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Relationships Between Food Processors and Traders in Hungary

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Summary: During the past years the market share of trade chains has increased substantially in Hungarian food commerce. The concentration of food commerce and the increasing presence of international and national trade chains can be observed in Hungary as well. It is generally true that small and middle-sized food trading enterprises are not competitive compared to large trade chains. However, this fact does not mean that their reason for existence or their support is questionable.

The former system of relations between food commerce and food industry has undergone radical changes due to the expansion of food chains. Due to the changes, requirements towards food industry have grown, food industry has to face fundamentally new mentality and concepts.

In conclusion we can state that during the many-year presence of trade chains (multinational and Hungarian) food industry has tried to adapt to the transformed competition conditions even so far, and this process is going on.

In addition to the fact that producers have to experience fundamental changes in mentality, economic policy has to provide this progress with the necessary background. A system of subsidies and regulations has to be established with the aim to prevent serious distortions by the expansion of trade chains. Economic policy has numerous known and yet unknown tasks in moderating the vulnerability of small and medium-sized enterprises against increasingly concentrating trade chains of large capital power.

Key words: agricultural and food trade, relationship of producers and traders, supply chain

1 Characteristics of the agricultural and food trade in the nineties

1.1 Marketing of agricultural products

Since the political and economic transition of Hungary the changes in the agricultural commerce and co-ordinating system of the last decade can be summarized according to Szabó (1997) as follows:

- A great number of the earlier actors of agricultural trade have disappeared or changed their activities
- The system of vertical relationships fell apart
- Due to the structural transformation of agriculture the supply sector became scattered
- Roles of the earlier market players (co-operatives, production systems) have changed
- New institutions of the market (commodity exchange and public warehouses) have strengthened
- Enterprises of food industry are well provided with capital (mainly in foreign ownership with more active production policy by production contracts with farmers)
- In order to increase efficiency the market players take over functions from other organizations: direct sales to consumers, producers store, export, functions of wholesale food trade are taken over partly by retailers, food processing companies acquire animal and poultry breeding plants, retailers develop “large-scale enterprise empires”
- It is in contrast to these tendencies that several functions which were earlier integrated became independent of the organization (e.g., the role of the collecting and purchasing wholesale trade has increased).

Summarizing the above mentioned items it can be stated that recently the system of agricultural trade and the co-ordinating relationships have become more varied. However, the fact is that sales channels before the political and economic transition of Hungary provided some kind of guarantee for producers (the question here is how they functioned).

Maybe this is the reason why the opinion arose that “producers should produce and the traders should sell”, which, unfortunately, has been continuing so far. Up to present the greatest problem, the question most frequently put by producers is: what to produce, what can be sold and what has a market? The lacking of or insufficient marketing activity causes problems even at large companies but it appears even more often at small companies.

1.2 Procurement sources and the relationships of food industry

Analyzing raw material purchasing and supply from the food industry’s viewpoint the situation varies by products depending on the characteristics of the relevant sector.

Characteristic for the *milling industry* is that at least half of the quantities to be processed originate from the given region.

As for *potato processing* the share from the own region is varying. Concerning the procurement the share of the Hungarian and foreign sources is approximately 50:50%.

In *sugar production* factories generally purchase the raw material in their own region.

In the case of *vegetable oil production* the large-scale companies in a monopolistic position purchase the raw material in the frame of integration.

The *canning factories* purchase the raw material in their own regions.

Characteristic for *vegetable processing* is that the largest companies ensure raw material by production contracts. In the fields of *fruit processing* the purchasing without preliminary contracts from small-scale producers is dominant (in particular for berry fruits).

As for fruit and vegetable juice production it is characteristic that the main actors procure the raw material based on production contracts. This is not valid for fruits (especially berry fruit), which are normally being processed without prior contract. Next to the berry fruit production areas several small-scale companies have been established.

At *pig production* it is striking that the share of raw material originating from individual farmers is very large. The problem is that the quality of the raw material originating from small farms is not always high. Black slaughtering is characteristic for this sector.

Concerning *poultry processing* a high level of integration can be found at companies in foreign ownership. At present the slaughtering plants provide the financing.

The *milk processing* companies provide the raw material by long-term contracts, in the frame of annual agreements. It is difficult to assess the procurement relationships of the milk processing plants as some large-scale companies themselves operate processing plants in several regions.

1.3 Food trade

During the last decade food trade has undergone fundamental changes in Hungary. Several multinational food chains have started operation either refurbishing old stores or building new ones. As a result of foreign investment, Hungarian food trade started to close up to the Western European standard. However, the majority of Hungarian food trade businesses are of small or medium size normally facing shortage of capital.

