CWC Winner 2007

A Home Market Abroad: New Departures of Fazer Bakeries in Russia

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The year 2006 was drawing to a close. "Well, Andrey. Let's have a meeting with the consulting team tomorrow," Alexey Timchenko, appointed as Hlebny Dom Company Executive Director a year ago, concluded his conversation with the company HR director. Hlebny Dom, a bread-making company located in the City of St. Petersburg was showing very good results, being a city market leader, and Timchenko was excited by the prospects. The only serious problem which remains unsolved was limited production facilities of all divisions of the company. "To start a green-field project or to acquire an existing competitor?" The answer to the question seemed to be clear to all top managers in the company. At the same time, the idea to have a group of independent consultants to undertake a strategic analysis of the situation and argue for one solution or another was very appealing. "There is nothing at risk," – Timchenko has summed up the results of his conversation with HR director Andrey Tsinchenko, whose responsibility was to introduce consultants to all the management team of Hlebny Dom tomorrow.

Few days later, recalling his meeting with consultants and their tutor, Alexey Timchenko recalled the comments of the tutor. "These are not just five MBA students who are finishing their two-year program in our institution. These are five experts; each of them is a top-class manager who has already succeeded in his or her company. They represent various industries, different markets, and separate management areas. But we do believe that all these circumstances together will help the "group of five" solve the problem for Hlebny Dom successfully and formulate an effective method of implementation of strategic direction selected for the company."

Each consultant naturally assumed his preferred role at the preliminary working meeting. Irina volunteered to evaluate internal resources of the company and its philosophy, Yelena was ready to make financial analysis of Hlebny Dom and its financial statement. It was decided that Alexey will undertake industry analysis, Alexandr will concentrate on market analysis and marketing issues, and Oleg will focus on supply and manufacturing problems.

In spite of all New Year Holiday and Christmas troubles, all five found time to meet the top managers of Hlebny Dom and understand situation in the company better. They also formulated the tasks to solve in the future. The consultants have evaluated company's financial statements, its organization design, human resources and marketing policy, and the statement of production facilities.

Everybody first looked at the brief company profile of Hlebny Dom shown below.

> *Hlebny Dom is one of the largest bread-making companies in Russia, which operates in the markets of St. Petersburg City, Leningrad Region (territory surrounding the city), Moscow City, and several other territories. It also exports its products to Baltic States and some European countries. Hlebny Dom, with around 2500 employees, produces 400 ton of bakery products daily and holds the leading position in St. Petersburg market.*
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> *The company's history counts more than 70 years starting from 1934 when Moskovsky District Bakery was established in the City of Leningrad. In 1992, the company was privatized and incorporated. Later in 1995, it was renamed as Hlebny Dom. At that time, the company produced only five types of so called "brown" bread and gingerbread and sold its products in only two (among 15) districts of St. Petersburg. After reconstructing production facilities and creating a strong managerial team, the company revised its product range and distribution policies successfully. It achieved considerable competitive advantages and occupied the leading position in the bakery market. This increased its attractiveness as an acquisition target for a potential strategic investor.*
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> *Since 1997, Fazer Bakeries, the bread-making division of Finland-based multinational corporation Fazer Group, is the main shareholder, investor and strategic partner of Hlebny Dom. In 2002, Hlebny Dom (initially together with Fazer Bakeries) acquired two bakeries in St. Petersburg: Murinsky Bakery and Vasileostrovsky District Bakery. Since 2003, Hlebny Dom owns control shares in both bakeries.*

On January 8, Yelena sent her colleagues the following memo.

To: Team members

From: Yelena

Based on the data we could collect, one may conclude that Fazer Group is going to expand its activities in Moscow City and Moscow Region, both in bread-making and other industries, trying to bring its market share in those territories to 30 percent and to create its first national brand within two years. In St. Petersburg, the task of becoming the market leader in bakery sector has been accomplished, according to Markku Numminen. Besides, Fazer has decided to start distributing products of its two other divisions in the Russian market directly since January 1, 2007.

That is why probably should not limit our consulting project with the choice between green-field construction and acquisition in St. Petersburg. Instead, we should carry out a complete strategic analysis of the situation. I would like to learn your opinions on the matter. After that, we may modify the task accordingly and define a framework of our study.

The first "full-scale" meeting of the team members took place on January 10, 2007. They have formed a clear vision of what Hlebny Dom is like today. The immediate step was to understand the company's strategy and to list the areas for more detailed analysis.

The First Consultants' Meeting

"Thinking about Hlebny Dom philosophy and strategy," said Irina, "one cannot ignore the fact that Hlebny Dom, a company with several subsidiaries is itself a subsidiary of a famous Fazer Group of Finland (or, more exactly, a subsidiary of Fazer Bakeries). The Finns own 78 percent of Hlebny Dom. That is why it seems to me that Hlebny Dom strategy has to be defined as a business unit strategy that supports overall corporate strategy. I have collected brief information about Fazer Group."

Finland-based Fazer Group originates from a family business founded in 1891 by Karl Fazer. Today the Group operates in three divisions, Fazer Bakeries, Fazer Amica, and Candyking. Fazer Bakeries offers fresh and tasty bakery products and owns factories in Finland, Sweden, Russia, Estonia, Latvia, and Lithuania. Fazer Amica is a leading contract catering company, offering customers delicious food and tailor-made service solutions; it operates in the Nordic countries, Estonia, Latvia. In the end of 2006, it started operations in Russia by acquisition of Abela Services, a St. Petersburg catering company. Candyking is a pioneer and a market leader in the pick & mix confectionery business in the Nordic countries, the United Kingdom and the Baltic States. Besides, Fazer Group owns a block of shares in its most important associated company, Cloetta Fazer AB, which is the leading confectionery company in the Nordic countries.

Being a leader of bakery industry in Finland, Fazer Bakeries has chosen the Baltic Sea region and Russia as its home market. It owns plants in Sweden, Lithuania, Latvia, and Estonia and exports to 20 countries as well. The total number of employees is about 6800. In Russia, Fazer Bakeries acquired Hlebny Dom Company in St. Petersburg City, with 78 percent of shares, and later Zvezdny Plant in Moscow City.

Fazer Group operates in total of nine countries. In 2006, the turnover of the Group was over 1 billion euro. The Group employs 15,300 people. In 1997-2005, Fazer Group invested 100 million euro in developing its Russian operations.

Irina explained that Hlebny Dom has renovated its production lines with the assistance of Fazer Bakeries and has adopted some process technologies that are used in manufacturing of some types of bread products that are not conventional in Russia; as a result, a number of items in the Hlebny Dom product portfolio jumped to 200. In the last several years, Fazer Bakeries invested more than 8.5 million euro in reconstruction of Vasileostrovsky Plant and Murinsky Plant, both currently parts of the Hlebny Dom Group. As a result, Murinsky facilities increased more than twice.

