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Market Entry Strategies of Foreign Firms into the German Food Industry

Oswin Maurer
Department of Agricultural Economics - Agribusiness Management,
University Kiel/Germany
Visiting Senior Lecturer, Department of Economics,
University of Tasmania, Hobart

1. Introduction

The realisation of the European Common Market has some important implications on strategic decisions of agro-food firms serving the European markets. On the one hand, these changes are expected to open up some new opportunities of international growth and development, but on the other hand it will, together with the expansion of multinational companies, increase the competitive pressures on incumbent firms within the food industry.

This paper does not attempt to cover the full range of opportunities and threats emerging from the realisation of the Single European Market and its' impact on European and non-European firms. It concentrates on the analysis of international market entry strategies of agro-food firms into the food industry of one of the member states of the EC, and is therefore attempting to cover one aspect of the possible reactions of firms to changes in the European business environment. The next section gives a brief review of some key features of the completion of the Common Market, their impact on the business environment and on the food industry in particular. Because the selection of an effective market entry strategy is one of the most complex decisions facing an international firm, section three attempts to provide a more detailed analysis of international market entry strategies, examining the main entry methods and their effects on a firm's competitiveness. Finally, in section four some data on market entries of foreign firms into specific segments of the German food industry is presented and industry specific factors are used to explain the methods of entry actually chosen by foreign firms.

2. Review of some key issues of the Single Market

In the mid-1980s, most discussions on European Integration were characterised by a sense of "Europessimism". Although the free movement of goods, capital, labour and services were stated in the Treaties of Rome in 1957, still hundreds of obstacles affecting the "four freedoms" remained. The growing dissatisfaction with the progress of integration, fostered by threats of global competition from Japan and the US., prompted the Commission of the European Community to take action in 1985. In its White Paper the Commission outlined a legislative program for the realisation of the Common Market by identifying the remaining barriers to the four freedoms and by proposing 279 specific measures to dismantle them within a period ending at 31. December 1992. More than one third of these directives were aimed at overcoming national differences in standards and regulations for the food industry.

Much of the progress towards the goal of free movement of goods and, therefore, of major importance to the food industry has been made due to the fact, that the European Commission switched from a "common standards approach" to a "mutual recognition approach". Under the first approach the EC-member states had (often unsuccessfully) to negotiate on the specifications of thousands of products. Under the latter approach, common standards are no longer necessary and products are allowed to be traded freely as long as they meet legal and specification requirements in one of the EC-member states. Although progress has been substantial and most of the structure of the Single European Market is in place, not all White Paper proposals have been met by the end of 1992. Delays have occurred in some areas, because the original proposals were inadequate. A major problem has been, the wide fluctuations in the rate at which member countries have succeeded in getting single market measures incorporated into their national law. Even if the Commission is prepared to react to countries slowing down the implementation progress by enforcing directives into national law, there are likely to be political problems with imposing these laws on countries. However, the common opinion now is that 1992 has to be seen more as a process than as a deadline.

2.1. Implications of Europe 1992

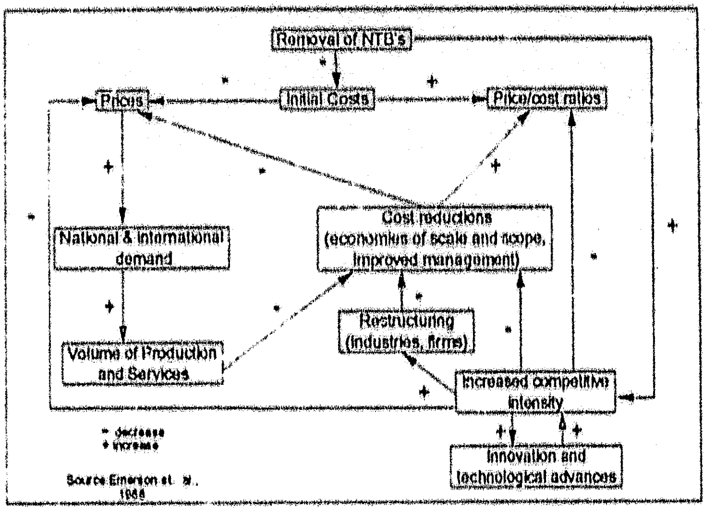
Perhaps the most important implication of the realisation of the Single European Market, is the economic growth that is expected to result. Several specific sources of increased growth have been identified (see CECCINI 1988, MAC Group 1988, BALDWIN 1989):

