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FACULTY OF ECONOMICS

MASTER'S THESIS

Medium Sized Enterprises in Croatia and their Growth Strategies

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IZJAVA

Študentka Danica Bakotić izjavljam, da sem avtorica tega magistrskega dela, ki sem ga napisala pod mentorstvom prof. dr. Janeza Prašnikara in skladno s 1. odstavkom 21. člena Zakona o avtorskih in sorodnih pravicah dovolim objavo magisterskega dela na fakultetskih straneh.

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Podpis:__________________________

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1. INTRODUCTION

1.1. Problem Definition and Research Scope

In theory and practice, there are three categories of enterprises according to size: small, medium and large. Small and medium sized enterprises, because of their common characteristics, are observed together, under the same name SMEs (Small and Medium Enterprises). In recent years, they have become significant subjects in many studies and also their importance in practice is greater.

The SMEs are basically of two types: the first type is the stable SME company, and the second type is the SME company with a high growth potential (Boot et al., 2005). Small companies with growth potential very soon become medium sized companies, because sometimes it is their only way of surviving in turbulent environment characterised by strong competition. The question that arises in this situation is which conditions should exist to improve position, and to realize the growth of medium sized companies, and which growth strategies should medium sized enterprises apply.

According to Byars, Rue and Zahra (1996, p. 115) possible growth strategies are: concentration strategy, vertical integration and diversification. The main idea of concentration strategy is to focus on a single product/service or on a small number of closely related products/services and involves increasing sales, profits, or market share faster than it has increased in the past. Vertical integration is a growth strategy that involves extending an organization's present business in two possible directions. Forward integration moves the organization into distributing its own products or services, and on the other hand, backward integration moves an organization into supplying some or all of the products or services used in producing its present products or services. Finally, the third type of growth strategy according to the authors stated above is diversification. It occurs when an organization moves into areas that are clearly differentiated from its current business (Byars, et al., 1996, p. 115).

If we turn to medium sized enterprises in Croatia, it can be pointed out that in 2003 medium enterprises in Croatia represent 3.8 percent of total number of economic entities, they employ 19.9 percent of total workforce, generate 18.4 percent of total revenues, 16.0 percent of total profit, and 25.5 percent of total loss (FINA, 2003, p. 17).

In accordance with the statistical definition of a medium sized enterprise in EU, relevant companies represented only 1.9 percent of all business subjects in the European area in the year 2001. However they employed 15.4 percent of the active workforce. For instance, data about Austria as one of the members of the EU can be pointed out. Namely, Austria has an above average share of medium sized companies in the EU, 2.2 percent of medium size companies, and 22.2 percent of employees in the medium sized companies. (http://www.kmuforschung.ac.at/an/table_sme.htm).

In Croatia, medium sized enterprises, generally, have potential for further growth and development, but they are faced with different problems (financial, legal, managerial, organizational, etc). Their future existence depends on the elimination of existing problems and on the focus on adequate strategies. They should build global presence in niche market, which could enable their coexistence with large enterprises. The niche markets can be seen as good opportunity for growth and development of their business. Furthermore, they should take in advance numerous incentives given by different institutions and Government, and use them to remove barriers that slow their growth.

In the gap of different characteristics of enterprises according to size, the medium sized enterprises can be one of the facilitators of future progress. Their business functions are developed enough to overcome problems of small companies, and they are more flexible and not burdened with the problems of large companies. They can make a significant contribution to the growth and development of the national economy, because of their certain advantages, such as: more productive and efficient use of scarce recourses (especially capital); employment creation; improved income distribution and development of dynamic private enterprises. All these advantages should be exploited in a strategically definite and meaningful way.

1.2. Research Purpose and Objectives

The purpose of this research is to present the theoretical background of aspects and characteristics of medium sized enterprises, and to provide an understanding and knowledge about the position of medium sized enterprises in Croatia, their importance, and possibilities for their future growth.

The motivation of this work lies in two arguments: (1) medium sized enterprises are important for the Croatian economy because large enterprises have significant problems, firstly caused by an inadequate process of privatisation, managerial incompetence, and inefficiency; so medium sized enterprises, which have mainly been established in the last 15 years, represent a new wave of progress, which can be the base for the further development of the Croatian economy. But unfortunately, not all medium sized enterprises grow equally as fast. The majority of them do not change their size very much. (2) In spite of unfavourable conditions medium sized enterprises, which manage to develop appropriate economics of scale or acquire some other competitive advantage through learning process, expand (Prašnikar, 2005). These companies should rely on strong and well-defined growth strategies and find adequate ways of financing.

The main goal of this paper is to provide a possible way for medium sized enterprises in Croatia to behave, concerning their development and growth into large companies, with the main focus on growth strategies which they can apply, and obstacles for their growth.

To obtain a complete picture about this issue, it is needed to comprehend the present macroeconomic situation in Croatia, but also the past experience regarding the turbulent process of transition and the war, which was happening in Croatia in the 1990s.

So, the aim of this research is also to generate an understanding about the conditions in which medium sized enterprises in Croatia perform their business activities.

Concerning the issues mentioned above, some questions arise, such as: How do Croatian medium sized enterprises observe their position regarding their future perspective? Why do they want to grow and become large enterprises, and how do they accomplish that? What kinds of problems and barriers are present in Croatia, which hinder the development of medium sized enterprises, and how do these conditions influence medium sized enterprises growth? What conditions have to be present to allow the growth of medium enterprises? Which strategies can medium sized enterprises use for their growth, and how can they apply them?

The answer to all these questions will be completed by reviewing two Croatian companies that belong to the category of medium sized enterprises, but want to develop into large enterprises. Their experience will offer a better understanding and awareness of the position of medium sized enterprises in Croatia and their perspective.

1.3. Methodology

In order to answer the above mentioned questions, and to gain an overview of this topic, academic research was conducted. It was concentrated on collecting and analysing literature about theoretical aspects of this topic. The literature provided a large quantity of information and knowledge which is invaluable for understanding the meaning and role of medium sized enterprises in any national economy, their characteristics, their similarities and differences compared to large and small enterprises, growth strategies which they can apply for their development, barriers to their growth, etc. Besides the literature, different publications and Internet sources were used, as additional support to this research.

The second source of useful information was different statistical reports from the Croatian Financial Agency (FINA), which is the leading Croatian company in the sphere of financial mediation. They focus, among other things and business activities, on collecting and sharing data about the financial results of business entities in Croatia. They provided their annual reports, which were helpful for obtaining a review about structure of enterprises in Croatia regarding size, their share in total employment, revenues from sale, profits, loss, etc.

The empirical research in this master's thesis is based on the case studies of two Croatian companies. These companies were selected because they satisfy our criteria. They belong to the sector of medium sized enterprises and they want to grow; more over, they already by some criteria, belong to the category of large enterprises. Because of this, their experience can be helpful for fulfilling the main aim of this thesis, and that is to find out how medium sized enterprises in Croatia become large ones.

The information about these companies was gathered firstly from their Internet sites. After that, the first questionnaires were distributed to owners/managers of these companies. Some questions in the questionnaire were created as the structure questions with multiple choice formats. Other questions were open questions and the examinees had to answer with a few short and precise sentences. After analysing the answers on the questions in the first questionnaires, the second ones were distributed with some additional questions in order to eliminate some misunderstandings and ambiguities.

And finally, in order to get a realistic and complete picture about these companies, a couple of interviews with owners/managers were carried out. They presented a large amount of documentation about the business activities of their companies. Besides that, a visit to the companies and discussion with employees were conducted. It was quite interesting and constructive to see, close up, the performance of business activities in these companies.

The collected data of selected companies was analysed firstly through explanation building and then through cross case analysis (Yin, 2003, p. 120). The first case is about a company called SMS, and the second one is about the PIVAC company. In the presentation of these cases, each individual case study consists of a "whole" study; explanation building and cross case synthesis are conducted in order to provide sufficient understanding of relevant issues.

1.4. Structure Overview

The structure of this master's thesis is consistent with determined objectives and research methodology and it is divided into 7 parts defined in the Table of Contents.

In the introductory part, the problem and scope of the research is defined, as well as the purpose and objectives. Methodology, which is used and applied in the research is also presented. And finally, the introduction is completed with a structure overview.

In the second, theoretical part of this thesis, the problem of the research is clarified in a proper and understandable way. The theoretical aspects of medium sized enterprises are defined. Since there are many criteria for the definition of enterprises regarding size, in this part some of them are explained, as well as the main characteristics of medium sized enterprises. A short review about medium sized enterprises in various countries is also provided. Growth strategies, as a crucial element for the development of medium sized enterprises are enlightened, with the emphasis on the broader aspect and meaning of the strategies, and factors which influence strategic decisions. At the end of this part, the relevance of growth strategies to medium sized enterprises is explained.

In the third part, the position of medium sized enterprises in Croatia is enlighten This section starts with the macroeconomic situation in Croatia, and the structure of the Croatian economy concerning company size; then the significance of medium sized enterprises is explained through their contribution in employment, revenues, and profits as well as their efficiency according to the relevant financial ratios. In this part, the obstacles to medium sized enterprises growth in Croatia are also presented.

In the fourth part of this thesis, the critical success factors for medium sized enterprises growth in Croatia are defined. These factors concern the possible means of growth and the development of medium sized enterprises, with the review of specifics in Croatian economy and conditions under which medium sized enterprises perform their business activities. In this part, some relevant research hypotheses are explained.

The fifth part includes the case study analysis of two Croatian companies: SMS and PIVAC. The whole study of each company is presented, and each can be divided into four parts. The first part relates to general aspects and the companies' backgrounds; the second part explains market position of these companies on the basis of tools for strategy formulation; the third part concerns the meaning and implementation of relevant growth strategies, and finally the fourth part presents the critical overview of observed companies and their future perspectives.

Cross case analysis, discussion and findings are in the sixth part or this work, with the focus on general similarities and differences of the observed companies; comparison of observed companies with a developed model and definite hypotheses; and final discussion on medium sized enterprises growth, in general, and in Croatia.

At the end of this master's thesis, there are summaries of all parts and final conclusions.

2. THEORETICAL ASPECTS OF MEDIUM SIZED ENTERPRISES AND THEIR GROWTH STRATEGIES

2.1. Criteria for Defining Medium Sized Enterprises

The literature provides different criteria for distinguishing enterprises according to size. These criteria are separated into quantitative and qualitative ones (Lazarić, 1993, p. 75).

According to quantitative criteria, the definition of medium sized enterprises uses elements such as: the number of employees, revenues from sale in the last business year, the sum of the balance sheet after deduction of losses, the total assets, etc.

On the other hand, qualitative criteria differentiate enterprises according to ownership, and managerial function. Differentiation on the basis of ownership define small enterprises as companies which are often owned by one person or family; medium sized enterprises are owned by one, two or more individuals, or family owned, and sometimes are even Ltd; and large enterprises are usually Ltd. Related to the managerial function, small enterprises are companies where the entrepreneurial and managerial functions are joined in one person, which is usually the owner. In the medium sized enterprises, there are larger management teams, and large enterprises have a huge developed organizational structure, with several levels of management.

Furthermore, the criteria for the definition of enterprises regarding the size can be one-dimensional and multidimensional (Mugler, 1995, p. 17). One-dimensional criteria use specific elements for the definition of enterprises such as the number of employees. On the other hand, multidimensional criteria use several elements at the same time, for example, besides the number of employees, they also use revenues from sale, total assets, and etc. Application of multidimensional criteria provides more precise and detail representation of enterprises. These multidimensional criteria are used in many countries, for instance in Germany, UK, Croatia, etc.

In Germany, besides the number of employees, revenue from sale is used; in the UK the criteria are: the number of employees, total assets and revenues from sale in the last business year (Burns and Dewhurs 1996, p. 199).

According to Croatian accounting law (NN 90/92), medium sized enterprises are companies which have an average of 50 to 250 employees, the sum of the balance sheet after deduction of the loss should be more than 1 million Euros, and less than 4 million Euros, and the income of the last 12 months before creating the balance sheet should be more than 2 and less than 8 million Euros.

The application of multidimensional criteria sometimes causes one enterprise to fit in two different categories. Actually this happens in practice, and it is called the flexibility of size, and companies use it as an advantage in situations such as tax break, for taking advantage of some State privileges, or for getting bank loans (http://www.voban.co.yu/sr/svetfin/Br195/SFbroj19502.pdf).

Various countries have different statistical definitions of medium sized enterprises, and in these definitions the number of employees is the most common criterion. That is reasonable because this criterion is a simple standard which does not need to take into account the exchange rate and it is unaffected by inflation; so the comparison of companies in different countries is easier. However, there are differences in the application of this criterion among different countries. These differences can be seen from the table 1.

Table 1: Definition of Enterprises Regarding the Size by Number of Employees in Different Countries

Country	SMEs	Small	Medium	Large
Germany	1-499	1-9	10-499	500-
Belgium	1-99	1-99		100-
Netherlands	1-99	1-9	10-99	100-
France	1-499	1-49	50-499	500-
UK	1-499	1-199	200-499	500-
Italy	1-499	1-99	100-499	500-
Austria	1-999	1-99	100-999	1000-
Switzerland	1-499	1-49	50-499	500-
Spain	1-199	1-199		200-
Japan	1-299	1-19	20-299	300-
USA	1-999	1-199	200-999	1000-
Hungary	1-249	1-50	51-249	250-
Poland	1-250	1-49	50-250	251-
Slovakia	1-499	1-24	25-499	500-
Croatia	1-249	1-49	50-249	250-

Source: ECE/Coordinating Unit for Operational Activities Database, 1999, and Handwrterbuch der Betriebwirechaft, Teilband 2, I-Q, Schiffer-Poeschel Verlag, MCMXCIII, p. 2895, adapted from Grubišić, 1998, p. 8

These differences impact on the specifics of every country and its observation of enterprises concerning size.

In order to give one overall definition of enterprises according to size, The European Union developed a definition for its members (Commission recommendation) in 1996. According to this, a medium sized enterprise is one which has 50 to 250 employees, an annual turnover of between 7 and 40 million Euros, and an annual balance sheet total of between 5 and 27 million Euros (http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31996H0280&model=guichett).

Most European countries have adopted their definitions to this recommendation.

The question is which category of criteria to use for the definition of enterprises regarding size. The quantitative criteria offer a better and simple option for comparing of companies, but the usage of only quantitative criteria may lead to misleading results. For example, a car dealer with 250 employees is, compared to the average car dealer, large. A car manufacturer with 250 employees, however, would be considered as a small player. So, in defining enterprises regarding size, it is important to take into consideration specific industry differences.

Similar to the quantitative definitions, a variety of qualitative definitions can be found. The element that is common in most of them is the strong linkage between manager and owner. By reviewing qualitative definitions of different authors concerning medium sized companies, some knowledge about these kinds of companies can be summarized.

Medium sized companies are too big to be small and too small to be big.

In contrast to small firms, marked by the role of one (few) person (people) in the organization and execution of its business, focus on local markets, and important role of the family in the organization of the company and provision of capital, medium enterprises are characterized by a larger management team.

The entrepreneur is still physically present in the company either in the management team or on the executives' board (board of directors). Because of his/her physical presence in the company s/he can more easily assert herself/himself as an entrepreneur - transformational leader.

Closer connection between the entrepreneur and employees compared to large companies enables the employees of medium sized companies to create special skills in their jobs and the formation of organizational rent. They build their global presence on niche markets due to their limited competitive scope and specialized skills. Medium sized enterprises can successfully fight with the competition if the possession of special skills enables them to create competitive advantages. This enables them coexistence with large enterprises that build their competitive advantages mainly on economies of scale, economies of scope, or on the learning curve.

Organizational structure and operational systems of medium sized companies are aimed at simplicity. Their goals are more simply defined and can be better communicated to employees. Medium sized enterprises maintain strong links with their geographical origins; there are stronger relations between employer and employees due to the relatively small workforce. The usage of human and physical capital is usually more intensive compared to large enterprises.

Medium sized companies usually finance their operations, provided by the family and by using internally generated funds (retained profits and depreciation). Capital market usually does not play a significant role in providing financial resources (Prašnikar et al., 2003, p. 18).

2.2. General Characteristics of Medium Sized Enterprises: Their Strengths and Weaknesses

Medium sized enterprises have mixed characteristics of large and small enterprises. Especially, it is difficult to differentiate the particular characteristics of small from medium sized enterprises. In some situations a characteristic can be strength, and in some other, can be a weakness. Firstly, it depends on the complexity of a situation.

In the following text, the strengths and weaknesses of medium sized enterprises are distinguished according to some business aspects and business functions.

Organizational strengths and weaknesses

Medium sized enterprises usually have a flat, flexible organizational structure. Their organization has simpler structures and systems, which can be described by Mintzberg (1996, p. 615) words: "... it has little or no staff, a loose division of labour and a small managerial hierarchy. Little of its activities is formalised, and it makes minimal use of planning procedures or training routines. ...Power tends to focus on the chief executive, who exercises a high formal profile... ...The creation of strategy is the responsibility of the chief executive, the process of tending to be highly intuitive" (Mintzberg and Qiunn, 1996, p. 615).

According to this, medium sized enterprises have an opportunity to be more sensitive and responsive to market changes, and to have greater efficiency in the usage of resources and entire control of all business activities. Their adaptability and short reaction time are their great strengths in organizational terms. In situations when customers become the main component of business activities, and when everything starts and ends with customers' needs and satisfaction, this characteristic represents the significant advantage of medium sized enterprises and differentiates them from large enterprises, which are usually weak in this aspect.

Greater labour productivity in comparison to large enterprises also can be pointed out. In medium sized enterprises, informal organization and contacts are present, which contribute to better communication and motivation which could increase labour productivity. This also can encourage innovation development as one of the well-known strengths of medium sized enterprises. They provide a larger amount of financial resources for R&D than small enterprises, so continuous innovations are one of their main focuses.

On the other hand, in organisational context, the weakness of medium sized enterprises lies in a high level of power and control concentrated in the hands of one person (chief executive, entrepreneur, owner), who has significant influence on many everyday activities and also places pressure and authority on strategy formulation. A further organisational weakness is the low level of specialisation which, if high, could lead to lower costs, and achieve the economies of scale, which is the case in large companies.

Managerial strengths and weaknesses

Personalized management is the often characteristic of medium sized enterprises. It implies that the owner actively participates in all aspects of management, starting from definition of vision, mission, strategies, distribution of recourses, and decision-making in all business aspects. One person is involved when any matter is concerned. His/Her views and values influence all aspects of the company's activities. This means that a business decision will often become a personal decision and the logic of the balance sheet will not always apply, so the success of the company and its market position depends on the vision, and the entrepreneurial talent (experience and knowledge) of the owner/manager.

This characteristic of medium sized enterprises can be both an advantage and disadvantage at the same time. One person does not know everything and he/she is not infallible. So, devolution or delegation of authority is needed. As soon as the owner/manager understands that fact, it is better for the company's performance and development. On the other hand, personalized management can be an advantage because small managerial hierarchy provides flexibility, adaptability and a short reaction time. With the owner/manager's network of contacts and information, medium sized enterprises can perceive a market opportunity when larger companies cannot.

Every owner/manager must be aware of the strengths and weaknesses for his/her company, which result from these facts, and he/she has to be ready for changes in his/her position and for the necessity of including new individuals in managerial activities.

Risk is the element which has to be "improved" in this situation, because the owner/manager is usually risk averse, and he/she wants to protect acquired fortune, and is not prepared to take a risk. Because risk is a usual part of business, it is desirable for company's performance to delegate authority to new manager, who will be ready to take reasonable risk, especially when the company has plans to expand.

Human resources strengths and weaknesses

Because very often the owner/manager's livelihood depends on the success of the business, medium sized enterprises are highly motivated organizations. Employees could be strongly inspired by the owner's vision and goals, and they could feel high identification and commitment to the company, and may establish a strong and stable organizational culture. All this can encourage and stimulate their creativity, which is the basic strength of medium sized enterprises over the large ones.

Besides these strengths, medium sized enterprises could feel some weaknesses regarding human resources potential. Limitations in personnel resources are relevant in management and functional expertise. In both areas, there is a lack of financial resources to hire experienced specialists, so other employees have to take over these functions, even though they may not necessarily be qualified for them. Dependence on a limited number of people sometimes may cause exhaustion among employees.

A special problem of owner-managed enterprises is to get outside management expertise into the company. Even if the owner is willing to share tasks with outsiders, such functions are often not attractive due to the dominance of the owner. As a result, many companies rely solely on the owner's knowledge and vision, which might be limited to his experience. Another thing, which can make it very difficult for outsiders to come into the business, is the issue of nepotism. If nepotism is present and obvious in the company, it is impossible to attract outside expertise and professional management. Overall stable relationships between employees or partners, in medium sized enterprises, can turn into a weakness when the owner/manager favours relatives and friends.

Marketing strengths and weaknesses

Most medium sized enterprises are unlikely to be able to exert much influence on their market. They are usually price takers and face significant competition. This makes the risk of failure high and means that competitive strategy is of paramount importance. However, some medium sized companies fight this danger very effectively by differentiating their product or service, segmenting the market and developing a market niche. But because of that, medium sized enterprises are likely to be over-reliant on a small number of customers. This means they are particularly vulnerable to losing any one customer, and the effect on the company of such loss will be disproportionately large. This is another reason why they are riskier than large enterprises.

But on the other hand, in terms of relationships with customers medium sized enterprises have the great advantage. This is connected with the above mentioned facts. Medium sized enterprises have a smaller number of customers, so they have to build close relationships with them in order to keep them. Niche strategy, which means the production of a single product for a single market segment (Besanko et al., 2000, p. 429), should be applied by medium sized companies in the aim of satisfying different customers' needs and getting close to customers. Due to the limited market volume, these segments are fairly unattractive for larger companies, and as a result, the competition in this area is not significant. Because the mass production of large enterprises and their service element is not so dedicated to the differentiation of customers and their needs, this strategy can be strength of medium sized enterprises.

Finance and costs strengths and weaknesses

Medium sized enterprises usually are not public companies. This means that they often have problems raising capital and this can significantly constrain their choice of strategies. Raising finance can become a major strategic issue and relationships with financial institutions, such as banks, can become a major resource concern. Financial institutions are usually not prepared to take risks (which is enlarged by information asymmetry) and to provide a large amount of capital to medium sized enterprises. To give a loan, they often demand different insurance of their risk, like a mortgage or state guarantees. This can be an unbridgeable obstacle for medium sized enterprises. So they usually have to finance their operations with their own capital, which can slow down their development and growth.

The relatively small size of medium sized enterprises often leads to disadvantages in economics of scale. But, Hauser points out that this size leads to one of the SMEs greatest strengths - their ability to offer customized and specialized goods and services. This, however, implies that many SMEs cannot make use of cost advantages in mass production. Furthermore, some types of costs are not variable in relationship to company size, for example, R&D costs. R&D as the basis for the creation of strengths in innovation and flexibility has to be undertaken on a certain minimum scale in order to lead to results. In the event of lower sales and not-down-sizable costs, SMEs often incur a higher proportion of fixed costs compared to large companies (http://www.themanager.or/resources/Small%20Business.htm).

Medium sized enterprises never can produce the cheapest products as large enterprises, but economics of scale, usually the great competitive advantage of large enterprises, recently are becoming less important to many customers, so medium sized enterprises can see a chance for satisfying different needs, giving additional services, customer designed products, etc.

Finally, after some strengths and weaknesses of medium enterprises have been emphasized, to conclude, it can be stressed that well managed medium sized enterprises may be able to overcome size-specific problems of resources by implementing an intelligent outsourcing strategy, by focusing on a few core competencies and by developing a motivating corporate culture.

2.3. Medium Sized Enterprises in Different European Countries

For a long time industrialization and economic development were assumed to be based on mass-production with relatively standardised products by means of specialised assets and technology. Large companies were seen as superior in efficiency as well as the most important driving force behind technology development.

The breaking point in this kind of observation was in the 80s, when small and medium sized companies became more visible in public debate, and political measures were taken in several Western European countries in order to improve the situation of small and medium sized enterprises.

During the 90's, interest in small and medium sized companies has increased further concurrently with deepening economic problems and increased unemployment in many European countries. Large companies contributed to an ever-increasing interest in small-scale economic activities through decentralization, downsizing and outsourcing which further emphasised the importance of small-scale activities (Landstrom et al., 1997, p. 2).

The situation in perception of SMEs sector in Central and Eastern Europe, and in former Soviet Union, was very similar, but with some specifics. After years of communist control, centralized planning and state control of all economic activities, small and medium sized enterprises have tended to flourish in all countries. Most governments in this region have approved programmes and legislation aimed at stimulating SMEs development, especially oriented toward the simplification of the taxation system and the introduction of tax concessions. Serious efforts have been made to reduce regulations and towards simplification of administrative procedures.

As might have been expected, in all countries, finance has emerged as the most pressing problem for new and expanding SMEs. An important constraint for SMEs growth is the availability and costs of finance. Information asymmetries create difficulties in obtaining readily available cheap sources of external finance for SMEs (both equity and debt). The consequence of these information problems is that these firms will depend heavily on internal sources of funds (retained earnings), and, if external finance is obtained, this will mostly come from private (non-market) external sources of finance. In the case of equity financing, these private sources usually take the form of angel finance and venture capital, while in the case of debt financing, the source regarded as the most suitable for resolving informational problems are commercial banks, using relationship-based bank loans (Boot et al., 2005).

The problem of finance was, and still is, considerable in transition countries where the banking system left behind by a communist regime was rudimentary and unsuitable for the financing needs of a growing private sector, and especially for SMEs. In recent years, banking system has been transformed in these countries, and many new commercial banks have been established. But they are not so strong and powerful to provide enough amounts of capital for SMEs development.

Furthermore, in transition countries, an additional problem for SMEs sector is the lack of adequate managerial knowledge and inexperienced management, so there is a constant need for training programmes, advice and assistance activities for owners/managers, because incapable management is one of the crucial reasons why most small enterprises decay.

The number of small and medium sized enterprises in Europe is significant, and they represent more than 95 percent of all companies. Out of that, medium sized enterprises have a share of about just 1 percent.

From table 2, the share of medium sized enterprises in the total number of enterprises, and their share in employment, in different European countries, can be seen.

Table 2: The Medium Sized Enterprises in Different European Countries

Country/Year	Percentage proportion in total number of companies	Percentage proportion in employment
Austria, 2000.	2.2	21.4
Belgium, 1996.	0.5	11
Denmark, 2003.	1.6	18
Finland, 1996.	0.9	17
France, 1996.	1.1	15
Germany, 1996.	1.5	14
Greece, 1996.	0.4	14
Hungary, 2002.	0.6	22
Ireland, 1996.	1.6	14
Italy, 1999.	1.8	15
Luxemburg, 1996.	3.0	29
Netherlands, 2002.	7.5	-
Norway, 1996.	1.0	18
Portugal, 1996.	0.9	18
Spain, 1996.	0.6	12
Sweden, 1996	1.3	16
Switzerland, 1996.	2.3	21
UK, 2002.	0.72	12

Source: National Competitiveness Council - Annual Competitiveness Reports [URL: http://www.forfas.ie/ncc/]

In all these countries, medium sized enterprises have a very low share. On average, it is around 1.6 percent, while they employ, on average, about 16 percent of the workforce. The smallest share of medium sized enterprises is in Greece, and the largest share is in the Netherlands. The Netherlands is a special case, because it defines medium sized enterprises as companies from 10 to 100 employees, so this high share basically includes enterprises which in other countries, belong to the category of small enterprises, and these enterprises are in the majority in all countries. It is also known, and it can be seen from table 2, that northern European countries have a greater share of medium sized enterprises. One reason for this lies in their political and economic stability.

Concerning the growth of medium sized enterprises and their expansion into large enterprises, different countries have different factor conditions, circumstances, surroundings and obstacles to growth.

In Germany, the main problems for medium sized enterprises growth are insufficient capital and difficulties in getting loans, long and complicated administration procedures and tax reasons. In order to grow, many German companies apply vertical and horizontal integrations, as mainly relevant growth strategies. In that way, they try to keep in touch with strong competition and globalisation.

The same obstacles for medium sized enterprises growth can be found in Austria. In this country, core factors for medium sized enterprises success and expansion are, as in Germany, high technological specialisation, orientation on market niche, high quality and great attention to customer relations.

In Italy, medium sized enterprises also use cooperative strategies, especially associations into clusters, which allow them to use the benefits of economies of scale.

Changes in world economy, firstly concerning globalisation, have stimulated the Netherlands government to provide help for the development of entrepreneurship and SMEs. This help was oriented on reforms in the legal system, tax breaks, and simpler administration procedures in order to facilitate access of SMEs to financial resources.

Denmark enterprises, because of the small national market are forced to be oriented on foreign markets, so 2 to 4 percent of Denmark SMEs perform their business activities in international markets. As in many other countries, Denmark companies are also faced with a lack of financial resources and difficulties in obtaining additional capital and this slows down their growth (Milenković et al., 2003, p. 64).

Medium sized enterprises in transition countries have a different history. They are found by the restructuring of large enterprises which were state owned (Milenković et al., 2003, p. 54). Another group of them was established after the introduction of market oriented economy and encouragement of entrepreneurship. All of these enterprises have the same problems regarding getting loans, lack of managerial knowledge and experience, and inadequate or indefinite corporate strategies.

2.4. Growth Strategies as Strategic Decision

This chapter will provide an understanding of strategies, their hierarchy, factors which influence the strategic decision-making process, and methods of strategy formulation.

Special attention will be directed towards growth strategies, their definition and classification, and their significance and meaning for medium sized companies.

2.4.1. Definition and Types of Strategy

Considering three leading contributors in the field of strategic management some definitions of strategy can be pointed out.

By Alfred Chandler (1962, p. 16), strategy is the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals (Chandler, 1962, p. 16).

Furthermore, strategy is defined as the pattern of objectives, purposes or goals, and the major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or should be in, and the kind of company it is or should be (Mintzberg and Quinn, 1996, p. 47).

Thomas and Stricland (1987, p. 8) define strategy as the framework for a firm's business activities, which provides guidelines for the usage and coordination of each resource in order to take advantage of opportunities and avoid threats (Thomas and Stricland, 1987, p. 8).

By Buble (1997, p. 141), strategy is a way a company deals with its environment (Buble et al., 1997, p. 141).

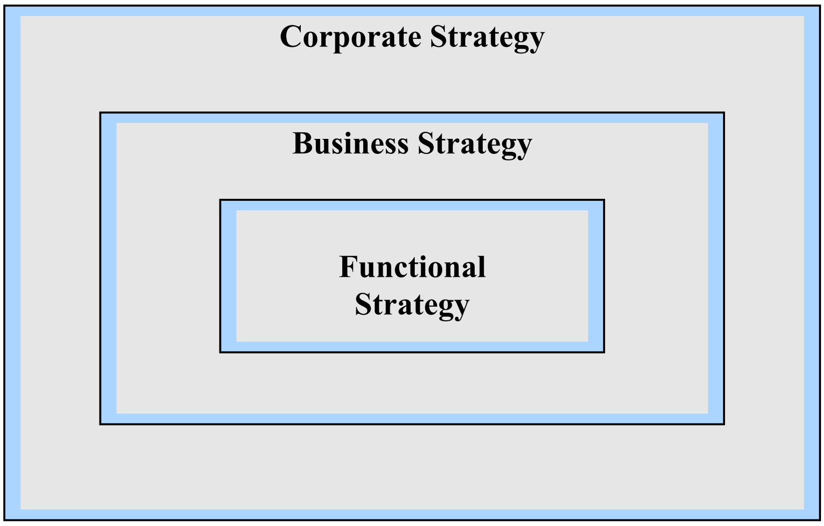
From all of these definitions, some common aspects can be perceived, such as long-term goals, major policies, big decisions, the framework of a company's business activities, environment; and in short, it can be concluded that strategy is fundamental to an organization's success; it should maximize competitive advantages and minimize competitive disadvantages of the company.

The typical business company usually considers three types of strategy: corporate, business and functional.

Corporate strategy is concerned with enterprise as a whole, and it is handled by top management. It describes a company's direction in terms of its general attitude toward growth and the management of its various businesses and product lines. Corporate strategies typically fit within three main categories of stability, growth and retrenchment. This strategy gives an answer to the question "What business or set of business should the company be in?" **Business strategy** usually occurs at the business unit or product level, and it emphasizes the improvement of the competitive position of a company's products or services in the specific industry or market segment served by that business unit. By focusing on the synergy and distinctive competencies components, business strategy attempts to answer the question "Given the particular product/market, how does the company best compete?" **Functional strategy** is the approach taken by a functional area to achieve corporate and business unit objectives and strategies by maximizing resource productivity. It is concerned with development and nurturing a distinctive competence to provide a company or business unit with a competitive advantage (Wheelen and Hunger, 1998, p. 160). Functional strategy is related to each specific function of a company, such as marketing, R&D, finance, human resource management.

Among these three levels of strategies, there are defined relations. This can be seen from figure 1.

