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GROWTH CHALLENGES IN SMALL MANUFACTURING VENTURES FROM EMERGING ECONOMIES: THE EVIDENCE FROM MOLDOVA

To grow or not to grow?

This is not a rhetorical question for Tamara Popa, the co-owner and Executive Director of VM-Plumcom Ltd. Clearly it is the former part of the question that is on Tamara’s agenda. The challenge thus is how to grow, a challenge that has been amplified for the last couple of years by the global economic crisis and recession, especially in the international markets VM-Plumcom Ltd. has been serving.

Since the time of the crisis in 2008, the revenue of the company dropped by 12% in 2009, with export sales dropping by 14% as compared to 2007. As the number of orders decreased during this period, VM-Plumcom Ltd. even stopped the production process in 2010 since the stock had piled up during the previous year. On top of the global economic crisis, VM-Plumcom Ltd. also experienced severe drought that heavily affected the yield of fruit and vegetables that are the company’s raw material.

Despite all this, Tamara strongly believes in a positive outlook for her business. The sales picked up in 2010 and reached the 2007 level. In a way this was due to the fact that two years ago VM-Plumcom Ltd. received organic certification that brought new, bigger business opportunities. Tamara has plans for the medium term to invest in and launch new products such as nut kernels; puree, juice, and nectar from peach, apricot and apples; dried vegetables; and frozen fruit and vegetables. To achieve these objectives, Tamara expects to invest over $3 million in new equipment and production capacity, and increase the number of permanent staff to between 100 and 150 employees over the next three years.

The emergence of the venture

VM-Plumcom Ltd. is a family-owned business. It was founded in spring of 2000 by Tamara and her husband, with their two daughters being the other two founding members. The company provides the basis for the establishment of an industrial cluster in a geographic area where smaller enterprises are just beginning to be established and are learning how to cooperate. VM-Plumcom Ltd. is in the business of processing fruit and vegetables. Its current main product range consists of dried fruit, e.g., prune and cherry with or without stones, skinned apple rondelle, whole or sliced pear, Dog rose (Rosa Canina), and prune and apple jam without sugar. The contribution of jam products to the total revenue is approximately 65%-70%, with dried fruit accounting for the remainder.
Prior to starting her venture, Tamara worked as the Executive Director of one of the largest fruit and vegetable processing enterprises in Moldova. Being frustrated mainly by the red tape and lack of support to induce dramatic changes in the organization, Tamara left her employer and decided to start own venture. Apart from her drive and motivation for success, Tamara brought to the new venture her knowledge, experience and understanding of the market and the business.

Initially, Tamara and her husband formed a sole proprietorship to collect fruit and vegetables, process them at various producers of canned fruit and vegetables throughout the country, and sell the finished goods. This process turned out, however, to be quite expensive and ineffective. Tamara and her husband then decided to create a venture, a limited company that would incorporate all those functions in aiming at a better performance. Three former colleagues joined Tamara in the newly established company covering the areas of marketing and sales, engineering, and accounting.

In 2000 Tamara bought 9800 m$^2$ of industrial land on the outskirts of Ungheni on which there was a decommissioned enterprise. With an initial investment of €10000, Tamara managed to start up the company, and produce and sell their first products in 2001, generating just over 31% of their revenue from international sales (Table 1). The company’s current early production capacity is 300 tonnes of dried fruit (prunes, apples, and pears), 60 tonnes of stone-less dried cherries, 400 tonnes of prune jam, and 200 tonnes of apple jam. From the date of its inception, VM-Plumcom Ltd. grew rapidly both in size and scope. The average growth rate of employees per year was about 30%, while the annual total revenue grew on average at 45% (before the crisis in 2008).

**Internationalization: East or West?**

Right from the company’s inception in 2000, Tamara was aware of the fact that she had to target international markets as the local market was too small, and exhibiting the emergence of intense competition. The question though was where to go: east or west? Given the historical ties with Russia, the Russian market, and for that matter, the markets of other CIS countries (the former Soviet Republics, with the exception of the Baltic States) would have been a natural choice for an international market entry, as it has been for a large number of entrepreneurs from Moldova.