- first, there will be gains from eliminating the transaction costs associated with boarder controls, customs procedures and so forth.
- second, economic growth will be spurred by the economies of scale that will be achieved when production facilities become more concentrated.
- third, gains also will result from more intensive competition among EC-companies. Firms having been monopolists in one country will now be subject to competition from other EC-firms.

Overall, the reforms may result in an estimated increase in European gross domestic product of about 5% over the medium term and it is expected that perhaps 2 million new jobs will be created. Besides these macro-economic effects the realisation of the European Common Market has important implications for firms within and outside Europe because it poses opportunities and threats, benefits and costs. The micro-economic effects of the market integration are shown in Figure 1.

Substantial benefits will arise for those firms already operating in Europe. They will gain because their operations in one country may now be freely expanded into others, and their products freely sold across borders. They will have access to about 345 million consumers, and in addition the free movement of capital will allow these firms to sell securities, raise capital, and recruit labour throughout Europe. Substantial economies of scale in production and marketing will also result. At the same time, however, firms operating in one European country will now have to contend with competition from firms in other EC-countries. Apart from these overall implications agro-food firms will now face all sorts of consequences arising from the removal of barriers. They will have to review their past product portfolios, marketing strategies and organisational structures in order to meet the new marketing framework (JAHN, 1991, pp. 52).

Figure 1: Micro-economic effects of the market integration


Removal of NTB's
Prices
Initial Costs
Price/cost ratios
National & international demand
Cost reductions (economies of scale and scope, improved management)
Volume of Production and Services
Restructuring (industries, firms)
Increased competitive intensity
Innovation and technological advances
- decrease
+ increase

Source Emerson et al., 1988

In the past, most European food companies have operated on a national basis, highly protected against competition from other EC-companies. This protective shield was mainly achieved by national norms and standards for individual products as well as through health and safety regulations. Even if the sector has been used to act under Single Market conditions in the purchase of raw materials, the new framework will impose changes to the industry as a whole, to firms and the market positioning of food products. Therefore, the ability of firms to develop new products, to employ new management, production and marketing methods and to detect market opportunities will be the crucial for survival and growth within the new business environment. On the other side, the removal of barriers will improve the efficiency within the food industries and price advantages will be the key factors for competitive success.

2.2. Responses of firms to the changing market conditions

To achieve the necessary "strategic fit" and be able to cope with upcoming opportunities and threats, firms will have to review and adjust their business strategies. According to studies from NERB (1988), KUEHL (1991) and JAHN (1991), firms in general consider three different options of strategic response:

- measures of internal and/or external restructuring,
- intensified cross border co-operation, and
- development of new markets, mainly through internationalisation.

All three of these strategic options involve, to a more or less extent, internationalisation activities in order to achieve, sustain or improve a competitive position within the European food industry. If competitiveness is defined as "the ability of a firm to meet and beat its rivals in supplying a product on a sustainable (long-term) and viable (profitable) basis" (BUCKLEY 1988), two main strategic options are open to firms to create a sustainable competitive advantage: cost leadership and product/service differentiation. According to PORTER (1985) firms can use these two forms of advantage to compete across the broad scope of an industry or focus on competing in niches. Sources of cost effectiveness include the exploitation of economies of scale to lower unit costs, investments in state-of-the-art technology and preferential access to raw materials and distribution channels. The general aim of this strategy is to become a major player or market leader within a specific market. To maintain cost advantages, investments in plant renewal and process innovations are essential over time. In the case of product differentiation, however, a firm seeks to be unique in its market along a dimension which is valued by its customers. Possibilities to differentiate vary from market to market but are associated with the potential for distinguishing products by variations in their properties and attributes. Product innovation and the ability to upgrade existing products are essential to maintain a competitive advantage with this strategy.

