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Partnerships in Hungarian food industry: A comparison with international tendencies

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Abstract

Hungarian food supply chains have been substantially changed in the last 10-15 years. This was caused mainly by the appearance of multinational producers as well as multinational retailers.

Aim of the paper is to identify the western European tendencies in Hungarian food industry and to describe the partnership characteristics in the supply chain.

First I will analyze the dominant trends in Hungarian food industry. Hungarian food producer companies face tendencies similar to western European, as I suppose, perhaps their problems are in an early phase: suffering SMEs, defencelessness to retail chains.

Second I try to identify if there appears a supply chain view in the food industry, I describe the partnerships considering that although concentration dedicate huge power to retail chains the sinking number of producers may balance their relationship through interdependence.

The partnership analysis is based on the questionnaire of Hungarian Competitiveness Research which was filled out by 1204 managers of 301 companies. Participating firms were mostly middle and large size companies. There were 30 food industry companies in the sample, my analysis is based upon these responses.

Results suggest that Hungarian companies face similar tendencies as in Western- Europe, but in case of partnerships and managed supply chains Hungarian firms are less developed, although there are many opportunities.

Keywords: partnership, supply chain, food industry

1. International tendencies

FMCG supply chains have been substantially changed in the last 10-15 years. The strong bargain position has been moved from the side of the manufacturers to retailers' side. Cullen and Whelan (1997) explained the phenomenon for three reasons:

- Retail Concentration: retail chains and buying clubs appear.
- Manufacturer concentration: only a few big brand owners can survive in global competition which are as powerful as retail chains and can stand up against them.

- Private label growth, representing the power of retail chains, meaning serious threat for brands.

Retail concentration

Retail concentration has increased throughout Europe over the last 15 years, as retail chains take a growing share of the FMCG sales. Concentration is measured as the percentage of industry sales controlled by the top five retailers (Cullen –Whelan, 1997). UK is the most concentrated retailing country in Europe with just five retail chains controlling 62% of all grocery turnover. In France the top five retailers realize almost 48% of grocery sales, in Germany the top five accounts for 55% while in Ireland the top two controls the 43% of food trade.

An important consequence of growing retail concentration is that manufacturer brands' total market share will strongly determined by its performance through large retail chains. If a brand obtains share of product category sales within the largest retailers which is equal or greater then that brand's national market share then that brand's total market share is likely to increase parallel with retail concentration increase. Conversely, brands which are being delisted or losing shelf place in large retail chains will face a fast decline in their total market share. This process leads to defencelessness of manufacturers, which are eager to get into and stay on the shelves of supermarket chains despite of its costs.

Manufacturer concentration

Along with the increase in retail concentration, manufacturer concentration has also increased, which measured by the percentage of sales controlled by top two brands (Cullen and Whelan, 1997). In Europe only Nestlé and Unilever are as large as the major retail chains and own brands that may balance the bargain power of retailers. Manufacturers' power is enhanced by having a global or European-wide presence which enables them to dominate particular product categories by individual brands. However, national brand producers often lack the resources to maintain dominant brands and facing descending role or take-over by larger competitors.

On a European level the balance of power is likely to rest between manufacturers of Euro-brands or global brands and large retailer chains while national brand owners with brands ranked third or fourth in FMCG market still face with descending their market share. Breakout could be becoming either as a niche-brand or a private label supplier. Supplying private label products enables small manufacturers first, to produce at economical volume second, to sell their individual product for high price and retailers' private label product for cheap price because this way the accounted turnover is likely to be higher then producing only a middle-price - small market share product. Production and selling of national brands and private label products work only in markets where easy to introduce a new product variant.

Private label growth

The increase in the number and share of private labels refers to the increasing power of the retail chains and to increased difficulties manufacturers face with in attempting to build brands. As a proportion of retail sales penetration of private label products is high in UK (41.2%) and Swiss (37.1%) market. The private label shares by country are correlated with retailer concentration.