"It is interestingly how Fazer formulates its mission," Irina went on telling. "It sounds laconically but significantly: "Taste sensations". The mission of Hlebny Dom, as a Fazer's business unit, specifies the general corporate mission for a particular bread-making sub-industry: "Provision of tasty and high quality products to consumers, unsurpassed service to its clients, and optimal income to its shareholders and partners."

The vision of a prospective as a binder for the corporate culture and diversified business of Fazer Group towards which Hlebny Dom develops, too, is stated as the aspiration “to be the leading food and service company on defined markets”.

The key competence of Fazer Group and Hlebny Dom subsidiary which gives them a potential access to markets, determines the advantage of offered products consumers are aware of, and distances them from competitors includes three points:

- passion for customer (exceeding the customer’s expectations);
- quality excellence (in all we do);
- co-operation (team spirit).

Corporate documents confirm that to perform its declared mission and key competences, Hlebny Dom is guided by the following four principles:

- preservation and strengthening of its leading positions;
- knowledge of consumers’ expectations, monitoring clients’ needs;
- high level business culture and personal culture of company’s staff;
- understanding of the imminence of changes and permanent readiness to face it.

"Why don’t we look at Fazer Group as a multinational corporation doing business in several countries?" asked Alexandr. "It is obvious that Fazer Group is not a global and even not European corporation," replied Irina. "Its geographic focus is in Northern Europe (more precisely, Scandinavian countries and the United Kingdom), the Baltic States, and Russia (naturally, North-West part of Russia, but also Moscow in the last years). Fazer Bakeries is not an exception. As Markku Numminen, executive director for Fazer Bakeries, explains, “the strategy of the division is to strengthen its presence in the Baltic Region”. By the way, there are many multinational corporations of such type in Finland; medium-sized, limiting their activity to a number of neighboring countries with common values, traditions, tastes, etc. If I am right, we used to call such corporations *regiocentric*."

"Do not forget that for many decades economic relationships between Finland and the Soviet Union had a special profile," Alexey turned everyone’s attention to history, "but they were drastically transformed quite seriously in the last two decades. The abandonment of clearing system of payments at the end of 1990, the collapse of the USSR at the end of 1991, and economic decline in Russia influenced the trade relationships among the two countries. The trade policy of many Finnish companies operating in the former USSR had to change radically. Liberalization of foreign trade since 1986 and cancellation of centrally planned orders for imports in the USSR and later in Russia were the reasons to close old distribution channels represented by foreign trade organizations. Many large industrial enterprises that for decades used to be good clients of numerous Finnish manufacturers were faced with many economic problems and found they nearly bankrupt. They were simply unable to pay for imported products. The demand for products of many Finnish firms reduced significantly."

A lot of radical changes took place in the early 1990s regarding business legislation in Russia, particularly, in export-import regulations, exchange control, and laws about foreign investment. First of all, Russian enterprises including foreign owned ones no longer had any restrictions for foreign trade transactions (with the exception of some special goods). Then, it was decided to start to use hard currency for trade payments between Russia and other countries including Finland. Later, Russia introduced unlimited convertibility of the rouble for current transactions (in 1996), and then for capital-flow transactions too (in 2006). Nowadays, according to the Russian law, any share of foreign capital in a Russian enterprise is permitted, up to 100 percent of foreign ownership.

With Finland having joined the European Union at the beginning of 1995, Russia now had 1300 km common border with the EU. This fact has given Finland an opportunity to explore its geographic advantages fully. Almost simultaneously, on November 11, 1995, the European Council passed the basic principles for the new Russian policy of the Union. This strategy emphasizes good relations between the EU and Russia, and focuses, among other issues, on promotion of economic co-operation.

Irina seconded Alexey’s considerations. "It is clear that Finnish companies are attracted by the Russian economy located in the neighborhood, both in terms of resources (as, for example, in wood-processing) and markets (the latter is typical for manufacturers of consumer products, particularly). Please, notice that the bread market in Russia with volume of 10.5 million ton (3.4 – 3.5 billion US dollar) annually is much bigger than all markets in the Baltic States put together. And we have to admit that for many years, Fazer management tried to form its strategy for Russia purposefully, though not all plans have been implemented. Look, what I could learn from paper and electronic sources."

Return on sales at Russian bakeries manufactured mass sorts of bread does not exceed 3–5 percent while it is around 8 percent in the food sector on the average. And yet, Fazer Bakeries has been consistently expanding its activities in Russia. Since 1997, it has invested about 80 million euro in Russian bakeries, and it is planning to invest 25 million euro more this year.

Initially, Fazer Bakeries acquired three bakeries in St. Petersburg; today they all are unified under the name of Hlebny Dom Group. Later, a bakery in Moscow was acquired. Today, Fazer Bakeries is the leader in the Russian bread market in terms of production volume. The bread market in the City of St. Petersburg, the second largest in the country (310 thousand ton annually), is developed much better than the Moscow one from the viewpoint of both product range and product quality. This is according to Sergey Melnichenko, former Fazer's consultant for acquisitions in Russia; currently head of Fazer Bakeries' Moscow subsidiary, namely Zvezdny Bakery. Many bakeries in St. Petersburg are equipped with modern technologies and use new processes, while in Moscow, for example, bread-makers still use wooden and not plastic trays to transport bread.

In 1997, Fazer Bakeries acquired small block of shares in Hlebny Dom, the biggest bakery in the City of St. Petersburg. In the early 1990-s, Valery Fedorenko, general director of Hlebny Dom, was trying to adjust the company to new market conditions in the country. Under heavy economic circumstances, the bakery was the first to start renovation. At that time, Hlebny Dom used to produce 100 ton of bread products daily and occupied approximately 15 percent of the bread market in St. Petersburg. To support modernization process, Fazer immediately invested 4 million euro, and it was completed in 2001. All these years during the reconstruction the profit was reinvested. The first dividend was paid to shareholders only in 2005. In 2002, Hlebny Dom acquired control blocks of two bakeries in St. Petersburg, Murinsky Bakery and Vasileostrovsky District Bakery. Both bakeries were fully renovated by the company. Overall, the Finns invested around 40 million euro in production facilities in St. Petersburg including acquisition of Hlebny Dom. In 2005, the turnover of the three St. Petersburg bakeries increased twice and reached 80 million euro. The product range has been broadened from 10 to almost 200 items. According to Numminen, "it is the only way for modern large-scale bread production: a bread-maker has to be presented in each segment".

In the summer of 2005, Fazer Bakeries acquired 78-percent block of Hlebny Dom shares from Hlebny Dom management. Today the company manufactures 400 ton of various bread products daily and occupies 34 to 37 percent in the St. Petersburg bread market. According to Institute for Agricultural Market Studies (IKAR), Hlebny Dom is the largest bakery in the country. Its products are presented in all large retail networks.