Figure 1: Hierarchy of Strategy

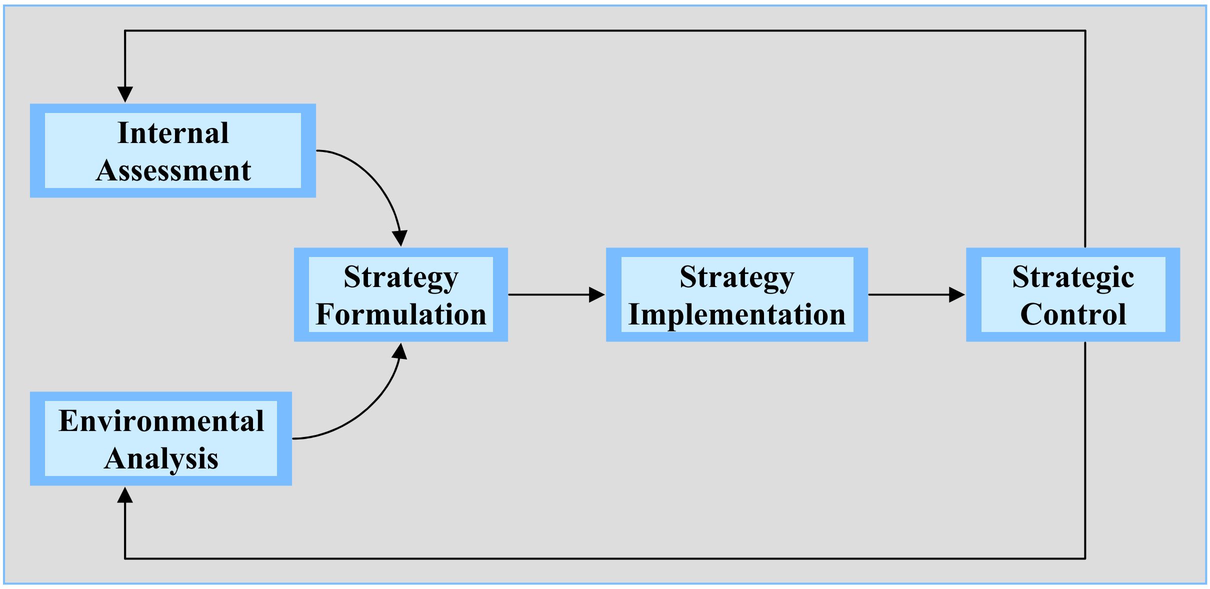


Source: Wheelen and Hunger, 1998, p. 13

Companies use all these strategies simultaneously. The hierarchy of strategies is the grouping of strategy types by level in the organisation. Functional strategies support business strategies, which in turn, support corporate strategies.

The real meaning of strategy is evident through the strategic management process. Strategic management is a set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives (Pearce and Robinson, 2000, p. 17). Figure 2 shows five major components of this process: 1. Internal assessments, 2. Environmental analysis, 3. Strategy formulation, 4. Strategy implementation and 5. Strategic control.

Figure 2: The Strategic Management Process



Source: Bateman and Zeithaml, 1993, p. 146

By internal assessment, the company analyses the quantity and quality of the company's financial, human and physical resources. It also assesses the strengths and weakness of the company's management and organisational structure. Finally, it contrasts the company's past successes and traditional concerns with the company's current capabilities in an attempt to identify the company's future capabilities. Environmental analyses include: industry and market analysis, competitor analysis, political and regulatory analysis, social analysis, human resources analysis, macroeconomic analysis and technological analysis (Bateman and Zeithaml, 1993, p. 151). Strategy formulation begins with a summary of the major facts and forecast derived, from the internal assessment and the environmental analysis. This summary leads to a series of statements that identify strategic issues confronting the organisation. These issues may be opportunities, problems or threats that require strategic action. Strategic managers must ensure effective and efficient strategy implementation. The strategy must be supported by a decision regarding an appropriate organisation structure, technology, human resources, reward system, information system, and leadership style. And finally, a strategic control as part of strategic management process is designed to support managers in evaluating the organisation's progress with its strategy, and where discrepancies exist, in taking corrective action (Hill et al., 1990, p. 117).

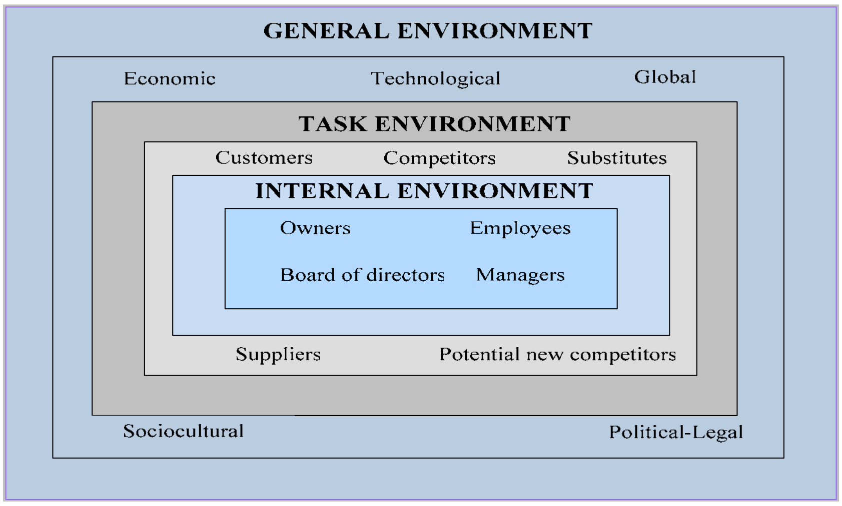
2.4.2. Factors which Influence Strategy Formulation

2.4.2.1. Nature of Environment

Managers must constantly be aware of factors both inside and outside the company that affect their decisions and actions. These factors are called environment. It is inherently complex, with many individuals and groups affects, which may represent opportunities or threats to company's performance.

Figure 3 presents the components of the environment within which managers must operate.

Figure 3: The Organizational Environment



Source: Adopted from Gatewood, et al., 1995, p. 61

The General Environment refers to the broad, complex factors that affect all organisations. It is often categorized into five groups: sociocultural, political-legal, technological, economic and global dimension (Gatewood et al., 1995, p. 61).

The sociocultural dimension includes the demographic and the values of the society within which an organisation operates. This dimension is especially important because it determines the goods, services and standards that a society values. Demographics are measures of the various characteristics of the people and social groups who make up a society. Age, gender and income are examples of commonly used demographic characteristics, which often determine consumer demand. Values refer to certain beliefs that people have about different models of behaviour or products (Gatewood et al., 1995, p. 65).

The political-legal dimension of the general environment refers to the nature of the relationship between various areas of government and the organisation. It provides stability within which organisation can effectively plan and operate. It can affect business opportunities through tax laws, economic policies and international trade rulings. The political element of the political-legal dimension refers to businesses' involvement in forming public policy, when companies, through some committees, are included in the modification of legislations on a local and national level. The legal element is the use of the judicial branches of government to resolve disputes between parties. The third part of the political-legal dimension is the regulatory element. Companies commonly view any government regulation negatively because complying with regulations increases the cost of doing business, and limits businesses' decision options (Gatewood et al., 1995, p. 63).

The technological dimension of the general environment refers to the knowledge and process of changing inputs (resources, labour and money) to outputs (products and services). Today a company cannot succeed without incorporating into its strategy the astonishing technologies that exist and continue to evolve. Technological advances create new products, production techniques, and ways of managing and communicating (Bateman and Zeithaml, 1993, p. 66).

The economic dimension reflects the overall condition of the complex interactions of economies throughout the world. Certain economic conditions of special concern to organisations include interest rates, inflation, unemployment rates, gross national product, and value of national currency (Gatewood et al., 1995, p. 65). These elements dramatically affect companies' ability to function effectively and influence their strategic decisions. Interest and inflation rates affect the accessibility and cost of capital, the ability to expand, prices, costs and consumer demand for products. Unemployment rates affect labour availability and the wages the company must pay, as well as product demand.

The global dimension of the general environment refers to those factors in other countries that affect the company. There is no doubt that the global dimension is becoming increasingly important to almost all aspects of business (Gatewood et al., 1995, p. 65). Falling political barriers and advanced communication and transportation technology are enabling many companies to sell their products in different countries. So, many companies perform their business on the international market, and managers must research the social, cultural, political, and legal background of target country, and obtain information on how to deal with tariffs, quotas and currency as well.

The Task Environment includes a company's competitors in industry as well as those parties that have a direct influence on the industry and company. These include suppliers, customers, organisations that produce substitute goods or services, and current and potential new competitors (Gatewood et al., 1995, p. 66).

Suppliers are organisations and individuals who provide resources, such as products, raw materials, capital, labour, and information, to other organisations. Their power lies in their ability to control the flow of these inputs and thus set prices for them. A business is at an advantage if it has many suppliers for a particular resource and at a disadvantage if it has only a few. A supplier may also be in a strong position if the cost switching sources is high (Gatewood et al., 1995, p. 66). Choosing the right supplier is an important strategic decision. Suppliers can affect manufacturing time, product quality and inventory levels. Recently, the close supplier relationship has become a new model for many organisations that are using a just-in-time manufacturing approach.

Customers are those who purchase an organisation's products or services. They may be individuals or other organisations. The customer is also a powerful force in an organisation's operation. The power of the customer increases when the company's product is no different from that of its competitors. The cost of the product is a significant expense for the customers, and they will more seriously attempt to negotiate a reduced price for expensive items, such as cars or boats, because they have more stringent standards for these products features than for e.g. magazines, shoes and video games. Recently, customer service can be a significant competitive advantage of the company. It includes the speed of filling and delivering normal orders, willingness to meet emergency needs, merchandise delivered in good condition, readiness to take back defective goods and resupply quickly, availability of installation and repair services and parts, and no charges service (Bateman and Zeithaml, 1993, p. 70).

Substitutes are goods and services that may be used in place of those furnished by a given business. Substitutes for a company's products and services can limit how much it may charge. Often substitutes come as a result of technological innovation. This is the reason why a company needs to be continuously in touch with technology and innovation development. Substitutes can have a very serious effect on a business by diminishing or eliminating consumer demand for its products. Depending on the cost of the substitute, its effect can be quite rapid.

Competitors are often other organisations that produce similar, or in some cases, identical products. Competitors are often the most powerful force in a firm's operations. Prices, services, and support after sales are all directly compared with those of competitors. All companies attempt to gain an advantage over competitors in some part of the business operation, and they hope this advantage will result in increased sales. Companies are constantly monitoring others in the same field and trying to anticipate what they might do in the future.

Potential New Competitors are companies not currently operating in a business's industry but which have a high potential for entering the industry. If an industry is profitable, it will attract the attention of other businesses seeking opportunities to expand, posing a threat to those already in the industry. Companies must collect information concerning the probability of entry or these interested companies, they must ensure that their own operations are as efficient as possible and that their products and services do not have any major weakness of which these potential new entrants could take advantage. The main entry barriers to some industry include: high entrance costs, economics of scale, lack of access to distribution channels, and lack of technical expertise (Gatewood et al., 1995, p. 69).

The Internal Environment is completely affected by the company, because it is its basic element. Managers need to continuously observe changes in this environment and influence these changes in a direction which will lead to greater effectiveness and efficiency of company. Regardless of organisational form, size, or scope, the internal environment includes owners, managers and employees.

Owners can have various degrees of influence and power within a company. Small entrepreneurial companies normally have a very "hands-on" owner who seeks to have control over all aspects of business. In large companies, the stockholders hold ownership collectively. However, many stockholders see their possession of stock not as a form of ownership, but rather as a form of investment, and consequently they do not seek to exert control over management. This has led to a separation of ownership and control in many companies (Gatewood et al., 1995, p. 69).

Managers In the smallest companies, the owner is the sole manager of the firm and fulfils all typical management tasks. As the organisation expands and becomes more complex, however, the owner will normally bring in additional persons to act as managers. For the purpose of interacting with the external environment, three types of managers can be identified: strategic, technical and operational. Strategic managers are involved with setting the overall direction of the company. They are concerned primarily with macroeconomic factors. Technical managers serve under strategic managers and act to coordinate the various levels. Operations managers are the ones who in some manner transform the organisational inputs into finished outputs. They are lower-level line managers or supervisors (Gatewood et al., 1995, p. 70).

Employees represent the company's workforce. They can be unionised or nonunionised. Unionised employees are represented by labour unions, which attempt to exert a strong influence on wages, working conditions, and job duties through a negotiation process with management. Two general environmental factors, sociocultural and technological, affect the demands of management on employees. Changing demographics is creating an older and more culturally diverse working force, and technological change is forcing employees to acquire more complex skills. Many companies are trying to increase employees' skills through training, and are then turning to employee involvement programs to take advantage of these skills (Gatewood et al., 1995, p. 70).

2.4.2.2. Environmental Scanning Techniques

Environmental scanning is the monitoring, evaluating, and disseminating of information from external and internal environments to key people within the company. A company uses this tool to avoid strategic surprise and to ensure its long-term health (Standard & Poor's, 1995, p. R63).

There are different environmental scanning techniques. Those used most often are explained in following text.

The PEST analysis is technique for general environment scanning. This analysis finds out threats and opportunities from political-legal (P), economic (E), sociocultural (S), and technological (T) dimension of environment. Table 3 shows important variables of each dimension in general environment which could be used for PEST analysis.

Table 3: Some Important Variables in the General Environment

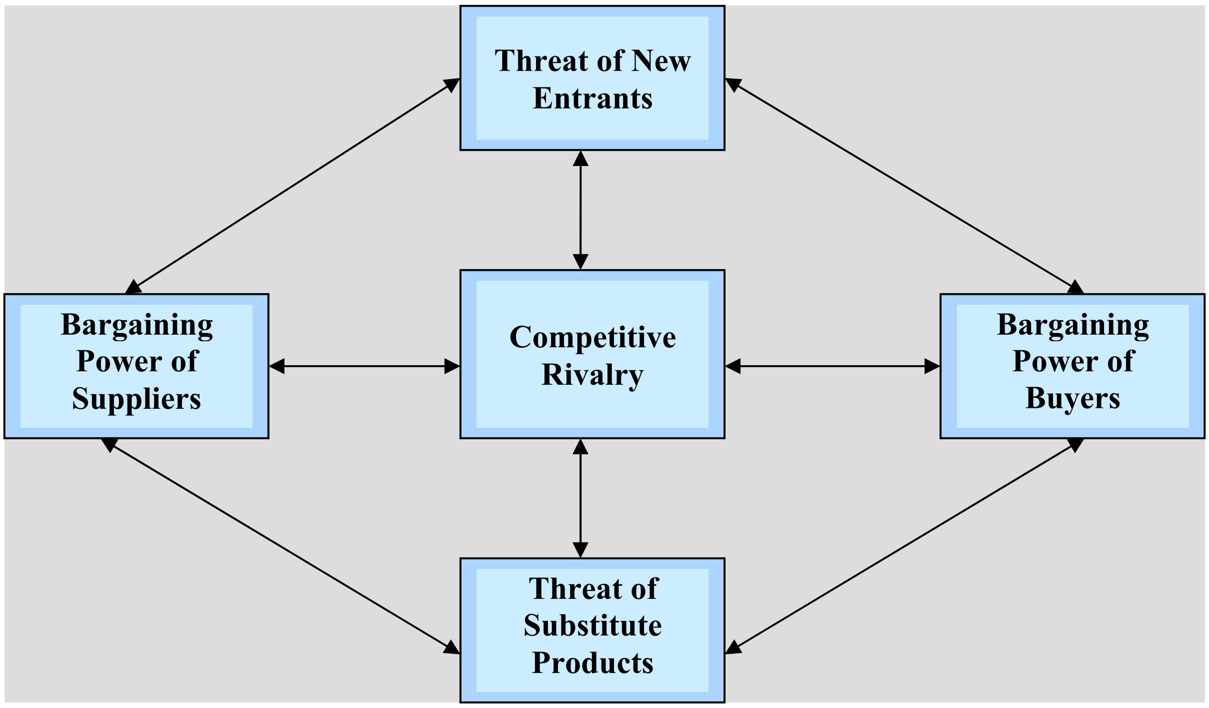
Economic	Technological	Political-legal	Sociocultural
• GDP trends • Interest rates • Money supply • Inflation rates • Unemployment levels • Wage/Price control • Devaluation/ Revaluation • Energy availability and cost • Disposable and discretionary income	• Total government spending for R&D • Total industry spending for R&D • Focus of technological efforts • Patent protection • New products • New developments in technology transfer from lab to marketplace • Productivity improvements through automation	• Antitrust regulations • Environmental protection laws • Tax laws • Special incentives • Foreign trade regulations • Attitudes toward foreign companies • Laws on hiring and promotion • Stability of government	• Lifestyle changes • Career expectations • Consumer activism • Rate of family formation • Growth rate of population • Age distribution of population • Regional shifts in population • Life expectancies • Birth rate

Source: Wheelen and Hunger, 1998, p. 13

On the basis of this analysis, the company may find out opportunities and threats related to each dimension of the general environment which can be helpful in strategic management process.

Besides analysing the general environment, company scanning of the environment will include analysis of all the relevant elements in task environment. According to **Porter's model**, the essence of strategy formulation is coping with competition. This is related to industry analysis which includes scanning the task environment. In carefully scanning the industry, the company must assess the importance of five forces: threat of new entrants, bargaining power of buyers, bargaining power of suppliers, threat of substitute products and competitive rivalry. The interaction among these forces is represented in figure 4.

Figure 4: Porter's Model for Competitive Analysis



Source: Adapted from Bateman and Zeithaml, 1993, p. 72

1. **Threat of New Entrants**

New entrants into an industry compete with established companies. If many factors prevent new companies from entering the industry, the threat to established companies is less serious. Some major barriers to entry are government policy, product differentiation, capital requirements, brand identification, cost advantages and distribution channels (Bateman and Zeithaml, 1993, p. 72). The government with its policies can limit or prevent entry, or can regulate some industries through licensing requirements by restricting access to raw materials, etc. Patents are also an entry barrier, and only when a patent expires, can other companies enter the market. Other barriers are less formal but can have the same effect. Existing companies can create a high entry barrier through their high levels of advertising and promotion. Capital requirements may be so high that companies will not risk or try to raise such large amounts of money. Brand identification forces new entrants to spend heavily to overcome customer loyalty. Cost advantage is related to large size with benefits of economies of scale. Finally, existing competitors may have such tight distribution channels that new entrants have difficulty getting their products or services to customers.

2. **Threat of Substitute Products**

Substitute products are those that appear to be different but can satisfy the same need as other products. Substitutes limit the potential returns of an industry. The industry could suffer in earnings and growth unless it improves the quality of its product or launcher effective, aggressive marketing campaigns.

3. Bargaining Power of Suppliers

Suppliers can affect an industry through their ability to raise prices or reduce the quality of purchased goods and services. A supplier or supplier group is powerful if some of the following factors apply:

- The supplier industry is dominated by a few companies.
- Its product or service is unique, or it has build up switching costs.[1]
- Substitutes are not readily available.
- Suppliers are able to integrate forward and compete directly with their present customers.

4. Bargaining Power of Buyers

Buyers affect an industry through their ability to force down prices, bargaining for higher quality or more services, and play competitors against each other. A buyer or a group of buyers is powerful if some of the following factors hold true:

- A buyer purchases a large proportion of the seller's product or service.
- A buyer has the potential to integrate backward by producing the product itself.
- Alternative suppliers are plentiful because the product is standard or undifferentiated.
- A buyer earns low profits and is thus very sensitive to costs and service differences.
- The purchased product is unimportant to the final quality or price of a buyer's product or service and thus can be easily substituted without affecting the final product.

5. Competitive Rivalry

Competitive rivalry is related to the presence of several factors. The first is number of competitors - when competitors are few and roughly equal in size, they watch each other carefully to make sure than any move by another company is matched by an equal countermove. The second factor is rate of industry growth - if the growth rate of industry is high, the rivalry is stronger. The only path to growth is to take sales away from a competitor. The third factor is product or service characteristics - if the product is seen as a commodity, and it is somehow standardised in functions and quality, the customer has no preferences toward a specific producer, so the rivalry among those producers is strong. And finally, the fourth factor, which will be explained, is amount of fixed costs - high fixed costs influence strong competition activities. Other factors which influence on competitive rivalry are: capacity; exit barriers; diversity of rivals.

The company's performance is determined by a combination of internal and external factors. After assessing external factors (general and task environment), which influence a company's business activities, it is necessary to examine the company's internal strengths (S), weaknesses (W), opportunities (O) and threats (T), associated with the business's external environment, or in other words, perform a **SWOT analysis**. A strength is ability or attribute that the company possesses which has the potential of giving it a distinctive competence. A weakness is a skill or attribute that the firm lacks or one that it has not developed and at which it performs poorly. An opportunity is an environmental

[1] Switching costs are fixed cost buyers faced if they change suppliers.

circumstance that is potentially beneficial for the firm. On the other hand, a threat is an environmental factor that could be potentially harmful to the company. The SWOT analysis emphasizes that the fit between a company and its environment is of paramount importance, and the company's strategy should be built around this match. The quality of a company's SWOT analysis depends on its ability to effectively scan the environment.

Table 4 indicates the kinds of factors managers should consider in determining a company's internal strengths and weaknesses and external opportunities and threats.

Table 4: SWOT Analysis

Potential Internal Strength	Potential Internal Weaknesses
• Core competencies in key areas • Adequate financial resources • Well-thought-of by buyers • An acknowledged market leader • Well-conceived functional area strategies • Access to economics of scale • Insulated from strong competitive pressures • Proprietary technology • Cost advantages • Better advertising campaigns • Product innovation skills • Proven management • Ahead on experience curve • Better manufacturing capability • Superior technological skills	• No clear strategic decision • Obsolete facilities • Lack of managerial depth and talent • Missing some key skills or competencies • Poor track record in implementing strategy • Plagued with internal operating problems • Falling behind R&D • Too narrow a product line • Weak market image • Weak distribution network • Below-average marketing skills • Unable to finance needed changes in strategy • Higher overall unit costs relative to key competitors
Potential External Opportunities	**Potential External Threats**
• Ability to serve additional customer groups or expand into new markets or segments • Ways to expand product line to meet broader range of customer needs • Ability to transfer skills or technological know-how to new businesses products • Integrating forward or backward • Falling trade barriers in attractive foreign markets • Complacency among rival firms • Ability to grow rapidly because of strong increases in market demand • Emerging new technologies	• Entry of lower-cost foreign competitors • Rising sales of substitute products • Slower market growth • Adverse shifts in foreign exchange rates and trade policies of foreign governments • Costly regulatory requirements • Vulnerability to recession and business cycle • Growing bargaining power of customers or suppliers • Changing buyer needs and tastes • Adverse demographic changes

Source: Thompson and Strickland, 1996, p. 93

SWOT analysis is an essential component of thinking strategically about a company's situation. On the basis of this analysis, the company can develop four types of strategies, which are represented in figure 5.

Figure 5: Possible Strategies Related to SWOT Analysis

	Strengths (S)	Weakness (W)
Opportunities (O)	**SO Strategy**	**WO Strategy**
Threats (T)	**ST Strategy**	**WT Strategy**

Source: Buble, 2000, p. 187

SO strategies are generated by thinking of ways a company could choose to use its strengths to take advantage of opportunities. ST strategies consider a company's strengths as a way to avoid threats. WO strategies attempt to take into advantage of opportunities by overcoming weaknesses, and finally, WT strategies are basically defensive, and primarily act to minimize weaknesses and avoid threats.

This identification of a company's strengths and weaknesses, opportunities and threats from the environment, as well as, the definition of related strategies should be used in the adaptation of adequate corporate strategies.

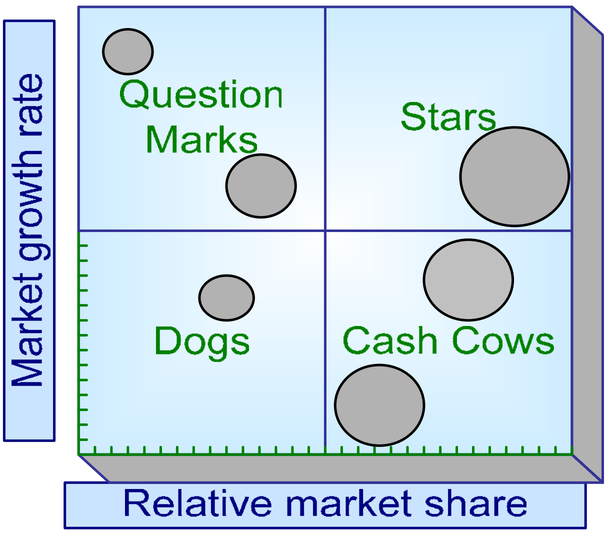
2.4.3. Methods of Strategy Formulation

As it was mentioned above, there are many external and internal factors with a strong influence on company's efficiency. In order to formulate adequate strategy the company should obtain the knowledge about its position on the market which directly influence on its effectiveness and efficiency. The most important methods[2] which are used in this direction are:

- BCG Growth-Share Matrix
- GE Business Screen
- Life-Cycle Matrix

The **BCG Growth-Share Matrix** is developed by Boston Consulting Group (BCG), with postulates that all except the smallest and simplest organisations are composed of more than one business. These businesses in an organisation are called its corporate portfolio. The BCG approach proposes that a separate strategy should be developed for each of these units. Figure 6 represents the visualisation of this approach.

Figure 6: BCG Growth Share Matrix



Source: Adapted from Bateman and Zeithaml, 1993, p. 144

[2] The usage of this method represents corporate portfolio analysis.

The horizontal axis indicates the market share of the business relative to its major competitor and characterizes the strength of the organisation in that business. The market share for any particular year is calculated as follows:

$$\text{Relative market share} = \frac{\text{Business unit sales (current year)}}{\text{Leading competitor's sales (current year)}}$$

The vertical axis indicates the percent of growth in the market in the current year and characterises the attractiveness of the market for the business unit. This market growth is calculated as follows:

$$\text{Market growth rate} = \frac{\text{Total market (current year) - Total market (previous year)}}{\text{Total market (previous year)}} \cdot 100$$

It is a projected rate of sales growth for the market served by a particular business. Usually, it is measured as the percentage increase in a market's sales or unit volume over the two most recent years.

The relative market share and the market growth rate are the two fundamental parameters that influence strategy selection. Relative market share determines the rate at which the business unit generates cash. A business unit with a relatively high share of the market compared to its competitors should have higher profit margins and thus higher cash flows.

On the other hand, the market growth rate has a twofold influence on strategy selection. First, the market growth rate influences the ease of gaining market share. In slow-growth markets, increases in market share generally come from decreases in competitor's market share. Second, the market growth rate determines the level of opportunity for investment. This opportunity can also present problems because the faster a business unit grows the more cash it needs to finance the growth. But businesses have external sources of cash for debt and equity financing (Byars et al., 1996, p. 177).

These two axes divide the matrix into four quadrants. Each quadrant in BCG growth matrix has its own meaning.

"Cash Cows" have low market growth rate and high market share. Because of high market share, profits and cash generation should be high. The low rate of growth means that the cash demands should be low. Thus, large cash surpluses are normally generated by "Cash Cows". They provide the cash to meet company needs and are thus the foundation of the company. With strong "Cash Cows", the company can use the excess funds to help support "Stars" and "Question Marks"(Gatewood et al., 1995, p. 286).

"Dogs" have a low market share and low market growth rate. The former normally implies poor profits. Because the growth rate is low, investments to increase market share are often unreasonable. Unfortunately, the cash required to maintain a competitive position often exceeds the cash generation.

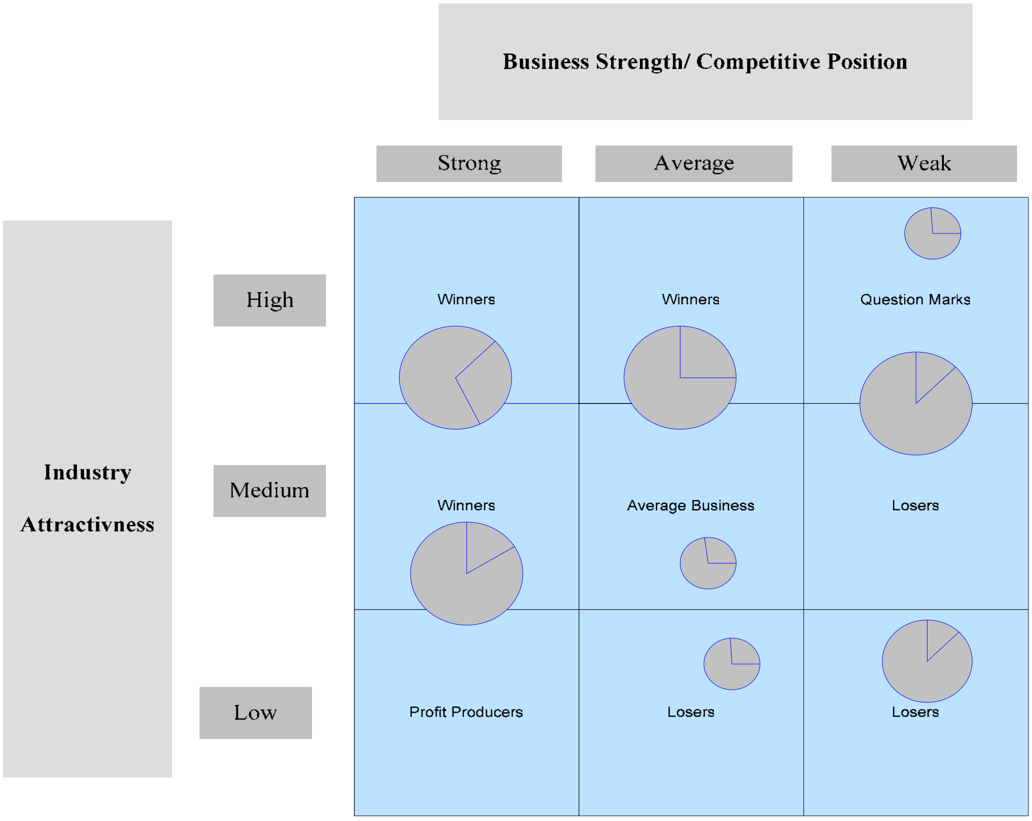
"Question Marks" have a low market share and high market growth rate. Their cash needs are high because of their growth, and the cash generated is low because of their market share. Because the growth is high, one strategy for a "Question Mark" is to make necessary investments to gain market share and become a "Star", but managers must evaluate if the business's potential earnings warrant this investments.

"Stars" have high growth and high market share. Because of that they generate large amounts of cash, and they represent the best profit and investment opportunities. Obviously, the best strategy for "Stars" is to make the necessary investments to maintain or improve their competitive position.

Strategy selection using the growth-share matrix assumes that the primary objectives of the organisation are growth and profitability. The advantage of multibusiness organisations is that they can transfer cash from business units that are highly profitable but have low growth potential to other units that have high growth and high profit potential. Strategy selection among the various business units is designed to produce a balanced portfolio in terms of the generation and use of cash (Byars et al., 1996, p. 179).

The **GE Business Screen** is another matrix developed by General Electric with the assistance of McKinsey and Company consulting firm. GE's approach was inspired by the need to develop a method of evaluating the plans of different business units in order to fund plans with the greatest potential. The GE matrix, as it can be seen from figure 7, includes nine cells based on long-term industry attractiveness and business strength/competitive position.

Figure 7: GE Business Screen Matrix



Source: Adopted from Gatewood, et al., 1995, p. 287

In contrast to the BCG matrix, the GE Business Screen Matrix includes much more data. On the horizontal axis of the GE matrix there is industry attractiveness, and the vertical axis represents business strengths or competitive position. Both industry attractiveness and business strengths are, in the matrix, ranked as low, medium or high. Circles on the GE Matrix identify the individual product lines or business units. The area of each circle is in proportion to the size of the industry in terms of scale. The pie slices within the circles represent the market share of each product line or business unit.

