Retail Globalization – Driver of Change in the Agri-Food Business

Jon H. Hanf

Leibniz Institute of Agricultural Development in Central and Eastern Europe, Theodor-Lieser-Str.2, 06120 Halle (Saale), Germany

Tel. 0049-(0)345-2928246,

Email: hanf@iamo.de

ABSTRACT

The paper deals with the ongoing internationalization process of retail firms and its implications for food processing firms. Five general trends in retailing that are intensified by retail globalization are elaborated. The effects of these tendencies are discussed in relation to the food industry. We distinguish five stylized groups of food processing firms in order to reflect the manifoldness of the industry and to allow for the differences in concern. The stylized firm groups are: (1) large multi-national food producers with a wide supply portfolio, (2) worldwide acting, specialized premium food processors, (3) national food processing firms, and (4) small and medium-sized specialists with contract production.

KEYWORDS

Globalization, retail, consequences

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1. Introduction

It is less than 20 years ago that almost all of the world's retail firms were pure national firms with a negligible share in foreign markets. Wal-Mart opened a first shop outside the US in Mexico City in 1991; Carrefour started its international business 1989 in Taiwan; Metro increased its foreign sales volume from 5% in 1987 to 47% in 2003; Tesco had its first hypermarkets in 1997 and Rewe start the internationalization by the acquisition of Billa in 1996 (Rudolph and Einhorn, 2001). The ranking of the world's largest retailers by Deloitte (2005) reveals that almost all players except the US retailers operate in numerous countries having established a noteworthy business capacity in foreign markets. However, the process is still a rather new one and it is to foresee without a great gift of prophecy that the process will further proceed, perhaps not in such a turbulent way like in the last decade. Indeed, some of the retail firms have already begun with re-arranging their influence spheres. For instance, the Auchan Group has published that they want to concentrate their commitment in Europe and in China and Taiwan, whereas the group will withdraw from the American markets (LZ, 07.01.2003). A recent development is that retailers are swapping their foreign involvement among each others in order to adjust their country portfolios. Since in Taiwan Tesco was not able to reach the critical seize it has left its six stores to its competitor Carrefour which had already 38 stores. The other part of the barter was that Carrefour has given its fifteen stores in the Czech Republic to Tesco strengthening Tesco`s market position (LZ, 21.10.2005).

The aim of our paper derives from the above scratched development. We want to firstly describe the internationalization process of the retail business. Based on this we want to elaborate on structural changes resulting from and connected with internationalization process that are in the center of interest to the food industry.

In the following chapter we will deal with the causes and triggers of the globalization and its impact on the organizational structure of the retail firms themselves. Afterwards we will analyze the consequences on the food sector. As the sector is very heterogeneous we will introduce a rough typology of firms. Based on this typology we will show the consequences of the internationalization on each different type. The paper will be ended by giving a short summary and drawing some conclusions.

2. Internationalization of the retail business

2.1 Causes and impetus of the global expansion

Except for some smaller subsidiaries in close-by countries, the retail firms only started in the 1990`s with a geographical expansion across the national borders. Whereas in the first half of the nineties the national market share of the largest three retailers in almost all the West European countries clearly surmounted 50 percent, the aggregated market share of the five biggest retail firms of the single "Western Europe” market did not exceed 15 percent. Therefore, a further concentration by merger and acquisition on the national market appeared to be impossible in face of the already realized degree of concentration, the jump over the borders seemed to be the easiest way to avoid the legal persecution by the Monopolies and Merger Commission. In many cases the entering foreign retailer was a really newcomer in the respective market so that the Antitrust department had no reason to foreclose any acquisition. Thus, George (1997) concluded that in particular the stagnating trade in the domestic food market was the main driving force for that internationalization. However, the concentration process in the different national systems was not so strongly synchronized that these factors could be solely responsible for such a simultaneous and explosive internationalization of retailing in several countries. On account of this, we assume that additionally at least three pull-factors are effecting this development. First, the degree of concentration and the organization structure of the retail sector considerably vary among West European countries in spite of the proceeding assimilation of consumption habits and food purchasing behavior. Thus, financially strong retailers can utilize this adjustment process to successfully install their own business ideas in new market environments on a grand scale (George and Diller, 1993) like Wal-Mart in UK and Lidl in France. Second, the collapse of the socialistic central planning system in Middle and East Europe left behind an economic vacuum that offered the unique opportunity to establish an entirely new retail system being modeled on Western ideas. The Western retail firms took this opportunity and they established subsidiaries all over the countries (Rapp, 1995). Third, an additional investment possibility for western retailers arose from the financial crises in South-East Asia as the Asian groups have temporarily been afflicted with shortage of money. By that way, western retailers hoped to take advantage of their presence in the region when China was opening its markets (Lingenfelder, 1996).

