Donnie*

The Donnie GmbH Case Study

Reference Number 0002/2013

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*This is a hypothetical case scenario adapted from general market information. All characters and events herein described are fictitious.
**Introduction**

In the evening of a cold winter day in January 2012, Chris Mass, CEO of Donnie GmbH, uttered a frustrated sigh and watched his senior management team hurriedly leaving the conference room. It has been the third strategy meeting within two weeks now, but nevertheless, there has been no conclusion yet where the company should focus its marketing efforts and how it should invest its capital resources for door handle products in Austria and selected Eastern Europe countries. A clear marketing strategy was imperative before the general sales meeting next month. Especially the return on sales, which was one of the lowest within the industry, was a worry to Mr Mass. Lost in thought, he returned to his office and, as his assistant had already left, scheduled another board meeting for next Thursday by himself.

**The Door Fixtures and Door Handles Industry in Europe**

The door fixtures market consists of door accessories and complementary products. A "door" in this case is defined as a room/area enclosure or furniture related closures. Examples of such fixtures are door handles, cupboard handles, door bells, stoppers, escutcheons, espagnolettes, finger plates, hinges, peep hole frames, locks & bolts, dead bolts, number plate and flush pulls. Door fixtures are important in maintaining the unique and tactile quality of a room, a home or a building. Therefore, the functionality and purpose as well as the design and form of door fixtures are essential product characteristics.

The primary product in this industry is door handles. There are two main product differences. The first has to do with the design and form. There are door handles that are round in shape and open via a circular motion. These are generally referred to as doorknobs or "mortise knobs". Then, there are handles that are elongated in form and open via a downward or upward motion. "Levers on plates" are the "traditional" style of door handles in Europe. These have a rectangular base, which is attached to a surface. The newer types of door handles are called "levers on round rose" where the base is round or square. All three forms of door handles may or may not have a security mechanism, such as a key or an electronic release gadget.

The second category of product differentiation has to do with function. These are:

1.) Classical door handles
2.) Privacy lock door handles
3.) Door pull handles

Classical lever door handles require a key to lock and unlock the door or enclosure. In general, these are used for interior as well as for exterior doors. If the same style of lock is used several times, then all the doors concerned can be opened with one single key. This type of handle represents 50 percent of total industry Euro sales and is, thus, the most prominent form. Privacy lock door handles also constitute a very popular type of door handles and represent 30 percent of total industry sales. These indoor handles are primarily found on bathroom doors and can only be locked and unlocked from the inside. Thus, these are useful where privacy is required. The third type of door handles, namely door pull handles, is used when there is no need for a latch mechanism. Furthermore, it is
especially utilized for aesthetic reasons and, consequently, often has no specific function per se. This version is mostly used for closet doors that cannot be locked. Pull grips account for 20 percent of total industry Euro sales.

**Classical Lever Door Handles**

In general, the classical door handle industry is a maturing industry in Europe, although it is anticipated to increase in selected markets in Central and Eastern Europe ("CEE"). Industry sales by year-end 2011 were approximately €12.7 billion. According to industry experts, the CEE sales of keyed classical lever door handles are predicted to be over €1.48 billion in 2012. Classical lever grips are regarded to constitute an early maturing market in the CEE. However, industry analysts further point out that the average historical growth rates for Eastern Europe alone from 2003 to 2010 was around twelve percent year on year. Future sales forecasts for classical lever door handles assume a pan-European annual growth rate of around six percent for the period 2012 to 2016.

**Trends and Competition in CEE for the Classical Door Handle Segment**

By mid 2009 sales for classical door handles slowed down due to the global recession and competition from international suppliers. Chinese and Korean based manufacturers brought another type of door fixtures and accessories in the world market. These new type of classic lever door handles were normally lighter in weight due to an inner plastic support mechanism. This was then overlaid with some laminate substance, which looked like aluminium, stainless steel or some newer synthetic material. The product was made to look like an "original" brass or stainless steel door handle. These new lightweight synthetic door handles were easier to manufacture and to ship. Prices were, therefore, lower for these "copy" products and the product quality differs substantially.

Online discount wholesalers often had user-friendly websites to encourage easy access by the consumer, be it an individual or a professional buyer. Mass volume purchases were the preference of Chinese and Korean suppliers as delivery is in bulk and profit margins were secured.

Privacy and security were the most important factors for consumers in deciding what type of classical door handles to purchase. Industry sources identified three factors that affected the demand for classical door handles.

First, there was the increasing popularity of electronic devices in the CEE. Traditional door handles were sometimes no longer necessary especially with the technical advances in microelectronics and wireless messaging. Some garage doors, for instance, opened by means of a remote control or voice sensor; thereby, eliminating the need for any kind of door handle.

Second, classical door handles faced competition from the round knob form. This was especially important in Eastern Europe, where the preference of young contemporary buyers (wholesale or individuals) was for North American taste for doorknobs. This trend led to the replacement of the classical lever style normally preferred in Europe.