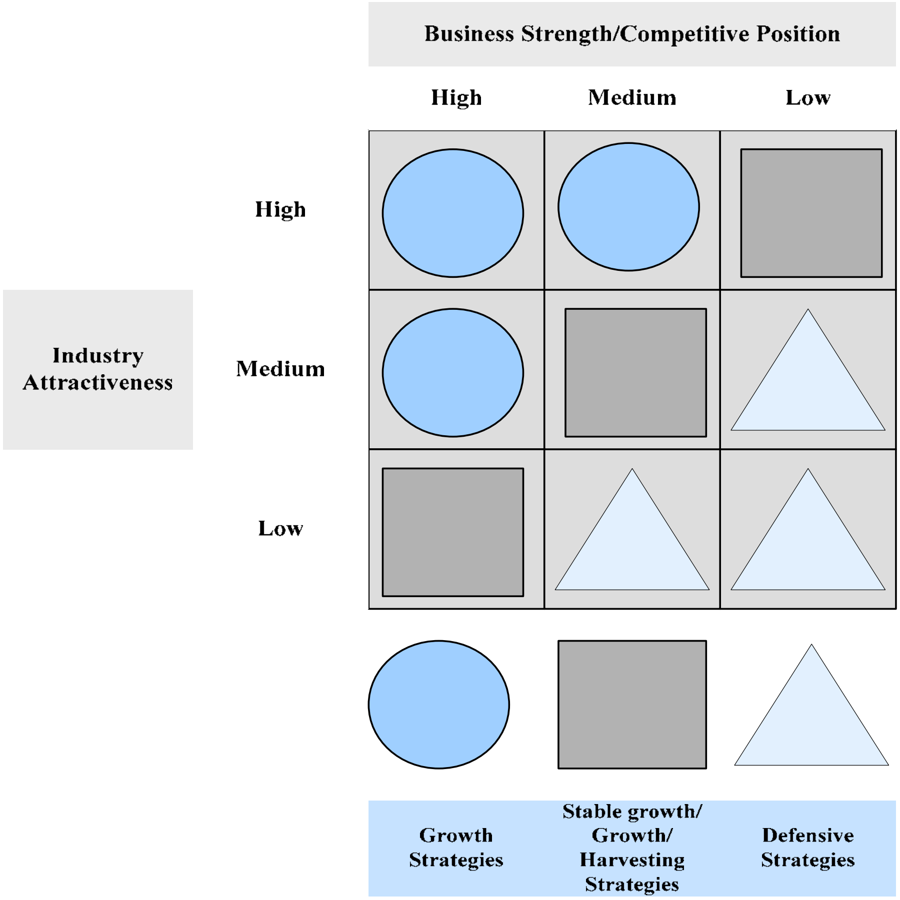
To develop the GE matrix, the following steps have to be included:

1. Select general criteria by which the industry will be rated. These criteria should be key aspects of the industry, such as: size, growth, pricing, market diversity, competitive structure, industry profitability, technical role, inflation vulnerability, cyclicality, customer, financial, energy impact, social, environmental, legal, and human. Then, these criteria should be weighted by their importance to the achievement of company's objectives from the management perception (for example from 0.0 to 0.20). Another step is to rate the industry on each of these criteria, from 1 (very unattractive) to 5 (very attractive). Finally, to get a weighted score, it is necessary to multiply the weight for each criterion by its rating. When these scored are added, the weighted attractiveness score for the industry as a whole is provided for a particular business unit.
2. Identify the business units key success factors in the industry. These factors could be: market share, business unit's growth rate, span of product line, sales distribution effectiveness, proprietary and key account advantages, price competitiveness, advertising and promotion effectiveness, facilities' location and newness, capacity and productivity, experience curve effects, raw materials cost, value added, relative product quality, R&D advantages/position, cash throw-off, quality of personnel and general image. Each factor should be weighted in terms of its relative importance to profitability or some other measure of success within the industry. Another step is to rate the business units' on each of the factors from 1 (very weak competitive position) to 5 (very strong competitive position). To get a weighted score, it is necessary to multiply the weight of each factor by its rating, and when these scores are added, the sum provides a weighted business strength/competitive position for a business unit as a whole.
3. Plot each business unit's current position on a matrix. The areas of the circles should be proportional to the size of the various industries involved; the company's current market share in each industry should be depicted as a pie-shaped wedge; and the circles should be centred on the coordinates of the business unit's industry attractiveness and business strength scores.
4. Plot the company' future portfolio assuming that present corporate and business strategies remain unchanged. If there is a gap between projected and desired portfolios, it should be a stimulus to seriously review the corporation's current mission, objectives, strategies, and policies (Buble et al., 1997, p. 208).

Because of the insufficiency of money and other resources, most companies must become selective and limit their investments to those business units that can provide an attractive payoff and in which they are strong. So, they must use some business units to finance the growth of others.

Figure 8 represents the corporate strategies that would be pursued for each cell of the matrix.

Figure 8: Strategy Options Using GE matrix



Source: Adapted from Byars, et al., 1996. p. 182

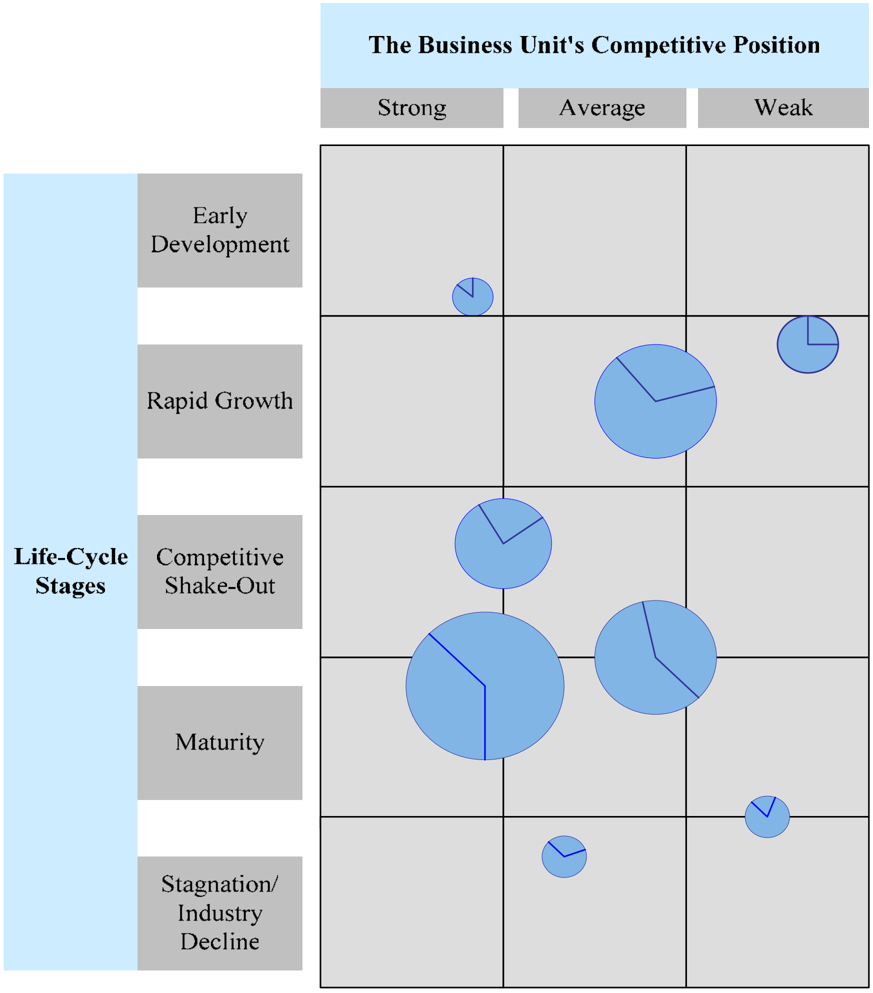
Generally, when a business unit is high in industry attractiveness and business unit strengths (figure 8), the strategy is to invest heavily and pursue growth strategy. When industry attractiveness and business unit strengths are positioned as low, the strategy would be one of the defensive strategies[3]. In the intermediate positions, the strategy generally involves concentrating resources on the most attractive business units that have unique competence. This implies stable growth strategies[4], growth and harvesting strategies[5] (Byars et al., 1996, p. 182).

Although the GE matrix is an improvement over the BCG matrix because it includes many more variables, it has some shortcomings such as: subjectivity and complication, and it cannot effectively show the position of new business units in developing industries.

[3] Defensive strategies or retrenchment strategies are used when a company wants or needs to reduce its operations, or to reverse a negative trend, or to overcome a crisis situation.
[4] Stable growth strategies are used when a company is satisfied with its past performance and continue to pursue the same or similar objectives.
[5] Harvesting strategies are implied when future growth appears doubtful or nor cost-effective and company try to "harvest" as much as it can from the products or services.

The Life-Cycle matrix is developed to better identify a developing winner business, using a 15-cell matrix (figure 9), where business units are plotted in stages of industry evolution and strength of competitive position. This matrix highlights how a diversified company's businesses are distributed across the stages of the industry life-cycle. Again, the circles represent the sizes of the industries involved, and pie parts denote the business's market share.

Figure 9: The Life-Cycle Matrix



Source: Adopted from Thompson and Strickland, 1996, p. 229

The first phase of **early development** involve minimal growth in sales, major R&D emphasis, rapid technological change in product, operating loses, and a need for sufficient resources or slack to support a temporarily unprofitable operation. Success at this introduction stage may be associated with technical skill, with being first in new markets, or with having a marketing advantage that creates widespread awareness. The strengths necessary for success change in the growth stage.

Rapid growth brings new competitors into the product market. At this stage, such factors as brand recognition, product differentiation, and the financial resources to support both heavy marketing expenses and the effect of price competition on cash flow can be key strengths.

As the industry moves through a **shakeout phase** and into the **maturity stage,** industry growth continues but at a decreasing rate. The number of industry segments expands, but technological change in product design slows considerably. As a result, competition usually becomes more intense, and promotion or pricing advantages and differentiation become key strengths. Technological change in process design becomes intense as the many competitors seek to provide the product in the most efficient manner. Where R&D was critical in the introduction stage, efficient production is critical in this phase to continued success in the broader industry segments.

When the industry moves into **decline stage,** strengths and weaknesses centre on cost advantages, superior supplier or customer relations and financial control. Competitive advantage exists at this stage, at least temporarily; if a company serves gradually shrinking markets that competitors are choosing to leave (Wheelen and Hunger, 1998, p. 166).

It is important to point out that these phases vary from the model, but the implication is the same.

In order to formulate adequate and appropriate strategy, it is necessary to use all three methods explained above. Each matrix has its pros and cons, and each tells a different story about the portfolio's strengths and weaknesses. Provided adequate data is available, all three matrices should be constructed since there is merit in assessing the company's business portfolio from different perspectives. Corporate managers need to understand the mix of industries represented in the portfolio, the strategic position each business has in its industry, the portfolio performance potential, and the kinds of financial and resource allocation considerations that have to be dealt with. Using all three matrices to view a diversified portfolio enhances such understanding.

2.4.4. Determination of Growth Strategies

Growth strategy is a type of corporate strategy, which is, as it has already been mentioned, primarily related to the choice of direction for the company as a whole. It involves a long-range time horizon, and it is established at the highest levels of the organisation. Growth strategy provides an opportunity to develop and expand business activities in different ways.

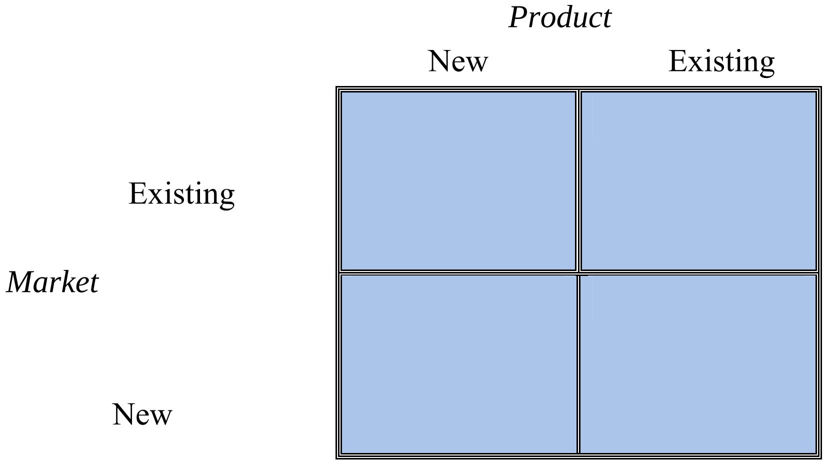
There are several reasons why a company decides to pursue a growth strategy.

- Growth can be seen as the "path to success". Running one’s own business is usually the quickest way to get rich.
- Managers are often given bonuses; salary increases and continued employment for achieving growth in sales and profits.
- Some managers who did not start or who do not own a significant interest in the company want to be remembered as having made "significant contributions" which is interpreted as having expanded the company.

- Pressures from investors and others with financial interest in the company stress growth. Stockholders, security analysis and bankers like to invest in and support growth-oriented companies.
- A belief exists that the company must growth if it is to survive. In certain volatile industries, a company does not have the option of remaining stable if it is to survive (Byars et al., 1996, p. 182).

The growth of the company may be focussed on grow in sales, assets, profits, or some combination. A systematic approach to building sales volume was developed earlier in the form of a matrix by Igor Ansoff as shown in figure 10.

Figure 10: Growth Matrix



Source: Barrow et al. 1992, p. 155

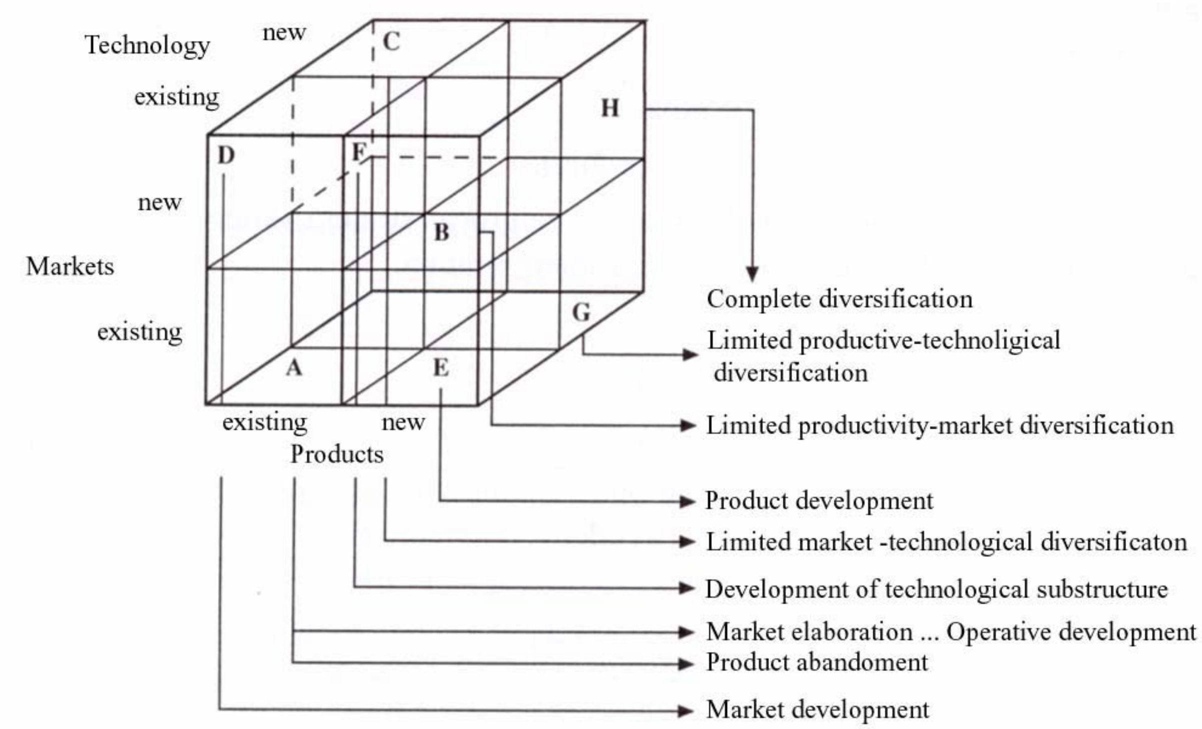
In terms of risk, developing new products for new markets is clearly the most difficult strategy. By keeping one of the variables constant, either an existing product or an existing market, the company is sure that "it keeps one foot on the ground" and reduces risk (Barrow et al., 1992, p. 154). The lowest risk is in competing more strongly with existing products and existing markets. It may be less glamorous than launching new products into exotic markers, but it usually ensures better returns. Any innovation, involving new products and new markets, is clearly a higher risk. Regarding innovation, the company can go in two directions. It can simply take existing proven products into a new geographic area, or it can pursue new products in existing markets.

As it has already been pointed out, companies that do business in expanding industries must grow to survive. Continuing growth means increasing sales and a chance to take advantage of the experience curve to reduce the per-unit cost of products sold, thereby increasing profits. This cost reduction becomes extremely important if a company's industry is growing quickly and competitors are engaging in price wars in attempts to increase their shares of the market. Companies that have not reached "critical mass" (economies of scale) will face large losses unless they can find and fill a small, but profitable niche where higher prices can be offset by special product and service features (Wheelen and Hunger, 1998, p. 134).

2.4.5. Classification of Growth Strategies

Several different generic strategies fall in the growth category. Most authors accept the division of growth strategies at eight basic strategies of enterprise development, which is represented in figure 11 (Buble et al., 1997. p. 160).

Figure 11: Basic Strategies for Enterprise Development



Source: Adapted from Buble et al., 1997, p.160

Strategy of market elaboration, i.e. operative development, is based on the preservation of all three existing substructures: market, technological and product substructure. This strategy includes efforts in improving the company's position in existing markets and its main characteristic is low risk.

Strategy of market development is based on the preservation of the existing product substructure and technological substructure, as well as penetration into new markets. Application of this strategy is related to high level of risk associated with new social and culture characteristics of new markets.

Strategy of product development is based on the preservation of market and technological substructure, as well as on the changes in product substructure. This kind of strategy is linked with the extension of the R&D function. It allows a company's fast growth, but includes higher risk than the strategy of market elaboration.

Strategy of limited productivity-market diversification is based on the preservation of technological substructure, as well as on the changes in the remaining two substructures product and market substructure (introduction of new products for new markets).

Strategy of development of technological substructure is based on the development of productive competence of the enterprise, along with a preservation of the existing product and market substructure. This strategy means restructuring and modernization of technological substructure, which demands huge investments, raises the costs, and influences efficiency of business. All this means the high risk related to this strategy.

Strategy of limited market-technological diversification is based on the preservation of the product substructure and on the development of productive competence, as well as on the winning of new markets. The basic idea of this strategy is to keep present product assortment, and to change market as well as technological substructure.

Strategy of limited productive-technological diversification is based on the preservation of the existing market substructure and on the changes in product substructure, as well as technological substructure. So this strategy concerns preparation of the company for new product introduction.

Strategy of complete diversification is based on the changes of all three basic tangible substructures of the enterprise. If those changes run in the direction of abridgement of tangible substructures, then it concerns the strategy of specialization. The strategy of specialization limits the product assortment and demands efficiency in economies of scale. The realisation of this strategy is possible if there are large markets and high flexibility of enterprise. Strategy of complete diversification is also successful in specific market niche which insist on adaptation to different customers' needs (Buble et al., 1997. p. 160).

The most frequently encountered and the clearest identification of the growth strategies is given by Byars, Rue and Zahra, 1996, p. 108. Their classification is as follows:

1. Concentration Strategy
    - Market Development
    - Product Development
    - Horizontal Integration
2. Vertical Integration
    - Forward Integration
    - Backward Integration
3. Diversification
    - Concentric Diversification
    - Conglomerate Diversification

2.4.5.1. Concentration Strategy

Concentration Strategy focuses on a single product/service or on a small number of closely related products/service and involves increasing sales, profits, or market share faster than it has increased in the past (Byars et al., 1996, p. 111). A company employing concentrated strategy grows by building on its competences, and it achieves a competitive edge by concentrating in the product-market segment it knows best. This strategy leads to enhanced performance. The ability to assess market needs, knowledge of buyer behaviour, customer price sensitivity and effectiveness of promotion are characteristics of concentration strategy.

Several factors might influence a company to pursue a concentration strategy. Some of these include lack of a full product line in the relevant market (product line gap); absent or inadequate distribution system to or within the relevant market (distribution gap), less than full usage in the market (usage gap) or competitor's sales (competitive gap). In order to fill these gaps company can perform some of following actions: filling out the existing product line (e.g. new sizes, options, styles or colours could be offer for existing product line); developing new products in the existing product line; expanding the distribution into new geographic areas either nationally or internationally; encouraging nonusers to use the product and light users to use it more frequently through use of advertising, promotions and special pricing campaigns; penetrating competitors' positions through pricing strategies, product differentiation and advertising (Byars et al., 1996, p. 111).

Basically, there are three general approaches to pursuing a concentration strategy:

Market Development The main idea in market development strategy is to expand the markets of a current business. It consists of marketing present products, often with only cosmetic modifications, to customers in related market areas (Pearce and Robinson, 2000, p. 257). This can be done by gaining a larger share of the current market, expanding into new geographic areas, or attracting new market segments. Expanding into new geographic areas means opening additional geographic markets such as: regional, national or international markets. Attracting new market segments includes developing product versions to appeal to other segments, entering other channels of distribution and advertising in other media. Market development allows firms to practice a form of concentrated strategy by identifying new users for existing products and new demographically, psychographically, or geographically defined markets (Pearce and Robinson, 2000, p. 257).

Product Development The key thought of this strategy is to alter the basic product or service, or to add a closely related product or service that can be sold through the current marketing channels. Successful product development strategies often capitalize on the favourable reputation of the company or related products. This strategy often is adopted either to prolong the life cycle of current products or to take advantage of a favourable reputation or brand name (Pearce and Robinson, 2000, p. 259). The idea is to attract satisfied customers to new products as a result of their positive experience with the company's initial offering. Some options available to companies undertaking product development are: to develop new products features, to develop quality variations or to develop additional models and sizes. So, the product development strategy is based on the penetration of existing markets by incorporating product modifications into existing items, or by developing new products with a clear connection to the existing product line.

Horizontal Integration This strategy occurs when a company adds one or more businesses that produce similar products or services and that are operating at the same stage in the product-marketing chain (Pearce and Robinson, 2000, p. 261). Almost all horizontal integrations are accomplished by buying another company in the same business.

One of the concerns of horizontal integration is to eliminate competition. Horizontal integration is attractive because it makes possible a quick increase in output capability. Moreover, in horizontal integration, the skills of the managers of the original business often are critical in converting newly acquired facilities into profitable contributors to the parent company. This expands a fundamental competitive advantage of the company, which is its management.

A concentration strategy offers a company several advantages. Firstly, the company has much of the knowledge and many of the resources necessary to compete in the market place. The second advantage is that a concentration strategy allows the company to focus its attention on doing a small number of things extremely well.

On the other hand, the major disadvantage of a concentration strategy is that it places all or most of the company's resources in the same basket. If the market for the organisation's product/service declines, then the company is in trouble. This is an especially important concern resulting from research in which it has been estimated that 80 percent of today's products will have disappeared from the market 10 years from now, while 80 percent of the products that will be sold in the next decade are as yet unknown (Byars et al., 1996, p. 113).

Under stable conditions, concentration strategy poses lower risk than any other strategy, but in a changing environment, a company commitment to concentration growth faces high risks. The greatest risk is that concentrating in a single product market makes a company particularly vulnerable to changes in that segment. Slowed growth in the segment would jeopardize the company because its investment, competitive edge, and technology are deeply entrenched in a specific offering. A company pursuing a concentration strategy is vulnerable also to the high opportunity costs that result from remaining in a specific product market and ignoring other options that could employ the company's resources more profitably.

The concentration strategy, market development and product development could be observed through Kotler's differentiation (Pearce and Robinson, 2000, p. 258):

Concentration (increasing use of present products in present markets):

1. Increasing present customer's rate of use
   a) Increasing the size of purchase
   b) Increasing the rate of product obsolescence
   c) Advertising other uses
   d) Giving price incentives for increased use
2. Attracting competitors' customers:
   e) Establishing sharper brand differentiation
   f) Increasing promotional effort
   g) Initiating price cuts
3. Attracting nonusers to buy the product:
   a) Inducing trial use through sampling, price incentives, and so on
   b) Pricing up or down
   c) Advertising to new users

Market development (selling present products in new markets):

1. Opening additional geographic markets:
   a) Regional expansion
   b) National expansion
   c) International expansion
2. Attracting other market segments:
   a) Developing product version to appeal to other segments
   b) Entering other channels of distribution
   c) Advertising in other media

Product development (developing new products for present markets):

1. Developing new product features:
   a) Adapt (to other ideas, developments)
   b) Modify (change colour, motion, sound, odour, form, shape)
   c) Magnify (stronger, longer, thicker, extra value)
   d) Minify (smaller, shorter, lighter)
   e) Substitute (other ingredients, process, power)
   f) Rearrange (other patterns, layout, sequence, components)
   g) Reverse (inside out)
   h) Combine (blend, alloy, assortment, ensemble, combine units, purposes, appeals, ideas)
2. Developing quality variations
3. Developing additional models and sizes (product proliferation).

From the differentiation above, it can be seen that concentration strategy allows a considerable range of actions. Broadly speaking, the company can attempt to capture a larger market share by increasing the usage rates of present customers, by attracting competitors' customers, or by selling to nonusers.

Concentration strategy is often the most practical option. The limited additional resources necessary to implement this strategy, coupled with the limited risk involved, make this strategy desirable for companies with limited funds. So this strategy is very often associated with small companies, which usually have limited resources and can not afford extra risks.

2.4.5.2. Vertical Integration

Vertical Integration is a growth strategy that involves extending a company's present business in two possible directions: forward or backward.

Forward integration moves the organisation into distributing its own products or services.

Backward integration moves an organisation into supplying some or all of the products or services used in producing its products or services.

Several factors may cause a company to pursue either forward or backward integration:

- Backward integration gives an organisation more control over the cost, accessibility and the quality of the raw materials it uses.
- When suppliers of an organisation's products or services have large profit margins, the organisation can convert a cost-centre into a profit centre by integrating backward.
- Forward integration gives an organisation control over sales and distribution channels, which can help in eliminating inventory buildups and production slowdowns.
- When the distributors of an organisation's products or services have large markups, the organisation may increase its own profits by integrating forward.
- Some organisations use either forward or backward integration in the hope of benefiting from the economies of scale available from the creation of nationwide sales and marketing organisations, and the construction of larger manufacturing plants.
- Some organisations use either backward of forward integration to increase their size and power in a particular market or industry in order to gain some degree of monopolistic control (Byars et al., 1996, p. 115).

For all of these reasons vertical integration is a reasonable and rational strategy. It is especially logical for companies with a strong competitive position in a high attractive industry, when technology is predictable and markets are growing (Slocum et al., 1994, p. 36).

Integrating backward generates cost savings only when the volume needed is big enough to capture the same scale economies suppliers have and when suppliers' production efficiency can be matched or exceeded. Backward integration is most advantageous when suppliers have sizable profit margins, when the item being supplied is a major cost component, and when the need technological skills are easily mastered. Backward integration can produce a differentiation-based competitive advantage, when a company, by performing in-house activities that were previously outsourced, ends up with a better quality product offering, improves the calibre of its customer service, or in other ways, enhances the performance of its final product (Thompson and Strickland, 1996, p. 143).

The strategic impetus form of forward integration has much the same roots. In many, industries, independent sales agents, wholesalers, and retailers handle competing brands of the same product; they have no allegiance to any one company's brand and tend to push "what sells" and earn them the biggest profits. Unpredictable sales and distribution channels can give rise to costly inventory pileups and frequent underutilization of capacity, thereby undermining the economies of a steady, near capacity production operation. In such cases, it can be advantageous for a manufacturer to integrate forward into wholesaling and/or retailing in order to build a committed group of dealers and outlets representing its products to end users. Integrating forward into the activity of selling directly to end users can result in a relative cost advantage and lower selling prices to end users, by eliminating many of the costs of using regular wholesale-retail channels (Thompson and Strickland, 1996, p. 144).

But there are also some disadvantages of vertical integration. The company should have in mind that integrated companies have become associated with mature and less profitable industries, and escape from these industries is difficult for large vertically integrated organisations. Besides this, some increased risks are associated with both types of integration. For backward integrated companies, the risks stem from increased commitment to one type of business, and for vertically integrated companies, the risks result from the company's expansion into areas and it requires strategic managers to broaden the base of their competences and to assume additional responsibilities (Pearce and Robinson, 2000, p. 263). Integrated companies reduce their manufacturing flexibility and have problems in balancing capacity. These disadvantages can be avoided via long term cooperative partnerships or outsourcing, which allow more flexibility and adaptability to customers' needs.

2.4.5.3. Diversification

Diversification occurs when a company moves into areas that are clearly differentiated from its current businesses. The reasons for embarking on a diversification strategy can be many and varied, but one of the most frequently encountered is to spread the risk so the organisation is not totally subject to the whims of any one given product or industry. The second reason for diversification is that management may believe the move represents an unusually attractive opportunity, especially compared with other possible growth strategies. A third reason to diversify is that the new area may be especially intriguing or challenging to management. A fourth reason why diversification can be attractive is to balance out seasonal and cyclical fluctuations in product demand. Diversification strategies can be classified as either concentric diversification or conglomerate diversification. The principal difference between the two types of diversification is that concentric diversification emphasises some commonality in markets, products, or technology, whereas conglomerate diversification is based on profit considerations (Pearce and Robinson, 2000, p. 265).

Concentric Diversification occurs when the diversification is in some way related to, but clearly differentiated from the company's current business. It is sometimes called related diversification. It involves adding products or services that lie within the company’s know-how and experience in terms of technology employed, product line, distribution system, or customer base (Byars et al., 1996, p. 115).

Some of the most commonly used approaches to related (concentric) diversification are:

- Entering business where sale force, advertising, and distribution activities can be shared.
- Exploiting closely related technologies.
- Transferring know-how and expertise from one business to another.
- Transferring organisation's brand name and reputation with consumers to a new product.

- Acquiring new business that will uniquely help the company's position in its existing business (Thompson and Strickland, 1996, p. 196).

The main advantage of concentric diversification strategy is that it allows the company to build on its expertise in a related area and it also has the advantage of spreading the company's risk. Growth through concentric diversification into a related industry may be a very appropriate corporate strategy when a firm has a strong competitive position but industry attractiveness is low. By focusing on the characteristics that have given the company its distinctive competence, the company uses those very strengths as its means of diversification (Wheelen and Hunger, 1998, p. 138).

Conglomerate Diversification occurs when the firm diversifies into areas totally unrelated to the company's current business. It is also known as unrelated diversification. It involves adding new products or services that are significantly different from the company's present product or service. The reasons for following such a strategy are numerous:

- Supporting some strategic business units (SBUs) with the cash flow from others (SBUs) during a period of development or temporary difficulties.
- Using the profits of one SBU to cover expenses in another SBU without paying taxes on the profits from the first SBU.
- Encouraging growth for its own sake, or to satisfy the values and ambitions of management or the owners.
- Taking advantage of unusually attractive growth opportunities.
- Distributing risk by serving several different markets.
- Improving the overall profitability and flexibility of the organisation by moving into industries that have better economic characteristics than those of the acquiring organisation.
- Gaining better access to capital markets and better stability or growth in earnings.
- Increasing the price of an organisation's stock.
- Reaping the benefits of synergy, when the combined organisation is more profitable than the two organisations operating independently (Byars et al., 1996, p. 116).

The main advantage of conglomerate diversification is dispersed risk over a variety of industries and the company is less dependent on any one business. Capital resources can be invested in whatever industries offer the best profit perspectives. Company profitability is somewhat more stable because hard times in one industry may be partially offset by good times in another; cyclical downswings in some of the company's businesses are counterbalanced by cyclical upswings in other businesses.

But on the other hand, in choosing a conglomerate diversification strategy, a company should proceed with caution and not diversify merely to be diversified. Conglomerate diversification brings with it bigness and the difficult management problems associated with bigness (Byars et al., 1996, p. 116).

2.4.6. Vehicles for Implementing Growth Strategies

All discussed growth strategies can be implemented through internal growth or through acquisition, mergers, or joint ventures. When a company expands its current market share, its markets, or its products through the use of internal resources, internal growth takes place.

An acquisition occurs when one company purchases the assets of another and absorbs them into its own operations.

A merger occurs when two, or more companies, combine into one company. In an acquisition, one company clearly acquires another. In a merger, neither participant acquires the other, but, rather, both companies merge together combining operations.

The third way of implementing growth strategies, joint venture is a cooperative business activity, formed by two or more separate organisations for strategic purposes, that creates an independent business entity and allocates ownership, operational responsibilities, and financial risks and rewards to each member, while preserving their separate identity and autonomy (Lynch, 1989, p. 7). Joint ventures occur because the companies involved do not wish to or cannot legally merge permanently. They provide a way to temporarily fit the different strengths of partners together, so that an outcome of value to both is achieved.

Whether it is wiser to grow through internal development of new activities or through acquisition or merger depends on many factors. Internal growth is generally slower and less traumatic for the company. It usually takes place over an extended period, allowing time to adjust to the change.

If a company is in a particular hurry to enter an area, the shorter time required by an acquisition or a merger, might be considered an advantage. Growth through acquisitions or mergers can also help avoid or eliminate many barriers to entry, such as patents, costly promotions and broad recognition (Byars et al., 1996, p. 117).

However, exceptions do exist; internal growth is generally less risky than an acquisition or a merger. This is because growth through internal means is incremental, and can be terminated at almost any time. Thus, if a company determines that an expansion is not working out, the project can be dropped. On the other hand, growth through acquisition or merger is not incremental and it requires a total financial commitment from the start.

One of the primary reasons why companies seek acquisition and mergers is the potential benefit that can accrue to the stockholders of both companies. For example, if the earnings of two companies are valued differently in the stock market (have different price-earnings ratios), a merger or acquisition can increase the market value of the stock of both organisations. This result is achieved if the acquiring company reports an increase in its earnings per share, and if the multiple applied to its earnings rises, as a result of the merger or acquisition.

Other reasons for acquisitions and mergers include: better utilization of existing manufacturing facilities, entering a new and growing field, evening out seasonal trends in present products, selling in the same channels as existing channels to make the existing sales organisation more productive, getting the services of a proven management team to strengthen or succeed the existing staff, providing resources for expanding the organisation, etc (Byars et al., 1996, p. 118).

From all these reasons the literature perceives potential benefits to stockholders as the most important, although it all depends on the situation in which a company performs its business, and stage of development of capital market.

Acquisition and mergers can be carried out in either a friendly or a hostile environment. Friendly acquisition and mergers are accomplished when the stockholders and management of both companies agree that the combination will benefit both firms, and then work together to ensure its success. On the other hand, hostile acquisition and mergers (takeover) result when the company to be acquired (target company) resists the attempt. Generally, three conditions can make a company a likely candidate for a takeover. First, the company's stock may be selling for less than book value. Second, the company may have a large cash surplus. Finally, the company may be performing poorly, compared to its competitors (Byars et al., 1996, p. 119).

Generally speaking, internal growth strategies work well for companies following a concentration strategy via product or market development. Almost all horizontal integrations are achieved through acquisition or mergers. Growth through vertical integration can be obtained by internal means, or by acquisition or merger. The best method is entirely dependent on the situation. Growth through concentric diversification is similar to growth through vertical integration, because it can be successfully realized either by internal means or by acquisition or a merger. Entry into new unrelated businesses (conglomerate diversification) is usually more successful through acquisition than through internal growth. The main problem with trying to develop new businesses through internal means is that the organisation usually does not possess the core skills required. Because of this, it is usually better to enter an unrelated business through an acquisition or a merger (Byars et al., 1996, p. 118.).

