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Marketing Strategies of Western Consumer Goods Firms in Central and Eastern Europe

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Abstract

The rapid and often drastic changes in national business environments in the course of the transition from centrally planned to free market economies pose specific challenges to Western consumer goods firms in Central and Eastern Europe. Once lured by the huge market potential they are faced with a poorly developed marketing infrastructure, price-conscious and not very brand-loyal consumers, and intense competition. When designing their marketing strategies they have to find a balance between likely returns on investment and the risks involved. Building up a local presence in a stepwise manner, transferring marketing strategies from the West in a sensitive way and developing regional management structures seem to be effective approaches for Western firms in this region.

9.1 Introduction

Most studies dealing with the massive changes in the economies and societies of the reforming countries of Central and Eastern Europe (CEE) in the years since the fall of the Iron Curtain focus on macroeconomic aspects, namely institutional reforms, their economic effects and the overall progress of the transition from a centrally planned to a market economy. Little attention has been paid to the consumer revolution that grasped the region, particularly in the more economically advanced countries of Central Europe. The economic opening of the region was followed by an influx of Western multinational corporations (MNCs), which flooded the markets with their international brands and products and introduced Western marketing methods. Developments that

unfolded in Western Europe over a period of 30 to 40 years happened in CEE in just a few years. Consumer choice, in the Western sense, had not existed before: no real brands had been available, buyers had not been able to make informed choices about products or judge prices and quality, and the mere availability of a product had often been the main buying incentive in times of scarcity in the communist era. The media had been controlled by the state and contained no advertisements.

Today these markets have become – or at least on the surface – more similar to West European markets. The increased product offering, the strong presence of Western brands in supermarkets and shopping centres, mostly owned and operated by well-known foreign retailers, and Western-style advertising is noticeable when one travels through metropolitan areas of Central Europe. However from the consumer's perspective the differences from the West are still striking. Although average household incomes have risen, purchasing power is lower than the West European average. This limits the disposable income of households and leads to very price-conscious shopping. Brand loyalty is relatively low and value-for-money is the most important criterion for consumers in CEE (Shama, 1992; Schuh and Damova, 2001). This raises the pressure on Western marketers to find ways of offering their quality products to lower-income mass markets without tarnishing the brand image and selling at a loss. The desire to attract the relatively small group of consumers who can afford Western brands is heating up competition between international firms (Dahm, 1996) and CEE markets are now among the most competitive in the world. For instance 11 firms are offering 14 brands in the Polish detergent market at 30 per cent less than the West European price and marketing is far more active than in comparable West European markets. In technology-driven product markets (for example detergents, cosmetics and body care products) the competition is mainly international, but local producers are major actors in the food and beverages sector, where local tastes and a strong affection for traditional (and cheaper) local brands are challenging the marketing efforts of Western firms.

Against this background we shall now analyze the market entry and marketing strategies of Western consumer goods firms in CEE and investigate the business logic guiding these moves. Based on published studies and empirical evidence we shall focus on three issues:

- What are the right modes of entry and operation for Western firms?
- Can marketing strategies be transferred from Western markets or should highly localized strategies be adopted?

- How should Western firms organize their marketing activities in CEE?

9.2 Motives for market entry

The liberalization of the political and economic systems in Central and Eastern Europe opened a huge new market for foreign firms. In particular the enormous growth potential of the region prompted a rush into these markets in the early 1990s. The CEEC-10 alone – consisting of the more economically advanced countries of Central Europe (Slovenia, Hungary, Poland, Czech Republic, Slovak Republic), the three Baltic states and Romania and Bulgaria – constitute a consumer market of about 105 million people. When the countries of former Yugoslavia, Ukraine and Russia are added the number rises to 325 million people, close to the 370 million in the EU-15. GDP growth rates are expected to rise above the EU average in the course of the catching up process.

The prospect of building a market almost from scratch fuelled the expansion to the east. However the average consumption of typical consumer products such as toiletries, beverages, confectionary, detergents and household cleaners is still well below Western levels and a considerable proportion of people still have no insurance cover or cheque accounts. Therefore it is no surprise that entry into these markets was and still is market driven (Engelhard and Eckert, 1993; EBRD, 1994; Wes and Lankes, 2001).

