

## **Strategic management in turbulent markets: The case of the German and Croatian brewing industries\***

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*European beer markets are characterized by major changes that are forcing breweries to redesign their competitive strategies. In this paper, we analyze the changes in the German and Croatian brewing industries by referring to Porter's five forces model and generic strategies framework. The analysis reveals growing competitive pressures in both markets and a wide spectrum of competitive strategies. Whereas in Germany cost leaders have gained market shares, the Croatian market is strongly influenced by the differentiation strategies of multinational brewing groups and medium-priced local brands. A comparison of the market characteristics and firm strategies in Germany and Croatia and some theoretical and managerial implications close the paper.*

*Die europäischen Biermärkte befinden sich in einem tiefgreifenden Wandel, der Brauereien zur Anpassung ihrer wettbewerbsstrategischen Positionierung zwingt. Unter Bezugnahme auf das wettbewerbsstrategische Konzept Porters analysieren wir diese Veränderungen am Beispiel der deutschen und der kroatischen Brauwirtschaft. Die Analyse zeigt einen in beiden Märkten wachsenden Wettbewerbsdruck und ein breites Strategiespektrum, das Anwendung findet. Während in Deutschland in den letzten Jahren die Strategie der Kostenführerschaft besonders erfolgreich war, wird die kroatische Brauwirtschaft durch die Differenzierungsstrategien internationaler Braukonzerne sowie lokale Anbieter im mittleren Preissegment geprägt. Ein Vergleich der Charakteristika der Branchen und Strategien in beiden Ländern sowie einige theoretische und praktische Implikationen beschließen den Beitrag.*

*Key words: Brewing industry, Croatia, competitiv analysis, strategic management*

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## 1. Introduction

For many years, the German brewing industry was characterized by low to moderate competitive pressures. A growing demand for beer in its home-market, strong consumer preferences for traditional local brands, forbearance of aggressive low-cost strategies and a lack of marketing and product innovations all created a very stable situation, guaranteeing high returns on investments for most breweries. This situation has been changing dramatically over the last decade. The market entry of large multinational breweries like Heineken, Carlsberg and InBev, shrinking demand due to changing consumer preferences, the emergence of more aggressive competitive strategies, growing concentration ratios and rapid changes in important distribution channels have created growing competitive pressures for German breweries. An industry that was used to stability must now find its way in an increasingly turbulent market environment.

In recent years, the Croatian beer market has also been in transition. Due, for instance, to the market entry of large international brewing companies, the industry structure has been characterized by dramatic changes. The aim of this paper is to analyze the ongoing changes in the German and Croatian brewing industries with reference to Michael E. Porter's five forces model and generic strategies framework and to sketch the current competitive strategies of breweries in both markets. This analysis leads to the identification of some theoretical implications and to some conclusions concerning the need for active strategic management in turbulent markets.

## 2. Theoretical framework and methodology

In his seminal work on strategic management, Michael E. Porter (1980, 1985) provides a powerful instrument for thoroughly analyzing environmental forces and market structures in an industry. Porter's five forces model provides a flexible framework for describing and assessing competitive pressures in an industry and industry attractiveness. Based on this analysis, a company can develop a competitive strategy for gaining and sustaining competitive advantages over rival firms and thereby generating above-average return on investments.

According to Porter (1980), five forces influence competitive pressures and industry attractiveness:

- *Degree of rivalry among existing competitors*: Rivalry among firms varies considerably between industries. It is influenced, for instance, by the number of competitors, market growth, fixed costs, switching costs, exit barriers and diversity of rivals. The higher the degree of rivalry in an industry, the lower the average return on investments. Concentration ratios are popular measures for gaining initial insights into the degree of rivalry in an industry.

- *Threat of substitutes*: A threat of substitutes exists when price changes in other industries influence product demand in the industry being analyzed. Close substitutes generally restrict a firm's ability to raise prices and thus limit profitability.
- *Threat of entry*: The threat that new competitors may enter an industry depends on barriers to entry. When barriers to entry are low, excessive profits will quickly attract new competitors, and price competition will become more intense.
- *Buyer power*: When buyers are powerful, they set prices and limit the supplying industry's profitability. Buyers are powerful when they are concentrated, possess credible backward integration options, purchase a significant portion of the supplier's output or can easily and cheaply switch to other suppliers or substitutes.
- *Supplier power*: Powerful suppliers can deliver raw materials at a high price to capture some of their customers' profits. Suppliers are powerful when they can credibly threaten their customers with forward integration, are more concentrated than their customers, sell differentiated products (instead of commodity products), provide important and difficult to replace inputs or when customers face high switching costs. Barriers to entry stem from legal actions by governments, patents, economies of scale, asset specificity that inhibits flexible use of resources and so on.

Each strategic analysis should also include an assessment of the important characteristics of the wider economic, ecological, technological, political, legal and socio-demographic environment since these environments influence market conditions and developments and should also be taken into account when developing competitive strategies.

Porter (1980) recommends companies find a position within an industry that allows the generation of above-average return on investments. Even in industries with low average profitability, an optimally positioned firm is able to generate superior returns. Porter distinguishes between three generic strategies that define a firm's position within an industry:

- *Cost leadership strategy*: The cost leader produces a given level of quality more cheaply than its competitors and sells products at average industry prices. A cost leadership strategy allows a company to remain profitable even when prices fall sharply due to growing competitive pressures. Cost leaders are usually large companies that realize economies of scale and can design cost-efficient purchasing, manufacturing and distribution activities.
- *Differentiation strategy*: Differentiated products offer unique attributes such as well-known brands, superior product quality, innovativeness, higher reliability, better after-sales services and so on. Companies with

differentiation strategies usually have a cost disadvantage but are nevertheless profitable due to higher customer loyalty and customers' willingness to pay a price premium.

- *Focus strategy*: Companies with focus strategies concentrate on narrow market segments. Within these market segments the firms try to achieve a cost advantage (cost focus) or differentiation (differentiation focus). Focus strategies depend on successful market segmentation and the identification of customer groups with special demands.

In his early contributions to strategic management, Porter (1980, 1985) advised firms to clearly focus on only one of the generic strategies since he expected firms that were “stuck in the middle” to be less successful than clearly positioned companies. Nevertheless, a wide body of literature exists that argues that under certain conditions a combination of different strategies may turn out to be the best way to gain and sustain competitive advantage (see, for instance, Miller/Friesen 1986; Murray 1988; Miller 1992). Therefore, it does not come as a surprise that in more recent publications Porter (2001:70) concedes that firms gain and sustain a competitive advantage “... by operating at a lower cost, by commanding a premium price, or by doing both.” Hybrid strategies stemming from blending different generic strategies thus constitute a fourth strategy type firms can choose.

In the text that follows we apply Porter's five forces model and generic strategies framework to the German and Croatian brewing industries.

### **3. Competitive pressures in the brewing industry**

#### **3.1. The German Brewing Industry**

Today intensity of rivalry in the German brewing industry is still greatly influenced by the very heterogeneous structure of the industry, in which large, medium-sized and a considerable number of small and micro-breweries co-exist (see Figure 1). Nevertheless, recently growing intensity of rivalry has forced many companies to leave the market, and the total number of German breweries remains high only due to the market entry of many micro-breweries. The decrease in the number of firms is largest in those groups in which breweries have an annual production volume between 5,000 and 1,000,000 hectoliters (hl). Companies in these groups are too large to find a profitable market niche but too small to compete successfully with more cost-efficient international brewing groups and national market leaders.

