



# Strategic alliances in the dairy industry –

— *with special reference to Arla Foods*

*Sofia Hedberg*



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## Sammanfattning

*Sofia Hedberg:*

*Strategic alliances in the dairy industry – with special reference to Arla Foods.*

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Konkurrensen på den europeiska mejerimarknaden hårdnar, och företagen måste vara flexibla för att klara sig under de allt mer dynamiska förhållanden. Många viktiga marknadsaktörer påverkar mejeriföretagen; dagligvaruhandeln koncentreras och internationaliseras mer och mer, storkökssektorn växer snabbt och får en allt större roll, konsumentbeteendet ändras och framtida revideringar av jordbrukspolitiken kommer att få stora konsekvenser för mejeriernas strategier. För att hantera dessa förändringar och samtidigt behålla sina konkurrensfördelar kan företagen samarbeta med andra. De senaste fyra åren har de 15 största mejeriföretagen i Europa ingått mer än 200 strategiska allianser. I denna uppsats behandlas sex typer av allianser, nämligen sammanslagningar, uppköp, joint ventures, deläggande, licensavtal och generella, ospecificerade samarbeten. Skillnader mellan dessa kan till stor del förklaras av olika grader av finansiell och resursmässig integrering.

Syftet med uppsatsen är att utröna vilka möjligheter som finns till alliansbildningar bland europeiska mejeriföretag, med fokus på Arla Foods och några av dess huvudkonkurrenter. Företag bildar allianser för att komplettera varandras resurser. För att undersöka företagens möjligheter till allianser används den sk resursbaserade teorin. Arla Foods, Friesland Coberco, Campina (alla tre bondekooperativa) och Danone (börsnoterat aktiebolag), är föremål för denna studie. De tre kooperativen skiljer sig åt både organisatoriskt och finansiellt, och detta har uppenbarligen betydelse för deras respektive val av allianser.

Motiv, strategisk kompatibilitet och resurser i respektive företag är tre viktiga variabler, när man undersöker strategiska allianser. Företagen skiljer sig åt rörande dessa variabler. Olika typer av *motiv* kan föranleda allianser, såsom strävan efter internationell expansion, ökad marknadsandel på befintliga marknader och en starkare produktportfölj. Motivet har betydelse för vilken typ av allians som bör väljas, vilket leder till att företagens strategier påverkar deras val av allianstyp. Andra faktorer som påverkar valet är företagets benägenhet att ta risker och dess förmåga att skaffa finansiella medel. *Strategisk överensstämmelse* mellan parterna i en allians är av stor betydelse om graden av integration är hög, exempelvis vid uppköp och sammanslagningar. Vilken *typ av resurser* som företagen har är av väsentlig vikt. Attraktiva resurser attraherar potentiella partners. Det är tydligt att nyckelresursen i de allianser, som ingåtts av företagen i denna studie, är finansiella medel.

Arla Foods har en ledande roll bland mejeriföretagen när det gäller strategiska allianser. Företaget har initierat flest allianser och har allianser av alla typer. Det skiljer sig från de övriga två kooperativen i denna uppsats genom att det inte har något individuellt kapital. Friesland Coberco och Campina har kooperativa former, som gör det möjligt för dem att skaffa kapital antingen från medlemmarna (Campina) eller från externa investerare (Friesland Coberco), vilket möjliggör allianser som kräver stora ekonomiska insatser. Arla Foods har huvudsakligen allierat sig genom joint ventures, varvid det utnyttjar sina kompetenser och sin starka marknadsposition. Friesland Cobercos och Campinas allianser domineras av uppköp. Med andra ord har mejeriföretagens organisationssätt betydelse för deras strategiska allianser.

## Summary

*Sofia Hedberg:*

*Strategic alliances in the dairy industry – with special reference to Arla Foods.  
Master's thesis from Swedish University of Agricultural Sciences, Uppsala, 2004.*

European dairy firms face intensified competition and continuously new challenges raised by a more dynamic business environment. Many important market players affect the dairy business environment; retailers are subject to structural changes as they are internationalizing and consolidating, food service is a fast growing sector, consumer demand is shifting and changes in the agricultural policy will influence future strategies. To be able to handle all business environmental issues simultaneously firms can benefit from co-operating with others. The top 15 dairies in Europe have initiated more than 200 strategic alliances over the last four years. In this thesis six types of strategic alliances are accounted for; mergers, acquisitions, joint ventures, shares, licensing agreements and general/unspecified co-operating agreements. These types differ in terms of financial and resource integration.

The aim of this study is to assess possible choices of alliance formation in the European dairy industry with special reference to Arla Foods and a few of its main competitors. Firms embark into alliances with the aim of supplementing each other's set of resources. To examine these firms' possibilities in the strategic alliance activities the resource-based theory is applied. Arla Foods, Friesland Coberco, Campina (cooperatives) and Danone (IOF), are subject to this study. The three cooperatives have internal disparities when it comes to organizational and financial structure, and apparently, this has implications for their respective choices of strategic alliances.

Motives, strategic fit and resources held by firms are important variables when examining the phenomenon of strategic alliances, and differences can be distinguished between firms regarding these factors. Different motives evoke strategic alliances, like international expansion, further penetration on markets where the firms are already present and to strengthen product portfolios. Different *motives* advocate different types of alliances, so depending on a firm's strategy different types of alliances are more or less appropriate. Other reasons why a firm chooses a certain type of alliance is its ability to take risks and its ability to raise necessary financial means. *Strategic fit* between two allying firms are of substantial importance if the level of resource or financial integration is high as in the cases of mergers and acquisitions. What kind of *resources* a firm holds is elementary in these matters. Attractive resources send signals to potential partners. Looking at the resources contributed in different alliances formed by the firms in this study it is obvious that financial resources are the far most important.

Arla Foods has taken a leading role in the strategic alliance activities in the dairy industry, forming many alliances utilizing the whole range of alliance types. Arla Foods diverge from Friesland Coberco and Campina to the extent that it has no allocated capital (owned individually by the members). Friesland Coberco and Campina both have cooperative forms that allow them to raise financial means either from members, in Campina's case, or from external investors, in Friesland Coberco's case, which makes them able to form alliances that require substantial financial means. Arla Foods has primarily formed joint ventures, capitalizing on its competence and market position, while Friesland Coberco and Campina have made several acquisitions, using their financial facilities. So, the organizational mode matters when it comes to strategic alliance activities conducted by dairy cooperatives.

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# 1. Introduction

## 1.1 Background

Many external factors affect food-processing firms, for example in the dairy industry. One such factor is the *agricultural policy*. One of the cornerstones of the European Union is the "internal market", based on free movement of goods, persons, services and capital. In 2004 the union is expanded with ten countries. Big differences between candidates and present member countries lead to difficulties in prosecuting the Common Agricultural Policy (CAP). Today's CAP aims to increase productivity, stabilise the market, and secure supplies of food at reasonable food prices. The enlargement of the union will necessitate a demodulation of export supports, boarder protection and direct reimbursement policies. As a likely consequence a drop in prices on primary products will occur. This will create problems especially for high-cost producers. ([http://europa.eu.int/pol/agr/index\\_sv.htm](http://europa.eu.int/pol/agr/index_sv.htm), 2003-12-15) Hence, Arla Foods has promised its members to pay one of the highest milk prices in the EU, thereby putting strong pressure on Arla Foods' management to continuously find new competitive business solutions.

*Competition* is changing as well. Many of the large European dairy firms undergo structural changes, for example undertake strategic alliances. Being one of the largest players, Arla Foods has taken a leading role in the strategic alliance activities. In the last four years the top 15 dairies in Europe have initiated more than 200 alliances of different types: acquisitions, mergers, equity share holdings, joint ventures, licensing agreements and general/unspecified co-operating agreements. Many firms expand outside the EU and Europe to penetrate the relatively unexploited emerging countries. As these structural changes in the manufacturing industry proceed, the dairy firms face continuously new challenges.

The European *grocery retail chains* are internationalising and consolidating. From 1991 to 1994 about 90 percent of growth in the top ten retailers took place within country borders. In the following four years almost 50 percent of the growth stemmed from European cross-boarder expansion (Gurdjian et al. 2000). Compared to most other European countries, the Swedish retail structure is very concentrated as the top three chains control more than 80 percent of the market. This concentration process has implications for the power balance between dairy firms and the even stronger retail chains (Hultén & Nyberg 2000). As retailers are Arla Foods' biggest customers the structural changes in this sector must be considered.

The changing *behaviour of consumers* has big impact on dairies. Consumers in different EU countries get more similar buying and consumption patterns, which has implications for the dairy firms in their decisions as to product portfolios. The constant flow of information and commercials from media and Internet etc. create similar behaviour and demands. At the same time people tend to individualize their behaviour as an expression of different life styles. Consumers are becoming more aware of the environmental problems caused by different industries, the relevance of health and weight watching, which raises pressure on food producers. This generates opportunities in growing markets for food service, organic food, healthier food and functional food. The market for food products with added value is growing.

All these changes pose challenges to the food producers. They have to be flexible and act fast to defend their market positions. More important is, though, that they continuously have to consider their structural arrangements. For example, core competencies within a firm seldom are sufficient – so, it is necessary to build alliances with other firms. Further, strategic

alliances can be used to create synergies and eliminate weaknesses, as well as to reach the size of operations necessary to gain competitiveness.

## 1.2 Problem

Arla Foods has the objective of achieving an average growth in turnover of 10% per year over a five-year period. This expansion should be attained through a combination of organic growth and growth through mergers and acquisitions in selected foreign markets (Arla Foods' annual report 2001/02). Considering the structural changes of the grocery retail chains and the dairy manufacturing sectors, as well as the changes in agricultural policy and consumer demand, this objective must be considered very ambitious. By all probability, alliance-building activities must be the most essential element in Arla Foods' expansion strategy.

Depending on the financial structure and the market positions of a firm, different types of strategic alliances are more or less appropriate. Important to consider is also the co-operative business form of the firm – alliance strategies are quite dissimilar in co-operatives and IOFs (Investor Owned Firms) as the two business forms deviate in many crucial respects. They have different types of ownership, different capital formation possibilities, different raw produce bases, different decision-making procedures, etc.

Hence, the problem addressed in this study is how European dairy processing firms can use strategic alliances in a way to strengthen their competitive positions on different markets. The focus is placed on Arla Foods, i.e., Arla Foods itself as well as its main competitors, both other farmer co-operatives and IOFs.

## 1.3 Problem analysis and aim

A *strategic alliance* exists when two or more firms co-operate under specific forms to achieve certain benefits. Firms can be expected to co-operate when the benefits of co-operation exceed those of working alone. Two important factors characterizing alliances are the degree of organizational integration and capital integration. The six categories of alliances – acquisitions, mergers, equity share holdings, joint ventures, licensing agreements and general or unspecified agreements – can be explained mainly through differences in these two factors. Apart from this the categories diverge in many other respects. This is explained in chapter 4.

Most firms operating in market economies are *IOFs (Investor-Owned Firms)*, organized in legal forms such as joint-stock companies, partnerships and proprietary firms. The purpose of an investor owned firm is to give investors return on capital invested. French Danone, Bongrain and Lactalis, Italian Parmalat and German Müller are examples of IOFs in the European dairy industry. *Co-operatives* are owned by a group of individuals or firms, who practice trade with the co-operative. Arla Foods is a cooperative society, whose members are milk suppliers, which makes this a vertical integrated organization with a common management. Other dairy co-operatives in Europe are Dutch Friesland Coberco, Campina, French Sodial and German Nordmilch. Co-operatives and IOFs compete on the same markets but with dissimilarities in prerequisites. This subject is more explicitly treated in chapter 4.

Strategic alliances can be horizontal, vertical or a combination of these two. *Horizontal alliances* are alliances between dairy firms, while *vertical alliances* concerns firms in

different stages of the value chain. This investigation includes all types of alliances. Likewise, the study concerns both national alliances and international, cross-border alliances.

The purpose of this study is to *assess possible choices of alliance formation in the European dairy industry with special reference to Arla Foods and a few of its main competitors. This includes both the identification of various alliance types and the evaluation of each of these, whereby the assessment is made according to criteria of dairy processor competitiveness, expressed in terms of expansion opportunities.*

To examine how alliance activities can strengthen competitive positions, the characteristics of the alliance types are identified and connected to the characteristics of co-operative firms. With reference to this a comparison between a few European dairy firms regarding strategic alliance activities is provided, elucidating the benefits and drawbacks of a co-operative against an IOF. To utilize strategic alliances in an optimal way both external and internal factors are of importance, and these factors are taken into consideration in the study.

Several theories are applicable to this subject but the findings in this study are analyzed according to *the resource-based theory* (RB theory). This theory sees the firm as a bundle of resources possessed, and it treats how these can be used to create added value in combination with various other resources. Hence, the resource-based theory seems to be promising as a tool for analysing strategic alliances. Alliance formations are a way whereby the participating partners hope to gain market strength by combining each partner's specific set of resources.

## **1.4 Structure and approach**

The number of strategic alliances, not only in the dairy industry but also in food industries at large, seems to be increasing. For example, the volume of corporate takeovers among European retail chains more than quadrupled between 1994 and 1998. This development is a consequence of changes in the market environment of the allying partners. Hence, a description of contemporary structural developments in the dairy sector is provided in *Chapter 2*. The various sectors of the dairy processors' business environment comprise a wide range – consumers, retail trade, etc. Together, these changes indicate further consolidation in the foreseeable future. One scenario is the evolution of a European giants league; another one is that countervailing forces will give space for dairy processors with regional strongholds.

*Chapter 3* presents some of the largest dairy processing firms in Europe and their strategies. Given the aim of the study, Arla Foods is of course chosen as one of firms to be presented. Due to limited resources for the study, only few other firms are selected, and these should be some of the main competitors of Arla. Another criterion is that these other firms should be different from each other in terms of strategy and markets. As the preceding section states that resource-based theory is a suitable tool for theoretical analyses of strategic alliances, the firms under study should above all be divergent when it comes to resource bases. This means that they should have different organizational structures. Departing from these criteria the choice of competitors falls on the Dutch dairy cooperative Friesland Coberco (with business operations conducted in a subsidiary that is jointly owned with investors), the Dutch cooperative Campina (which has suppliers with heavy individual investments in the cooperative firm), and Danone, which is a multinational, investor-owned conglomerate based in France. Chapter 3 provides a descriptive image of each of these firms' market positions,

products, and of course strategic alliances, thereby laying the ground for the theoretical discussions in the subsequent chapter.