In 2005, in order to reallocate and diversify its product portfolio, to increase production capacities, and to improve distribution channels, Hlebny Dom acquired another bakery in Russia, namely Zvezdny Bakery. Located in the City of Moscow, Zvezdny is a diversified factory manufacturing fresh bread, confectionery, deep-frozen dough, and pizzas. Since the acquisition was completed, Zvezdny increased its sales by one third, up to 45 ton daily. But even today, Zvezdny controls no more than 1.5 percent of the Moscow bread market. To raise its market share to 30 percent, Fazer made one attempt to find a plot in Moscow to launch a new bakery, but failed. It tried several times to acquire one of Moscow bread-makers, but again without success. The Moscow bread market is the least consolidated in Russia. While the 8 largest bakeries in St. Petersburg produce more than 80 percent of bread, the 8 largest bakeries in Moscow about 30 percent. According to IKAR, Cherkizovo, the largest Moscow manufacturer with 200 ton of bread products produced daily controls less that 10 percent of the Moscow market.

"Nevertheless, expansion to Moscow, a highly attractive market, is still in Fazer's plans. Moreover, "after taking roots in the [Russian] capital, we can easily expand to other [Russian] territories", – considers Berndt Brunow, President of Fazer Group, though he admits that to reach the leading position in Moscow "will need time and a lot of efforts". Such are the main steps of Fazer Bakeries in Russia," Irina summed up her impressions. "By the way, I think Yelena is absolutely right: speaking about Hlebny Dom plans and projects, managers in both Hlebny Dom and the parent company obviously have in their minds possible activities in Moscow and other parts of Russia."

"Let's look again at Fazer internationalization strategy. For all that, is the overall Group strategy multi-domestic or home-replication?" asked Oleg.

"As far back as the Soviet times, Fazer supplied biscuits and confectionery to the USSR, so managers of the Group believe they know local tastes well. Of course, some ideas may be transferred from Finland to Russia – first of all, technological solutions, but "to be local" is still quite important for Fazer in general. As Markku Numminen declares, "to exceed the customer expectations, we need to have understanding of tastes and consumer habits of people in one or another country. For the present, we are adjusting our products to local tastes. A Finnish rye bread has absolutely different shape than the Russian one; it has fewer crumbs than crust". Alexandr Zorin of Association of industrial enterprises of St. Petersburg explains that Finns use more additions. And in Russia, consumers prefer traditional products, standard "white" long loafs and "brown" bricks, with no additions". However, what is very interesting, the organization structure of the Fazer Group is, no doubt, global product structure. Each division takes responsibility for its product or service in all countries where it operates. But this is against the "pure theory". Evidently, is it more appropriate for the chocolate and confectionery business of Cloetta Fazer; in this case "home replication" approach is quite visible in Russia. Recall such foreign looking brands in Russian supermarkets as Karl Fazer, Fazermint, Geisha, Dumle and some other Fazer Group brands absolutely not adapted to Russian conditions."

"Of course, some ideas and solutions transferred from Finland could be adopted in St. Petersburg successfully. By that I mean modern management tools, product quality control, and competent marketing. Thus, Hlebny Dom, using the Fazer's experience, was the first among large Russian producers to pack bread in plastics. As Valery Fedorenko recalled, "when in the crisis year of 1998, we paid 500 thousand US dollar for the equipment to cool (bread has to be cooled before packing), cut and pack the bread, our colleagues were laughing at us. But when in 1999 the sales of packaged bread started to grow rapidly, they stopped laughing". One may print the date of production and producer's brand on the package; that is why it is easier to market the product. Buyers of the packaged bread are sure that nobody touched it. Such bread may be kept fresh three days more than the ordinary one, so retailers like to sell it."

"What is noteworthy, the business models used by Fazer Group in Russia are constantly being adjusted. Just another change in its marketing policy took place this month. From now on, Fazer Group will distribute its products in Russia independently (till January 2007, Italian company Ferrero was in charge of distributing Fazer products in the Russian market); it will open its new representation office in Russia with the responsibility to promote products produced by all Fazer divisions in the Russian market. Fazer Group is going to spend a lot on advertisement, on Russian TV in particular. Analysts see this decision as an effective one. RBC Daily cites the opinion of Irina Eldarhanova, chairman at Confael board of directors: Fazer Group "has chosen the right policy: first to test the market through other companies, and later, when the market potential was recognised, to start promoting their products themselves. Direct distribution without middlemen is sure to be effective in terms of sales volumes". Experts believe that Fazer Group can double its sales in a year through its own representative office."

Moreover, at the same time Fazer Group revised the organisation structure of Fazer Bakeries in Russia. Due to the strategic importance and continuing growth of its Russian operations, Fazer Bakeries decided to form a country organisation for Russia to cover operations in the whole country. A new administrative team of Fazer Bakeries in Russia has been appointed to supervise management and development of all bakeries and co-ordinate operational activities around Russia.

In the end of January, the team held its next meeting in Irina's office at a R&D-intensive company in St. Petersburg where she was a general director. The meeting was devoted to results of Hlebny Dom financial analysis and strategic analysis of the bread-making industry.

The Second Consultants' Meeting

"I have made the analysis of financial statement of Hlebny Dom and here are the results," told Yelena. "Please, note that Hlebny Dom, Murinsky Bakery, and Vasileostrovsky District Bakery form a group of companies with consolidated financial reports. That is why my conclusions concern Hlebny Dom as a whole group. First of all, I'd like to say that financial state of the group is stable and solid. Hlebny Dom generates sufficient cash flow, stable and predictable, which allows it to support internal growth and penetration of new markets. The company has access to necessary funds without affecting its existing capital structure much."

The assets of the company significantly increased between 2003 and 2006, which reveals the significant expansion of Hlebny Dom operations. In 2004, the company sales were 66 million euro; they increased to 82 million euro in 2005 and to 111 million euro in 2006. The company net profit was 6 million euro in 2004, 11 million euro in 2005 and 17 million euro in 2006.

At the same time, while the share of current assets in the total assets was 22 percent in 2004, it increased to 47 percent in 2006. Accounts receivable and short-term financial investment hold the largest portion in current assets at the end of 2006 (15 and 24 percent, respectively). Increase in accounts receivable is caused by requirements of large retail networks to allow them deferred payment for sold products.

Short-term financial investment testifies that the company has enough cash to finance not only operational activities but also to provide short-term loans and to keep free cash in deposit accounts. Stock grew due to increase in raw materials stock. By the end of 2006, raw material stock increased by 36 percent in comparison with 2004. Stocks of finished goods have a tendency to decrease.