Figure 1. Structure of the German brewing industry (Deutscher Brauer-Bund 2007:4):

Company size by annual production volume	Number of companies		Change (in %)
	1995	2006	
Micro-breweries (<5,000 hl p.a.)	643	816	+26.9
Small breweries (5,000 – 50,000 hl p.a.)	393	284	-27.7
Medium-sized breweries (50,000 - 200,000 hl p.a.)	136	104	-23.5
Large breweries (200,000 – 1,000,000 hl p.a.)	71	51	-28.2
Brewing groups (>1,000,000 hl p.a.)	29	29	+ - 0
Total	1,282	1,284	+0.01

In 2006 there were still 1,284 breweries in Germany—a globally unique market structure with primarily historical antecedents, such as the Thirty Years' War. 77% of all breweries in the European Union are located in Germany. Nonetheless, in 2002 the average annual output of German breweries was only 84,754 hl—the lowest in the EU and much smaller than, for instance, the United Kingdom (885,500 hl) or the Netherlands (1,556,125 hl) (Deutscher Brauer-Bund 2003b). The main reasons for this are the fragmented market structure and the large number of small and micro-breweries, especially in Southern Germany.

The shrinking market volume resulting from constantly falling per capita beer consumption is also spurring a sharp rise in the intensity of rivalry. Since the decline in domestic demand cannot be compensated for by growing exports, total annual production volume has been falling since the early 1990s, which has resulted in a fierce fight for market shares between German breweries (see Figure 2).

Against this background, additional market shares can only be gained by driving out or acquiring competitors or by merging with other companies. The main effect of this has been to jeopardize the market position and long-term economic success of small and medium-sized breweries, for which it is difficult to take part in such development. On the other hand, large brewing groups have gained market shares. Thus, concentration ratios (CR) have been rising considerably since the early 1990s (see Figure 3). In 2004, Germany's largest brewery had a market share of about 17% compared to less than 8% in 1991. The aggregated market share of the top three brewers (CR3) rose from 18.7% in 1991 to 23.8% in 2002 and 40.1% in 2004, and the aggregated market share of the five largest breweries (CR5) rose to 52% in 2004. Furthermore, the growth of concentration ratios has been accelerating in recent years. The latter has happened despite the growing number of micro-breweries; their output is so small that they do not really affect the overall industry trend.

Figure 2. Development of beer consumption per capita and production volume (Deutscher Brauer-Bund 2003a:26 and 64; \*estimated values: Deutscher Brauer-Bund 2003c:9):

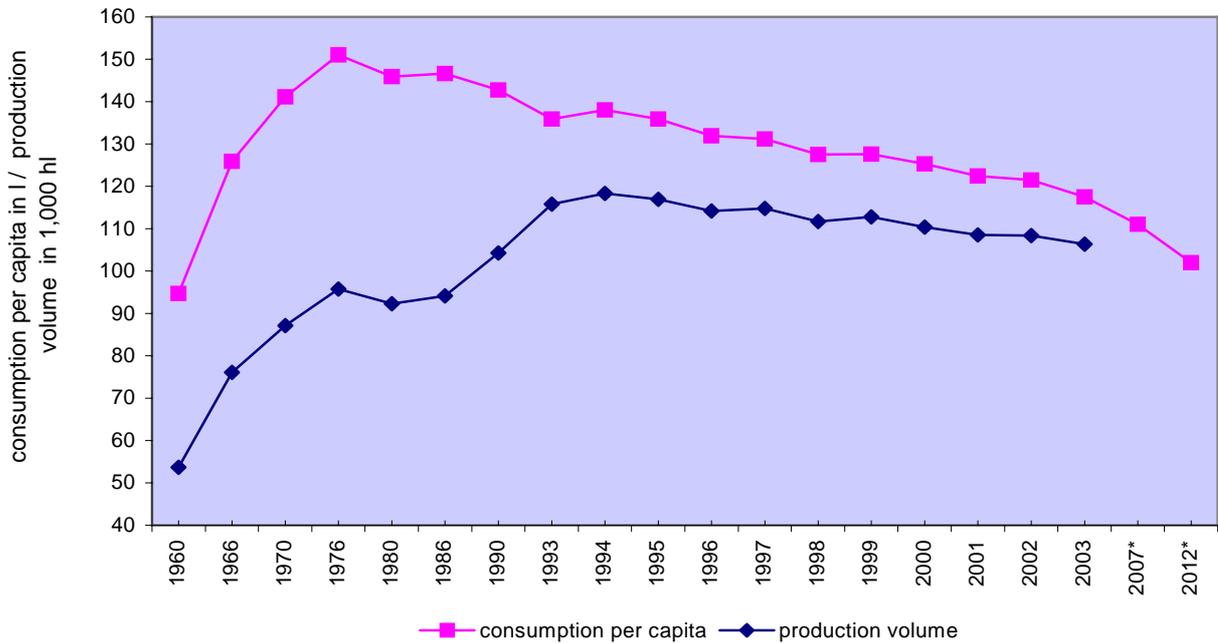
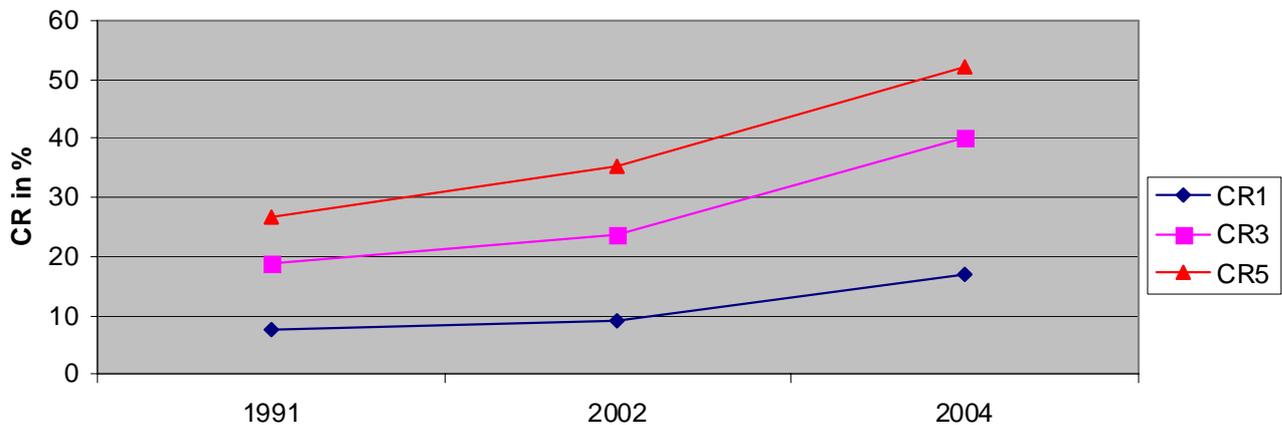


Figure 3. Concentration Ratios 1991-2004:



For a long time, the threat of entry of new competitors was low. But in recent years many major international brewing groups, such as Heineken, Carlsberg and Inbev, have entered the German beer market. Due to their enormous financial resources, there are no significant barriers to entry into the German market for international brewing groups. Whereas exports to Germany and international licensing were quite unsuccessful in the past, acquisitions of leading domestic brewers by international brewing groups has turned out to be a much more successful market entry strategy (Ebneht/Theuvsen 2007a).

