Milkam – expanding in the Scandinavian markets

Katarzyna Mroczek

Introduction

Thomas Kowalski, CEO of the *Milkam*[460] Poland, was sitting at the emergency meeting of the managerial team responsible for launching the company on the Scandinavian markets. The team has worked on preparing the strategy for expanding into the one of the few areas the company has yet to succeed.

The company was founded in the late 1920s and has virtually changed from a small-scale regional diary producer into a global player that attributes around 70% of its revenue from foreign markets. Entering the Scandinavian markets seemed to Thomas, however, as an endless struggle. The company has so far reached most of the European markets with moderate success or at least without much of internal debate on how to manage that. Sweden, Norway and Finland as the future target markets were causing unusual agitation. The question was not whether to enter these areas but how to do it.

Milkam – the quest to grow

Since it was founded, *Milkam* has sought to grow and become one of the key players both in Poland and in Europe. As Kowalski says: *We have a wide portfolio of products – any milk-based product you could think of– we make it. It is our goal to maintain high quality – to make the consumer taste it once and be sure that they come back for more"*.

The company has taken full advantage of the consolidation process taking place in Poland. It has acquired multiple facilities all over the country. The growth has been steady and the market – quite favourable. *We have been tempted to* let in *foreign capital. Our assets were growing, the sales revenue as well, and the company was prized in various areas on a year-to-year basis. But we didn't. We wanted it to be a 100% Polish firm. And we still do"*says Christopher Stow, the CFO of the company.

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This case study was written by Katarzyna Mroczek, Poznań University of Economics, Poland. It is intended to be used as the basis for class discussion. The author does not intend to illustrate either effective or ineffective handling of a managerial situation. Certain names and other identifying information may have been disguised to protect confidentiality. The company's name and managers' names have been changed in order to guarantee anonymity.

The Polish market is quite saturated. There are 725 companies operating in the diary industry but only about 20 of them are actively pursuing growth and market share. Most of the companies are local ones that focus on establishing regional bonds. The top 10 companies on the market generated around 44% of the market share in 2012 (Table 1).

Table 1. Turnover and market share of the top 15 diary companies active on the Polish market in 2012

No	Company	Turnover [‘000EUR]	Cumulative turnover [‘000EUR]	Market share [%]	Cumulative market share [%]
1	A	686 603	686 603	9.60	9.60
2	B	680 106	1 366 709	9.51	19.12
3	C	374 550	1 741 259	5.24	24.35
4	D	337 788	2 079 048	4.72	29.08
5	E	257 831	2 336 879	3.61	32.69
6	F	199 076	2 535 955	2.78	35.47
7	G	168 670	2 704 625	2.36	37.83
8	H	149 558	2 854 183	2.09	39.92
9	I	145 343	2 999 527	2.03	41.95
10	J	137 238	3 136 765	1.92	43.87
11	K	132 166	3 268 931	1.85	45.72
12	L	94 836	3 363 767	1.33	47.05
13	M	93 670	3 457 438	1.31	48.36
14	N	88 664	3 546 101	1.24	49.60
15	O	87 528	3 633 629	1.22	50.82

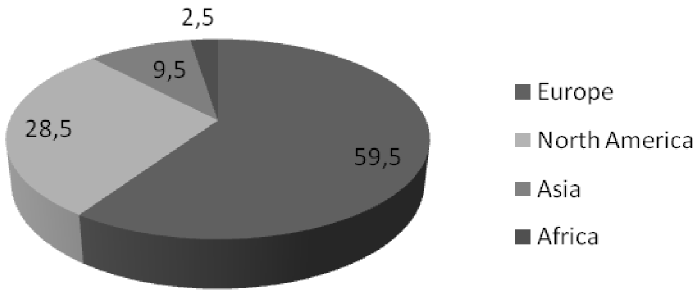
Source: Amadeus database

For the last 5 years Milkam has always been among the top 15 most effective companies. The turnover has been stable and the profitability has mounted up around 5% which is, in comparison to its competitors, a quite satisfying result.