Nonetheless, it was a different story for Tamara. Several factors played a crucial role in deciding on the direction of internationalization. From her experience, Tamara had learned that Russian partners are not trustworthy, unwilling to cooperate on payment and delivery terms, sometimes even refusing to pay while insinuating various motives. Moreover, the trading relationships between the two countries were quite politicized, exposing the Moldovan companies to a high political risk. Apart from the above, there were also market-related factors that influenced Tamara’s decision. Not all the company’s products had a market in Russia. For example, apple jam and apple juice concentrate were not in demand, though dried fruit, especially dried prunes, were in demand, as they are even today.
Table 1. Aggregate growth data of VM-Plumcom, 2001-2010

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of employees</td>
<td>15</td>
<td>22</td>
<td>35</td>
<td>40</td>
<td>45</td>
<td>45</td>
<td>65</td>
<td>72</td>
<td>70</td>
<td>56</td>
</tr>
<tr>
<td>Product range</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total revenue, €</td>
<td>82,926</td>
<td>202,615</td>
<td>290,599</td>
<td>301,250</td>
<td>477,515</td>
<td>504,100</td>
<td>574,254</td>
<td>625412</td>
<td>501420</td>
<td>572128</td>
</tr>
<tr>
<td>Export revenue, €</td>
<td>25,686</td>
<td>173,181</td>
<td>253,175</td>
<td>270,035</td>
<td>442,515</td>
<td>466,465</td>
<td>551,942</td>
<td>525289</td>
<td>479420</td>
<td>560768</td>
</tr>
<tr>
<td>Key export markets</td>
<td>Czech Republic, Ukraine, Romania</td>
<td>Germany, Austria, Lithuania, Czech Republic, Ukraine, Romania</td>
<td>Germany, Austria, Lithuania, Czech Republic, Ukraine, Romania</td>
<td>Germany, Austria, Lithuania, Czech Republic, Ukraine, Romania</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Investment, €          | 10,000 | 50,000 | 40,000 | 20,000 | 100,000 | 100,000 | 62,500 | 11560 | 0 | 0
The road to the west was not easy either. In fact the situation changed. In those days, ‘Made in Moldova’ was not evoking a lot of trust. So, Tamara had to earn the trust of the EU partners, and at the same time prove and maintain the quality of the products. To mitigate this risk, in addition to her efforts to sell directly, Tamara was exporting indirectly to the EU customers via Romanian trading agents. VM-Plumcom Ltd. was losing quite substantially on pricing, but that was the price Tamara was willing to pay to earn the trust of the key players in the market and keep the company going.

The first international market was the Czech Republic. Tamara knew one buyer from the Czech Republic from her previous experience as Executive Director. At the same time VM-Plumcom Ltd. entered the nearby markets of Romania and Ukraine. The Czech partner later introduced VM-Plumcom Ltd. to a large buyer in Austria, while the Romanian partner introduced VM-Plumcom Ltd. to another large buyer in Germany. As the company was growing, VM-Plumcom Ltd. was also approached by a large buyer from Lithuania.

VM-Plumcom Ltd. started exporting dried prunes, and now also focuses on organic food, having been certified as an organic food producer. Apart from exporting, Tamara has had plans to open a sales subsidiary in Germany; however, the financial constraints over the last few years due to the global economic crisis and recession have put this vision on hold. From the company’s inception, the sales from exports grew at a high rate, almost 120% per year, with the ratio of revenue coming from international sales growing from 31% in 2001 to 96% in 2007, and reaching 98% in 2010 (Table 1).

To continue expanding into the EU market, VM-Plumcom Ltd. had to enhance its compliance with the safety and quality requirements of the EU market. In 2007, the HACCP (Hazard Analysis Critical Control Point) framework was implemented at VM-Plumcom Ltd. with the support from CNFA (Citizens Network for Foreign Affairs) in order to comply with food safety requirements. In 2009, the key company products - dried prunes, dried cherries, and jam products – received organic certification, BIO, demonstrating compliance with a set of production standards for growing, storage, processing, packaging and shipping. To the above, their own agricultural land was also certified to make possible the growth of ecological products.