The realisation of one of the mentioned basic strategies depends mainly on a firm's specific goals, corporate resources and the competitive environment but operating internationally adds a number of other dimensions to competitiveness (PORTER 1990). For example, the advantage of low production costs in a centralised large plant might be offset by the extra costs of physical distribution. Or, in the case of product differentiation, cultural differences might require firms to customise their products and marketing efforts in order to meet regional or national preferences and tastes.

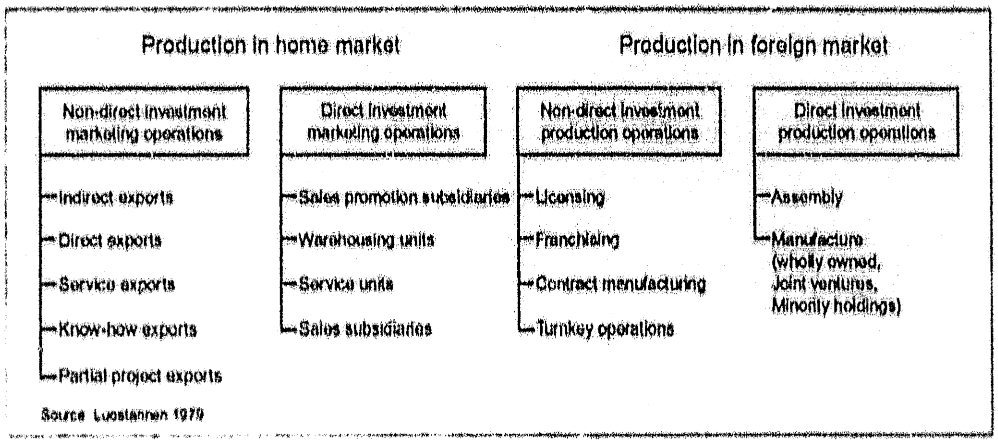
3. Foreign market entry strategies

The selection of the most effective international market entry and development strategy is seen as one of the most complex decisions facing an international firm (YOUNG et al. 1989). In principal, there are three generic strategies which firms can use to enter foreign markets:

- exporting, involving production in one country and the transfer and selling of goods and services across national boundaries via direct or indirect methods;
- licensing, involving the assignment of know-how, technology, production and selling rights or trade marks to foreign producers in return for financial compensation;
- foreign direct investment (FDI), involving the establishment of production and selling facilities in foreign markets.

Although a wide variety of classifying international business arrangements exists, all of them are assuming some implicit spectrum of involvement from exporting through to wholly owned subsidiaries. Figure 2 illustrates the alternatives on the basis of various criteria, in particular production in the home market vs. production in a foreign market, direct investment vs. non-direct investment activities and production vs. marketing operations.

Figure 2: Forms of international market entry and development


Production in home market
Production in foreign market
Non-direct investment marketing operations
Direct investment marketing operations
Non-direct investment production operations
Direct investment production operations
Indirect exports
Direct exports
Service exports
Know-how exports
Partial project exports
Sales promotion subsidiaries
Warehousing units
Service units
Sales subsidiaries
Licensing
Franchising
Contract manufacturing
Turnkey operations
Assembly
Manufacture (wholly owned, Joint ventures, Minority holdings)

Source Luostarinen 1979

3.1. Entry strategies and competitiveness

But, returning to the three generic strategies they can be distinguished by a location and an internalisation effect (BUCKLEY 1991). The location effect separates exporting from the other two methods, because most of the value adding activities take place in the home country, whereas, licensing and FDI transfer substantial proportions of these to foreign country markets. On the other side, exporting and FDI are separated from licensing by the internalisation effect. With licensing, rights and the use of assets (know-how, production methods, brand names) are sold to a foreign firm, whereas, in exporting and FDI such activities are internalised. Each of the alternatives has its own inherent pros and cons and is, therefore, interrelated with the maintenance and enhancement of a firms' competitive advantage. As each strategy involves trade-offs between the control available and the costs and riskiness, the choice of strategy is affected by a range of often conflicting forces.