In *Chapter 4* the theoretical framework is accounted for. The concept of resources follow the chapter as strategic alliances can be regarded as the participating partners' way of rearranging their resource bases so as to gain strength and competitiveness on the markets. The point of departure is the concept of strategic alliances (Section 4.1), followed by a classification of alliances that can be used in the following analyses (Section 4.2). The six most commonly adopted alliance types are explained and compared, thus arriving at specifications of the conditions when each of them is most appropriate. What are the pros and cons of the different categories; what makes them possible and what makes them successful? Further, which are the motives behind the formation of strategic alliances, as reported by previous studies? The resource-based theory is then scrutinized. The aim is to identify a number of theoretical constructs that can serve as criteria when assessing the various strategic alliances in the four firms under study. As these firms are structured according to quite different organisational models and hence, can be expected to have very varying resource bases, it is relevant to investigate these possible differences. The characteristics of the three co-operative business forms and the IOF business form are scrutinized from a resource base theoretical perspective, to identify which alliance type that matches the prerequisites of the different enterprise structures. Hence, the chapter concludes with a number of hypotheses concerning the strategic alliances of Arla Foods and three of its main competitors, and discussions about motives for forming alliances according to what earlier researchers report

The empirical material is presented in *Chapter 5*. It consists of a description of some strategic alliances that the four firms under study have conducted during the last few years, at least some alliances that are accessible through mass media. The information sources are Internet, journals and books and to some extent, personal communication. The data collected is classified according to the categorization, identified in Section 4. 2.

In *Chapter 6* the results are presented and discussed, derived from findings in Chapters 2 till 5. There are findings within two categories. One concerns explanations to the choice of different strategic alliance forms whereby the resource bases of the alliance partners turns out to be decisive, including how these resources match each other as well as the market requirements (Section 6.1). The other type of finding is related to the resource bases of dairy processors with different organisational structure, i.e., cooperatives with different organisational models and the investor-owned business model (Section 6.2). Depending on the organisational model, the firms differ in terms of resources and so their choice of strategic alliance type is due to differ.

## **2. The dairy business environment**

### **2.1 Elements of the dairy business environment**

A firm's strategy can be better understood by examining its business environment. All market participants, like suppliers, customers, consumers, the political government and competitors, affect a firm's actions. Some important market players that affect dairies are the retail industry, food service, and food manufacturers both in the dairy industry and in other sectors, consumers, competitors and agricultural policies. All these are undergoing structural changes that have an impact on future strategies of European dairy firms.

This chapter aims at exploring how the dairy cooperatives are affected by various changes in their business environment. Specifically, the chapter is focused towards factors that influence the dairy firms' propensity to form strategic alliances and undertake other major structural changes. The presentation of the dairy processing firms is found in Chapter 3 while all other factors are discussed below.

### **2.2 Retailing**

#### *Structural changes*

The internal market of the EU creates possibilities for retailers to operate on a larger scale, expanding over country borders. Within the union it is possible to sell and buy food and other goods with little hindrance from tariffs and other barriers. With the Euro, cross-border shopping will probably increase and the products sold will be more similar than today. Previous decades of structural changes in the retail sector are not solely an outcome facilitated by the EU. Internationalisation and consolidation actions in this field would have been motivated and executed anyway.

A few domestic retailers dominate many European countries, but patterns vary. In western Europe supermarkets and hypermarkets account for 96% of packaged food sales, 53% of fresh fruit and vegetables, 82% of soft drinks, 78% of cheese, 42% of fresh meat, 34% of fresh fish and sea food and 30% of fresh bread. Northern Europe has more super and hypermarkets per head than the southern parts, but the south is going toward a structure similar to the north. Internationalisation and consolidation activities in this sector are escalating all over Europe. From 1994 to 1998 the frequency of corporate takeovers in this sector more than quadrupled. From 1991 to 1994 about 90% of the European retail growth took place within country borders, while the following four years was dominated by cross-country growth. Significant consolidation within the western countries of Europe is increasing each country's top three's market shares as followed by Figure 2-1 (Gurdjian et al. 2000).

Grocery retailers follow three main growth strategies. Firstly they transform into new and bigger store formats increasing their shares of their home markets. Secondly, using superior competencies in different fields retailers can enter new markets and get competitive advantages over retailers lagging behind in the structural transformation. Thirdly, retailers expand through acquisitions of national competitors or foreign firms (Hultén & Nyberg 2000).

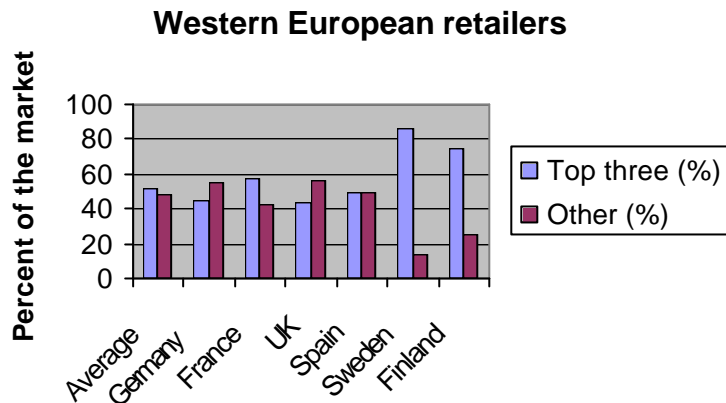


Figure 2-1: Concentration in the food retail industry (M+M Eurodata 2002)

American and European firms dominate in these activities, and so far European firms dominate the European markets. American Wal Mart is the biggest retailer in the world with annual sales of 191 billion US\$ by the year of 2000, (compared to the second largest, French Carrefour, with annual sales of 60 billion US\$) (Ghauri et al. 2003), and dominates the US market. Wal Marts expansion into Europe through takeovers in the UK, acquired ASDA in 1999, and in Germany, acquired Wertkauf in 1997 and Interspar in 1998, signals that it sees Europe as more than a test market. This strategy puts pressure on big European retail firms to secure their positions on different markets. As a response to Wal Mart's takeovers, French Carrefour and Promodès merged, to secure their positions toward competitors in the Belgian, French, Portuguese, Spanish and South American markets (Gurdjian et al. 2000).

On the Swedish market, where the market situation at the present is quite extreme, the top three retailers control more than 80% of the market. So far Swedish retailers have been successful in locking out competitors, and big European retail firms have preferred investments in other countries where cultural differences are smaller compared with their home markets, and where the markets are more open. This might change in the near future as foreign retail firms are starting to establish themselves in Sweden. In year 2000 Ahold acquired 50% of Swedish ICA, now controlling the company from Ahold's head office in the Netherlands. ICA Ahold owns stores in six countries: Sweden, Norway, Denmark, Estonia, Latvia and Lithuania. Coop Norden, owned by the unions of Swedish, Norwegian and Danish consumer cooperatives, operates stores in these three countries. Swedish Axfood, acquirer of Finish Spar, operates franchised shops in Finland and Sweden (Hultén & Nyberg 2000). By the year of 2003 a new player entered the Swedish retail market. Lidl, a German firm, intends to enter by making greenfield investments and operate supermarkets and hypermarkets with superior technology.

What factors determine the choice of new markets or countries to enter? A market can be more or less attractive to penetrate depending on entry barriers and the match between firm and market. Competitive strengths like technology, management and financial strengths of established firms relative to new entrants have impact on success or failure by the entrant. Market entering barriers can be a tactical barrier; established firms can deter entrants by limit pricing or predatory pricing. Alternatively, firms trying to keep out competitors can open new stores in a faster pace than otherwise motivated, to position themselves at attractive locations. Established firms have built up long-term relations with suppliers and loyalty among consumers, which can make it hard for entrants to take market shares. Structural barriers to

entry can be legal regulations and an underdeveloped system for FDI, (Foreign Direct Investments) (Hultén & Nyberg 2000).

Some of the drivers behind the consolidation wave are the capital market, competitive pressure and economies of scale and scope.

- Expectations from *the capital market* make growth necessary. Investors require return on capital and the situation of saturated home markets drive companies with growth objectives to expand through international expansion or acquisitions. The composition of market value of German METRO and French Casino shows that current cash flows account for only one-third of their capitalization and investors' expectations for the rest. Companies with a low market-to-book value may signal lack of credibility needed for future growth, which makes them potential targets for takeovers (Gurdjian et al. 2000).
- *Competition among retailers* intensifies as big actors expand over country borders. In a dynamic time of cross border expansion retailers need to act fast to get leadership positions on their target markets (Gurdjian et al. 2000).
- *Economic rationales by scale and scope* are more difficult to achieve in international expansions. The still fragmented retail sector in Europe with differences in management styles, legal regulations, consumer tastes, local market conditions, competitive environments, and incompatible IT and logistic systems, make international growth more complex. There is a trend toward converging tastes and lifestyles among Europeans, but compared to America dissimilarities are quite big. Economies of scale and scope by operating across borders are to some extent depending on large markets for identical products, currency and ability to synchronise logistics and administration, which is easier in domestic expansion. Only one third of the international takeovers between 1994 and 1998 won approval from the capital markets while the approval for national takeovers was two thirds. But despite the obstacles on the European market, retailers must act now. There is a trend toward converging tastes among Europeans, the introduction of the Euro has begun in several EU-countries and new technology for transporting information and products more effectively is constantly innovated (Gurdjian et al. 2000).

Another positive outcome of consolidation across borders can be joint purchasing. To realize savings from international purchasing, retailers try to improve competencies in three main areas: getting better deals from manufacturers, influence suppliers and harmonize assortments.

- The great variety in European *rebate systems* makes it hard to compare and find the lowest prices for food and other goods. Manufacturers earn a lot of money on price differences between countries and it will be hard to make them give up these gains (Gurdjian et al, 2000). Comparable and similar goods are sold at different prices on the European market, making it possible for market leaders with strong positions to charge higher prices than a newly established firm. By comparing the international price list a retailer can choose to purchase each product in the market where it is most favourably priced (Hultén & Nyberg 2000).
- When it comes to *influencing suppliers* the power balance between the players is a matter of importance. Prices are to some extent determined by the relative size of the parties, raising incentives for both sides to maintain a balance in size (Hultén & Nyberg 2000). When retailers are consolidating, manufacturers may not be able to resist demands from this sector in the future. In 1997, the top ten retailers accounted for about 34 percent of total sales of consumer goods in Europe while the top ten consumer goods manufacturers

accounted for only 14 percent. Manufacturers have so far avoided preferred- or integrated-supplier relationships with global retailers because it would damage their independence (Gurdjian et al. 2000).

- Research shows that the greater the *overlap in assortment*, in different markets, the greater purchasing conditions can be achieved. Streamlining the supplier base and product variety can make a firm more profitable. Private labelling generates advantages here because the products come from the same suppliers and therefore they are identical. Differences in consumer patterns set the limits (Gurdjian et al. 2000).

### *Private labelling*

Retailers with a high percentage of private labels can benefit from the identical products made by the same supplier when it comes to harmonizing. Through branding retailers can develop special images for quality and variety, using their superior consumer contacts. When selling private label products retailers can use their direct contact with the consumers to map their behaviour more exact than food manufacturers. According to Wickberg (2002), consumers demanding low price alternatives created markets for private labels and retailers could increase profitability through improved margins and increased business volumes by undercutting the traditional manufacturers' product prices.

Wickberg (2002) states that private label concepts are more developed in the northern parts of Europe. In the EU the UK has the largest share of private labels, where they stood for about 54% of total sales in supermarkets and hypermarkets by the year of 1998. In Sweden the corresponding figure was about 8%.

Private labels also affect the relationships between retailers and manufacturers. Relations depend on the market situation for private labels in different countries. Looking at dairy products, large Swedish dairies have been reluctant to manufacture private label products to retailers, exceptions made when they have had spare capacity to fill. Otherwise their margins on supplying private labels are lower than margins on their own brands. Swedish retailers seek cooperation with smaller manufacturers where the main attention can be dedicated to private labels and competences can be traded in long-term relationships. As long as private labels do not take larger shares of total sales than they do today, larger manufacturers, like Arla Foods, do not feel forced to cooperate through supplying private labels to retailers.

In the UK the situation is different since private labels stand for more than half of total sales. Dairies stand in line to sign private label contracts with retailers, and in some cases dairies rather use capacity to manufacture private labels. UK manufacturers can benefit from long-term relationships with retailers, since their own brands are promoted in the stores as well. Being a dedicated private label producer helps when introducing manufacturer brands in niche categories. High volumes of supplied private labels create security in revenues (Wickberg 2002).

Disadvantages of these relationships are that manufacturers are dependent on the contracts to fill capacity, and agreements are "loose", so a nullified contract can strike producers suddenly and with no warning. In case of lower-margin private labels, they also decrease shelf space in stores for national brands (Wickberg 2002).

When manufacturing private labels, traditional co-operatives have several advantages. Some of the conditions that favour co-operatives in these activities are (Nilsson & Björklund 2003):



- Competitive advantage through better prerequisites for producing at lower cost per unit produced.
- At times of intensified competition members are not willing to invest capital, and subcontract work does not require much capital.
- Co-operatives under obligation to buy any quantities produced by members may have difficulties with disposal of large volumes. Subcontract work for retailers can in a competitive environment be a good alternative.
- Traditional co-operatives in competitive environments are big, since the smaller ones cannot survive in open markets. A big firm can dedicate a smaller part of capacity for subcontract work without giving up its independency, and without risk of bankruptcy in case of a nullified contract.
- Members of traditional co-operatives tend to be quite conservative and cautious, which could advocate relatively simple activities like subcontract work in a competitive environment.

### *Wholesale*

The retail sector is affected by European consumer behaviour. Younger people's lifestyles are shifting and more meals are consumed outside the home. In 1995 about 32% of total food consumption was spent on meals outside the home, rose to 35% by the year of 2000 and is expected to approach 38% by 2005. This will generate an increase in wholesale demand with 4 to 5% a year, compared to the increase in retail demand of 1 to 2% (Castrillo et al. 2003).

Purchase patterns also shift toward fewer shopping occasions in bigger store formats. So, one big customer for retailers to target is food service. Large-scale operators in the food service sector are presently standing for 30% of food service sales and are expected to rise to 40% by the year of 2010. These big players prefer suppliers that can offer national coverage and competitive prices on their regular, homogeneous orders. Average overall margins are higher in wholesale than in retail. Changes in the competitive environment and today's fragmented market situation make it feasible for retailers to go into wholesaling and consolidate. Demands mainly come from smaller grocery stores too small to buy directly from producers, and food service operators. Retailers going into whole selling could make them even more powerful against food producers competing in orders from food service. One example of a European company that has succeeded with this format on a global scale is the German Metro-chain. Dutch Ahold's wholesale Deli XL is operating in the Netherlands and has plans of expanding into other European countries (Castrillo et al. 2003).