Traditionally brand manufacturers have followed a differentiation strategy, whereas private labels aimed to deliver value-for-money (Verhoef et al., 2002). However, European retailers have started to develop the quality of private labels. This process is damaging to the third, fourth brands in each market because small producers tend to compete on price and more likely to lose their competitive position in the new retailing environment. As De Wulf et al. (2005) explored by a taste test that private label products perform almost as well as branded products at blind test, although in non-blind test consumers perceived a lower quality as to branded products.

Developing quality of private labels causes a new problem: it degrades the customer's belief in the real value added of manufacturer brands.

Bontems et al. (1999) summarize circumstances under high private label market share is probable:

- Private label quality relative to national brands is high,
- Quality variability of private labels are low,
- Total sales of product are high,
- The relative gross margin is high,
- Number of national manufacturers is low, and
- National advertising expenditure is low.

In opinion of Bontems et al. there are two main reasons invoked in explanation of private label expansion. *First*, private labels are part of the strategy of horizontal differentiation between retailers. *Second*, private labels strengthen the position of retailers against brand manufacturers, as Cullen and Whelan appointed, too.
According to a survey Bontems cites, the private labels allow retailers to offer low prices, increase their margin, strengthen their image and develop customer loyalty.

2. Change of bargain position

The presented tendencies issued in change in bargain position in FMCG industry. In the 1980's the manufacturers had the strong bargain power but from 1990's - thank to the international expansion - retailers become the more powerful players in FMCG supply chains (Kumar, 1996).
In 1980's the brand manufacturers used to limit the quantities of most popular products to press retailers to carry all sizes of certain products. Manufacturers used to prescribe product range and forced retailers to participate in promotional programs.
Nowadays it is playback time. In the past 15 years retail chains become enormous and manufacturers fight for shelf place, pay for carrying their products and are pressed to cooperate in promotional programs. As the large retailers become more powerful, distribution access to these key retailers becomes critical for a brands' survival and performance.
According to Kumar exploiting power may be advantageous in short run, but tends to be self-hazardous in long run for three reasons. *First*, exploiting power to extract unfair concessions can come back if position of power changes, as it happened in manufacturer-retailer relationships. *Second,* when companies systematically exploit their advantage, their victims ultimately seek ways to escape as retailers did via expansion and developing private labels. *Third*, by working together as partners, retailers and manufacturers can provide the greatest value to customers at lowest possible cost.

Cullen and Whelan propose purposive brand policy to manage retailers' power. Purposive brand policy invokes high level of marketing expenditures id est marketing research and advertising (5% of revenues). On the other hand the ability to develop a distribution structure that matches the general distribution channel of the product-market in which the brand is used will certainly secure high market share.
Continuous product improvement, frequent new product line and wide range of brand variants are also essential for becoming market leader.

3. Sample of statistical analysis

The database used for the statistical analysis was collected in the Hungarian Competitiveness Research in 2004. 1204 managers of 301 companies have been asked about the performance, competitiveness of their firms.

The sample contains 30 food manufacturing companies my analysis is based on their answers. Among the 30 companies there are 14 large size firms (more then 250 employees and annual turnover is more then €16 Million), 11 middle size firms (51-249 employees, turnover of €2,81-15,99 Million) and 5 small size firms (less then 50 employees, annual turnover under €2,8 Million).

Regarding their ownership structure, 17 of 30 is in Hungarian private, 6 in Hungarian state and 6 in multinational ownership. One answer was missing.

Concentration of companies' main market was also evaluated based on the question "How many manufacturers account for the 75% of total market turnover at the market of your main product?" According to the answers, 8 firms operate on a concentrated market (1-4 companies realize the 75%of total market turnover), 13 work on semi-concentrated market (5-10 companies realize the 75% of turnover) and 5 operate on non-concentrated market. 4 answers were missing.

Sample attributions approximate the Hungarian food industry characteristics, although multinationals and small enterprises are under-represented, and state ownership is far less then 20% regarding the whole industry.

4. Retail sector and manufacturers in Hungary

Although the article of Cullen and Whelan has been published in 1997 its observations are still relevant for Hungarian food industry. Retail concentration has carried out in past ten years in Hungary. The milestone was the foundation of first Tesco in Gyor in 1996.

