From commodity to customer value

The transition from a production-oriented to a market-oriented European dairy industry

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Using such terms as 'demand-driven chains and networks', a transition seems to be taking place from production-oriented to market-oriented firms and systems in agribusiness. The objective of this report is to increase our insights into the transition to market-oriented agribusiness. To do so, we develop a model and apply it to two cases in the European dairy industry, namely Friesland Foods and Nordmilch. The transition from production-oriented to market-oriented happened relatively recently in dairy, and its impact has been quite dramatic. These cases may help us to understand and improve strategies in dairy and other industries.

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Preface

In recent years the Agricultural Economics Research Institute (LEI) has conducted various studies concerning the development of market-oriented agribusiness. It became clear that there is a need for more insight into the transition to market-oriented agribusiness, also in relation to the international competitive power of the Dutch agribusiness firms. The purpose of this project is to increase our insights in that transition. This report is the result of the comparison of two cases within the European dairy industry, i.e. Friesland Foods and Nordmilch. During the realisation process of this project, we benefited from discussions with Gerhard Schiefer, Karin Holm-Müller (both from Bonn University) and Mathias Vogelsang. We are grateful for their willingness to participate in the discussion on market-oriented agribusiness.

Dr J.C. Blom
Director General LEI B.V.

Summary

The European food industry has been regulated for a long time. Since the 1960s, the European market has been protected from imports by relatively high taxes. Companies in Europe therefore never had to fear real competition from outside the Union in their domestic markets. This changed, when, due to WTO negotiations, markets had to be more deregulated. Facing international competition, within the European food industry the concentration increased, leading to unified, oligopolistic markets. Trying to realise scale and scope effects, companies adopted growth strategies both within their national and international markets. Although scale and scope effects are still important, the focus to increase profitability and secure company survival is differentiation, or the creation of customer value in products and brands. Using such terms as 'demand-driven chains and networks', 'turning around chains', 'consumer orientation', 'customer orientation' or 'market orientation', a transition seems to take place from production-oriented to market-oriented firms and systems in agribusiness.

The objective of this report is to increase our insights in the transition to market-oriented agribusiness. We develop this model from a theoretical perspective, building on industry evolution and punctuated equilibrium theory, as well as Tedlow's development model for marketing. We test this model and improve it by conducting a multiple, holistic case study in the dairy industry. The transition from production-oriented to market-oriented happened relatively recent in dairy, and its impact has been relatively dramatic. Within the European dairy industry, we compare two cases, i.e. Friesland Foods and Nordmilch.

Overall, our cases provide support for the model. Both companies moved from a more fragmented industry structure, to a phase in which they increased scale and scope, and subsequently recognised the creation of customer value as a new key success factor (although Friesland was more able to respond to that than Nordmilch). An important exception is that our results also show that Friesland has throughout its history been an international company. The fact that Friesland (and some other European dairy firms) have operated in an international environment throughout its history and thereby learning from multinationals like Unilever and Nestlé that were encountered in the market, has influenced its mode of learning, development of marketing capabilities and brands, and contributes to the industry transition from production-oriented to market-oriented as a whole.

To arrive at where it is now, Friesland adopted a pattern of continuous change early in its existence. Its brands, market positions abroad and marketing capabilities were gradually developed in a step-by-step manner. This contrasts strongly with the pattern of change we found at Nordmilch: for a long time it was successful with the strategy it had, due to its large domestic market and defining itself as a German rather than a European dairy firm, it could continue this strategy without being too much bothered by the changing environment of the European dairy industry. Once it received signals that the strategy was no longer feasible in the business environment (like a historically low milk price and the

entrance of a new competitor, Campina), it went through a transformation in which leadership, power structure, organisational structure, business unit strategy and core values and beliefs changed. These findings suggest that in order to become a company at the forefront of the industry, continuous change is a requirement rather than an advantage. Punctuated change leaves companies with the remaining strategic options in the industry, whereas companies that are also changing in a punctuated fashion but respond relatively late, are the ones that are absorbed by the others searching for scale advantages.

On the basis of these results, implications are drawn for the dairy industry and extensions are drawn for other industries.

1. Introduction

The European food industry has been regulated for a long time, first by national governments and later by the European Union. Since the 1960s, the European market has been protected from imports by relatively high taxes. Companies in Europe therefore never had to fear real competition from outside the Union in their core markets. There were even minimum prices for most raw food products (such as milk powder and grain), due to European intervention policies. Only a few companies were internationally active; the majority were only regionally or nationally oriented.

This changed, when, due to WTO negotiations, markets had to be deregulated more and more. In the face of international competition, the concentration increased within the European food industry, leading to unified, oligopolistic markets. Trying to realise scale and scope effects, companies adopted growth strategies within both their national and international markets.

Nowadays, scale and scope effects are still important, but looking at the big international players, differentiation becomes more important. In particular, market research and marketing have become important in order to develop a market-based product innovation 'in such a way that buyers perceive a lasting improvement in the relationship between price and value, relative to competing products' (Grunert et al., 1996). Using such terms as 'demand-driven chains and networks', 'turning around chains', 'consumer orientation', 'customer orientation' or 'market orientation', a transition seems to be taking place from production-oriented to market-oriented firms and systems in agribusiness. In the production-oriented phase, the commodity product was central. Resources were deployed to produce this commodity as efficiently as possible and in sufficient quantities to feed the local population. In the market-oriented phase, the consumer's wants and needs are central. Resources are deployed to develop product innovations that meet latent or evident customer needs and offer superior customer value to predefined market segments.

The objective of this report is to increase our insights into the transition to market-oriented agribusiness. By developing a theoretically generalisable model of the transition from production-oriented to market-oriented agribusiness, it can be used to increase insights into industries that are currently moving from a production orientation to a market orientation, or are trying to initiate this transition.

We develop this model from an industry evolution perspective by a case comparison in the dairy industry focusing on Friesland Foods and Nordmilch. To the best of our knowledge, the change towards market orientation has not yet been analysed from the perspective of lifecycle or evolution theories. Various studies have been carried out, mainly focusing on the US market (Barkema, 1993; Boehlje, 1999; Hendrickson et al., 2001). All these studies establish that the developments in the agrofood industry - which are often referred to as the 'industrialisation of agriculture' - mean that companies must fulfil new requirements in order to be successful in doing their business. According to Yin (2003), of all research methods the case study method is the best one to apply when dealing with 'how' and 'why' questions on a contemporary phenomenon in which the researcher has little control. Especially when dealing with emergent phenomena on which little information (exploratory phase) is available, case study research is very useful (idem.).

This report is organised as follows. The theoretical background to structural change in the industry is explained in Section 2. In Section 3, the method is described. Section 4 presents a description and comparison of the two cases. Section 5 consists of a discussion, conclusions and recommendations.

2. Theoretical approach

This section provides an explanation of the development of companies and industries over time. It focuses on industry lifecycle theories, punctuated equilibrium theory and Tedlow's (1990) three phases of marketing. A model for agribusiness is developed on the basis of these three major theories.

2.1 Industry lifecycle

Lifecycle theories are used in various fields. Among these theories are models for single products, for organisations and for whole industries. The four phases of a lifecycle are (1) introduction, (2) growth, (3) maturity and (4) decline. 'As the industry goes through its lifecycle, the nature of competition will shift' (Porter, 1980). In the lifecycle theory, key factors that interact to drive the lifecycle include exogenous and endogenous technical change, rates at which firms imitate one another, differences in segmentation of customers, variation in the initial efficiencies of firms, and random factors that set the industry along a specific evolutionary path (Gort & Klepper, 1982; Klepper & Graddy, 1990).

The theory of product lifecycle states that products have a limited life and thus cannot be sold forever. Also product sales pass through distinct stages, each of which presents the seller with different challenges, opportunities and problems. Profits rise and fall at different stages of the product lifecycle, and products require different marketing, financial, manufacturing, purchasing and human resource strategies in each lifecycle stage.

Technology and scientific progress are strongly interactive with lifecycle models. This applies especially to the S-curve model of technical change (Foster, 1986). It has been used for decades to represent four key ideas about the relationship between the efforts devoted to innovation and the level of technical performance in an industry, namely: (1) early in an industry's development, efforts to innovate yield only marginal improvements in technical performance; (2) after an initial period, efforts to innovate yield large improvements in technical performance; (3) as an industry ages, additional efforts to innovate yield only marginal improvements in technical performance; (4) disruptions of the trajectory of technical progress tend to occur late in an industry's development, and involve an initially dramatic drop in technical performance and the transition to a new industry (McGahan et al., 2004).

Empirically testing the S-curve model, Sood and Tellis (2005) found that over time, technology follows multiple S-curves rather than a single one. They also found that improving an existing technology can lead to success even if a newer technology is already on the market. On the other hand, if new technologies are ignored by the existing companies, those with low performance in new niche started technologies can 'grow into mass market and replace the old technology' (ibid.).

2.2 Punctuated equilibrium theory

The theory of a punctuated equilibrium (Romanelli & Tushman, 1985; 1994) focuses on the way organisational change appears. Romanelli and Tushman's findings indicate that changes occur incrementally as well as radically, whereas radical changes - which the authors call reorientations or re-creations - are inevitable and affect fundamentally an organisation's strategic orientation and subsequently performance in a sustainable manner.

Punctuated equilibrium theory originates from biology, suggesting that species go through extended periods of stability interrupted by short, discrete periods of change (Gould & Eldredge, 1977). Gould and Eldredge argue that speciation through spatial isolation would produce new gene pools that differ sharply from parental pools. Gersick (1991) discusses the largely independent emergence of punctuated equilibrium models in biology (Gould, 1989), sociology (Kuhn, 1970) and psychology (Levinson, 1986), and at several levels of analysis in organisational theory.

The punctuated equilibrium model was mainly first worked out and used for the evolution of organisations by Tushman and Romanelli (1985). Their initial article has been cited more than 400 times (Google Scholar, 2005) and is one of the most influential articles in organisation evolution theory. Empirical literature tested the punctuated equilibrium and supports this theory in different industries, including airlines (Kelly & Amburgey, 1991; Miller & Chen, 1994), savings and loans (Haverman, 1992), minicomputers (Tushman, Virany & Romanelli, 1985), cement (Anderson & Tushman, 1990) and newspapers (Amburgey, Kelly & Barnett, 1993). Tushman and Romanelli (1994) note that processes within the organisation that shape convergence and punctuations are relatively poorly understood and that here more research is needed.

In this theory, organisations are seen as evolving through longer periods of stability, with punctuated interruptions of short revolutionary periods of change (Tushman & Romanelli, 1985; Romanelli & Tushman 1994; Gersick 1991; Miller & Friesen 1984). Tushman and Romanelli (1985) define five domains of organisational activity, namely: (1) core values and beliefs (why, how and where a firm competes); (2) business unit strategy (markets, products, time, technological constraints); (3) intra-organisation power distribution (control of allocation of scare resources); (4) fundamental structure (formalization of hierarchy, role relations and competitive emphases); (5) control systems (emphasis on efficiency).

According to Tushman and Romanelli, these domains are critical 'in characterizing organisations as they pursue a strategic orientation' (ibid.). If changes in one or more of these domains are recognised, this can be seen as an indication that the organisation requires a *reorientation* or *re-creation*. Periods of reorientation include simultaneous discontinuous shifts in strategy, the distribution of power, structures, and control systems. A recreation - a special case of reorientation - also includes a discontinuous shift in the firm's core values and beliefs. These changes occur mainly after longer periods of low performance or major changes in the 'competitive, technological, social and legal conditions of the environment' (ibid.).

Convergent periods are determined by stability. Middle and executive management focus on holding 'consistencies both among activity domains and that support a strategic orientation and between the strategic orientation and external environmental conditions' (ibid.).

Changes in this phase are considered to be incremental, and are mainly managed by middle management. As long as environmental influences are constant, long-lasting convergent periods are considered to be positively related to performance, whereas social complexity and interdependence within an organisation become more complex. Managing these increasing complexities whilst aiming for consistency creates resistance to radical change. During these convergent periods organisations get more and more into the modus of inertia.

Reorientations and recreations are triggered by both internal and external factors. Internal factors mainly result from inertial forces within an organisation, which lead to inflexibility regarding the competitive forces and therefore to low performance and, in turn, to organisational turbulences. Companies that do not initiate and successfully implement strategic reorientations or choose inappropriate reorientations will be selected out by the environment (ibid.). Especially in phases of declining industries, this can lead to a higher concentration because the successfully reorientated companies take over the unsuccessful ones or the latter leave the market for good.

Convergent periods and reorientations are clearly distinguishable. In their further empirical work taken from the computer industry, Romanelli and Tushman (1994) hypothesise that 'small changes in individual domains of organisational activity will not accumulate incrementally to yield a fundamental transformation.' Thus, evolutionary changes occur in the strategic orientation of an organisation as 'short, discontinuous bursts of change involving most or all key domains of organisational activity', triggered as already mentioned by changes in environmental conditions or major declines in performance.

Special attention is paid to changes in executive leadership. Bounded rationality causes inertia with its positive as well as negative impacts on an organisation's performance. In the sense of organisational inflexibility towards external and internal changes, inertia is regarded to be source of negative impact. Hence Romanelli and Tushman (ibid.) state that the 'installation of a new CEO will significantly increase the likelihood of revolutionary transformation'. If organisations master revolutionary change successfully, increasing performance is likely to be observable, whereas the risk of failure during these periods of transformation should not be ignored.

2.3 Tedlow's three phases of marketing

Tedlow (1990) researched the history of the US market and came up with three phases of consumer product marketing, namely *market fragmentation*, *market unification* and *market segmentation*. Tedlow's categorization into the three phases was later on regarded in book reviews as 'very useful' (Walker Laird, 1991), 'fascinating' (Fullerton, 1991) and 'intriguing' (Taylor, 1994).

In the first phase (fragmentation), the whole US market was divided into 'countless geographic fragments' (Tedlow, 1990). Due to an incomplete railroad network and exploitation of telephone and telegraph, until the 1880s only those products that were easy and suitable to transport had a national market. On these geographically limited markets, high margins were possible for the companies. In the second phase (unification), which ended in 1950, a national market with good infrastructure and political and economical stability existed in the US. As a result, the strategic characteristics included higher volumes but lower margins, due to higher competition for the companies. The third phase (segmentation) extended from the 1950s to the 1990s. In this phase, the consumers were segmented and value-pricing became possible for companies.

2.4 Model of the development in dairy industry

The following figure introduces the model for this research project. The horizontal axis shows the market structure through time. Information about major strategic management focus in the European dairy industry can be taken from the vertical axis. After having taken Tedlow's categorization and using it for the European dairy market with regard to the processes described above and developments, three main phases of industry and corporate development and management focus can be identified.