Third, the quality of material used to produce the door handles influenced the demand and price levels. Historically, there was a preference for brass and zinc alloy lever door handles in Central Europe and the United Kingdom. These material substances were strong enough
to support the weight of wooden or metal doors, which was the design of earlier decades. Brass and zinc alloy were also the preferred materials as these were supposed to prevent the transfer of germs and bacteria. The bacteria supposedly died on such metal surfaces earlier than on other types of materials and substances; thus, minimizing the transfer of dangerous virus.\(^1\) The newer types of materials were stainless steel, aluminium and plastic. Brass and zinc alloys commanded a higher price for door handles compared to stainless steel or plastic.

The need for ongoing research and development in the sector combined with the modernization of the CEE economies led to regional corporations and local country businesses to analyse their production and operating activities. Those who were either not able or unwilling to commit their capital and research capacity required sold their door handle businesses in order to stay competitive. According to industry sources, the number of door handle companies was currently 375, or about 45 percent fewer companies than in 1988. The number of door handle companies was presently declining at a rate of two to three percent per year due to increased competition from offshore suppliers in China and Korea. Despite this phenomenon, a small number of regional door handle manufacturers in Europe, such as Donnie GmbH, did compete with considerable success due to a regional specific strategy and its local knowledge of the CEE region.

Major door fixtures producers such as Hoppe, Cersanit, Excellent, Miles Nelson, Kawwe and Merker GsmbH accounted for around 65 percent of sales in the classical door handle segment. These companies either marketed their own in-house brand names or sourced classical door handles for retailers under private brands or store name brands.

In general about 55 percent of classical door handles were sold under in-house or private brands. The major distributors for such brands were large home centres and online wholesale discounters.

A very popular store format for buying classical door handles was represented by home centres such as Kika or Lutz. Additionally, general hardware stores such as Baumax, Bauhaus, Obi and Hornbach marketed door handle brands. Also, specialty door handle stores, independent hardware stores that sell door handles, and online wholesale discounters were able to compete in the door handle business. Industry sources estimated that general hardware stores accounted for about 28 percent of door handles while specialty door handle stores and independent hardware shops in non-metropolitan areas sold larger volumes of door handles than home centres. This was related to a lack of home centres in these areas primarily served by independent hardware shops and specialty door handle stores.

An independent consultant undertook a study on the consumer store patronage in Austria, Slovakia and Czech Republic. Exhibit 1 shows the store patronage of do-it-yourself customers (DIY) and professionals buying door handles for 2011. Home centres represented the most frequently patronized category of retailers used by DIY shoppers. Often, professional buyers such as building contractors, interior designers and established carpenters and sometimes architects favoured direct orders from specialty door handle stores, independent hardware shops and online wholesalers.

\(^1\) A local Austrian belief originating from the Austro-Hungarian Empire
Classical Door Handle Purchase Behaviour in the CEE

In 2011, approximately 60 percent of classical door handles Euro sales were accounted for by do-it-yourselfers (“DIYs”). Purchases by professionals and contractor sales represented about 20 percent each.

Almost 70 percent of annual classical door handle sales were for interior dwellings such as houses, apartment buildings and offices. Exterior usage accounted for about 30 percent of sales. Slightly less than one in five households purchased interior door handles in every given year. The percentage of households buying exterior door handles was considerably less than that for interior door handles. The popularity of do-it-yourself, particularly for interior applications, increased the door handles products line carried by retail outlets. Door handle industry consumer research showed that the average DIY buyer spent about €200 per purchase for classical door handles. The average price for a classical door handle in the CEE was around €45.
According to a recent study conducted by the European Commission for Consumer Home Improvement, DIY buyers plan their home projects carefully prior to any volume purchases. The study pointed out that DIY buyers preferred to choose a purchase location and then they decided on the brand of classic door handles. Exhibit 2 illustrates the consumers’ purchase behaviour process. This research further indicated that there were basically four steps in the DIY buyer’s decision process for home improvement products, including door handles.

Exhibit 2: Consumer Buying Process - Home Improvement Products

“Door handles have become popular commodities”, explained Mass once. “Do-it-yourselfers all too often viewed door handles simply as door handles and tried to get the best price. However, there was a substantial number of people who wanted services as well in the form of information about application, colour matching, surface preparation, durability and aesthetic impact on the interior design” he stated. However, he also admitted that “once the door handle is fixed on the door, you aren’t able to differentiate between premium-priced and competitively priced door handles.” Private homeowners tend to buy those affordable classic door handles more often than professional buyers. Such a buying decision could be problematic as door handles of inferior quality were sometimes not long lasting, rust easily and were not durable. Professional buyers, on the other hand, could not take the risk to buy low-quality products. This could negatively affect their reputation with their clients such as architects and well established construction firms. They, therefore, looked to purchase from distribution outlets that can offer that extra service based on the expertise of store employees. A university professor specializing in consumer behaviour at the WU Wien observed, “Last year, it seemed that specialty stores were still the preferred outlet for classical lever door handles for professionals in the CEE, while DIY consumers primarily sought the lowest price before quality.”