The starter's gun went off in 2001, when Dutch-based Heineken acquired a 49.9% stake in the Munich-based Schoerghuber Group. After Heineken had forged the way for acquisitions in Germany, several other international brewing groups quickly entered the market. Figure 4 provides an overview of major acquisitions of German breweries by large international competitors. Industry insiders expect an ongoing internationalization of the German brewing industry and growing competitive pressures due to the large financial resources of international brewing groups.

Figure 4. International mergers and acquisitions in the German brewing industry (FAZ-net 2004):

Date	Acquirer	Target	Production volume (million hl)
Feb-01	Heineken	Forms joint venture with Schoerghuber Group by acquiring 49.9% of Brau Holding International	4.7
Jul-01	Interbrew	Diebels	1.4
Aug-01	Interbrew	Beck's	5.5
Jun-02	Heineken (via Brau Holding International)	Karlsberg (45%)	3.9
Dec-02	Interbrew	Gilde	2.3
Sep-03	Interbrew	Spaten	3.6
Jan-04	Carlsberg	Holsten (except Koenig and Licher)	6.9
Oct-04	Heineken (via Brau Holding International)	Fuerstenberg	0.7
Oct-05	Heineken	Wuerzburger Brauerei (90.7%)	0.4

Buyer power is very different for breweries of different company and sales area sizes. For small breweries, sales through traditional *restaurants* and *pubs* are still very important, whereas large breweries sell a much smaller share of their production through these channels. Nevertheless, nearly 20% of total annual production is still sold as draft beer in restaurants and pubs, which guarantees higher prices and above-average profits per hl (Stauder 1995:35). Large breweries in particular view restaurants and pubs as marketing instruments for promoting image and consumer awareness of their brands. Due to long-term delivery contracts between breweries and restaurants/pubs, which are still very common in the German market, competitive pressures in this market segment and the buyer power of these distribution channels are generally low. An exception to the rule is highly prestigious restaurants and bars. Breweries compete intensely to become the preferred suppliers of these buyers. This competition manifests itself primarily through allowances for these buyers, so

that small and medium-sized breweries cannot compete with large domestic and international competitors in this market (Rolinck 2002:207; Marx 1998:32).

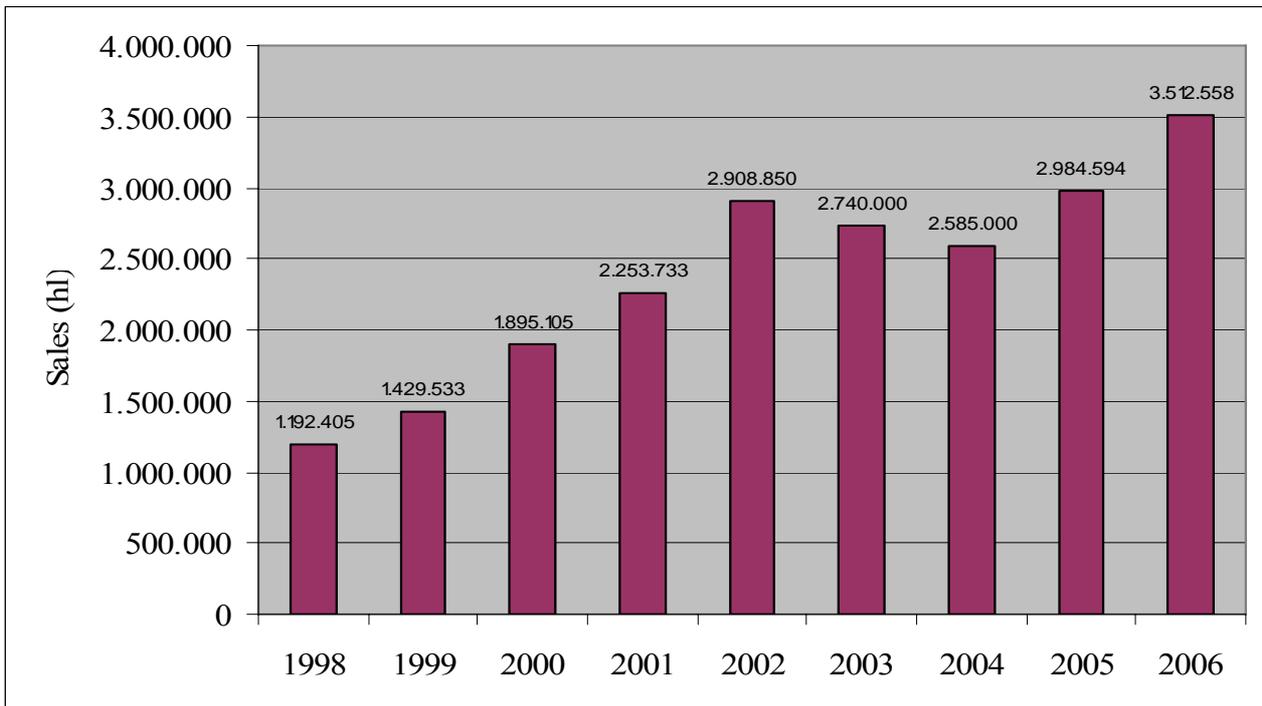
The importance of *beverage wholesalers* has been growing rapidly in the beer market due to the single- or dual-sourcing strategies of large retailers and a growing market share of returnable bottles due to legislative action against non-returnable bottles and cans. Recent figures indicate that 79% of beer is distributed through wholesalers. The size and market power of wholesalers have been growing quickly due to concentration processes. Therefore, several breweries have just recently started acquiring beverage wholesalers in order to avoid market foreclosure (Niederhut-Bollmann 2006). This strategy has further accelerated concentration processes, and market foreclosure for small and medium-sized breweries has become more probable.

In Germany *retailing* is concentrated in the hands of only a few very large groups. The ten leading retailers have a market share of about 84%, and the thirty leading companies have a market share of about 98.5% (Anonymous 1999). Breweries, therefore, are facing enormous buyer power with prices and other selling conditions strongly influenced by retailers. Small and medium-sized breweries, which lack strong national brands, very often have to act as pure price takers. Only national market leaders with strong brands have a somewhat more favorable market position. Since concentration ratios in the retailing sector are still growing, buyers will gain even more market power.

Due to changing consumer behavior and tastes, substitute products have become a major threat for German breweries. Increasingly consumers are replacing beer with other beverages, such as wine and soft drinks, that better reflect their changing lifestyles and attitudes. Therefore, soft drinks and mineral water have gained market shares (38.9% in 2003; 30% in 1991), whereas alcoholic beverages have lost market shares (21.7% in 2003; 26.2% in 1991) (Deutscher Brauer-Bund 2003a:66-67). Within the market for alcoholic beverages, there are also changes going on. In Western and Northern Europe, consumers are switching from beer to wine consumption, whereas, in Southern European countries with a strong and long-lasting wine tradition, beer is gaining market share. Despite this unfavorable development for German breweries, beer is still the most important alcoholic beverage in Germany, with a market share of about 80% (Credit Suisse/First Boston 2003).