The internationalization efforts were also facilitated by the EU Neighbourhood Policy that was developed in 2004 with the aim of avoiding the emergence of new dividing lines between the enlarged EU and EU neighbors (http://ec.europa.eu/world/enp/policy_en.htm). In 2005, based on this policy initiative, the EU-Moldova Action Plan was adopted. On the basis of this Plan, Moldova, inter alia, benefitted in 2006 from the new EU generalized system of preferences (GSP+) that made duty-free (zero tariff) access to the EU market possible for 6,400 products covered by GSP+ (European Commission, 2008). To the above, the EU introduced autonomous trade preferences to Moldova by removing all remaining tariff ceilings for industrial products and by improving access to the Community market for agricultural products (European Council, 2008).

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3 The eligibility of countries placed in the GSP+ incentive scheme is confirmed by an assessment of their effective implementation of core human and labour rights, good governance and environmental conventions (European Council, 2005).
The EU market

The consumption of dried fruit in the EU is valued at € 2.3 billion or 871 thousand tonnes (CBI, 2008). Being a net importer of dried fruit, EU production of dried fruit amounts to approximately € 1.7 billion or 428 thousand tonnes, and mainly consists of dried grapes, dates, figs and prunes. Total EU imports increased on average by 9.1% annually in value between 2003 and 2007. Developing countries account for approximately for 55% of the total imported value of selected dried fruit to the EU (CBI, 2005; 2008). Overall, the EU market absorbs approximately 80% the Moldovan sector’s output of dried fruit, with the remainder going to CIS markets, primarily Russia, Belarus, and Ukraine. Being a net exporter of dried fruit despite the fact that the sector is operating under its capacity (CNFA, 2008), Moldova is among the leading suppliers of selected dried fruit (from developing countries) to the EU with a total share of 3% (Table 2).

Table 2. Leading developing country suppliers of selected dried fruit, in € 1000

<table>
<thead>
<tr>
<th>Country</th>
<th>Dried prunes</th>
<th>Dried apples</th>
<th>Other dried fruit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>18314</td>
<td>7578</td>
<td>8070</td>
</tr>
<tr>
<td>China</td>
<td>265</td>
<td>4226</td>
<td>3587</td>
</tr>
<tr>
<td>Argentina</td>
<td>5043</td>
<td>291</td>
<td>0</td>
</tr>
<tr>
<td>Turkey</td>
<td>1062</td>
<td>2040</td>
<td>598</td>
</tr>
<tr>
<td>Serbia and Montenegro</td>
<td>1062</td>
<td>146</td>
<td>0</td>
</tr>
<tr>
<td>Moldova</td>
<td>265</td>
<td>146</td>
<td>299</td>
</tr>
<tr>
<td>Iran</td>
<td>0</td>
<td>0</td>
<td>598</td>
</tr>
<tr>
<td>Tunisia</td>
<td>531</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>South Africa</td>
<td>0</td>
<td>0</td>
<td>448</td>
</tr>
<tr>
<td>Albania</td>
<td>0</td>
<td>73</td>
<td>299</td>
</tr>
<tr>
<td>Philippines</td>
<td>0</td>
<td>0</td>
<td>149</td>
</tr>
<tr>
<td>Georgia</td>
<td>0</td>
<td>73</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>26,542</strong></td>
<td><strong>14,574</strong></td>
<td><strong>14,047</strong></td>
</tr>
</tbody>
</table>

Source: CBI, 2005

There are three market segments for dried fruit: the food processing market, the retail market, and the catering market. The food processing market is the largest market, accounting for approximately 80% of EU imports of dried fruit (CBI, 2008). Retail sector sales are dominated by the supermarket sector, but health stores are increasingly gaining market share; the catering market is the smallest market of the three (CBI, 2008). Dried fruit is used as raw
material input for further applications in breakfast cereals, baked goods, desserts and confectionery products. Dried fruit is usually imported to a centrally located EU country, often the Netherlands or Germany, and from there distributed to other EU member states (Figure 1).

