4

Development of the firm's international competitiveness

Contents

Learning objectives

After studying this chapter you should be able to do the following:

- **Define the concept 'international competitiveness' in a broader perspective from a macro level to a micro level.**
- **Discuss the factors influencing the firm's international competitiveness.**
- **Explain how Porter's traditional competitive-based five forces model can be extended to a collaborative (five sources) model.**
- **Explore the idea behind the 'competitive triangle'.**
- **Analyse the basic sources of competitive advantage.**
- **Explain the steps in competitive benchmarking.**

4.1 Introduction

The topic of this chapter is how the firm creates and develops competitive advantages in the international market. Development of a firm's international competitiveness takes place interactively with the environment. The firm must be able to adjust to customers, competitors and public authorities. To be able to participate in the international competitive arena the firm must have established a competitive basis consisting of resources, competences and relations to others in the international arena.

To enable an understanding of the development of a firm's international competitiveness in a broader perspective, a model in three stages (see Figure 4.1) will be presented:

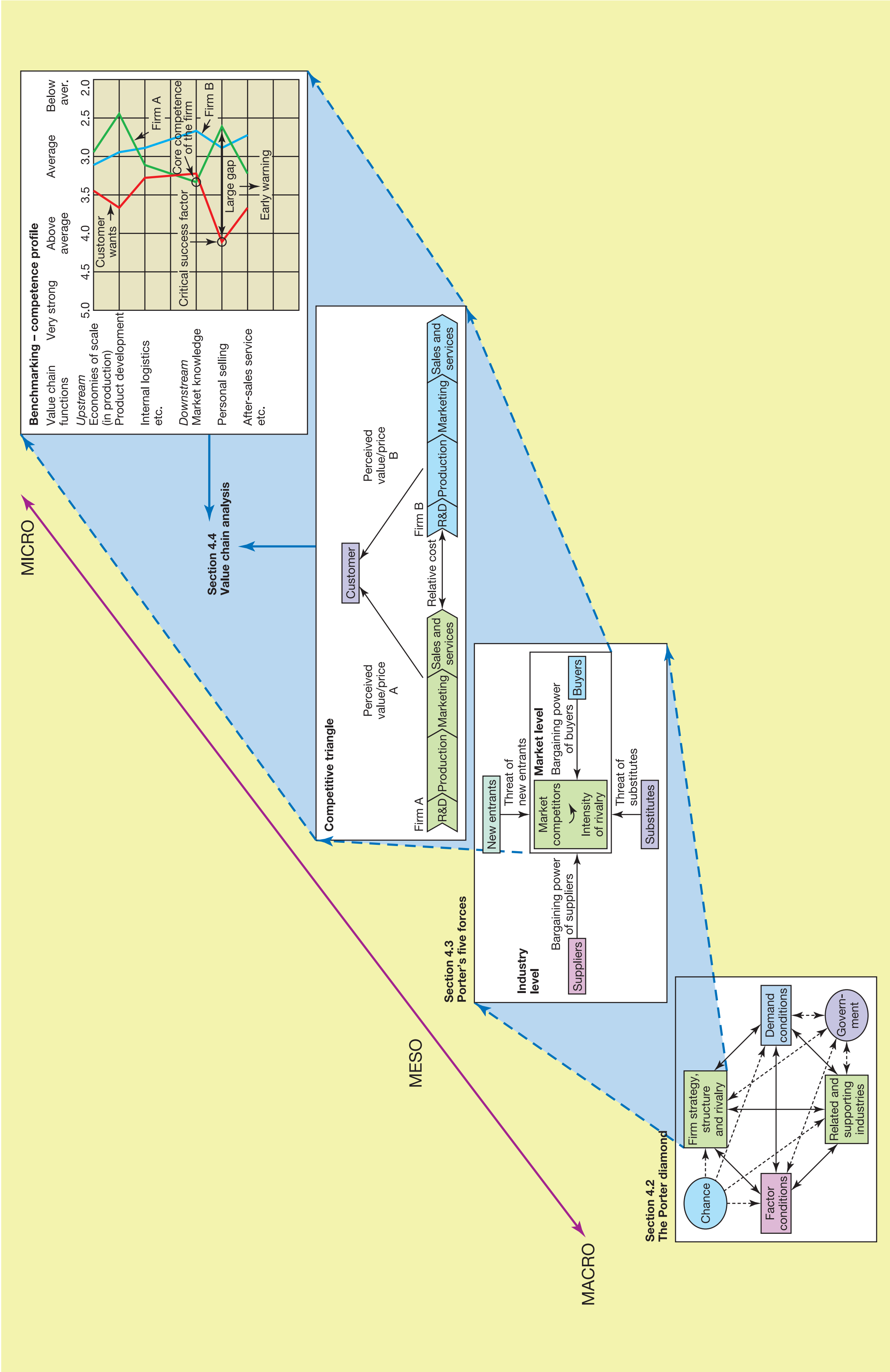


Figure 4.1 Development of a firm's international competitiveness

1 analysis of national competitiveness (the Porter diamond) – Macro level;
2 competition analysis in an industry (Porter's five forces) – Meso level;
3 value chain analysis – Micro level:
   (a) competitive triangle;
   (b) benchmarking.

The analysis starts at the macro level and then moves into the firm's competitive arena through Porter's five forces framework. Based on the firm's value chain, the analysis is concluded with a discussion of which activities/functions in the value chain are the firm's core competences (and must be developed internally in the firm) and which competences must be placed with others through alliances and market relations.

The graphical system used in Figure 4.1 (which will be referred to throughout this chapter) places the models after each other in a hierarchical windows logic, where you get from stage 1 to stage 2 by clicking on the icon box: 'Firm strategy, structure and rivalry'. Here Porter's five forces model appears. From stage 2 to 3 we click the middle box labelled 'Market competitors/Intensity of rivalry' and the model for a value chain analysis/competitive triangle appears.

Individual competitiveness and time-based competition

In this chapter the analysis ends at the firm level but it is possible to go a step further by analysing individual competitiveness (Veliyath and Zahra, 2000). The factors influencing the capacity of an individual to become competitive would include intrinsic abilities, skills, motivation levels and the amount of effort involved. Traditional decision-making perspectives maintain that uncertainty leads executives to search for more additional information with which to increase certainty. However Kedia *et al.* (2002) showed that some executives increase competitiveness by using tactics to accelerate analysis of information and alternatives during the decision-making process. For example, these executives examine several alternatives simultaneously. The comparison process speeds their analysis of the strengths and weaknesses of options.

4.2 Analysis of national competitiveness (the Porter diamond)

Analysis of national competitiveness represents the highest level in the entire model (Figure 4.1). Michael E. Porter called his work *The Competitive Advantage of Nations* (1990), but as a starting point it is important to say that it is firms which are competing in the international arena, not nations. Yet the characteristics of the home nation play a central role in a firm's international success. The home base shapes a company's capacity to innovate rapidly in technology and methods, and to do so in the proper directions. It is the place from which competitive advantage ultimately emanates and from which it must be sustained. Competitive advantage ultimately results from an effective combination of national circumstances and company strategy. Conditions in a nation may create an environment in which firms can attain international competitive advantage, but it is up to a company to seize the opportunity. The national diamond becomes central to choosing the industries to compete with, as well as the appropriate strategy. The home base is an important determinant of a firm's strengths and weaknesses relative to foreign rivals.

Understanding the home base of foreign competitors is essential in analysing them. Their home nation yields them advantages and disadvantages. It also shapes their likely future strategies.

Porter (1990) describes a concentration of firms within a certain industry as industrial clusters. Within such industrial clusters firms have a network of relations to other firms in the industry: customers (including firms that work on semi-manufactured goods), suppliers and competitors. These industrial clusters may go worldwide, but they will usually have their starting point and location in a certain country or region of a country.

A firm gains important competitive advantages from the presence in its home nation of world-class buyers, suppliers and related industries. They provide insight into future market needs and technological developments. They contribute to a climate for change and improvement, and become partners and allies in the innovation process. Having a strong cluster at home unblocks the flow of information and allows deeper and more open contact than is possible when dealing with foreign firms. Being part of a cluster localised in a small geographic area can be even more valuable, so the central question we can ask is: what accounts for the national location of a particular global industry? The answer begins, as does all classical trade theory, with the match between the factor endowments of the country and the needs of the industry.

Porter's diamond
The characteristics of the 'home base' play a central role in explaining the international competitiveness of the firm – the explaining elements consist of factor conditions, demand conditions, related and supporting industries, firm strategy – structure and rivalry, chance and government.

Let us now take a closer look at the different elements in **Porter's diamond**, beginning with the factor conditions.

Factor conditions

In this connection it is important to mention that the most enduring competitive advantages for nations are created by those factors that have the least degree of mobility. Factors with low mobility create the ground for international competitiveness. For example, India has a high growth in IT but the poor infrastructure is still a barrier for creating further international competitiveness in many industries. Table 4.1 lists the various factors of production and indicates the mobility of each.

At one extreme, we have climate with no mobility. Finland will never be a major producer of citrus fruit, no matter what government and industry do to try to change the rest of the national diamond.

At the other end of the mobility scale we have capital, probably the most mobile of the factors of production. Over the years we have seen enormous increases in the inflow and outflow of foreign investment capital in the industrialized and developing countries of the world. This can be seen as part of the process of global economic integration. Technology and the loosening of currency restrictions throughout the world have improved the flow of capital across nations and suggest that differences in capital availability are no longer likely to constitute a very stable competitive advantage for an area.

Demand conditions

The nature and size of home demand is represented in the right-hand box of Porter's diamond (Figure 4.1). There exists an interaction between scale economies,

Table 4.1 Factor conditions and their degree of mobility

Factor	Degree of mobility
Climate	*Low*
Physical infrastructure (transport, etc.)	↑
Natural resources (minerals, oil)	
Educational system	
Human resources (movement of labour)	
Technological infrastructure (software, communication network)	↓
Capital	*High*

transportation costs and the size of the home market. Given sufficiently strong economies of scale, each producer wants to serve a geographically extensive market from a single location. To minimize transportation costs the producer chooses a location with large local demand. When scale economies limit the number of production locations the size of a market will be an important determinant of its attractiveness. Large home markets will also ensure that firms located at that site develop a cost advantage based on scale and often on experience as well.

An interesting pattern is that an early large home market that has become saturated forces efficient firms to look abroad for new business. For example, the Japanese motorcycle industry with its large home market used its scale advantages in the global marketplace after an early start in Japan. The composition of demand also plays an important role.

A product's fundamental or core design nearly always reflects home market needs. In electrical transmission equipment, for example, Sweden dominates the world in the high-voltage distribution market. In Sweden there is a relatively large demand for transporting high voltage over long distances, as a consequence of the location of population and industry clusters. Here the needs of the home market shaped the industry that was later able to respond to global markets (with ABB as one of the leading producers in the world market).

The sophistication of the buyer is also important. The US government was the first buyer of chips and remained the only customer for many years. The price inelasticity of government encouraged firms to develop technically advanced products without worrying too much about costs. Under these conditions the technological frontier was clearly pushed much further and much faster than it would have been had the buyer been either less sophisticated or more price sensitive. Today the Japanese, who dominate the market for semiconductors, are influencing the shape of the industry and price issues have become more salient.

Related and supporting industries

In part, the advantages of clustering come from a reduction in the transportation costs for intermediate goods. In many other cases advantages come from being able to use labour that is attracted to an area to serve the core industry, but which is available and skilled for supporting industries. Coordination of technology is also eased by geographic proximity. Porter argues that Italian world leadership in gold and silver jewellery has been sustained in part by the local presence of manufacturers of jewellery-making machinery. Here the advantage of clustering is not so much transportation cost reductions but technical and marketing cooperation. In the semiconductor industry, the strength of the electronics industry in Japan (which buys the semiconductors) is a strong incentive to the location of semiconductors in the same area. It should be noted that clustering is not independent of scale economies. If there were no scale economies in the production of intermediate inputs, then the small-scale centres of production could rival the large-scale centres. It is the fact that there are scale economies in both semiconductors and electronics, coupled with the technological and marketing connections between the two, that give rise to clustering advantages.

Firm strategy, structure and rivalry

One of the most compelling results of Porter's study of successful industries in ten different nations is the powerful and positive effect that domestic competition has on the ability to compete in the global marketplace. In Germany, the fierce domestic rivalry among BASF, Hoechst and Bayer in the pharmaceutical industry is well known. Furthermore, the process of competition weeds out inferior technologies, products and management practices, and leaves as survivors only the most efficient firms. When domestic competition is vigorous firms are forced to become more efficient, adopt new cost-saving technologies, reduce product development time, and learn to motivate and control workers more effectively. Domestic rivalry is especially important in stimulating technological developments among global firms.

The small country of Denmark has three producers of hearing-aids (William Demant, Widex and GN Resound/Danavox), which are all among the top ten of the world's largest producers of hearing-aids. In 1996 Oticon (the earlier William Demant) and Widex fought a violent technological battle to be the first in the world to launch a 100 per cent digitalized hearing-aid. Widex (the smaller of the two producers) won, but forced Oticon at the same time to keep a leading edge in technological development.

Chance

When we look at the history of most industries we also see the role played by chance. Perhaps the most important instance of chance involves the question of who comes up with a major new idea first. For reasons having little to do with economics, entrepreneurs will typically start their new operations in their home countries. Once the industry begins in a given country scale and clustering effects can cement the industry's position in that country.

Government

Governments play a powerful role in encouraging the development of industries within their own borders that will assume global positions. One way governments do this is through their effect on other elements of the national diamond. Governments finance and construct infrastructure, providing roads, airports, education and health care, and can support use of alternative energy (e.g. windmills) or other environmental systems that affect factors of production.

From the firm's point of view the last two variables, chance and government, can be regarded as exogenous variables which the firm must adjust to. Alternatively, the government may be considered susceptible through lobbying, interest organizations and mass media.

In summary, we have identified six factors that influence the location of global industries: factors of production, home demand, the location of supporting industries, the internal structure of the domestic industry, chance and government. We have also suggested that these factors are interconnected. As industries evolve their dependence on particular locations may also change. For example, the shift in users of semiconductors from the military to the electronics industry has had a profound effect on the shape of the national diamond in that industry. To the extent that governments and firms recognize the source of any locational advantages that they have, they will be better able to both exploit those differences and anticipate their shifts.

4.3 Competition analysis in an industry

The next step in understanding the firm's competitiveness is to look at the competitive arena in an industry, which is the top box in the diamond model (see Figure 4.1).

One of the most useful frameworks for analysing the competitive structure has been developed by Porter. Porter (1980) suggests that competition in an industry is rooted in its underlying economic structure and goes beyond the behaviour of current competitors. The state of competition depends upon five basic competitive forces, as shown in Figure 4.1. Together these factors determine the ultimate profit potential in an industry, where profit is measured in terms of long-run return on invested capital. The profit potential will differ from industry to industry.

To make things clearer we need to define a number of key terms. An *industry* is a group of firms that offer a product or class of products which are close substitutes for each other. Examples are the car industry and the pharmaceutical industry (Kotler, 1997, p. 230). A *market* is a set of actual and potential buyers of a product and sellers. A distinction will be made between industry and market level, as we assume that the industry may contain several different markets. This is why the outer box in Figure 4.1 is designated 'industry level' and the inner box 'market level'.

Porter's five-forces model
The state of competition and profit potential in an industry depends on five basic competitive forces: new entrants, suppliers, buyers, substitutes, buyers and market competitors.

Thus the *industry level* (**Porter's five-forces model**) consists of all types of actors (new entrants, suppliers, substitutes, buyers and market competitors) that have a potential or current interest in the industry.

The *market level* consists of actors with a current interest in the market: that is, buyers and sellers (market competitors). In section 4.4 (value chain analysis) this market level will be further elaborated on as the buyers' perceived value of different competitor offerings will be discussed.

Although division into the above-mentioned two levels is appropriate for this approach, Levitt (1960) pointed out the danger of 'marketing myopia', where the seller defines the competition field (i.e. the market) too narrowly. For example, European luxury car manufacturers showed this myopia with their focus on each other rather than on the Japanese mass manufacturers, who were new entrants into the luxury car market.

The goal of competition analysis is to find a position in industry where the company can best defend itself against the five forces, or can influence them in its favour. Knowledge of these underlying pressures highlights the critical strengths and weaknesses of the company, shows its position in the industry, and clarifies areas where strategy changes yield the greatest pay-off. Structure analysis is fundamental for formulating competitive strategy.

Each of the five forces in the Porter model in turn comprises a number of elements that combine to determine the strength of each force, and its effect on the degree of competition. Each force is now discussed.

Market competitors

The intensity of rivalry between existing competitors in the market depends on a number of factors:

- *The concentration of the industry*. Numerous competitors of equal size will lead to more intense rivalry. There will be less rivalry when a clear leader (at least 50 per cent larger than the second) exists with a large cost advantage.
- *Rate of market growth*. Slow growth will tend towards greater rivalry.
- *Structure of costs*. High fixed costs encourage price cutting to fill capacity.
- *Degree of differentiation*. Commodity products encourage rivalry, while highly differentiated products, which are hard to copy, are associated with less intense rivalry.
- *Switching costs*. When switching costs are high because the product is specialized, the customer has invested a lot of resources in learning how to use the product or has made tailor-made investments that are worthless with other products and suppliers (high asset specificity), rivalry is reduced.

- *Exit barriers*. When barriers to leaving a market are high due to such factors as lack of opportunities elsewhere, high vertical integration, emotional barriers or the high cost of closing down plant, rivalry will be more intense than when exit barriers are low.

Firms need to be careful not to spoil a situation of competitive stability. They need to balance their own position against the well-being of the industry as a whole. For example, an intense price or promotional war may gain a few percentage points in market share, but lead to an overall fall in long-run industry profitability as competitors respond to these moves. It is sometimes better to protect industry structure than to follow short-term self-interest.

Suppliers

The cost of raw materials and components can have a major bearing on a firm's profitability. The higher the bargaining power of suppliers, the higher the costs. The bargaining power of suppliers will be higher in the following circumstances:

- Supply is dominated by few companies and they are more concentrated than the industry they sell to.
- Their products are unique or differentiated, or they have built up switching costs.
- They are not obliged to contend with other products for sale to the industry.
- They pose a credible threat of integrating forwards into the industry's business.
- Buyers do not threaten to integrate backwards into supply.
- The market is not an important customer to the supplier group.

A firm can reduce the bargaining power of suppliers by seeking new sources of supply, threatening to integrate backwards into supply, and designing standardized components so that many suppliers are capable of producing them.

Buyers

The bargaining power of buyers is higher in the following circumstances:

- Buyers are concentrated and/or purchase in large volumes.
- Buyers pose a credible threat of integrating backwards to manufacture the industry's product.
- Products they purchase are standard or undifferentiated.
- There are many suppliers (sellers) of the product.
- Buyers earn low profits, which create a great incentive to lower purchasing costs.
- The industry's product is unimportant to the quality of the buyer's products, but price is very important.

Firms in the industry can attempt to lower buyer power by increasing the number of buyers they sell to, threatening to integrate forward into the buyer's industry, and producing highly valued, differentiated products. In supermarket retailing, the brand leader normally achieves the highest profitability, partially because being number one means that supermarkets need to stock the brand, thereby reducing buyer power in price negotiations.

Substitutes

The presence of substitute products can reduce industry attractiveness and profitability because they put a constraint on price levels.

If the industry is successful and earning high profits it is more likely that competitors will enter the market via substitute products in order to obtain a share of the potential profits available. The threat of substitute products depends on the following factors:

- the buyer's willingness to substitute;
- the relative price and performance of substitutes;
- the costs of switching to substitutes.

The threat of substitute products can be lowered by building up switching costs. These costs may be psychological. Examples are the creation of strong, distinctive brand personalities, and maintaining a price differential commensurate with perceived customer values.