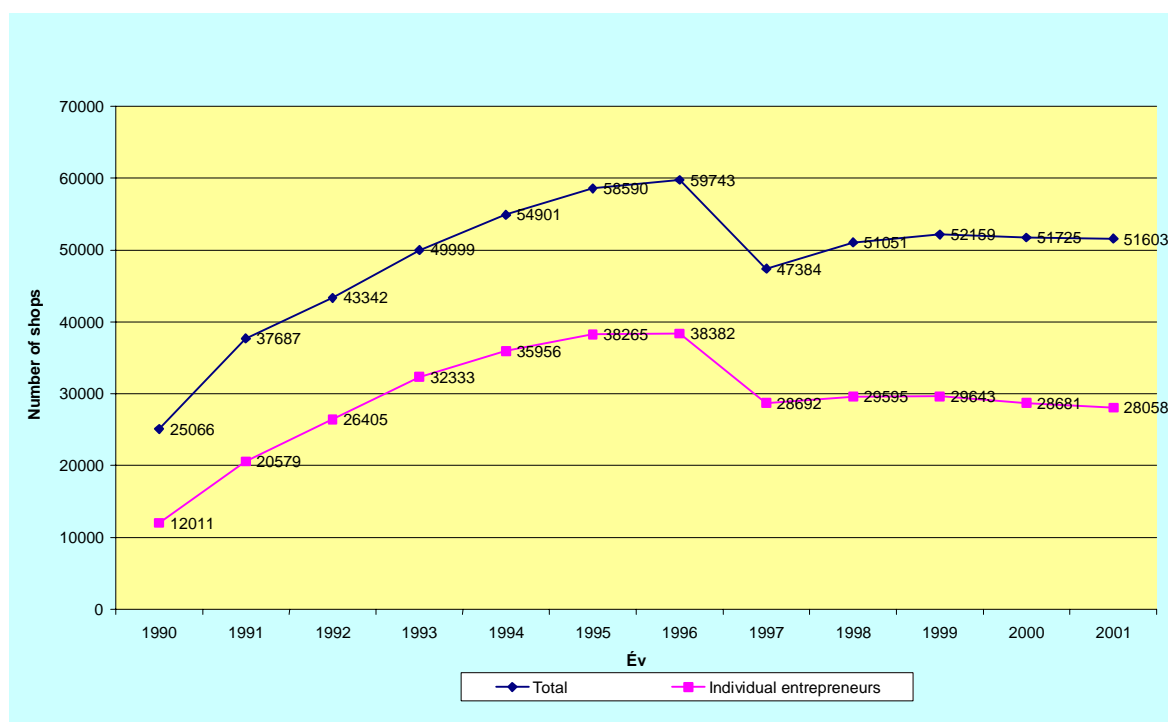
Concerning the changes in the Hungarian food trade three significant periods can be distinguished:

- | | |
|------------------------------|------------|
| 1. Spontaneous privatization | 1989–1991 |
| 2. Privatization | 1991–1995 |
| 3. Concentration | since 1996 |

In the second phase of the privatization, but mainly from 1995, the characteristics of concentration appeared.

Figure 1 shows the changing number of food retail stores in the decade of the nineties.

Figure 1



The changing number of food retail stores

Source: Yearbooks of the Hungarian Statistical Office (KSH)

Regarding the number of food retail stores the "break" of 1997 was due to the new system of census introduced. In the first half of the nineties the registration of new stores was obligatory but no information was available on the closing down of stores. In 1996 the Hungarian Central Statistical Office (KSH) carried out a census on retail stores. From 1997 on it is the task of local governments to keep continuously a register on the shops located on their area. (Süveges, 2001)

At the beginning of the nineties the number of stores increased rapidly. In this the number of stores operated by individual entrepreneurs increased significantly too. Their share was the largest in the middle of the decade. The later decrease was due to the appearance of large food chains and strengthening competition. (Agárdi – Bauer, 2000)

At the end of 2002 51,330 food stores and mixed retail businesses existed which indicated a further decrease compared to previous year.

An increasing share of the food business is concentrated in large food chains, hypermarkets and shopping centres. The share of large multinational food chains amounted approximately to 60% in 2000.

Based on 2002 data of the Central Statistical Office the value of the food and mixed retail business was 2,042 billion HUF (8.4 billion EUR).

