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Cheeses of the Atlantic

Internationalization of Insulac to the German Cheese Market

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Abstract

Insulac, an Azorean producer and wholesaler of dairy products, namely cheese, butter, powdered milk and sweet whey powder, was driven to expand internationally due to the inherent limitations of a small domestic market. In order to recommend a target market, a country screening was developed based on macro and micro indicators. The assessment suggested Germany as being the most attractive market to export Insulac's cheeses. This was followed by a detailed analysis of the target country, which reviewed the industry within the country. Lastly the paper proposes a potential entry mode and performs a financial and risk analysis.

Keywords: Insulac; Cheese; Internationalization; Germany;

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INTRODUCTION

Currently, the Dairy Industry continues to be pressured by many external factors, such as the milk quotas withdrawal in the European Union; however a gradual improvement and continuous economic growth, leveraged by innovation, is expected in 2016. Insulac, an Azorean producer and wholesaler of dairy products, namely cheese, butter, powdered milk and sweet whey powder, intends to leverage their international strategy, in order to attain sustainable growth beyond the small domestic market. It already successfully exports the majority of their powdered milk and sweet whey powder, while the cheeses and butter are mostly sold in Portugal, under the brands Valformoso and Navegador, having the capability for further exploitation of a foreign market. Thus, the purpose of this report is to define the highest potential country to be explored next. To recommend the best target market, a country selection was developed combining a preliminary screening and a country ranking. The analysis suggested Germany as being the most attractive market for Insulac to export its cheeses, being followed by a thorough analysis of the selected country at an industry and competition level. Lastly, it was proposed a potential entry mode and performed a financial and risk assessment.

LITERATURE REVIEW

When considering an international expansion, it is essential to recognise the differences between countries; including size, language, quality of lifestyle, culture or even the market approach used (Cavusgil, Kiyak and Yeniyurt, 2004). According to Johanson and Wiedersheim-Paul (1975) and Johanson and Vahlne (1977), the “**Uppsala Internationalization Model**” defends that internationalization is a process where firms increase their international involvement gradually. Therefore, it focuses on the firm’s improvement and steady commitment to the foreign market, assuming a time consuming organizational learning process (Madsen and Servais, 1997). It is given the

example of Swedish firms, as they characteristically develop themselves internationally; initially by only exporting through an agent, and ultimately settling a sales subsidiary or even start producing in the foreign country (Johanson and Vahlne, 1977). This model assumes that: firms always start by their domestic market, the lack of market knowledge is one of the major barriers and that neighbour or culturally similar countries are the first to be invested. It also classifies a sequence of four stages in terms of operation extension, called the establishment chain; where the first stage is when there is no regular export activities, the second includes exportation through independent representatives, the third occurs when sales subsidiaries are established and, finally, the fourth stage when the firm start producing in the host country. Over the establishment chain, the resource commitment to the market as well as the provision of information to and from the market increases (Johanson and Wiedersheim-Paul, 1975). The “**Innovation-Related Internationalization Model**” adopts a perspective similar to the Uppsala Model, defending the company's slow international commitment, yet emphasizing new and innovative methods of internationalizing (Madsen and Servais, 1997). However, some firms expand their businesses without pursuing the traditional stages, considering the whole globe as their marketplace and starting to internationalize at birth. Those are named **Born Global** firms (Madsen and Servais, 1997) that compete based on quality and high technological products to niche targets (Rennie, 1993).

For Cavusgil (1985), the country selection is a process with three stages. **1st Stage: Preliminary Screening** which is the selection of the countries with the highest potential to be thoroughly examined. This is a combination of two assessments: Country Clustering, which determines the markets with macro similarities, by clustering the countries with resemblances in terms of their commercial, economic, political and cultural dimensions (Cavusgil, Kiyal and Yeniyurt, 2004). When dealing

with consumer packaged goods industry, the environmental conditions are also important to be analysed (Day, Yip, and Christmann, 1995); Country Ranking, will establish which markets are more attractive, by ranking each country of the set according to some indicators of market potential (market size, intensity or growth) relevant for the home country. **2nd Stage: Assessment of Industry Market Potential** to estimate the present and future aggregate demand. **3rd Stage: Analysis of Company Sales Potential** to each of the previously designated markets (Cavusgil, 1985). Regarding the international market **entry mode**, the firm must consider variables that ensure the entry in the foreign country and the local customer's satisfaction using all its resources (Root, 1994). There are three possible market entry choices. Export Modes, when the products are produced in its home country or in a third one and are sold in the target country. While direct exporting involves direct contact with intermediaries from the host market, indirect exporting includes the usage of domestic intermediaries that will be in charge of the sell to the foreign market. Contractual Modes, when a relationship between firms from different countries is reached and there is an exchange of know-how. Finally, Investment Modes includes the possession of infrastructures in the foreign country (Driscoll and Paliwoda, 1997). The selection of the international market entry mode will depend on factors based on the commercialized product, the firm itself, the domestic market and the foreign market (Koch, 2001). Based on Insulac's strategy and analysis presented below, the Uppsala Model is the best model to adopt, as it fits the company's internationalization prospects. The model will consider the company's ambition for a gradual international growth; therefore, the market entry mode chosen will be partly influenced by the company's lack of experience in the international cheese market.

METHODOLOGY

A primary and a secondary research were carried out to retrieve the necessary data for this dissertation. For the primary research, planned interviews were conducted to some managers of Insulac and e-mails were exchanged whenever needed, to access both the qualitative and quantitative data. The company's overview, current international footprint and strategic goals and financial information are some of the examples of this data that was collected. The secondary research involved the gathering of information from books, published articles and web resources, including some databases such as Euromonitor, globalEDGE, International Monetary Fund (IMF), among others.

