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SPOILING THE RECIPE

Flavor Experiment for KitKat Leaves Nestlé With a Bad Taste

Effort to Extend Brand in U.K. Leads to 18% Drop in Sales; Now, It's Back to Basics

Passion Fruit, Lemon Yogurt

By DEBORAH BALL

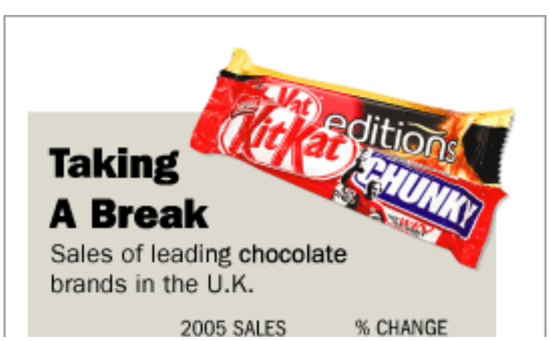
(See Corrections & Amplifications item below.)

YORK, England -- KitKat bars have been among the best-selling candies in Britain since they were invented here in the 1930s. Forty-seven of the chocolate-covered wafers are eaten every second in the United Kingdom, KitKat says.

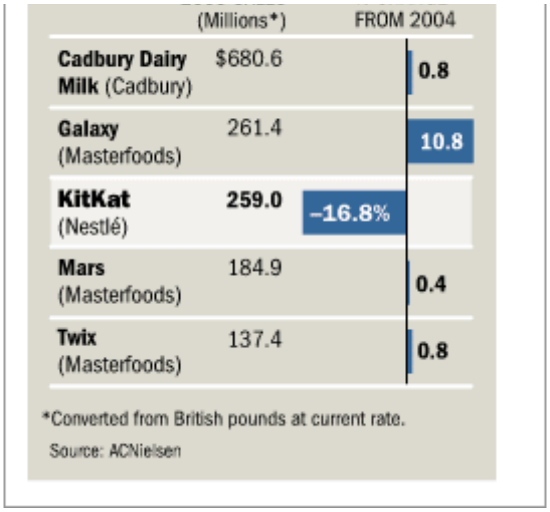
So it was natural for its maker, Nestlé SA, to apply to KitKat a marketing strategy that is becoming increasingly popular at food companies world-wide: extending a popular brand into new flavors and styles. The world's biggest food company brought a hotshot executive in from Australia in 2003 to find ways to add variety to the basic KitKat brand in the U.K.

Over the course of the next year, the company rolled out a dizzying array of new KitKats. For the summer months, it launched strawberries and cream, passion fruit and mango and even red berry versions. In the winter came "Christmas pudding" and tiramisu, which contained real wine and marscapone. Even though Britons never fully embraced the Atkins diet craze, the company launched a low-carb version.

The experiments flopped. In just two years, KitKat's overall sales in the U.K. dropped 18%, to $253 million for the 52 weeks ending in April. Nestlé recently abandoned virtually all of its exotic flavors. The executive in charge of the gambit has been replaced. And Nestlé's experience has become a lesson in the perils of trying to push new versions of much-loved brands too hard. "You could call it hyperventilation," Peter Brabeck, Nestlé's chief executive recently told reporters.



Finding new ways to sell old brands is easier than launching new and untried products, especially since marketers are finding it harder than in the past to reach a mass audience through advertising. Retailers such as Wal-Mart Stores Inc. are driving the brand-extension approach, too, by becoming stingier with shelf space. Often they stock only what they call "power brands," or a few best-sellers.



That has led Nestlé's rival Kraft Foods Inc. to turn Oreo cookies into Oreo ice-cream cones, an Oreo pie crust, miniature Oreos, and "spring themed" Oreos with purple filling. Consumer-products companies have followed suit, with Unilever turning Dove from hand soap to shampoos, lotions and facial cleansers. Though the results of these efforts are a mixed bag, food makers are sticking to them. Only 5% of new food and household products were new brands last year, down from 20% 10 years ago, says Information Resources, a Chicago-based consultancy.

"Line extensions are a lot less risky, while new brands tend to be fewer and far between now," says Tom Vierhile, analyst with Datamonitor, a consumer-goods consultancy based in London. "Companies would rather bat singles and doubles than aim for the fences and hit a home run."

KitKat is a global brand with $1.6 billion in 2004 sales, according to research firm Euromonitor. The classic KitKat was invented in 1935 by a York-based chocolate maker named Rowntree. It soon became a British candy mainstay. Britons typically ate a KitKat along with their midafternoon tea. Its ad slogan, "Have a break, have a KitKat," has been one of the best-known slogans here since it was introduced in 1957.