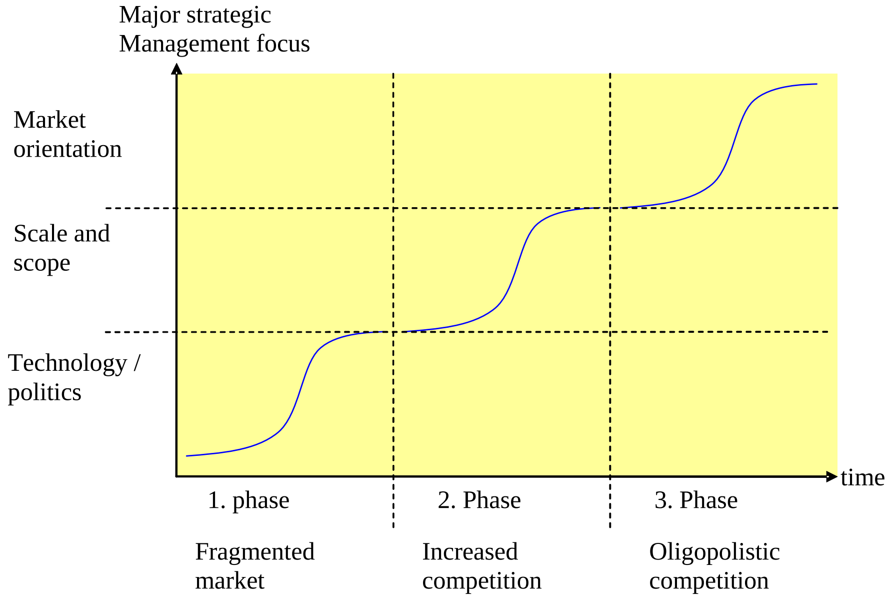

Figure 1 Phases of evolution in the European dairy industry of recent decades

The structure of the European dairy market is comparable to the one Tedlow (1990) describes for the latter part of the 19th century in the USA. In European dairy, during the first phase in the 1980s and before, the dairy industry's focus was mainly on politics and the local market. The mainly small companies used technology, processes, etc. only looking at the production side. It was a time of incremental growth for the majority of companies in the dairy industry. But some companies used this time to grow internationally or diversified into other sectors and thus became independent of the local markets.

When the environment changed too much, the equilibrium was interrupted until a new phase was built. This consisted of high competition in the market and management that mainly looked at economies of scale and scope. Similar to Tedlow's (ibid.) description of 'unification', here too smaller producers were taken over and a wave of consolidation swept across Europe. In particular vertical integration was seen as a good option for cutting costs. With their financial power, the big international players used this opportunity and applied their capacities and know-how to successfully build up new brands or to buy successful companies and their existing brands in many European markets.

Similarities to the European agrofood market can be seen in Tedlow's (ibid.) description of the US market from the 1930s to the 1970s with increasing market segmentation, high volumes and value-pricing strategies. Another shock, which originated mainly from the increased power of retailers and changed consumer claims to food, introduced a change for the dairy industry. In new phase -when in most European countries the dairy industry formed oligopolies - market and customer orientation have become the major strategic success factors for companies.

2.5 Summary

The theory underlining this research project has been explained in this section. Due to industry analysis theories like the lifecycle theory, but also the theory of punctuated equilibrium a deeper look into developments leading to changes in competition is taken. Even change-avoiding companies are part of this system. Following the theory, once when the changes are too big, they have to adapt and then it can come to a reorientation or even a recreation of the company and its strategies. Therefore a model originating from Tedlow (1990) has been adapted to the developments in the European dairy industry. It classifies the companies into different stages, but over time the companies are trying to follow one another on the next level. Levels in the industry structure are fragmentation, increased competition and oligopoly. In the management focus, these are governmental policies, the generation of scale and scope effects and finally a stronger market orientation.

3. Methodology

3.1 Research methodology

Yin (2003) summarises the main advantages of using a case study as a research method: (1) it provides a large quantity of data on how and why a process is occurring; (2) it is strongly recommended for the analysis of new phenomenon and for theory building; (3) it is a good tool for learning about a specific phenomenon that is to be analysed; (4) it is a flexible method, allowing the researcher to change research procedures along the case.

According to Eisenhardt (1989), case studies can be used to provide a description, to test theory or to generate theory. The model presented in Section 2 is both tested and improved by the case studies. The first level of analysis is the industry. To study strategic changes and organisational development, however, we primarily focus on the company level. The individual companies are therefore the primary units of analysis from which we make inferences about industry development. Our study can thus be called a 'holistic multiple case study'. Such a study, in contrast to an embedded multiple case study, analyses only the global nature of an organisation and does not go deeper into embedded units of the case. This means that each company examined and its global strategy is analysed as a whole, and not separately for each of its departments or its departments' single strategies.

3.2 Case selection

First, we made a decision which industry to analyse. To this respect we analysed contemporary research reports on agribusiness and consulted three agribusiness experts. We decided to focus on the dairy industry because, compared to other industries, the transition from production orientation to market orientation in dairy relatively was recent, relatively fast and relatively dramatic. In beverages, for example, the creation of customer value through brands and product innovation has a much longer tradition, while in fresh meet (e.g. pork and poultry) the transition to a market-oriented industry is at best just beginning and perhaps even non-existent.

The European dairy industry has changed a lot in recent years. Increased concentration in most national markets with companies nowadays focusing more on Internationalisation and brand development is a result of technological innovations, globalization and politics (European unification, WTO negotiations). Especially the increased retail dominance in the supply chain as well as the changes in consumer demand with a stronger need for value added products, increases the pressure on companies to adapt their strategies.

Consistent with the model developed in Section 2, these changes in the competitive environment have influenced the strategies of European dairy companies. But companies realised the need to change their strategies at different times. Due to globalization and retail dominance, companies had to change from only local or national competition to international markets. Realizing this trend, some went global very early, while others remained focused on production in their home countries. Along with Internationalisation, some companies also entered other product markets. As a consequence, Nestle, Unilever, Kraft Foods and Danone are food companies that have a strong position not only in dairy but also in many other product categories, where they concentrate on selling premium priced products.

In recent years, the willingness of the consumer to pay premium prices for added value products, together with the technological ability to produce such products, has led to stronger branding in the dairy industry. Global food companies, such as Nestlé and Unilever, were among the first to recognise and use this trend by increasing their efforts in branding and innovation of value added products. The dairy industry is very innovative, and thus - even though it has become more difficult to develop new brands - still introduces some very successful new product innovations each year.

Differences regarding the implementation of these new fields into corporative strategies can be seen between some groups of companies. On the one hand, Nestlé, Unilever and Kraft Food, together with the European dairy companies Danone and Friesland Foods, are very active in adding value products; on the other hand, there is a large group of dairy companies that mainly focus on the production of commodity goods and that have some side activities with branded or added value products. Companies that were not able to compete against the multinational food companies regarding the development of brands or value added products had to look for new fields and markets. Thus some of them adapted their strategies by adding a stronger focus on B2B markets and the production of ingredients for the food industry. For supplying other companies, brands and advertising capabilities play only a minor role and thus also companies without these resources can be successful in this segment.

The dairy companies needed a long time to change their strategies and become successful in value adding. For example in the production of ice cream and chocolate, the industry overlaps and sometimes competes with other food companies that have stronger traditions in developing brands and product innovations (e.g. Kraft, Unilever, Nestlé and, to some extent, Danone). It was through these companies that traditional dairy firms learned how to change the mode of competition in dairy.

Box 3.1 Brief description of the transition to market-oriented agribusiness in the European dairy industry

Next, we decided which firms should be analysed more specifically within this industry. First, we developed a sampling frame of the 15 largest dairy firms in the EU (largest in terms of both dairy sales and amount of milk processed). Second, we determined theoretically relevant dimensions for differences between cases. Following the initial model developed in Section 2, our aim was to select one case from the bottom left corner of the model and one from the top right corner. For this reason we decided to select two cases that differ as much as possible with respect to (1) generic strategy (Porter, 1980), aiming to select one firm with a cost leadership strategy and one with a differentiation strategy; and (2) Internationalisation, aiming to select one company with a more domestic focus and one with a more international focus. International companies may learn faster because they are active in different environments (Walsh, 1995). Third, to improve case comparison we maximised similarity on other dimensions, in that both companies have comparable ownership structures (Nilsson & van Dijk, 1997), that dairy is historically the core activity of the firm (e.g. does not make ice cream) and that they are leading in that they appear on the list of the 15 largest EU dairy companies. Finally, we took into account such practical considerations as the ability to generate sufficient information on the cases. Following this procedure, we selected Royal Friesland Foods (hereafter referred to as 'Friesland') from the Netherlands and Nordmilch from Germany.

Friesland
Royal Friesland Foods is a multinational Dutch cooperative. Zuivelcoöperatie Friesland Foods U.A. holds Friesland's shares. The firm holds all shares of Royal Friesland Foods B.V. and Friesland International B.V. The former operates all Dutch activities, the latter all foreign activities. The work force consist of 16,800 employees, of whom 11,200 work outside the Netherlands. Friesland has not made many acquisitions outside the Netherlands in recent years. Its strategy is to improve the quality of turnover and the profitability of operations. This is done by focusing on those markets where a strong position for branded products can be established. This firm is looking not for new markets but to further expand the market shares on the markets it has already penetrated. Tight control of costs and a reduction of dependence on standard dairy products by generating a greater share of turnover through branded products, are ways that Friesland will follow to keep competitive (Friesland's homepage).

Nordmilch
Nordmilch is one of the largest milk processors in Germany and ranks among the top ten in Europe. It is structured along cooperative lines with ownership of the business in the hands of the milk producers. With its origins deep-rooted in the local region, the group is nonetheless active in the international arena. Four German dairy cooperatives (Bremerland-Nordheide, Hansano, MZO, Nordmilch) merged in 1999 to become the Nordmilch eG. The company's branded products are sold under the main brand name 'Milram' and the 'Oetker' label. Nordmilch leads the German market for flavoured quarks preparations with a share of 75 per cent. The main areas of emphasis are the extended European single market, East and Southeast Asia, the Middle East and other non-EU countries. (Nordmilch homepage)

Box 3.2 Descriptions of case companies

3.3 Data collection

Data were collected from different sources of evidence to follow a process of triangulation in building up knowledge from the cases. Especially the triangulation of different sources to square the findings if needed is an important factor for the choice of sources (Yin, 2003). For data collection, we used both desk research sources (e.g. annual reports, research reports, websites) and interviews with industry experts and top level company representatives.

All the interviews were conducted by two researchers. One asked the scheduled questions while the other stepped in when interesting topics that could need some more explanation arose. The interviews were taped and transcribed. If an interviewee wished, he or she could read the transcript of the interview and comment on it. The interviews were held at different places, usually at the office of the person interviewed.

In order to make the best use of the interviews, the follow up was ordered in the accessibility and importance of each interview for this project's chain of evidence (Yin, 2003). We started interviews with industry experts, using snowballing techniques to detect the prominent experts in the field. The persons were selected because they had worked on different topics regarding the dairy business. Twelve industry experts working at research institutes, universities, banks and industry organisations in Germany, the Netherlands and Denmark were interviewed. They hold a variety of titles, such as 'researcher', 'professor', 'market analyst', 'managing director' or 'chairman'. In addition to these industry experts, three interviews were held with members of the management of the competitors of Nordmilch and Friesland. This again helped to verify the different information from each source, by making use of triangulation. The persons interviewed held such titles as 'former CEO', 'research and development director or 'marketing manager'.

To gain a deeper insight into the development of each company, the focus of the interviews was on the people who had been with the firm for a longer period. To get a triangulation of sources, we interviewed in each company one person from the board of management, one from the supervisory board, and one or two department leaders. We conducted three additional interviews for Friesland and four for Nordmilch. The information from the interviews was compared with information from other sources, such as annual reports for the period 1980-2005 and research reports.

3.4 Case study constructs

As Eisenhardt (1989) recommends a 'prior specification of constructs … to shape the initial design of theory building research', this subsection defines the key concepts used in this research project and gives the operationalisation of these concepts. The concepts for this research project are mainly based on punctuated equilibrium theory (Tushman & Romanelli, 1985), which holds that *changes in business unit strategy, fundamental structure, intra-organisation power distribution*, *control systems*, and *core values and beliefs* can lead to reorientations or even re-creations of a business.

Business unit strategies

Here especially Porter's generic strategies play a role because a transition from production orientation to market orientation suggests that some companies changed their strategies from *cost leadership* in the usual industrial products like dried milk powder or tined milk to *differentiated* products (Tozanli, 1997). The differentiation of companies is indicated by market segmentation, R&D expenditures, branding and advertising. According to Porter (1985) for the cost leadership, economies of scale in production (e.g. milk intake) and sales (e.g. market share) are important indicators.

Fundamental structure

The model outlined in Section 2 suggests that companies have experienced considerable growth, leading to high concentration the European dairy industry in the 1990s (Tozanli, 1997). Johnson and Scholes (2002) defined three strategies for the companies' growth: (1) *internal development* (based on own resources); (2) *mergers and acquisition* (getting access to resources); and (3) *collaboration* (joint ventures, sharing of resources). Decisions to merge, acquire or align (e.g. by joint ventures or contracts) led to changes in the fundamental structure of the companies. Also looking from the resource-based view, Krishan and colleagues (2004) assess that 'mergers force a large-scale revaluation and transformation in organisational structure…'. In addition to the degree of growth, we will also look at its international scope. Additionally, the *ownership structure* (Bethel & Liebeskind, 1993; Thomsen & Pedersen, 2000) is of importance, as it 'increases the likelihood of organisational transformation' (Romanelli & Tushman, 1994).

Intra-organisational power distribution

Here, especially changes in leadership (including changes in top management or the appointment of new CEOs) have been elaborated by Romanelli and Tushman (1994). With respect to power distribution, especially the power balance between cooperative members and cooperative management boards is of interest.

Control systems

Mainly *financial control* systems like the 'balanced scorecard' (Kaplan & Norton, 1992) and *quality systems* (e.g. total quality management; ISO 9001) are of importance for this research project. Regarding the cooperative structure and changes regarding this in the chosen companies, the influence of the owners on strategic decisions and changes in this influence are looked at. Also quality systems present a key element of competitive advantage that requires an assessment not only of the companies' basic operations but also of their overall business strategy (Shani & Rogberg, 1994). Day (1994) discusses the role of total quality management (TQM). Successful implementation of TQM gives firms a quality focus, which often coincides with what customers desire. What distinguishes companies that use TQM is their ability to adapt internal processes to the needs of the market just enough to allow them to moderately differentiate their products, while working to improve processes and increase efficiencies, even if they do not have market orientation as a strategy (ibid.).

The *values and beliefs* of a company can also be regarded as its corporate culture, which Cameron and Freeman (1991) defined along two dimensions into four groups, namely clan, adhocracy, hierarchy and market. Here, *market orientation* can be included in the field of adhocracy, because it mainly focuses on the external environment and also values flexibility and adaptability (Day, 1999). According to Narver and Slater (1990), three main behavioural components are important for market orientation. These are *customer orientation*, *competitor orientation* and the *interfunctional coordination*. Additionally they give two decision criteria, namely *long-term focus* and *profitability*.

Figure 3.1 summarises these concepts and shows some sources of information or measurements for them.

3.5 Case Analysis

For each case we compiled an extensive case analysis report based on the information that had been retrieved from both desk research and the interviews. The reports include background information on the history and detailed information on the case study constructs. Differences between various sources of information could generally be interpreted from their context. Reports were returned to interviewees in order to check for possible inconsistencies. Based on their comments, a few small changes were then made in the reports. The final versions of the reports were used as input to the cross-case analysis. We began our analysis from the model described in Section 2. By comparing the cases and the model, we searched for congruencies and differences across the cases and the model. Following this iterative process in which the model was adapted and then returning to the data to see how our theory matched the data, and again returning to the theory for yet another revision, a theoretical model was developed (Eisenhardt, 1989).

