Business operations during the crisis in the example of Podravka

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Professional thesis / Završni specijalistički

2018

Degree Grantor / Ustanova koja je dodijelila akademski / stručni stupanj: **University of Zagreb, Faculty of Agriculture / Sveučilište u Zagrebu, Agronomski fakultet**

Permanent link / Trajna poveznica: https://urn.nsk.hr/urn:nbn:hr:204:931487

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Download date / Datum preuzimanja: **2024-03-28**



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UNIVERSITY OF ZAGREB

FACULTY OF AGRICULTURE

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Business operations during the crisis in the example of Podravka

MBA THESIS

Zagreb, 2018

UNIVERSITY OF ZAGREB

FACULTY OF AGRICULTURE

Executive MBA in Agribusiness and Commerce

Tomislav Majdandžić

Business operations during the crisis in the example of Podravka

MBA THESIS

Mentor: doc. dr. sc. Branka Šakić Bobić

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1. Introduction

There are many reasons that can cause a crisis in a company. Some of them are internally and some externally driven. One of the key external factors is the macroeconomic environment. The history shows that each economy in the world has its ups and downs, often called business cycles. A business cycle consists of the contraction and expansion of the economy volume, mostly measured by GDP. Two hundred years ago the economists denied the existence of the business cycles, but the idea of cyclical movement of the economy is nowadays widely accepted. The last global financial and economic crisis was one of the biggest in the history and it affected almost any company in the world, at least in some way. The most common effects of the crisis on a business is reduced sales volume, which causes liquidity problems and forces the companies to restructure their business operations in order to cut costs. The labor cost is one of the costs that gets cut first since many companies cannot deal with too many inefficient employees.

The crisis does not affect all the companies in the same way, though. There are many factors determining possible effect of business cycles on company's operations. One of the key predictors is the industry of the company and it sensitivity on the business cycles. The food manufacturing and processing industry is an example of an industry relatively insensitive on the global market trends, since the demand for the food is both price and income inelastic. It means that the food consumption tends to be pretty stable even in recession.

Croatian food and beverage industry is one of the most important industry sectors and the most important manufacturing industry in Croatia. In total contribution of Croatian manufacturing industry to Croatian GDP, the food and beverage industry accumulates around 25% of the production and employs 21% of the employees. The economic crisis did not affect the Croatian food and beverage industry too much in terms of total revenues (relatively to other industries), but it still affected the liquidity of the companies and forced some of them to significantly cut their costs.

Another example of an industry that doesn't get too much affected by the business cycles is the pharmaceutical industry. In Croatia it is the leading high-tech industry. Still, the crisis did have some consequences on the industry, especially changing the structure of the demand in favor of generic, cheaper drugs and limiting the amount of the assets available for the research and development.

This MBA thesis will analyze both theoretical and empirical evidences of the impact of financial crisis on food and beverage and pharmaceutical industry. The theoretical analysis will be conducted using the available researches and other scientific literature and the theoretical knowledge will be empirically tested on an example of Podravka (Company), a company that operates in both industries.

The goal of the research is to test the impact of the financial crisis on business operations of Podravka between 2008 and 2013. This period was one of the most challenging periods in Podravka's history, because in the same time the Company had to deal with the global crisis, but also with internal problems caused by the bad management of the company.

2. The impact of business cycles on business operations

Each economy in the world has historically passed through good and bad times. Two hundred years ago the classical economists mostly denied the existence of business cycles. The idea of cyclical movement of economy started to gain its followers in early 1800s. One of the most important works in that field was Jean Charles Léonard de Sismondi's "*Nouveaux Principes d'économie politique*" in which he argues the nature of periodical economic crises, that can happen not only in war times. Since then the idea became very popular and many economists have described their vision of upward and downward movement of economy and their approaches for forecasting the future trends.

Since the business cycles present the movement of the economy in general, at the same time they represent the issue of macro- and microeconomics. There is almost no company that doesn't get affected by economic cycle. It is common that some businesses depend more and some less on the economy cycles, but they all get affected in one way or another, and so do their operations.

2.1. Definition of business cycles

There are many perspectives of business cycles, also known as economic cycles or trade cycles. One of the most popular definitions of business cycles is the one by Burns and Mitchell (1946)

> Business cycles are a type of fluctuation found in the aggregate economic activity of nations that organize their work mainly in business enterprises: a cycle consists of expansions occurring at about the same time in many economic activities, followed by similarly general recessions, contractions, and revivals which merge into the expansion phase of the next cycle.

The cited definition emphasizes two key features that are very important for identifying and measuring the business cycles. First is that business cycles are describing the general economy movement, so to measure them, we have to consider the aggregate economic activity. The most common way to measure an economic activity of a nation in total is by measuring gross domestic product (GDP). Blanchard and Johnson (2012) define GDP in three different ways:

1. GDP is the value of the final goods and services produced in the economy during a given period.

2. GDP is the sum of value added in the economy during a given period.

3. GDP is the sum of incomes in the economy during a given period.

The three definitions differ by their point of view (first two are from the production side and the last is from the income side), but all of them point out the measuring the aggregate economic activity, which makes the GDP a good starting point for identifying the business cycles.

The other key feature of the business cycle definition is the comovement among individual economic variables. In their analysis, Burns and Mitchell considered the historical concordance of hundreds of series which included those measuring commodity output, income, prices, interest rates, bank transactions, and transportation services (Diebold and Rudebush, 1996).

Although the definition of business cycles creates many new issues, many of them impacting measuring and identifying business cycles, it still serves as the foundation of modern thinking about business cycles (Škare and Stjepanović, 2016). In United States the key institution in defining the business cycles is The National Bureau of Economic Research (NBER), that has the access to data that allow identification of business cycle. According to NBER, the identification of a business cycle occurs in two steps:

1. Finding the cyclical peaks and troughs in observed economic variables

2. Determining whether these changes are common enough through the observed series.

If the answer on the second question is affirmative, the NBER identifies the aggregate business cycle or reference cycle (Škare and Stjepanović, 2016). The business cycle can be divided in four phases: expansion, peak, contraction and trough.

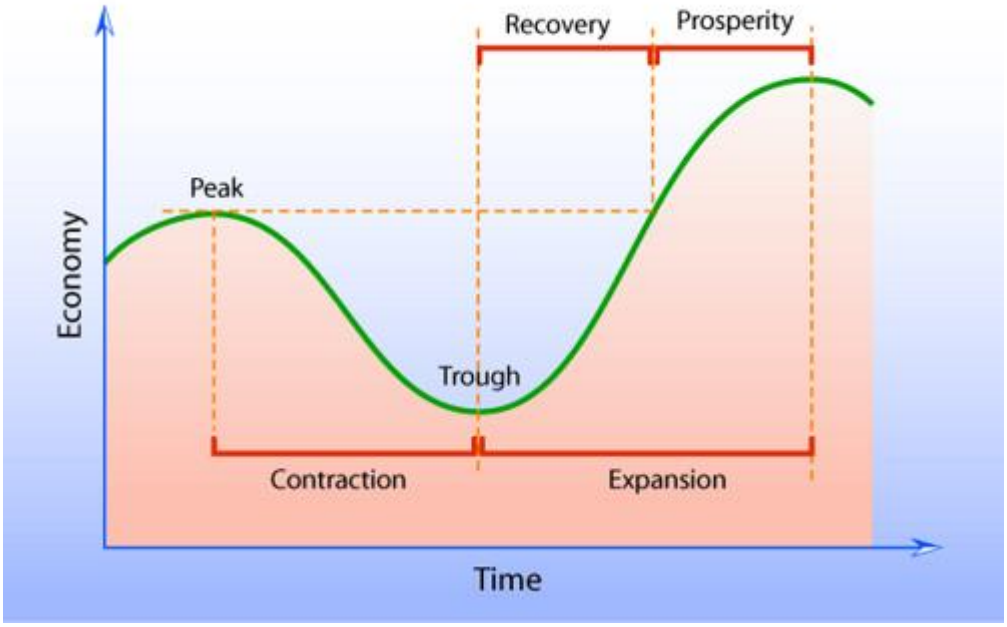
Expansion is the phase between the trough and the peak. This is the period when the economy is growing, and the GDP is increasing, mostly at its normal growth rate of two to three percent. It is commonly followed by the natural rate of unemployment of four to five percent and the inflation of around two percent. The stock market tends to show positive trend, and the phase can last for years.

But, the history shows us that most of the economies tend to start rising too much, which leads to the peak. It is the second phase of a business cycle and it mostly refers to the short period when the GDP growth starts to slow down, and it finally starts to fall.

The third phase is contraction. It starts at the peak of the cycle and ands at the trough. When the GDP starts to fall it is called recession. It is the period when the unemployment starts to raise and the stocks enter the bear market as the upset investors start to sell.

The trough is the fourth, and the last phase. This is the period when the economy transitions from the contraction phase to the expansion. All of the phases are shown in the figure 1.

Figure 1. Four phases of a business cycle



Source: http://kalyan-city.blogspot.hr/2011/07/what-is-trade-cycle-meaning-definition.html

This is not the only model for defining business cycles, but this is not the issue of this paper. The important fact for the purposes of this paper is that the existence of the business cycles in the world is proved by recent studies (Škare and Stjepanović, 2016). This paper will focus on the impact of those business cycles, especially the recession phase on the business process.

2.2. The impact of economic crisis on business

In the Oxford dictionary (Anon, 2017) the recession is defined as "a period of temporary economic decline during which trade and industrial activity are reduced, generally identified by a fall in GDP in two successive quarters". So, the recession in general describes the period of a decrease in real output (Blanchard and Johnson, 2012), which is connected with decline in real income, loss of jobs, a slowdown in industrial production and a significant drop in spending.

Recession is often also connected with terms depression, financial and economy crisis and other. Although those terms are not synonyms, they are pretty connected. The depression and economic crises mainly start with recession.

2.2.1. Financial performance

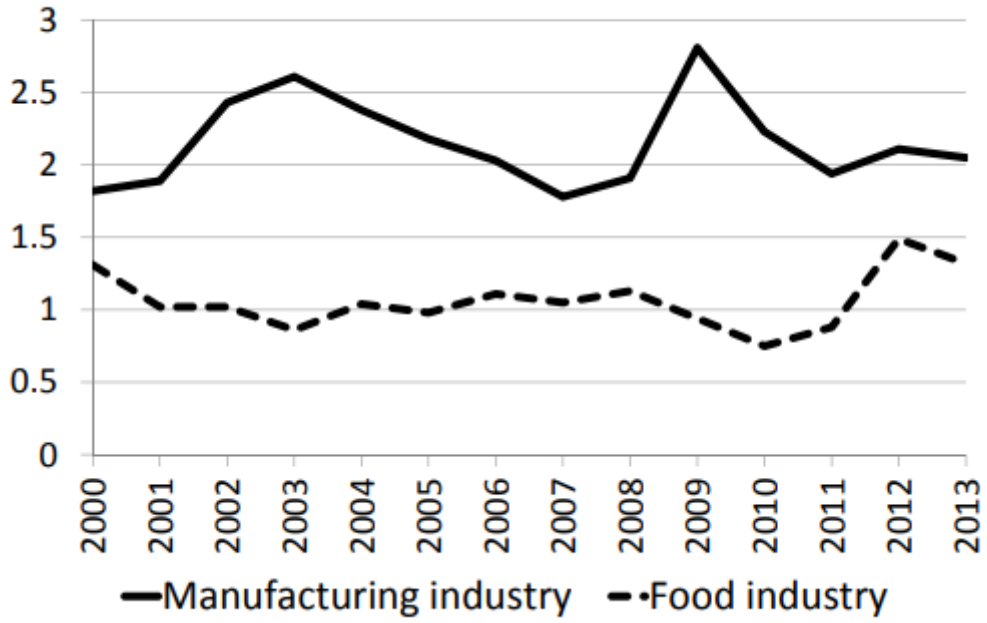
The crisis affects almost any business. First it affects the businesses financial performance, as sales revenues and profits decline. The first reaction of most companies is to start cutting costs. One of the first steps is to cut hiring new employees, and if necessary to fire some. In order to cut the costs even more, many manufacturers will stop buying the new equipment, cut the expanses of research and development and stop new product rollouts. Additionally, the cuts will be made in other areas, such as marketing expenditures. This affects other businesses that provide goods and services used by the manufacturer, so they have to do some of the restrictions on their own business.

The financial problems are often reflected on the company's quarterly earnings report which drops the stock price of the company. Due to the decrease in profits, most companies cut the dividend payments, so the shareholders become even more upset. The price fall of manufacturer's stocks can frighten the institutional investors, who may sell it and try to find a better performing investment. That can further depress the company's stock price.

Profits are not the only ones affected by the crisis. It may also impact the account receivables, as the customers of the company that owe it money may pay it more slowly than before, later or even not pay it at all. It affects the company's liquidity and solvency, so the company may start having problems in paying interests on its own debts. If the problems are not solved the company may default on bonds and other debt, further damaging its credit rating. In worst scenarios companies may eventually bankrupt.

One French study (Aleksanyan and Huiban, 2014) showed that the bankruptcy rate of manufacturers firms significantly rose in recent crisis. The crisis even affected the food companies in France, that had significantly lower (0.8%) annual bankruptcy rate in comparison with manufacturer companies (2.7%). Still, the rate doubled in the crisis years, which is shown in figure 2.

Figure 2. Annual bankruptcy rates for manufacturing and food industry in France



Source: (Aleksanyan and Huiban, 2014)

According to the study, the most vulnerable companies are the small and young companies, fighting for their position on the market. One of the key predictors of a bankruptcy is credit costs and productivity. The key to survive crisis is to manage financing the firm's operations, especially having ability to borrow money at reasonable cost.

2.2.2. Non-financial performance

The mentioned study highlights that the key non-financial predictor of a bankruptcy in crisis is productivity, even more important than any financial predictor. In order to survive the crisis, firms have to lower their costs, which mean that most of them have to cut the number of employees. It means that fewer people have to do more work, so the productivity per employee has to increase. On the other hand, this can significantly impact the morale of the employees since the work hours may become longer, the work conditions may be harder, and the wages tend to stay the same or even drop. Also, the employees fear of further layoffs. Some companies will even be forced to close entire brands that are poorly performing.

The crisis may also force the companies to cut quality of goods and services. In order to cut costs and improve bottom line some companies may compromise the quality of their products, which can impact their competitive advantage on the market. This is one of the common

strategies in the food industry. Some food companies may start offering less amount of the product, often in the same packaging as before, for the same price or simply reduce the quality of the product by using cheaper ingredients.

2.3. Business decision making in crisis

Recession and crisis times may be very difficult for a business. A crisis is very stressful for decision-making managers, who have to quickly adapt to the challenges of the new environment in which all the decisions "are made under considerable pressure and time constraints" (Bonn & Rundle-Thiele, 2007).

Pearson and Clair (1998) define an organizational crisis as "a low probability, high-impact event that threatens the viability of the organization and is characterized by ambiguity of cause, effect, and means of resolution, as well as by a belief that decisions must be made swiftly" (p.60). The definition highlights three important aspects of crisis (Bonn & Rundle-Thiele, 2007):

1. It is a major, unpredictable event that interferes with day-to-day business operations and places organizational survival in jeopardy;

2. With a low-probability of occurring, a crisis has an element of surprise;

3. A crisis has the pressure of time, demanding an immediate response to minimize its impact.

One research (Stefaniak, Baaki, & Blake, 2012) examines organizational leaders' decision-making process during the crisis, specifically during the latest economic recession, which has been considered as "the most serious recession since the Great Depression". The research explores three key research questions: (1) Are crisis decisions made using a discovery process rather than an idea-imposition process? (2) Do crisis response processes predominantly include ready-made solutions versus custom-made solutions? (3) Do crisis response decision processes include successive iterations through the evaluation and acceptance or rejection of distinct solution alternatives? The key findings of the research show that the crisis strongly affects the business decision-making progress. Most of the leaders claimed that in many cases they were not sure about the outcomes of their decisions. 90% of leaders said that they used some sort of custom solutions, rather than ready-made ones. Most of them also claim that they waited too long to see if the economy was going to turn around and they think that they should have made some key decisions several months earlier. This brings out the questions: When to start implementing crisis management decisions and what are those decisions?

