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**BACHELOR OF COMMERCE
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Table of Contents

Note from the Editors <i>Carmen Galang</i>	4
Austrian Airlines: An Analytical Examination Using Porter’s Diamond <i>Brett Forman</i>	5
Potato Chips in the Netherlands: An Analysis of Firm Strategy and Consumer Purchasing Behavior <i>David Francisty</i>	19
Entrepreneurship in Japan: Causes, Effects and Outcomes <i>Andrew MacInnis</i>	40
Global Cork Demand: The Competitive Challenges Facing Portuguese Producers <i>Daniel McCombe</i>	57
Sustainability within the French Luxury Consumer-Goods Market: The Role of Business and Consumer Demand <i>Lisa Simkus</i>	72

Note from the Editors

The mission of the University of Victoria's Bachelor of Commerce program is to give students the essential knowledge and skills they need to be a business leader in the global economy and ensure that our students are given opportunities to support and develop research. At the Faculty of Business, we also believe that international experience is a necessity in taking the lead in today's interdependent and intercultural world market.

Our international exchange program is the largest in Canada with over 75 active partnerships at universities in more than 35 countries. In the 2009-10 academic year, 136 BCom students participated in an international exchange. During their time away from UVic, students develop an international management perspective through direct experience with issues in their host country's economy and organizations. Some of these students then enrol in International Business Research (COM 470), a course designed to broaden their knowledge and enhance their research and writing skills by analyzing a business issue relating to their exchange destination. They can also focus on a specific aspect that pertains to a particular private, public or not-for-profit organization.

Beginning with the 2007 cohort, we started choosing the top articles to showcase in a published compilation of Best Business Research Papers. The topics range widely from small business sector survival to global financial crisis to changing poverty and inequity. Whatever the topic, these papers continue to have the capacity for remarkable and contemplative research from the best in their class.

On behalf of my colleague, Dr. Anthony Goerzen, we present this volume honouring a small group of students from the class of 2010. We thank the many people behind the scenes that allow this complex international exchange opportunity to work, including the International Programs team of Dr. A.R. Elangovan, Director; Brian Leacock, Associate Director; Jane Collins, Exchange Programs Coordinator; Ann Peng, Student Advisor; Ruth Davison, Outgoing Student Advisor; Jennifer Oakes, Academic Advisor, Donna Davis, Programs Clerk and to Shannon Perdigao, Academic Projects Officer, for coordinating and compiling this volume for publication.



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Austrian Airlines: An Analytical Examination Using Porter's Diamond

Brett Forman
Spring 2010

ABSTRACT

Austrian Airlines' long history of operating as an Austrian owned company has finally come to an end after their poor performance in 2008. This paper analyses the means by which Austrian Airlines has been able to compete globally for so many years in the competitive airlines industry and proposes reasons for their past success. The four components of Michael Porter's Diamond of National Advantage were used to analyze the company, in combination, with two other variables that have an effect on all four of the components, the government and chance. The main four components of Porter's framework include firm strategy, structure, and rivalry; demand conditions; related and supporting industries; and factor conditions which together work as a framework to determine the factors that allow Austrian Airlines to have a national comparative advantage. The information used in the paper was gathered from the company's annual report, various online sources that are not affiliated with Austrian Airlines, Michael Porter's book "The Competitive Advantage of Nations" and primary data from a customer satisfaction survey. From this analysis, it is evident that Austrian Airlines derives its ability to compete from many different sources such as the country's geographical location and the supporting industries located around their main airport hub in Vienna. It will become more apparent in the coming year, when more information is published, as to why the company's performance in 2009 was so poor which forced the privatization of the company.

INTRODUCTION

After 51 years of business under Austrian ownership, Austrian Airlines has the ability to compete as a government owned airline. In 2009, the company was taken over by Lufthansa Group after the Austrian government assumed a large amount of the airlines debt. This paper looks at Austrian Airlines' ability to be competitive in the global airline industry and analyses which aspects of their operations have been crucial in allowing them to remain a state owned business for such a long time. Austrian Airlines' comparative advantage is examined using Michael Porter's diamond model, which uses four pillars: firm strategy, structure, and rivalry, demand conditions, related and supporting industries, and factor conditions. This paper also highlights areas of the airlines' operations that have been detrimental to their success; however, due to a lack of in depth information on the 2009 operations of the company, a further analysis of the underlying reasons for their privatization was not possible.

1. COMPANY OVERVIEW

1.1 Austrian Airlines Group

Austrian Airlines was formed in 1957 as a merger between Austria's two airline companies, Air Austria and Austrian Airways. One year after the merger, the company began its first passenger flights from Vienna to London using a small fleet of four planes. (World Aviation) Austrian Airlines now offers flights

to North America, the Middle East, and Asia with the majority of its flights still to European destinations. The airline provided flights for over 10 million people in 2008 to 120 destinations across the globe. Their 91 aircraft fleet consists of a mixture of Airbus, Boeing, Bombardier, Fokker, and Canadair Jet planes, which range in size from the smaller Bombardier Q 300 seating 50 passengers to the larger Boeing 777-200 which seats 309 passengers. Their fleet has a relatively low average age; one of the main reason Austrian Airlines has had zero aircraft accidents. Over the entire existence of the company Austrian Airlines has maintained an impeccable safety record through their commitment to safety standards. (Austrian Airlines, 2009)

As the company has grown in size, it has expanded its operations to include charter flights under two subsidiary companies: Lauda Air and Slovak Airlines. Lauda Air, originally founded by the Austrian Formula One racer Andreas Nikolaus, became a part of Austrian Airlines in 1997 and flew long haul flights to Australia and Asia from Vienna. Before the merger, Lauda Air was one of Austrian Airlines main competitors flying out of Vienna; therefore, in an effort to reduce costs and increase business operations the company decided to purchase the airline.(Funding Universe, 2009) Austrian Airlines purchased a majority share in Slovak Airlines, but eventually had to withdraw their financial support as the Slovakian government did not live up to their partnership agreements.(Austrian Airlines, 2007) The company owns another fully owned subsidiary called Tyrolean Airways which they have re-named Austrian arrows which offers passenger flights. Austrian Arrows operates 50,000 regional flights a year from its headquarters in Innsbruck, Austria, in order to complement Lauda Air and Austrian Airlines medium and long haul flights. Austrian Airlines owns a number of other subsidiary companies that offer many services such as consulting, operating electronic travel distribution systems used by many travel agencies, and airline leasing. (LinkedIn, 2009)

In 2000, Austrian Airlines Group became a member of Star Alliance which is a global airline alliance whose goal is to make their passenger's travel more simple and comfortable. Star Alliance is able to offer their customers a smoother trip by integrating and combining all of their airline member facilities, resources, and services which gives Star Alliance customers access to the largest amount of products and services offered by any airline or airline group. Members of Star Alliance can also access many online services such as flight tracking, baggage tracing, visa and health information for travelling, and information on destination countries. (Star Alliance, 2009)

In 2008, Austrian Airlines Group ended the year with a net income loss of 429 million Euros and earnings per share of -5.19 Euros. Comparatively, their net loss was not terrible considering that US Airways incurred a 2,210 million dollar (1,471 million Euros) net loss in 2008. (United States Securities and Exchange Commission, 2009) As one would expect in an industry that requires high capital investment, Austrian Airlines has a debt to equity ratio of 7.57 for 2008. One reason for their high debt to equity ratio is the company's focus on maintaining a relatively low industry average age on their fleet. There are huge capital costs associated with purchasing new aircraft for their fleet which increases their total liabilities and consequently their debt to equity ratio. In addition, primarily due to the global financial crisis, shareholders equity decreased significantly 67% from 2007 to 2008.

Earlier in 2009, Lufthansa and Austrian Airlines started negotiations for the companies to merge allowing Lufthansa to purchase some of the state owned company. Lufthansa agreed to purchase Austrian Airlines only after the Austrian government decided that they would assume some of the company's debt from its previous year's performance. (Breaking Travel News, 2009) The companies believe that the merger will reduce their costs overall costs through resource sharing and that it will increase both of their revenues. The companies have estimate these cost savings around \$100 million dollars and hope that this will help bring Austrian Airlines out of their net loss from 2008. (MenaFN, 2008) This merger has a large impact on stakeholders other than just shareholders in Austria and

Germany; it also affects a large number of people travelling from Eastern Europe to Western Europe, or vice versa, as Vienna has acted as a hub for air travel between those regions. Using Vienna as a hub for people to travel between Eastern and Western Europe has been thought of as one of the reasons for the increased development of Eastern Europe, so if the merger does not go smoothly it may also affect businesses. For the merger to be successful the two companies will need to ensure that they successfully integrate and pool their resources, knowledge, and strategies to reduce costs any related to inefficiencies or duplication of routes, as well as, to earn greater revenues.

1.2 Customer Satisfaction Survey

To gain a better understanding of how satisfied customers are with Austrian Airlines, I surveyed 25 people who had flown with the airline and compiled the results. Overall, the people I interviewed were happy with the airline's customer service and they expressed positive feelings towards the friendliness, timeliness, and overall product offered by the company. The results of the survey seemed to correspond with the customer service awards the airline has won and the company's commitment to providing a high level of customer service. (Austrian Airlines, 2009:27) Although customer satisfaction is not as easily measured as other sources of competitive advantage, I believe that it is crucial source of any business's domestic or international success. The results from this survey indicate that customer satisfaction is a source of competitive advantage (but probably not a comparative advantage) for the airline. The survey questions and a summary of the results can be found in Appendix A.

2. THE AUSTRIAN ECONOMY

After joining the European Union in 1991, the biggest change in the Austrian economy came when they became members of the European economic and monetary unions. The first change Austria made was the adoption of the Euro from the Schilling which required the Austrian Central Bank to reform their monetary policy laws to fit with those of the European Union. In addition, the country would have to follow any future monetary policies set by the European Union to remain a member. The country also had to meet certain criteria regarding inflation control, national debt, exchange rate stability, and long term interest rates. Becoming a member of the European Union and adopting the Euro allowed Austria to become part of one large market. Having one currency allowed Austrian businesses to operate more efficiently across borders and made it less risky and less costly to do business. Other benefits include the simplicity of comparing prices of goods and services within the European Union, and making financing more accessible for Austrian businesses which is important for industries that require large amounts of capital. For a country such as Austria, that have a smaller Gross Domestic Product compared to other European countries, their entry into the union has provided the country with many opportunities to access cheaper goods and services and to expand their business opportunities outside the country by leveraging their central geographical location. This is especially important as more Eastern European countries become part of the European Union, as Austria will be able to act as a business hub to bridge the west and east. (European Commission, 2009)

Excluding the effects of the financial crisis on the 2009 market results, Austria has seen a positive real growth rate in their economy for the past six years representing an increase in Gross Domestic Product from \$253.1 billion US dollars in 2003 to 416.4 billion US dollars in 2008. (OECD, 2003) Austrian exports in 2008 were slightly less than their imports, which for a small European country is good as most small countries are unable to produce all of the goods domestically. Similar to Canada's close relationship with the US, most Austrian exports are sent to Germany which last year made up 29.4% of Austrian exports behind Italy and the US. To compete on the global export market, Austrian businesses focus on producing highly technical, high quality goods in order to gain a competitive advantage. (Dimireva, 2009) Businesses operating in Austria also benefit from business tax rates that are lower than many other

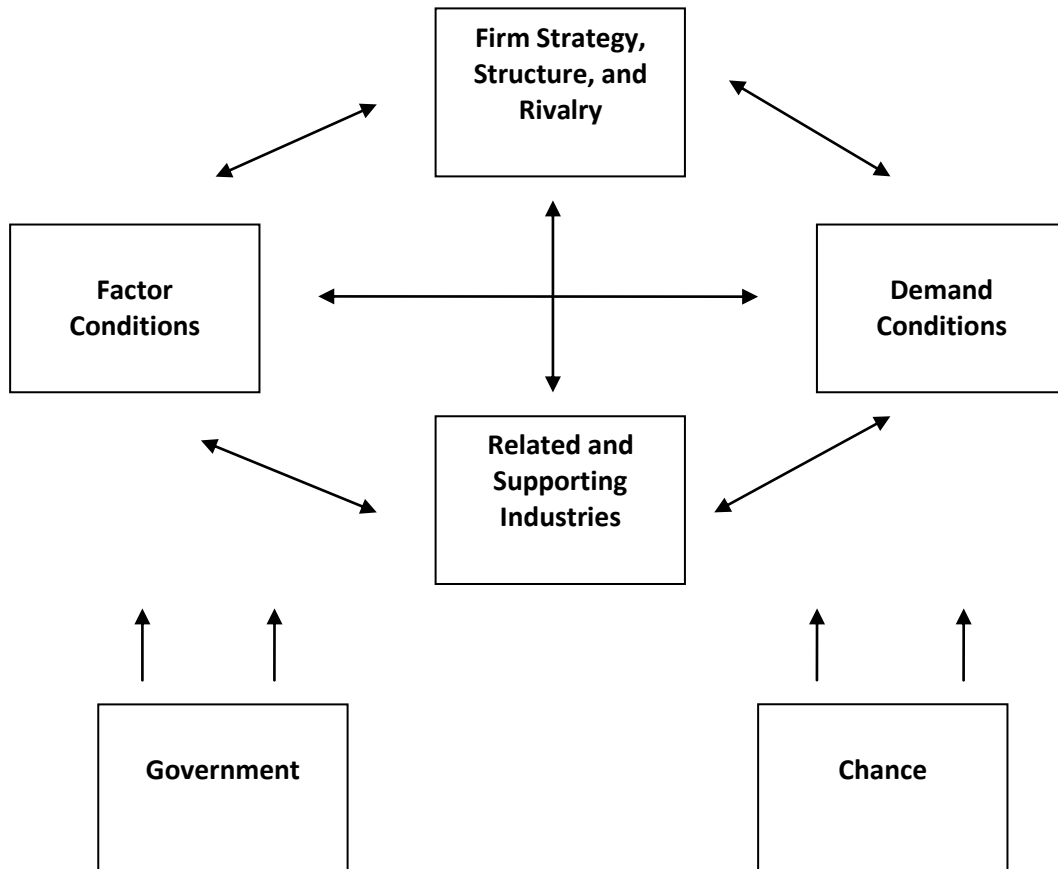
European Union countries such as the Netherlands, Italy, Sweden, France, Germany, and the UK. (Austrian Business Agency, 2009)

The Austrian economy can be broken down into three major sectors: the service sector which the airline industry falls under accounts for 67.4% of the economy, a small but highly developed agricultural sector makes up 1.9%, and industry accounts for the remaining 30.7% of the economy. One reason this large service sector has developed is because of the relatively high standard of living Austrians enjoy. Although the standard of living in Austria is comparable to other European Union countries, their GDP per capita of approximately \$40,200 US dollars in 2008 was slightly higher than the average. The country has been able to maintain a relatively high employment rate when compared to the European Union average with an unemployment rate of only 3.8% in 2009, a decrease from 2008. (Index Mundi, 2009) The country also has a well developed social system that provides healthcare and old age pensions for its citizens.

Austria has been one of the countries in Europe that has benefited the most from the fall of communism in Eastern Europe. Exports to Eastern Europe from Austria are on the rise and as more Eastern European countries join the European Union this trend will continue. An increasing amount of these Eastern European businesses are locating their business headquarters in Austria as a way to reach both the east and the west because of the country's central location. Another contributing factor for why companies are locating their businesses in Austria is because they have an extremely effective and well developed transportation system throughout the country that includes highways, expressways, railways, heavy air traffic, and Danube river ports. Also, a large amount of the financing that Eastern European companies acquire is from Austrian banks loaning them money. (Austrian Business Agency, 2009) These trends have benefited Austria in a few key areas: it has increased employment in the country by an estimated 10,000 jobs in 2007, which has helped lower the countries un-employment rate and keep people working during the financial crises, and it has had positive effects on the country's Gross Domestic Product. (Business Location Austria, 2007) There are many opportunities for Austrian companies in the growing Eastern European market and to take full advantage of these opportunities businesses need to leverage their location, transportation system, and close relationship with both the east and west.

3. PORTER'S DIAMOND OF NATIONAL ADVANTAGE

In the 1980's, a University of Harvard professor named Michael E. Porter researched national competitive advantages between countries and published a book in 1990 called "The Competitive Advantage of Nations." In this book, Porter developed a new way to look at national comparative advantage that differed from traditional theories which focused on how many factor endowments a country had such as natural resources, labour, land, and the size of the population. (Porter, 1990) Porter's model is shaped in form of a diamond and is comprised of four different components which can be seen in Figure 1: Firm strategy, structure, and rivalry; demand conditions; related and supporting industries; and factor conditions. (Recklies, 2001) Government and chance are two important variables to consider, as they both have the ability to affect the four other components of Porter's diamond. Together, these four components make up the basic framework that Porter developed to determine why some countries, industries, or businesses are more competitive than others globally. (ICMBA, 2009) It is important to understand each of the determining factors Porter developed before using the framework to determine why a company or nation may have more of a national comparative advantage.

Figure 1 – Porter’s Diamond of National Advantage

3.1 Firm Strategy, Structure and Rivalry

According to Porter, the firm's strategy can be thought of as their company vision or long term strategy as determinant of success. If a company does not have the foresight to plan for the future and follow a long term business strategy they will not be able to maintain a sustained comparative advantage over their competitors. The key to success for any business operating domestically or internationally is the ability to maintain this competitive advantage over competitors for the long term. This requires that companies must continuously innovate and analyze their business processes and operations to reduce inefficiencies and remain an industry leader. The structure of a company is also a very important determinant of national comparative advantage when competing internationally, according to Porter, because the structure of businesses can differ drastically from country to country. A company can benefit from their domestic business structure if it matches well with the industry they compete in. Conversely, if a company's domestically influenced business structure does not coincide with the industry, it may harm the company and put them at a disadvantage when competition globally. For example, US firms tend to be large in size and have a very hierarchal structure, typically hiring the most qualified person for the position; on the other hand, Italian firms tend to be smaller and hire people based on the personal connections of managers and employees, regardless of their qualifications. Domestic rivalry is another important determinant of how competitive a firm will be globally. If there is a large amount of domestic rivalry it will increase the company's international competitiveness for a few

reasons. In the long run, firms with a lot of domestic competition benefit because they are forced to innovate and improve their operations, whereas companies with low domestic competition often hold on to old products and production methods because they are not forced to innovate or change. According to Porter, firms with high domestic competition can not just rely on basic advantages such as low labour costs or large factor endowments because they are available to everyone operating in the country. This non-reliance on basic advantages forces companies to further develop their business operations, and makes them more competitive when they enter the global market.

3.2 Demand Conditions

The second component of Porter's diamond is demand conditions, which explains how the domestic demand for a product can affect the competitiveness of a firm. If there is a large domestic demand for a product in a country there is a greater chance that a firm will have a national comparative advantage. The main reason for increased competitiveness is that when there is more demand for a product in the country's domestic market, local firms tend to focus more on developing that product than their foreign competitors. This results in local firms innovating and improving their products or production process more than their foreign competitors, ultimately making a more attractive product to consumers. In addition, local firms who have a large amount of domestic demand are better able to identify customer needs in their own country than foreign firms, which can give them an advantage in product development and innovations. The national advantage occurs when the company then decides to export their superior product into a foreign market. If a market exists in a country that sets new trends, it benefits local firms as they are better able to predict future trends in the market. An example of this would be fashion companies in Milan or Paris being better able to predict future fashion trends as those two cities are the centres of the fashion world.

3.3 Factor Conditions

The final component of Porter's diamond is factor conditions which refer to the condition of production factors within a country such as natural resources, labour, location, infrastructure, research facilities, and entrepreneurship. Factor conditions can be broken up into two groups: basic factors and advanced factors. Basic factors include things such as natural resources, country location, climate, or demographics whereas advanced factors refer to factors such as communication infrastructure, skilled labour, and research facilities. These factor conditions provide companies with basic advantages that can be used to gain a competitive advantage in the short run; however, to maintain a long term competitive advantage companies need to develop and be supported by their advanced factors. Depending on the different mix of factor conditions that a country has, certain industries will benefit or be negatively affected by them. For example, a country that has low labour costs such as China may benefit a firm producing products that are labour intensive; however, a company producing a product that needs to have a high amount of intellectual property protection may not benefit. Although a country may have a large amount of one factor condition, it is the extent to which the country or company has developed and used that factor which dictates whether or not they will gain a competitive advantage from it. In addition, some factor conditions such as skilled labour or technology base can be created by a country and are not dependent on traditional factor endowments. Certain factor conditions that a country has can also be changed or further developed to benefit the companies operating within the country more. Countries that have a limited amount of a factor condition or a constraint on the use of that factor conditions tend to innovate and develop new processes that can help companies gain a national comparative advantage.

3.4 The Government's Role and Change

The government of a country can have many effects on a company operating in almost every industry. If the government highly regulates an industry it can force companies to increase the standards or quality of their products to meet regulations which can have a huge effect on the company's ability to compete internationally. A country with more regulations on a product tends to produce a better product that is more desirable to customers domestically and internationally. The government can also have a huge effect on the amount of competition there is in a market by regulating who is allowed to enter the market and how firms are allowed to compete. For example, a government could limit the amount of collaboration a domestic company could have with a foreign firm that may have more advanced technology which would have a direct impact on the growth of the industry. Governments can also have positive effects on industries by offering subsidies, tax breaks, or infrastructure to help develop new technologies. The government also has an impact on other factors of production such as the level of a skilled workforce which it controls by supporting (or not supporting) programs or schools that increase the skill level of its citizens. (Value Based Management, 2009)

Chance is also an important variable to consider when using Porter's diamond. Although it is difficult to account for, chance can affect any business in any industry and should be mentioned. For example, if a German distribution company has two main warehouses in Berlin to serve all of their European customers and one of those warehouses was to burn down in an accidental fire, the company's ability to continue operations would be greatly affected. No matter how rare, incidents like this need to be considered when conducting a thorough analysis of a company.

4. ANALYSIS USING PORTER'S FRAMEWORK

4.1 Firm Strategy, Structure and Rivalry of Austrian Airlines

Austrian Airlines' core strategy can be broken down into success factors that the company has outlined in their annual report: Attractive domestic market with a strong catchment area, attractive Vienna hub, leadership in Central and Eastern Europe, cost leadership based on Austrian arrows operated by Tyrolean, and high-yield focus product and service leadership. (Austrian Airlines, 2009: 12) The strong catchment area refers to Austrian Airlines' central business location which funnels customers from the surrounding areas into Austria as their starting point for flights. They have been very successful at this over the past years and it continues to be a very central part of the company's strategy. The firm leverages the desirable location of their Vienna hub to attract customers to fly with their airlines. According to Austrian Airlines, the airport has an average transfer time of 25 minutes which is a desirable trait to virtually all customers that have to transfer flights. The company is able to generate cost advantages by using Tyrolean to operate Austrian arrows which allows the company to offer flexible flights to new destinations at relatively low costs. One of the success factors which has contributed a great deal to Austrian Airlines overall strategy is their focus on providing a high-yield product and service leadership. This can be broken down further into two more parts: the reputation of Austrian Airlines for providing a high quality, reliable and safe service which retains customers, and the high level of service it provides customers which can be seen in the higher than industry average business class seats the airline sells. Austrian Airlines' current strategy is to expand and retain their position as a market leader in the Central and Eastern Europe airline industry while continuing to provide excellent service for their existing customers in Western Europe. Included in the airlines' "Focus East" orientated strategy are medium haul flights to destinations in the Middle East. (Austrian Airlines, 2009:10) The company will still be implementing their strategy regardless of the purchase of the company by Lufthansa, and plan to deliver the same high quality service they are known for. The market for airline passengers in Eastern

Europe continues to grow as more countries enter the European Union. As an increasing amount of countries recognize the benefits that can be had in the growing eastern market, more foreign businesses will want to take advantage of the opportunities to be had and enter the market; more domestic businesses will be created to meet rising customer demand for goods and services, and firms will be searching for a central location to locate their headquarters to conduct operations in both Eastern and Western Europe. Many businesses entering or operating in Eastern Europe have already decided to locate their business in Austria because of its central location, excellent transportation system, and close ties with Austrian banks that provide a large amount of financing to Eastern European businesses. (Business Location Austria, 2007) The company is in a very advantageous position to leverage its current position as a market leader in the industry to further take advantage of the recent trends; however, they must continue to innovate and improve other parts of their business to have a national comparative advantage. The same need for innovation and improvement applies to the other success factors that Austrian Airlines has if they want to build an overall strategy that will facilitate a sustainable national comparative advantage.