In the case of European and global MNCs that are major players in oligopolistic industries, competitive considerations are important drivers too. 'First mover advantage' is seen as vital to success in CEE (Quelch *et al*., 1991; Schuh and Damova, 2001) as first entrants can outmanoeuver their competitors by occupying 'first in the market' status in consumers' minds, blocking access to marketing channels or buying leading local firms to secure local production facilities, established brands and the existing customer base. More recently a quicker and less cautious entry pattern has been exhibited by Western companies in the countries of Eastern Europe (for example Ukraine) and South-Eastern Europe (Bulgaria, Croatia, Bosnia-Herzegovina). The major players in the region are now fighting for dominance and are trying to complement their existing Central European operations. Having a presence in these new markets is regarded as a strategic necessity and this seems to outweigh the rather low attractiveness of certain country markets. Production-oriented considerations also play a part as the lower local production costs allow Western firms to

service price-sensitive mass markets that could not be covered by exporting.

9.3 Market entry strategies

Market entry into the CEE countries more or less conforms to the modes laid down in internationalization theory, which is based on the experiences of European and US firms in Western Europe and other parts of the world in the 1970s. The dominant tendency is to increase resource commitments gradually over time (Engelhard and Eckert, 1993; Schuh *et al.*, 1994; Shama, 1995). Three major entry modes have been popular among Western firms: exporting, forming a joint venture with a local partner, and acquiring a local firm in the course of the privatization process.

International companies start with less risky entry modes such as exporting. Exporting to retailers or wholesalers presents the lowest financial risk and provides companies with valuable feedback on the acceptance of their products and the effectiveness of their sales tactics in the market in question. When sales rise and the local business outlook is favourable, companies may invest more in the market and open a representative office or a sales office. Representative offices allow companies to gain more information on the market, to educate customers and middlemen, and to secure better control over their marketing efforts. If the business develops according to plan the office may be transformed into a marketing and sales subsidiary, and parts of the production process (for example assembly or component production) may be shifted to the CEE.

The example of Philips Consumer Electronics depicted in Figure 9.1 can be regarded as a typical entry sequence in the mid 1990s. It also highlights the correspondence between level of commitment and the perceived economic development and political stability of the entered countries.

Besides exporting, joint ventures between Western and CEE partners have been very popular (Shama, 1995). There are several reasons for the attractiveness of joint ventures. At the beginning of the 1990s, in some countries (for example Russia) foreigners were not allowed to be the sole owner of a domestic company. Even where full ownership was permitted joint ventures were viewed as an effective mode of operation in non-transparent business environments such as economies in transition where a strong local partner's knowledge of the market and business customs, integration into the local business network and relationships

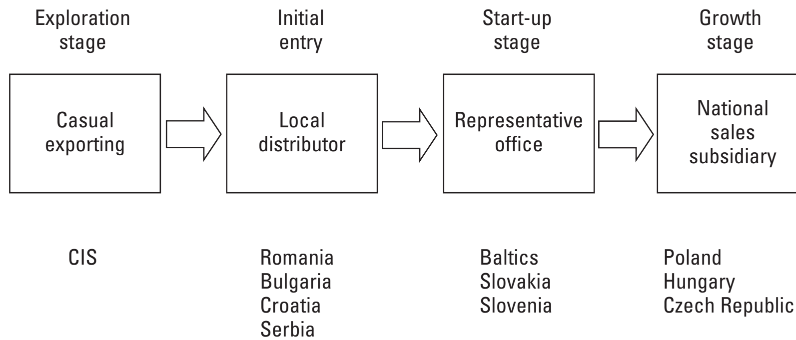

Figure 9.1 The entry of Philips Electronics into the CEE countries

with government officials were valuable assets for the foreign investor. Moreover it was often politically impossible or unwise to sell an established national flagship company to a foreign investor. Although the people in CEE were aware of the economic stimulus generated by foreign direct investment they were emotionally averse to the sale of their country's 'crown jewels'. A joint venture where a major stake remained with local owners, mostly state agencies, gave the impression that local representatives still had a say in the company. However a look back tells us that most of the joint ventures were only temporary in nature. Local partners acted mostly as caretakers, knowing full well that in order to survive they depended on the capital, management know-how, technology and business network of the investor. Success stories such as the acquisition of the majority share of the Czech car manufacturer Skoda by Volkswagen, and of the Slovak white goods producer Tatramat by Whirlpool Europe, show that major restructuring efforts and the subsequent turnaround happened only after the foreign investor obtained a qualified majority or full ownership of the firm.

When the privatization of state-owned companies began in the mid 1990s, the sale of large national companies offered a unique opportunity for established foreign companies to expand their market position and for new entrants to become major players in the market. While internationalization theory presupposes a trend from exporting to local production, the pattern in CEE was not uniform and differed by country and industry. Local production by foreign firms was more common in the consumer goods industry, where mass markets were served and therefore geographic coverage was important (for example in the case of retail outlets, breweries and petrol stations), and of course in financial

and other services and telecommunications. The cultural rootedness of products such as chocolate, dairy products and beer in terms of taste and regional identity made local producers attractive takeover candidates for foreign companies, and major players such as Nestlé, Unilever, Kraft Foods and Danone seized the opportunity offered by the privatization process to establish a presence in the region.

