Governance Problems in Networks: Cases of Franchising Chains and Co-operative Federations

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Abstract

A variety of inter-organizational networks have emerged between hierarchy and market. They are either internal networks in the same industries such as franchising and co-operatives, or external networks among organizations operating in the supply chain such as alliances. In the distributive trade, a strong tendency towards hierarchal corporate chains is observed in many places but there still exist successful franchise chains and co-operative federations (consortiums). These networks are not necessarily regulated by the top-down authority and require specific coordination mechanism to solve inherent governance problems. This paper describes how networks work in the Japanese retail chains and examines governance problems.

Keywords

Inter-organizational structure, alliance, franchise, consortium, governance.

Introduction

Inter-organizational networks are intensively studied from various perspectives. They involve a variety of relations in terms of power, communication, structure, culture and so on. There is also the tendency towards tighter inter-organizational structure from mutual adjustment and alliance to hierarchy irrespective of organizational forms.

In the grocery distribution industry, economically weaker actors such as consumers and small retailers chose the organizational forms of co-operatives or franchises in order to accomplish economy of scale and cope with the market power of large-scale corporate chains and manufacturers. Consumer co-ops have been set up by consumers and become federated to consolidate the buying power in many countries. In Europe the major form of pooling the buying power of retailers has been retailer co-operatives while in Japan the dominant form of networks adopted by small businesses has been

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the franchising of convenience stores or fast food stores.

Organizational theory attempts to explain the governance problems associated with different organizational forms. In co-operatives where property rights for both residual claims and control are vaguely defined (limited return to non-tradable shares, one member one vote), member-users have limited influence on management while the external control through the stock markets is not existent. Such governance constraints within co-operatives could feasibly lead to management domination while members would exercise less influence on crucial decision-making. The federated system where primaries delegate some functions might complicate the problems with duplicated boards. In the franchising system, although franchisees remain independent, their modes of operation are strictly controlled by the franchisers. They are owners of convenience stores but have little input with regard to contracts and royalty fees dictated by head offices. Such situations brought about growing discontent among franchisees and even serious lawsuits against franchisers.

The other aspects of the governance problems in networks are associated with the alliances in the supply chain. The retailers have sought to develop private brand products or logistic systems in collaboration with suppliers in order to improve productivity of all partners and establish win-win relations. These alliances are not necessarily regulated by the top-down authority and require specific coordination mechanism to solve inherent governance problems.

This paper will present the analytical framework of inter-organizational networks and depict the tendency toward more hierarchal structure. It will then describe the evolution of networks, taking cases of the Seven Eleven Japan as convenience store chain based on franchising system and the Consumer Co-operative Consortiums as consumer-owned voluntary chains. Finally it will examine governance problems associated with these networks to enlist some issues for further inquiries.

1. Analytical Framework: Inter-organizational Relations and Network

Inter-organizational relations can be analyzed from the different perspectives developed in organizational studies; Resource Dependence Perspective (RDP), Organization Set Perspective, Collective Strategy Perspective, Institutional Perspective, Transaction Cost Theory and so on. The RDP provides the analytical framework on why Inter-organizational relations are formed and how they are coordinated.

The core argument of RDP is that,

- organizations will respond to demands made by external actors or organizations upon whose resources they are heavily dependent.

- that organizations will try to minimize that dependence when possible. (Pfeffer 1982).

According to Scott (2003), organizations pursue a two-pronged approach to managing their resource dependence: buffering and bridging. Buffering strategies aim to increase an organization's tolerance of external resource shortage over a limited period of time. They include various methods, such as increasing stock levels, adjusting workflows to minimize variations in the input and output requirements, forecasting resource needs and adjusting the scale of production. In contrast, bridging strategies aim to reduce the chances of a resource shortage, by strengthening the links between the organization and its suppliers. Bridging can consist of bargaining to gain information and improve understanding between organizations, contracting to ensure compliance, incorporation of suppliers in the decision making, founding a joint venture, completely merging the ownership of the two organizations, creating trade associations and so on. It involves a variety offorms of network.

Inter-organizational networks imply that there are resource networks among organizations, which form dependent relations through the exchange/transfer of resources. The Inter-organizational power structure derived from such resource dependency leads to rules regulating the Inter-organizational relations.

These Inter-organizational relations can be seen as networks of human, material, monetary and information resources. Therefore their characteristics can be recognized according to the features of networks that provide significant tools for analyzing the Inter-organizational structure and its changes;

- Networks are hierarchal or horizontal.
- Networks are linked loosely or tightly.
- Networks are one-dimensional or multi- dimensional
- Networks are emergent or purpose-oriented
- Networks are patterned as a circle (round chain) or a star (hub-and spoke)

2. Types of Inter-organizational Structure

Inter-organizational structure means patterned and stable aspects of Inter-organizational relations and involves a mechanism of division and integration among organizations. It is a concept that shows what roles each organization will play and how it is integrated into Inter-organizational networks. It is formed and maintained by the power deriving from Inter-organizational resource dependence and therefore influenced by the power distribution among organizations. In this process, the rules are generated as a code of conduct or structural constraints under which the exchange of resources and coordination takes place.

Inter-organizational structure can be classified on the basis of the following criteria of the coordination among organizations;

- What is the rationale for coordination ---mutual adjustment, mutual agreement or ownership-based authority?
- Who does the coordination---participants themselves or specified intermediaries?
- To what extent is the coordination formalized--- written rules or just informal norms?
- What is the scope of the coordination---rare coordination or complete coordination?