The Austrian culture has many positive elements that have become embedded in the way Austrian Airlines' conducts business. The structure of Austrian and German corporations are hierarchal with a large emphasis put on qualifications and rank. In the business culture, Austrians are punctual people that operate their businesses in a formal work environment placing high importance on professionalism. As for any country with a large service sector, Austrian businesses are extremely service orientated, and focus a great deal of time and effort on customer satisfaction. Austrian people and firms are very risk adverse needing time to think about decisions they are about to make, and want to see facts to support their decisions. The Austrian business culture coincides well with the airline industry that Austrian Airlines operates in. Because Austrian Airlines is a large company, the hierarchal structure helps the division of labour (facilitates specialized groups that can focus on certain areas of the business), comparative advantage (allows the top people to use their expertise on important issues and not on issues that a less qualified person could complete), fair compensation (rewards people for their level of decision making and qualifications), and accountability which is also an important part of Austrians business culture. (The Other Librarian, 2007) Other more directly related elements that are beneficial for an airline are punctuality (planes arriving on time), professionalism and customer satisfaction focus (important when operating in a service industry), and risk adverse (important in an industry where safety is extremely important). For example, Austrian Airlines keeps a relatively low average age of their fleet to reduce risk and increase the level of safety they can provide customers. Overall, Austrian Airlines corporate structure increases their ability to compete globally.

Austrian Airlines no longer has a large domestic rivalry with another Austrian firm which in the long run can be a disadvantage for the company as they will not be as motivated to innovative and improve their operations from a domestic company. After the merger of Austrian Airways and Air Austria, the domestic market and Austrian customers would have been affected the most because the company was heavily forced to focus on meeting local customer needs which they would have in a heated rivalry; however, it is somewhat difficult to measure the exact effect that having no competition from another Austrian company had on Austrian Airlines because the company merged or purchased any existing domestic competitors. This being said, Austrian Airlines did not rely on a monopoly over the market to sustain its business because there was many other foreign competitors in the market competing for business at the time.

4.2 Demand Conditions of Austrian Airlines

The worldwide demand for air travel has been declining over the past few years for a few reasons: the rising price of fuel, the terrorist attacks of September 11, 2001 on the US, and the economic downturn of the global economy. The economic downturn left people unsure about their current employment and financial situation in the future which led to a massive decrease in the 2008 demand for flights worldwide. The company reported that the largest decrease in demand for flights was on the long haul flights which declined by 12.4% in 2008. The decrease in flight demand was also further exasperated by the negative connotation and perceived risk of air travel from the September 11th attack on the US by terrorists. Austrian Airlines was affected heavily by the decreased demand which, in addition to rising fuel costs, had a large impact on their net loss for the year. The result of these two affects on the company was that they forced management to privatize the business and search for a strong partner to help turn the financial situation of the company around. The decrease in global demand in combination with the rising fuel pricing also had a devastating effect on the company's share price in 2008; which is especially negative for a company in an industry that has large initial capital expenditures. (Environmental Economics, 2008) Management's response to these two problems was well below adequate as they had to privatize the company in order to continue its operations. Their inexperience in dealing with a decrease in demand may have to do with the lack of domestic competition the company had in the past which explains why the company was not able to formulate a new strategy to deal with the changing environment.

4.3 Related and Supporting Industries of Austrian Airlines

Austrian Airlines is able to derive a lot of value from their related and supporting industries to increase their global competitiveness. Although the main suppliers of the aircraft are located in Seattle, USA and Toulouse, France, the company uses many other local suppliers in Austria that add value to the company's value chain. Austrian Airlines' main hub in Vienna has attracted many supporting and supplying businesses to locate their operations at or near the airport such as restaurants, hotels, tourist and travel businesses, retail stores, buses, waste management services, and on flight meal suppliers. Other businesses such as train companies and fuel providers, have invested large amounts of money in infrastructure to allow their service to be provided to the airlines or customers that wish to travel to and from the airport. This cluster of related and supporting firms has strengthened the company's ability to compete globally and will increase its ability to have a national comparative advantage. There is a moderate level of competition in Austria in supporting and supplier industries, for example jet fuel suppliers, which increases the ability of the company to compete globally. Due to the increase in the number of businesses from Eastern European that are locating their headquarters in Austria, competition amongst suppliers and competitors would be expected to increase along with the volume of passengers flying out of the capital's international airport. Any increase in the competition of the company's supplier and supporting industries will have positive affects for the airline, as those companies competing are forced to further innovate and improve their operations. Ideally, an industry leading supplier would emerge from the competitive market that would further increase their ability to sustain a national comparative advantage.

4.4 Factor Conditions of Austrian Airlines

Austrian Airlines has been able to compete globally because of the basic factors that the company has been able to utilize. The company has been able to use the country's skilled labour force to hire competent employees which has allowed the airline to develop a reputation for excellent customer service. The main basic factor that Austrian Airlines benefits from is the location of the country and their

main airport hub in Vienna. The company is able to draw in customers from surrounding areas to use Vienna as a starting point for their flights, and the country itself draws in tourists from all over the world to visit the beautiful landscape. Their location also allows the airline to act as the primary means of transportation for business people entering Eastern Europe, or expanding to the west from the east which will be a huge factor contributing to the sustainability of a national comparative advantage. The well developed transportation system and infrastructure that Austria has also benefits the company in many ways, such as the ease of accessibility for customers to reach most of the airports in the country. Suppliers and supporting industries can also transport goods to the company with relative ease using one of many different transportation systems the country offers. In order to sustain a comparative advantage, Austrian Airlines needs to further develop their basic factors and support them with advanced factors.

4.5 The Government's Influence and Chance

The Austrian government has a large impact because the regulations they put in place directly affect Austrian Airlines. There are regulatory enforcement agencies in most European Union countries that address and investigate any non-regulatory behaviour by airlines. Because Austrian Airlines operates within Europe and internationally, the company has to meet both the international safety standards and the European Aviation Safety Policy, among other regulations, to ensure their operations are conducted in the safest way possible for passengers. (European Commission Transport, 2009) If these regulations are not met in any of the European Union countries, the company is subsequently banned from operating in all of the other European Union countries. In the case of Austrian Airlines, the company has a unique situation as it was a state owned company until recently, and that it had no other Austrian airline competitors. The protected domestic environment that the airline operated in for most of its existence may not have been beneficial for the development of the airline. The lack of competition and government ownership could have led to the inefficiencies in the airlines operations which have ended up costing the company millions of dollars a year. If the company was not government run, the state may have encouraged more competition in the industry in order to spur a rivalry; therefore, helping the company to innovate and improve their operations. Although most of the regulations affecting the airline industry deal with safety issues, the European Union has developed other regulations that address waste management, overbooking, cancellations, and delays which force the airlines to improve their operations.

Chance, especially in the airline industry, can make or break a company. The most recent example was the crash of Air France's plane flying out of Brazil. The immediate effect of this seemingly rare occurrence was a large amount of negative press that deterred customers from flying with the company, at least for the short term, because of safety issues. Another rare occurrence that affected all airlines was the September 11, 2001 attacks on the Twin Towers. This event has created more work for airline industry, in general, because there are stricter requirements, more thorough bag checks, and more limitations on items that can be brought on board the plane. If such an event was to happen to Austrian Airlines, it would greatly affect all four components of Porter's diamond and have a huge impact on the operations of the business and their ability to maintain a national comparative advantage.

CONCLUSION

Despite having many positive aspects related to the Austrian culture, the supporting and related industries, the structure and strategy of the firm, and factor conditions, the company has not been able to successfully deal with the changing industry environment. For the company to be successful in the future, they are going to need to re-evaluate some of their core business operations and adopt strategies that take into account changing industry environment. It is unlikely that the company will ever

Austrian Airlines Customer Satisfaction Survey 2009 Data Summary

This survey was completed by 15 people who have flown with Austrian Airlines that are currently living in Austria and the summarized data is displayed below:

1. When is the last time you flew with Austria Airlines?

Within 1 year (3)

Within 2 years (5)

Within 5 years (7)

2. How would you rate your experience with:

- the check in process? Excellent (2) Good (10) Fair (2) Poor (1) Terrible (0)

- the friendliness of staff? Excellent (2) Good (8) Fair (3) Poor (2) Terrible (0)

- the ability of staff to help you with any problems?
Excellent (1) Good (12) Fair (2) Poor (0) Terrible (0)

- the ease of boarding the plane? Excellent (0) Good (11) Fair (2) Poor (2) Terrible (0)

- your departure time? Excellent (0) Good (9) Fair (1) Poor (5) Terrible (0)

- the airlines on-route service (welcome and assistance)?
Excellent (3) Good (10) Fair (2) Poor (0) Terrible (0)

- your arrival time? Excellent (1) Good (9) Fair (3) Poor (2) Terrible (0)

- baggage retrieval times? Excellent (2) Good (10) Fair (2) Poor (0) Terrible (1)

3. How was the:

- cleanliness of the aircraft? Excellent (3) Good (9) Fair (2) Poor (0) Terrible (0)

- in-flight entertainment (when applicable)?
Excellent (1) Good (13) Fair (1) Poor (1) Terrible (0)

- in-flight meals (when applicable)? Excellent (0) Good (9) Fair (3) Poor (3) Terrible (0)

4. Would you recommend Austrian Airlines to a colleague or friend? Yes (13) No (2)

5. How would you rate your overall experience with Austrian Airlines?

Excellent (1) Good (11) Fair (3) Poor (0) Terrible (0)

6. Would you fly with Austrian Airlines again? Yes (14) No (1)

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Potato Chips in the Netherlands: An Analysis of Firm Strategy and Consumer Purchasing Behavior

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ABSTRACT

Potato chips sales are a multi-million dollar industry in the Netherlands. The purpose of this report is to analyze firm specific strategies and consumer purchasing behaviors in relation to this industry. A fundamental question is assessed throughout the report, while consistently considering the four principles of marketing (Price, Place, Product, and Promotion): How can small start-up producers strengthen their market position against global conglomerates in the Dutch potato chips market? Hoeksche Chips, a local Dutch start-up chips producer, is used as a comparison and a tool for discussion. Primary data collection, from 207 survey respondents, is analyzed and SPSS outputs considered. Results indicate that consumer's purchasing decisions are influenced by their perceived level of product quality. Consumers find taste, flavour selection, and price as the three most important buying factors. They are unwilling to pay a premium for locally produced chips, and do not consider a chips' healthiness as an important purchasing factor. This study concludes with a recommendation that by adapting the four principles of marketing, new start-ups can strengthen their existing strategies and be better positioned to navigate the challenges of business in the Netherlands.

ACKNOWLEDGMENTS

The completion of this report would not be possible without the close cooperation, and expertise of Maastricht University School of Business and Economics undergraduate students: Anna Orywal, Amir Reza Rezvani, Jeffrey Vulink, Jenny Dreiling, and Patrick Timmers. Their support and statistical capabilities, primarily with SPSS, were paramount to the success of my analysis. I would like to personally thank them for their contributions and continued support throughout the entire duration of this analysis.

INTRODUCTION

Potato chips are a snack food favourite of all generations. The first potato chip recipe was created by, American born, George Crum in August, 1853. His idea was to create a new side dish, using thinly sliced potato wedges, for his family's restaurant in New York. Crum used a multi stir-frying method to crisp up the potato slices, and served them to customers as an alternative to French fries. His new potato concoctions were a tremendous success, receiving raving reviews and increased demand.

After almost 160 years, potato chips have grown to become a global sensation. They come in many different sizes, shapes and flavours; from rippled original to regular barbeque. It is estimated that potato chip sales are in excess of \$16.4 billion US dollars worldwide and contribute to 35.5% of the total savoury snack market (Datamonitor, 2009). On an international scale, potato consumption is ranked second behind rice, and potato chips popularity is rapidly on the increase (Harmon, n. d.). Even though potato chips consumption is a multi-billion dollar market, not much investigation has been conducted

into the market’s newcomers; especially, here in the Netherlands. As I stroll through my local supermarket, I find it interesting to see a combination of multi-national brands, such as Frito-Lays, situated next to less known brands such as Hoeksche. How do these brands compete? Is it on price? Quality? Or ... something else? What is the business strategy for small start-up producers, and how can they strengthen their market position against global conglomerates?

To begin to analyze the Dutch potato chip market more intensely, I enlisted the help of Anna Orywal, and her group of fellow undergraduate business students at the University of Maastricht, Maastricht, the Netherlands. They were conducting a market research project on behalf of, coincidentally enough, Hoeksche Chips. As a recent entrant into the Dutch potato chip market, Hoeksche provides a good representation of small start-up manufactures and furthermore, a good foundation for the basis of this report. Orywal’s Maastricht based team agreed to share their expertise in market analysis, and cooperate in data collection on consumer behaviour. The methodology of our analysis will be explored and the results of our findings will be outlined. I have decided to take a marketing approach to this investigation. As such, I will primarily focus on the four “P’s” of marketing: Price, Product, Place and Promotion. The results gathered from our cooperation, through survey distribution, will be analyzed and applied to these marketing principles. It is the main goal of this report to outline particular factors that may be relevant and rewarding for new market entrants. The report will begin with a brief introduction regarding the Dutch potato chip market, as well as Hoeksche Chips; it will be followed by an explanation and analysis of the market environment; and will conclude with opportunities and recommendations for future business growth, using Hoeksche Chips as an example.

The Dutch Market for Potato Chips

In the Netherlands, potato chips are a commodity of growing interest. Over the past several years, potato chip manufactures have seen increased market stability and consecutive annual sales growth. Such conditions have been a catalyst for both development and expansion. New entrants have emerged, bringing local flavour to the Dutch market place; product lines have been developed, bringing more variety to consumers; and new products have been developed, bringing greater choice to customers. Although potato chips popularity is on the rise, other markets, such as for popcorn, savoury snacks, and snack-nut products, remain very competitive.

According to a 2003 study conducted by the business information company Datamonitor, the Dutch potato chip market is dominated by two major players: Walker Smith (37.9%), and Westmix (33.0%). Coincidentally, both consumer goods manufactures are owned by Pepsi Co., and control a combined market share of 70.9%. Product brands from these firms include Lay’s, Doritos, and Tostitos. The remaining market is divided between Private Label (20.4%) and Small Players [Other Category] (8.7%). See Figure 1 below (Adapted from Datamonitor, 2003: 7):

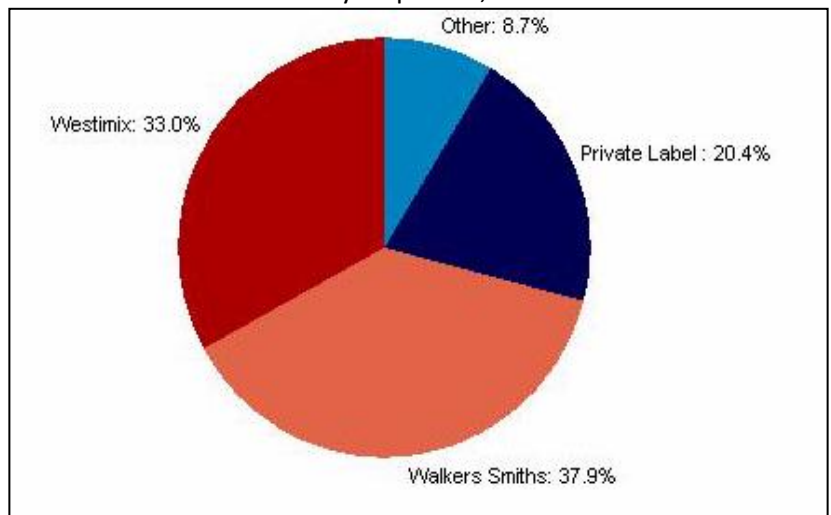


Figure 1 - Dutch Potato Chip Market Share, % by Value

Unlike other European countries, such as neighbours Germany and Belgium, potato chip consumption (per capita) in the Netherlands is far greater. Datamonitor (2003: 5) suggests this is a direct result of a more established snacking culture. Even though more chips are consumed, the overall value of the Dutch potato chips market is slightly lower than one may expect. Current estimates place the market at a value of \$146 million, with annual growth rates exceeding 1.2%. New market entrants are sure to increase overall value; especially with the introduction of healthier chips choices. Higher per capita consumption may translate into greater demand for low fat, low salt alternatives. As for distribution, potato chips products are sold through a variety of mediums: standard grocers, traditional grocers, convenience stores, kiosks, and gas stations. Some specialty chip manufactures sell their product specifically to small, whole-food outlets, or small, local businesses, while other more established players focus sales efforts on major shopping centers.

Hoeksche, A Potato Chips Company

Hoeksche Chips, created in 2002, is a Dutch company that specializes in premium potato chips. It was founded by three small-scale farmers in a region called Hoeksche Waard (near Rotterdam). The idea behind Hoeksche stems from the farmer's individual struggles with rising costs. They realized that by joining forces and combining operations, each farmer could reduce their farming costs dramatically. As a result, cooperation has become a key element of the company's success; allowing the farmers to share expertise, and take advantage of economies of scope and scale. The farmers each operate their own farm independently, but contribute collectively on the supply of potatoes to their company. A nearby processing facility, completely owned by the firm, transforms the raw potatoes into chips for sale throughout the Netherlands.

Currently, the company sells their chips in over one thousand retail shops in the Netherlands. Retail activities are primarily targeted to small traditional grocers and small whole-food stores, with larger retail activity in standard grocers near major cities. The firm strives to make a difference in the market place by reducing their carbon foot print, and upholding their commitment to corporate responsibility. Each step in production, from harvesting to processing, is done with the strictest of standards for both customers and the environment. Hoeksche cultivates their potatoes without using any environmentally unfriendly substances. This prevents their final product from causing allergies, and further contributes to the company's commitment on sustainability. In addition, the only additives added to each chips batch is sea salt or black pepper. During the final stages of production, even more commitment to detail is demonstrated. First, slicing and processing of each potato is completed with the peel on. Secondly, all chips are baked in one hundred percent sunflower oil. These features add to a solid product that could, if marketed correctly, stand out in front of the competition (Dreiling, Orywal, Rezvani, Timmers, and Vulink, 2009).

The company markets their product as "Premium Potato Chips," distinguishing its unique processing methods, and its distinctive characteristics; more taste and crunchiness, combined with low saturated fat, and minimum use of salt. Their mission remains the same, even after seven years: "to run three independent farms profitably, while maintaining an integrated company, and adding value to potatoes" (Hoeksche, 2009).

1. METHODOLOGY

Developing an appropriate research plan, for investigation and analysis, is of essential importance. It is a lengthy task which requires careful development and precise application of different statistical tools. The exact development of this particular research plan will not be discussed in depth in this paper; although, a brief outline will be presented. Every study begins with basic rules or assumptions,

describing what one expects to find or be able to prove. In this case, several assumptions were made not only concerning the relationship between demographic factors such as age, gender and income level, but also concerning an individual's attention to health awareness when purchasing potato chips. In order to provide a short overview of which questions and assumptions this study dealt with specifically, the Maastricht student research group has kindly agreed to share their statistical research questions. A list of the relevant questions used to arrive at the questionnaire and consequently, at this investigation's results, can be seen as follows (Adapted from Dreiling et al., 2009):

Research Question 1: Is the proportion of consumers who purchase potato chips at the location where they do their main grocery-shopping equal to the proportion of consumers who purchase potato chips at another location?

Research Question 2: Is there a relationship between income and the location where consumers purchase potato chips?

Research Question 3: Are consumers likely to purchase premium potato chips?

Research Question 4: Is there a relationship between consumer's monthly net income and the decision to purchase premium potato chips?

Research Question 5: Does age influence the frequency of purchasing premium potato chips?

Research Question 6: Does nationality influence consumer's decision to purchase premium potato chips?

Research Question 7: Does the packaging design of Hoeksche chips influence consumer's decision to purchase premium potato chips?

Research Question 8: Do respondents have a preference regarding the shape of potato chips?

Research Question 9: Is there a relationship between the flavour of potato chips and consumer's purchasing decision of premium potato chips?

Research Question 10: Are chips qualities equally important to consumers when purchasing potato chips?

Research Question 11: Is there a relationship between gender and consumer's decision to purchase healthy potato chips?

Research Question 12: Does the Dutch origin of potato chips influence consumer's reservation price?

Taking these twelve questions as the foundation for investigation is just one piece of the puzzle. The next step involves a decision on the sample size, as well as the data collection method. As no previous research has been conducted for potato chips in the Maastricht – Aachen region, the decision was made to conduct new primary data collection. A survey was chosen as the best means of obtaining this data. The survey's questionnaire was developed and tested using a cross-sectional design scheme. This scheme involves the systematic collection of quantitative information (Solomon, Marshall, and Stuart, 2008: 582). The questionnaire was designed to be distributed not only in the Netherlands, but also in neighbouring villages of Germany and Belgium. As a result, the original English version was translated

into both German and Dutch simultaneously. It consists of eighteen questions and was designed in such a way that, unambiguous, unbiased and statistically significant conclusions could be drawn (See APPENDIX A for an example of the survey). Although I will not elaborate specifically on the creation and development of this questionnaire, I will mention it involved a lengthy process; a process of matching, collaboration and statistical testing. Questions needed to be connected with the research assumptions, as well as appropriate statistical tests. To ensure statistical significance, it was determined that a minimum target sample size of 150 respondents would be required. Of the 150 respondents, 30 or more would need to be from each of the three previously defined nationalities independently: German (30), Belgian (30), and Dutch (30).

Our questionnaire participation turned out to exceed initial estimates. After a period of two weeks the final count of respondents was around 233 participants, but after close inspection only 207 were eligible: 118 Germans, 51 Dutch and 38 respondents of other nationalities, which included Belgians. The respondent's gender was divided between 61% male and 39% female. Once obtained, the questionnaire data was manually entered into SPSS for greater analysis. This converted the respondent's individual answers into quantitative output. It is not within the scope of this paper to explain the statistical tests performed in SPSS, but for reference, the outputs of the conducted tests can be found in APPENDIX B.

2. MARKET RESEARCH AND THE FOUR "P"S

Since this report takes a specific interest in marketing, special attention was given to ensure the questionnaire would cover the principles: place, product, price and promotion. As outlined below, certain questions relate directly to precise market principles. Each of the four principles will be identified, the particular questions pertaining to the principles will be highlighted and the results of the survey will be explained. It is important to note that the original survey was conducted with the emphasis on premium potato chip purchases, and more specifically, purchases of Hoeksche chips. When referencing particular Research Questions, the discussion of premium potato chips will be addressed. Given that premium potato chips are of higher cost, it has been determined that premium potato chips are considered chips of higher price, and therefore, higher consumer cost. Hoeksche is representative of start-up producers in the Dutch potato chip market.

3. ANALYSIS AND RESULTS

3.1 Place

Relevant survey questions included: question two, question three, and question eighteen.

By analyzing various statistical tests and comparing the results to Research Question One (page 9), it was concluded that the proportion of consumers who purchase potato chips at the location where they do their main grocery shopping is higher than the proportion of consumers who purchase their potato chips at other locations (See Figure 2 below). Specifically, 151 out of the 207 respondents answered that they buy potato chips at the location where they do their main grocery shopping. Therefore, locations such as gas stations or movie theatres seem rather inappropriate as attractive sales locations.