Some examples may be used to illustrate these trade-offs. In resource and competitive terms, exporting is generally recognised as a low-risk and relatively inexpensive method of internationalisation. Centralised production allows firms to exploit economies of scale and thus lower unit costs. But a firm can find itself at a competitive disadvantage if local producers have lower cost structures, i.e. because of preferential access to raw materials, or control of distribution channels. Likewise, licensing provides a firm with the advantage of rapid access to the international market, even if the firm is constrained in its internationalisation efforts by a shortage of management or capital resources. On the other hand, the financial compensation for the transfer of assets, may represent a poor return on an innovative process or product and it also implies the danger that technologies or products are captured by competing firms.

leading to the loss of a firms initial competitive advantage. As the most comprehensive method of entry, foreign direct investment comprises the transfer of capital, management and know-how and is therefore seen as a relative expensive and risky approach. But, in competitive terms, the presence of a firm in a foreign market may increase its familiarity and knowledge about local market conditions, an essential prerequisite to build up a profitable market share over the long term. Furthermore, FDI may enable the firm to avoid the transaction costs of using the market, i.e. costs of contracting and monitoring agents and distributors, and to increase its effectiveness through better control of distribution and marketing functions.

In conclusion, the selection of an appropriate foreign market entry strategy, designed to enhance and protect the competitiveness of a firm is dependent on an amalgam of (see ROOT 1987, YOUNG 1989, BUCKLEY 1991):

- firm-specific factors, eg. the nature and uniqueness of a firms' competitive advantage like the product design, a superior process technology, a well recognised brand name, an opportune organisational structure, and the ability of resources.
- industry-specific factors in the target market, eg. the competitive structure, the initial market size and growth prospects, the quality and costs of inputs, the marketing infrastructure and entry and exit barriers.
- and location-/country- specific factors, eg. political, economical and socio-cultural characteristics as governmental policies, legal regulations, norms, standards and inspection policies, local tastes and preferences, and the geographical and cultural distance.

4. Entry strategies of foreign agro-food firms in Germany

Whereas firm specific (internal) factors primarily influence the initial decision to internationalise and extend a firm's activities across borders, the choice of a specific entry mode is primarily determined by industry- and country-specific (external) factors. Country-specific factors, some basic industry indicators and an brief analysis of the main competitive forces can provide some initial evidence on possible opportunities and threats associated with the entry strategy considered by a firm.

4.1. Some key characteristics of the German agro-food industry

Germany is politicaly stable, with a well developed economic infrastructure providing easy access to a large number of consumers. These characteristics are generally seen as factors favouring investment activities by foreign firms. On the other side, relatively high labour costs and corporate taxes, limitations on operating hours and restrictive regulations on ingredients of food products are factors likely to limit a firms competitiveness. Furthermore, the German agro-food industry is a stagnant sector within the economy. Although industry turnover has increased by 9% in from 1989 to 1990, this is primarily an effect of the re-unification and a substantial growth cannot be expected in the future.

The main competitive forces driving the industry are the activities of incumbent food producing firms, wholesalers and distributors, consumer demand patterns and governmental regulations. In 1990, the industry comprised 4524 enterprises and concentration within the industry is relatively low. The ten largest food producing firms' accumulated turnover is just 11.5% of the industry total. In contrary, food trade and distribution is highly concentrated and the top ten food trading companies accounted for 65.5 % of total foodstuff turnover. Furthermore, food retail trade is characterised by a high number of chain stores, closely co-operating with the large wholesalers. Whereas in 1970 independent retailers were responsible for 58% of total food sales, their share decreased to 17% by 1990.