As already mentioned above, the internationalization process of the retailing sector is still in its turbulent starting phase with first signs of a beginning consolidation. The larger retail firms are in fact 'internationalized' but only in so far that they are composed of a number of business units that are active in different countries often with different business conduct and behavior. Only a few of the retailers have succeeded in internalizing this process until now and to accordingly adjust their organizational structure.

2.2 Organizational changes due to the internationalization

As different strategies of internationalization exists they also imply specific organizational changes. However, it is observable that retailers like Wal-Mart or Aldi stick to their business model when they enter foreign countries. In this sense there are at least three developments in common which offer outstanding opportunities for a more efficient use in conjunction with globalization.

The progresses in WTO negotiations in regard to quality and safety standards noticeably facilitate the trade of intermediate and convenience food products across borders (Fieten et al.,

1997) so that today retailers are able to procure worldwide. This can be understood as ***'global sourcing'***. Even though the retailers have always bought products from all over the world global sourcing has a wider meaning. Lingenfelder (1996) emphasizes that global sourcing applied as a strategic option can contribute to the added value not only by cost reduction but also by value enhancement. This is resulting from quality differentiation and early adaptation to changes in food trends and fashions. In case, that a national retailer converts to a multinational or even global firm, the procurement situation considerably changes. Retail firms also try to reach synergy effects by introducing simultaneously centralized procurement divisions for several countries. It is often observable that the number of employees in the domestic, centralized procurement department is more or less stable although the number of countries to be managed and the quantities to be coordinated are increasing. This development has the consequence that retailers take along their own suppliers to the foreign countries since the total number of suppliers should be more or less unchanged for the above mentioned economic reasons. On account of this, the quantity delivered by one supplier increases. Hence, the suppliers have to continually increase their level of professionalism and their IT-infrastructure. Having a centralized procurement department additionally creates the desire to negotiate the listing conditions for a greater territory. For example, in the past Schlecker - Germanys biggest drug store company - bought all of their goods in Germany and distributed it all over Germany and France. However, in future Schlecker would like to negotiate on Pan-European terms hoping to economize on cost advantages (Manager Magazin, 2004).

One of the most remarkable trends in retailing of the last years in all European countries is the steadily increasing dissemination of ***'retail brands'***. This development is self-evident as several empirical studies convincingly demonstrate that an increasing share of retail brands lead to rising profit shares (Mei-Folter and Barber, 1991). The positive relation between retail brand and profit holds true for national and international retail groups as well. Global retail firms can offer a retail brand in several countries. The thereby sold quantities probably exceed that of a national competitor and the achieved sale volumes are often in the same size like that of the leading producer brands. If the retail branded products are manufactured under contracting system, under these circumstances it might be possible to procure the necessary quantities to an incomparably low cost price. Additionally, the surge of retail branding is not only characterized by a rise in numbers of brands and an increase of the market share but also by a considerable augmentation of the standard quality. Being a focal company, retailers have to accept the responsibility for the correctness of the products sold under their own label. Therefore, retailers have to alter their conventional supply systems from purchasing on spot markets toutilizing cooperative supply chain networks (Hanf/Kühl 2005). Retailers as focal companies have to coordinate the product flows as well as the information flows by building cooperative vertical networks. If retailers take over this function they can be considered as the major and determining force in the food chain (KPMG, 2001). That can be characterized as the evolution of retail "eco-systems" (Eagle et al., 2000).