Figure 2 - Respondents' Potato Chips Buying Behaviour

(Adapted from Dreiling et al., 2009)

We also thought it would be interesting to analyze the relationship between income and the location where chips are purchased. In reference to Research Question 2 (page 9), our investigation yielded an interesting result. According to our findings, respondents with an average monthly net income of below 3001 Euros (as indicated by the questionnaire) tend to buy their potato chips at big grocery stores, while individuals with incomes exceeding 3001 Euros/month prefer to buy potato chips at other locations. A graphical representation, divided by representation groups, of average monthly incomes may be seen below (Figure 3). Given the indication that monthly income effects purchasing location, the next natural question is to ask where are the most popular purchasing locations? As survey question 3 indicates, the most popular potato chip buying locations include discounters, large grocery chains, and other, smaller operations. Figure 4 illustrates this relationship. Discounters and large grocery chains are popular places for main grocery purchases. These findings coincide with the results from Research Question 1. Discounters, such as Aldi and Lidl, provide customers with high quality products at a reasonable price. Large grocery chains, such as Albert Heijn on the other hand, offer high quality, great customer service, and spot sales. Prices may not be as low as discounters, but the selection of products is far greater. All of our findings indicate that these purchasing locations are of great interest to the consumer. Given that 73% of the people polled indicated that they purchase potato chips while grocery shopping, potato chips manufacturers would be well positioned to sell their product in these establishments.

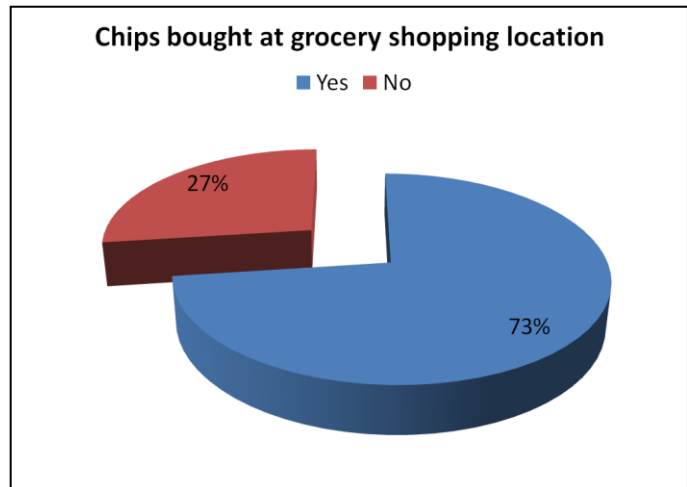
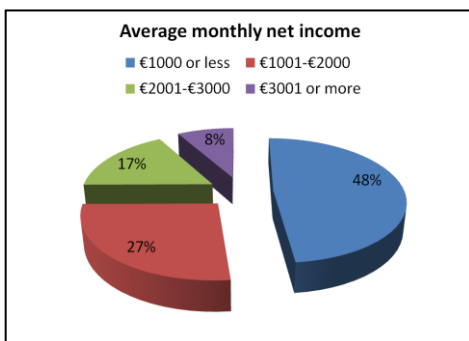
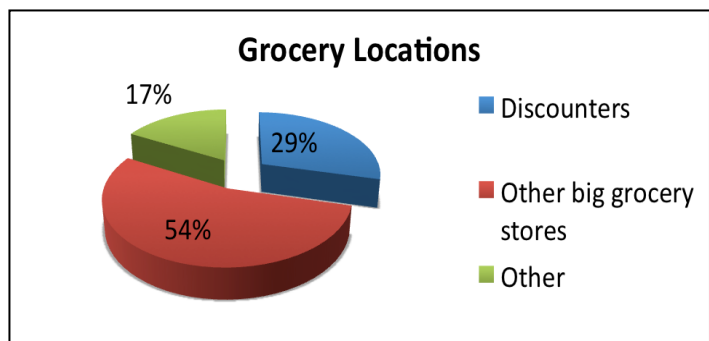


Figure 3: Division of Monthly Net Income



(Adapted from Dreiling et al., 2009)

Figure 4: Division of Popular Chips Purchasing Locations



(Adapted from Dreiling et al., 2009)

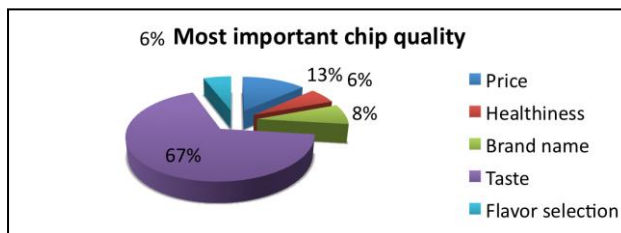
3.2 Product

Relevant survey questions included: question seven, question eight, question ten, question eleven, and question twelve.

Various potato chip competitors inhabit the Dutch market. Being able to distinguish your product from the competition is important. The first step is to understand your market place and understand your customer’s needs. What characteristics make consumers attracted to your product? According to the results from survey question eighteen, respondents are more concerned with “taste” (67%) than “price” and “flavour” selection combined (19%). Other characteristics included “brand name” and “healthiness.” Figure 5 shows the division between the various potato chip qualities. Research Question eight (page 10), addressing a respondent’s preferred chips shape, found that the shape of chips was perceived unimportant to consumers when making a purchasing decision. As a contrast, flavour selection, as addressed in Research Question nine and ten respectively (page 10), greatly influenced the purchasing decision of a consumer. It appeared that with respect to favourite flavour, “salted” (24%) and “paprika” (28%) were predominant (Total 52%), while unpopular flavours were “sour cream” (15%) and “chilli” (15%) (See Figure 6).

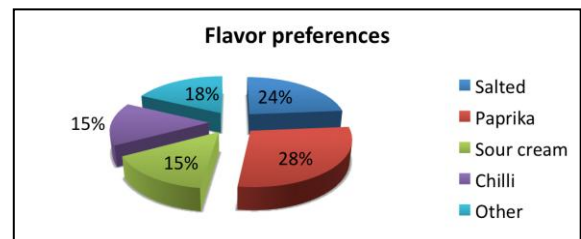
The overall analysis of this particular marketing principle produced a variety of interesting results. According to question eleven of the questionnaire, most respondents considered chips qualities (taste, healthiness, price, etc.) important when purchasing chips. Given that chip consumption is far greater (per capita) in the Netherlands, than any other direct European neighbour (Datamonitor, 2003: 5), it was the author’s assumption that healthiness would be the number one concern of most consumers; especially, given the push for healthier choices in recent years. This conclusion was challenged by the results of survey question twelve, which indicated that “taste,” “price,” and “brand name,” influenced a consumers purchasing decision far greater than the perceived “healthiness” of the given product. These findings were also supported by survey question ten, which indicated directly that healthiness was not a major concern when purchasing potato chips. Interestingly, this highlights the importance of product selection, and product scope; particularly, for new entrants into the Dutch potato chip market.

Figure 5:
Division of Popular Chips Qualities



(Adapted from Dreiling et al., 2009)

Figure 6:
Division of Popular Chips Flavours



(Adapted from Dreiling et al., 2009)

3.3 Price

Relevant survey questions included: question twelve, question thirteen, question fourteen, question seventeen, and question eighteen.

As described previously, “price” was chosen as the second most important selection criteria when purchasing chips; second behind “taste”. Consumers indicated that they would be willing to pay a premium for local potato chips, if they perceived these products were of higher quality, but would not pay a premium just for having a local brand. According to survey question thirteen, potato chips priced at 1 Euro or less, were not attractive to consumers; primarily once again, because of the perceived relationship between cost and quality. On the other hand, highly priced potato chips (priced 1.51 Euros or more) were expected to be undesirable due to their high cost. The findings of this report contradicted these initial assumptions. Consumers were actually inclined to spend more on potato chips if they

believed the product would provide better taste and flavour selection. This is supported by the results of survey question thirteen: chips priced 1 Euro or less – selected by 13.5% of respondents, chips priced 1.01 – 1.50 Euros – selected by 32.9% of respondents, and chips priced 1.51 Euros or above – selected by 53.6% of respondents.

Another area of investigation was demographics and the relationship to a chips price. Our findings, in reference to Research Questions 4 and 5 (page 10), indicate a direct relationship between monthly income and the willingness to spend more money on potato chips. The same can also be concluded about a customer's age and their buying habits. For starters, consumers with a high monthly income (2,001 Euros or greater) were more likely to purchase higher priced potato chips than individuals with incomes less than 1,000 Euros/month. A similar relationship can also be created between a consumer's age and purchase behaviour. Supported by survey question seventeen, as a customer's age group increases, they are more likely to purchase higher priced chips. These results were equivalent to our initial assumptions. Individuals in higher age categories tend to have greater monthly incomes, and therefore, greater flexibility to purchase higher priced potato chips. University students, in comparison, usually represent the 16-25 year old age category and do not have the financial freedom to purchase chips at a greater price. They are bound by external forces to purchase potato chips that fit within their limited budgets. These results highlight the importance for firms to clearly identify their target market. If firms would like to sell potato chip products in a city primarily populated by students, such as the case in the Dutch city Maastricht, they must be in sync with the budgetary constraints of their demographic; ensuring ultimate success.

3.4 Promotion

Relevant survey questions included: question five, question six, question sixteen, question seventeen, and question eighteen.

Since potato chips represent, for most people, a commodity product, it is important to promote a particular product's uniqueness. Is it simply effective to change packaging, or is it more advantageous to develop an extensive external marketing campaign? These ideas were analyzed and results shown. Research Question seven (page 10) addressed the appeal of the packaging design in a consumer's decision to purchase a particular brand of potato chips. Although our initial results, supported by survey question six, indicated that customers were not influenced by a particular firm's chips bag design, they were however, influenced by the perceived quality the bag design conveyed. Interestingly enough, respondents who answered survey question six, indicated that they liked Hoeksche's bag design, but would not purchase the product based on its "healthiness" appeal. This is an important distinction for players in the Dutch potato chip market. Consumers do not associate healthiness directly with potato chip quality.

As for demographic elements, such as age, gender, nationality, and income, surprisingly, each element had minimal impact on the overall design interest of a producer's packaging. Yes, there was a slightly greater interest in "premium potato chip" brand design by Dutch citizens, but other characteristics such as gender differentiation had little or no effect on purchase behaviour. From our previous discussions, it can be concluded that perceived quality (including taste and flavour selection), and price are key factors to consider in a promotional strategy. Age as well as monthly income, are also important elements to consider. Consumers with greater disposable incomes have more flexibility in potato chip purchases, and react less dramatically to changes in market price, as compared with students for example. It is important for producers to decide on a particular target market (target age group) and adjust their promotional plan appropriately.

4. LIMITATIONS

Naturally, this market investigation and subsequent research report encountered a variety of challenges. Financial capabilities, restricted timelines, inadequate resources and narrow expertise limited the potential and effectiveness of this market analysis. With greater resources, time, and financial assistance the outcome of this study would have been much more rewarding. It is also important to mention challenges faced during the primary data collection and analysis. To obtain a better understanding of the Dutch potato chip market, a greater amount of questionnaire participants should have been acquired. Once again, resource challenges limited the ability of this investigation to survey large amounts of people. The statistical interpretations on a sample size of 207 respondents, does not give a completely accurate picture of the entire potato chip market in the Netherlands, but it does however, indicate possible consumer behaviour in the regions we targeted. It would have also been more beneficial to survey an equal number of both male and female consumers. This report mostly focused on the findings of male respondent's (61%). A greater representation of female respondents would have strengthened the study's dataset. In addition, the Belgian sample size was relatively small when compared to the two other sample nationalities: German and Dutch. Since the overall sample size cannot be regarded as truly representative of Belgian interests in the Netherlands, the research can only yield pointers and hints for further research on Belgian chips buying behaviour in the Netherlands.

CONCLUSIONS AND RECOMMENDATIONS

Price, Place, Product and Promotion are all essential aspects to be considered when entering a new market. Entrants are commonly faced with a variety of challenges and barriers from product inexperience, to existing competitor loyalty. Being able to adapt, move quickly and target consumer's effectively, creates a desired competitive advantage. The four major principles of marketing can help businesses do just that: determine a pricing strategy, locate a responsive retail location, develop a desired product line, and create an effective promotional plan. Each principle is equally important, and each principle must not be ignored.

Throughout this investigation I have focused primarily on new start-up producers. I have considered Hoeksche Chips to be a good representation of the typical new market entrant, and have used their profile, plan and strategies as a comparative tool for other small scale players. Hoeksche entered the Dutch potato chips market in 2002. Since then, they have expanded from a regional potato chip supplier, to a national potato chips supplier. They have faced a considerable number of challenges, including, most recently, decreased inventory turnover (Dreiling et al., 2009). Competition in the Dutch potato chips market, predominantly controlled by the multi-national conglomerate Pepsi Co., is on the increase. Pepsi's market dominance creates many issues for smaller scale players. Domestic firms, such as Hoeksche, find it difficult to compete on price. Hoeksche's current strategy is to compete on quality instead of price. The company has decided to adopt a "premium product" strategy; targeting their product as a healthier alternative to the competition. Unfortunately, their current strategy is not feasible in the long term. This analysis of customer opinion and consumer behaviour has concluded a "healthier choice" approach is not advisable in the long term. According to studies by my Maastricht colleagues (Dreiling et al., 2009), Hoeksche Chips is facing a reduced inventory turnover that increases year by year. This may be an indication of weaknesses in their corporate strategy.

Re-structuring the firm's business strategies may improve company health and increase incremental revenues. By focusing efforts on improving the producer's four marketing principles: Price, Place, Product and Promotion, Hoeksche Chips may be able to reposition itself into a better strategic position. Taking advantage of customer's demand for greater taste and more diverse flavours can assist Hoeksche in attracting greater market share. The company could sustain its current "healthy choice" image, but

emphasize their chips quality as a primary selling point. According to this report's findings, price is also an important element in the consumer's purchasing decision. Products at a higher price point, in our case exceeding 2.00 Euros/bag, limit the available consumer base. Depending on an individual's monthly income, certain price points are unattainable. This same relationship is true for consumer age groups. It was discovered that older individuals are more inclined to purchase premium or more expensive potato chips than younger age groups. A relationship between age and monthly income can be identified. Younger age groups are usually equated with lower monthly income, while older age groups have greater financial freedom. This distinction and connection must be considered when targeting a particular product. Currently, Hoeksche prices their chips at a high market value near the 2.60 Euros/200g bag price point. Their intention is to attract increased student consumer's; especially, in student cities such as Eindhoven and Maastricht. With a price point exceeding 1.80 Euros/bag, Hoeksche will encounter challenges with this goal. Other demographic elements this analysis considered included gender and nationality. The conclusion however, indicated that gender and nationality played a very minimal role in consumer purchasing behaviour. It could be noted that Dutch consumer's favoured "premium" brands because of their perceived attention to quality, but were unwilling to pay an addition amount for locally produced potato chips. Overall consumer preference among the various nationalities still enforced taste and flavour variety as their number one purchasing considerations. This emphasises the importance for potato chip producers to diversify their flavour range and improve their chips taste.

In addition, product placement is an important decision to consider. Where a product is located, ultimately determines its corresponding revenue. According to the findings on location, most respondents indicated they purchased potato chips while buying groceries. Target centers for grocery shopping were identified as discount retailers, and large grocery store chains. To improve sales at Hoeksche, the company may consider approaching these two grocery mediums simultaneously. Discounters, such as Aldi and Lidl, offer large turn over opportunities. The revenue per bag unit is considerably lower, due to reduced prices on all merchandise, but given the high turnover rates, revenue could be increased by volume. The advantages of large grocery store chains such as Jumbo and Albert Heijn, is their nation-wide reach. Hoeksche could use this advantage to enter new regions, and improve their products reach.

All of these improvements will not be successful without a targeted and effective promotional campaign. Consumer interest towards chips packaging highlighted the importance to promote key chip qualities, not corporate strategies. Respondents indicated that they were only responsive to packaging if it increased the perceived product quality, and emphasized their interest in a chips taste and flavour options. If a company such as Hoeksche wants to promote its corporate strategy of healthier eating, an extensive advertising campaign will need to be undertaken. Given the limited financial resources of many start-up entrants, including Hoeksche, intensive nation-wide advertizing campaigns are unrealistic. Small scale producers who want to capture marketshare can easily focus on little adjustments and by encompassing the four "P's" of marketing, ensure they meet the needs of their consumers within the Dutch potato chip market.

Adaptation combined with small changes in strategy, can assist entrants in the competitive environment presented by the Dutch Potato Chips Market. As changes in consumer demand and perception occur, producers need to be prepared for action. Companies need to remain dynamic and ahead of new product trends. Although it may be difficult for small market players, it is important for all companies to consider. Using the principles of marketing as a tool for success, new start-ups can strengthen their existing strategies and be better positioned to navigate the challenges of business in the Netherlands.

APPENDIX A

Survey Questionnaire Example

“Dit onderzoek wordt uitgevoerd voor niet-commerciële doeleinden en kadert in een onderwijsopdracht.”

1. Do you buy chips?

- Yes No

If you answered 'yes', please continue with question 2.

If you answered 'no', you don't have to answer any further questions. Thank you for your participation!

2. Do you buy potato chips at the location where you do your main grocery shopping?

- Yes No

3. I usually buy potato chips at the following: *(please only tick one)*

- Discounters (Lidl, Aldi, etc.)
- Other big grocery stores (Albert Heijn, Jumbo, Edeka, Rewe, etc.)
- Wholefood shops
- Mom-and-Pop grocery stores
- Other *(please specify)*:

	Very unlikely	Unlikely	Neutral	Likely	Very likely
4. How likely is it that you buy premium potato chips?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

5. How often do you buy premium potato chips?

- Never
- Once a month or less
- Twice a month
- Three times a month
- Four times a month
- Five times a month or more

12. Which of the following five chips qualities is to be most important to you when purchasing potato chips?
(Please make only one cross 'X')

- Brand name
- Price
- Flavor varieties
- Taste
- Healthiness



13. How much are you willing to spend for a bag of potato chips (200gr.)?

- € 1 or less € 2.01 and above
- € 1.01 - € 1.50 The price doesn't matter to me
- € 1.51 - € 2.00

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
14. I would spend more money on potato chips if they were produced in the Netherlands.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

15. What is your gender?

- Male Female

16. What is your nationality?

- German Belgian
- Dutch Other

17. What age range do you fall into?

- 15 years old or less 36 - 45
- 16 - 25 46 - 55
- 26 - 35 56 years or older

18. What is your average monthly net income?

- € 1,000 or less € 3,001 to € 4,000
- € 1,001 to € 2,000 € 4,001 and more
- € 2,001 to € 3,000 prefer not to answer

Thank you for your participation! 😊

APPENDIX B

SPSS Survey Results

Research Question 1

Table B1

Frequencies

Chips bought where grocery

	Observed N	Expected N	Residual
Yes	151	103,5	47,5
No	56	103,5	-47,5
Total	207		

Table B2

Test Statistics

	Chips bought where grocery
Chi-Square	43,599 ^a
df	1
Asymp. Sig.	,000

Research Question 2

Table B3

Case Processing Summary

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent
Location of chips purchase * Average monthly net income	207	99,0%	2	1,0%	209	100,0%

Table B4

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	51,212 ^a	6	,000
Likelihood Ratio	42,939	6	,000
Linear-by-Linear Association	27,393	1	,000
N of Valid Cases	207		

Table B5

Location of chips purchase * Average monthly net income Crosstabulation

			Average monthly net income				Total
			€1000 or less	€1001 - €2000	€2001 - €3000	€3001 and more	
Location of chips purchase	Discounters	Count	33	22	4	1	60
		% within	33,0%	40,0%	11,4%	5,9%	29,0%
		Average monthly net income					
Other big grocery stores		Count	60	26	22	4	112
		% within	60,0%	47,3%	62,9%	23,5%	54,1%
		Average monthly net income					
Others		Count	7	7	9	12	35
		% within	7,0%	12,7%	25,7%	70,6%	16,9%
		Average monthly net income					
Total		Count	100	55	35	17	207
		% within	100,0%	100,0%	100,0%	100,0%	100,0%
		Average monthly net income					

Research Question 3

Table B6

One-Sample Statistics

	N	Mean	Std. Deviation	Std. Error Mean
Likelihood of premium chips purchase	207	2,96	1,439	,100

Table B7

One-Sample Test

	Test Value = 3					
	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
Likelihood of premium chips purchase	-.435	206	,664	-.043	-.24	,15

Research Question 4

Table B8

Descriptives

Likelihood of premium chips purchase

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
€1000 or less	100	2,57	1,423	,142	2,29	2,85	1	5
€1001 - €2000	55	3,05	1,420	,191	2,67	3,44	1	5
€2001 or more	52	3,60	1,257	,174	3,25	3,95	1	5
Total	207	2,96	1,439	,100	2,76	3,15	1	5

Table B9

ANOVA

Likelihood of premium chips purchase

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	36,743	2	18,372	9,613	,000
Within Groups	389,866	204	1,911		
Total	426,609	206			

Research Question 5

Table B10

Descriptives

Frequency of premium chips purchase

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
25 years or younger	92	2,02	1,109	,116	1,79	2,25	1	5
26 - 35 years	53	2,06	1,082	,149	1,76	2,35	1	5
36 - 45 years	34	2,35	1,390	,238	1,87	2,84	1	6
46 years or older	28	2,75	1,323	,250	2,24	3,26	1	6
Total	207	2,18	1,201	,083	2,02	2,35	1	6

Table B11

ANOVA

Frequency of premium chips purchase

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	13,223	3	4,408	3,153	,026
Within Groups	283,801	203	1,398		
Total	297,024	206			

Research Question 6

Table B12

Descriptives

Likelihood of premium chips purchase

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
German	118	2,86	1,473	,136	2,60	3,13	1	5
Dutch	51	3,20	1,414	,198	2,80	3,59	1	5
Other	38	2,92	1,363	,221	2,47	3,37	1	5
Total	207	2,96	1,439	,100	2,76	3,15	1	5

Table B13

ANOVA

Likelihood of premium chips purchase

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	3,976	2	1,988	,960	,385
Within Groups	422,633	204	2,072		
Total	426,609	206			

Research Question 7

Table B14

Descriptives

Likelihood of premium chips purchase

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
					Yes	94		
Neutral	51	3,00	1,428	,200	2,60	3,40	1	5
No	62	3,23	1,407	,179	2,87	3,58	1	5
Total	207	2,96	1,439	,100	2,76	3,15	1	5

Table B15

ANOVA

Likelihood of premium chips purchase

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	8,398	2	4,199	2,048	,132
Within Groups	418,211	204	2,050		
Total	426,609	206			

Table B16

Descriptives

Likelihood of premium chips purchase

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
					Yes	73		
Neutral	50	2,54	1,446	,204	2,13	2,95	1	5
No	84	3,00	1,406	,153	2,69	3,31	1	5
Total	207	2,96	1,439	,100	2,76	3,15	1	5

Table B17

ANOVA

Likelihood of premium chips purchase

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	12,874	2	6,437	3,174	,044
Within Groups	413,735	204	2,028		
Total	426,609	206			

Table B18

Descriptives

Likelihood of premium chips purchase

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
					Yes	88		
Neutral	58	2,81	1,317	,173	2,46	3,16	1	5
No	61	3,00	1,402	,180	2,64	3,36	1	5
Total	207	2,96	1,439	,100	2,76	3,15	1	5

Table B19

ANOVA

Likelihood of premium chips purchase

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	1,740	2	,870	,418	,659
Within Groups	424,868	204	2,083		
Total	426,609	206			

Research Question 8

Table B20

Observed Numbers of different shape preferences:

	Observed N
Wavy/Rippled	57
Flat	55
No preference	95
Total	207

Table B21

Chi-square test:

Frequencies

Favorite shape			
	Observed N	Expected N	Residual
Preference	112	103,5	8,5
No preference	95	103,5	-8,5
Total	207		

Test Statistics

	Favorite shape
Chi-Square	1,396 ^a
df	1
Asymp. Sig.	,237

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell

Research Question 9

Table B22

Descriptives

Purchase premium chips if favored flavor offered

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Salted	49	2,69	,918	,131	2,43	2,96	1	5
Paprika	59	3,29	1,084	,141	3,01	3,57	1	5
Chilli	31	3,48	,962	,173	3,13	3,84	1	5
Sour	31	3,23	1,055	,190	2,84	3,61	1	5
Cream								
Other	37	3,46	1,070	,176	3,10	3,82	1	5
Total	207	3,20	1,054	,073	3,05	3,34	1	5

Table B23

ANOVA

Purchase premium chips if favored flavor offered

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	18,019	4	4,505	4,315	,002
Within Groups	210,860	202	1,044		
Total	228,879	206			

Research Question 10

Table B24

Chi-Square Test

Frequencies

Most important chip qualities			
	Observed N	Expected N	Residual
Price	23	34,2	-11,2
Healthiness	10	34,2	-24,2
Brand name	13	34,2	-21,2
Flavor selection	10	34,2	-24,2
Taste	115	34,2	80,8
Total	171		

Table B25

Test Statistics

	Most important chip qualities
Chi-Square	241,953 ^a
df	4
Asymp. Sig.	,000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 34,2.