Concepts	*Narrowed concept*	*Description*	*Measure / sources*
Case study analysis:			
Change in business unit strategy	Porter's generic strategies	Cost leadership: focus on process efficiency and scale and scope effects. Companies always try to save money by cheaper processes, products, etc. Differentiation: here *something unique (brand, technology, service, quality...) is produced. Positioning of SBUs is dependent not on costs but on the value added for the customer.*	– Standardization / specialization of SBUs or plants – Tight cost control systems. Low tolerance for exceptions – Price sensitivity of customers – Number of SBUs, different strategies for some SBUs – Amount of R&D expenses and marketing expenses
Change in fundamental structure	*Growth*	Growth takes place in three ways: internal, collaboration and, finally, by acquisition and merging. Especially strong growth within a short period can affect the whole structure of a company. From RBV reasons for growing can be: - development of capabilities and resources; - buying of capabilities and resources; - adding different capabilities and resources.	– Internal growth – Bought companies or SBUs – Mergers – Reasons for mergers, Acquisitions, etc. – Long-term effect in ROA or ROI after merging… – New or modernised plants with higher output

Figure 3.1 Summary of constructs

Change in fundamental structure	*Internationalisation*	Internationalisation is important for learning and thus for reacting faster to changes in the environment. Also has the positive effect of diversifying risks for a product.	– Number of countries for production – Number of countries for selling – Share of products sold/produced abroad – Share of turnover generated abroad
	Organisational and ownership structure	Here changes in the hierarchy and in the set-up of departments are regarded. Thus, a change from decentralisation to centralisation can affect the whole fundamental structure of a company. *A change in the ownership structure, (e.g. from cooperative to IOF) can have an impact on the relationship with suppliers and on how power is distributed in the firm.*	– Hierarchy – No of departments, SBUs – Independence of SBUs – Changes in ownership or majorities – Changes in legal form
Change in intra-organisational power distribution	*Change in leadership*	*A new CEO has the possibility to change the whole structure of the company, introduce new systems, etc.*	– New, external or internal CEO or board member – Number of changes over time – Way of change (planned or unplanned problems)
Control system	*Efficiency and quality control systems*	*To check if strategies are really implemented and structures really bring the wished effects, controls such the balanced scorecard are needed.*	– Do control systems exist? – How is their importance seen by mangers?

Figure 3.1 Summary of constructs (continuation)

Change in core values	*Market orientation*	*It is examined how far the companies look at the customer's wishes and wanted changes for their products to create value for them. Understanding of competitor's capabilities and strategies, in both the short and the long term to be able to reach customers in the same way or use the same or better technology. Different departments of the company work together to create customer value for the products and thus make use of their different skills and knowledge. For the implementation of market orientation and the relation to profit in market-oriented companies, a longer term focus is taken. Performance and profit are closely related to market orientation.*	– Element in the Mission of company – Structures in the organisation that support interaction with consumers – Measurement of customer satisfaction; after-sales service – Rapid response to competitors' actions – Information sharing among departments – Functional integration in strategy – All departments contribute to customer value – Constantly discover and implement additional value – Positive margin in long term – Acceptance of negative performance in short term, if outlook sees much higher performance in future

Figure 3.1 Summary of constructs (continuation)

3.6 Summary

This section described why a holistic multiple case study was chosen for the research project. One important feature of information generation was the triangulation of different sources: the main data were generated by interviewing industry and company experts and by analysing the annual reports of the companies chosen (i.e. Royal Friesland Foods and Nordmilch). Among the experts were former CEOs of the companies and their competitors. For the industry analysis and the case studies, core constructs from industry lifecycle for the industry analysis and punctuated equilibrium for the case studies were presented and explained.

4. Case study results

4.1 Royal Friesland Foods N.V.

4.1.1 Origin and development

The company's roots go back to 1879, when the Arnhemsche Melkinrichting was formed to deliver its customers fresh milk, butter and other dairy products. A few years later, the cooperatives Frico and Domo were established; in 1983, they merged to form the Noord-Nederland cooperative. Coöperatieve Condensfabriek Friesland (ccFriesland) was founded in 1913 in Leeuwarden as a second-order cooperative (i.e. it was owned by many smaller cooperatives whose aim was to produce and sell condensed milk in the UK). At the time, Friesland had no direct contact with the farmers; contact was via the primary cooperatives. The package of their first major product also allowed Friesland to label brand names on the products and thus helped to set the basis for the later core strategy to sell only branded products in predominantly foreign markets.

Royal Friesland Foods is an example of a company that grew through mergers in the home market (the Netherlands) and acquisitions or direct investments in foreign markets. Till the end of the 1970s, the major predecessor (ccFriesland) grew mainly abroad, especially in Southeast Asia. Due to the type of products and also a stronger acceptance of brands, the company also started here with its focus on the development of brand dairy products. Here the company had to adapt to changes in those markets. Thus in the beginning, Friesland only sold its products there, but due to political problems, the company had to make direct investments and acquisitions in order to stay in the markets. Today, Friesland is a strong competitor in many countries' dairy industries. Friesland's international strategy differs from that of other multinational companies with respects to its appearance in the world markets. Whereas Nestlé, Unilever and Danone aim to be present in almost every dairy market in the world, Friesland decided to deliver only some core regions where the company already had a strong position in branded products. This strategy included the addition of Central Europe to its core regions, after Friesland acquired Nutricia Dairy&Drinks, which had already been very successful in this area. The markets in the core regions are further elaborated to increase revenues there. Acquisitions or investments are undertaken only if they offer higher returns through value added products. Thus, the major strategy in all their international activities is differentiation.

Following these differentiation strategies in the international markets, successfully competing against much bigger multinational competitors, in its home market Friesland Foods follows another strategy. In the past, the company grew only in the foreign markets and not in Europe. The management was not interested in more milk. This changed when, due to the new European milk quota system in 1984, the base of raw milk became limited. In its home market the company could no longer grow internally and thus needed partners in order to keep up with its local competitors, which grew fast. Especially Friesland's merger with Noord-Nederland (1990) and that with Coberco (1997) were steps in this direction. To compete with the other producers in this market, Friesland follows a cost leadership strategy, by focusing on scale and scope effects. Thus, it is the company's aim to become at least one of the cost leaders in the European commodity business. In its international businesses, Friesland always looks at other multinational players in the branded dairy product categories (e.g. Nestlé, Danone, Unilever) in order to learn from the success of their steps in the markets On the other hand, in Friesland's home market, major competitors to compare with are Arla Foods, Campina and Nordmilch.

Management and cooperative have always been separated at Friesland, so that the management was able to follow such a twofold strategy. Market orientation was introduced into the company's business strategy very early. Due to its introduction by its major competitors, it started in the international business, but was very rapidly implemented in the Dutch commodity business, too. This acting close to the market also helped the management to react very early to the changing corporative environment, by deciding to merge with other cooperatives in the Netherlands and by buying supportive brands and activities in the international markets. In its mergers, the company always took the leading position and dominated the newly formed cooperative and its structure. The progress of strategies and also the organisational structure have been planned on longer term and are part of a continuous process in the development of the company. It is Friesland's aim to increase revenues from branded products and its international activities in order to be able to pay high milk prices and dividends to its farmers.

With the help of the constructs detailed above, the following explains Friesland's development. The historical development of the cooperative and the strategies leading to new developments are explained in each of the following subsections.

4.1.2 Generic strategies

According to former CEO Mr Olijslager, Friesland follows a twofold strategy. On the one hand, the corporative focuses on the differentiation strategy, wherever this is possible. Especially in its foreign markets the company only produces and sells branded products that will bring the cooperative extra value because of the premium prices the consumers are willing to pay for them. Thus the share of branded products in the company's turnover increased from 34 per cent in 2000 to 46 per cent in 2005. According to Olijslager, Friesland sees growth in its markets as very important, but it has to be growth in terms of value adding or increasing returns in order to stay competitive in the future.

On the other hand, Friesland is also very active in the commodity and industry goods segment. This business is mainly located in the Netherlands, where Friesland tries to focus more competition on costs. Here they follow mass market strategies and do not look only at differentiation, because for many product categories, marketing and placing new branded products at the retailers would be too expensive for the company. The mergers in the Netherlands, especially the one with Coberco, must be seen as an improvement in Friesland's cost-focused Dutch production. In line with this strategy, immediately after the merger in 1997, many smaller or unproductive plants were closed down and processes were adjusted to produce as cheaply as possible.

Due to the merger with Coberco, Friesland started to regroup its business. This on the one hand let do a divestment in Poland, where no successful market position had been reached and future outlook for long-term profitability was not good. On the other hand, the company decided to close many of its production plants in the Netherlands. Especially in their cheese section, it was agreed to close half of all locations in the Netherlands to reduce costs and become more competitive. In 2000, the brands Coberco and Domo were withdrawn from the Dutch market, in order to focus marketing support and retailing policies on the remaining strong brands, especially Friesche Vlag, which is the second largest food brand in the Netherlands in terms of sales volume.

Especially the independence of its international SBUs shows that in each country, managers themselves can concentrate on the relevant market segments and still can benefit from the resources of the big company. Also the management of Friesland's commodity business is mainly responsible for this business and thus can concentrate on efficient ways of production. Production processes are the same in all countries, which allows transfer of new ideas from one plant or country to another. The positioning of Friesland's SBUs is dependent not on costs but on the value added for the customer. The advertising budget has been increased since the merger in 1997: in 2004, Friesland spent EUR 186 million on advertising.

Compared to its competitors, Friesland has always been more focused on innovation regarding the branding of products or the developing of products for special markets. The company has lots of brands that are well known in many countries of the world. In the Netherlands, the company has some very innovative new products, but their biggest competitor (Campina) leads the fresh dairy market with its products. In recent years, Campina itself has become a well-known brand, while Friesland is still trying to focus more on its brand names like Friesche Vlag, which is the number four in the Netherlands with a turnover of EUR 223 million in 2005. Also some of their other brands are among the best known product brands in the Netherlands. Regarding innovation, each year Friesland produces many successful innovative products for its markets. In 2006, for example, Appelsientje mild, Frico halfvoller and Dubble Friss brought high returns in their early years. Nevertheless, in the Netherlands Campina is ahead as regards number and turnover of innovative products (*Foodmagazine*, 2006). In world markets, Friesland competes against global players (e.g. Nestlé and Danone) that are also very innovative and have the financial means to support lots of new ideas or products.

Friesland, as a very big food company, does not specialise in a specific market niche. However, segmentation of consumer groups is still important for them to find new customers for their products. Most important for Friesland is that each segment that is delivered with products needs a minimum size to be profitable for the company. Due to its size and structure, Friesland is more interested in larger consumer groups, for which one marketing strategy can be used. Thus they have mainly one or only few national brands in each country. Smaller regional brands do not belong to their portfolio. One group of consumers in which the company is especially interested is the consumer of functional foods. Thus their innovations and new products in the light and wellness product groups are increasing. But this is not their only delivered consumer segment, as figure 4.1 shows. In addition to their broad-based dairy brands, which are sold in different regions all over the world, Friesland has brands for drinks in the Benelux states and Central Europe and some brands for other segments, like cheese or industrial products for European and international markets.

Figure 4.1 Brands and its layers of Friesland Foods (annual report 2005)

The company's medium-term objectives (till 2008) are (1) to improve the profitability of activities based on milk supplied by their members by a further shift away from the range of standard dairy products to more value added products, and (2) to bring about revenue and profit increases for its companies operating in the strategic markets of Central Europe, the Middle East, Southeast Asia and West Africa, which purchase milk upon demand.

4.3.1 Growth

In 1984, the introduction of EU milk quotas encouraged a big restructuring within the domestic industry of ccFriesland. All the dairy companies had to look for ways to secure their milk supplies from the farmers. A direct consequence for the companies was the closing down of unused capacities in each company at the end of the 1980s. Then, in the early 1990s, following a merger between Friesland's competitors DMV-Campina and Melkunie, ccFriesland and Noord-Nederland merged into Friesland Frico Domo. This finally put an end to the high fragmentation in the Dutch dairy industry: of the 26 dairy cooperatives that existed in 1983, only 15 remained active in 1993, and the three leading cooperatives - Campina Melkunie, Friesland Dairy Foods and Coberco - together had a

70+ per cent market share in Dutch milk collection. Private dairy organisations have always played a minor role in the Netherlands.

Table 4.1 Mergers and takeovers of Friesland and predecessors in the Netherlands

<table>
<tr><th>1980s</th><th>1990</th><th>1991</th><th>1997</th><th>2001</th><th>2004</th></tr>
<tr><td>Noord-Nederland (itself formed from eight cooperatives)</td><td rowspan="2">Friesland Frico Domo Cooperative</td><td rowspan="2">Friesland Dairy Foods</td><td rowspan="8">Friesland Coberco Dairy Foods Holding N.V. (FCDF)</td><td rowspan="9">Friesland Coberco Dairy Foods Holding N.V. (FCDF)</td><td rowspan="9">Royal Friesland Foods N.V.</td></tr>
<tr><td>ccFriesland</td></tr>
<tr><td colspan="2">Ormet</td><td rowspan="4">Coberco</td></tr>
<tr><td colspan="2">Hovo</td></tr>
<tr><td colspan="2">Heino</td></tr>
<tr><td colspan="2">De Eendracht</td></tr>
<tr><td colspan="3">Twee Provincien</td></tr>
<tr><td colspan="3">De Zuid-Oost-Hoek</td></tr>
<tr><td colspan="4">Nutricia Dairy&Drinks</td></tr>
</table>

The dairy market is still growing. There are regional differences: the major growth is in Asian markets, not in Europe. Whereas in international markets Friesland sells only further processed branded products, in its home market (the Netherlands) the cooperative mainly sells commodity products like milk and standard types of cheese. Thus Friesland's major reason for the mergers in the Netherlands was to strengthen this commodity segment. Especially after the 1997 merger with Coberco and two smaller cooperatives specialised mainly in cheese, Friesland reached such a size in the Dutch market that it could successfully compete with others on costs. Nevertheless, it still does not really earn money above the milk price there. Especially nowadays, dairy products are under even more pressure due to the growing position of discounters in the Netherlands. As a consequence, Friesland mainly sees possibilities to grow in branded fresh dairy products, even if the returns are relatively low compared to foreign markets. Their real target concept for growth of Friesland has always been the international market for branded products from which it still earns the most money. The return from these foreign investments allowed the company to remain leading company in the Netherlands and to be attractive for other cooperatives to merge.

According to Friesland, other reasons for merging with Coberco were the reduced support of dairy products in the EU after WTO negotiations, and new EU policies. Also the need for scale and to capture economies of scale, to counter the increased power of retailers was an important reason, next to continued pressure on the milk price paid to members and the intensifying competition across European markets, where the companies wanted to focus on more. The supervisory board member also saw this merger as 'mainly cheese driven' because before the merger, management saw the chance to control the Dutch cheese market as market leader and thus be able to determine prices by adjusting the volume. However, this attempt did not work out successfully, because retailers were still too powerful in the chain. But even if they could not control prices, this merger left the

Dutch dairy industry with just two major players, namely Friesland and Campina, who today account for over 90 per cent of the milk processed in the Netherlands.

Some acquisitions followed in 1998 and 1999. These took place mainly in the Netherlands and included two cheese trading companies, an organic milk factory, the food ingredients factory De Kievit and the commercial activities of DSM Bakery Ingredients (total cost: EUR 111 million). A bigger step in their strategy of improving the profitability and quality of turnover by strengthening the international market position of the firm was when it bought the Nutricia Dairy&Drinks division of Numico for EUR 663 million. This division added to the markets in which they company already had a strong position - namely the Netherlands, Southeast Asia, Greece, a number of emerging economies in Africa and some countries in Central Europe - and led to higher market shares in Benelux.

Friesland's aim to become a strong competitor in the European commodity market is guided by cost-cutting programmes and process-improving actions. The number of plants that Friesland has shows that productivity both per plant and per employee has increased in recent years. For its cheese production, for example, it now has just eight plants - which is fewer than half the number it had ten years ago (22), although it now produces more cheese than ever before. Friesland reduced its milk intake in the Netherlands from nearly 6 billion kilograms in 2000 to 5.2 billion kilograms in 2005. Due to the problems it has had with profitably selling this Dutch milk, they welcome any farmer who plans to stop producing milk. They are not interested in additional milk intake in future. Therefore, even the ambition of the Dutch Dairy board, which tries to achieve higher prices by imposing temporary milk delivery stoppages, is not seen as a problem for the company.