INTERNAL ANALYSIS

a. Company Overview

Insulac – Produtos Lácteos Açoreanos, S.A. is an Azorean family enterprise that produces and sells dairy products, namely cheese, butter, powdered milk and sweet whey powder. It was founded in 1992, but started its activity only in 1995. Currently, Insulac counts with 180 employees. It owns a sales warehouse at Camarate (Lisbon) to help them cover the entire continental territory. Its **mission** is to produce high quality products, taking into account the innovation path, while its **vision** is to be a reference in the national dairy industry. Today, they are the 3rd biggest producer of dairy products in the Archipelago of the Azores and hold 4% of the total Portuguese market share¹.

Insulac products' portfolio comprises three different categories such as cheese, butter and powdered milk and sweet whey powder (**Appendix 1**). The company is specialized in the **cheese** production, which, in 2015, represented 41% of the total production and 64% of the total sales, commercializing under the brands Valformoso and Navegador a vast product portfolio, of Flemish, island, mozzarella, cured buttery, medium fat and spreadable fresh cheeses in different formats. Also, its **butter** products amount to 8%

of the total sales. These are the company's commercial products as they are directed to the final consumer and are available through the more relevant retail supermarkets. The average price for spreadable cheese is of 1,75€/200g., grated packaged cheese varies between 1,49€-1,79€/150gr. and the bigger formats of cheese may range around 5,99-8,99€/Kg (being purchased in pre-weighed bulk pieces) and butter about 1,15€/250g.. Given the highly fragmented market and huge supply in different pricing strategies, the firm's prices can be considered as affordable, competing with the majority of brands within the market. A significant amount of their retail production is sold to private labels from clients like Continente, Pingo Doce, Lidl or Auchan. Insulac has also a modernized drying equipment of milk and lactose powder, producing **powdered milk** and **sweet whey powder**, which represent 25% of the total sales. Since these products still need some processing, they constitute their industrial products (**Appendix 2**).

Concerning the **suppliers**, they sum a total of about 200 farmers that deliver the milk to either the factory or to one of the seven existing receiving stations scattered around the island, which is then collected and forwarded to the factory. This happens every day morning, to ensure that the milk is always fresh and guaranteeing its high quality.

Insulac was the first company in Azores and medium-large dimension enterprises from Portugal to receive an **international certification** of alimentary safety (ISO 22000:2005¹). Moreover, they were awarded other certifications, due to their transformation and production control systems. Thus, they can meet the highest quality standards of any market. In order to satisfy their customers, Insulac became aware that they had to be more innovative, fostering **Product Development**. Consequently, it is

¹ About 2196 ISO 22000 certificates were emitted worldwide, through IQNet Association, that is the most reputable network of certification associations globally. Approximately 90% of the emitted certifies are regarding alimentary organizations. More than 150 certificates were already emitted in Portugal. Apcer Portugal. http://www2.apcer.pt/arq/fich/Apresenta_o_APCER_0.pdf Retrieved November 10, 2016

essential for the firm to have a continuous investment in the quality and innovation of their products. They were the national pioneers of the production of Spreadable Fresh Cheese and, a new flavour of Herbs and Garlic has been added to it lately. Nevertheless, as the key is to exploit new ideas, they are experimenting new concepts to be developed and launched such as flavoured cheese cubes for salads or appetizers, but are doing so, first, in the local market to evaluate the customer's response.

b. Financial Information

In 2015, the total production reflected a total **Sales Volume** of €30,6 Million. Insulac manufactured 4.646 tons of cheese amounting to about €19,7 Million; 607 tons of butter attaining €2,3 Million; 3.639 tons of sweet whey powder and 2.438 tons of powdered milk reaching a total of €7,5 Million (**Appendix 3 and Appendix 4**). From 2006 to 2015, Insulac showed a positive trend in terms of revenues, since they have been gradually increasing them, in spite of some volatility. When compared with the year before, the total sales volume decreased 10,5%, mainly due to the reduction of the prices of the powdered products in the international markets. The decrease of sales volume was verified in almost every category. Cheese, the most significant one, as it represents 64% of the total revenues, had the highest drop of 10,87%, not only because of the afore mentioned reason, but also, due to the 7% decrease in the quantity sold. Nevertheless, the sales of cheese and butter under the brand Valformoso grew 35% compared to 2014. In 2015, they attained €5,7 Million more than in 2006, yet it was in 2014 they reached their highest value of €34.2 Million (**Appendix 5**).

c. International Operations

The limitations of the insularity inherent to the archipelago and the reduced dimension of the national market motivated the company's internationalization process. About

83% of Insulac's total sales volume is obtained from sales in Portugal, while the remaining comes from Netherlands (6%), Greece (3%), Spain (3%), Belgium (3%), United States of America (USA), Canada, France, Cyprus, Romania and even from the African continent, from countries as São Tomé and Príncipe, Angola, Morocco and Cape Verde (**Appendix 6**). While about 70% of the powdered products are exported to countries as Netherlands, Spain and Belgium, more than 90% of the cheeses and butter are sold in Portugal. Thus, as cheese is mainly sold in Portugal and it holds the largest margins (representing 64% of the total revenues), it has the highest potential to be explored. Additionally, the increasing pressure in the EU dairy market (with the milk quotas withdrawal) and a national market already so fragmented, whilst being concentrated amongst the largest producers, will lead to a tighter competition, which is why it is important to have other markets consuming the products.