Research Question 11

Table B26

T-Test

Group Statistics

	Gender	N	Mean	Std. Deviation	Std. Error Mean
Health concern when buying chips	Male	127	2,75	1,154	,102
	Female	80	2,75	1,278	,143

Table B27

Independent Samples Test

		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.						95% Confidence Interval of the Difference	
				t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	Lower	Upper
Health concern when buying chips	Equal variances assumed	2,390	,124	-,011	205	,991	-,002	,172	-,341	,337
	Equal variances not assumed			-,011	155,369	,991	-,002	,176	-,349	,345

Research Question 12

Table B28

Crosstabs

Case Processing Summary

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent
Willingness to spend for chips * Spend more money for products from NL	207	99,0%	2	1,0%	209	100,0%

Table B29

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	,659 ^a	4	,956
Likelihood Ratio	,663	4	,956
Linear-by-Linear Association	,322	1	,570
N of Valid Cases	207		

a. 1 cells (11,1%) have expected count less than 5. The minimum expected count is 2,16.

Table B30

Willingness to spend for chips * Spend more money for products from NL Crosstabulation

		Spend more money for products from NL			Total	
		Disagree	Neutral	Agree		
Willingness to spend for chips	€1 or less	Count	18	8	2	28
		% within Spend more money for products from NL	13,8%	13,1%	12,5%	13,5%
	€1.01 - €1.50	Count	45	18	5	68
	% within Spend more money for products from NL	34,6%	29,5%	31,3%	32,9%	
€1.51 or above	Count	67	35	9	111	
	% within Spend more money for products from NL	51,5%	57,4%	56,3%	53,6%	
Total	Count	130	61	16	207	
	% within Spend more money for products from NL	100,0%	100,0%	100,0%	100,0%	

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Entrepreneurship in Japan: Causes, Effects and Outcomes

Andy MacInnis
Spring 2010

ABSTRACT

This paper is directed to any potential Japanese entrepreneurs. It uses the Global Entrepreneurship Monitor's three components of entrepreneurship to measure the state of entrepreneurship in Japan. The three components are: Entrepreneurial attitude, entrepreneurial activity and entrepreneurial aspiration. The paper examines the traditional business characteristics of the Japanese economy, as well as cultural and demographical issues which may affect entrepreneurship components. I also examine the effects of post-industrialism on Japan, and what that signifies for the economy and potential entrepreneurs. Finally the government and educational facilities' roles in entrepreneurship are explored. I also discuss examples of recent Japanese entrepreneurial endeavours which have had some mixed success. Sources of research include an interview with Dr. Michael Lacktorin, of the Center for Entrepreneurship and Leadership Studies, a visit to a local Japanese business incubator, a student survey conducted at Akita International University and many sources of secondary research.

I have concluded that although the Japanese are very hesitant to conduct entrepreneurial activity, the current economic climate in Japan is a changing one, and one which will likely welcome entrepreneurial innovation and new business practices. A reduction in manufacturing is leading to an upswing in service businesses – businesses Japan appears reluctant to embrace. Major obstacles in starting new businesses in Japan included protectionist government policies, a negative attitude towards entrepreneurs, as well as a difficult market in which to sell new products.

INTRODUCTION

Japan is well known as one of the world's largest and most advanced economies. For years Japan has been a global leader in many industries, including electronics and automobiles – two of the world's most prominent products. Toyota is now among the world's most dominant vehicle companies, Canon a leader in camera products, Sony with electronics, and these are just a few examples. Why then, this century, does Japan have one of the lowest rates of entrepreneurial activity among the world's leading nations (International Entrepreneurship, 2009)? Is the lack of activity a sign that there is room for new companies to grow, or does it signal a particularly challenging small business environment? Recent developments in global logistics and technology have forced more economically advanced countries – such as Japan – to seek a post-industrial business model. As this globalization trend takes place manufacturing and support facilities move offshore, domestic economies become more service based and demand more innovation. Entrepreneurship is meant to foster innovation, and this leads me to believe that Japan's current economic climate would encourage hosting a budding small business community, yet this isn't the case.

There may be many factors which contribute to the hesitant Japanese entrepreneur. This paper will explore the economic and cultural business environment in Japan, and try to extract reasons behind the

lack of business starts; as well as what steps are being taken to change the trends, if any. The research will focus on the three main components of entrepreneurship as identified by Acs, Autio, Bosma, Coduras and Levie in the 2008 Global Entrepreneurship Monitor. These three components are summarized as: entrepreneurial attitudes, entrepreneurial activity and entrepreneurial aspirations. I performed additional research on Japan's economic state in order to get a more complete picture of the factors affecting these three components. Methods of research included a student survey, interviews, as well as extensive secondary fact-finding.

Entrepreneurial attitude is the national as well as individual attitude towards new business ventures, and whether they are perceived as a viable method of earning a living. It also entails the willingness a population has to take risks, and how much confidence they have in their skills.

Entrepreneurial activity is the current trends of entrepreneurship in the country, for example the opening versus the closing of businesses. I will also examine reasons for the current activity.

Entrepreneurial aspiration is the driver and methods behind entrepreneurial activity. For example aspirations to engage foreign markets, or develop new processes.

Benefactors

This paper will be useful to any potential entrepreneurs contemplating a Japanese business, whether as an extension of their own international business, or as a purely Japanese start-up. Japan has some diverse characteristics which set it apart from other countries – both in the cultural and economic sense, and it is therefore important to familiarize oneself with these differences in order to succeed.

1. JAPANESE BUSINESS CLIMATE

1.1 Bigger was Better

Business in Japan has taken a number of different forms in recent history. After the Meiji restoration of 1868, which saw the end of a system of feudal lords – Shoguns – in power, the main government functions were centralized and posted in Tokyo. Learning the value of powerful conglomerates from overseas visits to America and Europe, the Japanese system soon gave birth to some of the world's most powerful business groups, or the Zaibatsu. During the First World War, with decreased competition for shipping routes and an increased demand for supplies, the Zaibatsu continually gained strength and size. Shortly before World War II the Zaibatsu peaked, and thanks to an increasingly nationalistic climate in Japan, supplied most of the equipment needed in Japan's war efforts. By the end of their reign, during the post-war allied occupation, the four largest Zaibatsu controlled half of Japan's financial industry and a third of the heavy industry, the rest was split primarily among a dozen or so smaller Zaibatsu groups (Russel & Miyashita, 1995).

Following Japan's defeat in World War II, the allied General Headquarters made it their prerogative to dismantle the holding companies which supposedly held the Zaibatsu together. Although in theory the Zaibatsu were then disbanded, the subsequent development of the Keiretsu business groups has carried on Japan's conglomerate based business structure. Although small and medium businesses account for 70 per cent of jobs in Japan, their profits are meagre compared to the large Keiretsu groups, and therefore they have a hard time competitively paying and attracting good employees (Economist, 2009). Figure 1 shows the profit distribution among large and medium firms compared to small ones in Japan.

Figure 1: Concentration of Profits Among Firms

Source: *The Economist*, August 13th, 2009

The tendency of Japanese business to form monopolistic companies isn't strictly a corporate one. The Japanese government and its corresponding ministries, especially the Ministry of International Trade and Industry (now the Ministry of Economy Trade and Industry – METI), were the reason that the Anti-Monopoly Act, and the Fair Trade Commission which was formed to enforce it, were dissolved and rendered powerless soon after the end of the occupation (Russel & Miyashita, 1995). The constant 'administrative guidance' hitherto offered by the government in an effort to consolidate industries and make businesses competitive on an international level has left the Japanese corporate landscape, for the most part, in the hands of few large business groups. Although the Zaibatsu of days gone by are officially broken into pieces, old and new bonds, such as vertical supplier relations and horizontal financing arrangements, still combine to create very consolidated industries. In the case of Keiretsu, these business groups are most often designed around a main bank or a central trading company (Russel & Miyashita, 1995). Figure 2 shows a typical Keiretsu structure.



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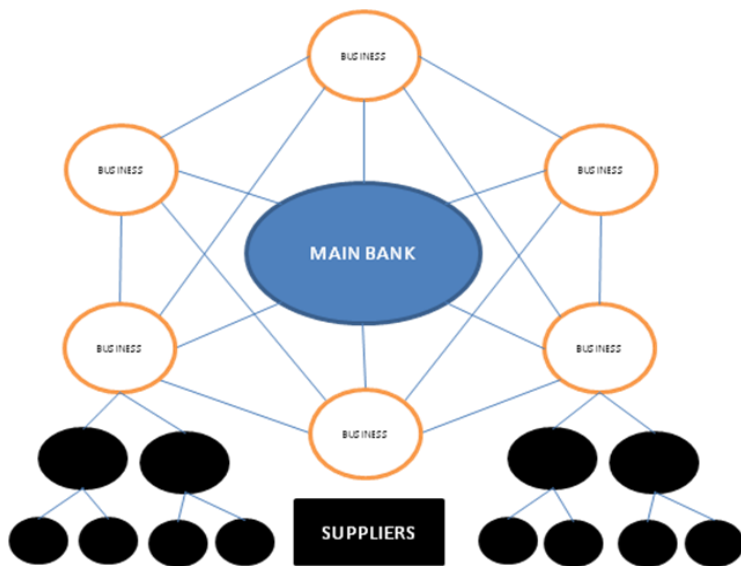


Figure 2: Typical Keiretsu Structure

The Keiretsu groups often use 'Just In Time' supply practices, which pit two similar suppliers against each other. Those suppliers are then expected to absorb any increase in production costs (Scher, 1997). Most Japanese firms compete very aggressively and use mass production to gain cost efficiencies and achieve market dominance (Ford & Honeycutt, Jr. 1992). As these Keiretsu suppliers grow and their production costs are reduced, the benefits of a tight supplier relationship become more pronounced.

Also, Japanese companies have a far longer life expectancy than their western counterparts. Almost a hundred listed Japanese companies were founded prior to the 20th century, some private ones as long ago as the 6th century; in contrast the average life-span of non-Japanese multinational corporations is only between 40 and 50 years (Abegglen, 2006). This, in turn, creates buyer-supplier relationships which

can span over decades or generations – especially considering the importance Japanese business executives place on the ritual of meeting and uncovering the ‘real person’ before conducting any business.

Accomplishing any objective in Japan requires building solid relationships (Campbell, 1993). That means that to preserve harmony the Japanese will often not deal with strangers, since they will not know what to expect (Alston & Takei, 2005). What does this mean for entrepreneurs? The Japanese business environment creates a rather unattractive market for entry of a new firm, with markets tightened severely by existing impenetrable business relationships between much larger firms.

1.2 Impacts of Corporations and Cultures

Corporate Tendencies: There are three pillars of Japanese business culture which have come to be accepted since the post war development. Many Japanese businesses, as well as their employees, believe that lifetime employment, seniority promotion, and the right to be represented by an enterprise union are the cornerstones of Japanese employment practices (Abegglen & Stalk, 1985). Although as of late there has been an effort to recommend promotions and pay raises based at least partially on performance, and the significance of the employee unions has diminished, the average tenure for Japanese *regular* employees has – contrary to popular thought – increased. My emphasis on regular employees reflects the reality that there has been an increase in part-time and contract workers due to recent economic downturns - as Japanese businesses are forced to find more flexibility in labour costs (Abegglen, 2006). Also, the lifetime employment system applies mostly to men, as women are often expected to end their original employment period at marriage or at the birth of their first child. Although Japanese style management with lifetime employment has helped Japan attain and continue a high level of success with large businesses, offering this type of employment security may be uneconomical for smaller firms with fewer resources, and in turn may render their employment options less attractive to potential employees. Without being able to attract good employees, in search of high risk, high reward careers, Japanese small business is without the type of talented human capital required to compete, and therefore is bound to suffer.

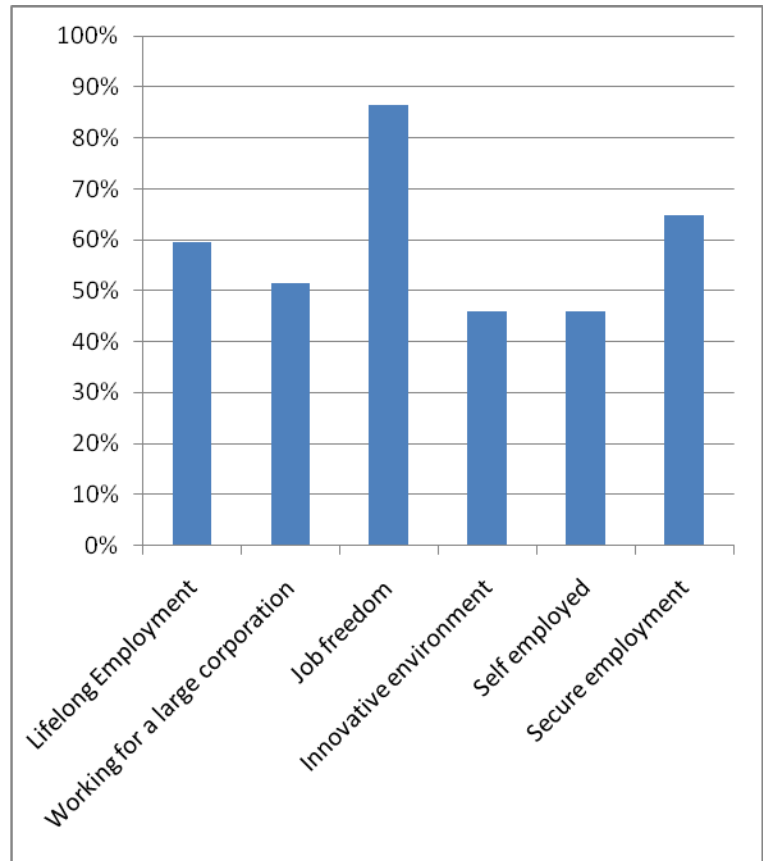
Cultural tendencies: The security offered by the aforementioned ‘regular employment’ in Japan is unparalleled. Securing such a job which guarantees pay increases with tenure makes company employment a very attractive option – especially for naturally risk-adverse Japanese. Hofstede, in his research on cultural relativity (1984), classified the Japanese as having one of the world’s highest levels of uncertainty avoidance. Further, as notes Abegglen and Stalk (1985), until relatively recently Japan was a poor country, with limited resources, a relentlessly threatening geographic environment, and long periods of war coupled with a feeling of complete defeat. Therefore, it isn’t surprising that many Japanese seek secure employment.

This sentiment was echoed by Dr. Lacktorin, of the Center for Entrepreneurship and Leadership Studies. In an interview November 18th, 2009 Dr. Lacktorin admitted that in Japan, there is no mercy for failures. Anyone who has been at the helm of a failing business is deemed a personal failure as well a professional one, and will rarely ever again work for a good company, let alone secure loans for another endeavour. He went on to mention that Japanese, from a young age are entrenched with goals of making their parents proud by securing jobs with big firms like Mitsubishi, the Bank of Japan, or in government ministries such as METI. Mr. Sugawara, owner of a small and successful software company in Akita, Japan, in a personal communication November 9th, 2009 mentioned that most ambitious university graduates want to work for large companies, and not small start-up businesses. I conducted a survey amongst students at Akita International University (AIU) which supported these characteristics.

The survey results showed that although 78.4 per cent of students regarded entrepreneurs as an important part of the Japanese economy, only 13.4 per cent would ever consider trying to start their own business. In the same survey, the need for security, as demonstrated by working for a ‘large respected company,’ and having ‘secure,’ or ‘lifetime’ employment ranked as important employment factors. Interestingly, students also considered having freedom at their job most important, yet not coupled with working in an innovative environment. This may reflect the freedom and dynamic employment opportunities offered by many large Japanese corporations. Figure 3 shows the spread of job factors and their importance to students at AIU, based on the students answering either ‘important’ or ‘very important’ on the survey. Complete results of the survey are found in appendix A.

Figure 3: Important Employment Characteristic Preferences for AIU Students

Source: Student Survey



Another conclusion reached by Hofstede’s research (1984) was that the Japanese are one of the world’s least individualistic (collective) populations. That being said, research by Tiessen (1997) supports that those who generate new start ups are generally individualistic types; although it also states that once the business is established, a collective culture can do much to support entrepreneurial endeavours. Fortunately, the respect for those who start new businesses in Japan is growing; in 2007, 48 per cent of people respected a new business owner, up from 8 per cent in 1999 (Study Group for the Creation and Development of Start-ups, 2008). Hopefully this new-found respect will help encourage would-be entrepreneurs to launch some new endeavours and seek support from their close-knit, collective community.

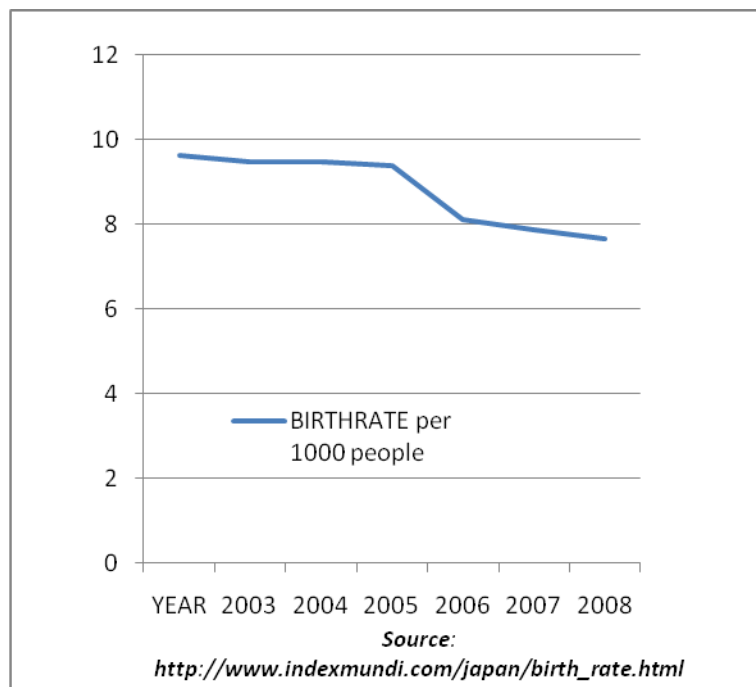
According to the Organization for Economic Co-operation and Development (OECD) Japan has a respectable self employed population at 13.4 per cent (2007), however this number doesn’t necessarily represent innovative entrepreneurs, as it includes farm hands and family employees. A more accurate assessment of entrepreneurial inclination can be found in the Global Entrepreneurship Monitor (GEM), which puts new Japanese entrepreneurs at only 2.4 per cent of workers. This number includes any manager or founder of companies that have been in business for less than 42 months (Acs et al., 2009). In contrast America and South Korea are 5.0 and 6.5 per cent respectively. The same report gives another grim indication: only 9 per cent of Japanese believe they have the required knowledge to start a business. This is by far the lowest of countries examined in the the GEM report; America and South Korea recorded 48 and 23 per cent in this category. Such a lack of confidence is surely crippling to Japanese entrepreneurial hopes. Another hurdle for Japanese entrepreneurs is the tendency of Japanese

consumers not to try new products. Japan ranked lowest among innovation driven economies¹ on the Innovation Confidence Index for 2007 and 2008 (Acs et al., 2009). The index measures how receptive consumers are to new or innovative products – and whether they believe these products will improve their lives. The Study Group for the Creation and Development of Start-ups in Japan, 2008 concurs, stating that Japanese consumers – corporate and retail – prefer products with proven performance. The student survey conducted as a part of my research also showed that 73.9 per cent of students would rather purchase products from an established brand than one they didn't know as much about.

1.3 Ageing Workforce

Japan is shrinking. Not in a geographic sense, but the population is decreasing at the substantial rate of 0.2 per cent per year (Central Intelligence Agency, 2009). This long run of declining birthrates means that Japan's workforce is ageing. Figure 4 shows the decline of birthrates over the last 5 years

Figure 4: Japanese Birth Rates



With senior employees being paid more as they age, an ageing population leads to one which is receiving more money, which in turn leads to a decline in the income ratio between new, relatively low-paid entrepreneurs and their senior, salaried counterparts (Yasuda, 2002). Consequentially, this leads to entrepreneurs rarely being revered as the ones reaping more success. Further, as tenure generally dictates salary, any failed business venture would waste time that could otherwise be invested in gaining a higher salary as a company man, again reducing an individual's motivation to branch out into an entrepreneurial endeavor.

Even more recently, according to the Economist (2009), a large portion of the Japanese work force has, or soon will reach the age of retirement. Since pension earnings are lower than senior salaries, this will

¹ An *innovation driven economy* is one that has developed passed the earlier stages of *factor driven* and *efficiency driven*, essentially meaning a wealthy, developed economy which no longer relies on manufacturing as its main industry (as measured by the Global Entrepreneurship Monitor).

have the opposite effect of lowering average wages, and therefore lowering the strength of the domestic market. New businesses should be aware of these trends as an ageing population presents opportunities in elderly care services, and a potential market perhaps less accepting of new concepts. Many pensioners also puts a strain on government, as well as corporate balance sheets. This strain has been apparent in many long-established airlines and car manufacturers as they accumulate more expensive pensions to pay to their retired workers. New businesses do not have to pay retired employees which may help them compete by allocating those savings to research and development. In summary an ageing domestic market will present further challenges for new products, yet may help to weaken large existing companies.

2. JAPANESE ECONOMIC CLIMATE

2.1 Post-Industrial Economies

A post-industrial economy is defined as one which has experienced the effects of deindustrialisation. Deindustrialisation is a decline in the manufacturing sectors of an economy, as a percentage of total employment. Although often gross output from manufacturing will remain constant, or even increase related employment will fall. Much research (Alderson, 1999, Kollmeyer, 2009, Sasaki, 2007) points to 3 major sources of deindustrialisation: (1) Rising consumer affluence, leading to less relative demand for manufactured products, (2) increasing foreign investment and global trade, and (3) more efficient manufacturing productivity founded on increases in automotion and technology. Kollmeyer (2009) found that the stongest correlation exists between affluence and deindustrialization; the more affluent the popluation, the greater the deindustrialization. The resulting rise in demand for service products offsets the decline in demand for manufactured products, thus shifting jobs from the manufacturing to the service industries. This is often referred to as 'positive' deindustrialization (Alderson, 1999). In order, though, for the effects to be 'positive,' the economy must maintain performance thoroughout the loss of manufacturing labour, and often this isn't the case. The end result becomes 'negative' deindustrualisation whereabouts a decline in overall demand occurs and the excess labour is not absorbed into services. The increased affluence also leads to increased technology and automation, which decreases the need for employees. Alderson (1999) and Kollmeyer (2009) also explored the compounding effects of foreign direct investment in domestic industries. As more production shifts offshore, and higher returns are made from foreign direct investment, the marginal rate of return required from domestic investment is increased, putting further pressures on domestic manufacturing facilities, as well as reducing inclination for investment into domestic manufacturing.