In its international businesses, Friesland - like the private competitors Danone or Nestlé - buys only the amount of raw milk that it needs for its production, whereas in the Netherlands the entire milk production of the member farmers has to be bought. Abroad, mainly ready milk products like milk powder, which are cheaper on world market than they are in their home country, are bought. The main reason they still transport one third of all their milk from Europe to their international markets (including milk from such competitors as Nordmilch) is to stay independent from their major supplier Fonterra, from New Zealand.

When we asked industry experts and company representatives for their opinion about the future growth of Friesland Foods, everybody gave the same answer. To quote one respondent: 'Yes there will be growth and a finally much bigger company in future.' Most expect some big mergers within Europe, a way the planned mergers of Campina and Arla or Nordmilch and Humana have shown. But in Friesland's history, growth has taken place in three other ways, namely by internal growth, by collaboration with others and by acquisition. The strategy of collaboration was followed by Friesland for a long time in its international business: the company had local partners in each country or region. Due to stronger competition, finally in the 1960s and 1970 the company acquired 100 per cent of most of these collaborations in order to have more possibilities in decision-making. In its home market, Friesland mainly grew by merging with other cooperatives and internal growth. The biggest step here was the merger with three other cooperatives in 1997. Due to the strong positions of cooperatives in the Netherlands, this was the only way for it to grow.

One exception was the acquisition of Nutrica Dairy&Drinks in 2001, which gave Friesland access to and a strong position in Dutch and in many international markets. The financing of these acquisitions is a minor problem for Friesland, because of the policies of keeping 60 per cent of each year's profit in the company for such future investments. The farmers invest a part of their annual returns in their cooperative. Future growth is part of Friesland's strategy, but according to a supervisory board member, 'everybody waits for the first step of one of the competitors'. As a consequence, for Friesland especially developments in 'Germany are interesting, because a new strong competitor there could change the business a lot.'

4.1.4 Internationalisation

With Friesland, the Internationalisation of the company in some regions of the world was accompanied by its growing branding skills. Already in 1921, ccFriesland introduced new brands, including Dutch Lady, which today is still a famous dairy brand. In the mid 1930s, due to good contacts with Asian countries, the company opened its first international sales office: it was in Hong Kong, where mainly branded products were sold. ccFriesland rapidly entered one country after the other in this region with its sales offices, such as Singapore in 1954 and Malaysia in 1964. Whereas in the beginning the company internationalised only in order to sell condensed milk to Great Britain, this Internationalisation wave was done to find new markets for the Dutch milk. These regions were easy to reach, so it was no big deal for the management to go there. Due to changing tariff policies during the 1950s, ccFriesland experienced strong competition from locally produced recombined milk, primarily in Southeast Asia. As a result, exports fell and companies were forced to cooperate with local producers, which meant that many competitors left those countries. However, Friesland decided to stay and changed its strategy for those markets. Due to closed borders, they could no longer deliver their products and thus the strategy of selling Dutch milk products to those countries ended, followed by a strategy of acquisitions in that region. Mr Olijslager, the former Friesland CEO, summarised this strategy change: 'We had very good positions on those markets and saw the possibility to keep them by buying milk powder on the international market and process it further in local plants.'

This strategy was also followed in 1968, when the company entered Thailand by acquiring Phranakom Milk Industries. Indonesia and Vietnam followed in 1969, also by acquisition. Because of local difficulties in Vietnam they used the first time in their history a joint venture with a local company to enter the market. This made it possible to use the partner's existing contacts and to grow faster. Asia has always been the core market in Friesland's Internationalisation strategy. In the 1970s, a new core region for future activities was added when the company entered Nigeria with the foundation of WAMCO (West African Milk Company). The map below shows Friesland's core regions, which now include not only Western Europe but also Asia, Africa and Central Europe. The map also shows where Friesland produces and sells, and where it only sells.

Belgium	Sales and production	Malaysia	Sales and production
China	Sales and production	The Netherlands	Sales and production
Colombia	Sales and production	Nigeria	Sales and production
Czech Republic	Sales and production	Portugal	Sales
France	Sales and production	Romania	Sales and production
Germany	Sales and production	Russia	Sales
Greece	Sales	Saudi Arabia	Sales and production
Guam (USA)	Sales and production	Singapore	Sales
Hong Kong	Sales	Slovak Republic	Sales and production
Hungary	Sales and production	Spain	Sales
Indonesia	Sales and production	Taiwan	Sales
Italy	Sales	Thailand	Sales and production
Ivory Coast	Sales	United Kingdom	Sales
Kazakhstan	Sales	Vietnam	Sales and production

Figure 4.2 International activities of Friesland Foods in 2004 (annual report 2003)

Friesland usually takes over only small, local companies. However, in 1984 it purchased a larger US company - Foremost - which gave ccFriesland access to more production plants in different African and Asian markets. This was a big step for the cooperative to increase the international share of its sales, especially in the core regions: in 1995, only 40 per cent of its revenues came from the Netherlands. Another important factor in these acquisitions was the long-term staying of the management of acquired companies. Such as in the case of Nutricia, Friesland wanted to learn from their know-how.

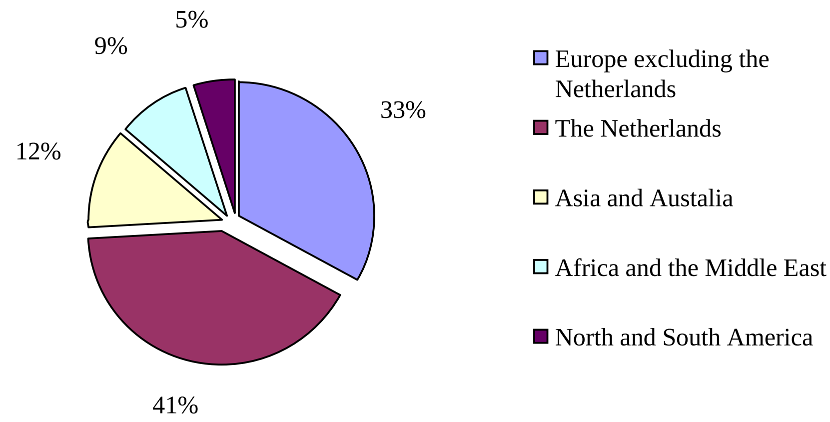

Figure 4.3 Revenue by geographical area in 1995

In 2001, Friesland made another big acquisition, when it the Nutricia Dairy&Drinks segment from Numico. With its international markets, Nutricia fitted into the strategy of Friesland. Because of the strong position in Central Europe, this region was also added to Friesland's core regions. 'It was a unique possibility to buy very good brands in different markets with no milk supply contracts at all' (interview former CEO). With this step, the international share of Friesland's turnover increased again: in 2005, it was 70 per cent.

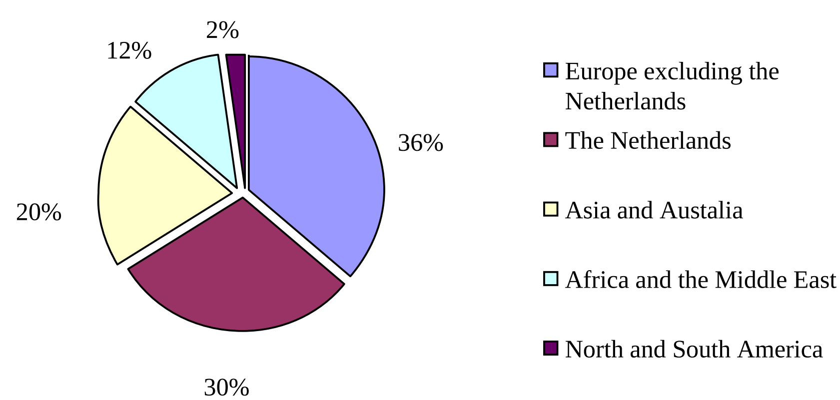

Figure 4.4 Revenue by geographical area in 2005

Compared to the other big players in the international dairy market, this Internationalisation strategy made Friesland more independent of the strong competition in the home country. Friesland examined the Internationalisation steps taken by Nestlé and Unilever and how they entered one market after the other with their successful products, to learn from them for its development in the core regions. Also for the future, the management expects the major growth in the international markets, basically in the core regions; Asia, Africa and Central Europe. As a member of Friesland's supervisory board mentioned: 'There are still so many countries and regions to go to.' Within Europe, Friesland built up sales offices in, for example, Greece, Germany and France; however, the entire production remained located in its home market (the Netherlands), from where Friesland exports to Western Europe. Nowadays, due to the takeover of Nutricia, Friesland also has plants in Belgium, France and Germany.

4.1.5 Organisational and ownership structure

After the merger with Coberco and the two smaller cooperatives (Twee Provincen and Sud-Ooster-Hook) in 1997, the former second-order cooperative Friesland became the dominating part of a first-order cooperative with direct access to the farmers. Together they formed the cooperative Zuivelcooperatie De Zeven Provincien U.A. But as the former organisational structure was still seen as good, in the new structure the whole operational processing part of the cooperative was grouped together to become the limited liability company Friesland Coberco Dairy Foods Holding N.V. (FCDF). This company is completely owned by the cooperative Zuivelcooperatie De Zeven Provincien U.A., later renamed Zuivelcoöperatie Friesland Foods U.A.

'The cooperative and the Company are strictly divided, to make use of the advantages of both systems' (former CEO). An advantage supporting this structure of Friesland is that the cooperative always generated profits above the milk price, something that is quite uncommon among dairy cooperatives in Europe. With this money, a dividend could always be paid to the shareholders.

The change in the ownership structure of Friesland Foods from the cooperative structure to an IOF, where the investors are the cooperative, did not directly impact the relationship with the suppliers (the farmers). The cooperative always communicates its strategies to the farmers, so that there is a broad consensus among the farmers that this is the right way, even if they do not understand why the biggest dairy cooperative in the Netherlands does not have as many products in Dutch retail shops as, for example, Campina does. The communication is seen as very important in this case, because if the farmers did not accept the strategy, they could reduce the amount of money they leave in the company's reserves in order to have more money available for their farms.

Friesland Foods has lots of autonomous working SBUs for the different product or regional categories in their businesses. In all its principal subsidiaries, Friesland holds at least 50 per cent of shares and thus keeps control of the company. According to the former CEO, this is the only possibility for other companies to access Friesland Foods' business. This is possible on regional or product focused projects, but never on the holding level. Here the whole control will stay with the cooperative. After the acquisition of Nutricia Dairy&Drinks in 2001, Friesland reorganised its businesses in Central Europe, because there were some overlaps between the businesses. Thus, the former Friesland departments in Hungary were integrated into the Nutricia Hungary department, and in Romania it was the other way round, depending on the market position each company had in that region before.

4.1.6 Leadership and power distribution

Friesland Foods has had a continuous surrender of business from one manager to the following one. Mr Dahlhaus had already been with the company (and its predecessors) for a long time when in 2005 he took over from Mr Olijslager as CEO of Friesland Foods. He had the experience of being manager in various international markets of Friesland and did not change many things after taking up his new position. Mr Olijslager had been in charge for a long time, and had worked for the company's predecessor, ccFriesland.

The owner of the limited liability company Friesland Foods - the cooperative - has one major goal for the company. Therefore the main contracted relationship between the cooperative and Friesland Foods is that the company has to take all the milk from the farmers. In order to do this in a fair way, an average milk price is paid to the farmers. This average is made of four major European dairy cooperatives' milk prices, namely Nordmilch, Campina, Arla and Belgomilk. This means that the farmers do not have to negotiate with the company or the cooperative for higher prices, because they always get the same as their European colleagues do. If the want to earn more, they are allowed to buy shares of the company, which can only be bought and sold by members of the cooperative.

As a cooperative, Friesland never had the possibility to limit the milk intake to what it needed for its successful products. Thus, even if the management were to see it as a more profitable advantage to sell the commodity business in Europe, which makes no profit but lots of problems and work, and continue only with the branded products, they could not do this, because as a cooperative it is their task to add value to their members' milk or to the farmers' investments in the cooperative. These farmers want not only dividends on their Friesland shares but also a good price for their milk. That is their core business, on which they have to live. When farmers decide to divest, this could become a possibility but other farmers on the other hand so far can still increase their production. Here the management tries to persuade more farmers to invest not in more production but in shares of the company.

4.1.7 Control systems

As in the dairy industry as a whole, quality control systems have always been important for Friesland Foods. When a new regulation is introduced, the company always implements it into their processes, so that a continuous process of quality improvements has been reached. This is the case not only within Europe, but in all plants all over the world. In other words, the plants in Africa have to fulfil the same requirements as those in Europe.

Because of Friesland's many subsidiaries with relatively independent managements, they always needed good financial control systems to ensure that everything regarding upcoming problems or changes still was in their hands.

4.1.8 Market orientation

Friesland's corporate mission sees the well-being of the consumer as one of the company's targets. Friesland acts close to the market and is innovating along big or growing consumer segments. To generate information about these, Friesland works closely with universities and research institutes both in the Netherlands and worldwide. Because of this, new products - such as Breaker (a milk drink in a new convenient package designed to be consumed en route) - and functional food products have been successfully introduced to the markets in recent years. Especially abroad, only branded products that add value to the consumer and also to the members' milk are sold. One key part of their strategy is the implementation of clear responsibilities and local authorities for the products, accompanied by interaction of different departments and regions in periodically meetings. This facilitates the transfer of good ideas from one region or product group to another country or product group.

The company's R&D department looks closely at the consumer markets and also uses panel data from market research institutes for this. Also, the percentage of turnover from branded products is measured each year and the management continuously plans to increase it further. In 2005, it represented over 46 per cent of the company's turnover.

The ambitions of competitors are always closely watched and own products are continuously benchmarked with the products of major competitors. For this always the best competitor for the product is taken. For the international and branded products, often Danone and Nestlé with their products are taken for this. In the home market, where the production of commodity products dominates Friesland's business, the major competitors are the larger European cooperatives like Campina, Arla and Nordmilch. Especially for the supervisory board, further steps regarding growth in Europe by merging with other cooperatives etc. depends on the actions of Friesland's competitors.

Their long-term ambition in the markets is indicated by the size of investments in brands and the mentioned target profits for the farmers in the long term. Also, the cooperative has to do what its owners - the farmers - want it to do. Therefore, a divestment would seem quite incredible in this case.

Friesland's management strictly separates commodity business from the branded production. Although this is not easy, it is necessary in the eyes of Friesland's former CEO. 'It was always difficult to switch from cost-saving discussions to value-adding products, depending on the management team, coming in. Ideas that were good for our brands sometimes would have been a disaster for the commodities' (interview with former CEO).

4.1.9 Summary of the Royal Friesland Foods case

Throughout its development, Friesland continuously adapted its strategy to the changing environment. Since its founding, Friesland has followed a strategy that is oriented towards the international markets. In the beginning, the major reason was to sell the surplus Dutch milk. In order to be more independent of the home market, always when possible, this international engagement has been increased later on. Thus, at a time when most other dairy companies only thought about selling abroad, Friesland also started to invest there directly by acquisitions and joint ventures. This strategy was introduced when Friesland reacted to the growing demand for branded products all over the world. Very early, even before Danone became a big player in the business, Friesland started to focus on the development of brands in its international markets and to aim for a top three position in each market.