The Eastern Europe Region

Macroeconomic Data

In the Eastern Europe region, real GDP growth averaged 6.9 percent annually during the period 2004 to 2007. In 2009, real GDP fell by 6.2 percent due to the global recession. However, the economy rebounded in 2010 to return growth of 3.3 percent. The region’s private consumption in real terms, which had grown at an average annual rate of 13.9 percent in the period 2005-2008, fell by 24.1 percent in 2009, but also recovered in 2010
when it increased by 2.8 percent. Unemployment was 9.1 percent of the workforce in 2010 and is growing.\(^2\)

According to a report of Euromonitor International from January 2012\(^3\), Eastern Europe as a whole is expected to perform well in the medium term, resulting in an average GDP growth of 3.7 percent over 2011-2015, despite the threat of a credit crunch in 2012. This rate exceeds most advanced economies, many of which are now facing a recession. Nevertheless, the Eurozone crisis also affects Eastern Europe, with Hungary potentially becoming the first EU nation to default. Since mid-January, the country is in negotiations with the IMF for a financial package as its domestic currency continues to plunge and borrowing costs soar. Countries with high budget deficits and an overreliance on Western lenders are most vulnerable to further shocks, where Romania and Latvia are especially at risk. Russia and Poland are best placed to ride out the storm, taking into account their large domestic markets, strong economic growth and the fact that Russian investors are in a strong position to expend operations across the region. Eastern European consumer expenditure is projected to expand by 16.3 percent in real terms over the period 2011 to 2015, far outperforming Western Europe’s anticipated 4.5 percent over the same period.

Inflation in Eastern Europe is expected to average out between about five and six percent during the next five years, while it will amount to around four percent Europe-wide and to slightly above two percent in the European Union. Exhibit 3 shows a forecast on GDP year on year growth (referring to current prices) and inflation rates in selected Eastern Europe countries as well as Eastern Europe totals.\(^4,5\)

**Exhibit 3: Forecast on GDP Growth and Inflation in Eastern Europe**

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nual growth rate (CAGR) of 15.5 percent for the period 2005 to 2009. Non-decorative materials sales were the most lucrative of the market, generating 36 percent of the market’s overall value. The performance of the market is forecast to decelerate, but will still be growing by 13.2 percent (CAGR) for the five-year period 2009 to 2014. However, the Czech market is forecast to grow with a CAGR of 3.2 percent only. Charts on actual and projected market size and growth can be found in the appendix. Hardware, including door fixtures, made up for twelve percent of total market value in 2009.

Trends in the Eastern Europe Construction and DIY Industry

During the past few years, CEE governments have tried to boost direct investments in the construction of new housing developments, office buildings and manufacturing facilities. New government regulations in selected countries such as Poland, Slovakia and the Czech Republic led to an influx of construction activity. The changing structure towards a more “westernized lifestyle” has led to a preference for different types of housing and dwelling in these countries. A “revolution” in infrastructure development also occurred due to both national government incentives in the form of subsidized state credit support or tax breaks as well as the influx of European based investors. The growth in housing developments resulted in an increasing trend in the preference for “Do-It-Yourself” (DIY) products. Exhibit 4 presents the market size of the DIY and gardening industry in Eastern Europe countries. From 2003 till 2011, Eastern Europe experienced a compound annual growth rate of 11.1 percent, resulting in a total market size of €23.3 billion. During the same period, Poland grew by 120.3 percent and Russia by 236.2 percent, while the Hungarian market shrank by 21.9 percent. The remaining Eastern Europe countries grew by a CAGR of 2.4 percent.\(^7\)

Exhibit 4: DIY and Gardening Market Size in Eastern Europe (in m€)

Industry experts predict a compound annual growth rate of 1.7 percent for new dwellings completed in Eastern Europe during the period 2012 to 2016. Data on new dwellings completed in selected countries level can be found in Exhibit 5\(^8\). Forecasts assume that the

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customer expenditure on maintenance and repair of dwellings in CEE will rise from €34.2 billion in 2011 to €48.9 billion in 2016.9

**Exhibit 5: Forecast on New Dwellings Completed in Selected CEE Countries (in 1,000 Units)**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>39.6</td>
<td>38.2</td>
<td>36.9</td>
<td>36.2</td>
<td>35.6</td>
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<tr>
<td>Belarus</td>
<td>51.7</td>
<td>53.0</td>
<td>53.6</td>
<td>54.4</td>
<td>55.3</td>
</tr>
<tr>
<td>Bulgaria</td>
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<td>17.6</td>
<td>18.2</td>
<td>18.7</td>
<td>19.1</td>
</tr>
<tr>
<td>Croatia</td>
<td>16.2</td>
<td>15.4</td>
<td>14.8</td>
<td>14.5</td>
<td>14.3</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>28.6</td>
<td>25.5</td>
<td>23.1</td>
<td>21.8</td>
<td>21.2</td>
</tr>
<tr>
<td>Hungary</td>
<td>11.7</td>
<td>15.1</td>
<td>17.0</td>
<td>17.5</td>
<td>18.4</td>
</tr>
<tr>
<td>Poland</td>
<td>134.3</td>
<td>138.6</td>
<td>139.5</td>
<td>142.3</td>
<td>140.2</td>
</tr>
<tr>
<td>Romania</td>
<td>61.2</td>
<td>61.6</td>
<td>62.3</td>
<td>63.0</td>
<td>63.2</td>
</tr>
<tr>
<td>Russia</td>
<td>693.5</td>
<td>712.1</td>
<td>724.8</td>
<td>738.7</td>
<td>752.3</td>
</tr>
<tr>
<td>Serbia</td>
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<td>21.1</td>
<td>21.0</td>
<td>20.9</td>
<td>20.8</td>
</tr>
<tr>
<td>Slovakia</td>
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<td>16.7</td>
<td>17.0</td>
<td>17.0</td>
<td>17.1</td>
</tr>
<tr>
<td>Ukraine</td>
<td>81.2</td>
<td>83.4</td>
<td>86.5</td>
<td>88.1</td>
<td>89.9</td>
</tr>
</tbody>
</table>