Regarding **distribution**, Insulac commercialize their powdered products through European distributors who will sell them on their own, over the direct exporting intermediation. The export of the leftovers of cheese and butter to countries like USA, Canada or Angola results from indirect exporting intermediation, through the existence of Portuguese clients that possess their own companies and intend to retail their products to the Portuguese communities of the foreign countries. Usually, they initiate their expansion to a certain country considering first their network of contacts.

As this industry suffered some problems a few years ago, their biggest aim is to have a **gradual sustainable international growth**. Although Insulac already sell to these countries, it is visible the interest in exploiting markets like Cape Verde and São Tomé and Príncipe with the powdered products and markets such as USA and Canada with the cheese and butter, given the potential market sizes and number of Azorean

emigrants. As they already export to those countries, even if in small volumes, this report will not include them. The company considers as possible relevant markets Colombia and China. Colombia is considered to be an attractive country, as it currently opened its market to the importation of Portuguese dairy productsⁱⁱ and a Portuguese distributorⁱⁱⁱ recently opened a store there what can facilitate the access to the American market. China is also an interesting country, as, in 2014, it has opened its market to the importation of dairy products from Portugal including Insulac^{iv}. Europe is the largest cheese market worldwide and possibly the least risky one to export to, therefore the European countries in which Insulac is not present should be also assessed.

EXTERNAL ANALYSIS

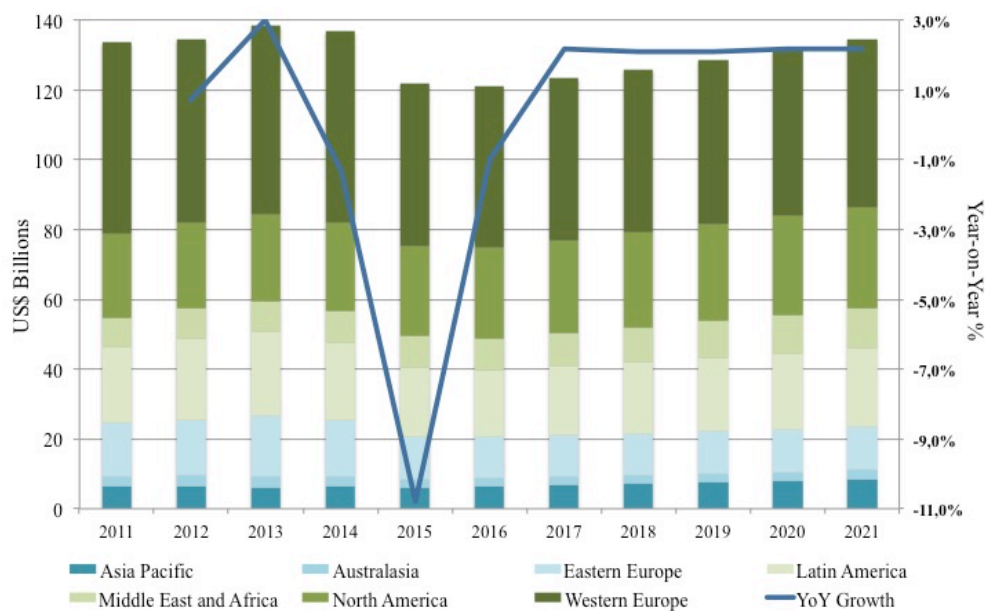
The Packaged Food Market comprises the food sales from Retail Sales and from Foodservice. Therefore, Insulac is inserted in the Retail Sales, as it is defined as sales resulted from establishments primarily engaged in the sales of fresh, packaged and prepared foods for home preparation and consumption, while Foodservice sales incorporates the sales stemmed from foodservice outlets that serve the general public in a non-captive environment. Also and more specifically, Insulac is integrated in the Dairy Market that can be subdivided in Butter and Margarine, Cheese, Drinking Milk Products, Yoghurt and Sour Milk Drinks and Other Dairy Products. Thereby, the Cheese Market will be the focus of this analysis.

a. Market Size and Growth

The **Global Cheese Market** is the second largest within the Dairy Products, after Drinking Milk Products. Within the last five years, it was in 2013 that its aggregated sales attained its greatest value amounting to almost \$139 Billion. From 2013 to 2015, it fell drastically amounting about \$122 Billion and it is expected to drop to \$120 Billion in 2016, mainly due to the economic and political instability of the biggest

economies globally, specially, given the weakening of the currency exchange against the US Dollar. Consequently, the percentage of CAGR² from 2011 to 2016 was of -2%. Besides, the dairy industry will continue to be pressured, given the overproduction of the EU, EUA and Oceania, the petroleum crisis and the Russian embargo. Meanwhile, China has returned to the markets, starting to import significant amounts of products, the petroleum has been slowly increasing its values comparing with last year and there are indices of negotiations between Russia and EU, to put an end to the embargo of the agricultural and alimentary products from EU.