Gross margin at Hlebny Dom reached 43.5 percent in 2006, six to seven times higher than the average level in Russia. In 2004, it was as 36.5 percent, in 2005 – 41.9 percent. Return on equity increased from 15 percent in 2004 to 21 percent in 2005 and to 25 percent in 2006. Based on the profit received in 2005, a shareholders' meeting made the decision to pay dividends with the dividend pay-out ratio at 11 percent.

Yelena continued. "What is very interesting, every year Russia plays more important role in the operations of Fazer Group. For example, Fazer Group sales in Russia jumped 40 percent in 2006. Fazer bakery operations in Russia now constitute 14 percent of the Group's turnover. 23 percent of the Group's staff is employed in Russia. Looking at the Fazer Bakeries division (it represents 40 percent of Fazer Group overall turnover), 33 percent of the division revenues came from Russia in 2006. At the same time, Finland contributed 48 percent to sales. Currently, about half of all Fazer Bakeries personnel work in Russia. In its 2006 Annual Report, Fazer announces that "Russia is a strategic growth area for Fazer Bakeries". Since the end of 2006, Fazer Amica division is presented in Russia. Some Russian experts are skeptical about Candyking attempts to enter the Russian market. That is why the strategy on the Russian direction attracts so much the attention of Fazer Group management. At the same time, understanding of this strategy and even participation in its formulation is very important for Hlebny Dom, which becomes an increasingly valuable asset for the Finns."

"Do you remember a typology of subsidiaries we considered at our International Management lessons? Starting as an "implementer" or a "rational manufacturer", Hlebny Dom is gradually becoming a "strategic leader", because it has both become a highly competent national subsidiary and is located in a strategically critical market for its parent company."

"And now for the industry analysis. Let us define the industry, in which Hlebny Dom operates, as manufacture of bakery products including those with long shelf-life and gingerbread," proposed Alexey. "I have sent all of you a memo where all main characteristics of the branch in St. Petersburg were presented. I hope everybody has studied it."

To understand the situation in the industry and the condition of Hlebny Dom better, Alexey proposed to consider the two separate modes of bread-making industry development widespread in the world. "Here the American model provides narrow specialization, strong consolidation of the bread market and centralization of sales and supply as well. A company may have several bakeries, each one producing dozens, and even thousands ton of bread daily, usually including just two or three types of mass produced items. Then they deliver ready-to-sell bread to a distribution centre, which supplies several states simultaneously. That gives a company huge advantages in the productivity level and production efficiency. At the same time, small bakeries occupy a niche of producing bread with additives, which are priced several times higher than mass sorts of bread. The European model is different. There small bakeries predominate, but this is not acceptable in Russia where rapid growth of small bakeries in the beginning of 1990s was followed by a significant decline. As result, the majority of small bakeries were closed while those that survived have become half-legal trying to avoid taxation. It happened because small bakeries tried to compete with huge bakeries in producing mass sorts of bread. They often have not stuck production process and tried to reduce prices at the cost of product quality. The customer would never buy such bread more than once. This situation is typical for small and middle-size cities in Russia. In bigger cities, large and small bakeries can always co-exist. Small bakeries occupy their niches by producing a few ton daily of high-value products with different additives what would be unprofitable for large bread-makers. The high price allows small players to get profits while selling limited volumes of products."

"Most industry experts consider the main problems of the bread-making industry in Russia to be low technical level at almost all bakeries, high degree of equipment wear and obsolescence since most bakeries were launched in the late 1970s – early 1980s. Thus, only few bakeries have a stable market share in the Moscow market; the majority of Moscow bakeries survive trying to earn money by producing confectionery. This is caused by the relatively high cost of manufacturing resources in all large cities. That is why about 40 percent of all bread products sold in Moscow is brought over from Moscow Region and other Russian territories, Tver and St. Petersburg particularly. In St. Petersburg, manufacturing capacities at some bakeries are utilized at only 30 percent. The situation is similar in many regional centers of Russia. Based on this, one may forecast inevitable intensification of consolidation process in bread-making industry in the next 5 to 7 years. Instead of 1200 independent factories there will be only several dozens of big companies that will own all existing bakery facilities. As I understand, Fazer Bakeries intends to play a major role in this consolidation process."

To: Team members

From: Alexey

Date: January 23, 2007

Please, look through the review below which represents the main characteristics of the bread-making industry in St. Petersburg. We may discuss details during the meeting.

Market size. Annual sales are around 416 million euro with production volume of 311 thousand ton. Market growth rate. 12 percent of annual growth in rouble equivalent, but a 4 *percent annual decline in tonnage.*

Profitability level in the industry. Considerably low.

Competition scope. Sales are made mainly within city limits and in the nearest suburbs.

Number of companies in the industry. 15 companies; three of them control more than 65 percent of the market. Consolidation stage – specialization.

Consumers. About 4 thousand retail outlets; large manufacturers prefer to co-operate with retail chains.

Degree of vertical integration. Companies in the industry are looking to start forward and back vertical integration.

Entry barriers. Entering the industry for large-scale activities is hardly possible without buying a leading player but it looks feasible for small bakeries.

Technology and innovation. Production processes are mostly standardized. The main changes occur with the product range, composition of products, and recipes.

Product features. High level of standardization (because of state standards requirements) for mass-produced types of products and wide range of products manufactured in relatively low amount (under so called technical terms requirements). Consumers distinguish between different packages and brands. They also show clear preferences based on product quality.

Scale economy in production. All companies in the industry fall into two categories. Companies in the first group rely on mass production of standardized products, so they may benefit from the scale economy; those in the second group are small bakeries which produce small quantities of a product range, adjusted to suit changing consumers tastes, with higher prices.

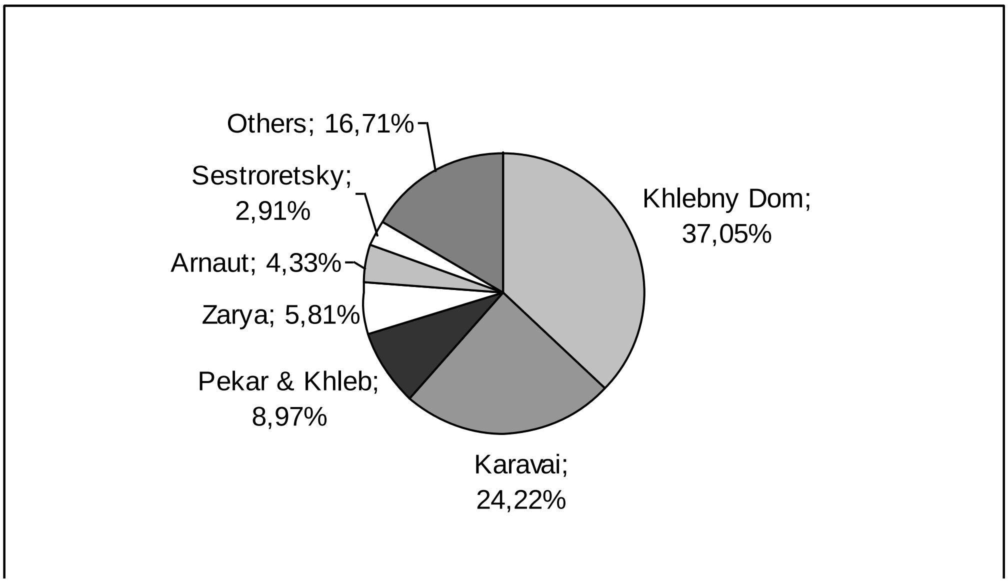
Capacity use. Considerably high, 85 to 90 percent among leading bakeries. It depends substantially on product quality and target markets. The use of capacities among non-leading bakeries does not exceed 50 percent and has a tendency to decrease.