Professor Paul Strebel (2008) points up seven recommendations for dealing with recession and crisis:

1. Liquidity

No matter what is the industry, if the revenues of a company drop sharply, and the debtors stop paying their debts, creditors can lose their confidence and insist on immediate payment. Therefore, the best way to prepare for the crisis situation is liquidity planning. It should be done based on analysis of the payments schedule, creditor terms and debtor collectability.

2. Reducing fixed costs and increasing flexibility

Large fixed costs may produce serious problems for a company in crisis, since they prevent the company from downsizing the activity. The ability to rapidly scale back the activity in recession without incurring major losses, and then scale back when the economy recovers can be crucial for the survival. The example are the budget airlines, with leased fleets and highly flexible pricing that came out of the 2001. downturn much better then slow-moving larger airlines.

3. Boldly restructuring

The bad economic environment soon reveals which parts of the business are underperforming and are not profitable. Those may be the parts that either are non-profitable through a full economic cycle, or that are just hardly affected by them. Either way, if the restructuring is needed, it is important to act as soon as possible, before the markets for he assets begin to freeze up. Although the business decisions connected with restructuring may be hard, they can save the company, so therefore they might be indispensable.

4. Supporting critical long term partners

Some partners can still be critical for the company, especially if they are critical distributors or customers of a company. With the company they often build a value chain. So, if the partners go down, the whole value chain might be jeopardized. To reduce that risk, some manufacturers can decide to offer a special support to help their week suppliers survive the crisis.

5. Crisis may create opportunities

For the firms with strong balance sheets and liquidity, recession may present a nice opportunity to acquire talents, assets, access to market or buy whole businesses cheaply. It may change the entire industry situation when the economy recovers.

6. Responsible management

The role of the leaders in crisis situations is crucial. The leaders have to “keep their heads when those around them are losing theirs and blaming it on them” (Strebel, 2008). The key is to maintain credibility, which in crisis situations also means cutting down personal expenses and keeping moral on sustainable level.

7. Board members can play a crucial role

Board members have a dual role. In one hand they have to control the operations of the management, so they meet the needs of shareholders, and in the same time they support management in value-creating process. Board members with industry expertise may support the management in making crucial decisions like downsizing or investing in new opportunities.

3. Croatian food and pharmaceutical industry in recent global financial crisis

The food industry is one of the biggest industries in European Union, even bigger then car industry. The situation is very similar in Croatia. In last few years the food and beverage industry in Croatia contributed to GDP with 4% (3.1% food and 0.9% beverage in year 2014). The industry was significantly affected by crisis, and it took 7 years to recover, but finally, in 2015 the aggregate activity in food industry reached its performance from 2008 and in 2016 it surpassed those numbers by 3.5%. In the period between 2008 the food industry export grew 83.7%, while the import grew 64.7% (Palić, 2017).

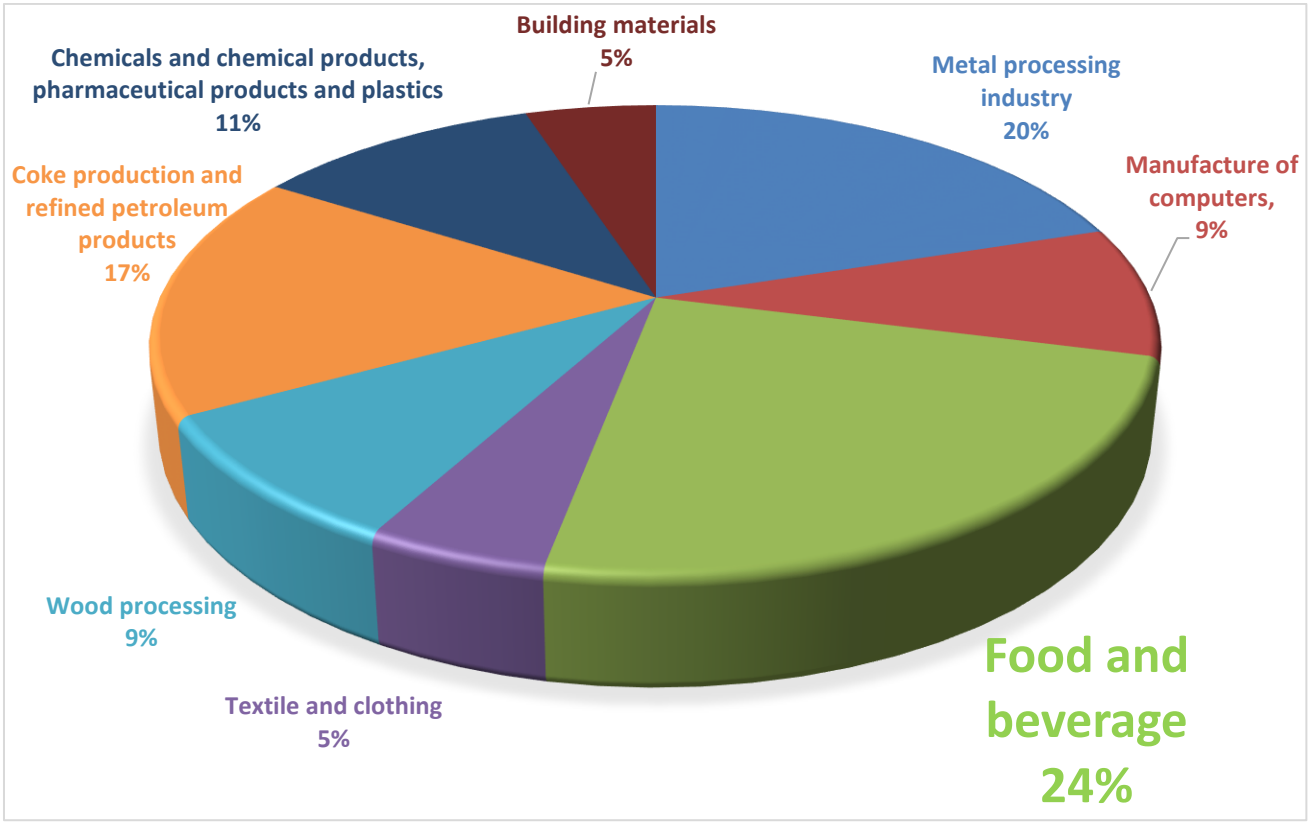
Pharmaceutical industry shows also positive trend in the year 2016. In European Union it has one of the leading positions in high technology industries. The aggregate production in the industry in European Union is around 250 billion euros, and it employs about 745 000 people. Besides global financial trends, the industry faces some special challenges like regulations, government spending cuts and rising costs of research and development.

3.1. Croatian food industry

Food and beverage industry is one of the most important industry sectors and the most important manufacturing industry in Croatia. In total Croatian manufacturing industry GDP, food and beverage industry contribute with 24 to 26.9% (numbers vary in different sources), as shown in figure 3. It is also one of the most important manufacturing industries considering employment because in overall manufacturing industry, food and beverage industry employs 21% of people.

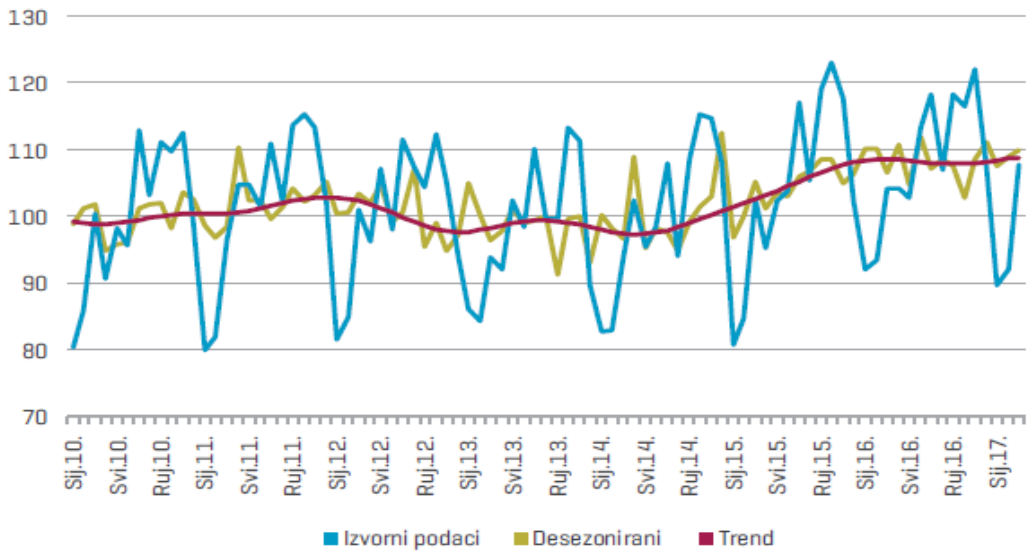
The industry has been affected by the crisis, but the total production was not too volatile in last ten years. Since food consumption doesn't fall too much in bad economic environment, food and beverage industry is known as one of the industries that gets at least affected by business cycles (Pelagatti, 2004). The figure 4 shows the movement of the Croatian food industry production from 2010 to 2017. Although the quarterly data seem to be pretty volatile, the seasonally adjusted trend shows a stable movement with a positive direction. In 2016 the food industry production level was 3.6% higher than in 2008.

Figure 3. Croatian manufacturing industry by sector income in 2014



Source: Croatian Chamber of Economy, 2016

Figure 4. Croatian food production index from 2010 to 2017, 2010=100



Source: Palić, 2017

Although the production of Croatian food market showed the positive trend, the number of employees did not follow that rise. In the end of 2016 the food industry was employing 7.4% less employees than in the end of 2015. This indicates the rise of the productivity of Croatian food industry, which was slightly followed by increases in salaries.

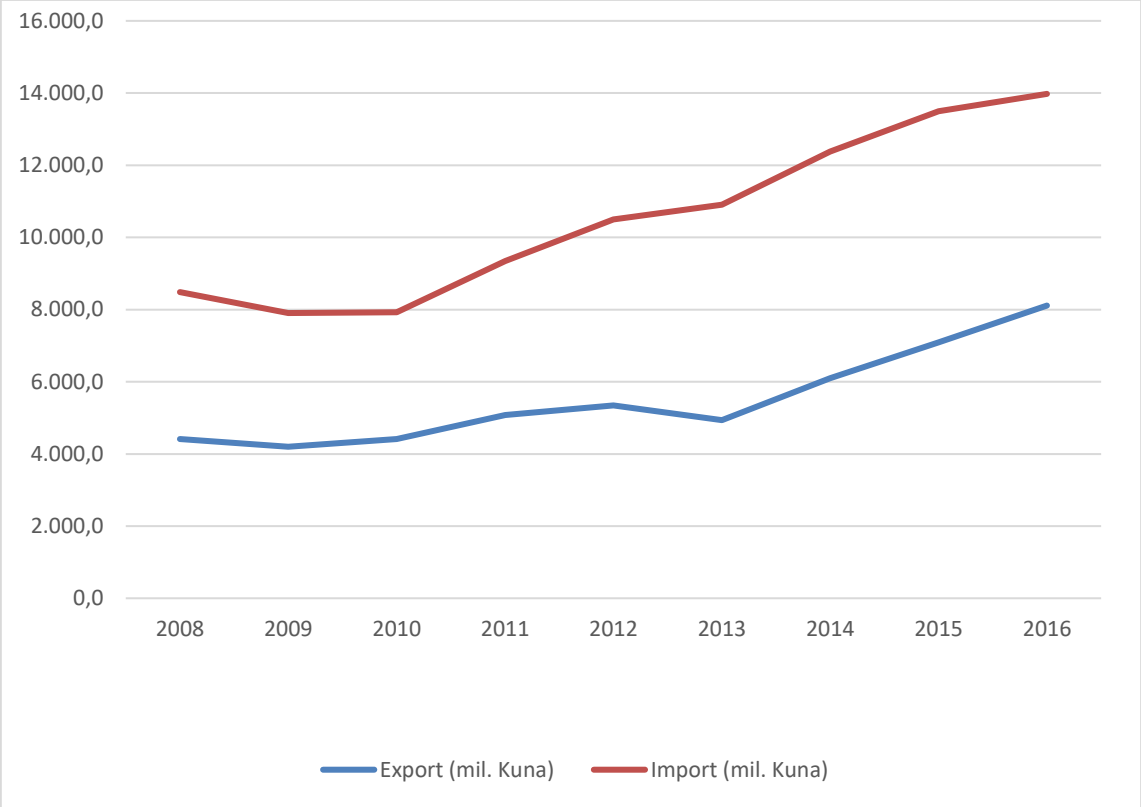
On Croatian stock market, Zagreb Stock Exchange, there are fourteen food industry companies and three beverage manufacturing companies. Among top ten food manufacturers five companies are publically traded:

- Podravka PLC,
- Dukat PLC,
- Kraš PLC,
- Ledo PLC and
- Čakovečki mlinovi PLC

The remaining five top food companies are private companies: Franck PLC, Mesna industrija braća Pivac Ltd, PIK Vrbovec – mesna industrija PLC, PPK PLC, Vindija PLC and Viro tvornica šećera PLC. It is important to highlight that every mentioned company is owned by Croatian citizens, but Croatia still imports about twice as much food as it exports. Still, despite the global financial crisis, Croatian food export grew faster than the import, which improved Croatian trade balance. In 2016 the food export was 83.7% higher than in 2008, while the import of food goods grew only 64.7% in the same period. In 2016 Croatia imported food worth 8.5 billion kunas and exported 4.5 billion kunas, so 58% of the import was covered by export, which is 6 percentage points more than in 2008.

As shown in Figure 5, entering European Union in 2013, strongly affected Croatian food import and export. One year after accessing European Union, Croatian food import grew, while cheaper products entered Croatian market and in the same year the export fell. But, in next years the export recovered, reaching its mentioned figures.

Figure 5. Croatian import and export in food industry



Source: Author, data from Bureau of Statistics

According to Agency for Investments and Competitiveness (2013), the most profitable food and beverage industry fields in Croatia are milk and cheese manufacturing, beer manufacturing, tea and coffee manufacturing and nonalcoholic drinks manufacturing and confectionery industry.