Figure 1: Cheese Market Size in US\$ Billion and Year-on-Year Growth %



Source: Euromonitor International

Still, the market is projected to have a slow growth and normalize within the next five years, hitting the \$134 Billion in 2021 [Figure 1]. In 2015, the major Cheese Market Sizes were Western Europe (39%) and North America (21%) representing more than 50% of the total (Appendix 7). Specifically, USA (19%), France (8%), Germany (6%), Italy (6%), Russia (5%) and UK (5%) were the largest cheese markets (Appendix 8). Globally, the top cheese producers are the USA (26%), Germany (10%), France (10%),

² Compound Annual Growth Rate

Italy (6%), the Netherlands (4%), Poland (3%), Egypt (3%), Russia (3%), Argentina (3%) and Canada (2%)^v. Considering the Portuguese cheese market, it represents 0,7% of the total cheese market sizeⁱ and nearly 0.4% of the global cheese production^{vi}.

b. Market Trends

The Dairy Products are seen as beneficial and very rich in nutrients, gaining more attention for exploitation from snacks producers who want to invest in a healthier path^{vii}. It has been noticed the greater interest in milk alternatives, mainly sour milk products and flavoured milk drinks in the dairy developed markets. Additionally, conventional snacks like chocolates or tortilla chips, typically perceived as “junk food”, are losing share against snack replacements, which are smaller-portioned alternatives of basic and more nutritious food; these are for example cheese, yoghurts or drinking milk^{viii}. Thus, dairy producers can take advantage of this by exploring new opportunities, without being a snack producer. The key point will be to use a strategy leveraging innovation, for example by focusing in a determined target niche (e.g. cheese snacks for children’s school lunchboxes), by creating a new package format (e.g. cheese as a portable snack or at bite-sized cubes) or by differentiating the perceived image (e.g. cheese as a sweet snack competing with candies or cheese with different toppings). Currently in Portugal, the unpackaged format hard cheese (mainly sliced versions) has been the type of cheese with more developments, due to the economic crisis as the average unit price is lower.

c. Competitive Landscape

The Dairy Products are obtained from milk and its derivatives, which occur from its transformation process. Thus, the producers usually operate in several divisions of the Dairy Market, selling more than one type of product. For this reason, the Dairy Product competitor sample is very wide and broad, so it has become more significant to

examine the direct competitors. Focusing on the Global Cheese Market, the main direct competitors are big brands as Kraft Heinz Co. leading with 6.4% of the market share and commercializing top cheeses like *Kraft* (leader of the cheese brand market), *Philadelphia* or *Kraft Singles*, Lactalis Groupe with 6.3% of the market share manufacturing the brands *Président* (the second leader of the cheese brand market) or *Galbani*, or even Bel Groupe with 3% of the market producing the cheese *La Vache Qui Rit* or *Leerdammer* (**Appendix 9**). In Portugal, the strongest leader is Bel Groupe (or Bel Portugal) with 21.1% of market share commercializing the top cheeses *Limiano* (leader cheese), *Terra Nostra* or even *Pastor*, followed by Lactogal – Produtos Alimentares, S.A. with 16.6% of market share manufacturing *Castelões* or *Agros* (**Appendix 10**). As it is understandable, the Dairy and the Cheese Market are highly fragmented industries, the need of constant innovation is compulsory to meet the new consumer trends and obtain a sustained performance.

d. Industry Analysis: The “Six Forces” Model

The “Six Forces” Model is an extension of the known Michael Porter’s Five Forces Framework. It is a very useful and detailed model used to analyse the intensity of competition and the level of profitability of a determined industry. In this case, the Global Cheese Market will be the industry analysed [**Figure 2**]. A more detailed “Six Forces” Industry Analysis can be found in the **Appendix 11**.

Figure 2: “Six Forces” Model for the Global Cheese Market

<p>Threat of Substitution</p> <p>Moderate and Increasing</p>	<ul style="list-style-type: none"> - Substitutes: vegan or soy cheeses, crumbled seasoned tofu, nutritional yeast flakes, yogurts, common charcuterie products, jams or other products to spread; - Cheese continues to be the nutritionally richer and healthier product at the same time, being thus more difficult to stop consuming it; - Given the diversity of cheeses and the variety of prices, customers may firstly change to other cheaper cheeses or start consuming smaller quantities instead of switching to other different categories of products; - Although it is still seen as niche markets, it is important to highlight the rising of new trends that might cause a negative impact on the cheese consumption: the importance of breakfast cereals, vegan substitutes and soy beverages and the new tendency of Asian cuisines.
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<p>Threat of Entry</p> <p>Moderate and Stable</p>	<ul style="list-style-type: none"> - Relatively large amount of capital is required; - Firms wanting to go global will have to adapt their processes to large-scale operations to ensure economies of scale; - Domestic entrants might compete with the big brands, yet in local markets; - Cheeses are relatively similar among it selves; - Not difficult to understand the know-how of this industry; - The most used distribution channel is Store-Based Retailers where the capacity is very limited and restricted, giving more importance to the already known cheese brands or to their own cheese private labels; - Mainly as we are trading food product there are some governmental and legal barriers to consider as every country has its own standard market rules.
<p>Buyer Power</p> <p>High and Stable</p>	<ul style="list-style-type: none"> - Buyers: mainly Store-Based Retailers (supermarkets, hypermarkets, independent small grocers, discounters); - Given the huge variety of cheese offered and its small differentiation, the buyer's price sensitivity is smaller and, thus, there is more pressure for price reductions; - More than 50% of the distribution channels used to retail cheese are Supermarkets and Hypermarkets that will require a small amount of purchases having a smaller cost of losing a determined supplier and, thus, an higher relative bargaining power; - Existence of vertical integration from some retailers that start producing and selling their own-brand cheeses and increasing the consumers' willingness to switch brands due to the lower price practiced; - The pricing strategies are the key factor for the retailers.
<p>Supplier Power</p> <p>Low and Stable</p>	<ul style="list-style-type: none"> - Suppliers: dairy farmers that provide the milk to be transformed; - Commonly, they are smaller-sized with higher switching costs; - Milk is a non-differentiated product and buyers make great amounts of purchases, being extremely significant for the dairy farmer's final revenues, resulting in a higher supplier's price sensitivity; - Typically, farmers provide one type of milk, they are smaller scale and do not have a significant impact in the market which leads to a weak relative bargaining power; - Suppliers may integrate vertically, by producing and selling their own cheese in the local and domestic markets.
<p>Industry Rivalry</p> <p>High and Stable</p>	<ul style="list-style-type: none"> - The global cheese market is highly fragmented and competitive; - In 2015, the <i>CR4</i> was of 18.4% and the <i>CR8</i> was of 24%, meaning the industry has a scarcely degree of concentration as none of the biggest companies owns a very large portion of the market, increasing the level of competition between them; - Competitors differentiate themselves through its country of origin (for instance Italian and French cheeses are very well known globally for its intrinsic characteristics related to its origin), having the chance to avoid pricing strategies; - Cheese can be differentiated through its categories (fresh, soft, semi-soft, firm, hard and veined cheese); - The price tends to be the truly decision maker, leading to producer's smaller profits; - The cheese market is expected to have a slow growth during the next years, which means that companies will be competing for each other's market share, increasing the competition.