### *Future scenarios*

According to Gurdjian et al. (2000), there are two scenarios. The first is a Europe where a handful of giant companies merge and the top tens will control 60% of the market. The situation of today is far from this scenario, but some players tend to strive in this direction. European takeovers by Wal-Mart, Carrefour-Promodès and METRO reveal strategies suggesting that this is a possible outcome. The second is a regional-stronghold scenario, where the regional consolidation will continue and the big companies will strengthen their positions but stick to their home markets. In this scenario the top tens hold 50% of the market.

## 2.3 Food service

The facts about the food service sector is taken from Promar International (not dated). The European food service sector is growing, on average, at a rate of 2.75% per year, which is about five times as fast as the retail sector. Food service is available in a wide range of formats and under the right circumstances it will create a great potential of profitability for manufacturers. Food service supply chains are more complex and longer than in retail, making it a challenge to manufacturers and strong, interactive relationships and partnerships throughout the supply chain will be crucial to success. Considerable consolidations and a better-organized supply chain are about to open valuable opportunities for manufacturers making it easier to control the flow of products to a less fragmented customer base.

Consolidation and organization of the food service sector have implications on sales and purchasing procedures, negotiations and the distribution of power between suppliers and customers. For manufacturers to successfully exploit the opportunities of supplying the food service sector they must consider some critical issues:

- What relationships exist within the supply chain?
- Who takes control (or has the power) over product selection and price?
- If and how is power being redistributed?
- How can these relationships be designed to operate effectively in the European food service sector?

In more developed markets manufacturers are starting to pay more attention to the food service sector and becoming more responsive to food service customer requirements. Many customers purchase their products from the cash and carry sector while larger food service chains are more likely to contract with suppliers. One general trend in Europe is the rationalisation and streamlining of supplier bases. Instead of having a faceted base of suppliers caterers seem to prefer fewer suppliers, which will enable them to deal with larger volumes.

The key requirements and points of value in food service can be stated as follows:

- *Product:* The product criteria are most important and include product quality, consistency and a lower level of preparation time. A high level of customisation and adaptation (added value) to the caterer industry are preferred. A good way of achieving the optimal fit between product and customer is to work together to create the right product formula.
- *Packaging:* Most customers do not view this criterion as very important as long as products are well protected and easy to store. Own label products face different requirements. Customers demand functional pack sizes and minimized wastage.
- *Price:* Price is ranked highly among customers, and highest among publicly owned firms. Price is compared with the ability to add value. Ingredients tend to be selected by qualities rather than price while products with which the operator has less involvement (ready prepared foods and ready-to-consume products) seem to be selected by price.
- *Service:* This criterion relates to reliability and support from suppliers and is an important customer requirement. In the long run it will probably gain further emphasis when partnerships between suppliers and customers become more frequent. Customers wait for manufacturers to understand food service better so business can be better for both parts. There is also a need for expansion and development of manufacturers' product portfolios for food service concepts.

## **2.4 Consumer demand**

The constant flow of information and commercials from media and Internet etc. affects people and create similar behaviours and demands. A counter tendency is that people tend to individualize in consumer behaviour due to life style, personality, preferences etc. Consumers are also becoming more aware of environmental problems caused by different industries, the relevance of health and weight watching, which raises pressure on food producers. More meals are eaten outside homes and the food service sector is growing. These factors generate opportunities in growing markets for food service, ecological food, healthier food and functional food. The market for products with added value is growing. When expanding product portfolios firms have to consider their customers' needs. Differentiation is costly, and often requires big investments and marketing expenditures.

## **2.5 Competition**

Milk production and milk consumption in the world are increasing with 1-2% per year, and all big dairy firms want part of this to increase market shares. Countries within the EU stand for about 25% of total milk production and in the last ten year period countries like Australia and New Zealand have radically increased their production of milk and thereby their influence in global trade with dairy products ([www.svenskmjolk.se/branschfakta.asp](http://www.svenskmjolk.se/branschfakta.asp) 2003-09-04). Only 20 dairy firms have a turnover larger than 1 billion Euros up to 6 billion Euros but several smaller firms are also to be considered competitors. Among competitors there are manufacturers in other product categories, like soft-drink producers, non-dairy sandwich spread manufacturers and producers of other snacks. All these firms have different capacities, i.e. production, marketing, financial, human and logistical resources (van der Krogt 2003)

Markets and competition are dissimilar for different dairy products. Competition on cheese markets is intense and has led to price pressure and consolidation among producers. Fresh product distribution depends on geography and logistics and competition on these markets is relatively weak. Retailers and purchasers in food service have not many options but to buy from local suppliers, but just knowing that customers can turn to competitors affects dairies' marketing. A trend toward increasing imports can be identified and competition has intensified the last few years and will continue to grow stronger in the near future. Retailers will start to look for partners to develop private labels and if one dairy firm contracts with a retailer on a specific market the others will follow (Nilsson & Björklund, 2003).

## **2.6 The political scene**

The upcoming reform of the EU agricultural policy points toward a decline in profits for Swedish dairies. Calculations indicate a possible decrease in the raw milk price with 0,80 SEK from today's almost 3 SEK in the next five years ([www.svenskmjolk.se/press/IE/Pressmeddelande.asp](http://www.svenskmjolk.se/press/IE/Pressmeddelande.asp) 2003-03-11).

Direct reimbursements will cover about half of the decline of the milk price but supports will be based on farms instead of production, which will lead to misdirected supports according to Svensk Mjök, (Swedish Dairy Association). With no requirements on continued production a milk producing farmer in business 2004 can quit producing the next year and still get support while a farmer who starts milk production after 2004 will have to manage without subsidies.

An untenable situation where no one will have enough incentives to invest in a capital and labour intensive business in which profits decline and supports do not stand in proportion to performance ([www.svenskmjolk.se/press/IE/Pressmeddelande.asp](http://www.svenskmjolk.se/press/IE/Pressmeddelande.asp) 2003-01-23).

Swedish dairies have been strongly protected by agricultural policies both before the entry into the EU in 1995 and after through CAP. CAP is especially constructive for traditional cooperatives. When dairies do not succeed to sell their milk on the open markets, they can sell it to the EU at a guaranteed price. This weakens competition because smaller volumes reach the market. Thanks to these policies firms can set a raw milk price that makes it possible for the members to manage economically and put aside some for collective funds. This way money is available for subsidies between member categories (Nilsson & Björklund 2003)

## **2.7 Development of alliances**

Observing the ongoing changes in the immediate surroundings of dairies one can understand the need for new strategies. To be able to meet the challenges arising from several environmental sources simultaneously firms need a strong resource base, and few firms are experts in all necessary domains to beat competition on their own.

In the last four years more than 200 alliances have been initiated between European dairy firms. In a strategic alliance only some of the participants' business activities are involved and except for these activities partners remain autonomous and often competitors (apart from the cases of mergers and acquisitions). By combining firms' resources possibilities are created to promote international expansion, to further penetrate home markets, to strengthen product portfolios etc.

### **3. Major European dairy firms**

#### **3.1 Arla Foods**

In 2000 Swedish Arla and Danish MD Foods initiated a cross border merger. The new firm was named Arla Foods amba. To exploit the synergies of the merger a structure plan was drawn up. In 2003 about two thirds of the projects have been carried out and the plan is supposed to be completely fulfilled by the year of 2005. Arla Foods is a cooperative owned by 6539 Swedish and 7103 Danish members. Since Arla Foods bought 50% of the shares in English Express Dairies, one of UK's biggest dairies, it will have three domestic markets. In 2002 the number of employees was 17 866 (Nilsson & Björklund 2003).

About 7000 million tons of milk is processed every year. The total turnover by the year of 2002 was 39 441 MDKK. Arla Foods is the largest transnational cooperatives in the world (Nilsson & Björklund 2003)

The market situation is moving toward a more unified Nordic as well as European market where competition intensifies. For Arla Foods to retain its competitiveness it must incorporate these facts into its strategy. The introductions of a common Arla brand, as well as the streamlining of operations and reallocation of resources, are steps in this direction. Arla's master brand, a red mark with white text, is the new trademark under which all the other trademarks will be gathered. The purpose of this trademark is to increase consciousness about products and values of the firm, and make it a leading brand for European dairy products (Arla Foods' Annual Report 2001/02). With few exceptions Arla Foods is at present reluctant towards retail private brands.

([www.arlafoods.se/press/artikel.asp?more=757&firstYear=1997&firstMonth=9&y1=2002&m1=alla&fras=2003-09-26](http://www.arlafoods.se/press/artikel.asp?more=757&firstYear=1997&firstMonth=9&y1=2002&m1=alla&fras=2003-09-26)).

#### *The Swedish and Danish markets*

Arla Foods has a strong market position in Sweden and Denmark. To gain even larger market shares on these markets, the firm has to grow through new products developed for new consumer groups, and products that can be consumed at new occasions. Efforts are made to accomplish growth through opportunities created by the expanding food service sector. Competition is intensified in Denmark as retailers strive to increase sales of private brands. Arla Foods will cooperate with the retail chains to the extent that independence will not be threatened, and a good balance between private brands and Arla Foods' own brands must be obtained (Arla Foods' Annual Report 2001/02).

#### *The UK market*

In the UK, Arla Foods' third domestic market, the firm works to strengthen its market position, especially in the categories of butter and fresh milk. Arla Foods has announced a merger with the UK's second largest dairy firm Express Dairies. Express is the biggest supplier of fresh milk and cream, which is its main business, to retailers in the UK. It is also the biggest doorstep deliverer of milk. Express and Arla Foods will become a leading dairy supplier to supermarkets with strong brands. This strategic step will strengthen Arla Foods' position on this market.

By combining the two firms' businesses, production sites and distribution channels can be utilized more effectively. The two firms will have access to each other's R&D and technical facilities and create greater financial strength. Together they can cope with growing demands from retailers and cover a larger geographical area (<http://www.arlafoods.se/press/artikel.asp?more=891&firstYear=1997&firstMonth=9&y1=2003&m1=9&fras=>, 2004-01-07).

Arla Foods and the New Zealand dairy Fonterra created a JV owned by Arla Foods to 75%. The motives for this alliance were product development of butter, better utilization of the firm's production capacity and creation of a company to handle decreasing demand. Distribution, marketing and sales of the strong brands Lurpak and Anchor on the UK market will be more efficient through the JV. Lurpak is the second biggest and Anchor third in sales volume in the butter category and market shares are still increasing (Arla Foods' Annual Report 2001/02).

Another strategic step made by Arla Foods to strengthen its position on the UK market was to acquire HT Webb. HT Webb imports and produces special cheese so now Arla Foods can offer local and foreign cheese products to retailers.

Arla Foods UK has established a food service division to exploit the opportunities in this growing sector (Arla Foods annual report 2001/02). Another effort is to change people's breakfast habits. In England only 10% of all yogurts sold are consumed in the morning compared to Sweden and Denmark where the corresponding figure is 70%. Arla Foods, together with the retail chain Tesco, has introduced three new yogurts as an alternative to the traditional English breakfast of eggs and bacon. Some other well-known Scandinavian yogurt products, adapted to English food habits, are produced in Denmark and sold under Tesco's private brands ([www.arlafoods.se/press/artikel.asp?more=758&firstYear=1997&firstMonth=9&y1=2002&m1=alla&fras=](http://www.arlafoods.se/press/artikel.asp?more=758&firstYear=1997&firstMonth=9&y1=2002&m1=alla&fras=) 2003-09-26).

### *Europe*

A general trend in Europe has been weak economies and anxiety at the prospect of the future. Demodulation of agricultural policies, the enlargement of the EU and the introduction of the Euro in some countries are some factors that will redesign conditions for dairy firms. In spite of price pressure and tougher competition Arla Foods, in the year of 2002, managed to reach a good result. Division Europe works with focus on more value-added products instead of bulk products that are facing declining prices. To keep up the speed in introducing value-added products investments and marketing expenses for product development will increase. Resources will be assigned to strengthen sales to the food service sector, which advances and grows in most parts of Europe (Arla Foods annual report 2001/02).

### *The Eastern European markets*

Arla Foods' market position on the Eastern European markets is weak. As several of these nations enter the EU, it will be easier to operate on these markets. Selected markets and product categories will be prioritised (Arla Foods annual report 2001/02) and Arla Foods has declared that it wishes to gain a strong market position in Poland. The Polish economy becomes more similar to the German, which means increased import of for example cheeses such as dessert cheese and blue cheese. The Polish retail sector is still dominated by smaller

shops that stand for about 65% of total sales, but big international chains are gaining ground ([www.arlafoods.se/press/artikel.asp?more=855&mer=start 2003-09-26](http://www.arlafoods.se/press/artikel.asp?more=855&mer=start%202003-09-26)) and control 23% of the market. With Poland as its base Arla Foods intends to tenfold sales in Eastern Europe in a five-year period. The most important category will be cheese. According to a study by German ZMP people in Eastern Europe will increase cheese consumption from 7.5 to 9 kilos per head in six years. Goals will be achieved by acquisitions of local dairies and through export of value-added products from Scandinavia ([http://www.arlafoods.se/press/artikel.asp?more=785&firstYear=1997&firstMonth=9&y1=2002&m1=11&fras= 2003-09-26](http://www.arlafoods.se/press/artikel.asp?more=785&firstYear=1997&firstMonth=9&y1=2002&m1=11&fras=2003-09-26)).

### *The North American, Middle East and Japanese markets*

Arla Foods has strong market positions on the North American, Middle East and Japanese markets. Value-added products have helped in times of general price pressure on these markets. The US dollar is an important currency for Arla Foods and fluctuating and weak exchange rates in 2002 affected results. This could partly be avoided if higher prices could be attained (Arla Foods' annual report 2001/02).