What this means for evolving businesses is that there are changing trends in what sort of businesses will be competitive. The shift will most likely be from classical manufacturing applications which formed the foundation of many large modern companies, into service oriented business models. This transformation is nearly complete in America, where in 2009 all of the ten largest corporate employers are service based, such as Wal Mart and Target, whereas in 1960 the top employers were mainly manufacturing companies, such as GE and US Steel. The shift in Amercia has also led to Wal Mart employing as many people as the 20 largest American manufacturers combined; and manufacturing accounting for less than ten per cent of the total labour force (Davis, 2009). This shift demands for a 'creative destruction' approach to entrepreneurship, in which new products disrupt current economic activity, and push forward the barrier of innovation and technology (Acs et al., 2009), something entrepreneurs are generally known for.

2.2 Post-Industrialism in Japan

Japan, like many modern societies is facing changing pressures thanks to the onset of post-industrialism. Although Japan's deindustrialization is not as advanced as in America, the considerable outflow of foreign direct investment signals that the effects are becoming apparent. The GEM report (Acs et al., 2009) lists Japan as an innovation driven economy in contrast to factor or efficiency driven economies, which are essentially less developed and industry based. Between 1995 and 2004 employment in Japan's manufacturing industry fell by two per cent annually (Sasaki, 2007). Whereas production and manufacturing ruled the Japanese business landscape for much of the past century, whether in automotive, electronics or steel making, increasingly, more resources are being imported, and more production is being shipped to lower wage economies such as China and India. Japan's foreign direct investment into China alone in 2004 was almost 6 trillion Yen, or US\$60 billion (Alvstam, Strom & Yoshino, 2009). Japan has lost some of its biggest industries of the past. For example the coal mining industry which produced 56 million tons in 1940 closed its last mine and let go the last 1000 employees in 2002 – demonstrating that today, what used to be a major employer, is gone (Voice of America News, 2002).

Japan however remains more industrialized than the US for a couple of reasons. Firstly, because of the war and subsequent defeat and destruction, the Japanese economy didn't reach the a real GDP per capita of US\$6,311 until 1969. This compares to other countries such as Australia, Canada and the US who reached this milestone prior to 1950 (Alderson, 1999). This amount of GDP per capita is important, because members of the Organization for Economic Co-operation and Development (OECD) who reach this economic indicator start to show sure signs of deindustrialization, specifically reduced employment in the manufacturing sector.

Japan also displays very protectionist practices in international trade policy, which in turn helps to protect domestic manufacturing industries. One method the Japanese government has used to limit imports is to impose stiff tariffs on incoming goods (Kaplan, 1972). This has the effect of allowing domestic industries to supply more of the domestic demand for those products, although at a considerable cost to consumers, and to society as well.² In fact, according to OECD statistics, Japan has the smallest relative annual growth of import goods of any OECD member country from 1997-2007, and ranks amongst the highest in GDP per capita. Even so, the value added by industry in Japan, as a percentage of total value added, has declined from 29 per cent in the 1990's to just 22 per cent in 2007 (OECD, 2009).

In summary, Japan is, and continues to be, deindustrialized. As the process continues, more focus is shifted away from manufacturing and the Japanese economy is relying more on specialized knowledge and services. Low cost labour will continue to shift offshore, especially to other parts of Asia. Government attempts to protect low technology industries at home could serve only to stifle innovation by misallocating resources. As the shift occurs, opportunities for new businesses will be found in facilitating international cooperation and foreign investing. Service industries such as financial, computing and travel services should, as a characteristic of post-industrialism, remain strong, as well as technologically innovative businesses such as telecoms or internet retailers.

There may also be opportunity in the restructuring of large, old manufacturing companies which are struggling with the new economic landscape. These businesses will be in need of consulting on how to

² Limiting imports has the effect of raising costs of goods which would be otherwise imported at a lesser price. The result is an increase in supplier surplus, and a reduction in the consumer surplus, as well as the creation of dead weight loss, which in theory is a loss to society as whole.

adapt to new global supply chains as operations are relocated and internal labour demand shifts from manufacturing to knowledge base. In fact, training and education on globalization trends was one of U.S. News' 'best small businesses to start' (Bandyk, 2008). One such opportunity might be found in retraining 'lifetime' employees in an effort to minimize labour cuts and keep with Japanese business practices – for example, a firm that used to manufacture computer parts might restructure to become a consultancy for emerging manufacturing firms in China.

Unfortunately, Japan's track record with regards to service businesses is not good; they are in fact so inefficient that they have reduced labour-productivity growth from four to two per cent. Reportedly, the only services that are succeeding are brothels, which are experiencing growth as restaurants, builders, hairdressers and similar enterprises suffer (Economist, 2009).

The recent financial concerns, thanks to a global economic crisis, also serve to discourage potential entrepreneurs from taking the financial risk of starting a new business. With credit becoming tighter and consumer spending low, opportunities initially seem scarce. Tim Draper though, of Draper Fisher Jurvetson Venture Capital in Silicon Valley makes interesting arguments for opening a small business during a downturn (2009), stating that businesses which begin to operate with frugality tend to keep those trends, and that hard times force managers into new ideas and innovative practices. This advice may well be worth heeding coming from the man behind such successful companies as Hotmail and Skype. Furthermore the dynamic, envelope-pushing component of entrepreneurship may be essential for the change in economic activity needed to push through the current economic slump, and revitalize the Japanese economy as new business takes greater risks and challenges existing business models (Acs et al., 2009, Study Group for the Creation and Development of Start-ups, 2008).

As Japan is in a post-industrial state, regardless of the overall economic scene, it must shift the focus of its policies to innovation based industries, and away from the old fading manufacturing sectors. This will involve encouraging banks to move away from the bad loans it has with old manufacturing companies, take some risks financing innovative start up businesses, and providing some capital that the Japanese service industry needs to improve its operating profits (Economist, 2004).

2.3 Government Role in Japan

The Japanese government has a long history of working closely with business interests (Kaplan, 1972). More often than not, Japanese politicians have been accused of closing Japanese business off to the rest of the world, encouraging business consolidation, and restricting incoming foreign direct investment (FDI). Previous government 'attempts' to open Japan to increased FDI were eventually deemed purely cosmetic, as the government and METI usually manage to discourage investment with punitive taxes and policies (Ibison, 2007).

The Ministry of Foreign Affairs of Japan states that the recently ejected, long ruling Liberal Democratic Party of Japan had vowed to double FDI in five years, by 2008; and as of 2006 their plan was on track. Although much FDI is executed through mergers and acquisitions of existing businesses, perhaps the proposed increased inflow of foreign capital could find its way to cash-strapped Japanese start-ups. Opening up international markets also motivates businesses to expand overseas to seek clients and technology. As it stands, Japanese venture companies, aided by new global technologies are beginning to expand internationally, however only 33.5 per cent have, and another 30.6 per cent are not even considering the prospect (Study Group for the Creation and Development of Start-ups, 2008).

The most recent announcements by the newly elected government indicate reform on unrestricted capitalism and a focus on fostering growth in the domestic markets (Economist, 2009). This is bad news

for venture companies who depend on free market capital to get off the ground. It could also be a sign that business will have to rely on a domestic market which is weakening with age and lower wages. Policies, for example, supporting a strong Yen are in no way beneficial to exporters, however may be necessary to support a growing pension-collecting population. The new government policies also have the effect of hindering the recent labour flexibility and raising the minimum wage, while at the same time trying to increase social welfare for the unemployed (Murphy, 2009, Economist, 2009). Inflexible labour and high minimum wages are not a positive climate for new, cash-poor businesses.

The Japanese government has in the past bolstered industries until they are strong enough to stand on their own, even directing economic development through a set of economic priorities (Economist, 2009). Unfortunately recent developing companies have been less fortunate than the likes of Toyota and Sony in the past (Shoenberger, 2009). Shroenberger also notes that Japan only generates ten per cent as much venture funding as America, where venture capitalists enjoy returns of three to four times the meager four per cent expected in Japan.

In the face of the latest economic crisis, the Japanese government has taken direct routes to help struggling entrepreneurs. Tokyo's Ota ward, for example, which houses over 4,800 businesses recently awarded a 10 million Yen (US\$105,000) interest-free loan to a crippled plastics manufacturer (Murphy, 2008). The government also allows small Japanese businesses to form cooperatives, exempt from the anti-trust regulations, in order to offer them more corporate visibility and security in numbers (Lee & Mulford, 1990). Local governments get involved by subsidising regional 'business incubation' buildings where new and growing businesses are able to lease office space at a fraction of the market rate. I had the opportunity to visit the local business incubator in Akita where I met Mr. Sugawara, a local entrepreneur, and was able to witness some of Akita's newest start-ups. Unfortunately, only five per cent of AIU students surveyed had any knowledge of any government programs to bolster entrepreneurship.

In an effort to keep venture companies afloat, the government approved a US\$12.7 billion fund for distressed small and medium sized firms. Unfortunately, thanks to Japanese bureaucrats, this money most likely ended up in the hands of older 'favorite' failing industries, instead of new innovative ones (Kunii, 2003). To give entrepreneurship a chance, the old bonds between government and business must be shifted towards new upcoming industries and the government will have to reinstate its roll of helping developing business.

Japanese bureaucracy used to create many barriers to new entrants even before taking the market into consideration; however this is changing. Until recently, forming a company with stock in Japan required US\$3,000 in fees and US\$85,000 in startup capital. That amount is likely hard to come by when venture capital represents only 0.04 per cent of GDP – one tenth of the US figure (Kunii, 2003). The government has since eliminated the minimum capital requirements and has tried to develop systems and institutions for ventures, such as equity exchanges. Regardless, the opening rate for businesses from 2004-2006 of 5.1 per cent was still below the closing rate of 6.2% (Study Group for the Creation and Development of Start-ups, 2008).

2.4 Education

As I mentioned previously, Japanese have little confidence in their abilities to open a business. These skills can be obtained in a number of educational settings, whether through formal educational means, or through less conventional self-paced internet courses. In Japan, according to Acs et al. in the GEM, through whatever method entrepreneurial training is acquired, an individual's level of training is positively correlated to how well they perceive they could start a business - and whether they see any

opportunities in their local markets. For example, of those without training only 6.3 per cent see themselves as having what it takes to launch a business, against 34.5 amongst those with some kind of voluntary training. The Japanese however remain resistant to opportunity, even with training, as only 13 per cent perceive good opportunity in their local area – this may be a reflection of Japanese consumer habits of sticking to well known products.

Education is especially important in Japan where the population is currently quite sceptical of entrepreneurial endeavors. Since 1999 METI has been trying to develop entrepreneurial education from elementary schools all the way through to universities. Unfortunately, only half of the programs that were launched in elementary and secondary schools continue today, largely because of budget and time constraints. At the university level improvements are being made. In 2000 only 1.6 per cent of adults in Japan received any sort of entrepreneurial training in university, whereas a 2003 survey showed that 40 per cent of universities offered entrepreneurship courses, and two thirds of graduate schools did so (Study Group for the Creation and Development of Start-ups, 2008).

Entrepreneurs require a special type of education, as they must develop a wide array of skills to help ensure their success. One method of providing excellent hand on education is for universities to support business ventures through incubation centers. These university-originated ventures have blossomed in Japan, growing three fold to 1,590 from 2001 to 2007 (Study Group for the Creation and Development of Start-ups, 2008). As mentioned earlier, these companies still face the same challenges of a tough Japanese market, cultural penalties for failure, and a lack of willing talent.

2.5 Recent Japanese Entrepreneurial Endeavors

The outlook in Japan is not all bleak. In the past few years there have been a number of success stories – and some not so successful. Masayoshi Son, the founder of Softbank, a Japanese software, web and telecommunications giant, is often referred to as the Bill Gates of Japan. He made his first million by the time he was twenty, and has since gone on to be the founder of Yahoo in Japan and reap a net worth of over US\$7 billion, making him one of Japan's richest men (Crunchbase, 2008).

Hiroshi Mikitani, the founder of Rakuten, a Japanese online super store, now has online businesses including a travel agency, a stock brokerage, an e-bank, a credit company and a baseball team in addition to the core retail service. The company, founded in 1997 with six employees, now employs 4,500 people (Corkill, 2009).

Takafumi Horie is an interesting story. At 33 years old, the CEO of Japanese Livedoor internet company was untouchable. He had purchased 27 companies, and amassed an impressive US\$800 million revenue gain. What sets Mr. Horie apart is the way he went about his business, with no regard for Japanese business traditions. In fact, Horie was convinced that the old and favoured businesses of manufacturing were on their way out, and that internet businesses would be the way of the future. Whether he was correct or not is now somewhat irrelevant. Since being convicted of securities fraud Mr. Horie is now serving five years in prison (Frederick, 2006).

What's interesting about this story is the delight most classical Japanese executives found in with the demise of Horie, who was seen as a threat to their traditional business model. Regardless of his dislike throughout the Japanese business community, and before breaking the law, Horie had a very successful business plan.

I believe that these examples speak well enough for the direction in which Japan's economy is shifting – towards services. In those services some Japanese entrepreneurs have found tremendous success,

similar to their counterparts around the world. Thanks to these examples helping encourage a more favourable outlook towards new business, the rate of early stage entrepreneurship in Japan has gradually increased in recent years – albeit not to the levels of many other developed, innovative economies (Acs et al., 2009). These success stories do receive full coverage from the media, however, only 43 per cent of the respondents to the student survey thought that Japan was a good place to start a business.

CONCLUSION

Given a number of factors, opening a new business in Japan is not easy, especially, it would seem, for the Japanese. Much of the Japanese population has been conditioned to appreciate large conglomerates, and stable, predictable employment over the risks involved with entrepreneurship. It is unfair however, to paint a population of 127 million people with one stroke of the brush. As I've demonstrated, within Japan are people who are ambitious enough to make headway with new business ideas. Dr. Lacktorin has argued that a country would never have come as far as Japan has without innovation and entrepreneurship – he suspects most innovative activity happens slowly within large corporations. Either way I believe that entrepreneurial attitude in Japan is improving, as government and educational institutions do more to support entrepreneurs, more will be successful and this in turn will further improve Japan's attitude.

Entrepreneurial activity is growing as more Japanese are becoming comfortable with working outside the traditional boundaries their parents respected. If large corporations will not adapt to satisfy the gaps that exist within Japanese service markets, new companies will have to play the role. Global pressures will continue prompting Japan to open its borders to more investment, and with that will come opportunities to expand international ventures into Japan.

This internationalism will also help Japanese would-be entrepreneurs to see the potential of entering foreign markets, therefore increasing their entrepreneurial aspiration. Already the aspiration demonstrated by Mikitani and Son is on par with that of any great entrepreneur. Government and educational incentives will again play an important role in fostering more activity in new business, and will hopefully be matched by dynamic venture funds trying to build on already successful entrepreneurial empires.

One important barrier is still government policy. Throughout my education in Japan, I've been taught that although the rest of the world does not appreciate Japan's closed market structure, it has been pivotal in the country's fantastic industrial success. Regardless, I believe that given the innovative stage of the economy it is important to invite international investment and trade in order to strengthen key developing service industries. This development can happen through direct investment, or through cooperation with foreign business. Economics work in phases and that there is no way to go backwards and become the same manufacturing superpower that ruled decades past. It is a painful transition, as traditional jobs and industries are lost, but a necessary transition nonetheless – and Japan is no stranger to adversity.

As to whether Japan is a good place to start a business, I conclude that yes, depending on the nature and the motivation of the business venture, any potential entrepreneur could have as much success in Japan as any other economically developed country. I believe, given the research, that Japan's problem with entrepreneurship is due less to economic potential than to inhibiting cultures, discouraging structures and lack of willing participants. The ability of small business to adapt to changing market demands, while old businesses are encumbered by pension pay-outs and bureaucracy should improve the outlook for new companies in Japan's rapidly changing business landscape.

RECOMMENDATIONS

To any prospective entrepreneurs in Japan, I would make the following recommendations. First, concentrate on future enterprises, regardless of the attention the country and media give to large manufacturing industries of the past. The natural path for Japan to take is that of a leader in services, therefore, concentrate on service-providing industries such as financial, technological or consultancy services. Second, focus on international cooperation. Position your business to be attractive domestically, as well as internationally. Use new technology to communicate with and solicit to overseas markets and talent. Third, be active in lobbying government, for change in foreign policy, especially towards inbound foreign investment, as well as for more entrepreneurial growth strategy at home – such as more venture-friendly lending policies. Meet with fellow entrepreneurs and form cooperatives to make your voice louder. Finally, ensure high visibility and high quality for your product. The Japanese market is sceptical and needs proof that your product is one which will at least meet its needs. With innovation, motivation, drive, and hopefully some acceptance, Japan has 127 million potential customers, and the world almost 7 billion more.

APPENDIX A

STUDENT SURVEY RESULTS

74 Students Interviewed

1. ··What year will you graduate? VARIED 2009 - 2012
2. ··Are you planning on having a career in Japan? YES 75.7% / NO 24.3%
3. Are you planning on attending a graduate program? YES 37.8% / NO 62.2%
4. Have you made you secured employment yet? YES 5.4% / NO 94.6%
5. What are some of the most important aspects of employment to you?
1 – Unimportant, and 5 – Very Important

	1	2	3	4	5
Lifelong employment	0	5.4%	35.1%	40.5%	18.9%
Working for a large, respected company	2.7%	8.1%	37.8%	43.2%	8.1%
Having freedom with respects to your work environment	0	0	13.5%	29.7%	56.8%
Working in an innovative environment	2.7%	5.4%	45.9%	32.4%	13.5%
Working for yourself	2.7%	18.9%	32.4%	21.6%	24.3%
Having secure employment	0	2.7%	32.4%	40.5%	24.3%

6. Would you consider starting your own business? YES 13.5% / NO 86.5%
 *If so, is your plan to start your own business? YES 1.4% / NO / UNSURE
 *Again, if so, what sort of business? Export/Technology
7. Do you consider new entrepreneurs to be an important factor to the economy? YES 78.4% / NO 21.6% YES
8. Are you aware of any Japanese programs to stimulate entrepreneurship?
 YES 5.4% / NO 94.6%
 *If so, which ones? NONE
9. Do you think that Japan is a good potential place to start a business?
 YES 43.2% / NO 56.8%
 *Why or why not? Skepticism, wealth, already enough businesses...
10. Does it make a difference to you who produces the products you purchase?
 YES 73.9% / NO 26.1%

Thank you for taking the time to take my survey, have a nice day!
Andy MacInnis

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Global Cork Demand: The Competitive Challenges Facing Portuguese Producers

Daniel McCombe
Spring 2010

ABSTRACT

This paper profiles and examines the competitive landscape of the Portuguese cork industry through the lens of an individual producer, Jan Dalhuisen, a plantation owner and cork producer of over 20 years. His unique experience as a cork producer, summarized in the form of an article, is used as a reference point in identifying linkages in the competitive challenges he faces to those facing the domestic and global cork industry.

Foremost, domestic market conditions of the industry are examined, analyzing the evolution of the primary factor input of production: labour. Next, emerging trends in production of this unique market in Portugal are evaluated. The focus, in these two areas is to find determinants of domestic supply and demand conditions and ascertain how they are effecting the macro-economic environment. That is, what economic forces in the domestic cork industry are impacting the global competitiveness of individual producers?

Second, global supply and demand trends are assessed, specifically, changes in the landscape of the wine bottling industry, its historic use of traditional cork stoppers, and the emergence of substitutes. In respect to substitutes, global market data is examined to assess if their emergence has had significant impact on global pricing trends of natural cork.

Finally, the implications of all observations for manufacturers and producers in the Portuguese cork industry are stated. Individual and collaborative strategies for industry members to utilize are discussed, all with the clear objective to improve competitiveness for the Portuguese industry as a whole, as well as sustain profitability for small scale producers.

ARTICLE

Jan Dalhuisen & Small Scale Cork Production

Jan Dalhuisen, a highly regarded law professor at Kings College London, purchased land in Portugal in 1989. His intended use of the land was “primarily for leisure,” as the 20 hectare waterfront property is situated in Lower Alentejo, a region with wide appeal due to the Mediterranean climate and temperate ocean waters.¹ Like the vast majority of landscape in this region, various tree species thrive, none more abundantly than cork oak (*Quercus Suber*). In fact, the Alentejo Region accounts for 72% of all cork forest area in Portugal and 23% of the world stock (APCOR ANUARIO, 2009). Jan estimates that his property boasts “nearly 500 trees capable of yielding 700 arrobas” (1050kg) of raw cork on harvest years.² His first harvest was in 1994 and his second in 2003, and while Portuguese environmental law requires only 9 years between harvests, his next harvest is planned for 2013.

¹ Jan Dalhuisen, Law Professor, Universidade Catolica Portuguesa, Interviewed by the author with permission, November 13, 2007

² IBIB

Harvesting is a major endeavour requiring the careful removal of the exterior bark of the trees, a process called stripping, that must be undergone with precision and care to protect the tree and ensure future re-growth. In most cases, the stripping “is carried out during the most active phase of the cork’s annual growth: from mid-May to the end of August.” (www.realcork.org) Jan, along with a vast majority of other producers of similar size and resources, contract out this task to local family owned companies. This highly specialized labour is the primary factor input in production and, aside from the land, is the most expensive part of any cork operation.

Once the trees are stripped they are then piled on site in preparation for sale. Jan, to date, has exclusively sold his piled cork to the Amorim Group and insists that this is “the only option for small scale producers,” adding that, “they have a virtual monopoly over the industry.”³ Whether that is in fact the case remains open to debate. It is, however, quite accurate for Jan to imply that the Amorim Group has a very strong foothold in the industry, as it purchases the largest share of all raw cork in Portugal. Jan’s cork, once purchased by the Amorim Group conglomerate Corticeira Amorim (CA), is first shipped to their manufacturing facilities in northern Portugal and then manufactured into various finished products. The most common product, not surprisingly, is cork stoppers for wine, although other business units (BUs) in CA produce floor & wall coverings, composite cork, and insulation cork.

Jan’s cork, self described as of “the highest quality,” is used solely for the manufacture of natural cork stoppers.⁴ His concerns, entering his third harvest year in 2013, are primarily related to what he sees as a “deflated domestic market, where individual producers can’t compensate for falling prices.”⁵ Mainly, he contends that “high inelasticity of demand” for labour he employs is making it increasingly difficult for producers to stay profitable.⁶ Furthermore, he has growing concerns about the negative impacts of the Amorim Group’s influence on the piled cork prices in the domestic market. As a PhD. of law and practicing lawyer, he believes that the matter is significant enough to warrant an investigation by the European Council, which enforces Europe’s competition laws in all jurisdictions.

Although limited in scope, and in need of more rigorous examination, Jan’s assumptions regarding labour conditions are logically sound. It is quite apparent, as well, that these concerns, as well as concerns of industry monopolization, are shared amongst many small scale cork producers. Overall, though, the greatest obstacle facing cork producers in staying competitive are global macro-economic changes affecting prices, which have dropped rapidly by 31% since 2003 highs (APCOR Annuario, 2009: 22). Are domestic micro and macro determinants root causes of the industry decline? Perhaps, but it is not without examination of the major macro-economic forces that drive the global consumer market for cork and cork products that one can verify this assertion. In fact, a closer look into the evolution of the wine industry in recent years tells a very different story; mainly, that cork is facing new competition in the form of substitutes for wine bottle stoppers and that these substitutes may well be the root cause of price deflation.