3.2. Croatian pharmaceutical industry

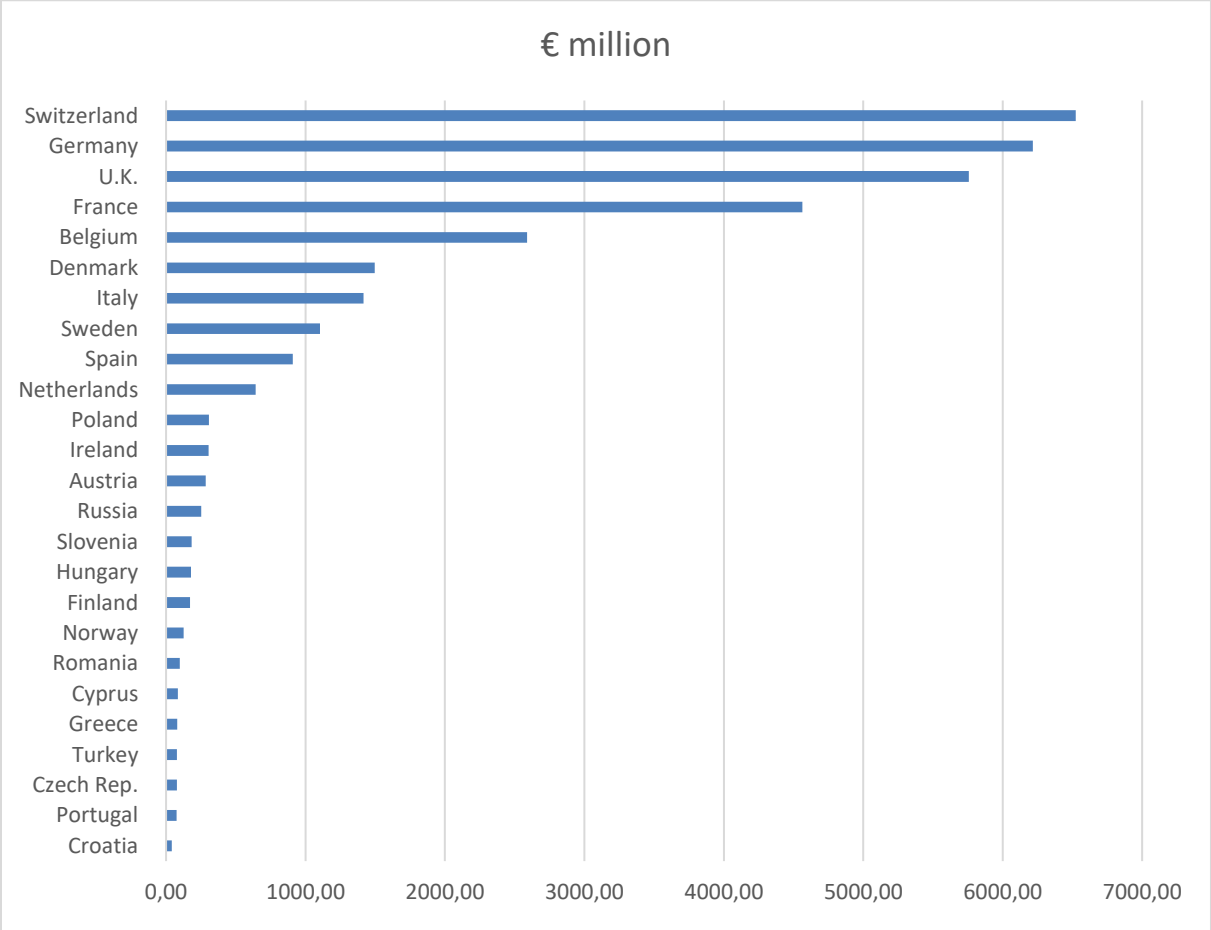
Podravka operates not only in the food industry, but also in the pharmaceutical industry through its subsidiary Belupo PLC. Pharmaceutical industry is one of the leading high-technology industries in Croatia. In 2016 the total pharmaceutical production was around 250 billion euros in European Union (Barbić, 2017). In 2016 the industry showed positive trend in Croatia, but also globally. The know-how is one of the key competitive advantage sources, which explains the high salary costs in the industry. In 2016 the pharmaceutical industry employed 745.000 people in European Union, among whom there are 115000 highly qualified employees (Barbić, 2017). In 2011 the average gross salary in pharmaceutical industry was 1800 euros, while the average gross salary in Croatia was 1000 euros (Agency for Investments and Competitiveness, 2014).

3.2.1. Research and development

Most of the highly qualified employees in pharmaceutical industry are in charge of the activities of research and development. The pharmaceutical industry is one of the sectors of Croatian economy where investing in research and development is extensive (Agency for Investments and Competitiveness, 2014). The European Federation of Pharmaceutical Industries and Associations (EFPIA, 2017) research and development of a new medicine is a very risky investment since:

- By the time a medicinal product reaches the market, an average of 12-13 years will have elapsed since the first synthesis of the new active substance;
- The cost of researching and developing a new chemical or biological entity is estimated at €1,926 million ($2,558 million in year 2013) in 2016;
- On average, only one to two of every 10,000 substances synthesized in laboratories will successfully pass all stages of development required to become a marketable medicine.

Figure 6. Research and development investments in 2015.



Source: EFPIA, 2017

Still, the investing in research and development in pharmaceutical industry is indispensable if a company wants to stay on the very competitive market. This is why in 2015 nearly 33,600 million euros was invested in pharmaceutical research and development in Europe. The figure 6 shows the investments in research and development in European Union. Among all the listed countries (for some countries there is no available data) in 2015 Croatia invested the least in pharmaceutical research and development, 40 million euros, followed by Portugal with 75 million euros (EFPIA, 2017).

The smaller research and development investments are the result of two key factors. First, Croatian workforce is cheaper, which lowers the costs of research and development. According to Agency for Investments and Competitiveness (2014), the average labor cost in pharmaceutical industry in Croatia is €9.2 per hour, which is much lower than the labor costs in other countries in European Union.

Another reason for smaller investment in research and development is the smaller market. Croatian pharmaceutical production in 2015 was 434 million euros (EFPIA, 2017). Generic products make 42% of Croatian pharmaceutical sales value, which puts Croatia on the fourth place in Europe when calculating the share of generic products in total sales value (Barbić, 2017). The term generic product or generic describes a product sold by a manufacturer who is not "the inventor of the original product", and marketed when intellectual property protection rights are exhausted (EFPIA, 2017).

3.2.2. Most important companies

There are more than thirty companies operating in Croatian pharmaceutical industry, but there is a significant disproportion between the bigger and smaller ones. The top ten companies generate more than 90% of sectors revenues and employ more than 90% of employees in the sector. Among those ten companies three should be highlighted:

- Pliva,
- Jadranski Galenski Laboratorij (JGL) and
- Belupo.

Pliva is the biggest Croatian pharmaceutical company. In 2016 the revenues of Pliva were 2.6 billion kunas, which is 62.1% of total pharmaceutical industry in Croatia. The followers JGL and Belupo both managed to raise their revenues in 2016 to 661.1 and 653.7 million kunas.

With that revenue level those two companies make around 9% of Croatian pharmaceutical market each.

Figure 7. Key performance indicators of Croatian top pharmaceutical companies in 2016

	Pliva	JGL	Belupo	TOP ten average
Total revenues (in HRKm)	4.601,80	661,1	653,7	666,7
2016/2015 revenues (%)	15,9	5,9	8,7	-8,6
Net profit (in HRKm)	554,8	91,3	60,3	79,1
Net profit margin (%)	12,1	13,8	9,2	8,3
ROA (%)	8,7	9,6	4,8	10,4
ROE (%)	15,1	20,3	7,7	3,8
Current ratio	1,1	2,9	1,7	2,4
Days receivables outstanding	106	317	184	215
Days inventories outstanding	134	139	83	99
Debt to equity ratio	0,6	1,6	0,9	0,8
Number of employees	2.095	615	1.062	442
Productivity (in HRKt)	583,9	312,9	247,8	491,5

Source: Babić 2017

The Figure 7 shows some of the key performance indicators of top three Croatian pharmaceutical companies. Although Pliva employees 43% of all top ten companies in the industry, it still shows the best productivity per employee. On the other hand, the activity ratios indicate one problems of the pharmaceutical industry related to receivables collection. The average days receivables outstanding in the industry is 215 days. This problem is a common problem for the pharmaceutical industry in Croatia, especially for the companies operating mostly in Croatia. The problems with collecting the receivables cause problems with liquidity. Another issue for companies in Croatia is presented by lower prices of prescription drugs.

3.3. The impact of global financial crisis on Croatian food and pharmaceutical industry

It is generally known that the food industry is very stable in terms of cyclical evolution (Castañer, 2009) since both in times of growth and recession changes in food and beverage

industry tend to be relatively moderate. In comparison, the sales of new cars in US declined 31% in January 2009, while the retail sales (mostly food and hygiene products) declined only 1.8%. Even in the periods of deepest recession, the decline of food consumption in developed countries rarely reaches 2%.

Still, the crisis affects some segments of the food industry. Mostly it affects the segments with bigger elasticity based on income level of consumers. For example, in 2008 the out-of-home food consumption declined 4.1% in US, especially in high-end retail, while the fast food chains have increased their sales. The same effect can be seen in sector of cheaper products at home like private brands and products on special offer. In January 2009 the sales of overall retail in US dropped 1.8%, while Wallmart succeeded to raise its sales for 2.1% (Castañer, 2009).

3.3.1. Price elasticity of demand for food products

Price elasticity is a measure that shows the change in demanded quantity of certain product when its price changes. When speaking about the products satisfying essential human needs, like food, the elasticity tends to be lower.

The CPI (consumer price index) shows changes in the prices of market basket of consumer goods and services purchased by households. The goods are mostly classified by its purpose (COICOP - Classification of Individual Consumption by Purpose) in 14 main groups: Food and non-alcoholic beverages, Alcoholic beverages and tobacco, Clothing and footwear, Housing, water, electricity, gas and other fuels, Furnishings, household equipment and routine household maintenance, Health, Transport, Communication, Recreation and culture, Education, Restaurants and hotels, Miscellaneous goods and services, Individual consumption expenditure of non-profit institutions serving households (NPISHs), Individual consumption expenditure of general government. The Figure 8 shows the level of CPI in general and for food and non-alcoholic beverage between 2001 and 2014.

Figure 8. CPI 2001-2014

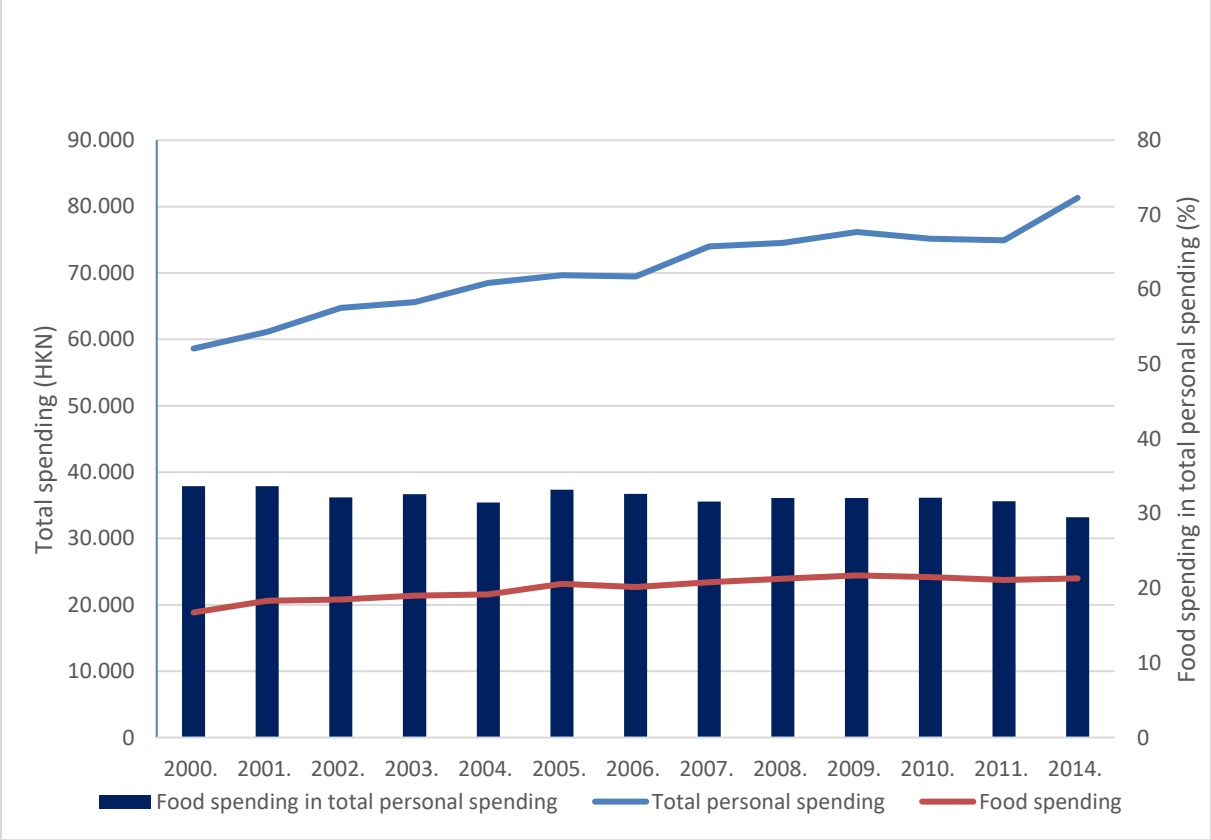
Year	CPI general	CPI Food and non-alcoholic beverage
2001/2000	103.8	102.5
2002/2001	101.7	100.2
2003/2002	101.8	101.6
2004/2003	102.1	101.4
2005/2004	103.3	104.6
2006/2005	103.2	102.5
2007/2006	102.9	103.3

2008/2007	106.1	110.0
2009/2008	102.4	101.6
2010/2009	101.1	98.5
2011/2010	102.3	103.5
2012/2011	103.4	103.7
2013/2012	102.2	103.7
2014/2013	99.8	97.8

Source: Author, According to Croatian Bureau of Statistics: *Statistical yearbook* 2003-2015

In 2008 the prices of food and non-alcoholic beverages raised significantly, but that didn't cause a significant change in total personal spending for food and non-alcoholic beverages. As the Figure 9 shows, although the total personal spending varied through years, the spending for food and non-alcoholic beverages remains relatively stable, so the percentage of food spending in total personal spending tends to drop when the total spending increases.

Figure 8. Total personal spending and food spending 2000-2014



Source: Author, According to Croatian Bureau of Statistics: *Statistical yearbook* 2003-2015

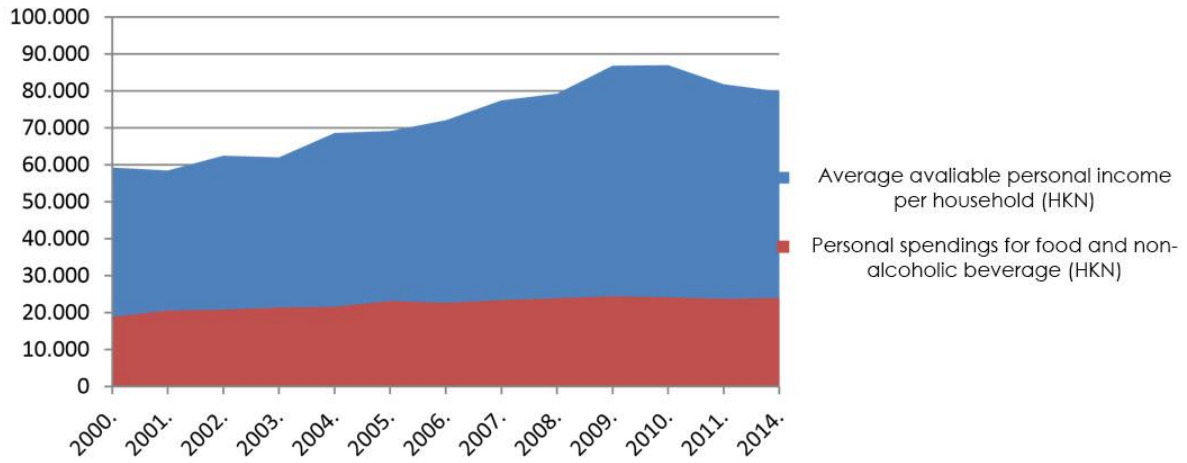
This proves that the food consumption and demand are stable, even when the prices and total personal consumptions are changing. The total spending in 2014 was 9.11% higher than in

2008, while the spending for food and non-alcoholic beverage increased only 0.35% in the same period.

3.3.2. Income elasticity of demand for food products

Most of the economy textbooks cite Engel's law which points that as income rises, the proportion of income spent on food falls, even if absolute expenditure on food rises (Dubravčić, 2004), so it can be concluded that the income elasticity of demand for food is between 0 and 1. This relationship between available personal income per household and personal spending on food and non-alcoholic drinks is shown on Figure 9.

Figure 9. Average available personal income per household and personal spending of the household on food and non-alcoholic beverages



Source: Author, According to Croatian Bureau of Statistics: *Statistical yearbook* 2003-2015

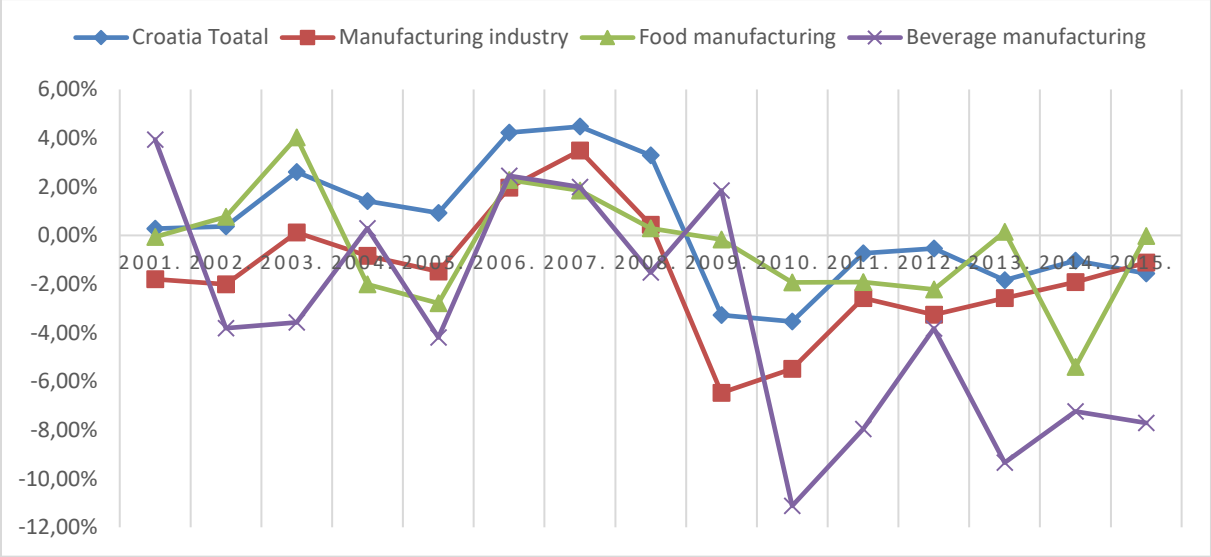
During the period from 2000 to 2014 the average share of personal spending for food and non-alcoholic beverage in average available income of household was 31.27%. Even when the personal income rose, the spending for food remained the same, which proves the Engel's law.