In terms of per-capita food consumption, an already high nutritional level has been reached. Growth in population is marginal, and thus increased volumes of consumption are unlikely. Expenditure on food, as a proportion of total consumer expenditure, is at about 12.5% and rather constant during the last years. Overall, at an already high level of expenditure for food no quantitative growth in demand can be expected. But consumers are getting more sophisticated about food items they buy, spurring qualitative growth of demand. Quality, healthiness, convenience, origin and prestige of food products are some of the key factors having an impact on this qualitative growth.

The German food industry is affected by a high number of regulations. There are national provisions concerning the production, trade and selling of food which include regulations on ingredients permitted, the unconditional use of recipes, how products must be marked, as well as health and sanitary regulations. The complex nature and interactions between vertical (product-specific) and horizontal regulations for food in Germany may have forced foreign firms to defer the export of food products to the German market till 1993. But, for firms located in non-EC-countries many of these provisions will still apply after the completion of the single European market.

4.2. Industry specific factors as determinants of entry mode

A study on market entry strategies of EC and non-EC agro-food firms examined the impact of industry-specific factors on the mode of market entry chosen (ROBOCK 1992). The original data material[1] comprises 212 investment activities of foreign food firms, split into two groups. Group 1 includes 126 activities of companies located outside Germany and group 2 covers 86 activities of German subsidiaries of foreign parent companies. In principal, activities of this group involve horizontal integrations in one industry segment. According to Figure 2, activities of foreign firms can be distinguished by the criterion direct and non-

[1] Because data on this topic is rarely published officially, information has been collected on a random basis and been extracted from publications of the Federal German Anti-trust Commission, from market surveys on mergers and acquisitions, yearly reports of trade unions and large corporations and from reports in relevant newspapers and magazines. Therefore, the data does not provide complete information on all transactions and activities undertaken by foreign firms, but it provides some useful insights into factors determining firms' internationalisation strategies.

direct investments in marketing or production operations. As Table 1 shows, entry through direct investments has been the main option of the firms surveyed. This is partly due to the fact that the data sources chosen mainly concentrate on the activities of large and/or well-known firms and/or if transactions in ownership rights have been involved.

Table 1 Number and nature of observed investment activities of foreign firms in the German food industry (1985 - 1991)

	Group 1	Group 2
1. Marketing operations	**48**	-
non-direct investments	8	-
direct investments	40	19
2. Production operations	**78**	**67**
non-direct investments	3	-
direct investments	75	67
Total 1. + 2.	**126**	**86**

Source: Robock 1992

Because of the small number of non-direct investment activities observed, the discussion has to concentrate on direct-investment operations chosen by foreign firms. With respect to the fact that firms are able to use different methods of international market entry simultanuosly, the choice of a particular entry method is seen to be highly influenced by factors specific to the industry segment targeted (ROOT 1987). Due to this assumed interrelationship, some of the factors comprising the structural conditions in a particular industry are used to explain the actual mode of entry of foreign firms, whereas seven of the industry segments presented in Table 2 are included in the following discussion.

Table 2: Number of investment activities by industry segments (1985 - 1991)

Industry segment	Total	Group 1	Group 2
Breads & pastries	26	8	18
Processed fruits & vegetables	21	15	6
Spirits & liqueur	19	16	3
Confectionery	16	13	3
Non-alcoholic beverages	13	6	7
Meat and meat products	13	4	9
Dairy products	12	8	4
Cereal products	8	7	1
Beer	7	7	0
Potato products	7	5	2
Wine	6	4	2
Vegetable oils and fats	4	3	1
Fish and shellfish products	4	3	1
others	56	27	29
Total	212	126	86

Source: Robock 1992

4.3. Industry structure and barriers to entry

In general, the attractiveness of an industry (PORTER 1985, ROOT 1987) is made up by its market growth, market size and market quality. As indicators for these factors, the annual variation of industry turnover (for market growth), the market volume (for market size), the annual rate of return on investment and a concentration ratio, reflecting the turnover share of the 10 largest firms within the industry (for market quality) are used. The highest increases in annual turnover are yielded in the industries producing breads and pastries, processed fruits and vegatables, potato products, cereals, fish and shellfish and non-alcoholic beverages. Market volumes for these industries' output are seen to be relatively low. An increase of more than 3% in annual turnover can be observed for the producers of wine, confectionary, beer, meat and dairy products, whereas the spirits and liqueur and the vegetable oil industry show small or negative rate of growth in turnover and a low market volume (Table 3).