**Donnie GmbH Service Area**

Donnie GmbH currently operates in three countries, namely Austria, Czech Republic and Slovakia. It was the only door handle manufacturer that managed to maintain its sales during the financial and economic crisis in 2008 and 2009 in absolute terms. The company produces and sells a full range of door handles, specializing in classical lever door handles. Its main production facilities are located in the outskirts of Vienna with other satellite manufacturing centres in Slovakia.

Competition at the retail level has speeded up in recent years. Kika and Lutz have multiple outlets in the main city centres of Austria, Slovakia and the Czech Republic. The same is true for Baumax and Obi. Competition for retail shelf space in specialty stores, independent hardware shops, and online wholesale discounters have grown. "Our internal research shows that 1,500 of all retail outlets are currently operating in the three countries served by Donnie GmbH and about 563 of these stores are located in the main city areas of Vienna, Bratislava and Prague." explained Mass recently. "When you reflect on the fact that the typical independent hardware or general hardware stores generated ten percent of its volume (around €81,250) from door handles and the specialty door handle store has annual sales of around €177,000 with three brands, you can just see how important it is to keep an extensive distribution. This is a key determinant for success for this product market. More than 600 outlets were operating in this area in 2011; approximately 300 were located in the city centres."

Similarly, there is stiffer competition for the production of door handles. The primary change in competitive actions occurred among door handle companies that serve general contractors undertaking home construction projects. These companies have started to aggressively price their products to increase their share of the home construction market. "Fortunately, these firms have not pursued the 500 or so professional door handle firms in city centres (Vienna, Bratislava and Prague) and the 250 professionals outside the city

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areas or the do-it-yourself market as yet.” mentioned Mass. “They have not managed to access the retail outlets, however, they may buy their way in through free promotional devices and samples or whatever tools are available to them in the near future.”

Classical door handle sales in Donnie’s service area amounted to €251.6 million in 2005 and grew until 2008, reaching €292.6 million. After a slight drop in 2009, they continued to rise, exceeding the €300 million mark in 2011. The three-city area of Vienna, Prague and Bratislava accounted for approximately 18 percent of this figure. According to industry experts, DIY buyers were considered to account for 65 percent of non-contractor related sales in the city areas and 85 percent in outlying areas. A summary of classical door handle sales in Donnie’s service area is shown in Exhibit 6.

Exhibit 6: Classical Door Handle Sales Volume in Austria, Czech Republic and Slovakia (in m€)

<table>
<thead>
<tr>
<th>Year</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
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<tr>
<td>Total Euro Sales</td>
<td>251.6</td>
<td>251.9</td>
<td>277.4</td>
<td>292.6</td>
<td>287.5</td>
<td>293.6</td>
<td>307.2</td>
</tr>
<tr>
<td>- Austria</td>
<td>177.1</td>
<td>170.4</td>
<td>177.7</td>
<td>184.9</td>
<td>182.5</td>
<td>189.8</td>
<td>198.7</td>
</tr>
<tr>
<td>- Czech Republic</td>
<td>43.2</td>
<td>44.2</td>
<td>55.4</td>
<td>56.3</td>
<td>56.5</td>
<td>57.4</td>
<td>60.4</td>
</tr>
<tr>
<td>- Slovakia</td>
<td>31.3</td>
<td>37.2</td>
<td>44.3</td>
<td>51.5</td>
<td>48.4</td>
<td>46.4</td>
<td>48.1</td>
</tr>
<tr>
<td>o/w 3 City Area Sales</td>
<td>45.9</td>
<td>46.6</td>
<td>51.4</td>
<td>52.1</td>
<td>51.4</td>
<td>52.8</td>
<td>55.5</td>
</tr>
<tr>
<td>- Austria</td>
<td>33.4</td>
<td>33.4</td>
<td>34.4</td>
<td>35.8</td>
<td>35.4</td>
<td>36.8</td>
<td>38.6</td>
</tr>
<tr>
<td>- Czech Republic</td>
<td>7.6</td>
<td>7.3</td>
<td>9.5</td>
<td>9.7</td>
<td>9.9</td>
<td>10.1</td>
<td>10.7</td>
</tr>
<tr>
<td>- Slovakia</td>
<td>4.9</td>
<td>6.0</td>
<td>7.5</td>
<td>6.5</td>
<td>6.2</td>
<td>5.9</td>
<td>6.1</td>
</tr>
<tr>
<td>o/w Outside City Area Sales</td>
<td>205.7</td>
<td>205.3</td>
<td>226.0</td>
<td>240.6</td>
<td>236.0</td>
<td>240.8</td>
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<tr>
<td>- Austria</td>
<td>143.7</td>
<td>137.1</td>
<td>143.3</td>
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<td>153.0</td>
<td>160.1</td>
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<td>- Czech Republic</td>
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<td>47.3</td>
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<td>44.9</td>
<td>42.2</td>
<td>40.5</td>
<td>41.9</td>
</tr>
</tbody>
</table>

