European Foundation for the Improvement of Living and Working Conditions

EMCC case studies

Trends and drivers of change in the food and beverage industry in Europe: The Kalev Group

European Monitoring Centre on Change

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Wyattville Road, Loughlinstown, Dublin 18, Ireland. - Tel: (+353 1) 204 31 00 - Fax: 282 42 09 / 282 64 56
email: postmaster@eurofound.eu.int - website: www.eurofound.eu.int

Company profile

The Kalev Group is the largest food production group in Estonia. According to a market survey in 2005, the Kalev trademark was recognised as the best known and most positive trademark in the country. In June 2004, AS Kalev received the ISO 9001:2000 certificate.

Kalev, which celebrates its 200th anniversary in 2006, is the largest producer of chocolate and sugar confectionery in Estonia and the group is among the country's largest food producers. The Kalev Group consists of seven companies, of which AS Kalev, the mother company, is by far the largest with more than half the workforce. As well as confectionery, the Kalev Group produces baked goods and milk products. The group had a turnover of 53.8 million euro in 2004–05 and has almost 800 employees.

Kalev changed greatly since Soviet times when it was known as Kalev Confectionery Factory. Between 1948 and 1991, the company supplied the entire Soviet Union with superior grade chocolate and confectionery. The factory was located in the middle of Tallinn in a historic five-storey building.

In 1991, the state enterprise, Kalev, was founded on the basis of the Kalev Confectionery Factory and in 1995, a public limited company was founded. Since 1996, AS Kalev have been listed on the Tallinn Stock Exchange, and today it is one of the few Estonian food industry enterprises based mainly on Estonian capital.

In the early 2000s, Kalev had achieved a financial strength that made it possible to acquire other operations and increase its market potential. In 2006, in addition to AS Kalev, the group includes

- Three companies in different regions of Estonia that produce baked goods like bread, cake and biscuits. These were acquired because they produce related products and it was hoped to create synergy.
- One company producing milk powder and UHT milk, acquired partly because it was a sound enterprise and partly because its products are used as raw materials in chocolate and candy.
- A real estate company to deal with the large estate that belonged to the Kalev Confectionery Factory.
- A marketing and sales company to deal with exports to the US.

In 2003, Kalev moved the confectionery production and the central administration to new modern facilities 15 kilometers outside Tallinn. The move was needed to meet the EU hygiene regulations, which would have been impossible or very costly in the old premises.

The new facilities are larger than the old ones, but production capacity has never been a problem. On the contrary, there is considerable excess capacity in the confectionery production, because Kalev lost about 85% of its market with the accession to the EU, which meant a steep increase in the export taxes for its exports to Russia.

The group's vision and mission statement were both under revision at the time of the present study.

Products and clients

Kalev Group's three product lines have quite different customer profiles.

- The confectionery line consists of different forms of confectionery. Chocolate products (solid and filled) represent 76% of the confectionery produced. The remaining 24% includes hard candies, toffees, chewing candies, different dragées, marzipan (of which a range of luxury marzipan is hand formed and hand painted) and chewing gum. The product portfolio is very wide and management is considering reducing it for greater production efficiency.

  The products are packaged in the factory and sold in retail shops and chains under the Kalev brand – private label production is recognised as a trend, but it is not yet as pervasive in the Baltics and Russia as in Western Europe. Consumer trends towards healthy foods are being picked up, and new developments include, for example, sugar-free hard candies, chewing candies with added calcium and vitamin C, and chocolate with a high cocoa content.

  However, the largest part of the market is still traditional (milk) chocolates and filled chocolates. The chocolate from Kalev has a comparatively low shelf life because no preservatives are added, but this natural quality is seen as a distribution problem rather than as a marketing advantage. Chocolate consumers are conservative – it is difficult to replace old, well known products with new ones, and some products have not changed for more than 40 years.

  The home market is partly seasonal with high points during Christmas and Easter holidays.

- Baked goods consist of bread, cakes and biscuits and these, too, are sold by retailers under the Kalev brand, but mainly close to the production sites. Customers for these products are considered less loyal and more price-driven than those for chocolate and candy.

- The milk products, which comprise milk powder, liquidised skimmed milk, UHT milk and butter, are sold mainly to industrial customers in various EU member states.

About 80% of Kalev's output is sold by five Baltic retail chains but Kalev confectionery is on the shelves of almost all convenience shops in Estonia. Bread and cakes are sold mainly in the immediate vicinity of the factories; with a small portion sold in Tallinn shops. The customers for the milk products are industrial enterprises, which means that different, less intensive, marketing is needed than for other product lines.

