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Franklins Ltd:
The development of value chain relationships in a fresh produce category

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Abstract

This case describes the opportunities and dilemmas faced by managers of agribusiness firms as they contemplate forming a strategic alliance in a fresh produce category. It challenges each of the managers to evaluate their own 'readiness to partner' and to define their expectations of their prospective partners.

The case highlights that the success of strategy alliances is closely linked to how complementary the firms are in terms of culture strategy and structure. Although Franklins supermarkets no longer exist in Australia, the principles of supply chain partnerships outlined in this case are still valid. In 2002, The Mulgowie Farming Company was named Woolworths Supply of the Year

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The Case

Anthony Di Peitro, Director of Premier Fruits, is reflecting on a meeting that he had the previous Saturday in the picturesque Lockyer Valley of Queensland. Present at the meeting were Michael O'Keeffe, the newly appointed National Business Manager, Produce for Franklins Ltd and members of the Emerick family who own and operate Mulgowie Farms - a leading producer/packer of fresh sweet corn.

The topic of discussion at the meeting was a proposal for Mulgowie Farms to be the sole supplier of pre-packed fresh sweet corn to Franklins on a year-round basis. Premier Fruits would co-ordinate the supply and distribution of the sweet corn to Franklins stores in New South Wales, Victoria, South Australia and Queensland.

> *"This is pretty exciting stuff. We have the right businesses involved, the right people are involved and the market opportunity is there. This wouldn't have been possible 5 years ago."*

It struck Anthony that five years ago, as an agent, he actively tried to keep his growers and customers apart. Yet, now he is genuinely excited after this meeting with Mulgowie Farms and Franklins.

What has happened in the market for fresh produce?

Consumers have changed.

In the fresh produce segment, the consumption of vegetables has increased from 148 to 160 kg/capita in the period 1988/89 - 1996/97.

Table 1: Apparent Per Capita Consumption of Vegetables- Australia

Item (kg/head)	1958/59	1968/69	1978/79	1988/89	1996/97
Potatoes	51.7	53.7	50.1	61.5	68.2
Other root vegetables	15.9	17.1	16.7	19.3	23.8
Tomatoes	13.0	14.2	13.6	19.3	25.2
Leafy/green vegetables	17.9	21.3	24.3	23.8	21.4
Other vegetables	18.6	18.1	17.9	24.2	22.3
TOTAL	117.1	124.3	122.5	148.1	160.9

The driving force behind this increased consumption of vegetables is the desire by consumers for a diet that is fresh, nutritious, safe and tasty. In addition consumers demand:

- Convenience.
- The all-year-round availability of an increasing range of produce lines.
- Value for money.

Retailing has changed.

The retailing of fresh produce in Australia has change dramatically over the past ten years since Woolworths (the dominant national supermarket chain) embarked on their "Fresh Food People" branding strategy. This has shifted the retail emphasis in fresh produce away from small specialist fruit and vegetable outlets to the three major supermarket chains.

Precise data on the relative market shares of the supermarkets and specialist fruit and vegetable retailers in the fresh produce category is difficult to obtain. It is estimated that supermarket sales account for approximately 53 per cent of the total market and growing at the expenses of speciality fruit and vegetable outlets.

All chains see 'fresh' sales as a major area of growth in an otherwise mature market for dry grocery products. For example, Franklins Ltd, the smallest of the national chains, forecast that 'fresh sales' will account for 25 per cent of their total sales in 2000 - up from 14 per cent of the $AUD4.2 billion sales in 1998.

Wholesaling has changed.

Traditionally, wholesale markets that are located in the major capital cities were the centrepiece of the selling and distribution system associated with horticultural produce. The normal practice was that producers delivered produce to 'their agent' on consignment to sell on their behalf although the activities of these wholesale operators were more akin to those of a merchant than an agent. There was little, if any, information exchange or supply co-ordination - practices that became the focus of grower discontent and mistrust. The buyers for the supermarket chains 'trawled' the central markets and purchased their requirements on an opportunistic basis.

Although central wholesale markets do continue to perform these roles, their relative importance as a 'clearing house' has declined as more direct linkages have been formed between growers and retailers. Antidotal evidence suggests that the supermarket chains source approximately 40 per cent of their requirements from the central markets and this percentage continues to fall.

Farming has changed.

The number of farmers in Australia has declined while production in most sectors has increased. These trends indicate that individual farm businesses are becoming larger. Australian Bureau of Agricultural and Resouce Economics data suggests that approximately 70 per cent of raw agricultural food and fibre products is produced, or controlled, by 30 per cent of farms. These statistics are supported by production figures from the Lockyer Valley - the major horticultural area in Queensland, where production is dominated by four major businesses.

How has Franklins Ltd. responded to these changes?