³ IBIB

⁴ IBIB

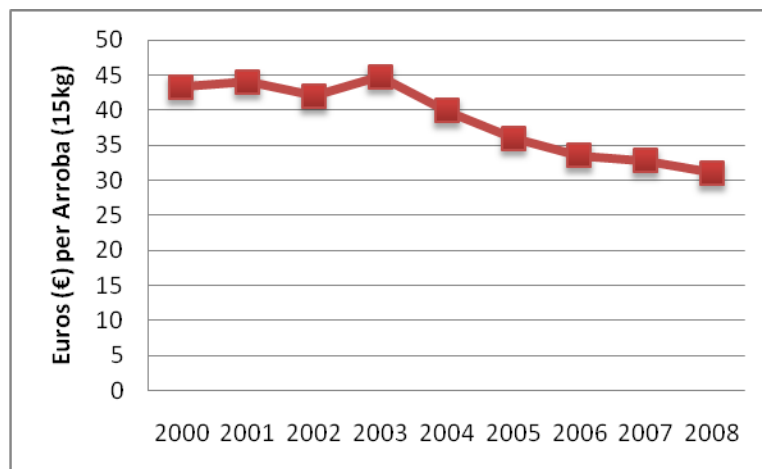
⁵ Jan Dalhuisen, Law Professor, Universidade Catolica Portuguesa, Interviewed by the author with permission, November 13, 2007

⁶ IBIB

INTRODUCTION

Almost 7 years after his last harvest, Jan Dalhuisen has noticed a marked change in the domestic conditions of cork production in Portugal. His primary concern, undoubtedly, is the potential profitability of his fast approaching third harvest, which will take place in 3 short years. Mainly, he cites the increases in labour costs as primary factors in profit erosion in the industry. In comparison, though, these erosion effects are insignificant when compared to the root cause of the Portuguese cork industries global competitiveness. The industry as a whole must contend with much more significant competitive threats: Substitutes. Their introduction and subsequent market growth is the primary reason for the fall in cork prices in the last 8 years. How much have prices dropped? Well, since Jan's last harvest, the average price of piled cork has plummeted from highs of 42.89€ per arroba to an astonishing low of 31.40€, seen in Figure 1 (APCOR Anuario, 2009: 22).

Figure 1: Selling Price of Piled Cork⁷



This drop in prices can be attributed to the increasingly elastic demand, or price sensitivity, of wine producers, a result of low cost substitutes replacing their cork counterparts. Wine makers' secondary concerns are related to the widespread occurrence of cork taint, a phenomenon which was one of the main reasons the wine closure market welcomed synthetic and screw cap substitutes initially. Now, with economic uncertainty of one of Portugal's oldest industries increasing, industry leaders must collaborate to re-establish cork as the closure of choice for the wine market. First, they must enhance their products by developing lower cost alternatives to compete in the low cost segment. Second, they must work diligently to reduce the presence of cork taint in their products, thus, alleviating these quality concerns held by many potential customers. Finally, they must seek new strategies to promote their product; specifically, they must increase the environmentally sustainable profile of their industry, one of their strongest differentiating qualities.

1. DOMESTIC ECONOMIC DETERMINANTS OF PRICE

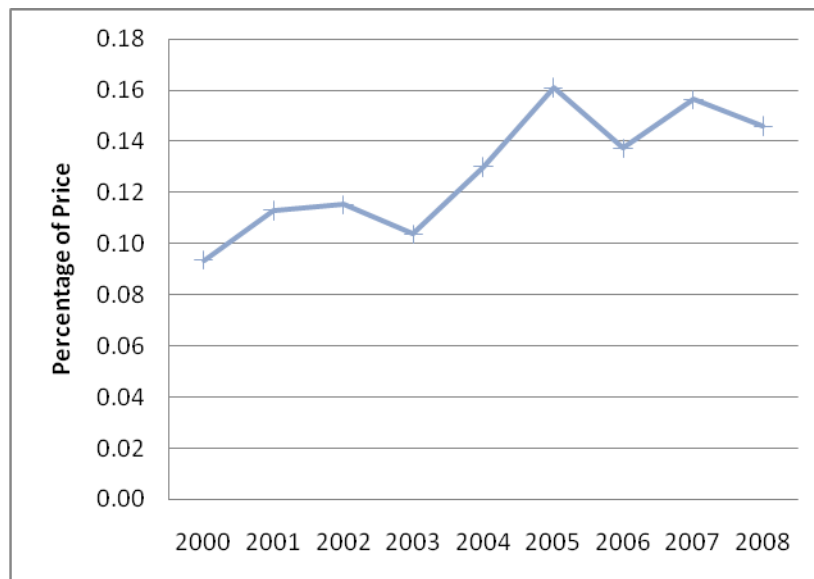
1.1 Labour Market

As mentioned, Jan's primary concern regarding profitability is in reference to labour costs, and what he contends are producers' highly inelastic demand for this extremely specialized factor input. Inelastic

⁷ Figure 1: APCOR Anuario, Page 22, Chart 12: "Evolution of the Selling and Extraction Prices of Reproduction Cork"

demand, in this case, implies that a producer will not greatly alter the quantity of labour utilized as the price of that labour increases or decreases. This can be attributed to the extremely high labour intensity of production in the industry, where producers are unable to utilize other factor inputs when it comes to extracting raw cork in harvest years. Particularly, this inelasticity of demand has had considerable negative impacts on producers in the last 8 years, as extraction costs as a percent of prevailing prices have increased by 67%, shown in Figure 2. Resoundingly, cork producers who participated in the survey I conducted all agreed that rising labour costs greatly impacted their profitability.⁸ In fact, they identified rising labour costs as the greatest domestic macro factor impacting profitability by a 70% majority.⁹

Figure 2: Average Extraction Cost of Cork as a Percent of Price¹⁰



Average Extraction Cost of Cork as a Percent of Price¹¹

What, then, are possible explanations for labour costs to increase? One such explanation, as Jan points out, is that the labour market has become more organized in recent years and has, collectively, increased the cost of their services disproportionately to inflation. Compounding this is the fact that prices of piled cork, as stated, have been in decline over the past 8 years, which means producers were unable to pass on these costs to consumers by increasing prices. Thus, unit labour costs of production rose while unit revenues fell, resulting in profit erosion. What cannot be overlooked; however, are the underlying reasons for the labour force to organize and increase the cost of their services so significantly. Perhaps, the best explanation is the considerable changes in the macro-economic environment brought on by Portugal’s adoption of the euro currency in 1999.

It was, precisely, at this time that Jan identified a gradual and sustained increase in labour costs. Evidently, the adoption of the euro increased the cost of living for all Portuguese citizens, including those working in the labour market of the cork industry. Unlike many industries, though, where demand is more elastic, labourers in the cork industry are able to exercise market power over prevailing labour costs, this, a result of high inelasticity of demand for their employment.

⁸ APPENDIX A: “Cork Production Survey”, Conducted By Daniel Mccombe Administered To 10 Individual Portuguese Cork Producers with Land Sizes of 15-50 Hectares

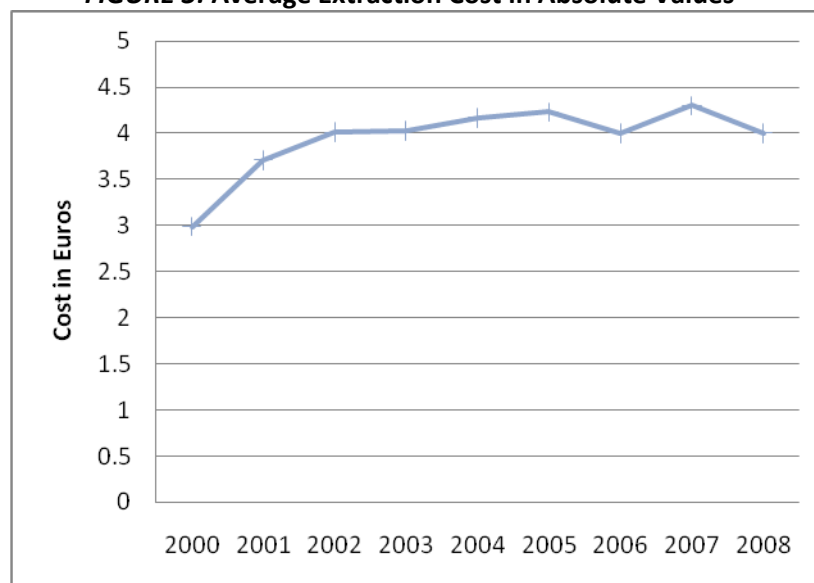
⁹ IBIB

¹⁰ Figure 2: APCOR Anuario, Page 22, Chart 12: “Evolution of the Selling and Extraction Prices of Reproduction Cork”

¹¹ Figure 2: APCOR Anuario, Page 22, Chart 12: “Evolution of the Selling and Extraction Prices of Reproduction Cork”

What can be concluded about labour effects on competitiveness and global pricing? First, increased labour prices are having negative impacts on the economic bottom line of producers, eroding profits since Portugal's adoption of the euro. Second, the increase in labour costs is resultant of producers having inelastic demand for this highly specialized labour, which became more organized in recent years and collectively raised the cost of their services. These challenges, albeit difficult for producers to overcome, are comparably insignificant when comparing the impact of global price decline. When assessing the increasing extraction costs in absolute terms it is clear that their effects are not as drastic at second glance, seen in Figure 3, increasing by a combined 25% in the last 8 years (APCOR Anuario, 2009: 22). In fact, comparing profit erosion due to global price decline from 2000 to 2008 with labour cost increases in that same time span shows that prices have fallen 12 times more than extraction costs have risen (APCOR Anuario, 2009: 22). Clearly then, the greater obstacle facing producers in remaining competitive is declining prices for their piled cork, and given a closer look, the transformative effects of global price decline are quite apparent in the emerging production trends of the domestic industry.

FIGURE 3: Average Extraction Cost in Absolute Values¹²



1.2 Cork Grades & Production Trends

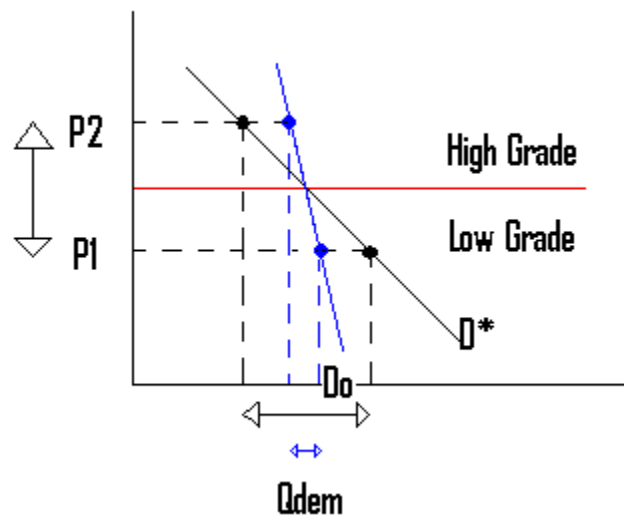
Production starts foremost with the fully re-grown bark mature trees in one of Portugal's forested regions such as Alentejo. Understandably, the characteristics and applications of cork vary from region to region based on subtle differences in climate and soil. For example, cork grown in soil with a high concentration of sand is less desirable for natural stopper production, thereby classifying the cork as low grade (Dalhuisen, 2009). Low grade cork, however, has many applications of its own such as flooring and insulation as well as the production of agglomerated cork stoppers, which are made of natural cork stopper by-products and other particles of cork. Naturally, the price of low grade piled cork is lower than its high grade counterpoint. As a result, land values have a significant variance in heterogeneous regions where different climate and soil produce cork with different physical properties.

Interestingly, recent decline in the price of piled cork has had unexpected effects on the relative use of each respective grade of cork. The cork manufacturing industry utilized lower grades of cork to produce agglomerated stoppers increasingly from 2000 to 2007 by 39% (APCOR Anuario, 2009: 27). On the other hand, utilization of high grade cork for the production of natural stoppers fell by 13% (APCOR

¹² Figure 3: APCOR Anuario, Page 22, Chart 12: "Evolution of the Selling and Extraction Prices of Reproduction Cork"

Annuario, 2009: 27). What does this indicate? Mainly, it shows a clear shift to production of lower cost cork stoppers, which are of the agglomerated variety. This shift is in direct response to increasing price elasticity of demand for natural wine stoppers illustrated in Figure 4. That is, wine companies are demanding relatively fewer quantities of high grade natural cork stoppers at high grade prices (P2). They are, conversely, opting to purchase relatively larger quantities of low grade agglomerated stoppers at lower grade prices (P1). This change in demand can be characterized by the shift in the linear demand curve from D_0 to D^* . The next step, then, is to assess how the domestic industry is reacting to changing demand conditions, and to do this, I found it prudent to use the industry leading company as the focus of my analysis.

Figure 4: Price Elasticity of Demand for Different Grades of Cork



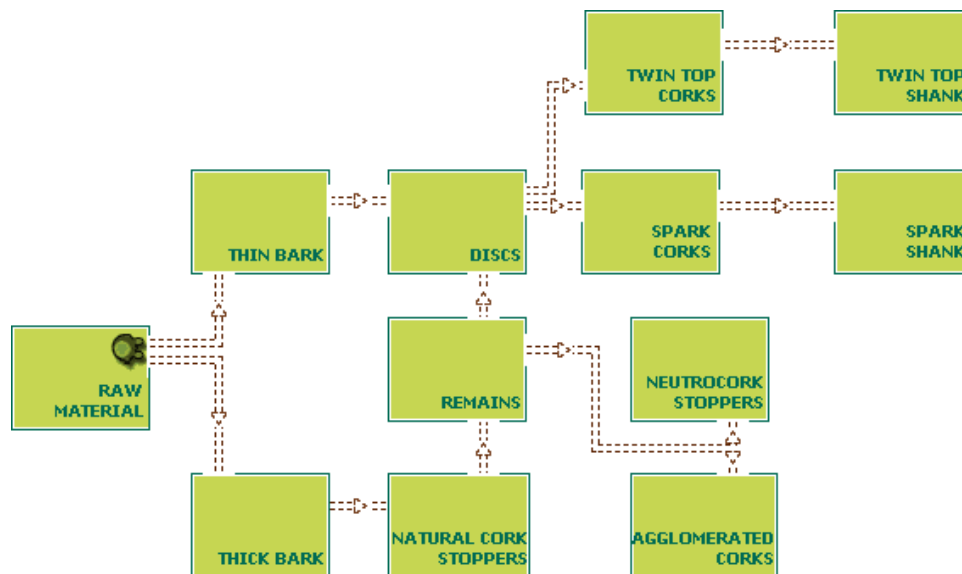
1.3 Corticeira Amorim: Scale Effects & Monopoly Concerns

The industry leader referred I refer to is the aforementioned Corticeira Amorim (CA), the world’s largest cork producer of both natural and agglomerated cork stoppers. Active in all sectors of the cork market, their vertically integrated operations are most concentrated in Portugal. On an annual basis, they establish a provisioning strategy based on predicted supply levels in the domestic market. Their objective is to supply cork that best meets “the needs of each of its Business Units (BUs) in terms of quantity, quality and price (CA Annual Report, 2009: 30).” Combined, the business units generated an industry high €468 million in sales (CA Annual Report, 2009: 133). As expected, while sales in agglomerated varieties of stoppers such as champagne and Neutrocork® rose by 12% and 4.1% respectively, sales of “the BUs most important product – natural cork stoppers” fell by 7.7% (CA Annual Report, 2009: 31). These numbers support the assertion made previously that global demand conditions have changed, becoming more price sensitive. Despite this increasing price sensitivity, however, CA remains profitable by relying on its competitive advantages: scale economies and supply chain management.

Of course, that supply chain starts with raw materials, which leads us back to small scale producers like Jan Dalhuisen. Often, and in the case of Jan, small scale producers have only one option for whom to sell their product to: CA. The reason for this is because no other producers enjoy the same economies of scale as CA does. They are able to purchase relatively small quantities of piled cork (400-1000 Arrobas) in a profitable manner, when other smaller and less integrated companies often cannot. This stems from

the fact that CA has significant investments in state of the art manufacturing plants where a wide range of products are produced, putting to use all grades of cork as seen in Figure 5. Their 2008 balance sheet states that their asset values in property, plant and equipment totals €180 million (CA Annual Report, 2009: 130), and with large capital investments such as these, their fixed costs are proportionally higher than their competitors. The result is, however, lower variable costs of production, making purchases of smaller harvest quantities of cork like Jan's a profitable venture.

Figure 5: Corticeira Amorim: Inputs and Outputs Process Map¹³



Just how profitable are these purchasing activities? Well, Jan and 30% of small scale producers that participated in previously introduced survey I conducted believe that CA is, in fact, profiting too much from their purchases.¹⁴ When asked if they believed Corticeira Amorim is using their strong market presence to put downwards pressure on purchasing prices, three of ten producers answered yes.¹⁵ Their contention is that it is becoming near impossible for producers to locate alternative buyers, this because the domestic market has seen an increasing rate of businesses exiting the industry while output remains near constant. The result, then, is CA gaining an increasingly large proportion of the industry pie.

The Portuguese Cork Association (APCOR) is representative of 85% of the domestic industry, totalling 250 companies, who “manufacture, commercialize, and export cork products” (APCOR Annuario, 2009: 6). Noteworthy is the distribution of these companies in terms of size, with micro sized operations of less than 6 employees being the most common at 40%, while large corporations of over 100 employees represent 5% of the industry (APCOR Annuario, 2009: 6). Impressively, CA has captured 25% of the global cork stopper output, and has shown consistent growth, making it by large majority, the biggest player in the Portuguese piled cork market. (APCOR Annuario, 2009: 6).

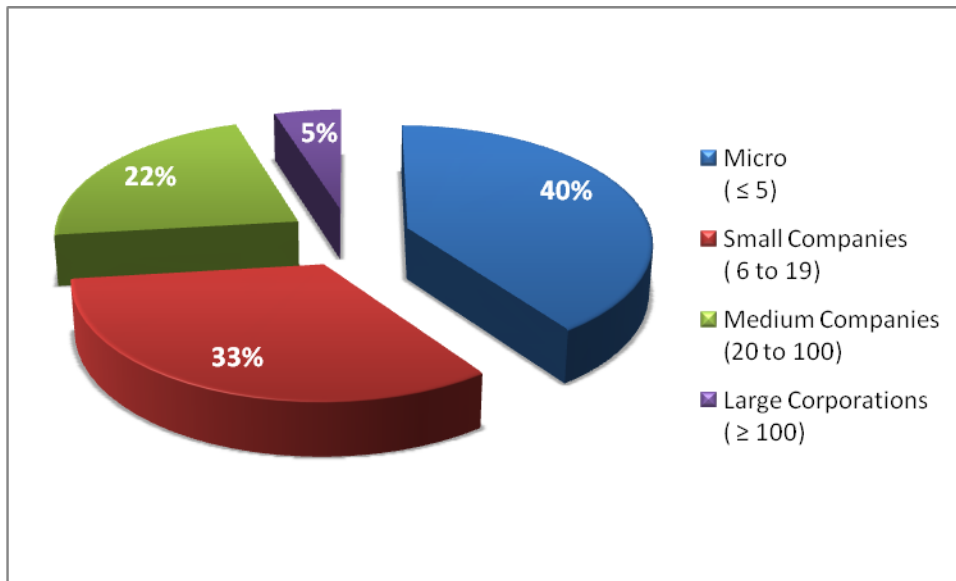
Figure 6: APCOR 250 Member Companies by Size¹⁶

¹³ Figure 5: Inputs/Outputs, www.amorimcork.com

¹⁴ APPENDIX A: “Cork Production Survey”, Conducted By Daniel Mccombe Administered To 10 Individual Portuguese Cork Producers with Land Sizes of 15-50 Hectares

¹⁵ IBID

¹⁶ Figure 6: APCOR Annuario, Page 8, Chart 2: “Number of Workers per Member Company”



Should this be cause of concern for individual producers weary of the negative effects of monopolized industries? At first glance, the answer may indeed be yes; however, evidence of the Amorim Company’s collaboration and participation in a variety of industry wide initiatives leads to an alternative conclusion: their domestic market influence is borne out of changing global demand conditions, not anti-competitive behavior. In fact, their advocacy efforts for the promotion and use of natural cork is paramount to the long term sustainability of the industry and, hence, the profitability of individual producers. While most of these promotional activities are funded solely by CA, their benefits are public to the entire domestic market.

For example, CA is amongst the most active members of APCOR, with CEO António Amorim sitting as current President. APCOR’s mission is to “promote and add value to cork, as a raw material of excellence,” and among other initiatives, APCOR collectively works “to reinforce the competitiveness of [its] companies” (APCOR Anuario, 2009: 6). Aside from collaborative efforts, CA has individually established important research centers that have focused on defending the quality and applications of natural cork products in comparison to synthetics. Second, the Amorim Group has funded various research efforts establishing the green credentials of cork and cork products.

Why then has CA worked so diligently and invested so much into initiatives that will benefit the entire cork industry and not solely enhance its on economic bottom line? Clearly, it has identified the greatest external threat to long term profitability: competition in the form of synthetic substitutes for wine bottle closures. As César Gomes de Pina, marketing director of Alvaro Coelho & Irmaos, S.A., pointed out back in 2000 at the World Cork Congress held that year in Lisbon, “cork stoppers plugged most every medicine bottle until plastic caps replaced them 80 years ago” (Matusky, 2009, Wine Business Monthly). A similar shift in the wine bottling industry would undoubtedly be devastating for small scale producers like Jan.

2. EXTERNAL PRICE DETERMINANTS AND SUBSTITUTES

Now, almost ten years later, it is clear that Mr. Gomes de Pina was justified in his concerns of increasing competition from synthetic cork manufacturers. An article published in *Forbes* cites prominent industry member, Peter Weber, director of the Natural Cork Quality Council (an association of cork producing companies that supply about 75% of the U.S. market), who suggests that “synthetic corks appeared on the market in 1993” (Wilcox, 2002). The report also suggests that “synthetic corks cost considerably less than natural ones: about 7 cents each, as opposed to anywhere from 13 cents apiece for low-grade natural cork to 75 cents for high-grade” (Wilcox, 2002). These comparatively low costs of production are exactly what have led to the consistent expansion of synthetic corks in the global wine industry over the past two decades. In fact, an industry leader in synthetics, Nomacorc, has an annual production volume of nearly 2 billion units, “and they claim a 15% share of all bottled wines globally” (Goode, 2008). Their operations span all 6 inhabited continents, with a major presence in Europe and North America as illustrated in Figure 7. In total, according to Jamie Goode, wine writer and doctor of plant biology, the synthetic industry represents one third of the global wine closure market.

Figure 7: Nomacorc Operations and Distribution Locations¹⁷



Why has the market, at least in part, shifted toward the use of synthetics? First, with the introduction of these lower cost alternatives, many producers who differentiate on a low cost strategy have increasingly turned to synthetic closures. Mainly, the reason for this is because lower cost varieties of wine, which some contend make up nearly 85% of the global market, are usually consumed in the first 3 years after bottling (Goode, 2008). On one hand, wine companies are able to reduce costs on a per bottle basis and remain competitive in the low cost segment of the industry; on the other hand, they are ensuring that the wine itself is not affected by what is known as “cork taint,” or TCA.

First identified in 1981, “cork taint is caused by aroma-intense compounds, present in the cork, transferring into the wine after bottling” (Sefton & Simpson, 2005). The presence of cork taint as a percentage of all bottled wine is a definitive point of contention between natural cork producers and

¹⁷ Figure 7: “Leading the Way Around the World,” <http://www.nomacorc.com/partners.php>

synthetic producers. In fact, according to wine writer Beagan Wilcox, “while producers place the percentage at as low as 2%, some California winemakers claim that as much as 20% of all wine bottles have cork taint.” Ultimately, there remains much debate as to the extent taint spoils wine, which has spurred large investments in research from both synthetic and natural cork producers. Unsurprisingly, CA has made the largest investments of any natural cork producers to date, and it seems that these investments have yielded favorable results. With a better understanding of the causes and properties of cork taint, CA and other cork producers have increasingly utilized improved methods of raw material collection and enhanced their manufacturing processes. The result has been a marked reduction in the presence of cork taint, which was confirmed in a May/June edition of *Vineyard & Winery* magazine by Dr. Butzke, professor of enology at Indiana’s Purdue University, who stated that “TCA was no longer a major issue from both a consumer and winemaker perspective” (*Vineyard & Winery Management*, 2009).