<p>Complementor's</p> <p>Moderate and Stable</p>	<ul style="list-style-type: none"> - Cheese can be consumed in variable situations during the day, not have a single and unique complementor; - Possible complementor's: bread, crackers, spreads like jams or chutneys, some fruits, olives or nuts, olive oil or honey, wine or even meat; - From 2011 to 2016, nuts, fruits and meat had the major % CAGR growth rate and are foreseen to continue to grow until 2020.
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Thus, it does not seem appealing to compete in the Global Cheese Market as it does not look very profitable, given its highly fragmented and competitive environment that is dominated by the largest firms. Nevertheless, and given the similarity of the product, companies should differentiate themselves by leveraging on innovation.

COMPETITIVE ADVANTAGE

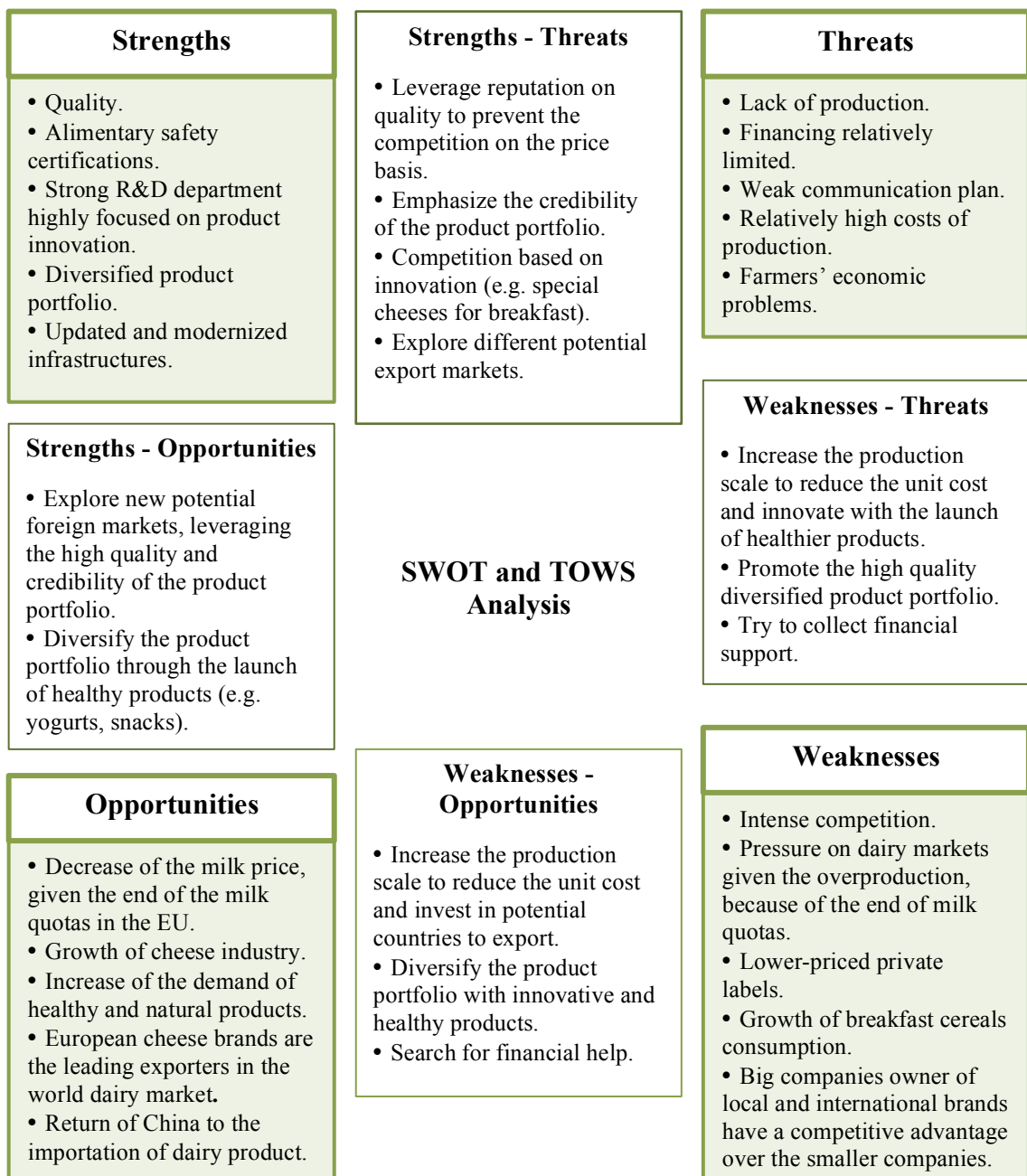
The success within the Cheese Industry can be achieved by different factors that make the company survive and grow – the **Key Success Factors**. While some companies intend to compete on a price basis strategy, reaching a wide range of consumers, other firms compete via product innovation and differentiation, following the new consumer's trends (**Appendix 12**). In external environments subject to constant changes, it is the internal and idiosyncratic organizational resources that offer a more secure basis for strategy than the industry focus. Thus, an **Organizational Resources Platform** was conducted to Insulac's resources and, through the illustrative assessment, it revealed that the core resources of the business are: **Location**, given its intrinsic characteristics, which guarantees the excellence of its cheeses, **Alimentary Safety Management System**, ensuring the Insulac's highest food quality standards to facilitate the entrance in foreign markets and **Research&Development**, where the focus is to be updated in accordance with the market innovations and trends (**Appendix 13**). Further, it was necessary to understand if those key strengths were “**VRINNO**”, meaning if they guarantee a sustainable competitive advantage or not. It concluded that Insulac only has Temporary Competitive Advantage, as the isolating mechanisms of Alimentary Safety

