

PROBLEMS OF THE CO-OPERATIONAL ATTITUDE OF SUPPLY CHAIN MEMBERS IN THE HUNGARIAN FMCG SECTOR

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Abstract

In today's competitive environment companies must aspire for improving their service level and simultaneously cutting their costs in order to maintain their competitiveness. This kind of paradigm has appeared in our economy because of the economic-financial crisis of the recent years. It plays a critical role in today's network economy, where the importance of interorganizational partnerships becomes more and more remarkable. Companies can only be competitive by managing interorganizational processes efficiently and forming strategic alliances.

The study provides a general picture of the typical types of supply chain partnerships, and the advantages and disadvantages of these co-operations. It also deals with the power relationships along the supply chain, placing special emphasis on the FMCG/Food sector.

Key words: logistics, supply chain, cooperation, partnerships, power relationships, FMCG/Food sector

1. INTRODUCTION

In the examination of new competitiveness criteria, it becomes clear for companies that the importance of partnerships and alliances between chain members is increasing. Having time-based competition in mind, one of the major motivations for establishing close partnerships is to shorten the "cycle time" of the supply chain by way of co-operation.

In recent decades, a number of trends and changes have occurred which have made co-operation even more important, including internationalization and globalization, outsourcing and the reduction of the number of suppliers, the prominent role of research and development, and a drastic shortening of product life cycles and the cycle times of business administration processes in general.

As a consequence of the above, a company cannot compete alone at the competitive marketplace: strategic allies must be found. Obviously, this implies drawbacks in addition to benefits (interests are prejudiced e.g. by disclosing certain types of market information to partners); however, international surveys show that eight out of ten companies do not wish to leave an already operational supply chain. (Herz-Alfredsson 2003)

2. CO-OPERATION MODELS FOR CHAIN MEMBERS

The competitiveness of the supply chain depends on how the members of the chain can resolve their conflicts of interest. Intra-company activities must be taken care of invariably, with the addition of the need to manage partnerships between the suppliers and clients of the company, and even the entire chain (network). With the "blurring" of company boundaries, by making the flow of materials, information and money more seamless and streamlined, partners may also be able to get closer to both their consumers and their suppliers. The biggest problem is the efficient setup and operation of the organizational and operational system of connections between organizations.

If partners can co-operate successfully in the long run, members can reach economic advantages

1. in stock taking (e.g. lower levels of investment into inventories, shorter lead times and shorter times for completing orders),
2. in time-based competition (e.g. quicker returns, possibility of satisfying consumer demands more quickly),

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3. in respect of costs and efficiency (e.g. lower costs of operation, procurement, manufacturing and logistics, higher work efficiency), or
4. in terms of better information supply (e.g. better insights into consumer demands), etc.

The key to success is the organizational ability based on the complex combination and the integration of processes, assets and labour, thereby producing value (know-how difficult to imitate by competitors), which can be a source of competitive advantage for the chain and the organizations constituting it.

This organizational ability can only develop in the perspective of a longer period, which represents advantages and disadvantages as well:

A competitive advantage is that other companies cannot establish such an integrated supply chain overnight;

A competitive disadvantage is that it takes long years for the given company as well before it succeeds in accumulating the knowledge, system of relations, abilities and trust required for the implementation / operation of such a complex system.

One of the criteria for establishing efficient chains is to change over from the competitive model to the co-operative model. The following is an overview thereof. (Table 1).

Table 1. Comparison of models of co-operation between supply chain members

<i>Model features</i>	<i>Competitive model</i>	<i>Co-operative model</i>
<i>Type of relationship</i>	Supplier is enemy (lack of confidence)	Supplier is partner (confidence)
<i>Number of suppliers</i>	many	one or few
<i>Length of relationship</i>	one-time	medium or long-term
<i>Type of contract</i>	regulated, rigid	flexible, providing a framework
<i>Joint activity</i>	none	in important areas
<i>Production and activity</i>	separated	integrated, interconnected
<i>Orders</i>	occasional	frequent, in small batches
<i>Negotiation strategy</i>	win-lose	win-win
<i>Supplier selection</i>	by competition	by negotiation
<i>Supplier evaluation</i>	unilateral	bilateral, relationship evaluation
<i>On the whole</i>	<i>exploitation of ad hoc market opportunities</i>	<i>relationship management</i>

Source: based on Szegedi-Prezenszki (2010)

This model presumes trust-based, long-term, integrated, and mutually beneficial operation.

