An Analysis and Comparison of Business Model and Profitability of Yili and Mengniu

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Abstract. This essay reflected and compared the business performance of two dairy companies in China within the past few years. According to the increasing focus of the public on the intake of nutrients, the dairy industry has been greatly affected. Due to the business property of Yili and Mengniu, there is a potential competition existing in-between them. The financial statements from both companies were the major source being used to build the fundamental part of this analysis. Based on the previous data, this analysis has also included the profitability analysis of both Yili and Mengniu. This analysis aimed to provide an overview and multiple perspective to compare the past operation and future potential of Yili and Mengniu.

Keywords: Yili, Mengniu, Business Model, Financial Analysis.

1 Introduction

In the modern days, the demand for having a healthy diet has increased significantly. Apart from the agricultural products that individuals consume, dairy products have also increased its presence to the public. China has the world's fourth-largest dairy producer and second-largest dairy market. Due to the implementation of the focus on nutrients intake [1], dairy industry in China was well developed within a relatively shorter time length in compare with other countries. Studying the dairy industry in China, most investigators will focus on "Mengniu" and "Yili", since they were two of the largest scaled and well-known dairy products producing companies.

Yili was established in Hohhot. Due to the natural disasters in China in the past, the foundation of the previous Yili brand was facing multiple challenges. Although Yili once accepted a part of the subsidy from the UN World Food Programme, Yili was still struggling when competing with large scaled and matured dairy producers in the industry. In 1993, Yili has officially changed itself into corporate enterprise, taking the advantage of the growing demand for dairy production, rapidly expanded in its scale and range of well-known products to the public. Currently, Yili was listed by Kantar BrandZ to have the highest value in the global dairy industry. It gained nearly 1.3billion customers and maintained its place to be the most preferred dairy brand in China for the 8th consecutive year.

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The founder of Mengniu was named "Niu Gensheng", he was a member on Yili's director, as well as vice president of production and operations. Due to the internal conflicts between Niu Gensheng and other directors, the board of directors removed his position from Yili. In 1999, the demand for dairy products boosted in China. In Hohhot city, Inner Mongolia, Mengniu instantly discovered this business incentive and established itself. Since it can also take the geographical advantage of Hohhot, its sources of milk and other agriculture resources were easy to access, providing Mengniu a strong base to start up and develop [2-3]. Recently, Mengniu has made its "FIRST" strategic objectives. Its effectiveness has been displayed through the increasing market share on Mengniu in the liquid milk market (Milk Deluxe), while its chilled yogurt business maintained its top rank in the market through themselves achieving a counter-trend growth. Table 1 has displayed the summary of the balance sheet of Yili and Mengniu in 2023

Table 1. Balance Sheet Summary of Yili and Mengniu in 2023

	Total Assets	Total Liability
Yili	151620.25	94299.9
Mengniu	115219.95	64568.24

The products of Yili and Mengniu are mostly similar with each other, hence it is crucial for Mengniu and Yili to differentiate themselves through their market strategies and compete against other existing competitors in the industry. In the following essay, the current situation and business strategy of Yili and Mengniu will be introduced based on the research, combining with the application of Five Forces Model. There will be an analysis on the profitability of both companies based on their financial data displayed to the public. Lastly, there will be a forecast and discussion on the revenue for Mengniu and Yili according to their previous performance in the industry.

2 Business Analysis Using "Porter's Five Forces"

Michael Porter's Five forces model was published in the Harvard Business Review in 1979, this business tool has remained to be a fundamental way to use for business analysis, especially in identifying the competitive forces in a specific industry. The five forces include the threat of new entrants to the industry, the negotiation power of suppliers, the negotiating power of customers, the ability of customers to find substitutes, and internal competition.

2.1 New Entrants to The Industry

Currently, Mengniu and Yili remained their leading position in the dairy industry in China. The dairy industry has already grown mature and saturated within years [4], the leading producers has achieved economies scale, producing a set of qualified dairy products for their customers. As a result, from the increasing attention on food safety and the perfection of relating policies, the dairy industry will have a higher barrier of entrance.