Management System and Research&Development resources do not ensure its uniqueness and sustainability. A detailed VRINNO Framework is in **Appendix 14**.

SWOT AND TOWS ANALYSIS

The SWOT Analysis helps to understand the internal strengths and weaknesses of Insulac and identify the external opportunities and threats it faces within the Cheese Market. The TOWS Analysis transforms the SWOT results into meaningful and efficient strategies to be adopted afterwards [Figure 3].

Figure 3: SWOT and TOWS Analysis



INTERNATIONALIZATION READINESS

As Insulac's cheeses are mainly sold nationally and only the leftovers are to export, there is an opportunity for further exploitation of a foreign market. To assess Insulac's readiness to internationalization, a complementary approach, the CORE Tool, was applied. The CORE Tool showed that Insulac's readiness to internationalize is **moderate**, meaning that they are able to internationalize, yet there are some dimensions that need some improvement, especially, regarding the product readiness that may not be outstandingly equipped for foreign market penetration (**Appendix 15**).

COUNTRY SELECTION

After assessing Insulac's internal and external analysis, it should be determined the country with the highest potential to expand the firm's products. This selection will be divided in three steps: (i) definition of an initial set of potential countries, (ii) combination of two country screening approaches (clustering and ranking), and (iii) discussion of the results and definition of the target country.

a. Initial Set of Countries

According to Insulac, there are some interesting countries to where they would like to expand. As it was already mentioned in the International Operations, **Colombia, China** and the **European Countries** are seen as very attractive countries that should be included in the analysis. On the whole, it is an initial set of 33 countries³.

b. Country Screening

To identify the markets with the highest potential, a **preliminary screening** was developed to reduce the initial set of countries. To identify the most attractive countries to be analysed afterwards, the preliminary screening was based on the macro criteria - Urban Population, Index of Economic Freedom, Country Risk, Currency Risk and

³ Countries or independent territories such as Armenia, Belarus, Georgia, Kosovo, Liechtenstein, Monaco, Montenegro, Russia and San Marino were not considered given the lack of information available and the Russian embargo.

Political Risk (**Appendix 16**). After studying the country data on the macro criteria, a final set of 10 countries was attained (**Appendix 17**).

i. Criteria Selection

According to Cavusgil (2004), the country selection should consider “new and more firm- or industry-specific dimensions”. Therefore, macro (including the preliminary screening’ criteria) and micro or firm-specific indicators were taken into account to define the criteria. Macro level criteria include Urban Population, Gross National Income through the Purchasing Power to Parity (PPP) method, Gross Domestic Product Growth Rate, Gross National Income PPP Per Capita, Country Risk, Currency Risk, Political Risk and Index of Economic Freedom. And micro and specific-industry level criteria such as Cheese Market Size, Forecasted Cheese Market Growth Rate, Herfindahl-Hirschman Index, Importance of Cheese in the Dairy Industry, Expenditure on Cheese Per Capita, Consumption of Cheese Per Capita and Tariff on Imports of Portuguese Cheese. They are described in detail in the **Appendix 18** and **Appendix 19**.

ii. Criteria Standardization and Distribution of Weights

To avoid artificial weighting when examining the country data (Cavusgil et al, 2004), all the information was standardized, being converted to a scale of 1 to 100 by the **Formula 1** in the **Appendix 20**. Also, every variable was weighted and as the micro and firm-specific indicators are more relevant, it represents 80% of the final decision while the macro indicators express 20% [**Figure 4**].