Donnie GmbH

Donnie GmbH is an Austrian privately held business, specializing in classical lever door handles, which are sold under a brand called “Donna”. The company offers also a line of private lock handles. Its products are known for their superior quality. Nevertheless, sales people are submitting that Donnie is one of the highest-priced door handle manufacturers in its operating area. Mass also admitted recently that “we have probably come close to the threshold regarding our prices.” Currently, the company sells about half of its products in Austria, the rest being allotted to Czech Republic and Slovakia at the ratio of 3:2. Sales in the three-city area represented by Vienna, Prague and Bratislava account for about 45 percent of total sales.

Financial Situation

Donnie’s sales volume amounted to approximately €30 million in 2011. Cost-of-goods sold has historically been relatively stable, amounting to 55 percent of gross revenue in 2011. Fixed costs mainly consist of advertising costs, personnel costs, interest and depreciation. Exhibit 7 shows a preliminary simplified balance sheet for beginning of 2012.
Interest on outstanding bank liabilities averages out at seven percent; the remaining period of use of the depreciating assets amounts to eight years on average. The high number of inventory results from a miscalculation of the purchasing department in December 2010, ordering far too much brass. "Other assets" mainly refers to real estate property. For internal calculations, the company uses a weighted average cost of capital of 8.75 percent. The company calculates with a tax rate of 25 percent. If a customer pays within two weeks, Donnie grants a one percent cash discount, which about one third of the customers make use of.

**Distribution**

Donnie distributes its products through 250 independent stores, specialty stores focusing on door equipment and general hardware outlets. Apart from contractor sales, these stores act as the company’s retailers, following a one-step distribution strategy.

The company currently employs six sales people which earn a yearly gross salary of €60,000 on average. Three of them are taking care of the Austrian market, two of them are operating in the Czech Republic and one of them sells Donnie’s products in Slovakia. Besides their fixed salary, they receive a one percent commission for all sales in their respective region. Their main task is to observe Donnie’s inventories in each retail outlet as well as order taking. In addition, they are responsible for coordinating advertising in Czech Republic and Slovakia, whereas Austria has a designated marketing person in charge of advertising programs. A market survey of Donnie’s door handle dealers in Slovakia and Czech Republic showed that the sales personnel are highly respected by the dealers due to their expertise, clarity, directness as well as their professional behaviour. Commenting on the survey findings, Mass explained, "Our sellers know their customers very well and are on a friendly basis with most of them. In many cases, they are invited into the homes of the dealers to discuss both business and family matters." Exhibit 8 shows the distribution of sales volume among Donnie’s accounts by the size of their yearly purchases.
Donnie GmbH is currently investing about four percent of its net sales into promotional activities. In Austria, most of the advertising budget is used for one big advertising program with the retail accounts. Donnie offers a cooperative program where the firm shares a portion of an account's media costs based on the purchased volume of door handles. This program is applicable only to print advertisements and seasonal catalogues offered in the retailer’s trade area. The remaining budget is utilized for corporate brand advertising and advertisements in countrywide DIY magazines.

In Czech Republic, the responsible sales manager decided to invest in exclusive in-store displays. Once, he commented on this approach in a meeting with Alicia Hetzle, head of marketing, “Well, I think most people that would like to furnish or renovate their homes decide directly in the store which door handle they are going to buy, no matter if they are aware of the available brands or not.” Despite that, approximately half of the budget runs into print advertisements of two Czech premium home style magazines, which have its largest circulation in the area of Prague. The remaining budget is used for informal temporary programs, mostly ending up with price reductions granted to the retailers.

The Slovakian sales manager has developed his own promotional program in 2006 where he sets sales targets to his customers, based on past sales and a system of different growth rates. At the end of the year, the customers who have reached their targets receive a bonus, computed by the percentage of overachievement multiplied by total sales value and a multiplier. That bonus can be used for any advertisements related do the “Donna” brand. On average, about 40 percent of the customers received a bonus each year. The Slovakian seller is convinced that this is the most effective way the available budget can be used in his country. In a former marketing meeting he stated,

After a few acceptance problems among my customers, this is a highly successful way of promoting our door handles. For many dealers it is fun to participate in the program and most of them are really motivated to sell our products. Besides, they highly appreciate their freedom in deciding what to do with the money.
Exhibit 9: Typical Donnie GmbH Print Advertisement