Based on such criteria, several types of Inter-organizational structure are identified. The first one is **Mutual adjustment**. In this type of Inter-organizational structure, each organization is autonomous in the competitive market but may undergo Inter-organizational coordination on specific problems through informal contact (influence). Therefore the rules are informal and created haphazardly among those who are concerned. The coordination is not made at the upper level but done at the lower level among concerned parties.

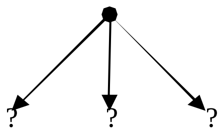
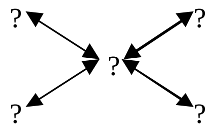
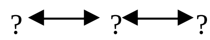
The second type is **Alliance,** which is in the middle ground. In this type of Inter-organizational structure, coordination is constantly made through making and maintaining formal rules based on negotiation among interdependent autonomous organizations. The negotiated agreements among organizations function as the coordination mechanism. Therefore, the rules are more formal than in the mutual adjustment type and the extent of coordination is larger.

The Alliance type can be further divided into **Coalitions** and **Federations** depending on whether the coordination is made by participating organizations or intermediaries. The former is a structure where rules are made through direct negotiation among organizations while the latter is a more formal structure where rules are made through central administrations. The former attaches importance to each organization's autonomy and limits coordination to the procedural aspects while the latter makes much of integration and extends coordination to setting of collective objectives.

The third one is **Hierarchy.** In this type of Inter-organizational structure, integration of organizations is sought on the basis of authority as the coordination mechanism, which acts like the divisions of a single corporation will do. The rules are made by ownership-based authority and the role of each organization is assigned in line with collective objectives under the central administration’s directives. Therefore, the rules are more formal with a high degree of sanctions and coordination.

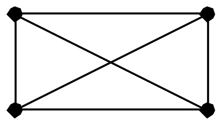
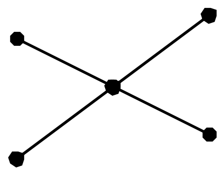
The characteristics of Inter-organizational structure are illustrated as follows. Which types are chosen depends on environmental factors, inter-organizational relations and inner-organizational factors.

Table 1. Types of Inter-organizational Structure

Type of structure	Hierarchy	Alliance	Mutual adjustment
Network image			
Coordination mechanism	Authority	Negotiation	Influence
Who coordinate	Owner organization	Each and focal organization	Each organization
Formalization	Formal rules made by authority	Rules made by each organization	Informal expectation
Extent of coordination	Large	Medium	Small
Sanction	High	Some	Rare

Source: Yamakura,1993

Table 2. Types of Alliance

	Coalition	Federation
Network image		
Intermediary organization	Not exists	Exists
Basis of relations	Mutual benefits	Mutual benefits Reduced complexity in network
Who coordinates	Each organization	Focal organization.
Number of org.	Fewer	More
Network’s importance for legitimacy	Low	High

In the distributive trade, chain stores are the most popular type of Inter-organizational structure. They involve a range of retail outlets which share a brand and central management, usually with standardized business methods and practices. Such stores may be branches owned by one company (corporate chain) or franchisees owned by local individuals or firms and operated under contracts with head offices (franchise chain). Stores may be owned and operated by independent merchants but serviced and supplied by a central organization (voluntary chain). Features common to all chains are centralized marketing and purchasing to accomplish economies of scale, i.e. lower costs and presumably higher profits.

Table 3. Types of Retail Chains

	Corporate chain	Franchise chain	Voluntary chain
Org. structure	Corporation	Corporation	Federation
Chain management	Head office	Head office	Head office/wholesaler
Store management	Assigned employees	Proprietors	Proprietors/primaries
Store development	New opening/M&A	New opening/affiliation	Mainly affiliation
Store remodel/close	Head office decision	Head office negotiation	Proprietors/primaries
Scope of contract	None	All-round	Partial
Central buying	Compulsory	Compulsory	Voluntary
Pricing of products	Head office	Head office	Proprietor/primaries
Training/education	Head office	Head office	Free to use
Management guide	Supervisors	Supervisors	Free to use
Sales promotion	Head office	Head office	Free to use
Central control	Complete	Strong	Weak

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3. Transformation from Alliance to Hierarchy: Cases of Swedish Co-operatives

There exist various types of Inter-organizational structure ranging from mutual adjustment and alliance to hierarchy but in last decades we have witnessed a strong tendency toward corporate chains to cope with the intensified competition spurred on by globalization. To facilitate economy of scale, organizations have pursued consolidation at the regional/national levels through horizontal and vertical integration. Many of them have sought international expansion through M&A, Strategic Alliance and Joint Ventures. There are ample examples but herewith I examine the cases of the Swedish consumer and retailer co-operatives, both of which started as loosely connected voluntary chains but eventually transformed into hierarchal corporate chains. They had different origins as consumer- or retailer- owned voluntary chains and developed distinct identities until the 1970s but made parallel evolution to hierarchal organizations with similar ownership structure, corporate policies and store formats.