### *Some alliances formed by Arla Foods*

In 2001 Arla Foods formulated a strategy, which included strong growth through mergers and acquisitions. Since then, several projects have been implemented while others are still to be conducted. Some of these projects are being subject to analyses in Chapter 5. Projects include:

- An Argentine whey factory has been built in cooperation with Argentine SanCor, with the purpose to strengthen Arla Foods' leading position as global supplier of whey proteins to the food industry.
- A joint venture company was initiated with German Nordzucker, to produce the sweetener Gaio tagatose.
- In connection with the merger with Express Dairies, a new dairy is built in Leeds because the existing one in the middle of the city cannot increase its capacity. The new factory is a step toward further rationalizations.
- Arla Foods' joint venture agreement with New Zealand Fonterra has also led to rationalizations. About 35 000 tons of butter and compound products are now produced at Arla Foods' dairies in Varde and Götene instead of in England.
- Arla Foods acquired English H.T. Webb, which imports cheese, in 2002 to widen the scope of the cheese assortment.
- In 2002 Arla Foods merged with Danish Hellevad Omegns Andelsmejeri as a continuation of a close relationship.
- In March 2002 Arla Foods bought 50% of the shares in Danish Cocio Chokolademælk A/S.
- The effort to strengthen the market positions in Poland, acquiring Lindals, and other Eastern European markets was mentioned above.
- Of course, also the merger between Arla and MD Foods is in itself a case to be analyzed.

### **3.3 Friesland Coberco Dairy Foods Holding**

Friesland Coberco is a multinational Dutch co-operative. Zuivelcoöperatie De Zeven Provinciën U.A. holds Friesland Coberco's shares. The firm is holding all shares of Friesland

Coberco Dairy Foods B.V. and Friesland International B.V. The former operates all Dutch activities and the latter operates all foreign activities. The work force consist of 16800 employees of whom 11200 work outside the Netherlands. By the year of 2002 Friesland Coberco processed 5100 million kg of milk, bought from 11500 dairy farmers who are members of Zuivelcoöperatie De Zeven Provinciën U.A. The turnover in 2002 was 4723 million Euros in Europe, West Africa and Southeast Asia, selling a wide range of dairy products and fruit-based drinks for the consumer market (FC's annual report 2002).

Friesland Coberco has not made many acquisitions outside the Netherlands. Its strategy is to improve the quality of turnover and the profitability of operations. This is done through focusing on the markets where a strong position for branded products can be established. This firm is not prior looking for new markets but to further expand the market shares on already penetrated markets. Tight control of costs and a reduction of dependence on standard dairy products by generating a greater share of the turnover through branded products, are ways that Friesland Coberco will follow to keep competitive (FC's annual report 2002).

Friesland Coberco, like Arla Foods, pursues a multinational approach. Major cooperatives following this strategy extend their business over the five continents where they control industrial and commercial subsidiaries. In these respects there is no longer any difference compared to non-cooperative dairy multinational firms. Friesland Coberco and Arla Foods produce a wide range of sophisticated added-value products and develop mainly through intangible assets, like brand names and innovation potentials. These firms' exploitation of market-power and abilities to innovate in research and development enable them to take positions on the world markets through price competitiveness. To succeed with this strategy a firm must be able to raise the necessary financial means (Guillouzo & Ruffio 2003).

### **3.2 Campina**

Campina is a Dutch firm, which operates internationally. It is a dairy co-operative owned by 9200 members (Campina's Annual report 2002). The number of employees is about 6 900 of whom 50% is situated outside the Netherlands. This firm processed 5140 million kg of milk in year 2002, approximately half supplied by members. Net turnover in 2002 was 3707 million Euros (Campina's annual report 2002).

Campina's main focus is on the European market, for consumer products under the brands Campina, Landliebe in Germany and Mona in the Netherlands (Campina's Annual report 2002). Innovation, branding, efficiency and total chain control are key words in the Campina strategy (mail webmaster@campina.com). The firm is a major supplier of dairy products in the Netherlands, Germany and Belgium, and it is investing to grow in Poland, Spain, Russia and the UK. Consumer products are also marketed in Africa and in the Middle and Far East. Development and production of ingredients for food and pharmaceutical industry are other important activities performed in the Netherlands, Germany and the US, and these products are sold all over the world (årsredov). Campina has done some acquisitions in Europe the last three years, mainly in Germany and the UK. Campina has a strong financial position (mail webmaster@campina.com).

Campina's strategy is to pay an over average price for milk produced by its members, and to do this it needs to operate on a large scale. An adequate scale is maintained through internationalisation with focus on consumer dairy products in Europe and dairy ingredients



worldwide. More exactly it will try to pursue a geographical market leadership in dairy drinks in Western Europe, above average growth in desserts in Europe and a world leadership in specific dairy ingredients. It tries to achieve its goals through organic growth as well as acquisitions. In October 2002 Campina acquired Superlife in the UK, which is a leading flavoured milk brand. This strengthened Campina's position in the UK. In Germany it has strengthened its market position for desserts by acquiring Molkerei H. Stothmann GmbH (Campina's annual report 2002).

Campina follows a "cooperative strategy to the European market" to extend the domestic market. Relying on its strong cooperative identity and organizational resources that allow plans of original strategy of gradual membership internationalisation, Campina's strategy aims at creating a European cooperative with members with similar rights and obligations. This strategy means high level of business rationalization, especially in the industrial domain where plants no longer match the local market requirements. Qualities used in extensions are industrial efficiency, product portfolio, brand reputation and innovation potential. For twenty years Campina was committed to a very ambitious external growth strategy on Dutch territory and abroad, Belgian and German markets in particular (Guillouzo & Ruffio 2003). Campina has a larger share of international turnover than Arla Foods and Friesland Coberco. (Bekkum 2001, p 114)

### **3.4 Danone**

Danone is a French IOF with about 92.209 employees in more than 120 countries. Danone is the volume leader in the world food industry with a wide range of products. Group Danone is made up of numerous companies consolidated either through the purchase accounting method or the equity method ([http://www.danonegroup.com/group/index\\_group.html](http://www.danonegroup.com/group/index_group.html) 2003-09-18).

Danone's strategy builds on three product groups, namely fresh dairy products, beverages, and biscuits and cereal products. It focuses on these products on a limited number of countries, selected for their growth potential, where Danone has the size to achieve economies of scale. On these markets Danone aims for close ties to consumers and long-term relationships with major retailers. To capitalize on its worldwide presence and leading position in local markets, Group Danone has introduced international cross-border structures to promote promising products and concepts in new geographical areas to accelerate growth while keeping costs down ([http://www.danonegroup.com/group/index\\_group.html](http://www.danonegroup.com/group/index_group.html) 2003-09-18).

About 70% of Danone's sales occur in Western Europe. Danone is the leading producer of fresh dairy products in the US and Canada and has a strong position on the bottled water market there. In Brazil and Argentina its market position is very strong concerning cereal biscuits and snacks food. Danone has gone through with acquisitions in Tunisia and Morocco and have managed to become the leader in fresh dairy products on these markets. Saudi Arabia, Algeria, Turkey and Israel are other countries where Danone's market position is strong. In the 1990s Danone expanded in central and Eastern Europe and is now number one in fresh dairy products, biscuits and snacks foods. In 1980s the Group expanded in the region of Asia through a joint venture with a Japanese firm to make and market fresh dairy products. Today it is the leading producer of bottled water and biscuits in a limited number of countries with strong local brands ([http://www.danonegroup.com/group/index\\_group.html](http://www.danonegroup.com/group/index_group.html) 2003-09-18).

## 4. Theory

### 4.1 The concept of strategic alliances

There are different conceptions about what constitutes a strategic alliance. Some include mergers and acquisitions and even loose collaborative agreements between producers and suppliers. According to Murray and Mahon (1993) the partners in an alliance are free to exit the relationship, which would exclude mergers and acquisitions. Some minimum criteria should be met though: the existence of strategically significant goals, mutual (but not necessarily equally distributed) benefits and that the benefits achieved through an alliance should outweigh those derived from other actions (Murray & Mahon, 1993). The subject seems to be in its theoretical beginning with many researchers trying to find generalizations; so different characteristics are accounted for, not excluding any type of alliance.

Murray and Mahon (1993 pp. 103) define strategic alliances as "a coalition of two or more organizations to achieve strategically significant goals and objectives that are mutually beneficial. These goals and objectives can be pursued in either the economic or political arena, and can be flexible in time orientation. Mutually beneficial does not imply equality of benefits, but does mean that all parties to the alliance receive benefit from it in proportion to contributions made. Moreover, the stability of the alliance will be a direct consequence of these benefits outweighing those of alternate arrangements".

Firms must be able to keep up in the speed of technological innovations and be fast when they aim for new markets. One key to be victorious in these tasks is to create collaborative advantages through strategic alliances (SAs). SAs can be seen as an alternative to internalisation and market exchange. Standing before a decision a firm may choose to (1) produce on its own, (2) purchase from markets, or (3) perform in collaboration with another firm. If efficient market exchanges are possible it is likely that a firm will continue alone (Das & Teng 2000).

To meet consumer needs companies need their own skills and sometimes others to make products good enough. One firm is hardly ever an expert in all essential domains so it would benefit from seeking complement. Firms cooperate when the benefits of the cooperation exceed those of operating alone. Alliances can occur in response to two underlying motivations: a defensive instinct to survive or an offensive desire to achieve competitive advantage (Murray & Mahon 1993).

Strategic alliances are a function of both organizational objectives and the conditions found in the environment. Both external environmental and internal organizational factors can be critical and create needs that can be satisfied through alliance activities. Organizational objectives as rationales to form alliances are to obtain technological and/or manufacturing capabilities and to get access to specific markets. These rationales are offensive to their character and undertaken to improve the competitive position before rivals. Defensive organizational rationales are to reduce financial risk, to reduce political risks (for example when doing foreign direct investments) and to achieve or ensure competitive parity (pre-emptive alliances to block another organization's action or to assure parity with a stronger industrial rival) (Murray & Mahon 1993).

Environmental conditions under which strategic alliances are appropriate are, according to Murray & Mahon (1993).

- turbulence or uncertainty,
- discontinuous changes,
- rapid technological change,
- technological change from numerous sources,
- significant financial risk,
- markets undergoing rapid change,
- shifting rules of the game making penetration more difficult,
- increasing political complexity,
- large and complex projects,
- increased competitiveness,
- government protection and assistance.

## 4.2 Alliance types

### *Mergers and acquisition (M&A)*

Mergers are when two (or more) companies unify into a single organization, while in acquisition one company fully takes over another. In both cases full integration occurs. One central issue in these cases is the degree of interdependence. The more interdependent the partners are the greater the need for boundary permeability. Otherwise the cooperation would be very difficult to manage. In acquisitions there are often a big firm purchasing a smaller one, which makes it important how to allocate control. One drawback of M&A is that all resources of the digested firm are obtained, even the ones with no value for the acquirer. The unwanted assets may be hard to separate from the rest, which will lead to surplus or costs for disposal of unneeded resources. The degree of specificity in these assets will set the price for disposal (Das & Teng 2000)

Acquisitions require financial capital and that the acquirer is not to risk averse. M&As enable firms to obtain scale advantages utilize physical resource bases, share risks and costs and create bigger capital bases. Acquisitions are the most frequently applied alliance type among dairies with 43% the last four years. Probable reasons are international expansion, home market expansion and taking control over competitors. Mergers have been few but the ones initiated have been big and cooperatives are involved in most of them. (van der Krogt, pers. communication 2003) A merger is an enormous endeavour in integrating. Owners, management staff, employees and all others involved have to shift mentally and be a part of a new corporate culture.

### *Joint ventures*

The partners in joint ventures are separate legal entities bounded by a contract. A joint venture has its own identity and institutions and the relationship is often an evolving collaboration, which grows stronger with time. JVs with competitor firms as parents are more likely to fail because of overlapping in products and geographical markets (Das & Teng 2000). Firms in the alliance own the joint venture with equal or different shares of equity. A problem with the contract is that it reflects the situation when it is signed. But the market is in fact changing and this may lead to disputes, which is not really regulated in the contract.

One reason to go into this sort of collaboration is when a company wants to dispose some resources. It can be difficult to get a price that reflects the real value of the resource if the

degree of specificity is high (tacit skills). If the seller and the potential buyer start a joint venture the buying company has the time to learn and realize the true value, and it will be in the selling company's interest to do this in a good way to get the most out of it when it is time to sell. Mutual benefits are vital to avoid opportunistic behaviour. Other reasons for JVs are scale effects, synergy effects, easier to give good service to large retailers and increased competitiveness. Research shows that JVs are more commonly adopted in mature industries where it is important to gain economies of scale and scope (Das & Teng 2000). The greater part of JVs among dairies is international and is equally adopted by IOFs and cooperatives (van der Krogt, pers. communication 2003).

### *Shares*

Buying shares in other firms can be a step toward a complete acquisition. A shareholder can give a firm power to affect decisions taken by another firm, and thereby influence the situation on the market. Level of control depends on the size of the share. Owning more than 50% gives control because it will give the deciding vote in strategic decisions. The level of integration is low when a firm buys shares in other firms (van der Krogt, pers. communication 2003).

### *Co-operative agreements*

In the category of unspecified co-operating, cooperatives are the ones primarily engaged. The real structure of alliances placed in this category is not revealed and perhaps hidden agendas are the reason for this. It could be the limited owner / share incentive hindering a firm to publicly reveal its purpose. Strengthening of home market positions, international expansion, sale and synergy effects are the main reasons here (van der Krogt, pers. communication 2003).

### *Licensing*

A license agreement is when a firm purchases the right to use an asset for a particular time. It can be a product, a technology, a patent or innovation or some other specific resource. This alliance has a more narrow purpose than for example a joint venture; the need for collaboration is usually not as big. The licensor gets a royalty and revenues for former expenditure that it had developing the resource, and the licensee may overcome weaknesses in its organization without having to develop this, already developed, resource. Licensing a technology widely can lead to standardization.

To make R&D profitable the Finnish dairy firm Valio has licensed its bacterial cultures and lactose-free milk all over the world. In the USA and in Canada cheese producers make cheese for Arla Foods after Danish recipe. Sodiaal's yogurt Yoplait is represented in almost 50 countries, and thereby has the largest global coverage of all fresh dairy brands. A trend toward fewer but larger global brands can be distinguished so brand licensing will probably increase in the near future (van der Krogt, pers. communication 2003).

### 4.3 Motives for strategic alliances

#### *Facilitation of international expansion*

Strategic alliances can be seen as vehicles through which mid-sized firms can compete more effectively against large companies and gain entry to markets without investing capital. Entering a country where the political climate is unstable and uncertain, a native guide is needed for local knowledge and contacts. In general, as turbulence and uncertainty increase an alliance can reduce or at least spread the risk. Political, economic, social and bureaucratic rules are changing all over the world and all the time, thereby creating a dynamic climate for international firms to operate in (Murray & Mahon 1993).