New entrants

New entrants can serve to increase the degree of competition in an industry. In turn, the threat of new entrants is largely a function of the extent to which barriers to entry exist in the market. Some key factors affecting these entry barriers include the following:

- economies of scale;
- product differentiation and brand identity, which give existing firms customer loyalty;
- capital requirements in production;
- switching costs – the cost of switching from one supplier to another;
- access to distribution channels.

Because high barriers to entry can make even a potentially lucrative market unattractive (or even impossible) to enter for new competitors, the marketing planner should not take a passive approach but should actively pursue ways of raising barriers to new competitors.

High promotional and R&D expenditures and clearly communicated retaliatory actions to entry are some methods of raising barriers. Some managerial actions can unwittingly lower barriers. For example, new product designs that dramatically lower manufacturing costs can make entry by newcomers easier.

The collaborative 'five-sources' model

Porter's original model is based on the hypothesis that the competitive advantage of the firm is best developed in a very competitive market with intense rivalry relations.

The five-forces framework thus provides an analysis for considering how to squeeze the maximum competitive gain out of the context in which the business is located – or how to minimize the prospect of being squeezed by it – on the five competitive dimensions that it confronts.

Over the past decade, however, an alternative school (e.g. Reve, 1990; Kanter, 1994; Burton, 1995) has emerged which emphasises the positive role of cooperative (rather than competitive) arrangements between industry participants, and the consequent importance of what Kanter (1994) has termed 'collaborative advantage' as a foundation of superior business performance.

An all-or-nothing choice between a single-minded striving for either competitive or collaborative advantage would, however, be a false one. The real strategic choice problem that all businesses face is where (and how much) to collaborate, and where (and how intensely) to act competitively.

Put another way, the basic questions that firms must deal with in respect of these matters are as follows:

- choosing the combination of competitive and collaborative strategies that are appropriate in the various dimensions of the industry environment of the firm;
- blending the two elements together so that they interact in a mutually consistent and reinforcing, and not counterproductive, manner;
- in this way, optimizing the firm's overall position, drawing upon the foundation and utilization of both collaborative and competitive advantage.

This points to the imperative in the contemporary context of complementing the competitive strategy model with a sister framework that focuses on the assessment of collaborative advantage and strategy. Such a complementary analysis, which is called the *five-sources framework* (Burton, 1995), is outlined below.

Corresponding to the array of five competitive forces that surround a company – as elaborated in Porter's treatment – there are also five potential sources for the building of collaborative advantage in the industrial environments of the firm (the **five-sources model**). These sources are listed in Table 4.2.

Five-sources model
Corresponding to Porter's five competitive forces there are also five potential sources for building collaborative advantages together with the firm's surrounding actors.

In order to forge an effective and coherent business strategy, a firm must evaluate and formulate its collaborative and competitive policies side by side. It should do this for two purposes:

- to achieve the appropriate balance between collaboration and competition in each dimension of its industry environment (e.g. relations with suppliers, policies towards customers/channels);

Table 4.2 The five sources model and the corresponding five forces in the Porter model

Porter's five-forces model	The five-sources model
Market competitors	Horizontal collaborations with other enterprises operating at the same stage of the production process/producing the same group of closely related products (e.g. contemporary global partnering arrangements among car manufacturers).
Suppliers	Vertical collaborations with suppliers of components or services to the firm – sometimes termed vertical quasi-integration arrangements (e.g. the *keiretsu* formations between suppliers and assemblers that typify the car, electronics and other industries in Japan).
Buyers	Selective partnering arrangements with specific channels or customers (e.g. lead users) that involve collaboration extending beyond standard, purely transactional relationships.
Substitutes	Related diversification alliances with producers of both complements and substitutes. Producers of substitutes are not 'natural allies', but such alliances are not inconceivable (e.g. collaborations between fixed-wire and mobile telephone firms in order to grow their joint network size).
New entrants	Diversification alliances with firms based in previously unrelated sectors, but between which a 'blurring' of industry borders is potentially occurring, or a process (commonly due to new technological possibilities) that opens up the prospect of cross-industry fertilization of technologies/business that did not exist before (e.g. the collaborations in the emerging multimedia field).

Source: from Burton, 1995. Reproduced with permission from The Braybrooke Press Ltd.

- to integrate them in a way that avoids potential clashes and possibly destructive inconsistencies between them.

This is the terrain of composite strategy, which concerns the bringing together of competitive and collaborative endeavours.

4.4 Value chain analysis

Until now we have discussed the firm's international competitiveness from a strategic point of view. To get closer to the firm's core competences we will now look at the market-level box in Porter's five-forces model, which treats buyers and sellers (market competitors). Here we will look more closely at what creates a competitive advantage among market competitors towards customers at the same competitive level.

The competitive triangle

Success in the marketplace is dependent not only upon identifying and responding to customer needs, but also upon our ability to ensure that our response is judged by customers to be superior to that of competitors (i.e. high perceived value). Several writers (e.g. Porter, 1980; Day and Wensley, 1988) have argued that causes of difference in performance within a market can be analysed at various levels. The immediate causes of differences in the performance of different firms, these writers argue, can be reduced to two basic factors:

1 The *perceived value* of the product/services offered, compared to the perceived sacrifice. The *perceived sacrifice* includes all the 'costs' the buyer faces when making a purchase, primarily the *purchase price*, but also acquisition costs, transportation, installation, handling, repairs and maintenance (Ravald and Grönroos, 1996). In the models presented the (purchase) price will be used as a representative of the perceived sacrifice.
2 The firm-related *costs* incurred in creating this perceived value.

These two basic factors will be further discussed later in this section.

The more value customers perceive in a market offering relative to competing offerings, and the lower the costs in producing the value relative to competing producers, the higher the performance of the business. Hence firms producing offerings with a higher perceived value and/or lower relative costs than competing firms are said to have a competitive advantage in that market.

Competitive triangle
Consists of a customer, the firm and a competitor (the 'triangle'). The firm or competitor 'winning' the customer's favour depends on perceived value offered to the customer compared to the relative costs between the firm and the competitor.

Perceived value
The customer's overall evaluation of the product/service offered by a firm.

This can be illustrated by the '**competitive triangle**' (see Figure 4.1, earlier). There is no one-dimensional measure of competitive advantage, and **perceived value** (compared to the price) and relative costs have to be assessed simultaneously. Given this two-dimensional nature of competitive advantage it will not always be clear which of the two businesses will have a competitive advantage over the other.

Looking at Figure 4.2, firm A will clearly have an advantage over firm B in case I, and clearly have a disadvantage in case IV, while cases II and III do not immediately allow such a conclusion. Firm B may have an advantage in case II, if customers in the market are highly quality conscious and have differentiated needs and low price elasticity, while firm A may have a similar advantage in case II when customers have homogeneous needs and high price elasticity. The opposite will take place in case III.

Figure 4.2 **Perceived value, relative costs and competitive advantage**

		Perceived value (compared to the purchase price)	
		Higher for A	*Higher for B*
Relative costs	*Lower for A*	I	II
	Lower for B	III	IV

Even if firm A has a clear competitive advantage over firm B, this may not necessarily result in a higher return on investment for A, if A has a growth and B a hold policy. Thus performance would have to be measured by a combination of return on investment and capacity expansion, which can be regarded as postponed return on investment.

While the relationship between perceived value, relative costs and performance is rather intricate, we can retain the basic statement that these two variables are the cornerstone of competitive advantage. Let us take a closer look at these two fundamental sources of competitive advantage.

Perceived value advantage

We have already observed that customers do not buy products, they buy benefits. Put another way, the product is purchased not for itself but for the promise of what it will 'deliver'. These benefits may be intangible: that is, they may relate not to specific product features but rather to such things as image or reputation. Alternatively, the delivered offering may be seen to outperform its rivals in some functional aspect.

Perceived value is the customer's overall evaluation of the product/service offered. So, establishing what value the customer is actually seeking from the firm's offering (value chain) is the starting point for being able to deliver the correct mix of value-providing activities. It may be some combination of physical attributes, service attributes and technical support available in relation to the particular use of the product. This also requires an understanding of the activities that constitute the customer's value chain.

Unless the product or service we offer can be distinguished in some way from its competitors there is a strong likelihood that the marketplace will view it as a 'commodity', and so the sale will tend to go to the cheapest supplier. Hence the importance of seeking to attach additional values to our offering to mark it out from the competition.

What are the means by which such value differentiation may be gained?

If we start in the value chain perspective (see section 1.6), we can say that each activity in the business system adds perceived value to the product or service. Value, for the customer, is the perceived stream of benefits that accrue from obtaining the product or service. Price is what the customer is willing to pay for that stream of benefits. If the price of a good or service is high it must provide high value, otherwise it is driven out of the market. If the value of a good or service is low its price must be low, otherwise it is also driven out of the market. Hence, in a competitive situation, and over a period of time, the price that customers are willing to pay for a good or service is a good proxy measure of its value.

If we look especially at the downstream functions of the value chain, a differential advantage can be created with any aspect of the traditional 4-P marketing mix: product, distribution, promotion and price are all capable of creating added customer perceived value. The key to whether improving an aspect of marketing is worthwhile is to know if the potential benefit provides value to the customer.

If we extend this model particular emphasis must be placed upon the following (see Booms and Bitner, 1981; Magrath, 1986; Rafiq and Ahmed, 1995):

- *People*. These include both consumers, who must be educated to participate in the service, and employees (personnel), who must be motivated and well trained in order to ensure that high standards of service are maintained. Customers identify and associate the traits of service personnel with the firms they work for.
- *Physical aspects*. These include the appearance of the delivery location and the elements provided to make the service more tangible. For example, visitors experience Disneyland by what they see, but the hidden, below-ground support machinery is essential for the park's fantasy fulfilment.
- *Process*. The service is dependent on a well-designed method of delivery. Process management assures service availability and consistent quality in the face of simultaneous consumption and production of the service offered. Without sound process management balancing service demand with service supply is extremely difficult.

Of these three additional Ps, the firm's *personnel* occupy a key position in influencing customer perception of product quality. As a consequence the *image* of the firm is very much influenced by the personnel. It is therefore important to pay particular attention to the quality of employees and to monitor their performance. Marketing managers need to manage not only the service provider – customer interface – but also the actions of other customers; for example, the number, type and behaviour of other people will influence a meal at a restaurant.

Relative cost advantage

Each activity in the value chain is performed at a cost. Getting the stream of benefits that accrue from the good or service to the customer is thus done at a certain 'delivered cost', which sets a lower limit to the price of the good or service if the business system is to remain profitable. Decreasing the price will thus imply that the delivered cost be first decreased by adjusting the business system. As mentioned earlier, the rules of the game may be described as *providing the highest possible perceived value to the final customer, at the lowest possible delivered cost*.

A firm's cost position depends on the configuration of the activities in its value chain versus that of competitors and its relative location on the cost drivers of each activity. A cost advantage is gained when the cumulative cost of performing all the activities is lower than competitors' costs. This evaluation of the relative cost position requires an identification of each important competitor's value chain. In practice, this step is extremely difficult because the firm does not have direct information on the costs of competitors' value activities. However, some costs can be estimated from public data or interviews with suppliers and distributors.

Relative cost advantage
A firm's cost position depends on the configuration of the activities in its value chain versus that of the competitors.

Creating a **relative cost advantage** requires an understanding of the factors that affect costs. It is often said that 'big is beautiful'. This is partly due to economies of scale, which enable fixed costs to be spread over a greater output, but more particularly it is due to the impact of the *experience curve*.

The experience curve is a phenomenon that has its roots in the earlier notion of the learning curve. The effects of learning on costs were seen in the manufacture of fighter planes for the Second World War. The time taken to produce each plane gradually fell as learning took place. The combined effect of economies of scale and learning on cumulative output has been termed the experience curve. The Boston Consulting Group estimated that costs reduced on average by approximately 15–20 per cent each time cumulative output doubled.

Subsequent work by Bruce Henderson, founder of the Boston Consulting Group, extended this concept by demonstrating that all costs, not just production costs, would decline at a given rate as volume increased. In fact, to be precise, the relationship that the experience curve describes is between real unit costs and cumulative volume.

This suggests that firms with greater market share will have a cost advantage through the experience curve effect, assuming that all companies are operating on the same curve. However, a move towards a new manufacturing technology can lower the experience curve for adopting companies, allowing them to leapfrog over more traditional firms and thereby gain a cost advantage even though cumulative output may be lower.

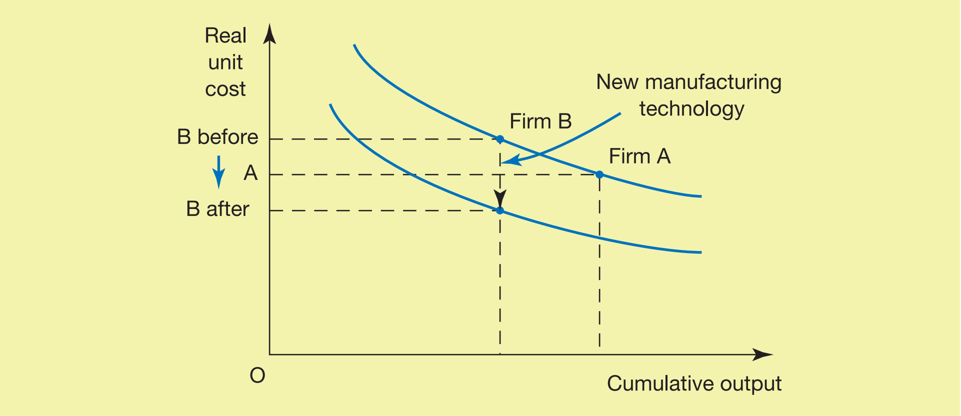
The general form of the experience curve and the above-mentioned leapfrogging to another curve are shown in Figure 4.3.

Leapfrogging the experience curve by investing in new technology is a special opportunity for SMEs and newcomers to a market, since they will (as a starting point) have only a small market share and thereby a small cumulative output.

The implications of the experience curve for the pricing strategy will be discussed further in Chapter 16. According to Porter (1980) there are other cost drivers that determine the costs in value chains:

- *Capacity utilization*. Underutilization incurs costs.
- *Linkages*. Costs of activities are affected by how other activities are performed. For example, improving quality assurance can reduce after-sales service costs.
- *Interrelationships*. For example, different SBUs' sharing of R&D, purchasing and marketing will lower costs.
- *Integration*. For example, deintegration (outsourcing) of activities to subsuppliers can lower costs and raise flexibility.
- *Timing*. For example, first movers in a market can gain cost advantage. It is cheaper to establish a brand name in the minds of the customers if there are no competitors.
- *Policy decisions*. Product width, level of service and channel decisions are examples of policy decisions that affect costs.
- *Location*. Locating near suppliers reduces in-bound distribution costs. Locating near customers can lower out-bound distribution costs. Some producers locate their production activities in eastern Europe or the Far East to take advantage of low wage costs.

Figure 4.3 Leapfrogging the experience curve



- *Institutional factors*. Government regulations, tariffs, local content rules, etc., will affect costs.

The basic sources of competitive advantage

Resources
Basic units of analysis – financial, technological, human and organizational resources – found in the firm's different departments.

Competences
Combination of different resources into capabilities and later competences – being something that the firm is really good at.

The perceived value created and the costs incurred will depend on the firm's **resources** and its **competences** (see Figure 4.4).

Resources

Resources are the basic units of analysis. They include all inputs into the business processes – that is, financial, technological, human and organizational resources. Although resources provide the basis for competence building, on their own they are barely productive.

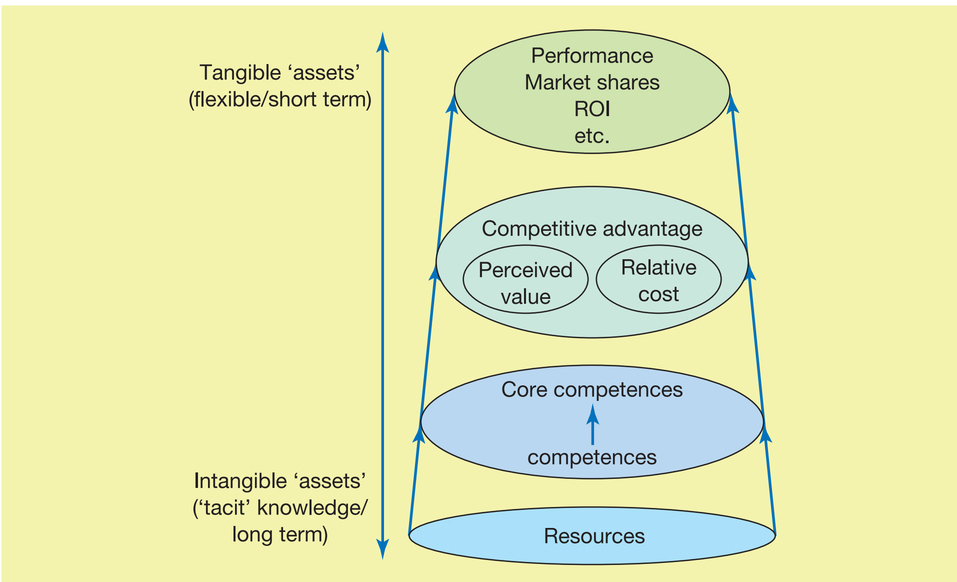
Resources are necessary in order to participate in the market. The competitors in a market will thus not usually be very different with regard to these skills and resources, and the latter will not explain differences in created perceived value, relative costs and the resulting performance. They are failure preventers, but not success producers. They may, however, act as barriers to entry for potential new competitors, and hence raise the average level of performance in the market.

Competences

Competences – being components of a higher level – result from a combination of the various resources. Their formation and quality depend on two factors. The first factor is the specific capabilities of the firm in integrating resources. These capabilities are developed and improved in a collective learning process. On the other hand, the basis for the quality of a competence is the resource assortment. This forms a potential for competences, which should be exploited to the maximum extent.

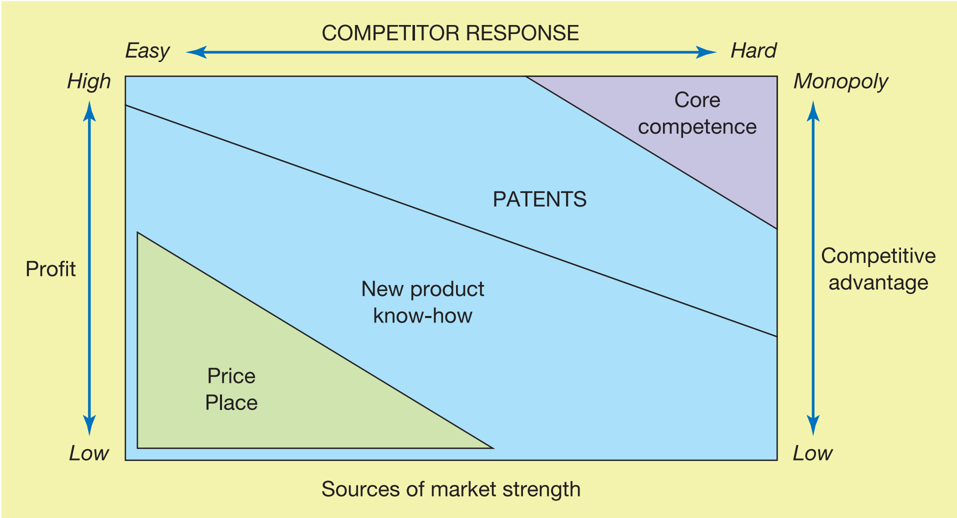
Cardy and Selvarajan (2006) classify competences into two broad categories: *personal* or *corporate*. Personal competences are possessed by individuals and include characteristics such as knowledge, skills, abilities, experience, and personality.