Due to strong competition and further concentration in the Dutch dairy industry and in order to strengthen their home business, Friesland followed the other dairy companies and changed its strategy by merging in 1997 with Coberco, a company that mainly concentrates on the Netherlands.

The new strategy was twofold, separated into two major business units. Thus in the international markets, Friesland is following differentiation strategies, competing against much bigger multinational competitors, whereas in its home market, Friesland follows another strategy. Due to its cooperative background, the company has to process and sell all the milk its member farmers deliver to it. Thus Friesland follows a cost leadership strategy, by focusing on scale and scope effects. The progress of strategies and the organisational structure have been planned on longer term and are part of a continuous process in the development of the company. Due to its development of more and more products in addition to the classical dairy business, this former dairy processor is increasingly becoming a food company that acts in different segments.

4.2 Nordmilch eG

4.2.1 Origin and development of Nordmilch

Nordmilch was founded in 1946 in Germany as a second-order cooperative; its only task was to take all the milk its shareholders - the small dairy cooperatives - did not need for their products. Their first plant and its headquarters were located in Zeven, a small city near Hamburg. Its function (which the head of its supervisory board describes as being a 'waste disposal unit') was maintained till 1999. During this period, Nordmilch had no direct contact with its farmers. All the milk collection was done through the 39 small member cooperatives and later on, a collective member cooperative, the Milch-Erfassung-Nordmilch (MEN) which was built up as a first step towards merging the smaller cooperatives in the catchment area of Nordmilch. But still today after the big merger in 1999, Nordmilch, which is now a primary cooperative, still has 14 former cooperatives among its members. At the end of the 1960s, it had about 75 member cooperatives.

Nordmilch is a cooperative that focuses mainly on the production of commodity goods and industrial products. Here, the major focus is on scale and scope effects in order to reach a cost leadership position. Its still existing brand Milram is in an audit phase, which will show whether Nordmilch should stay in this segment or go on without its own brands. As an example of a discontinuous development, Nordmilch is different from Friesland. At Nordmilch, the organisational structure was maintained until the end of the 1990s and only small steps were undertaken in terms of growing or adapting to the environment. Thus when due to EU policies they produced for intervention prices, they did not immediately change their strategies when policies changed, but tried to keep it for another few years. First when pressure from the environment became too strong to withstand it, Nordmilch merged with other cooperatives but still did not restructure its business except some slightly changes in administration.

The major reason behind the big merger in 1999 between Nordmilch MZO, Hansano and Bremerland-Nordheide was the market entry of Campina into the German dairy market by acquiring some local companies from 1991 to 1993. This new pressure forced the cooperative to react, although a major focus was still put on the securing of milk intake, finally leading to the merger. After the merger, the new Nordmilch still tried to keep the whole business as it has been before and did not adapt its strategies to the new environment with more demanding consumers. This was different to Campina, which was interested not in the additional milk intake but in the market share and know-how of the acquired companies. In 2003, when the pressure for Nordmilch was too high and the whole cooperation had lost lots of money, within a very short period of time strategy, structure and leading personnel were changed and adapted to the new environment. Regarding marketing, innovation and new product development, competitors like Campina are already far in front of Nordmilch.

Reasons for Nordmilch's strategy also lay in its structure with a strong influence of farmers in the operational policy of the company in the past. Nordmilch's management has not been independent in its decision-making. Always some farmers had to be members of the operational board of the company. This never allowed concentrating on the long-term business, because the farmers were mainly interested in high milk prices in the short term. This also influenced the set-up of the new management board after the 1999 merger. Because the former cooperatives were still very much focused on each regional influence on the new board, many functions were double filled or even new management posts were created to make a place for everybody. These internal problems couple with inconsistent decisions resulting from problems in the hierarchy did not allow Nordmilch to focus on its markets or the enforcing changes in the competitive environment.

Thus the international business of Nordmilch, which in the last 30 years has always provided 20-30 per cent of its turnover, has never been worked out any further and still today is mainly made of commodity goods. The company never made direct investments in foreign markets. Since 2002, this has changed. Like in other dairy cooperatives, farmers now control the company from a strong supervisory board. Nordmilch has also invested in new sales offices in some local markets. But still the company's structure and organisation is far from being a market-oriented system. The company still compares itself with its German competitors, but does not really look beyond the borders.

4.2.2 Generic strategies

Nordmilch has always been a more cost-focused company. In the past they had many regional brands, especially after the 1999 merger. Each of these brands was well known and distributed, but always only in a very small geographic region. Regarding Nordmilch's segmentation of consumer groups, it can be stated that Nordmilch produces only for larger segments because the smaller consumer niches became too small for their production units to be competitive there. Due to the fact that retailers in the 1980s started to grow very fast and mainly worked on national rather than regional level, this strategy caused more and more problems for the cooperative, so that in 2003 most of the weak and regional brands were sold or adjusted to retail brands. In 2003 the company sold its remaining non-core activities, such as a home delivery service for the final consumers because these did not fit into their strategy of growth in the big consumer groups.

Nordmilch's businesses have always focused on process efficiency and scale and scope effects. In this way, the company tries to save money through cheaper processes, products, etc. This allows the firm to earn money even when the best competitor is making losses. Especially in the production of cut standard cheese for self-service shelves in supermarkets, they are among cost leaders in Europe. This is achieved by a strict specialization of the plants in few products, including some additional value adding steps of the chain such as packaging, labelling and distribution. Thus, Nordmilch's plant in Edewecht is specialised in cheese and the one in Zeven is specialised in the production of various milk powders. Within the cooperative, this is seen as a big advantage compared to its competitors. The strategy also includes the delivery of milk products for the European intervention policies. Within their structures and processes, cost saving is very important. This is one reason why only one national brand survived the big rationalization of the company in 2003. Nordmilch also always tries to have as few suppliers as possible for machinery and other production goods.

With its remaining brand Milram, Nordmilch tries to follow a differentiation strategy next to its more cost-focused other businesses. Nordmilch has only a few independent SBUs, and most production, research and marketing is done within the cooperative. This makes the processes needed to be successful in differentiation more difficult for the company. Especially because Nordmilch invested only EUR 1 million in 2003 in advertising and less than EUR 5 million in 2005, the differentiation possibilities seem to be limited. With this small financial budget for advertising, both industry experts and people within the company are unsure whether this strategy will be successful in the future.

Nordmilch used its capacity to be successful in big markets where it could really make use of its power as a big company. Like many other dairy companies, Nordmilch started very early with its first brands. In the 1950s it introduced Milram, which became nationally known in the 1960s when the company developed Milram Frühlingsquark. Milram is still their most important brand. Due to its structure with cooperatives as members, Nordmilch's management always had to look for markets where it would not compete with its member cooperatives. These acted on a local or regional level with commodity goods, mainly fresh dairy products. This left only few markets for Nordmilch, one of which was the market of spiced quarks preparations, where the company has been market leader with a market share of 75 per cent. This was possible because the investment in the machinery needed for the quark products was too big for most of the member cooperatives, so that centralisation was possible at Nordmilch. This internal competition always led Nordmilch to be more innovative in process forming and centralizing in its plants. To keep investments in the second-order cooperative Nordmilch and to prevent the members from investing in their own production facilities, Nordmilch also started to produce to order and for the account of their members' diverse dairy products for their regional markets. This had the advantage that use could be made of economies of scale in production and still everybody could sell under his own label. Over the years, Nordmilch also used possibilities to buy smaller private dairy companies in northern Germany, to include their production facilities into its own one and also invest in new production facilities for various dairy products.

One of Nordmilch's focuses of production was to produce diverse unbranded commodity goods like milk powder products, butter, etc. as well as some specialties for national markets, like Milram Frühlingsquark. After the introduction of Milram, more dairy products were advertised and sold on the national German market. Since the change in leadership, the new CEO is working more on brand developments and trying not only to decrease production costs but also to use the capacity of Nordmilch to develop products for new consumer groups.

Nordmilch had three national brands (Milram, Oldenburger and Botterbloom), two regional brands (Hansano and Bremerland) and some more diverse brands (e.g. Bunte Berte). Except Botterbloom (a brand for ice products), all these brands were mainly for fresh dairy products. The strategy of the management was to support all these brands.

National brands:

Regional brands:

Figure 4.5 Major brands of Nordmilch after merger in 1999

When the pressure due to losses in market share and from the farmers (due to too low milk prices) became too great, the company started to restructure its brand strategy. The regional brands were sold or stopped, and on a national level the focus was laid on Milram. Oldenburger would be used only for the international markets of Nordmilch.

With the appointment of Mr Tomat, a new strategy was developed for the cooperative. He introduced a new culture in Nordmilch. When he entered the company, after a time of analysis in 2003, he started a three-step programme, guided by professional consulting agencies. This was also the first time for many years that a long-term strategy for the company was developed.

For 2004 the theme was 'restructuring', including a new organisation of the board, whereby the honorary positions on the board of management were scrapped. To keep the influence of the owners (the farmers) on a high level, the rights of the supervisory board were increased so that they had more right to decide about expenses and corporate strategies. Other parts of the restructuring programme were the closing of more plants, a focus on core businesses, the selling off of smaller activities, and a brand focus on Milram and Oldenburger by selling off the brands Hansano and Botterbloom and reducing other brands to retail brands without advertising expenses. Whereas in the past also regional brands had a good market, due to the national planning of retailers, nowadays the costs for those brands could not be afforded any more. All in all, due to the programme with the closing or selling of 35 per cent of production facilities and the discharge of one third of workers, Nordmilch saves EUR 80 million annually. This money will be invested in 'future growth, but only in products with positive returns'. As Mr Tomat said in an interview in 2006, 'the big aim of this programme is to gain cost leadership in the market'.

In 2005, the second step in Mr Tomat's plan - the 'path to grow' - was taken. This included the formation of new teams with high potential from Nordmilch, but also with new employees coming from other big players in the food business. Here especially in the second hierarchy level with heads of departments, jobs were mainly given to people from outside. With this backbone of new staff, the creation of a market adequate R&D structure and organisation with the building up of a new R&D centre in Zeven was started. Here a special focus was laid on product development for industry products, which are responsible for 47 per cent of 2005 revenues.

In 2006, the last step of the programme - the 'market potentials' phase - was started. The number of company divisions was reduced from fifteen to three, namely Industry products, Retail Germany, and Retail International. The development and production of products for the industry became a focus of Nordmilch. Especially the R&D centre will bring innovation in this field. Another important aspect for Mr Tomat's plan for 2006 is the transformation of Nordmilch in a public limited company by keeping the registered cooperative society. Thus by 2007 the whole production unit of Nordmilch will become an AG, of which all shares will be held by the cooperative Nordmilch. This will provide more possibilities for future growth.

4.2.3 Growth

Nordmilch has grown by merging with other northern German cooperatives and, to a lesser extent, by acquiring smaller private dairy companies in northern Germany. This limited the company's expansion to this region. Especially in the 1980s Nordmilch made some small mergers and acquisitions, but could not grow from them, because the new milk simply replaced the milk lost from farmers who left the business and sold their milk quota outside Nordmilch's collection area. Most of the merged or acquired companies were nearly bankrupt, which limited Nordmilch's chances of obtaining big advantages from them.

As the following figure shows, until the introduction of the milk quota by the EU in 1984, Nordmilch increased its milk intake every year. With the new quota this interrupted until the beginning of the 1990s. The management always made use of acquisition or merger possibilities, of which there were not so many, to catch up the whole amount of lost milk from retiring farmers. As their former CEO explained, in the beginning they lost lots of milk, but management expected that due to the good farming area in northern Germany, milk would come back into the region very fast. This in fact happened, mainly because farmers bought additional quotas.

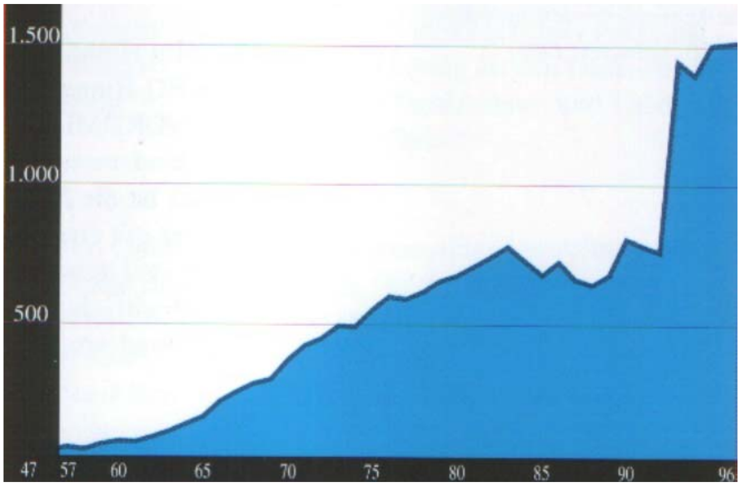

Figure 4.6 Nordmilch's milk intake till 1996 in million kg

The major problem of Nordmilch at the time was that the EU paid subsidies for feeding whey products to calves in order to decrease the amount of milk in Europe. This usage was very attractive for many of Nordmilch's member cooperatives, so that Nordmilch had to close some of its plants and also stopped investing in new products etc. The following graph shows the enormous decrease (by two thirds) of Nordmilch's investments in the years since 1984.

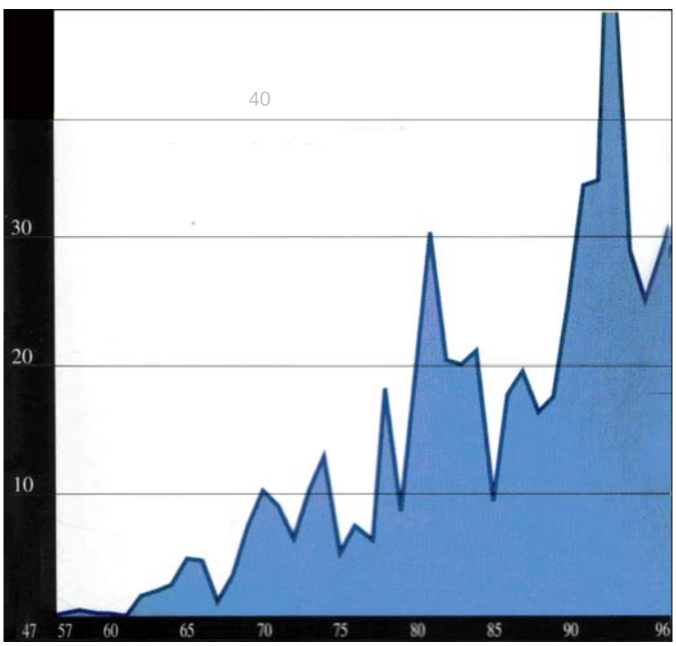

Figure 4.7 Nordmilch's investments in million DM

The programme of subsidies for feeding whey was scrapped at the end of the 1980s and Nordmilch increased its milk intake. To catch up with increasing concentration among its member cooperatives, Nordmilch started to merge all willing cooperatives into the Milch-Erfassung-Nordmilch (MEN), a first-order cooperative with close connections with Nordmilch by double functioning of leading personnel in both cooperatives' boards. The further concentration among its members also increased the importance of the MEN over time. In 1990, due to German unification, Nordmilch planned to get a big market share in the new Eastern German markets. The Milchhof Magdeburg was bought, new plants were set up and the cooperative was able to introduce its Bunte Berte brand successfully in Eastern Germany. The management invested a lot here, as the graph of Nordmilch's investments above shows. Even though other companies (e.g. Danone, Campina and Friesland) invested internationally at this time, Nordmilch used its whole financial capacity to grow within Germany. The northern part of Germany was its core region. All other businesses were simply side activities for the management.