3. FEATURES OF RESERVED AND COMMITTED RELATIONSHIPS

The lasting quality and success of a relationship depends on the degree of trust between the companies related to each other. Trust has a value because the reduction of future-related uncertainties carries business value. The two (extreme) forms of relationships between companies are “reserved” and “committed” relations.

In a **reserved relation**, the (traditional?) relationship between the client and the supplier is rather hostile.

- There is no trust. The client and the supplier have different goals and interests.

- They consider their relationship to be a zero sum game, which means that they can only acquire returns to the detriment of each other: what is won by one of them is lost by the other. In general such a relationship is focussed on a given economic transaction which is limited in content and timespan.
- The duties and obligations of the parties are set out in a clear-cut and detailed contract. Should an unexpected event occur, they settle the dispute according to legal or ethical rules.
- Transactions are effected from a “proper distance”, so that interconnections can be avoided. Suppliers are provided only a minimum amount of information.
- If some points of the relationship are improperly defined, it leads to a lack of co-ordination in goods and/or data flow.
- The other party can be easily replaced upon the expiry of the contract.

So, on the whole, drawbacks of a *reserved relationship* include the following:

- a) minimum communication frequently goes on through indirect channels and
- b) can lead to misunderstandings, so the relationship fails to live up to the opportunities.

Nevertheless, the most important advantages of this type of relationship are as follows:

- a) It requires relatively inconsiderable resources to establish.
- b) The company can replace its suppliers easily and at a low cost if so required by prices and expenses.

A **committed relationship** is more like friendly. Characteristics include the following:

- It is based on mutual confidence.
- Before a transaction, the parties do not agree on each and every condition: the contract rather serves as a framework for co-operation only.
- Even if there is a detailed contract in effect, the parties are interested in doing more than just what is obligatory because they assume that extra performance elicits a similar reaction from the partner.
- So confidence based on open commitment comes into the picture. This makes it possible for companies to share confidential information as well.

A committed partnering relation can provide advantages to both the supplier and the customer.

These advantages are the following from the general business point of view:

- client and supplier can mutually understand and respect each other;
- they can exploit their resources more efficiently;
- they can optimize their related processes;
- both of them can increase their profits (they can share the profits generated by one of the partners);
- by way of co-operation, they have the opportunity for continuous development and improvement.

The advantages above are only available if the supplier's and the customer's conduct changes from the opposition of “we and them” to a win-win position of “we and we” type co-operation.

The possible advantages of partnerships can also be examined from the operational, technological, and economic points of view.

From the operational point of view, a smaller supplier base is easier to manage. Interdependence can ensure greater procurement stability. Higher service standards, more reliable and shorter lead times can be achieved; and in the event that problems arise, the parties can pay more attention to each other. Time devoted to collect new offers and to select suppliers is reduced. Suppliers can play a greater role in company strategy development. Partners can harmonize their processes better by on-going communication.

From the technological point of view, partners are ready to take part in product design and development processes. If a supplier is involved in product development, quality can be improved and the time for the development and launch of a new product can decrease.

From the financial point of view, risks can be reduced and / or shared by way of joint investments and research and development. Lower inventory levels can be achieved by information sharing, which can reduce costs. A long-term co-operation may result in more stable prices. In a reserved relationship, the company can achieve lower prices by making suppliers compete; at the same time, its transaction expenses (e.g. contacting the partner company, conducting the price negotiation, drawing up the contract, continuous control of compliance with the contract, contract amendments as required by market events, on-going arrangements for transport and storage, constant quality inspection, etc.) will be higher than in case of a trust-based relationship.

However, there are *drawbacks* in long-term partnerships as well. Highlights include that it is difficult to plan the lifecycle of partnerships, and it also occurs that not the most suitable partner is selected in the end and forced co-operation is required.

Many times, separation not only depends on determination, as it frequently requires considerable expenses to terminate the relationship and to establish a new partnership (partner exchange cost).

The organization can also resist, thwarting the changeover.

4. POWER RELATIONS AND DOMINANCE

Members of the supply chain have different abilities to enforce their economic interests. In a dual relationship of customer and supplier, both the customer and the supplier can be “dominant”. This can depend on several factors, e.g. the size of the company (multinational), the nature of the product (special product, a novelty on the market) or even the regulatory environment (public procurement), etc.