2 Relations between food commerce and industry

2.1 Imbalanced mutual positions

The former system of relations between food commerce and food industry has undergone radical changes due to the expansion of food chains. In the relations of trade chains and food producers partners are usually not equal, one of the parties is in a dominant position. Trade chains are usually

disinterested in the marketing of brands, they are interested in that of the given product category. A large part of food products are replaceable with each other, therefore, the dictating position of the trade chains prevail most often. Some Hungarian producers drop out of the circle of suppliers of large multinational trade chains due to their frittered selection of goods. However, there are some product categories in which one or two or perhaps three brands dominate the market. In these rare cases it is possible for producers to occupy a dominant position.

Even despite the frequent collisions between the aims of production and trade the task is to establish a system of relations between these two participants of the market which is beneficial for both parties. Of course, this can be achieved through compromises and by respecting each other's aims.

Between production and trade there is a natural "collaboration zone" due to the mutual objectives and the focus on consumers. Special literature groups producers' possible marketing strategies towards trade into four basic classes:

- adaptation strategy
- conflict strategy
- cooperation strategy and
- evasion strategy.

All in all, out of the four main strategies the majority of food processors choose the cooperation strategy.

2.2 Marketing tasks of trade marketing

However, there are significant sources of error in the implementation of certain elements of the marketing mix applied by producers. The majority of wrongly used methods are connected to the "magical" 4 P (Product-Price-Place-Promotion), the most critical point being sales promotion.

In line with the transformation of the relations between production and trade it is less and less possible to sell the product in itself; the object of sales will be the combination of "product&conditions". Consequently, the evaluation of the quality of relations with the different merchants must be based on the simultaneous evaluation of sales and systems of conditions. For this, however, producers must be aware of the number of conditions provided (in EU countries with stronger traditions in this field producers can build up their systems from nearly 50 conditions), and of the influence of these conditions on the income from sales.

According to experts, communication competition is becoming more important than product competition in EU countries. Practically, product quality is becoming evident, while winning or losing in a competition increasingly depends on the intensity and quality of communication. Communication has an increasing role in the system of relations between producer and trader successful marketing of the products depends on it as well. In communication the present "standing on one foot" must be replaced by "standing on two feet", that is, not only consumers but also trade must be targeted by communication.

2.3 New mentality and concepts

The unity of interests and the conflicts of producers and traders are characteristic to the Hungarian situation as well, so much the more because the share of foreign capital is nearly 80% in food industry, multinational companies are present on the Hungarian market. The expansion of international trade chains is increasing in food commerce as well. Due to the changes, requirements towards food industry have grown. Food industry has to face fundamentally new mentality and concepts. Besides the so far unknown shelf-fee, listing fee and advertising contribution suppliers are to reach high standards regarding the reliability, scheduling and punctuality of supplies, unvarying product quality and packing most suitable for trade, while in the field of sales conditions (sales promotion towards trade, price discounts, rebate, bonus etc.) and terms of payment food trade chains have done their best in order to exploit their power positions.

There is a new type of competition among the producers. In the food industry other kinds of competition factors have gained ground than before: factors like the speed of product circulation on the shelves, shelf coverage etc. are also to be taken into account. All of these have produced a shocking effect among food producers, and they often "got exhausted" by being indignant at the aggressive price and condition policies of food trade chains instead of searching for adaptation opportunities. Together with the expansion of food trade chains however, food industry had to realize that trade chains are such elements, fundamentals in the market with whom they must find cooperation opportunities, regarding these organizations as partners not adversaries. The terms of trade chains have also softened in their relations with suppliers (especially smaller companies) compared to the initial years, since they are not interested in the ruining of producers either. Nowadays, however, according to interviews with producers it seems that trade chains have "hardened" again.

The effect of international and national trade chains on food producers can be summarized as follows:

Negative effects

- strict conditions (product quality, well-organized logistics system)
- strict terms of price and payment
- power dominance of trade
- uncertainty (removal from lists from one day to the other)

Positive effects

- purchasing in large quantities
- suppliers to Hungarian stores are helped in obtaining foreign orders
- secure payment
- logistics advantages (delivery to warehouse)
- fast speed of circulation in the stores etc.

In practice, however, many effects materialize differently from the way "it is written down" in theory or from the way it works in countries with developed market economies, despite the fact that the same multinational or international food processing companies or food trade chains operate in Hungary.

Examining future tendencies it can be stated that the expansion of food chains has not stopped, the plans of different chains include the opening of further new stores. Based on prognoses regarding food commerce the concentration of retail trade will continue further: now the top 5 companies realize about 64% of total food commerce. In line with the western European structure, further increase of the chains can be expected, together with the increase of the importance of retail units with large store surface: in the future the appearance of new chains as well as further ownership changes can be expected. According to forecasts, none of the trade formations will gain dominance in Hungary, the palette of Hungarian trade will remain broad.