**Figure 1. Distribution channels for dried fruit entering the EU market**

According to Foodanddrinkeurope.com, one of the key factors that boosts the consumption of dried fruit is the need for convenience, on-the-go snack food, which is related to innovative packaging design and marketing. Recent research conducted by EHI Retail Institute showed that despite the substantial progress made to reduce the costs that packaging brings to retailers, the main retail requirements relevant to packaging are still a challenge, with marketing and cost being the other two top priorities (www.foodanddrinkeurope.com). The consumption of various (organic) dried-fruit products is forecasted to continue to increase as consumers become more and more aware of the contribution of dried fruit to a healthy diet (CBI, 2008).

The dried fruit market is characterized by high prices, but low margins, with prices being determined (but not ‘set’) by importers and wholesalers (CBI, 2008). There are several factors that effect the high level of pricing. One of the main factors relates to the expensive and rather difficult production process, which requires large quantities of fresh fruit and tight quality control, as well as to the drying/processing method. The other factors affecting prices of dried fruit are for example, the quantities, and the type of dried fruit in question; the harvest output in the supplying countries in relationship to demand; negotiations between the different chain partners and the number of intermediaries buying and selling; the quality of fresh fruit (and vegetables) aimed at the consumer markets; and exchange rates. Overall, changes in supply due
to wide variations in availability caused by fluctuating harvests, weather conditions or disasters, have a much larger effect on price levels than changes in demand (CBI, 2008).

Successful access to the EU market is also determined by compliance to the EU requirements for dried fruit that are based on environmental, consumer health and safety and social concerns, and the legislated requirements concerning labels, codes and management systems (CBI, 2008). Two of the most important EU regulations are the Regulation on Maximum Residue Levels⁴ and the Regulation on Approved Additives⁵.

Local market

VM-Plumcom Ltd. is located in Ungheni city, just over 100 km north-west of the capital of Moldova, Chisinau (Figure 2). Ungheni is a district centre, located at the border with Romania, and has an international railroad hub. Moldova is a country landlocked between Romania and Ukraine; she became independent in 1991 as a result of the collapse of the USSR. Moldova stretches just under 450 km from north to south, and less than 250 km from east to west, having just over 3.5 million citizens (Eurostat, 2009).

Figure 2. Map of Moldova


Historically, the agricultural sector has been considered as one of the main pillars of the national economy, accounting for over 16% of the country’s GDP, and contributing approximately 50% to Moldova’s total exports. The production of dried fruit per year is somewhere between 2000 and 3500 tonnes, subject to the quality and growing conditions of the raw material. A few large and medium companies dominate the dried fruit market in Moldova, accounting for about 67% of the total turnover; the remainder being generated by a large number of small companies (CNFA, 2008). Some of the key players in the sector are:

**Inmark** (www.inmark.md). The company was founded in 1998 to produce dried fruit and vegetables, such as cherries, peaches, apricots, prunes, tomatoes, peppers, eggplants, and zucchini, and to process and sell walnuts. The initial export markets were Russia and other CIS countries. In 2008, Inmark started implementing the HACCP framework, with a view to start producing organic food. It invested in its own supply base: in 2008 the company planted 120 ha of orchards, which would allow it, from 2010 to 2012 inclusive, to harvest approximately 800 tonnes of apples, 100 tonnes of prunes, 200 tonnes of cherries, and 300 tonnes of peaches. These efforts have made it possible for Inmark to extend its export markets to EU countries and beyond.

**Monicol** (www.monicol.md). Monicol was founded in 2001 with the aim of producing and exporting walnut kernels and dried fruit. It has 10 employees as permanent staff, and during the harvest season it employs somewhere between 200 and 250 people. With the help of CNFA under the USAID project, Monicol invested 1.9 million USD in a fruit drying facility upgrade. The fruit drying facility has an annual production capacity of 200 tonnes of dried apples and 300 tonnes of dried prunes. The company attained a revenue of 0.67 million USD in 2004, and more than 3.5 million USD in 2007. It purchases its raw material from over 50 farmers and 50 small-scale processors. Monicol exports mainly to the EU. The company is ISO 9001:2000 certified, and has implemented the HACCP system.