Learning effect. It is important. That is why the larger a producer is the higher is its competitive advantage.

Big flour-grinding plants and grain traders could also contribute to the industry consolidation.

Today, the combined market share of the three leading bakeries in St. Petersburg is about 65 percent. It corresponds with the third stage of industry development – specialization, when additional resources and efforts are needed to maintain growth rate achieved by the leading companies in the industry. Incorporating an acquired rival into the corporate management system may bring the acquirer some benefits. High level of centralization is “a must” to guarantee synergy. During 2007, the leaders in the industry have to finalize acquisition of the second group companies.

"Look at the chart. It is obvious that the largest industry players in St. Petersburg are Hlebny Dom (with 37 percent of the market) and Karavay (24 percent). Cheremushki is a Moscow-based player expanding actively in the St. Petersburg market and striving to be among the leaders in the first strategic group of companies. It had no chances to buy any of the two leaders, so Cheremushki tried to integrate companies from the second group by direct takeover mode, without selling them the right to use its technologies and know-how. Selling internal or external franchises is uncommon in the bread market of St. Petersburg, so while this method is usually recommended in the third consolidation stage, here it is out of question. Cheremushki finished their acquisitions of Pekar and Khleb bakeries in 2006 and is now negotiating takeover of Sestroretsky Bakery. Chances for Cheremushki further development in St. Petersburg depend on its strategic choice for the nearest future."



"Three leaders are followed by Zarya and Arnaut bakeries in the second strategic group (other bakeries from the second group were acquired by Cheremushki). All other factories combined account for less than 17 percent of total production volume. Among these companies, a special attention must be paid to Petrokhleb, which operates mainly in the Leningrad Region market and has good opportunities for market development in the future if provided with necessary funding. You may find more detailed information in my report."

"It seems to me, that we are ready to formulate final conclusions on the company strategy and link it with the results of the market analysis, brand-policy analysis and study of distribution channels at our next meeting in February," – Irina closed the discussion. "Let's conduct this meeting in our business school."

The Third Consultants' Meeting

The meeting started with Alexandr's report on the market statement. "One may find abundant market data about bread production and consumption in Russia," – that's how Alexandr started presenting the results of his research. "Consumption of bread, the cheapest food product, grows only when population income decreases. In 1998–1999, Russians consumed about 80 kg of bread per capita annually. Since 2000, bread consumption was decreasing by 8–10 percent annually, however. In the last years, bread production in Russia more than halved. In 1991, Russian bakeries produced around 18 million ton of bread products, but today they make only 8.2 million ton. Production of rye bread (brown bread) fell from 7.5 to 2 million ton. The Russians prefer wheat bread to rye bread, despite of the fact that the rye bread is much healthier."

"According to the Federal State Statistics Service, in the period of January to June 2005, the consumption of bread and bakery products was declining in St. Petersburg in physical terms (95.1 percent in comparison with the same period in 2004). The market is still growing in money terms, however, not only because of price growth, but also due to re-allocation of consumer demand in favour of sweet fancy bread products, cut bread, and as some special kinds of bread. Buyers prefer to buy original, non-traditional bread products, for example, baguettes, hamburger buns, and fresh-baked bread closer to their homes. This is common for Europe and is becoming a norm for Russians. As the living standards improve, consumption of traditional, mass sorts of bread (where demand is very sensitive to changes in price) declines. The most promising products are those with new characteristics, different from mass sorts, for example, bread with healthy additives, long shelf-life and frozen-type bread products."

"Significant expansion of bread product range is a noticeable trend. Earlier, the majority of bakeries produced 5 to 6 items only, now they manufacture more than 50, and in some cases up to 200 items. The demand for fresh-baked bread, bread with added grains, diet bread sorts, has also increased significantly. According to statistics, out of 800–900 ton of bread that St. Petersburg customers purchase daily, 150 ton is new products, mainly bread with healthy additions."

At this point, Oleg interfered in Alexandr's monologue. "Well, how does Hlebny Dom product portfolio look like considering the main market trends?" "Let's look at the data in this table. It seems to me that the product range is optimally balanced. Mainly presented here are products with high market share in the stable market and products with high share in the growing market. Sugarless fancy bread is still in the growing stages and it does not influence the company's sales significantly; however Hlebny Dom is a leader in sales of this category in St. Petersburg."

Alexey added. "The product portfolio also fits the company's resources. Hlebny Dom surpasses its rivals in packaging and cutting products, which nowadays are required in the market."

Hlebny Dom Product Range

	Product category	Share of the category in the market of St. Petersburg (in euro terms)	Market growth rate	Share in Hlebny Dom total sales (in euro terms)	Hlebny Dom market share (in ton)
1	White bread	33%	Low	45%	44%
2	Sweet fancy bread	31%	Very high	24%	21%
3	Long shelf-life products	13%	High	15%	36%
4	Brown bread	21%	Very low	14%	35%
5	Non-sweet fancy bread	2%	High	2%	20%

"Gradual reduction in demand for bread may lead to radical changes in the market configuration and considerable reduction in number of manufacturers in the coming two years. Some players who could not adapt themselves to the new market conditions are leaving the market. Smolninsky Bakery, one of the biggest in St. Petersburg, stopped its operations in August 2005. Analysts suppose that the majority of bakeries, especially those with daily capacities below 55–50 ton, will be forced to either diversify or sell their premises. Thus, we may predict that the share of "the other bakeries" will inevitably decrease."

"And finally, what are the conclusions based on our strategic study and market analysis?" Yelena, who was concentrating on making notes in her papers, asked suddenly and glanced at Alexey quickly. He turned to Yelena and continued. "We have evaluated industry factors, designed an industry map, carried out PEST-analysis and sensitivity analysis, assessed influence of five forces of the competition, identified strategic rivals and made analysis of strategic groups of companies – so we have done everything we have learned from our MBA program. The general conclusion is that the most appropriate strategy which meets effectively both the external industrial environment and internal Hlebny Dom objectives is *focused differentiation*. That the company has all the advantages required is irrefutable: large distribution network, innovativeness, technological support from the parent company. Growing concentration in the retail sector may also be viewed as an external favorable factor. Another positive external factor is population income growth and enough a stable political and economic situation in the country."