The KF (Kooperativ Förbundet: Swedish Co-operative Union) was created as a national federation of consumer co-ops in 1899. It had played an explicit role of "cartel busters" in a number of industries from margarine to light bulbs to protect consumer's interests during the 1900s-1930s, creating its own industrial plants to supply alternative products. KF group became the largest retailer in the country with ca. 600 affiliated co-ops and a wide range of industrial and service subsidiaries in the 1960s. However it has lost its supremacy in the competition since the 1960s. Sweden's accession to the EU meant even tougher borderless competition. Facing the threat from the multinational chains, KF undertook a series of restructuring aiming at transforming to a food retailer since 1992. It took over retail and related business operations of major regional co-ops and bought some retail chains (hypermarkets, specialty stores etc) while divesting from industrial and service businesses. KF became the parent company controlling non-core businesses and real estates while maintaining its status as a national federation of consumer co-ops. In 2001 it joined forces with the Danish Co-operative Union (FDB) and the Norwegian Co-operative Union (NKL) to form Coop Norden AB as the international Joint Venture company. Co-op Norden took over all the business functions from the national organizations; central buying and product development, running physical distribution and information network, store operations and marketing. However it could not bring about an overall improvement in performances and decided to give back store operations and marketing to the national organizations in 2006.

On the other hand, Hakonbolaget, the origin of today's ICA, was founded in 1917 by Hakon Swenson who aimed to achieve the same economies of scale as corporate chains by creating retailers' joint purchase, establishing stores and sharing marketing costs in order to cope with the strong market power of manufacturers/wholesalers and the competition from consumer co-ops. Purchasing centers founded in the '20s and '30s in line with the same idea established ICA AB in 1938. ICA Förbundet (Federation) was formed as the membership organization for affiliated retailers and subsequently became the largest owner of ICA AB during 1972-2000. In the 1950s ICA group built regional distribution centers and in the 1960s started uniform marketing using the same logo. ICA group became a market leader in 1966 with sales figures overtaking those of the KF group. ICA AB was reorganized into a parent company ICA Handlarnas AB in 1995, which merged with Norway's Hakon Gruppen AS in 1998. In 2000 ICA group underwent the most extensive change to its ownership structure when the agreement with Royal Ahold came into force. Now the joint venture ICA Ahold AB is owned by Royal Ahold and ICA Förbundet Invest.

Figure 1. Corporate Structure of Coop Norden

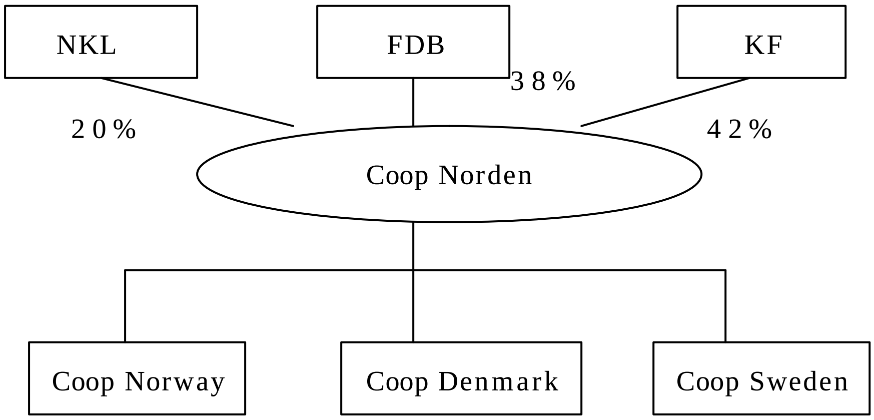
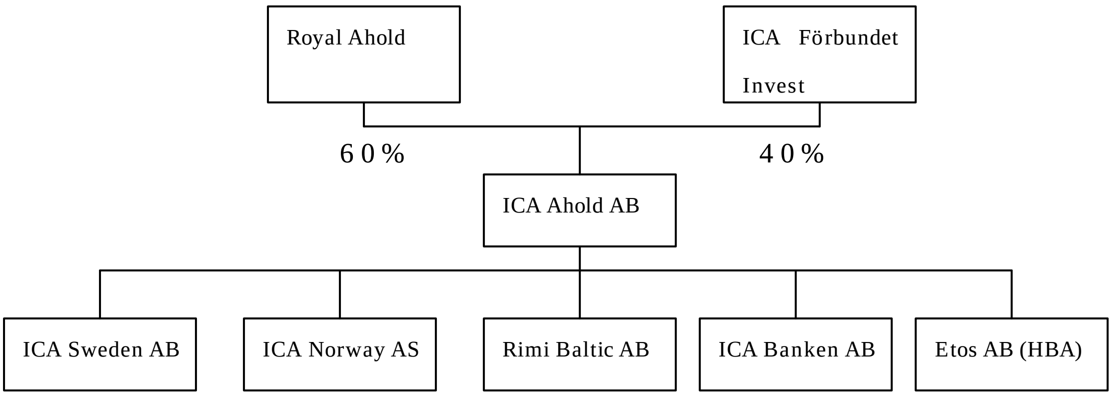


Figure 2. Corporate Structure of ICA Ahold



4. Franchising System and Supply Chain: Case of Seven-Eleven Japan

4-1. Evolution of Japan-style Convenience Store

The first convenience store chain in the United States was opened in Dallas, Texas in 1927 by Southland Ice Co., which eventually became 7-Eleven Inc. Seven-Eleven is the largest convenience retailer operating, franchising and licensing some 30,000 stores in 18 countries. Seven-Eleven Japan (SEJ) was started as franchise store chain licensed by Southland in 1973. While struggling to localize its operation through the 1970s and 1980s, it evolved to be the most successful Japanese style convenience store chain with a number of innovations including POS-based business operations, supply chain management and so on. SEJ invested in the ailing 7-Eleven Inc. to give managerial/financial assistance as its subsidiary in 1991.