However, dominance can be observed in respect of the entire chain as well. The following part of the study discusses typical power relations within the supply chains of the FMCG/Food sector.

The FMCG/Food sector can be characterized by the fact that the impacts of time-based competition are strongly perceivable, as a result of which today “the quicker one devours the slower one, rather than the bigger one eating the smaller one”. There is an enormous competition between the supply chains operating within the sector (e.g. Tesco, Auchan, Cora, Metro, Lidl, etc.), generated by large multinational corporations (dominant channel members) (Szegedi, 2008).

In respect of FMCG product chains (both food and non-food), the dominance of large hypermarket chains can be observed². They are the ones to determine:

- a) what to enter the chain on the upstream side. They influence production, quality, technical development, etc. Global competition is realized through their international procurements.
- b) on the downstream side, they are the ones to satisfy customer demands, but they also modify them. They possibly generate new demands.

The role of hypermarket chains in supply chain control is inestimable. However, the subject is over-politicized all over the world (as well as in Hungary). Therefore objective surveys are difficult to conduct. Attempts in this direction by two of my PhD students have failed in recent years.

It can also occur in the FMCG sector that some of the suppliers of a (dominant) hypermarket chain are themselves “dominant” (global) corporations (of quality soft drinks, cosmetics, etc.). So the hypermarket chain “cannot refrain from” selling these products. Nevertheless, in the absence of full co-operation, there is still some “scope for decision” through the use of certain marketing tools (e.g. relocation from shelves at eye level).

Figure 2 shows a typical FMCG supply chain (network).

² These companies have strengthened in absolute value as well in recent decades. (E.g. Wal-Mart has become the company with the largest turnover in the world.)

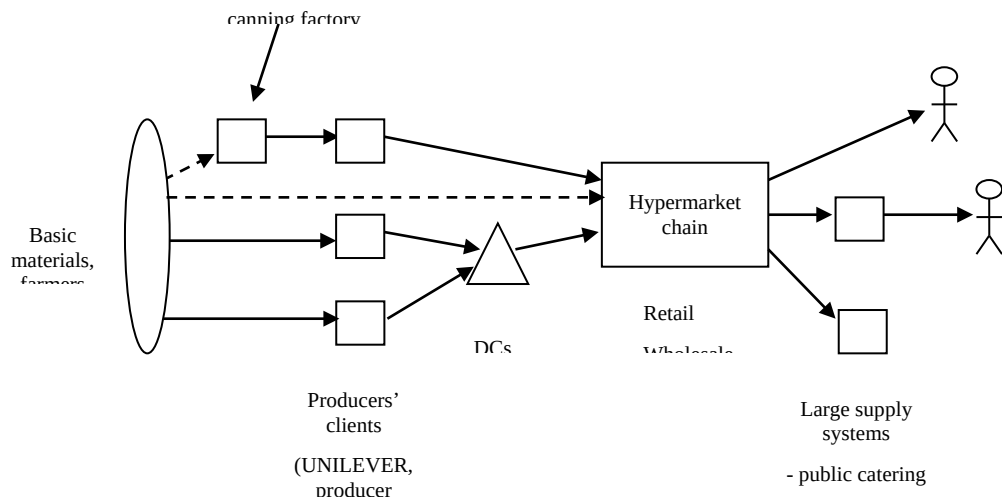


Figure 2. Supply chain in the FMCG sector

Source: based on own compilation (Szegedi 2011)

In the course of the past decade, the Hungarian FMCG/Food sector has been characterized by the increased role and proportions of retail chains, as well as by supplementary and local supply chains losing out. The distribution of companies by size shows a peculiar picture as there is a high proportion of small and medium-sized enterprises (though their market share is inconsiderable), with a variety of input sources and a large number of suppliers. So the sector can be described by complex supply chains (networks) with many players involved. At the same time, a considerable part of the market volume can be associated with a few large chains of stores: roles are unequal in the supply chain, characterized by traders' dominance. A further feature of supply chains in the sector is the strong presence of a whiplash effect, as a consequence of which the producer takes the rap most frequently. Chains have become simplified / shortened with the appearance of producer organizations. A further feature of the sector is that the wholesaler is occasionally "missing" from the classic supply chain (supplier – producer – wholesaler – retailer – consumer). (Wholesaler functions are also performed by retail hypermarket chains.)