"Focused differentiation means that a company uses differentiation as its main competitive advantage and, at the same time, operates in a narrow target segment of clients. In case of B2B market, this manifests itself in strategic partnership with retail network players. Asking for a highest volume of purchase, they demand better product quality and communicate with end customers from various social groups. It allows the manufacturer to diversify its product portfolio and introducing new more profitable items based on company's strategic plans. Hlebny Dom may influence the end B2C market through its marketing policy in order to increase the bread market profitability together with its retail network partners."

Alexey continued. "Three possible directions fit the focused differentiation strategy, namely product development, market development, and vertical integration. First, let's look at *product development*. It is mostly preferable for Hlebny Dom since the company has special competence in R&D; besides, it historically relies on ongoing modernization of its production departments. Since putting in place a complete production line is an expensive and risky step, the company has a real competitive advantage in the form of technological and innovation support from Fazer Bakeries, its main shareholder. As an example of new products for development and production in the nearest future, we may recommend "sweet fancy bread products" from the fastest growing high profit segment as well as frozen-type bread. Second, we recommend the company to consider *market development*, especially for mid-term future. Since its key competence links to product rather that market factor, it looks more beneficial to commercialize product potential through market development. Supporting position of its existing products, the company has to enter into new market segments, in particular, by expanding to new territories with diversified and unique products. It is possible if the company establishes partnership with companies of retail networks and distributes its products and brands in various territories through this partnership. And, finally, the third direction. When the products are presented in many geographical markets, the company will be forced to use forward vertical integration. The dealers and business partners will be integrated into a federal sales network. The network would operate either as Hlebny Dom's subsidiary or as a structural division of a managing company, for example, owned by Fazer Group or Fazer Bakeries. It will co-ordinate all actions including logistics and sales to its own business units in Russia."

"At this point, we come back to our main question: by what means of methods should the strategy be implemented?" Again and again, Oleg returned his colleagues to the question posed by Hlebny Dom managers – to construct a new plant as a green-field or to acquire a rival.

"As we know, there are three methods to implement company's strategy: internal development, acquisition, and joint development," answered Alexey. "The choice between these methods assumes a compromise between such factors as cost, time, and risk. To improve its core competence, Hlebny Dom can use both its own achievements and those of the parent company, mainly bakery process technologies. Internal development looks as the preferred method of product development since there is no potential provider of a product technology with appropriate quality in St. Petersburg bakery industry. Leasing of production facilities is also impossible because there are no appropriate offers."

"Considering market development with the help of acquisition of a competitor in St. Petersburg, only two companies from the second strategic group may be considered as potential candidates, namely Arnaut and Zarya. Smaller companies aren't interesting while the leading players do not wish to be acquired. In case of Arnaut, one would get some production lines and some trademarks for the money. The total production volume of about 60 ton daily will not allow Hlebny Dom to increase its production capacities adequate to predicted market opportunities. In case of Zarya, it is possible to acquire approximately same capacity, but at a higher price than in the case of Arnaut. Having in mind obvious risks of buying obsolete assets as well as a company with very different corporate culture (in case of Zarya), it looks to be a bad investment. Besides, it also does not provide any significant increase in production. Thus, in regards to both product development and market development, the company has to use the internal development method, such as construction of its own new facilities and probably introduction of a new product, the frozen-type bread, together with retail networks, as a mutually beneficial project."

"Let us look again at the general picture," suggested Alexandr. "At the moment we know the following. Hlebny Dom manufactures a huge number of products and works with many retail clients. Keeping in mind the current situation in St. Petersburg market and development trends in the retail industry, we have concluded that the company needs to concentrate its efforts on collaboration with retail networks, which, in mid-term, will become the target segment for large diversified bread-makers."

"That is why the company should select a strategy of focused differentiation which assumes manufacture of a wide product range and concentration on co-operation with "retail network" segment. We are convinced that the company surpasses its main competitors on all the basic characteristics. I should remind once again: Hlebny Dom has the biggest production in the city, the widest product range, best skills to co-operate with retail networks; it defines the industry standard of packaging and cutting, high levels of innovativeness and product quality. Hlebny Dom is also the leader in all product segments. Despite the shrinking of the market for certain product categories in terms of tonnage, the company not only maintains production volume but even increases it. It means that Hlebny Dom takes away its competitors' market share."

"Nowadays, St. Petersburg represents 85 percent of Hlebny Dom sales. The remaining 15 percent of products are sold in Moscow market and some other territories. If we fix the current tonnage of products sold in the St. Petersburg market and increase share of regional sales from 15 to 40 percent (the forecast is favorable according to the preliminary analysis of demand in regions), it looks possible to increase manufacture by 150 ton daily. It means that Hlebny Dom has huge perspectives in sales growth. By the way, according to numerous mass-media sources, Fazer Bakeries would like very much to repeat in Moscow its St. Petersburg success."

"But the manufacturing potential is exhausted, isn't it?" Oleg has interrupted Alexandr, not hiding emotions. "And there is no real opportunity to acquire a competitor in St. Petersburg or in Moscow, as we have been convinced. It looks like construction of a new factory is the only realistic alternative…"

"Though, there is still a target for Fazer's possible acquisition, Volzhsky Pekar, a bakery in the town of Tver. At the moment, Fazer has negotiations there. Town of Tver is located close to Moscow, 160 km North-West of the capital, what is obvious plus, but one may supply customers in Moscow with bread made in St. Petersburg too, especially with frozen-type products."

Largest cities in Russia

They have decided that at the March meeting the team should make its final choice between acquisition and (more likely) construction of a new factory. They had their meeting in a media-company led by Alexey, in his working office and the meeting dragged until late night.

The Fourth Consultants' Meeting

Almost nobody doubted that the strategic choice will be made in favor of green-field construction of a new Hlebny Dom bakery plant to expand production of highly profitable bread products. Besides, new project allows building some reserve capacities for further development and flexible manufacturing re-adjustment if market conditions change. Despite obvious benefits, the decision to start a new green-field project was not without certain risks.

"I have analyzed the risks," Oleg shared his report with his colleagues. "Look at all the items. Let me first say that there is no risk with official permissions – the main activities of the company do not need licensing. Industry risks are more serious, however. The market is characterized by intensive competition in the segment of traditional mass products***, where production processes are regulated by the state standards. Theoretically, new players may try to enter the market or existing rivals may invest huge funds in manufacture and promotion*** of their products. For example, the total investment made by Karavay, the main rival of Hlebny Dom in St. Petersburg, jumped 70 percent in 2003 in comparison with 2002. The company has invested 6 million US dollar in new equipment and reconstruction of its plant. After new lines for manufacturing round bread and small bakery products are in operation, Karavay and its subsidiaries will increase total production more that 40 percent."