Entry strategies may be licensing or franchising, entering into a joint venture or setting up a wholly owned subsidiary. Which way to go are partly a question of control and the level of resource commitment. The level of control is assumed to be lowest in licensing, highest in case of wholly owned subsidiary and somewhere between in the case of JVs. Resource commitment is low in licensing, high with wholly owned subsidiary and falls between these extremes in JVs. Starting up alone in foreign markets is an expensive, difficult and time-consuming business and strategic alliances can offer considerable time savings. Also, the speed of internationalisation is critical and an early entry can be of crucial importance if a firm is going to gain a significant market share (Glaister & Buckley 1996).

#### *Product rationalization and economies of scale*

Organic growth may be limited by low product demand and the cost of firm growth. In an alliance costs can be reduced by comparative advantages, moving production of components or whole products to the firm with the best prerequisites for that particular production. Horizontal alliances can also reduce costs of larger outputs (Glaister & Buckley 1996).

When it comes to investments to improve already existing products or the development of new ones R&D costs are significant. Sharing these costs and simultaneously making use of synergies by complementary resources, strategic alliances can be a good deal. New advanced technology is introduced on the market in a speed that most firms find it hard to cope with. Technological changes come from numerous sources and it is important to select the ones that will yield long-term competitive advantage at minimal cost and risk (Murray & Mahon 1993).

#### *Transfer of complementary technology, and exchange of patents*

Technology differences and degree of innovations separate firms regarding strategy. Highly innovative firms require substantial resources that can be provided by an alliance partner. When developing pioneering technology it can be good to tie other firms and their resources to it to make it legitimate. Interfirm cooperation has many times led to a standardization of new technology. One example of this is when Betamax developed a video recording format superior to VHS, but could never gain praise for this since VHS, through non-technical reasons including interfirm co-operation, made its format the standard (Eisenhardt, Bird & Schoonhoven 1996)

Transfer of technology within an alliance is not just movement of technicalities. It must involve a long-term relationship in which the partners work closely together and learn by each other. In alliances firms are enabled to bring together complementary skills and talents, which

cover different aspects of the know-how needed in high technology industries. Exchange of patents can open for fast entry into new markets. Smaller firms seldom have the manufacturing capabilities needed to exploit developed technology and they benefit from alliances with bigger firms that can commercialise the technology (Glaister & Buckley 1996).

### *Building competitiveness*

Joining forces in an alliance may enable firms to resist strong forces of competition, which could be hard for a single firm to withstand. In times of intense competition a joint venture with combined internal resources may have the opportunity to compete more effectively (Glaister & Buckley 1996).

### *Conformity to host government policy*

Government policies affect firms and alliances can be formed to strengthen firms' ability to affect policies. A firm that wants to enter a foreign market may be hindered by host government policies and some countries even insist that there is collaboration with local firms to get access to the market. Protectionist policies are not the only reason why firms choose to ally with local firms. Strategic alliances can be a convenient way of selling products in foreign markets (Glaister & Buckley 1996).

### *Risk sharing*

Risk is often a critical aspect when it comes to investments, and strategic decisions are inevitably concerned with assessing odds for successful performance (Das & Teng, 1998). By collaborating with other firms one firm does not have to bear the full costs and risks.

Reduction of risk in alliances can be: 1) spreading the risk of a large project over more than one firm; 2) enabling product diversification and thus reducing market risk associated with being reliant on only one product; 3) enabling faster market entry and quicker establishment of a presence in the market, which in turn allows a more rapid pay back of investment; 4) cost subadditivity, i.e. the cost of the partnership is less than the cost of investment undertaken by each firm alone. In strategic alliances slack and expertise can be combined which lower costs (Glaister & Buckley 1996).

Even if alliances can be a good option to reduce risk they also create risk. By forming an alliance a firm exposes itself to relational risk. Economic theory suggests that decision makers try to maximize utility. Firms are supposed to pursue their self-interest, even at the expense of the partner. Opportunistic behaviour may yield returns higher than fair play, so precautions should be taken to reduce this kind of risk. Shared equity holding can prevent opportunistic behaviour since interest is aligned and exploiting the venture would hurt both. Stringent control mechanisms and detailed contractual clauses may serve as counter weighting factors (Das & Teng 1998)

### *Social opportunities*

Two factors that yield particularly high payoffs in alliances are when a firm is in a vulnerable strategic position, depending on the firm and the market, or when the firm has a strong social position. In an intensely competitive market a firm is vulnerable because of low margins, and a high speed of innovation leads to expensive product differentiation. To handle this and continuously be competitive a firm may need to seek allies to share costs and risks. The social

aspects are of significance to succeed in an alliance. Cooperation between firms runs smoother when managers have good personal relations that facilitate better governance, trust, and commitment are deepened. In an outward looking perspective a firm with good reputation and status signals trustworthiness for potential partners, thus facilitating cooperation. It is also important that a firm has the ability to be flexible in times of rapid change (Eisenhardt, Bird & Schoonhoven 1996).

The three main reasons for alliance formation among dairy firms during the last four years are closely related to the firms' overall strategies: 1) to promote international expansion; 2) to further penetrate home markets; and 3) to strengthen product portfolios (van der Krogt, 2003).

#### **4.4 The Resource-Based Theory**

The accounts in the preceding section mention repeatedly that the various types of strategic alliances involve the use of resources. The partners embark into an alliance with the aim of supplementing each other's set of resources, be it market access, financial assets, R&D, product portfolios, etc. As the resources from the different partners are combined, both or all of them can strengthen their market positions and their competitiveness. Hence, the Resource-Based Theory promises to be a valuable tool for the analyses to follow in the two subsequent chapters. After the theory is presented below, the last few sections of this chapter identify how the resource-based theory can be made use of.

The resource-based (RB) theory has an inward-looking perspective. It sees firms as collections of resources, which is a bundle of potential productive services, possessed by a firm for a limited time. Only services, not resources, are inputs in production processes. By organizing and coordinating these resources in an optimal way a firm can create competitive advantages (Tsang 1997). According to the RB theory firms could utilize possessed resources by combining them with others to make profits. Social factors are of fundamental importance in cooperative arrangements. Personal good relations within and outside the firm create opportunities through trust and good connections between firms. Learning incentives may also initiate alliances. Specific skills of others cannot be bought or taught by imitation in most cases (Eisenhardt, Bird & Schoonhoven 1996).

There is a strong link between resources and competitive advantage. Bounded rationality is a behavioural assumption in the sense that it is a question of how firms deal with the uncertainties using their organizational routines, not taking opportunism for granted. Hence the RB theory also considers social factors. This approach is more about needs and opportunities than efficiency (Eisenhardt, Bird & Schoonhoven 1996).

Rather than being defined by the competitive environment the resource-based theory defines a firm by accumulated resources. If firms are to be competitive they have to be heterogeneous in terms of resources. The heterogeneity itself becomes a source of competitive advantage and is created through possessed resources that are scarce, not perfectly imitable or mobile or lack perfect substitutes. But even if this theory stresses internal aspects there is an important connection between the firm and the competitive environment. Substantial differences between firms' profitability are better explained by differences in resources than if all firms' existence and actions would be explained just by looking at their common industrial environment (Das & Teng 2000). Firms in different countries often imply a higher degree of

heterogeneity because countries differ in terms of political, social, cultural and economic conditions (Tsang 1997).

### *Resources*

Depending on the characteristics of a resource different types of SAs are more or less suitable. Two possible reasons to form alliances are to acquire some other firms' know-how, thereby obtaining resources, or to maintain one's own know-how, retaining resources, while benefiting from other's resources. If a firm choose to ally to get hold of some essential resource it should consider what alliance type that fit the particular objective the most. In mergers and acquisitions all resources possessed by the other firm will go along in the deal. All these resources may not be of importance or they may even be redundant. Less valuable resources are not always easy to dispose without taking a loss when they are not readily separable and have a certain degree of asset specificity. So, if not all resources of the acquired firm are valuable and wanted some other type of alliance should be applied (Das & Teng 2000).

Sometimes resources are not fully used. A firm can wait until the opportunity comes to utilize the resource optimally on its own, or it can ally with another firm. One example is excess capacity that can be used in private label production, or when research personnel do not have enough meaningful work at hand, they can be out-sourced to other firms. If relinquishing resources permanently is a better solution mergers or acquisitions is a good option while other alliances fit the purpose better if the currently under-utilized assets are to be kept internally in the long run. Regardless of the motive, decisions must be made after consideration of the opportunity costs of the resource. Strategic alliances should only be applied if the long-term value is higher than if resources should be kept internally, deployed or sold. After all, strategic alliances usually entail high governance costs and loss of organizational control (Das & Teng 2000).

When choosing alliance type a firm must carefully consider what kind of resources it will provide. To get access to another firm's resources it must be able to protect its own vulnerable property (Das & Teng 2000).

Some suggest that resources, and their characteristics, held by a firm affect the likelihood of the company to form alliances. Apart from internationalisation, expensive and new technology, perceived environmental uncertainty or other reasons to ally the RB perspective sees resources as an important factor in these decisions. Firms that possess attractive resources are more likely to form alliances. A firm's resource base can say a lot about self-reliance. When competition is intense companies should employ alliances because their survival might be threatened due to resource stress. When working together, using each other's resources and skills, firms could create something that differentiates them from other competitors, which they couldn't have done working separately. Besides creation of synergies by pooling resources together a partner may provide new distribution channels or be a customer helping to send signals to the market that there is a need for the product (Das & Teng 2000).

### *Categorisations of resources*

Without heterogeneity among firms there would be little incentive for alliances. Characteristics of resources that prevent homogeneity are imperfect mobility, imperfect



imitability and imperfect substitutability, all instrumental in the formation of strategic alliances. If a firm possesses resources that are scarce, imperfectly mobile, imperfectly imitable or imperfectly substitutable its homogeneity towards other firms is prevented. These kinds of characteristics are attached to those resources that cannot be imitated or bought for a fair price at the market. Causal ambiguity concerns the diffuse connection between competitive advantage and resources. Causal ambiguity depends on the degree of tacitness, complexity and specificity (Das & Teng 2000).

Several characterizations of resources have been developed. They can be divided into tangible and intangible, and further into property-based and knowledge-based (Das & Teng 2000).

Resources that are based on knowledge can be hard to protect against opportunistic behaviour in an alliance. These resources are intangible skills and know-how in a specific firm. These assets are vague and ambiguous and protected by information barriers, so they are not easy to imitate. Company culture and learning capacity are not particularly mobile while technology and managerial knowledge are quite easily acquired through the market. Knowledge-based resources are not as safe as property-based resources because the former are more vulnerable to unintended transfers (Das & Teng 2000).

If a firm wants full protection it should only expose the resources that are patented or secured by other legal protections in the alliance, which often is the case with property-based resources. Property based resources are protected by patents, contracts and deeds of ownership, and the right to use them is solely held by the owner firm. Property-based resources can have different characteristics depending on type of asset. For example human resources are imperfectly mobile. Property-based resources that are easy to copy are inimitable because of patents, copyrights or contracts etc. (Das & Teng 2000).

The choice of alliance type is also affected by the resource characteristics. Firms that mainly possess property-based resources, like financial assets, physical resources and human resources, can choose a collaboration type, such as an equity joint venture, where the close relationship does not jeopardize the resources because of the legal property rights. On the other hand, if the resources are mainly knowledge-based there is a risk involved in these kinds of alliances. It is hard to prevent the transfer of knowledge between firms when they are exposed to each other's tacit skills in such an intimate entity as a joint venture. To avoid unwanted transfer of expertise firms could use more easily dissolvable contract-based alliances. Despite carefully considered choices concerning resources contributed, the performance of the collaboration is not a given success (Das & Teng 2000).

Resources can be categorized into financial, technological, physical or managerial. What kind of resources a firm contributes can tell a lot about its objectives and orientation in an alliance. The companies involved in an alliance can have different orientation, such as controlling the management or securing technology. It is important to understand the direction of the partner because it will set its operational objectives based on its orientation. If these issues are cleared they will provide guidelines for managing. The firm who provides financial resources in an alliance naturally wants as good a return on investments as possible. If it does not trust its partner fully it would want to control decisions. This is achieved in a joint venture where the investing firm holds the largest share and therefore is in control over decisions. If trust is not a critical issue but the success of the performance is unsecured, the investing company should promote more easily dissolvable alliances. If a firm holds valuable technological resources they could utilize them by licensing them to several other firms, securing them with patents.

Physical resources can be protected by recurrent contracts. If the outcome of the alliance is not as good as the providing company had hoped it could withdraw. Or, it could try to get the partner to embed in the alliance good enough to prevent opportunistic behaviour. The duration of the alliance also affect trust. The longer the duration the more it is in both firms' interest to keep good relations and work toward good results (Das & Teng 1998).

The RB theory sets forward a number of assumptions, which are investigated further in section 6.1.

- The RB theory suggests that there is a strong link between resources possessed by firms and competitive advantages. It defines a firm in terms of its accumulated resources, and heterogeneity in terms of resources is essential for competitiveness.
- The RB theory explains how the purpose of the co-operation decides the type of alliance. Acquisitions and mergers are applied when all resources are of interest to obtain, and alliance types with less financial and organisational integration are applied when the cooperation has a more narrow purpose.
- The RB theory suggests that a firm with attractive resources is more likely to form alliances than a firm with less attractive resources.

#### **4.5 Motives for strategic alliances: a resource base perspective**

The motives presented in Section 4.4 can be derived from the RB theory. Alliances are formed driven by motives that put possessed resources in focus, and by matching them benefits are created. Here some motives for SA by Tsang (1997) are presented.

##### *Creation of rents*

Rent earned can be defined as excess of the firm's opportunity cost. When competition is intense rents are generally close to zero. Ricardian rents refer to rents generated by resources that produce services insufficient to meet the demand, thereby scarce. Ricardian rents are created because they make it possible to produce at lower cost, better products at a similar cost or better products at lower cost. A scarce resource in this sense may also be a combination of resources that separately are not particularly attractive. The significance of heterogeneity among firms in the RB perspective suggest that the higher the degree of heterogeneity the higher is the chance of forming alliances which would create rents. Heterogeneity increases as firms form alliances across countries. Implementation of strategies and coordination of control have become easier with the advance of information and communication technology.

