



Analysing supply chain partnerships in the Hungarian FMCG-sector

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Összefoglalás: A műhelytanulmány célja egy folyamatban levő kutatás részeredményének ismertetése, s annak feltátása, hogy mely tényezők befolyásolják a magyar FMCG szektor ellátási lánc partnerkapcsolatainak struktúráját. A szerző az elemzés során egy hasonló, az Egyesült Királyságban végzett kutatás alapmodelljét használja fel, amelyet Fearne és Duffy (2001) alkottak meg. Konceptiójuk szerint az ellátási lánc partnerkapcsolatok teljesítményét a hatalom, az együttműködés és a bizalom tényezői határozzák meg. A műhelytanulmány kvalitatív kutatási eredmények alapján az említett három befolyásoló tényező megjelenési formáját és egymáshoz való viszonyát elemzi.

Kulcsszavak: FMCG, ellátási lánc partnerkapcsolat, hatalom, bizalom, együttműködés

Abstract: The aim of this paper is to introduce an on-going research and its preliminary results about partnerships in the Hungarian FMCG (Fast Moving Consumer Goods) -Sector. The Hungarian FMCG supply chains, and their basic influence tools and their relationships with each other are analyzed via dyadic (supplier/producer -buyer/retailer) partnerships. A description will be given concerning the structure of the Hungarian FMCG supply chains. Following Fearne and Duffy's (2001) conception, supplier-buyer partnerships will be analysed through the dimensions of nature of the power structure, nature and scope of joint activity and relational norms.

Key words: FMCG, supply chain partnerships, power, cooperation, relational norms

Introduction

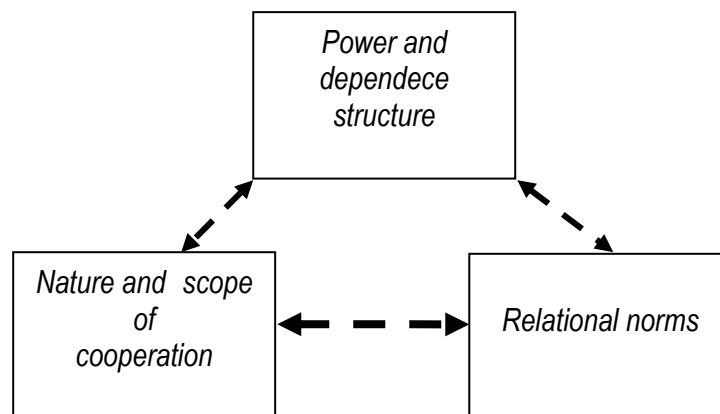
In the last decade the strategic management literature stated that firms can not reach business successes alone in isolated environment. If they want to achieve competitive advantages, they have to cooperate with customers and suppliers to harmonise their information and physical processes. These theories have focused on cooperative supply chain concepts in every industry. After several mergers and acquisitions in the retail and FMCG manufacturing industry, the mentioned cooperation became stronger and stronger in Western-Europe and North-America during the 1990s. The solutions of Efficient Consumer Response, Vendor Managed Inventory have been applied in more and more FMCG supply chains. These trends have appeared in Hungary only in the second part of 1990s. After the economic transition, the public retail and manufacturing sector was privatised and several multinational and local companies appeared on the market. At the end of 1990s and early 2000s a capacity

consolidation has started, and the number of retailers and manufacturers has reduced. After this consolidation the first signs of the mentioned cooperation have appeared, but the level of the cooperation among FMCG supply chain members is still much lower than in western countries.

The theoretical framework of this research is based on Fearne and Duffy's (2002) conception. This concept was made after similar FMCG-researches in the UK supply chains. According to this concept the supply chain relationships' performance is identified by three key performance factors:

- The structure of the relationship economy-the nature and scope of joint activities undertaken
- The structure of relationship polity-the nature of the power dependence relationship
- The relational norms- the dominant attitudes and sentiments that exist.

“These three factors combine to positively influence performance of dyadic relationships between strategically important buyers and suppliers-those who engage in joint activities, develop mutual dependence over time and exhibit trust and functional methods of conflict resolution. “ (Fearne-Duffy, 2001 pp.12.). These three basic supply chain influence tools are in horizontal relationship, they affect each other to same extent. Their structure can be illustrated by Figure 1.