2.5. Relevance of Growth Strategies to Medium Sized Enterprises

Much of the economic theory of growth of small and medium sized enterprises has been concerned with the relationship between growth and firm size. The literature shows a consistent negative relationship between firm size and firm growth, spanning several studies and many countries. Most studies relating to the period since 1985 show that, small firms grow more quickly than larger firms (Hart, 2000, p. 229). There are several possible explanations of the reason.

Small firms may grow faster than large firms because they are initially uncertain about their costs and enter the market at less than minimum efficient scale, and subsequently grow to reach it (Jovanović, 1982, p. 649).

A second explanation relies on the theories of flexibility and adaptability of small firms, emphasised the phenomenon of the industrial district and of the strength of network economies which can offset the economies of scale enjoyed by large firms (Bartlett and Franičević, 2001, p. 63).

A third explanation is that large firms suffer from managerial diseconomies of scale. This is linked to the increase in managerial costs as firm size increases, and the costs of coordinating across an expanding span of control encounter limits placed by bounded rationality (Penrose, 1980).

A fourth explanation is the impact of the many measures introduced by Western governments to promote and support the growth of small firms and entrepreneurship in recent decades in those economies. This implies that the "invisible hand" of the market is not enough to generate economic growth on its own: an activist state pursuing an energetic enterprise policy is a key mechanism to get the most out of the market economy system (Hart, 2000, p. 229).

Contrary to these arguments, Gibrat's law of proportionate growth states that the probability of a proportionate increase in firm size over an interval of time is the same for all firms, regardless of their size at the beginning of the period (Prašnikar, 2005).

To found a company is the most risk entrepreneurial option. Many questions arise in that phase of a company's being. The first is related to its survival in a market characterised by strong competition and many changes. Only 55 percent of small enterprises survive the first five years of their business activities (Buble, 2003, p. 31).

Regarding the growth options, the fact is that most small companies do not grow to any size; they are a life-style business that provides the owner/manager with an acceptable income, but more importantly, a comfortable life-style. But also, it can happen that where the owner does not go into business with the express purpose of growing a successful company, but the success of the business is encouraging, so he may consider growth as an inevitable part of that success (Burns and Dewhurst, 1996, p. 41).

Medium sized enterprises are a category which, generally can, on the basis of the achieved size and business functions development, pursue growth and exploit growth strategies. Many of them, which have demanding resources, have a clear goal of growth. The reasons for establishing this goal can be different.

Those companies that do business in a dynamic environment must grow in order to survive. Continuing growth means increasing sales and a chance to take advantage of the experience curve to reduce the per-unit cost of products sold, thereby increasing profits. The cost reduction becomes extremely important if a company's industry is growing quickly and competitors are engaging in price wars in attempts to increase their shares of the market. Those firms that have not reached "critical mass" which means economics of scale, will face large loses unless they can find and fill a small, but profitable niche, where higher prices can be offset by special product or service features.

So, medium sized enterprises could perform their business in two directions. They could apply growth strategies and become a large company with low unit costs and related to that high profitability. In this case, they are ready to resist competition attacks, they have a strong position in the market and with continuous R&D they can continue to exist at a sufficiently high level of profitability. On the other hand, if medium sized enterprises are not able to grow, the way and place for their survival and profitability could be found in niche markets. They should develop a strong competitive advantage, which will stop the entrance of new competitors in the target niche market.

Another reason for growth concerns the owner/manager of the company. The owner, because of his/her personal ambition may want to have a large company, and that can be his/her life confirmation. But this raises the question about his/her capability to manage a growing company.

Furthermore, growing companies can cover up mistakes and inefficiencies more easily than stable ones can. A growing flow of revenue into highly leveraged companies can create a large amount of unused resources that can be used quickly, resolve problems and conflicts between departments and divisions. There are more opportunities for advancement, promotion, and interesting jobs in growing companies. They tend to be seen as a "winners" or "on the move" by the marketplace and by potential investors. Large companies are also more difficult to acquire than smaller ones, and the executive's job is more secure (Dalton and Kesner, 1985, p. 38).

A 1989 report from the London Business School identified six common factors associated with successful growth: (1) an experienced owner/manager with a good knowledge of the market and industry; (2) close contact with customers and a commitment to the quality of the product and/or service; (3) innovation and flexibility in marketing and technology, which provide differential advantage over competitors; (4) a focus on profit not sales, with good management systems controlling costs; (5) attention to good employee relations; (6) operating in a growing market (Burns and Dewhurst, 1996, p. 42).

To have their own competitive advantage is crucial for growing companies. Michael Porter (1985) argued that there are only three fundamental ways of achieving sustainable competitive advantage: cost leadership, differentiation and focus. Cost leadership means that the company sets out to be the low cost producer in the industry. The cost leadership cannot be sustained, because competitors might imitate the basis for it. This is an inherently unattractive alternative for smaller firms as they can rarely achieve the economies of scale of large firms. Differentiation means developing a unique selling proposition which is different from competitors', and then the company can charge a premium price. And finally, the firm focuses on a narrow target market segment. The risk of all these strategies is the possibility of imitation, and to achieve a strong sustainable competitive advantage, the company should combine all three strategies (Porter, 1985).

A further characteristic of growing companies can be find in the report of 3i European Enterprise Centre in which the high growth companies were found to set clear objectives, even up to three years ahead, while the low growth or declining companies were found to be continuously adapting their plans to changes in the market-place (Burns and Dewhurst, 1996, p. 42). Clear identification of objectives then implies the choice of adequate strategies as a way of achieving the determined objectives. As mentioned above, medium sized enterprises are a category which can, on the basis of the achieved size and business functions development, exploit growth strategies, as defined in literature, and explained in section 2.4.5. of this thesis.

There are many controversial issues surrounding the growth strategies, especially in their application in different companies which perform their business in different environmental conditions. One issue deals with the impact of concentric versus conglomerate diversification on corporate performance. Several researchers have argued that conglomerate (unrelated) diversification into other industries is less profitable than concentric (related) diversification (Rumelt, 1974). It is most probable that concentric and conglomerate diversifications are equally valuable strategies for company's growth, but are successful in different situations. A company with a strong competitive position in a particular industry will do better if it diversifies concentrically into a related industry, where it can most easily apply its distinctive competence. On the other hand, a company with an only average competitive position should thus do better by diversifying into unrelated industries. The issue may not be concentric versus conglomerate diversification, but concerns the level of managing these operations. Appropriate and efficient management will be able to pull the best from both alternatives. This can be a shortcoming related to medium sized enterprises, which often do not have valuable management in terms of knowledge and adequate experience, because they are usually family owner companies where the owner entrepreneurial is the manager of the company.

The main problems medium sized enterprises face with growth are related to financial issues, capabilities of managers and organisational problems.

Whatever strategic direction a company proposes to pursue, it is almost certain to require money. Generally, there are two main sources of money: internal and external, with the number of sub-divisions of each sector. Getting the right balance of funds from these different sources is the key to profitable growth, and perhaps even, to survival (Barrow et al., 1992, p. 174). Internal sources are the company's own capital and retain earnings, which are usually limited, so the companies often use additional capital from external sources. There are two fundamentally different types of external money which a growing company can tap into: debt and equity. Debt is money borrowed, usually from a bank, on which the company has to pay interest and one day has to repay it. Equity is the money put in by shareholders. The company does not have to give the shareholders their money back, but they do expect the managers to increase the value of their shares and they will probably expect a stream of dividends too. The fact is that fast growing firms typically have no cash available to pay dividends, and investors can only profit by selling their holdings. If the company does not meet the shareholders' expectations, they will not be there when the company needs more money, or if they are powerful enough, they will take steps to change the management (Barrow et al., 1992, p. 183).

The owners/managers, generally, are not passionate about the practice of equity financing, because they lose independency and have obligations to shareholders, and this is the last option which they will use for getting additional finance resources. So, they will turn towards bank loans. But, this option will bring some other problems regarding availability and cost of finance, as a result of information asymmetry between external providers of finance, and inside owners/managers of the company (Boot, et al., 2005). These information problems could be solved by relationship banking which understands the role of commercial banks as house banks. With this practice, banks accumulate knowledge about the particular company and eliminate information problems.

The nature, style and functions of management change considerably as a company grows and evolves, and new managerial skills are required, together with the new levels of sophistication in existing skills, which can be achieved in three ways: the owners themselves can develop new skills; new individuals with proved managerial skills may be brought in from outside the firm; and finally, within the company there may be individuals who are not currently exercising a managerial function, but who could be promoted into managerial positions (Burns and Dewhurst, 1996, p. 86). These options could be the solution to existence of incapable owner/manager, and his/her tendency towards having a growth oriented company.

In growing companies, organisational problems become significant. Although small organisations are very flexible and adaptable to changes, some tips could be pointed out in order to effectively organise a growing company. The company needs to stay in touch with its customers, competitors and other external pressures, and try to design its organisation around changing business requirements. The owner/manager needs to create and communicate a clear vision. S/he has to give employees something to identify with, a meaning and purpose. The vision must be owned and lived by everyone in the organisation. The organisation culture should be developed on the basis of a definite vision. It is important that the organisation culture has values which motivate employees and provide control and coordination. The owner/manager should empower people. His/her position does not need to be superior in front of others, because, in an effectively growing organisation everyone may be a hero. In this sense, rewarding systems should be based on some measure of profit sharing and recognition. Growing companies should be, and usually are, flexible organisations, with flat organisation structure and an emphasis on team work (Barrow et al., 1992, p. 104).

The company which successfully solves financial, managerial and organisational problems that are typical for growing companies has opened its doors to the world of less vulnerable large companies.

3. MEDIUM SIZED ENTERPRISES IN CROATIA

3.1. Macroeconomic Situation in Croatia since Transition

Since independence in 1991, Croatia has been experiencing a thorough economic and institutional transformation. Market mechanisms and institutions have been introduced in economic life, including trade liberalisation, privatisation of companies, restructuring and privatisation of the banking system, legal improvements regarding the role and meaning of private property, new working and ecological legislature, and laws concerning the reinforcement of private sector position in infrastructure development. All these processes were disturbed by war, and war conditions, which caused huge social and economic expenses. During the war period, total production was decreased by one third. However, after the end of the war, high expenses also existed and were connected with large investments in reconstruction, which diminished the social consequences of war and were an attempt to stop hyperinflation. Only now is Croatia's total production at its pre-war and pre-independence level.

The key macroeconomic indicators for Croatia in recent times are shown in table 5.

Table 5: Key Macroeconomic Indicators for Croatia

Indicators (u %)	2000.	2001.	2002.	2003.	Project 2004.
Change of real GDP	2.9	3.8	5.2	4.7	4.5
Unemployment	16.1	15.8	14.8	-	-
Inflation	6.2	4.9	2,2	1.7	3.5
Total external debt in GDP	59.7	58.0	68.5	68.4	67.8
Export	5.1	4.4	1.4	6.9	2.9
Import	-1.9	-5.7	-6.1	-8.0	-2.9

Source: Ekonomski institut, Zagreb i Ministarstvo financija Republike Hrvatske. Privredna kretanja i ekonomska politika br. 96, 2003, p. 18

From table 5, it can be noticed that real GDP has constantly increased from 2000 by the rate of 2.9 percent to 2003 (4.7 percent). Its increase started in 1994, and in the period from 1994 to 1997 it increased by 6.4 percent. This growth was the result of domestic expenditure, and investments on after war reconstruction. In 2003, the increase in investments was firstly linked with the construction of highways and buildings. Rapid and large increase in borrowing, public expenditures and sales growth resulted in massive total consumption, which caused a deficit in the balance of payments in 1997, which is continuously present until now.

With an unemployment rate of 14.8 percent in 2002, Croatia has one of the lowest levels of employment compared with the total workforce among all European countries. The high level of unemployment is, apart from other factors, also caused by relatively low employment before the transition process. But, there is a discrepancy between the official data on unemployment, and the surveys. These differences show that the right rate of unemployment is 50 percent lower. One of the reasons for this lies in the fact that Croatia deals with serious problems of unofficial economy. In the context of employment, it is important to mention that there are quite regional differences in rate of unemployment. The highest unemployment is evident in Vukovarsko-srijemska County, Šibensko-kninska and Brodsko-posavka, and the lowest is in the City of Zagreb, Istarska County, and Primorsko-goranska County.

From the inflation rate shown in table 5, it can be concluded that, in observed years, this rate is low, and also in this period, the Croatian currency was stable.

The biggest problem of the Croatian economy is the high external debt, which has had a tendency of growth in recent years. The Croatian government considers this problem as a very serious one, and has taken monetary and fiscal action with the aim of diminishing this debt.

The results from import and export are disappointing. Total export constantly increased from 1993 to 2001 with a proportion of 46 percent of GDP in 2001. This growth has mainly been caused by revenues from tourism. Export of goods stagnated. Export in the EU decreased from 0.34 percent of GDP in 1993 to 0.19 percent of GDP in 2000. On the other hand, export in south eastern European countries has doubled (World Bank Dokument, Country Economic Memorandum, 2003).

The precise picture of Croatian economic activity can be seen from table 6.

Table 6: Total Employment, Total Revenue, Profit and Loss in the Croatian Economy

Indicators	1997.	1998.	1999.	2000.	2001.	2002.	2003.
Total employment	742,395	735,921	716,195	741,856	727,233	754,186	796,896
Total revenue (in mil EUR)	37,320	35,674	36,706.8	40.686,67	45,764.13	52,299.07	60,259.74
Profit after deduction of taxes (in mil EUR)	1,105.33	909.87	1,115.2	1,606.13	1,969.47	2,989.73	2,665.85
Loss after deduction of taxes (in mil EUR)	1,035.6	168.53	2,011.33	1,717.87	1,540.27	1,554.4	1,644.81
Consolidated financial result (in mil EUR)	69.73	741.34	-896,13	-111.74	429.2	1,435.33	1,021.04

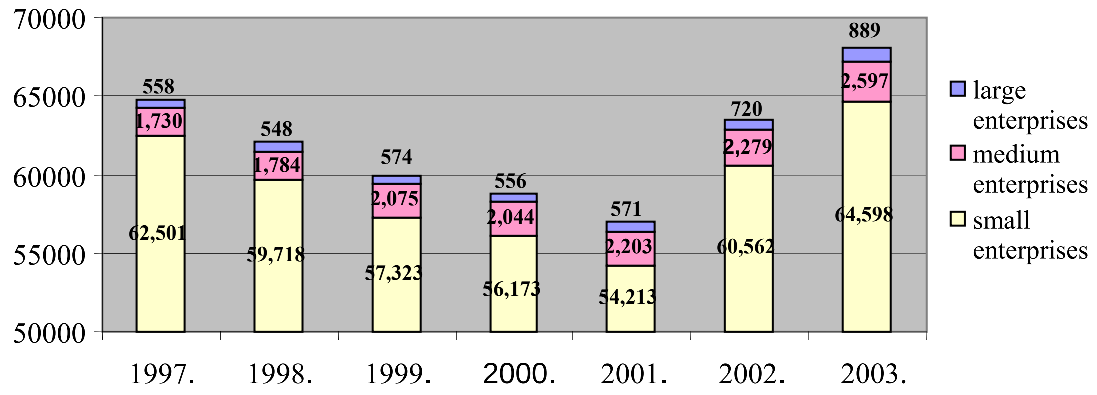
Source: Annual Statistical Reports from Croatian Financial Agency (in following text FINA)

Table 6 shows that total employment in the Croatian economy had quite a cyclic movement. In 1999, the total number of employees decreased, it increased in 2000, decreased in 2001, and finally, in 2002 increased and reached a higher level than in 1997. Total revenue and profit after the deduction of taxes from 1998, had a tendency of growth. Consolidated financial result shows recovery of the Croatian economy. Namely, this result in recent years has had a positive trend.

3.2. Structure of the Croatian Economy Regarding Company Size, Industrial Activity and Counties

As in every other economy, the Croatian economy represents a spectrum of enterprises regarding size, industry and regional affiliation and many other characteristics. Graph 1 represents the structure of the Croatian economy regarding company size[6].

Graph 1. Number of enterprises in Croatia regarding the size, in period 1997 - 2003



Source: FINA

It can be noticed that in the period 1997 - 2001, there was a decreasing trend in the total number of enterprises in Croatia. The lowest number of enterprises in Croatia was in 2001, but in 2002 this number increased by 12 percent, and in 2003 by 7 percent.

Table 7 gives detailed information about the structure of Croatian economy regarding company size.

Table 7: Percentage Proportion of Enterprises Regarding Size in the Total Number of Enterprises in Croatia

Year	1997.	1998.	1999.	2000.	2001.	2002.	2003.
Large enterprises	0.86	0.88	0.96	0.95	1.00	1.13	1.30
Medium enterprises	2.67	2.88	3.46	3.48	3.87	3.59	3.80
Small enterprises	96.47	96.24	95.58	95.58	95.13	95.28	94.90
Total	100	100	100	100	100	100	100

Source: FINA

The proportion of large enterprises does not show a discrepancy, but has a trend of slight growth. On the other hand, the proportion of medium sized enterprises shows some fluctuation, but also with a tendency of growth. The highest growth in the number of these

[6] It is obvious that this data has great oscillations, especially in last two years. The cause of these oscillations is the change in collection procedure of company annual reports. In the last two years these reports should be delivered only to Register of annual reports, while in previous years they could be delivered to two other institutions.

enterprises was evident in 1999, by 0.58 percent, in comparison to the year before. In 2002, their proportion decreased by 0.28 percent compared to 2001, but in 2003, it increased again by 0.21 percent. The proportion of small enterprises was continuously over 95 percent, except in 2003 when this proportion decreased to 94.9 percent.

Monitoring the Croatian economy through different industries, the basic conclusion is that there was a continuously decreasing number of enterprises in manufacturing, and on the other hand, there was a growing number of trade enterprises

Commerce in Croatia, besides a growing proportion in the total number of enterprises, also leads in the generation of total revenue (37.9 percent in 2002). On the other hand, manufacturing has the advantage in the number of employees (31.5 percent in 2002), and profit creation (48 percent in 2002).

This structure of the Croatian economy is quite unacceptable because, as a rule, manufacturing generates about 95 percent of export. But this export in recent years stagnated, or even declined. The fact that exports to the EU also decreased causes concern. Another problem is that, in export, there is the domination of low technology goods, while the export of technologically advanced products is disappearing.

With regard to other industries, it is important to point out that the proportion of agriculture and hotel service enterprises has decreased, while the proportion of transporting, warehousing and financial enterprises increased (Privredni vjesnik, June 2003, p. 33).

Regarding the regional structure of the Croatian economy, it can be noticed that most enterprises have headquarters in the Croatian capital city of Zagreb. This implies a significant concentration of economic activity in the capital and Zagrebačka County. This concentration has an impact on the other Croatian counties, which are less developed. For example, comparing 2002 with 2001, there was a decreasing number of enterprises in ten counties, and an increase was evident only in two counties, Splitsko-dalmatinska and Istarska. The reason for this unfavourable allocation lies in the events and consequences of war, which have had a long-term impact on the whole Croatian economy.

Table 8 on the page 51 shows basic financial information about economic activity in different Croatian counties in 2001.

It is obvious that the city of Zagreb has the highest economic potential, which was expected. Besides Zagreb, a strong economic position is evident in Primorsko-goranska, Splitsko-dalmatinska and Istarska County. These counties have the advantage over others in a higher number of enterprises, total employment, and a high level of total revenue.

The precise picture can be gathered by real indicators, which are presented in table 9, on the page 52.

Table 8: Financial Data about Economic Activity in Different Croatian Counties in 2001

County	Number of enterprises	Number of employees	Total revenue (in EUR)	Profit after deduction of taxes (in EUR)	Loss after deduction of taxes (in EUR)
Zagrebačka	3,419	29,213	2,180,682,800	80,632,933	45,894,533
Krapinsko-zagorska	900	14,658	638,727,733	20,243,333	18,032,800
Sisačko-moslavačka	963	17,454	739,200,133	22,499,200	37,106,933
Karlovačka	1,233	15,516	812,105,333	23,070,133	36,199,333
Varaždinska	1,680	30,576	160,3491,600	48,993,200	18,796,533
Koprivničko-križevačka	844	17,194	915,330,267	23,082,400	14,818,267
Bjelovarsko-bilogorska	1,004	14,483	595,995,067	12,522,267	43,875,733
Primorsko-goranska	5,241	51,854	285,6624,933	93,671,467	176,180,533
Ličko-senjska	305	3,469	137,207,733	3,233,333	22,264,533
Virovitičko-podravska	502	9,897	406,806,533	7,277,467	16,331,867
Požeško-slavonska	505	9,436	414,133,067	11,760,133	20,486,800
Brodsko-posavska	1,002	13,706	610,561,200	16,117,067	26,881,867
Zadarska	1,284	14,461	904,177,867	35,405,333	61,191,467
Osječko-baranjska	2,905	43,651	2,258,577,067	71,942,000	98,266,667
Šibensko-kninska	954	10,638	480,826,667	10,052,133	43,320,000
Vukovarsko-srijemska	969	14,035	652,414,800	20,232,667	55,079,600
Splitsko-dalmatinska	5,865	58,161	3,292,962,800	193,664,400	169,531,467
Istarska	4,451	39,010	2,608,536,000	191,108,533	76,076,400
Dubrovačko-neretvanska	1,598	16,988	766,703,200	22,575,200	71,041,867
Međimurska	1,416	19,976	841,747,733	23,256,667	9,631,600
City Zagreb	19,947	282,857	22,046,887,733	1,038,191,733	479,284,667

Source: FINA

Table 9: The Real Indicators of Economic Activity in Different Croatian Counties in 2001

County	The number of employees per enterprise	The total revenue per employee (in EUR)	Profit per employee (in EUR)	Consolidated financial result (in EUR)
Zagrebačka	8.5	74,653	2,760	34,738,400
Krapinsko-zagorska	16.3	43,573	1,387	2,210,533
Sisačko-moslavačka	18.1	42,347	1,293	-14,607,733
Karlovačka	12.6	52,333	1,493	-13,129,200
Varaždinska	18.2	52,440	1,600	30,196,667
Koprivničko-križevačka	20.4	53,240	1,347	8,264,133
Bjelovarsko-bilogorska	14.4	41,147	867	-31,353,467
Primorsko-goranska	9.9	55,093	1,800	-82,509,067
Ličko-senjska	11.4	3,947	933	-19,031,200
Virovitičko-podravska	19.7	41,107	733	-9,054,400
Požeško-slavonska	18.7	43,893	1,240	-8.726.667
Brodsko-posavska	13.7	44,547.	1,173	-10,764,800
Zadarska	11.3	61,520	2,453	-25,786,133
Osječko-baranjska	15	51,746	1,653	-26,324,667
Šibensko-kninska	11.2	45,200	947	-33,267,867
Vukovarsko-srijemska	14.5	46,480	1,440	-34,846,933
Splitsko-dalmatinska	9.9	56,613	3,333	24,132,933
Istarska	8.8	66,867	4,893	115,032,133
Dubrovačko-neretvanska	10.6	45,133	1,333	-48,466,667
Međimurska	14.1	42,133	1,160	13,625,067
Zagreb City	14.2	77,946	3,667	558,907,067

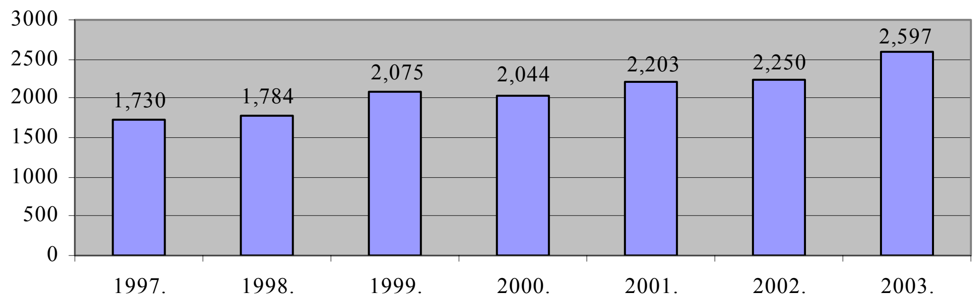
Source: FINA

According to real indicators, besides the City of Zagreb, Istarska County has the highest profit per employee, and the highest consolidated financial result. Splitsko-dalmatinska and Zadarska County have the highest profit per employee. On the other hand, Zadarska County has a negative consolidated financial result, which is the consequence of losses from previous years, especially from the war period. A similar example is Primorsko-goranska County, which also has a very negative difference between profit and loss. This negative financial result can be explained by the existence of large enterprises, which have generated a loss over the years, and perform their business activities in the area of this county.

3.3. Significance of Medium Sized Enterprises in the Croatian Economy

In this part of the master's thesis, the focus will be on medium sized enterprises in Croatia and their importance in the national economy. As can be seen in graph 2, the total number of medium sized enterprises in Croatia in 2003 was 2,597, which represents 3.8 percent (graph 3) of the total number of enterprises. With this percentage, Croatia is among the European countries with the highest level of medium sized enterprises. Most of these enterprises originate from small entrepreneurship companies, which were established after the introduction of market oriented economy in Croatia, at the beginning of the nineties. A small part of them comes from the privatisation and the restructuring of large enterprises.

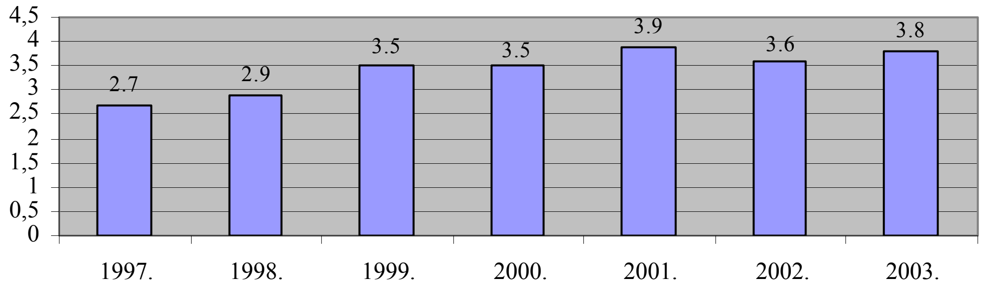
Graph 2. The number of medium sized enterprises in Croatia



Source: FINA

Observing the number of medium sized enterprises in Croatia during the last seven years, it can be seen that the number of medium sized enterprises has a tendency of growth, although in 2000 their number fell by 31 enterprises (graph 2). This tendency is reflected in the proportion of medium sized enterprises in Croatia, which can be seen from graph 3. This proportion also has increased in the observed period, with the exception of 2002, when it decreased by 0.3 percent, compared to the year before.

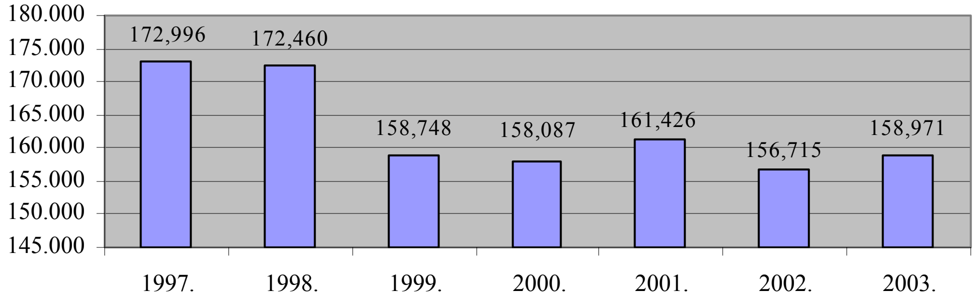
Graph 3. The proportion of medium sized enterprises in total number of enterprises in Croatia



Source: FINA

Graph 4 represents the total number of employees in medium sized enterprises in Croatia, in the period 1997-2003. This number had a huge decrease in 1999. In the years after 1999, the number of employees in medium sized enterprises had pretty much a cyclic movement, and it numbers around 158,000 employees, which represent the decline of 8 percent comparing to1997.

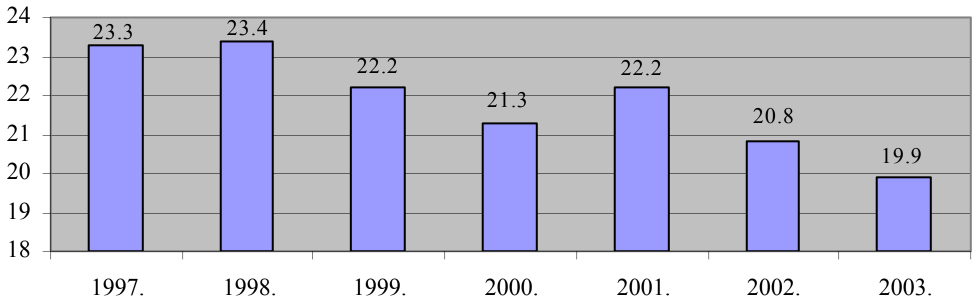
Graph 4. The total number of employees in medium sized enterprises in Croatia



Source: FINA

Examining the proportion of medium sized enterprises in total employment in Croatia, over the same period, it can be concluded that there was a relative constant proportion of medium sized enterprises, of about 22 percent in total employment, but in the last two observed years, this proportion was a little lower, which can be seen from graph 5.

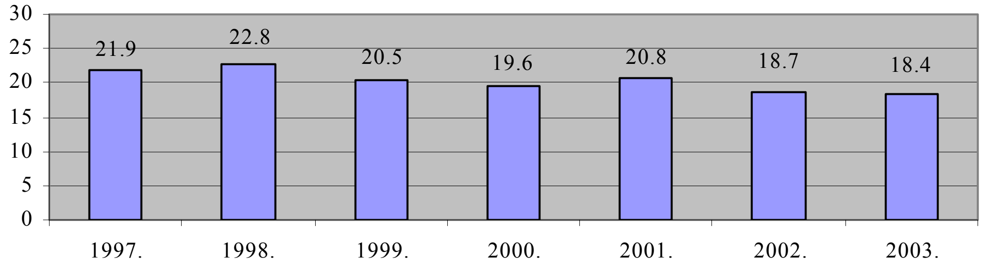
Graph 5. The proportion of medium sized enterprises in total employment in Croatia



Source: FINA

The proportion of medium sized enterprises in total revenue is at the level of about 20 percent, although in the last two years, it has had a tendency of decline. This can be noticed in graph 6.

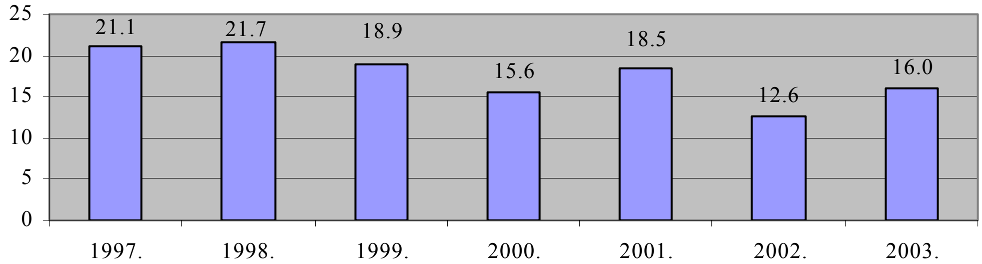
Graph 6. The proportion of medium sized enterprises in total revenue in Croatia



Source: FINA

Observing the proportion of medium sized enterprises in total profit, it can be seen that it has a cyclic trend (graph 7). In the period observed from 1997 to 2003, this proportion decreased from 21.1 percent (1997) to 16 percent (2003).

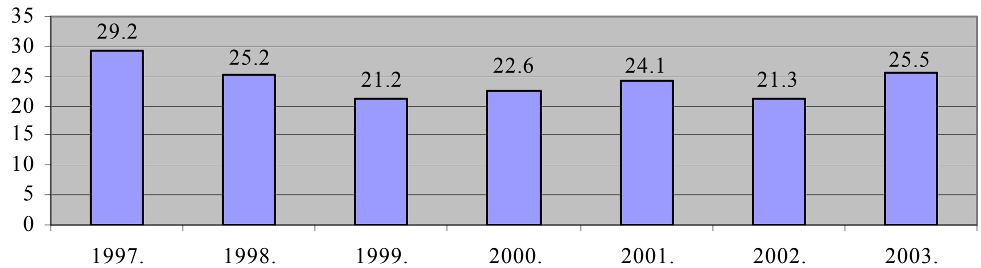
Graph 7. The proportion of medium sized enterprises in total profit in Croatia



Source: FINA

And finally, observing the proportion of medium sized enterprises in total loss, which is shown in graph 8, it can be noticed that this proportion was, in every observed year, more than 20 percent. Especially worrying is the fact, that in 2003 this proportion increased by 25.5 percent. Comparing the proportion of medium sized enterprises in total profit and total loss, we can note that both proportions increased in the year observed last.

Graph 8. The proportion of medium sized enterprises in total loss in Croatia



Source: FINA

From all the data represented above, the conclusion can be that Croatia has the highest proportion of medium sized enterprises compared to other European countries. In accordance with the statistical definition of medium sized enterprises in the EU, relevant companies represented only 1.9 percent of all business subjects in the European area in the year 2001, bearing in mind that 15.4 percent of the active workforce was employed by them. Apart from Croatia, the countries with a high proportion of medium sized enterprises in the total number of enterprises are the Netherlands, Luxemburg and Austria (see chapter 2.3).