Figure 4.4 The roots of performance and competitive advantage



Source: adapted from Jüttner and Wehrli, 1994.

Figure 4.5 Illustration of the core competence



Source: Reprinted from *Long Range Planning*, Vol. 27, No. 4, Tampoe, M. (1994) 'Exploiting the core competences of your organization', p. 74, Copyright 1994, with permission from Elsevier.

Corporate competences belong to the organization and are embedded processes and structures that tend to reside within the organization, even when individuals leave. These two categories are not entirely independent. The collection of personal competences can form a way of doing things or a culture that becomes embedded in the organization. In addition, corporate characteristics can determine the type of personal competences that will best work or fit in the organization.

Core competences
Value chain activities in which the firm is regarded as better than its competitors.

A firm can have a lot of competences but only a few of them are **core competences**: that is, a value chain activity in which the firm is regarded as a better performer than any of its competitors (see Figure 4.5).

In Figure 4.5 a core competence is represented by a strategic resource (asset) that competitors cannot easily imitate and which has the potential to earn long-term profit. The objective of the firm will be to place products and services at the top-right corner. The top-left corner also represents profit possibilities, but the competitive advantage is easier to imitate, so the high profit will only be short term. The bottom-left corner represents the position of the price-sensitive commodity supplier. Here the profits are likely to be low because the product is primarily differentiated by place (distribution) and especially price.

Competitive benchmarking

The ultimate test of the efficiency of any marketing strategy has to be in terms of profit. Those companies that strive for market share, but measure market share in terms of volume sales, may be deluding themselves to the extent that volume is bought at the expense of profit.

Because market share is an 'after the event' measure, we need to utilize continuing indicators of competitive performance. This will highlight areas where improvements in the marketing mix can be made.

Competitive benchmarking
A technique for assessing relative marketplace performance compared with main competitors.

In recent years a number of companies have developed a technique for assessing relative marketplace performance, which has come to be known as ***competitive benchmarking***. Originally the idea of competitive benchmarking was literally to take apart a competitor's product, component by component, and compare its performance in a value engineering sense with your own product. This approach has often been attributed to the Japanese, but many western companies have also found the value of such detailed comparisons.

The concept of competitive benchmarking is similar to what Porter (1996) calls operational effectiveness (OE), meaning performing similar activities better than competitors perform them. However, Porter (1996) also thinks that OE is a necessary but not a sufficient condition for outperforming rivals. Firms also have to consider strategic (or market) positioning, meaning the performance of *different* activities from rivals or performing similar activities in different ways. Only a few firms have competed successfully on the basis of OE over a long period. The main reason is the rapid diffusion of best practices. Competitors can rapidly imitate management techniques and new technologies with support from consultants.

However, the idea of benchmarking is capable of extension beyond this simple comparison of technology and cost effectiveness. Because the battle in the marketplace is for 'share of mind', it is customers' perceptions that we must measure.

The measures that can be used in this type of benchmarking programme include delivery reliability, ease of ordering, after-sales service, the quality of sales representation and the accuracy of invoices and other documentation. These measures are not chosen at random, but are selected because of their importance to the customer. Market research, often based on in-depth interviews, would typically be employed to identify what these 'key success factors' are. The elements that customers identify as being the most important (see Figure 4.6) then form the basis for the benchmark questionnaire. This questionnaire is administered to a sample of customers on a regular basis: for example, German Telecom carries out a daily telephone survey of a random sample of its domestic and business customers to measure customers' perceptions of service. For most companies an annual survey might suffice; in other cases, perhaps a quarterly survey, particularly if market conditions are dynamic. The output these surveys might typically be presented in the form of a competitive profile, as in the example in Figure 4.6.

Most of the criteria mentioned above relate to downstream functions in the value chain. Concurrently with closer relations between buyers and suppliers, especially in the industrial market, there will be more focus on the supplier's competences in the upstream functions.

Development of a dynamic benchmarking model

On the basis of the value chain's functions, we will suggest a model for the development of a firm's competitiveness in a defined market. The model will be based on a specific market as the market demands are assumed to differ from market to market, and from country to country.

Before presenting the basic model for development of international competitiveness we will first define two key terms:

1 *Critical success factors*. Those value chain functions where the customer demands/expects the supplier (firm X) to have a strong competence.
2 *Core competences*. Those value chain functions where firm X has a strong competitive position.

The strategy process

The model for the strategy process is shown in Figure 4.7.

Stage 1: Analysis of situation (identification of competence gaps)

We will not go into detail here about the problems there have been in measuring the value chain functions. The measurements cannot be objective in the traditional way of

Figure 4.6 Competitive benchmarking (example with only a few criteria)

Examples of value chain functions (mainly downstream functions)	**Customer** Importance to customer (key success factors)					**Own firm (Firm A)** How do customers rate performance of our firm?					**Key competitor (Firm B)** How do customers rate performance of key competitor?				
	High importance				*Low importance*	*Good*				*Bad*	*Good*				*Bad*
	5	4	3	2	1	5	4	3	2	1	5	4	3	2	1
Uses new technology															
High technical quality and competence															
Uses proven technology															
Easy to buy from															
Understands what customers want															
Low price															
Delivery on schedule															
Accessible for enquiries															
Takes full responsibility															
Flexible and quick															
Known contact person															
Provides customer training															
Take account of future requirements															
Courteous and helpful															
Specified invoices															
Gives guarantees															
ISO 9000 certified															
Right first time															
Can give references															
Environment conscious															

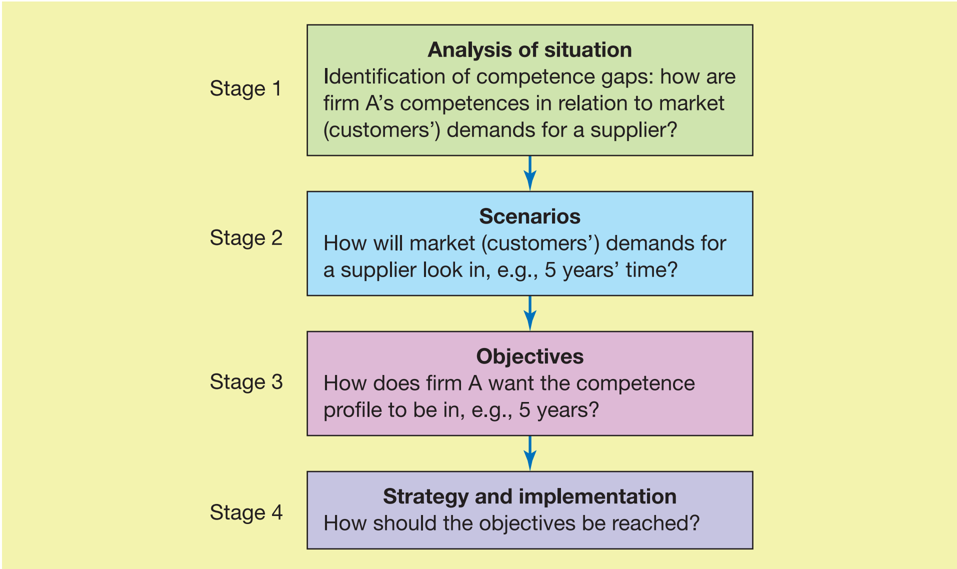
thinking, but must rely on internal assessments from firm representatives (interviews with relevant managers) supplemented by external experts ('key informants') who are able to judge the market's (customers') demand now and in the future.

The competence profile for firm A in Figure 4.1 (top-right diagram) is an example of how a firm is not in accordance with the market (= customer) demand. The company has its core competences in parts of the value chain's functions where customers place little importance (market knowledge in Figure 4.1).

If there is a generally good match between the critical success factors and firm A's initial position, it is important to concentrate resources and improve this core competence to create sustainable competitive advantages.

If, on the other hand, there is a large gap between customers' demands and the firm's initial position in critical success factors in Figure 4.1 (as with the personal selling functions), it may give rise to the following alternatives:

Figure 4.7 Model for development of core competences



- Improve the position of the critical success factor(s).
- Find business areas where firm A's competence profile better suits the market demand and expectations.

As a new business area involves risk, it is often important to identify an eventual gap in a critical success factor as early as possible. In other words, an 'early warning' system must be established that continuously monitors the critical competitive factors so that it is possible to start initiatives that limit an eventual gap as early as possible.

In Figure 4.1 the competence profile of firm B is also shown.

Stages 2 and 3: Scenarios and objectives

To be able to estimate future market demand different scenarios are made of the possible future development. These trends are first described generally, then the effect of the market's future demand/expectations on a supplier's value chain function is concretized.

By this procedure the described 'gap' between market expectations and firm A's initial position becomes more clear. At the same time the biggest gap for firm A may have moved from personal sales to, for example, product development. From knowledge of the market leader's strategy it is possible to complete scenarios of the market leader's future competence profile.

These scenarios may be the foundation for a discussion of objectives and of which competence profile the company wants in, say, five years' time. Objectives must be set realistically and with due consideration of the organization's resources (the scenarios are not shown in Figure 4.1).

Stage 4: Strategy and implementation

Depending on which of firm A's value chain functions are to be developed, a strategy is prepared. This results in implementation plans that include the adjustment of the organization's current competence level.

4.5 Blue ocean strategy and value innovation

Red oceans
Tough head-to-head competition in mature industries often results in nothing but a bloody red ocean of rivals fighting over a shrinking profit pool.

Blue oceans
The unserved market, where competitors are not yet structured and the market is relatively unknown. Here it is about avoiding head-to-head competition.

Kim and Mauborgne (2005a, b, c) use the ocean as a metaphor to describe the competitive space in which an organization chooses to swim. **Red oceans** refer to the frequently accessed marketspaces where the products are well-defined, competitors are known and competition is based on price, product quality and service. In other words, red oceans are an old paradigm that represents all the industries in existence today.

In contrast, the **blue oceans** denote an environment where products are not yet well-defined, competitors are not structured and the market is relatively unknown. Companies that sail in the blue oceans are those beating the competition by focusing on developing compelling value innovations that create uncontested marketspace. Adopters of blue ocean strategy believe that it is no longer valid for companies to engage in head-to-head competition in search of sustained, profitable growth.

In Michael Porter (1980, 1985) companies are fighting for competitive advantage, battling for market share and struggling for differentiation, blue ocean strategists argue that cut-throat competition results in nothing but a bloody red ocean of rivals fighting over a shrinking profit pool.

Blue ocean is a marketspace that is created by identifying an unserved set of customers, then delivering to them a compelling new value proposition. This is done by reconfiguring what is on offer to better balance customer needs with the economic costs of doing so. This is as opposed to a red ocean, where the market is well defined and heavily populated by the competition. All parties in these markets are engaged in an intense competitive struggle for the same customers, with different and incremental, yet easily comparable, value propositions. The blue ocean is the unserved, unstructured demand that is all around us, if we could only see it. The blue ocean strategy is all about avoiding head-to-head competition. Because established markets in the developed world are saturated, head-to-head competition cannot bring attractive returns.

Blue-ocean strategy should not be a static process but a dynamic one. Consider The Body Shop. In the 1980s, The Body Shop was highly successful, and rather than compete head on with large cosmetics companies, it invented a whole new marketspace for natural beauty products. During the 1990s The Body Shop also struggled, but that does not diminish the excellence of its original strategic move. Its genius lay in creating a new marketspace in an intensely competitive industry that historically competed on glamour (Kim and Mauborgne, 2005b).

Kim and Mauborgne (2005a) is based on a study of 150 strategic moves that spanned more than 100 years (1880–2000) and 30 industries. Kim and Mauborgne's first point in distinguishing this strategy from the traditional strategic frameworks is that in the traditional business literature, the company forms the basic unit of analysis, and the industry analysis is the means of positioning the company. Their hypothesis is that since markets are constantly changing in their levels of attractiveness, and companies over time vary in their level of performance, it is the particular *strategic move of the company*, and not the company itself or the industry, which is the correct criterion for evaluating the difference between red and blue ocean strategies.

Value innovation

Kim and Mauborgne (2005a) argue that tomorrow's leading companies will succeed not by battling competitors, but by making strategic moves, which they call *value innovation*.

The combination of value with innovation is not just marketing and taxonomic positioning. It has consequences. Value without innovation tends to focus on value creation on an incremental scale, and innovation without value tends to be technology driven, market pioneering, or futuristic, often overshooting what buyers are ready to accept and pay for. Conventional Porter logic (1980, 1985) leads companies only to compete at the margin for incremental share. The logic of value innovation starts with an ambition to dominate the market by offering a tremendous leap in value. Many companies seek growth by retaining and expanding their customer base. This often leads to finer segmentation and greater customization of offerings to meet specialized needs. Instead of focusing on the differences between customers, value innovators build on the powerful commonalities in the features that customers value (Kim and Mauborgne, 1997).

Value innovation is intensely customer focused, but not exclusively so. Like value chain analysis it balances costs of delivering the value proposition with what the buyer values are, and then resolves the trade-off dilemma between the value delivered and the costs involved. Instead of compromising the value wanted by the customer because of the high costs associated with delivering it, costs are eliminated or reduced if there is no or less value placed on the offering by the customer. This is a real win–win resolution that creates the compelling proposition. Customers get what they really want for less, and sellers get a higher rate of return on invested capital by reducing start-up and/or operational delivery costs. The combination of these two is the catalyst of blue ocean market creation. Exhibit 4.1 illustrates this by using the case of Formule 1.

Exhibit 4.1 Value innovation at Hotel Chain Formule 1

When Accor launched Formule 1 (a line of French budget hotels) in 1985, the budget hotel industry was suffering from stagnation and overcapacity. The top management urged the managers to forget everything they knew of the existing rules, practices and traditions of the industry. There were two distinct market segments in the industry. One segment consisted of no-star and one star (very cheap, around €20 per room per night) and the other segment was two-star hotels, with an average price €40 per room. These more expensive two-star hotels attracted customers by offering better sleeping facilities than the cheap segment. Accor's management undertook market research and found out what most customers of all budget hotels wanted: a good night's sleep at a low price. Then they asked themselves (and answered) the four fundamental questions:

1 Which of the factors that the budget hotel industry took for granted should be eliminated?

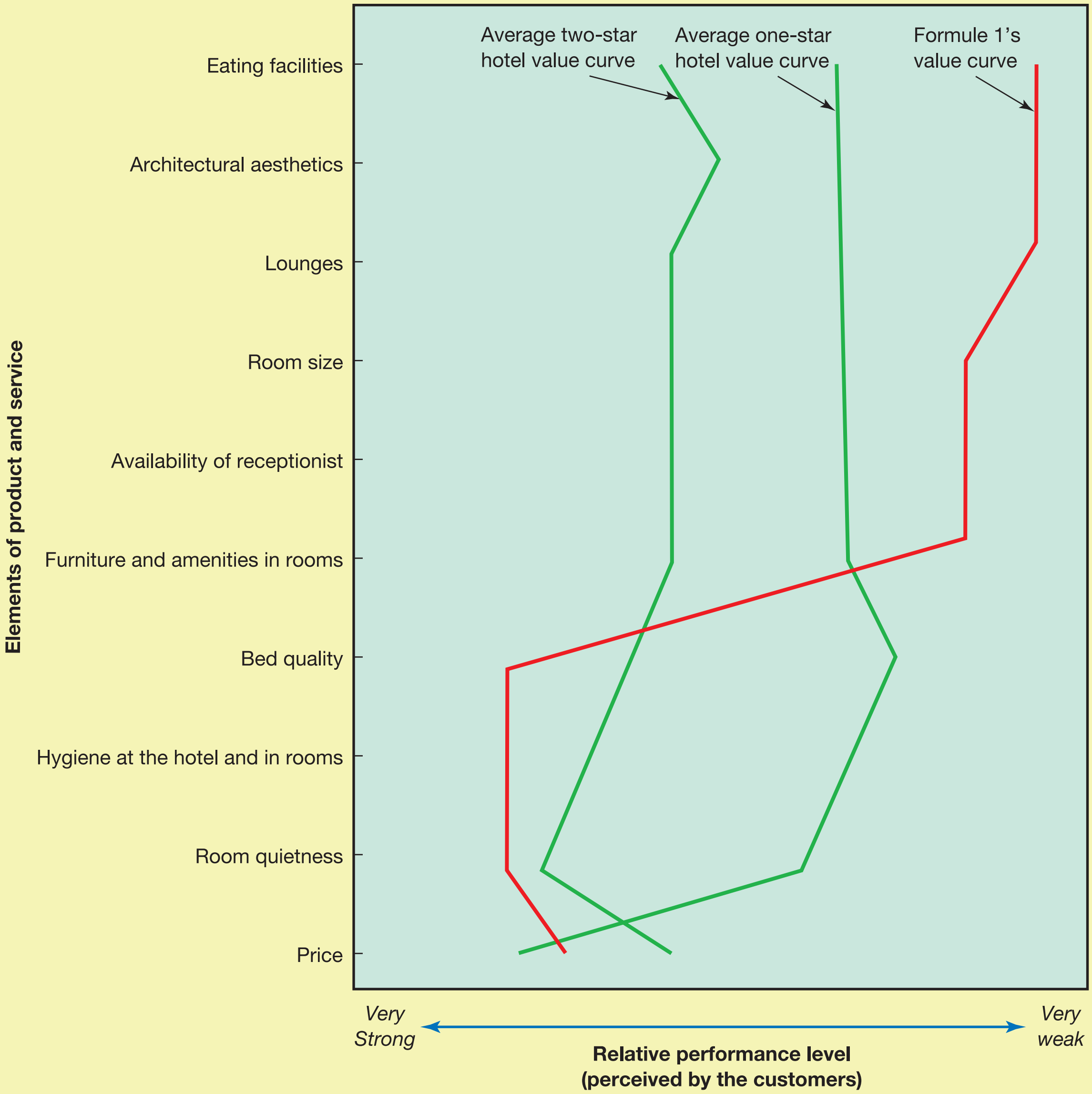
The Accor management eliminated such standard hotel features as costly restaurants and appealing lounges. Accor reckoned that they might lose some customers by this, but they also knew that most customers could live without these features.

Source: Tony Souter © Dorling Kindersley.

2 Which factors should be reduced well below the industry standard?

Accor also believed that budget hotels were overperforming along other dimensions. For example, at Formule 1 receptionists are on hand only during peak checkin and checkout hours. At all other times, customers use an automated teller. The rooms at Formule 1 are small and equipped only with a bed and bare necessities – no desks or decorations. Instead of closets there are a few shelves for clothing.

Figure 4.8 **Formule 1's value curve**



Source: Adapted from Kim and Mauborgne (1997).

3 Which factors should be raised well above the industry standard?

As seen in Fomule 1's value curve (Figure 4.8) the following factors:

- the bed quality,
- hygiene and
- room quietness,

were raised above the relative level of the low budget hotels (the one-star and two-star hotels). The price-performance was perceived as being at the same level as the average one-star hotels.

4 Which new factors (that the industry had never offered) should be developed?

These covered cost-minimizing factors such as the availability of room keys via an automated teller. The rooms themselves are modular blocks manufactured in a factory. That is a method which is may not result in the nicest architectural aesthetics but give economies of scale in production and considerable cost advantages. Formule 1

Exhibit 4.1 continued

has cut in half the average cost of building a room and its staff costs (in relation to total sales) dropped below the industry average (approximately 30 per cent) to between 20 per cent and 23 per cent. These cost savings have allowed Accor to improve the features, that customers value most ('a good night's sleep at a low price').

Note that in Figure 4.8 if the price is perceived as relatively low, it is regarded as a strong performance.

What has happened with Accor and Formule 1?