3.3.3. Employment in food and beverage industry in crisis

The crisis has a strong impact on employment, but the impact often occurs few months after the start of the crisis, when the companies start adopting the new environment. This effect could be seen on Croatian food and beverage industry. In 2009 the total number of employees dropped for 3.27% in Croatia in total and 6.47% in manufacturing industry. The next year, 2010, the number of employees in Croatia dropped another 3.54% in Croatia and 5.49% in manufacturing industry. The Croatian food and beverage manufacturers, though, reacted to the crisis a bit later.

In 2009 the numbers of the employees in the food industry dropped for 0.16% and in beverage industry it increased for 1.85%. The next year in the food industry there was 1.93 and in beverage industry 11.12% less employees then the year before. This numbers prove again the stability of the food industry, which is not the case in the beverage industry. Figure 10 shows the changes of the number of employees in Croatia in general, manufacturing industry and food and beverage industry.

Figure 10. Changes of the number of employees in Croatia in general, manufacturing industry and food and beverage industry 2001 – 2014.



Source: Author, According to Croatian Bureau of Statistics: *Statistical yearbook* 2003-2015

Although the food industry, like any other in the crisis had to lay off some of the employees in order to cut costs it did not cut salaries. As shown on Figure 11, the crisis stopped the stable growth of salaries in food manufacturing industry, but the companies did not cut them significantly. From 2001 to 2008 the average salary in food industry grew on average 4.9% every year, in 2009 the increase was only 1%, and from then until 2014 the salaries remained pretty much the same. That way the total food industry in Croatia cut its labor costs for 3.46% between 2008 and 2011 (CBS, 2003-2016).

Figure 11. Total number of employees in food industry and average salary between 2001 and 2014



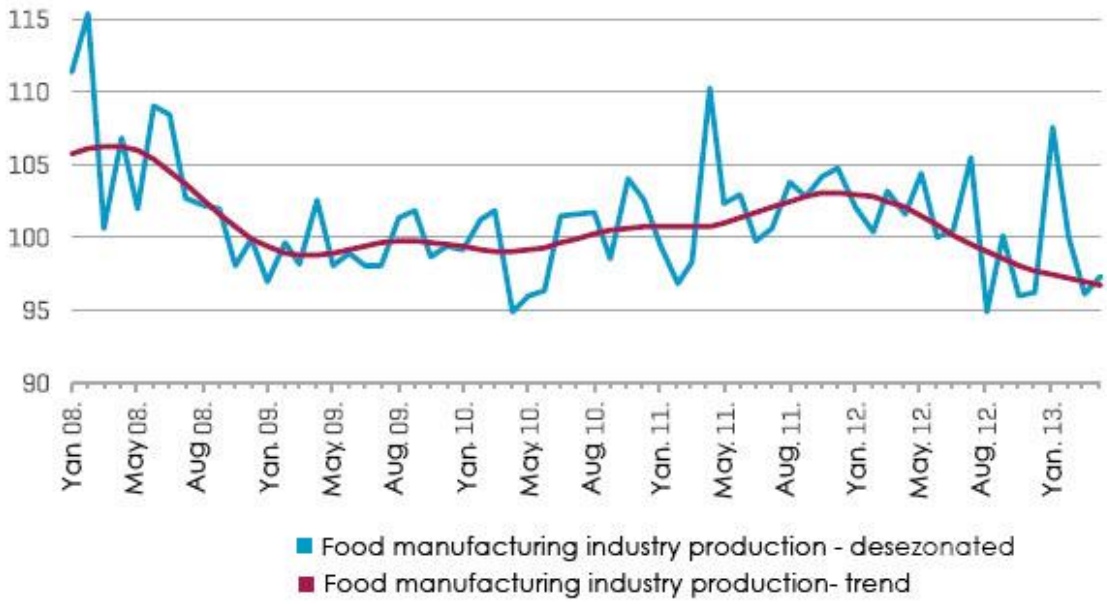
Source: Author, According to Croatian Bureau of Statistics: *Statistical yearbook* 2003-2015

3.3.4. Production and sales in food industry in crisis

Croatian manufacturing industry production was significantly affected by the crisis. In 2008 the production slowed down and in 2009 it decreased 10.6%. The trend was similar in food and beverage manufacturing industry, but with less intensity. The negative trend in the food industry started in May 2008 and peaked in the May 2010, but the production was not volatile. In 2009 the production decreased for only 0.5% and in the next year it recovered (CBS, 2013). The industry continued its positive trend for two years and then, in the beginning of 2012 the production started decreasing, as showed on Figure 12.

According to the Institute of Economics, Zagreb (Barbić, 2013) the global financial crisis impacted the food manufacturing industry in Croatia with the lag of two years. That was followed by entering the European Union in 2013 which encouraged the producers of cheaper goods (like private brands) to penetrate the Croatian market. Another problem was the unsatisfying level of vertical and horizontal connection between the companies and institutions in the food market and the lack of innovative companies.

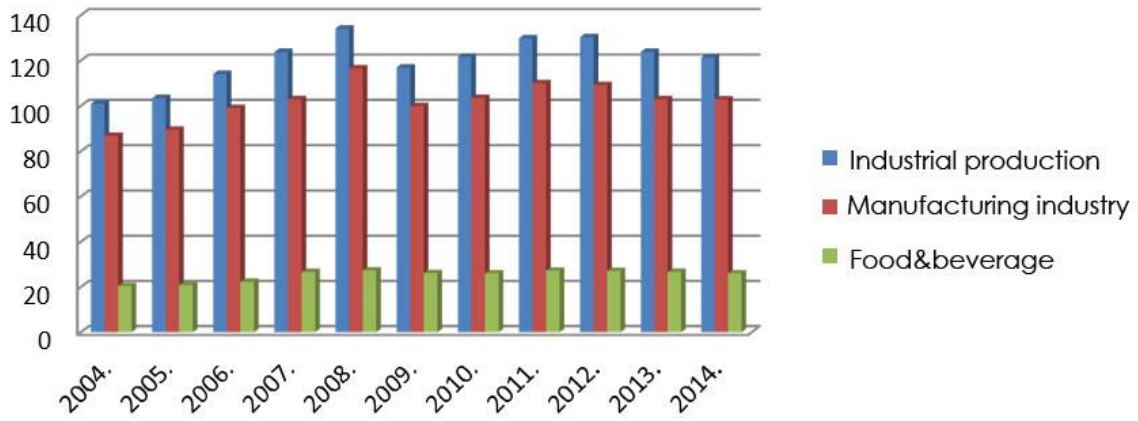
Figure 12. Food products production, 2010=100



Source: Barbić, 2013

The sales of food products showed higher volatility than its production. The sales of the manufacturing industry showed positive trend between 2004 and 2008, growing at the stable average rate of 7.74% a year in which the food manufacturing industry showed the highest average growth rate of 7.77%. The crisis decreased the manufacturing industry's sales for 14.26% in 2009, and the sales of the food and beverage products was affected at least, with 4.39% decrease. The sales of the food and beverage products still showed pretty unusual volatility in Croatia. In 2007, a year before crisis, the sales of the sector increased 19.08%, then it slowed down in 2008 rising 2.66% and finally in 2009 the sales dropped. The same scenario as in the production occurred in sales too. The 2011 was a recovery year, when the sales of food and beverage increased for 4.7%, but it started decreasing again in the next year, keeping its negative trend until 2015.

Figure 13. Industrial sales between 2004 and 2014



Source: Author, According to Croatian Bureau of Statistics: *Statistical yearbook* 2003-2015

The changes in sales of food products impacted the number of the companies in the industry. Between 2004 and 2014 the number of companies in the food industry increased more than three times, but the increase was not evenly distributed through the years. In 2006 there was 78.57 more companies in the industry than a year before, but the recession slowed down the raise. Still, as already mentioned, the Croatian food industry is pretty concentrated, with top companies earning the most of the industry's revenues.

The biggest companies in the industry are Podravka, Vindija, TDR, Dukat, PIK Vrbovec, Ledo, Coca Cola Beverages Croatia, Jamnica, Kraš and Zagrebačka pivovara. Some of the companies were affected more and some less by the crisis. Dukat, one of Croatian key milk manufacturer, was affected by the crisis in two waves. In 2008 the company had an excellent year with 1.84 billion kunas revenues, but they decreased the next year for 3.26%, which was followed by another 2.8% drop in 2010. In 2011 the company managed to recover and even surpass the revenues from 2008, but not for long time, because in 2012 the revenues of the company decreased again 4.28%, followed by another 6.15% decrease in 2013. The described movement of the revenues represents exactly the movement of the Croatian food and beverage industry in the crisis. Still, the company managed to control its revenues per employee, by cutting down the number of employees.

Another example is from the meat manufacturing industry. Braća (eng. Brothers) Pivac is one of the leading companies in the Meat industry. The crisis affected its revenues only in 2010 with the drop of 8.57% and all the other years the company retained its stable revenue growth.

Despite the revenue stability, the gross profit of the company was pretty volatile. In the period between 2009 and 2012 the gross profit of the company decreased for 41.26%, but it recovered in the following years, growing 185.3% in the next four years.

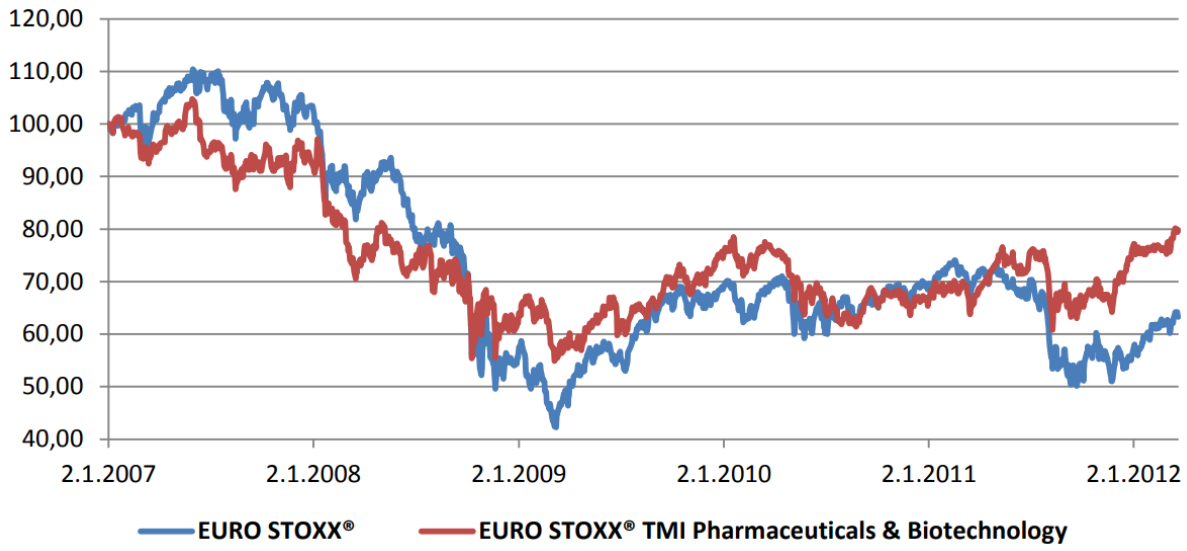
Almost every company from the sector experienced one of the two described scenarios, but in many cases it is hard to distinguish the lagging effects of the crisis and the effects connected with entering the European Union in the period after 2013. Croatian food industry strongly relies on the export, especially the one connected with the tourism. Some of the key exporting markets for Croatian food products are the neighbor Bosnia and Hercegovina, Italy, Slovenia and Serbia, while the imported products mostly come from Italy, Germany, Brazil, Hungary and Holland.

3.3.5. The impact of the crisis on Croatian pharmaceutical industry

The pharmaceutical and food industry both are quite cyclical insensitive, since the products of the industry have almost no substitutes. The Croatian pharmaceutical industry was no exception to described rule both in terms of companies' performance and stock market volatility.

The crisis affected all the capital markets including the pharmaceutical industry, but it showed more resistance than other industries. Comparing the movement of EURO STOXX® TMI Pharmaceuticals & Biotechnology index, that in 2012 included 16 pharmaceutical companies, to its respective EURO STOXX® index, that in the same year included 304 companies, the correlation stands out.

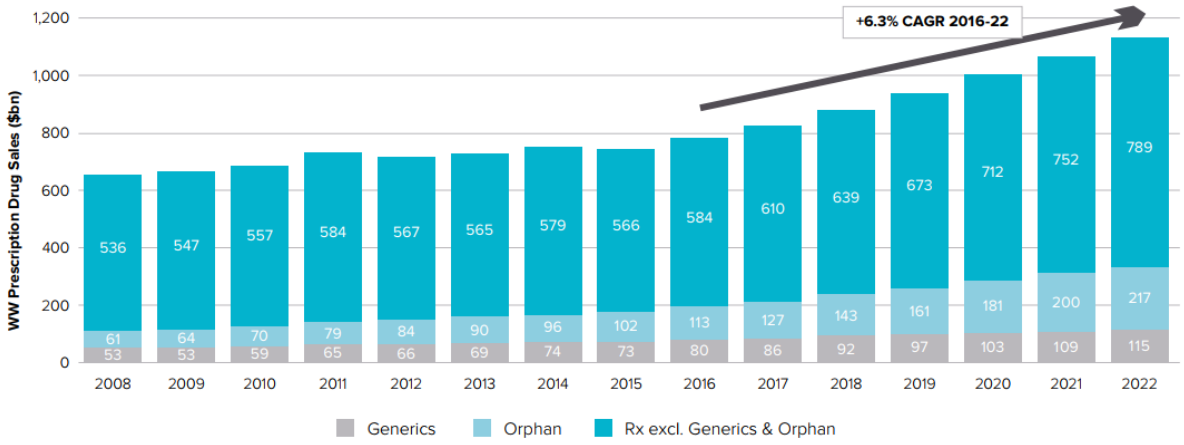
Figure 14. Movement of sector index relative to respective Eurozone index



The figure 14 also proves the fact that pharmaceutical industry is defensive industry and thus less volatile compared to its respective index. In the recession the pharmaceutical market shows less intense correction, and it recovers from the recession faster than the rest of the market.

The early 2010s were affected not only by the global financial crisis, but also by the general fear of Greek, Portugal's and Spain's debt crisis potential of harming the rest of the Europe. Still, the industry succeeded to remain its stable compounded annual growth rate (CAGR) between 5 and 8% worldwide. The exception was 2012 when the worldwide total drug sales dropped due to reduced sales of medical prescription (Rx) medicine of 3% (EvaluatePharma, 2016). The orphan drugs and generics retained their growing trends even in crisis and keeping the growth ever since. The Figure 15 shows the worldwide total prescription drug sales between 2008 and 2016 and the projection of the next five years.

Figure 15. Worldwide Total Prescription Drug Sales (2008-2022)



Source: EvaluatePharma, 2016

The recession has a common effect on the pharmaceutical market, pushing the sales to the generic products, rather than to the originals, since the consumers hurt by the economic crisis struggle to pay for over-the-counter (OTC) drugs (Behner, et.al., 2009). The governments boost that trend intensifying scrutiny of healthcare budgets, and encouraging the cost containment measures, forcing the healthcare system to increase generic substitution for original drugs which tend to be 30 to 80% cheaper. This is why the crisis can positively affect the generic drugs market.