**Prometeu-T** (PT, www.walnut.md). PT was established in 1995 to grow/acquire, process, and sell walnut kernels and in-shell walnuts. In 2008 it started to produce dried fruit, such as prunes, cherries, and apples. It grew rapidly over the years, approximately 25% per year, reaching an annual revenue of up to 10 million USD. PT is a medium-sized company with less than 500 employees. PT exports between 91% and 100% of its products to the EU, Turkey and the Middle East. PT owns approximately 110 ha of agricultural land, of which 35 ha are planted with walnut trees, 50 ha with prune trees, 15 ha with almond trees, 5 ha with peach threes, and 5 ha with sour cherry trees. In 2009, PT passed ISO 22000:2005 certification for the processing of walnut kernels and dried fruit.

**Reforma Natural Nuts & Fruits** (RNNF, www.reforma.eu). RNNF is a subsidiary of Reforma-Werk, a European enterprise with a long tradition in the natural and organic food business. With an initial investment of about 18 million DEM, the company was established in 1996 with the sole aim of producing organic food. It grew rapidly over the years to about 1000 employees today. The company has a wide product range, e.g., animal feed, dried fruit and vegetables, nuts, and seeds, with 99% of its output being
exported. The range of dried fruit includes: apples (rings and cubes), apricots, cherries (sweet and sour), melons, peaches, and pears. It has over 3250 small farms as suppliers. All organic products are certified according to EU regulation 2092/91 (www.organic-europe.net).

There are also a large number of small exporters that are focused on the Russian market and/or the markets of other CIS countries. These exporters could be described as the ones that do not have the necessary capabilities to meet the safety and quality requirements of the EU market, as well as those unable to ensure proper communications with EU customers (CNFA, 2008).

**Growth challenges and opportunities**

Given that the changes in supply have a much larger effect on price levels than do changes in demand, the quantity and quality of raw material become of paramount importance to the success of the venture. The poor raw material production base in Moldova is considered to be the major constraint to further expansion of the dried fruit sector (CNFA, 2008). This is due chiefly to the aging and decreasing of orchards, the lack of varieties suitable for drying, and inefficient growing technologies. To the above, Tamara factors in the human factor in making the supply of raw material unreliable. For example, local suppliers do not know what a contract means: “today they, suppliers, deliver you a loaded truck; tomorrow they will not, saying they have a delivery for somebody else, for their relatives, etc” – as Tamara explained.

Tamara started facing all these issues as the company was growing. To mitigate these risks, in 2006 Tamara bought 100 ha of agricultural land, with the aim of starting to plant plum and cherry trees in 2007. However, this did not happen for several reasons. The soil was in a very deplorable state and required time to be prepared and ready for new orchards. At the same time, the planting trees and seeds had to be imported as there was no local production-base for such planting material. To the above, an import tax of 15% and VAT of 20% were put on such planting material, which made such imports unattractive. Only in 2008/2009 did the production-base of local planting trees and seeds start to emerge, which made it possible for VN-Plumcom Ltd. to buy the necessary planting material locally. In 2010, VN-Plumcom Ltd. planted its own orchards of plums and cherries.

This kind of backward integration has required VM-Plumcom Ltd. to acquire additional and considerable expertise in the management of physical resources such as land and water/irrigation, production systems such as crop rotation, varieties, operating costs, technology and husbandry, related human resources, such as family labour, permanent employees, picking labour, related capital items such as debt management and depreciation, and off-farm interests (RMCG, 2004). To the above, VM-Plumcom Ltd. has had to implement best business practices directed towards the protection of the environment.

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6 This backward integration trend could also be witnessed in other sectors of the economy, e.g., sugar and wine. The author had the opportunity to work as a consultant within a USAID project to one of the local sugar producers that was supporting sugar beet growers financially, logistically, and technologically (sometimes taking stakes in the ownership). The wine makers started buying land and growing their own vineyards in early 2000.
When VM-Plumcom Ltd. bought the industrial land, there was no access (distribution pipes) to gas, and there was no proper road. Tamara approached local gas company asking them to build a distribution pipe to their premises. She was told to use her own resources to build the pipe with later reimbursement. Tamara spent approximately € 65,000 to build this pipeline. After the pipe was built and functional, many other residential and small commercial customers ‘hooked’ onto the pipeline. To this day, the local gas company refuses to take the pipe onto their balance sheet and reimburse the money. The same happened with the road. Tamara invested in the construction of the road that connects VM-Plumcom Ltd. to the main road. When Tamara asked the mayor to take the road onto the balance sheet, she was refused on the argument that such a road was not budgeted by the mayor’s office.

