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HBR CASE STUDY

Should Neptune launch a mass-market brand?

Class—or Mass?

by Idalene F. Kesner and Rockney Walters

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Stuck with excess inventory, Neptune Gourmet Seafood is toying with the idea of launching a second, inexpensive product line. But if Neptune stoops to conquer, rivals might retaliate with price cuts, and the new line might end up cannibalizing the old.

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Jim Hargrove's startled expression would have been amusing had he not been in such a pitiable state. He was standing in the yacht's magnificently appointed galley, wondering if his stomach would be able to hold down the cola he was pouring into a crystal flute, when his colleague, Rita Sanchez, said something outrageous. Now the drink had spilled down the length of his pleated khakis, and he was sputtering. "You aren't seriously suggesting that we reduce prices by 50%. Are you?"

It had been a long day for Hargrove, marketing director of $820 million Neptune Gourmet Seafood, North America's third-largest seafood producer. When the firm's chairman and CEO, Stanley Renser, had invited his senior managers to sail with him to inspect one of Neptune's new freezer trawlers, Hargrove had demurred. He hated sailing on small boats—they made him sick, he told his boss. Renser had pointed out that the 120-foot yacht he owned wasn't exactly small. Besides, *Poseidon II* never rolled, even in a storm; the renowned Tommaso Spadolini had designed it. In fact, it was one of the last boats built by Italy's famous Tecnomarine boatyard! Eventually, Renser had won him over, and Hargrove had arrived that Friday morning as eager to see the yacht as he was to visit one of the state-of-the-art fishing vessels on which Neptune had bet its future.

Hargrove hadn't felt seasick all morning. There were no swells that day. Flat and glassy, the ocean glittered in shades of turquoise, silver, and gold. Aboard the freezer trawler, he had been fascinated by the technologies that allowed the vessel to catch fish in an environmentally sustainable way and to freeze them in a manner that gave Neptune an edge over rivals. But when the yacht had started to head back to Fort Lauderdale, Hargrove had crumpled. While his colleagues had made a beeline for the sundeck, he had spent the afternoon in

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the oak-lined main saloon, where he'd sunk into a leather sofa, clenching and unclenching his muscles to fight the ocean's incessant motion.

Tired of trying to take his mind off the problem by focusing on the distant horizon, Hargrove was exploring the galley when Sanchez, his counterpart in sales, had walked in.

"Hey, Jim. You better?" she had asked solicitously.

"I'll survive," Hargrove had grimaced. "We can't be too far from home now. But let's not talk about it. What's happening topside?"

"Oh, nothing much. Stanley's showing people the garage where he parks the water scooters and Windsurfers," Sanchez informed him. She gave Hargrove a challenging look and added: "You want to hear something that'll really take your mind off your seasickness? I'm convinced that we have to drop our prices by 40% to 50%—and soon."

Big Fish in a Small Pond

Hargrove snatched a stack of cocktail napkins to mop up the cola, but his eyes never left Sanchez's face. He hoped she'd break into a smile to indicate that she was teasing him about the price cut. It had to be a joke, right? Seafood was a high-end business in North America, and Neptune was an upmarket—many believed the most upmarket—player in the $20 billion industry. During the past 40 years, the company had earned a reputation for producing the best seafood, and Neptune did everything it could to preserve that premium image among customers.

The company reached its consumers, who were extremely demanding, through various channels. Neptune generated about 30% of its revenues by selling frozen and processed fish products to U.S. grocery chains, like Shaw's Supermarkets, and organic food retailers, like Whole Foods Market, all along the eastern seaboard and in parts of the Midwest.

The Neptune's Gold line of seafood products, manufactured in two sophisticated plants near Cedar Key, Florida, and Norfolk, Virginia, dominated most segments in terms of quality, and therefore sold at premiums compared with other brands. For example, Neptune's Gold canned salmon, tuna, sardines, mackerel, herring, and pilchard enjoyed a 30% higher price point, on average, than other brands; and Neptune's Gold lump crabmeat, anchovies, clams, lobster meat, mussels, oysters, and shrimp commanded a 25% premium over rival products.

That wasn't the company's biggest market, though. Neptune had emerged as the supplier of choice to the best restaurants within 250 miles of its Fort Lauderdale headquarters as well as to the biggest cruise lines, which together accounted for a third of the company's sales. Another 33% came from wholesalers that distributed the company's products to restaurants all over the United States. In fact, sushi bars from New York to Los Angeles increasingly bought Neptune's frozen fish instead of buying fresh fish and freezing it themselves. And, befitting the humble origins of founder John Renser, approximately 4% of Neptune's sales came from a fish market outside Fort Lauderdale that the company owned and operated.