On the convenience store platform, SEJ has constantly expanded its range of products and services. The avarage Seven-Eleven convenience store with selling area of 100 ? carries ca. 3,000 items including:

- Foods, such as fast food, frozen food, bread, soft drink, mineral water, milk, snack food, candy with toy, instant coffee, ice cream, seasoning, pet food.
- Alcoholic beverage, tobacco or medicine.
- Gifts and seasonal festive meals.
- Meals on wheel (on demand home delivery).
- Sundries, such as cosmetics, soap, shampoo, undergarment, umbrella, dry cell, light bulb, tissue paper, toilet paper, feminine hygiene product, or condom.
- Office equipments, including official postcard, postage stamp, or stationery.
- Entertainments, such as CD, DVD, video game, magazine, newspaper or book.
- Services such as courier or postal service, photocopying or fax service,.
- ATM for bank, credit card, consumer finance or charging for electronic money
- Utility charges, such as telephone, electricity, gas, water, TV fee, tax, social insurance and pension fee, or insurance for motorcycle.
- Tickets for concert, movie, theme park, airline, or bus.

It is forecast that the sales of services will soon surpass those of products in 2007. In the course of such diversification SEJ has developed various types of Inter-organizational networks through joint ventures and direct investments. In 2000 it created 7dream.com, a joint venture for e-commerce, with NEC and other partners while it joined force with Yahoo Japan to create Seven & Y as a joint venture for online shopping of books, CDs etc. that can be picked up at stores free of delivery charge. It also founded Seven Meal Service for cooked meals, which can be ordered by phone or on the Internet and delivered home or picked up at stores. In 2001 SEJ established its own bank specialized in cashing related services, which eventually became the Seven Bank, and installed ATM machines in all stores. In 2007 it launched the electronic money 'nanaco'.

Now SEJ is the largest retailer in Japan with 11,310 stores and annual sales of ¥2,500 billion in 2005. It joined with its parent Ito Yokado and Millennium Retailing Group (department store alliance) to form Seven & I Holdings Co., Ltd in 2005 and acquired its US-based subsidiary 7-Eleven Inc. by a take over bid. It has subsidiaries in China and Hawaii while its business model heavily influenced convenience store operators in other Asian nations, such as South Korea, Taiwan, and Thailand.

4-2. Franchise System Equipped with IT

Franchising is a method of doing business wherein a franchiser licenses trademarks to a franchisee in exchange for recurring payment, and usually a percentage piece of gross sales or gross profits as well as the annual fees. Various tangible and intangible supports such as advertising, training and other services are commonly made available by the franchiser, which generally requires audited books, and may subject the franchisee to periodic and surprise spot checks. Failure of such tests typically involve non-renewal or cancellation of franchise rights.

SEJ has established its own franchise system based on such principles but with a number of modifications in franchise contracts and the POS-based retail support system. SEJ offers two kind of contracts depending on the ownership/leasing rights of store properties. The majority of affiliates had been operating as independent retailers (liquor shops, rice sellers, grocers etc) and chose type A. In this case SEJ's field counselors make a feasibility studies based on extensive market researches on location, population and competition before contracting and offering training at the head office and directly managed local stores after contracting. Based on store layouts designed by the head office, store construction and/or remodeling is made and furnitures/fittings are installed befire each grand opening.

Table 5. Types of Franchise Contracts

Type	Manager	Term of contract	Property own/lease	Utility cost sharing	Deposit on contracting	Royalty charge	Owner's guaranteed income
A	Proprietor	15 years	Owner	HO 80% Affil.20%	¥3,075,000	GPx43%	¥19,000,000 annually
C	Proprietor	15 years	HO	HO 80% Affil.20%	¥2,550,000	GPxSR	¥17,000,000 annually

Source: SEJ:Profile 2006

HO:head office, Affil:affiliates, GP:gross profit, SR:sliding rates

After each grand opening, the franchisees are supported by the head office in multiple ways. The head office bears advertising costs, 80% of utility costs while it guaranties owner's minimum annual income. It provides regular management consultation, book-keeping and accounting services. But the most effective retail support system has been built on information network connecting the host computer, suppliers, distribution centers, regional branches, field counselors and affiliated stores. The store computers frequently send sales data of individual items accumulated by POS cash registers to the head office, which feads back analized sales data, the weather forecasts and other relevant information on local events and special promotions which may affect sales at stores. At the same time, stores conduct stock and temperature control using in-store scanner terminals while they make orders using graphic order terminals.

As such, franchisees are fully dependent to SEJ for supply of products, information system, store design, furniture and fittings, marketing and so on. They can concentrate on store and personal management while they are responsible for profittability as independent proprietors.

4-3. Managing Supply Chain

SEJ has sought to establish a so-called 'Manufacturer-Retailer Alliance', which means the inter-organizational collaboration among actors in the supply chain aiming to offer added value to customers. This ranges from joint development of products or information systems to joint launching of new ventures. There are several reasons why such alliances were created. On the demand side, customer's diversified values and life styles have made it difficult for a single organization to meet all their requirements while on the supply side the advent of discount stores and increased cheep imports have squeezed the margins of manufacturers and retailers through 'price destruction'. To cope with this situation, the alliance was constructed to establish a lean product development/supply system aiming to offer products with attractive quality and prices, which are not available elsewhere on the market. Such alliance required a vast network of sales outlets and the capacity to collect customer information from the retailer side, a merchandising capacity to meet retailer's requirements on the manufacturers' side and the financial strength to make investments for logistic/information system on both sides.

