

THE DETERMINANTS AND CREATION OF FOOD INDUSTRY DEVELOPMENT STRATEGIES

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Abstract:

This paper presents the evolution, state and functioning of food industry companies – as an example of the fastest developing sectors of Polish economy. Alike other sectors of market economy, food industry meets many problems and threats evolving from the European integration processes and world economy globalization. The companies from food industry have to include in their functioning the external factors from the economic and sector environment and also the internal factors from the inside of the changing company. In summary the presentation of Wawel SA company is included, and the company belongs to the WIG-Spożywczy stock index of Warsaw Stock Exchange, and is putting into practice the complex strategy assumptions in many fields at the same time.

1. Introduction

In the middle of 2008 financial situation of food and soft drinks producing companies that belong to the WIG – Spożywczy has worsen. The causes of the situation were placed among many factors inhibiting the food industry development. The most important cause was the world economic crisis, initially observed in United States. Financial problems affecting consecutively European Union and other European countries are getting more and more painful for food companies. Undoubtedly the influence of panic initiated by capital markets destructively influences the companies functioning, but at the same time it brings the disclosure of threats caused earlier by integration and globalization processes. The food companies are facing many challenges related with strategy creation or constant modernization of current strategies. These companies as organizations have to evolve in a way that their “early warning” systems can react appropriately fast on the changes in global

economy. The companies of WIG – Spożywczy stock exchange are the members of international business, irrespective of the size of the company. The boards of these companies have to face the challenges that force them to survive and develop further. Evolving strategies are essential for functioning and development and they have to include new attitudes towards international management, competition and market positioning. In European western countries the main position in food industry is created by so called “core companies” that are large companies with the dominant position in relation to the size, the ownership of specialized working capital, market share or company function in the production net¹.

Food industry is one of the most important for Polish economy, it is one of the fastest developing sectors. The accession of Poland to the European Union has caused rapid increase in the development of food industry as a part of economy². It's share in the sale value of the industry is 24% and it is 9 percent points higher than in the 15 European Union countries, where this rate is 15% on average. Among EU, the higher sales value share percentage than in Poland is observed in Denmark (28%) and Greece (27%)³. National food industry companies use the beneficial circumstances and their export activity after the accession of Poland to the European Union has largely increased. As R. Urban says, the accession of Poland to the European Union has significantly changed the conditions of functioning in the food line, including the conditions of the food companies functioning. The food producers has shown the capabilities to use the comparative advantages and they are able to overcome extra-economic barriers of market entrance⁴.

2. The development barriers and the risk factors in food industry

During the last years food producers face many threats emerging from regional integration processes and economy globalization. The most important threats are changing rates of exchange, quotation of milk, sugar and potato starch production, increasing quality requirements, and increasing inflation rates. These factors are not necessarily related with economic stagnation, although it means the decreasing rate of the Polish food industry production development below 5% per year, and the export rate of this sector products below 10% per year. In the opinion of producers, the factors inhibiting the development further are the growing employment cost, the most important part of company cost. The company owners are afraid of clients' stronger position, among which the share of large trading nets. The consolidation among retail traders makes the disproportion even larger. The comparison of the concentration rate in retail trade in Poland and other European market shows that this process

is still ongoing. The businessmen complaints include unstable and unclear legal regulations. This category relates to national institutional and legal environment and the changing European regulations concerning wider and wider functioning of producers that needs to be adjusted.

Discussing problems related with food production development it needs to be noticed which factors influence strategies the most. The development of food producers depends on production factors both endogenic and egzogenic. In order to present them the following classification shows their cause and effect relationship. The food production determinants are causative agents for changes with diverse characteristics according to the discipline of origin. The relations between multidimensional character of scientific disciplines is shown by economy and the influence on food production is clearly seen. The classification of food production development determinants is presented in Table 1⁵.

Table 1.

The classification of food production determinants

| General factors | Detailed factors |
|----------------------|---|
| Production | Soil Work Capital |
| Egzogenic (external) | Development dynamics of economy The tempo of economic changes Elasticity in relation to challenges |
| Endogenic (internal) | The level and stability of quality, attractiveness and functionality of products and services The level of cost and price Company's economic power Market efficiency of companies depending on organization and management |

Source: authors' elaboration.

The most important factor is soil, which quality is directly related with food production. This factor has got its own production potential. The evaluation of soil value as productive factor influencing food production emphasizes the direct proportional relation of the quality to the share of farming the product.

The second production factor in agribusiness is work, and its resources as a matter of fact. These play 3 important roles in production process – initiating it, putting into practice and using the effects. Work can be understood as a main production factor, because of the properties of work that are most important for development dynamics. The resources of work can be discussed in 3 dimensions: as a resource of physical strength, as a resource of know-

how, motivations and aspirations. The third production factor influencing food production is capital, that is the joint stock taking part in production process.