The other enduring challenge is access to credit. The local financial market is not sophisticated, dominated by local banks, with foreign banks first being granted access to the market in 2008. The issue, however, is not so much the amount; it is about the cost and time. The interest rates are very high, 14% to 16% for USD or Euros, and over 20% for Moldova Lei. The settlement period for the loan is somewhere between 1 and 3 years. From 2006 to 2008 inclusive VM-Plumcom Ltd. benefited from a better loan from CNFA to support its capital investment in new equipment. The issue here is further amplified by the reluctance of banks to extend credit to the agricultural sector due to perceived high risks (CNFA, 2009).

The other related challenge has been the exchange rate. For political reasons (due to the upcoming general elections in spring of 2009), the Moldovan Lei was strengthened artificially in 2008 against the US dollar (Figure 3). Due to this artificial strengthening of the dollar, VM-Plumcom Ltd. encountered a loss of approximately 4 million Lei.

Another growth challenge for VM-Plumcom Ltd., that is also part of the variable costs of production, is labour. It is estimated that somewhere between 500 thousand and 1 million citizens left Moldova to work abroad since independence in 1991 (www.state.gov). Such scarcity of labour poses a real threat to the operations of VM-Plumcom Ltd., being in rural areas, far away from the capital and district centres. The scarcity of labour in numbers is further amplified by the scarcity of the quality of the labour. For example, VM-Plumcom Ltd. needs plumbers and electricians, as well as shift engineers/managers. Vocational education has been nearly destroyed since independence in 1991, and the extant university graduates are of low quality. The company internships are only on paper, with students coming only to ask for attendance papers to be signed without any real interest to learn from hands-on experience.

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7 In 2009, Moldova was ranked as the fifth most stable economy in the world, the main reasons being the primitive financial system, the low level of credit issuing, being an agricultural rather real based economy, thus making Moldova less vulnerable to the global financial and economic crisis (www.thebanker.com).

8 Again, this trend is not sector specific. As an Executive Director of IABP-Moldova (the International Association of Business and Parliament, an NGO that facilitates the dialogue between members of the parliament and business community), the author had the opportunity to take part in several company attachments/internships for members of the parliament in several ICT and apparel companies. In both sectors, high turn over of employees, and low quality of graduates were one of the main concerns of the entrepreneurs.
Yet another challenge is to cope with the disloyal competition in the market that comes from small dried fruit producers. Their products are of low quality and are unofficial (bypassing the tax authorities), making them ‘low cost/low price’ producers/exporters. To deal with these kinds of issues, VM-Plumcom Ltd. joined the Association of Canned Producers. Through this association, VM-Plumcom Ltd. has also received support in finding potential investors, and making its voice heard at the Government and Parliament levels.

The vision

There is an increasing interest in different (organic) products in the EU, addressing key consumer demands such as health, wellness, enjoyment, and convenience (CBI, 2008). With a reliable and high quality supply base, Moldova may double or triple its exports to the EU market (CNFA, 2008). Tamara wants to take advantage of these opportunities by expanding her business through an investment in the production of dried and frozen vegetables. In addition to the quest for a needed $ 3 million, Tamara understands that there is another, equally challenging quest for suitable, reliable suppliers of needed vegetables with whom Tamara can sign long-term contracts.

Another growth path Tamara is considering today is an international joint venture. Recently she has been introduced to one of the largest German wholesalers of dried fruit products who expressed an interest in such a venture. Currently both parties have taken some time off to learn more about each other and prepare for the negotiations. The quest for funding could end if the deal is successful. However, the quest for a quality and reliable raw material base remains a challenge. With this in mind, the question is how much further VM-Plumcom
Ltd. should integrate backward horizontally? Will VM-Plumcom Ltd. be able then to preserve its mission to produce and sell dried fruit products?

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