SEJ initiated 'Team Merchandising' involving leading manufacturers and wholesalers in the process of product development to establish win-win relations. In order to reduce its dependence on national brands that had market power, it developed private brand products in the field of dry groceries. These products are sold by 20-30%

lower price than the comparable national brands and constitute a half of sales in most of categories. It also helped establish the Nippon Delica Foods Co-operative (NDF) consisting of a wide range of food manufacturers/processors in order to develop high quality fast food items (box lunches, rice balls, sandwiches, delicatessen etc.), which became the major attractions of convenience stores. SEJ played a pivotal role as focal organizations (channel leaders) in the coordination of Inter-organizational network without exercising ownership-based control. Now 188 factories of 87 firms are assigned by NDF as specialized suppliers to SEJ.

But such an alliance has not been formed and maintained without tension among organizations. SEJ has often challenged the high price of national brands by introducing private brand items in the same categories. Let's take an example of the soft drink category. SEJ is the biggest distribution channel selling 2 billion PET bottles per annum, however these beverages in the convenience stores were sold at higher prices than in supermarkets or drug stores. Such pricing has been justified by convenience stores while they have been imposed higher wholesale prices as they were newcomers. However, convenience stores are facing stiffer competition with supermarkets extending operating hours and become increasingly intolerant to such discriminating pricing policy imposed by manufacturers. SEJ had challenged makers by developing private brand green tee (500 ml.) at ¥98 as against dominant national brands sold at ¥147 while it also requested to lower the wholesale price for national brand beverages.

SEJ's logistics system is characterized by the high frequency of multiple items in small quantity based on the **just-in-time** method so that inventories at stores can be reduced to the minimum level. This has facilitated quick replenishment at stores and contributed to the elimination of chance losses but it has also invited some criticisms; stores had to receive frequent deliveries, which might cause higher delivery costs, traffic congestion and increased CO_2 emission. SEJ asked major suppliers to carry products of the same category including other brands to improve delivery efficiency. This proposal was against the prevailing trade practices but eventually accepted by partners as 'Team Logistics'. SEJ established joint distribution system based on category and temperature as shown herewith. As a result, the number of delivery trucks which each store receives a day was reduced from 70 to 9 while the proportion of logistics costs in sales was lower than the industrial avarage (6.3% as against 10.9%) . SEJ had played a crucial role as focal organizations in creating such alliances without direct investment in partners.

Table 4. Types of Distribution Centers according to category and temperature

Types	Category	Temperature	Frequency
Dry grocery	Beverage, snacks, noodles	Room temp.	7 times a week
Fast food	Rice balls, box lunches, bakeries	20?	3 times a day
Frozen	Frozen food, ice cream	Minus 20?	3-7 times a week
Chilled	Dairy goods, salad, delicatessen	5?	3 times a day
Printed items	Books, magazines	Room temp.	6 times a week

Source: SEJ:Profile 2006

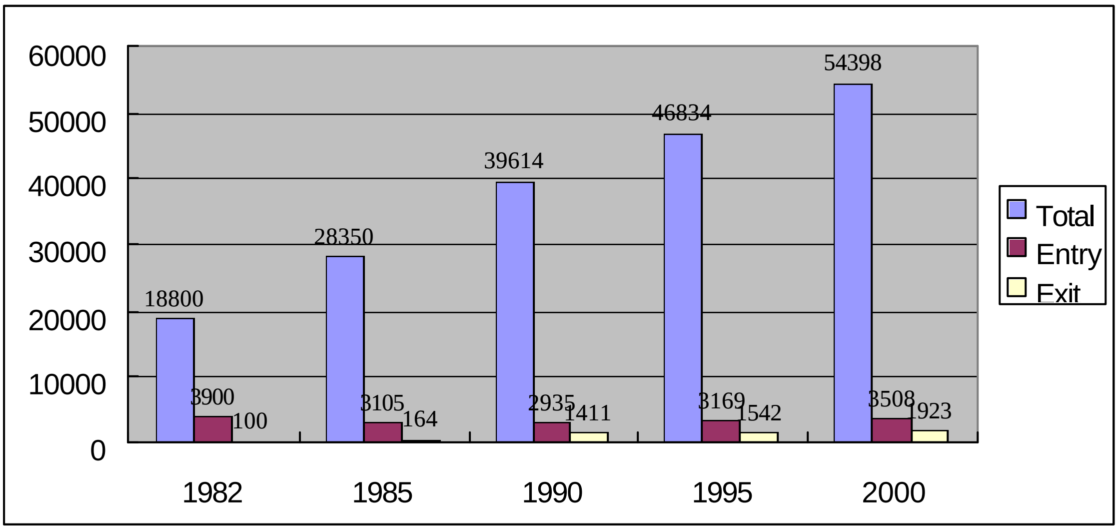
4-4. Governance Problems associated with Franchising and Alliance

The convenience stores became an indispensable infrastructure for daily life of the majority of Japanese. They have been accepted by a wide range of the population from teens to young families to singles and pensioners. They accomplished the fastest growth during the past 30 years and the highest sales per selling area among retail formats. They accounted for 5% of turnover and 7.4% of employees in total retailing in 2002. Although their growth has slowed down recently, they are penetrating into office buildings, hospitals and universities. Also their business hours were expanded; 78% are operating around the clock.[2]

However convenience stores seem to be facing stagnation: the like-for-like store sales have been declining since 1995. They are characterized by 'high natality, high mortality'. The turnover of franchisees has been rising; the exit/entry ratio was as low as 2.6% in 1982, rose to around 50% during the 1990s and reached 55% in 2000. They are increasingly overcrowded in some areas in large cities. It is said the market is saturated if the population per store falls below 3,000 s in the US but in 2000 that was 2,314 in Japan. It is partly attributable to the intensified competition with other chains and partly franchisers' 'dominant area formation strategy', which seeks to establish densely located stores in the targeted areas aiming at efficient logistics. Taking into considerations the catchments area, they identify the location of new stores, which were sometimes close enough to affect existing stores (cannibalism). Thus there emerged 'Conveni hell' where more than 10 stores are operating in the area of 500-meter radius. Under such circumstances, the owners had to work very hard to survive, often relying on their own and family's labor to save personnel costs. Some of them had ended with burnouts, as the labor protection legislations were not applied.