The distribution strategy is under consideration. Kalev currently owns and runs 11 brand shops in Estonia, and is considering establishing similar shops in other markets. Otherwise, Kalev wants to partner with agents or wholesalers in local markets.

The company has an online ordering facility directed at wholesalers and retailers. Direct internet interaction with end-use customers operates at the high season times of Christmas and Easter, and a more permanent online shop is under development.

Market dynamics and company changes

Kalev has experienced very turbulent times in its market. During Soviet times, the confectionery factory produced 40,000 tonnes per year, in 2006, annual production is down to 7,000 tonnes. The markets for the group's three product lines are very different so different strategic considerations apply to each.

- As well as the home market, the group currently markets its confectionery in Latvia, Lithuania, Finland and, to a lesser degree, in Russia, Belarus and Ukraine. A very small amount is exported to the rest of the EU. Kalev has 42% of the market for confectionery in Estonia and its competitors are mainly big multinational companies.
- Competition in the market for baked goods is much fiercer with more international (mainly Finnish) players, and Kalev has only 14–15% of the market for biscuits. Baked goods are sold through local retailers.
- The partnership relations for marketing milk products are relatively stable.

In the latest fiscal year, Kalev had a net loss. The annual report explains this by fluctuations in raw material and energy prices connected to joining the EU, but the entrance of new players on the market is also recognised as a factor.

The strategy director is concerned that competition is increasing year by year. Estonia is a very liberal market, and global brands are entering the market as Estonians' purchasing power of increases. The company is very focused on expansion and the considerations as to portfolio, pricing and partners that goes with it.

Kalev's strategic answer to the intensified competition is an attempt to increase its markets, mainly by increasing exports.

- Expansion of the confectionery market must take place abroad, because the market share in Estonia for these products can increase only marginally, if at all. Expansion is primarily planned to the East, because a recent market survey showed that Kalev is still recognised by Russian consumers as a premium confectionery brand, whereas penetration of the EU market outside the Baltic republics is seen as very costly in terms of branding and marketing. Kalev is gaining a foothold in the Finnish market, which is somewhat difficult because of strong relations between retail chains and local producers. The rest of the Scandinavian market is considered not worthwhile, because retailer-producer alliances are even stronger there than in Finland.
- The strategy for the baked goods market is to increase the share of the Estonian market by more focus on product development and marketing. Actions so far include discontinuing some product lines to reduce competition between the group's own trademarks and rebranding some lines of bread and biscuits under the group brand, Kalev.
- The group relies on organic growth as the market strategy for milk products.

The strategy director says that the company has decided not to pursue a copycat strategy but to go for a strong identity built on well known trademarks while at the same time enhancing the group's brand as a quality food producer. The identity of the confectionery products is tied to customer loyalty and recognition, and tradition is a key word. The PR manager says, 'It is important for Estonians to buy Estonian food, because they feel it is more natural'. Yet it is also recognised that young consumers might prefer global brands and that Kalev could be squeezed out of its traditional mainstream market.

At the high end of the market, Kalev's luxury products are not marketed very aggressively outside Estonia so the market for them is very limited. Other (niche) producers are beginning to work in this segment, e.g. Anneli Viik, which produces and sells handmade chocolate branded with reference to the origin of the cocoa beans. In addition to selling this niche product through an upmarket café in Tallinn, the company targets the corporate market for chocolate as business gifts.

While greater competition at the high end of the market can help increase the popularity of Estonian chocolate and even have a positive effect on the group's sales of its high end products, the pressures from the global producers are the major challenge to Kalev, geared as it is to the local mainstream and traditional market. The decision so far seems to be to go on playing the midfield, but the strategy director says that the outcome of the battle to retain the Estonian market and expand outwards is by no means a given.

Managers who were interviewed have somewhat different perspectives on the main obstacles to a successful realisation of the market strategy. The PR manager is concerned mainly about the products. There are national differences in taste for confectionery, so success in any export market depends on the ability to pick up that market's preferences and translate them into a viable product portfolio.

The products' limited shelf life is seen as a major obstacle to increasing exports. The strategy director agrees that focus on the product is necessary, insofar as the company is not competitive in all segments.

Projecting five years ahead, the strategy director said that he foresees further concentration in the national market, so that the retail sector will be dominated by at most three retail chains. This means that strengthening negotiating power with the retail chains must be a strategic priority for Kalev and business must be focused still more. A further diversification of product lines is plausible. This will call for capital input, but first and foremost, this hinges on Kalev's ability to attract competent employees and staff, especially staff with export-relevant skills.