The second group of factors influencing food production are egzogenic factors, also called external factors. These are independent from decisions of producer, but they have to be included as a part of external limitations. In case of macro scale evaluation of food production these include main economic determinants created by the development of agribusiness, general economic development and random natural and socio-economic phenomena. The development tempo of general economy, the restructurization tempo and market elasticity can also be included.

The third group of factors consists of endogenic factors (internal) , that the most often are created by food producer. The most important of them are the level and stability of product quality, the attractiveness and functionality of the product for the client the level of cost and price, the economic power of the company and market efficiency of a company, depending on organization and management.

3. Development strategies of food production companies

The development strategy is a kind of management strategy in market economy that is defined as “a strategy concerning company’s expansiveness, what can be illustrated by new markets creation, production diversification and investments”. An important way of development is the strategy of structural changes (organizational changes), as a part of general management strategy. It concerns privatization changes and new structural solutions related with corporation creation and relations described as mergers and take-overs (Stabryła, 2000)⁶. The creation and implementation of strategy aims at the most beneficial distinction of a company at the background of direct and indirect competition that leads the best use of strengths in order to fulfill clients’ requirements. Strategic decisions emerge directly from the relation company-environment and sometimes from the inside of a company. IN case of development strategy however, the company is a proactive agent so it creates changes. The company initiative creates market and is a development factor. The dynamic evaluation of financial index analysis such as: profitability of sales, profitability of capital, gross margin rate or share profitability rate – can help to evaluate the implementation process and to enforce the strategy in time. The scientific literature concerning company management presents many typologies of development strategies, for example:

A) intensive development strategies – emphasizing market share and its enlargement, and also new geographical areas range creation. The important part of this strategy is an utilitarian function a product that increases its attractiveness for clients, what can be illustrated by sales rates. These strategies include:

- a) market penetration strategies,
- b) markets development strategies,
- c) product development strategies.

B) integrative strategies – among them the sales orientation and dominant corporation creation. Expansion strategies aiming at market monopolization are emerging from integration, both horizontal and vertical. The integration strategies consist of:

- a) vertical integration strategies,
- b) horizontal integration strategies.

C) diversification strategies – aimed at product development, emerging from offer widening, new market segments take-over and the production of brand new products.

4. WAWEL company – evolution and characteristics

Wawel SA is a joint stock company with the tradition that has began in 19th century. The company was established in 1898 as a confectioner's company with the staff of 5 people. In 1910 the production company was established based on a model of confectioner's companies of the world, and it started to produce chocolates that were believed to be of a very good quality and taste. Some of the products created by master Piasecki himself are produced even today. In 1951 three Cracovian confectioner's companies: „A.Piasecki”, „Suchard”, „Pischinger” and two smaller: „Kryształ” and „Helia” have joined in one company with the new trade mark and brand name: Confectioner's Company “Wawel”⁷. In 1992 the process of privatization has began that led to joint stock company Confectioner's Company Wawel SA creation. Now it is a developing, modern company, implementing new management and technology solutions. The elegant packaging and the classic taste distinct the Cracovian confection from many other products. That is why the sweets are chosen by people who appreciate quality and beautiful form. In recognition of the highest quality of Wawel products the company was awarded prestigious: „Teraz Polska”, „Srebrny As” czy „Diabetyka Expo” awards. In 2001 Wawel was certified ISO 9001. The quality system has encompassed the functioning of a company from the project of products and its package through quality control of materials to the control of sales process⁸. The company is one of the biggest producers of

sweets in Poland. The main products are: chocolates with filling (44% sales share), chocolate sweets with soft filling and caramel (20%), chocolate in bars (11%) and chocolate coated waffles (7%). The company is a Polish market leader in production of sugar-free products that are called LIGHT type. The company production is mainly for domestic market (75% of sale). The concentration of sale can be seen especially in Małopolska region (40%)⁹. The shares of Wawel SA are available at Warsaw Stock Exchange since the 11th March 1998¹⁰. In stock exchange the shares of B-series are present (the emission with the pre-emption for previous shareholders) and C-series shares, sold in a public offer. The nominal price of a share of both series was 5 PLN. In public offer the shares were sold at a price of 32 PLN. On the day of a Stock debut the price per one share was 42 PLN. On the 28th May 2007 the price per one share has reached historical maximum – one share price was 403 PLN that day. The historical minimum was on 4th November 1998, when the price per one share was 14,60 PLN. On 17th November 2000 the new stock system WARSET was introduced. Wawel SA shares were included to the uniform quotation system with single price definition. According to the decision of Warsaw Stock Exchange Board since 18th April 2001 Wawel SA shares are quoted in constant quotation system¹¹.