[2] National Commerce Census 2002.

Figure 3. Rapid Proliferation of Convenience Stores and Rising Turnover



Source: 'Bi-monthly Conveni', April 2001

The overwhelming power of franchisers resulted in the extreme asymmetric relations. There exist no mechanism to reflect franchisees' voice in the corporate governance. Their discontent has been growing as indicated by increasing conflicts on terms of contracts and even lawsuits against franchisers. The Franchisees Association of Japan was created in 1998 as an interest group aiming to solve such problems and establish fairer relationship with franchisers. It is lobbying to the government and the parliament to introduce adequate regulations for fairer franchising contracts.

SEJ established the most successful business model for convenience stores but it is not immune from problems as discussed here although its performance is still much better both at head office and affiliates levels than other chains and its turnover rates of franchisees remained fewer.

As far as the alliances are concerned, SEJ sought to establish the long-term contracts with suppliers. There always exist conflicting interests between store brand retailers and national brand manufacturers as mentioned before. In addition, it is increasingly significant to establish traceability of the products from farm/factory to table since food scares are spreading among consumers with regard to BSE, SARS and food poisoning. The retailers are responsible to secure food safety throughout the supply chain and have to bear the increasing monitoring costs since it is difficult to shift them onto price under the tougher competition.

5. Consortium and Direct Transaction: Case of Japanese Consumer Co-operatives

5-1. Evolution of Co-operative Business Model

The Japanese consumer co-operatives constitute the 3rd largest retail group with annual sales of ¥3,000 billion which accounts for 5.4% of the food retail market. Approximately. 500 co-operative societies affiliated with the Japanese Consumers' Co-operatives Union (JCCU) are running supermarkets of various sizes. They have created innovative business models for home delivery; Joint Buying and Individual Home Delivery.

Joint Buying is a unique system of consumers' collective buying of food and daily necessaries based on Han groups in which co-op members place orders and receive a delivery of products a week later.[3] It was invented in the 1970s to cope with faced multiple consumer problems including excessive use of chemicals in food production/processing, deteriorating environment, the lack of shopping facilities within newly developed suburbs and so on Under such circumstances consumerism gained strength attracting a large number of consumers; especially housewives who were concerned about the safety of food for their children and dissatisfied with milk processed with food additives, which was marketed by major dairy companies. These consumers worked together to obtain 'pure milk' at an affordable price. Such spontaneous buying clubs grew into consumer co-ops in urban areas. In the 1980s co-ops made innovative breakthroughs which attracted much wider segments of consumers; computer-read order sheets and automatic payment through consumer's bank accounts replaced the cumbersome chores of tallying individual orders by hand and handling with cash. Joint Buying proved to be a driving force of co-operative development attracting the bulk of housewives during the 1970s and 1980s.

However Joint Buying faced the changing environment in the 1990s. The most visible change was that more and more members were working outside the home. Consumer's lifestyle was changing and diversified while a more individualistic attitude has prevailed, especially among the younger generation. To respond to such changes, Individual Home Delivery System was initiated by Pal System Consumer Co-op Federation operating in Metropolitan area. In 1990, it started an experiment of individual home delivery system, in which individual members can receive products for a ¥500 surcharge per delivery to cope with the difficulty in maintaining Han groups and penetrating into a saturated market. The response was far beyond expectation; in one

[3] Han is a group of more than 3 members living in the same neighborhood.

year this system attracted 4,000 members, which was the break-even number. In 1993 the PSCCF decided to introduce this system into all affiliated co-ops. In 1998 Individual Home Delivery surpassed Joint Buying in term of sales and became the principal business format. It has been adopted by major co-ops and grown rapidly offsetting the declining sales of Joint Buying. Its proportion in terms of sales of co-op's non-store retailing is now exceeding 50%. It has proved to be effective in catering to the needs of working couples, families rearing babies, singles, elderly and the handicapped, which had not necessarily been met by Joint Buying. In this regard it has supplemented Joint Buying by serving consumer's wants for convenience. At the same time the bulk of members switched to Individual Home Delivery seeking convenience. The surcharge has not hampered the shift and has come down to ¥200. In this regard it has replaced Joint Buying. Co-ops are estimated to account for two thirds of the subscribed home delivery market except for on-demand pizza delivery.

The organizational aspect of innovation was the outsourcing of delivery to professional distributors. The PSCCF decided to collaborate with partner companies to deliver products since it could not meet the demands of rapidly expanding operations by recruiting/training staff. It was an inevitable decision to sustain double-digit growth but co-op could rely on the resources and expertise of partners at relatively low cost, which enabled co-op's rapid expansion. Now a half of all deliveries is commissioned to several distributors, which are co-op's subsidiaries, joint ventures and the third party companies while the remaining half is done by co-op employees. Such resource dependence has generated win-win relations with partners but its long-term effects on the quality of services and communications with members are to be watched carefully.