Nowadays entering CEE markets has become more costly and difficult, new entrants are faced with stiff competition from well-entrenched international competitors and well-known local brands have already been bought up, although new local companies are mushrooming. Advertising prices have soared, making media campaigns more expensive. However, as retailing in CEE has been Westernized in the last few years (with the arrival of Metro, Carrefour, Tesco, Rewe/Billa, Spar and so on), entry via a retail partner has been another market entry option. The idea here is to capitalize on good business relations with Western retailers in the home market by following them into the CEE region. Exporting through a middleman suits producers of consumer goods aimed at upper market segments (for example spirits, confectionary, cosmetics) whose growth is highly dependent on overall economic development and where sales volumes are still very small. For smaller MNCs that cannot afford huge up-front investments the incremental approach offers a good balance between returns and risks.

9.4 Marketing strategies

A major consideration when entering a foreign market is the degree to which a marketing strategy used successfully in the core market should be adapted to the business environment and market conditions in the target market (Hooley, 1993). The main elements of this strategic marketing decision are the choice of target segment, the positioning of the product *vis-à-vis* local consumers and the selection of the marketing programme. By varying these factors it is possible to develop marketing strategies that are tailored to particular local markets. As there are huge gaps in purchasing power and overall market development between CEE and the West, at first sight a differentiation strategy seems most appropriate. The average GDP per capita, in purchasing power standards, ranges from 23 per cent of the EU-15 average in Bulgaria, 29 per cent in Romania, 48 per cent in Hungary to 60 per cent in the Czech Republic and 68 per cent in Slovenia (Eurostat, 1998). However efficiency considerations and the tendency towards more homogeneous global brand strategies are limiting the scope for local customization.

Parallel to the political and economic liberalization of the CEE countries there has been a strengthening of the market globalization perspective and global business logic (Schuh, 2000; Kozminski and Yip, 2000). World markets and consumer behaviour are viewed as increasingly converging, which is enabling internationally operating firms to adopt a more standardized marketing strategy worldwide, including CEE. Most of the marketing strategies of Western MNCs belong to one of three types:

- Transfer of Western strategy.
- Multitier product and brand strategy.
- Regional strategy.

Transferring the strategy used in Western markets is typical at the entry stage as it is not sensible to enter a market with an adapted product and a highly localized marketing programme (Arnold and Quelch, 1998). Adaptations are made only if they are not too costly. This is especially important in high-risk environments such as transition economies as firms, especially small and medium-sized ones, do not wish to invest heavily in product adaptations when the return is unclear, and the need for economies of scale prohibits costly variations in products and packaging. Core elements of the marketing mix – the product itself, packaging and advertising – are increasingly centrally determined and cannot be changed by the local management, although labelling, package design, package size and the name of the product sometimes have to be changed to meet local legal requirements (if not yet incorporated into the global or regional brand concept) and instructions have to be translated into the local language. Package sizes are often smaller in CEE because most households cannot afford to buy large quantities without reducing their spending on other necessary products. For instance Pampers disposable nappies can be bought singly in Bulgaria and shampoo and instant coffee are available in small sachets.

While exporting reduces the risk involved it also limits the scope for customization. However the Western origin of products is of appeal to consumers in CEE (Johnson and Loveman, 1995) who are familiar with Western brands from trips to the West or from media coverage, and are willing to pay a higher price for them, or at least as long as the price–quality ratio in relation to locally produced goods is considered fair. In combination with exporting, transfer of the Western strategy works well when product markets are small or just beginning to emerge, when local usages are not markedly different from in the West and

when the product's superiority (in terms of quality, performance or image) is obvious to local target groups. Then the only obstacle to local expansion of the business is the high price.

Prices in CEE markets tend to be in line with those in the West and are not usually adjusted to the lower local purchasing power levels. The additional costs of exporting (transportation, taxes, import duties and so on) and the threat of re-export to the West by Europe-wide wholesalers or retail chains restrict the room for downward price adjustments. Even MNCs which manufacture global brands at lower cost in CEE have to follow the global pricing policy and are not allowed to offer these brands at reduced prices which are more in line with local purchasing power levels.