Assessments carried out in several countries were aimed at revealing if food industry is able to do something against its vulnerability to trade chains. The result of the assessment was that it is usually impossible to terminate "defencelessness", but it can be moderated.

Its first step is, having overcome preconceptions, to accept the fact that the existence and expansion of the chains are inevitable parts of our economy. The task is to emphasize adaptation to the new situation instead of confrontation as well as to "clutch at every straw" which might moderate defencelessness. The elements of the "defence tactics" of the companies can be the following:

- producers' cooperation, the establishment of manufacturers' brand communities
- concentration on specialties instead of everyday products in the product structure
- the development of trade-centred sales policies
- adaptation regarding mentality, methodology and organization.

In conclusion we can state that during the many-year presence of trade chains food industry has tried to adapt to the transformed competition conditions even so far, and this process is going on.

3 Findings of the survey with questionnaires

Small entrepreneurs who wish to become suppliers constitute a special segment in the relationship of producers and traders. Based on the interviews conducted with the managers of the food trading companies we summarised the results. Unfortunately it was not possible to make interviews to the same depth with small entrepreneurs. By evaluating the significance of small enterprises difficulty was caused by the fact that the general directors of the companies do not know in fact which of their 300 suppliers have less than 50 employees. However, it might be that the purchasing manager does not make decisions based on the number of the employees of the supplier; that is, there is no discrimination of this kind.

In general we can state that it is characteristic that the majority of small-size food processing enterprises do not have a definite marketing approach, practice or market strategy. It is not obvious even in the cases of much larger companies either.

On the other hand, however, if they wish to become suppliers of a food trade chain (small or large, Hungarian or multinational) they, of course, have to carry out some market research and based on that start the production. It was the general opinion of food traders that small-size enterprises have chances in particular in those fields (in the case of lacking lobbying - since it is possible to produce large quantities of products of uniform quality also with numerous participants) where small-scale production and special products are characteristic. A typical example is provided by bakery products; another example for supplying opportunities and regional supply are the pasta or sweets production. Other special products sold in small quantities, such as, goat cheese and nuts in honey could also be supplied by small size enterprises.

A further requirement or the secret of the success is that these products have to satisfy niche markets. No small-size enterprise can be successful with universal production.

The requirements of food traders was also general that the products should be of good quality (it can happen that they visit the plant and check the conditions of production and the production documents) and the origin should also be certified.

We asked about the share of the small-size suppliers of certain product groups but the answers (if received at all) cannot be evaluated as no general conclusions can be drawn. At one company, for example, the suppliers of meat and milk products were small-size enterprises but at another one small enterprises were definitely excluded.

It was stated by them that the secret of success is that small-size enterprises can get on the market with special products, they are more flexible than a large-scale enterprise. An important factor mentioned by one store was that success is due also to the personal participation of the entrepreneur himself.

Traders do not expect large advertising contribution from small-size enterprises, however, they try to compensate it somehow; for example, by paying lower purchasing prices. However, one supplier was requested to pay advertising contribution.

There is a problem, which is due to the small size of the companies; that is, they are not able to supply in sufficient quantities even to a small chain. They do not realise what it means to be a supplier of a food chain. This means that the product supplied has to be found in each store of the chain and it cannot be out of stock. This obstacle can be overcome by marketing co-operation established by the producers (co-operation might be useful also in the cases of regional specialities). Another significant

disadvantage of the small-size enterprises is the lacking capital, that is, the power of market. In general they are not able to establish strong brands or renew the old ones (Traubisoda provides a counter-example).

Small-size entrepreneurs are much more exposed on the market than the large ones; in general they are not able to invest capital in order to defend themselves.

Regarding the distribution and logistics small-size enterprises cannot provide direct transport and this is a disadvantage - this might sometimes also prevent them from becoming a supplier.

Based on the publication of Seres (2002) the majority of the Hungarian small size enterprises do not develop a marketing strategy adjusted to the business philosophy of stores with large surfaces. They prepare offers without a profound knowledge of the market and these consequently differ in price and quality significantly from the requirements of the stores with large surfaces.