In the 1970s and 1980s, the primary focus of the management of Nordmilch was to act fast on the changes of the European policies. Thus after the introduction of fixed prices for milk powder and butter, the production of these products was increased.

When Campina entered the German market in 1993, it was a shock for the established German dairy companies. But Nordmilch had no chance to interfere. The management tried to, but they did not have enough money to make a better offer than Campina and there was still a lot of local protectionism and rivalry, so that they could only see from the side position what was coming up to them. This, the dominance of retailers and the (in comparison to Nordmilch) much grown European competitors finally paved the way for the big merger of Nordmilch, MZO, Bremerland-Nordheide and Hansano in 1999.

Till the 1990s, 'the development and growing of Nordmilch was a continuous process' (interview with former CEO), where in normal steps the company increased its turnover and milk intake. This ended with the big merger. These four companies already worked together for a longer time in diverse fields, so that a merger was seen as an opportunity to increase their market position. The management of all companies saw this as a good way to regain power in retail pricing. Of these dairy cooperatives, only Nordmilch with its 24 member cooperatives was not a primary cooperative. The merger was led by the two largest partners, Nordmilch and MZO, both of which sent their former CEO (Dr Tag and Dr Dumstorf) as new team chief executive officers to the new Nordmilch company. The additional four honorary posts on the board of management of the new Nordmilch were occupied by all the partners. A newly installed supervisory board with six members from the cooperatives and six labour representatives had to elect and control the board of management. A new headquarters was established at Bremen Airport business park, a place that was geographically central for all the partners.

The new cooperative had a turnover of about EUR 2.3 billion and a milk intake of 4.4 billion kg milk to be processed in 18 plants all over northern Germany. Due to the different specializations of the partners, the new cooperative also had a very diversified range of products. Its product fields - namely fresh dairy products, cheese, UHT milk, butter, milk powder and feeds - each had a share of 13-19 per cent of turnover. This was welcomed by the management as a possibility to decrease the risks of too little diversification.

Table 4.2   Mergers or takeovers of Nordmilch

<table>
<tr><td colspan="2">1980s and 1990s</td><td>1999</td><td>2002</td><td>2004</td><td>2007</td></tr>
<tr><td>Nordmilch (held by many small cooperatives)</td><td rowspan="4">Nordmilch (mergers of member cooperatives within the MEN)</td><td rowspan="7">Nordmilch eG</td><td rowspan="8">Nordmilch eG</td><td rowspan="9">Nordmilch eG</td><td rowspan="9">Nordmilch AG with shares hold only by Nordmilch eG</td></tr>
<tr><td>1991 takeover of Milchhof Magdeburg</td></tr>
<tr><td>1992: takeover of milk intake contracts of bankrupt Meierei Gesellschaft Nordmark</td></tr>
<tr><td>1993: takeover of plants from bankrupt Nordbutter</td></tr>
<tr><td colspan="2">Hansano</td></tr>
<tr><td colspan="2">MZO</td></tr>
<tr><td colspan="2">Bremerland-Nordheide</td></tr>
<tr><td colspan="3">Adelbyer Nordfriesland Milch eG</td></tr>
<tr><td colspan="4">Milchversorgung Stade eG</td></tr>
</table>

Management saw this merger as an ideal situation and did not plan to restructure the business except for some minor entities. They even always tried to assure everybody that in 'a merger of healthy companies no big restructuring was needed' (interview with former CEO) and only because of its size would prices and returns become better for Nordmilch. The reality after 1999 showed that the position of retail was that strong, that it could even force Nordmilch to decrease prices by delisting some products. In the coming years, also the few planned cost decreasing projects after 1999 always let to arguments of the former cooperatives standing against one another. The whole cooperative was only active with itself and had no time to look at market developments. Due to the doubled filling of many leading positions (such as CEO, sales officer and production officer), often decisions were replaced by new contrary decisions. Also the sales and the production department did not really work together, so that 'the decision to produce more yogurt was not made by the sales department but by the production department, which just saw the possibility to produce more' (interview with the head of the supervisory board). Then the job of sales office was to find customers for this production. In those years, growth was not possible for Nordmilch.

This was the first time that they realised that the strong position of discounters increases pressure on commodity product prices such as milk. Furthermore, due to WTO negotiations, the EU had to reduce prices for butter and milk powder, which basically set the minimum price for milk. Therefore Nordmilch and many other dairy companies invested in new products only if they were convinced that the products would bring higher returns than those sold at European intervention prices.

Nordmilch is planning to increase the amount of process milk, because it is investing in new production capacities for cheese. But after the new corporate structure of a limited liability company is built up in 2007, the management plans to change the strategy from an open cooperative to a closed one. They want to stop looking for additional milk and thus enclose their cooperative only for members in future.

Nordmilch sees its position in the European commodity and branded product segments. Leaving one segment has never been an option for the management. As a dairy cooperative, they even could not leave many parts of the business because they have to take all the milk their farmers produce. Due to their cost leadership in some product categories, such as some types of cheese and milk powder, they can earn money in this strong competition. But for the future, the management wants to grow here as well as in the branded product segment. The negotiation with Humana about a merger between both cooperatives was seen as the best possibility to save money on transportation and production of the products. This would have also allowed Nordmilch to access different product categories, as Humana produces them in order to make use of synergy effects. Therefore they even would have accepted a leadership of Humana in that merging discussion. For the future, now that Nordmilch is reorganised and profitable again, they would accept such a merger only if they could take the leading position. A further concentration in the market is still needed and desired by all players, but negotiations will take a longer time till possibilities are found. As a Nordmilch supervisory board member said during the interview: 'In a merger no one wants to be an unequal partner, even if it is clear that one is dominating, in the beginning a merger of equals is needed to start a successful negotiation.'

4.2.4 Internationalisation

Nordmilch always focused mainly on the German market. For the company, its international business was only a small activity in which it did not want to invest too much. According to their former CEO, farmers would not have understood this. For them a high milk price was always more important than long-term plans. Next to its position on the German market, Nordmilch tried to use the European intervention policies to sell butter and milk powder. Some of their cheese factories have even been completely organised for the production for European intervention policy with its special requirements for size and quality of products.

All the production facilities are in Germany. In the past, exports have always been organised via the German Milchkontor and other private export or distribution companies, so that, with the exception of the Berlin office with its contact with Russia and Asia, no direct contacts or offices in the export countries existed. In recent years, however, under the CEO Mr Tomat, this centralised strategy has been changed and sales offices in the Czech Republic, Hungary and China have been opened. In 2005 Nordmilch also bought the remaining parts of Milchkontor in order to have more direct contacts with its export markets. But still the whole production will be kept and located in northern Germany. The exported products are mainly unbranded commodity goods and industrial products. For the branded products, Nordmilch's brand Milram is only for Germany and the European markets. The brand Oldenburger, with its local relation to Germany, is only for markets outside Europe.

Internationalisation has not been a strong issue in strategy until last years. But still today, figures for 2005 show that Nordmilch's international retail business is responsible for only 11 per cent (EUR 230 million) of the company' revenues. Industrial products sold abroad contribute another 15 per cent to the company's revenues. As the above figure shows, the major international market for Nordmilch is the EU.

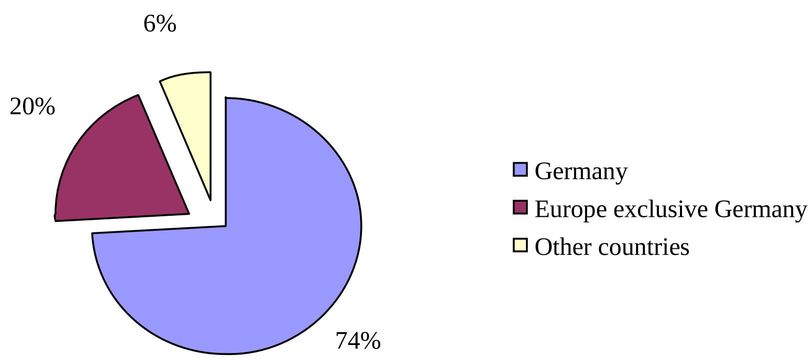

Figure 4.8 Revenue by geographical area in 2004

The company's international activities in over 80 countries are mainly focused on Europe, Asia and Russia. Especially its activities in Russia are very successful. Its strong position in the Russian fresh dairy product segment has been developed by the MZO (merged with Nordmilch in 1999) since the fall of the Iron Curtain. It was their strategy to recruit market experts and gatekeepers from the DDR and also former Soviet states to get access to the supply chains of so far mainly public owned retail groups. The main office for these activities was and still is located in Berlin. The Nordmilch management plans to use existing contacts and know-how in the existing supplied markets to grow there. The 80 countries are shown in the map below.

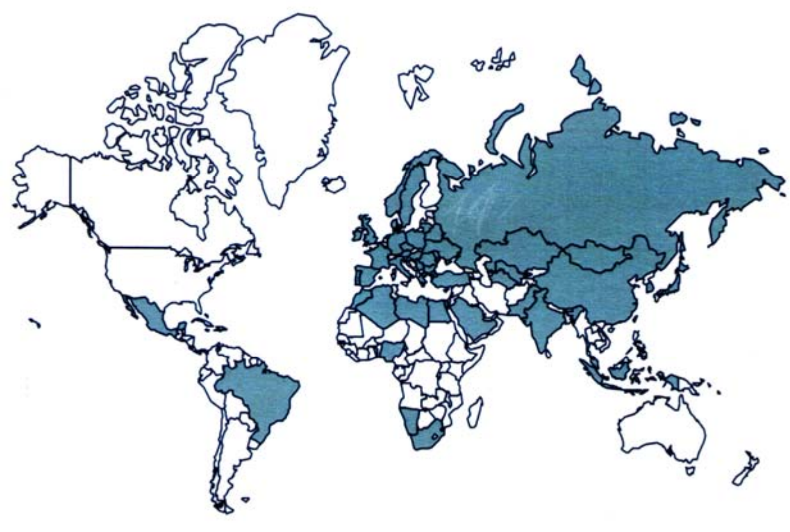

Figure 4.9 Export countries of Nordmilch (2006)

Nordmilch never acquired other companies in the foreign markets, nor did it plan any joint ventures with local or international companies to get access to new markets. Because of the unwillingness of the shareholders (the farmers), management's strategy has always been to internationalise only by internal growth and with the help of other export companies.

Figure 4.10 shows that revenues from exported products contributed 15-20 per cent of Nordmilch's sales in the 1980s and around 20-30 per cent in 1990-2004.

In recent years, especially since the closed discussion about a merger between Campina and Arla, industry experts saw potential for a merger between Arla and Nordmilch. According to these experts, this would help Arla to further increase its strong position in Germany, and for Nordmilch this would solve the financial problems. But according to the management, for the future a German merger in which Nordmilch has a dominating role is seen as the favoured solution for further growth. But if 'other European companies make good offers' such options will not be excluded (interview with the head of the supervisory board).

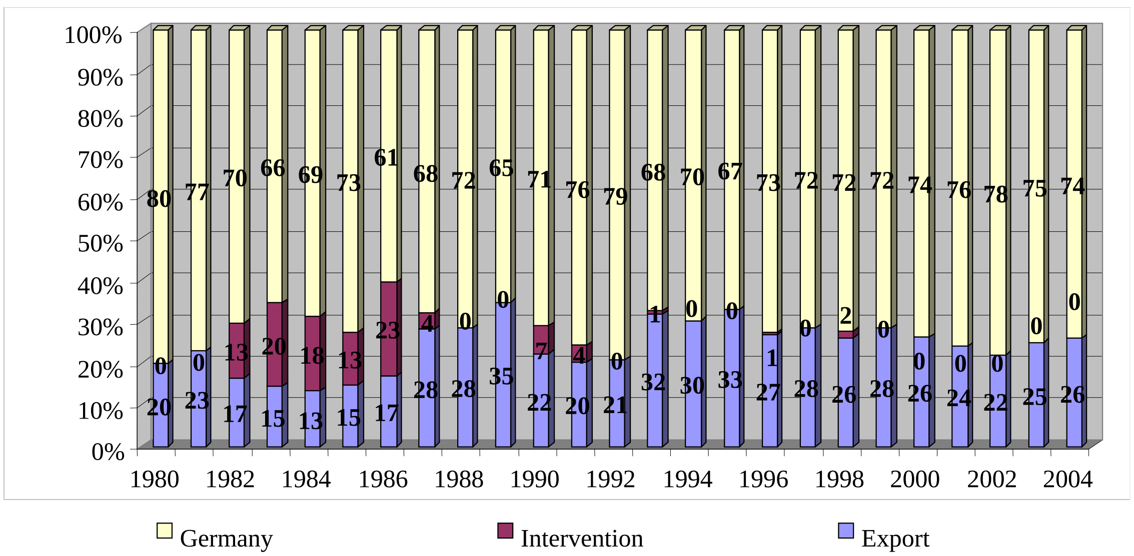

Figure 4.10   Turnover by geographical area or intervention in from 1980 to 2004

4.2.5 Organisational and ownership structure

Nordmilch was holding discussions with its farmers in the years following the 1999 merger. The milk price was reduced and in 2002 on the bottom of German milk price comparison. There are no other payments from the cooperative to the farmers, so that this started many discussions about future strategy of the cooperative. Many farmers planned to leave the cooperative and this increased the pressure on the boards to do something about it. After Mr Tomat entered the cooperative and started the restructuring programme, he invested all the saved money in an increased milk price, so that Nordmilch was again paying a price above the German average milk price. Since then he has been accepted by the farmers and gets support for his plans.

One of the changes in the structure of the company was the scrapping of farmers' honorary positions on the management board, because this made it easier to divide the main responsibility between management and ownership. In the old system, if the company had gone bankrupt the honorary members of the board of management (the farmers) would have lost everything. 'These farmers often did not know the risk they were facing' (interview with the head of the supervisory board). The new system allows the farmers to make clear distinctions, what the management is responsible for and also became operative business and the cooperative tasks and duties more separated from each other.

The planned formation of a private limited company is a further step in this direction. Additionally, this gives the opportunity for the farmers that if in case of further growth plans of Nordmilch more money is needed, it can be obtained from banks, which will take shares of Nordmilch AG. Thus farmers do not have to invest more in the cooperative in the future. But the farmers always have the possibility to allow or deny this in the supervisory board. At the moment, the only excluded option is to go public with the shares of Nordmilch. Here, the company sees many risks and much work, and no compensating advantages.

4.2.6 Leadership and power distribution

After the merger in 1999, the two equitable CEOs (Dr Tag and Dr Dumstorf) led Nordmilch for two years. Farmers, workers and management saw the first year as a good year. All plans regarding the merger were achieved successfully and everybody expected a great future. But in 2001 it became obvious to the supervisory board that the two CEOs did not work together successfully, even did not communicate, and Dr Dumstorf was dismissed. The expected advantage regarding price negotiations was not only not reached but even reversed, because the retail sector called for lower prices or even delisted Nordmilch's products. Also, due to the different strategic orientations of the former cooperatives, there still was no common culture in the new company and many processes were still not harmonised with one another, so that money was lost and decisions took a long time. Additionally the very low milk price of Nordmilch increased the anger of the farmers against their cooperative management. At that moment the supervisory board, which in the beginning had only a few rights (mainly information requests), started to intervene. It simply decided what it found the best thing to do. Due to good contacts with the employee representatives on the supervisory board, it was possible to increase the right of the board to be asked for its approval in more cases than before.