"And what about suppliers?" asked Alexey. "The main raw materials used in bread and bread products manufacture are flour, sugar, yeast, vegetable oil, and fat. L***ocated in St. Petersburg,*** Kirov Plant for Bread Products ***is the*** main supplier for Hlebny Dom. In the last few years, prices of the main raw materials were growing at most 10 percent annually. However, analysts think considerable growth in flour price is possible in 2006–2007. As for imports, their share among all raw materials supplied to Hlebny Dom is only 5 percent."

"What about the distribution?" It was Alexandr, who almost finalized his marketing analysis. He explained the situation to his colleagues. "As for distribution channels***, some pressure is possible*** (in terms of prices and terms of payment) from large retail chains, an important client segment for the bread-makers. Market power is still concentrated in retail segment, and it tends to increase following the consolidation process. Another problem is growing influence of retail chains on the customer caused by direct communications, for example, advertisement of retail players in mass-media and promotion of “private label” products. The pressure from retail companies will continue to grow and managers of Hlebny Dom have to take this into account while designing a good distribution policy. Do not forget that in St. Petersburg, Hlebny Dom sales are done directly through retail companies. In Moscow and other territorial markets, Hlebny Dom sells through wholesale companies as well. Still, Hlebny Dom is mostly using the “follow the networks” model."

Development of retail sector in Russia as well as world experience shows that retail networks will be the target segment for bread-makers in the future. I suppose, Hlebny Dom needs to increase its sales through retail networks up to 75 percent, and this idea has been supported by the company managers. The retail networks are represented in St. Petersburg by hypermarkets, discounters, and supermarkets. As far as we have learned the manufacturers of fresh bread products influence the end market through their communication policy, for example, advertisement of their brands. At the same time, end customers demand fresh bread products in retail trade which, in turn, appeals to bread-makers.

"Should we say something about exchange risks?" Yelena asked her colleagues and continued. "Exchange rate fluctuations may influence negatively the company profitability in case of purchasing import equipment for reconstruction of existing facilities or creation of new ones. Increase in import duties may also influence Hlebny Dom negatively. At the same time, the export quota of Hlebny Dom is quite low to have a substantial effect on company's profitability if exchange regulations are modified."

"And what about the staff?" asked Irina. "According to the managers of Hlebny Dom, there is no problem with workers," answered Oleg. "At the same time, the company feels a lack of professional core staff, process technologists, in particular. The lack of professional staff may have negative influence on the implementation of company's strategy. As for the top managers in the company, I think they are highly qualified, energetic, and effective managers with a great track record."

From 1989 until mid-2006, the company was led by Valery Fedorenko, who graduated from Leningrad College for Food Industry and later from Leningrad Institute for Economics and Finance. Before working as general director of Moskovsky District Bakery (the initial name of Hlebny Dom), he gained operational and managerial experience as a shift supervisor at Primorsky District Bakery, deputy director at Krasny Pekar bakery and director at Krasnaya Zarya bakery.

Since the autumn of 2006, the company is led by Alexey Timchenko. Before joining Hlebny Dom, he worked at Karavay Bakery. Since 1990, his responsibilities were logistics and supply, before that he worked as a chief accountant. After being appointed as Hlebny Dom executive director, Timchenko paid close attention at improvement in the company logistics, development of production facilities, and widening the product range. Under his supervision, Hlebny Dom is looking for new measures which may help the company satisfy high customer demand and keep adjusting the product range under current limitation of production facilities.

"Let us sum it all up," Irina looked at her colleagues. "What risks are the most significant? I think high probability risks include competitive pressure on prices and delivery terms, pressure from large clients, i. e. retail networks and from large suppliers, demographic trends, possible entrance of new players in the target territorial markets or large investment projects realized by Hlebny Dom competitors. Our recommendations on how to reduce these risks look quite obvious: maintain the good reputation of the company, strengthen its image, develop well-recognized brands, monitor of consumer preferences and optimize the product range. For example, shift to manufacturing higher quality and higher profitability products as well as expand more actively to new markets by making products with a longer shelf-life, more innovative and unique products. Finally, keep the constant quality control and better client and customer services."

"By the way, Hlebny Dom brand is positively valued by experts," noticed Alexandr. "It has passed through all stages of introduction and development in St. Petersburg market and won customer confidence and loyalty with the image of guaranteed quality and innovativeness. So, it has all chances to develop into successful federal bread brand, a project which will be pushed by the company marketers for the first time in the history of bread-making in Russia. It is one more argument to confirm the “multi-domestic” nature of the industry."

"Now let's look again at Fazer Group Annual Report for 2006," proposed Yelena. "In the Risk Management paragraph “risk connected with the growing business in Russia” is noticed among “the most significant risks of Fazer Group”. This is viewing Russia as a home market! Everything is perfect if the business grows, but if something goes wrong, it immediately influences the all Group performance. That is why Group' management has to look for new business departures permanently."

The Fifth Consultants' Meeting

The fifth meeting of the consultants took place in the beginning of April at one of in St. Petersburg construction companies, where Oleg worked as general director. Immediately, he asked his secretary to make a good coffee for everybody.

"I was absolutely right," declared Yelena proudly. "Russian bakery operations turned out to be so much important for Fazer, that since April 1 2007, the management of the Group changed its organizational structure. It is not a global product structure anymore, but a hybrid of product and geographic structure. All Fazer's bakery operations in Russia are now the responsibility of a newly established separate division, Fazer Russia. Fazer Group's CFO, Dr. Tech Harri-Pekka Kaukonen has been nominated Managing Director of Fazer Russia. Among the main tasks of the new division, as it was announced, there is active search for interesting assets to be acquired, in particular, in Moscow. Once again Moscow, a promising market..."

By the moment, Oleg has finalized the preliminary feasibility study of a new bakery plant construction in St. Petersburg. He started with the assumption that Hlebny Dom management is considering to buy a plot in the area of the Ring Road. New production premises of 30000 m^2 could be established of in this territory. Ten production lines with the daily capacity of 15 ton each are planned to be installed in the new production site. 5 MW of electric power, 11 million m^3 of gas per year, 900 m^3 of water per day are required for operations of the new bakery. The new plant will require 600 new employees. All managerial positions are planned to be occupied by existing company staff. The head office of the company will remain at the same location as now.