Today Accor is owner of several hotel chains (besides Formule 1), for example, Mercure, Sofitel, Novotel, Ibis and Motel 6. In 2005 the sales of Accor Group were €7.6 billion. As of 1 January 2006 Fomule 1 has the following number of hotels in the following regions of the world:

Table 4.1 Number of Formule 1 hotels worldwide

Region	Number
France	284
Rest of Europe	44
North America	–
South America	5
Africa (South Africa)	24
Asia Pacific	20
Total	377

Formule 1 is represented in 12 countries: France, Germany, Sweden, the UK, the Netherlands, Switzerland, Spain, Belgium, South Africa, Japan, Australia and Brazil. In France, Formule 1's market share in the budget hotel segment is approximately 50 per cent.

Source: www.accor.com, www.hotelformule1.com; Kim and Mauborgne, 1997.

4.6 Summary

The main issue of this chapter is how the firm creates and develops competitive advantages in the international marketplace. A three-stage model allows us to understand the development of a firm's international competitiveness in a broader perspective:

1 analysis of national competitiveness (the Porter diamond);
2 competition analysis (Porter's five forces);
3 value chain analysis:
   (a) competitive triangle;
   (b) benchmarking.

Analysis of national competitiveness

The analysis starts at the macro level, where the Porter diamond indicates that the characteristics of the home nation play a central role in the firm's international success.

Competition analysis

The next stage is to move to the competitive arena where the firm is the unit of analysis. Porter's five-forces model suggests that competition in an industry is rooted in its underlying economic structure and goes beyond the behaviour of current competitors. The state of competition depends upon five basic competitive forces, which determine the profit potential in an industry.

Value chain analysis

Here we look at what creates a competitive advantage at the same competitive level (among industry competitors). According to the *competitive triangle*, it can be concluded that firms have a competitive advantage in a market if they offer products with the following:

- a higher perceived value to the customers;
- lower relative costs than competing firms.

A firm can find out its competitive advantages or core competences by using *competitive benchmarking*, which is a technique where customers measure marketplace performance of the firm compared to a 'first-class' competitor. The measures in the value chain that can be used include delivery reliability, ease of ordering, after-sales service and quality of sales representation. These value chain activities are chosen on the basis of their importance to the customer. As customers' perceptions change over time, it may be relevant to try and estimate customers' future demands on a supplier of particular products.

According to the blue ocean strategy, the red oceans represent all the industries in existence today. This is *known* marketspace. Blue oceans denote all the industries not in existence today. This is *unknown* marketspace.

In the red oceans, industry boundaries are defined and accepted, and the competitive rules of the game are known. Here companies try to outperform their rivals to grab a greater share of existing demand. As the marketspace gets more and more crowded, prospects for profits and growth are reduced. Products become commodities, and cutthroat competition turns the red ocean bloody.

Blue oceans, in contrast, are defined by untapped marketspace, demand creation and the opportunity for highly profitable growth. While blue oceans are occasionally created well beyond existing industry boundaries, most are created by expanding existing industry boundaries. In blue oceans, competition is irrelevant as the rules of the game are waiting to be set.

Once a company has created a blue ocean, it should prolong its profit and growth sanctuary by swimming as far as possible in the blue ocean, making itself a moving target, distancing itself from potential imitators, and discouraging them in the process. The aim here is to dominate the blue ocean over imitators for as long as possible. But, as other companies' strategies converge on your market, and the blue ocean turns red with intense competition, companies need to reach out to create a new blue ocean to break away from the competition yet again.

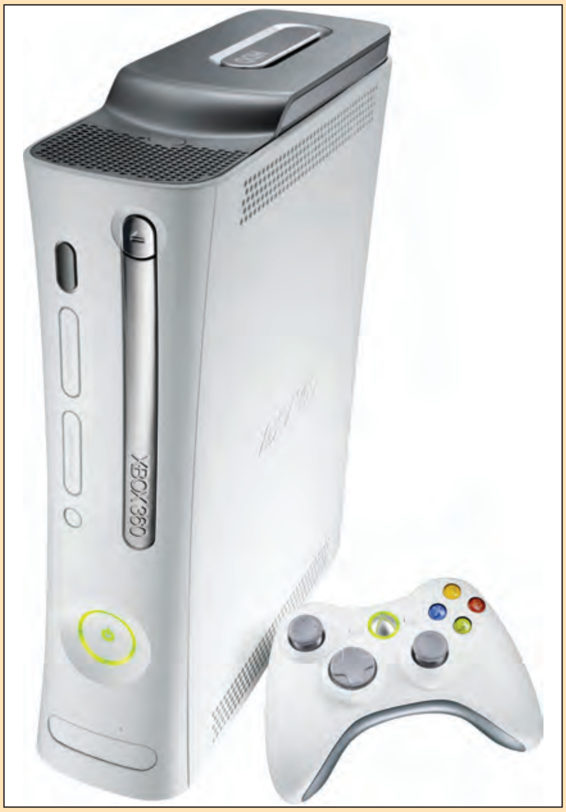
CASE STUDY 4.1

Microsoft Xbox: The battle for gaming leadership against Nintendo's Wii and Sony PlayStation 3

In the video game market leadership has changed with each new generation of consoles, which come along every three to five years.

In a challenge that could have come from a 'beat-'em-up' computer game, Microsoft (the world's biggest software company), has launched its own games console. But the Seattle company's attempts to muscle into a market that is worth £10 billion worldwide will meet stiff opposition from its rivals, which already have new, faster machines either released or planned. Microsoft's product, dubbed the 'Xbox', was launched in autumn 2000.

Microsoft subcontracted production of the Xbox to an unnamed third party, but it chose to market and sell the games console under its own name. Unlike Nitendo, which targets children aged 7–18,



Source: Reprinted by permission from Microsoft Corporation.

Microsoft is going after an older and more sophisticated user. Specifically, Xbox is geared towards men aged 16–35, the same market that Sony is targeting with its Sony PlayStation 2. Microsoft intends to have the world's largest online gaming community powered by its Xbox console. It stresses the 'plug and play' elements of the online service so that the non-technically minded may use it easily.

In February 2001 Sega announced its departure from the console market, intending to focus strictly on software development. This departure from the market left three global players: Sony, Nintendo and Microsoft.

The world gaming market

In the United States and Western Europe the online gaming market is set to be worth $5.5 billion, with 32 million gamers in Europe by 2005.

Datamonitor claims from its research that there is substantial consumer demand for online gaming and surf and play solutions. This will be met by two principal growth factors – games consoles and online gaming.

In 2005 the the Playstation outsold the Xbox, as seen in Table 1.

Table 1 The world-wide sales of game consoles in 2005

Manufacturer	Millions of sold units in 2005	Market shares (%)
Sony Playstation 2	101	69
Microsoft Xbox	24	17
Nintendo GameCube	21	14
Total	146	100

Source: Demos, T. (2006) 'Xbox will capitalize on PS3 delay', *CNNMoney*, 17 March, p. 1.

The introduction of better bandwidth – broadband – will increase popularity and consumer awareness, with the console gradually phasing out the PC as the main gaming device.

Xbox 360 vs Playstation 3

The Xbox 360 is the successor to Microsoft's Xbox video game console, developed in co-operation with IBM, ATI, Samsung and SiS. It also serves as the first entrant in a new generation of game consoles and will compete against Sony's PlayStation 3 and Nintendo's Wii. Both products were introduced by the end of 2006. Microsoft believes that its push towards high-definition gaming, its year-early head-start and its Xbox Live online gaming service will help in the console's success.

The Xbox 360 was released on 22 November 2005 in North America and later in Europe, Japan, Australia and New Zealand.

As is the case with most platform launches, each new console is costing Microsoft money – so much money, that Xbox 360 costs wiped out income from Home and Entertainment's profitable projects. Though the division took in $4.2 billion in fiscal-year revenue and $1.14 billion of revenue during its most recent quarter, it is still in the red. The department suffered an annual operating loss of $1.26 billion.

It should be noted that the strategy of selling a console at a loss or near-loss is common in the console games industry, as console makers can usually expect to make up the loss through game licensing. Furthermore, since Microsoft owns the intellectual property rights to the hardware used in the Xbox 360, it can easily switch to new fabrication processes or change suppliers in the future in order to reduce manufacturing costs. This flexibility stands in contrast to the situation faced with the original Xbox, where Microsoft was never able to reduce manufacturing costs below the break-even point.

By 30 June 2007 Microsoft expects to have sold 13–15 million Xbox 360.

The Sony Playstation 3 was released in North America on 17 November 2006. Sony also announced that the launch in Europe and Australia/New Zealand had been delayed until March 2007 due to shortage of certain components.

However, it was not only Microsoft versus Sony. In November 2006 it seemed that Nintendo would make a come-back as they launched their new Wii in most regions of the world. For example, in several of the UK's leading retail chains it was claimed that Wii had become the fastest selling console in the region's recorded history.

Sources: Gamespot (2006) 'Microsoft to ship 13–15 million 360s by June 2007', www.gamespot.com, 21 July; *Financial Times* (2000) 'Companies and Markets: Microsoft to take on video game leaders', 10 March; *New Media Age* (2000) 'Let the games begin', 8 March; BBC News (2002) 'Works starts on new Xbox', 26 June; BBC News (2002) 'Price cut boosts Xbox sales', 24 July; CNN News (2002) 'Console wars: Round two', 22 May.

Questions

1 What were Microsoft's motives in entering the games console market?

2 What are the competitive advantages in the business model of the Xbox 360?

3 What are the chances that Microsoft will 'beat' the other games console suppliers, Nintendo and Sony?

CASE STUDY 4.2

Senseo: Creating competitiveness through an international alliance

The Senseo coffee pod system (**www.senseo.com**) is the result of a partnership between electronics expert Philips (supplier of the Senseo-machine) and coffee roaster Douwe Egberts (supplier of the coffee pods), both world-renowned companies originally from the Netherlands.

Short presentation of the two alliance partners:

Philips

Royal Philips Electronics of the Netherlands is one of the world's biggest electronics companies and Europe's largest, with sales of €30.4 billion in 2005. With activities in the three interlocking domains of health care, lifestyle and technology and 161,500 employees in more than 60 countries, it has market leadership positions in medical diagnostic imaging and patient monitoring, colour television sets, electric shavers, lighting and silicon system solutions.

Sara Lee/Douwe Egberts (DE)

A subsidiary of Chicago based Sara Lee Corporation is Sara Lee/DE, with headquarters in Utrecht, The Netherlands. Sara Lee/DE is a global group of branded consumer packaged good companies. Activities include coffee, tea and household and body care products. The origin of Douwe Egberts dates back to 1753, when Egbert Douwes and his wife Akke Thysses founded the company. When their son Douwe Egberts, entered the business around 1780, he built up a reputation regionally by also supplying shop owners elsewhere, thereby spreading the Douwe Egberts brand around the country. Gradually, Douwes and his descendants built a company that grew to become the Dutch market leader for its core products, coffee and tea.

Since 1978 Douwe Egberts has been allied to the Sara Lee Corporation, which opened new horizons worldwide. Today Douwe Egberts is the second largest coffee roaster in the world, employing over 26,000 people worldwide.

Table 1 World market for coffee machines

Coffee machines	Retail volume (million units)
Western Europe	16.6
Eastern Europe	0.6
North America	28.4
Latin America and Carribbean	4.1
Asia Pacific (minus Australia and NZ)	2.9
Australia and NZ	0.3
Africa and Middle East	0.7
World total	53.6

Source: Adapted from Euromonitor.

Working in tandem, the two innovators developed every aspect of Senseo – from its patented coffee machine and the brewing process to its one-of-a-kind coffee pods.

The machine uses single portion Senseo coffee pods, containing the finest ground coffee, to guarantee a perfect cup every time it is used. Senseo has now been launched in ten countries worldwide: Austria, Australia, Belgium, China, Denmark, France, Germany, the Netherlands, the United Kingdom and the United States.

The main target group of Senseo is one/two person households with people between 25 and 39 years of age and where the personal household income would be average or above.

The world market for coffee machines is shown in Table 1.

Since Philips & Douwe Egberts introduced the coffee pod machine in spring 2001 it has sold more than 12 million total and more than 7 billion coffee pods were sold in the first five years of its lifetime. In Germany alone 3 million Senseo-machines were sold together with 900 million coffee pods. In this way the Senseo coffee machine achieved 80 per cent of the German pod-coffee-machine market and the coffee pods themselves achieved nearly 5 per cent of the very competitive German coffee market.

When the Senseo coffee pod machine was introduced, the end-user price was around €75, the current recommended price is €69, but in Spring 2006 it was available for around €58.

Today Philips is one of the world's biggest electronics companies and Douwe Egberts is the second largest coffee roaster in the world.

It is reported that almost one-third of Dutch households own a Senseo machine, and the figure is expected to climb steadily in years to come. Although most Dutch households continue to use both conventional filter coffee machines and single-serve coffee systems, unit sales of the latter have clearly outperformed the former. Nevertheless, industry experts suggest that it will take a long time for conventional filter machines to disappear completely. Many Dutch households are expected to continue to use conventional machines when holding a party and the Senseo-type machines for everyday use.

Competitive advantages of Senseo

Low-cost followers from China, used to selling cheaper filter coffee machines, have had problems catching up on this alliance, because they cannot easily copy the tight collaboration between Philips and Sara Lee's Douwe Egberts subsidiary which produces the coffee packets designed especially for the Senseo.

When big retail chains like Aldi and Wal-Mart see a product like this, they usually go to China to request something similar. But in the Senseo case this is not so easy, because the main profits from the Senseo concept come partly from coffee machines but mainly from coffee pads. Chinese rivals have to recoup that money from machines alone and this is unattainable.

Competition is coming up

The battle among coffee makers for at-home use intensified in 2005, with other leading coffee players such as Procter & Gamble and Kraft Foods launching single-service machines, which can brew a high-quality cup of coffee in less than a minute.

Coffee suppliers have teamed up with electrical appliances makers to produce the machines jointly. Philips and Sara Lee were early pioneers of this format, but Kraft Foods has also cooperated with Saeco International to produce its coffee maker called Tassimo. In both systems, the coffee comes in single-serve bags called 'pods' specifically suited for the machines designed as companions for the product lines. These types of coffee makers are intended to retain consumer loyalty towards certain brands. In order to gain a competitive edge, Melitta announced that from the third quarter of 2005 its pods would be adapted to fit competitors' machines.

In line with developments in other food and beverage categories, the strong growth of private labels remains a concern. Private labels have already emerged in the portioned coffee market. In the Netherlands some supermarket private labels offer varieties of coffee pods that exactly match the technical specifications of Senseo's machines, and with private labels' price advantage, many Dutch consumers opt for private label pods rather than the more expensive Douwe Egberts range.

Sources: www.senseo.com; www.philips.com; http://www.msnbc.msn.com/id/10805655/, 11 January 2006; www.euromonitor.

Questions

1. What are 'key success factors' in this industry?
2. Explain how the competences represented in the Senseo concept can create international competitiveness.
3. Which threats is Senseo facing in the future sales of its product concept?
4. Which new markets are relevant for Senseo to enter?

VIDEO CASE STUDY 4.3

download from www.pearsoned.co.uk/hollensen

Nike

Nike (**www.nike.com**) is the largest seller of athletic footwear and athletic apparel in the world. Nike's strategy for growth around the globe is to develop greater reach into diverse market segments. The three main segments are (1) performance athletes, (2) participant athletes, and (3) those that influence the world and the culture of sport. Partnerships are formed with athletes not just because of their status, but also because they are integral in the product development process. For example, to increase market share in Europe, Nike needed to produce a strong soccer product, which it did with the help of star soccer players.

Questions

1. Discuss how Nike's growth can be attributed to its targeting of diverse market global segments.
2. How did Nike penetrate the European soccer footwear market?
3. What are the key driving forces behind Nike's international competitiveness?

For further exercises and cases, see this book's website at www.pearsoned.co.uk/hollensen

Questions for discussion

1. How can analysis of national competitiveness explain the competitive advantage of the single firm?
2. Identify the major dimensions used to analyse a competitor's strengths and weaknesses profile. Do local, regional and global competitors need to be analysed separately?
3. How can a country with high labour costs improve its national competitiveness?
4. As the global marketing manager for Coca-Cola, how would you monitor reactions around the world to a major competitor such as Pepsi?

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CASE STUDY I.1

Manchester United: Still trying to establish a global brand

Manchester United (abbreviated as ManUtd, **www.manutd.com**) has developed into one of the most famous and financially successful football clubs in the world, being recognized in virtually every country, even those with little interest in the sport. Real Madrid has displaced ManUtd from the pole position in Deloitte's football money league. The list, which has been running for the last nine years, identifies the top 20 clubs by value.

The top five in 2006 were: Real Madrid with €275.7 million, Manchester United (€246.4 million), AC Milan (€234 million), Juventus (€229.4 million) and Chelsea (€220.8 million) (*Accountancy*, 2006). The most valuable US sport teams, the National Football League's Washington Redskins and Baseball's New York Yankees are both worth somewhat more, but more than any US sports team, ManUtd has built a global brand.

Source: www.ManUtd.com. Manchester United Limited.

The intangible assets of ManUtd

ManUtd has developed a huge fanbase. In 2005, its global fan base reached 75 million. Europe had 24 million, Asia (including Australia) had 40 million, Southern Africa had 6 million, and the Americas had 5 million. Expanding this base and developing lifelong allegiances is critical to ManUtd's long-term growth. And providing international fans with a taste of the excitement at a game, through TV and Internet coverage, is key to maintaining and building the brand.

Brand assets

ManUtd's brand assets includes (1) the physical aspects of logos, colours, names, and facilities, and (2) the intangible aspects of reputation, image, and perception. The official mascot of the team is the Red Devil. Although centrally featured in ManUtd's logo, the mascot doesn't play a prominent role in promotions. The team's nickname is the Reds, which seems logical enough, given the dominant colour of its home jerseys, but unfortunately, Liverpool, another top team in the Premier League, is also referred to as the Reds.

International brand evolution

For British fans of ManUtd, passions run deep. Although the brand is solidly entrenched in British soccer fans' psyches, it is in transition. ManUtd is no longer simply a British brand; it is a world brand. It boasts incredible number of fans in China. A survey of China's 12 largest markets shows that 42 per cent of fans are between 15 and 24, and that 26 per cent are between 25 and 34. The team is positioned to take advantage of China's growing middle class, with members who are anxious to enjoy the good life and associate themselves with successful Western brands. As an early entrant, ManUtd has the chance to establish itself as one of Asia's dominant brands (Olson *et al.*, 2006).

Although the absolute numbers are much smaller, the United States also represents fertile ground. Of course, international soccer must compete with established groups such as the Major League Baseball, National Football League, the National Basketball Association and the National Hockey League. But soccer has become a staple at schools across the country. A recent, unprompted awareness study of European soccer teams revealed that among North American fans, the most frequently mentioned team was ManUtd, at 10 per cent; Liverpool, Real Madrid, and Barcelona each generated 3 per cent, and Arsenal generated 2 per cent. The study also showed that awareness of ManUtd is strongest in the North-Eastern and Western parts of the United States.

In order to be successful in foreign markets, ManUtd must generate memberships, sell kits and other merchandise, have access to media markets (including TV, Internet, mobile phones, and publishing), set up soccer schools, form licensing agreements with strong local sponsors, and embark on tours to create halo effects.

The challenge ManUtd faces is accomplishing this transition without destroying what made it distinctly British and highly successful. Today's team is composed of players from around the globe. (Although ManUtd still has British players, the Premier League is no longer dominated by them.) And that raises another concern: strong teams employ strong players who become brands themselves. Most notable for ManUtd was the rise of David Beckham to the ranks of superstar, on the pitch and in the media, for example., through his marriage to Victoria, previously one of the Spice Girls. ManUtd considered that Beckham's market value was greater than they could afford, so they sold him to Real Madrid one year before the contract expired. But now the brand building of ManUtd depends on new and upcoming stars such as Wayne Rooney, Cristiano Ronaldo and Rio Ferdinand. At the same time as they are ManUtd brand builders, it also allows them to build their own personal brand.