Figure 4: Distribution of Weights

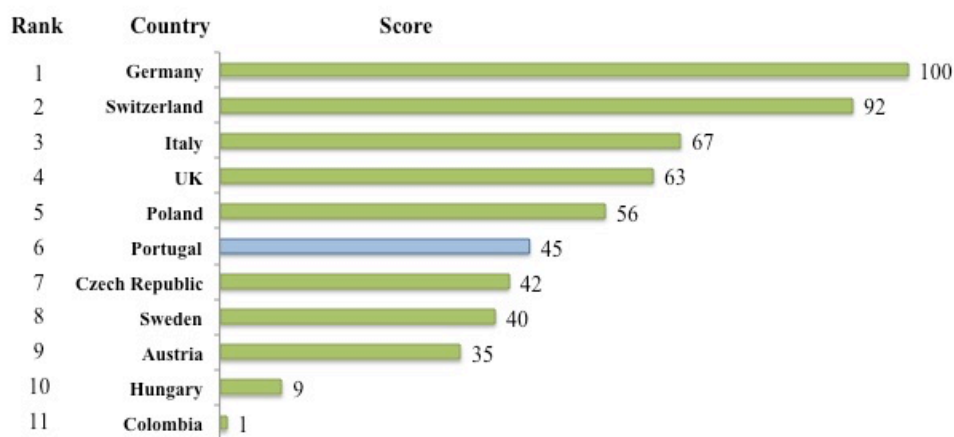
Level	Variables	Weight
Macro (20%)	Urban Population	2,00%
	GNI PPP	4,00%
	GDP Growth	4,50%
	GNI PPP Per Capita	3,50%
	Country Risk	1,00%
	Currency Risk	1,00%
	Political Risk	1,00%
	Index of Economic Freedom	3,00%

Micro and Firm-Specific (80%)	Cheese Market Size	10,00%
	Cheese Market Growth	20,00%
	HHI	15,00%
	Importance of Cheese in the Dairy Industry	10,00%
	Expenditure on Cheese Per Capita	10,00%
	Consumption of Cheese Per Capita	10,00%
	Tariff on Imports of Portuguese Cheeses	5,00%

iii. Results

Once the analysis was completed (**Appendix 21**), the country with the highest score was Germany, followed by Switzerland, Italy, UK, Poland, Czech Republic, Sweden, Austria, Hungary and Colombia as it is presented in **Figure 5**. If Portugal were considered, it would be ranked as #6 of the overall.

Figure 5: Standardized Scoring Results by Country



Therefore, Germany is the suggested target market to export Insulac's cheeses.

THE GERMAN MARKET

Germany has the largest population (81 Million) and the largest economy of the EU. It is a developed high-income country and one of the wealthiest in the world, with a GDP of \$3,356 Trillion^{ix} and \$47,268.5 Per Capita.

a. Macro-Economic Analysis (PESTLE)

In order to understand the macro-environmental factors of Germany, a PESTLE Analysis was assessed. **Figure 6** summarizes the important forces of each component of the analysis and a detailed PESTLE is provided in **Appendix 22**.

Figure 6: PESTLE Analysis for the German Market

Political	<ul style="list-style-type: none"> • Strong democratic system; • One of the founding members of the European Union; • Prominent member of numerous international organizations; • Ranked 10th in Transparency International's Corruption Perception Index.
Economic	<ul style="list-style-type: none"> • World's 5th largest economy in PPP terms and the greatest of the EU with a GDP of \$3,356 Trillion; • Specialized in the industrial sector; • World's 4th largest exporter and importer; • Unemployment rate of 4,6% in 2015.
Social	<ul style="list-style-type: none"> • Largest population of the EU of about 81 Million culturally diversified; • Demographic problems as ageing population (21,45%), low fertility rates (1,47children/woman) and an increase in net immigration; • Germans tend to be more individualists and more rational / objective.
Technological	<ul style="list-style-type: none"> • Highly dedicated to the national science, technology and research; • Telecommunication systems are worldwide technologically advanced; • About 90% of all households homes have cable or satellite TV, about 91% have access to computers from home and 90,3% have Internet access, representing the 8th largest internet population in the world.
Legal	<ul style="list-style-type: none"> • Scored with 74,4 in to the Index of Economic Freedom; • Mostly follows free trade policies; • No customs duty on the import of goods from other EU members; • Ranked as 17th in the World Bank's Doing Business Report.
Environmental	<ul style="list-style-type: none"> • 31% share of renewable energy in gross electricity consumption; • Ranked as 30th in the Environmental Performance Index; • High air pollution levels, cause of many deaths.

b. Industry Analysis

In 2015, the Dairy Industry in Germany reached \$20.097 Million, being the largest industry within Packaged Food. Specifically, the **Cheese Market** accounted for 37% of the dairy market (**Appendix 23**), having aggregated \$7.463 Million and it is expected to grow 1,8% (CAGR%) from 2016 to 2021 (**Appendix 24**), although, the forecasts for the whole dairy industry suggest a growth of only 1%. Regarding **competition**, the cheese market is highly fragmented, signalling a high degree of rivalry, and with no company holding more than 10% of the market. The largest players include Savencia Fromage&Dairy (9,3% of market share in 2015ⁱ), Hochland SE (6,8%), Groupe Bel (5,4%) and Groupe Lactalis (3,4%) (**Appendix 25**). Considering **distribution**, the most used channels are store-based retailers, specifically discounters (39,1% of salesⁱ),

supermarkets (22,4%), hypermarkets (17%) and independent small grocers (12,8%). In terms of **prices**, when considering the average price per kilo of cheese in Portugal and Germany (7,21€ and 7,58€ respectively) there is a slight difference as in Germany prices may rise more, yielding a positive impact for Insulac when defining its margins lightly lower (**Appendix 26**).