1. Figure Theoretical framework of supplier-buyer relationships (Fearne-Duffy, 2001)

Research questions

The aim of my paper is to describe basic elements of supply chain partnerships in Hungarian FMCG supply chains regarding to basic supply chain influence tools: power, cooperation and relational norms.

The basic research questions of this paper are connected to the application of Fearne and Duffy's model in the Hungarian FMCG- Sector:

- Describe the power, cooperation and relational norms appearance in the Hungarian FMCG-sector.
- Due to Fearne and Duffy's conception: what is the internal structure of the supply chain partnership influence tools in the Hungarian FMCG supply chains?

The mentioned research questions can be extended into wider context as follows. I will analyze the questions below in further phase of the research, not in this paper.

- What kind of additional partnership influence tools can be identified? How can the whole range of influence tools affect each other?
- Can the structure of the above analyzed influence tools be different from each other in case of multinational and local Hungarian supply chain members?

Structure of my research

The structure of the research can be divided into three parts. At first I started my work with literature review to find results and methodologies of similar researches, and to get familiar with the major points of these partnerships. After that I started the qualitative phase. I am making interviews with sales persons at multinational producers and smaller Hungarian producers, and category managers/buyers at multinational and Hungarian retail chains. After closing the second part I will create a questionnaire to measure the influence tools of the partnerships and distribute it among the mentioned supply chain members. I will analyze the results by using multivariable statistical methods.

Literature review

Following the three basic supply chain influence tools, which were identified by Fearne and Duffy (2001) I have focused my literature research in order to introduce basic conceptions regarding power, cooperation and relational norms.

At the *power-dependence* structure I will use the traditional arm's length and partnership model. The basic elements of these concepts are summarized in the table below.

| | Arm's length model | Partnership model |
|-------------------------------|--|--|
| Nature of relationship | Competitive Win-Lose Game | Cooperative Win-Win Game |
| Number of suppliers | Huge | Limited |
| Length of relationship | Short term | Long term |
| Contract | "Closed" or formal, detailed | "Opened" or informal |
| Conflict management | Reduce conflict potential by detailed contracts | Reduce conflict potential by selecting partners with similar values and by increasing mutual understanding |
| Influence | Through coercion | Through expertise |
| Negotiating strategy | Avoid dependence by playing multiple partners off against each other | Create interdependence by limiting the number of partnerships |

1. **Table:** Traditional points of Arm's length and Partnership model (Kumar, 1996)

The second concept, which is applied in this part, is the *Bensaou*-matrix (1999). Bensaou has identified the level of the partner-specific investments between buyers and suppliers and created a matrix-portfolio regarding to these investment levels. According to his findings we can talk about *market exchange* relationship, when there is no commitment between buyers and suppliers, and the level of their partner-specific investments is mutually low, power of the partners is similar. The opposite of this situation is the *strategic partnership*. In this case the level of partner-specific investments is mutually high, there is strong commitment between the partners, and we can talk about innovative and complex products and long term relationships as well. If the level of the partner-specific investments is high on the buyer's side and low on the supplier's side we can state a *captive buyer* relationship. In this situation the number of suppliers is limited, but the number of the buyers is high, and consequently suppliers can easily substitute the buyers. On the other side *captive supplier* relationship can

be identified, when the level of partner-specific investments is high on supplier's side and low on buyer's side. This relationship is determined by opposite characteristics than the captive buyer one.

The third applied concept of power structure is Cox's (2001) points. According to Cox, the power structure of partnerships is identified by:

- number of buyers and suppliers,
- proportion of partner's in buyer's /supplier's output,
- cost of partner's substitution,
- product's characteristics,
- information gaps,
- level of partner-specific investments
- threat of vertical integration.