Planning Meeting

As planned, top management of Donnie met again the following Thursday. Chris Mass was determined to develop a consistent marketing strategy with his executive team. He was confident that they would agree on a plan of action on the distribution of capital for various activities this afternoon. When everybody had arrived, Mass opened the meeting by reiterating the expectations and objectives of the upcoming general sales meeting. Mass said,

So next month our sales managers and all our dealers will be coming together in Vienna. They expect us to provide them with a clear strategy how we plan to drive our business in the near future given the current economic challenges in our markets. They would need reassurances from us what we are going to do and how we are going to achieve our corporate objectives. So, ladies and gentlemen, the floor is now open to suggestions and open discussions. Let me remind you about the urgency of this matter. We are not leaving until we have a decision and a plan of action.

Peter White, Vice President of Business Development:

Chris, I believe that we should consider entering the Hungarian market. I know that we already talked about it last year but I think, now more than ever, we should tackle this opportunity. Apart from the years of the crisis, we experienced an almost constant rise in sales over the past decade by about 6 percent a year. However, I’m wondering if we can continue this story in the current environment. The Hungarian market is more than 50 percent bigger than the market in Czech Republic. I really think it could help us to sustain growth in the medium term. Our sales are currently distributed between Austria, Czech Republic and Slovakia at the ratio of 50-30-20; I think adding a fourth market would considerably diversify our risk.

Martin Woidich, Vice President of Sales:

Let me jump in here for a moment. I fully agree that times are not getting easier. Anyway, I believe that it would make more sense to focus on raising our market
share in the markets we’re already working. First, I’m concerned because the number of new dwellings, an economic indicator that highly affects our business, is predicted to go down.\(^{10}\) Second, I do not like our high dependence on the DIY sector – more than half of our sales result from these customers while professional sales account for only 35 percent. Don’t get me wrong here, but if we manage to hire two more sales people, who focus on the professional sector, it would help us to reduce this dependency. You know, it’s not a secret that my people are doing a good job in cultivating relationships with our customers. But this is a very time-consuming job, as you all can imagine. Competition is getting harder, so we need to intensify our presence. I think one sales person could generate altogether additional revenue of three and a half to four million when concentrating on outlying areas. Furthermore, the labour market is quite favourable at the moment for us; I estimate the gross salary of one person not to exceed €50,000, without sales commission, of course. Also, please take into account that if we expand to Hungary we would need to assign at least two more persons in order to build the market there.

**Jerome Blascke, Vice President of Operations:**

In my opinion, we should better decrease our prices. As you both mentioned, we are facing powerful competition from the emerging countries. I guess we will lose at least five percent of our customers per year, the majority of them in the region of Prague, Vienna and Bratislava, if we keep our current price policy. You know, I also use to speak a lot to your people, Martin, and they always complain about the cheaper prices the other companies offer. And I’m afraid that this price war will get tougher and tougher....

**Martin Woidich, Vice President of Sales:**

Well, I do not fully agree with that. We know that for some people our products are too expensive. But the ones that buy Donna are usually highly satisfied with the quality they receive for their money. What I could think about, and this is my next proposal, is introducing a new brand to gain access to the more price-conscious segment. I think there’s a high discrepancy between brand awareness and last brand purchased, isn’t that true Alicia? I think a product line that is half the price of Donna would generate about 50 percent additional sales volume. I already talked to our production manager and he estimated the additional investment necessary for such a project to be about eleven million for new machines. I know it’s a lot of money but it would probably pay off in future.

**Alicia Hetzle, Vice President of Marketing:**

So far so good, but have you thought about the adverse effects on our reputation as high-end manufacturer? Besides, a new product line could cannibalize Donna, so that customers switch to the new brand, which probably offers a lower profit margin. I mean, could we still argue why people should buy the Donna line then? Would they see the difference between the higher and the lower priced brand? I would definitely not do something like that before extensive market research has been done. I’d rather go for some new ad campaign, probably in rural areas where our market penetration is particularly low. During recent talks with the ad agency

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resulted in the estimation that a campaign of €750,000 would increase the awareness level by about 35 percent, probably a bit less in rural areas where it’s more difficult to reach customers. And please let me point out, Peter, that expanding into another country would probably make twice as much marketing efforts necessary there, compared with existing markets, in order to build brand awareness and educate potential customers.

Exhibit 10: Brand Awareness Study - Percentage of the Three City Area Population of Vienna, Prague and Bratislava Who Was Aware of Door Handle Brands and Purchased Door Handles in the Last 12 Months

Survey Questions

Last Brand Purchased: What brand did you purchase when you last bought a classic door handle?

Awareness: What brands of classic door handles would you purchase for your home?