Table 3: Some structural indicators of industry segments

Industry segment	Turnover variation,% p.a. (1980 - 1990)	Market volume (billion DM)	Return on Investment (%) (1977 - 1986)	CR 10 in % (1988)
Breads & pastries	7.1	8.7	4.1	22.3
Proc. fruits & vegetables	6.4	12.1	2.7	51.0
Spirits & liqueur	1.0	6.8	1.5	64.0
Confectionery	3.8	13.3	3.0	55.1
Non-alcoholic beverages	6.5	9.6	5.8	31.9
Meat and meat products	3.3	21.0	2.5	32.1
Dairy products	3.0	24.1	1.1	28.1
Cereal products	7.2	5.6	3.2	84.1
Beer	3.2	16.1	3.3	27.7
Potato products	7.6	2.0	3.3	92.4
Wine	4.2	3.8	2.3	81.5
Vegetable oils and fats	- 2.7	6.1	0.8	97.1
Fish & shellfish products	7.9	5.0	1.1	72.4

Sources: Statistisches Bundesamt, Fachserie 4 & 7; Robock 1992

With respect to the average returns on investment (ROI) and concentration ratios (CR 10) , lower concentrated industries (in particular bread and pastries, beer, non alcoholic beverages, confectionary, meat products and processed fruits and vegetables) yield higher ROI's than the high concentrated industries (wine, fish and vegetable oils). Furthermore, industries with a high market volume show relatively low concentration ratios.

In sum, the more unattractive industry segments (wine, fish and shellfish), characterised by a high concentration ratio, a low market volume and a low rate of ROI's, are showing the least number of foreign market entry activities. On the contrary, the highly attractive industries, featuring low concentration ratios, a high ROI and a substantial increase in turnover have attracted a high number of foreign firms. Industries for cereal products, non-alcoholic beverages, beer and potato products all show high ROI, but different concentration ratios. Also the number of entry activities does not allow an assumption as to the industries' attractiveness or otherwise. This also applies to the dairy and meat industry, except if the market volume is seen to be the decisive factor. The liqueur and spirits industry has to be seen as an exception. Despite a poor development of industry turnovers, a low ROI and a small market volume, this industry shows a high number of market entries. But with regard to the entry mode, most activities have been concerned with investments in marketing operations. Overall, whereas the variables used so far to explain market attractiveness provide some insights, they do not provide a definite and clear picture.

Because the choice of an appropriate foreign market entry mode also depends on the actual entry barriers in a foreign market, firms are likely to choose a strategy which helps to by-pass or to overcome them (MAURER 1991). As primary sources of entry barriers within the food industry, economies of scale, product differentiation and the structure of distribution channels are of some importance (PORTER 1985; CONNOR et al. 1985). Whereas some structural features of food trade and distributing firms have already been discussed, scale economies in production and marketing normally amount to substantial cost-saving potentials in most industries. New entrants need to match the minimum efficient technical scale within an industry in order to avoid significantly higher costs than incumbent firms. But in contrast to other industries, the minimum efficient technical scale is quiet small in the food industry (see CONNOR et al. 1985). Reasons for the small cost savings potential due to scale economies in production, are to be found in the high amount of intermediate inputs used and the low complexity of the production process and technology. Therefore, substantial scale effects in the food industry are achieved mainly through a standardisation of promotion strategies.