In their pricing decisions local managers often have to comply with 'European price corridors' that limit the maximum reduction from the highest price in Europe to 6–8 per cent. This does not reflect the differences in purchasing power between Western and CEE countries, and thus hampers or slows the expansion of the international brand business. To compensate for this, Western MNCs often switch to a so-called multitier brand and product strategy, in which well-known local brands are marketed alongside the international brands (Batra, 1997; Schuh, 2000). Typically such brands are acquired by an MNC through the purchase of a local firm. While the international brands cater to the luxury end of the market, the revamped local brands are aimed at the low- to medium-price segments (Table 9.1). The value-for-money local (and often regionalized) brands – are an extremely effective vehicle for opening up price-sensitive mass markets.

The 'portfolio' concept used by the German firm Henkel is a good example of a multitier brand strategy. Henkel divides the detergent market into three price tiers:

- Premium: brands such as Persil are promoted as offering top quality performance and are priced comparably to the West European levels.
- Medium: acquired local brands (Palmex, Tomi) are aimed at traditional, brand-loyal customers and are priced about 20 per cent lower than their counterparts in the premium range.
- Economy: new brands such as Rex are aimed at highly price-sensitive consumers and are priced about 40 per cent lower than the premium brands.

The incorporation of Western quality and modern image into reasonably priced products that meet local demands is very appealing to local

Table 9.1 Brand portfolios of selected firms following a multitier strategy in Central and Eastern Europe

	Product category	*International brands*	*Examples of regional or local brands in CEE*
Henkel (Germany)	Detergent	Persil	Orion (Poland) Palmex (Czech Republic, Slovakia) Tomi (Hungary) Rex (throughout CEE)
Procter & Gamle (USA)	Detergent	Ariel	Tix (Czech Republic, Slovakia) Bonux (throughout CEE)
Kraft Foods (USA)	Chocolate	Milka Suchard	3Bit (Czech Republic, Poland, Hungary) Poiana (Romania) Svoge (Bulgarian)
Nestlé (Switzerland)	Chocolate Sweets	KitKat Nestlé Polo	Orion (Czech Republic, Slovakia) Boci (Hungary) Sfinx (Czech Republic, Slovakia)
Interbrew (Belgium)	Beer	Stella Artois, Beck's	Klinskoye (Rumania) Borsoni Sör (Hungary) AstikA (Bulgaria) Ozujsko Pivo (Croatia) Niksico Pivo (Yugoslavia) Chernigivski Pivo (Ukraina)
BBAG (Austria)	Beer	Zipfer Kaiser Gösser	Silva (Romania) Soproni aszok (Hungary) Starobrno (Czech Republic), Van Pur (Poland)

consumers. From the perspective of Western MNCs, the parallel coverage of all market segments gives them some protection against fluctuations in demand, which can be dramatic in transitional economies as economic slumps usually lead to extreme cut-backs in household spending. Under budgetary pressure households will switch to the MNC's cheaper products and therefore will not be lost as customers. A diversified brand portfolio can also help to secure economies of scope in local production and logistics, to strengthen bargaining power *vis-à-vis* suppliers and retailers, and to fund the introduction of international brands to the local market. However, in strongly culture-bound product categories such as beer the major demand is still for local brands and international brands are less popular in most CEE countries.

When considering whether to keep the existing brands or to introduce new ones managers are faced with cost issues. The sales volume of a local brand is often too small to generate sufficient profits to cover the cost of upgrading and relaunching the brand, especially, when it is aimed at the lower end of the market. Regionalization is often seen as a solution to this problem. The centralized production of products for a

group of country markets allows firms to realize economies of scope and scale, as well as the opportunity to cater to regional preferences and tastes in product design or formula. Kraft Foods' 3Bit chocolate bars and detergents such as Procter and Gamble's Bonux and Henkel's Rex are now produced for several CEE markets after a successful start as local brands. The basic product technology is made available by the parent company and then adapted to regional needs. In order to improve efficiency the production sites are specialized by product line and are integrated into the regional or global production network of the multinational group. Regional free trade arrangements such as the Central European Free Trade Area (CEFTA) facilitate the development of such regional production networks. The planned eastward expansion of the European Union has also accelerated the use of CEE production sites as export platforms for Western European markets.

The current marketing practices of Western MNCs in the region provide a good picture of how localization is handled under the conditions of globalization. Marketing decisions in local markets are strongly guided by efficiency motives. Strategic considerations such as cost reduction by procuring and producing locally and saving costs and strengthening the impact of the brand by leveraging existing Western product and brand concepts often outweigh more market-related aspects such as adapting the products to local consumer tastes and preferences. This logic can be often found in small or strategically unimportant markets of the region.