It wasn't easy to live up to the tagline "The Best Seafood on the Water Planet." Dogged by competition—especially from China, Peru, Chile, and Japan—as well as tough fishing laws, Neptune invested heavily to stay ahead of rivals. Stanley Renser, the company's largest shareholder, had recently expanded the firm's equity base, although doing so had shrunk his share to 10%. The capital infusion allowed Neptune to invest $9 million in six freezer trawlers of the kind Hargrove had visited. Those ships' autopilot mechanisms guided them to the best fishing grounds, manipulated fishing gear, landed catches, and reported data to shore. Other systems, along with new fishing equipment, ensured that only mature fish were caught and that the nets were not overfilled, thus reducing damage to the haul. As a result, Neptune increasingly landed only top-quality catches.

What's more, the freezer trawlers used a new technology to superfreeze fish to -70°F (instead of the usual -10°F or -23°F) within four hours of capture. The fish would freeze so quickly with this method that ice crystals couldn't form in them or on them. That allowed the fish to retain their original flavor, texture, and color; and when cooked, they tasted like they were fresh out of the water. Moreover, by packing the catch in snow made from dry ice and surrounding it with liquid nitrogen, the process increased shelf life by 50%. No wonder the gourmet magazine *Connoisseur's Choice* had rated Neptune's products

Idalene F. Kesner (ikesner@indiana.edu) is the Frank P. Popoff Chair of Strategic Management and MBA program chairperson, and ***Rockney Walters*** (rwalters@indiana.edu) is a professor of marketing and the Ford Teaching Faculty Fellow, at Indiana University's Kelley School of Business in Bloomington.

foremost in quality for the tenth year in a row.

Against the Current

To Hargrove, the company's premium image, investments in new technologies, and obsession with quality made any price cut—let alone the notion of chopping prices in half—unthinkable. But Sanchez refused to back down. "I'm not kidding, Jim. It's pretty clear that we have a big inventory problem. We have to slash prices to get rid of those excess stocks."

Hargrove knew exactly what Sanchez was talking about. In the past three months, Neptune's finished goods inventory had shot up to 60 days' supply—twice the normal level and three times what it had been a year ago. Like many of his colleagues, Hargrove considered the inventory pileup a temporary phenomenon; stocks had risen because the company had added ships to the fleet and could process catches more efficiently than before. Surely, if Neptune sold some old ships and stuck to its plan of launching ready-to-eat, fish-based meals, its inventory would soon fall to normal levels.

Sanchez and her sales team, however, were convinced that they faced a more enduring situation. "I told you this a month ago, Jim, and I'll say it again. The new laws have reduced our access to fish near the coast and forced us to go farther out to sea. Because the fishing grounds are richer there, and because we're using new technologies, our catches have grown bigger on average. That's why, even in the past four weeks when we've seen demand reach an all-time high, our inventory has continued to grow."

"First of all, it makes no sense to me to cut prices when demand is rising," Hargrove said, exasperatedly. "Besides, think about how customers would perceive a large price cut. If you slash prices by 50%, people will think there's something wrong with the fish—like it's rotten or full of mercury! It would destroy our premium image and permanently erode our brand equity."

Sanchez shook her head. "Customers recognize that we sell a perishable product and that the supply of fish fluctuates from day to day. They expect prices to vary. The prices of fruits, vegetables, and flowers change all the time, don't they? A few years ago, coffee bean prices plummeted when growers realized they'd be better off selling inventories than watching the beans rot. Since then, coffee prices have gone up again. No one seems to object when the prices of chicken, beef, or pork rise and fall because of changes in the marketplace. I'm not willing to leave money on the table by refusing to react to supply-and-demand fluctuations."

"But why do you want to cut prices so drastically? Why not just offer customers a 10% discount? I can see us doing that in the winter, when sales are slow, anyway," Hargrove pointed out.

Sanchez shook her head again. "It won't work, Jim. Our warehouses are so full that it's going to take a lot more than that to make a difference. And with $9 million tied up in the new ships, you know we won't be keeping them in harbor. Our inventories are going to keep growing unless we do something radical."