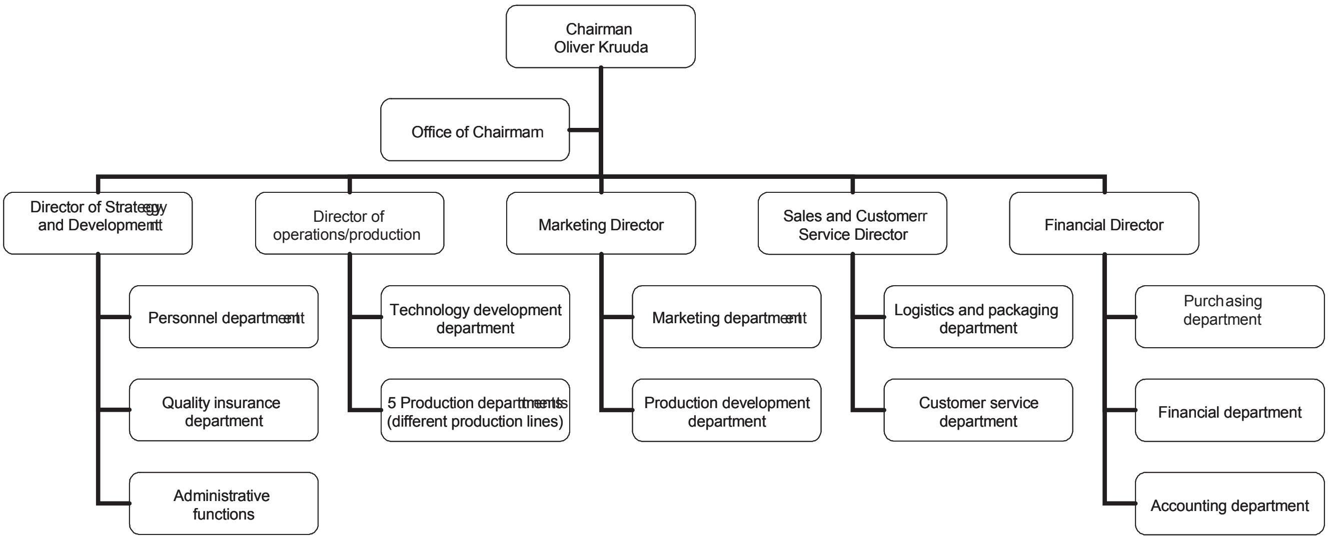
Organisation, production and market

The Kalev Group has AS Kalev (the confectionery branch) as the mother company and six subsidiaries as follows:

- AS Kalev Paide Tootmine produces milk products (UHT milk, milk powders, butter etc).
- AS Kalev Jõhvi Tootmine produces baked goods which include bread, cakes, biscuits and cookies.
- AS Vilma produces baked goods and powdery half products.
- OÜ Maiasmokk produces baked goods.
- AS Kalev Real Estate Company focuses on development, administration, servicing, leasing, purchasing and selling real estate.
- Kalev Merchant Services Ltd markets and sells Kalev's products in the US.

Group management, finance, HR and IT are centralised so that the large part of group administrative functions are physically located at AS Kalev. The organisation chart is shown below.

Management and organisation, Kalev AS



The strategy director observes that it is a challenge for management to run a group – not just a company – because it must coordinate the strategies of the whole group. In addition to the coordination demands, Kalev's management has found that cultures differ between the companies and not only corporate culture is different – one of the bread factories is located in a Russian speaking region, and this presents a challenge to communication within the group, which has to be bilingual.

Production is organised in production lines overseen by foremen (masters), usually recruited from within the companies, each of whom is responsible for two to three lines. Masters oversee production and are responsible for solving technical problems. The master and selected key workers are allowed to operate the PCs that are in the production area to get an overview of orders etc.

Because of the large production capacity, only one 10-hour shift is needed except in the run up to Christmas and Easter, when employees work two shifts in a working week of four days. Efforts are ongoing to modernise production, improve quality and increase efficiency by organising production to minimise waste of time and materials. In order to help this process, Kalev is considering implementing the '20 keys to workplace improvement'[1] management system. It is also considering implementing principles of lean production to further improve efficiency, and the production manager is currently being trained on the topic.

The company has the advantage of having its own logistics department, which streamlines deliveries without having to rely on external warehouses or carriers.

[1] The '20 Keys to workplace improvement' were developed more than 12 years ago by Professor Iwao Kobayashi of the Practical Program of Renewal in Factories Institute in Japan. The primary feature of the system is a scoring system for evaluating organisational strength, known as the 20 Keys five-point evaluation system.