"Franklins" was founded in 1941 and acquired by Dairy Farm International Holdings (DFIHL) as a wholly owned subsidiary in 1979. DFIHL is a leading food and drugstore retailer in the Asia-Pacific Region. At the end of 1998 the group and it's associates operated 1871 outlets, employed 74,000 people and had sales of $US6.6 billion.

Historically, Franklins Ltd has positioned itself as the "no frills" supermarket chain. The emphasis was on low prices, minimum service levels and a concentration on dry grocery lines. Since 1993 the company has placed an increasing emphasis on developing "fresh" categories such as meat, fruit, vegetables and delicatessen lines

The focus of the business is on opening stores in the Franklins Fresh format and transforming appropriate "No Frills" stores into the fresh format. It is anticipated that approximately 15-20 new stores to come on line each year for the next 3 years.

Franklins is currently the third largest supermarket chain in Australia and operates across four states; New South Wales, Queensland, Victoria and South Australia. Approximate market shares of the major supermarket chains are shown in Table 2.

Table 2: Market Shares of the Major Supermarket Chains

Supermarket Chain	Market Share - Dry Groceries %	Market Share - Fresh Produce %
Woolworth's Ltd	35	30
Coles-Myer	30	18
Franklins Ltd	15	5

Sales were $AUD4.2 billion in 1998 with a split between grocery and fresh of 86% and 14% respectively. Profit before tax was $AUD65 million. Currently fresh sales account for 19% of total sales and by the end of the year 2000 this is predicted to rise to 25%.

Michael O'Keeffe was recruited from Rabo Australia in May 1999 to develop and implement Franklins' expansion plans in the fresh produce category. During his career Michael had undertaken numerous research and consultancy projects involving value chain alliances in agribusiness.

> *"This is my big opportunity to personally put my ideas into practice. Collectively we at Franklins and our supply chain partners, have to develop innovative ways of creating superior value for our customers if we are to capture market share from our competitors. We have good check-out scan data but we don't use it well."*
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> *"I face three important challenges. First, we have to find the right firms to partner with; second, I have to manage the relationship with our partners well and thirdly I have to change my team in the field from produce buyers to category managers."*

The marketing of fresh produce is oriented around wholesale (terminal) markets that are located in the capital city of each State - Sydney, Melbourne, Brisbane and Adelaide - in which Franklins Ltd. operates.

This necessitates a regional buying structure and one of the key challenges facing Franklins Produce is to build a national unified purchasing operation spread across different physical locations.

Franklins currently purchases Mulgowie farms' pre-packed corn, on a non-exclusive basis, from wholesalers in the Sydney, Melbourne and Brisbane markets. Premier Fruits are Franklins' Melbourne agent.

How has Premier Fruits evolved?

Premier Fruits P/L had its origins in three distinct family owned wholesale fruit and vegetable businesses that operated out of Melbourne's central wholesale market. The senior member of the families involved - Brancatisano, Petroro and Di Pietro, began their businesses in the 1950's and as a result, they have extensive experience in both the wholesale and retail levels of fresh produce marketing.

In 1997, the families investigated the feasibility of amalgamating their individual operations as a strategic response to changing competitive environment that confronted them. The outcome from this analysis was the formation of Premier Fruits in January 1998.

The company's main product lines are beans, sweet corn, zucchini, capsicum, lettuce, melons (rockmelon/ honeydew/ watermelon) and stone fruits (peach/ nectarine/ apricot/ plum).

The formation of Premier Fruits has allowed its shareholders to rationalise their operations in four key areas:

- Operational Structure - the pooling of human resources has resulted in a better utilisation of experience and expertise within the company, particularly in the areas of administration, operations and marketing. Premier Fruits have developed a semi-corporatised business administration and operational structure, but has retained a typical family style 'hands on' approach at all levels within the company.
- Infrastructure - the pooling of physical and financial resources has enabled Premier Fruits to develop high quality storage, handling and distribution facilities, which are now the benchmark of the Melbourne Markets. These facilities have allowed the development of a 'Cold Chain' management system that exceeds the requirements specified in the company's Quality Assurance program.
- Product supply network - over the years, each of the partners in Premium Fruits had developed key supplier relationships with major grower/packers of their speciality lines throughout the growing region of Australia. The pooling of supplier networks has enabled Premier Fruits to specialise in chosen lines of produce and to eliminate second rate growers. This select network of growers guarantees consistency of supply and quality throughout the year.
- Customers - Premier Fruits has a number of "main customer" groups. Approximately 40 per cent of the company's business is with the major supermarket chains (Franklins, Woolworths, and Coles). A further 35 per cent of the business is servicing the needs of Food Service operations and/ or other smaller independent providores. A declining segment of Premier Fruits customer base is that of servicing specialist fruit shops and independent supermarkets.