In the early 1970s, Rowntree sold the rights to sell KitKats in the U.S. to Hershey Inc. The Hershey, Pa., company has been conservative with the KitKat brand, sticking to subtle changes such as a dark-chocolate version and limited editions such as an orange-and-cream flavor for Halloween. It plans a caramel flavor at the end of this year. Sales of the brand, which is the sixth-largest candy in the U.S., have largely been flat in recent years, while the overall U.S. chocolate-candy market shrank in 2005.

In 1989, Nestlé bought Rowntree with plans to aggressively expand KitKat internationally. The Swiss foods giant, which sold $8.8 billion in confectionery and biscuits last year, pushed the candy during the 1990s in new markets such as China, India and Eastern Europe, making it the world's No. 2 chocolate candy bar after the Mars bar. In the U.K., the company took pains not to tinker with its popularity for much of the 1990s. It occasionally launched limited-edition versions in different flavors, but only for a couple of months each year, and stuck to flavors such as peppermint and orange, proven winners in chocolate.

A Chunky Hit

Nestlé's U.K. chocolate business peaked in 1999, with the launch of KitKat Chunky, a large single-finger bar, aimed at younger consumers and its first major extension of the brand. It was such a hit that Nestlé struggled for a while to produce enough to meet demand. But within three years, the novelty of the Chunky was wearing off and sales were down sharply. Even worse, sales of the traditional four-finger KitKat declined because the Chunky bar was cannibalizing it. Another brand extension -- KitKat Kubes, a miniature version of KitKats -- was struggling soon after its launch in the fall of 2003.

The rest of Nestlé's U.K. candy business was struggling, too. A costly project to launch a premium chocolate bar called Double Cream failed. Moreover, with advertising costs rising and more pressure from retailers to pay for prime display space, Nestlé found it difficult to support the more than 20 different brands it had in the U.K. Nestlé decided to make cutbacks in the KitKat brand to save money. It scaled back advertising and reduced the sales

Peter Brabeck

force. It even shaved the amount of chocolate used on the traditional KitKat bar, prompting customer complaints.

In the meantime, Nestlé was facing pressure from other changes in the big and fiercely competitive British candy market. Britons eat 19.4 pounds of chocolate per capita each year, compared with 11.6 for Americans, according to European candy trade group Caobisco. Starting in 2002, Cadbury Schweppes PLC simplified its jumble of candy brands and introduced new packaging in many of its products, boosting sales. It also poured millions into agreements with supermarkets to give its candy bars prime display space, such as the end of the shopping aisle.

Cadbury's U.K. chocolate business grew 8% in 2002. By contrast, Nestlé's U.K. candy sales were declining, dragging on its global candy business. The global business grew by only 0.8% in 2002, after adjusting for currency movements, and declined 4.2% without those adjustments, to $8.8 billion.

In November 2003, Nestlé drafted Chris White, a New Zealander and former Coke marketer, to revive the fortunes of Nestlé's chocolate brands in the U.K., of which KitKat made up about a quarter of sales. After joining Nestlé in 2001, Mr. White had impressed Mr. Brabeck, the CEO, by doubling the size of Nestlé's Australian ice-cream business in little over two years. His strategy: introducing a lot of new varieties and reorganizing the sales force.

Mr. White, then 41 years old, was given a target of increasing sales for the U.K. candy business by 3% in 2004. But the budget was tight as the company wrote off millions of dollars in investment in KitKat Kubes. In an effort to come up with low-cost innovations, he decided to introduce a slew of new KitKat flavors that had worked well in other countries such as a lemon yogurt version that Germans liked. Early tests in Britain also indicated the flavor might work there. Flavored versions of the classic four-finger bar had the virtue of being inexpensive to make. Using existing production lines, the company simply switched the recipe for the chocolate.

After rolling out one product after another in the first year, the company dumped the "Have a break, have a KitKat" slogan because it had become so familiar that it no longer seemed to be selling candy, according to a person familiar with the situation. The new version: "Make the most of your break." Nestlé officials in the U.K. thought the change would bring new attention to the brand, while not completely doing away with the old slogan.

Early Success

Initially the strategy worked. In 2004, Nestlé's U.K. chocolate-candy business stopped shrinking and its market share stabilized, as curious consumers tried the new flavors. The flavored variants amounted to about 5% of sales at their peak.

Too Many Flavors?

Flavored KitKat bars launched in the U.K. in 2004 and 2005 and later discontinued:

- Blood Orange
- Christmas Pudding
- Dark Chocolate
- Lemon & Yogurt
- Lime Crush
- Mango & Passionfruit
- Red Berry
- Seville Orange
- Strawberries & Cream
- White Chocolate

Source: Nestlé

However, by early 2005, some shopkeepers say they noticed that their regular customers were complaining the candy tasted strange or too sweet. They weren't interested in trying the new flavors a second time. The new flavored KitKats began piling up in warehouses around the U.K.