Internal communication is partly through a company intranet, still under construction, where all production data can be accessed by those to whom they are relevant.

Supplier relations

The group's products rely mainly on raw materials for which a global market exists and which represent a large share of the costs. However, for some raw materials like cocoa beans and sugar, Kalev relies on stable relationships with suppliers as long as there is a reasonable balance between price and conditions.

Packaging is a strategic asset in confectionery production, and the company recognises a need to be innovative about wrapping and packaging. Its packaging specialists , both technical and creative, cooperate with the marketing specialists in selecting suppliers and developing specifications for packaging materials. They get their inspiration from industry periodicals and from visits to shows and exhibitions. The choice of suppliers depends on the balance between the quality of the packing materials and the price. The quality is important because of food-packaging regulations.

Workforce and the market

Towards the end of the 1980s, Kalev had 2,000 employees, but a large proportion of them were in auxiliary activities not directly related to confectionery production. By 2001, it was a much slimmer company with 450 employees. Following growth and acquisitions, the Kalev Group has around 800 employees in 2006. The numbers increased in the following categories:

- Shop-floor workers.
- Product development – the group had to hire people who know about baked goods.
- Group management functions, e.g. there are more employees in the bookkeeping and personnel department, and because of the total employee increase the personnel department now has six employees.

The employees represent different ethnic and national groups. Most are from Estonia or Russia, but a few are from Ukraine, Belarus and Kazakhstan. The average age is around 40 years. Typically, the technical specialists are ageing while blue collar workers and administrative and managing staff are mainly young people. Most employees are on full-time contracts, but during Christmas and Easter, Kalev employs several temporary staff, most recruited from a pool of (mainly local) people who come to work as temporary employees year after year.

It is a challenge for Kalev to recruit specialists in the technical and engineering fields. The quality of further and higher business education in Estonia is still developing so there are not enough highly qualified graduates to meet the demand.

Kalev is in some danger of losing out in the competition for qualified employees because foreign companies recruit more aggressively, using head hunting and perhaps offering more interesting propositions to graduates. Kalev's recruiting efforts include media channels and searching CV databases on the internet.

Salary structure and benefits

At almost all levels in Kalev salaries are linked to results, that is, they consist of a fixed part and a bonus part.

- Each production group is allocated a monthly bonus that the foreman distributes to individual workers on the basis of their performance.
- Managers, specialists and administrative staff get bonuses in proportion to their performance on a balanced scorecard.

Salaries and wages are low compared to the rest of the EU. The average monthly salary in 2005 was 427 euro. Contracts are mostly full time.

A superficial look at the company reveals nothing to distinguish Kalev from any medium sized food company in Europe. The machinery, while not state-of-the-art, is a mix of old and new that seems average. The buildings are new and spacious and the office layout is open, with small coffee corners and lots of daylight. The management structure and attitudes also match those of today's or even tomorrow's midsized, European manufacturing company. Finally, many of the employee benefits are very much in line with benefits offered by Scandinavian companies.

Yet at the same time, it is the employee benefits that most recall the Soviet past. In the Soviet Union, social security and welfare was closely tied to the factories, which had policlinics, restaurants, holiday homes, health resorts, kindergartens etc. Kalev's benefits and welfare programmes, rather than seeming a contemporary strategic means of recruiting skilled employees, echoes a past in which the factory took care of workers' entire lives.

Benefits can be an asset in the competition for highly skilled employees because they can contribute to Kalev's image as a company that cares for its employees. However, it seems that HR and management should evaluate the benefits and decide which are worth keeping and which are so costly or counterproductive that they should be discarded. Replacing costly benefits by higher salaries will enhance Kalev's competitive position in the labour market.

The list of benefits is so comprehensive that only a few examples are given here.

- Management and clerical staff have access to a children's room with toys, videos etc., where parents can bring their children if they are recovering from illness. Because many women work in administration this benefit is probably good for productivity.
- A health room, used mainly by shop-floor workers, is staffed by a nurse who deals with minor ailments. This room also has water massage, which is probably good for productivity because of its preventive effects.
- Saunas and resting rooms are available to all employees.
- Another kind of benefit has to do with time off. In addition to sick days guaranteed by health insurance, employees can take up to three sick days a year without a doctor's certificate and get paid 60% of their usual salaries. There are ways of getting additional vacation. Workers get time off plus a bonus for family events like birth, marriage or death.
- The company has a number of traditional get-togethers for the entire staff, including a 'summer day' with sports and picnics with families and a end-of-year gathering where performance awards are presented. This serves to increase loyalty and benefits the working environment.