Because of the age of Dr Tag, the remaining CEO of Nordmilch, in 2001 the supervisory board started to look for his successor. Due to the many problems in the cooperative, they decided to get someone from outside, who would start unbiased from the former cooperatives and with new ideas for the future. Thus in 2003 Mr Tomat, a young manager from the competitor Nestlé, became the CEO at Nordmilch. Before he took that job, he was responsible for a big share of Nestlé's German business. At Nordmilch Mr Tomat had the possibility to change the whole structure of the company by introducing new systems and structures. Especially the second level of Nordmilch's personnel hierarchy was renewed after Mr Tomat had joined the company. Here he hired workers from big competitors such as Danone, Unilever, etc. who had the needed skills and know-how to restructure the business. These people also have experience with branded products and international sales.

Nordmilch has changed its structure more often in recent years. As a cooperative of cooperatives, it had had no direct contact with the farmers since the merger in 1999. From then on it was a direct cooperative, which also did most businesses itself and had only few subsidiaries. Due to the problems at the beginning of this new century, the new CEO Mr Tomat changed some businesses and structures in the cooperative and introduced the new system of a limited liability company whose shares are held by the cooperative for 2007. Also the honorary posts on the board of management were replaced by professional managers controlled by a stronger supervisory board, in which the farmers can have an influence on their company.

4.2.7 Control systems

The importance of quality control system at Nordmilch has always been seen as very high. Therefore Nordmilch implemented new process regulations very fast to meet the standards. This was also very important regarding their exports to many countries that required higher quality standards.

During the reorganisation at Nordmilch, also financial control systems were implemented. In contrast to prior attempts, this time also the management was interested not only in showing the final results but also in reaching targets. Each department had to fulfil its goals, so that with the help of these systems it can be checked very fast if the new strategies are really implemented and whether structures really bring the wished for, positive effects. Actually, it is tried to implement one IT structure in the company, containing these systems as well, to improve transparency and also to integrate as much as possible the so far not included farmers in the quality and efficiency management,.

With the recently changed structure of Nordmilch and the upcoming formation of an AG, the farmers' control possibilities have been completely transferred to the supervisory board, which has to approve many longer term decisions of the management in order to make these valid.

4.2.8 Market orientation

Nordmilch nowadays works with inter-functional teams comprised of representatives from the company's Sales, R&D and Marketing departments. This will help to improve the success rate especially in the industry segments by adding improvement to customer relations. The company has also centralised its milk R&D centre in Zeven and all their cheese research and development activities in Edewecht, where they also have one of the largest European cheese plants. In the past, research was done by each single plant and only for already existing markets. Nordmilch used to wait till a company came to them to research something. This has changed. Nowadays the R&D centres regularly carry out research in different fields and actively try to work together with other companies, as well as with universities and research institutes. Mr Tomat reorganised the marketing departments and connected all 'white' research and development activities (milk and milk products) in Zeven and all 'yellow' departments (cheese) in Edewecht. This ended the past disconnected research in each of Nordmilch's plants.

In the past, Nordmilch had no direct consumer orientation: the company was production and process oriented. In recent years, this seems to have changed. Nordmilch is now advertising a lot with its bicycle racing team, the Milram Team, which has already been successful at some events. There is also a stronger retail orientation and the company uses more panel data on consumers to get closer to the market.

During reorganisation, the cost focus was central to the discussions about the future strategy of Nordmilch. Now also the branding strategies are discussed in the company. Especially the problem that branding is very expensive, is closely regarded by the management. Due to good collaboration of Nordmilch's nowadays centralised research department with universities and other research institutes, Nordmilch has introduced some very successful new licensed products in higher price categories. Here also all departments of Nordmilch work together. Especially Käfer yogurt is very successful in the higher priced product categories.

Figure 4.11 Licensed products of Nordmilch

With the arrival of Mr Tomat, Nordmilch changed the company's culture. Following a period of analysis in 2003, he launched the above-mentioned three-step programme, guided by professional consulting agencies. According to the head of the supervisory board, this was the first time for many years that a long-term strategy for the company was developed with true ambition to be realised.

Till 2003, at Nordmilch, innovations, product development and marketing together made less than one per cent of the cooperative's annual turnover. Research was only done in some various fields or on demand of the industry and then also independent from the whole company for each plant itself. Small successes such as the milk drink Milram Vitality, which was developed in 2000, were the exception rather the rule. So their recent most important new product innovation was Milram Frühlingsquark in the 1970s. The budget for innovation and branding has been increased and it is planned to increase it further up to 10 per cent of Nordmilch's turnover, but still innovations in better processes are an important part of the company's research.

4.2.9 Summary of the Nordmilch case

For a long time, Nordmilch refused to change its strategy. The developments in recent years show that developments at Nordmilch are an example of a discontinuous development, which is different from Friesland Foods. At Nordmilch, till the end of the 1990s, the organisational structure was kept in the same way and always only small steps were taken in terms of growing or adapting to the environment. When pressure from the environment, due to the market entry of Campina, became too strong to withstand, Nordmilch merged with other cooperatives but still tried to keep the core strategies in the way they had been before. In 2003, when the pressure was too high and the whole cooperation had lost lots of money within a very short period of time, strategy, structure and leading personnel were changed and adapted to the new environment.

In the 1990s and at the beginning of the new century, Nordmilch and nearly all other dairy companies reacted to the increased consumer demand for value added products and tried to do more for its brands in Germany. But Nordmilch could only introduce a few new and innovative products to the market. The majority of Nordmilch's brands were placed in commodity product categories and were sold by retailers without a premium price. Due to this, Nordmilch changed its strategy some years ago and now mainly focuses on the production of commodity goods and industrial products. Here major focus is on scale and scope effects, in order to reach a cost leadership position. Its still existing brand Milram is in an audit phase, which will show whether Nordmilch should stay in this segment or go on without own brands.

Even if Nordmilch's international share of turnover is relatively high at 20-30 per cent, nothing has been done to enlarge the international markets: Nordmilch sells but does not produce anything at all abroad. In recent years, due to the strong competition in Germany, foreign offices have been opened. But whereas in the past Nordmilch always tried to sell its brands through these offices, this new strategy is focused more on industry products and commodity goods.

4.3 Comparison of cases

4.3.1 Origin and development of cases

Both Friesland and Nordmilch were founded as second-order cooperatives almost at the same time, but Friesland was initially supposed to deliver international markets, whereas Nordmilch's task was based on the national German market. The Netherlands produces twice as much milk as its population consumes, and 'due to their small home market, the Dutch companies always had to look outside for new markets, whereas in Germany the home market is very big and gives many companies enough place for existence' (Sanders, 2006).

Both markets, the German and the Dutch, grew slightly in recent years, but in the Dutch market, companies merged fast to be big enough for exports. Thus, finally a very concentrated marked was reached, with Friesland and Campina at the top. In Germany, competition is still far from an oligopoly. Here, many small and only a few big companies (namely Nordmilch, Humana, Campina and Müller) are active in the market. Big multinational companies such as Nestlé and Unilever are older than both cooperatives and never really looked at single national markets. Danone was built up in the 1980s when BSN merged with Gervais and afterwards started its international strategy in branded dairy and biscuits products all over the world.

4.3.2 Generic strategies

Friesland follows a twofold strategy: in its international activities it follows differentiation strategies, while in its home market it acts as a cost-led commodity goods producer. Here it has to market its members' milk by following mass market strategies and focusing the whole organisation on costs and efficiency, whereas on the international markets, Friesland (like the multinationals) buys only the amount of milk it needs for its products. In these SBUs, product innovation, advertisement and customer research are important. When Friesland took over Nutrica Dairy&Drinks, this was because it wanted to enlarge its expertise and market share in branded products in the Netherlands and also abroad. Nowadays, Friesland spends EUR 184 million a year just on advertising.

Here, Nordmilch differs a lot. Due to financial problems, the cooperative reduced its marketing budget in recent years and invested only EUR 1-5 million in advertisement and promotion. Nordmilch mainly follows a cost leadership strategy and its remaining brand (Milram) plays only a side activity for the business. One major reason for Nordmilch's problems with its branded products is the strong competition in fresh dairy products in Germany. The entry of Campina into the German market was seen as a real threat to the company. Within a very short period, Campina became third biggest dairy processor in Germany. As for its sales in dairy products, Campina was able to sell more branded products in Germany and became more competitive in this compared to Nordmilch and its other competitors. Also Arla, which sells but does not produce in Germany, is becoming stronger in this market. Its brands are more and more accepted by the consumer and are thus increasing the pressure on Nordmilch's remaining brand Milram.

Looking at other companies in the market, it can be seen that some companies (e.g. the German based IOFs Ehrmann and Bauer) only produce and sell within small niches like yogurts, which have relatively high margins and offer continuous growth. Others, like Nestlé, Kraft Foods, Unilever and Danone, are active in more segments, but focus on specialties etc. with opportunities for premium prices. They are no longer real dairy companies but global food companies, which are acting in various product markets. Unilever has its core business in the production of soap and other non-food products. Dairy is only one activity among many others there. Friesland Foods with its strategic orientation is on its way to becoming a global food producer and fits in this group, too. The third group, to which most cooperatives like Nordmilch, Arla and Campina belong, mainly produces commodity goods and has some branded products in niches of the market. Whereas the first two groups are very market oriented, the last one is only partly or not at all market oriented.

Nordmilch has started focusing on the industry product segment, which seems very profitable and where no brands are needed. Here a lot is invested in research and product development and Nordmilch is trying to enlarge this segment on more product fields.

Friesland is also active on this market, but it is not as important for them as it is for Nordmilch.

4.3.3 Growth

Due to the European milk quota system, possibilities for internal growth were limited within Europe. Friesland and Nordmilch grew in their home markets mainly by merging with other cooperatives or by acquiring smaller private dairy companies. Due to Friesland's strong financial background, it was possible for it to buy bigger and more successful companies than Nordmilch could. Thus when Friesland acquired Foremost and Nutricia, it bought not only the brands and international subsidiaries, but also the know-how of brand developing and selling in those markets. The former Hungarian subsidiary of Nutrica, for example, took over Friesland's processing and sales union in that region and was then over a longer period integrated in the company. This strategy also helps Friesland to keep the management and its skills within the company. Nestlé etc. followed this strategy already for a longer time and used every possibility to take over well-functioning companies in the different markets all over the world. But other than those multinationals, Friesland only concentrates on few geographic regions, where it invests. Nordmilch on the other hand mainly took over relatively badly situated companies that were close to collapsing (or had just collapsed) and thus often could not really benefit more than just scaling up in milk intake. The merger, when three other healthy companies merged with Nordmilch, had no real strategy for the time after the merger and due to very different corporate cultures and no real leading group, failed to bring additional resources to the company.

For both companies, size in their markets was seen as an important factor for economic success. All mergers with other cooperatives had the strategic aim of enlarging each company's size in the production of commodity goods, by increasing the milk collection. But additionally Friesland took over other companies in foreign markets that harmonised with its strategies. Here it also used possibilities and grew internally as well as by acquisition, whereas Nordmilch did not grow in foreign markets, except some minor trade relationships.

4.3.4 Internationalisation

When at the end of the 1980s and the beginning of the 1990s Internationalisation became an important topic in the dairy industry, Friesland had the advantage of already being in many international markets. The management simply increased its ambition there by buying processing plants and acquiring local companies. Nordmilch and other German companies also grew, but in the main period of Internationalisation they had to build up capacities in the new Eastern German market, which needed large investments (interview with Weindlmaier). Other big companies used similar strategies. Nestlé tried to market its existing products in all countries and if possible, acquired well-functioning local producers and their brands. Campina secured its most important foreign markets, namely Germany and Belgium, by direct investments and acquired local processors.

Nordmilch did not have the resources or the opportunities to enter more markets. This fact was especially underlined when Campina entered Germany and due to their limited resources, the German companies could not prevent Campina from buying itself a strong market position. Friesland always compared itself in its international business with Nestlé and Unilever. Danone internationalised at the same time as Friesland did and, according to the management, was no real example to follow. Nordmilch always had a share of 15-30 per cent of turnover coming from the international markets. Compared to other German companies, this was seen as a good result. Farmers were not willing to invest more in such an expansion policy and thus Nordmilch limited its expansion on Germany and only sold products abroad but did not produce there. If the management of Nordmilch looked at competitors' actions, then they only looked at the German competitors and later on Campina's strategies in the market, to react to them. The business of multinational players, such as Nestlé, was regarded as useful for other sectors but not for their dairy business. In recent years, this strategy has changed and new sales offices have been opened in some countries. Nordmilch's lagging behind regarding Internationalisation is more obvious to the management nowadays and managers think about options in those markets.

4.3.5 Organisational and ownership structure

During all its mergers and acquisitions, Friesland was always the dominating party. It set the rules and its organisation strategy dominated the new company regarding ownership structure. There were only a few changes. One was the change from second-order cooperative to first-order cooperative; another was after the merger with Coberco the establishment of a public company for the processing, all the shares of which are held by the cooperative. Industry experts see this as a structure similar to that of a second-order cooperative, so that it would fit into Friesland's strategy of splitting cooperative and company. This structure is also similar to IOFs, which also have an independent management and a control panel with a supervisory board, controlled by the shareholding owners.

Nordmilch, on the other hand, did not dominate its big merger in 1999. Many different farmers and managers worked at the new company and finally no-one could dominate the process, so that a mixture of different structures and procedures was laid as background for the new cooperative. In contrast to Friesland, Nordmilch never separated its operative business from the cooperative business. In recent years, Nordmilch has tried to work on this by leaving the operative management to external managers and limiting the influence and control of the farmers and the cooperative on a strong supervisory board. The independence of the management and such a strong supervisory board exists at Friesland already for a longer time. One important point regarding the differentiation of cooperative and operative business is also the estimation of a fair milk price for both sides. Here Friesland pays an average of European competitors and in the past never had discussions about the price with its farmers. Those who wanted to earn more could always buy B shares and thus get high dividends. Nordmilch on the other hand always has to communicate a lot with its farmers to prove that they cannot pay them more.

4.3.6 Leadership and power distribution

During its mergers in the past, the CEO of Friesland always stayed at the top of the new company. At Nordmilch after the 1999 merger, two CEOs were at the top but could not worked together efficiently and could not implement clear strategy in the company. This is a major different between the two cases at hand. In both companies, the CEOs were in office for a relatively long period, but whereas at Friesland Mr Olijslager dominated the company after each merger, Mr Tag faced stronger rivalry within Nordmilch after the merger from 1999. A further difference is that Mr Olijslager is still involved in some activities at Friesland Foods, whereas Mr Tag and Nordmilch have gone separate ways.

Regarding the changes within the management at Nordmilch and Friesland, one major difference is that at Friesland the change was continuous and planned on the long term, whereas at Nordmilch the change was a big interruption in the organisation. Mr Tomat by profession is a business manager, whereas his predecessors and the whole management were comprised of dairy specialists who learned the business part on the job. After Mr Tomat, more business people joined Nordmilch and thus changed the whole way of leadership and organisation in a way similar to Friesland Foods. At Friesland, but also at other companies, such as Arla Foods and Nestlé, the leaving CEO was in charge of finding his successor.

4.3.7 Control systems

Quality control systems have always been important in the European dairy industry. In both cooperatives, various different systems and norms have been implemented in the processes.

A closer look at the financial control systems shows that these have always been important at Friesland Foods, but have only in recent years become important at Nordmilch. In the past, the Nordmilch management always set benchmarks, but never really checked if these were reached.

4.3.8 Market orientation

Friesland has always been market oriented in its international and branded product businesses. Learning from major competitors like Nestlé and Unilever, the company implemented major features of market orientation, such as being innovative for the consumer in their corporate mission. Also benchmarking with major competitors and their steps in the markets are part of Friesland's normal procedures in defining its success. The management plans the company's strategies for both the short term and the long-term. Due to its twofold organisation, the introduction of market orientation for the commodity business came later on, but this part of Friesland is also market oriented in its organisation and structure.