Brand challenges

ManUtd is in the enviable position of market leader, during a time of dramatic media growth in the world's most popular game. But leaders can stumble and the team is not immune to the sensitive nature of sports fans. To address this concern, ManUtd has developed a customer relationship management (CRM) database of more than 2.5 million fans. Many of these database members are game-day customers.

A substantial group of US ManUtd fans are not loyal. They climb on the bandwagon of team, when it has success, only to climb off the instant it stumbles. With the number of US soccer players holding steady at 18 million, the market is relatively small.

Chinese fans don't possess the same level of experience with professional teams as US fans and might not be as fickle. Nevertheless, cultural and physical barriers exist between British and Chinese fans. To develop deeper loyalties in Chinese markets, ManUtd established a Mandarin website, started a soccer school in Hong Kong, and is constantly planning Asian tours while looking to add Asian players to the roster (e.g. Ji-Sung Park, who joined the ManUtd team in July 2005). Although these are sound moves to build brand loyalty, well-funded competitors such as Chelsea or Liverpool can copy ManUtd.

Even in England, ManUtd faces significant challenges. Especially after the Glazer invasion (see below) it generates a love-them-or-hate-them mentality. Fans of opposing teams were thrilled to see Chelsea, Arsenal and Liverpool secure the three major championships – leaving ManUtd without a major trophy in the last two years.

Then Glazer came . . .

In the late 1990s and early part of the 2000s, an increasing source of concern for many United supporters was the possibility of the club being taken over. The supporters' group IMUSA (Independent Manchester United Supporters' Association) were extremely active in opposing a proposed takeover by Rupert Murdoch in 1998. However, they could not do anything in May 2005 when the US sports tycoon Malcolm Glazer (who also owns the American Football team Tampa Bay Buccaneers) paid \$1.4 billion for a 98 per cent stake in ManUtd, following a nearly year-long takeover battle. So is the ManUtd brand worth \$1.5 billion? Glazer seemed to think so, as he paid roughly \$200 million more than the team's open-market stock valuation.

It was a hostile takeover of the club which plunged the club into massive debt as his bid was heavily funded by borrowing on the assets owned already by ManUtd. The takeover was fiercely opposed by many fans of ManUtd. Many supporters were outraged and some formed a new club called F.C. United of Manchester. This club entered the second division of the North West Counties Football League and were confirmed as champions on 15 April 2006. They will play in the first division in the 2006–07 season.

After the takeover the Glazer family (Malcolm Glazer and his three sons) took big steps to shore up the club's finances. They cut more than 20 staff members, including some executives. They also plan to raise ticket prices and have been lending 23 players to other clubs, saving ManUtd more than \$20 million in fees and salaries. In general, they have been cutting expenses everywhere they can.

The 2004–05 season was characterized by a failure to score goals, and ManUtd finished the season trophyless and in third place in the Premier League.

ManUtd made a poor start to the 2005–06 season, with midfielder Roy Keane leaving the club to join his boyhood heroes Celtic after publicly criticizing several of his teammates, and the club failed to qualify for the knock-out phase of the UEFA Champions League for the first time in over a decade after losing to Portuguese team Benfica Lissabon. ManUtd also ensured a second-place finish in the Premier League and automatic Champions League qualification.

Sponsorships

On 23 November 2005 Vodafone ended their £36 million, four-year shirt sponsorship deal with ManUtd. On 6 April 2006, ManUtd announced AIG as its new shirt sponsors ManUtd in a British record shirt sponsorship deal worth £56.5 million to be paid over four years (£14.1 million a year). ManUtd will have the largest sponsorship in the world ahead of Italian side Juventus, who have a £12.8 million a year sponsorship deal with Tamoil. The four-year agreement has been heralded as the largest sponsorship deal in British history, eclipsing Chelsea's deal with Samsung.

In 2006 ManUtd also finalised a four-year sponsorship deal with US-based financial services giant American International Group for a record $56 million. The deal replaces Vodafone, which had previously had its name emblazoned on ManUtd's famous red jerseys.

Besides these sponsorships there still exists a few others: the 13-year, £303 million ($527.2 million) deal with Nike also provides ManUtd with two vital advantages. First, it calls for Nike to pay the team a fixed fee for merchandise rights to its kits (shirts, shorts, and so on), generating a guaranteed revenue base for ManUtd while transferring product development and merchandising to a firm with proven international expertise. Second, the team links its brand with a market leader in a complementary industry (sporting goods apparel, shoes and equipment). In the first 22 months of the agreement, Nike sold 3.8 million replica shirts.

ManUtd retains eight second-tier sponsors: Pepsi, Budweiser, Audi, Wilkinson Sword, Dimension Data, Lycos.co.uk, Fuji and Century Radio. In 2004, as part of this relationship, the team invested £2 million ($3.5 million) in light-emitting diode digital-advertising boards around three sides of the pitch. Future plans call for a reduction in licensing agreements to two principals (Vodafone and Nike) and four platinum firms (to be determined). Under this arrangement, these six major sponsors will have expanded international opportunities and a stronger presence at Old Trafford. The team will then sell additional local licensing agreements with restricted rights for specific geographic markets.

Besides licensing, ManUtd generates revenues from additional secondary business lines, predominantly financial. Fans now can finance their houses or cars with a ManUtd mortgage or loan, buy tickets with a ManUtd credit card, insure their homes/cars/travel plans with ManUtd insurance, invest in ManUtd bonds, gamble in ManUtd Super Pool lotteries, or see a movie at the Red Cinema in Salford, Greater Manchester. Of course, other firms manage these lines; nevertheless, these businesses generate additional revenues while promoting the team and developing lifelong fans.

Financial situation

	2005	2004	2003
Revenues ($m)	286	308	230
Net profits ($m)	13	35	48
Employees (number)	480	504	493

In 2005, ManUtd blamed a drop in television revenues following the negotiation of a new UK broadcast rights deal, and a decline in the club's share of Champion's League media earnings as a result of its weaker performance in the tournament. The football club also incurred one-off costs in fees relating to its takeover by Glazer.

In a statement to the 2005 financial report, chief executive David Gill said, in a statement published on the club's website. 'Manchester United continues to be the world's biggest football club based on its global brand revenues and profits' (**www.manutd.com**).

Although current international revenues account for only 1–2 per cent of total revenues, this segment of the business holds tremendous potential.

Sources: Cohn, L. and Holmes, S. (2005) 'ManU Gets Kicked In the Head – Again', *Business Week*, 12 December, pp. 34–35; *Accountancy* (2006) 'Manchester United loses top spot in Deloitte football league', March, 137(1351), p. 16; Olson, E.M., Slater, S.F., Cooper R.D. and Reddy V. (2006) 'Good Sport: Manchester United is no longer just a British brand', *Marketing Management*, 15(1) (January/February), pp. 14–16.

Questions

1 How do you evaluate the international competitiveness of ManUtd after the takeover of Malcolm Glazer?

2 Discuss and explain how the different alliances can increase the competitiveness of ManUtd.

3 What are the main threats to retaining 'Manchester United' as a global brand?

CASE STUDY I.2

Bridgestone Tyres: European marketing strategy

It is a lovely spring morning in central Tokyo in 2006. Although the city is just awakening, with all its noise and stress, that does not bother the Chairman of Bridgestone Corporation, Shoshi Arakawa, as he is on his way to work. Here are some basic data about Bridgestone.

Bridgestone Corporation (Bridgestone) is one of the world's largest manufacturers of tyres and other rubber products. The company is primarily engaged in the production of tyres and tubes for passenger cars, trucks and buses, construction and mining vehicles, industrial machinery, agricultural machinery, aircraft, motorcycles and scooters. The company has operations in Japan, the United States and Europe. It is headquartered in Tokyo, Japan and employs about 113,700 people.

The company recorded revenues of $24 billion during the fiscal year ended December 2005, an increase of 11 per cent over 2004. The operating profit of the company during fiscal 2004 was $1.9 billion, an increase of 8 per cent over fiscal 2004. As the tyres segment accounts for nearly 80 per cent of the company's total revenues, its strong market position in the tyre segment ensures a stable top line for the company.

The prospects look good. On his way into his office Shoshi Arakawa asks his assistant to give him a copy of the different manufacturers' 2005 market shares in the world market (see Table 1), plus Bridgestone's 2005 market shares in the most important tyre markets in the world. Arakawa has a meeting with the board of directors the next day, when they will discuss Bridgestone's strategies in Europe, Asia and North America.

Table 1 Market share for tyres in the world market, 2005

Manufacturer	Market share (%)
Michelin	19
Bridgestone	19
Goodyear	17
Continental	7
Pirelli	5
Sumitomo	4
Yokohama	3
Cooper	2
Toyo	2
Others	22
World total	100

As can be seen from Table 1, together with Goodyear and Michelin, Bridgestone is among the world's largest manufacturers of tyres. Bridgestone has a 19 per cent worldwide market share (see Table 2).

But still Bridgestone has a comparatively low market share (8 per cent) and low brand awareness in Europe. The question for Shoshi Arakawa is: how can Bridgestone increase its market share in Europe? The following is a concentrated report on the market conditions for tyres in Europe.

The European tyre market

The European market for car tyres (including commercial vehicles) fell slightly from 2000 to 2005. Competition among tyre producers is fierce and tyre prices in real terms have fallen over the past few years.

In 2005 the total European market for tyres was 229.8 million. A breakdown of the total market is shown in

Table 2 Bridgestone's market share for tyres in the most important markets, 2005

Market area	Bridgestone market share (%)
Asia	29
Europe	10
US	22
World total	19

Table 3 The European tyre market, 2005

Million units	Car tyres	Truck tyres	Total
New sales	65.4	9.3	74.7
Replacement sales	131.8	23.3	155.1
Total	197.2	32.6	229.8

Table 3. This table shows sales of new tyres for new cars (= new sales) and replacements of worn tyres (= replacement sales). Table 4 shows the total European tyre market broken down into countries, together with the market shares of the most important producers in the individual markets. On the basis of Table 4 the Boston Consulting Group (BCG) charts of the individual producers have been prepared (see Figure 1). In this connection it should be noted that the areas of the circles show total sales in the respective countries and not the sales of the individual companies in the markets in question, which is normally the case in BCG charts.

Retreaded tyres

So far the markets have been described on the assumption that only the production and sale of new tyres was involved. For many years consumers have considered the retreaded tyre one of low price and low quality. In consequence, European consumers have been somewhat reluctant to buy retreaded tyres. Tyres can be recycled. The main problem is economic: recycling costs more than dumping, so many tyres end up in landfills or on illegal dumps, adding to those already polluting the landscape. Tyre dumps are potentially dangerous: they can catch fire and, when they do, toxic chemicals are released, leaving an oily residue that can contaminate groundwater.

Currently only about 12 per cent of the European Union's scrap tyres are retreaded and reused. The percentage has been decreasing over the last few years because new tyres are now so price competitive that many consumers prefer to buy them. However retreaded tyres are still recommended by the European Commission, primarily for two reasons:

1 Waste problems connected to the accumulation of used tyres have made retreaded tyres an environmentally correct recycling solution.
2 The use of retreaded tyres reduces consumption of natural rubber, natural minerals, metal wire, oil and other chemicals that are normally used in the production of new tyres.

In 2005 sales of retreaded tyres were distributed as shown in Table 5. The European Commission encourages and recommends the increased use of retreaded tyres (rising to approximately 20 per cent of total sales).

One threat against such a development is, however, that the price of new imported tyres from the Far East is sometimes lower than that of retreaded tyres.

Characteristics of the leading producers (mentioned in Table 3)

In many countries the producers use several different brands to appeal to a larger clientele who have different preferences for different brands of tyres. A list of brand names is given in Table 6.

Europe's leading tyre suppliers may be briefly characterized as follows.

Michelin

Michelin is currently the largest tyre manufacturer in the world together with Bridgestone.

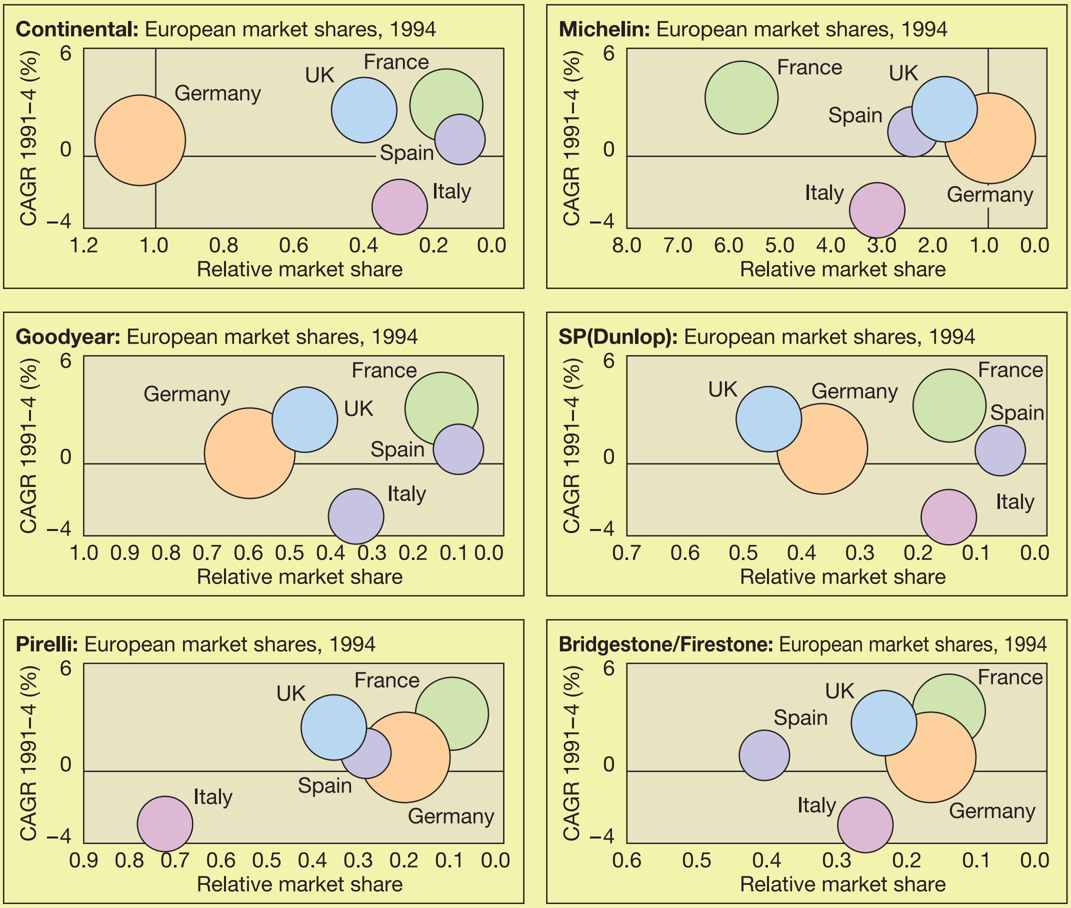
Compagnie Generale des Etablissements Michelin (Michelin) manufactures a wide range of tyres, publishes maps and guides and operates digital services such as wireless application protocol (WAP) and

Table 4 The European market for tyres (cars and trucks)

	France	Germany	Italy	Spain	UK	Other markets	Total
Sales (million units)							
New sales	13.2	22.7	7.0	9.1	8.7	14.0	74.7
Replacement sales	24.2	36.7	15.8	8.9	22.0	47.5	155.1
Total	37.4	59.4	22.8	18.0	30.7	61.5	229.8
Producers' market shares (%)							
Michelin	55	24	31	44	30	—	35.0
Continental	4	26	8	7	13	—	14.4
Goodyear	7	16	11	4	16	—	11.3
Pirelli	5	6	23	13	11	—	10.4
SP (Dunlop)	10	10	4	4	14	—	8.9
Bridgestone/Firestone	7	5	8	18	7	—	8.0
Others	12	13	15	10	9	—	12.0
Total	100	100	100	100	100	—	100.0

Note: 'Other markets' include Eastern Europe and Scandinavia, for which market shares are not available.

Figure 1 BCG charts for leading tyre producers



Notes:
CAGR = compound annual growth rate.
Relative market share = the market share of the individual producer in relation to the largest producer on the market.
Source: MarketLine.

Table 5 Sales of retreaded tyres in main European markets, 2005 (million units)

	France	Germany	Italy	Spain	UK
Cars	2.30	3.50	2.70	0.03	4.80
Trucks	0.85	1.40	0.95	0.44	0.95
Total	3.15	4.90	3.65	0.47	5.75

mobile internet services. The company has a presence in 170 countries worldwide. It is headquartered in France and employs about 126,000 people.

The company recorded revenues of $19.5 billion during the fiscal year ended December 2004, an increase of 2.1 per cent over 2003. The increase was primarily attributable to increased revenues from passenger car, light truck, and truck segments. The net profit was $640.2 million during fiscal year 2004, an increase of 62.2 per cent over 2003.

The French-based company organizes its operations into the following business units:

Table 6 Producers' nationality and different brand names

Producer	Nationality (ownership)	Brands
Michelin	France	Michelin, Kléber, Tyremaster
Continental	Germany	Continental, Uniroyal, Semperit, Barum, Viking, Gislaved, Mabor, Sava
Bridgestone/ Firestone	Japan	Bridgestone, Firestone, Dayton, Europa, First Stop
Pirelli	Italy	Pirelli, Curier
Goodyear	US	Goodyear, DunlOp, Kelly, Fulda
Others		Stomil, Tigar, Komho, Lassa, Marshal, Toyo

- passenger car and light truck tyres;
- truck tyres;
- earthmover tyres;

- agricultural tyres;
- aircraft tyres;
- two-wheel tyres;
- components (rubber and elastomers, reinforcement materials);
- suspension systems;
- tourism services (maps, guidebooks).

In contrast to its traditional single-brand strategy Michelin now has a long list of associate brands such as BF Goodrich, Kléber, Riken, Kormoran, Taurus, Laurent, Wolber, Tyremaster, Siamtyre, and Uniroyal (North America only). The company produces 3,500 different types of tyre, which are made in 65 factories in 13 countries.

As part of the group's strategy to expand its share outside Europe, particularly in Asia and Latin America, Michelin has acquired MRF in the Philippines and the Colombian manufacturer, Icollantas. In Europe, meanwhile, Michelin has announced plans to improve productivity by 20 per cent within three years. It expects to achieve this through developing its products, services and multibrand policy while restructuring all its European activities, possibly by closing plants or terminating technical activities and services.

In Europe Michelin is the clear market leader, with a market share of 32 per cent, well ahead of Continental and Goodyear.

Michelin's largest market is North America, which takes about 45 per cent of its tyre production, followed by Europe with 40 per cent and Asia with 5 per cent.

In the 1990s Michelin registered huge financial losses. This led to widespread rationalization: for example, staff numbers were reduced. Since then, there has been a lot of fluctuation in Michelin's results.

Bridgestone/Firestone

Bridgestone was founded by Shojiro Ishibashi in 1931. (The English translation of the surname Ishibashi is 'stone bridge'.) Firestone was acquired by the Japanese-owned Bridgestone Corporation in 1988. Traditionally, Bridgestone has targeted the upper 'price-quality' segment, while Firestone appeals more to the 'mid-range' segment. Firestone has in particular contributed to strengthening the group's sales to car producers (new sales) in Europe (primarily Ford, Opel/Vauxhall, VW/Audi and Fiat).