5-2. Consolidation through Co-operative Consortium

The Consumer Co-operative Law of 1948 prohibited the merger of co-operatives across borders in all 47 prefectures. To accomplish 'economies of scale' under such an institutional constraint, co-operatives have formed regional consortiums (federations) since 1990, as a legitimate form of consolidation. It is up to the decisions of primary co-ops whether to join a consortium, which functions they delegate to it and how much they buy from it. Such voluntary nature has resulted in slow and diversified integration in consortiums. Now thirteen co-operative consortiums covering most parts of Japan, The second largest Co-op Sapporo has achieved full-fledged concentration of all consumer co-ops on Hokkaido Island through mergers with and transfer of engagements from other co-op societies while the largest Co-op Kobe has developed a strategic alliance with its sister Osaka Kita Co-op by sharing merchandising and human resources.[4]

Table 6. Basic figures of Larger Consortiums

Name of consortium	Setup	HQ	No. of affiliates	Consortium's sales 1)	Affiliated co-operatives		Concentration 3)
					Sales 1)	Members 2)	
Tohoku SunNet	1995	Sendai	4	42,674	176,741	831	36%
Co-opNet	1992	Saitama	7	267,789	433,565	2,594	86%
Pal System	1990	Tokyo	9	106,064	150,861	765	96%
U Co-op	1990	Yokohama	3	163,230	224,356	1,655	97%
Tokai Co-op	1994	Nagoya	4	64,257	98,197	586	87%
Co-op Hokuriku	1992	Kanazawa	3	18,735	35,160	256	72%
Co-op Kinki	2003	Osaka	7	30,063	241,760	1,489	17%
Co-op Chugoku-Shikoku	2005	Hiroshima	9	NA	209,916	1,366	NA
Co-op Kyushu	1992	Fukuoka	8	64,446	192,056	1,377	46%
Total				757,258	1,762,612	10,919	67%

1) Fiscal year 2004, in million yen. 2) As of March 2004, in thousand household. 3) Proportion of central buying in total retail turnover.

The most important function of a consortium is to buy products collectively from manufacturers and wholesalers at reduced prices. But the extent of integration of buying and related business functions varies from one consortium to another, largely depending on the consensus on the development strategies among top leaders of the affiliated co-ops. The concentration of buying ranges from 96-97% to 17%. Pal System Consortium and the U Co-op concentrate purchasing power and related logistic functions, with the aim to allow primary co-ops to concentrate on retailing and communication with their consumer members. Both consortiums have invested in facilities for distribution and food processing on behalf of affiliated co-ops. In contrast, the consortiums in the Tohoku and Kyushu regions have only limited functions where more than half of all commodities sold are being independently procured and therefore have little assets because distribution facilities are owned by primaries.

The joint purchasing lowers wholesale prices as well as other expenses. The third largest Co-op Tokyo, joined Co-opNet in 1999, and successfully reduced their purchasing price by ca. 2 percent. These advantages are obtained in mass-produced processed foods, in which quantity matters. Co-op's home-delivery operations dealing with

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relatively fewer items can benefit from joint purchasing compared to store operation, which handles a much larger number of items. Co-op brands have been emphasized, but they are relatively costly as higher safety standards are applied and specific production methods are often required. Even though many primary co-ops and regional consortiums developed their own Co-op labels, they have not always succeeded in accomplishing competitive prices nor differentiating quality. Co-opNet, therefore, decided to tie up with the JCCU to integrate Co-op brand products aiming at competitive prices in 2000.

5-3. Strategic Alliance with Producers and Suppliers

The strategic alliance of consumer co-ops with suppliers and producers facilitated the development of CO-OP labels and the direct transaction of produce (Sanchoku). The principal reason why co-op members undertake Joint Buying was to buy safe and reliable products, which were not available at other retailers. Consumers' concerns about food additives, residual agri-chemicals, excessive packaging, misleading labeling and environmental impacts have resulted in the development of the alternative products. CO-OP label products have been developed by the JCCU since the 1960s to materialize member's voices for the safer products. These are products that have eliminated hazardous food additives (preservatives, coloring etc.) or chemicals (pesticide, formalin, etc). They have simpler packaging but had more detailed information on ingredients or usage while they are priced lower than comparable brands. Except for some cases of own production (bread, noodles, bean curd etc.), co-ops commissioned manufacturers to produce private brands according to their specifications on products. Co-op labels were established as the most successful private brand accounting for 40% of grocery products and daily necessaries sold by co-ops.

For farm products, the Sanchoku transaction between consumers and farmers has been made to ensure safety and reliability based on contracts, which precisely defined the cultivating/feeding ways, the use of chemicals/drugs, and guaranteed record keeping etc. In this regard Sanchoku can be seen as an endeavor to reinstate trust and mutual understanding between consumers and producers who were separated in the course of industrialization. The collaborating producers often join in Sanchoku Partner's Councils to promote mutual learning and consumer communication. In a sense, Sanchoku combines consumer's direct access to farms and producer's direct marketing to tables. These products offered values to consumers who were concerned with food safety.

These products constitute the bulk of the assortment of Joint Buying, which ranges from 400 to 1,000 items. Through these products, consumer co-ops have gained a good reputation among consumers for their 'safe and reliable' products, which has in turn impacted the market and public policies. To this end they have made efforts to establish a supply chain with reliable suppliers and install a quality assurance system.