For enterprises operating in the sector, the target is not only to improve their market position but it is also of high priority to improve their channel position. In order to improve their market and channel positions, companies co-ordinate their actions, which is manifested at both vertical and horizontal levels. An illustrative example of vertical co-ordination is the prolonged co-operation of producers and retail chains, to provide advantages for both parties (e.g. category management, where the supplier brand owner company and the trade chain work together to increase the turnover of the given product category), and joint operations by retailers and wholesalers to improve their procurement positions (e.g. METSPA: a joint procurement company of Metro, Spar and Praktiker). Chains of stores established in the course of horizontal co-ordination co-ordinate both procurements and sales (e.g. Co-op Hungary Zrt., CBA Kereskedelmi Kft.), and the benefits arising therefrom improve the market position as well as the business administration processes of member companies. (Pénzes, 2009)

Dominant channel members – "large retail networks" – play a prominent role in the supply chains of the FMCG/Food sector; in other words, the sector's logistics operations are centralized by these system integrators. As a result of global procurement, there is a frequent feeling that product efficiency should be increased. This primarily applies to Hungarian small and medium-sized enterprises. At the same time, the presence of dominant channel members (retail chains) entails a number of advantages as well. From the customer's point of view, it is favourable that they bring prices down on the supplier side, so they sell their products cheaper on the output side. Furthermore, they affect research and innovation, and they play an important role in the co-ordination of chains. They conduct market research; they test the market, as a result of which they buy products from their suppliers which they can actually sell: thereby they play a special role of finishing production. And from the logistics point of view, they play a role in process acceleration. They measure their logistics processes to be able to accelerate their inventory turnover and thus to reduce or even discontinue warehousing activities (e.g. by applying Cross-

Docking). As a result of their dominance, they raise certain expectations for their suppliers. (For instance, requirements of connectivity to the information system of the chain - Wal-Mart expects its suppliers to place RFID tags on the products or batches supplied.)

5. RESULTS OF AN EMPIRICAL RESEARCH OF THE ASSESSMENT OF QUALITY OF INTER-ENTERPRISE COOPERATION

Since the time of joining the European Union in 2004, experience shows that the agricultural cooperatives (TÉSz) in Hungary cannot completely fulfil the role in the fruit-vegetable sector they were supposed to play. Despite the significant subventions from the European Union the cooperatives have not become those flagships of the sector that would attract crowds of the producers.

Several sectors of the agriculture are in a difficult situation because of market power asymmetries, as sectors of agriculture are wedged in between a highly concentrated input and output market in Hungary. Having recognized the problem, considerable efforts have been made at governmental level as well, e.g. to support producer organizations in horticulture (TÉSZ).

Bargaining positions of the market in this area were examined by Domján E. & Farkas- Fekete M. (2012). On the basis of the calculations performed, the authors showed that food retail trade in Hungary can be considered as an asymmetric oligopoly, so retail trade players are present on the market in a much more concentrated manner than suppliers or customers are. According to their proposal, co-operation between vegetable growers and fruit growers should be encouraged in order to offset the strong bargaining position of commercial chains by establishing producer groups and producer organizations. The authors studied the example of a recently established producer group.

Having improved the model published by Pihkala et al in 1999, they developed a framework to measure and assess which phase of network development the organization studied is in. Network competency measurements involved the ability of communication, co-operation culture, confidence, strategic thinking and co-operation attachment competency. Scores for each of the group factors were stated on the basis of their existence or estimated level. Values applied: weak or deficient = 1, sufficient = 2, medium = 3, good =4, excellent = 5 points.

Factors belonging together were arranged into groups and the relative importance of factors was weighed (normal = 1 or important = 2). The figures thus yielded served as a basis for classifying the producer organization studied into a state of organizational development (Figure 1).