For the most part, German breweries are reacting to the growing threat of substitutes by introducing product and design innovations. Recently beer mixes (mainly beer plus soft drinks) have gained considerable market share and partly compensated for market share losses by traditional beer brands (see Figure 5). In 2003 this development was distorted by legislative action against non-returnable bottles and cans, which were more important in the beer mixes segment than in the rest of the market. Since then, sales of beer mixes have increased remarkably.

Figure 5. Sales of Beer Mixes (Deutscher Brauer-Bund 2003a:42; Deutscher Brauer-Bund 2007:9):



The main suppliers of the brewing industry are farmers (grain and hops), the malt industry and producers of containers and manufacturing equipment. Due to the shrinking beer market, there are considerable overcapacities, not only in the brewing industry but also in certain of its supplying industries. Thus, supplier power is generally low. But, due to the strong political (and financial support) for bioenergies in Germany, brewing barley has become scarce, and prices have nearly doubled since 2005 (Berenz/Heissenhuber 2007).

An analysis of the wider environment has to take into account several factors of major relevance for long-term market development: sociodemographic changes, political and legal developments and the general economic situation.

Firstly, the German population is aging quickly. Beer consumption is highest (50% of total consumption) among individuals between 15 and 34 years of age. However, between 1998 and 2003, their share of the population shrank by 11% to only 25%, and it is expected to sink to 18% by 2008 (Statistisches Bundesamt 2003). Due to this decrease in the beer-drinking segments of the population, a further decline of per capita and total annual consumption is to be expected.

In 2003 the political and legal environment exerted a strong influence on the brewing industry with the introduction of a compulsory deposit on non-returnable bottles and cans. This resulted in a steep decline in consumption since major retailers banned beer from their retail stores. Furthermore, important substitute products, like wine, remained deposit-free and gained market shares.

All in all, extensive legislation at the national level (such as the famous Reinheitsgebot, which restricts the use of low-cost inputs in beer production) increases costs and restricts such entrepreneurial actions by German breweries as product innovations. Whereas regional and local governments are of minor relevance to breweries, EU legislation on such diverse issues such as product traceability (Regulation [EC] 178/2002) and drug policies (Council of the European Union 2003) strongly influences the brewing industry. The German Brewers' Association reacted to the discussion about alcohol abuse by passing a code of ethics in 2006 that promotes the responsible consumption of alcohol and, at the same time, rejects alcohol abuse, advertising beer to adolescents and aggressive marketing campaigns (Deutscher Brauer-Bund 2006).

The general economic environment is characterized by low to moderate growth rates and on-going reforms of social security systems. Many consumers experience lower living standards and react by strongly focusing on price as their major determinant in buying decisions. This strongly favors cost leadership strategies in the retailing sector, restaurants and pubs and in the brewing industry.

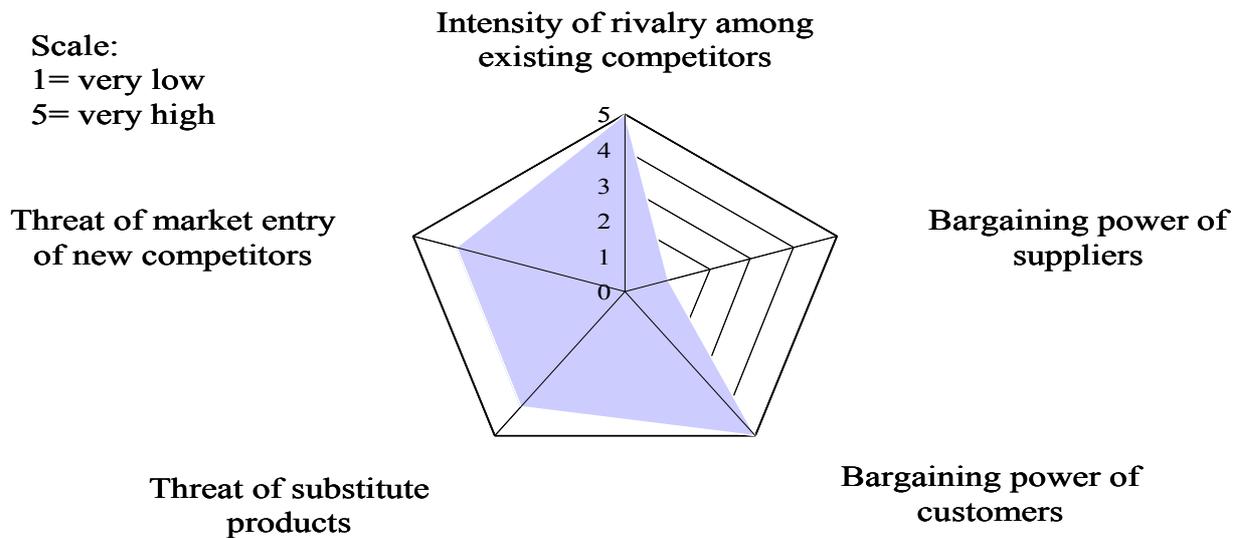
The following spider web graphic (Figure 6) summarizes competitive pressures in the German brewing industry by referring to Porter's five forces. Competitive pressures stemming from the wider environment are of a more fundamental nature. Therefore, they have not been included directly but influence the competitive forces taken into account in the spider web graphic.

It can be seen that competitive pressures in the German brewing industry have become high and can be expected to grow further within the next few years. How German breweries have reacted to this development by reshaping their competitive positioning is described below by referring to case study material.

### **3.2. The Croatian brewing industry**

Unlike Germany, in Croatia beer consumption and production have been enjoying moderate growth (Larimo/Marinov/Marinova 2003). In 2003 Croatian breweries' annual output was 3.68 million hl (1996: 3.395 million hl); another 322,000 hl were imported. As for Croatian beer export (228,000 hl in 2003), 92% was destined for Bosnia-Herzegovina. Total domestic consumption grew by 2.4% in 2003 and went up to 3.774 million hl, but decreased slightly in 2004. Per capita consumption grew by about 25% between 1995 (64.7 l) and 2004 (81.2 l). In 2003 the premium segment grew by 20%, and the mainstream segment by 6%, whereas low price brands lost 15% market share.

Figure 6. Competitive Pressures in the German Brewing Industry:



The Croatian market is dominated by large international brewing groups, which have acquired leading domestic breweries. For some of the international brewing groups, Croatia represented a test market for Southeastern Europe (Larimo/Marinov/Marinova 2003). In 2003 Heineken, Inbev and Carlsberg had a combined market share of 80%. The remaining share of the market is dominated by three more important breweries—Osjecka Pivovara, Jadranska Pivovara and Daruvarska Pivovara. Several small breweries and about ten micro-breweries are also active in the market. Figure 7 displays shares in the Croatian beer market.