On the other hand, this trend creates a lot of pressure on the companies that invest in research and development of new drugs, because after the patent expires, the market replaces the drug

with its generic substitute, and the sales drop significantly. The term “patent cliff” visually demonstrates what happens to the drug sales when its patent expires. The described phenomenon dissimulates companies from investing in the research and development, which encourages some of the companies to move their activities to the less price sensitive niches like oncology and immunology.

Many companies tried to find their opportunities on emerging markets, mostly on China, Brazil, Russia and India. The markets in the time were still not saturated, so the fight for the market share was still on. The problem with those markets is that they are in large part self-paying markets for all pharmaceuticals; in Brazil and India out-of-pocket expenses make up to 80% of drug spending (Behner, et.al., 2009), which again produces better opportunities for generic drugs then for original ones.

4. Business operations of Podravka in crisis

In the theoretical part of this paper, the crisis was defined, and its effect on food manufacturing and pharmaceutical industry was described. In the following part the theoretical implications will be tested on the company Podravka PLC According to its financial statements and other available data, its performance in the crisis (2008-2013) will be described.

The recent global financial crisis in 2008 had a huge impact on most of the Croatian companies, regardless of the industry. The Podravka was no exception. In 2009 its net profit reached the loss of 380 million kunas, which was a terrible performance compared to 44 million kunas gains in 2008. As described in the theoretical part, this is a very unusual outcome of the crisis neither for a food manufacturing or pharmaceutical companies. Therefore, the performance of the company has to be examined both internally and externally, highlighting the management activities performed to anticipate and react on the crisis.

4.1. Company and products overview

Podravka is one of the key Croatian food processing companies, and its brand Belupo is one of the key brands on the pharmaceutical market. The name of the company originates from the name of the geographical area where it comes from, Podravina (Podravka is an expression for a girl coming from Podravina). The company was founded in 1947 as an upgrade of an existing jam and fruit factory "Wolf".

Figure 16. The logo of Podravka



Source: Podravka, 2017

For many years the company built its position on Croatian and foreign markets, strengthening the brand and trying to emotionally connect with its customers. This is the reason why the company uses the heart sign in the logo and also highlights it with the slogans like: "From heart to heart" or "The company with a heart".

In 1993 the company Podravka was registered as private company and in 1998 the company went public with an initial public offering on Zagreb Stock Exchange (ZSE). There are 7.120.003 stocks issued and the price on 04/12/2017 is 299.00 kunas. The stocks are unevenly divided by different investors:

- 25.4% - Republic of Croatia,
- 49.1% - Croatian pension funds,
- 2.3% - treasury shares and
- 23.2% - others.

Some of the most famous Podravka's brands are recognized in Croatia, but also abroad: Vegeta, Dolcela, Lino, Eva, Fant, Kviki etc. Among them, the most famous one is Vegeta, that is been exported for more than 50 years in more than 40 countries.

4.1.1. Company's organization and products

Podravka Group is divided in two strategic business areas (hr. strateška poslovna područja – SPP): SPP Food and beverage and SPP Pharmaceutical. The existing business structure is actually the result of company's reorganization during 2009 and 2010 that was conducted in order to cut costs, and recover from the crisis. Podravka divides the food and beverage sector on four different sectors:

- Food – Podravka produces different food products. The most recognizable brands are
    - Lino (Lada - the sweet spread produced of roastet hazelnuts, cocoa and milk; Čokolino – children food)
    - Fini-mini – instant soups – the tasty and quick meal prepared in only few minutes
    - Talianetta – quickly prepared pasta that can be used as meal or side dish
    - Podravka – products under brand Podravka are mainly traditional food like fruit spread, chutney and sausages
    - Eva – fish products for preparing Mediterranean dishes
- Food condiments – Vegeta is the most famous company's products. It is an original combination of spices and dried vegetables.
- Meat – The meat products are mostly under the brand Podravka. Some of them are beef goulash, Jeger – homemade hunter sausage, Tyrol sausage Danica, grill sausages, ham luncheon meat, pâtés etc.
- Beverage – Podravka teas are very popular in Croatia.

The pharmaceutical sector operates under the company Belupo PLC and it mainly produces generic drugs. Belupo is the leader on the market of drugs for heart and vascular system, with the market share of around 30% (Bajić, 2010) in that area, but it also provides drugs for skin, infection treatment, nerves system, muscular system, digestion system etc.

Belupo PLC also provides pharmacy services through the company Deltis Pharm Ltd. Through that company Belupo entered the business of drugstore wholesale, joining the Pharma Net, the net of about hundred drugstores working as one unit in order to increase negotiating power and liquidity.

4.2. Podravka's business decisions in dealing with crisis

As shown, Podravka operates in two very different industry sectors, and has a very diversified product portfolio. On the one hand, this can be very helpful in competing on the heterogeneous markets, such as food and beverage market, especially in the period when the customers change their preferences and diet habits. In such an environment a food processing company has to differentiate its products to reach the customers with different preferences.

Too many products

On the other hand, too many products in the portfolio can reduce company's profitability, as the profits of the profitable products have to be invested in maintaining those less profitable. This can be a serious problem in crisis, which was exactly one of the key problems of Podravka in 2008 and in the following years. In the Annual report 2009, the Management Board President Miroslav Vitković says that the company is aware of the need to increase profitability of the business. Podravka has, therefore, for several years been improving processes which in 2009 resulted in operating costs savings, amounting HRK 131 million. The President highlights that the improvement of the processes included "insight in all the business processes and revealing the deficiencies of each, the result of what were the economies in the raw materials procurement process, savings in production through optimization of production processes and creating preconditions for additional savings in the processes of sales and distribution in the upcoming period" (Podravka, 2009). Still, six years later, some investment companies still think that the potential for Podravka lies in improving its efficiency by disposals of certain suboptimal assets that could improve the profitability of the company, and the funds could be used for new investments in the core segment (Bajić, 2015).

Competition

The unsatisfying efficiency was not the only problem of Podravka in 2009, one of the worst years in Podravka's modern history. The food industry is defined with rising demand that is a result of improvements in standards of living and diet qualities. The demand increased the competitiveness of the industry and the trend was encouraged with the globalization and market liberalization. The analyzed period was affected by Croatian joining European Union which impacted the industry by changes in the regulations, but also by encouraging the foreign competitors in entering Croatian market, especially the invasion of foreign discount supermarket chains with their private brands.

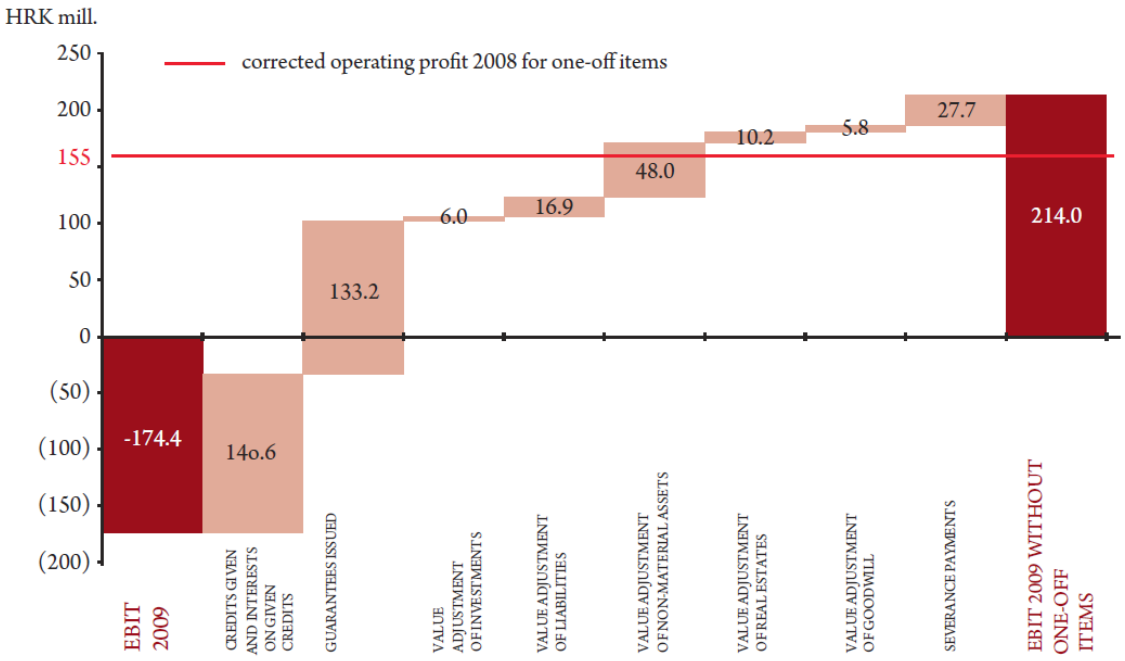
"Spice" scandal

The 2009 was a really tough year for Podravka. The financial performance of the company in that year was not only affected by the crisis and other common problems, but also by a huge scandal that involved some of the key persons from Podravkas management. Out of eight people arrested in the scandal, six were the managers of Podravka. The issue was a complex share-buying operation, suspected of embezzling $47.5m, reported the BBC (Lungescu, 2010).

In the 2009 Annual report the financial auditor highlights that the negative one-offs have affected the company's business result with HRK 388.4 million. So, due to uncertain return, value adjustments for loans and accrued interest were made in the amount of HRK 140.7 million for loans granted to the companies SMS Ltd., FIMA Grupa PLC and the company Gradec. "These loans except the long-term loans to the company SMS Ltd. were granted and paid out during the year 2009. Value adjustments of granted guarantees in the amount of HRK 133.2 million were also made (FIMA Grupa PLC) (Podravka, 2009)."

It is important to review the company's adjusted data to get an accurate picture about Podravka's performance in 2009. When the data gets adjusted for above mentioned one-off items, the numbers show a much better performance. The adjusted operating profit in 2009 was HRK 214 million, which is 58.6 million above the operating profit in 2008 disclosed in a comparable manner. This presents an increase of 35%.

Figure 17. Operating profit of the Podravka Group without one-off items, 2009



Source: Podravka, Annual report 2009

The affair left a huge mark on Podravka's history, and it started a series of changes in the top management of the company. In December, 2009, the Chairman of the Supervisory Board, Ljubo Jurčić, announced the new President of the Management Board, Miroslav Vitković. The key goal of the new management was to retrieve the company's financial stability, and to strategically prepare the company for the next few years of instability. One of the first moves of the new board president was to cut the number of Supervisory Board members from eleven to seven. The next few years the company struggled to clean all the financial mess caused by inadequate leadership. Only two years after, in February 2012, the company changed its leadership again. Miroslav Vitković was replaced by Zvonimir Mršić and Daubravko Štimac got Ljubo Jurčić's position. Although he had a much better starting position than Vitković, Zvonimir Mršić thought that the company needs another restructuring. He decided to give the company a "clean financial start" which is why the company's Annual report 2012 is under heavy influence of one-off items like value adjustments of material and non-material assets.

4.2.1. Dealing with employees

The problems with unclear financial reporting were not the only ones bothering the new and old management. In every annual report in the analyzed period Podravka highlights the problems with efficiency, especially the problems with too many employees. The problem was

connected with too many brands, among which some were underperforming in financial terms. Podravka's management recognized the problem, which is why in 2011 they started the "big 5" plan, the plan of strategically focusing on 5 key brands of the company. In the crisis years the company continuously focused on taking care of needless employees in order to increase its efficiency and profitability. In 2009 39,869 thousand of retirement benefits were accrued and paid for 350 employees (Podravka, 2009). The following years the company continued its retirement plan. In 2010 the company spent HRK 24,764 thousand and next year another HRK 25,693 thousand for retirement benefits (Podravka, 2011). In Podravka, the retirement plans are an issue of the Collective Agreement, which obligates the Group to pay jubilee awards retirement and other benefits to employees.

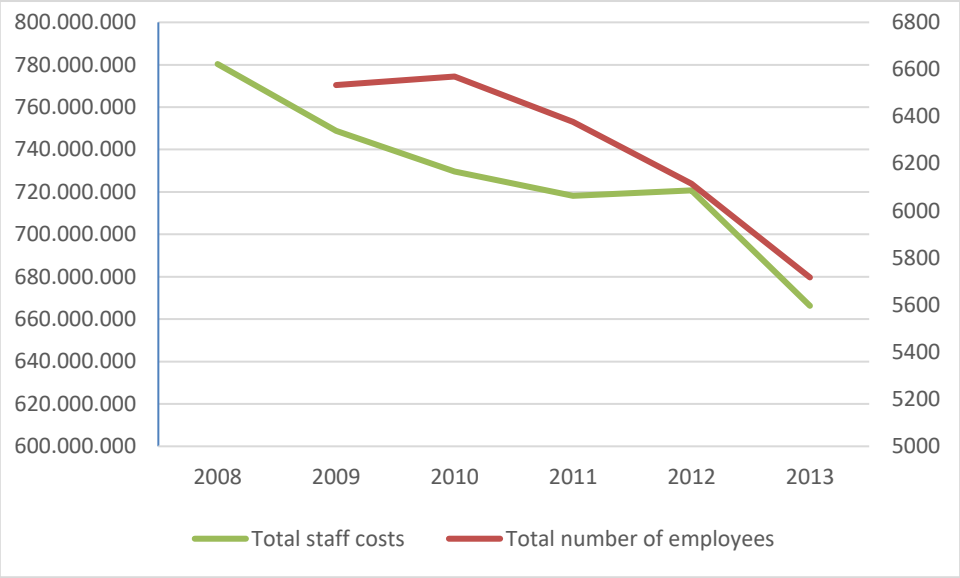
The Group operates defined benefit schemes for qualifying employees. Under the schemes, the employees are entitled to a regular retirement benefit (without stimulating retirement benefit) in the net amount of HRK 10 thousand, of which HRK 2 thousand are taxable. No other post-retirement benefits are provided. Jubilee awards are paid out according to the Collective Agreement, in the following net amounts and at the following anniversary dates:

- HRK 1,200 for 10 years of continuous service
- HRK 1,600 for 15 years of continuous service
- HRK 2,000 for 20 years of continuous service
- HRK 2,500 for 25 years of continuous service
- HRK 3,000 for 30 years of continuous service
- HRK 3,500 for 35 years of continuous service
- HRK 4,000 for 40 years of continuous service.

(Podravka, 2011)

The company claims that cutting the staff costs was one of the key factors in keeping the company profitable during the crisis. Between 2008 and 2013 the company managed to cut the total staff costs for 14.61%. The largest cuts occurred in 2009 (4.3%) and 2013 (7.55%). In the same period, the number of total employees dropped for 12.5%.

Figure 18. Total staff costs and number of employees 2008 – 2013



Source: Author, According to Podravka annual reports 2008 - 2013

As shown on Figure 18, the company tried to keep the number of employees stable until 2010, but then it started to reduce the staff. Actually, just in 2013 the company made its first "real" series of lay-offs. Until then, all the workers who left the firm did it willingly or as a part of stimulated earlier retirement programs.

In its annual reports, the Company always highlights its employees as a key success factor number one. Podravka (2009) states that "the employees have been given the biggest significance, since their knowledge and competencies positively distinguish the company from the competition and provide it with competitive advantage. Knowledge and competencies today are the most valuable asset".

We can conclude that cutting staff costs in Podravka was not only the matter of dealing with global financial crisis, but also the matter of company's profitability. Investing too much in non-performing assets seems to be one of the key company's problems, and every new management leadership has to deal with it.