The above-mentioned points jointly define the nature of power positions in supplier-buyer relationships. According to these points Cox (2001) state 4 forms of power situation, which are illustrated below.

| | | |
|--|--|--------------------------|
| Bargaining power of buyer compared to supplier's one LOW HIGH | Dominant Buyer | Mutual Dependence |
| | Independence | Dominant Supplier |
| | LOW | HIGH |
| | Bargaining power of supplier compared to buyer's one | |

2. Table: Power -portfolio matrix by Cox (2001)

If we compare Bensaou's and Cox's concepts, we can argue that their findings and power-dependence types are very similar to each other. Market exchange relationships can mean independence, in case of dominant buyer's situation we can state captive suppliers on the other side, and the opposite in dominant suppliers and captive buyer's case. And most of the cases, when there is mutual dependence between supply chain members, strategic partnership

can be identified.

At the analyses of the *cooperation structure* I will apply the concept of *van Goor* (2001) and *Ellram and Hendrick* (1995). Van Goor defines four stages of the cooperation between supply chain partners. The aim of the even stronger cooperation is to provide even faster and reliable supply and reduce physical and informational disruptions. The main findings of his model are as follows: the cooperation levels of supply chain partners can be divided into four stages. Physical integration: at this phase only the physical processes are harmonised among supply chain members, by using similar selling units, product identity tools etc.

1. Information integration: in the second stage of the integration, the primary process (i.e. physical integration) is tuned between vendors and suppliers through information flow. Chain partners have to be prepared to share information that is needed to manage the chain as a single entity.
2. Control integration: At this stage one member of the supply chain takes the responsibility of monitoring demand, managing inventory and ensuring replenishment activity.
3. Structure integration: supply chain members harmonising their planning and forecasting activity, and making their innovation, product and operation development processes together.

Cooperation's characteristic points of *Ellram and Hendrick* (1995) will be also applied. According to their findings the major points of joint activities are as follows:

- Futuristic orientation: future transactions, long-term expectation, suppliers are chosen based on total cost of ownership concept.
- Risk sharing: willingness to help to the other partner in difficult situations, willingness to handle exceptions by negotiations. If the commitment in risk sharing is high win-win game can be identified among supply chain partners, and on the opposite side win-lose game can be stated.
- Computer linkages: direct computer-to-computer links, software compatibility.
- Corporate communication: frequent face-to-face planning/communication, many corporate levels of communication.
- Information sharing/understanding: joint planning committees, buyer shares demand forecasts.
- Operations information: monitoring of end results, buyers and suppliers regularly

studies partner's processes.

The *relational norms* will be analyzed by applying the risk-based view of trust. The definition of risk-based trust is created by *Mayer, Davis and Schoorman* (1995). "Trust is willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party." (Mayer-Davis-Schoorman, 1995, pp. 712.) Trust and risk are comparative elements, trust propensity is defined by risk propensity. According to *Das and Teng's* (2004) concept, trust levels can be divided into two parts. Goodwill trust describes personal characteristics of trustee and belongs to relational risk. Competence trust identifies relevant knowledge and competence of trustee and belongs to performance risk. So if my neighbor asks me to lend him 1.000 Euros, this is a goodwill trust issue, because I can feel relational risk. If my neighbor asks me to found a company together, it is a competence trust issue. Can I trust in his competencies enough to run a company together with him? *Barney and Hansen* (1994) have defined the rationale trust and risk combination levels in business relationships. They identified three levels of trust and risk in business partnerships:

- *Weak form of trust*: in this case the relationship-specific risk is very low, there are limited opportunities for opportunism. The quality of goods or services that are being exchanged can be evaluated at low cost. The level of partner-specific investments is very low, transaction costs of partner's substitution are also low. Weak form of trust can be the norm of highly competitive commodity markets.
- *Semi-strong form of trust*: when significant exchange vulnerabilities exist trust can still emerge, if parties to an exchange are protected through various governance devices. Trust can be a coordination tool in these relationships, which can limit the opportunities for opportunism. If the cost of trust creation is lower than its benefits, trust will become relevant governance device in relationships.
- *Strong form of trust*: in strong form of trust, trust emerges in the face of significant exchange vulnerabilities, independent of whether or not elaborate social and economic governance mechanisms exist, because opportunistic would violate values, principles, and standards of behavior that have been internalized by parties to an exchange. Strong form of trust can be called as hard-core trust. It is more than a cultural issue, which can be created during decades, and its creation cost is even more than its benefits.