Both Yili and Mengniu has presented new and diversified products to their customers in the market, since they both identified the raising demand for healthier products in the market. Yili in year 2023 focused on implementing probiotics into dairy products, because probiotics has the function of repairing and improving the digestive system of human body. Hence, the brand “QuanJiaYi” and its products were introduced to the customers, it successfully captured the interest of people and gained a success in this project. Mengniu in year 2023 also focused on improving a group of products. According to the aging population in China, Mengniu captured the potential of adult formula segment. The brand “Yourui” upgraded the nutrients added into their products, mainly targeted on the need from the perspective of an adult and elderly groups of customers. Despite “QuanJiaYi” and “Yourui”, Yili and Mengniu were also having a variety of attempts to improve on different types of their dairy products [5]. Product diversifications were able to allow Mengniu and Yili to cover the demand from multiple types of demand from their customers [6]. Such a wide range of products will require a significant amount of investments and professional technologies, it will made up a heavy startup cost for new entrances.

Additionally, since Mengniu and Yili has already gained a wide range of consumer loyalty, it is hard to take away those customers, hence the amount potential customers left for infant business trying to enter the Chinese dairy industry would face a difficult situation.

2.2 Internal Competition

For internal competition, this perspective mainly focuses on the rivalry of existing competitors in the industry. The milk production in China is highly concentrated, the northern part of China was the location where milk production is primarily based. Since the type of products that take the most percentage of sales in the industry are already fixed into liquid milk, although Mengniu and Yili already developed a set of mature production system, the next attempt for them should be more focused on maintaining and improving in the yield and forage in their supply farms. As a result, from the purpose of meeting the quality requirement from costumers, it is essential for Mengniu and Yili to capture their buyers by offering organic, grass-fed, or specialty milk products. Also, since the Chinese economy was facing a downturn due to structural imbalances, the consumer behaviors and spending patterns will change, which alternatively stimulate and affect the competition between the suppliers in the dairy industry [7].

2.3 Bargaining Power of Suppliers

The bargaining power of suppliers refers to the pressure that suppliers can use when deciding the prices for their products, changes in their quality, or the changes in the availability of their products. The dairy industry has a high requirement to the quality of fresh milk, hence the time for the production, transportation, manufacture, sanitation, and selling dairy product shout be kept short and neat. For both Mengniu and Yili, they both own their own supply farm for milk, allowing them to access milk source in a faster and convenient way. Mengniu and Yili has already solved the main source they require for production on their own, hence other suppliers are not the only choice for those companies, therefore they will be having a relatively lower bargaining power.

2.4 Bargaining Power of Customers

The bargaining power customers refers to the level of pressure that customers have on a business to make higher quality products with a lower price. In Chinese dairy industry, the customer preferences were influenced by multiple factors. Despite the attention on having a heathy diet, level of income is another important factor that decided the potential customer group in Chinese dairy industry. Most customers in the market were having middle level of income, their consumption was taking a great percentage in the industry as a whole. In addition to the increasing literacy rate, consumer behavior will become to a more rational stage, which they will acquire more information of the product they consume, maximizing their utility and surplus. Hence, in the Chinese dairy industry, Mengniu and Yili were having customers with strong bargaining power.

2.5 Substitutes

Substitutes are products satisfying the same basic demand form customers in a different way, it usually hurts the profitability of the original company. Mengniu and Yili originally focused on the production of dairy products, however the cost for cattle farming remains high. In comparison, the cost for raising soya-bean is cheaper, since China has a set of mature agriculture technique and land available for planting soya-bean. Hence, the lower cost allowed the soya-bean products to use a lower price to attract a group of Chinese customers. Meanwhile, the soya-bean products were having different types of nutrients that human body needed comparing with milk, and some characteristics of soya-bean products are more suitable to Chinese customers, such as zero lactose. Therefore, the greatest challenge that the Mengniu, Yili, and the whole dairy industry will be facing is from the soya-bean products. However, it is important to notice that Mengniu and Yili has already noticed this risk, and invented new soya-bean products to solve this challenge to their company.

3 Profitability Analysis

In the following profitability analysis, I will be using several financial ratios to evaluate the ability of Mengniu and Yili when generating profit. The following context provided an assessment on the performance of Mengniu and Yili in the industry according to the financial data released, followed by comparisons on the difference and suggested reason that caused such difference between Mengniu and Yili.

3.1 Income Statement

The income statement is a financial report that summarizes the revenue and expenses of a company in between a certain period, this is usually reported quarterly or annually.

Table 2 and 3 are the income statement of Yili and Mengniu reported on Investing.com, the data were assessed over annual basis. Since the 2024 annual income statement of both companies was not released, the data starting from 2020 to 2023 will be used in the following analysis.