##### *Expansion of resource usage*

Striving for long-run profits firms ought to expand whenever profitable opportunities exist. Some resources can be used simultaneously in virtually unlimited amounts, like computer programs or know-how, and therefore they can be put to use in other companies at the same time as they are retained within the firm. Increased usage can generate higher rents. R&D costs have skyrocketed the last years and this forces firms to amortize their fixed costs over a much bigger market. Many resources that require big investments are beneficial for a relative short time, which makes it essential to reap the most out of them before they become obsolete, to cover investments. Some resources, like technology and managerial skills are not that easy

to implement in other firms without guidance or adjustments. The more unfamiliar the other firm or industry are, the greater the loss in efficiency of the technology. When transferring tacit knowledge the transferor requires more human resources.

#### *Diversification of resource usage*

Even if a firm has all required resources to engage in a new project, there is no guarantee for success. Someone else may be the first to come up with a similar solution or the desired result may not be accomplished. Risk is always a critical issue when big investments are made and by spreading risk over one or several more firms in the same industry, risk can be reduced through diversification.

#### *Imitation of resources*

Imitating the alliance partner's resources is another incentive to form alliances. Some resources are non tradable and therefore the only way to obtain them is through cooperation with the firm that possesses them. But even in intimate cooperation some resources are imperfectly imitable because of causal ambiguity. It is impossible to virtually identify the causal links between the resources and their capabilities to create certain products or services. The degree of tacit knowledge is high and capabilities are the result of a complex combination of physical, human and organizational resources. Ability to imitate is of course depending on the alliance type. The more intimate interactions the easier to understand the complex links that create the actual resource of another firm. This motive is closely associated with alliance instability. Secret imitation takes place without intention of letting the partner learn the tacit skills while open imitation occur when the firm that possesses the resource agrees to let the partner use the skills.

One example of open imitation is in licensing, where the licensor agrees to teach and let the licensee use the technology under specific conditions. A determining factor for a firm to be able to learn and imitate others is its "absorptive capacity". To have absorptive capacity means to "recognize the value of new information, assimilate it, and apply it to commercial ends" (Tsang 1998, p 216) A firm with absorptive capacity has prior related knowledge, which is history-dependent, complementary capabilities, personnel who have training, experience and equipment and its own related resources.

#### *Disposal of resources*

Sometimes a firm needs to dispose some unit to focus on the core business. To do this in an efficient way some critical factors must be considered. When a decision is made to sell a unit, there is a risk of loss of human resources if personnel involved leave for other opportunities or it will lead to a decline in moral. Loyal customers and suppliers may turn to other business partners. If the unit for disposal is highly integrated with the corporate parent it can be hard to separate them without loss of value. If the unit is strongly linked to the corporate parent it can be difficult to convince potential buyers that the price is fair, especially if the resources involved are intangible. It may require special knowledge about internal operations to see the real value. And, if the unit for sale and the core-business units share facilities, systems, personnel and other administrative backup it reduces the value of the single unit.

Maintaining the health of the business is important. The more integrated the units are the more likely that the selling process will be realized through an alliance formation. Through a

JV the resources of the for-sale-unit will gradually be integrated with the resources of the buying firm. If everything progresses smoothly the buyer will purchase the remaining shares held by its partner. (Tsang 1996)

#### *Resource - and risk management in the alliance-formation process*

By examining the type of resources a firm brings into an alliance its objective and orientation can be predicted. Different types of resources are also the origin of different kinds of risks. To get access to another firm's resources through strategic alliances a firm has to expose some of its own resources, which are more or less vulnerable to unintended transfers, and therefore exposes itself to a risk. Risks in an SA can be divided into relational risk and performance risk. Relational risk refers to the probability that the partner does not comply with the spirit of the cooperation, like for instance opportunistic behaviour. Performance risk is concerned with the probability that the goals of the cooperation will not be satisfactory carried out. These two types of risk are independent because they have different sources. Relational risk is a factor of firm-firm interactions and performance risk is generated by external factors. So, despite from the fact that a high level of performance risk can create a sense of crisis and mitigate relational risk, the two risk types are not correlated (Das & Teng 1998).

All these motives and drivers for strategic alliances open possibilities for firms to expand and innovate faster than if they should go through with all projects without cooperation. When a more dynamic business environment is created the pace of strategic alliance formations will reasonably increase.

#### **4.6 Strategic fit**

If a firm considers it having enough reasons to form an alliance it must be prepared to give it much time and patience. Cooperating with other firms, often competitors in horizontal formations, requires great management skills to work out a process through which both parties can achieve a common purpose and understand each other's domains. Key individuals must be devoted to the project to be able to identify and take advantage of the opportunities when they come. Opportunistic behaviour from one part can be foreseen and avoided to some extent if managers are well prepared and aware of the risks and the need for barriers against unintended transfers (Das & Teng 2000).

It is often better to align with companies of the same size and similar culture. A good balance in resources contributed and common objectives can prevent learning races and opportunistic behaviour. Goals ought to be compatible; the more the partners' goals overlap the greater the benefits of the alliance. But, even if an alliance seems like a good option to strengthen a firm's competitiveness, many things can go wrong since two competing firms have a lot of sources to conflict (Das & Teng 2000). Although partners don't have a perfect fit, differences can be worked out as long as managers are aware of the potential problems and have a dynamic view of the partnership. Before any alliance is formed firms should evaluate strategic and organizational fit and decide if the cooperation is too complex to work out efficiently. Objectives set up when forming an alliance should regularly be compared with the performance (Douma et al. 2000).

In the benefits of synergy and resource utilization, the costs for coordination and control must be calculated. These costs will be higher if the firms involved are dissimilar when it comes to

culture, strategies, management and technological systems. Strategic fit is important if the cooperation is going to work smoothly, and more time can be spent on the actual purpose than on discussing administrative issues. It also can prevent that one big firm out rules a small one. It is a good thing when strategic goals converge and competitive goals diverge (Das & Teng 2000).

#### **4.7 Resource alignment**

Resources must be wisely aligned. Resources can be complementary, similar, and supplementary aligned to achieve economies of scale, risk sharing or market power etc. Complementary resources are different, not similar, and as one can understand complementing each other. Complementary resources are probably the best alternative when it makes the overall resource base stronger by non-redundancy.

Surplus alignment can arise because of slack when similar resources are provided. Resources contributed to the alliance are in excess and not utilized fully in the accomplishment of the task. When resources are dissimilar and firms do not manage to integrate them properly they are wasteful. Wasteful and surplus resources may be difficult to avoid in an alliance because some resources are hard to separate. Sometimes a surplus of resources can be a good thing. It will reduce the constraints faced by the firms and through this prevent some potential conflicts. It can also ease decentralization of decisions. But, if the alignment is not a good fit and the collective strengths are not satisfactory, firms should either dissolve the alliance or make a good attempt to make it better. This will be up to the managers of the firms, who must carefully consider what kind of resources, they and their allies are contributing with, and how the resources are affecting the performance of the alliance (Das & Teng 2000).

#### **4.8 Resource bases in cooperatives versus investor-owned firms**

The preceding sections explain how formations of strategic alliances are dependent upon the set of resources that the alliance partners have and how these resources are linked to the requirements from the markets as well as the goals that the partners want to achieve through the alliances. The theoretical sources for these accounts seem, however, to be based on studies of investor-owned firms, being by far the most dominating type of business form. Hence, it is relevant to wonder if agricultural cooperatives differ in these respects: Are there any systematic differences between cooperatives and IOFs in terms of resources? Do the two organizational forms differ in terms when it comes to the type of market they serve? Are there any divergences concerning their market strategies, expressed as need for investments of various kinds, market orientation, etc?

The answer to these questions is contingent upon what is understood as a cooperative firm. Many authors distinguish between different organisational structures for cooperatives. Nilsson & Björklund (2003), for example, identify three organisational models for cooperatives, working under open market conditions (and a fourth one, suitable for strictly regulated markets – this one is excluded from further discussions). The three are traditional cooperatives, Internal entrepreneurial cooperatives and External entrepreneurial cooperatives. It should be underlined that these three constitute pure, theoretical constructs – real world cooperatives are most often a combination of the three. Table 4-1 summarises the discussion as well as a few other factors.

Table 4-1: Cooperative organizational models, characterized in terms of resource bases, strategies and market choice.

Characteristics	Cooperative organizational model		
	Traditional cooperatives	Internal entrepreneurial cooperatives	External entrepreneurial cooperatives
<b>Ownership</b>	Collectively by the membership	Members/suppliers have individual ownership (tradable delivery rights)	Collective owns part; External investors have individual ownership to the rest
<i>Financial resources per unit of produce</i>	Small	Fairly limited	Fairly large or large
<i>Market characteristics</i>	Large stable markets	Small, dynamic market	Large, dynamic market
<i>Top professional management</i>	Not absolutely necessary	Yes	Very much so
<i>Value-added products</i>	No	Yes	Yes
<i>R&amp;D investments</i>	Very small	Large	Very large
<i>Strategy</i>	Cost leadership strategy	Focus strategy	Differentiation strategy
<i>Member role</i>	Supplier only	Supplier and investor	Supplier and eventually investor
<i>Member orientation</i>	Production orientation	Market orientation	Mostly market orientation
<i>Task of the cooperative</i>	Defensive	Offensive	Offensive
<i>Success factor</i>	Economies of scale (low costs, low prices)	Economies of scope (streamlining)	Economies of scale and scope (streamlining)
<i>Technology</i>	Well-known, simple	Innovative	Innovative, advanced
<i>Market signals from</i>	Raw product markets	Raw product markets and financial market	Financial market and raw product market

*Traditional cooperatives* have a set of resources that make them adapting to an *overall cost leadership strategy*. This strategy is about producing at lower cost than competitors to be able to sell products cheaper and capture the price sensitive buyers. To succeed in keeping the cost-per-unit price down large scale production is necessary. The pace of product development is low and firms working by this strategy are large in number. For a cooperative to successfully apply a low-cost strategy it has to, except stimulate volumes, operate commercially- no unnecessary costs. Volume stimulating measures are applied only in cases where they lead to cost savings higher than the cost caused by volume stimulating measures.

*Internal entrepreneurial cooperatives* are well-suited for a *focus strategy*. This implies becoming the preferred supplier to a smaller market segment. To accomplish this firms have to be able to produce at low cost, (low cost because of large-scale production is not an option here), or sell an attractive product to a less price sensitive market niche. The suppliers have to invest large amounts to acquire delivery rights in their cooperative to become members, but as these delivery rights can be sold or bought to a market price, the ownership becomes individualised. As owners to such rights members would want these to have as high value as possible. What becomes important is raw product price in the long run and members have incentives to invest in the cooperative society. Internal entrepreneurial cooperatives fit the focus strategy – when capital originates from members it will never grow large.

*External entrepreneurial cooperatives* are adapted to follow a *differentiation strategy*. Firms following this strategy make products that differ from competitors' products. Differentiated products need to have qualities good enough for consumers to pay a premium price. Large-scale production is favourable but returns can be good even if costs are high. Most essential

are attractive products. Always having products that differ from competitors requires high speed of product development, which means large investments and extreme market orientation. To obtain the required financial strength, the cooperative invites external investors as co-owners, either to the cooperative society itself or (more probable) to one or several subsidiary firms. Investors require return on invested capital in forms of either yearly disbursements or as an increase in value. In either case the cooperative's capital base grows and incentives will be created in a commercially good way. Investors would never accept old-fashioned cooperative ideology to curb profitability by operating over capacity and paying a higher raw product price than what would be economically justified.

The four dairy processing firms that are presented in Chapter 3 and whose strategic alliance activities are investigated further in Chapter 5, differ as to organisational form. *Danone* is an *investor-owned firm (IOF)*, while the three others are cooperatives. These three have, however, quite different cooperative organisational models. They represent the same three cooperative models that are presented above, and so, they have also different resource bases, different goals and different market opportunities, i.e., they can be expected to apply different policies when it comes to strategic alliances:

- *Arla Foods* is a *traditional cooperative*, i.e., it is collectively financed and the governance is highly collective. An expression for the collective governance is that the cooperative applies the one member – one vote principle.
- Also *Campina* is to some extent traditionally organised, but there are significant differences. One is that the members have very large individual investments in the cooperative; otherwise they are not allowed to deliver. These investments are, however, not exactly in the form of tradable delivery rights, but the effect is quite similar, as the members' investments increase in value as the cooperative extends its capital base, and the exiting member will redeem an amount significantly larger than the one he or she invested. Likewise, as *Campina* has differentiated voting – more votes to members with larger deliveries – also the governance diverts from the traditional cooperative model. So, most of all, *Campina* resembles an *internal entrepreneurial cooperative*, but its capital base is considerably larger than is most often found in this type of cooperatives.
- *Friesland-Coberco* runs its business operations within a subsidiary – *Friesland Dairy Food Company* – owned together with external co-owners. The shares of *FDFC* are floating at the Amsterdam Stock Exchange. Hence, *Friesland* is characterised as an *external entrepreneurial cooperative*.

Based on the accounts of Section 4.8, a number of expectations could be set forward:

- *Danone* could be expected to involve mainly in acquisitions of other dairy processing firms, and so without any limitations as to country. Probably *Danone* is more interested in buying all the shares of these firms, otherwise large parts of them. Further, being an IOF, *Danone* would have advantages in doing business with value-added dairy products as well as non-dairy products, and not the least, products in the intersection between dairy and non-dairy.
- Being a traditional cooperative, *Arla Foods* suffers from a limited capital base, and so, its alliance activities are more likely to have the form of mergers, collaborative agreements and the acquisition of minor shares. The base being Danish and Swedish dairy farmer, *Arla Foods* could be expected to expand in the neighbouring countries. It is unlikely that a dairy farmer owned business would expand into non-dairy operations. The strategy is due to be fairly conservative, due to the restrictions of a traditional cooperative.

- *Campina's* members are due to be less risk averse and more prone to invest in new businesses as they have much more individual ownership in their cooperative. Hence, Campina could be expected to expand into markets further away from the domestic market, as well as to invest larger amounts.
- *Friesland's* expected strategy would be the most offensive of the three cooperatives. The firm does not only have access to capital from external co-owners – these owners also provide signals to the cooperative from the capital market, and these signals mean that the firm must follow an aggressive and expansionist strategy, otherwise the investors will become dissatisfied with their capital returns.

These hypotheses are investigated in the next chapter where a number of cases are presented – strategic alliance initiatives from each of the four dairy processors. Conclusions on them follow in Section 6.2.