Research findings

At this part I will introduce the qualitative findings of my research. First I start the introduction with a general description about the analyzed sector, and after it I will apply the theoretical concepts of the literature review.

Research methodology

At the qualitative part of my research I have made eight interviews and some action research. The interviews were made with operational buyers at Hungarian and multinational retail chains, sales and supply chain managers at both local and multinational retailers. The action research was organized at a multinational food producer's sales department. During the research session I could follow the sales managers' tasks, the supply chains operation processes and the buyers' behavior.

Basic characteristics of Hungarian Fast Moving Consumer Goods sector

Highly concentrated retail market can be described through the high market share of hypermarkets, horizontal cooperation among retail chains (buying groups), and even more independent stores join to traditional local retail chains.

Dynamically growing and changing product portfolio. Mainstream brands are not enough to fulfill consumer's requirements. There are more and more niche markets and brands.

Low complexity of products, production technology has been well developed for decades, innovation concentrates on to reduce production cost and to achieve higher utilization, or to make the products more attractive by developing new packaging and tastes. This innovation activity means even growing number of SKU-s that increases the complexity of the supply chain.

Reducing number of producers: capacity consolidation is continuous, fierce competition force producers to reduce prices in line with increasing quality and even customized supply. Only big producers can preserve their competitiveness in this environment, smaller ones are acquired in most of the cases.

Reducing brand loyalty: producers offer very similar products in terms of quality, design, variety and availability. Great variety of products urges consumers to try more and different ones and not to be loyal to traditional brands. The majority of the brands can be easily substituted with each other.

Increasing power of private label products: the share of private label products can be higher than 50 per cent in many food segments (AC Nielsen, 2005). This huge market share of

private labels enhances retail chains power. Many local brands have lost their competitiveness against private labels, so producers made contract with retail chains and started to manufacture their products as well. There is still overcapacity on the supplier's side, especially among local producers. Concerning to it the buyers can easily find partners to have their private label products produced.

Increasing customer's requirements in logistics solutions: producers have to ensure very fast and reliable supply of their products. The standard level of service is within 48 hours. Direct deliveries to stores are used frequently.

Fierce competition: fierce competition characterizes the whole supply chain. Reasons are derived from the statements above.

Future outlook- anticipated tendencies

Based on the interviews the following changes and tendencies can be anticipated in the analyzed sector:

- *In the next 5 years the consolidation of the retail sector will be continued, and probably the hypermarket, discounter and traditional local chains can be the winners of this tendency.*

The experts anticipated continuous growth of the hypermarket sector in the premises of bigger cities, rapid rise of discounters can be also expected in all cities and smaller towns as well. On the countryside the local retail chains network can be dominant, and the majority of independent stores will join to them.

This prediction is in line with the results of a scientific research, which state that the main drivers of increasing share of supermarket's are: urbanization, female participation in the labour force and openness to foreign competition through FDIs. This article forecasted that in Hungary the share of supermarkets in the retail sector will grow from 48 percent to 62 percent between 2002 and 2015 (Traill, 2006).

- *Increasing competition among local, multinational and private label brands.*

In this field three main tendencies are expected. First increasing concentration is expected among suppliers. Some manufacturers, especially the multinational and bigger local companies will increase their power by taking over smaller ones from the second or third tier mass market brands within the FMCG industry. This capacity consolidation can be stronger in some markets, for example dairy products, waters and beverages, sweets and cookies, hard drinks.

Second, concerning to strengthening consolidation among producers, some brands can lose their market shares. Due to the consolidation the large multinational companies, who produce strong brands can increase their market share, and their brands power. But the smaller or/and weaker local companies who's brands belong to second tier categories can be caught in an accelerating downward spiral in market share. So big gaps can be generated between well-known multinational and smaller local brands, and the local ones can lose their market position. There will be two options for the local producers to survive this situation either concentrating on supplying smaller regional retail chains, niche markets or producing private label brands. This tendency is also in line with global ones. After analyzing UK FMCG sector Cullen and Whelan (1996) stated that two major groups could be identified among FMCG brands. The group of Euro-brands or global brands is produced by big multinational companies who have enough resources to invest in their products innovation, supply and marketing activity. These are top-brands with big market share and listing in all retail chains. The group of trapped brands is produced by local suppliers with lack of resources to maintain dominant brands and they are facing a diminishing role in the future or else take over by larger players.