9.5 Implementing marketing programme in CEE

Designing a business and marketing strategy for CEE operations is not only about choosing the right structure (in terms of formal definition of responsibilities and lines of reporting), but also about managing the decision-making and implementation process. This includes decisions about the composition of local management boards (locals versus expatriates) and the degree of autonomy headquarters should grant to local managers.

Different Western firms organize their CEE marketing efforts in different ways. Some choose to run the operations from headquarters or the home office. This is typical for the early stage of market entry when products are sold through local distributors or a company-owned sales office. In large firms the international division or the European group is made responsible for the operations, which ensures that the CEE strategy is integrated into the overall international or European strategy and pooled know-how is available during the preparations for market entry.

One problem with this approach is that large international divisions tend not to pay sufficient attention to small CEE markets and therefore MNCs can easily forfeit opportunities to competitors who recognize the strategic importance of the region.

Another option is to assign a regional management mandate to an established subsidiary located close to the region. For example, companies like Henkel, Philips Electronics and Beiersdorf made use of the business relationships of their Austrian subsidiaries with firms and trade organizations in the neighbouring countries of CEE that existed already before 1989. Thus, the knowledge about the business in the region and the contacts of the Austrian management provided a pioneering advantage for these Western companies after the fall of the Iron Curtain. The advantage of this approach lies in the faster response to rapidly new sales opportunities in CEE (often the Austrian management initiated the entry into those markets) and form a coherent strategy for the region. Such shifts of responsibility from the international division to the regional management centre frequently run parallel to a changeover from opportunistic to strategic behaviour in the region, with the regional management centre taking charge of the development and implementation of a regional strategy. This makes sense when there is a certain degree of homogeneity among the countries of the region in terms of culture and economic and market development, and when a common regional strategy can be expected to produce synergies and economies of scale. Typical tasks include the coordination of production and logistics; making key decisions about the brand portfolio (the mix of global, regional and local brands), product introductions, the development of regional brands and advertising campaigns; the setting up of operations; the selection and training of local managers; and the provision of on-the-spot support to local teams' marketing activities.

When planning to enter a CEE country it is common practice to set up a team to select a target country, make the preparations for entry and find suitable local partners (distributors, dealers, suppliers). Local partners are important in countries where the market structures and institutions are not yet fully developed and numerous local peculiarities exist as they can act as interpreters of local business customs and facilitate access to the relevant authorities, established businesses and customer bases.

When it is decided to invest directly in a subsidiary or acquire a local firm, in the initial stages the presence of expatriates is required to take care of the transfer and implantation of the corporate culture, management style and management processes (planning, budgeting, reporting, remuneration, information dissemination, quality standards, the selection and

training of staff and so on) and to maintain control over the local operations. In the case of the acquisition of a former state-owned company, the management team has to initiate and quickly implement a change and integration programme, with particular attention being paid to the timely integration of the local unit into the corporate group. The management's task is to instil a market and profit orientation, improve overall productivity, trim down the product portfolio, revitalize sales and develop brand management. Cooperation between subsidiaries is also very common in this start-up phase. Nestlé uses a 'patronage model', whereby a West European subsidiary provides operational assistance to a CEE sister company. For instance, Nestlé Austria has supported and advised the Hungarian subsidiary in areas such as market research and packaging design, as well as providing managerial assistance for a short period. This is an efficient and flexible way of distributing know-how and resources within a corporate group.

When the expatriate managers have completed their tasks they are gradually replaced by local managers (Lawrence and Vlachoutsicos, 1993). Just after the fall of the Iron Curtain there was a shortage of local managerial talent, and this was the main reason for the considerable transfer of Western managers to CEE operations. Since then, however, the provision of Western management training has boomed in the region, and colleges, universities and management training institutions are producing an abundant supply of junior managers and are updating and improving the skills of more senior managers (*Economist*, 5 January 2002, p. 27). An added bonus for MNCs is that these young managers are less expensive than non-locals, with their generous 'expatriate packages'. While the transfer of Western managers to CEE is declining there has been a growth of managerial exchange within the region. It is difficult to find managers in the West for assignments exceeding a few weeks in East European countries such as Belarus, the Ukraine or other ex-Soviet republics in Central Asia. Harsh living conditions and a poor command of the local language are barriers for the transfer. However, it is more likely to come across a candidate with close cultural ties to the Ukraine or Belarus among the managers of the Polish subsidiary or to find someone among the local management in the Hungarian subsidiary for an assignment in Romania. This intraregional managers' exchange also fosters a stronger regional identity among MNC subsidiaries.

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