It can be concluded that the medium sized enterprises in Croatia have potential, but there are many problems facing this sector, and a strong effort is needed to find a way to further develop it, which would generate more profits and less losses. This can be accomplishment by choosing a proper niche market strategy, and adequate management potential.

3.4. Efficiency of Croatian Medium Sized Enterprises

The efficiency of Croatian medium sized enterprises will be analysed by definite and known financial ratios, and it will be compared to the efficiency of large enterprises in Croatia, and to the efficiency of the Croatian economy as a whole.

According to Brigham and Daves, the classification of financial ratios is as follows:

- Liquidity ratios,
- Asset management ratios,
- Debt management ratios,
- Profitability ratios,
- Market value ratios.

Every one of these ratios is further classified concerning some specific aspect of business, but in this part of the thesis, only some of them will be calculated[7] as a tool for analysing the efficiency of medium sized enterprises in Croatia.

Liquidity ratios show the relationship of a company's current assets to its current liability, and thus its ability to meet maturing debts (Brigham and Daves, 2002, p. 242). Current ratio is one of the commonly used liquidity ratios, and it is calculated by dividing current assets by current liabilities. In table 10, there is the calculated current ratio for medium sized enterprises, and in table 11, there is a current ratio for the whole Croatian economy over the last five years. This ratio is around 1,0 for medium sized enterprises, and it is on pretty much the same level for the Croatian economy as a whole. Although there is no general requested level of this ratio, the recommendation is that it has to be at least 2 (or 1.5) in order to avoid illiquidity problems (Vidučić, 2000, p. 402). Comparing this ratio for medium sized enterprises, national economy, and large enterprises (table 12), the conclusion is that medium sized enterprises have a higher ratio than the national economy,

[7] Because the distribution data of observed companies is not available, only the mean could be calculated, which is presented in table 10, 11 and 12.

but a lower one compared with large enterprises. So, the fact is that the Croatian economy deals with liquidity problems, and medium sized enterprises have greater problems within this than large ones.

Table 10: Financial Ratios for Croatian Medium Sized Enterprises in the period 1999 - 2003

Ratio	1999.	2000.	2001.	2002.	2003.
Current ratio	1.01	1.01	1.08	1.14	1.19
Total assets turnover ratio	0.72	0.74	0.85	0.88	0.91
Debt ratio (in %)	52.30	53.74	53.60	52.59	55.11
ROA	2.03	2.34	3.23	3.40	3.51
ROE	4.51	5.51	7.54	7.58	8.30
Revenue per employee (in EUR)	47,461.33	50,488	59,052	62,361.33	69,912
Profit per employee (in EUR)	1,329.33	1,588	2,253.33	2,397.33	2,689.33

Table 11: Financial Ratios for the Croatian Economy in the period 1999 - 2003

Ratio	1999.	2000.	2001.	2002.	2003.
Current ratio	0.98	1.02	1.04	1.08	1.11
Total assets turnover ratio	0.67	0.71	0.64	0.67	0.69
Debt ratio (in %)	48.4	48.7	41.2	46.2	48.18
ROA	2.02	2.82	2.75	3.86	3.05
ROE	4.18	5.90	4.94	7.55	6.22
Revenue per employee (in EUR)	51,252	54,844	62,929.33	69,345.33	75,618.67
Profit per employee (in EUR)	1,557.33	2,165.33	2,708	3,964	3,345.33

Table 12: Financial Ratios for Croatian Large Enterprises in period 1999 - 2003

Ratio	1999.	2000.	2001.	2002.	2003.
Current ratio	1.04	1.0	1.13	1.20	1.23
Total assets turnover ratio	0.52	0.59	0.48	0.57	0.59
Debt ratio (in %)	38.1	38.5	29.5	37.4	39.96
ROA	1.65	2.65	2.15	4.12	2.92
ROE	2.81	4.59	3.20	6.91	5.13
Revenue per employee (in EUR)	52,069.33	60,774.67	69,374.67	83,278.67	92,541.33
Profit per employee (in EUR)	1,641.33	2,732	3,126.67	5,992	4,422.67

Asset management ratios measure how effectively a company manages its assets, or analyses business efficiency (Vidučić, 2000, p. 403). For this analysis, the total assets turnover ratio for the Croatian national economy, medium and large enterprises is calculated by dividing sales by total assets, and it is presented in tables 10, 11 and 12. The total assets turnover ratio for the Croatian economy is around 0.7, and means that for 1 kuna of invested assets, the generation of sales is 0.7 kuna, which indicates that the economy is not generating a sufficient volume of business, given its total assets investment. For medium sized enterprises, this ratio is higher in all observed years. Also, it is higher compared to large enterprises. It can be concluded that medium sized enterprises are more efficient than large ones, but their total assets turnover ratio of about 0.7 or 0.8 is still very low.

Debt management ratios reveal the extent to which the firm is financed with debt, and the likelihood of it defaulting on debt obligations (Brigham and Daves, 2002, p. 242). Debt ratio is one of the debt management ratios, and it is calculated by dividing the total debt by total assets, and it measures the percentage of funds provided by creditors. For medium sized enterprises, this ratio is above 52 percent (table 10), in all observed years. For the national economy, it is lower (about 40 percent - table 11), and for large enterprise it is lower, around 38 percent (table 12). The conclusion is that medium sized enterprises are more indebted than large ones and than the whole economy. This could be explained by their desire to grow, so they borrow money in order to invest and finance that growth.

Profitability ratios show the combined effects of liquidity, asset management and debt management policies on operating results (Brigham and Daves, 2002, p. 242). Two profitability ratios are calculated and represented in tables 10, 11 and 12. ROA is the return on total assets, and it is calculated by dividing net income (profit) by total assets, and multiplying by 100. ROA shows the power of economy or company. From table 10, it can be seen that ROA for medium sized enterprises in 2003 was 3.51 percent. For the national economy, it is 3.05 percent (table 11), and for large enterprises, it is 2.92 percent (table 12). The positive thing for medium sized enterprises and national economy is that this ratio has a growth tendency.

The return on common equity - ROE, is another profitability ratio. It is calculated by dividing net income (profit) by common equity, and multiplying by 100. In 2003, for medium sized enterprises it is 8.30 percent, for the Croatian economy it is 6.22 percent, and for large enterprises it is 5.13 percent. The values of these ratios in period 1999 - 2003, also can be seen from tables 10, 11 and 12. For medium sized enterprises this ratio means than for 1 kuna of invested capital the generation of profit is 0.083 kuna. This is higher than for large enterprises, and the economy as a whole. But, in order to observe this ratio in an adequate way, it is necessary to compare it with the average interest rate of Croatian banks, and with the average return of investment funds. The average annual interest rate on deposits for a period of 12 months (2003) in Croatia is 5.56 percent. So it is obvious, that ROE for medium sized enterprises is higher than interest rate, and it is satisfactory. On the other hand, the average annual return in investment funds is as follows: in equity funds, it is -2.53 percent, in bond funds, it is 5.02 percent, in money market funds is 5.16 percent, and finally, in balance funds is 8.91 percent (http://www.to-one.com). From all these percentages, it can be seen that the ROE of medium sized enterprises in Croatia mainly exceeds the return of invested funds. So, the conclusion is that, it is better to invest in medium sized enterprises than in investment funds, or to deposit the money in banks. Another positive fact is that this ratio had a tendency of growth in the observed period for medium sized enterprises, as well as for the Croatian economy as a whole, and for large enterprises.

Summarising the efficiency of medium sized enterprises, and also of the Croatian economy, the conclusion is that liquidity ratios (current ratio), and asset management ratios (total assets turnover ratio) are at an unsatisfactory level, so problems concerning liquidity can be expected. Besides this, the generation of sales is not sufficient given the total assets investment, and medium sized enterprises are highly indebted. On the other hand, profitability ratios, ROA and ROE, show a better performance and efficiency of medium sized enterprises, and also of the national economy. Furthermore, the situation with revenue per employee and profit per employee is similar, as both have increased in all years.

3.5. Barriers to Medium Sized Enterprise Growth in Croatia

Barriers to growth include all the factors, which make it hard for entrepreneurs with existing business, to put them into operation, or to expand their activities. But, not all entrepreneurs seek growth, and growth is not a necessary or even desirable objective, for all companies. In fact, the large majority of enterprises will not grow, and their owners and managers will have other objectives, such as an easy life, or a minimum target income. On the other hand, the owner, because of his/her own ambition, may want to have a large company, but s/he is often not capable of managing this kind of company in an adequate way, so his/her desire may not be achieved. In other cases, the nature of the market is such that there is a relatively low minimum efficient scale of business activity.

Transition countries are an interesting subject in the analysis of barriers to company growth. Besides the usual barriers, common to all countries in different parts of world, transition countries have some special ones, which are the result of economic and institutional transformation. The Croatia is an example of this kind of country, and its business sector is faced with different barriers. The most significant are: financial barriers, managerial barriers, social barriers, institutional barriers and regulatory barriers.

3.5.1. Financial barriers

The most crucial barriers for the growth and development of medium sized enterprises, as well as for small ones, are financial barriers. They are concerned with the conditions under which bank financing is offered to companies. These barriers include the high cost of credit, bank charges and fees, high collateral requirements, lack of outside equity, and some less frequent ones, such as, overly long waiting periods to get a loan and banking bureaucratic procedures. Also, these barriers include information asymmetries between lenders and borrowers, and this can make it very difficult for a bank to determine the real value of a project (Bartlett et al., 2002, p. 24). Financial barriers are considered to be very serious in transition economies.

Medium sized enterprises present special challenges to banks. They are more likely to be relatively young firms (although this is not a rule), with short business histories. Also they tend to disclose less financial data than larger firms, partly because they usually do not seek financial markets, or even credit markets, as much as larger firms, and partly because legal regulations sometimes do not require them to even provide audited income statements and balance sheets.

Some Croatian banks, particularly the smaller ones, have attempted to address the needs of smaller enterprises by providing quick loan approval and a non-bureaucratic approach. Working capital type loans of relatively small amounts dominate bank lending in terms of the number of loans (but not necessarily the overall value). Many Croatian banks, again especially the smaller ones, are generally quite reluctant or incapable of lending over a long period. This suggests that medium sized enterprises may find it quite difficult to secure longer-term external financing. Lending to smaller companies, in an environment of rapid change and in a poorly functioning legal system, requires special techniques including visits to the firm and the taking of very high amounts of collateral to secure loans. It is an open question whether smaller banks will survive, and if they do not, whether the larger banks will fill this market niche (Bartlett et al., 2002, p. 128).

There are some special challenges facing transition bankers. One of them is the underdevelopment of banking culture. For example, clients may be slow to understand the advantages of sharing business information with their bankers, and may regard bankers' requests for information as burdensome and unnecessary (Koford and Tschoegl, 1999, p. 123). Also, since depositors are inexperienced in the ways of market economies, they find it difficult to distinguish bad banks from good ones.

Yet another difficult aspect of banking in transition is the underdevelopment of the legal system. The creation and adaptation of new commercial codes and business legislation is a very demanding task. All participants in the legal system need time to learn how to use the new laws as well. Other problems, which can arise from situations in transition economies, are the weak development of real estate markets, the inefficiency of the court system, etc.

All of these external factors limit the ability of transition banks to function effectively. However, one must also consider the internal weaknesses of transition banks. Transition banks face a steep learning curve, since for many of them, under the Communist system, the carrying out political orders was more important than assessing business risk. Furthermore, the lack of a strong banking culture is often within banks themselves. A lack of shareholder culture can be seen in unrealistic expectations about the level of dividends, and in an underestimation of the importance of reinvesting profits. In the early days of transition, where conditions were turbulent, and entry to the banking market easy, many banks were set up for the wrong reason: to support an entrepreneur's other business interests, or to engage in risky undertakings.

To overcome the enormous information asymmetries of transition, Croatian banks quite reasonably ask clients for a large amount of documentation. Bankers mention a number of important information problems:

- Financial statements. Under Croatian law, small firms are not required to prepare audited financial statements. In addition, even when audited financial statements are available, the quality of information is often inadequate. Banks find that firms' balance sheets do not include all business activities due to tax evasion efforts.
- Land records. Land records are inaccurate and out of date.
- Credit registers. Banks cannot find out whether a client has loans from other banks,

except through informal channels.

- Co-debtors and Guarantors. It is common practice for banks to require that individuals provide two or three co-debtors and a guarantor. However, banks cannot find out, whether a co-debtor or guarantor is using the same income or collateral in more than one loan.

In screening applications, the key elements usually are past performance and the proposed project. Many bankers agree that past business experience is a key indictor; some feel that this is so important that a person without experience simply cannot expect to get a loan.

Regarding future projections, some kind of analysis of future cash flow is universally required. Given the short-term nature of most loans, investment project studies are usually not required. When long term and larger value loans are discussed, however, many banks require professionally prepared investments studies (64 percent - Research of Croatian National Bank, 1997-2000). Another factor that plays great part in risk assessment practice is the quality of management, but in Croatia only 20 percent of banks emphasised the quality of management personnel, as a key factor in lending (Research of Croatian National Bank, 1997-2000).

Another factor in lending is character. The issue of recommendation seems to be an important one in Croatia banking. "Recommendation" from the right people can, in fact, decide the fate of the loan. This practice leaves a wide space open to political influence within the lending process.

A further characteristic of Croatian banking is the importance of being a client of the bank to get a loan. Banks feel that their ability to monitor a client is limited if the client does not do all, or most of his/her business, at the bank. This goes back to information asymmetry, in particular to the lack of credit register or credit reporting agencies. This practice is not unusual in many countries, because it represent a way to eliminate the information asymmetry, and helps medium sized enterprises to get needed financial resources.

3.5.2. Managerial barriers

In most medium sized companies, owner and managerial or leading function are joined in the same person (which is not the case in larger companies). Some medium sized companies engage a larger managerial team, which could help to position them in a niche market. The role of owner is important for these companies. Regardless of whether s/he undertakes these activities by him/herself or in cooperation with others, his/her physical presence is important in the company.

The development of scientific knowledge brings pressures that bear upon the manager's perception of his/her role. One of the most difficult to resolve has to do with the professionalisation of management. The systematic and rapid accumulation of knowledge, in all the disciplines that relate to management, is a major phenomenon of our time. Computer technology, applied mathematics, statistics and others are highly relevant for professional managers. Professional managers should always be in touch with improvements and should apply what they have learned. They should be effective contributors to their professions, strong mentors, collaborative team players, who value interdisciplinary decisions, active advocates of consensus and growth, and powerful leaders, whose creative analysis and problem solving allow them to influence policy and decision making. In their role, managers should develop their own plan of action; they should be creative enough to recognise, and to be able to accept the risk of new actions.

Croatian managers are mostly not capable of applying modern management in practice, because the control function of management is the first priority for them, and lack of knowledge and risk aversion, present some barriers to their professionalism. Some Croatian researchers consider that today's managerial competence has been widened due to globalisation and new computing technology. Therefore, in some medium sized enterprises, there is a need for professionals to replace owners/managers, or even, in some cases, managerial teams are considered as being the most capable of performing all managerial functions. The owners/managers, due to their sentiments towards their companies and risk aversion, sometimes do not take the best actions in the field of planning, organisation, leadership, HRM and controlling.

Teamwork is also a significant problem in Croatian medium sized companies. The entrepreneurs do not think that teamwork is necessary in the organisation. They have an aversion to delegating authority, they are uncomfortable about managing team meetings, or they do not want to spread data and information. This causes lack of trust in the organisation, poor communication, and finally, poor employee efficiency. The problem is that Croatian owner/managers are not aware of the importance of teamwork, and its advantages, and that is also the consequence of lack of knowledge.

Another barrier which is related to managerial problems is uncontrolled diversification, which arises in the situation, when owner or manager wants to expand the company, and s/he orients towards diversification of the business. Sometimes, this diversification widens and becomes uncontrolled. Corbetta defines some reasons for this situation:

- An owner/manager attitude favourable to entry into a new business only because the opportunities to do so are pushed by people, who the owner/manager trusts, or to please someone, or merely to imitate other firms.
- An incorrect strategic valuation regarding the "attractiveness" of the new business, and the financial and managerial resources, necessary to successfully enter a new business.
- An owner/manager attitude which undervalues the fact that sometimes the firm has specialised competencies and skills, which are appropriate to a specific strategy, in a specific business, but not to others.
- An owner/manager attitude which leads to an uncontrolled growth of the firm and does not take into account that it is also necessary to periodically consolidate the dimensions, which have already been arrived at (Corbetta, 2003, p. 91).

The main elements of all these reasons are lack of knowledge, experience and professionalism. This lack is usual for managers in medium sized enterprises in Croatia, and it is a consequence of transition, and the different values used in the past economic system, the inappropriate privatisation process, and the generally inadequate education of managers, especially entrepreneurs, who found companies without experience, or sufficient understanding of economic variables and relations.

The solution to these problems is the separation of managerial and owner function, but this increases agency costs due to moral hazard, imperfect observability and risk aversion. Moral hazard is defined as opportunities for shirking due to hidden action or hidden information, which cannot be prevented by contracts. Agents (managers) and principles (owners) usually have different objectives. For example, the owners of a business may want to maximize profits, but if managers seek to minimize their chances of losing their jobs, they may take fewer risks than the owner might prefer. Or, managers may seek to minimize effort, thereby working less than the owner would prefer. The principal and agent could address such problems by agreeing to a contract that bids the agent to act in the principal's interests. But contracts are inevitably incomplete. As a result, there are opportunities for shirking, or what is often referred to as moral hazard.

A key to preventing shrinking is observability. If the principal can observe actions and outcomes, and the desired actions and outcomes can be spelt out in a contract that can be enforced in court, then the principal can solve the agency problem. The principal contractually requires agents to take appropriate action to achieve the desired outcomes, and punishes them, if they fail to do so. If the principal cannot adequately measure the action or outcome, s/he can use a proxy measure (Besanko, et al., 2000, p. 514).

If the company decides to hire a professional manager, it can be faced with another barrier of finding the appropriate person, as well as, how to keep him/her. If people are working for too long in the position of manager, or any other position, then they create certain business connections, ties and trust, so it can become very difficult to replace them.

On the other hand, the separation of managerial and ownership function can have certain advantages. The advantage is evident in the fact that disposal capital and managerial knowledge may not be joined in the same person. Those companies that employ capable managers could achieve a higher value of the company, in spite of agency costs, than the company with the less capable owner. This leads to the fact that the company should focus on professional managers.

If the company confronts the situation where the owner and manager is the same person, then some additional barriers, apart from the lack of knowledge, can arise. If companies are family owned, then problems such as, a lack of hires can exist. If the hires are present, a problem can also arise from the situation when they are not motivated well enough to continue with that job, or they do not have the necessary knowledge, or they are not appropriate. The family owned medium sized enterprises, could also be faced with the fact that their owners/managers are ageing, but are still holding on to all the power. All of this has implications on the employment of a professional manager.

All these facts about managerial barriers could be found in almost every country, and in every medium sized company. But in Croatia, these problems are more intensive, because of the fact that it is a transition country, and this process influences the more serious problems regarding managers' competence and performance.

3.5.3. Other barriers

There are many other barriers, which can be considered as obstacles to medium sized enterprise growth. They are mainly general, and can be observed in any kind of enterprise. In this text, some of them will be briefly explained including: lack of well-organised institutional support, social barriers, taxation and regulation, and environmental barriers.

In some transition countries, the lack of efficient institutional support can present an important barrier to medium sized enterprise growth, because the State does not provide the needed support, information, advice and training services, for the growth of these companies. It can be considered, that this barrier has been overcome in Croatia, because of the growing institutional support network, including CEPOR (SME Policy Centre), Ministry of the Economy, Labour and Entrepreneurship and financial institutions, such as HBOR (Croatian Bank for Reconstruction and Development). But institutional support by itself does not provide adequate help for Croatian companies, especially for small and medium sized ones, because all their activities, and company assistance, finally ends up with commercial banks, or other financial institutions, which are the main barrier to this process.

The other types of barriers, which have to be observed in this context, are social barriers. Social capital, trust and network ties between entrepreneurs are important factors for company development. Without a degree of trust between business partners, the parties to a transaction will feel exposed to opportunistic behaviour, which will either raise the transaction costs of doing business, or even prevent the transaction from being carried altogether.

In Croatia, there is an absence of open networks, in which economic agents can place their trust in anonymous trading partners, or in causal acquaintances. The reliance on personal connections replaces anonymous market transaction as a basis for doing business. Clienteles, paternalism and corruption can flourish in such an atmosphere. The main social barriers are: late payment of bills, lack of trust in economy and the need to bribe officials. Above all, the main barrier is the late payment of bills. It is problematic for a number of reasons. It can easily spiral out of control, into a chain reaction, giving rise to a generalised liquidity crisis. The widespread nature of late payment problems reflects the more general problem of the low level of efficiency of the judicial system (Bartlett et al., 2002, p. 30).

From the point of taxation and regulation, there are also some barriers to medium sized enterprise growth. Many business owners see high taxation and contributions on wages as a problematic issue. This largely reflects the crisis in the pension and health system, the ageing labour force, the high level of benefits for war pensioners, and the extensively used practice of early retirement, as a means of bringing about voluntary redundancies in the restructuring of the large company sector (Bartlett et al., 2002, p. 28). This all is stressed by high bureaucracy and regulatory obstacles.

And finally, the success of every company also depends on some factors concerning their environment, which means that environment also contains certain barriers that can slow down the growth and development of these companies. The companies can create big problems for themselves, if they do not care about their environment and the importance of Information Technology. A difficult situation can be reached, because of the lack of managerial knowledge and ability in the field of technological innovation.

4. THEORETICAL FRAMEWORK AND CRITICAL SUCCESS FACTORS FOR MEDIUM SIZED ENTERPRISE GROWTH IN CROATIA

This part of the master's thesis contains an explanation of a possible model of behaviour for medium sized enterprises in Croatia, or a model for their growth and development.

As a means for growth, enterprises use different growth strategies. Strategy identification and choice of adequate strategy is the initial, and also the most important step, in the process of company growth. When this initial step is not realized in a proper way, the final result can not be satisfactory. Strategic decisions should take into consideration the many aspects of a company's existence, and many determinate tools could be helpful in these decisions, so companies should exploit them. The main questions are, when and how to employ the determined strategy.

Most companies begin as small single-business enterprises serving a local or regional market, or some market niche. In the beginning of their existence, they are in the phase of researching their market position and their opportunities. They try to win over some customers, to cover costs and to survive. In that period, significant profit generation is not their main goal (Thompson and Strickland, 1996, p. 187).

During a company's early years, its product line tends to be limited, its capital base thin, and its competitive position vulnerable. Usually, a young company's strategic emphasis is on increasing sales volume, boosting market share and cultivating a loyal clientele. It has to compete with present market players that are usually strong established companies.

In these early years, profits are reinvested and new debts taken on to grow the business as fast as conditions permit. Price, quality, service and promotion are tailored more precisely to customer needs. This is done in order to attract new customers, because only new customers provide opportunities for future growth.

As soon as practical, the product line is extended to meet variations in customer wants, and to capture sales opportunities in related end-use applications. The customer is at the centre of a company's thoughts, and different variations of products are developed, to also satisfy different customer needs and preferences. To accomplish this, the R&D function has a powerful role. It is important in bringing new ideas and new solutions, which advance present products, the production process, or some other business aspect.

Opportunities for geographic market expansion are normally pursued next. The natural sequence of geographic expansion proceeds from local to regional to national to international markets, although the degree of penetration may be uneven from area to area, because of varying profit potentials, or some specific conditions. Geographic expansion may stop well short of global or even national proportions, because of intense competition, lack of resources, or the unattractiveness of further market coverage, different legislations, etc.

Somewhere along the way, the potential of vertical integration - backward, to sources of supply, or forward, to the ultimate consumer, may become a strategic consideration. Vertical integration makes sense only if it significantly enhances a company's profitability and competitive strength (Thompson and Strickland, 1996, p. 187).

Usually, these integrations demand considerably high investments, which are realized by retained earnings, or by bank loans. Vertical integrations involve a significant level of risk, and the companies should be aware of that in advance. The companies finance vertical integration mainly by bank loans, thereby becoming indebted, which increases risk. On the other hand, integrated companies are less flexible, and this also additionally extends the risk. So all of this together, affects the high risk associated with vertically integrated companies.

When a company's growth potential starts to wane, the strategic options are either to become more aggressive in taking market share away from rivals, which could be accomplished by strong marketing campaigns, or to pursue diversification into other lines of business, which represents concentric diversification. On the other hand, there are some other reasons or motives for conglomerate diversification, such as the dispersion of risks, new challenge, the opportunity to earn extra profit, etc.

And finally, when diversification is achieved, the time may come when management has to consider divesting or liquidating a business that is no longer attractive. If some business or product lines do not satisfy customers' needs in an adequate way, or if they do not generate a sufficient level of sales, it is better to abandon them, than to hold them and burden some other business units.

Performing business and within it, the application of growth strategies is some kind of rotation. One strategy is followed by another, and in this movement, the most important factor is the proper timing of when definite strategies are applied. Strategy determination and implementation are crucial moments in a company's existence, and companies, which give a lot of consideration to this aspect, have the basis for the creation strong competitive advantages.

Special conditions in Croatia, which could slow down this process, are:

- Croatia is still a transition country with many problems related to the process of privatisation and restructuring, although this does not affect all companies;
- Many companies do not have a well educated management;
- How to finance investments is a huge problem, because of complicated and slow administration process;
- High taxation, an inefficient legal system, and regulatory problems are some obstacles specific to Croatia;
- Access to the EU demands many changes for all enterprises in Croatia, and the question is, whether Croatian companies are ready to respond and to adjust to these demands and changes in an adequate way.

On the basis of theoretical aspects of medium sized enterprises and their growth strategies, several hypotheses are developed. The first group of hypotheses (H1 - H4) relates to the general characteristics of medium sized enterprises, especially regarding the relationship between entrepreneur and employees, their position in the market, and prospective finance opportunities. Hypothesis H5 concerns the growth and development of medium sized enterprises, with the accent on important growth bases (human capital, finance capital and R&D). Finally, hypothesis H6 concerns the concrete barriers and obstacles to medium sized enterprise growth in Croatia.

H 1: *In medium sized enterprises, there is a close relationship between the entrepreneur and employees.*

Many of medium sized companies start as entrepreneur enterprises, and with time, they expand their business activities, and become medium sized companies. In this process, the entrepreneur is the centre person of the company, its owner and manager. S/he inspires employees with strong vision, and has a huge influence on business activities and the process of business decision-making (Burns and Dewhurst, 1996, p. 3).

So, in medium sized firms, a higher degree of pressure regarding the achievement of company goals can usually be found. There can be a number of reasons for this. The goals are much more simply defined, due to the lower level of strategic diversification, and therefore can be more effectively communicated. The physical presence of the owner in the company, either in management or its governing body, helps to create more commitment in employee behaviour, relative to the defined goals (Corbetta, 2003, p. 78).

But, the role of the owner/manager needs to be changed, as the business develops, and professional management should replace the entrepreneurs, because the characteristics of managers who run the company in some stage of growth, are quite different from the characteristics of entrepreneurs, who established the company.

H 2: *Medium sized enterprises focus themselves on the market as niche producers.*

Due to the obvious fact, that medium sized enterprises cannot be serious competition to large enterprises regarding costs, prices, recourses, etc., their opportunity lies in their position in niche markets. One desired outcome of analysing strategic factors is identifying a niche where an organisation can use its core competence to take advantage of a particular market opportunity. A niche is a need in a marketplace that is currently unsatisfied, and it is sometimes called strategic window (Wheelen and Hunger, 1998, p. 110).

This kind of strategy in literature is observed under focus strategy. Focus allows some business to compete on the basis of low cost, differentiation, and rapid response, against a much larger business with greater resources. Focus lets a business "learn" about its target customers, their needs, special considerations they want accommodated, and establishes personal relationships in a way that "differentiate" the smaller firm, or make it valuable to the target customer (Pearce and Robinson, 2000, p. 305).

H 3: *Medium sized enterprises finance their growth with retained earnings and own resources, or by banks loans.*

The first source of finance, for the growth of medium sized enterprises, is retained earnings. This capital is the cheapest, but usually is not enough for planned investments. Consequently, companies need to find additional sources. So, the second solution to financing growth is to get a bank loan. Large banks seem to avoid SMEs lending, or keep it limited, leaving the field open to smaller banks. Smaller banks are generally quite reluctant or incapable of lending for long periods. Working capital type loans of relatively small amounts dominate bank lending, in terms of the number of loans. This suggests that medium sized enterprises may find it quite difficult to secure long term external financing (Bartlett et al., 2002, p. 142). Furthermore, bank financing is constrained by information asymmetries, which create difficulties in obtaining readily available and cheap capital. But, these information problems can be solved by using relationship based bank loans (Boot et al., 2005).

H 4: *Organisational structure and operational systems in medium sized companies tend to be simple.*

This simplicity is due to highly focused strategy, to the widespread presence of functional structures, which enable the avoidance of functional duplications that take place in organisations with divisional structures, to the scarcity of staff resources committed to creating sophisticated operational systems, and to the care that is taken to avoid the creation of costly complications in the methods of carrying out company activities (Corbetta, 2003, p. 79).

H 5: *Growing medium sized enterprises are the ones, which have resources (human capital, finance sources and strong R&D function), developed competitive advantages, and well defined and adequate growth strategies relying on achieved competitive advantages.*

In recent years in Croatia, there is an awareness of the necessity for strategic planning, and a growing number of companies have developed strategic plans, with an explicit description of the strategies which they apply. This is especially the case in medium sized enterprises, which have become big enough to have developed all business functions, so the need for serious strategic planning is present. In this context, great consideration is placed on employees and their creation of added value, observing them as the company's most valuable resource. Financing opportunities are also treated as highly important (more about this is mentioned under H3). Furthermore, the company who wants to have success in the niche market need to provide extra quality, design, service and high level of all other aspects of product, which will attract customers. The R&D strategy is the basis for this, and awareness of this fact is the first stage in building and keeping good customer relationships. To accomplish growth, it is crucial to choose adequate growth strategies. Some potential growth strategies are concentration strategy, vertical integration and diversification (Byars et al., 1996, p. 117). They should be based on accomplished competitive advantages, and should be focused on sustaining these advantages.

H 6: *Medium sized enterprises growth in Croatia is additionally constrained by barriers specific to the Croatian economy, such as: an unfavourable macroeconomic situation (highly indebt economy, unfavourable effects of the process of privatisation, low economic growth), State concentration on political issues rather than economic (the consequences of war and reconstruction, neighbour relations, cooperation with the Haag tribunal), a high level of bureaucracy in the regulatory system, and inefficiency of the judiciary.*

Among others, the high level of bureaucracy in the regulatory system is a crucial obstacle, which has constrained medium sized enterprise growth in Croatia. It can be observed through the following facts. For starting a business in Croatia, 12 procedures and 49 days are needed. For example, in Australia this last only 2 days, in Canada 3 days and in Denmark 4 days. The average for the 15 members of the EU is 31 days. To register ownership in Croatia, companies need to wait for 956 days. In the Netherlands this can be done in only 1 day, in Slovenia in 391 days, in Nigeria 274 days. Realization of contracts and charge of debts in Croatia take 415 days, and costs 17 percent of the debt. For example, in New Zealand, this lasts 50 days, and costs only 4.8 percent of debt (Poslovni magazin, December 2003, p. 24).

5. CASE STUDY ANALYSIS

5.1. Methodology of Case Study Research

In the literature, there are many definitions of case study. Robson defines case study as a strategy for doing research, which involves an empirical investigation of a particular contemporary phenomenon, within its real life context using multiple sources of evidence (Robson, 2002, p. 178). According to Bromley, it is a systematic inquiry into an event, or a set of related events, which aims to describe and explain the phenomenon of interest (Bromley, 1990, p. 299). The case study method is used when a rich understanding of the object and processes of the research has to be gained. This method has the considerable ability of generating answers to the questions of "why", and "how". On the other hand, the questions "what", "who" and "where" are likely to lead to the use of survey strategies (Yin, 2003, p. 6). The eventual questions and suspicions about the unscientific feel of the case study method can be rejected by fact that the case study can be a very valuable way of exploring existing theory, and also can enable an existing theory to be challenged and provide a source of new hypotheses (Saunders et al., 2003, p. 93).

So, in this master's thesis, the case study method is used because the questions of "why" and "how" are especially relevant to research on medium sized enterprises in Croatia, and their growth strategies. Therefore, the main questions of this investigation are: How do Croatian medium sized enterprises observe their position regarding their future prospects? Why do they want to grow and become large enterprises, and how can they accomplish that? What kinds of problems and barriers are present in Croatia, which hinder the development of medium enterprises, and how can these companies avoid these barriers? Which growth strategies can medium enterprises apply, and how?

After deciding on, and explaining the application of the case study method, the units of analysis must be defined. Units of analysis result from research questions. So in this thesis, units of analysis are medium sized enterprises in Croatia. Multiple case studies will be conducted and substantiation will follow, rather than sampling logic (Yin, 2003, p. 33). The evidence from multiple cases is often considered more compelling, and the overall study is therefore regarded as being more robust (Herriott and Firestone, 1983, p. 14).

Two cases will be presented, firstly through explanation building and then through cross case analysis (Yin, 2003, p. 120). The first case is about a company called SMS d.o.o. Split, and the other is about PIVAC d.o.o. Vrgorac. In the presentation of these cases, each individual case study consists of a "whole" study, in which convergent evidence is sought regarding the facts and conclusions of the case. Each case's conclusions are then considered as information requiring substantiation by other individual cases. Both the individual cases, and the multiple-case results will be the focus of a summary report (Yin, 2003, p. 141).