## 4.9 Conclusions

The conclusions from the theoretic analyses are of three kinds. *The first ones* concern the concept of strategic alliances as well as the classification of these into six types. These types of alliances give the structure of the empirical investigation in the next chapter.

*Second*, alliance formation is a consequence of the partners' respective possession of resources, to be involved in the alliance project. When these resources are combined, they should fit the needs of the markets. Hence the resource-based theory provides valuable concepts, mainly the ones concerning the partners' motives for involving their resources in the joint project, the degree of fit between the partners' different sets of resources, and the types of resources invested in the alliance.

*Third*, the possession of resources can be expected to differ significantly between firms with different organisational structures, and this is very important in the dairy industry, where farmer cooperatives have large market shares. Hence, a classification of cooperative organisational models may prove instrumental to understand the differences in alliance formation, as each model is characterised by quite different sets of resources.



## 5. Examples of strategic alliances

### 5.1 Alliance types in the dairy industry

Looking at alliances initiated by dairies during the last years one can identify differences between firms with different ownership structures. Like other IOFs, Danone has made several acquisitions and bought a significant number of shares in other firms. The co-operatives, on the other hand, seem to be more divergent, applying the whole range of alliance types. Licensing seems to be the less frequently used strategy in alliance activities, apart from Finnish Valio, which has utilized its Lactobacillus GG in selling licenses to several firms.

In this chapter some strategic alliances initiated by Arla Foods, Danone, Friesland Coberco and Campina are presented. This is meant to illustrate the theoretical discussions in the preceding chapter. Even though the case descriptions are not representative for the entirety of strategic alliances in the dairy industry, they can still serve as a basis for the discussion that is conducted in Chapter 6. In analysing how the strategies differ between the firms, the analytical toolbox consists of three theoretical constructs: motives (cf. Sections 4.3 and 4.5), resources (Section 4.7) and strategic fit (Section 4.6).

An overview of the strategic alliances in the European dairy industry is provided in Table 5-1. The presentation in this chapter covers only a selection of these, enough to illustrate the various types of alliances. The data was collected mainly through search at the Internet, but also a personal interview as well as literature studies.

Table 5-1: Number of alliances by type made by four firms in the European dairy industry from 1998-2002 (Source: Dirk van der Krogt, pers. communication, 2003)

Firm	Number of alliances by type					
	Mergers	Acquisitions	Joint ventures	Shares	Co-op. agreement	Licensing
Arla Foods	3	1	8	3	2	2
Friesland Coberco	2	7	-	3	-	-
Campina	2	7	1	2	1	-
Danone	-	5	1	12	(1)	-

### 5.2 Mergers

*Arla – MD Foods (2000)*. Swedish Arla and Danish MD Foods initiated a cross border merger between the two dairy cooperatives in 2000. Arla Foods is now one of Europe's largest dairies. Despite of the modest size of the home markets, Arla Foods is internationally competitive. The main reason for the merger was consolidation and concentration in retail and among competing dairies on the European market. Together the two can successfully meet demands from international customers on product development, marketing and processing ([www.arlafoods.com](http://www.arlafoods.com)). After the merger a harmonizing plan was worked out to make sure that all members would operate under equal conditions in economic matters. At the same time cultural differences between the countries are respected ([www.arlafoods.se/press/artikel.asp?more=787&firstYear=1997&firstMonth=9&y1=2002&m1=alla&fras=2003-09-26](http://www.arlafoods.se/press/artikel.asp?more=787&firstYear=1997&firstMonth=9&y1=2002&m1=alla&fras=2003-09-26)). The merger capitalizes on former MD Foods' considerable competencies within exports and Arla's strong brand position in the Nordic countries as well

as it strong balance sheet

(<http://www.arlafoods.com/412567A1004C695D/alldocs/Q1A2ADA130637BD53C1256B7900455C76!Open&IC022D01Cat06&&2003-11-18>).

Looking at *Danone's* alliance formations the last five years it is obvious that mergers are not part of its strategy. Shares and acquisitions are the alliance types most frequently applied by this firm.

*Friesland Dairy Foods – Coberco (1997)*. A large merger between four dairy cooperatives took place in 1997, when Dutch Coberco, Friesland Dairy Foods, Twee Provinciën and De Zuid-Oost-Hoek joined forces. The merger capitalized on developments in the dairy market ([www.fcdf.nl/content\\_engels/over\\_fcdf/main-popup.asp?fd=6](http://www.fcdf.nl/content_engels/over_fcdf/main-popup.asp?fd=6) 2003-09-23):

- Reduction in state support;
- Increasing importance of the European market;
- Fiercer competition in the European market;
- Increasing economies of scale and concentration of operations on both the demand and retail sides;
- Continued pressure in the milk price paid to members.

Friesland and Coberco were complementing each other's market coverage well. Friesland had better finances and Coberco was lagging behind in developments but had a more modern structure that Friesland's farmers could benefit from. When uniting the firms a whole new corporate culture was created (Jos ver Woort, pers. communication 2003)

In the year of 2000 the representatives of the dairy co-op *Milchwerke Köln/Wuppertal e.G. (MKW)* approved the integration with Dutch *Campina Melkunie*, as a continuation of the JV established in 1997. This cross-border co-operative makes it possible for Campina to realize its strategy towards international growth and its focus on value-added products. The merger strengthens Campina's position in both the German and the Dutch market. MKW brought in its operational activities and Campina achieved capital. By merging with MKW Campina Melkunie increased its share in *Tuffi Campina Emzett GmbH* to 79%. The result from this merger will be one of Europe's largest dairy co-operatives and it will be carried out in three steps, starting in January 2001 and fulfilled in January 2007 (Bekkum 2001).

### 5.3 Acquisitions

*Arla Foods and Skånemejerier* commonly owned Lindals, running dairy operations in Poland, before the complete takeover by Arla Foods in year 2000. The reason for this take-over is that Arla Foods sees Lindals and Poland as an integrated part of the northern European market, and Skånemejerier has decided to focus on the Nordic countries

(<http://www.arlafoods.se/press/artikel.asp?more=376&firstYear=1997&firstMonth=9&y1=2000&m1=7&fras=> 2003-09-18).

*Danone – Shape/Uniq Plc (2002)*. Danone acquired Uniq Plc's Shape branded fresh dairy products portfolio. Shape is the number-two brand in the UK in the low fat fresh dairy segment. Through this acquisition Group Danone strengthened its market share in fresh dairy products and accelerated its focused growth strategy

([http://www.danonegroup.com/finance/index\\_finance.html](http://www.danonegroup.com/finance/index_finance.html) 2003-09-26). Uniq needed the

financial means to reduce borrowings. When the acquisition is fully completed the factory where Uniq produced Shape yogurt will be closed and Uniq will sell it separately, since it was operating at below an economical scale. After disposing the yogurt business Uniq will be able to focus on its core activities in the European chilled convenience food sector (<http://www.uniqplc.com/Uniqplc/infopool.nsf/HTML/4B05B615C34A027C80256C69004ED2B2> 2003-09-26).

In 2001 *Friesland Coberco* bought the *Nutricia Dairy & Drinks Group*, a division of Royal Numico N.V. The group consists of several dairies in the Netherlands, Germany, England, Hungary, Romania, Czech Republic and Slovakia. Purchasing Nutricia is part of Friesland Coberco's strategy to improve the quality of sales and profitability by enlarging the segment of distinguished branded products within the total sales. Strong brands combined with an excellent addition to their present assortment for supermarkets and for the strongly growing out-of-home market Nutricia can strengthen Friesland Coberco in fast developing dairy markets in Central Europe. Disposal of Nutricia was part of Numico's strategy to focus on its core business. Anticipating the transfer, the Nutricia operated as a separate entity, both legally and managerially. Nutricia will operate as a separate entity within the Friesland Coberco organization ([www.fcdf.nl/content\\_engels/nieuws/news-popup.asp?id=193](http://www.fcdf.nl/content_engels/nieuws/news-popup.asp?id=193) 2003-09-23). According to Jos ver Voort (pers. communication, 2003) a lot of effort was made to adjust the firms' culture to fit Friesland Coberco.

*Campina UK* acquired *Superlife's* flavoured milk brand with 20-years' heritages, in 2002. Yazoo, the UK's number one flavoured milk brand, is already owned by Campina and the purchase of Superlife which holds 5,3% home market share, will strengthen Campina's position in the UK. Yazoo has its strong position in retail and Superlife has strong sales through foodservice customers, an area which Campina intends to exploit further (<http://www.campina.com/default.asp?selected=camcom.engels.newspress.pressrelea|1&l=en&page=2&selectedItem=camcom.engels.newspress.pressrelea.PBSuperlif> 2003-09-23).

## 5.4 Joint Ventures

In 2001 *Arla Foods* and the New Zealand dairy *Fonterra* created a JV owned by Arla Foods to 75% to improve their positions in the highly competitive yellow fats market. The JV involved establishing a business responsible for marketing and distributing the brands in the British Isles, and developing new products for the yellow fats and spreads markets. (Fonterra's annual report 2001/02) Distribution, marketing and sales of the strong brands Lurpak (Arla Foods) and Anchor (Fonterra) will be more effective through the JV. Lurpak is the second biggest and Anchor third in sales volume in the butter category. Market shares are increasing (Arla Foods' annual report 2001/02).

*Group Danone* has signed a partnership agreement with Egyptian *Rachid group*, in 2001, to expand its three core businesses, fresh dairy products, biscuits and beverages. In the Near and Middle East region, Rachid is one of the main market players for consumer goods. The plan with this JV, in which Danone initially holds 51% interest, is that it will expand on a regional basis through acquisitions and greenfield projects. Danone has strategic interests in this region. With about 65 million inhabitants, of whom 35% is below 15 years old, this market offers a strong growth potential ([http://www.danonegroup.com/finance/index\\_finance.html](http://www.danonegroup.com/finance/index_finance.html) 2003-09-18).

*Campina – Tuffi Campina Emzett (2000)*. In the year of 2000 a JV was initiated between Campina (50%), MKW (29%) and BMG (21%). Tuffi Campina started to enlarge its activities to the Eastern part of Germany with the merger of Tuffi Campina (Cologne, in the west) and Emzett (Berlin). Campina was already present in the south (Heilbronn) (Bekkum 2001).

## 5.5 Shares

*Arla Foods* bought a share of interest in Swedish *Kron Ost* in the year of 2000 (2002?), to which Arla Foods is a supplier. Kron Ost produces and packs cheese and is a good complement to Arla Foods other activities. The strength in this firm is its great knowledge about cheese and its close individual arrangements with customers. Kron Ost has around 80 employees and its activities will continue as before (<http://www.arlafoods.se/press/artikel.asp?more=673&firstYear=1997&firstMonth=9&y1=2002&m1=2&fras=2003-09-18>).

*Danone – Stonyfield (2001)*. Group Danone purchased initially 40% holding in US Stonyfield Farm in the year of 2001. Under the agreement Danone will have an opportunity to acquire a majority holding in 2004. Stonyfield Farm is the fastest-growing yogurt company and the fourth largest yogurt brand in the US. This American firm is a leader in organics, natural nutrition and corporate and environmental responsibility. Both firms will remain autonomously managed. Danone will build upon and expand Stonyfield's leadership in the US natural and organic yogurt segment, as it will provide pivotal assistance in terms of manufacturing, purchasing, logistics and other efficiencies. Compatible missions are both environmental responsibility and the health and nutrition concept ([http://www.danonegroup.com/finance/index\\_finance.htm](http://www.danonegroup.com/finance/index_finance.htm) 2003-09-18).

*Friesland Coberco – Napolact (2002)*. In 2002 Friesland Romania, a subsidiary of Friesland Coberco Dairy Foods, made a public offer for shares in Napolact S.A. Napolact operates in Romania and produces a wide range of dairy products which it sells on the Romanian market of which it has a substantial market share. Beside the strong home market position Napolact also exports special cheese types. Friesland Romania made this strategic step as a completion of three previous acquisitions that have made the firm one of the leading dairy players on the Romanian market in terms of product range as well as location ([http://www.fcdf.com/content\\_engels/index.html](http://www.fcdf.com/content_engels/index.html) 2003-09-23).

In 1999 *Campina* bought a 53% share in *Emzett* (Berlin). The year after the German activities were regrouped in a new company, Tuffi Campina Emzett, with shares held by Campina (50%), MKW (29%) and BMG (21%) (Bekkum 2001).

## 5.6 Co-operative agreements

In 2002 *Arla Foods* and Swedish *Skånemejerier* signed a contract with the substance that *Skånemejerier* is going to produce whey protein concentrate for Arla Foods. Arla Foods has a big export market for advanced whey products and sees this co-operation as an opportunity to further strengthening this position (<http://www.arlafoods.se/press/artikel.asp?more=750&firstYear=1997&firstMonth=9&y1=2002&m1=9&fras=2003-09-18>).

*Danone* purchased a minority stake in *Shanghai Bright Dairy* in the year of 2000. Shanghai Bright Dairy is a leading dairy firm in China and the alliance enables Danone and Shanghai Bright Dairy to extend their market coverage. The two firms join forces in yogurt and dairy-desserts in China aiming at bringing Danone's activities together with those of Shanghai Bright Dairy ([http://www.danonegroup.com/finance/index\\_finance.html](http://www.danonegroup.com/finance/index_finance.html) 2003-09-23).

*Veghel, The Netherlands-DMV International, a division of Campina*, entered into an agreement with *AgriMark* (2001), a dairy cooperative in the USA, for the production of lactoferrin. DMV will control the operations at the AgriMark plant, and will purchase all lactoferrin produced. Ingredients for the food, nutritional and pharmaceutical industries are one of the three strategic growth areas of Campina. To be able to meet the demand, it needed to larger production capacity. This agreement further expands DMV's capacity for lactoferrin, anticipating market development ([www.lfplus.com](http://www.lfplus.com) 2003-11-26).

## 5.7 Licensing

One firm that has used this type of alliance type to exploit a patented resource is Finnish Valio. Valio's *Lactobacillus GG* was first identified in 1983 and functions as a protection against GI infections and imbalances in the body. Aware of the value of this discovery Valio acquired a worldwide exclusive license in 1987. The first LGG product was launched in 1990 and today the firm offers a wide range of LGG products and grants LGG rights to other firms under sublicense agreements in more than 30 countries ([http://www.valio.fi/channels/konserni/eng/tanaan/unnamed/unnamed\\_4/unnamed\\_7.html](http://www.valio.fi/channels/konserni/eng/tanaan/unnamed/unnamed_4/unnamed_7.html) 2003-10-15).