Pace of *retail concentration* is increasing. According to AC Nielsen's data Table 1 shows the changes of shares in grocery retail in different outlet types.

Table 1: Proportion of different types of outlet of total grocery turnover in Hungary (AC Nielsen, 2005)

Type of outlet	2000	2001	2002	2003	2004	2005 prognosis	2009 prognosis
Hypermarket	14	17	19	21	22	24	28
Supermarket	15	15	14	14	15	15	14
Discount	16	15	15	15	15	16	17

Cash & Carry	6	5	4	4	4	4	2
Independent outlets allied in buying club	5	8	10	14	15	16	20
Independent store	29	27	25	21	17	15	12
Other	15	12	12	10	12	10	7
Herfindahl-index	0.1775	0.1701	0.1667	0.1615	0.1608	0.1654	0.1866

Role of allied trade companies is increasing, and decreases the number of non-allied and C&C outlets. Hypermarkets have realized a dynamic increase conquered customers from almost all other type of stores. Although supermarkets also operate in chain structure and have a bargain position as good as hypers, they are only able to keep their market share. Enhancing number of discounts caused by their hard expansion in last few years, particularly by Lidl since 2004. Losers of concentration are independent traders who did not recognise the importance of being a member of an alliance and constantly loosing their customers.

According to Szirmai (2005) among top five retailers there are a supermarket chain, a discount and three hypermarket chains. The share of top five in food retailing is about 30 per cent. According to the prognosis of AC Nielsen share of hypermarkets will raise to 28% until 2009, discounts and independent stores allied in buying clubs also will increase their role in consumer goods trade by 2-2 per cents at the expense of independent stores and C&Cs.

Table 2: Largest Hungarian retailers, their net annual revenue and share of total revenue of sector in 2004

Ranking	Company	Net revenue (Million €)	Share of sectorial revenue
1	Tesco	1492	16.95%
2	Merto AG	877	9.96%
3	Spar-group	702	8%
4	Auchan Hungary	620	7%
5	Penny Market (Rewe)	452	5,1%
Total revenue of retail in 2004: 8,8 Billion Euros			

To analyze *manufacturers' concentration* I used the questionnaire and database of Hungarian Competitiveness Research (HCR). The sample contains the data of 30 companies from food industry. The applied questions to describe concentration of manufacturers were:

- How many manufacturers account for the 75% of total market turnover at the market of your main product?
- How many counterparts you have at the market of your main product which has at least 5% market share?

- How the branded products share of total turnover at the market of your main product?
- How large is the share of loyal customers at the market of your main product?

(Each answer is based on respondent's estimate.)

Table 3: Largest Hungarian food manufacturers, their net annual revenue and share of total revenue of food industry in 2004 (Szirmai, 2005)

Rankin	Company	Net revenue (Million €)	Share of total food industry revenue
1	Unilever	311	3%
2	Nestlé	262	2,5%
3	Friesland (diary)	227	2,2%
4	Coca-Cola Beverages	203	1,95%
5	Bunge (oilseed processing)	193	1,86%
Total revenue of food industry in 2004: €10,4 Billion			

Manufacturers' main market concentration has been analysed at Sample characteristics chapter as well, and was explored that half of respondents operate on semi-concentrated, a quarter of them on concentrated market. Regarding their main products respondents compete with 4-7 companies which control 5% or more from the market.

According to the responses the share of branded products at companies' main market is 36.8 per cent in average. At same market respondents estimates the rate of loyal customers to 24%, although much of them think that their customers are not loyal at all.

In Hungary the share of *private labels* at consumer goods market was approximately 23 per cent in 2005. The ratio differs along the type of outlet and product categories.

Table 4. Share of private labels in Hungarian consumer goods market (FN, 2006)

	2003	2004	2005
Share of private labels sales from consumer goods	15%	18%	23%

In hard-discounts the share of private label exceed the average, it was 33% in 2004 and increased to 45% in 2005. This dynamic increase is caused by the aggressive expansion of discounts (Lidl and Plus) which usually reduce prices by selling almost only cheap, private label products produced in an economical volume (INDEX, 2007).