4.2.3. Market position of the company during crisis

As mentioned, the Group operates with a lot of different brands from a variety of product types. Podravka's core business is food processing and its key brands come from the sectors of all-purpose food seasoning, soups, dehydrated baby food and fish cans. In 2009 the Group was the market leader in those four categories in Croatia, but also in dehydrated sweets and in the category of mineral water noncarbonated, it had a second market position in Croatia. The

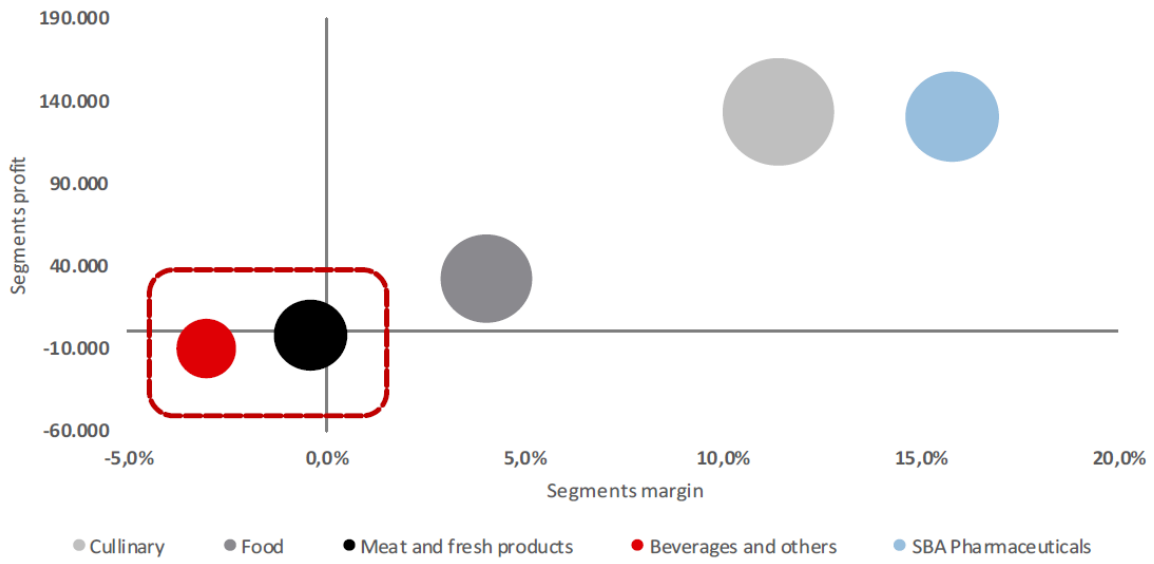
situation is pretty similar in neighbor countries, especially Slovenia, Bosnia and Hercegovina, but also in Macedonia. In Serbia and Montenegro it had a bit weaker position, with the third position in category all-purpose food seasoning. In Central Europe and Russia the company had a leading position almost only in all-purpose food seasoning category (Podravka, 2009-2013). Through the years of crisis, the Group succeeded to retain most of its leading position and even strengthen almost every of them in Serbia and Montenegro.

4.2.3. Key management challenges in Podravka during and after the crisis

As mentioned, Podravka is a stable company, but in the analyzed period it had a lot of room for improvement. The crisis hit the Company in the same time when it was dealing with internal challenges, which produced much higher pressure on Company's top management. Between 2009 and 2013 the key management challenge was to deal with inefficient sectors, trying to keep the jobs in the same time.

One of the most important management moves was the mentioned organizational restructuring that led to higher efficiency of the managerial expenses and cutting the costs. Those savings produced an extra opportunity for marketing investments, especially in the underperforming sectors in order to increase their profitability. Although the company invested a lot of efforts in those segments, some of them stayed unprofitable even in 2013.

Figure 19. Segment profitability, 2013



Source: Bajić, 2014

As the Figure 18 shows, the culinary segment, that includes Food Seasoning, Podravka Meals, Condiments, Vegetable Products, and Tomato Products, is the Company's most profitable sector. It is followed by Pharmaceutical and Food segment. The Meat and fresh products and Bverages were at least profitable segments, but a year after analyzed period, in 2014, the company started showing some serious improvements by disposing some non-profitable business segments, such as meat, frozen food and bakery. The divestiture process started in 2013, as a 5-year plan for improving efficiency, as well as reaffirming the Company's presence on domestic and export markets.

The results of the plan were seen already in 2013, even before disposing the segments. In that year the Company intentionally reduced the sales of fresh meat through the restructuring progress by HRK 31m, beverages for HRK 18m and the frozen and bakery programs for about HRK 6m. In the same year, on Zagreb Stock Exchange, the Company announced that the implemented restructuring measures have already been providing operating savings of about HRK 70m annually (Bajić, 2014).

At year-end 2013, the company counted 5717 employees and generated HRK 3,6b sales, which counts average sales vs. personnel amounted EUR 83k per employee (EUR 81,6k in Food and beverage and EUR 87,4 in Pharmaceuticals). With that performance, the company was still lagging behind the peer group, and should have considered another lay-off program in order to achieve their level.

At the end of 2013 the market started to expect slow recovery from recession in the following years. The company finished that year with HRK 3,626b sales revenues, which is only 1% less than the sales revenues in 2008. Still, some of the key challenges remained to be dealt with:

- **Competing with private labels.** The representation of private brands in Europe was reaching 30-40%, while only 20% in Croatia, with tendency of growth. Podravka's management was therefore facing a new market challenge which in the analyzed period had still not affected its market share.
- **Political situation.** Podravka is often connected with political situation, which could have affected the dynamics of restructuring process, because the parliamentary elections were two years away.
- **The cleaning of the balance sheet.** Although the company stated several times that the balance sheet was cleaned, the business result of 2013 show that it was still not the case,

since they were affected by non-recurrent items which amounted to a total of HRK 133,4m. In the following years, the company's management still had to deal with financial reporting problems.

- **Selling the Belupo.** Although the Belupo performed well, some of the experts raised the question of its adequacy in Podravka's portfolio. The idea was to sell the Belupo, which at the moment could achieve a high valuation, and to invest that capital in a major acquisition in foreign markets. It was just an idea that did not happen.

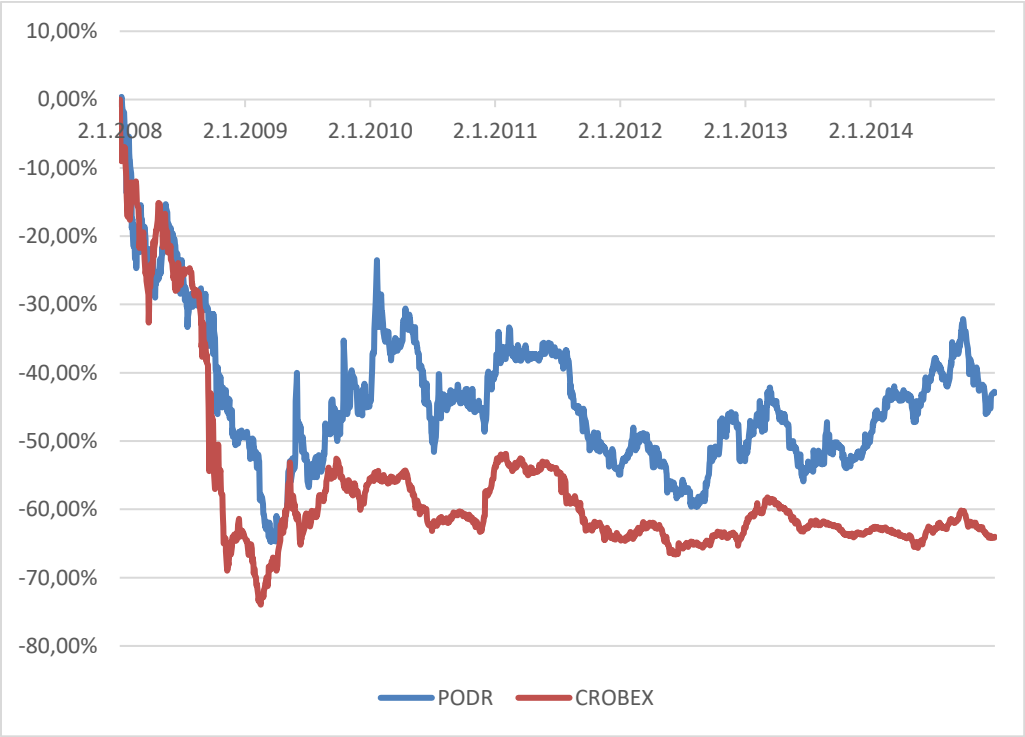
Considering all the mentioned facts, we can conclude that the analyzed period of crisis was a real challenge for the Company's management and decision making. Keeping all in mind, it is safe to conclude that it was a pretty complex period of Podravka's life, which significantly complicates the analysis of the Company's business performance in the analyzed period. The financial analysis will be performed on the financial statements, using mainly the public annual reports and some reports of investment companies. After the "Spice" affair, the company did its best to produce accurate information, but it is important to keep in mind that the complexity of the situation with many one-offs can blur the real picture of Company's performance.

4.3. The impact of the crisis on Podravka's financial performance

On its official web site Podravka informs investors about the Company's business results, which can also be found on the pages of Zagreb Stock Exchange (ZSE). Both information sources were used in this analysis. Since Podravka is a group, in analyzing its performance it is best to use consolidated and audited data. The analyzed period was pretty complex, so the data significantly varies between accounting and financial reports. In order to get an even better picture of Company's performance, the data from an investment company Interkapital was also taken into account.

Podravka's stocks are traded on ZSE under a ticker PODR. The market makers for the stock are Interkapital Ltc. and Zagrebačka baka PLC. There are 7.120.003 stocks on the market. Despite the internal problems, during the crisis the Company's stock price performed less volatile than the market in general. One reason for that could be the stability of the food industry, but it could also indicate that the market trusted the Company's management and their promises about the restructuring.

Figure 20. Price change of Podravka and CROBEX, 2008-2015



Source: Author, according the data from ZSE

From the beginning of 2008 until the end of 2013 the price of the stock dropped 50.2%, but then it started recovering, as the crisis was at the end, and Company started showing some positive effects of its restructuring.

4.3.1. Horizontal financial statement analysis

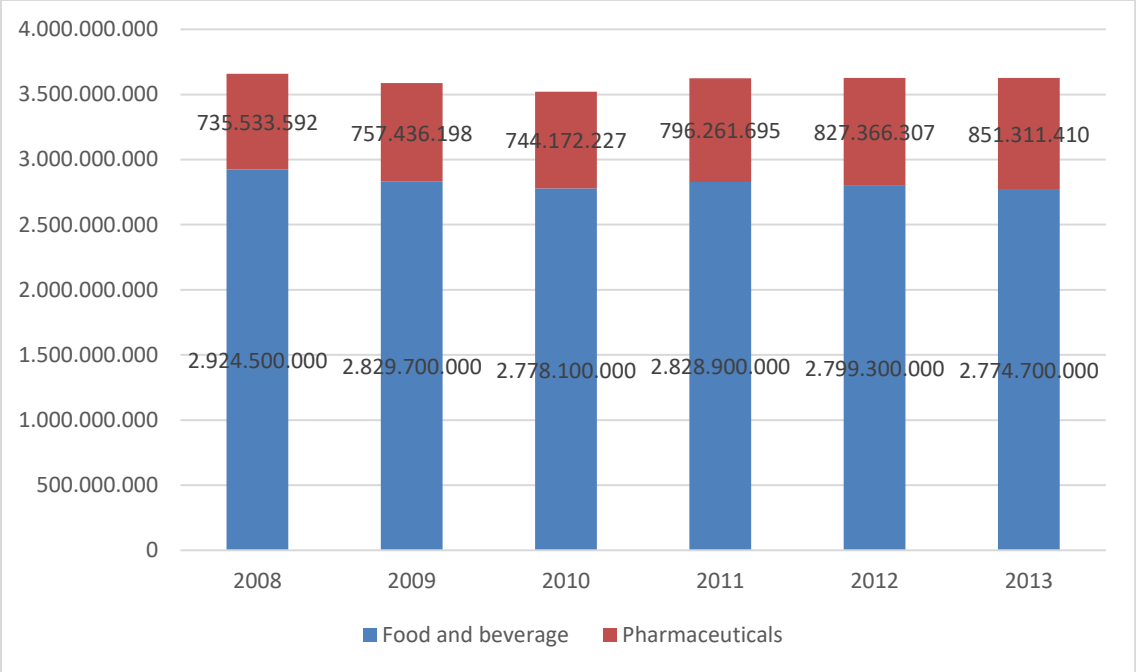
4.3.1.1. Income statement horisontal analysis

Podravka's sales revenues records prove the fact that the food industry doesn't get too much affected by business cycles. The most significant decrease of revenues, 1.99%, the Company recorded in 2009 which was followed by another drop of 1.81% in 2010. After that the sales started to recover with an exception of 2013, when they dropped 0.02%. In total, the sales decreased only 0.93% between 2008 and 2013.

In 2009 Food and beverage sector accumulated 79% of the Company's sales revenues and Pharmaceutical accounted the remaining 21%. The share of Food and beverage dropped by 2% in next three years since Food and beverage was more affected by the crisis then the Pharmaceutical sector. Before crisis, in the period between 2002 and 2009 the sales revenues of the Company grew compounded average growth rate (CAGR) of 3%, while in the same

period they grew 4.9% on the foreign markets. That growth was slowed down by the crisis, especially for the Food and beverage sector.

Figure 21. Sales revenues per product groups



Source: Author, according Podravka's annual reports, 2008-2013

The Food and beverage sector started reflecting the crisis already in 2009. The drop of the sales revenues of 3% was caused more by the Croatian market (4%) than from the foreign market (2%). Still, within the context of the fall of retail sales in Croatia of 15.3% this doesn't seem like a significant drop. On the foreign market the most intense decrease of sales revenues occurred in Poland and Czech Republic, but those numbers were affected by the weakening of the Polish zloty compared to Croatian kuna exchange rate (-18%) (Podravka, 2009). Since the Food and beverage sector accumulates the majority of the Company's revenues, the changes in the following years of its revenues were similar to the changes of the Company's revenues in total.

On the other hand, the Pharmaceuticals sectors revenues didn't follow the Company's revenues trends. In 2009 the revenues of the sector increased for 2.98% and the drop in the revenues occurred a year later for 1.75%. The best performers in the sector were the drugs for respiratory system treatment (52% increase) and OTC drugs (17% increase), especially Neofen and Lupocet. On the foreign market the Pharmaceuticals sector reached a sales growth of 14% with the highest contribution from the market of Bosnia and Hercegovina (34%). The year 2011 was

another important year for Pharmaceuticals sector. The revenues increased for 7%. This unusual growth was mainly driven by the foreign markets which recorded a growth of 13%. The best performing markets in 2011 were Russia (22%), Bosnia and Hercegovina (8%) and Slovenia (28%).

Besides the mentioned two sectors, the company has also a sector of Services, but it has a really insignificant effect on the Company's total revenues.