In the 1990s the company reached a point where it was ready to expand internationally. The first obvious directions to expand seemed to be the direct neighbours: Germany, Slovakia, and the

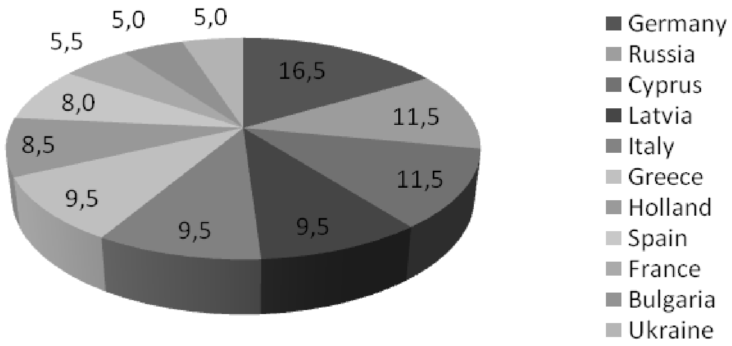
Czech Republic. The choice was quite simple – let's start with export and see how it proceeds with time.The internationalisation turned out to be a milestone in the company's growth strategy. In 2013, *Milkam's* revenue was mostly generated in foreign locations (Exhibit 1,2).

Exhibit 1. Overall exports share (according to revenue) 2013



Source: poland-export.pl

Exhibit 2. Exports share in Europe (according to revenue) 2013



Source: poland-export.pl

The quest to expand internationally has, however, not been an easy task. Due to the products' specifics, dairy producers need to acquire special permits to export. The company has submitted applications for ISO certificates and was accredited – which is proof of its high quality pursuit.

So far, the company has reached most of the European markets through exports. The task has been relatively simple, excluding Russia. Only around 50 Polish dairy producers acquired the necessary certificates to be allowed to export its products to Russia, with *Milkam* being one of the largest of them as far as quota is concerned. In 2013, however, the Russian Federation revoked the right for *Milkam* to sell its goods in Russia. The Phytosaniatry Office claimed to have found bacteria in the samples tested. The matter was quite quickly resolved however it did bring bad publicity just before launching the products on the Scandinavian markets.

Scandinavia – where does the problem lie?

"The Russian case has caused us major PR damage. We have always cherished the image of pursuing high quality. That was essentially important for the Scandinavian markets where clients are known for eco-friendly behaviour and high-quality attributes" says Thomas Kowalski.

The Scandinavian markets were always perceived as demanding markets but at the same time the market researched revealed that the net profits expected would be relatively high. The question arouse to when and how to enter these markets.

"We previously had some doubt on whether exports would be the best option for expanding in the area. We have no experience in handling this area and the clients are culturally different from the Poles. We have only settled for exports as this was the way we had dealt with internationalisation before" says Thomas Kowalski.

Poland and Scandinavian markets are culturally different. In fact, if cultural difference measures are applied, the gap between these countries is the biggest in comparison to all European countries. That indicates that the uncertainty of handling business in these markets is high. After the Russian crisis the company has considered whether a partnership or a joint venture would not diminish this risk. The products could be launched under a different brand not to be associated with the bacteria incident.

Although milk and dairy consumption in Scandinavian markets is decreasing, it is still one of the highest in Europe. At the same time, when compared to other countries, the cost of producing dairy (including labour costs and milk cost) are one of the highest. This fact has also highly influenced the options of choosing the entry mode.

In 2015, the European Union is planning to liberate the *milk quota*, which means that there will be no administrative limit of milk available for sale in a particular market. The quota system has been in force for over 30 years and it is hard to predict whether, and how, it might influence different companies' strategy for growth. Milkam fears that it may additionally draw even a stronger difference between the milk costs between home and host countries.

The team working on the expansion strategy has also taken into consideration the specifics of the transactions in mind. Dairy products require special transportation and not all products can be taken into consideration if exports is preferred. The team predicts that the delivery schedule would have to become quite frequent – at least a couple of times a month.

The decision of the entry mode is no doubt crucial. Taking the *safe route* – exports – seems satisfying enough as the company should be able to follow its previous path. In case of failure, the switching costs or costs of abandoning the market should be controllable. Equity modes however provide the company with a possibility of much bigger scope of actions and much higher market sharegrowth. On the other hand, a joint venture or a direct investment would mean higher financial risk and, in case of failure, the possibility of strong financial consequences for the whole company.