4 Summary and conclusions

If we analyse the trade of agricultural and food products taking into account the whole of the supply chain our main findings are the following:

1. Within the agriculture:
 - In the 90's basic raw material production became scattered
 - Most of the vertical linkages fall apart
 - At the same time new market players appeared and new institutions were established
 - Original institutional systems were restructured with additional functions
 - In the whole, the marketing of agricultural products "became more difficult". The currently disintegrated supplies do not support marketing in great quantity and in even quality
2. By looking at the processing, and the food industry:
 - The food industry became more concentrated and its interests separated from the producer's ones
 - Foreign investments are important not only at the larger businesses but also at the small and medium-size enterprises.
 - Opinions regarding foreign investments, their positive and negative impacts on the economy, are greatly differing.
 - At the beginning of the privatisation process the original "hope" of agricultural producers to gain some ownership and control over food processing businesses has been shattered and thus their interest expressing ability had been further decreased.
3. If we look at the next element of the supply chain, we can state that the most dramatic change took place in food retailing in the 90's:
 - Structural and ownership changes were coupled with the basic transformation of sales mentality thus coming closer to the ideal "consumer society", although in many cases the solvent consumer was missing to capitalise the new situation.
 - In food retailing, parallel to the large number of smaller stores (showing a decrease in the last couple of years) we can notice a strong concentration and increasing competition of international and Hungarian food chains. Although sometimes the consumers are profiting from this situation, it does not favour the agricultural producers and most of the market players of the food industry.
4. The relationship between producers (in agriculture and food industry) and food retailers has dramatically changed over the past couple of years. Today it is quite common that retailers have the dominant power in the business relationship, dictating most of the conditions. Adapting to this situation problems raised not only for the Hungarian producers in the transition period, but for the farmers and processors of the developed market economies as well. Furthermore, trade globalisation has an ever increasing effect on developing countries, too. Integration and co-operation between agricultural producers and increased marketing activities can be one effective

way of softening the drawbacks of globalisation. Similarly, the food producers could gain a stronger market position with expanded marketing activity but it will not mean a definite solution itself.

5. In order to maintain an efficient supply chain, it is important to develop both “supporting” and “service” activities such as logistics, information technology, e-business and e-commerce.
6. Substantial developments took place in the food industry and trade in terms of logistics. This primarily impacted upon the multinationals and did not affect the small and medium size businesses. Of course we could not assume a similar rate of development within the two sectors but there should be some prospect of closing the gap with government support, enhancing the development of co-operations and smaller businesses.
7. Opinions on the evolution of e-commerce based on Hungarian and international experiences differ quite considerably. During the last couple of years we could experience “booms” and “busts” within the technology industry, supported with different explanations. In our opinion we cannot rule out the use of e-commerce; however it would not be wise to base our future on it solely. The development of e-commerce is greatly influenced by the degree of development of individual countries, consumer behaviour and cultural impacts. We believe that with carefully planned strategy (and support) e-commerce can have an important role to play within some segments (such as the home delivery of readymade food products) in the long-term.
8. If we come back to the original question of the study whether the “agro” supply chain is efficient or not, we cannot be too optimistic. For certain, co-operation between market players will need to be strengthened at all levels, with particular focus on raw materials production at the farm level. This is not only important in agricultural product marketing but it needs to be further extended to information management. We do not say that there is not sufficient information in agriculture, but we believe that the information channels and feedbacks are not working efficiently. At the same time it is worth to mention that there is a lack of initiative of producers to obtain the right information, but this could be the topic of a separate study altogether.
9. There is also plenty to do at micro level also in order to operate an efficient supply chain. Even if we do not call it business strategy, a system needs to be developed where businesses can monitor consumer needs, the changes in their behaviour, the level of demand at both international and Hungarian markets as well as monitoring IT innovations which could impact upon an industry structure.
10. If we look at the structural change that took place in food trade since the political and economic transition and we analyse its impact upon the agriculture and ownership structure, we could say that there is not a strong relationship between these elements. In our view, the privatisation process brought the most important developments in agriculture. Stronger correlation between these factors would be possible, if the marketing knowledge of agricultural producers would be more advanced, and they would take into account the consumer and market demands during production. Although there has been some developments within this area but the change of attitude is likely to be a slow process. It cannot be expected however that all agricultural producers will have an equally high involvement in marketing activities, as it is not the case in developed countries either.
11. If we state that the scattered ownership structure in itself has weakened the producers bargaining position, we cannot get a fuller picture either. Because before the change of regime, the joint market channels of larger farm estates, “household plots” and specialist producer groups did not result products in constant quality either. Similarly today, smaller producers market their products through and with other businesses, thus large proportion of products comes from different producers. The same situation exists in developed countries, but they have a continuous tradition of integration and co-operation between businesses (supply and marketing) and this helped them to deal with the changing market conditions, the concentration of the food industry and retailing. This road is also open for Hungary to be explored. The larger farm estates with an average size of thousands of hectares have great potentials. These businesses are currently struggling with financial difficulties but in the longer run they can be seen as a competitive threat in many EU countries.

12. It is important to notice that there are great requirements in the areas of quality, food safety, traceability and labelling of products. These requirements are transmitted towards agricultural producers by the food retailers and processors.

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