In 1994 Inbev acquired a share of 23.7% (2004: about 70%) in Zagrebacka Pivovara, which is the clear market leader in the Croatian beer market (Marinov/Marinova 2002). This company owns Croatia's strongest beer brand, Ozujsko, which accounts for 46% of total consumption in the domestic market. Heineken entered the Croatian market in April 2003, when the brewing group acquired a majority stake in Croatia's second largest brewery, Karlovacka Pivovara. Karlovacko pivo is the second strongest brand in the Croatian market and holds a market share of 22%. The Danish brewing group Carlsberg has a market share of 11% (2006: 13%) via its local subsidiary Panonska Pivovara, in which Carlsberg has had an 80% stake since 2002; the remaining 20% is owned by a Danish investment fund. In 2004, Panonska changed its name to Carlsberg Croatia. Since Carlsberg operates the Pan, Tuborg and Kaj brands, it owns three of the ten leading brands in Croatia. Osjecka Pivovara has a market share of 7%. Its major brand, Osjecko, has suffered considerable losses in market share in recent years. It is rumored that German investors are interested in Osjecka Pivovara. Jadranska Pivovara (market share of 6%; major brand: Zlatorog) and Daruvarska Pivovara (market share of 3%; major brand: StaroCesko) are the

only other important players in the market. So concentration ratios (CR) are much higher than in the German beer market (Figure 8).

Figure 7. Shares of Annual Production (Canadean 2004):

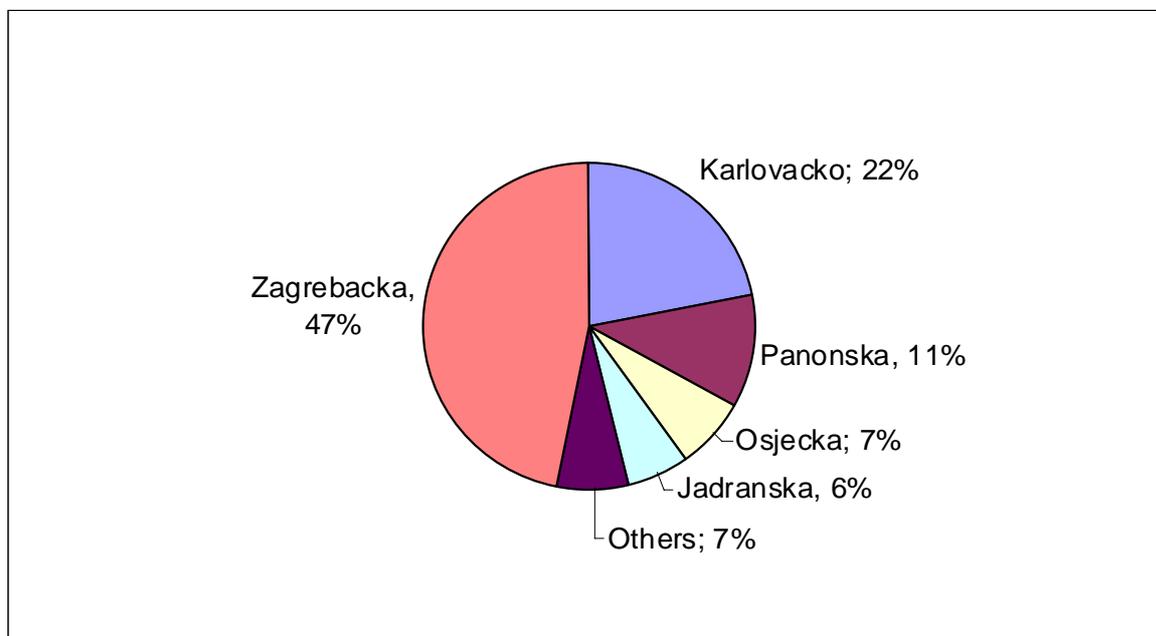


Figure 8. Concentration ratios in Croatia and Germany: A comparison:

Market share of ...	Croatia	Germany
market leader (CR1)	47 %	17 %
top 3 breweries (CR3)	80 %	23.8 %
top 5 breweries (CR5)	93 %	52 %

On the one hand, high concentration ratios, the market entry of large international brewing groups and imported brands dominating the premium segment all create considerable competitive pressures and a high intensity of rivalry in the Croatian brewing industry. Furthermore, the very moderate growth of the Croatian population limits market potential, which will contribute to an even tougher battle for market shares. The large international brewers, which had an aggregated market share of 80% in Croatia in 2000 (Canadean 2004), form a narrow oligopoly with huge market power. These players will exert strong pressure on the remaining independent Croatian brewers but can also be expected to fight each other for supremacy in the local market. On the other hand, the growing wealth and purchasing power of the Croatian population and a growing number of tourists, especially in the coastal region, will contribute to further moderate growth of the market. In 2003, for instance, consumption was 2.4% and local production 1.5% higher than in 2002. Market growth limits the intensity of rivalry among existing competitors (Porter 1980), although the

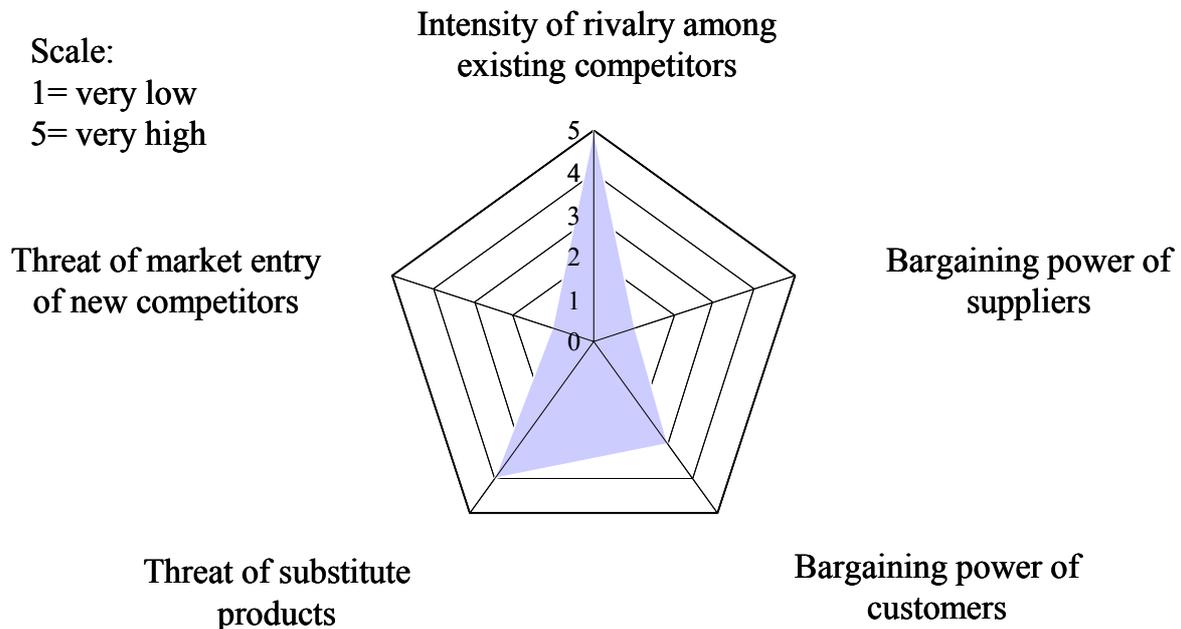
growth of the Croatian beer market is much lower than the growth of wine and spirits consumption (Canadean 2004). Furthermore, empirical analyses of beer markets show that prices and firm profitability are higher in highly concentrated markets (Ebneht/Theuvsen 2007b). Thus, intensity of rivalry may be limited by the predominance of a limited number of international brewing groups in the Croatian market.