Third the current share of private label brands will not grow as rapidly as it was in the last decade, but quality- and concerning to its price- segmentation is expected among private label products. According to this segmentation the quality focus will also appear in brand's competition, because currently only price focus is dominant.

Applying the elements of the literature review

At further phases of this part I will apply the theoretical concepts which were introduced during the literature review. First I start to introduce my research's findings by analyzing the *power structure*. Following Cox's *power conception* following research findings can be stated:

- *Number of buyers and suppliers:* there is highly concentrated market on the buyer's side; and currently there is still high surplus of capacities on the supplier's side. If we calculate with the buying groups, there are ten retail chains, and more than one thousand of suppliers. The suppliers can be differentiated; many multinational producers have subsidiaries in Hungary also. Their power position is more advantageous than the majority of local Hungarian ones, because multinationals can negotiate on global level. The majority of retail chains are also multinational ones, only two of them are Hungarian, they concentrating their operation on small local

stores.

- *Proportion of partner's in buyer's supplier's output:* the hyper-and supermarkets are overrepresented in the supplier's customer-portfolio. This point can be easily illustrated by two figures. In most of the cases one supplier can reach maximum 2-3 per cents shares in one retailer's supplier portfolio. On the opposite side one retail chain can reach from 10 to 25 per cents in one supplier's customer portfolio (Interviews, 2007). At this point it is very important to talk about private label brands. Private label brands are very popular, due to the high price-sensitiveness of the Hungarian consumers. These products account for the majority (approximately 40-60 per cent) of sales in each FMCG products' market. This situation can be illustrated by the following example. Before Spar Group introduced its own label products, 90 per cent of soft drinks' sales derived from Coca Cola and Pepsi. Three months after the introduction of private label beverages, these products have generated 60 per cent of the turnover (Interviews, 2007).
- *Cost of partner's substitution:* due to the above mentioned figures it is very low on the buyer's side, and difficult and costly on the supplier's side. The buyer's can easily delist a supplier, but the suppliers can not loose a retailer, because in this case they can loose one-fourth or one-fifth of their turnover as well.
- *Product's characteristics:* complexity of the products is very low, production technology is well-developed, and majority of innovation concentrates on cost and production-effectiveness. The details of this point were mentioned at the introduction of the sector.
- *Information gaps:* buyers are in much better position to cooperate with each other and get information about suppliers.
- *Level of partner-specific investments:* very low, currently the retailers can realize even growing profit results in every segment, so they not interested in to cooperate with suppliers. Experts anticipate the consolidation of retail sector with the rise of hypermarkets, hard-discounts and local traditional chains. When trends of this consolidation will strengthen, cooperation between buyers and suppliers can become stronger as well.
- *Threat of vertical integration:* is not dominant, but on the buyers side there were several merger and acquisition in last years, so smaller suppliers are always threatened buy bigger ones.

According to the above mentioned points it can be state that this is an arm's length relationship, and in the Bensaou-matrix the majority of the partnerships are in captive supplier position. This is dominant buyer position in Cox's power structure matrix. In some cases -between multinational partners- we can talk about market exchange relationships, because the dependency level of bigger multinational supplier companies is lower than Hungarian ones. Multinational manufacturers can negotiate on global level with retailers and most of the cases their brands are more valuable than Hungarian ones.

At *cooperation/ supply chain integration* part the application of *Ellram and Hendrick's* points are as follows:

- Futuristic orientation: real futuristic orientation can not be identified in these relationships, because of the following points: suppliers are always chosen based on product's price and rebates; the focus is always on current transactions; and written agreements are not longer than one year, however the duration of the transactions can be longer.
- Risk-sharing: only win-loose game can be identified in partnerships, there is low willingness on both sides to handle problematic situations together, majority of the risks are on the suppliers side.
- Computer linkages are only exceptions, it can be developed only in case of multinational partners, but suppliers have to pay refund to buyers for EDI connection.
- Corporate communication: in case of multinational suppliers and retailers it is informal, most of the cases it happens on weekly basis between Key Account Mangers and buyers. The issues of the communication concentrate on price promotions and supply problems.
- Information sharing: price information and the conditions of yearly agreements are always sensitive issues. Partners share only the most necessary information about their business, because suppliers would like to reduce their dependency level by not providing information about their processes to buyers.
- Operations information: only the turnover's results and supply problems are monitored, suppliers are not interested in to understand partner's business processes.