Of the total turnover, around 25 per cent comes from non-tyre products, including conveyor belts, rubber crawlers, construction materials and vibration isolation parts (for vehicles). In Europe, Brussels-based Bridgestone/Firestone Europe SA oversees local production and R&D at the European facilities. There are five European tyre plants: one in France, one in Italy and three in Spain. Bridgestone's European sales subsidiaries are located in Austria, Benelux, Denmark, Finland, France, Germany, Italy, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

Table 7 Brand awareness in the major European markets: spontaneous (unaided) awareness (%)

Brand	UK	Germany	France	Italy	Spain	Total
Michelin	73	78	98	92	90	85
Pirelli	51	45	40	91	66	57
Goodyear	52	48	56	70	41	54
Dunlop	60	53	48	25	25	44
Firestone	32	25	40	37	69	38
Continental	12	65	15	26	20	31
Bridgestone	10	26	7	17	9	15
Population (million)	58	81	58	57	39	223

Source: Compiled by the author from different sources.

However, brand awareness is still lower for Bridgestone than some of its competitors, as shown in Table 7. As a consequence Bridgestone began supplying Bridgestone tyres to Formula One teams in 1996.

The company's status as tyre supplier to the Formula One World Championship is an important part of Bridgestone's promotional strategy and has helped increase awareness of the Bridgestone brand substantially in recent years, particularly in Europe.

Bridgestone is looking to increase its global market share to 20 per cent from 19 per cent and its European market share to around 15 per cent from 10 per cent. To achieve this the company admits that it needs to gain a much stronger presence in Europe and North America, even though its share in North America has been increasing during the last ten years.

The company's main focus is on its Bridgestone and Firestone brands, although its multibrand approach to business extends to a range of budget and private brands such as Europa and First Stop in Europe or Dayton, Gillette and Peerless in North America.

Continental

Continental is Germany's largest manufacturer of tyres for commercial vehicles.

The company also manufactures power transmission systems, engine and suspension mounts, vehicle interiors, and electronic brake and traction control systems. The company operates in the Americas, Europe, Asia and Africa. It is headquartered in Hanover, Germany and employs about 69,000 people. The company recorded revenues of $17.2 billion during the fiscal year ended December 2004, an increase of 18.7 per cent over 2003. The net income was $919.1 million during fiscal year 2004, an increase of 133.2 per cent over 2003.

Continental produces tyres for all forms of vehicles: cars, trucks, heavy vehicles, agricultural machinery, bicycles, motor cycles, etc. Continental bought (from Michelin) the rights to use the Uniroyal brand all over Europe.

Continental is the fourth largest tyre manufacturer in the world as well as being a world leader in the braking segment following the 1998 acquisition of ITT's Brake and Chassis Division. The Group's operations are split into five different sectors:

1 the Passenger Tire Group (controlling the controlled distribution chains);
2 the Commercial Vehicle Tire Group;
3 the Automotive Systems Group (includes Continental Teves);
4 Continental General Tire (the group's US subsidiary);
5 ContiTech (industrial rubber products).

Continental was the first manufacturer to actively develop a multibrand strategy due to the uneven strength of its key brands across Europe. Today the company has eight main brands – Continental, Uniroyal (in Europe only), Semperit, General, Viking, Gislaved, Barum and Mabor. Part of its global strategy is to increase its strength in markets where it is under-represented, considered by the company to be the United States, France, Italy, Spain and Asia. In 1998 Continental acquired Grupo Carso (Mexico), General Tyre and Rubber (Pakistan) and Gentyre South Africa as part of a move towards the developing markets, along with joint venture and technology agreements such as those made in Belarus, Slovakia and Argentina.

By reorganizing its controlled distribution networks the company has been seeking to develop its share of the European market. The expansion of the Pneus Expert Europe-wide branded retail network has been central to this aim, combining Continental's wholly-owned subsidiaries such as National Tyres (UK) and Vergoelst (Germany) with the activities of partner groups and nationally organized franchise networks. Since Continental began to actively develop Pneus Expert in mid-1997 it has grown to become the biggest branded retail network in Europe.

Continental's main strategy is to develop a position as a complete systems supplier to the automotive industry. It has been developing wheel assembly facilities in conjunction with vehicle manufacturers worldwide for some time and the company's Automotive Systems Group has also focused on high-tech automotive developments.

Continental is very dependent on the German market, which accounts for 33 per cent of its worldwide sales.

Goodyear

The Goodyear Tire & Rubber Company (Goodyear) develops, manufactures, distributes and sells tyres and rubber products. The company has operations across the world. It is headquartered in Ohio, USA and employs about 84,000 people; 20 per cent of them are working in Europe. The company recorded revenues of $20 billion in fiscal 2005, an increase of 7.4 per cent on 2004. Net income rose by 98.6 per cent from fiscal 2004, to reach $228 million.

Goodyear has 86 factories in 26 different countries. Some 55 per cent of the Group's sales relate to the US market, where Goodyear is the market leader. Besides tyres, the company makes several lines of belt, hose and other rubber products, rubber-related chemicals, and owns retail stores worldwide. It is split into six business units:

1 Goodyear Asia;
2 Goodyear European Union;
3 Goodyear Latin America;
4 North American Tire;
5 Engineered and Chemical Products;
6 Goodyear Eastern Europe, Africa, and Middle East.

Its tyres are sold under various brand names besides Goodyear, including Dunlop, Kelly, Fulda, Lee, Sava, Pneumant, India and Debica.

The Group's main aims are to maintain its current status by holding a number one or number two position in specific markets, keep up a fast and profitable growth in all core businesses and gain strategic acquisitions and expansions while being the lowest cost producer of the top three companies.

The alliance with Sumitomo Rubber Industries/Dunlop was announced in January 1999 and covered the establishment of four joint venture sales companies, one in North America, two in Japan and one in Europe. The North American joint venture includes Dunlop's tyre activities in the region but not Goodyear's. In Europe, both Goodyear and Dunlop activities in Western Europe are included but not Goodyear's activities in Poland, Turkey and Slovenia. The Japanese joint ventures will cover OEM sales of both brands and replacement sales of Goodyear tyres with Sumitomo owning 75 per cent of both. Two further joint venture companies, majority owned by Goodyear, will be set up in the United States, one for purchasing and one for technology development. Activities by both companies in Asia and Latin America remain outside the deal. The alliance, unique in its scope and arrangement, means that Goodyear has gained control of the Dunlop brand in both Europe and North America, a move that is considered by some to be a precursor to a complete takeover of Dunlop's tyre activities.

Pirelli

The Italian Pirelli Group has two main activities: tyres and cables, and employs 3,800 employees worldwide.

Pirelli is the sixth largest tyre manufacturer in the world. The company has a presence in all areas of the tyre market but its particular strengths lie in the high-performance end of the passenger tyre market, where it can justifiably claim market leadership within Europe. The Pirelli brand is an out-and-out premium brand. However, the Group also owns a number of subsidiary brands including Courier, Ceat, Armstrong and the Metzeler brand of motorcycle tyres.

Within Europe Pirelli has key manufacturing plants in Italy, Germany, Spain and the United Kingdom.

Pirelli has the best market position in Italy, where it is second to Michelin. In 1992 Pirelli tried in vain to acquire its German competitor, Continental.

The distribution of tyres in Europe

The majority of replacement sales (replacement of tyres) take place through specialised tyre distributors:

- independent chains;
- producer-owned chains (e.g. in Germany Continental owns the Vergös chain and Michelin owns the Euromaster chain);
- franchise-based chains.

In addition, service stations have a certain share of replacement sales. This share is highest in newly developed Eastern European markets, while it is decreasing in Western Europe.

Questions

As a consultant for Chairman Shoshi Arakawa you are required to answer the following questions.

1 Make an assessment of the competitive strategies that Michelin, Continental and Goodyear, respectively may pursue to strengthen their European market positions.

2 Make an assessment of the alternative competitive strategies that Bridgestone can pursue to strengthen its European market position.

3 Give a well-reasoned proposal for criteria to be used by Bridgestone when choosing a market (country) that requires a larger marketing effort.

4 Give a well-reasoned proposal for Bridgestone's distribution and communication strategies in a market chosen by you.

CASE STUDY I.3

OneCafé:
A 'born global' penetrates the coffee industry

Today, coffee is found in every corner store or restaurant around the world. Drunk by people of every age, lifestyle and background, it is available in many flavours and at widely differing prices – especially since the recent boom in fashionable coffee-shop chains.

The fact that it is drunk by almost everybody makes coffee one of the world's most valuable commodities and, as we have seen, gives the big players in the coffee trade an enormous influence over the world market, and hence over the lives of producers in Southern countries. However, the same popularity issue gives consumers enormous power to change things by exercising freedom to choose what coffee they purchase.

The background story

In 2001, Håkan Löfholm and Lars Bendix had a cup of coffee at Arlanda Airport in Stockholm. As usual, this was not a very pleasant experience. And, while reluctantly sipping their coffee, they started to wonder why there wasn't an easy way to make a cup of freshly brewed coffee.

As true entrepreneurs, Håkan and Lars couldn't stop thinking about the problem. Together they started to investigate the matter. They soon discovered that many others had tried before them, and by studying their mistakes they started to realize what problems they had to solve. One of the crucial barriers to cross was the construction of the filter bag. It had to contain the coffee, but still be able to let the water flow through without any barriers. In addition, the package had to be designed in a way that made it easy to use and dispose of without stains and leakages.

After two years of research and development, they had a fully functional prototype. At this point, they decided that it was time to make it in to a full time commitment. Together with Frank Thygesen and Johnny Ragazzo they formed OneCafé International AB (www.onecafe.se).

Today the head office of OneCafé International AB is at the Ideon Science Park in Lund, Sweden. The company also owns a production plant in Uganda through the wholly-owned subsidiary OneCafé Elgonia International Ltd.

As shown, the coffee is packaged in an individual portion, which resemble a coffee bean. Each portion weighs 9 grams and is made of a water-resistant

moulded fibre material. Inside is a filter bag, which is made of a patented coffeebag that allows the coffee to fully mix with the hot water. In that way OneCafé resembles the principle behind making tea by using tea bags (see Case study 5.1: Teepack Spezialmaschinen GmbH).

Production in Uganda – being a social responsible company

Almost from the start, OneCafé realized that they needed an especially grinded coffee with superior quality. Their research led them to Africa – and to Uganda. Here OneCafé found not just coffee beans of the right quality, but also craftsmen and women with both the experience and commitment. In cooperation with them, 'OneCafé' developed the brand, Uganda Original. This is now produced at their own plant in Uganda, Elgonia OneCafé International Ltd.

Initially, the reason for manufacturing both the coffee and the package in Uganda was to maintain a consistent grade of high quality throughout the whole production process – from bean to cup. Soon it also became a significant part of the vision that drives OneCafé: a sustainable development.

With their presence in Uganda, 'OneCafé' can actually make a difference. They can contribute to Uganda's development and ensure that the farmers get a fair part of the profit. OneCafé has also decided to work in accordance with UN's Millennium Development Goals 2015 (http://cyberschoolbus.un.org/). This means that OneCafé, among other things, strives to promote

How to brew a cup of OneCafé

gender equality and empower women to ensure environmental sustainability and to be a part of a global partnership for development.

As an example, OneCafé supports a project to plant trees to improve the farmers' coffee production. Coffee grown without tree shade yields 2 kg beans per tree in average. By planting a tree that shadows about ten plants, the yield grows to 4 kg each, which means an extra 20 kg per year from the ten coffee plants. In addition, the beans produced are larger and of better quality. Planting trees also helps to sustain underground water sources and control of landslides.

The world coffee industry

Supply

Coffee is grown in more than 50 countries around the world, but the three leading producing countries (Brazil, Vietnam and Columbia) account for more than half of total global production. Brazil is by far the largest producer, with over one third of the world's supply. 80 per cent of Brazil's organic coffee production is exported, primarily to Germany, the Netherlands, Japan and the United States.

Coffee beans begin at the farm on coffee trees. After trees are planted, it takes between one and three years for the trees to bear coffee 'cherries,' which typically contain two beans. Each tree produces 2,000 to 4,000 beans a year. However, yields alternate with a good crop one year and a poor crop the next. Farm sizes range from 5 acres (traditional farms) to large plantations covering thousands of acres. Farming and harvesting methods differ greatly between traditional small-scale and large coffee farms.

Between 50 and 70 per cent of the global coffee supply came from small-scale farms by 2001. Coffee must be processed, and it is common for small farmers to accept a considerably lower price to be able to get their coffee to market. Often, these small producers have difficulties financing their operations throughout the year and would sell their crop to middlemen prior to harvest to receive a cash advance. These middlemen provided small farmers with credit at high interest rates in exchange for bringing their beans to market. The small-scale farmers are often caught in a perpetual cycle of poverty: small production levels limited their access to cash which, in turn, hindered the potential for increasing output. For many producing countries, coffee was tightly connected to the social and political power structures that had existed for hundreds of years.

Although several coffee species exist, only two make up the majority of worldwide coffee consumption. They differ greatly in taste, caffeine content, disease resistance, and cultivation conditions. Coffea Arabica, commonly referred to as arabica beans, are the oldest beans used in coffee production and account for 65 per cent of the world's coffee supply; 80 per cent of these beans come from Central and Latin America. Arabicas were susceptible to poor soils and diseases and thus required great care in growing. Coffee connoisseurs consider arabicas to be tastier than their counterpart, coffea canephora, also known as robusta beans. These beans evolved around 1850 but only entered the commercial market after World War Two. Robusta beans, typically grown in West Africa and South-East Asia, were easier to grow because they tolerated warmer and more humid climates and a wider range of soil conditions. Experts claim that although these beans contain more caffeine, robustas are inferior in flavour because of their distinct bitterness. Since robustas were easier to grow and not nearly as tasty, the beans tended to command a much lower price on the market. As a result, robusta beans are primarily used in the instant and mass-produced coffee sold in large supermarket stores.

After oil, coffee is the second most traded commodity on worldwide markets and coffee prices are set on the New York Coffee and Sugar Exchange. Overproduction is not unusual in the coffee industry and is one of the major reasons why historically prices have travelled in cycles.

The fair trade movement

Over the years, small plantations have been taken over and converted to industrial cultivation on larger plantations. Coffee farmers have increasingly converted to more intensive systems, involving high-yielding coffee varieties grown with no shade, and the application of large quantities of chemical fertilizers and pesticides. However, the fair trade trend motivates the small coffee farmers to move away from non-shade-grown methods and to encourage environmentally, economically and socially sustainable farms instead.

Fair trade coffees are normally purchased directly from cooperatives of small farmers at a guaranteed floor price. Unlike shade and organic coffees, fair trade coffee focuses on the worker's economic sustainability. Fair trade coffee attempts to cut out or limit the middlemen and provides much-needed credit to small farmers so that they can end their poverty cycle.

European socialists were also concerned with the coffee cultivation system and Dutchman, Bert Beekman, entered into a debate with the Dutch roaster Douwe Egberts about selling fair trade coffee. However, this subsidiary of Sara Lee never agreed to sell fair trade coffee, so Beekman and other fair trade advocates decided to create their own fair trade brand. A group of smaller roasters approached Beekman and offered to launch the coffee if the advocates created a certification label. In 1988, Beekman launched the *Max Havelaar Quality Mark* in Holland and the label quickly appeared in Switzerland, Belgium, Denmark, France, Germany and Austria. Since *Max Havelaar* was introduced in 1988, 17 countries had developed a fair trade seal. In 1997, an umbrella group called the Fairtrade Labelling Organizations International (FLO) was formed to coordinate monitoring and certification processes. There were 277 cooperatives from 24 countries representing 550,000 farmers that produced coffee on the Fair Trade Registry in 2001. FLO estimated that in 2006, fair trade farmers produced 180 million pounds of coffee but only 35 million were actually sold as fair trade coffee with a retail value of $450 million. The 180 million pounds produced in 2005 was 1.5 per cent of the total global output and influenced only 2.2 per cent of the farmers and workers in coffee producing countries.

Consumers in the United States and Europe are creating growing demand for fair trade and organically certified coffee, and a number of the multinationals have responded to demand and introduced fair trade products, including Procter & Gamble and Starbucks. However, the fair trade market constitutes a tiny proportion of total coffee sales and critics have derided these moves by the multinationals as little more than marketing ploys.

Café Direct in UK shows how fair trade brands can rapidly gain market share. Established in the UK the company sources coffee from 18 small-scale farmer associations in nine developing countries. Café Direct's expanding coffee range is now stocked by all major supermarkets. Owing to high product quality, successful advertising and widespread availability, Café Direct now claims 4 per cent by value of the UK roast and ground coffee market, with sales of over £6 million per annum.

Demand

The largest coffee consuming region is Western Europe (33 per cent of total volume), as shown in Table 1.

The largest markets and the markets with the highest growth rates are shown in Table 2.

The industry can be broken into two main categories on the consumption side: mass-marketed and specialty coffee. The five largest companies and their brands are Nestlé (Nescafé), Kraft Foods (Maxwell House), Sara

Table 1 Sales of coffee by Region, 2005

Region	Volume (tonnes)	%	Value (US$million)	%
Western Europe	1,182	33	11,729	35
Eastern Europe	335	9	3,947	12
North America	723	20	6,001	18
Latin America	811	23	2,850	9
Asia Pacific	316	9	6,483	19
Australasia	22	1	478	2
Africa and Middle East	173	5	1,681	5
World	3,562	100	33,169	100

Source: Adapted from Euromonitor and other sources.

Table 2 Major coffee markets 2000–2005

Country	2005 per capita consumption (kg)	2005 volume sales as % of world total	% volume growth 2000/2005
Largest markets:			
USA	2.3	19	–1.5
Brazil	3.3	17	1.0
Germany	4.4	11	3.2
France	3.1	5	–7.1
Italy	2.3	4	4.7
Japan	0.8	3	10.2
Poland	2.5	3	11.4
Mexico	0.7	3	–1.6
Netherlands	4.3	2	–11.7
Fastest growing markets:			
Russia	0.5	1.9	106.4
South Africa	0.1	0.1	96.3
China	0.01	0.2	86.1
Malaysia	0.6	0.4	70.6
Vietnam	0.2	0.4	64.6
South Korea	0.8	1.0	62.5
Ukraine	0.6	0.5	55.5
Morocco	1.1	0.3	48.9
Thailand	0.4	0.3	43.2
Indonesia	0.3	1.8	36.9

Source: Adapted from Datamonitor, Euromonitor and other sources.

Table 3 Global company market shares and their brands, 2005

Company	Nationality	Main brands	Global market share (%)
Nestle SA	CH	Nescafé, Exella	20
Kraft Foods Inc.	US	Maxwell House, Jacobs, Maxim	16
Sara Lee Corp.	US	Douwe Egberts, Hill Brothers	7
Procter & Gamble Co.	US	Folgers	4
Tchibo Holding AG	D	Tchibo	4
Others	US, D	Starbucks, Melitta, Strauss-Elite Group	49
			100

Source: Adapted from Euromonitor, Datamonitor and other sources.

Lee (Douwe Egberts), Procter & Gamble (Folgers) and Tchibo (Tchibo). These companies are mostly operating in the mass-marketed segment and their products accounted for 51 per cent of world consumption in 2005, as shown in Table 3. Due to their size and market reach, these companies had a large impact on coffee quality and consumption patterns. Starbucks, on the other hand, counted among the speciality players.

Health concerns

In terms of key health concerns in the coffee market, caffeine continues to be a thorny issue. While many, particularly younger people, continue to consume coffee for its stimulant properties, increased consumer awareness of the adverse effects of caffeine is seen in mature markets such as the United States and some European countries. In these markets older consumers are likely to avoid anything that prevents sleep or agitates the heart. Generally decaffeinated coffee accounts for some 10 per cent of the world coffee market.