In this context, it is important to elaborate the reasons and criteria for choosing these particular two companies. The first step in selecting companies for this analysis was to observe different industries, and their life cycle stages. That observation shows that the food industry in Croatia has considerable potential regarding the grow rate, and number of enterprises. The State perceives this industry as a vehicle of progress for the total national economy, because of its natural potential, and bearing this in mind, promotes and encourages it through many incentives. Given this, it was interesting and important to find out how companies perform their business activities in industry with this potential, and how they can grow and develop in this kind of environment.

The focus of this research is on medium sized companies who are bordering between medium and large. The crucial idea is that these companies have some "history of growth", and that it is possible to detect how they develop (under what conditions and circumstances). The criterion for the definition of medium sized enterprises is Croatian Accounting law, with the focus on the number of employees. According to this criterion were these two companies chosen.

Another reason, which was followed in the determination of these cases, was the same geographic region in which these companies have headquarters. This was important, because these companies perform their business under equal conditions generated from the same environment, have similar problems and obstacles regarding that, and the State incentives are pretty much the same, so mutual conclusions can be made.

The fact that both companies have developed from entrepreneurial activities was also important for this study. The key aspect is to find out and enlighten how these companies have risen, and which strategies they follow in that growth. So the fact that both companies expand from zero offers the possibility of following all steps in their development. The tendency of growth was present from their beginnings, and that was an additional reason and criterion for their selection in this research.

Finally, the fact that they are successful was another criterion for focusing on these particular companies. Only successful companies can grow and develop themselves. The selected companies received awards in recent years from the Croatian Chamber of Commerce for special accomplishments in business activities and the contribution made to the development of the total national economy, and for the promotion of Croatian products all over the world. For example, Pivac d.o.o. received a special Gold Medal for the most successful medium sized company in Croatia in 2003. SMS d.o.o. had received a similar award some years previously.

When units of analysis are defined and explained, an additional step in the case study method is data collection. The data collection process for case studies is more complex than those used in other research strategies. Data for case studies come from many evidence: documentation, archival records, interviews, direct observation, participant-observation and physical artefacts. In the process of data collection, there are three principles: the use of multiple sources of evidence, creation of a case study data base, and maintenance of a chain of evidence. All of these principles are respected in this investigation, and the following sources of evidence are used: administrative documents, newspaper clippings and other articles in the mass media, service records, organizational records (organizational charts and budgets), interviews with managers and employees, direct observation and Internet sources.

After the collection of data, a further stage in conducting a case study is analysing case study evidence, which can be done by three strategies: relying on theoretical propositions, rival explanation or descriptive frameworks. In this context Yin determines five specific techniques: pattern matching, explanation building, time series analysis, logic models and cross case synthesis (Yin, 2003, p. 109). Among the mentioned techniques, in this research, and in the following text, explanation building and cross case synthesis are conducted, in order to provide a sufficient understanding of relevant issues.

5.2. Case study 1: SMS d.o.o. - Split

5.2.1. Company background

5.2.1.1. Foundation and History

SMS d.o.o - Split was established in 1989 during a year of political changes in ex-Yugoslavia. That year, Srđan Mladinić today's sole owner and manager of the company, decided to enter a new era of free entrepreneurship. He had a great desire to start with his ability to achieve new values. He had a vision of producing the products of his childhood (olives, wine, fish), animating them in a modern way. In a time of typical socialistic supply, he wanted to offer something different -"a realizable luxury" that everybody can afford.

Starting only with an old refrigerated truck, Srđan Mladinić started off by transporting fish for large fish companies. He earned a little money, and with a few colleagues, started to produce salted fish, and offered half of their products to fish companies that were very satisfied with the quality of the products. Thereby he was able to begin "cooperating" with these companies.

Wanting to move forward with his vision, Mr. Mladinić decided to take an additional step. Instead of the old traditional open-air fish markets, which were the only places to get fresh fish, he opened a modern fish market, with a great selection of top quality fish.

In 1991, he began with the third phase of SMS, the phase that they are still in, of producing top quality Dalmatian products, by the brand name "SMS". The first such product, from this phase, was sardine paste. Products to follow were salted anchovies and sardine fillets.

In 1994, the range of products was further developed with Dalmatian olives, capers and olive oil. Not long afterward, at the 1996 Zagreb Fair, they were awarded a gold medal for quality. With the start of production, SMS began to export to Slovenia, Bosnia and Herzegovina, Switzerland and Germany, with the promise of great success in a new assortment of products.

The most recent history of this company is oriented on the following aspects, which will be furthered developed in following years:

- They established a modern lab for the thorough control and analysis of raw materials and production processes, and also organoleptic and sensor quality evaluation of the olive oil (the tasting of olive oil, which will be included in the development centre for new food products).
- They purchased land in the countryside using it to develop SMS's own cultivation of olives. This will allow them to achieve their own special sort of olives using organic biological production methods. These olive trees will be their source for the production of table olives and olive oil.
- They built a modern plant for the production of table olives, different varieties of olive oils and refined olive oil.
- They started production of a special range of jams and marmalades (fig, orange, cherry, etc), in specialized industrial and commercial packaging. These jams and marmalades are very well accepted in the US, and offer great potential to SMS for the further expansion of its products in this part of world.
- They developed unique sorts of non-domestic olives in this area.
- They initiated the production of fresh and preserved vegetables, in cooperation with food producers from areas with a Mediterranean climate.

SMS's vision is to become the top producer in the food production industry in Splitsko- dalmatinska County within the next 5 years, with 50 percent of their production as export.

They have created a mission by means of becoming a modern market oriented company dedicated to development, production, and the distribution of high quality products throughout the world. At the same time, they will promote the development of agriculture and the fishing industry in Croatia.

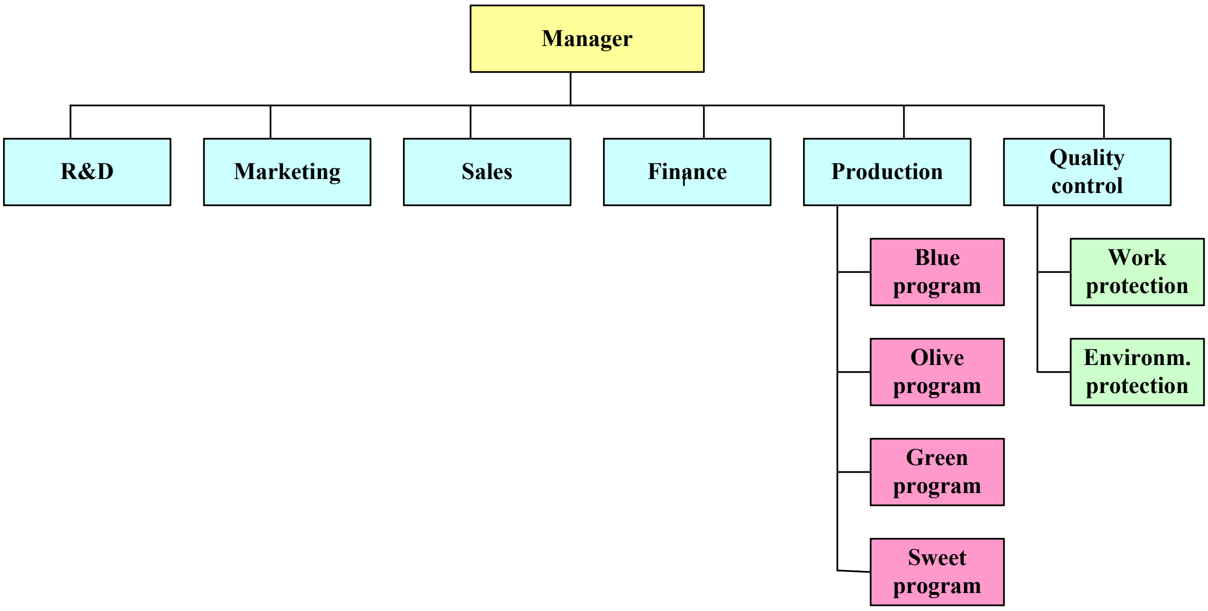
5.2.1.2. Organisation and Products

In order to achieve company goals and to realize a defined strategy, every company needs to organise its activities. The organising process leads to the creation of organisational structure, which defines how tasks are divided and resources deployed.

SMS's organisation structure is a functional structure, which groups jobs according to similar economic activities, such as finance, production, marketing, etc., and is convenient for companies of this size.

The visual representation of SMS's organisational structure is presented in figure 12.

Figure 12: SMS's Organisation Structure



Source: Company's documentation

From the organisational structure, four basic SMS product programs can be distinguished. They are:

- Blue program - includes sardines and anchovies in olive oil, with different additions, e.g. capers. They are prepared and salted according to traditions developed throughout generations of fish salting.
- Olive oil program - The assortment of olive oil is harmoniously balanced to satisfy the tastes of every customer. The oil is packaged in bottles of 1 l, 0.75 l, 0.5 l and 0.25 l.
- Green program - contains a wide range of olive products, green, black, whole, pitted and stuffed olives, with different additions like cheese, capers, pimento, paprika, etc., all in olive oil.
- Sweet program - fig spreads traditionally produced from the highest quality dried figs, capturing all the healthy qualities and unsurpassed flavour of the Adriatic fig. The different additions, such as cochleae, orange and cocoa, are also used in fig spread production. In the SMS company, there are plans to expand Sweet program to other spreads and jams.

5.2.1.3. Human Potential and Employees

Today, SMS has 207 employees and they represent the major potential of this company. This company pays great attention to the education and training of its employees, and many of them are regularly sent on different seminars, training programs, trade fairs, etc. In SMS, there is a generally accepted opinion that well educated and skilled workers, who are up to date with new knowledge and the best business practices, are the main strength, competitive advantage and growth resource.

The structure of employees according to their level of education is represented in table 13:

Table 13: SMS's Employees According to Education Level

Ph.D/M.Sc	Faculty Degree	College Degree	High school degree	Qualified workers	Unqualified workers
4	30	8	132	11	22

Source: Company's documentation

Strong organisational culture is one of the main competitive advantages of this company. The employees are highly motivated, not by salaries, but by the well-being of the company and high charisma of the SMS founder. Evidence for this, lies in the fact that in the research conducted among SMS's employees in December 2002, salaries as a motivational factor is ranked penultimately, while the strong motivators are company growth and development, good relationships among employees, etc.

From the interviews with SMS's employees the same thing is discovered, so it can be concluded that SMS is a company with highly involved and loyal employees, who are dedicated to the company's goals. All of them make their own contribution to the development of this company and strategy achievement, no matter in which department they work.

5.2.1.4. Financial Indicators

In order to obtain a complete understanding of the SMS company, it is necessary to observe the financial indicators about its business activities. These indicators are presented in table 14.

Table 14: Some Financial Indicators of the SMS company

(in EUR)

Indicator	2002.	2003.	Index 03/02
Total assets	6,125,736	8,601,291	1.40
Long-term assets	2,247,738	5,607,901	2.49
Current assets	3,847,258	2,962,458	0.77
Inventories	1,013,887	1,161,323	1,15
Accounts receivable	2,389,612	1,547,283	0.65
Total equity	1,962,133	2,761,537	1.41
Long-term liability	2,373,660	3,674,781	1.55
Current liability	1,507,535	2,164,974	1.44
Accounts payable	1,308,091	1,710,454	1.31
Total revenues	6,358,627	8,004,415	1.26
Revenues from export	2,108,079	2,354,104	1.12
Total expenses	6,326,329	7,896,468	1.25
Profit	22,273	82,070	3.68

Source: FINA

From the available financial data, it can be pointed out that, in 2003 compared to 2002, the majority of SMS's financial indicators increased. This suggests that this company is on the way to growth and development. Long-term assets increased by 149 percent, which was, on the other hand, followed by an increase in long-term liability by 55 percent. As the result of these changes, the profit of this company increased by 268 percent. Beside this, it is important to notice that the proportion of revenues from export is 29 percent.

But, a more concrete picture about the business performance of this company can be obtained from some calculated financial ratios, which are presented in table 15.

Table 15: Financial Ratios for the SMS Company

Ratio	2002.	2003.
Current ratio	2.55	1.37
Days sales outstanding (DSO)	88	89
Total assets turnover ratio	1.04	0.93
Debt ratio (in %)	63.36	67.89
Debt, in number of years	12.00	29.00
ROA	0.36	0.95
ROE	1.14	2.97
Revenue per employee (in EUR)	30,718.01	38,668.67
Profit per employee (in EUR)	107.60	396.47

The current ratio belongs to the category of liquidity ratios, and it is calculated by dividing current assets by current liabilities. For SMS, this ratio is 2.55 for 2002 and 1.37 for 2003. Although there is no general requested level of this ratio, the recommendation is that it has to be at least 2 (or 1.5) in order to avoid illiquidity problems (Vidučić, 2000, p. 402). So in 2003, SMS had some liquidity problems. The liquidity problems are connected with days sales outstanding, which are 88 or 89 days. This means that, SMS needs to wait 89 days after making a sale before receiving cash. This number is above industry average, and it can be a reason for liquidity problems.

Total assets turnover ratio is calculated by dividing sales by total assets. For SMS, it was 1.04 in 2002, and 0.93 in 2003. This means than for 1 EUR invested assets, the generation of sales, in 2002, was 1.04 EUR, and in 2003, it was 0.93 EUR. For medium sized enterprises in Croatia, this ratio is 0.7 or 0.8. The average for the industry which SMS performs is 0.65. So, it can be concluded that SMS's generation of sales, given its total assets, is above industry average.

Debt ratio is one of the debt management ratios, and it is calculated by dividing total debt by total assets, and it measures the percentage of funds provided by creditors. For medium sized enterprises in Croatia, this ratio is above 52 percent, and for SMS it is 63.36 percent in 2002, and 67.89 percent in 2003. This shows that SMS is highly indebt.

Profitability ratios show the combined effects of liquidity, asset management and debt management policies on operating results (Brigham and Daves, 2002, p. 242). ROA is return on total assets, and it is calculated dividing net income (profit) by total assets, and multiplying by 100. ROA shows the power of company. For medium sized enterprises in Croatia, ROA in 2003 is 3.51 percent, and for SMS, it is 0.95 percent, which is very low. The reason for this is in the fact that SMS's investments in assets have not yet made a significant contribution to profit generation.

Return on common equity - ROE, is another profitability ratio. It is calculated by dividing net income (profit) by common equity, and multiplying by 100. In 2003, for medium sized enterprises, it is 8.3 percent, and for SMS, it is 2.97, which means that for 1 EUR invested capital the generation of profit is 0.0297 EUR. When this percentage is compared with the average annual interest rate on deposits over a period of 12 months (2003) in Croatia, which is 5.56 percent, the conclusion is that is better to put money into the bank, than to invest it in SMS. But this is again, the result of high investments, which have not produced a significant profit.

According to all these financial data and financial ratios, the opinion is that SMS could be in certain danger, primarily because of liquidity problems and high debt. But the fact that they have invested in improvements of production and advanced equipment, shows an expectation that these new investments will bring benefits, especially from abroad.

5.2.2. Tools for Strategy Formulation

The meaning of this section is to clarify the position of the SMS company on the basis of very often used tools and methods helpful in the strategy formulation process.

5.2.2.1. Porter's Model of Competitive Analysis

Porter's model for competitive analysis is commonly used as a tool for strategy formulation. The theoretical explanation of this model is presented in theoretical part of this master's thesis, so in this part, it will be used in order to provide a better understanding of the industry structure and the position of SMS in the food industry.

The competitive analysis of company SMS will be clarified by using every element of this model.

In literature, threats of new entrants or barriers to entry are observed through: economies of scale, product differentiation, government policy, patents, capital requirements, switching costs, brand identification, distribution channels, etc (Bateman and Zeithaml, 1993, p. 72). In the case of SMS, these barriers, in general, do not prevent other companies from entering this industry, and on the other hand, SMS's market niche competitors (Trenton, PZ Marina, PZ Lučica) do not have enough strength to overcome SMS, or in other words, they are not capable enough of producing better quality for the targeted customers, as SMS can. This company is much ahead of others, thanks to the quality of their products, to which they pay great attention, fulfilled with a sense for design, which attracts customers' attention, and add greater value to the products, as well as their constant introduction of new programs and products, which is supported by their centre for R&D. All this creates a strong SMS brand name, which competitors cannot easily achieve. But, in today's situation, there is one barrier that protect SMS's market position, and that is dutiable protection, which prevents foreign competitors from freely entering the Croatian market, and competing with SMS. This will certainly happen after

Croatian entry in the EU, when the threats of Spanish, Greek, Italian and other competitors will be strong and dangerous.

The bargaining power of suppliers is evident, but not too strong and disturbing for SMS, at the moment. SMS's suppliers are mostly small producers of olives, fruits and vegetables, and they are mostly organised into cooperatives. Their power firstly depends on olive, vegetable and fruit crops, and not so much on their business strategies. In recent years, there have been great fires in Croatia, especially in Dalmatia, which destroyed olive plantations, so supply was decreased. This has allowed producers to increase prices, and in this way their bargaining power has become stronger. In order to avoid these suppliers, SMS started to grow its own ingredients (olives, fruits and vegetables). In literature this is called backward integration. The first steps in this direction were undertaken in 2002, when SMS planted first olive and fig trees. The only supplier, which cannot be avoided, is the supplier of glass jars. SMS has established good and strong relationships with this company, and at this moment, it does not represent a threat. The design of these jars is outsourced and is left to an experienced and famous designer. Furthermore, SMS patents these jars to prevent any possibility of copying, and after that the producer of jars starts production. As its role is clarified, it is obvious that this supplier does not represent a threat to SMS.

The bargaining power of buyers is not evident in the case of SMS according to the theoretical explanation of this barrier. The situation of one buyer or small number of buyers does not exist in this case, but the danger of the small market niche is present. SMS satisfies all the needs of their target customers in this market niche providing them with high quality products. These target customers recognise SMS's quality, and they are ready to pay for it. However, on the other hand, SMS must not become complacent, because competitors are always ready, and awake to jump and copy their products, design, packaging and distribution channels. In order to expand its market share SMS needs to be aware of the fact that customers care about prices and try to find high quality products with low prices.

The threat of substitute products is not so evident in the field of olives and olive oils, because SMS is the leading company in that sector, due to their quality and well-known brand name. But, there are some large competitors, which produce other types of vegetables (cucumbers, peppers, tomatoes, etc.), and offer their products to the wider market. These large producers represent a threat to SMS, because they can take away SMS's market share. In order to avoid this possible situation, SMS is in the process of the introduction of a new range of products, which will include different types of vegetables and fruits. Another way of decreasing the threat of substitute products is to undertake aggressive marketing campaigns.

With the threat of competitive rivalry, it has to be pointed out that SMS should consider larger producers, with a wide range of products, as well as smaller olive producers, as its competition. In the present situation, SMS has certain advantages related to both groups of competitors. Its advantage is firstly evident in its brand name recognition, clearly defined mission and vision, developed strategies, human resources potential, R&D

activities, and ecological production. SMS is aware of the fact that these advantages must be sustained, and also further developed.

5.2.2.2. SWOT Analysis

On the basis of collected materials and documentation, as well as on the basis of interviews, which are carried out with the owner/manager and the employees of the company, the main strengths, weaknesses, opportunities and threats to the SMS company are grouped and presented in table 16 (strengths and weaknesses), and table 17 (opportunities and threats).

Table 16: Strengths and Weaknesses of the SMS Company

Potential Internal Strengths	Sign.	Relat.	Potential Internal Weaknesses	Sign.	Relat.
• Recognizable brand name	10	0.063	• No economies of scale	7	0.078
• First mover on the market - position of market leader	9	0.056	• Highly indebted and financial instable	10	0.111
• High quality products - usage of high quality ingredients	8	0.050	• Owner/manager barrier	7	0.078
• Ecological method of production and great attention to environmental protection	6	0.038	• Higher prices of products compared to competition	8	0.089
• Traditional image of products	5	0,031	• Liquidity problems	9	0.100
• Strong R&D	6	0.038	• Unqualified management - Owner/manager has no education in economics	4	0.044
• Developed competitive advantages	6	0.038	• Authoritative leadership style - Although team work is present, manager is highly involved in decision making process	5	0.056
• Human potential - qualified and motivated individuals	7	0.044	• Dependence on others distribution network	8	0.089
• Customer orientation - Ability to meet different customers' needs	8	0.050	• Higher overall unit costs relative to key competitors	8	0.089
• Emphasised team work	4	0.025			
• Strong organizational culture	4	0.025			
• Clearly defined vision and strategies	7	0.044			
• Strong marketing campaigns (promotion and packaging design)	6	0.038			
• Product innovation skills	5	0.031			
• Proven and charismatic manager	5	0.031			
• Wide range of products	7	0.044			
TOTAL	**-**	**0.644**	**TOTAL**	**-**	**0.733**

Table 17: Opportunities and Threats of the SMS Company

Potential External Opportunities	Sign.	Relat.	Potential External Threats	Sign.	Relat.
• Nutritional trends - Customer orientation on ecological and natural products	10	0.2	• EU legislation	6	0.050
• Ability to serve additional customer groups or expand into new markets or segments	10	0.2	• Inappropriate functioning of legal system and high bureaucracy	5	0.042
• Ability to transfer skills or technological know-how to new product or businesses	8	0.16	• Entry of lower-cost foreign competitors - after access to EU	9	0.075
• Integrating backward	7	0.14	• Weather and climate conditions	7	0.058
• Access to EU funds	7	0.14	• Intensifying competition	5	0.042
			• High customer price elasticity	7	0.058
			• Tight market niche	8	0.067
			• Large scale of substitute products	8	0.067
			• Slower domestic market growth	8	0.067
			• Exchange rate - appreciate domestic currency	6	0.050
			• Insufficient State incentives	4	0.033
			• Inadequate financing opportunities	8	0.067
TOTAL	**-**	**0.84**	**TOTAL**	**-**	**0.675**

As it can be seen from tables 16 and 17, every element of SWOT analysis has determinate significance, which presents the meaning or importance of each element compared to other elements.

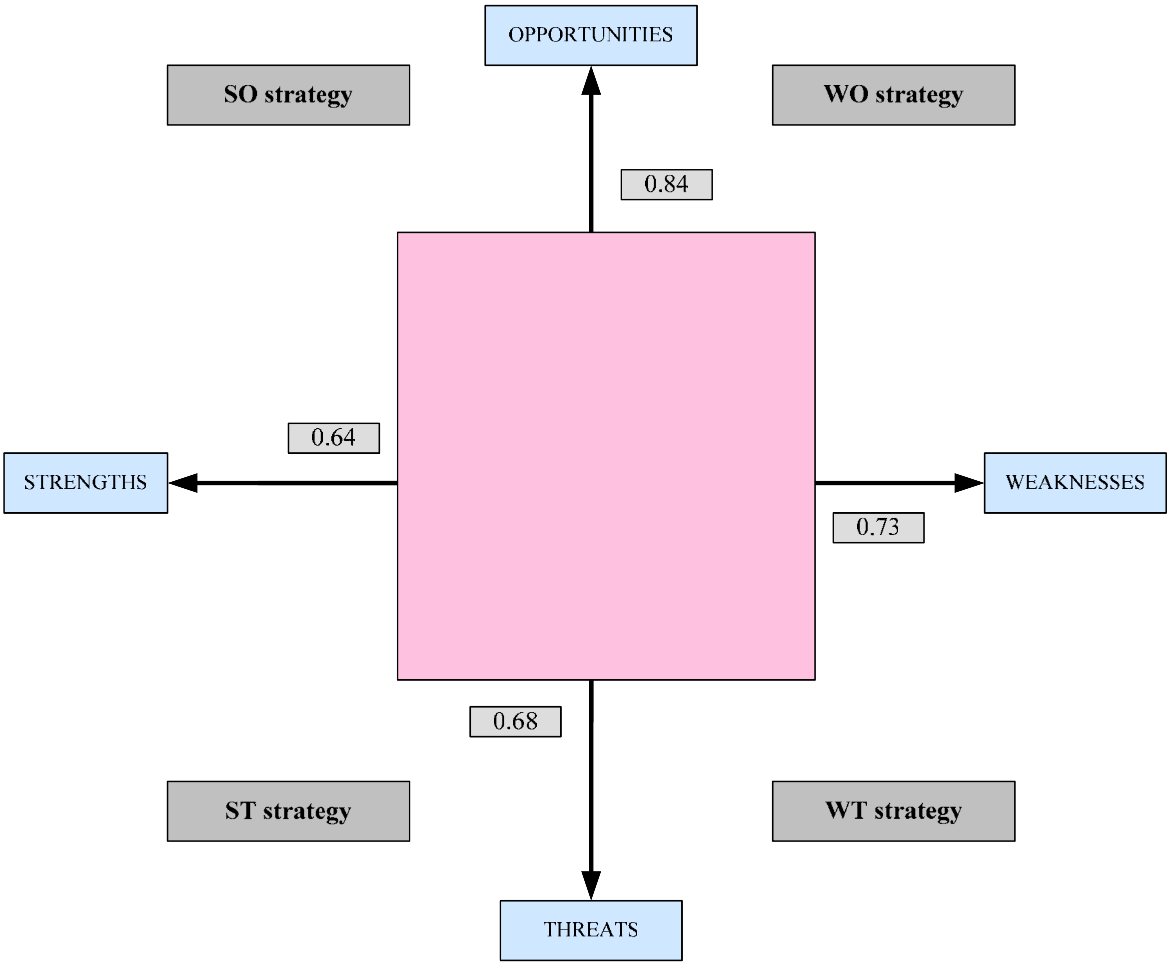
This significance is defined subjectively, and it has a range from 1 to 10. By this, 10 means that the element is highly significant, and 1 means that the element is highly insignificant.

In order to obtain a more precise and realistic picture, the relative measure is calculated by dividing the significance of each element with the sum of the maximum possible significance of all elements. Then these values are summarised, and presented on an adapted graph.

Figure 13 represents the strategies' polygon[8] and SMS's position regarding the strategies, which this company can apply.

[8] The strategies polygon is developed by S. Goić, assistant professor, Faculty of Economics Split, to advance the project "Sustainable Development of Town Split".

Figure 13: SMS's Strategies' Polygon



As it can be seen from the figure above, each axis of the strategies polygon represents one variable of SWOT analysis. These axes define four quadrants, and four possible strategies. There are SO Strategy, WO Strategy, ST Strategy, and WT Strategy. The explanation for each of these strategies is in part 2.4.2.2. of this master’s thesis. SMS's position in the strategies' polygon is defined by the pink area. This position determines the sum of relative measures of each SWOT variable.

It can be observed that the most relevant SMS strategy is WO strategy, which means that the company needs to take advantage of opportunities by overcoming weaknesses. The positive thing for SMS is that the relative meaning of opportunities is greater than the meaning of weaknesses. Furthermore, the meaning of threats and strengths is pretty much the same, and in general, threats could be eliminated by determinate strengths.

This polygon represents a visual analysis of SMS's position concerning its internal characteristics and external factors, and it can be helpful in the creation of future plans and for choosing appropriate strategies. So, the strategic plans of this company should be concentrated on serious observation of opportunities, with the clear goal of taking advantage of all of them.

5.2.2.3. SMS's BCG matrix

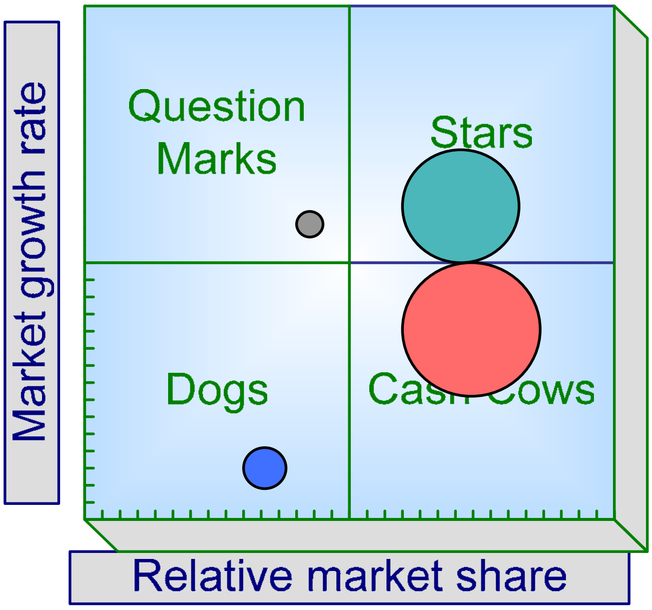
As previously mentioned, BCG matrix is another method for strategy formulation. In this part, it will be used for the analysis of the SMS company.

In the process of the creation and application of the BCG matrix, some steps need to be followed:

1. Divide the company into its business units.
2. Determine the business's unit relative size within the total organisation. Relative size can be measured by number of employees, total sales, and total assets. On the matrix, the circles represent business unit and their relative size.
3. Determine the market growth rate for each business unit.
4. Determine the relative market share of each business unit.
5. Develop a graphic picture of the company's overall portfolio of business.
6. Select a strategy for each business unit based on its position in the matrix.

As the result of these steps, the final BCG matrix for SMS is achieved, and presented in figure 14.

Figure 14: SMS's BCG Matrix



As a result of organizational structure observation, four business units are differentiated. Every one of them represents a production program of this company, and in the graph above, they are presented by different coloured circles. The size of the circles determines total sales generation.

The black circle represents the sweet program, which has a low relative market share below (1.5 percent), and a high market grow rate. This program represents a "Question Mark", which means that their cash needs are high because of their growth, and the cash generated is low because of their low market share. Because growth is high, one possible strategy for a "Question Mark" is to make the necessary investments to gain market share, and become a "Star". This cash should be directed toward marketing campaign and strong promotion of this kind of product.

The blue cycle symbolizes the blue program - salted sardines and anchovies, and this business unit or assortment belongs to "Dogs". This program has a low market share and low market growth rate, and it generates poor profits. Because of this fact, the manager of SMS is considering abandoning this program.

The red cycle represents the olive oil program, and in the BCG matrix, it is positioned as a "Cash Cow". "Cash Cows" have low market growth rate and a high market share, so profits and cash generation are high, and cash demands are low. Since large cash surpluses are normally generated by "Cash Cows", they provide the company with help and support business units, which are in the field of "Stars" and "Question Marks" or, in the case of SMS, the green and black program.

The green circle symbolizes the green program which includes olives. This program belongs to the "Stars", which means that it has a high growth rate and a high market share. The green program generates large amounts of cash, and it represents the best profit and investment opportunity. The best strategy for this business unit is to make the necessary investments to maintain or improve their competitive position.

According to the presented BCG matrix, the conclusion is that SMS, generally, has well positioned business units, especially the green and olive oil program. The sweet program offers opportunities for further growth and development. Only the blue program does not represent potential for this company. So, the expectation is that SMS, in the near future, will abandon the production of salted sardines and anchovies.

5.2.3. Meaning and Implementation of Growth Strategies

The main purpose of this section is to explain which growth strategies the SMS company exploits, and how it implements those strategies given the present conditions in Croatia, which affect every business activity.

In SMS, growth is seen as path to success. Every employee is committed to this thought, and the charismatic owner/manager has a great influence on employees in this direction. They want to be the best food producer in Splitsko-dalmatinska County, with a large proportion of export; so growth is the main component of their mission. The employees are a crucial factor in the realization of company mission, and they represent a great and valuable force.

In the direction of growth, SMS applies some well-known growth strategies: Concentration strategy, Vertical integration and Diversification.

The application of concentration strategy means that the company is oriented towards a small number of closely related products. SMS has four groups of products, which can be briefly described, as the fish program, the olive program, the olive oil program and the fruit program. In order to increase sales, profit, or market share, SMS is trying to expand these products in new geographical areas, and to attract new market segments, especially abroad, which means that it is pursuing market development strategy.

Attracting new market segments includes developing product versions to appeal to other segments, entering other channels of distribution and advertising in other media (Pearce and Robinson, 2000, p. 257). So in order to expand on new markets, SMS adapts its products to different potential customers.

Different regions have different requirements for flavours and odours. For instance, inhabitants in Slavonia (the north-eastern region of Croatia) mostly do not prefer olive oil because of its specific odour, so SMS had to make adjustments and reduced its packaging (the bottle is only 250 ml).

More specific requirements came from foreign countries. For example, in the Netherlands, customers prefer sourer flavours and Americans prefer sweet and sour. These adaptations to different needs and preferences have resulted in obtaining a larger market share and increased sales.

In the future, SMS will develop in this direction. Its R&D lab is established and organised to carry out different research, which will offer customers some new tastes, healthier and nutritional rich food. SMS has constantly increased its sales in all geographical regions in Croatia, and its exports are in a similar phase. Target countries are: Slovenia, Bosnia and Herzegovina, Germany, Switzerland, Baltic countries, Benelux countries and the US.

Besides market development, SMS is also oriented towards a second aspect of concentration strategy - product development. The key thought of this strategy is to alter the basic product or service, or to add a closely related product or service, that can be sold through current marketing channels. SMS has variety of related products, for example in the olive program, it produces olives with different additions, such as paprika, capers, cheese; in the olive oil program, it produces oil of different odours and flavours (strong odour or less strong, etc.), all to satisfy different customers' preferences. Different additions, new flavours and odours used in olive and olive oil production present SMS's innovations in the Croatian market, because before in Croatia, olives were produced as pure, only black or green, and the olive oil was the same for all markets. In this context again, SMS's R&D department has a huge role. All these products are distributed through the same marketing channels, and new products take advantage of the favourable reputation of present products.