5. The development strategies of WAWEL company

The Wawel company implements the plan of its complex strategy at many levels at the same time. In 2009 Wawel has planned to begin the single property developer investment, the construction of offices or flats for sale or rent on a parcel of land in Cracow left after old company buildings removal. The decision was caused by the localization change and the transfer of a company to modern buildings in Dobczyce. The decision of Board based on investment profitability was completely different and the property developer plan was abandoned. One of the properties in Cracow city center was already sold. In 2007 Wawel SA has bought Ukrainian Trade-Production Company "Łasoszci" in Ivano-Frankowsk. With its base a new investment project will be implemented. "Łasoszci" also produces sweets so the products from Ukraine will be sold in Ukrainian market and other Easter Europe markets. Wawel also planned to build in 2010 a new factory in Ukraine. The investment was about to begin at the beginning of 2009, and initial assumptions projected investment cost of 50 million PLN. The cost was about to be paid by Wawel SA and its main shareholder, Hosta International AG, which has got 52,13% of shares. The projected sales value was about 100-130 million PLN. With the problems of parcel of land close enough to the city and the price of

it and the infrastructure level, the investment plan was abandoned. Instead the Board has decided to invest and build-up the factory in Ivano-Frankowsk. The potential loss because of not-sold land in the city center was to be refunded by lower cost of factory modernization, smaller size of investment and the income from higher product sales rate through the fast increase of production power in existing company. Wawel is constantly developing range of goods in basic functioning that is the production and sale of new kinds of sweets. The trade mark of “Wawel” is common for 12 factories. The next shops will be open in the middle of November in Gliwice and at the beginning of December in Jelenia Góra. Wawel shops – with the total area of 735 square meters – are located in the biggest Polish cities: Cracow, Warsaw, Łódź, Poznań, Katowice and recently Lublin. Wawel also plans to open 15 new shops soon so the sales net is developing.

The Board of Supervisors has positively evaluated the state of Wawel SA in 2007, and the financial outcome was evaluated satisfactory. The evaluation included the effect of property sale on financial outcome in 2006. The Board of Supervisors has positively evaluated the fact of earlier bank loan repayment, which is why the company has almost no loans to pay (except for a loan on a current account). The continuation of changes in the product sphere was also positively evaluated. These included the assortment list limitation to the products of high sales volume with their constant support and development. Wawel SA company has had 2,21 million PLN of net profit in the second quarter of 2008 in comparison with 1,84 million PLN in the previous year. The operational profit was 2,40 million PLN in comparison with 2,42 million PLN. The income was 46,34 million PLN in comparison with 46,13 million PLN in a previous year. Increasingly in the first and second quarter of 2008 the company profit was 8,87 million PLN in comparison with 8,94 million PLN in the previous year, with the turnover 111,20 million PLN in comparison with 110,74 million PLN¹².

6. Summary

Presented strategy of Wawel SA is a development strategy allowing Board to reach the projected aims and create market share with stabile position. Based on statistical data it can be seen that the company increases market share, creates new markets and increasing quality and attractiveness of products at the same time. As an outcome it can be seen that the sales volume and clients' group are increasing. The second strategy is the diversification strategy, aimed at the development of a product. The company widens assortment offer, takes over new market segments and produces new products. The integrative strategy in this company was

not observed because the company is not interested in corporation creation. The confectioner's branch is not likely to integrate, both vertically and horizontally. The Stock debut and quotation of Wawel SA shares by Warsaw Stock Exchange caused the implementation of development strategies and is very promising for the future. Although the materials prices were high at the beginning of 2008, the company's financial situation is good. The net profit from shares in 2007, although almost two-fold lower than in record 2006, was at the level of 2005, and it is a very good outcome. It has to be emphasized that the company was able to overcome the threats limiting its functioning. The determinants and barriers of development were the impulse to coordinate actions aimed at production increase and profit gain. It has happened, although the company's environment is difficult due to international market changes affecting food production companies of WIG-Spożywczy index. Food sector company functioning indexed by WIG-Spożywczy allowed to invest additional financial capital and forced the competitive rivalry with other producers, such as Confectioner's Company JUTRZENKA SA from Bydgoszcz and Confectioner's Company MIESZKO SA from Warsaw.

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⁷<http://www.wawel-sklep.com.pl/index.php?page=artykuly&id=43>; dostęp: 2.11.2008.

⁸ibidem;

⁹http://forsal.pl/notowania/PLWAWEL00013_WAWEL.html; dostęp: 2.11.2008.

¹⁰http://www.magazynhandlowiec.pl/pl/historia_marki/slodkosci_z_krakowa_%E2%80%93.html; dostęp: 2.11.2008.

¹¹<http://www.wawel.com.pl/gielda/?pg=historia>, dostęp: 31.10.2008 r.

¹² http://www.money.pl/gielda/spolki_gpw/artykul/WWL,wawel; dostęp: 4.11.2008 r.