In 2003, per capita consumption of beer was up to 81 liters, that is, 18.8% of consumption of commercial beverages. Per capita consumption is expected to reach around 90 liters by the year 2009, contributing to a market volume of more than 4 million hl. Nevertheless, a more rapid rise in the consumption of wine and spirits (each increasing by 7%) and soft drinks (14% market growth in 2003) show that the threat of substitute products is high. Specialty beers (for instance, beer plus lemon), which are creating new market segments and serving variety-seeking consumers in many developed countries, play only a minor role in the Croatian market (less than 1%; Canadean 2004).

Since multinational brewing groups clearly dominate the market, the threat of entry of additional foreign competitors is very low. The formation of new local breweries is also unlikely except in the micro-brewery segment. But due to their very limited company size, micro-breweries do not strongly influence competitive pressures in the national market.

In Croatia on-trade consumption in bars, pubs and restaurants continues to decline in favor of off-trade consumption. In 2003 around two-thirds of consumption was off-trade, while one-third was on-trade (Canadean 2004). Due to radical economic changes after the fall of the Iron Curtain and the 1991–1995 war, the Croatian retail industry is still rather unsettled (Euromonitor 2004). At the end of 2001, 97% of retailers were small-sized enterprises, whereas 2% were medium-sized and only 1% large companies (Dunkovic 2004). All in all, the Croatian food marketing system still suffers from disruptions in the after-war and transition phases and faces major challenges (Shultz/Crnjak-Karanovic/Renko 2005). Therefore, traditional retail still dominates and buyer power is comparatively low. Nevertheless, modern trade is now expanding rapidly, mainly due to the improved shop formats of local companies, like Konzum, but also due to the market entry of foreign retailers, primarily from Slovenia, Italy, Austria and Germany (Canadean 2004). Therefore, buyer power will grow and become more relevant to competitive pressures on breweries. Figure 9 summarizes the findings and assumes that the bargaining power of suppliers is again very low.

Figure 9. Competitive Pressures in the Croatian Brewing Industry:



#### 4. Competitive strategies in the brewing industry

According to the grounded theory approach, management researchers must generate formal theories in order to advance understanding of the economic world. However, Glaser and Strauss (1967) insist that, to be valid, formal theory must be developed from a substantive grounding in concrete social or economic situations. Substantive theory is often derived from qualitative research, for example, case studies. In the early phases of theorizing, case studies enable theories to be tested by replicating previous cases and to be extended by choosing cases that allow the researcher to fill in holes in theoretical formulations or that are the polar opposite of previous cases (Yin 1994; Locke 2001). Due to the very limited scientific resources on strategic management in the European brewing industries, we chose a case study approach in order to highlight how breweries in Germany and Croatia adapt to their market environments.

##### 4.1. Strategies in the German brewing industry

In the 1970s and 1980s German breweries had somewhat unfocused strategies, which prevented them from finding profitable positions in an increasingly turbulent market. Some breweries are still lagging behind and have not improved their competitive positioning, but there are also companies that are leading the way in successful adaptation to the new competitive environment. Some of these breweries choose cost leadership or differentiation strategies with a clear strategic focus, whereas others implement hybrid strategies by combining elements of different generic strategies. Breweries with focused competitive

strategies often react predominantly to one main competitive pressure in their industry (for instance, buyer power or the threat of substitutes), whereas hybrid strategies allow more than one competitive force to be addressed simultaneously.

#### *4.1.1. Focused competitive strategies*

##### *Cost leadership*

*Oettinger Brauerei* pursues the most successful cost leadership strategy in the German beer market. The brewery is still family-owned and had 930 employees and a turnover of about €300 million in 2004. Starting as a medium-sized Bavarian brewery with a regional focus, *Oettinger Brauerei* very quickly managed to become Germany's bestselling beer brand (5.4 million hl domestic sales in 2005) and overtook even the former German market leader, *Krombacher* (5.3 million hl). The company's success is based on low prices (around €6 per beer crate in retail stores), undercutting premium breweries' prices by about 50%. Nevertheless, it is its clear cost leadership strategy that makes *Oettinger Brauerei* profitable. This strategy is based on the efficient size of their production facilities, which work at full capacity. Furthermore, the brewery eliminates wholesaling by delivering its products to large retailers directly with its own transport fleet. The company's five production sites are evenly distributed over Germany, thus minimizing logistic costs. All other costs are kept low as well: hardly any advertising; only one bottle size; and low R&D, service and distribution costs. According to the company's statement, this results in cost savings of about €4 per beer crate.

##### *Differentiation through national brands*

Unlike *Oettinger Brauerei*, many other German breweries, such as *Krombacher*, *Bitburger* and the local subsidiaries of international brewing groups (*Beck*, *Spaten*, *Hasseroeder* and so on), seek to gain a competitive advantage through huge marketing investments in strong national brands. Differentiation through the introduction of national brands is a reaction to the ever-increasing rivalry among existing competitors in the market and the success of low-price products such as *Oettinger*. Differentiation aims at creating customer loyalty and customers' willingness to pay a price premium.

The family-owned *Krombacher* brewery, for instance, became the German market leader by strongly focusing on brand image and brand leadership. In 2006 *Krombacher* produced 5.7 million hl, had 849 employees and enjoyed a turnover of nearly €540 million. *Krombacher's* top priority is to strengthen and extend its brand image. Therefore, since the low-price strategies of discount stores are considered a major threat to *Krombacher's* brand image, which is built on naturalness, home and high quality, the company decided to refrain from distributing its beer through these retailers. *Krombacher* also offers a large

number of product varieties and a large variety of bottle and beer-crate sizes in order to meet consumer expectations. The company spends about 11% of its turnover on marketing activities—€55 million in 2003. According to a study by a leading European brand consultant, the Krombacher brand is worth €324 million, which is the second highest value in Germany after the internationally distributed Beck's brand (€551 million) (Anonymous, 2004).

#### *Differentiation through innovation*

The family-owned *Karlsberg* brewery focuses mainly on the growing threat of substitutes by introducing innovative mixed beers into the market. In 2006 Karlsberg sold about 4.3 million hl, of which about 800,000 hl (2003) can be attributed to mixed beers, such as Mixery (beer plus cola), Radler (beer plus Sprite) und Desperados (Tequila-flavored beer). In 2003 Karlsberg's market share in the mixed beer market went up to about 35%. Due to several successful product innovations, Karlsberg's image is now that of a market innovator although competing brands as well as low-cost me-too products have started to erode this position.

#### *Focus strategy (differentiation focus)*

Small and medium-sized breweries often try to find profitable market niches in which they can hide from intensified competition in the mass market. Market niches are created by, for instance, producing traditional and local beer specialties, emphasizing long-lasting local brewing traditions and strong local roots or using old-fashioned brewing techniques.

A typical example is Klosterbrauerei Neuzelle, which is situated in the German state of Brandenburg close to the border between Germany and Poland. The brewery was founded in 1589, when the German emperor Rudolf II allowed the monks of Neuzelle to sell their beer in the area surrounding their monastery. The monastery brewery (Klosterbrauerei) continued as a private company after the closure of the monastery in 1817. Today the brewery is owner-managed. The owner bought the brewery when, after German reunification, the East German economy was privatized. The monastery is still Neuzelle's main attraction and is visited by about 150,000 tourists every year. About 30,000 of these visit the former monastery brewery, too.