In several food categories private labels are also over-represented (see Bontemp's criteria). Tomato puree, energy drinks, frozen chips and dog meal are typical product categories where

the share of private labels is over 70 per cent. Whereas the share of private labels in detergents and beauty stagnates at 9% for years (INDEX, 2006).
The share of private labels increases along the retailers' concentration, and in several product categories the cheap private label products are popular among the price-sensitive Hungarian customers.

5. Effects of change in bargain position

To manage the changed bargain position Cullen and Whelan advised purposive brand policy (marketing research, advertisement), development of distribution channels and continuous product improvement.
Questionnaire of Hungarian Competitiveness Research (HCR) asks questions about advertising expenditure of the company comparing to its main counterpart (Share of advertising expenditure form revenue in comparison with the main counterpart). According to the respondents, companies spend 5.7% of their revenues to advertising their products. This amount matches what Cullen and Whelan advise (5%) but companies estimate counterparts' similar expenditures to 8.3%, so they perceive disadvantage.
Developing new distribution channels seems to be a hard problem to manufacturers. The answers to question "How many of your top five buyers could not to be substituted in short term?" distributed among 2 and 3 at a 5 point Likert-scale (average: 2.67). Finding new distribution channels seems to be difficult; manufacturers could not substitute 2 or 3 of their top buyers if they cancel the contract.
Companies allocate relative low amount for new product development, €92,000 per annum in average (0.26% of revenue), in comparison with Hungarian average expenditure of 1% (which is also a very low level).

6. Partnerships in the supply chain

Chapters above represent similar tendencies in Hungarian FMCG industry to Western-Europeans. Next chapters will analyze that how Hungarian companies behave in similar environment, do they apply the supply chain management techniques which are developed in Western Europe and US as to respond to the presented tendencies.

Role of partnership in manufacturer-retailer relationships has been researched by UK Competition Commission. Their research suggests that by encouraging the development of co-operative attitude helps to enhance the quality of relationship, and decrease costs associated with exchange (Duffy and Fearne, 2004). Kannan and Tan (2006) have found that buyers tend to prefer closer relationships when they wish to control the dependability of supply or influence supplier quality. Suppliers may be similarly motivated when they seek to secure long-term, reliable markets, or to influence customer quality.

To analyze supply chain in Hungarian food industry I collected characteristics of an ideal partnership.

HCR questionnaire asked *directly* whether companies use supply chain management methods:

- How your business success dependent on your supply chain partners? (5-point Liker-scale, 1 – not at all, 5 – very much dependent).
- Do you apply supply chain management methods with your partners? (Yes/No)

Besides the direct questions partnership characteristics were captured mostly in indirect way. To describe partnerships I used three dimensions along to Ellram and Hendrick (1995), Bensaou (1999), Duffy and Fearne (2004) and Kannan and Tan (2006).

- Futuristic orientation: companies tend to work together in an extended time period, plan future transactions with each other therefore contract for a long run.
- Relation-specific investments are physical or intellectual investments of partners which are able to be used only in a given relationship.
- Communication, sharing information among supply chain partners is very much emphasized in literature. Spreading sales and inventory data by retailers helps to reduce the bullwhip effect that still often threaten manufacturers in sale season. Information sharing increase customer service level by solving the problem of empty shelves and lack of goods. Spreading actual and relevant information is an elementary condition of strong bounds, exploiting advantages and partnering success. Besides sharing information retailers still can exploit their bargain power and change suppliers frequently. However retailers have to realize that manufacturers would invest in electronic data interchange, in integrated ECR or CRM systems if they rely on a long run relationship with the buyer.

Table 5 summarizes the partnership characteristics and appropriate questions of HCR questionnaire.