Colin Snead, a 24-year-old Londoner, has been a fan of KitKats since he was a kid, often stocking up on them so he can eat one with his afternoon tea. Curious about the new flavors, he tried the new strawberries-and-cream variant last year. "It was a bit sickly and sweet," he says. "It wasn't what I wanted from a KitKat. That was it for me. I noticed the red berry flavor, but after that strawberry one, I stuck with the normal KitKat."

Distributors started heavily discounting the unsold candies as the KitKats approached their expiration dates, often demanding that Nestlé pay the difference. Nestlé relies on the distributors to deliver to stores but often pays for unsold goods that are returned. One big distributor, Bestway, slashed the prices of some flavors, such as the passion fruit and mango KitKat, by as much as 90%. Even at that price, Bestway managers couldn't sell it all and had to throw some stock away.

'Flooding the Market'

"They were flooding the market," says Arshad Chaudhary, head buyer for Bestway. "Initially, we were comfortable with one or two varieties, but when they started coming out with another one every few months, it became a joke."

In the spring of 2005, Mike Hudson, who buys up heavily discounted items to sell in open-stall markets, started buying the flavored KitKats. He paid about 90 cents per 36-bar box, compared with Nestlé's full price of about $20. He sold it on to owners of market stalls, who then tried to sell it to bargain-hunters at about $1.85 a box. But even at that price, some of it wouldn't sell, he says. "I love KitKats and I normally love anything orange flavored, but this was absolutely awful," he says of one of the KitKat versions.

As 2005 wore on, Mr. White canceled the launch of other new flavors in the works. He also hired third-party sales people to help get mom-and-pop shops -- a particularly big seller of candy in the U.K. -- to take special displays and promotional materials to help grab the attention of shoppers.

Nestlé's rivals made the most of its problems. Salespeople from Masterfoods, which makes Mars, Twix and Snickers, showed sales figures and articles in the trade press detailing KitKat's woes to mom-and-pop shops, according to a person familiar with Masterfoods' marketing. They tried to persuade the owners to take the flavored KitKats off the main candy counter and put them in discount bins. A spokesman for Masterfoods declined to comment.

Last year, sales of Mars's top-selling U.K. candy, Galaxy, grew to $264 million, up 10.8% over 2004, according to ACNielsen. Meanwhile, KitKat's whole range declined by 16.8% to $260 million.

"They've ripped up 100 years of brand investment," says Mike Hughes, chief executive officer of marketing group CPM, whose major clients include Masterfoods.

Last fall, Nestlé decided to remove Mr. White, offering him a job in Australia. In November, he quit.

"White was very successful in running an ice-cream business," Mr. Brabeck told reporters earlier this year. "In ice cream, you have new products and they live a season. But the situation in confectionery is not the same. It is a much more stable business."

Nestlé drafted Paul Grimwood, an executive at its headquarters in Vevey, Switzerland, to fix the troubled business. Among his first moves was to arrange for call centers to ask consumers what bothered them about KitKat. The callers complained that they didn't like the flavored versions and sometimes couldn't find the classic KitKat bars amid the new varieties.

"They were saying, 'Why?' " Mr. Grimwood says in an interview. "They said it was nice to try them once, but I'm not sure I'll buy them again."

Cutting Back

Within weeks of taking over, Mr. Grimwood axed most of the flavored KitKats, leaving only tiramisu and caramel, which had performed better. He then drew up a marketing plan to spend more than $24 million this year -- about triple the 2005 amount -- to revive the basic KitKat brand. And he brought back the "Have a break" slogan in advertisements.

Still, lacking an alternative strategy to brand extensions, Mr. Grimwood in March launched a peanut-butter version of KitKat Chunky, figuring that the proven combination would be a winner.

According to Nestlé figures, sales of KitKat Chunky bars, including both the peanut butter and chocolate varieties, rose 66% in the first five months of the year, compared with the same period in 2004. Sales of the traditional four-finger KitKat, which had declined by about half between 2000 and 2005, are up 12%.

After the summer, Mr. Grimwood will introduce some other changes, but they will be modest. "What we're not going to do is come out with tens of dozens of new activities that we throw at the wall in the hope that something will stick," he says.

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Corrections & Amplifications:

Forty-seven KitKats are eaten every second in the United Kingdom. The initial version of this article incorrectly said one of the chocolate-covered wafers is eaten every 47 seconds in the U.K.

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