According to the above mentioned, the application of concentration strategy brings SMS some advantages:

- The company can utilize the obtained knowledge and resources for further development and growth.
- For the distribution of new products they use the same channels.
- No matter if it uses market or product development strategy, there are no extra costs concerning the application of these strategies.
- The company can concentrate on the aspects which it performs particularly well.
- The limited additional resources necessary to implement this strategy, coupled with the limited risk involved, make this strategy desirable for companies with limited funds, such as SMS.

The general disadvantage of concentration strategy is the placement of all resources in one basket. This can be a threat in the case of SMS, because of its great concentration and dependence on olives and olive oil, which can be seen from the BCG matrix of this company, section 5.2.2.3. SMS has also two other programs (jams and fish), but their strengths are not so significant, and they do not bring enough volume of sales and profits to be sure that the company will not be in trouble if olives and the olive oil program run into some problems.

Another growth strategy, which SMS applies is vertical integration, more precisely, backward integration. This strategy means that SMS goes back to supply to provide its own ingredients (olives and figs) for its production. In the literature, generally, there are two main reasons for backward integration: the desire to decrease the dependability on suppliers, and the desire to increase the quality of raw materials used as production inputs. The desire to eliminate suppliers is greater when the number of suppliers is small, because then they can determine the prices of inputs.

Olive producers in Croatia are mostly small producers, or families, who have planted olives for centuries; it is some kind of tradition in this region. Many of them are associated into cooperatives. Their offer is mostly quality uneven, and this directly affects SMS's final products. The olive suppliers were not highly priced (more about them is explained in Porter's model, section 5.2.2.1.), and that was not the reason why SMS went for backward integration. The main aim of backward integration, in the case of SMS, was to get their own high quality ingredients, which will improve final products, and then offer better quality to customers.

The situation in fig production is pretty much the same, although fig producers are even more poorly organised, because the figs are mostly sold in the market hall or used only for household consumption.

In order to eliminate suppliers, in SMS's R&D lab, by mixing different varieties, it produces its own seedlings of the best kind, and plants 30,000 olive seedlings and 12,000 fig seedlings on rented land near their production plant. The first crop will be in 2007.

The building of its own plants of olives was a huge investment and it will show its results in the future. By this, SMS will be less dependent on its suppliers, and it will have ingredients with exact quality, so its final products will be higher quality products.

On the other hand, the general disadvantage of backward integration is the fact that it limits the company's flexibility, and increases risk. In the case of SMS, limitation flexibility is obvious, because the company cannot easily turn its production into other products, because too many resources are engaged in olive, olive oil and fig production. The introduction of new products, which is planned, would demand new investments and additional time, and all that reduces flexibility.

The one aspect of risk linked with backward integration, in the case of SMS, is evident from the fact that agriculture is very much attached to weather conditions, and the company can not on its own resist bad weather storms or fires, which are unfortunately frequent in this area. So, if this aspect is taken into consideration, then it can be observed that this investment suffers from additional risk.

The final growth strategy which SMS applies is diversification, precisely concentric diversification, which involves adding products or services that lie within the company's know-how and experience in terms of technology employment, product line, distribution system or customer base. When to diversify, depends partly on a company's growth opportunities in its present industry, and partly on its competitive position. In the case of SMS, growth opportunities are evident, and the company's competitive position is strong, so SMS is ready to pursue concentric diversification.

SMS's application of concentric diversification strategy represents the production of fig jam, which is positioned on the market with great success. This product is not so popular and demand in the Croatian market, and although there is a long tradition in its preparation, this jam was not produced for sale. SMS was the first company which launched this product on the market, and great success was accomplished, especially in the US, where it got a golden medal at the International Fancy Food Show 2004 in New York, and large sales were evident.

SMS has plans to expand its product assortment of other vegetables and fruits, and the building of new production plant near Split is headed in this direction. Namely, present SMS production is based the manufacturing method of production, which means hand-made products. This ensures an absolutely ecological way of production and pure natural products, but the quantity is determinate, the costs are high, and the profits are questionable. So, in market conditions, which are present everywhere, and when the company needs to be cost competitive, the industrial way of production is inevitable. Today, SMS is in the process of introducing industrialisation in its production, and the further application of concentric diversification strategy will be easier, because present technology and know-how can be used for launching new products, and this will happen in the close future.

To summarise, SMS applies different growth strategies for its growth and development. Often companies use different strategies at the same time, and this is also the case for SMS. Its growth can be observed chronologically. Firstly, it grows by the application of the concentration strategy, market and products development, then it engages in backward integration, and finally it goes forward to concentric diversification.

5.2.4. Critical Overview of the SMS Company and its Future Perspective

SMS is a company which possesses a differential advantage, and thanks to that, it can be easily recognized among a wide range of consumers. Its differentiation advantage results from its very well known and established brand name, which is immediately connected with its reputation. It is easily recognizable and contains a deeper meaning (sun, sea, salt - in Croatian - Sunce, More, Sol), associated with pure nature, and at the same time, with products which are healthy and natural. Today, SMS has a significant advantage in comparison to its competition, and due to the above mentioned, image and brand name forms SMS's core competence. That is what SMS does better compared to others.

SMS's future is oriented towards sustaining and further developing its brand name and recognizable image. In this direction, SMS has to continue with its vision, and that means keeping the quality high, being original, paying great attention to R&D and providing great consumer as well as employee satisfaction.

If a critical overview of the SMS company should be done, it could be concluded that for its future growth, SMS mostly relies on its brand name, and basically, it is a very indebted company, which at the moment, produces highly priced products for a tiny niche market, and could have many problems after entry to the EU, when European standards become obligatory. But, it is hard to project anything regarding SMS's future, especially because of the fact that its products were totally unimportant for customers in Croatia, but SMS builds a business on them, because it employs appropriate production and organizes market placement in an adequate way. For example, figs were being thrown away in many households in Croatia, but SMS has achieved significant success in America with its fig jam.

Of course, just the idea is not enough in a turbulent and even hostile environment, but it is a starting point. To support the idea, SMS pays a lot of attention and money to R&D. Its R&D centre has been a huge investment of over 4 million EUR. This company considers research and new knowledge as extremely valuable. SMS tries to improve its products in every way possible that is exclusively ecological. In the future, its objective is to expand its range of products of vegetables and fruits, to eliminate hand made production, which will allow lowing the prices, and, if SMS continues this way, it will experience further success.

In this way it could suffer from two threats. The first is concerned with its huge debt, and some undesirable economic conditions could cause this to become a problem. The second threat concerns access to the EU where competition will be tough and dangerous.

5.3. Case study 2: Meat Industry Braća PIVAC d.o.o. - Vrgorac

5.3.1. Company background

5.3.1.1. Foundation and History

The meat Industry Braća Pivac d.o.o. Vrgorac (further referred to as: PIVAC), is a family owned company established in 1952. In that year, they opened their first official butcher's trade in the town of Vrgorac.

From the period 1952 to 1992, despite the economic and political circumstances that did not stimulate private entrepreneurship, the next generation of this family took over the butcher's trade, and expanded it by opening more shops.

In the year 1990, the company known as Meat Industry Braća Pivac d.o.o. was registered in the town of Vrgorac for the first time. Besides the production of meat products, the company began to distribute its products, and decided to open more retail and wholesale outlets throughout Croatia.

In 1994 they started the construction of a curing plant in Zavojani and expanded its capacities in the production of cured-meat products. In following years, this company oriented itself towards further expansion. So, in 1997, they became the majority owners of Interproduct d.d. farm in Pitomača, and renovated the slaughterhouse and the cattle stock. They completed their first significant investment in tourism by acquiring Hotel Miramare in Makarska that had been closed during 1980s, and now PIVAC is rebuilding this hotel.

PIVAC also followed this trend of growth in 2002. First, it became a 50 percent owner of the meat industry of Bermes d.o.o., Donja Pušća; then it invested in tourism by buying Hotel Biokovo d.o.o., Makarska; and a year later, PIVAC became the single biggest shareholder in PPK Karlovac Meat Industry and appointed their management.

In June 2003, the company opened new modernized production plants in the town of Vrgorac, and presented new production lines. With this, the production plants where enlarged, and are 4.000 m^2 in total, equipped with the newest technology. In order to export its products, PIVAC made a contract with Karliko d.o.o. - Ljubuški, and this company became its agent and distributor in Bosnia and Herzegovina. By this time, PIVAC had 30 retail trade outlets, and 8 wholesale outlets, entirely fully equipped.

In the year (2004) this company developed in two directions:

- The curing plant in Zavojani and the production capacities have been expanded; the traditional production of Dalmatian cured-meat products has been modernized.
- The company management considers the R&D function as highly demanding, because it has the key role in strategic planning. In this context, in 2004, additional emphasis and effort are given in order to achieve constant interaction between the PIVAC company, and leading European meat producers, with the goal of achieving the best know-how, and training employees on the basis of modern and advanced methods.
- In this year the company continues to expand the distribution network by opening retail and wholesale outlets throughout Croatia, creating a network of 45 retail and wholesale distribution centres.

The vision of PIVAC is to become the leading meat industry in this part of Europe, by implementing global standards of quality control, range and services, in the manufacture of traditional products of the highest quality, and to develop healthy nutritional habits in current and future customers.

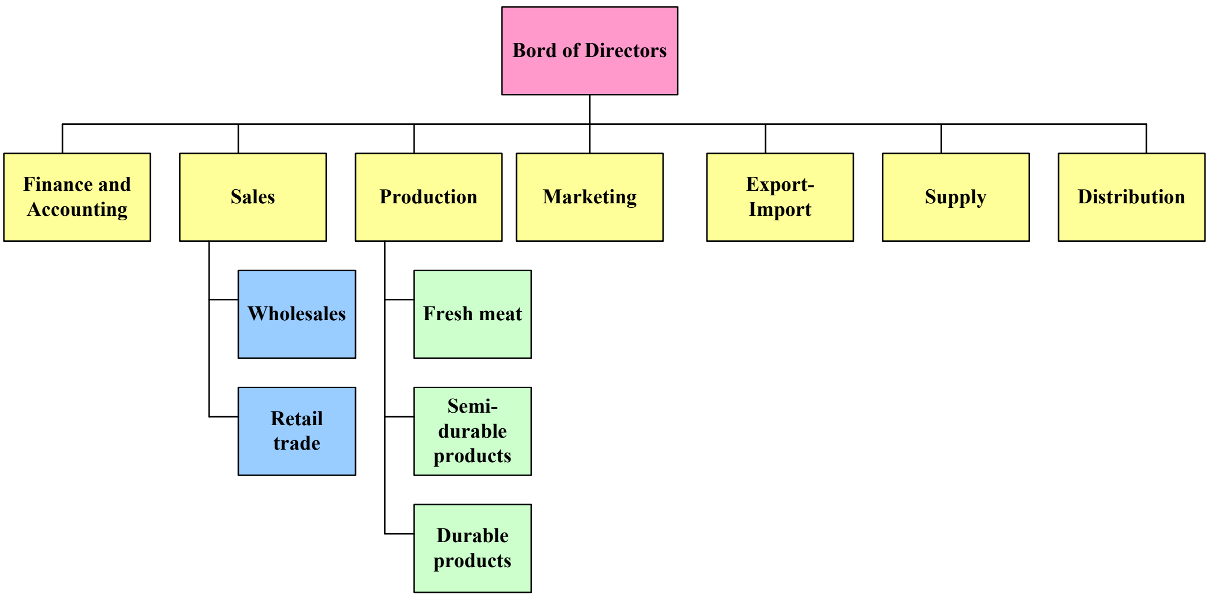
PIVAC's mission is to provide its customers with top quality service, as well as, state-of-the-art equipment and technology in the traditional production of processed meats. PIVAC is focused on developing a product distribution network, and adapting to its business partners' requirements, and has developed long-term cooperation with business partners and customers. PIVAC protects the environment by investing in environmental standards and applying the sustainable growth principle in accordance with global standards. The company ensures veterinary, sanitary, hygienic, environmental and microbiological conditions comply with global standards of quality control. PIVAC is striving toward continuous progress, and increased workers productivity.

5.3.1.2. Organisation and Products

Organisational structure is the set of formal tasks assigned to individuals and departments. It is a system that ensures effective coordination of employees across departments. The choice of organisational structure depends on many factors such as: company size, nature of the environment, geographical areas related to business activities, etc. PIVAC applies functional organisational structure, which is based on a combination of similar jobs into one department.

Its organisational structure is presented in figure 15.

Figure 15: PIVAC's Organisational Structure



Source: Company's documentation

The PIVAC company has three groups of products:

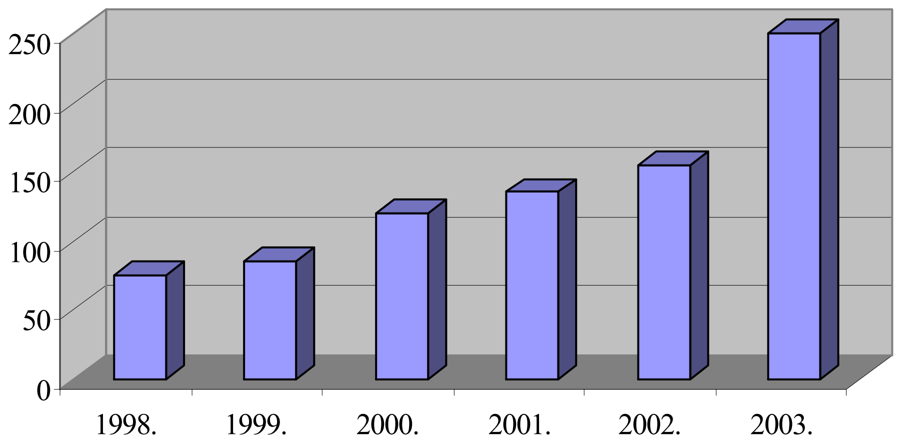
- Fresh meat - The assortment of fresh meat consists of veal, beef, pork, lamb and young beef. All cattle are domestically bred - from PIVAC's own farms, or supplied by small producers. PIVAC only offers its fresh meat in its own butcheries.
- Semi-durable products - The assortment of semi durable products is divided into salami and sausages, and delicatessen products. The meat used in the production of these products is mostly imported from the Netherlands, France, Denmark, and small part of it, is from domestic production. The process of production is adapted in order to follow the traditional way of drying and curing meat.
- Durable products - This assortment of durable products is similar as assortment of semi-durable products, but the process of its production is different, because the

process of drying for durable products is longer. The assortment of durable products is also divided into salami and sausages, and delicatessen products, and a traditional recipe for its production is also followed.

5.3.1.3. Human Potential and Employees

Today, the PIVAC company has 250 employees. In graph 9, an increasing trend of employment in this company can be observed in the period 1998 - 2003.

Graph 9. Number of employees in the PIVAC company



Source: Company's documentation

In a period of six years, the number of employees has doubled. This company only employs a workforce from local area of Vrgorac, which encourages the development of this part of Croatia. The majority of employees (80 percent) are high school educated. They are mostly men who are engaged in production, while women are employed in administration. All of PIVAC's employees have salaries above the Croatian average. Production workers have higher salaries, compared to workers employed in sales, due to harder working conditions.

PIVAC's employees are very loyal to the company, because it offers them possibility to work, and to be adequately paid. The geographical area, where PIVAC is situated, does not offer many employment possibilities, so employee loyalty is reasonable. But also, it is important to stress, that PIVAC considers people as one of its valuable resources, and gives great attention to their progress. Apart from this, the PIVAC family has lived in this geographical area for centuries, and region well-being and its development represent one of the motives for their work. This fact encourages the organisational culture of this company.

5.3.1.4. Financial Indicators

The business performance of the PIVAC company will be better clarified in the financial data presented in table 18.

Table 18: Some Financial Indicators of the PIVAC Company

(in EUR)

Indicator	2002.	2003.	Index 03/02
Total assets	22,725,784	32,303,645	1.42
Long-term assets	7,680,923	15,133,168	1.97
Current assets	15,044,861	17,170,477	1.14
Inventories	4,106,250	4,181,807	1.02
Accounts receivable	8,504,824	10,275,655	1.21
Total equity	12,396,754	14,901,093	1.20
Long-term liability	1,014,235	3,227,040	3.18
Current liability	9,314,796	14,175,513	1.52
Accounts payable	1,817,533	4,276,528	2.35
Total revenues	45,369,699	52,055,385	1.15
Revenues from export	417,537	52,091	0.12
Total expenses	42,557,265	49,224,636	1.16
Profit	2,248,642	2,436,219	1.08

Source: FINA

In 2003, the financial indicators of this company had a significant increase, except for revenues from export, which have decreased by 88 percent. The hugest increase is evident in long-term liability by 218 percent, and in long-term assets by 97 percent. This is evidence of the investments in modernised production plants, which PIVAC company opened in June 2003 (see section 5.3.1.1.).

A more precise picture of PIVAC's business activities can be obtained from table 19, where the financial ratios of this company are presented.

Table 19: Financial Ratios for the PIVAC Company

Ratio	2002.	2003.
Current ratio	1.62	1.21
Days outstanding (DSO)	64	72
Total assets turnover ratio	2.00	1.61
Debt ratio (in %)	45.45	53.87
Debt, in number of years	2.00	3.00
ROA	9.89	7.54
ROE	18.14	16.35
Revenue per employee (in EUR)	181,478.80	208,221.54
Profit per employee (in EUR)	8,994.57	9,744.88

The current ratio is calculated by dividing current assets by current liabilities. For PIVAC, in 2003, this ratio is at a lower level than the year before, and it is 1.21. The general recommendation is that it has to be at least 1.5. So, this means that in 2003, this company had liquidity problems, but they will be diminished, because of the developing distribution network.

Days sales outstanding are 64 days in 2002, and 72 days in 2003. This means that, in 2003, PIVAC needed to wait 72 days after making a sale, before it received payment. The industry average for 2003 is 62 days, which means that PIVAC have problems concerning payments.

The total assets turnover ratio is calculated by dividing sales by total assets. For the PIVAC company, in 2003, it was 1.61, and means that for 1 EUR of invested assets, the generation of sales was 1.61 EUR. Comparing this number with industry average, which is 1.42, the conclusion is that PIVAC's generation of sales is above industry average, and at a sufficient level.

The debt ratio is calculated by dividing total debt by total assets, and it measures the percentage of funds provided by creditors. For PIVAC, in 2002, this ratio was 45.45 percent, and in 2003, it was 53.67 percent, which means that this company has some debt, but mainly short term. This could be also explained by new investments conducted in 2002 and 2003.

The ROA - return on total assets, is calculated dividing net income (profit) by total assets, and multiplying by 100. For medium sized enterprises in Croatia, the ROA in 2003 was 3.51 percent, and for PIVAC, it was 7.54 percent, and this is a very satisfactory level.

The return on common equity - ROE, is calculated by dividing net income (profit) by common equity, and multiplying by 100. In 2003, for medium sized enterprises in Croatia, it is 8.3 percent, and for PIVAC, it is 16.35 percent. The average annual interest rate on deposits for a period of 12 months (2003) in Croatia is 5.56 percent, so the investments in company PIVAC could be considered as highly profitable.

Given all these financial indicators and ratios, a brief conclusion can be reached. All financial ratios of this company are at a sufficient level, except for liquidity ratios (current ratio and DSO), which can be evidence of liquidity problems. Beside this, the debt ratio shows that some of the debt of this company, connected to liquidity problems, could cause difficulties. The positive fact is that debt is short term, so the company could solve this problem very quickly by sufficiently generating profits, and further development of the distribution network. It should be pointed out, that according to its ROA and ROE, as well as to its profit per employee, PIVAC is, at this moment, a very profitable company.

5.3.2. Tools for Strategy Formulation

The strategy formulation process is equipped with many tools and methods. Some of them, which are explained further in the text, illustrate the position of the PIVAC company, and offer support in the development of adequate strategies for the observed company.

5.3.2.1. Porter's Model of Competitive Analysis

In strategic decision-making, an excellent example of analysing, adapting to and shaping the environment is Porter's model (Bateman and Zeithaml, 1993, p. 71). This model is, in this master’s thesis, used again, this time for the competitive analysis of the PIVAC company.

Threats of new entrants to PIVAC are possible, although the barriers to entry are high. These barriers could be observed through:

- Economies of scale, which, in the case of PIVAC, are present.
- Product differentiation, which, in the case of PIVAC, is evident.
- Access to distribution channels, could be observed as low in the industry as whole, but in the case of PIVAC, the situation is different, because it has its own distribution outlets, and this forward integration gives it an advantage over other competitors, especially new ones.
- Capital requirements for new entrants are high, because huge investments are needed to start production.
- There are established companies which have performed business in this industry for a long time. They represent strong competition for PIVAC, and especially for new companies, who want to penetrate the market.
- Legislation, which will be topical with access to the EU, will influence the increase of barriers regarding entrance to this industry.
- With access to the EU, dutiable protection will be abandoned, and the entrance of foreign meat producers will be free.

In the case of PIVAC, the bargaining power of suppliers is present, but not so high. PIVAC's suppliers can be divided into domestic and foreign suppliers. Domestic suppliers provide the company with raw material, energy and capital. They are not so well organised, behind in technology, and they cover only 40 percent of market needs. On the other hand, foreign suppliers provide this company with raw materials, know-how and technology. The most important of PIVAC's suppliers are: DUMECO (Netherlands), SOCOPA (France), DANISH CROWN (Denmark) and from Croatia: IREKS AROMA, GASTROMARKT, etc. The fact is that there are many potential suppliers, and switching costs from one supplier to another is low. Besides this, PIVAC has long-term relations with their best suppliers. The other advantage to this company, concerning suppliers, is backward integration, which means that PIVAC partially provides raw material by itself.

The bargaining power of buyers is present, but there are many buyers, and no one is so powerful that it is able to determine the majority of demand. But, on the other hand, it is important to point out that buyers are price sensitive, and they buy lower priced products. For this reason, they could easily turn to other products, especially those imported from Hungary or Italy. In this context, PIVAC wants to create awareness of the quality and benefits of the traditional products, which it produces, and at the same time, its products are lower in price compared with the competition.

Threats of substitute products generally exist, if there are alternative products with lower prices, or better performance parameters for the same purpose. They could potentially attract a significant proportion of market volume, and hence reduce the potential sales volume for existing players. In the case of PIVAC, the substitution of needs is not possible, as it is hard to substitute for example salami. Of course, an extreme situation is possible, where consumers substitute meat with vegetarian food. On the other hand, PIVAC products may be substituted by similar competitive products, which can have lower prices, but similar characteristics and tastes. In this context, the threats of substitute products can be characterised as high.

The threat of competitive rivalry is high. The meat industry in Croatia is, at the moment, in the restructuring phase, and the competition should be observed from different aspects such as: product range, region, company size, company background, management, etc. But, the main characteristic of Croatian meat industry is the existence of high competition among large producers. Some of them are Gavrilović, Danica, Sljeme, and many smaller ones. They are mostly strong companies, with a long history, well known brand name and large resources. Besides this, although today some State protection of domestic industry is present, there are many imported meat products, mainly lower priced, and in a situation where price elasticity is high, this is a crucial threat for PIVAC, and it stimulates competition even more. Entry to the EU will be an additional influence in this direction, because then foreign competition will be stronger.

5.3.2.2. SWOT Analysis

Elements of SWOT analysis for the PIVAC company are defined on the basis of direct observation and discussion with management. Strengths and weaknesses are presented in table 20, while opportunities and threats are presented in table 21.

Table 20: Strengths and Weaknesses of the PIVAC Company

Potential Internal Strengths	Sign.	Relat.	Potential Internal Weaknesses	Sign.	Relat.
• Clear strategy identification	10	0.059	• Owner/manager barrier	7	0.14
• Implementation of European standards	9	0.053	• Geographical position	8	0.16
• Educated and proven management	7	0.041	• Lack of experts	8	0.16
• Diversification	5	0.029	• Authoritative leadership style	4	0.08
• Lower prices of products compared to competitors	9	0.053	• Debt and liquidity problems	7	0.14
• New technology	8	0.047			
• Management is highly involvement - Family business	8	0.047			
• High level of flexibility	4	0.024			
• Rapid growth rate	6	0.035			
• Strong team work	4	0.024			
• Constant improvements in brand name	7	0.041			
• Wide range of products	7	0.041			
• Traditional image of the products - production from traditional recipes	9	0.053			
• Very strong and developed distribution network (own shops...)	9	0.053			
• Access to economies of scale	9	0.053			
• Adequate natural conditions for durable products production	8	0.047			
• Great marketing success	5	0.029			
TOTAL		**0.729**	**TOTAL**		**0.68**

Table 21: Opportunities and Threats of the PIVAC Company

Potential External Opportunities	Sign.	Relat.	Potential External Threats	Sign.	Relat.
• Traditional products are observed as highly valuable by customers	10	0.2	• EU legislation	6	0.067
• Ability to serve additional customer groups or expand into new markets or segments - Possibility to export to foreign countries	10	0.2	• Strong competition	8	0,089
• Ability to transfer skills or technological know-how to new product or businesses	10	0.2	• Inefficient legal system in Croatia and high administration	5	0.056
• Integrating forward and backward	9	0.18	• High customer price elasticity	7	0.078
• Access to EU funds	7	0.14	• Entry of lower-cost foreign competitors - after entry to EU	9	0.100
			• Large scale of substitute products	8	0.089
			• Disloyal competition	8	0.089
			• Exchange rate - appreciating domestic currency	5	0.056
			• Insufficient State incentives	4	0.044
TOTAL		**0.92**	**TOTAL**		**0.667**

As it can be seen in tables 20 and 21, each strength, weakness, opportunity or a threat, has its own determinate significance. The significance is rated from 1 to 10, and presents the meaning or importance of each element compared to others.

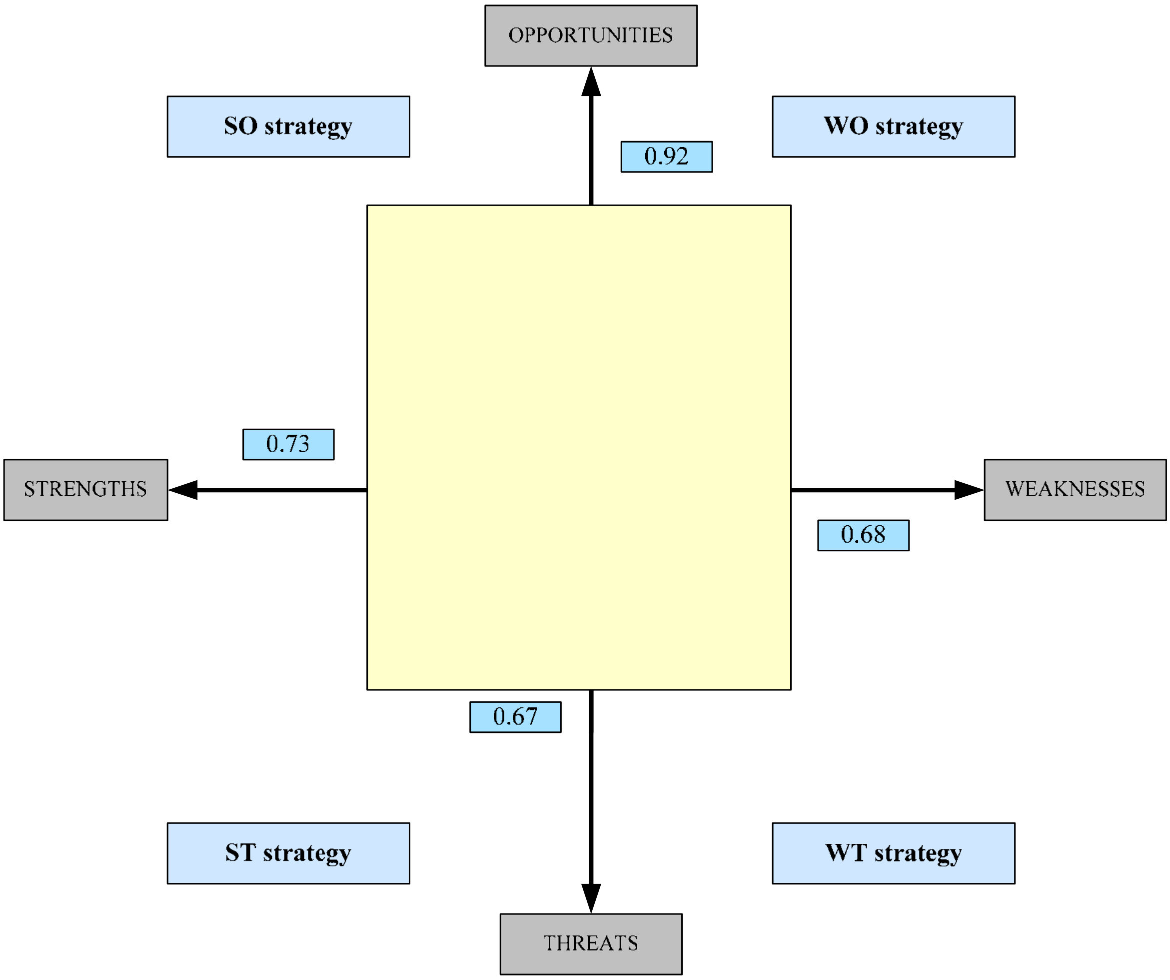
In order to obtain a more precise and realistic picture, the relative measure is calculated by dividing the significance of each element, with the sum of the maximum possible significance of all elements. Then these values are summarised, and presented in an adapted graph.

Figure 16 on the page 97 represents the strategies' polygon, and PIVAC's position regarding the strategies it can apply.

The strategies' polygon has four quadrants, which represent four possible strategies. The yellow area presents the position of the PIVAC company. This position determines the sum of relative measures of each SWOT variable.

From figure 16, it can be observed that PIVAC's relevant strategy is the SO strategy, which means that this company needs to use its strengths to take advantage of opportunities. This strategy offers many positive options for further growth. In addition, the WO strategy is also relevant for this company, which means that PIVAC should attempt to take advantage of opportunities by overcoming weaknesses. The conclusion is that this company has a good strategic position, and it should exploit it, in the direction of further development.

Figure 16: PIVAC's Strategies' Polygon



5.3.2.3. PIVAC's BCG matrix

The business units, which are presented in PIVAC's BCG matrix, are determined by the organisational structure of this company, which is presented in figure 15 on the page 91. The general steps, which are defined in the case of the SMS company, are conducted in order to formulate PIVAC's BCG matrix. This matrix is represented in figure 17 on the page 98.

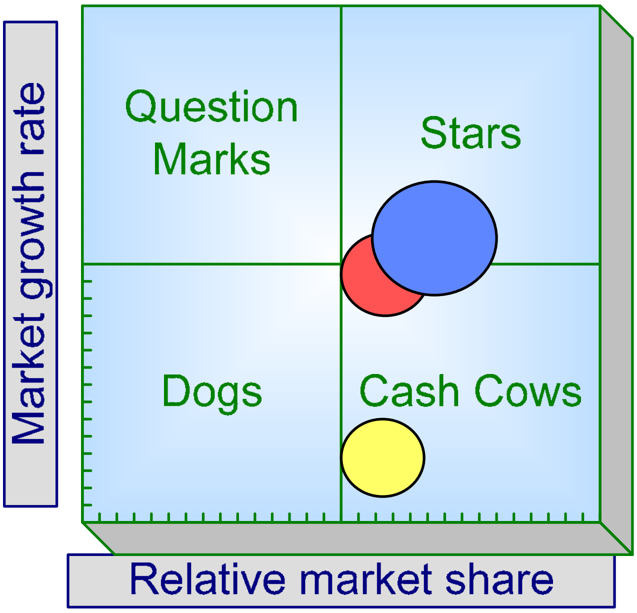
Each product assortment is one business unit, and is represented by a circle. The size of the circles is determined by total sales.

The yellow circle represents fresh meat as one of PIVAC's range of products. It is positioned in the quadrant called "Cash Cows", and it has low market growth rate, and a high market share. This product has been in PIVAC's business from the beginning of its existence and it offers sufficient profit generation, although it is not as big compared to others. The assortment of fresh meat is characterised by high profit, and it provides the possibility of using its extra funds to support other business units.

The red circle symbolises durable products. This group of products has increased market growth rate, and a relatively high market share. Durable products, in PIVAC's BCG matrix, are positioned on the border between "Cash Cows" and "Stars", which means that this business unit has a high generation of cash, and has some growth opportunities. Its cash generation should be notable for other business units.

Pretty much the same thing is with semi-durable products, which are represented by blue circles in the BCG matrix. The semi-durable products represent the largest business unit of this company, because its sales generation is the highest. They have high market growth rate and a high market share. Because of this fact, their competitive position should be encouraged by a strong marketing campaign.

Figure 17: PIVAC's BCG Matrix



The conclusion is that PIVAC has well positioned business units, with sufficient cash generation and growth potential. Business units could support each other, and because of this, PIVAC should consider the introduction of a new range of products.

5.3.3. Meaning and Implementation of Growth Strategies

The PIVAC company is on the way to growth and development. The fact which evidences this statement is that the number of employees in this company, in 2003 compared to 2002 has increased by 67 percent.

This company was established forty years ago, but its fast growth is present in the last ten years, with a tendency of further expansion. PIVAC is a family owned company, and what is important, family managed (three brothers, and the oldest brother's son are at the top of the company). They all consider growth as their goal, and all do their best in order to achieve their mission.

PIVAC competes with large, recognized, and well-equipped companies in this area, and every day it becomes a serious threat to them. That is the result of their strong vision, clearly defined goals, persistent work and commitment to the company, and to the family.