Does this mean that the synthetics market will no longer figure as a prominent competitor to natural cork? Unfortunately for producers like Jan, who all agreed that substitutes were negatively impacting the price of their piled cork, this appears not to be the case.¹⁸ Aside from TCA concerns, synthetics fill the previously unmet need of a low cost alternative for 85% of bottled wine. Furthermore, other substitutes have emerged as an even lower cost alternative, such as screw caps, which have captured more than 10% of the closure market (Goode, 2008). This trend towards low cost closures highlights an important change in global demand for wine closures. As indicated previously, demand has become more elastic, or price sensitive, with the presence of low cost substitutes serving as alternatives for wine producers to utilize. This alone, in the last two decades, has put the greatest downward pressure on the price of piled cork. As such, there are important implications on the cork industry in Portugal that must be taken into consideration in the strategic planning of the companies that make up the domestic industry.

3. IMPLICATIONS AND COMMENTS

3.1 Consumer Focus

Foremost, the industry as a whole would be well served to investigate the preferences of consumers to a greater extent. One proponent of synthetics, business journalist and author George Taber, points out that prior to synthetics, cork producers in Portugal and Spain had “a very inefficient monopoly: They had no quality controls, it was a backyard industry and they had lousy consumer relations with their customers” (Taber, 2007). *Already, major markets have seen the widespread adoption of substitute closures. For example, New Zealand and Australia are leaders in the utilization of screw caps, with usage at nearly 90% and 70% respectively (Goode, 2008). Britain, one of the largest wine consuming markets, on the other hand, has seen increasing acceptance of synthetic corks amongst consumers. In large part, this has been due to customer engagement efforts made by synthetic producers citing that their product can provide both a solution to cork taint while remaining the lowest cost solution for all bottling needs.*

What, then, must cork manufacturing companies do to remain competitive and address customer needs? First, new and improved products need to be developed that combat the occurrence of cork taint. In this area, CA has developed a line of new natural cork stoppers that boast Aquamark® technology. According to their website, “the Aquamark® cork is extracted from natural resources before undergoing technically-rich processing to deliver a superior performance in fundamental attributes such as sealing capacity and wine preservation” (www.aquamark.com). Second, the domestic industry must address the changing global demand conditions by developing effective low cost alternatives that can

¹⁸ APPENDIX A: “Cork Production Survey”, Conducted By Daniel Mccombe
Administered To 10 Individual Portuguese Cork Producers with Land Sizes of 15-50 Hectares

compete with substitutes. Again, CA has been a leader in this regard, producing a new variety of cork closure known as Neutracork®. This product is made with thin natural cork disks on both the top and bottom of the stopper, while the interior portion of the closure is made of agglomerated cork. Thus, the costs of production are reduced, while the quality of the closure, in large part, is maintained. Clearly, the natural cork industry has a variety of manufacturing techniques, yet unexplored, that may prove vital to their long term presence as the closure of choice in the wine market. There remains, however, another important strategic advantage that will differentiate cork in the eyes of consumers: the environmentally sustainable profile of cork products.

3.2 Environmental Consideration

Cork forests, as mentioned, populate some 2.3 million hectares of the southern Mediterranean (APCOR Annuario, 2009: 19). With Portugal holding the largest stock of this native species (*Quercus Suber*), the domestic cork industry plays a significant role in the conservation and continued protection of this vital habitat. According to APCOR's annually published yearbook, the cork production cycle "contributes to the sustainability and preservation of an ecosystem, as well as to a better environment" (APCOR Annuario: 11). In terms of the forest's impact as a CO₂ retainer, the Portuguese forested area retains 4.8 million tons annually (APCOR Annuario, 2009: 14). Furthermore, in a life cycle study conducted by Price Waterhouse Coopers, it was found that, compared to natural cork stoppers, plastic stoppers release 10 times more CO₂, while aluminum screw caps release 26 times more than their cork counterparts (APCOR Annuario, 2009: 14). It may even be argued, because of the CO₂ retention properties of cork trees and the conservation role of the cork industry, that cork production has negative aggregate CO₂ emissions. The same P.W.C study indicates that the figure could be as large as -147 kilos of emissions per 1000 cork stoppers (APCOR Annuario, 2009: 15).

What does this mean for the competitiveness of the industry and individual producers like Jan? From an industry perspective, the ecologically friendly nature of their product can be a strategic advantage in terms of consumer appeal. Wine makers wishing to market themselves as an environmentally conscious producer are likely to opt for the use of natural cork over synthetics, given competitive pricing. More importantly, though, the environmentally sustainable nature of the industry may be used as leverage in establishing government subsidy programs. Currently, there is a subsidy program that partially funds the plantation of new trees. To date, however, these programs have proven "ineffective", especially for small scale producers like Jan, with only 2 out of 10 producers indicating that the programs have any impact on their incentives to plant new trees.¹⁹ Improvements to these programs, whereby public investments are both feasible and effective, would have positive economic and environmental impacts domestically.

Nonetheless, collaborative efforts are being made by APCOR and individual companies like CA, which aim to enhance the effectiveness of conservation and recycling efforts. Currently, CA is partnering with the World Wildlife Foundation (WWF) to fund the "*provision of free technical guidance to forest producers*" (www.amorim.com). Second, they are establishing recycling programs such as ReCork America, which is "*focused on obtaining used and surplus corks from winery tasting rooms, bottling lines and quality assurance laboratories,*" all in an effort to redirect used corks into the production new products and not into landfills (www.recorkamerica.com). *Programs such as these serve the industry foremost by enhancing competitiveness, allowing cork as an industry to promote itself as an eco-friendly option for wine makers. Whether these programs can be improved and expanded to increase their positive impacts is uncertain; however, in terms of differentiation, they serve the industry well as it*

¹⁹ APPENDIX A: "Cork Production Survey", Conducted By Daniel Mccombe
Administered to 10 Individual Portuguese Cork Producers with Land Sizes of 15-50 Hectares

attempts to redefine itself against growing competition. To stay competitive, the Portuguese cork industry will need to enhance its existing strengths, take advantage of new opportunities, and guard itself against threats by eliminating, in large part, its weaknesses, all identified in Figure 8.

Figure 8: Domestic Industry SWOT Analysis for the Portuguese Cork Industry

Strengths	Weaknesses
<ul style="list-style-type: none"> * Stable & sustainable supply chain * Collaboration in product promotion & industry development (APCOR) 	<ul style="list-style-type: none"> * Increasing labour costs in production * Anti-competitiveness concerns
Opportunities	Threats
<ul style="list-style-type: none"> * Increasing consumer demand for products that are environmentally sustainable * Agglomerated and technical product R&D 	<ul style="list-style-type: none"> * Substitutes (synthetic, twist caps) that compete on low cost platform * TCA (cork taint) and its proponents

CONCLUSION

To conclude, it is apparent that the global cork industry has transitioned into a new, highly competitive, era. The major players in the global wine closure market are of course natural cork producers, and in increasing scale, producers of synthetics and other substitute closures such as screw caps, which present competitive threats to the domestic industry. Indeed, internal weaknesses have led to domestic profitability concerns, which face individual small scale producers like Jan Dalhuisen. Predominantly, increased labour prices have eroded profits in the past 8 years; however, other competitive concerns such as domestic industry anti-competitive conditions may also be cause for apprehension amongst individual producers. More importantly, though, the downward trend in global cork prices is the result of industry wide failures to continually improve itself by enhancing product quality and cost effectiveness. Thus, these challenges must be tackled by the industry as a whole.

Already, leading manufacturing companies have begun to utilizing opportunities to transition both the image and applications of cork products. Mainly, product developments have been aimed at reducing the occurrence of cork taint as well as to develop lower cost varieties of technical closures that maintain quality standards the cork industry is known for. Coticeira Amorim, as the leading partner with a combined 250 member companies of the Portuguese Cork Association, must continue their collaborative rebranding efforts if the industry is to thrive and maintain its share of the wine closure market. Specifically, it should continually enhance its research efforts into product development and continue to promote and increase the green credentials of its products. In doing so, it can enhance its strengths by ensuring a stable domestic industry supply chain, ultimately, alleviating the growing pressures on individual small scale producers like Jan Dalhuisen and many others who for generations have relied on the cork industry for their livelihoods.

APPENDIX A

**CORK PRODUCTION SURVEY, Conducted By Daniel Mccombe
Administered To 10 Individual Portuguese Cork Producers with Land Sizes of 15-50 Hectares**

Survey Questions Part 1:

A Have rising labour costs strongly impacted your profitability?
B Do you believe Corticeira Amorim is using a form of monopoly to put downwards pressure on purchasing prices?
C Is the fact that the piled cork market is private and not regulated preventing your operation from reaching its profit potential?
D Has the growing uncertainty of cashflows changed your incentives to stay in the industry?
E Does the current government subsidized program for planting new trees have significant impact on your incentives to plant new trees?
F Have substitutes for cork stoppers such as synthetic cork and twist caps significantly effected the price of your cork?
G Is global cork production in other countries impacting the price of your cork?

Table A1:

	Domestic Macro Factors			Domestic Micro Factors		Global Macro Factors	
	A	B	C	D	E	F	G
Alexandre de Azeredo Malheiro Tavares Festas	Y	Y	Y	Y	N	Y	N
Cláudio Ferreirinho Correia	Y	N	N	Y	N	Y	N
Francisco Fernando Leal Marques Augusto	Y	N	Y	Y	N	Y	N
Manuel Filipe Pereira Abrantes	Y	N	Y	Y	Y	Y	Y
Miguel de Pape Portocarrero de Almada e Ary	Y	N	N	Y	N	Y	Y
Rita Reis Costa de Sommer Carvalho	Y	Y	Y	Y	Y	Y	N
Ana Luísa Mendes Ventura	Y	N	N	Y	N	Y	N
André Filipe Cativo Oliveira	Y	N	Y	Y	N	Y	Y
Catarina Bebiano de Sousa e Holstein	Y	N	Y	Y	N	Y	N
Filipe Nunes da Silva Carvalhão	Y	Y	Y	Y	N	Y	N
	100%	30%	70%	100%	20%	100%	30%

Survey Questions Part 2:

A, B, & C	Rank the competitive impacts of Labour cost changes, Monopolistic industry characteristics, and non existence of Regulation on your profitability (1 = greatest impact)
F & G	Rank the competitive impacts of competition in the form of substitutes for cork stoppers to those presented by foreign cork production on your profitability (1 = greatest impact)

Table A2:

	Domestic Macro Factors			Global Macro Factors			
	A	B	C	F	G		
Alexandre de Azeredo Malheiro Tavares Festas	2	1	3	1	2		
Cláudio Ferreirinho Correia	1	3	2	1	2		
Francisco Fernando Leal Marques Augusto	1	3	2	1	2		
Manuel Filipe Pereira Abrantes	1	3	2	2	1		
Miguel de Pape Portocarrero de Almada e Ary	1	2	3	1	2		
Rita Reis Costa de Sommer Carvalho	2	1	3	1	2		
Ana Luísa Mendes Ventura	1	3	2	1	2		
André Filipe Cativo Oliveira	1	3	2	2	1		
Catarina Bebiano de Sousa e Holstein	3	2	1	1	2		
Filipe Nunes da Silva Carvalhão	1	3	2	1	2		
	1	70%	20%	10%	1	80%	20%
	2	20%	20%	60%	2	20%	80%
	3	10%	60%	30%			

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Sustainability within the French Luxury Consumer-Goods Market: The Role of Business and Consumer Demand

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ABSTRACT

The business case for sustainability is becoming one of the most important considerations for businesses today. Although there have been large improvements in reporting, transparency and sustainable initiatives in many industries, the consumer goods luxury market is failing to meet the mark. Evidence for this is found in the WWF's Report that ranked ten luxury businesses in terms of their initiatives. No company was ranked higher than a C+.

The purpose of this paper is to explore the French luxury industry as a market leader with the power and influence to shape the sustainable development of this industry. In particular, the initiatives of French luxury conglomerate, LVMH, are explored as an archetypal corporation within the industry with the power to shape consumer tastes.

Although there does seem to be a drive towards sustainability within the luxury goods industry, these initiatives and reports put out by luxury companies are often seen as "greenwashing". Therefore, this paper explores what the true drivers behind adopting sustainability are. The hypothesis raised is that consumer demand for sustainability has perhaps the greatest influence. As such, a survey was conducted of French and Canadian citizens to compare their awareness and demand for sustainability; it was found that there is less awareness and demand for sustainability within France. This paper will argue that this difference is due to a culture that highly values luxury as part of their cultural capital. As such, it is up to businesses to use their influence and make sustainability the new consumer trend.

INTRODUCTION

"Sustainable development meets the needs of the present without compromising the ability of future generations to meet their own needs."

This definition of sustainable development, as defined by the Brundtland Report from 1987, sums up the idea that the future of development lies in the ability of governments, businesses and people to make choices that enable the planet to survive (Brundtland, 1989). The need for a view of development that takes on a Triple Bottom Line (TBL) approach is an issue that faces each and every business and government today. The capacity for future generations to meet their own needs is rapidly decreasing and the challenge for the world has now become an issue of trying to reverse the damages that mankind has already inflicted. According to the Ecological Footprint, a measure put out by the World Wildlife Federation (WWF) that determines how we are depleting renewable resources, in 2001, our ecological footprint exceeded Earth's natural capacity by 20% (Bendell & Kleantous, 2007). This highlights the very nature of unsustainable development.

The overall purpose of this report is to explore the role of business in the push towards Sustainable Development and the drivers behind it. As consumers are becoming more aware of the need for widespread changes in order to preserve the environment, businesses are beginning to understand the need for Corporate Social Responsibility (CSR). Many industries have set high standards for reporting, sustainable initiatives and innovations, thus spurring businesses to make decisions that have a wider responsibility than simple profit making.

In particular, this report will focus on the luxury consumer goods industry and the steps that are being taken by large luxury conglomerates such as LVMH on the path towards sustainable development. Since the luxury industry is often where many trends begin, the luxury industry may be poised to be at the forefront of the global drive towards Sustainable Development. The reason behind my choice to cover the French luxury industry stems from the fact that France is the market leader in the consumer luxury goods industry and thus has the power to influence it even more profoundly.

Although this market encompasses some of the most well known brands globally and generally receives high profit margins, the luxury sector does not seem to be exceedingly engaged in terms of the business trend towards CSR. For instance, there was not a single luxury corporation, French or otherwise, on investment analyst Innovest's list of "the 100 most responsible corporations of 2007." In addition, only a few companies including LVMH, Hermes and L'Oreal, were part of the FTSE4Good 2006 Index (see: FTSE4Good). Moreover, LVMH was removed from this list in 2007 for issues with their supply chain (Bendell & Kleanthous, 2007).

Although many companies in the luxury industry constantly produce impressive financial results, sustainable development does not appear to be part of their core strategies. This paper will seek to understand the drivers behind sustainability, such as consumer demand, and why the luxury market is falling behind in a world that is moving towards sustainability at a rapid pace.

1. CHALLENGES AFFECTING SUSTAINABILITY WITHIN THE LUXURY MARKET

The issue of business sustainability is affected by many factors. Traditionally, the luxury consumer goods market has not been at the forefront of environmentally or socially responsible companies. The business case for sustainability, however, is becoming increasingly clear and is not something that any firm can ignore. Aside from managing and reducing risk, cutting costs, taking advantage of new innovations and technologies and providing added value for consumers, creating a sustainable business is becoming a mandatory necessity.

The main macro forces that are affecting the luxury industry are political, economic, social and global. For example, on the subject of political regulation, the French government has passed laws concerning TBL reporting (see: Nouvelles Régulations Economiques) and limiting packaging (see: Grenelle Law). Although these governmental attempts to instil a need for sustainability within businesses may be a good first step, it is not the solution in order to ensure that companies embrace the idea of true sustainable development. Although governments are often held accountable for keeping their countries and industries environmentally and socially responsible, there must be more corporate involvement. Although corporations are often the largest consumers of resources, they also have the most influence to change consumer mindsets.

By tradition, the luxury market has been seen as the antithesis to sustainable development. In an industry based almost entirely on excess, the notion of creating products that are socially and environmentally responsible seems counter-intuitive. As such, many issues surrounding the design, manufacture, promotion and distribution of luxury goods can be cited as being highly unsustainable. For

instance, some of the key issues that represent the negative impact of the fashion luxury market include the use of animal skins and furs, the lack of responsible marketing by using unhealthy models, issues within supply chains, and the creation of the drive for consumption (Bendell & Kleanthous, 2007).

Issues surrounding the use of animal furs and skins in goods raise the concerns surrounding the protection of endangered species, pollution in preparation practices and the welfare of animals during the process of rearing and termination. There are procedures in place to attempt to control the trade of skins and furs, such as certification from The Convention on International Trade in Endangered Species (CITES); however, illegal trading still exists. Some examples of this include the trading of skins from endangered wild animal populations and using unethical means of obtaining furs, such as the need to kill the Chiru Tibetan antelope in order to use its fur. Because three to four skins are needed for one wool shawl, the global Chiru population has declined to less than 100,000 in the wild (Bendell & Kleanthous, 2007).

In an industry based on consumption, it can be difficult to see a way around this issue. However, the luxury industry may be well placed to start a trend of sustainable consumption such as a focus on high quality garments that can be worn for more than one season. Since, in their essence, luxury goods are backed with a reputation for quality and timelessness, French luxury industries can combat the trend of mass consumption and waste by encouraging consumers to buy expensive goods that do not have to be replaced as often. As a business case for sustainability, this does not have to mean a drop in revenues. Instead, sustainable products can offer new types of value for consumers, presenting them with more intelligent and responsible goods (Bendell & Kleanthous, 2007). Not only does this help the environment, it increases the emotional connection of consumers to the goods.

2. THE FRENCH LUXURY INDUSTRY

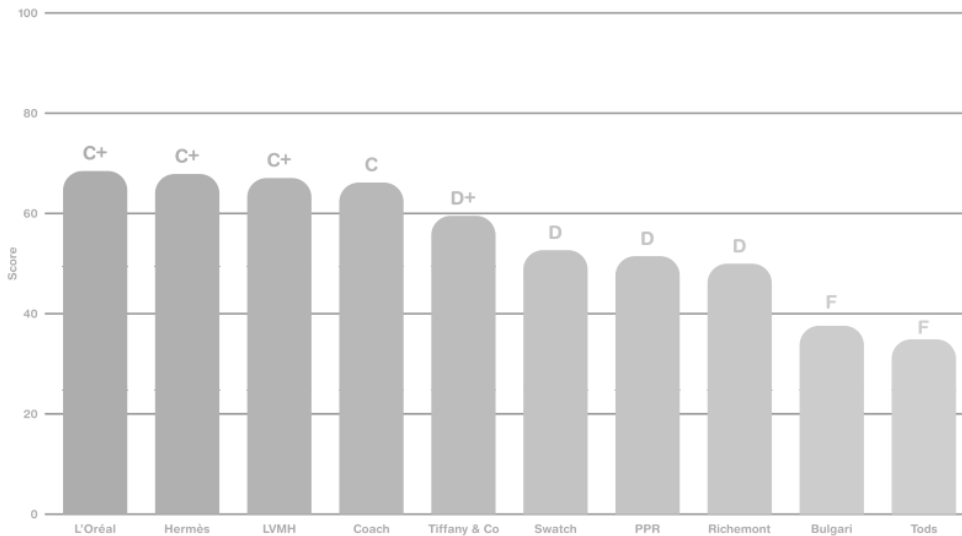
Luxury has always been synonymous with France. French fashion has been linked with the height of class and status since the reign of King Louis XIV from 1643 to 1715. During this time period, luxury goods industries became largely under royal control and thus France became the European and world authority on style and taste (Wikipedia Contributors, 2009). Today, French fashion is still seen as the epitome of luxury. Although many French luxury houses are under the control of large conglomerates such as Louis Vuitton Moët Hennessey (LVMH) and PPR, they have not lost their reputation and prestige. Some of the iconic luxury fashion brands until LVMH's control include Dior, Celine, Chanel, Louis Vuitton, and Givenchy.

In addition, although France is renowned for its high cultural capital and affinity for luxury goods, it is also known for its lack of commitment to sustainable development initiatives as compared with its European neighbours (Lock, 2009).

Although French brands in the luxury sector have been around for many years, such as Louis Vuitton, which was founded in 1854, the French private sector has never been considered dynamic, innovative and entrepreneurial (Fukuyama, 1995). Traditions tend to be upheld in France where long-established attitudes towards authority and affinity for bureaucracy have led to less entrepreneurial spirit within companies (Burt, Hogarth, & Michaud, 2000). In 1940, economic historian David Landes argued that France's delay in adopting new processes has its roots in the country's pre-dominance of the traditional family firm. In addition, France's culture is one that is still relatively class based. According to Fukuyama, "The relatively late growth of a mass consumer market in France and the persistence of small markets for expensive, high quality goods is testimony to the lingering effects of aristocratic sensibilities among middle class French consumers" (Fukuyama, 1995).

In a report, entitled *Deeper Luxury*, the WWF ranked ten firms within the luxury market on their environmental, social, governance performance, and reputation (Figure 1). These rankings were based on what the companies themselves report about their performance as well as what the media, NGOs and other non-governmental organizations report.

Figure 1: Ranking of Environmental, Social and Governance Performance and Reputation of Luxury Corporate Groups (Bendell & Kleanthous, 2007)



In examining Figure 1, it becomes clear that the luxury industry is falling behind in terms of CSR. Large French firms such as L’Oreal, LVMH, Hermes and PPR succeed in only achieving a grade of C+ at best. Even with high margins, large customer bases and a lot of brand recognition, the luxury industry seems to be missing something.

As large conglomerates, including those within the luxury industry, are becoming more powerful than even some governments, CSR is becoming increasingly important. Although there are issues facing the luxury consumer goods industry, these are not issues that cannot be remedied. Perhaps one of the main factors influencing the drive towards corporate sustainability is changing consumer demands. Increasingly, consumers want greater accountability and they search for more meaning within products and services (Winn, 2008). For businesses, the satisfaction of consumer demands is a primary goal. Therefore, the need for consumers to be aware of and demand more CSR and sustainability from companies may be seen as the key to true sustainable business. This issue will be explored further later in this report.

As previously mentioned, the French luxury industry is a global market leader in the sense that it encompasses many top brands and influences style and taste throughout the world. Because of its sizeable influence within this sector, this report pays particular attention to LVMH since it may be considered an archetypal company in the French luxury market as well as a leader in the entire industry. Because of this, if the French luxury industry does not embrace sustainable development, it may be less likely that the rest of the industry will.

As a company that recorded revenues of 17.2 billion Euros in 2008, LVMH should be taking more of a stride towards sustainable development within its own company as well as acting as an exemplary for sustainable development for other businesses (LVMH, 2009). However, even with impressive CSR reports and media coverage of initiatives, luxury companies like LVMH do not have inspiring score cards.

3. LVMH AND SUSTAINABILITY

“For over fifteen years, the LVMH Group has been committed to preserving the environment. It was also one of the first groups to establish an Environmental Department in 1992. This commitment became a strategy in 2001 when Bernard Arnault signed the Environmental Charter that encouraged each Company to establish an environmental management program and every Chairman to become involved in the initiative. The commitment was further strengthened in 2003 when the Group joined the Global Pact, an initiative launched by Kofi Annan that is based on its signers’ voluntary commitment to respect ten principles relating to human and citizen rights, working conditions, and the environment, to contribute to more sustainable growth at the international level. In 2008, the companies engaged in concrete actions including ISO 14001 certification, the completion of Bilans Carbone®, the construction of green buildings and the use of eco-design.”