Table 5: Partnership characteristics and appropriate questions of HCR questionnaire

Characteristic	Descriptive questions
Futuristic orientation	How large share of sales is carried out in long term contracts? (interval estimate) Why does your company contract for a long term with buyers? (evaluation of options on 5-point Liker-scale) Why your company does not contract for a long term with buyers? (evaluation of options on 5-point Liker-scale)
Relation-specific investments	Do you and your buyer invest in relation-specific investments in cited fields: information system, equipment, warehouse capacity, human resource? (evaluation of options on 5-point Likert-scale)
Communication issues	How usual is in company's partnerships: • Use of shared database? • Use of sales data sharing system? • Use of inventory data sharing system? • Buyer shares actual sales data? • Sharing demand-forecast data? • Use of common planning? (each answer is evaluated on 5-point Likert scale)

7. Partnerships in Hungarian food supply chain

Role of cooperating partners in the supply chain success is realized by respondents, 11 of 30 ranked their partners "important" in the performance of supply chain (4^{th} on a 5-point Likert-scale). Regarding the second *direct* question, whether the companies use supply chain management methods, only 8 of 30 companies gave positive answer. Companies have yet realized the importance of partners in success of whole supply chain however they lagged behind in applying the new management methods.

Stressing the bound would meet the interests of retailer as well as manufacturers. Close and purposive cooperation tend to reduce several transaction costs. Sharing up to date and relevant information can decrease coordination costs, the cost of debates and legal actions.

Futuristic orientation

First analyzed question was the ratio of long term contracts in sales transactions. Answers were given by sales managers. Results shows that long term sales contracts are not typical at all, as it presented in Table 6. At the most of 20% of sales is carried out through long term contracts. Results not definitely means the lack of long term orientation because partners may work together in long run by repeated transactions and without long term contract to hold up the retailers' strong bargain position.

Table 6: Share of long term contracts in sales transactions between food manufacturers and retailers (sales managers' opinion)

Share of sales	Frequency	Percent
0-20%	12	40
21-40%	6	20
41-60%	3	10
61-80%	7	23.3
81-100%	2	6.7
Total	30	100

Production managers were also asked about period of cooperation with buyers. According to the responses 82.8% of manufacturers are working together with more then 50 buyers. 78.6% of products were sold through annual framework contracts, and 28.1% through single transactions. Two or three-year long contracts are quite rare, concerns 10.7% of cases and ratio of more then three-year long contracts is only 7.1%.

Interesting to explore why manufacturers make (or would make) a contract for a long term. Top arguments for long term orientation were stable revenue and capacity utilization. Future business opportunities and cost saving play also important role in building long term partnership.

Table 7: Reasons for long term contract with buyers among Hungarian food manufacturers

How characteristic are the listed reasons for long term contracts with buyers? (Evaluation in 5 point Likert-scale)	Mean	Std. Deviation
Stable gross revenue	3.79	1.287
Stable use of capacity	3.71	1.329
Chance for future contracts	3.46	1.170
Cost saving opportunity	3.32	1.416
Predictable demand	3.29	1.182
Common strategy	2.93	1.331
Common problem-solving	2.74	1.228

Interesting point that common strategy and problem solving which are very important methods of supply chain management are less acknowledged.

To answer the question why companies do not make long term contracts although they are working together in a supply chain Table 8 shows up the top arguments, inter alia, the buyers refuse.

Table 8: Reasons for not contracting for long term with buyers among Hungarian food manufacturers

How characteristic are the listed reasons for not contracting for long term with buyers? (Evaluation on 5 point Likert-scale)	Mean	Std. Deviation
Buyer wants not	3.04	1.428
Using market opportunities	2.78	1.423
Cost-saving	2.77	1.505

Cost saving expectation emerges as pro and con of long term contracts, as well, and seems to be controversial to my assumption about difficulty of finding new partners. Whether a manufacturer does not enter into a contract to retain cost-saving opportunity it trusts in finding new buyers easy and feel not threatened by the concentration of retail.

Relation-specific investments

Types and direction of relation-specific investments was also analyzed. Questionnaire listed the typical forms of relation-specific investments: information system, equipment, warehouse capacity, human resource. Respondents evaluated these forms of relation-specific investments on 5-point Likert-scale according to its relevance on their own or their buyers' operations. In general, level of relation-specific investments is very low, and direction matches to the bargain power, manufacturers are to invest mainly into several equipment and warehouse capacity. Buyers usually develop warehouse capacity but frequency of their investments is low. Unfortunately neither manufacturers nor buyers do invest into information system

Communication

Communication and information sharing behaviour was explored by the information system built up between partners.