Table 2. Income Statement of Yili

	2023	2022
Total revenue	126179.46	123171.04
Gross Profit	40168.87	39460.18
Net Income	10428.54	9431.06
Total Operating Expenses	114790.56	113660.66

Table 3. Income Statement of Mengniu.

	2023	2022
Total revenue	98624.04	92593.32
Gross Profit	36316.42	32451.73
Net Income	4809.2	5302.97
Total Operating Expenses	93169.29	87992.13

Fig. 1 is a graph plotted based on the data from Table 1 and 2. It combines the liner graph that displayed the total revenue of Mengniu and Yili, visualizing the trend of changes on the total revenue of each company from 2020 to 2023.

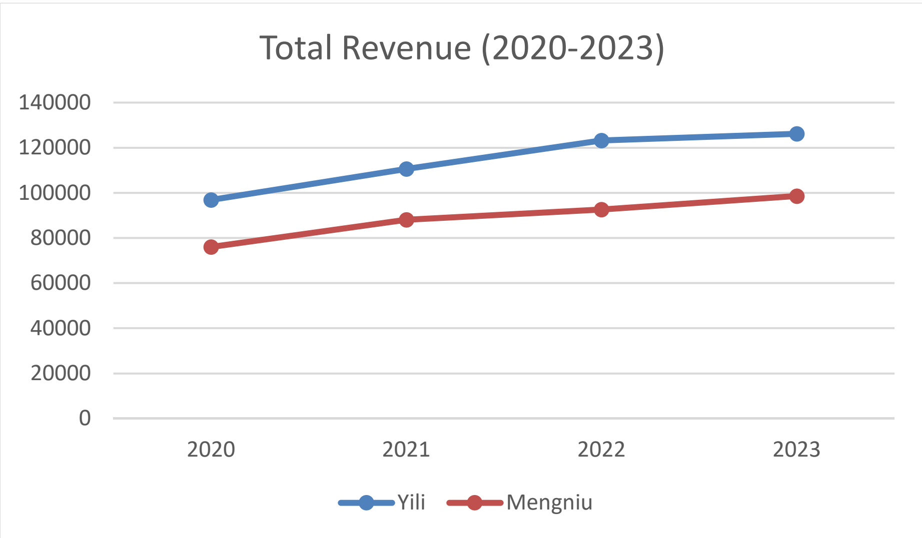

Fig. 1. Total Revenue of Yili and Mengniu (2020-2023)

Generally, Mengniu has a lower total revenue than Yili for 4 consecutive years, the difference reaches the maximum in 2022 which is 30577.72, while their average difference in total revenue is 24109.415.

3.2 Gross Profit Margin

Gross profit was calculated by subtracting the cost of goods sold (COGS) from total sales revenue, it can indicate the operational efficiency, overall profitability, and financial well-being of a company. This number can be used to calculate the gross profit margin of a company, by dividing the gross profit by sales revenue, then express as a percentage.

From Table 2 and 3, the gross profit of each company was used made a graph to visualize their trend. The graph is shown in Fig. 2 below. Then the calculation of the gross profit margin of both companies were done, then the result was combined into the graph shown in Fig. 3.