"Selling product at a loss is radical, all right," Hargrove muttered grimly. On many of its products, Neptune wasn't making enough profit after manufacturing costs to sustain a deep price cut. In fact, the company's margins had already shrunk by 10% in the past year because of rising costs and growing competition.

"You're talking about sunk costs," Sanchez shot back. "Selling product at a loss to generate some revenue is better than throwing it away. What I'm proposing, though—"

"Have you considered how our competitors will react?" Hargrove cut in. "If we do this, some of them are bound to retaliate with even deeper price cuts, and then we'll be in a price war none of us can afford—Neptune least of all, given our cost structure."

Sanchez held up a hand. "Of course, of course. But you're assuming it says 'Neptune's Gold' on the discounted product. I actually envision a new brand."

Hargrove exploded. "You don't create a new brand to deal with a temporary increase in supply! Besides, you won't fool anybody. Everyone will know who's responsible for flooding the market and eroding margins."

It was clear to Sanchez that she wasn't making much headway with Hargrove. "Look, Jim, this really isn't the place for this discussion, and perhaps I'm not being as clear as I should be. I want to put this issue on the MOC's agenda for Friday." The Marketing and Operations Council, which comprised Neptune's top executives, met twice per month.

"Fine, as long as Stanley is at the meeting, too. I'll go up on deck and talk to him right away," said Hargrove, his seasickness all but forgotten. "The sooner you stop thinking about a price cut, the better."

Swimming with the Sharks

As the week progressed, word spread about the solution that Sanchez had proposed to tackle Neptune's inventory problem. Both Hargrove and Sanchez were drawn into lively debates with their colleagues, and they soon realized that whether people were in favor of price cuts or against them, everyone had an opinion on the subject.

A day before the MOC meeting, Sanchez received an unexpected visitor. It was Nelson Stowe, the company's legal counsel and a longtime confidant of the Renser family, hovering at her door. "Ah, Rita. Got a minute?" Stowe asked in his mild-mannered fashion.

Realizing that this was no ordinary visit—Stowe had never called on her before—Sanchez quickly invited him into her office. After they had settled in, Stowe got slowly to the point. "I've been hearing that you want to launch a mass-market brand. Interesting! You know, before we opened the fish market, John Renser wanted to do something similar. He wanted to sell some of our fish at a low price so that more people would eat seafood. But that was a long time ago.

"I'm sure you're thinking through the implications of your strategy," he continued, "but one issue concerns me. Have you thought about how the Association will react?"

Stowe was referring to the powerful U.S. Association of Seafood Processors and Distributors, whose members, such as Neptune, accounted for 80% of America's seafood production. The ASPD influenced American and global policies related to the fishing industry and imposed quality standards on members. It also conducted surveys of wholesale and retail seafood prices and, twice a year, published benchmark prices that influenced the pricing policies of seafood producers and distributors.

"I don't know, Nelson," Sanchez sighed. "But I doubt that the Association can do anything."

"I wouldn't be so sure," said Stowe. "At the prices you're suggesting, you're likely to endanger our ASPD Gold Seal of Approval. We're the only company that has the seal on every product we sell. But the Association could easily change that."

"No!" Sanchez cried out. "It can't! Regardless of the prices we charge, our products will still meet the ASPD's quality standards. Besides, we're just selling the same fish under a different brand."

"Don't fool yourself, Rita. The Association has a great deal of discretion about who gets the Gold Seal and who doesn't. If it believes that our pricing strategy will cost the fishing industry a lot of money, it might withhold the seal on our low-end products—for starters. I'd like us to remember that the Association isn't going to stand by idly while we disrupt the industry," Stowe warned as he got up to leave. "Keep me posted, will you?"

A Pretty Kettle of Fish

At 8 AM on Friday, Sanchez walked into the conference room on Renser's heels. "How was Newfoundland?" she asked.

"Lousy," croaked Renser, who had returned late the previous night after delivering the keynote address at the Canadian Fish Producers' annual conference. "I caught a cold," he complained. "Happens every time I fly commercial."

"At least riding in planes doesn't make you feel nauseated," Hargrove quipped as he joined them. "That's more than I can say for riding in boats."

Once everyone had settled down, Hargrove got the meeting under way. "We have several routine items on the agenda," he began. "But Rita and I have added a topic we think is important, so I suggest we move to that first." When everyone nodded in agreement, Sanchez and Hargrove ran through the issues they had discussed on the yacht.

As they concluded their summaries, Bernard Germain, Neptune's COO, spoke up. "Do we know which of our rivals are considering price cuts? We aren't the only company facing overcapacity. It would be naive of us to believe that all our competitors will hold prices for the industry's good."