The case descriptions in this chapter contain a large number of variables that explain why dairy firms launch alliances of various kinds, what the alliances were meant to achieve and how they were formed. These issues are discussed in the following chapter.

## 6. Discussion and conclusions

### 6.1 Alliances as a consequence of partners' resources

The theoretical discussion (Chapter 4) concludes with the observation that three constructs play a decisive role for the formation of strategic alliances – the partners' motives for investing resources in an alliance project, the degree of strategic fit obtained between the partners' respective set of resources, and the type of resources involved in the alliance. On the basis of the empirical material presented in Chapter 5 Table 6-1 is constructed. The table hence constitutes an abstract summary of all the cases in the six categories of alliances.

Some of the motives mentioned in Chapter 4 are not accounted for in the table, as these were not identified in the cases. This does not necessarily mean that those motives do not exist – only that they have not been stated by the allying partners. Actually, only a few of the motives presented in Chapter 4 are represented. Generally international expansion and further penetration on markets where the firms are already present seem to be the most common motives.

The table includes the cases mentioned in the preceding chapter, to illustrate the conclusions. These require a number of comments: All three cooperatives included in this study have applied mergers. Danone, on the contrary, has not used this type of alliance in its growth strategy. The RB theory explains how the purpose of the cooperation decides the type of alliance. Acquisitions and mergers are applied when all resources are of interest to obtain, and alliance types with less financial and organisational integration are applied when the cooperation has a more narrow purpose. This and financial structure seem to decide the type of alliance. There is no doubt that Danone is a very attractive firm to ally with, considering its alliance formation activities the last years, which could entail that if enough financial means is available, firms rather acquire than merge. All these observations are in line with the propositions put forward in Section 4.4, on the basis of the analyses of the Resource-Based Theory.

Turning to the number of acquisitions made by the four firms all but Arla Foods have completed several. Danone, Friesland Coberco and Campina all have capacity to raise necessary financial means to go through with acquisitions because of their favourable financial structures. Danone and Friesland Coberco can raise funds from external investors, and Campina from its members. Firms use their prerequisites for different alliance formation activities to achieve competitiveness. But is the choice between acquisitions and mergers solely a question of strategy, or is it access to money?

Arla Foods has limited chances to raise necessary financial means to acquire or purchase large shares in other firms because it has very little member allocated equity and no non-member allocated equity capital. Danone is the one firm with biggest potential to acquire and buy large shares because of external investors and shares floating on the stock market. The difference between Arla Foods and Danone is very clear while differences among the three cooperatives in the study need more scrutiny (followed in the next section).

The RB theory suggests that a firm with attractive resources is more likely to form alliances. Looking at the number of alliances formed by the four firms Arla Foods outnumbers the others.

Table 6-1: Explanations to choice of strategic alliance types

Alliance type	Motive		Variable		Resource	
			Strategic fit			
<i>Merger</i>	Obtain scale advantages, utilize physical resources, create synergies, share risk, share cost, create bigger capital bases, and strengthen position toward customers and competitors.	Arla – MD Foods 2000 Friesland – Coberco 1997 Campina – MKW 2000	Total integration requires good fit. Both parts in control. Compatible cultures, organization models and compatible goals are important.	Brand position- export competence. Finances – modern structure. Brand pos. – Operational activities and capital.	Market position, strong brands, good finances etc. Compatible competences and resources.	Mergers have been applied by all three cooperatives, but not by Danone. Financial means not necessarily a key resource.
<i>Acquisition</i>	Obtain scale advantages, utilize physical resources, share risk, share cost, and create bigger capital bases. International expansion, home market expansion, and take control over competitors.	Arla Foods – Skånemejerier 2000 Danone – Shape/Uniq Plc 2002 Friesland Coberco – Nutricia Dairy & Drinks 2001 Campina – Superlife 2002	Total integration requires good fit. Acquirer in control. Acquires objects with concepts that fit the firm strategy.	Finances – Market position. Finances – Market position. Finances – Market position, strong brands. Finances – Market position, strong brands	Financial capital, ability to take some risk.	Danone, Campina & Friesland Coberco have done several acquisitions. They all have capacity to raise necessary financial means.
<i>Joint Venture</i>	Obtain scale effects and international expansion, create synergies, and to strengthen position toward customers and competitors.	Arla Foods – Fonterra 2001 Danone – Rachid 2001 Campina – Tuffi Emzett 2000	Strategic fit for the resources involved in JV is important. Separate legal entity. Medium integration. Control allocated after contract and equity share. Parent firms should not be competitors.	Synergies in distribution, marketing & sales. Strong brands-market position. Complementing markets.	Production sites, good market position, strong brands, good management skills etc.	Arla Foods dominates this category. Arla Foods has capitalized on its market position and competence to successfully expand through JV's.
<i>Share</i>	A step toward a complete take-over, influence in decisions and thereby affect ones own market situation.	Arla Foods – Kron Ost 2000 Danone – Stonyfield Farms 2001 Friesland Coberco – Napolact 2002 Campina – Emzett 1999	Important if the purchasing firm buys a significant share. Can be a step toward complete take over. Level of integration is low, (depending of the size of the share). Control if >50% of shares.	Finances- Competence & strong brands Finances- Market position Finances- Market position Finances- Market position	Financial capital, ability to take some risk.	Danone strongly dominates the appliance of shares. Danone has the most favourable financial structure to raise capital to buy shares.
<i>Co-operative agreement</i>	Strengthen market position, international expansion, and sale and synergy effects.	Arla Foods – Skånemejerier 2002 Danone – Shanghai Bright Dairy 2000 Campina – Agrimark 2001	Strategic fit is not of immediate importance but for the purpose of the alliance that is quite narrow. Level of integration is low.	Strong export market position- Production capacity. Synergies Strong export market position- Production capacity	Prod capacity, market position with growth potential etc.	None of the four firms apply co-operative agreements very often. Here a good match is more important.
<i>Licensing</i>	Narrow purpose. Achieve standardization of a patented product, utilize innovative product optimally or overcome weaknesses without having to develop the solution.	Valio	Level of integration is low.	Attractive product – Production possibilities & market.	Attractive patented product, market position, spared capacity etc.	Requires a genuine attractive product that can be patented.

Motives found in the cases support the theory. From a resource-based perspective one can observe that all alliances are formed to align different kinds of resources. A good match of resources means good strategic fit, and complementing resource alignment seems to be frequently occurring. This generates heterogeneity among firms' resources. Depending on what kind of resources the firms have different kinds of collaboration to obtain competitive advantages occur. Arla Foods has capitalized on its market position, strong brands and competence, while Danone has used its capacity to raise financial means to go through with acquisitions and buy shares.

The motives for acquisitions and mergers are quite similar, in fact those motives go for almost any type of alliance, but the immediate importance of something must stand in proportion to resource and financial integration. So, from mergers and acquisitions to co-operative and licensing agreements a drop-of of motives can be observed as the level of resource and financial integration decreases. Even if motives are similar some firms choose acquisitions and some choose mergers. One obvious difference is available financial capital.

In the mergers resources are complementarily aligned to create opportunities for growth. In acquisitions and shares, it is more of a one-way seeking for attractive resources where one firm purchases other firms' resources. In JVs synergies are made by aligning resources within a specific purpose. Co-operative agreements and licensing have more narrow purposes and are applied when the reason for the partnership is not strong enough to create full integration.

## **6.2 Alliances as a consequence of resources in organisational models**

Arla Foods is a traditional cooperative but follows a strategy that is better suited for other forms of organisational structures. Its objective within its strategic alliance activities is more an offensive desire to achieve competitive advantages than a defensive instinct to survive. According to theory (Section 4.8), Arla Foods can be expected to have no value-added products, insignificant amounts invested in R&D, expand in the neighbouring countries and to apply the cost leadership strategy. In real world Arla Foods has a wide range of sophisticated value-added products, invests large amounts of money in R&D to be able to keep up its differentiating strategy and has a multinational approach reaching over all five continents.

When it comes to alliance formation Arla Foods has a limited capital base, and mergers, shares and JVs are the most frequently applied alliance types. Arla Foods is the one firm in this study that has formed the most alliances, and it has used all six types.

Danone is an IOF that can be expected to involve mainly in acquisitions and shares and grow through value-added dairy products and non-dairy products. This assumptions mirror reality quite well. Alliances formed between Danone and other dairy firms are mainly shares and several acquisitions. Financial means are raised through external investors.

Campina's cooperative organisational model set up presumptions that agree well with the real case. Its members are less risk averse and more prone to invest in new businesses than members in traditional cooperatives like Arla Foods. The dominating alliance type applied is acquisitions. But according to theory an internal entrepreneurial cooperative is supposed to operate on small dynamic markets with a focus strategy while Campina operates multinationally, following a differentiation strategy.



As an external entrepreneurial cooperative Friesland Coberco can be expected to follow the most offensive strategy of the cooperatives in this study. Acquisitions are the most frequently formed alliance type in Friesland Coberco's multinational approach, but according to the number of alliances formed, and the type of alliances formed, during the last four years it has not appeared more offensive than Campina. Campina and Friesland Coberco have a very similar pattern in their alliance formations.

In fact all three cooperatives have more similar patterns concerning market characteristics, strategy, management, R&D investments, value-added products and innovative technology, than what could be expected from the general characteristics for the different cooperative organisation forms, all tending to operate like external entrepreneurial cooperatives.

The member governance structures in these co-operatives may have implications for decision-making concerning strategic alliances. The structures differ among the three firms. The internal governance diverge in terms of rights and responsibilities of the various decision-making bodies, and of the membership itself. Arla Foods and Friesland Coberco have democratic voting procedures with one vote per member while Campina uses a system with five votes per member up to 100,000 kg of milk, with one additional vote for every next 20,000 kg with a maximum of 25 votes. Everything else being equal, one may expect co-operatives with one vote per member to be more conservative in their investment decisions than co-operatives with differentiated voting rights.

When comparing cooperatives in terms of investment relationship, an important concept is that of allocated capital as opposed to collective capital. The risk-bearing capital structure of Arla Foods differs from the two other cooperatives in this study, as it does not have any member allocated non-equity or non-member allocated non-equity. (Bekkum 2001, p 207) More important is that the share of member allocated equity in Arla Foods is considerably smaller than in Campina and Friesland Coberco. To give members incentives to invest in their cooperative proper rewards must be provided. Only when capital is allocated this is possible. If investments are stable during the period of membership a perpetually higher milk price can reflect a return to members, but as soon as the investment intensity increases, incentives to invest are necessary. A high milk price during the membership period does not stimulate investments; additionally the member-investor must be able to capture the real value increase of the firm since this would otherwise fall into the hands of the firm at a presumable sell-out of the farm. Capture of real value may be attained by making financial instruments freely tradable, either internally or externally (Friesland Coberco), or by means of administrative appreciation (Campina), or through bonus share issues (Bekkum 2001, pp 124).

In most European dairy cooperatives the share of unallocated capital ranges between 40 and 60% (49.9% average). In Arla Foods this share is 85.1%. Member allocated risk-bearing capital averages 33.5% while Arla Foods only has 12.7%. Campina and Friesland Coberco did not have any allocated capital before they found themselves in a situation forced to alter the capital structure to raise capital for investments. Today both Campina, (39.6%), and Friesland Coberco, (31.4%), are close to average (Bekkum 2001, pp 127).

Looking at alliances formed among European dairies the far most important resource seems to be financial resources. Differences found in alliance activities among IOFs and cooperatives and between cooperatives with different organizational forms have its most apparent explanation in divergent capital structures. If a firm had sufficient capital and the suitable capital structure to invest in acquisitions and shares rather than mergers, joint ventures and

cooperative agreements, it probably would. Anyhow, if one competitor has a larger range of options available than another firm, the first one will win in the competitive game. Cooperatives with no external entrepreneurial capital, like Arla Foods, have not many options but to grow through alliances that do not require much capital. Obtaining more financial means is difficult for a cooperative that is traditionally organised and wants to remain so.

According to van Bekkum (2001) Arla Foods' situation is untenable. His study points out that differentiation strategies work best in combination with entrepreneurial organization qualities, which is lacking in Arla Foods. When farmers' profitability is decreasing members do not think they can afford cooperative ideologies, which lead to investment incentive problems. Another conclusion in the study concerns firms with a high level of horizontal integration; the bigger the firms are the more individualized structure they tend to have. With increasing size of a firm heterogeneity among members increase, which gives a stronger reason to treat them differently. The study suggests that Arla Foods should change strategy when competition becomes intensified, otherwise it will be hard to motivate members to contribute to finance. Bringing in external parties to invest in the value-added business is Bekkum's solution, which would require individualization in Arla Foods primary business units to reach sufficient market orientation.

If Arla Foods wishes to proceed with its offensive alliance making strategy, thereby achieving competitive advantages, there are two options, both of which, however, would mean radical changes in the cooperative character. One is that the cooperative invites external financiers to own part of its subsidiaries, and the other one is that external investors buy B-shares in the cooperative society. In both cases there is a risk that the investors have little trust in the cooperative, and thus, they are hesitant to invest large amounts. They may, often rightfully, expect that the cooperative may reduce the profits by paying high milk prices to the farmers.

In Arla Foods the board of directors is appointed by the rule one-member one-vote. Hence, smaller farmers carry greater weight than larger and more commercially oriented farmers since the former outnumber the latter. A board of directors elected this way is likely to be more risk averse, also when it decides about strategic alliances, acquisitions and shares are more precarious than mergers and co-operative agreements. In cooperatives like Friesland Coberco (which also practices the one member one vote system) and Campina, that has external investors whose interests and demand for return on invested capital must be considered, decisions tend to be less risk averse. Maybe this is why Friesland Coberco and Campina have initiated more acquisitions and less JVs than Arla Foods.

Other important resources that make a firm an attractive partner are market position and competence. Arla Foods has managed to keep its market position and capitalizes on its market dominance in the Nordic countries. Arla Foods has so far managed to grow considerably as a result of successful mergers and JVs the last four years.

All motives driving strategic alliance activities forward create a more dynamic business environment for dairy firms. As firms form alliances new combinations of resources arise and create synergies, decreased risk enables bigger and more expensive projects and R&D, which creates a faster pace of innovation, and so on. All these factors affect the competitive climate. The top 15 dairies in Europe have initiated more than 200 alliances the last four years shaking and demodulating the market, which raise challenges that reasonably will generate an even faster pace of alliance formation in the future.

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