At Nordmilch, where the commodity segment is the main business of the company, cost and production rather than consumer or market orientation were central. In recent years, the company has tried to bring innovativeness along the customer more in the centre of its research activities by including external know-how from research institutes etc. This is also shown in the progress Nordmilch is making in advertising. The sponsoring of a bike racing team was a success and still fits into Nordmilch's small budget. One major difference is, again, who both companies see as their major customers. For Friesland this is the end consumer, whereas for Nordmilch it is the industry and the retailers. One reason may be its weak position in the branded product segment in Germany.

5. Discussion, conclusions and recommendations

The aim of this project was to establish how the transition from production-oriented to market-oriented agribusiness has taken place in the European dairy industry. The idea was to provide insights that can be applied to the strategies of dairy companies themselves and to understand developments in other agribusiness sectors.

Overall, our cases provide support for the model described in Section 2. Both companies moved from a more fragmented industry structure to a phase in which they increased scale and scope, and subsequently recognised the creation of customer value as a new key success factor (although Friesland was more able to respond to this than Nordmilch was). An important exception is that our results also show that firms may have internationalised from the very beginning. This has influenced their mode of learning and contributes to the industry transition from production oriented to market oriented as a whole. Both companies managed to survive the changing environment by growing strongly, but with different geographical focus: Nordmilch was focused on the relatively large domestic market in Germany, whereas Friesland - with its relatively small domestic market - grew internationally. Throughout its history Friesland has been an international company. Hence, its Internationalisation strategy cannot be understood as a 'clever management plan' alone: it should also be understood as something that has been in the 'genes' of the company throughout its existence, and perhaps even as a core competence of the firm.

Developments within the dairy industry can be explained by using change and evolution theories. Within the dairy industry, change of corporative strategies appeared in different ways. In the case of Nordmilch, it was a re-creation of the whole business, as it is explained in the punctuated equilibrium theory (Romanelli & Tushman, 1985; 1994), whereas in the case of Friesland Foods, the change is an example of continuous change theories (Brown & Eisenhardt, 1997). To arrive at its current position, Friesland adopted a pattern of continuous change early on in its existence. Its brands, market positions abroad and marketing capabilities were gradually developed in a step-by-step manner. This strongly contradicts the pattern of change found at Nordmilch. Nordmilch can be regarded a classic example of punctuated change: for a long time it was successful with the strategy it had, due to its large domestic market, and defining itself as a German rather than a European dairy firm it could continue this strategy without being too bothered by the changing environment of the European dairy industry. Once it received signals that the strategy was no longer feasible in the business environment (e.g. a historically low milk price and the entrance of a new competitor, Campina), it underwent a transformation in which leadership, power structure, organisational structure, business unit strategy, and core values and beliefs changed.

Going through this transformation phase in a relatively short period of time did not enable Nordmilch to catch up with Friesland. Compared to Friesland, Nordmilch could not build on a long history in which it developed brands, market positions, market entry experience and other marketing assets. It therefore analysed the remaining strategic space in the industry and re-established its position as a cost leader. This finding suggests that in order to become a company at the forefront of the industry, continuous change is a requirement rather than an advantage. Punctuated change leaves companies with the remaining strategic options in the industry, whereas companies that are also changing in a punctuated fashion but respond relatively late, are the ones that are absorbed by those that are searching for scale advantages.

An interesting question is why Friesland adopted the pattern of continuous change, continuously strengthening its market orientation, while Nordmilch did not. The answer that emerges from our data is that both Friesland and Nordmilch learned from their markets, but that the market environment from which each learned (and therefore also the things that each learned) were dramatically different. Whereas Nordmilch learned from its German competitors that were comparable to Nordmilch itself, it ran a learning curve of efficiency optimization, Friesland competed on many international markets where it met competitors like Nestlé and Unilever, which have a strong tradition in developing and marketing branded products in various industries. Moreover, in several of these markets, brands were a critical success factor because guarantees of food safety and quality were not guaranteed by the national governments. Recognizing the importance of strengthening its marketing capabilities, Friesland started to strengthen these, both by internal development and by acquiring companies that had a major strength in marketing. Perhaps comparably, Danone developed its marketing capabilities in industries other than dairy and subsequently applied them to its product line in dairy. This suggests that the transition of an industry from an orientation towards commodity products to a market orientation, is generated by external forces. Companies that look over the traditional borders of their industry discover new practices and new ways to compete. If they apply these new capabilities to the traditional commodity industry, they become the intermediaries of knowledge and skills, and eventually the forerunners of change in their own industry.

The following picture helps to understand how industries move from production oriented to market oriented, and perhaps eventually even beyond the point at which industry categorizations no longer make sense because competition can be understood only as something that occurs on market segments. At the bottom left, we indicate the *modern cost leaders in domestic dairy processing*, such as Nordmilch. They are production-oriented national dairy companies that managed to survive the transition in their industry by engaging in a transformation just in time. These companies have a strong production focus and if they have any brands, these brands are generally weak and supported by large advertising budgets. Their focus is predominantly national, because in their national environment they can compete with fresh, perishable products on the basis of costs, whereas with non-perishable products like milk powder they would probably lose their cost advantage to cheaper and larger players on the world market.

The firms in the next step of industry development are the *dairy differentiators*. Unlike the firms with a production focus, the differentiation strategy of these firms is relatively more important than their cost leadership strategy. They have developed some capabilities on the basis of which they manage to be distinctive, and they apply these capabilities in a few carefully selected international markets. A clear example of such a company is Campina. Campina has developed a strong capability in product development, mainly based on a superior technology. In addition to its home market in the Netherlands, it also looks abroad merely to the German market.

The subsequent step in industry development is labelled *market-oriented, internationalising dairy companies*. These companies have strong marketing capabilities, resulting in strong brands. Being relatively unique, they can apply their capabilities to a relatively large number of international markets. Friesland is probably the best example of this type of company. Friesland still has a strong foothold in the production of milk, which is what distinguishes this company from the global brand manufacturers. These global brand manufacturers can be seen as the next stage of industry development. Although strictly speaking they are not part of this industry because they do not produce milk, they do compete with them (especially with the market-oriented, internationalizing dairy companies) and thus are a source of learning to them. A company like Danone has a position in between the two: it has a foothold in dairy but is doing equally well (or perhaps even better) in selling branded products in other categories.

Finally, there is the question whether companies evolve from one stage of industry development to another. Our interpretation is that they do not. Instead, some companies within an industry manage to learn more and to do so over longer periods and more continuously than others, and thus reach higher 'levels'. Levels are associated with a higher profit potential because the firm has the capability to increase the price ceiling (willingness to pay). Because to reach higher levels firms seem to learn in a more continuous manner, the learning curves in the figure flatten out as one climbs higher. Whether a firm runs such a flat learning curve depends on both internal and external factors, including its market environment (national vs international), the type of competitors it encounters on its markets, and such forces as power distribution that may encourage the firm to look beyond its horizons or prevent it from doing so.

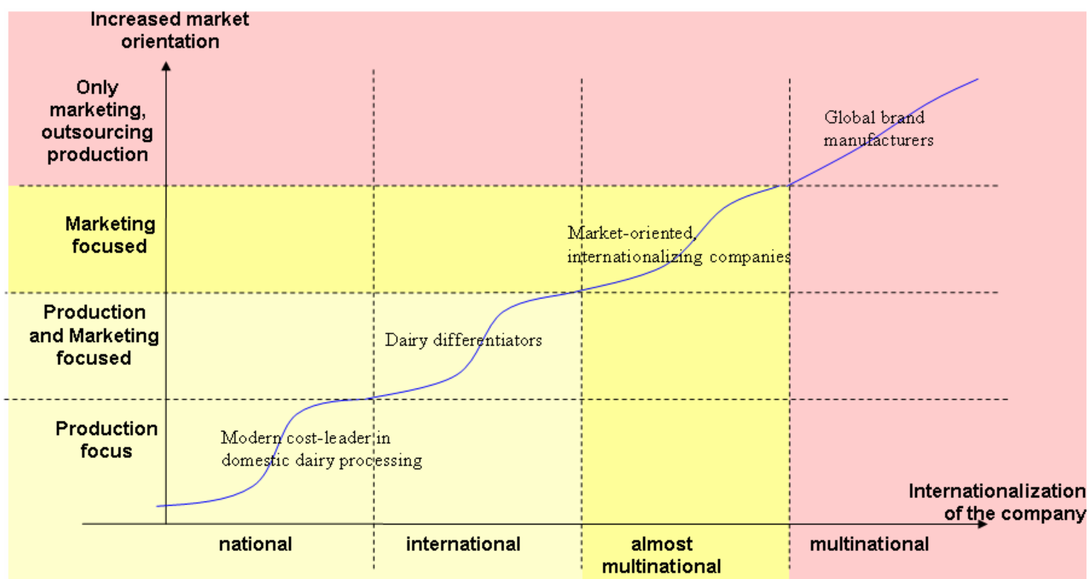

Figure 5.1 Evolutionary Model of European Dairy Industry

5.1 Implications for the dairy industry

This research will firms in the dairy industry to understand their strategic position and what it takes to change it. This is especially relevant to companies that are at the more lower stages of industry development according to the model, such as Nordmilch, Humana, Campina and Arla. By analysing more closely the developments at competitors (such as Friesland and Danone, or even Nestlé and Unilever), they could generate more knowledge on Internationalisation and value creation. This knowledge, together with long-term planning, could enable these companies to develop the needed resources and capabilities earlier in time, as other competitors do. But here the early mover advantages of the food companies lead to higher entrance costs for companies, such as Nordmilch, who are far behind the others regarding branding and Internationalisation. Especially the risk for the need of a re-creation would not be decreased then. Thus a decision about further strategy could also mean abandoning the whole business of branded consumer products. If firms in these early stages would study the trends of Danone, Nestlé and Unilever more closely, the Nordmilch management could prepare the cooperative for its future in a better way, even if it would concentrate more on supplying those food companies with ingredients. An opportunity seems to arise for companies that are at the earlier stages of industry development to become a supplier of brand manufacturers in the future. In this new role, these firms may internationalise following their customer companies to international markets (also Fonterra from New Zealand is following a strategy comparable to this one).

In general, market orientation is probably an important key success factor for the future of companies in the dairy industry. Here, especially firms that are in the early stage of industry development have to work hard in order to keep up with the other dairy companies. One aspect that is very important for cooperatives in this case is the relationship with the farmers. If the management cannot establish a feeling of trust among the members of the cooperative, the farmers will not be willing to increase the business further or to invest more money in the cooperative. Here, good long-term information strategies, such as Friesland used, are needed.

For such companies as Friesland and Danone, which are very successful with their strategic orientation, the future development of the market can also change their environment. Both companies are relatively small compared to big multinational food and beverages companies like Nestlé, Unilever, Kraft Foods, Coca Cola and Pepsi. In the past, all these companies acquired many smaller competitors that had found success in their markets or had developed useful capabilities. These companies also have the capital required to buy such competitors and also within the industry, this is seen as a normal way for growth. Here, the long-term views of the owners are important. As long as the farmers and owners of for example Friesland Foods keep their shares and invest in the future, the company will stay independent and probably also competitive. For such companies as Nestlé, for whom dairy is only one small segment among many, the future depends on the management's aims and strategies. If they see the dairy unit as too small, to be a core business for the future, a spin-off and sale seem possible.

In the future, some companies will probably focus their strategies not on the value creation for consumers, but on producing ingredients for other companies. Here the generalization of scale and scope effects is one core success factor for the companies.

Skills in branding are not that important. It is more important to implant market orientation in strategies and structures of the system. Only if the innovativeness of a company, together with good market research, allows the development of products that the market needs, can future success be achieved.

5.1.1 Implications for other industries

We can extend our line of thinking to analyse different industries within agribusiness. Some industries may encounter the global brand manufacturers more directly in the competitive arena than others. Similarly, some industries may be represented in diversified corporations in which learning effects may be transferred across divisions, more often than others industries.

Thus, if one compares the meat industry to the dairy industry, it can be said that the former is following the latter in some aspects, but with a delay of about twenty years. Market orientation has not been developed in the European meat industry so far, but industry experts expect such in the future.

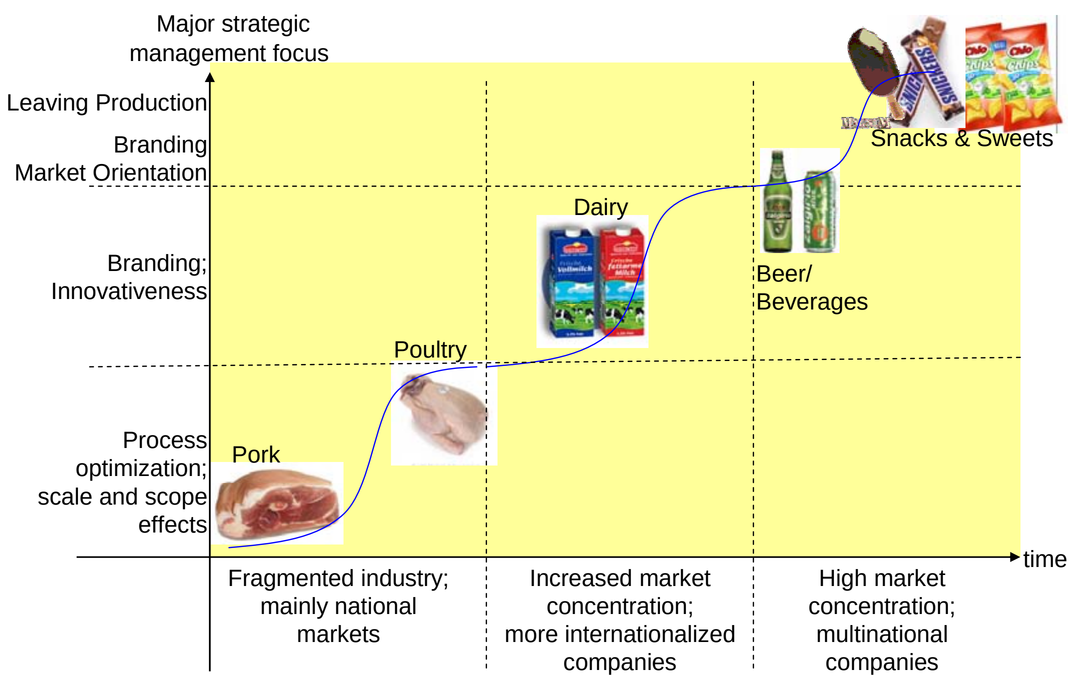

Figure 5.2 Evolution of different European food industries

Especially for further processed meat products, branding seems to be possible, such as it happened in the dairy industry (some processed meat products are already included in the product line of brand manufacturers, but a spin-off from those products to other meat products seems absent). Studies show that there are difficulties regarding the establishment of brands for fresh meat (Schramm et al., 2006). So far, there are only a few brands for fresh meat products (e.g. Wiesenhof for German poultry, and Tulip for Danish pork meat). The meat industry in Europe is also not that concentrated, as the dairy industry is, but an increase has occurred in recent years.

Other industries, such as the beer industry, are probably ahead of the dairy industry. There, a few multinational companies manage a large share of the whole market and often control national markets with their high advertising expenditures. Nowadays, producers of snacks foods and sweets concentrate more or less only on marketing and innovation. Nestlé and Unilever also belong to this group. For a long time, it has been quite normal in this segment to outsource as many production processes as possible, as Nestlé and Unilever have now started to do with their dairy products.

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