Figure 22. Podravka's business results

	2008	2009	2010	2011	2012	2013
Sales revenues	3.660.033.592	3.587.136.198	3.522.272.227	3.625.161.695	3.626.666.307	3.626.011.410
Food and beverage	2.924.500.000	2.829.700.000	2.778.100.000	2.828.900.000	2.799.300.000	2.774.700.000
Pharmaceuticals	735.533.592	757.436.198	744.172.227	796.261.695	827.366.307	851.311.410
EBITDA	287.704.000	-110.751.000	360.150.000	350.651.000	256.991.000	279.335.000
EBIT	127.680.000	-267.288.000	204.858.000	193.163.000	103.300.000	131.032.000
EBIT (by Podravka)		-174.400.000	204.900.000			
EBIT adjusted (by Podravka)	155.000.000	214.000.000	271.800.000	193.163.000	103.300.000	131.032.000
Net Profit	47.606.000	-380.991.000	84.236.000	69.281.000	-14.102.000	66.601.000
EBITDA margin	7,86%	-3,09%	10,22%	9,67%	7,09%	7,70%
EBIT margin	3,49%	-7,45%	5,82%	5,33%	2,85%	3,61%
Profit margin	1,30%	-10,62%	2,39%	1,91%	-0,39%	1,84%
ROE	2,50%	-18,00%	5,30%	4,20%	-0,90%	115,29%
ROA	1,00%	-7,00%	2,10%	1,80%	-67,56%	265,09%
P/E	29,70			18,10		23,20

Source: Podravka's annual reports and Interkapital analysis report

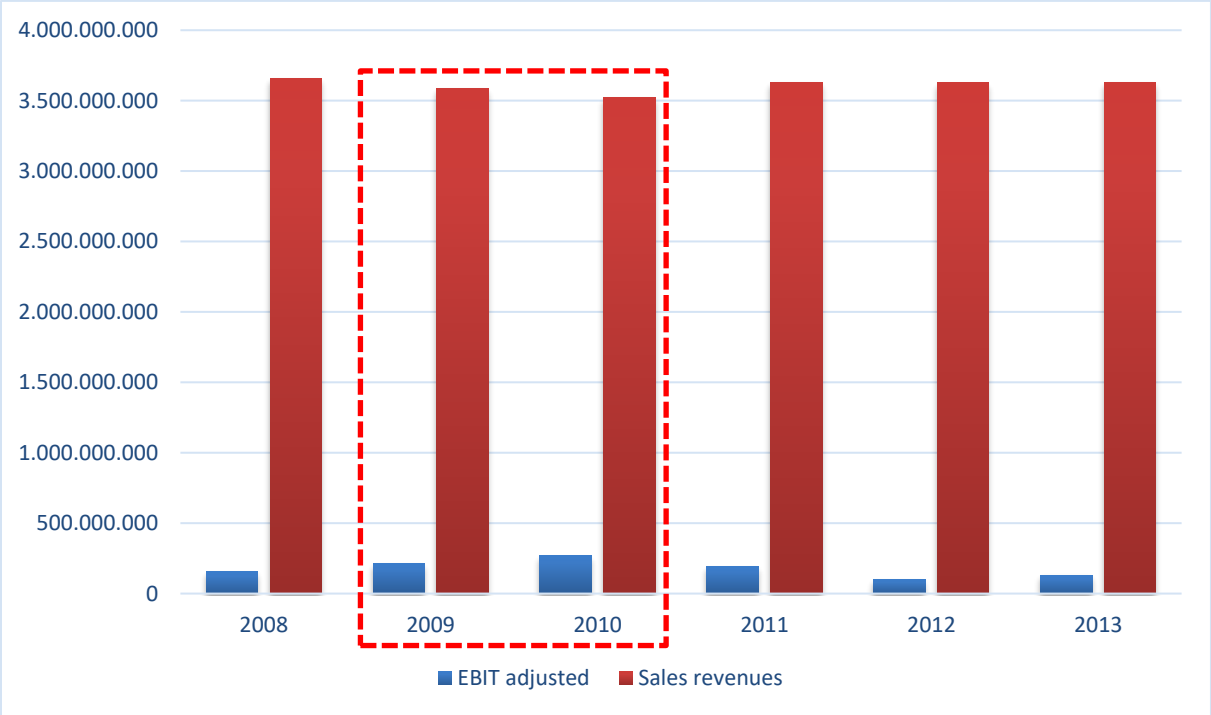
The sales records seem to be the only stable numbers among different information sources. All other items were highly affected by many one-offs, especially in 2009. For example, in 2009 the EBIT reported by the Company before adjustments were HRK -174,4m, while Interkapital reported HRK -267,3m loss. The Company reported that the EBIT should be adjusted to HRK 271,8m. In 2010 the Company again recommends adjusting the EBIT for one-offs, but in the following years the data differences stabilized.

The Figure 23 shows the changes in sales revenues and adjusted EBIT of the company. The years 2009 and 2010, again, bring the most attention. Although the Company's sales revenues dropped in both years, the company significantly increased it operating profit. The growth of the operating profit was driven by the restructuring which increased the Company's EBIT margin from 4.32% in 2008 to 5.97% in 2009, peaking on 7.72% in 2010.

In the year 2009 the most credits for the increased profitability of the Company go to the better allocation of the existing human resources in production process, due to which seasonal labor

employment was not necessary, which also decreased the Cost of goods sold structure of Food and beverage sector. The improved operating margin was also the result of reduction of Selling and distribution expenses (-5%), Marketing costs (-13%) and a reduction of General and administrative expenses (-9%) (Podravka, 2009). On the other hand, the Pharmaceuticals sector showed opposite trend in the same year. The sales revenues of the sector increased 3%, but the operating margin dropped.

Figure 23. Sales revenues and adjusted EBIT



Source: Author, according Podravka's annual reports

The positive trend of improvement of business processes and more rational cost management continued in 2010. The sales revenues of the Food and beverage sector decreased, but the change occurred in the sales structure in favor of more profitable categories, which, followed by savings achieved in manufacturing expenses, increased the profitability of the sector. The operating costs of the Food and beverage sector decreased 5%, which led to the improvement of the sectors operating margin. The Pharmaceuticals sector also improved its operating margin. Although the sales revenues of the sector dropped 1%, the operating margin improved, since the cost of goods sold declined 4%. That improved the operating profit by 5%, which increased the operating margin by 13.2%. The improvement was made on the financing plan of the sector

too. The financing costs declined 4%, which had a positive effect on the gross margin of the sector too.

The positive trend of improving the Company's profitability finished in the year 2011. The situation shifted. Sales revenues started to grow (3%), but both operating and gross profit declined. Namely, the prices of raw materials increased significantly in that year, which made the costs of goods sold grow much faster than the sales prices and sales revenues. In the annual report 2011, the Company reported the drop of EBIT of 6%. The Figure 23 shows a bigger change because in that year the Company stopped reporting about the exact adjusted operating profit, and started using the EBITDA instead, which was strongly affected by corrections and reduction of brand values, impairment of long-term assets held for sale and impairment of goodwill. Therefore, the EBIT calculated by Interkapital was used in the next years.

The Food and beverage sector was the one driving profitability drop of the company. The gross profit of the sector recorded a 5% drop, and a 250bp drop of the gross profit margin as a result. In the same year, the Pharmaceuticals sector reported a profitability improvement. The sales revenue of the sector grew 7% (mostly the foreign market – 23%) and, as the growth was driven by more profitable products, the gross profit grew 8%, taking the gross profit margin of the sector on 54.9%.

The described trend of rising operating costs (2%) of the Group continued in 2012, which was not followed by a similar sales revenues increase. The gross profit of the company declined 1%, dropping the gross margin by 30bp.

4.3.1.2. Balance sheet horisontal analysis

In the analyzed period the Company made some major changes on its balance sheet. Some of the changes were caused because of the challenging period of restructuring in the middle of the crisis, but other were also made in order to correct the mistakes caused by sloppy accounting in the past. Those changes were non-recurrent items referred to impaired value of long-term assets held for sale, loss from reduced values of brands and pharmacy rights, bond value adjustments, impairment of goodwill, value adjustment of fund investment etc.

The non-recurrent items affected the results from 2011 and 2012 the most. In those years the Company made some serious value reductions on intangible assets, trying to keep up with the market trends. The corrections were also made on the tangible assets that are not in the function of creating new value.

In the entire analyzed period, the Company shows a negative trend of total assets, both current and non-current. The most significant drop occurred in 2009 when the total assets value dropped 10.8%, mainly driven by the decrease of cash and cash equivalents of almost HRK 280m, that was mainly generated from financial activities (mostly by reduced proceeds from long-term and short-term borrowings).

Figure 24. Consolidated statement of financial position (Assets), 2008-2013

	2008	2009	2010	2011	2012	2013
ASSETS (in HRK thousands)						
Non-current assets						
Goodwill	48.428	42.877	44.293	41.129	41.984	25.881
Intangible assets	343.599	311.609	308.040	270.798	237.657	218.438
Property, plant and equipment	1.770.858	1.711.646	1.642.820	1.519.649	1.400.740	1.218.264
Long term financial assets	0	11.573	9.142	43.223	5.343	5.607
Defferred tax assets	44.552	53.589	52.330	56.022	35.420	49.573
Total non-current assets	2.269.265	2.131.294	2.056.625	1.891.921	1.721.144	1.517.736
Current assets						
Inventories	631.760	646.839	692.094	700.583	631.117	572.616
Trade and other receviables	1.286.899	1.186.974	1.083.543	1.058.040	1.074.648	1.026.635
Financial assets at fair value through profit and loss	23.416	22.321	14.796	559	600	0
Cash and cash equivalents	419.248	145.269	152.363	145.960	118.208	179.461
Non-current assets held for sale		4.004	8.768	57.657	64.418	155.354
Total current assets	2.361.323	2.005.407	1.951.564	1.962.799	1.896.528	1.940.395
Total assets	**4.635.105**	**4.136.701**	**4.008.189**	**3.854.720**	**3.617.672**	**3.458.158**

	% CHANGE				
	2009	2010	2011	2012	2013
ASSETS (in HRK thousands)					
Non-current assets					
Goodwill	-11,5%	3,3%	-7,1%	2,1%	-38,4%
Intangible assets	-9,3%	-1,1%	-12,1%	-12,2%	-8,1%
Property, plant and equipment	-3,3%	-4,0%	-7,5%	-7,8%	-13,0%
Long term financial assets		-21,0%	372,8%	-87,6%	4,9%
Defferred tax assets	20,3%	-2,3%	7,1%	-36,8%	40,0%
Total non-current assets	-6,1%	-3,5%	-8,0%	-9,0%	-11,8%
Current assets					
Inventories	2,4%	7,0%	1,2%	-9,9%	-9,3%
Trade and other receviables	-7,8%	-8,7%	-2,4%	1,6%	-4,5%
Financial assets at fair value through profit and loss	-4,7%	-33,7%	-96,2%	7,3%	-100,0%
Cash and cash equivalents	-65,4%	4,9%	-4,2%	-19,0%	51,8%
Non-current assets held for sale		119,0%	557,6%	11,7%	141,2%
Total current assets	-15,1%	-2,7%	0,6%	-3,4%	2,3%
Total assets	**-10,8%**	**-3,1%**	**-3,8%**	**-6,1%**	**-4,4%**

Source: Author, according Podravka's annual reports

Another bigger drop of the total assets occurred in 2012, also significantly influenced by decrease of cash and cash equivalents. At the end of 2013 the total assets of the Company were 25.4% lower than in 2008. This presents a huge decrease, but it is really important to keep in

mind the effects of many non-recurrent items and financial affairs connected to the Company during the period.

Figure 25. Consolidated statement of financial position (Equity and liabilities), 2008-2013

EQUITY AND LIABILITIES						
Shareholders equity						
Share capital	1.587.356	1.583.691	1.580.734	1.582.966	1.584.862	1.062.329
Reserves	83.458	109.825	126937	119.645	173.503	249.320
(Acumulated loss)/Retained earnings	218.520	-188.781	-107200	-41.611	-162.600	345.701
Attributable to equity holders of the parent	1.889.334	1.504.735	1.600.471	1.661.000	1.595.765	1.657.350
Non-controling interests	34.113	34.361	34.347	34.787	32.027	34.040
Total shareholders' equity	1.923.447	1.539.096	1634818	1.695.787	1.627.792	1.691.390
Non-current liabilities						
Long-term borrowings	597.572	452.916	558.957	897.616	727.255	572.872
Provisions	27.339	29.226	30.037	34.326	46.778	49.279
Defferred tax liability	8.356	7.616	7.141	6.997	6.298	5.577
Total non-current liabilities	952.017	826.058	596135	938.939	780.331	627.728
Current liabilities						
Trade and other payables	849.077	942.009	800.591	710.789	720.111	620.781
Financial liabilities at fair value through profit and lo	0	-	371.100	0	6.775	2.709
Short-term borrowings	805.050	805.050	581.691	485.733	463.851	490.413
Provisions	24.488	24.488	23.854	23.472	18.453	22.288
Total current liabilities	1.759.641	1.771.547	1.777.236	1.219.994	1.209.549	1.139.040
Total liabilities	2.711.658	2.597.605	2.373.371	2.158.933	1.989.880	1.766.768
Total equity and liabilities	**4.635.105**	**4.136.701**	**4.008.189**	**3.854.720**	**3.617.672**	**3.458.158**

EQUITY AND LIABILITIES					
Shareholders equity					
Share capital	-0,2%	-0,2%	0,1%	0,1%	-33,0%
Reserves	31,6%	15,6%	-5,7%	45,0%	43,7%
(Acumulated loss)/Retained earnings	-186,4%	-43,2%	-61,2%	290,8%	-312,6%
Attributable to equity holders of the parent	-20,4%	6,4%	3,8%	-3,9%	3,9%
Non-controling interests	0,7%	0,0%	1,3%	-7,9%	6,3%
Total shareholders' equity	-20,0%	6,2%	3,7%	-4,0%	3,9%
Non-current liabilities					
Long-term borrowings	-24,2%	23,4%	60,6%	-19,0%	-21,2%
Provisions	6,9%	2,8%	14,3%	36,3%	5,3%
Defferred tax liability	-8,9%	-6,2%	-2,0%	-10,0%	-11,4%
Total non-current liabilities	-13,2%	-27,8%	57,5%	-16,9%	-19,6%
Current liabilities					
Trade and other payables	10,9%	-15,0%	-11,2%	1,3%	-13,8%
Financial liabilities at fair value through profit and lo			-100,0%		-60,0%
Short-term borrowings	0,0%	-27,7%	-16,5%	-4,5%	5,7%
Provisions	0,0%	-2,6%	-1,6%	-21,4%	20,8%
Total current liabilities	0,7%	0,3%	-31,4%	-0,9%	-5,8%
Total liabilities	-4,2%	-8,6%	-9,0%	-7,8%	-11,2%
Total equity and liabilities	**-10,8%**	**-3,1%**	**-3,8%**	**-6,1%**	**-4,4%**

Source: Author, according Podravka's annual reports

The other part of the balance sheet, equity and liabilities, confirms all the facts mentioned before. The equity was mostly affected by the changes in the income statement through its

accumulated loss/retained earnings position. During the crisis years, the Company has accumulated a lot of loss, which had to be taken care of in 2013 when the Company covered the loss by reducing shares capital value. Besides that change, the share capital was stable through the years.

In the middle of the crisis (2010 and 2011) the Company had to increase its long term borrowings by the banks in Croatia, but it started to return them in 2012. In the same year the Company's short-term borrowings and trade payables significantly decreased.