Klemens Prager, Vice President of Finance and Controlling:

Ladies and gentlemen, it is true that we have some resources accumulated from the past decade, despite the last financial and economic crisis. Nevertheless, we should invest them only after carefully analysing costs and benefits. For example, I don’t believe what the advertising agency says; according to my experience, suppliers tend to overestimate such effects by about 30 percent, so please be careful here. From a financial point of view, we could probably afford the investments necessary for entering Hungary, but is it really the right time now? Wouldn’t it be wiser to pay back debt in times of uncertainty, in order to raise our equity ratio? We already have fixed costs of approximately four million plus interest and depreciation, which cuts our profits and return on sales. Apart from that, what I would like to do is trying to reduce the payment period of our customers. Our credit period currently averages to something between five and six weeks, which is a bit too much in my view. For sure, a measure like that would lead to a slight decrease in our net sales, but I want to ensure that we have the necessary liquidity without drawing on expensive credits. I guess that if we double the cash discount, payments settled within the discount period will also double.
Chris Mass, Chief Executive Officer:

Okay, we have now heard a lot of suggestions and arguments. Thank you a lot so far for this open discussion; I think all your points are reasonable but we have to set priorities now and start to develop our action plan. Let’s reflect on what would help us most to drive our business and increase our return on sales the next two or three years.

As Klemens said, we have to analyse carefully where it makes sense to commit resources. Talking about Hungary, to be honest, I’m really not sure about it. How much risk would we face in times like these? Increasing our advertising effort always seems quite plausible, no? But the question is how long will the effects last? We know that pan-European door fixture companies outspend us tenfold in absolute terms. The additional sales personnel would most probably be a lot cheaper in the short and medium term. But to which extent will their efforts be transferred into sales and profits? And where exactly should they operate?

Cutting prices would be a quite aggressive step to take. We will probably be forced to do so in order to maintain our volume. Given current forecasts on key economic indicators, I believe it is almost impossible to increase our prices this year. The question is, how can we increase our profitability in spite of this restriction? I honestly do not think that we will manage to cut our costs of goods sold. I like the idea of a new product line, but I also agree with Alicia’s concerns. How long will we need in order to amortise this investment? Will it influence our overall risk substantially?

Finally, I’m always open to suggestions that aim at increasing efficiency. But, Klemens, we also have to consider the possible negative effects of your suggestions. Paying back debt sounds nice in theory but will it lower our return on equity, for example? In order to develop a reasonable list of action, we really have to consider Donnie as a whole. And as we are not leaving until we have come to a decision, I have already ordered some pizza.
Appendices

Appendix 1: Data on Europe and Eastern Europe Home Improvement Market Value

Europe Home Improvement Market Value Forecast: $ million, 2009-14

<table>
<thead>
<tr>
<th>Year</th>
<th>$ million</th>
<th>€ million</th>
<th>% Growth</th>
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</thead>
<tbody>
<tr>
<td>2009</td>
<td>187,235.9</td>
<td>134,652.7</td>
<td>2.7%</td>
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<tr>
<td>2010</td>
<td>192,394.1</td>
<td>138,362.3</td>
<td>2.8%</td>
</tr>
<tr>
<td>2011</td>
<td>200,368.5</td>
<td>144,097.1</td>
<td>4.1%</td>
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<tr>
<td>2012</td>
<td>211,577.1</td>
<td>152,157.9</td>
<td>5.6%</td>
</tr>
<tr>
<td>2013</td>
<td>226,534.0</td>
<td>164,914.3</td>
<td>7.1%</td>
</tr>
<tr>
<td>2014</td>
<td>236,125.5</td>
<td>169,812.2</td>
<td>4.2%</td>
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</tbody>
</table>

CAGR 2009-14 4.7%

Appendix 2: Consumer Expenditure on Hardware and DIY Goods in Czech Republic, Slovakia and Austria

Source: © Euromonitor International, ‘Consumer Expenditure on Hardware and DIY Goods.’

Appendix 3: DIY Retail in Europe

SUMMARY

2009 was an incredibly tough year for the DIY retail sector. The economic downturn heavily impacted the housing market, making mortgages difficult to obtain and thus preventing many people from moving house. As a result, consumers cut spend on upgrading their homes leading to a heavy fall of 4.5% in DIY expenditure across the EU in 2009. The strong fall has meant that total DIY expenditure in the region has now fallen back to 2004 levels of expenditure. Nevertheless, retailers are identifying key growth opportunities to counteract falling spend. As heavy DIY has suffered the most, retailers are investing in new product categories to drive growth. These include softer home improvement products such as homewares and decorative items as well as gardening products. Value continues to be an overriding factor with private label taking increased prominence instore. However, the growing eco trend provides the most encouraging prospect for DIY retailers and will substantially help to fuel growth going forward.