To offer a ***'differentiated and multi-faceted'*** food supply is a differentiation strategy that many food retailers try to pursue. This strategy has gained considerable attentiveness in the last three years as a counter-strategy against food discounters and their remarkable success. Retail firms which exercise global sourcing have good presupposition to find possibilities to newly differentiate their product portfolio in order to distinguish themselves from competing firms. In this context a specific role plays the basket of regional goods that have to be offered for cultural, traditional, and sociological reasons in order to be accepted by the local costumers as a local distributor (Zentes and Ferring, 1995). These basket of regional goods is necessary for the local clients on the one side, but this basket can also serve as a niche assortment in other regions. By this way, products that have a noticeable demand in one country could be a supplement in other countries without causing high costs owing to low sales quantity.

3. Consequences of the internationalization on the food sector

The described organizational and strategic changes in the retail sector that are to be expected with ongoing internationalization are also effective upstream and downstream. However, we will confine our analysis to the expected and speculated impacts on the food processing industry. Differently adjusting to an international environment by retailers these impacts concern food processing firms to a very different extent and also in different directions. The discussion will be facilitated by subdividing the food processing industry in four categories of firms. The following categorization is very crude and imprecise but sufficient for our purposes:

(1) The first category comprises very large multinational food processing firms that traditionally dispose over a large number of subsidiary companies that are worldwide distributed and engaged in many different food branches. The subsidiary companies are usually relatively independent and responsible to a national headquarter. This category possesses many well introduced national and international brands. Examples are Nestle, Unilever Bestfoods, and Danone.

(2) The second category includes firms that are more or less strictly concentrated around their kernel competence but are globally producing and supplying. They are competing in rather narrow markets in which they often held market shares of more than 50%, or sometimes they occupy the premium class with an outstanding quality (Simon, 1996). Hence, these firms dispose over a remarkable market power that is based not on size but on consumers' appreciation. Typical examples are Ferrero or Haribo.

(3) The third category is made up of medium-sized firms that produce diverse food for the national or regional market. Their competitive strength is based on a few strong national brands and a large number of more or less weak or regionally supplied brands. In a national context, these firms have the capability to produce a good standard quality at reasonable costs.

A considerable share of their products is marketed as retail brands or as no-name products. As most of these firms only dispose of a small number of regional or national producer brands – if at all – their substantial interest lies in cost savings. Examples are Suedzucker and Nordmilch.

(4) The fourth category shall consist of small and medium specialized food processors that mainly produce by order of retail firms.

If retail procurement alternate from a *predominantly national sourcing* to *global sourcing*, and if retail firms internationally centralize and re-organize the supply chain network, that will have of course serious consequences for food processing industries. If we consider the different firm categories, we can recognize remarkable differences within the food processing industry. Firms of the **first group** are only marginally touched by the concentration of retail procurement. The multinationals dispose of strong brands in almost all relevant national markets so that increasing international retail procurement will not cause a substantial effect on the quantity of sales. Firms of the **second category** have more or less the same status as those of the first group. The volume of sales will probably not be seriously affected by the international pooling of retail procurement presupposed that they appropriately adjust their sales organization. Both categories may gain to a certain degree from the increasing globalization of retail sourcing by cost savings particularly through smaller sales divisions, unified promotion activities, and lesser transaction operations.