The strategy identification is one of the main strengths of this company, and in that context, the growth strategies determination and implementation are significant. The relevant growth strategies for this company are: Concentration strategy (product development and market development), Vertical integration (backward and forward), and Diversification (conglomerate).

Concentration strategy means that this company focuses on one product or small number of closely related products. PIVAC started as a small butchery, and its only product was fresh meat. Over time, and by major investments, the Pivac family developed its business, and extended it to new related products, such as semi-durable and durable salami and sausages, and delicatessen products. These products are similar; the only differentiation results from the type of meat used in their production, the quantity of salt and other spices, and variety of additions, such as cheese, olives, etc. All these products are distributed by the same distribution channels and under the same brand name.

The PIVAC company is very successful in the building and development of its brand name. Evidence of this is the fact that it got a silver medal in an international contest in Portland 2004, in the category of Logo/Trademark-Consumer. This company has built its reputation and brand name on the basis of the traditional way of production, which is recognized as high quality, and nutritionally acceptable. Beside this, PIVAC pays a lot of attention to the prices of its products, and tries to offer products of at reasonable prices. In this way, it is making an effort to cut costs and to achieve economies of scale.

PIVAC's concentration on product development strategy is major. In order to satisfy many different customers they develop many products, for example, the category of semi-durable products consists of 71 different salami, sausages and delicatessen products, while durable products include 27 different durable meat products. PIVAC has developed many of its products to satisfy the different tastes of customers, and to offer high quality, which customers will recognise. By this strategy, PIVAC has achieved some advantages: obtained knowledge and resources, which have been used for additional progress, at no extra cost. The company concentrates on things which it performs well, and no significant additional resources are demanded.

Besides the product development strategy, PIVAC has applied another approach of concentration strategy - market development. Splitsko-dalmatinska County was PIVAC's initial market, but very fast, it has expanded to other Croatian counties, and to Bosnia and Herzegovina. That was a difficult job, because in Croatia, there are some large and well-known companies, who have long-term relations with retail traders, and to enter this market was extremely hard for a new company, such as PIVAC.

So, in order to obtain its market share and accessibility of its products, PIVAC needed to find its own way. It has established and developed 9 wholesale centres, which cover all parts of Croatia, and 26 retail units, which are by now, mostly situated in the southern parts of Croatia.

The building of its own distribution network represents another type of growth strategy called forward integration. By this, PIVAC has the opportunity to control its sales, and to eliminate costs regarding inventory build-ups, and production slowdowns. The company's plan is to continue the expansion of the distribution network, by opening retail and wholesale outlets throughout Croatia, and to create a network of 45 retail and wholesale distribution centres.

Side by side to forward integration, PIVAC employs another type of vertical integration - backward integration. Backward integration moves an organisation into supplying some, or all of the products used in production of its products. In this context, in 1997, PIVAC became the majority owner of one farm in the northern part of Croatia. It has invested in its renovation and modernisation, especially in the renovation of the slaughterhouse and cattle stock. Although presently, the majority of raw materials used in PIVAC’s production is imported from abroad, the goal is to produce some of its own raw material of determinate quality, so that the final products would be first-class quality products. But, in the meat industry not all parts of cows or pigs are used for production. There are many parts of cattle, which can not be used and they should be thrown away, which is not efficient. So, the breeding of all types of cattle is not a good economic decision, and PIVAC will always purchase some raw materials from its suppliers.

In order to grow, and due to the geographical position of the company and knowledge of tourism, in 1997 PIVAC bought Hotel Miramare, and in 2002 it bought Hotel Biokovo. These investments in hotels represent PIVAC's implementation of unrelated or conglomerate diversification. PIVAC considers investments in tourism as attractive, valuable and prospective for two reasons. The first is the fact that one of the main strategies of Croatia is to build its competitive advantages in tourism, and to become a recognizable tourist destination. In this context, PIVAC considers activities in tourism as highly potential business ones. The second reason lies in the present efforts of this company, which is to develop a strong distribution network. In this direction, PIVAC bought the previously mentioned hotels, in order to use them, as outlets for the placement of its products.

These hotels are separate companies, and officially do not represent part of the PIVAC company, and they have not yet brought significant benefits, because they are in the process of reconstruction and renovation. Hotel Miramare was pulled down and in its place a new hotel is being built, and hotel Biokovo is in the process of renovation. Very soon these hotels will be equipped and ready for future seasons.

The usage of differentiation strategy offers the possibility of dispersing risk, to accelerate the generation of cash and to take advantage of attractive growth opportunities, which exist in tourism at the moment in Croatia.

Although diversification applied in the case of PIVAC is not a powerful strategy in the way of presenting benefits for this company, this is an initial step in dispersing risk, and it represents future prospects and opportunity in the company's future development and growth. So, through diversification, PIVAC diminishes the main disadvantage of concentric strategy, which is its main growth strategy, and that reduces risk.

Generally, there are two ways of implementing growth strategies: internal and external growth. Internal growth means that the company is expanding in its current market share, its markets, or its products, through the use of internal resources. External growth is when a company expands by acquisitions, mergers or joint ventures.

In the case of PIVAC, it is evident that both internal and external growth is taking place. Internal growth considers the application of concentration strategy and vertical integration, and on the other hand, external growth concerns the acquisition of hotels and the PPK Karlovac Meat Industry.

Namely, the PPK Karlovac Meat Industry company had a significant market share in the early 90s, and represented one of PIVAC's competitors. But this company has had some business difficulties, and PIVAC has capitalised on that situation, and offered them the possibility to continue working. So in 2002/3, it became PPK's single shareholder.

This acquisition of PPK Karlovac can be classified as horizontal integration, which is one type of concentration strategy. This strategy occurs when a company adds one or more business that produces similar products or services, which are operating at the same stage in the product-marketing chain.

The acquisitions of hotels and the PPK company represent PIVAC's valuable strategic choice for several reasons:

- Concerning the process of privatisation and restructuring in Croatia, there is the fact that the price PIVAC paid for these hotels was smaller than their value.
- These hotels have significant future potential, so PIVAC considers these investments as potentially profitable.
- The reason for PPK's acquisition was to take advantage of its developed distribution channels and market share.
- By PPK's acquisition PIVAC makes it possible to rapidly increase output capacity.

In its process of growth and development PIVAC has followed the usual path confirmed by many companies and proven by theory.

Although this company has been present in the market for over sixty years, its growth started in the nineties, with the new economic conditions in Croatia, which stimulated entrepreneurship and a market oriented economy. These new conditions provided PIVAC with the new experience of rapid growth and development.

In its business practice, it relies on strong strategy, qualified management and family unity. In a period of ten years, PIVAC has become a strong medium sized company with a tendency of further growth. Today in Croatia, this company is now a significant competitor to the strong, large and well-known company GAVRILOVIĆ.

To summarise PIVAC's development, it should be pointed out that, firstly, it implements the concentration strategy in order to gain market share and to promote its brand name. Then it employs both types of vertical integration, backward and forward, which demand large investments, and finally, it diversifies into services sector.

All of these strategies have been utilised in an efficient way in only ten years, and this is a reflection of the fact that a well defined strategy, clear goals and adequate management can build a strong and healthy company with significant future prospects.

5.3.4. Critical Overview of the PIVAC Company and its Future Perspective

The main characteristic of the PIVAC company, and at the same time, its main strength, is clear strategy identification. In all the years of its being, the Pivac family has known what they want to be, and what kind of company they want to have. This family has been synonymous with all aspects and changes in the meat industry for decades, and has invested all its knowledge and experience, and of course capital, into the company. The well being of the company represents the most important thing in their life.

Thus, the competitive advantages of this company are undoubtedly a defined strategic approach and absolute dedication of the company's management to the company's goals. These factors have influenced PIVAC's position in the market. It is a strong medium sized company, with a tendency of further growth and development. Customers consider PIVAC's products as high quality ones and middle priced ones, and this is one of PIVAC's goals - to offer as much quality as it can, at a reasonable price. Only with this strategy can PIVAC be competitive.

This company wants to be close to its customers. In that way, it pays a lot of attention to the application of European standards, such as ISO 9001 and HACCP system, which provide improvements in organisation, and the advancement of all aspects of business activities. Since, PIVAC satisfies EU standards, it gets the "European number for export", which allows export to the EU. The management of the company considers that they can compete with their durable products, which are high quality products and have lower prices than those of potential competitors.

In the future, they intend to additionally improve the production process by the implementation of 20 keys of Iwao Kobayashi. This will be applied with the aim of reducing all unnecessary costs, but also to protect the environment.

Moreover, further efforts of PIVAC are related to the marketing position of this company. Although, PIVAC has achieved certain marketing success, the management considers that company's main future objective is to continue with the development of its strong brand name. That is, one of the crucial advantages of PIVAC's major competitor, the GAVRILOVIĆ company. PIVAC considers the distribution network as the fundamental precondition, which is needed to advance, when the marketing campaign and other marketing activities are performed. Its object is to build a brand name of high quality traditional products, adapted to different customer needs, and at a middle price range; and it will engage all possible marketing tools in this direction.

In short, it is obvious that PIVAC's strategic behaviour is oriented to the imitation of its main competitor, the GAVRILOVIĆ company. The attempt to achieve its position and to take its place on the market is explicitly defined in PIVAC's mission, and it is obvious from its strategies. To copy somebody's strategic behaviour can bring some positive results in terms of market share, profits, etc., but if another firm has its own strategies and invests effort in sustaining its competitive advantages, then its competitors should find their own way to overcome this. Imitation alone will not bring successful results. It is helpful when a company starts with production, and when it explores its market position, but when it gets close to its competitors, in order to overcome this, something new and serious should exposed and used. If PIVAC wants to surpass GAVRILOVIĆ, it should develop its own competitive advantage, which will differentiate it from GAVRILOVIĆ, and offer something new to the customers. To beat GAVRILOVIĆ on the basis of quality and brand name is not possible at this moment, because of its main competitive advantage, so PIVAC orients itself towards lower prices, but that is not enough. PIVAC should introduce some new products, which do not exist in the market at the moment. It should impress the customers and attract their attention. At this moment PIVAC could overcome GAVRILOVIĆ only if this company gets into serious problems, which is not impossible in these turbulent market conditions.

Generally, there are two threats, which can slow down PIVAC's future growth and development. The first one is access to the EU, which implies the entry of new foreign products, mostly lower priced, thereby the appearance of strong competition. Another possible threat is the high debt, which this company is faced with. But, it is important to point out that these threats are not unbridgeable for the PIVAC company.

6. CROSS CASE ANALYSIS, DISCUSSION AND FINDINGS

In this part of the master's thesis, firstly, a short comparison of the two observed companies will be provided. As is obvious from their analysis, these companies are growing medium sized enterprises, and in the following text, the emphasis will be on their general similarities and differences, and growth strategies implementation.

Furthermore, a comparison with the presented theoretical framework will be offered, with a special analysis (acceptance or rejection) of definite hypotheses.

Finally, a discussion on medium sized enterprises growth, in general, will be conducted, and some Croatian specifics will be pointed out and examined.

6.1. General Similarities and Differences in Observed Companies

Significant development of both companies (SMS and PIVAC) started after the economic changes in Croatia. Although PIVAC was established as a butcher's trade many years ago, its significant business development started after 1990. Both companies survived a period of war in this area, and continued to exist in a turbulent and politically unstable environment. In these conditions, they invested efforts in the direction of growth and development, and from small entrepreneur enterprises they have become strong medium sized companies with strong visions and determined goals.

Although these companies are not similar, and cannot be precisely comparable, because their production is different, even though they belong to the food industry, some similarities are evident in the following facts:

- Both companies have experienced rapid growth since 1990.
- They produce traditional Dalmatian products.
- Number of employees is similar;
  SMS has 207 employees and PIVAC has 250 employees.
- Both companies have functional organisation structure.
- Management of both companies is in the hands of owners.
- Both companies are in debt and have liquidity problems, although PIVAC is in a better position related to these issues.
- Both companies are niche players.

The main difference between these two companies, which originates from being in different industries, is evident from financial indicators. In terms of profitability indicators, the PIVAC company is much more profitable than SMS, with a profit per employee of 8,744.88 EUR in 2003, while in SMS, the profit per employee was 396.47 EUR. The high ROA and ROE, calculated for PIVAC also suggests this high profit. This is to be expected, because the meat industry is more profitable than the production of vegetables, fruits and related products. In this context, PIVAC has three times greater total assets than SMS, and six times greater total revenues and total expenses. On the other hand, one more financial indicator determines the differences between these two companies. Namely, SMS's share of revenues from export in 2003 was 29 percent of total revenue, and in PIVAC, this share was only 0.1 percent. This can be explained by the general tendency of SMS to export about 50 percent of its production, while PIVAC wants to have a significant and high domestic market share.

To be more clear and comprehensive in the comparison of these two companies, great attention should be placed on their evaluation on the basis of tools which are used, both in literature and practice, for strategy formulation. It is difficult to define precisely, which company has the superior competitive position, stronger strengths, and better opportunities, and which business units are better positioned inside of the company. However, in the following text effort is invested in that direction.

Porter's model of competitive analysis shows the strong competitive position of both companies. Threats of new entrants are possible in both cases, but both companies have developed competitive advantages, which protect them from new competition. Bargaining power of suppliers is also present, but in order to eliminate the influence of suppliers, these companies integrate backward, or build up strong relationships with main suppliers. Because of the fact that SMS and PIVAC offer their products to many customers, the bargaining power of buyers cannot be observed as a significant threat. But, in this context, both companies should consider the prices of their products and distribution channels, as factors which influence buyers. The threat of substitute products is more significant in the case of SMS, because there are many substitutes for olives, fig jams, etc. In the case of PIVAC, substitute products are mostly vegetarian products, which in general, do not represent a strong threat to PIVAC. But on the other hand, there is a wide assortment of similar competitive products, and they represent a strong threat. The factor which cannot be avoided is competition. The competition of SMS and PIVAC are mostly large domestic companies, and foreign products offered through foreign retail stores. It could be observed that PIVAC faces stronger competition than SMS. Its stronger competitors are well-established domestic companies with strong brand names, which offer similar products as PIVAC. In the case of SMS, no one competitor offers the exact same products as SMS, which makes this company better positioned on the market, but not more profitable.

The many details and information, which are discovered on the basis of Porter's model, are more thoroughly explained by a SWOT analysis. On the basis of strategies polygons it could be noted that PIVAC has a better position regarding the strengths it possesses, and possible opportunities. It should focus on using its strengths in order to take advantage of opportunities, while SMS mostly has to use its strengths in order to avoid threats. It has also been found that both companies have the same weakness (high debt), but the significance of the weakness is greater in the case of SMS. Both companies are also faced with the same opportunity - of expanding in other markets. Weaknesses and opportunities are consequences of the economic situation in Croatia.

The position of business units in the observed companies could be perceived as adequate, but both companies have some shortcomings in that positioning. The disadvantage of SMS's business unit position is the existence of a business unit, which belong to "Dogs", and it should be eliminated, because it has a low market share and does not have the opportunity for growth. On the other hand, the main disadvantage of PIVAC's business matrix is the extinction of business units, which are positioned as "Question Marks". It is important to achieve a balance of BCG matrix in a way that business units could support each other.

In comparison to the growth strategies applied in the observed companies, it should be pointed out that both companies give a lot of consideration to the formulation and implementation of growth strategies and their evaluation shows that they pursue similar growth strategies.

In this context, PIVAC employs all of the theoretically explained growth strategies, and SMS exploits most of them, except for horizontal integration, conglomerate diversification and forward integration. But, in the future the application of these strategies is not excluded.

It is interesting to explain the circumstances related to SMS, which will clarify why this company does not employ the above mentioned growth strategies.

The reason why it does not apply horizontal integration, is the fact that in Croatia, there is no company which produces only olives or olive oil, except SMS and its competitor TRENTON, which supplies only the local market, and which is in fact, SMS's imitator. Other producers of olives are either cooperatives, which unite many small single producers of olives, or big companies, which produce a wide range of vegetable products. The application of horizontal integration related to these companies is not possible.

The reason why SMS does not apply forward integration lies in the fact that its profit generation does not permit further investments, which forward integration infallibly demands. But in the future, with the enlargement of its product range this could be imperative for this company, because it could eliminate liquidity problems, which affect this company.

On the other hand, conglomerate integration, at this moment, according to the words of SMS's manager Mr. Mladinić, is not attractive to this company, and it is not associated with its vision.

6.2. Comparison of Observed Companies with Developed Model and Definite Hypotheses

The case study analysis shows that both companies can be observed under the developed model in section 4. The growth strategies which are pursued, and time when they are employed are in correlation with the developed model.

Both companies started as small entrepreneur enterprises, and serve a market niche and a tiny local market. In their early years, they had limited product lines, but they tried to convince customers of the quality of their products. In this process they have emphasized the traditional component of their products as highly valuable, and on the basis of this they have tried to build their competitive advantages. They were focused on satisfying different customer preferences, and on the adaptation of its products according to those preferences.

With clearly defined strategy options, and effort oriented toward competitive advantages development, they have become significant market players. All profits were reinvested and new debts were taken for financing further development.

When these companies had, to some extent, established a position in the market, and when possibilities for financing were provided, growth strategies were pursued.

Firstly, the product lines were extended to meet variations in customer wants, and to capture sales opportunities, the role of R&D function in both companies was significant. After that, geographical expansion followed. The natural sequence of geographical expansion proceeded from local to regional to national to international markets. In the context of international expansion, SMS has better results.

Very soon the need to eliminate suppliers and the need to be close to customers became present. So, this required vertical integration. Both companies pursue backward integration, and PIVAC is engaged in forward integration too.

The benefits of differentiation were wanted, because the growth rate of present product lines started to decrease, so concentric differentiation was conducted in both companies. PIVAC went further and pursued conglomerate integration as well.

And finally, when some product lines do not bring satisfactory benefits they become abandoned. This is the case for SMS, which is considering abandoning one of its product lines.

On the basis of developed hypotheses presented in section 4, the research results can be summarized and explained.

The first group of hypotheses regarding the general characteristics of medium sized enterprises (H1-H4) is accepted, which means the following:

In both companies, there is a close relationship between the entrepreneur and employees (H1). The managers are at the same time the owners of the companies, who were, at the beginning of companies' existence, the entrepreneurs. In both companies, they have a strong influence on employees; they inspire them with their visions and goals. In SMS, all employees consider their owner/manager as a highly charismatic person, and they have a strong feeling of loyalty. On the other hand, in PIVAC company, the Pivac family motivates their employees with their unity and harmony. This all contributes to a strong organizational culture in both companies. Accordingly, in both companies the owners/ managers strong influence on the business decision-making process.

Both companies focus themselves in the market as niche producers (H2). As new market players, both companies at the beginning of their existence had to find their own piece of the market, so they had to find niche for the placement of traditional products. The products, which they offer, were present on the market as industrial products without a sense of tradition. Both companies built their competitive advantages on the traditional attributes of those products, and developed a new market niche.

They finance their growth with retained earnings or by bank loans (H3). The fact is that medium sized enterprises finance their growth by retained earnings, but this capital is not sufficient, so they also use bank loans. Both companies use relationship based bank loans, which are the only way to avoid the problem of information asymmetry. Regarding this, both companies are in debt. SMS is in a poorer position related with debt, because its debt is higher, over a long period, and its profit generation is significantly lower.

Both companies have a similar organizational structure and operational systems (H4). From the organizational charts of both companies, it is obvious that they have a simple organizational structure, which is functional, and groups jobs according to similar economic activities, such as finance, production, marketing, etc., and it is convenient for companies of this size. Accordingly, the organisational systems are simple; a lot of attention is placed on cost saving, and on the satisfaction of the principle of the right person for the job, in order to eliminate any kind of cost and employee duplication.

Hypothesis H5 is also accepted, which means that the observed companies grow on the basis of adequate and sufficient resources, which include human potential, finance capital, and R&D base. These resources are used for creating the strong and sustainable competitive advantages, which with clearly defined growth strategies provide company development. In that context, the R&D function is crucial, because the only way to satisfy the market niche is to provide it with some extra quality, special tastes and innovation of any kind. For strong R&D function, employees are a fundamental resource, and all of that together, with adequate financial opportunities, provide an expansion perspective for medium sized enterprises.

And finally, a hypothesis about specific Croatian obstacles to medium sized enterprise growth (H6) is also accepted. From the interview of the managers of both companies, the same thing is discovered. The inefficient legal and regulatory systems obstruct any business activities, and slow down the process of growth. In their expansion on the basis of backward integration, SMS needed to abandon some land, which it wanted for olive planting, because the bureaucracy was too difficult and the legal aspects were so complicated and demanded too much time for a few simple registrations. PIVAC's experience is pretty much the same. The manager says that it is absurd that, when financial resources are obtained, some regulatory problems could slow down or even stop the planned business activities, which inevitably occurs.

6.3. Final Discussion on Medium Sized Enterprise Growth, in General, and in Croatia

Medium sized enterprises are companies, which cross the first step of growth that includes the change from a small company to a medium sized company. In this process they should be aware of the necessity and importance of the possession of adequate and strong resources, and also, they suffer from different obstacles and problems, but finally experience the success of growth. The question is, can medium sized enterprises easily become large enterprises, and which conditions should exist in order to support and stimulate the achievement of that growth?

The literature deals with the relationship between the size and growth, and there are inconsistent thoughts on this question. Some authors consider that small companies grow more quickly than larger ones, because they are uncertain about their cost efficient scale and they want to reach it and are very active in this direction; small companies are more flexible and adaptable, and can easily turn towards profitable opportunities; in many countries the State supports the growth of small companies with different incentives, etc (Hart, 2000, p. 229; Jovanović, 1982, p. 649; Hart, 2000, p. 229).

Contrary to these arguments, Gibrat's law of proportionate growth states that the probability of a proportionate increase in firm size over an interval of time is the same for all firms, regardless of their size at the beginning of the period (Prašnikar, 2005).

Medium sized enterprises are a category, which generally, on the basis of achieved size and business functions development, could have a tendency of further growth, and in this direction, the determination of growth as a strategic goal should be formed.

On the other hand, not all medium sized enterprises grow, because they do not have this strategic orientation, or there are certain circumstances which limit their expansion, such as strong competition, small market niche, limited resources, etc.

The reasons for establishing the strategic goal of company growth can be different; a dynamic environment demands company growth as a means of survival; hard competition and price wars force cost reduction and achievement of the economies of scale; the owner/manager could have strong ambitions of having a large company; growing companies can cover up mistakes and inefficiencies more easily than stable ones; growing flow of revenue can create a large amount of unused resources; in growing companies, there are more opportunities for employees such as, advancement, promotion and interesting jobs; growing companies tend to be seen as "winners", or "on the move" by the marketplace and by potential investors; they are also more difficult to acquire, etc.

In order to grow, medium sized enterprises should satisfy two essential conditions: they should possess adequate resources and they should pursue adequate growth strategies.

Resources are a crucial precondition for growth. Financial capital is the base of any kind of business activity, especially expansion. It could be from its own sources, but moreover financial capital exists in the manner of bank loans or capital of some other stakeholders. Human potential is another factor for growth. It could be observed as educated, creative and motivated employees, and capable management who is able to handle business activities in a proper and efficient way. In addition, one more element is crucial, and that is the R&D base, which includes innovation in products, process or in any other activity that can initiate and support the creation of competitive advantages, as the bases for company growth. These three preconditions should be managed and combined in an appropriate way, with all other business elements, in order to achieve growth.

Regarding resources there are often problems and obstacles concerning reaching sufficient and adequate resources. Financial resources are often deficient, and obstacles to getting additional financial capital are regularly present. These obstacles include the high cost of credit, bank charges and fees, high collateral requirements and lack of outside equity, and some less frequent such as, overly long time to get a loan, and banking bureaucratic procedures. All these barriers include information asymmetries between lenders and borrowers (Bartlett et al., 2002, p. 24).

Besides these obstacles, which are common to all countries, financial barriers in Croatia are larger and deeper. They are firstly the consequence of the former political and economic system, and can be observed as underdevelopments of banking culture - clients regard bankers' requests for information as burdensome and unnecessary (Koford and Tschoegl, 1999, p. 123); underdevelopments of the legal system; weak development of real estate markets; the inefficiency of the court system; the issue of recommendation seems to be an important one in Croatian banking - "recommendation" from the right people can in fact decide the fate of the loan, and opens up a wide space for political influence within the lending process.

Croatian companies try to overcome all these barriers, by close relations with the banks through which money is deposited and payments made. In this way, a bank becomes a "house bank" and then getting a loan is much simpler.

Another obstacle to medium sized enterprises grow is managerial barrier. In most medium sized companies, owner and managerial or leading function are joined in the same person. The systematic and rapid accumulation of knowledge, in all the disciplines that have relevance to management, is a major phenomenon of our time. Managers should always be in touch with improvements, and should apply what they have learned. They should be effective contributors to their professions, strong mentors and collaborative team players, who value interdisciplinary decisions, active advocates for consensus and growth, and powerful leaders whose creative analysis and problem solving allow them to influence policy and decision making.

Croatian managers mostly are not capable of applying modern management in practice, because the control function of management is their priority. The lack of knowledge and experience, and risk aversion, present some barriers to their professionalism. This lack is usual in managers of medium sized enterprises in Croatia, and it is a consequence of transition; the different values used in the past economic system, an inappropriate privatisation process, and the generally inadequate education of managers especially entrepreneurs, who founded companies without experience or sufficient understanding of economic variables and relations. This is evident through failures in the strategic planning process, aversion to delegating authority, incapability in managing teamwork, lack of trust, poor communication skills, etc.

The solution to this unfavourable situation in Croatia is the engagement of young well-educated mangers with developed managerial skills, who are not burdened with the past system. The common situation for many Croatian medium sized companies is that the entrepreneur is the owner/manager, or the family is at the top on the company. But the role of the owner/manager needs to be changed as the business develops, and professional management should replace the entrepreneurs, because the characteristics of managers, who run the company in some growing stage, are quite different from the characteristics of entrepreneurs who established the company.

The financial and managerial obstacles are pretty much the same for medium sized companies in all developed countries, but Croatia has some specific obstacles, such as the unfavourable macroeconomic situation (highly indebted economy, unfavourable effects of the process of privatisation, low economic growth, high taxation and contributions on wages, which largely reflect the crisis in the pensions and health system, the ageing labour force, and the high level of benefits for war pensioners); the State concentrates on political issues rather than on economic ones (war consequences and reconstruction, relations with neighbours, cooperation with the Hague Tribunal); there is a high level of bureaucracy in the regulatory system; inefficiency in the judiciary and corruption.

Some of these specific Croatian barriers cannot be solved easily, but with high-quality State activity, and coordination with the economic sector, the solution to some of the problems could be initiated.

7. EXCECUTIVE SUMMARY AND CONCLUSIONS

Medium sized companies are too big to be small and too small to be big (Prašnikar, et al., 2003, p. 13). On the basis of their mixed features, some general characteristics of medium sized enterprises can be distinguished:

- Adaptability and short reaction time, as well as greater productivity in comparison to large enterprises.
- Personalized management.
- In terms of relationships with customers, medium sized enterprises have a great advantage comparing to large companies.
- Medium sized enterprises are highly motivated organizations, with a strong and stable organizational culture.
- Limitations in personnel resources are relevant in management and functional experts.
- Most medium sized enterprises are unlikely to be able to exert much influence on their market. They are usually price takers and face significant competition.
- They often have problems raising capital, and this can significantly constrain their choice of strategies.
- Medium sized enterprises can never produce the cheapest products as large enterprises can.

In some situations this characteristic can be a strength, and in others, can be a weakness. Firstly, it depends on the situation complexity.

Very often, one of the first medium sized enterprise long-term objective, or even vision, is their growth and development into a large company. Sometimes, it is their only way of survival in a turbulent environment, characterised by strong competition. To accomplish growth and development, medium sized enterprises should have adequate resources (human potential, finance capital, R&D), and pursue growth strategies.

In order to apply adequate growth strategies, it is important to analyse internal characteristics and the external conditions and factors, which influence business activities, and company position in the market. These analyses can be conducted by different scanning techniques and methods, such as PEST analysis, SWOT analysis, Porter's model, BCG matrix, etc. The results and findings from these analyses should be used for the selection of adequate strategies.

According to Byars, Rue and Zahra possible growth strategies are: concentration strategy, vertical integration and diversification. The main idea of concentration strategy is to focus on a single product/service, or on a small number of closely related products/services, and involves increasing sales, profits, or market share faster than in the past. Vertical integration is a growth strategy that involves extending an organization's present business in two possible directions. Forward integration moves the organization into distributing its own products or services, and on the other hand, backward integration moves an organization into supplying some or all of the products or services, used in producing its present products or services. Finally, the third type of growth strategy according to the authors mentioned above is diversification. It occurs when an organization moves into areas that are clearly differentiated from its current business (Byars, et al., 1996, p. 115). Medium sized enterprises are a category which can, on the basis of the achieved size and business functions development, in their right meaning, exploit growth strategies, as defined in the literature.

If we turn to medium sized enterprises in Croatia, it can be pointed out that, in 2003 medium enterprises in Croatia represented 3.8 percent of the total number of economic entities, they employed 19.9 percent of total workforce, generated 18.4 percent of total revenues, 16.0 percent of total profit and 25.5 percent of total loss (FINA, 2003, p. 17). In observing the efficiency of medium sized enterprises in Croatia, some findings can be summarised: the liquidity ratios (current ratio) and asset management ratios (total assets turnover ratio) are at an unsatisfactory level, so the problems concerning liquidity can be expected. Besides this, the generation of sales is not sufficient, given total asset investment, and medium sized enterprises are highly indebted. On the other hand, profitability ratios ROA and ROE show better performance and efficiency of medium sized enterprises and also of the national economy. Furthermore, it is a similar situation with revenue per employee, and profit per employee, which have increased in all years.

The empirical research of this thesis was directed at discovering a possible model of behaviour for medium sized enterprises in Croatia, concerning their development and growth into large companies with the main focus on the growth strategies they can apply.

To achieve this goal, two Croatian companies were selected, and a case study analysis was conducted. The first case concerns a company called SMS d.o.o. Split, and the other is PIVAC d.o.o. Vrgorac. In the presentation of these cases, each individual case study consists of a "whole" study in which convergent evidence is sought regarding the facts and conclusions for the case; then a cross case analysis was obtained and discussion and final findings are presented.

Both companies have experienced rapid growth since 1990. They produce traditional Dalmatian products and have a similar number of employees and functional organisational structure. The management of both companies is in the hands of owners, and both companies are in debt. The differences of these companies lie in fact that PIVAC is much more profitable than SMS, its debt is mainly short term, and its distribution network could eliminate present liquidity problems. On the other hand, SMS has greater exports.

In the comparison of growth strategies applied in the observed companies, it should be pointed out that both companies give a lot of consideration to the formulation and implementation of growth strategies and their evaluation shows that they pursue similar growth strategies.

According to the developed model of the possible behaviour of medium sized enterprises and related hypotheses, research results can be summarized.

In both companies, there is a close relationship between the entrepreneur and employees. Both companies focus themselves on the market as niche producers. They finance their growth with retained earnings or by bank loans. They have similar organizational structure and operational systems. The observed companies grow on the basis of adequate and sufficient resources, which include human potential, finance capital and R&D base. The inefficient legal and regulatory systems in Croatia seriously obstruct any business activities, and slow down the process of growth of medium sized companies.

After the conducting the literature overview and the empirical research on two growing Croatian medium sized companies, some knowledge about these relevant issues can be offered.

In order to grow, medium sized enterprises should satisfy two essential conditions: they should possess adequate resources and they should pursue adequate growth strategies.

Regarding resources, there are often problems and obstacles concerning reaching sufficient and adequate resources. Financial resources are often deficient and obstacles to getting additional financial capital are regularly present. Besides these obstacles, which are common to all countries, financial barriers in Croatia are larger and deeper. They are firstly the consequence of the former political and economic system, and can be observed as the underdevelopments in banking culture (Koford and Tschoegl, 1999, p. 123); underdevelopments in the legal system; the weak development of real estate markets; the inefficiency of the court system; the issue of recommendation which seems to be important in Croatian banking. Croatian companies try to overcome all these barriers, by close relationships with the banks through which money is deposited and all payments made. In this way a particular bank becomes a "house bank", and then getting a loan is much simpler.

Another obstacle to medium sized enterprise growth is the managerial barrier. Croatian managers are mostly not capable of applying modern management in practice, because the control function of management is their priority, and the lack of knowledge and experience, and risk aversion present some barriers to their professionalism. The solution to this unfavourable situation in Croatia is employment of young well-educated mangers, with developed managerial skills, who are not burdened with the past system.

For many Croatian medium sized companies, the common situation is that the entrepreneur is the owner/manager, or the family is at the top on the company. But the role of the owner/manager needs to be changed as the business develops, and professional management should replace the entrepreneurs, because the characteristics of managers, who run the company in its growing stage, are quite different from the characteristics of entrepreneurs who establish the company

Additionally, Croatia has some specific obstacles which constrain medium sized enterprise growth, such as the unfavourable macroeconomic situation (a highly indebted economy, unfavourable effects of process of privatisation, low economic growth, high taxation and contributions on wages, an ageing labour force); the State concentrates on political issues rather than on economic ones; there is a high level of bureaucracy in regulatory system; inefficiency of judiciary and corruption.

Some of these specific Croatian barriers cannot be solved easily, but with high-quality State activity and coordination with the economic sector, the solution to some of the problems could be initiated.

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