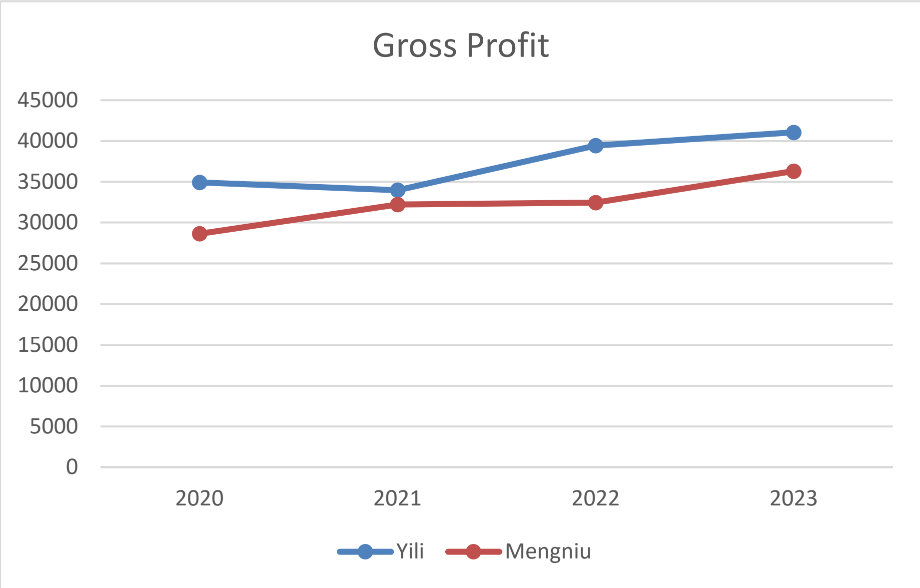

Fig. 2. Gross Profit of Yili and Mengniu (2020-2023)

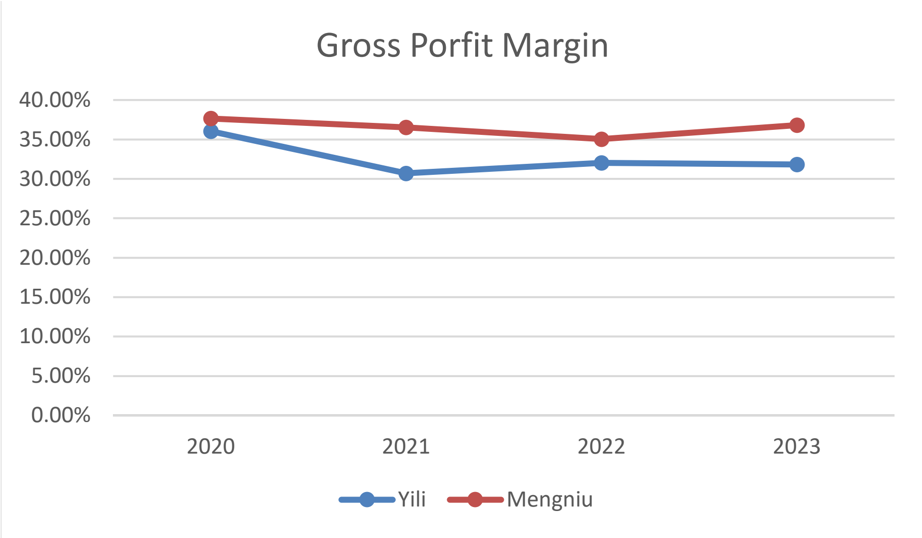

Fig. 3. Gross Profit Margin of Yili and Mengniu (2020-2023)

As shown on Fig. 3, Yili has a higher gross profit than Mengniu for four consecutive years, although Mengniu also displayed a consistent trend of increase in its gross profit. Yili was having a greater consumer loyalty from worldwide, it was the only Chinese brand that satisfied the requirement and gained its spot for advertising in the 2008 Olympics. The strong customer base and market power owned by Yili provided them advantage when competing with Mengniu in the following years. However, the Fig.4 indicated that both companies was having a decrease in their gross profit margin between year 2020 to 2021. Although the gross profit margin between 2021 to 2023 remained constant with a slight fluctuation, the number still came to be lower than in 2020. Possible factor that influenced this trend is the decreasing price of dairy product, and the increasing cost of producing in the dairy industry. However, their operating efficiency and financial wellbeing was relatively stable, hence both Mengniu and Yili displayed outstanding profitability in the industry.

3.3 Net Profit Margin

Net profit margin is a ratio of net profits to revenues for a company, in compared to gross profit margin, net profit margin appeared to be a bottom line of the operation of a company. Net profit margin tends to be more accurate than gross profit margin. The calculation of net profit margin subtracted operating expenses, debt interest, taxes, and COGS from total revenue to get net income, eventually divided by the total revenue.

Table 4. Net Profit Margin (TTM and 5 year Avg.) of Yili and Mengniu

	Net profit margin (TTM)	Net profit margin (5-year Avg.)
Yili	10.16%	7.94%

Mengniu	4.88%	5.28%

According to the data displayed, Yili remained to have a higher net profit margin (TTM), not only to its 5-year average, but also the net profit margin (TTM) of Mengniu [8]. Currently, the net profit margin (TTM) of Mengniu appeared to be lower than its 5-year average, indicating that Mengniu was facing a decrease in its overall efficiency. It is possible resulting from its cost when inventing or innovating its products and production process [9]. However, it still expressed a signal to the examiners that Yili has a relative better profitability than Mengniu currently.