The most important effects of the change in retail procurement will likely ensue in the **third category** – the nationally oriented processing firms. Some food processing firms will substantially win in the altered situation, many firms will drastically lose. At first, we will address firms that hold a national cost leadership and do not dispose over strong producer brands. As long as national retail procurement systems prevail, a strong cost leadership protects these firms from existence threatening competition because they possess the necessary experience and the know-how to undercut the competitors' cost level and to counter any price war. If retailers unite their national procurement divisions to a multinational division, national processors with cost leadership will lose control over competitors as they will now be confronted with cost leaders from other countries that are skilled in the same way. In consequence, the market power and the price margin of national cost leaders radically shrink, and at least several of the former national cost leaders are forced out of the market. The surviving processors reside in a relatively positive situation although they have forfeited some market power but in return they win sales and turnover.

The situation is clearly different if we look at processing firms that compete with their business rivals on the national market by product differentiation. In an unified international procurement market the number of competitors also increases with the number of countries involved but only very few of them - if at all - are to consider as direct substitutes. In case that the product differentiation is narrowly adjusted to the national consumer habits and preferences, there is no reason to assume that fundamental and abrupt displacements in demand arise from changing procurement. In the long run, the products offered in one country will probably gain market shares in other countries, too, but will also lose shares in the own country. Such shifts in demand will be facilitated in consequence of a centralized supply management, and the number of competitors will become somewhat smaller but in principle the supply of differentiated products is only marginally affected. Similar applies for regional and national niche products. However, in some cases, a niche may become larger by the internationalization of retail, and in a piggyback process with the retail firm the small processor may use this larger niche. In other cases, a foreign competitor is introduced into a niche by the same piggyback process.

Although no general advantages or disadvantages of an internationalization of retail with respect to producers of differentiated goods can be ascertained, each single case under discussion has to be analyzed very carefully. Even an increase in sales of a differentiated food product that is induced by internationalization of retail may be connected by more disadvantages than advantages. The enlargement of the marketing area and the thereby changed procurement policy can sometimes bring the respective food processor in serious economic difficulties. The advertising, promotion, and distribution costs grow with the marketed quantity so that the growth gives rise to a deterioration of profits, particularly if a regional growth is unintended. Smaller producers with a specialized, relatively narrow assortment of differentiated products may be overstrained by a too sudden and too heavy international market enlargement with respect to its financial and personal resources.

Small and medium-sized food processors that produce retail brands by contract with a retailer (**group four**) are usually among the winners of internationalization of the retail firm. Every time, when the retail firm invades a new country or enlarges its engagement in one of the countries, additional quantities of the retail branded product are needed and the necessary products are purchased from the primary supplier. For example, when in 2003 Lidl entered the Swedish market they were importing milk from Germany. Hanf and Maurer (1994) argue that this advantage is particularly important when the retail enters economically and politically unstable regions. By this, the respective food processors are able to grow with the growth path of the retailer without investments in market development.

4. Summary and conclusions

For about one decade the retail industry has performed an immense structural change. The former nationally orientated players have become suddenly global players. In many cases the global giants still act like an agglomerate of national tycoons but that will drastically change in the near future. Some of the organizational adjustments to the changed economic situation have already become visible although most of the organizational measures are still pending to implement.

Future structural development of the food processing industry will be vigorously stamped from the ongoing globalization process of the retail sector. The distinct firm groups will be very differently affected. Large multinational food producers with a wide supply portfolio and worldwide acting, and specialized premium food processors are groups that can easily adjust to the changed requirements on the part of globalized retailers. Certainly, it will give individual winners and losers but the group as such will not be affected seriously.

The most important impact of retail globalization is to be expected in the large group of national and regional food processing firms. A few firms will profit from the international retail development. On the one hand, processing firms will gain that success in asserting themselves as multinational cost leaders. On the other hand, such firms will survive that become accepted as differentiated brand producer in one or several national markets. The bulk of firms of this category will sooner or later vanish.

A part of the small and medium-sized contract processors will disappear because they are not able to adequately extend their delivery to foreign countries. However, the majority of these firms will grow with the international growth of their contract giving retail firm. In the future it is likely that rather more than less of these firms are required because retail brands will conquer additional market shares. Hence, the competitive situation of specialized food contractors is rather promising presupposed the firms are capable to adjust to changing business obligations.

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