According to *van Goor's* concept the analyzed supply chain's integration are mostly at the *physical* stage. In some cases when EDI connection can be found between partners, information stage can be stated.

The basic findings of the *relational norms*/ risk based trust's part can be described as follows:

- The dominant members of the FMCG supply chains are the buyers (retailers), who's risk propensity are very low, because they can easily substitute the suppliers.
- According to the point above, the level of trust is very low in these relationships. Weak form of trust can be identified in these relationships, because of the substitution point, and buyers can easily coordinate their relationships by power. The transactional costs of trust building would be much higher than its benefits for them.

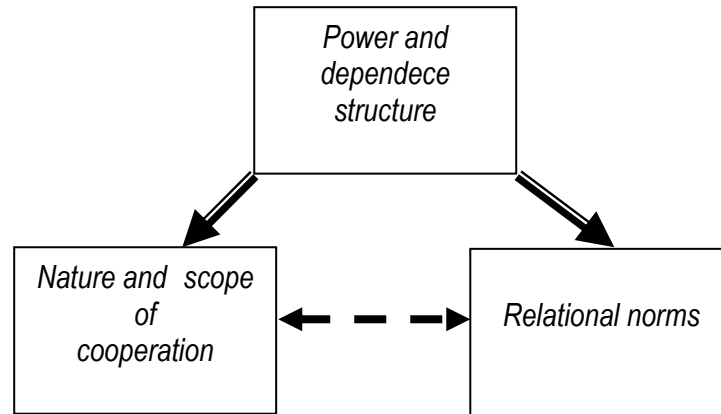
After understanding the structure of Hungarian FMCG supply chains by the qualitative phase, I have created 3 hypothesizes according to the supply chains' influence tool's structure. I would like to test these hypothesizes in the next phase of my research by survey. These hypothesizes were developed by using the findings of Fearné and Duffy (2001)'s theory. As it was mentioned before they stated horizontal relationships among power, cooperation and relational norms in supply chains performance. My hypothesizes analyze the relationships of these three elements of each other, and state the follows.

H1: The power structure determinates the cooperation and integration level of the supply chains.

H2: The power structure determinates the relational norms of the supply chains as well.

H3: The cooperation among supply chain members are affected by the relational norms, without hierarchical relationship.

So I would like to confirm by testing these hypothesizes that power structure is the most important tool in Hungarian FMCG supply chains, and it absolutely dominates cooperation and trust in the analyzed dyadic relationships. Due to these statements the relationship among these elements can be illustrated as follows:



2. Figure: Relationship among power, cooperation and relational norms-based on my hypothesizes

Research perspectives

As it was mentioned in this paper the next phase of this research will be the quantitative testing of the hypothesizes. The theoretical framework will be analyzed and tested in wilder context as well. As a part of Hungarian Competitiveness Research context the Hungarian FMCG sector's supply chain influence tool and their relationship will be identified, and these supply chain influence tool's effect on competitiveness will be also analyzed. This research will also focus on whether these supply chain influence tool and their relationship different in case of local suppliers' chains.

Summary

In this paper I have analyzed the basic influence tools of supply chain partnerships in the Hungarian FMCG sector. To analyze these partnerships I have applied Fearn and Duffy's conception about supply chain relationships. In the literature review I have introduced several concepts regarding to power, cooperation and relational norms. At the second phase of my paper I have introduced the results of my qualitative research by adopting the concepts, which were mentioned in the literature review. After it I have created three hypothesizes regarding to the relationships of power, cooperation and trust to each other, and I will test these hypothesizes in the following part of my research. In next phase of my research I would like to answer my second research question as well, what kind of another supply chain influence tools can be identified except power, cooperation and relational norms. How these newly identified supply chain elements effect the "old ones"?

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