(LVMH, 2008 b)

The above quote is from LVMH’s environmental report and outlines their background in environmental efforts. It paints a picture of a corporation that has strong commitments to sustainable development through various initiatives. Although these words could be taken at face value and the assumption could be made that LVMH is thoroughly committed to sustainability, this report will look deeper into these initiatives in order to understand why LVMH received only a C+ grade in WWF’s *Deeper Luxury* report (Figure 1).

According to their website, LVMH is committed to preserving the environment and Sustainable Development. While complying with regulations and trying to become certified by internationally recognized standards such as ISO 14001, LVMH attempts to reduce their risks by setting and following through with targets. In particular, LVMH focuses on the life cycle of its products by ensuring their sustainability from design to disposal. By raising employee awareness through training and dedicated management, LVMH wishes to maintain a proactive policy towards the environment and Sustainable Development. Through the incorporation of environmental goals in management performance reviews and by conducting regular internal and external environmental audits, LVMH has demonstrated its commitment to environmental responsibility (LVMH Group, 2009).

Some examples of the aforementioned environmental and social targets include the reduction of perfume packaging, the use of recycled materials in transport packaging and the establishment of initiatives to sustain wild populations of natural species used in the production of goods. Through some of these initiatives, LVMH has been able to achieve an annual savings of 30 tons of tin, 186 tons of cardboard and now has transport boxes that are made up of 61% recycled materials, resulting in a savings of 232 tons of raw materials annually. With respect to the sustainment of wild populations of species used in goods, an excellent example of this is the Annogelline project in Burkina Faso. The purpose of this project is to preserve the *Anogeissus leiocarpus* tree, from which active ingredients have been used for Christian Dior swimsuits. By setting up a controlled bark-harvesting system, involving local inhabitants and re-planting trees in the Koro Pedagogical and Botanical Garden, LVMH wishes to educate people about the natural flora in this area and ensure its survival (LVMH Group, 2009).

In addition to some of these design and manufacturing initiatives, LVMH also has more widespread targets that include the construction of “green” buildings. By undertaking initiatives that will see various LVMH-owned buildings become more environmentally friendly, the company wishes to achieve HEQ status for both new and existing buildings (see: HEQ). One of the major projects that has received HEQ

certification is the Eole warehouse building in France. The challenge of the Eole project was “integrating a building into its environment, managing energy and water, and creating visual harmony in the workplace” (LVMH, 2008 b). The building includes rainwater runoff treatment and usage, special routes to encourage pedestrian activity, water management systems where waste water is naturally treated using plant filtration and the use of construction products, such as VOC-free paint, that are not harmful to the environment. In terms of energy efficiency, Eole uses geothermal heating and air/water type cooling systems in warehouses among other things. LVMH is currently working on making environmentally conscious construction standard throughout its operations (LVMH, 2008 b).

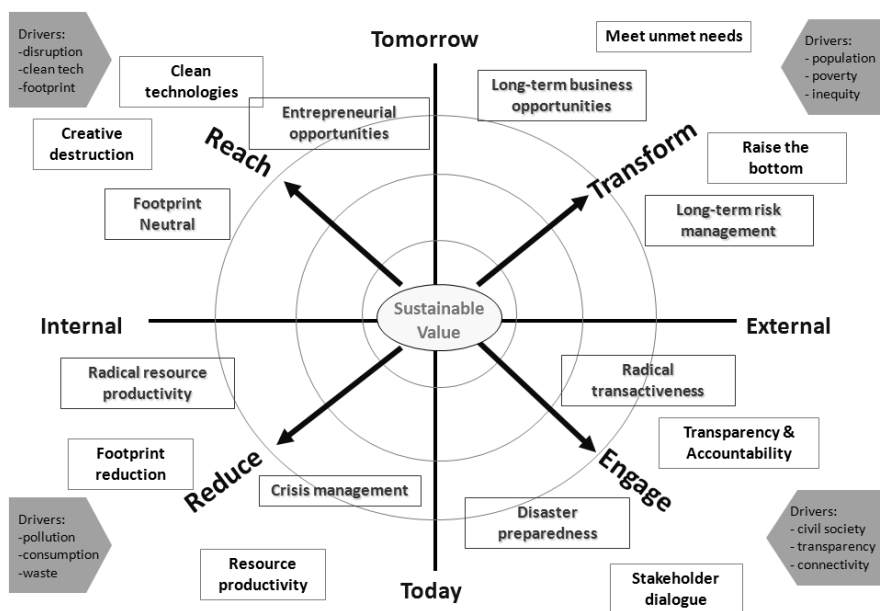
On another note, LVMH has also begun to engage with external stakeholders by operating a contest in conjunction with New York’s Fashion Institute of Technology. The challenge behind this project is for students to design “stylish cycling garb to promote energy-saving, zero-pollution commutes via bicycle” (Santoli, 2009).

As mentioned, the main department within LVMH that deals with the issue of sustainable development is the Environmental Department. This Department reports directly to the CEO, Bernard Arnault, and establishes environmental guidelines for the company and its various brands. Some of the responsibilities of this department include providing each brand with practical tools including regulatory and technical oversight, information and guidelines on anything from packaging to suppliers to green initiatives, supervision of the implementation of the company’s Environmental Charter and the organization of internal audits (LVMH, 2008 b). Although these responsibilities ensure the company follows through with initiatives, the Environmental Department seems to lack external innovation and radical entrepreneurial ideas within their own operations.

4. SUSTAINABLE VALUE FRAMEWORK – LVMH

The Sustainable Value Framework_(SVFW) (Figure 2) is a conceptual model that can be used by companies as a strategic and diagnostic tool to help assess their progress in terms of their current portfolio of initiatives.

Figure 2: Sustainable Value Framework (Winn, 2008)



Adapted from Hart & Milstein, 2003; Tebo, 2003

According to the World Business Council for Sustainable Development:

“Eco-efficiency is reached by the delivery of competitively priced goods and services that satisfy human needs and bring quality of life, while progressively reducing environmental impacts and resource intensity throughout the life cycle, to a level at least in line with the earth’s estimated carrying capacity.”

As evidenced by their commitment to ensuring sustainability and reducing waste within the entire product life cycle, LVMH is clearly focused on eco-efficiency and changing the values and culture within the company. As such, many of LVMH’s sustainable initiatives fall into the internal side of the SVFW. In addition, their focus on HEQ certified buildings shows an initiative to reduce their ecological footprint and apply more focus to clean technologies. Furthermore, LVMH has made a point of encouraging sustainable entrepreneurship by taking a stake in Edun, an eco-luxury clothing label, which was founded by U2’s Bono and his wife Ali Hewson (Lock, 2009). Despite these internal initiatives, there could be more innovation within the company in terms of finding new sustainable materials or processes and encouragement of entrepreneurship within LVMH’s own brands.

Although LVMH is making considerable attempts to become a more sustainable enterprise, they seem to be missing the more external part of the SVFW. Although they do engage with stakeholders by putting out CSR reports and engaging in activities that promote environmental awareness, LVMH could increase their emphasis on this right-hand section of the diagnostic tool. For instance, LVMH’s CSR reports do not follow GRI standards of reporting which is an international guideline for preparing sustainability reports (Bendell & Kleanthous, 2007). This may result in inadequate reporting on some aspects of their practices and does not show a very high degree of transparency. Moreover, there does not seem to be a large amount of stakeholder engagement. Although their Annual Report from 2008 highlighted an entire section on Sustainable Development, there is no emphasis on engaging stakeholders and creating a two-way dialogue with them (LVMH, 2008 a).

In addition to lack of stakeholder engagement and transparency, LVMH seems to lack an emphasis on long-term business opportunities and focus on the bottom of the pyramid (see: BOP Approach). Although adopting a BOP approach is the opposite of the typical consumers that luxury companies normally transact with, there may be opportunities in operating programs in impoverished countries. For example, with the large access to funding and resources that large multi-national corporations like LVMH have access to, it would be in their benefit to engage in initiatives such as microcredit or building schools and hospitals in third-world nations.

5. RANKING OF LUXURY GROUPS

For their rankings in the *Deeper Luxury Report* (Figure 1), WWF took data from two sources. The first source of data was the Ethical Investment Research Service (EIRIS) that analyses information directly put out by and taken from companies through questionnaires, public documents, websites and reports. Data is collected from these self-reported sources based on fifty criteria and are placed within the categories of environment, human rights, corporate governance, and stakeholder relations. The second source of data for this ranking came from Covalence, a research house that takes both positive and negative news from global media sources about companies and compiles it into rankings. Thus the EIRIS ranking is seen as more of an internal ranking and the Covalence ranking is seen as more of an external one. The rankings for each of the ten luxury companies can be seen in Figure 3 (Bendell & Kleanthous, 2007).

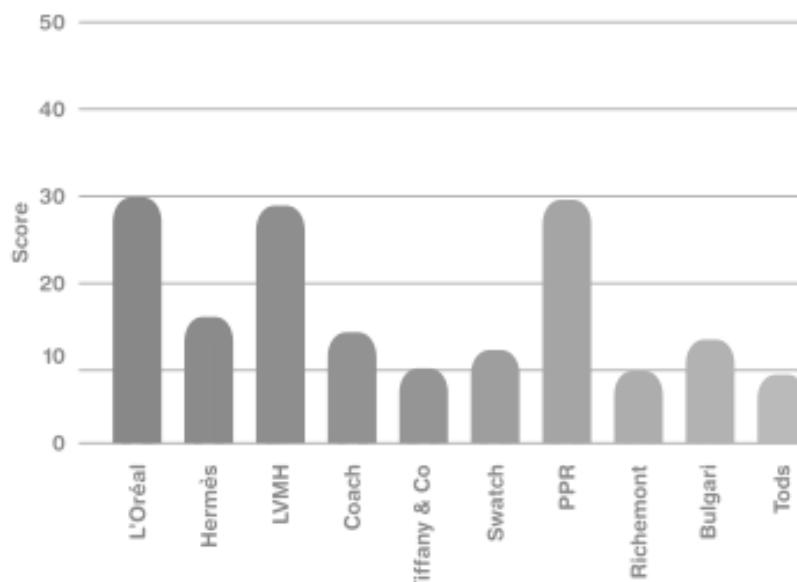
Figure 3: Scores from WWF’s Deeper Luxury Report (Bendell & Kleanthous, 2007)

Group	Covalence	EIRIS	Total	Rank	Grade
L’Oréal	38.5	30.0	68.5	1	C+
Hermès	50.0	17.9	67.9	2	C+
LVMH	37.2	29.9	67.1	3	C+
Coach	50.0	16.2	66.2	4	C
Tiffany	47.8	11.9	59.7	5	D+
Swatch	38.9	13.8	52.7	6	D
PPR	21.3	30.3	51.5	7	D
Richemont	35.5	15.2	50.6	8	D
Bulgari	20.0	17.6	37.6	9	F
Tods	25.0	9.9	34.9	10	F

From these scores, it can be seen that although LVMH scored above average from both Covalence and EIRIS, since each score is out of fifty, there is a large discrepancy between these two scores. LVMH’s relatively higher Covalence score of 37.2 may help highlight the fact that the company is more focused on creating a positive image and reputation than they are on actually following through with initiatives.

Although LVMH did score higher than many other companies ranked in this list with 29.9 in terms of their scores from EIRIS, it does not mean that they are in a secure position. A score of 29.9 suggests that LVMH is only doing slightly above mediocre in terms of their initiatives even though they have one of the highest rankings for self-reported performance (Figure 4). This may be because they are not reporting on all sides of their business or are not incorporating social and environmental responsibility into their business strategy enough.

Figure 4: Self-Reported Performance (Bendell & Kleanthous, 2007)



One of the main complaints about sustainability within the luxury industry is that it that corporations are simply “greenwashing”, or making efforts to portray themselves as environmentally responsible in an effort to improve their reputations (Presidio Management School). By using the issue of sustainability to promote lavish events where money is raised for various philanthropic events, “high-society” is given a chance to feel they are being socially and environmentally responsible. Unfortunately, this is the approach that many luxury companies take towards sustainability. According to WWF, the luxury industry’s approach to sustainable development is more one of “piecemeal philanthropy, glamorous sponsorship projects and the management of reputational risks” than anything else (Bendell & Kleanthous, 2007).

Consequently, the reasons behind this lack of true strategic commitment to sustainable development, although not without lack of reporting on it, need to be examined. The question thus becomes, if luxury firms like LVMH are simply using the idea of sustainable development as a way to manage their risks in an attempt to improve their reputation, then what needs to be done for them to truly become sustainable businesses?

6. DRIVERS BEHIND SUSTAINABILITY – CONSUMER DEMAND

Sustainability has become a key success factor for many businesses today. Especially in North America, sustainability has been increasingly at the forefront of consumer and investor decision making over the past number of years. Although this may not be as prevalent in other areas of the world, consumers in Asia, Europe and the Middle East are beginning to see the value in companies that are dedicated to strong CSR (Bendell & Kleanthous, 2007). This demand for sustainability has become obvious in many countries and industries as businesses are having to shift their strategies and product offerings to meet consumer demand. An excellent example of this is the increasing prevalence of hybrid vehicles in the automotive industry.

There is often a myth that consumers of luxury goods do not demand socially and environmentally conscious goods. However, with increasing education and awareness, it is slowly becoming a purchase criteria for many consumers, especially in Western markets. However, since there seems to be a lack of Sustainable Development within the consumer luxury goods market, especially in France, could this myth be true?

As mentioned, the business case for sustainability is growing and the luxury industry will have to improve its social and environmental record. As shown, although many luxury brands are making strides towards incorporating CSR into their company strategies, the industry is still lagging. Luxury brands are becoming more accessible through a process of democratization where more middle class consumers are becoming able to afford such luxury goods as Louis Vuitton handbags (Bendell & Kleanthous, 2007). This mass consumer market is quickly beginning to become more educated and concerned about environmental and social issues. Therefore, these products may no longer remain the coveted items they once were based on brand name and image alone. Luxury companies need to find a way to add new value for consumers.

Furthermore, it has been suggested that in fact the current economic downturn will further increase customer demand for sustainability. According to a survey by American marketing agency Cone, “50% of Americans ages 18 to 24 said they have ‘higher expectations of companies to make and sell environmentally responsible products and services during the economic downturn,’ compared with 35% of Americans overall.” Furthermore, Figure 5 shows that 34% of consumers said they are more likely to buy environmentally responsible products due to the recession (Dodes & Schechner, 2009). This shows

that American consumers, especially those aged 18-24, are becoming more interested in buying goods that are environmentally and socially conscious.

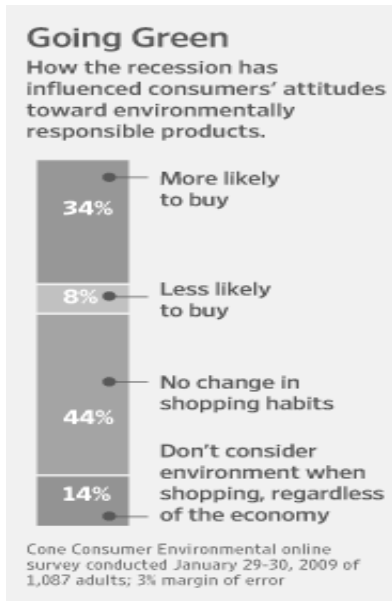


Figure 5: Cone Marketing Survey on Consumer Behaviour (Dodes & Schechner, 2009)

Evidently, there is consumer demand for sustainability elsewhere in the world. Consequently, this paper will explore the role of consumer demand for sustainability in France and its potential effect on the sustainability of companies in the French consumer goods luxury market. Since French brands are seen as models of style and taste throughout the world, it may be possible that there needs to be high level of consumer demand for sustainability within in France in order for the luxury industry to really become sustainable.

7. FRENCH CULTURAL CAPITAL

According to Professor Anne Witte from EDHEC Business School in Nice, France, luxury brands are attached to French history. Evidenced by the existence of royal enterprises, royal goods, and specialized foods and dress for the aristocracy, luxury goods are often “linked in popular imagination to personal and cultural excellence, taste and refinement. They reinforce people's sense of success” (Witte, Professor - EDHEC Business School, 2009).

Especially in France where classes still exist, luxury industries encompass a defining part of culture. Culture in France is often seen as exemplifying “high society” and as such, fashion, art, wine and other luxury goods are linked to a sense of national pride and can even be seen as cultural symbols of the “refinement” of the French population. This may be the very reason behind the lack of action and pressure on luxury companies to become more sustainable “because it is socially awkward to attack ‘family names’ in a society where class consciousness reinforces a sense of order and meaning” (Witte, Professor - EDHEC Business School, 2009). It is impossible to demand sustainability from the luxury industry without attacking its practices and regarding operations as elements that need to be changed. This may potentially, however, be seen as an attack on the French personally since the line between luxury and culture has been blurred.

Cultural Capital may be defined as “a social relation within a system of exchange that includes the accumulated cultural knowledge that confers power and status” (Barker, 2004). The concept, first presented by Pierre Bourdieu, can be extended to incorporate the practices, local knowledge, language, esthetics and philosophy of a culture that allow the society to differ successfully from another one. As previously mentioned, for France, cultural capital often signifies high culture. Luxury industries are part of the “preferred industries” in France and are often supported by the government. There are also educational systems in place to maintain these industries and many students choose career paths that relate to the luxury business (Witte, Social Capital Presentation - Types of Capital, 2009). As such, these lucrative industries often employ many people and are thus also highly economically tied to France. Therefore, because the luxury industry is so tied into French culture and way of life, it may be difficult

for people to be aware of and take into consideration something like sustainability, which traditionally runs counter to luxury, into their cultural capital as well.

Luxury goods are a way of showing success; however, the definition of success is changing throughout the world. Many people are searching for more value within the products they buy and as such they demand goods that are more ethical and responsible. One possible reason why the French do not demand as much sustainable responsibility is that their definition of success is still very tied into luxury goods, as deemed by their culture.

Professor Witte has also spoken about several cultural “stereotypes” of the French. One of these typical French attributes is resistance to change. There is a relatively high degree of uncertainty avoidance and ambiguity within the French culture that leads to strict adherence to rules and norms. These factors, compounded with the penchant for formality, structure, materialism and familialism leads to a negative function of society that cannot last (Witte, Social Capital Presentation - Types of Capital, 2009).

8. SURVEY OF FRENCH AND CANADIAN SUSTAINABILITY PERCEPTIONS

To delve further into this subject and find out whether there is actually less consideration for sustainability when making purchase decisions and conducting everyday life, I conducted a survey of 15 French citizens and 25 Canadian citizens (Figure 6). The intention behind this survey was to get an idea about views on sustainability and get some firsthand reactions from people about luxury and sustainability.

Figure 6: Survey: Consumer Perspectives on Sustainability (English)

1. How often do you shop for luxury goods?				
Very often	Somewhat often	Sometimes	Not very often	Never
2. How important is it to you to have luxury goods?				
Very important	Somewhat important	Neutral	Not that important	Not important at all
3. When shopping, are you concerned about the social/environmental practices of the company?				
Very concerned	Somewhat concerned	Neutral	Not that concerned	It doesn't matter to me
4. How strongly do you believe that companies should have Corporate Social Responsibility Reports/Transparency?				
Very strongly	Somewhat strongly	Neutral	Not that strongly	It doesn't matter to me
5. How aware and knowledgeable are you of environmental/social issues in the world (eg. Child labour, global warming, poverty, environmental degradation, etc.)?				
Very informed	Somewhat informed	Not well informed	It doesn't bother me	
6. Where do you learn the most about environmental and social issues?				
Friends and Family	School	Work	News and the Media	My own research
7. Would you buy a product that you wanted even if you knew that it was bad for the environment or that it was socially harmful (ie. child labour)?				
Yes certainly	Probably yes	I would have to think about it	Probably not	Definitely not
8. Ideally, where would be your first choice in places to shop?				
1. A luxury store with a poor environmental or social reputation/practices				
2. A semi-high end store with decent environmental or social reputation/practices				
3. A semi-high end store with decent environmental or social reputation/practices				
4. A semi-high end store with decent environmental or social reputation/practices				
9. How much does the issue of sustainability influence your daily life?				

The overall results from the French respondents who were surveyed represent more of a passive attitude towards sustainability. For example, 73.33% of respondents said they were “Not that concerned” or “It doesn’t matter to me” on the subject of whether they were concerned about the social and environmental practices of companies while shopping. This is as opposed to 68% of Canadian respondents who said they were “Somewhat concerned” or “Very concerned”. Further more, when asked the question, “How aware and knowledgeable are you of environmental and social issues in the world?”, 96% of Canadian respondents answered “Somewhat informed” or “Very informed” as opposed to only 60% of French respondents who answered the same way.

Furthermore, when asked the question, “How aware and knowledgeable are you of environmental and social issues in the world?”, 96% of Canadian respondents answered “Somewhat informed” or “Very informed” as opposed to only 60% of French respondents who answered the same way.

Further evidence that points to more concern for society and the environment when making purchase decisions within Canada can be seen in Figure 7. Figure 7 shows the responses to Question 7 and suggests that Canadian respondents tend to need to think about purchase decisions when the product or company is bad for the environment or socially harmful. In addition to needing to think about the decision, another 44% of Canadian respondents answered “Probably not” or “Definitely not” as opposed to only 26.7% of French respondents. On the other hand, the majority of French respondents said they would “Certainly” or “Probably” buy the product. These two responses only made up for 16% of Canadian answers.

Figure 7: Survey: Question 7 Results

Canadian Responses

7. Would you buy a product that you wanted even if you knew that it was bad for the environment or that it was socially harmful (ie. child labour)?		Create Chart	Download
		Response Percent	Response Count
Yes certainly	<input type="checkbox"/>	4.0%	1
Probably	<input type="checkbox"/>	12.0%	3
I would have to think about it	<input type="checkbox"/>	40.0%	10
Probably not	<input type="checkbox"/>	28.0%	7
Definitely not	<input type="checkbox"/>	16.0%	4
answered question			25
skipped question			0

French Responses

7. Achèteriez-vous un produit que vous avez voulu même si vous savez qu'il était mauvais pour l'environnement ou ait été socialement nocif ? [Create Chart](#) [Download](#)

		Response Percent	Response Count
Oui certainement		33.3%	5
Oui probablement		26.7%	4
Je devrais penser cela		13.3%	2
Probablement pas		20.0%	3
Certainement pas		6.7%	1
		answered question	15
		skipped question	0

In regards to how strongly they believe that companies should have CSR reports, the majority of respondents from both countries answered “Somewhat strongly” or “Very strongly” although there were more respondents in Canada that leaned towards “Very strongly”. This does show evidence that French consumers believe that companies should be more sustainable but they do not seem to demand it from them when purchasing.

On the final question regarding how much sustainability affects their daily lives, most French respondents answered “Pas beaucoup (Not a lot)” or “Aucune influence (No influence)”. On the other hand, most Canadians answered with a variation of “I try to make sure to take it into account when making purchases and personal decision(s)” or “I am starting to realize that I should be more aware of it in my daily life. So right now it doesn't influence it that much, but it probably should.”

These results demonstrate less French awareness and concern for sustainability and the environmental and social reputations of companies. Although these results are only from a small population, they do draw attention to the idea that there is not as much consumer demand for sustainability from businesses.

Nonetheless, overall the survey’s results show more awareness than originally hypothesized. This may be due to the fact that many of the respondents were students. This highlights the idea that young people all over the world are beginning to be aware of sustainable development, even in France.

In a recent survey, New York research firm the Luxury Institute, found that “Younger and more-affluent consumers seek information about corporate social responsibility more actively than their older and less well-off counterparts.” The Luxury Institute’s CEO, Milton Pedraza, stated, “Young consumers believe that caring about the environment is how you create a meaningful life.”

Since young people today are much more globalized than older generations, through social media, etc, there is a faster dissemination of knowledge. Therefore, it isn’t shocking that young people are the ones to become more aware of these issues because they are being highlighted in many of the media outlets they turn to such as MTV and Facebook. As a result, young, affluent consumers may be a prime market for luxury companies to target in order to spread the idea and demand for sustainability.

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