3.4 Operating Margin

Operating margin illustrates the percentage of revenue that companies keep as operating profit. This number can inform both business owners and investors on the efficiency of company convert its revenue into a unit of profit after accounting for all the expenses required to run the business. It was calculated by dividing operating profit by total revenue and displayed as a percentage.

Table 5. Operating Margin (TTM and 5 year Avg.) of Yili and Mengniu

	Operating margin (TTM)	Operating margin (5-year Avg.)
Yili	9.08%	5.53%
Mengniu	8.22%	4.55%

The operating margin of Yili was higher than Mengniu by 0.86%, which indicate that Yili has a higher profitability in compare with Mengniu, it might be a result from the different targets from each corporation. Mengniu was focusing more on its product quality assurance [10], while Yili was imporving more on its operation efficiency. In compare with their own 5-year average data, both Mengniu and Yili has a higher operating margin in current stage, which indicate that both companies were performing well in their profitability.

4 Forecast and Discuss

According to the present data from Mengniu and Yili, their future performance in the dairy industry can be predicted in using their net profit.

Net profit refers to the profit that a company generated after reducing all the total expenses of that company. In the case of Mengniu and Yili, assuming their net profit growth rate from 2023 to 2024 would keep constant with the growth rate from 2022 to 2023, the future net profit of Mengniu and Yili can be predicted.

Table 6. Net Profit, Actual Growth Rate, and Prediction

	2022A	2023A	Growth rate (2022-2023)	2024E
Mengniu	5184804	4886975	-5.74%	4606462.64
Yili	9318205.87	10284306.2	10.37%	11359788.8

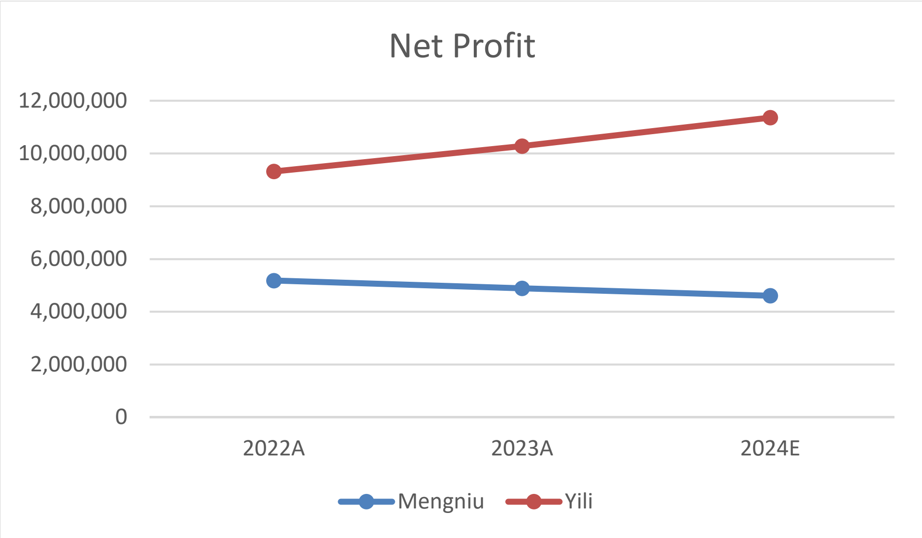

Fig. 4. Net Profit, Actual Growth Rate, and Prediction

From 2023 to 2023, Yili has a positive growth rate in its net profit by 10.37%, therefore if the growth rate from 2023 to 2024 remained to be in the same gradient, Yili would have a continuously increasing net profit, forming a positive liner graph. Opposingly, Mengniu not only have a lower net profit in compare with Yili, but it also has a negate rate of growth in net profit. Therefore, it is predicted that Mengniu is possibly going to have a decrease in its net profit from 2023 to 2024.

5 Conclusion

Within the social background, the consciously increasing demand for daily nutrients encouraged the saturation of the dairy industry. Both Yili and Mengniu had different attempts and strategies made to face the potential challenge from competitors, while they also maintained and increased their market share. Generally, Yili focused more on the speed of efficient operation, while Mengniu is more onto the speed of development and overall. Through the profitability analysis of Yili and Mengniu, although Yili was predicted to have a better performance than Mengniu in future, both companies displayed great potential in generating profit.

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