Private labels in the global coffee market

Private label is a significant factor in the hot drinks market, and continued to increase its presence, with a 7 per cent share of global value sales in 2004, representing growth in absolute value terms of just over 25 per cent between 2000 and 2004.

Private labels are particularly strong in Western Europe and North America, where the retail market is highly consolidated and private label brands are well established as alternatives to traditionally branded products. However, in 2004, the two regions experienced contrasting private label share performances, with Western Europe advancing strongly and share in North America falling slightly.

Germany is a prime example of the strong performance of private label products. Discounters, such as Aldi, have improved the quality of their private label offer and in return stimulated further sales. Consequently, Germany is characterized by a high level of private label sales, with its penetration in core sectors such as tea and coffee well above the global average in 2004. The high private label shares in the United Kingdom are attributable to the deep penetration of private label in black standard tea.

In emerging markets, private label sales remain insignificant, as retail markets are highly fragmented. China, for example, recorded no private label sales in 2004. However, as multinational retailers make inroads into emerging markets, the availability of private label products is expected to increase in the medium term.

Coffee shop chains

Despite the strong performance of chained coffee shops over the review period, coffee distribution remained dominated by other food service formats in 2004.

Chained coffee shops initially made breakthroughs into markets where the traditional drink was not coffee; or in places such as the United States and United Kingdom where consumers had less sophisticated tastes in coffee, tending to consume instant coffee. However, globalization of the Starbucks brand was made complete in 2004, when a branch opened in Paris, France, a country associated with high quality coffee consumption. The company has increased its store numbers to about 10,000 outlets in 37 countries.

The increasingly hectic nature of contemporary urban lifestyles has underpinned the more dynamic growth of the instant coffee format, which affords time-strapped consumers greater convenience in terms of product preparation. Time, or the lack thereof, has also been one of the key factors supporting the rapid expansion of the coffee shop/bar concept and subsequent consumer exposure to a wider range of premium quality coffee varieties. While greater sophistication of the palate has benefited the fresh coffee category, it has also informed rising demand for premium instant coffee, ably met by manufacturers launching speciality variants, such as cappuccino or latte macchiato in Germany.

Coffee pods create at-home 'café experience'

Faced with sluggish retail sales of coffee in mature Western markets and the burgeoning coffee bar cultures in many of these markets, manufacturers are trying to increase value sales by introducing a similar 'café experience' at home.

Coffee suppliers normally team up with electrical appliances makers to produce the machines jointly. For example, Sara Lee and Philips were early pioneers of this format, with the Senseo one-cup system using Douwe Egberts coffee. More recently, Kraft Foods has cooperated with Saeco International to produce its coffee maker called Tassimo. In both systems, the coffee comes in single-serve bags called 'pods' specifically suited for the machines designed as companions for the product lines. These types of coffee makers are intended to retain consumer loyalty towards certain brands.

As consumers face growing choices of new style coffee makers for home use, one of the deciding factors could be the availability of pods. After consumers have made their machine choice, probably based on price and the physical aspects of each machine, having easy access to the coffee pods themselves will be key. Flexibility may also turn out to be a competitive advantage. In addition to coffee, the Tassimo system also allows consumers to make hot chocolate or tea, a feature that rival Senseo has yet to offer.

The single-serve packaging format for coffee (including the OneCafé concept) is something of a revolution in coffee consumption. As the amount of ground coffee is pre-determined, and is packaged either in pod capsules or flat pods, consumers can rest assured that the correct amount of ground coffee is used. This is particularly useful for people who drink coffee only occasionally and are therefore unsure about how much to use.

The sealed metal capsules also ensure maximum freshness, and this unique selling point of coffee pods has attracted considerable consumer interest in many coffee-drinking nations where demographic trends show that populations are ageing and household sizes are becoming smaller. It can take some time for a single person who does not spend a lot of time at home to finish 500g of fresh ground coffee, and the freshness of the coffee will therefore be compromized towards the end of the package, whereas coffee pods will provide more consistent quality. Despite the fact that the average unit price of coffee pods is higher than that of regular filter versions (in most countries, prices for coffee pods are 2.5 times higher than regular filter coffee), small households and institutions are still prepared to opt for coffee pods simply due to the economic advantages of the system.

In the Netherlands, the largest national market for Sara Lee's Senseo system by value, the growing popularity of coffee pods and reduction in wastage of coffee have led directly to slower volume growth but higher value growth in retail sales of coffee in recent years. Understandably, value sales of larger packaging sizes, namely 500g and 250g, are showing signs of decline, while single-serve coffee pods have shown explosive growth in sales since the introduction of Sara Lee's Senseo in 2001 (see also Case study 4.2 Senseo).

Pod control vital to long-term profitability

In a repeat of similar format wars in industries such as razors/blades, it is not the hardware (coffee machines) itself but the software (pods) that is the real power behind the success of these systems. As a consequence, whoever controls the pods is likely to control market share. Following the entry of another consumer products giant, Kraft Foods (with Tassimo) into the US single-serve market in mid-2005, what remains to be determined in the short term is whether the market can support multiple systems, such as Melitta One:One, Home Café, Senseo, Keurig, Tassimo and Bunn. Such launches underscore how competitive and serious the battle is for America's single-serve coffee cup. In order to gain a competitive edge, Melitta also announced that from the third quarter of 2005 its pods are also adapted to fit competitors' machines. The single-serve market will also have to deal with the fallout from Procter & Gamble's acquisition of Gillette, which is a partner of arch-rivals Procter & Gamble and Kraft in the Tassimo venture, with the Tassimo machines being distributed and serviced by Braun, a division of Gillette.

Lighter and creamier coffee appeals

In order to persuade consumers to migrate from conventional filter coffee to coffee pods, manufacturers are introducing new flavours and varieties into their coffee pod lines. The maturity of coffee consumption in Western markets means that the main task for coffee marketers is to persuade young consumers to continue drinking coffee. Young consumers demand more variety in terms of coffee flavours and frothy coffee (lighter and creamer) has become a fashionable drink over the past five years. The trend in consumption is largely in line with global trends favouring 'light' beverages and self-indulgence.

To this end, the ability to produce frothy coffee instantly is commonly exploited in marketing strategies. The Senseo coffee pod system claims that it 'makes it possible to prepare a filtered cup of coffee proportioned perfectly with a delicious frothy layer on top'. On a similar theme, Tchibo Cafissimo claims 'with its special steam nozzle, Tchibo Cafissimo produces a rich, creamy head of frothed milk in the blink of an eye for your favorite coffee specialties, such as cappuccino or latte macchiato'. These claims appeal particularly to consumers aged 25–45 years, who are more likely to use high-tech home appliances, value the contemporary features and enjoy the frothy taste of the coffee.

Slow penetration of single-serve pods in the US market

The Senseo coffee machine system, which combines single-serve 'pods' of Sara Lee's Douwe Egberts coffee with new single-serve machines made by Philips, has experienced rapid success in Europe, but the anticipated revolution in home coffee consumption in the United States has yet to materialize. Faced with intensifying competition from the likes of Kraft (with Tassimo) and slower than expected sales for its Senseo one-cup coffee system, Sara Lee has decided to change its advertising direction. The tagline 'Coffee that feels as good as it tastes' remained the same, but Sara Lee also offered a US$20 'Bet you can't find a better-tasting cup of coffee' rebate on the US$70 machines.

Sara Lee has indicated that the Senseo single-serve coffee system is earmarked for 'strategic investment', and while overall sales of the brand reached US$210 million in fiscal 2004 (up from US$100 million in fiscal 2003), the company expects Senseo sales to reach US$500 million by fiscal 2007.

Private labels are entering the portioned coffee market

As more players are entering the market, the competition for share is intensifying. Despite the strong growth in sales, mainstream players are wary about potential threats and challenges in this new market. The next few years will see home coffee marketers try to outperform each other in terms of coffee offerings, machine specification and pricing.

In line with developments in other food and beverage categories, the strong growth of private labels remains a concern for many mainstream players. Private labels have already emerged in the portioned coffee market and currently pose a threat to Sara Lee's position in the Netherlands. Supermarket private labels offer varieties of coffee pods that exactly match the technical specifications of Senseo's machines, and with private labels' obvious price advantage, many Dutch consumers opt for private label pods rather than the expensive Douwe Egberts range.

Coffee retailing

The growing dominance of the supermarkets/hypermarkets channel is a key feature of the wider hot drinks market. Rapid expansion of discount outlets by operators such as Wal-Mart and Aldi, and the popularity of EDLP (every day low prices) strategies underpinned the one percentage point increase in global share of coffee distribution for the discounter channel.

Consolidation in retailing

During the recent years, the key incentive behind retailer consolidation has been the drive to reduce costs through economies of scale, increase negotiating power with suppliers, and build profit through expansion into emerging regional markets. Another key factor has been the development of new convenience-style food-/beverage-based stores in urban locations, which exploited busier consumer lifestyles and 'on-the-go' consumption. A further significant factor has been the development of on-line retailing infrastructure, with a number of major retailers entering the growing business of 'e-tailing'.

The impact of retailer consolidation on hot drinks distribution has been to increase the emphasis on the relationship between manufacturers and a small number of increasingly important retail accounts. This has led to the development of direct delivery, rapid response production and co-promotional efforts in stores.

Major retailing developments over the review period focused on the following three areas:

1 retailer consolidation
2 new retail formats
3 online retailing.

Consumer demand for cheaper private label hot drinks has also spurred retailer consolidation. Economies of scale in retailing, driven by the relentless elimination of supply costs, has also encouraged manufacturer consolidation in order to meet the low-cost demands of major retailers.

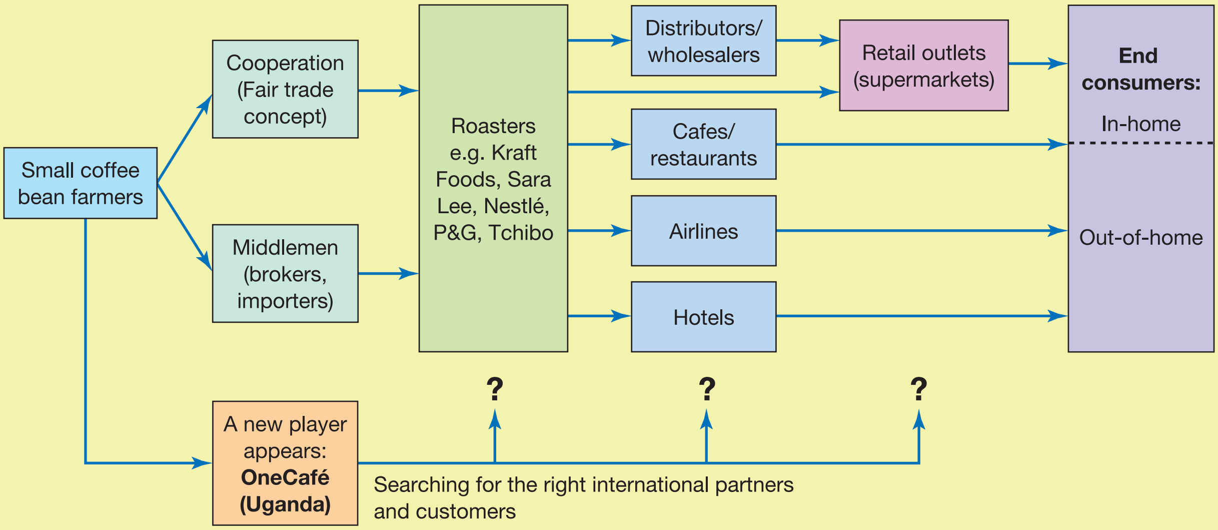
Greater consolidation in the retail industry has also led to an unprecedented level of information-sharing and alliance-based partnerships between leading retail chains, in order to remain competitive with giant retailers such as Wal-Mart.

Greater sophistication in consumption patterns

Coffee roasters (manufacturers) view greater segmentation as a good opportunity to stimulate growth in both mature and developing markets. Manufacturers in major markets have increasingly segmented their ranges to target more specific categories of consumers. Cultural factors have continued to exert influence on the coffee market. The spread of the US-originated coffee house boom and continental-style espresso bars has impacted on almost all regional markets. Starbucks and others are an increasing presence in large urban areas. The company's ongoing expansion plans suggest that Starbucks is not resting on its laurels and the concept has yet to hit saturation point.

Further widening of travel horizons and more adventurous consumer choice can be expected to lead to increasing consumption of products that have until now comprised a niche market. Flavoured coffee and specialty coffee will carry on their strong growth during the forecast period, given their association with high

Figure 1 The supply chain of coffee and OneCafés role in this



quality beans and high production standards by many consumers in major markets in Western Europe and North America. These products also offer consumers a drink associated with sophistication.

The coffee supply chain and OneCafé's role in this

First the 'normal' coffee supply chain is explained as follows. The coffee supply chain process varies greatly depending on origin country and buyer. In some countries, beans are exported through government coffee boards while other countries use private exporters only. After they are shipped to the import country, coffee beans are visually inspected and test-tasted for quality through a process called 'cupping.' After passing inspection, coffee is stored in warehouses until it is shipped to roasters. Large roasters often have their own coffee buyers and procure green beans directly from producers. Large roasters also stockpiled green coffee at the import warehouses to help decrease their exposure to market conditions. Conversely, smaller roasters bought coffee from independent brokers and importers who may have beans at warehouses and thus were exposed to a much larger risk of price fluctuations.

After roasters buy green coffee, the beans are shipped to roasting facilities where they are roasted until they receive their characteristic colour and aroma, and then cooled. Once the beans are cooled, roasters blend beans from different countries to balance the flavours and strengths. This process is essential because it allows for a consistent flavour even if supplies vary due to prices and availability. Roasters then package, market, and distribute coffee through a variety of methods. The largest roasters grind and vacuum-pack coffee in packed bricks or cans and distribute their products through wholesale channels. These roasters can supply coffee for restaurants, airlines, and hotels in addition to selling directly to consumer through retail channels. Specialty coffee, in contrast, is roasted and packaged in a manner to guarantee quality and freshness. It is sold in both whole bean and ground forms through wholesale and retail channels.

In the *OneCafé* case the supply chain is somewhat different (see Figure 1).

In Elgonia, on the hillsides of the highest mountains in Uganda, OneCafé find their coffee beans of superior Arabica AA quality. The coffee bean farmers ripe them at the right moment, and afterwards One Café dry and sort them. Only the biggest and most even are chosen to become the Uganda Original. After this process, the beans are roasted and ground in the OneCafé plant in Uganda. To keep the aromatic substances of the fresh coffee, OneCafé packages directly on the spot in their own production unit, Elgonia OneCafé.

Until now OneCafé has mainly sold their products to the catering market in East Africa, but soon OneCafé should have a clear strategy of how to expand internationally with its unique product and which partners it should choose for this internationalization process.

As illustrated in Figure 1 there are several options:

- Offer the production and packaging equipment for the big roasters on a license basis. This means that the big coffee companies could offer the OneCafé in their product range with their own logo or as cobranding with OneCafé, as shown in Figure 1. This could be done for a small licensing royalty per produced unit.

- OneCafé could produce the OneCafé products itself and sell them to the big roasters as an OEM-product under the roaster's logo or with OneCafé co-branding.
- OneCafé could sell its product directly to the distributors/wholesalers and/or directly to the retail chains under the OneCafé brand.
- OneCafé could sell its product directly to the retail chains under its own brands (private labels), or combined with some OneCafé co-branding.
- OneCafé could sell its product directly to the catering (food service) market under its own brand (e.g. under the Hotel group name) or as co-branding with OneCafé. The possible cooperation partners would be restaurant chains, hotel chains, airline catering companies, etc.

The average retail price across borders for 'OneCafé' is planned to be €0.9 (the price paid by the end-consumer in the retail outlet).

Sources: Material from OneCafé (www.onecafe.se) – the author would like to thank one of the four founders, Lars Bendix, for his valuable contribution; Wallteg, B. (2005), 'OneCafé – Hoping to be a generic name in the coffee market', *Nordem ballage* 4, April, pp. 20–21; Waridel, L. (1996), 'Sustainable Trade: The Case of Coffee in North America', *Minor International Development Studies*, McGill University; Doonar, J. (2004), 'Fair Trade Case Study: The Direct approach', *Brand Strategy*, July/August, pp. 28–29; material from Euromonitor (www.euromonitor.com); material from Datamonitor (www.datamonitor.com); UN's Millennium Development Goals 2015 (http://cyberschoolbus.un.org/).

Questions

In Spring 2007 Lars Bendix is preparing one of his many trips to visit the production unit in Uganda. He is convinced that the product concept is the right one. But how should the unique product be turned into a global marketing success for OneCafé? The company is still in the process of attracting foreign investors, and right now it has only got limited financial resources. On his way to Arlanda Airport, Lars tries to collect his thoughts, but he still has his doubts about what to do. He decides to call you as an international marketing expert. Before Lars returns to Sweden in one week, he would like you to prepare a report with answers to the following questions. Of course you would like to help in this situation, and you agree to prepare the report within the next week.

1. To what degree would you characterize OneCafé as a 'Born Global'?
2. What are OneCafé's main motives for establishing production in Uganda?
3. Which international partners should OneCafé try to cooperate with and how? Set up a priority list of potential cooperation partners.
4. Which of the above-mentioned options would you recommend to the OneCafé management. Set up a time plan for the implementation of the strategy option.

CASE STUDY I.4

Cereal Partners Worldwide (CPW): The No. 2 world player is challenging the No. 1 – Kellogg

On a lovely spring morning in April 2007, while giving her kids some Cheerios, the CEO of Cereal Partners Worldwide S.A. (CPW), Carol Smith thinks about how CPW might expand international sales and/or capture further market shares in the saturated breakfast cereals market. Right now, CPW is the clear No. 2 in the world market for breakfast cereals, but it is a tough competition, primarily with the Kellogg Company, which is the world market leader.

Maybe there would be other ways of gaining new sales in this competitive market? Carol has just read the business bestseller *Blue Ocean Strategy* and she is fascinated by the thought of moving competition in the cereals breakfast market from the 'red ocean' to the 'blue ocean'. The question is just how?

Maybe it would be better just to take the 'head-on' battle with Kellogg Company. After all, CPW has managed to beat Kellogg in several minor international markets (e.g. in Middle and Far East).

The children have finished their Cheerios and it is time to drive them to the kindergarten in Lausanne, Switzerland where CPW has its HQ.

Later that day, Carol has to present the long-term global strategy for CPW, so she hurries to her office, and starts preparing the presentation. One of her marketing managers has prepared a background report about CPW and its position in the world breakfast cereals market. The following shows some important parts of the report.

History of breakfast cereals

Ready-to-eat cereals first appeared during the late 1800s. According to one account, John Kellogg, a doctor who belonged to a vegetarian group, developed wheat and corn flakes to extend the group's dietary choices. John's brother, Will Kellogg, saw potential in the innovative grain products and initiated commercial production and marketing. Patients at a Battle Creek, Michigan, sanitarium were among Kellogg's first customers.

Another cereal producer with roots in the nineteenth century was the Quaker Oats Company. In 1873, the North Star Oatmeal Mill built an oatmeal plant in Cedar Rapids, Iowa. North Star reorganized with other enterprises and together they formed Quaker Oats in 1901.

The Washburn Crosby Company, a predecessor to General Mills, entered the market during the 1920s. The company's first ready-to-eat cereal, Wheaties, was introduced to the American public in 1924. According to General Mills, Wheaties was developed when a Minneapolis clinician spilled a mixture of gruel that he was making for his patients on a hot stove.