"What investment is needed, and how soon the construction may be finished?" Irina wanted details. "I have made calculations. They are in euro – it will be more suitable for the parent company managers," explained Oleg. "Cost of land – 5 million euro. Project design and co-ordination – 1.4 million euro, power supply installation – 3 million euro. The construction of a building and purchase of equipment as well as getting the plant ready need around 45 million euro (each of ten production lines costs 2.5 million euro). Thus, totally 55 million euro is needed. If 30 percent of all investment cost is financed by the company's own funds, the rest may be raised as a 10-year rouble loan from European Bank for Reconstruction and Development."

The new bakery may be designed and constructed in two years. Production lines are planned to be introduced in three stages (three, four, and three lines, respectively) with 2-year intervals, i.e. in the third, fifth, and seventh year. Thus, borrowed funds may be raised in tranches.

"I have calculated the necessary investment indicators for the project, and they all show its profitability even under negative circumstances, which has been confirmed by the sensitivity analysis. The project implementation will support Hlebny Dom strategic directions in short-term and mid-term, both product and market development."

Oleg was showing his colleagues cash flow projections and charts describing project dynamics. He was obviously satisfied with the results. "And, please, do not forget, that we have to present our conclusions to Hlebny Dom management next week," he concluded. "Why don't we all meet together day after tomorrow in a restaurant to have a lunch and discuss our results?"

* * *

As Alexey Timchenko looked at the consultants' reports on his desk he wondered which elements of the proposed strategy are really significant, and which are of minor importance. An option was to start green-field project immediately but there were risks in that too. Is a new plant worth of fast launching? If yes, what its product portfolio has to look like? Is the view of Hlebny Dom management team similar to that of top executives at Fazer Russia? And what about employees? How to build relationships with retail networks? Which territories in Russia do look most attractive for geographic expansion of the company? What would new strategy do to their image?

There were many decisions to be made, and Timchenko had his work cut out for him. He and all Hlebny Dom team had a lot of good experience working in the industry, and Timchenko was counting on the competencies and enthusiasm of his colleagues as well as on comprehensive support from the parent company. They have some new departures and a number of new projects ahead…

Home is where the bread is.

Appendices

Vasileostrovsky District Bakery, St. Petersburg

Founded in 1931, Vasileostrovsky District Bakery was specialised in making brown bread. Since 1938, it produced gingerbread and biscuits instead. During the WWII period, the bakery returned to manufacturing bread and rusts again. The company worked without interruption supplying people of the city surrounded by the blockade ring. After the war, the plant was reconstructed several times. Since 1951, Vasileostrovsky produced sweet rusks. New facilities to produce bread and diet products were introduced in 1969. From the beginning of 2000, Vasileostrovsky stopped to make bread and was diversified to manufacture some special kinds of bread made of rye and wheaten flour mix with various additions. Besides, it produces such products with long shelf-life as rusks and dry bread-rings. Vasileostrovsky products were awarded with the “Sign of public acknowledgement” in 1997. In 1999, Vasileostrovsky District Bakery was the only one in St. Petersburg to win the “Ecologically safe product” medal at an International exhibition. Since 2003, the control block of Vasileostrovsky shares is owned by Hlebny Dom.

Murinsky Bakery, St. Petersburg

Established in 1987 as Kalininsky District Bakery, the company was privatised in 1992 and reorganised as a joint stock company Murinsky Bakery in 1996. The company was awarded the “Sign of public acknowledgement” in 1997. In 1999, the bakery was awarded “Russian Quality Traditions” Diploma for the implementation of new processes and high quality product manufacture. In June 2002, in order to develop and renovate production facilities, the shareholders’ meeting at Murinsky Bakery decided to sell the control block of shares to Fazer Bakeries. In co-operation with Hlebny Dom, Murinsky made a large-scale modernisation of production facilities, made changes in the product range concentrating on white bread mainly, and increase sales significantly. The strategic direction of further development of the bakery is customer orientation. Since 2003, Hlebny Dom owns the control block of shares of Murinsky.

Zvezdny Bakery, Moscow City

Experimental confectionery and bread plant Zvezdny was established as a merger between Bakery № 11, operating from 1937, and rusts-confectionery plant built on the same site in 1979. In 1994, the state owned Zvezdny was privatised as a stock company. With new technological equipment installed in 1996, the plant began to produce fresh bread and confectionery products with long shelf-life. In 1998, a new production line was installed to manufacture quickly-frozen dough products. The company introduced such products as pizza, croissants, puff paste. At the moment, Zvezdny, with 1000 employees, is developing three main areas: frozen-type products, confectionery, and fresh bread manufacturing. Zvezdny makes and sells cut and packed fresh bread under Hlebny Dom brand.

Three strategic groups of St. Petersburg bakeries

Report prepared by Alexey

As on March 2007, among the main competitors manufacturing bread products in St. Petersburg Hlebny Dom stands out with the market share of 34 to 37 percent (according to separate sources) and Karavay with 22 to 24 percent. Moscow-based Cheremushki is very active in St. Petersburg. It acquired two bakeries in the city, Pekar in the beginning of 2006 and Khleb in December 2006, seems to be a very active player. In the spring of 2007 it started negotiations on acquisition of Sestroretsky Bakery. In case of success, which looks rather likely, Cheremushki will be able to consolidate assets of the three bakeries and increase its 9-percent share in the market (as in December 2006) up to 15 percent. If the planned facility modernization with investment of about 20 million US dollar is fulfilled Cheremushki will have real chances to approach the leaders. These three competitors represent the first group of companies among the three strategic groups typical for the third stage of industry consolidation.

In the second strategic group of companies, looking for the growth, one may find Zarya Bakery with its 6-percent market share and Arnaut Bakery with 4.5 percent share. These players are equipped with modern equipment producing a wide range of high quality bread products but the volume of production is rather low, around 60 ton daily. These companies have not enough resources to overcome acquisition in some way. Taking into account that Arnaut has a multi-storied building in the historical centre of St. Petersburg City, next to Chernyshevskaya underground station, and is constructing a new administrative building next to Gorkovskaya underground station, one may suppose that its production lines and brands will be sold and the main efforts are concentrated on real estate and development business. Zarya, which now controls more than 70 percent of Kronshtadtsky Bakery, has new production lines and an office next to the Ring Road in the South-West of Saint Petersburg. However, in 2007, it will be forced to make a strategic decision either to consolidate its assets with a big market player (most probably, Karavay or Cheremushki) or to find a stable niche combining bread and confectionery products.

Numerous small and niche businesses are concentrated in the third strategic group; their positions are more stable that those of the second group representatives. Among them, Petrokhleb Holding Company, Baltiysky Khleb, Okhtinsky, and several private bakeries may be mentioned. Petrokhleb company has consolidated a number of enterprises integrating vertically from elevators and storehouses up to 13 bakeries and 160 of retail outlets located all over Leningrad Region. Baltiysky Khleb is a niche player representing a group of private bakeries whose success depends on their location, access to financial resources, quality management, and the most important, on effective reaction to consumers' demand.