Concerning the **consumer trends**, unlike many other edibles, cheese continues to sustain a good reputation in Germany, as it is widely perceived as a healthy food and it is popular, not only for consumption with bread, but also for cooking and baking or even with salads and at barbecues. Increasingly companies innovate in their product portfolio, by launching new flavours of cheeses, such as spicy flavours with chilli and paprika or pepper or producing in new formats. Within the soft cheese, mozzarella and feta are becoming trendy and are mainly used in salads. In 2016, packaged hard cheese saw the strongest performance, given the growing demand for long-aged cheese, due to its greater convenience as they are often purchased in pre-weighed bulk pieces. Considering the spreadable processed cheese, the biggest innovation besides new flavours, was regarding the packaging format by changing the typical rectangular shape into the form of a tartlet. Within the processed cheese, the cream cheese continues to be the most popular with a 69% share of the overall sales of spreadable processed cheese¹.

c. Entry Mode Definition

The extent of involvement when internationalizing will depend on the commercialized product, the firm itself, the domestic market and the foreign market (Koch, 2001). The highly fragmented market combined with the Insulac's relatively small international expertise of the cheese market, with the moderately limited resources and the gradual sustainable international growth strategy suggests exporting as the preferential entry mode. Nevertheless, the firm may determine the type of exportation. While direct

exporting involves the direct contact with intermediaries from the host market, indirect exporting includes the usage of domestic intermediaries that will be in charge of the sell to the foreign market. Although, the direct exporting provides Insulac with the market knowledge and a higher level of control, the usage of domestic intermediaries helps to reduce some uncertainties and other risks related with expansion (Fernández-Olmos and Díez-Vial, 2014). In other words, indirect exporting benefits from the intermediaries' know-how, which allows saving costs related to search of new customers, implementation of contracts and to prevent the direct trade costs of getting into the international market. According to Fernández-Olmos and Díez-Vial (2014), the chances of selecting direct exportation as mode of internationalization increase with the growth of the firm's international experience. Thus, and given the Insulac's relatively reduced size and lack of knowledge and resources required to viably operate in international markets on its own, the **indirect exporting** through an export **agent** is recommended as the most appropriate entry mode choice.

d. Financial and Risk Analysis

Numerous factors should be considered when evaluating the viability of the entry in the German cheese market. Regarding the **entry costs**, the entrance in Germany does not require significant investments as Insulac currently holds **sufficient spare production capacity** for this initial stage of exportation. Additionally, the company already produces for export purposes and the quantity of cheese sold in the domestic market has decreased by 7% in 2015, meaning that having other markets to sell is an advantage. There seems to be no related opportunity cost as it is expected to accommodate both domestic and German projected sales. Additionally, there is **no expected need to hire a supplementary person** as this initial contact with the export agent can be managed by the team responsible for the cheese exportation. Besides, there is no need for

numerous modifications of the **packaging** as the requirements are similar across EU, to where Insulac already exports. Other costs may include expenses to protect intellectual property, in this case, through the Institute for Intellectual Property of the European Union, where the **trademark registration** costs about 850€^x and also **marketing expenses**, concerning the presence in Fairs directed to the Cheese Market. The contribution margin of each product will be subject of the **export agent commission** that is usually around 10% for consumer goods^{xi}. The **shipping cost** will be similar to the cost to countries such as the Netherlands where Insulac is already present. Ultimately, the firm should also include the **potential savings** inherent to economies of scale given the increase in the production volumes. In terms of **exit costs**, these seem to be relatively low. Even if an order is annulled and its production has already started, the packages can be used for other markets. To determine whether the **investment is worthwhile**, due to the lack of data, like the retailer's margin, the final margin cannot be calculated. Nevertheless, the forecasted enough spare capacity and, given that some of the afore stated entry costs, particularly the shipping costs, which can be combined with other EU countries, it appears to be worthwhile to enter Germany. If Insulac decides to export to Germany, it should consider the following **risks**: (i) **managerial risk** - the selection of the export agent may become an issue, as, usually, these agents allocate higher commercial effort to products that ensures them an higher commission and with their exporters with whom they have a better relationship; (ii) **business risk** – the usage of the existing spare capacity to sell in Germany may force Insulac to abandon sporadic orders that could possibly yield higher margins; (iii) **competitive risk** - the leading player in the cheese German market can undermine Insulac's entry given its low brand awareness; (iv) **market risk** – although cheese market forecasts a positive market growth for the next years, this industry is very uncertain.

CONCLUSIONS AND RECOMMENDATIONS

Given Insulac's intent to pursue its expansion, the conducted research suggested **Germany** as the highest potential market. The company should initially approach this market through **indirect exporting** via an **export agent**. In order to be successful with this exportation, a set of **recommendations** should be considered. It is recommended for Insulac to conduct a field market research to estimate the potential sales in Germany and determine if it needs to expand its production capacity, as a detailed financial analysis was not executed due to the lack of information available. The company should assess whether their existing **export agents** are present in the German market. If not, they should identify the agent with higher sector knowledge, market experience and coverage. Nevertheless, the company should supervise the performance of their products and obtain valuable market insights, because, if the sales volume increases it might be the time to consider the direct exporting mode. It should protect the **intellectual property** of its exported products if it decides to increase its commitment. Also, it should evaluate the launch of **innovations**, for instance, the development of new flavours, such as spicy flavours, or new cheese formats proper for salads. Regarding **product-line**, Insulac should start by exporting the spreadable fresh cheeses, mozzarella and the island cheese (the one with higher maturity) under the brand Valformoso to meet the customer's demand. Moreover, the presence in the **European Cheese Fairs** is essential to follow the trends of the region. In order to diminish the lack of brand awareness, its products should be **priced within the market average** or, if the margins allow, slightly lower and leverage their **certifications** to strengthen its credibility. The German retailer Lidl and Portuguese retail shops should be assessed as potential **distributors**. Finally, as the number of **Portuguese** living in Germany is relatively relevant^{xii}, their cheeses could be promoted near those communities, leveraging the 'nostalgic or diaspora market'.

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