Cereal Partners Worldwide (CPW)

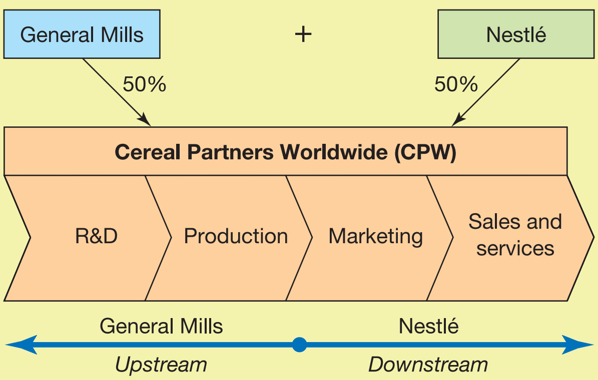
Cereal Partners Worldwide (CPW) was formed in 1990 as a 50:50 joint venture between Nestlé and General Mills (see Figure 1).

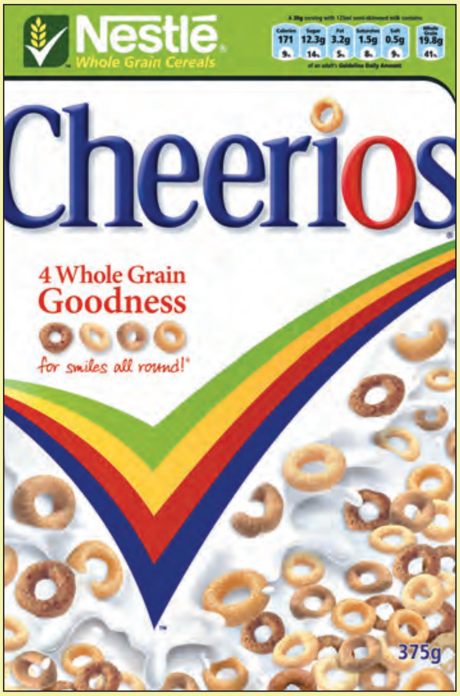
General Mills

General Mills, a leading global manufacturer of consumer food products, operates in more than 30 global markets and exports to over 100 countries. General Mills has 66 production facilities: 34 are located in the United States; 15 in the Asia/Pacific region; six in Canada; five in Europe; five in Latin America and Mexico; and one in South Africa. The company is headquartered in Minneapolis, Minnesota. In financial year 2006 the total net sales were US$11.6 of which 16 per cent came from outside the United States.

In October 2001 General Mills completed the largest acquisition in its history when it purchased The Pillsbury Company from Diageo. The US$10.4 billion deal almost doubled the size of the company, and consequently boosted General Mills's worldwide ranking, making General Mills one of the world's largest food companies. However, the company is heavily debt-laden following its Pillsbury acquisition, which will continue

Figure 1 The CPW joint venture





to eat into operating and net profits for the next few years.

The company now has more than 100 US consumer brands, including Betty Crocker, Cheerios, Yoplait, Pillsbury Doughboy, Green Giant and Old El Paso.

Integral to the successes of General Mills has been its ability to build and sustain huge brand names and maintain continued net growth. Betty Crocker, originally a pen name invented in 1921 by an employee in the consumer response department, has become an umbrella brand for products as diverse as cookie mixes to ready meals. The Cheerios cereal brand, which grew rapidly in the US post-war generation, remains one of the top cereal brands worldwide.

However, heavy domestic dependence leaves the company vulnerable to variations in that market, such as supermarket price-cutting or sluggish sales in prominent product types such as breakfast cereals.

Internationally, General Mills uses its 50 per cent stake in Cereal Partners Worldwide (CPW) to sell its breakfast cereals abroad. Cereal sales have faced tough competition recently leading to significant drops in sales, particularly tough competition from private labels.

Nestlé

Founded in 1866, Nestlé is the world's largest food and beverage company in terms of sales. The company began in the field of dairy-based products and later diversified to food and beverages in the 1930s. Nestlé is headquartered in Vevey, Switzerland and the company has 500 factories in 83 countries. It has about 406 subsidiaries located across the world. The company employs 247,000 people around the world, of which 131,000 employees work in factories, while the remaining employees work in administration and sales.

Nestlé's businesses are classified into six divisions based on product groups, which include Beverages; Milk Products, Nutrition and Ice Cream; Prepared Dishes and Cooking Aids; Chocolate, Confectionery and Biscuits; PetCare; and Pharmaceutical Products. Nestlé's global brands include Nescafé, Taster's Choice, Nestlé Pure Life, Perrier, Nestea, Nesquik, Milo, Carnation, Nido, Nestlé, Milkmaid, Sveltesse, Yoco, Mövenpick, Lactogen, Beba, Nestogen, Cerelac, Nestum, PowerBar, Pria, Nutren, Maggi, Buitoni, Toll House, Crunch, Kit-Kat, Polo, Chef, Purina, Alcon, and L'Oréal (equity stake).

Nestlé reported net sales of $83 billion for the fiscal year 2005.

CPW

CPW markets cereals in more than 130 countries, except for the United States and Canada, where the two companies market themselves seperately. The joint venture was established in 1990 and the agreement also extends to the production of private label cereals in the UK. Volume growth for CPW was 4 per cent in 2005. The company's cereals are sold under the Nestlé brand, although many originated from General Mills. Brand names manufactured (primarily by General Mills) under the Nestlé name under this agreement include Corn Flakes, Crunch, Fitness, Cheerios and Nesquik. Shredded Wheat and Shreddies were once made by Nabisco, but are now marketed by CPW.

The CPW turnover in 2005 was a little less than US$2 billion.

When CPW was established in 1990 each partner was bringing distinctive competences into the joint venture:

General Mills:
- proven cereal marketing expertise;
- technical excellence in products and production processes;
- broad portfolio of successful brand.

Nestlé:
- world's largest food company;
- strong worldwide organization;
- deep marketing and distribution knowledge.

CPW is No. 2 in most international markets, but it is also market leader in some of the smaller breakfast cereal markets like China (80 per cent market share), Poland (70 per cent market share), Turkey (70 per cent market share), East/Central Europe (50 per cent market share) and South East Asia (50 per cent market share).

The world market for breakfast cereals

In the early 2000s breakfast cereal makers were facing stagnant, if not declining, sales. Gone are the days of the family breakfast, of which a bowl of cereal was standard fare. The fast-paced American lifestyle has more and more consumers eating breakfast on the go. Quick-serve restaurants like McDonald's, ready-to-eat breakfast bars, bagels and muffins offer consumers less labour-intensive alternatives to cereal. Although the value of product shipped by cereal manufacturers has grown in absolute figures, increased revenues came primarily from price hikes rather than market growth.

English-speaking nations represented the largest cereal markets. Consumption in non-English markets was estimated at only one-fourth the amount consumed by English speakers (see Table 1), where the breakfast cereal consumption per capita is 6 kg in UK, but only 1.5 kg in South-west Europe (France, Spain and Portugal). On the European continent, consumption per capita averaged 1.5 kg per year.

Growth in the cereal industry has been slow to non-existent in this century. The question at hand for the industry is how to remake cereal's image in light of the

Table 1 Breakfast cereal consumption per capita per year – 2005

Region	Per capita consumption per year (kg)
Sweden	9.0
Canada	7.0
UK	6.0
Australia	6.0
USA	5.0
South West Europe (France, Spain)	1.5
South East Asia	0.1
Russia	0.1

Table 2 World market for breakfast cereals by region – 2005

Region	Billion US$	%
North America	10	50
Europe	6	30
Rest of the World	4	20
Total	20	100

new culture. Tinkering with flavourings and offerings, such as the recent trend toward the addition of dried fresh fruit, proves some relief, but with over 150 different choices on store shelves and 20 new offerings added annually, variety has done more to overwhelm than excite consumers. In addition, cereal companies are committing fewer dollars to their marketing budgets.

Development in geographical regions

As seen in Table 2, the United States is by far the largest breakfast cereals market in the world. In total North America accounts for 50 per cent of the global sales of $20 billion in 2005. The United States accounts for about 90 per cent of the North American market.

The European region accounts for 30 per cent of global sales, at US$6 billion in 2005. By far the largest market is the UK, contributing nearly 40 per cent of the regional total, with France and Germany other key, if notably smaller, players. Eastern Europe is a minor breakfast cereal market, reflecting the product's generally new status in the region. It contributed just 3 per cent of world sales in 2005. However, the market is vibrant as new lifestyles born from growing urbanization and westernization – key themes in emerging market development – have fuelled steady sales growth. Despite its low level of per capita spending, Russia is the largest market in Eastern Europe, accounting for over 40 per cent of regional sales in 2005. The continued steady growth of this market underpinned overall regional development over the review period. Cereals remain a niche market in Russia, as they do across the region, with the product benefiting from a perception of novelty. A key target for manufacturers has been children and young women, at which advertising has been aimed.

The Australasian breakfast cereals sector, like Western Europe and North America, dominated by a single nation, Australia, is becoming increasingly polarized. In common with the key US and UK markets, breakfast cereals in Australia are suffering from a high degree of maturity, with annual growth at a low single-digit level.

The Latin American breakfast cereals sector is the third largest in the world, but at US$2 billion in 2005, it is notably overshadowed by the vastly larger North American and Western European markets. However, in common with these developed regions, one country plays a dominant role in the regional make-up, Mexico, accounting for nearly 60 per cent of the overall breakfast cereal markets in Latin America.

In common with Eastern Europe, breakfast cereal sales, whilst small in Africa and the Middle East, have displayed marked growth in recent years as a direct result of greater urbanization and a growing trend (in some areas) towards westernization. Given the overriding influence of this factor on market development, sales are largely concentrated in the more developed regional markets, such as Israel and South Africa, where the investment by multinationals has been at its highest.

In Asia the concept of breakfast cereals is relatively new, with the growing influence of Western culture fostering a notable increase in consumption in major urban cities. Market development has been rapid in China, reflecting the overall rate of industry expansion in the country, with breakfast cereals sales rising by 19 per cent in 2005. In the region's developed markets, in particular Japan, market performance is broadly similar, although the key growth driver is different, in that it is health. Overall, in both developed and developing markets, breakfast cereals are in their infancy.

Health trend

With regards to health, breakfast cereals have been hurt by the rise of fad diets such as Atkins and South Beach, which have heaped much scorn on carbohydrate-based products. The influence of these diets is on the wane but their footprint remains highly visible on national eating trends. In addition, the high sugar content of children's cereals has come under intense scrutiny, which caused a downturn in this sector, although the industry is now coming back with a range of 'better for you' variants.

Regarding convenience, this trend, once a growth driver for breakfast cereals, has now become a threat, with an increasing number of consumers opting to skip breakfast. Portability has become a key facet of convenience, a development that has fed the emergence and expansion of breakfast bars at the expense of traditional foods, such as breakfast cereals. In an increasingly cash-rich, time-poor society, consumers are opting to abandon a formal breakfast meal and instead are relying on an 'on-the-go' solution, such as breakfast bars or pastries. These latter products, in particular breakfast bars, are taking share from cereals, a trend that looks set to gather pace in the short term.

Trends in product development

Consumer awareness of health and nutrition also played a major part in shaping the industry in recent years. Cereal manufacturers began to tout the benefits of eating breakfast cereal right on the package – vitamin-fortified, low in fat, and a good source of fibre. Another trend, begun in the 1990s and picking up steam in the 2000s, is adding dehydrated whole fruits to cereal, which provides colour, flavour, and nutritional value. Yet touting health benefits to adults and marketing film characters to children have not been sufficient to reinvigorate this mature industry.

Under the difficult market conditions, cereal packaging is receiving new attention. Packaging was a secondary consideration, other than throwing in special offers to tempt kids. But these days, with meal occasions boiled down to their bare essentials, packaging and delivery have emerged as key weapons in the cereal marketer's arsenal. New ideas circulating in the industry usually include doing away with the traditional cereal box, which has undergone little change in its lifetime. Alternatives range from clear plastic containers to a return of the small variety six-packs.

Trends in distribution

Supermarkets tend to be the dominant distribution format for breakfast cereals. The discounter format is dominated by mass merchandisers, the most famous example of which is Wal-Mart in the United States. This discounter format tends to favour shelf-stable, packaged products and as a result they are increasingly viewed as direct competitors to supermarkets.

Independent food stores have suffered a decline during the past years. They have been at a competitive disadvantage compared to their larger and better resourced chained competitors.

Trends in advertising

Advertising expenditures of most cereal companies were down in recent years due to decreases in consumer spending. However there are still a lot of marketing activities going on.

General Mills has a comprehensive marketing programme for each of its core brands, from traditional television and print advertisements to in-store promotions, coupons and free gifts. In 2002, the company teamed up with US publisher Simon & Schuster to include books or audio CDs with the purchase of its Oatmeal Crisp Raisin and Basic 4 cereals.

Other promotions have included free Hasbro computer games included in boxes, promotion of new millennium pennies and golden dollars in 2000, and the inclusion of scale models of the Cheerios-sponsored NASCAR.

In response to Kellogg's 2001 launch of Special K Red Berries, General Mills countered with the introduction of freeze dried fruit in Cheerios, with Berry Burst and Triple Berry Burst product extensions from February 2003. The introduction is a response to the need for the packaging to communicate the inclusion of real berries in the box and not just flavouring. Consequently, the chosen designs consisted of vibrant red and purple boxes, each featuring a spoonful of Cheerios and fruit splashing in milk. Since freeze-dried fruit tends to absorb moisture, the company was also compelled to develop a more moisture-resistant package liner.

The introduction of Berry Burst Cheerios was supported by a US$40 million advertising and promotional campaign that included TV advertising, consumer couponing, outdoor advertising, in-store sampling and merchandising.

Celebrity glamour

Celebrity endorsements continue to play a critical part of General Mills's marketing strategies, in particular its association with sporting personalities dating back to the 1930s with baseball sponsorship. One of the main lines of celebrity endorsement involves Wheaties boxes and a long line of sports people have appeared on the box since the 1930s. In 2001, Tiger Woods, spokesman for the Wheaties brand, appeared on special edition packaging for Wheaties to commemorate his victory of four Grand Slam golf titles.

Distribution

General Mills distributes the majority of its products directly through its own sales organization to retailers, cooperatives and wholesalers. In Europe and Asia-Pacific the company licenses products for local production, but it also exports to over 100 different countries.

New products, new channels

New products and new product innovations have helped create new distribution channels for General Mills recently. The success of General Mills's snack products has helped create a large demand for products in convenience stores and the company has actively developed products to meet the demands of the convenience store consumer such as its healthy Chex Mex range. A new chocolate-flavoured Chex Mex was added to the product line in 2005.

The development of cereal-in-a-bowl range has helped create new outlets for General Mills's products in college cafeterias and hotel restaurants. This may see the development of additional products to compliment these channels.

Traditional channels

Traditional retailers such as supermarkets continue to play a major role in the distribution of General Mills's products, and the company has an extensive number

Table 3 The world market for breakfast cereals, by company – 2005

Manufacturer	Germany % market share	UK % market share	USA % market share	World % market share
Kellogg Company	27	30	30	30
CPW (General Mills + Nestlé)	12	15	30[1]	20
PepsiCo (Quaker)	–	6	14	10
Weetabix	–	10	–	5
Private label	35	15	10	15
Others	26	24	16	20
Total	100	100	100	100

[1] In the United States General Mills and Nestlé market each of their breakfast cereal products independently, because the CPW only covers international markets outside the United States.

of cereal, snack, meal and yoghurt brands to maintain shelf space in major retail outlets.

Private label competition intensifies

Across many categories, rising costs have led to price increases in branded products which have not been matched by any pricing actions taken in private labels. As a result, the price gaps between branded and private label products have increased dramatically and in some cases can be as much as 30 per cent.

This creates intense competitive environments for branded products, particularly in categories such as cereals which is one of General Mills's biggest markets, as consumers have started to focus more on price than brand identity. This shift in focus is partly the result of private labels' increased quality as they compete for consumer loyalty and confidence in their label products.

Competitors

Kellogg's

The company that makes breakfast foods and snacks for millions began with only 25 employees in Battle Creek in 1906. Today, Kellogg Company employs more than 25,000 people, manufactures in 17 countries and sells its products in more than 180 countries.

Kellogg was the first American company to enter the foreign market for ready-to-eat breakfast cereals. Company founder Will Keith (W.K.) Kellogg was an early believer in the potential of international growth and began establishing Kellogg's as a global brand with the introduction of *Kellogg's Corn Flakes®* in Canada in 1914. As success followed and demand grew, Kellogg Company continued to build manufacturing facilities around the world, including Sydney, Australia (1924), Manchester, England (1938), Queretaro, Mexico (1951), Takasaki, Japan (1963), Bombay, India (1994) and Toluca, Mexico (2004).

Kellogg Company is the leader among global breakfast cereal manufacturers with 2005 sales revenue of $10.2 billion (net earnings were $980 million). Wal-Mart Stores, Inc. and its affiliates, accounted for approximately 17 per cent of consolidated net sales during 2005.

Established in 1906, Kellogg Company was the world's market leader in ready-to-eat cereals throughout most of the twentieth century. In 2005, Kellogg had 30 per cent of the world market share for breakfast cereals (see Table 3). Canada, the United Kingdom, and Australia represented Kellogg's three largest overseas markets.

A few well-known Kellogg products are Corn Flakes, Frosted Mini-Wheats, Corn Pops, and Fruit Loops.

PepsiCo

In August 2001, PepsiCo merged with Quaker Foods, thereby expanding its existing portfolio. Quaker's family of brands includes Quaker Oatmeal, Cap'n Crunch and Life cereals, Rice-A-Roni and Near East side dishes, and Aunt Jemima pancake mixes and syrups.

The Quaker Food's first puffed product, 'Puffed Rice', was introduced in 1905. In 1992, Quaker Oats held an 8.9 per cent share of the ready-to-eat cereal market, and its principal product was Cap'n Crunch. Within the smaller hot cereal segment, however, the company held approximately 60 per cent of the market. In addition to cereal products, Quaker Oats produced Aunt Jemima Pancake mix and Gatorade sports drinks.

The PepsiCo brands in the breakfast cereal sector include Cap'n Crunch, Puffed Wheat, Crunchy Bran, Frosted Mini Wheats and Quaker.

Despite recent moves to extend its presence into new markets, PepsiCo tends to focus on its North American operations.

Weetabix

Weetabix is an UK manufacturer, with a relatively high market share (10 per cent) in United Kingdom. The company is owned by a private investment group – Lion Capital. The company sells its cereals in over 80 countries and has a product line that includes Weetabix, Weetos, and Alpen. Weetabix is headquartered in Northamptonshire, UK. In 2005 Weetabix has an estimated turnover of US$1 billion.

Sources: www.cerealpartners.co.uk; www.generalmills.com; www.nestle.com; www.euromonitor.com; www.datamonitor.com; www.marketwatch.com; Bowery, J. (2006) 'Kellogg broadens healthy cereals portfolio', *Marketing*, 8 February, p. 5; Sanders, T. (2006) 'Cereals spark debate', *Food Manufacture*; August, 81(8), p. 4; Reyes, S. (2006) 'Saving Private Label', *Brandweek*, 5 August, 47(19), pp. 30–34; Hanson, P. (2005) 'Market focus breakfast cereals', *Brand Strategy*, March, 190, p. 50; Pehanich, M. (2003) 'Cereals Run Sweet and Healthy', *Prepared Foods*, March, pp. 75–76; Vignali, C. (2001) 'Kellogg's – internationalisation versus globalisation of the marketing mix', *British Food Journal*, 103(2), pp. 112–130.

Questions

Carol has heard that you are the new global marketing specialist so you are called in as a 'last-minute' consultant before the presentation to the board of directors. You are confronted with the following questions, which you are supposed to answer as best you can.

1 How can General Mills and Nestlé create international competitiveness by joining forces in CPW?

2 Evaluate the international competitiveness of CPW compared to the Kellogg Company.

3 Suggest how CPW can create a blue ocean strategy.

4 Where and how can CPW create further international sales growth?