Klosterbrauerei Neuzelle produces about 40,000 hl every year. The product line consists of several beer specialties. Some of these are brewed according to the traditional recipes of the monks of Neuzelle; others were created after the privatization of the brewery. In order to stay in contact with its visitors (and potential customers), Klosterbrauerei Neuzelle successfully started electronic commerce activities in 1997. Today 5% of the production volume is sold via the Internet to consumers all over Germany and the rest of the world (Theuvsen 2003; Theuvsen 2005).

#### 4.1.2. Hybrid competitive strategies

Several breweries simultaneously address more than one competitive force. These breweries implement hybrid strategies that combine elements of different generic strategies. The family-owned *Cramer Group* provides a typical example of such a strategy:

- The Cramer Group reacts to growing rivalry among existing competitors by serving the premium as well as the low-price segment with different brands. Besides its national brand, Warsteiner (2.8 million hl in 2005), the brewing group owns several regional brands in the medium-price sector and a brand in the low-price sector. Its low-price brand, Paderborner (150,000 hl in 2004, down from 628,000 hl in 2003 after new legislation on nonreturnable bottles and cans), is mainly packaged in cans and distributed nationally.
- Growing concentration in the wholesaling sector has motivated the Cramer Group to vertically integrate into wholesaling in order to avoid market foreclosure. Forward integration is organized in cooperation with several other family-owned German breweries.
- In 2003 the threat of substitutes was countered with the introduction of several product innovations, such as mixed beers.

#### 4.2. Strategies in the Croatian brewing industry

Although much smaller than the German brewing industry, the Croatian market is characterized by very similar strategies among competing companies. Again local subsidiaries of multinational brewing groups pursue differentiation strategies by promoting strong national brands in the mainstream segment. Furthermore, the international brewing groups also import their highly differentiated international brands, which are positioned in the premium segment of the Croatian market. Concerning product and other innovations, the Croatian breweries with foreign majority shareholders largely mimic strategies pursued by international brewing groups in other European countries. This is an outcome of the transfer of competencies into the Croatian subsidiaries by the multinational brewing groups. Such transfers are typical of the internationalization strategies of multinational firms that attempt to exploit their competitive strengths abroad (Dunning 1980) and have been observed frequently in the aftermath of foreign direct investments by Western and East Asian firms in Central and Eastern Europe (Majek 2005).

The Croatian market is characterized by top-selling national brands in the medium-price segment. This is an interesting development that cannot be observed in the German market, where the mainstream segment is quickly losing market shares. In Croatia many of the successful medium-priced national brands are owned by international brewing groups, but marketing domestic production and national heritage (or even independence from international brewing groups)

may also turn out to be a successful strategy for the remaining independent Croatian breweries.

Cost leadership strategies have not turned out to be overwhelmingly successful in the Croatian market in recent years (sales in the low-price segment declined by 18% in 2003; Canadean 2004). Nevertheless, due to the dominating differentiation strategies of international breweries, a few independent local breweries may stand their ground against these financially powerful competitors by strictly pursuing cost leadership strategies. The success of Oettinger Brauerei in Germany proves that, even in countries with high per capita income, there is always a place for catering to price-sensitive consumers. Since leading breweries may counterattack by introducing their own low-price brands and opening a price war, this strategy can only be successful in the long run when a clear cost advantage can be preserved by those companies that pursue a cost leadership strategy. Cooperation with other independent local breweries may turn out to be an efficient way of realizing economies of scale and other cost savings.

Micro-breweries usually pursue niche strategies and diversify into their own restaurants and pubs. The high esteem of diversification reflects a general trend in the Croatian industry (Lahovnik 2004). Press releases by Croatian food manufacturers, such as the leading Croatian dairy, Lura, as well as recent publications (Filipovic 2004) indicate that diversification into diverse food businesses is still a prevalent strategy in Croatia. Furthermore, Croatian startups tend to focus on innovation strategies (Buble et al. 2003). Growing purchasing power, especially in major cities, and growing tourism, especially in coastal regions, offer additional opportunities for successful niche strategies in the premium segment.

## **5. The German and the Croatian brewing industries: Comparison and implications**

A comparison of the German and the Croatian beer markets reveals interesting differences with regard to market size, type of economy and dominant market forces, players and strategic foci.

With regard to size, Germany is the third largest beer market in the world, outnumbered in terms of production volume only by the Chinese and the U.S. markets. The Croatian market, on the other hand, is nearly thirty times smaller. The Dutch Heineken group, for instance, has established its Heineken Adria division, which is active in Croatia, Slovenia, Bosnia and Herzegovina, Kosovo, Serbia and Montenegro and manages these markets from a single perspective. This indicates that smaller markets are less likely to be managed from a multinational perspective, that is, through relatively autonomous local subsidiaries (Bartlett/Ghoshal 1987). Instead, it is more likely that the local subsidiaries of international brewing groups have to pursue somewhat

standardized competitive strategies that do not take into account the potential peculiarities of the local markets.

The German and the Croatian markets represent two completely different types of economies. Germany is a typical Western (post-)industrialized economy that has been transformed more and more into a knowledge-based economy. The latter is “directly based on the production, distribution and use of knowledge and information (OECD, 1996: 7). Croatia is a transformational economy that has been experiencing fundamental systemic changes since the fall of the Iron Curtain. The economics of transformation have highlighted the special conditions in these economies with regard to the (re-)distribution of property rights, trade liberalization, market conditions and also political economy issues (Schipke/Taylor 1994). Although Central and Eastern European countries are also trying to develop into knowledge-based economies (Piech/Radosevic 2006), it is still very likely that competitive strategies will be strongly influenced by the different histories of both economies. In many of the transformational economies, multinational companies have entered the markets through foreign direct investments and have introduced new managerial styles (Vargic 2005) and transferred competencies to affiliated companies (Majek 2005).

The different type and history of both economies is also reflected in the dominant market forces, players and strategic foci in the industries under analysis. The situation in the German brewing industry is typical of a mature, declining industry in which competitive pressures and especially price competition are high and firms are trying to find a sustainable position through growth or niche market strategies (Parrish/Cassill/Oxenham 2006). The situation is different in Croatia, where major parts of the market were taken over by only a few international brewing groups now forming a stable oligopoly.

The abovementioned differences between both markets have interesting theoretical implications. Whereas Porter’s five forces and generic strategies frameworks conceptualize an industry more or less independent of time and space, the comparison of the German and the Croatian brewing industries suggests that both factors might be important determinants of competitive strategies. This is recognized by some recent theoretical advances. Spatial econometrics as well as the new economic geography both take into account spatial aspects of an economy (Anselin 1999; Mikkelsen 2004; Eckey/Kosfeld 2004). Nevertheless, these theoretical strands are still very much concerned with the question of where economic activities take place but do not provide much insight into how space may influence a firm's choice of competitive strategies. From a more neoclassical perspective, Elberfeld and Goetz (2002) argue that market size affects technology choice. Small markets may be too small to justify large-scale technologies and, thus, are less likely to allow aggressive low-cost strategies (Goetz 2005). But the interrelationship between competitive strategy and space clearly deserves more attention.