4.3.2. Vertical financial statement analysis

4.3.2.1. Income statement horizontal analysis

Figure 26. Income statement, vertical analysis, 2008-2013

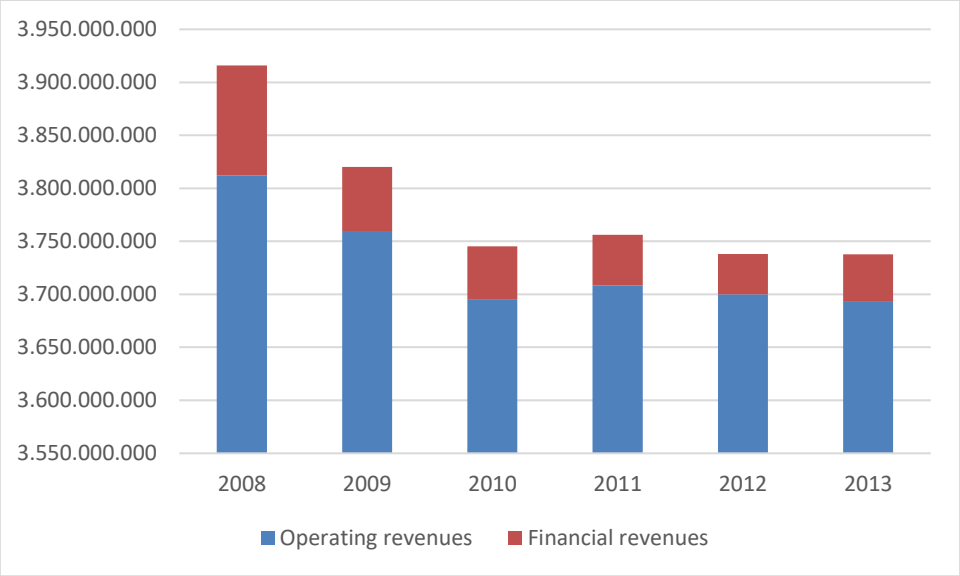
PROFIT & LOSS ACCOUNT	% OF SALES				
Item	2009	2010	2011	2012	2013
I. OPERATING REVENUES (108 to 110)					
1. Sales revenues	100,00%	100,00%	100,00%	100,00%	100,00%
3. Material costs (115 to 117)	64,88%	65,71%	65,44%	64,74%	63,58%
GROSS PROFIT	35,12%	34,29%	34,56%	35,26%	36,42%
4. Staff costs (119 to 121)	21,32%	20,88%	20,72%	19,81%	19,87%
5. Depreciation	4,37%	4,36%	4,41%	4,41%	4,24%
6. Other costs	9,20%	6,39%	5,55%	5,89%	6,88%
7. Value adjustment (125+126)	0,54%	2,26%	0,80%	1,70%	1,41%
8. Provisions	0,33%	0,36%	0,24%	0,16%	0,43%
9. Other operating costs	0,51%	11,40%	1,83%	1,88%	1,50%
III. FINANCIAL REVENUES (130 to 134)	2,84%	1,71%	1,43%	1,32%	1,05%
3. Portion of revenue from associated parties and participating interests	0,00%	0,00%	0,00%	0,00%	0,00%
4. Unrealized gains (revenues)	0,45%	0,00%	0,14%	0,03%	0,00%
5. Other financial revenues	0,98%	0,00%	0,00%	0,00%	0,00%
IV. FINANCIAL EXPENSE (136 to 139)	4,58%	5,27%	4,99%	4,09%	2,91%
1. Interests, currency differences and other expenses from related parties	0,00%	0,00%	0,00%	0,00%	0,00%
2. Interests, currency differences and other expenses from unrelated parties	4,35%	4,63%	3,78%	3,83%	2,82%
3. Unrealized loss (expense) from financial assets	0,23%	0,64%	1,21%	0,26%	0,10%
VII. TOTAL REVENUES (107+129+140)	106,99%	106,50%	106,33%	103,62%	103,07%
VIII. TOTAL EXPENSE (111+135+141)	105,43%	116,69%	103,23%	101,97%	102,24%
IX. PROFIT BEFORE TAX (142-143)	1,56%	0,00%	3,10%	1,65%	0,83%
X. LOSS BEFORE TAX (143-142)	0,00%	10,18%	0,00%	0,00%	0,00%
XI. PROFIT TAX	0,27%	0,43%	0,72%	0,53%	1,26%
XII. PROFIT IN THE PERIOD (144-146)	1296,80%	0,00%	2,39%	1,12%	0,00%
XIII. LOSS IN THE PERIOD (145+146) or (146-144)	0,00%	10,62%	0,00%	0,00%	0,43%

Source: Author, according Podravka's annual reports

Material costs are the biggest expense of the Company, around 65% of the sales revenues, which keeps the gross profit margin around 35%. The material costs increased in 2010 and 2011 due the increase of the raw material costs, which were reflected on the gross profit margin immediately. Among the other costs, it is important to highlight the staff costs that tend to

decrease in the share of the sales revenues. This proves that the restructuring was indeed been increasing the productivity of the staff.

Figure 27. Total revenues structure



Source: Author, according Podravka's annual reports

The total revenues were decreasing through the entire period, but the structure of the revenues was changing also. The financial revenues had much more importance for the company in the beginning of the analyzed period. The sales revenues were around 95% of the total revenues in first three years, but their significance increased to 98% in 2013. As mentioned, even the structure of the different product groups in the sales revenues was changing, so we can conclude that the structure of the Company's business was changing parallel with its volume.

4.3.2.2. Balance sheet vertical analysis

The share of the non-current assets in Company's total assets was around 49% during the entire period, slightly rising in 2010 and 2011, as the liquidity of the Company dropped. The property, plant and equipment are the Company's most valuable non-current assets, followed by the intangible assets, which comes mostly from the patents and licenses, mainly from the Pharmaceuticals sector.

Figure 28. Balance sheet vertical analysis, 2008-2013

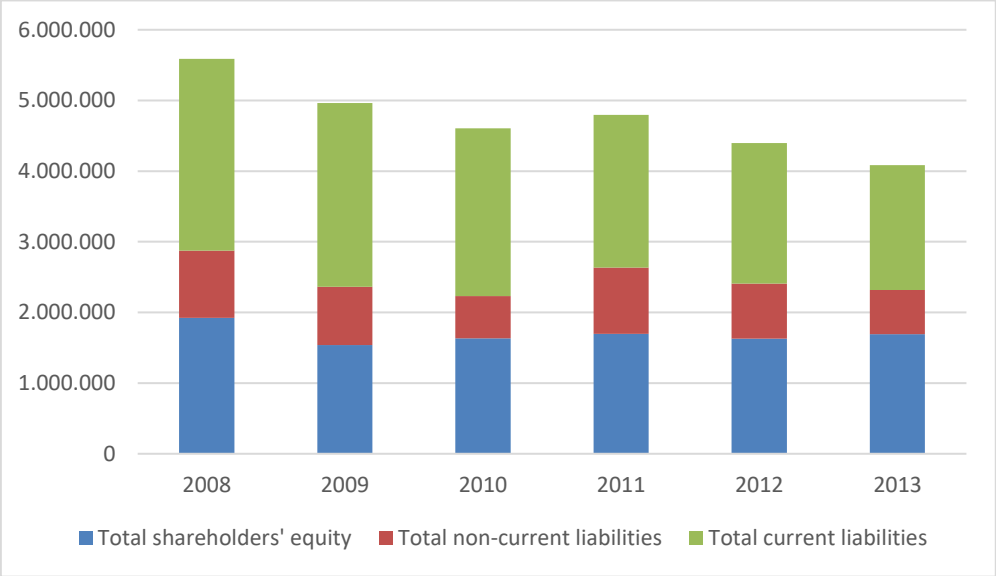
	% OF TOTAL ASSETS				
	2009	2010	2011	2012	2013
ASSETS (in HRK thousands)					
Non-current assets					
Goodwill	1,0%	1,0%	1,1%	1,1%	1,2%
Intangible assets	7,4%	7,5%	7,7%	7,0%	6,6%
Property, plant and equipment	38,2%	41,4%	41,0%	39,4%	38,7%
Long term financial assets	0,0%	0,3%	0,2%	1,1%	0,1%
Defferred tax assets	1,0%	1,3%	1,3%	1,5%	1,0%
Total non-current assets	49,0%	51,5%	51,3%	49,1%	47,6%
Current assets	0,0%	0,0%	0,0%	0,0%	0,0%
Inventories	13,6%	15,6%	17,3%	18,2%	17,4%
Trade and other receviables	27,8%	28,7%	27,0%	27,4%	29,7%
Financial assets at fair value through profit and loss	0,5%	0,5%	0,4%	0,0%	0,0%
Cash and cash equivalents	9,0%	3,5%	3,8%	3,8%	3,3%
Non-current assets held for sale	0,0%	0,1%	0,2%	1,5%	1,8%
Total current assets	50,9%	48,5%	48,7%	50,9%	52,4%
Total assets					
EQUITY AND LIABILITIES					
Shareholders equity					
Share capital	34,2%	38,3%	39,4%	41,1%	43,8%
Reserves	1,8%	2,7%	3,2%	3,1%	4,8%
(Acumulated loss)/Retained earnings	4,7%	-4,6%	-2,7%	-1,1%	-4,5%
Attributable to equity holders of the parent	40,8%	36,4%	39,9%	43,1%	44,1%
Non-controling interests	0,7%	0,8%	0,9%	0,9%	0,9%
Total shareholders' equity	41,5%	37,2%	40,8%	44,0%	45,0%
Non-current liabilities	0,0%	0,0%	0,0%	0,0%	0,0%
Long-term borrowings	12,9%	10,9%	13,9%	23,3%	20,1%
Provisions	0,6%	0,7%	0,7%	0,9%	1,3%
Defferred tax liability	0,2%	0,2%	0,2%	0,2%	0,2%
Total non-current liabilities	20,5%	20,0%	14,9%	24,4%	21,6%
Current liabilities	0,0%	0,0%	0,0%	0,0%	0,0%
Trade and other payables	18,3%	22,8%	20,0%	18,4%	19,9%
Financial liabilities at fair value through profit and lo	0,0%		9,3%	0,0%	0,2%
Short-term borrowings	17,4%	19,5%	14,5%	12,6%	12,8%
Provisions	0,5%	0,6%	0,6%	0,6%	0,5%
Total current liabilities	38,0%	42,8%	44,3%	31,6%	33,4%
Total liabilities	58,5%	62,8%	59,2%	56,0%	55,0%

Source: Author, according Podravka's annual reports

Among the Company's current assets, the trade and other receivables and inventories have the biggest share. As the sales volume decreased in 2010, the share of the inventories (mainly finished goods and trade goods) in total assets increased. It is interesting to watch the Company's trade and other receivables. As seen on the Figure 28, their share in total assets is very important, but it did not significantly increase during the crisis, as expected.

Watching the financing part of the balance sheet, it can be noticed that the Company is intensively financed from current sources such as trade and other payables and short-term borrowings. The level of the shareholders equity was pretty stable, but its share changed as the total assets value changed.

Figure 29. The structure of Company's financing sources



Source: Author, according Podravka's annual reports

The biggest change in the structure was the decrease of the total non-current liabilities in 2010. At the beginning of that year the Company repaid its liability to Fima group PLC, amounting HRK 102.7m. In the same year the Company did not increase its leverage, but it did change the borrowing structure, reclassifying the bonds liabilities from non-current to current.

4.3.3. Financial ratios analysis

Financial ratios analysis will give us better perspective about the Company's performance during the analyzed period. All the ratios are calculated by the author according to the Company's annual reports.

Leverage Ratios

	2008	2009	2010	2011	2012	2013
Debt to equity ratio	91,5%	115,1%	108,7%	71,9%	74,3%	67,3%

Debt to equity (D/E) ratio measures the company's capital structure. It divides the company's total liabilities with its total assets. According to the textbooks, when the ratio is less than 1

(100%), it indicates a conservative company and a higher ratio indicates a leveraged company. Podravka's D/E ratio indicates that it is a conservative company. The numbers from 2009 and 2010 are just a reflection of negative net profit.

Profitability ratios

	2008	2009	2010	2011	2012	2013
Net Profit	47.606.000	-380.991.000	84.236.000	69.281.000	-14.102.000	66.601.000
ROE	2,5%	-18,0%	5,3%	4,2%	-0,9%	3,9%
ROA	1,0%	-7,0%	2,1%	1,8%	-4,6%	2,0%

The profitability ratios are measuring the net profit as a percentage of shareholders equity (ROE) or total assets (ROA). Both of the relevant ratios indicate a pretty bad situation in the company in 2009 and 2012, but those numbers don't show a relevant picture of the company, since they are influenced by the mentioned one-offs. Other years can give a much better perspective, especially when compared with other companies. Interkapital compares the Company with other companies in the region. In 2011 the median ROA for the Food and beverage industry was 1.6 and ROE 6.2%. In the Pharmaceuticals industry the median ROA was 7.5 and ROE 9.7%. Combining those numbers, the median ROA for a company like Podravka is 4.6 and ROE 8.0% (Bajić, 2009). Now it is possible to conclude that Podravka had a profitability below the industrial average. This proves that Podravka, although a pretty stable cash flow producing company, had a lot of room for improvement when speaking about the profitability during the crisis period.

Liquidity ratios

	2008	2009	2010	2011	2012	2013
Current ratio	1,34	1,13	1,10	1,61	1,57	1,70
Working Capital	601.682	233.860	174.328	742.805	686.979	801.355
Quick ratio	0,98	0,77	0,71	1,03	1,04	1,20
Cash Ratio	0,24	0,08	0,09	0,12	0,10	0,16

The Company's liquidity and solvency situation was worsened by the financial crisis, but it was not critical in any point, so the business operations were not jeopardized. The current ratio divides company's total current assets by its current liabilities. The textbooks suggest that it should be at the level of 2 or more, but often, especially in the case of crisis it gets lower. It is important to keep it above 1, which means that the company should have enough current assets to cover its current liabilities. In the years 2009 and 2010 the drop of the ratio can be seen, but it is important to remember that a big non-current debt was repaid in those years, and that some of the non-current borrowings were transformed into current. If the current ratio is above 1 it

already means that the "golden rule" of financing is followed. It means that the company finances its non-current assets with non-current liabilities, or in other words, that company has some working capital. The working capital of Podravka was significantly decreased in 2009 and 2010, but it recovered in the following years. The quick ratio divides the company's most liquid current assets (cash and accounts receivable) with its current liabilities. When it is above 1, we speak about a liquid company. Observing the changes in the ratio value, the same pattern as with the current ratio can be noticed.

Management efficiency ratios

	2008	2009	2010	2011	2012	2013
Sales	3.660.033.592	3.587.136.198	3.522.272.227	3.625.161.695	3.626.666.307	3.626.011.410
Receivable turnover	2,84	3,02	3,25	3,43	3,37	3,53
Days sales outstanding	126,58	119,12	110,75	105,07	106,67	101,93
Inventory turnover	5,79	5,55	5,09	5,17	5,75	6,33
Days inventory outstanding	62,14	64,92	70,74	69,57	62,65	56,85
Total asset turnover	0,79	0,87	0,88	0,94	1,00	1,05

The receivables turnover shows the ratio between the total sales and receivables. It can be easily transformed to days sales outstanding ratio, which shows the average number of days needed to collect the receivables. The company has improved its receivables collection during the analyzed years. It is still pretty high (above 100), but given the industry, especially in Croatia and the financial circumstances, it can be concluded that the company did a very good job improving its receivable collection in that time. The inventory turnover dropped in the 2009 and 2010, primarily because the decreased sales revenues. The same goes for the total assets turnover.

5. Conclusion

Dealing with the business cycles can be one of the company's most challenging tasks. When the economy starts to contract (the GDP starts to drop), it can destroy the companies that were not prepared for the recession. Some industries like car industry are exposed more to the cycles and some like food and beverage industry less. Either way the crisis affects each company in one way or another.

Despite the changes of the prices and personal income, the total expenditures of the households for food and beverages did not change significantly in Croatia during the crisis. The crisis did affect the employment in the industry, though. The number of the employees in the industry dropped, but not as much in the beginning of the crisis, but few years after. This is a common impact of the crisis, because sometimes the companies need some time to adjust to the new environment. The employment of the beverage industry was much more affected by the crisis then in food industry, which again proves the stability of that sector. The production of the industry had a similar trend. In 2009 and 2010 the production dropped, then 2011 was a recovery year, and in 2013 it dropped again, which presents a lagging effect of the crisis which was followed by other macroeconomic evets, such as Croatia joining the European Union. Some of the changes occurred in the pharmaceutical industry too. Although the amount of the drugs stayed stable, the structure of the demand changed. The customers started to ask for cheaper, generic products, more than for the originals. This presented an opportunity for the companies focusing on generics, and a threat for the companies investing in research and development, trying to find new solutions.

Podravka operates in both industries, but earns 79 % revenues from food and beverage industry, which is why it gets more affected by the trends in that industry. In order to analyze the Company's business operations in crisis, the financial reports and other public data between 2008 and 2013 were used. That period was really challenging for the Company because of many different influences on its reports, which is why the professional analysis by an investment company were also considered.

The 2009 was really a bad year for the Company. In its financial report it reported a significant net profit loss. Many business events influenced that number. First of all, the crisis did affect the sales, but as expected, it was only 2%, which is a relatively low drop, considering the other industries. The internal factors had a much important impact on the Company's results. First of all, in the time there was a huge affair connected to the management of the Company, and their

illegal activities that damaged the Company. Besides that, the company was struggling with a low productivity, caused by the structural organization of the business, and too many ineffective employees.

Podravka started to deal with that problem in 2007, but it was not solved many years after. The case is that the Company manages lots of brands on the market, among which some are pretty unprofitable. Fighting with the inefficiency the Company started stimulating retirement of the labor surplus, trying to keep as many jobs as possible in the crisis times. That was not enough to increase the profitability of the Company, so finally it had to cut off some inefficient product programs and lay off a lot of the employees.

It can be finally concluded that Podravka is a very stable company in a very stable business. It is a pretty big business, which in the same time presents an opportunity to create stable cash flows, but also lowers the Company's flexibility and reduces the growth possibilities. Analyzing the Company's financial reports in the particular time is a real challenge, since they are full of different non-recurring items. But, using the different sources it is clear that the Company is profitable, but it has a lot of room for improvement. The future growth could come from focusing on the Company's top brands, and cutting off the less profitable ones. One of ideas is to get rid of Belupo, the pharmaceutical company that is not operating in the core business of the Group, and to use those assets for further penetration on foreign markets.

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