (Central Vietnam). A fourth distributor was dedicated to the international market. The three domestic distributors comprised 48% of the company’s domestic sales dollars. Additionally, there were a series of regional distributors that provided coverage in confined rural areas and constituted 11% of volume and 8% of domestic revenues. The company’s internal sales force made up the remaining volume, as they maintained direct relations with select customers and serviced the distributors. Distributor profitability was not easily tracked, but it was believed that net profitability was roughly 3-5%.

Minh Long I distributors were contractually obligated to maintain specified resale prices when selling to agents, hospitality and retail customers. The company constructed a program discount schedule for their national distributors. Typically, distributors worked off of a set margin of 30-40% (depending on lines and product classes), but if they kept a show room, met standards regarding its layout and design, stocked product, created sales materials, and met their sales targets they could receive margins in excess of 37% for even the lowest margin products.

Retailers were required to maintain uniformed prices as well. Distributors were contractually obligated to monitor their retail accounts. Retailers caught selling products below the company’s stated price levels faced termination.

Minh Long I also sold directly to large clients, whose agents contacted the company and therefore bypassed the distributors. In such cases, Minh Long sold to the agent at the same price they would have bought it from the distributor and reimbursed the bypassed distributor for the missed profit (about 3%).

Minh Long I’s uniformed pricing policy had implications for their distribution channel. A distributor who bought the product from Minh Long I could sell it to the end users (e.g., hotels and restaurants) through its stores for a 40% mark-up from manufacturer price, or sell it to an agent at a 21% mark-up. Agents were required to sell at the same final sales price to end customers or risk being dropped.

**Storm Clouds Gather**

Mr. Minh had to rely on his distributors to help distinguish his products in the marketplace. While Minh Long I quality was apparent to the expert, the consumer did not always recognize it. Consumers didn’t know what to look for when buying porcelain products, as these were not frequent purchases.

The company had set up two showrooms where they showcased porcelain dinnerware sets and artistic collection items. The company’s special collection of giant vases and the world’s largest kiln fired cup were testaments to their manufacturing and artistic prowess. The showrooms were intended to serve as an example for distributors on how to best display and market Minh Long I products. However, distributors were hesitant to bring new wholesale customers to the company’s showrooms. Minh Long’s distributors were also pressing Mr. Minh to decrease manufacturer prices to the trade so that they could either profit more on the established selling price or potentially lower prices.

Metro department stores did not represent Minh Long’s only discounting issue. Nguyen Kim, a chain of electronics and home furnishing department stores had also recently lowered prices. These two accounts together represented 4 and 5% of company sales respectively. Minh had created Minh Long forty years ago with the goal of producing the best quality porcelain in Southeast Asia. He had put his family’s name on the products and that was all the more reason to strive for greatness. He needed to protect the family name, but he wondered what the value was if he could not sell the goods he manufactured.

It was becoming clear to Mr. Minh that the price issue with Metro and Nguyen Kim stores was only the tip of the iceberg. The larger issue at stake was that the ever-increasing number of retail outlets purchasing Minh Long porcelain products had begun to make individual store price checking cumbersome, if not impossible. Also, Mr. Minh had to listen to his distributors’ demands for higher profits but he was uncertain whether simply raising the prices of his product was the solution in this economy.
Porcelain is a ceramic material that has been baked at temperatures between 1,200 and 1,400 °C until it obtains a glassy state characterized by its well known translucence, low porosity and hardness. The term porcelain derives from the Italian word for a type of shell “porcellana” that can be found on the Mediterranean coastline. Porcelain has several types of applications such as tableware, chemical ware, figurines, dental crowns and electric insulators. There are two main types of porcelain: soft-paste and hard-paste.

Soft-paste porcelain is made from a mixture of kaolin clay and powdered glass (frit). Soft-paste porcelain cannot withstand very high temperatures as it tends to warp and lose shape. Soft-paste porcelain was first made in Europe three centuries ago, in an attempt of reproducing its hard-paste counterpart from South Asia. For that reason, soft-paste porcelain has been dubbed China, but it is in fact a misnomer.

The higher quality hard-paste porcelain, such as that produced by Minh Long I, is made from a mixture of kaolin clay, quartz and feldspar. Minh Long I management sources its clay from countries providing the best choice of raw materials, such as New Zealand, China, United Kingdom, India, Russia, Canada and the US. The clay is crushed and milled to remove impurities, before being mixed with quartz and feldspar at three different levels of moisture: powder, clay paste and gel.

Powder is used for the simplest of tableware items such as dishes. With this technique, the clay powder is shaped at high pressure between resin molds. For more delicate shapes, such as cups, pots or embossed objects, clay paste, with its higher plasticity is used instead. The clay paste is spun at high speeds and molded into the desired shape. For non-cylindrical shapes a clay gel at higher moisture content is poured by hand into a plaster mold or a robot can also be used for very large objects such as large odd-shaped platters.

Once unfired items are formed, odd components such as spouts and handles are attached before being glazed. Glazing not only improves hardness, but also serves decorative purposes such as coloring (bisque is the natural color of porcelain), but also makes porcelain stain resistant. Porcelain glaze is made from the same raw materials as the main body, although in different amounts.

Glazed items are then baked in a large kiln. At Minh Long I, the baking process lasts 7 hours and reaches a temperature of 1,380 °C at which all the impurities in the clay evaporate and the silica in the clay rearranges itself into liquid glass. It should be noted that besides Minh Long I, no other porcelain manufacturer, with the exception of a few high quality EU producers, are able to fire porcelain at such a high temperature. As the clay slowly cools down, the material solidifies.
into porcelain, a glassy translucent, smooth and very hard material. In order to qualify for high-grade hard-paste porcelain, water content must be lower than 0.05%.

When the fired items exit the kiln, they are cooled off to room temperature before being branded with the Minh Long logo and quality inspected and decorated using paints that in certain designs can contain noble materials such as gold and platinum. For large decorations, such as the band around the body of a plate, a decal is used instead. Once the decoration is complete, the item is refired at a slightly lower temperature (about 1,250 °C), so that the paint and decals are embedded into the surface of the porcelain.
Exhibit 2 – Minh Long Historical Sales Volume

Source: Minh Long

Exhibit 3 – Hotel and Restaurant Sales in Vietnam

Source: General Statistics Office of Vietnam
Exhibit 4 – Company’s cost structure*

*Cookware and dinnerware product line

Source: Minh Long