The empirical findings also highlight the important role multinational corporations play in globalizing markets. Despite its long history as a local industry, the brewing sector has turned into a global market governed by cross-border takeovers and company growth through international mergers and acquisitions (Ebneht 2005). Especially in the Central and Eastern European markets, only five international brewing groups pull the strings (Ebneht/Theuvsen 2006). This development parallels observations from other sectors of the economy, where intrafirm trade, that is, trade between multinational companies and their affiliates, has become a dominant characteristic of the markets (OECD 2002). But, due to the low value of beer, its sensitivity to transport costs and the important role of local brands, internationalization of production in the brewing industry closely parallels internationalization modes typical of service industries. Licensing agreements, joint ventures with local firms and acquisitions of established local producers are typical market entry strategies in the service sector (Groenroos 1999) but can also frequently be found in the brewing industry. Since much of the literature on internationalization strategies is still geared to the manufacturing sector, future research may analyze in greater detail internationalization strategies in the brewing industry and, most of all, the interplay between the global and regional headquarters of multinational brewing groups and their local subsidiaries.

Last but not least, the German and the Croatian brewing industries are interesting research objects from the perspective of path research. Since the publication of David's seminal work (1985), the idea that "history matters" has made its way into contemporary economic and management thinking. Referring to the QWERTY keyboard, David (1985) demonstrated how, despite an a priori efficient market situation, a technology has been able to achieve a dominant market position, supersede competing technologies and prevent the dissemination of technical solutions that were developed later and are presumably more efficient. Path research highlights the relevance of the starting point and the processual sequence of events: "History matters in the sense that what happens next depends critically on the details of the existing state of affairs, which in turn is the outcome of the pre-existing situation" (Rutherford 1994:11). From this perspective, the German brewing industry is still strongly influenced by path-dependent processes that started a long time ago, such as the dominance of the *Reinheitsgebot*, the prevalence of many family-owned businesses, diverse regional consumer preferences and the small size of many breweries, especially in Southern Germany.

More recently, the discussion in path research has been enriched by a shift of attention towards processes of leaving an existing path and creating a new one (path creation). Nevertheless, in this theoretical strand, researchers focus on entrepreneurial processes of mindful deviation from existing artifacts and relevance structures and of generating momentum for a new path. The latter

comprises a wide spectrum of initiatives and attempts to mobilize the necessary resources, to get the process timing and sequence right and to organize intra- and interorganizational support for new ideas, behaviors and standards (Garud/Karnøe 2001). Due to the fundamental systemic changes after the fall of the Iron Curtain, the Croatian beer market provides an interesting example of how an industry had to leave an existing path and swivel in a new direction. But this path creation has not resulted solely from managerial insight and entrepreneurial spirit; it has been enforced largely by the turmoil during the transformation and postwar period. Such external path-breaking events have not been adequately taken into account in the path research literature and deserve more attention.

Besides theoretical implications, the analysis of the German and the Croatian brewing industries also has important managerial implications. The above case studies have revealed a wide variety of strategic (re-)orientations in the German and Croatian brewing industries. Nevertheless, especially in the German market, many small and medium-sized companies still lack a clear strategic focus. In turbulent markets, such a shortcoming is a major obstacle to long-term economic survival. This indicates a clear challenge to managers in these companies.

Against the background of growing rivalry among existing competitors, large domestic brewers and international brewing groups enjoy a much better starting position than small and medium-sized domestic brewers. For large brewers it is much easier to expand through mergers and acquisitions and to enter growing international markets, for instance, in Asia or Eastern Europe. Furthermore, these companies can easily export their well-established international brands to new markets through their local subsidiaries and survive price wars in one country due to their financial background in others.

Breweries that are not among the national market leaders or international brewing groups have to find a profitable niche in their regional or local markets; otherwise, in the long run, they will not be able to compete with their larger competitors. Thus, from a core competence perspective (Prahalad/Hamel 1990), the large number of medium-sized breweries, especially in Germany, can be considered an endangered species since they often lack the financial and managerial resources necessary to compete with large international competitors and national market leaders. But they are too large and too unfocused to find an attractive niche market in which they are not challenged by larger competitors.

For the remaining independent breweries in Croatia it is imperative to find a sustainable strategic position in a market dominated by local subsidiaries of international brewing groups. Like medium-sized German breweries, independent Croatian breweries need a clear strategic focus. Due to their more limited financial resources, independent local brewers should avoid direct confrontation with local subsidiaries of international brewing groups and focus

on, for instance, low price strategies or differentiation strategies different from those of the large multinationals.

In both countries cooperative strategies may be a way for so far independent medium-sized breweries to strengthen their position in the market. A recent study of strategic management in the German brewing industry has revealed a growing willingness among brewers to enter horizontal cooperations with other breweries. Breweries producing less than 100,000 hl per year see the largest potential in joint purchasing and production activities, whereas larger breweries also consider cooperation with regard to assortment, marketing and sales, and internationalization. So far, 44% of all German breweries have already entered into some kind of horizontal cooperation; 5% of the respondents are planning to do so. With regard to existing cooperation, purchasing is by far the most important activity (Niederhut-Bollmann 2006).

Vertical cooperations are less prevalent. Only 12% of the breweries surveyed have already entered some kind of vertical cooperation, in most cases with beverage wholesalers or other distributors. The empirical results show that the willingness to cooperate horizontally or vertically has been growing during recent years due to growing economic pressures on breweries (Niederhut-Bollmann 2006).

Independent medium-sized breweries in the Croatian market as well as some of the remaining family-owned breweries in Germany are in a special situation since they compete against multinational brewing groups that transfer brands and core competencies (especially in marketing) to their local subsidiaries and have “deep pockets” that enable them to engage in aggressive marketing strategies and, in the long run, to outperform less resourceful competitors. Nevertheless, recent experiences in the German market show that the standardized marketing concepts of multinational companies can fail in highly fragmented national markets with very special consumer demands. Therefore, some divestitures of regional brands by international brewing groups have recently taken place so that multinationals are now focusing more on their larger national and international brands. Thus, successfully competing against resourceful international competitors is possible if local firms are able to better adapt to consumer demands. Furthermore, local medium-sized firms may participate in the knowledge and competency transfers of multinational brewing groups to their local subsidiaries by enticing marketing and other experts from the multinationals’ local affiliates.

The strategic situation is somewhat easier for small and micro-breweries in both markets, as they can find market niches not served by larger competitors, are strongly rooted in their local home markets or can diversify into operating restaurants and pubs. For these companies, brewing beer is very often only a way of differentiating their other operations (such as restaurants) but not a major source of profit.

In the long run only (very) small and very large companies will survive in the German beer market; the rest are doomed to leave it. For the latter, cooperative arrangements or disinvestment strategies may be in the best interest of owners. A long-lasting history of local brewing, especially in Southern Germany, exit barriers in the form of specific investments without alternative uses and the emotional attachment of family owners to their business heritage prevent market exits.

From this point of view, the Croatian beer market is further developed than the German one since the number of medium-sized local breweries is much smaller. Thus, the situation for the more limited number of medium-sized Croatian brewers is more promising than for their German counterparts. Nevertheless, more and more liberalized foreign trading activities may turn out to become a growing challenge for independent local brewers.

Regardless of how and where a brewery is positioned in the market, strategic management is paramount in turbulent markets with increasing competitive pressures. Companies that do not keep this in mind are doomed to fail regardless of how strongly they began.

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