Labour relations

Trade union membership in the group is quite high. Among the workers it is higher than 80%, and overall (including administrative and managerial functions) it is 62%. There are six elected trade union representatives in the workplace who meet every month to discuss new laws and regulations. There is also a weekly meeting in the administration where the masters discuss production and orders and where management disseminates information.

A monthly newsletter in Estonian and Russian also gives information to employees.

There is no works council in the group. All collective agreements at AS Kalev are negotiated by the representatives of the different trade unions. Trade union representatives in the subsidiaries negotiate their own agreements.

A trade union representative says that the company culture is generally friendly and also relatively informal, mainly because of the informal attitude of the Chairman (CEO), who likes to talk to everybody.

Education and training

The labour market for people with a further or higher educations is very tight in Estonia and recruiting skilled employees for middle management and specialist jobs is especially difficult. Kalev generally encourages employees to pursue further education but provides financial support only for training that is directly related to the company's needs. However, targeted training is offered free of charge and during working hours to employees and management.

When new equipment is introduced, the employees who will work with it are trained, usually by the equipment producer. These skills are then passed on by a process where employees train colleagues. The trade union representative says that in future, processes will become increasingly automated and effective. This will lead to less demand for staff with only manual skills and higher demand for more skilled employees. The training efforts must be intensified in order to keep up with technological developments.

All production employees must have certain qualifications, e.g. a certificate in hygiene and in first aid. The right to training is part of the collective agreements.

The company gives priority to raising competence in administration and management. For example, two employees from product development are currently studying in Sweden and the strategy director has completed a course at the London Business School. Employees can attend training during working hours with full pay. They can apply for a contribution to course fees and if a course is deemed relevant, the company might pay half the fee.

Kalev also works closely with local providers of education and training to improve the content of their courses at all levels.

Research and development

Kalev employs several specialists in fields such as food chemistry, confectionery production and packaging in the product development department. Research and development activities are divided between different departments and budget lines.

Technology in the workplace

Production is capital intensive. Technologies for chocolate manufacturing are continuously refined and developed. This means that old machines, which were moved from the Tallinn factory and are still operating satisfactorily, are steadily being replaced. The machines are conventional, very few are CNC-controlled and there are no robots in the production.

Sales and marketing make comprehensive use of internet and computer technology. Sales staff travel with hand-held computers that allow them to order online directly from a customer's location.

Conclusion

Kalev has survived the change from being state owned in the former Soviet Union to become a fully commercial operation that has managed to grow, modernise and acquire new operations in a market environment. More than a decade after the change, as the Baltic markets are becoming interesting for global operators in the food sector, the Kalev Group is getting ready for intensified competition. Major challenges for the group include:

- Lack of bargaining power compared to global competitors in the competition for shelf space in a still more powerful retail sector. This is currently a challenge in export markets and, as multinational companies enter the Estonian market, it can be expected to make the home market difficult as well.
- Although access to skills and expertise is not a big issue yet, it will be a major challenge in future. Kalev expects that the problem will mostly affect production workers, but will also affect recruitment of specialists and managers.
- A more targeted marketing effort will demand increased focus on the product portfolio.
- Managing a group that includes dissimilar, geographically dispersed operations is also a challenge.

On the other hand, the company has a number of unique strengths, including:

- A strong local and regional brand.
- A strong brand and good contacts in the Russian market, which can help it gain a foothold there ahead of global competitors.

Given these challenges and strengths, there is no doubt that management's strategic choices in the immediate future will be decisive for the Kalev Group's future and that these choices might be difficult.

Tine Andersen, Danish Technological Institute

Contact details

Case company

Company name: Kalev Grupp
Website address: **http://www.kalev.ee**
Address: Põrguvälja tee 6, Lehmja, Rae vald, Harjumaa 75301
Country: Estonia
Phone: +372 6077 710
Fax: +372 6077 725
Email: kalev@kalev.ee

Source list

- Interviews (23 March 2006) with:
  - Andres Rannamäe (director, strategy and organisational development)
  - Ruth Roht (PR manager)
  - Tiiu Märtson (trade union representative)
  - Aire Mill (executive assistant)
- Guided tour (by Otto Kubo, researcher) of the confectionery factory
- Supplementary documentation on organisation from the company
- Company website: **http://www.kalev.ee**
- Annual report 2006 accessible at **http://market.ee.omxgroup.com/upload/reports/klv/2005_ar_en_eur.pdf**
- Anneli Viik website: (**http://www.anneliviik.ee/**)

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