Appendix 4: Selected Macroeconomic Data of Austria, Czech Republic, Slovakia and Hungary

**Austria**

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<tbody>
<tr>
<td>Nominal GDP (US$ at PPP)</td>
<td>bil USD</td>
<td>274.65</td>
<td>292.7</td>
<td>306.92</td>
<td>315.6</td>
<td>308.73</td>
<td>318.82</td>
<td>334.4</td>
<td>346.6</td>
<td>361.6</td>
<td>378.4</td>
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<td>414.9</td>
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<td>Consumer prices (% change pa; av)</td>
<td>%</td>
<td>2.05</td>
<td>1.684</td>
<td>2.294</td>
<td>3.224</td>
<td>0.406</td>
<td>1.693</td>
<td>3.3</td>
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<td>2.1</td>
<td>2.2</td>
<td>2.3</td>
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<tr>
<td>Lending interest rate (%)</td>
<td>%</td>
<td>3.678</td>
<td>4.164</td>
<td>5.103</td>
<td>5.561</td>
<td>3.101</td>
<td>2.564</td>
<td>3</td>
<td>3.5</td>
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**Czech Republic**

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<td>Nominal GDP (US$ at PPP)</td>
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<td>207.28</td>
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<td>261.4</td>
<td>253.22</td>
<td>262.14</td>
<td>272.7</td>
<td>285.3</td>
<td>301.6</td>
<td>319.1</td>
<td>336.8</td>
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<td>Consumer prices (% change pa; av)</td>
<td>%</td>
<td>1.843</td>
<td>2.543</td>
<td>2.862</td>
<td>6.339</td>
<td>1.033</td>
<td>1.464</td>
<td>2.3</td>
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<td>2.1</td>
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<td>Lending interest rate (%)</td>
<td>%</td>
<td>5.97/</td>
<td>5.994</td>
<td>5.799</td>
<td>6.253</td>
<td>5.991</td>
<td>5.889</td>
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<td>Nominal GDP (US$ at PPP)</td>
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<td>1.615</td>
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<tr>
<td>Lending interest rate (%)</td>
<td>%</td>
<td>6.675</td>
<td>7.873</td>
<td>7.989</td>
<td>5.769</td>
<td>2.91</td>
<td>3.39</td>
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<td>4</td>
<td>4.5</td>
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<td>Nominal GDP (US$ at PPP)</td>
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<td>171.18</td>
<td>182.6</td>
<td>189.3</td>
<td>195.1</td>
<td>184</td>
<td>188.3</td>
<td>190.6</td>
<td>204.7</td>
<td>212.4</td>
<td>216.3</td>
<td>218.4</td>
<td>215.4</td>
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<td>7.969</td>
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<td>4.21</td>
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<td>2.9</td>
<td>2.9</td>
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<td>Lending interest rate (%)</td>
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<td>8.083</td>
<td>9.092</td>
<td>10.19</td>
<td>11.058</td>
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<td>7.7</td>
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Appendix 5: Ease of Doing Business Ranking Austria, Slovak Republic, Hungary, Czech Republic

Economies are ranked on their ease of doing business, from 1 – 183. A high ranking on the ease of doing business index means the regulatory environment is more conducive to the starting and operation of a local firm. This index averages the country’s percentile rankings on 10 topics, made up of a variety of indicators, giving equal weight to each topic. The rankings for all economies are benchmarked to June 2011.

PESTLE highlights

Political landscape
The country’s ties with Slovakia have improved, with Prime Minister Viktor Orban visiting Slovakia in January 2011, the first visit by a Hungarian prime minister in 12 years. The two countries are currently working on a bilateral agreement.

Hungary’s loan arrangement with the EU and the International Monetary Fund (IMF), worth $25bn, lapsed due to disagreements over the country’s macroeconomic policies. The government cannot follow a policy that antagonizes its relations with international financial institutions and trade blocs.

Economic landscape
According to the country’s central bank, Magyar Nemzeti Bank (MNB), Hungary recorded a current account surplus of $2.7bn in 2010 (or 2.3% of GDP), a sharp turnaround from the current account deficit of more than 7% of GDP during 2005–08.

Foreign direct investment (FDI) in the country declined considerably between 2005 and 2010. From a high of $7.7bn in 2005, FDI fell to $2.4bn in 2010, a decline of nearly 70%.

Social landscape
The country’s Human Development Index score for 2010 was 0.805, meaning that it was ranked 36th out of 169 countries. This is indicative of a healthy life expectancy, literacy rate, and standard of living.

In early 2011, Tatabanya, a provincial town, and Mayor Istvan Tarlos of Budapest both passed decrees against homeless people. Treating homeless individuals as criminals is a serious blot on the country’s human rights record.

Technology landscape
The country is an important destination for high technology companies. It is home to the overseas production bases of some of the world’s biggest contract manufacturers, including Flextronics, Jabil, and Sanmina-SCI.

According to the Innovation Union Scoreboard 2010, Hungary is ranked along with the moderate innovators due to below average innovation as a result of weaknesses in research systems, financial support, R&D investments, entrepreneurship, and intellectual assets.

Legal landscape
The government plans to gradually reduce corporate tax to 10%, from the current range of 10–19%, to act as an incentive for individuals and companies to invest in new businesses and expand existing operations.
According to Transparency International’s 2010 Corruption Perceptions Index, the country was ranked 50th, down from 46th in 2009, which suggests that corruption in Hungary is on the rise.

Environmental landscape

Carbon dioxide emissions dropped from around 67 million metric tons in 1990 to 56.4 million metric tons in 2010.

Hazardous waste is a major problem in the country. Of the more than 1,000 natural and artificial water bodies in Hungary, 579 face an increasing risk from hazardous substances. Rivers are also under threat from municipal and industrial wastewater.

List of References