Another inter-organizational collaboration can be seen in the retailer-supplier coalition aiming to find the best merchandising solution by sharing POS data generated at cashier's checkout counters. Co-op Sapporo started the 'Merchandising Coalition' with suppliers to listen to their proposals in 1999. Then it decided to disclose all the POS data and invited suppliers to a data-sharing scheme named 'Co-op's Treasure Box' in 2003. Co-op developed this system from which participating suppliers could draw sales data of individual items at any time while they paid subscriptions to cover the cost of the system. Win-win results were obtained; Co-op could get adequate proposals from suppliers and increase competitiveness while the latter could reduce marketing costs, make effective sales promotion and eventually increase sales to the former. For example, the outputs of the experimental sales promotion could be obtained in a few hours and enabled suppliers to measure the impacts and make prompt adjustments. Both parties could increase sales by increasing accuracy in sales data analysis without resorting to special discounts. Co-op intends to link this system with the electronic market place GNX for global sourcing. Co-op Sapporo also undertakes 'Weekly Merchandising Rally' together with suppliers by sampling comparable products sold by major competitors and to produce the best products in each category.

5-4. Governance Problems in Co-operative Federations and Alliance

The Co-operative Consortiums, as secondary organizations, require specific arrangements in their governance structure. The general assembly, made up of delegates elected from primary co-ops, is the consortium's supreme decision-making organ that elects the board of directors who has the authority to run the organization. In primary co-ops, lay board members elected from the membership constitutes a majority of the board with a smaller number of executives, while in consortiums, the majority is composed of professional managers including some full-time executive directors, most of whom are seconded by primary co-operatives. It is expected that such interlocking directorate enable effective decision-making mitigating potential conflicts between consortiums and primaries. However, such dual structures of boards may complicate the decision-making process, costing more and requiring more time.

Some argue that this organizational structure alienates individual co-op members and does not allow for their opinions to be reflected in the decision-making of the consortium's board. Yet, individual members are expected to participate in various committees and activities such as visits to farms or factories. There is a problem of how to ensure member participation in large-scale organizations, no matter if they are single or federal organizations.

The functions of consortiums and primary co-ops often overlap. To avoid this, Co-opNet, Co-op Tokyo and Saitama Co-op, have consolidated buying and administrative functions to reduce overall costs. They were heading for a de facto merger, while mergers of co-ops from different prefectures have not been permitted under the current law. However, the Diet resolved to amend the Consumer Co-operative Law in May 2007, which has been pursued by the JCCU's persistent efforts for nearly 60 years. The new law will permit co-operatives in the adjacent prefecture to merge. It is expected that such merger will remove some problems of costly and complicated governance and management.

The governance problems associated with alliances were often caused by the long-term contracts, which were concluded without effective monitoring and cost sharing procedures. Consumer co-ops have built one of the most extensive food laboratories for bacteriological and bio-chemical testing in the private sector but could not prevent fraudulent behaviors of suppliers. In 2001, Zennoh's subsidiary company[5] supplied with falsely labeled products to co-ops. They were labeled as chicken domestically bred without chemicals but it was disclosed that they were raised with chemicals and imported from China. Co-ops had to refund to customers and review the process of monitoring. In 2007, it was revealed the JCCU's CO-OP brand beef croquesttes contained other meats that were intentionally mingled by one of the material suppliers. In both cases suppliers were legally guilty of frauds but co-ops could not escape from accountability as sellers of products and lost consumer's trust to a large extent. In the former case, co-ops realized that they transferred the responsibility for supply-demand adjustment to suppliers alone who made do with imported chicken to cope with the shortage of products due to sudden increase of orders. In the latter case the question is being raised on how to monitor all the echelons of food chains to prevent such frauds in food processing and who would pay the costs involved in such monitoring including DNA testing.

Conclusion

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[5] Zennoh (National Federation of Agricultural Co-operatives) is a largest co-operative in the ICA's global 300 with annual turnover of USD 54 billion. .

There exists a strong tendency toward consolidation of functions and more hierarchal structures irrespective of organizational forms and chain store formats. In many European countries, consumer and retailer co-ops have chosen organizational patterns similar to corporate chains such as international joint ventures and holding companies with binding ownership structure. Yet there exist different inter-organizational networks such as franchise and voluntary chains in Japan, which have proved to be competitive through offering innovative services and creating alliances of varied forms with suppliers. These alliances were not necessarily bound by property rights but worked well in building win-win relations by sharing information/knowledge among those who took part in the supply chains.

At the same time, franchise chains and co-operative consortiums are facing some governance problems. The franchise convenience store chain had been localized to fit the Japanese consumer's demands and as such evolved to be the most successful business model. It was intended to modernize small independent retailers that were declining due to low productivity and bring about mutual prosperity among franchisers and franchisees. This intention was accomplished in that many franchisees could survive and thrive. But the convenience stores are facing market saturation and the growing discontent of franchisees. They are neither owners nor employees of the chain organizations but they are crucial stakeholders for the success of the franchise system and there should be some mechanism whereby their voice can be heard. Apparently the head offices have the overwhelming power in deciding terms of contracts and modes of operations while they need to maintain proper communication with affiliates.

Co-operative consortiums have been formed by primary co-ops to accomplish economies of scale bypassing the institutional constraints but their performances have been mixed depending on the extent of their consolidation. Such organizational form requires more time in decision making because of the dual board structure. The new legislation will remove some of the constraints but it will not alter the basic problem of democratic governance in a large-scale organization with millions of members. These are the subjects of further inquiries to understand and improve the governance of networks.

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