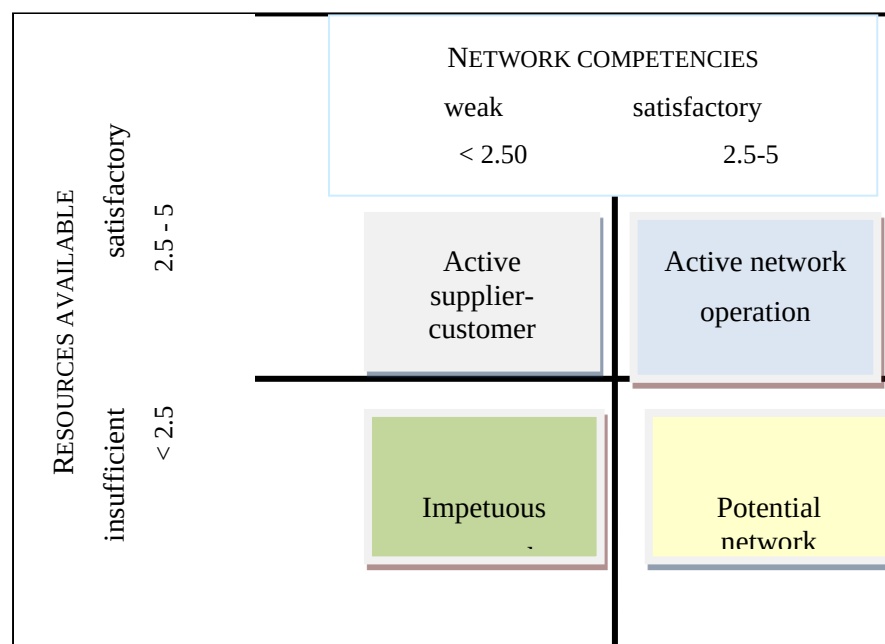


Figure 1 Co-operation status assessment matrix

Source: own compilation based on Pihkala et al. (1999)

Applying the framework described, the development of a producer group established in 2011 was examined three times. The group was formed by 9 natural persons and 4 business companies with 380 hectares of plantations (apples, sour cherries and peaches).

Measurement results are shown in Table 1.

Table 1. Development of co-operation status

Description	Measurement 1 (13.06.2011.)	Measurement 2 (31.05.2012.)	Measurement 3 (31.12.2012.)
Resources			
Financial resources	1.49	1.18	2.48
Physical (material) resources	3.18	3.46	2.62
Weighted average of resources	2.33	2.32	2.55
Network competencies			
Ability of communication	2.35	3.17	3.64
Co-operation culture	2.46	3.04	2.77
Confidence	3.15	3.45	2.75
Strategic thinking ability	2.46	2.15	2.15
Co-operation attachment competency	2.18	2.26	2.85
Weighted average of network competencies	2.52	2.81	2.83
Status of co-operation	potential network	potential network	potential network

Source: authors' own measurement

The results can be evaluated as follows:

- The volume and quantity of co-operation resources made available were not managed to be improved in the period examined. It can be stated that the original members of the organization failed to duly contribute to the successful operation of the organisation in terms of financial and physical resources. Although the exchange of members brought about an improvement in the status of financial resources through contributions by new members, the volume of material resources decreased as a consequence of the exchange of members.
- Having examined network competencies it can be established that communication between members was improving during the period examined. On the contrary, confidence and the ability of cooperation among members did not change considerably. And a lack of long-term strategic thinking further impeded the development of the organization studied.

Based on the first two measurements, it can be stated that the development of the producer organizations has been slow. Although the measurement indicated some improvement in the “potential network” segment of the assessment matrix, the organization still could not proceed further from this state: it is still classified into the (lower level) position of the so called “potential network”. Nevertheless, the study demonstrated that the measurement framework can provide a picture of the state of art of the organization examined and its tendency of development, revealing problems the elimination of which can ensure its development.

6. SUMMARY

According to our present hypothesis, Hungarian companies (including players in the FMCG sector) are generally characterized by relatively lower levels of willingness to co-operate and less confidence compared to Western

European companies, which makes it even more difficult to realize supply chain integration. (This hypothesis should be verified by research evidence. To our knowledge, there is no research in Hungary in this respect.)

In the event that this hypothesis is verified, negative consequences of lower levels of willingness to co-operate may include the following: a lack of spreading information properly (resulting in higher inventory levels throughout the entire chain), a lack of collective developments, the absence of risk sharing, etc. In addition, suppliers cannot enforce their interests against dominant retail chains in the absence of co-operation / association as required (for instance, fruit grower farmers cannot sell their products due to extremely low buying-in prices). Less close co-operation also makes it difficult to ensure product traceability, which is a high priority in the food industry.

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