Important and fairly high entry barriers, especialily in the branded food segment, are a result of product differentiation. Because of the complex nexus between product differentiation and promotion, the latter being a cause and a consequence of the former, the level of promotional expenditures within an industry can indicate the degree of the barrier established through product differentiation. Promotional expenditures differ significantly between food industries and data is available for seven of the discussed segments. On average, the bread and pastry, the meat processing and the fruit and vegetable processing industries spend less than 0.5% of total industry turnover on promotion. Product differentiation and product prices are relatively low and brands for bread, pastries and processed meat are rarely found in the market. The confectionary, the spirits and liqueur as well as the non-alcoholic drinks producing industries show a different picture, and 3.5 - 4.5 % of industry revenues are spent on promotion. Furthermore, in all three segments strong brand names are present. The dairy industry spends about 1% of turnover on promotion and although the differentiation level is low, dairies have intenisified their efforts to increase the variety of products in recent years.

Using these indicators of product differentiation and a composite of the previously discussed structural features, that approximately reflect the attractiveness of the industries, a classification of the individual industries along these two lines is possible. It can be argued that investments in production facilities are the appropriate entry mode into industries characterised by a low level of product differentiation and a high market attractiveness. Especially if the market volume is large, this might allow the entering firm to set up the necessary efficient firm size and to exploit economies of scale. Furthermore, a low level of product differentiation usually results in lower product prices, not justifying high transport costs. According to PORTER (1985) a cost-leader strategy seems to be the most feasible one in this industry segments. On the contrary, industries with a high level of product differentiation and low market attractiveness favour entry through investments in marketing operations. Actually small markets with poor growth and development prospects do not justify capital intensive investments. Furthermore this could lead to retaliation from incumbent firms if the new entrant substantially increases industry output. From a competitive point of view, a differentiation strategy aimed at achieving a high customer loyalty in the "narrow" market seems to be the most appropriate one. Both forms of investment provide equally favourable entry modes, if industry attractiveness and the level of product differentition are high.

4.4. Industry attractiveness and foreign market entry

A comparison of the expected market entry methods with the actual entry modes chosen by foreign firms partly confirms the arguments used throughout the above discussion. The spirits and liqueur industry, characterised by a high level of product differentiation and a low market attractiveness, has been entered mainly by investment in marketing operations, whereas investments in production facilities have been the preferred option in the bread and pastry, dairy and meat processing industries (Table 4).

Table 4: Expected and actual modes of foreign market entry

Industry segment	expected mode of entry	actual mode	of entry
		DIMO[a)]	DIPO[b)]
Breads & pastries	DIPO	2	5
Proc. fruits & vegetables	(DIPO)	8	7
Spirits & liqueur	DIMO	12	2
Confectionery	DIPO/DIMO	3	10
Non-alcoholic beverages	DIPO/DIMO	4	1
Meat and meat products	DIPO	0	4
Dairy products	DIPO	1	6
Total	-	30	34

Source: Robock 1992

[a)] Direct-Investments Marketing-Operations
[b)] Direct-Investments Production-Operations

Both entry modes are seen to be equally favoured to gain access to the fruit and vegetable processing industry, however, according to the factors discussed, direct investment in production operations should be the preferred option. But, considering the fairly high amount of imported products used in this industry, the results reflect the important role of trading companies in the fruit and vegetable processing industry. Entries into the highly attractive non-alcoholic drinks and confectionary industry have been, in accordance to the discussion, achieved through investments in marketing or production operations.

5. Concluding remarks

Overall, to some extent the chosen factors are appropriate in explaining the strategic objectives of firms, which are reflected in the entry strategy actually chosen. As argued, industries characterised by a high level of product differentiation and a relatively poor attractiveness have been entered through investments in marketing operations, whereas investments in production facilities have been the preferred option in more attractive industries with lower levels of product differentiation (except the fruit and vegetable processing segment). On the contrary, the very attractive industries with high product differentiation levels have been targeted with both entry methods. Nevertheless, a more extended discussion, e.g. considering firm-specific factors and the major motives to internationalisation could provide further insights into the internationalisation strategies of agro-food firms. With regard to the single European market, foreign investment activities within the German food industry are likely to increase in the future.

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