Only 1 of 30 respondents has existing common database with its partners, and another 8 reported on working sales data sharing system. Development is predicable because eleven respondents planed in 2004 to invest in electronic data interchange systems in close future.

Share of inventory data also not widespread among respondents, average value is 2.37 on a 5-point Likert-scale, which refers to the low incidence of system.

Buyers usually do not share actual sales data, its average level on 5-point Likert-scale is 2.26, although actual sales and inventory data are the most important in enhancing service level and performance of whole supply chain.

A bit higher the importance of demand-forecast data distribution most of respondents, 12 company evaluated to 3 (modus) the frequency of use of such systems. However this level is still small enough to building and managing partnership.
Integration of common planning system is underdeveloped, as well. Its importance is ranked to 2.3 on 5-point Likert-scale.
To complete the picture, the manufacturers' intention to sharing information is not enough to a partnership and to managing a supply chain retailers also have to recognise their role in this game and cooperate because their sales data and stock information are the most relevant to achieve common success.

Hungarian food supply chain partnerships have to be developed in all supply chain management methods. Declared long term orientation, investments into the relationships and appropriate information are elementary for successful cooperation in long run.

8. Future outlook

Regarding the future of food industry in Hungary further concentration in retail as well as in manufacturing is expected, according to the Western pattern. Western retailers have yet realized that close relations with key suppliers is indispensable. The most widespread methods for developing relationships with manufacturers are Efficient Customer Response and category management.
The fundamental principle of ECR is that through partnership within supply chain, significant cost reduction and improved performance can be achieved through a better allocation of shelf space in the retail store, fewer wasteful promotions and new product introductions and more efficient physical replenishment. The key to the achievement of these goals is shared information, in particular, information on sales and transferred directly to suppliers through Electronic Data Interchange (Fearne et al. 2001). ECR is now known by Hungarian firms although its use is not widespread at all.
Other method of close cooperation is category management which is not used by Hungarian food industry players at all. The category management relies on comprehensive analyses of store and market-level data for making a wide range of strategic and tactical decisions. Further, it requires the retailer to appraise its relationships with key suppliers and to move away from confrontation and towards co-operation (Fearne et al. 2001).

Conclusion

Aim of the paper was dyadic: *first*, to explore the position of manufacturers and retailers in Hungarian food industry and compare its trends with Western-European tendencies. *Second* to analyze the Hungarian food supply chain partnerships if there is any sign for purposive and close cooperation.

Regarding the tendencies, the Hungarian grocery industry face similar trends like Cullen and Whelan reported about for 10 years. Retail chains started a dynamic expansion, nowadays hyper- and supermarket chains account for 40% of grocery turnover. Top five retailers control the 30% of food sales. Hungarian retailing is dominated by several retail networks, number of players is descending.

Concentration concerns manufacturers, as well. According to the data of Hungarian Competitiveness Research at main market of asked food manufacturers 75% of market turnover is controlled by 3-5 producers.

Average share of private label product in Hungarian FMCG market is 23%, however it deviates along outlet types and product categories.

Strategic partnership among the retailers and the manufacturers is not characteristic in Hungary. The present business environment not really motivates retailers to behave otherwise and engage themselves with suppliers. Pace of growth of food retailing was 6.3% in first half of 2006. The continuous increase of consumption does not make necessary for retailers to closely work together with manufacturers, retailers keep the opportunity of changing supplier, therefore makes only short term or transaction-based contracts.

Level of communication between cooperating partners is very low at the present. Several companies have yet introduced common database share sales and inventory information but these techniques are applied by only a quarter of 30 analysed firms. According to all indications companies tend to invest into developing information system.

Presence of relation-specific investments in manufacturer-retailer partnerships is rare and at low level. Typically manufacturers are to invest into equipments and warehouse capacity.

Although today the cooperation is not typical in Hungarian food industry but according to the Western tendencies of increasing concentration retailers will tend to develop their relationships and the low level of relation specific investments and communication will sure change. Leading management methods like ECR and category management have not yet widespread applied but companies will soon recognize the advantages of close cooperation if concentration goes on.

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