"I can't believe it!" Hargrove burst out. "You're in favor of price cuts?"

"I don't know yet, Jim. I'm trying to understand why Rita's suggestion that we introduce a low-priced seafood brand is so off-the-wall. Why can't we use a new brand to appeal to value-minded customers? Seems to me that we have the product; we can distribute it using our existing channels; and we can achieve a new positioning through packaging, advertising, and pricing. I don't see the difference between this strategy and what companies like Kellogg do with their private-label businesses. In fact, if we don't want to launch a second brand, we could think about supplying retailers with private-label products."

"I'm not suggesting that we get into the private-label business," Sanchez was quick to reply. "That can pose problems, as many consumer goods manufacturers have discovered. I feel we should create a mass-market brand called, say, Neptune's Silver."

"That's terrible!" snapped Hargrove. "By calling it Neptune's Silver, you're positioning the cheap product right next to Neptune's Gold in the eyes of consumers. Then they'll be more likely to try it and, once they do, they'll realize there's no difference in quality. We'll end up cannibalizing our own sales. Why would any company in a high-end segment do something so crazy?"

"I guess you don't remember what transpired in the wine industry a couple of years ago," responded Pat Gilman, the head of Neptune's institutional business, whose taste for high-end products was well known. "A California vintner, Bronco Wines, did something exactly that 'crazy.' It was the same kind of situation: a glut of grapes, huge inventories. They slapped a new brand name on the stuff and sold it through Trader Joe's for $1.99 a bottle. It's called Charles Shaw, but people nicknamed it Two-Buck Chuck."

"Not only do I know about it, but I've also tried it," Sandy McKain, head of the company's consumer business, piped in. "I can tell you, it's worth every penny. But Pat, I don't think the scenario is exactly the same. Even in Bordeaux, a lot of winemakers offer a premium wine and several cheaper wines, but they use grapes of different qualities to make the different grades. Would we be doing that?"

"In Bronco's case, it was the same grapes they'd been using for higher-priced wines," Gilman said. "As for Jim's point, I'm sure they had some customers migrate to the cheaper stuff. But think about the upside. In the United States, 88% of wine sold is consumed by 12% of the population—"

"Hey, Pat," Hargrove called out. "How much of that do you personally account for?"

Gilman joined in the laughter before continuing: "The point is, more people will opt for a bottle of wine with dinner if they can get a passable one on the cheap. Wine sales have grown at the expense of other beverages in recent years. The same thing could happen to us. Even with people eating healthier things, seafood sales lag behind those of beef, chicken, and pork. The way I see it, this isn't about reducing inventory. It's about introducing our products to a bigger market: the more budget-conscious consumer. And if it's like wine, the educated consumer will then trade up to Neptune's Gold."

A furious discussion followed about how hard it would be for Neptune to win shelf space in supermarkets for a new brand, particularly for a low-priced product that might go head-to-head with the grocers' own private-label offerings. The group was also divided about whether it should sell a second brand through the same channels or through different ones. Germain wondered aloud whether Neptune should target new geographic markets—like South America and Central America—with a low-priced offering.

"Hang on!" exclaimed a clearly frustrated Hargrove. "When we started, weren't we debating whether it made sense to launch a new brand to deal with a temporary inventory problem? That would mean we'd kill it once we solved that problem. I—"

"If customers like our new brand, it might constitute a better growth strategy," Sanchez interrupted. "The way I look at it, the second brand could prove to be a win-win proposition."

"I don't know if it's as simple as that," Germain said slowly. "Every luxury company I know of—Gucci, Mercedes-Benz, BMW, Tiffany, even Hyatt—has struggled to go mass without destroying its premium image. For that matter, when fashion designers like Isaac Mizrahi create an affordable line for a retailer like Target, I wonder if that adds to the brand's luster or tarnishes it?"

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Renser, who had been quiet until then, cleared his scratchy throat. His colleagues were starting to rehash territory they had already covered, and instead of sharpening their arguments, they seemed to be obfuscating them. On one hand, they appeared to agree that it would be important to keep the two brands separate. On the other hand, they were talking about migrating customers from the low-end brand to the high-end brand, which would mean linking the two. Renser knew that the group was waiting to hear where he stood, but he didn't yet know what to say. How long could he leave them hanging—along with his company's fortunes—between the devil and the deep blue sea?

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