The management of Premier Fruits believes that the company's current and future success depends upon its ability to work and communicate with growers and retailers, and assist them to achieve their ultimate goal of “building sales”.

> *"We could see that the traditional wholesale business had a limited life. The major chains were restructuring their fresh produce purchasing strategies and we were in danger of being left out of the loop," Anthony Di Pietro reflected.*
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> *"The challenge we face is proving to producers and retailers that we can add value to their operations. If this partnership works then we can use it as a model for our other produce lines."*

Meanwhile, back on the Farm

Mulgowie Farms is a private company owned by the Emerick family that has its origins in the early 1960's when John Emerick exited from the dairy industry to grow heavy produce (potatoes and onions) on 20 hectares of land at Mulgowie in the Lockyer Valley of Queensland.

In 1981 Mulgowie Farms adopted a growth strategy which involved the investment of capital in working assets such as machinery and pack-house facilities rather than in land ownership. To effectively utilise these investments, Mulgowie Farms began contracting local growers to supply them with beans, Chinese cabbages and sweet corn. Mulgowie Farms are actively involved in the operations of their contract suppliers. They schedule, plant and harvest all crops as well as conducting regular crop inspections. There are no written product specifications associated with their grower contracts but there is an expectation that that they will grow a high tonnage quality crop.

"We have a very good relationship with our contract growers. The majority of them have been with us for years, and they do their job well - in a way they are like family," said Rod Emerick who is responsible for managing the relationship.

In 1999, Mulgowie Farms has access to produce grown on approximately 1500 hectares and supplied by 30 contract growers. This area includes 300 hectare in north Queensland that was purchase that year after several attempts to establish a reliable contract base for sweet corn in this region. With their existing supplier base, Mulgowie Farms has the capability of supplying Franklins' stores nationally with pre-packed fresh sweet corn on a year round basis.

Mulgowie Farms sell 80 per cent of their produce on the domestic market and historically were always strong supporters of central wholesale markets. This is because of the importance of central markets as a price reference point for horticultural products and their agents' ability to market their entire product range.

Mulgowie Farms have utilised the services of a wholesale agent in each of the central markets of Brisbane, Sydney and Melbourne. The Di Pietro family has handled their business in the Melbourne markets for the last four years.

> *"We value our agents, we are good at the production and packing operations our agents have the marketing skills. It would be difficult for us to deal exclusively with one agent on a national basis because of the relationships we have developed with our agents in the three markets and the level of service each provides in their market."*

The initial attitude of the major supermarkets to sourcing product directly from growers did not provide any real incentives for producers such as Mulgowie Farms - it was seen as more of a cost cutting exercise for the supermarkets rather than a win-win situation.

Queensland Fruit and Vegetable Growers Chairman, Paul Ziebarth summed -up this attitude in a recent newspaper interview: "There is concern from wholesalers that numerous times they have had product returned to them. Where this was because the produce did not meet quality specifications that's one thing, but there have been other cases not related to quality where product has been returned after a couple of days simply because it hasn't been sold."

However, there has been a change in approach by the supermarket chains over the last five years. There has been an increased emphasis on value creation through more attention being paid to product specification, quality maintenance and better communication with growers.

"We have supplied pre-packed sweet corn under our own brand to all three supermarket chains through our agents. We are proud of what we produce and by supplying all three chains we minimise the risk of being held to ransom by any one chain and gain access to the widest possible market," according to Rod Emerick.

Its Decision Time

Anthony, Michael and Rob are all faced with the same questions as they attempt to come to a decision whether to participate in the alliance or not. This type of interdependence is uncharted water for each of them. The opportunity is great but so are the investment and risks involved.

In their own way, they are contemplating the following questions:

- Is it worthwhile for us to be involved?
- Are we ready to be involved - what value does our firm bring to the partnership, what will need to change and can we deliver?
- What do we expect of our partners and will they deliver?
- What would you advise each of the players to do?

Teaching Note

The objective of this case is to demonstrate the issues that must be faced by prospective partners who are in the initial stages of forming an alliance. The strength in this case is that analysts are required to evaluate the appropriateness of the alliance from the different perspectives of the grower, agent and retailer before arriving at an overall conclusion.

This teaching note is structured around a series of questions used when teaching this case.

What is driving their interest in this alliance?

This question is designed to elicit the imperatives that are driving the partners. How crucial is it to their survival or growth? In other words what alternatives do they have? The answers will provide an indication of their commitment to the alliance and the degree of alignment in their corporate objectives.

Franklins Ltd. are playing a catch-up game and they realize that:

They have move quickly to reposition themselves in the fresh segment - the growth segment for the major chains.

- They have to be innovative in their approach to customer value - a 'me too' approach will not work.
- They have to invest in buildings and people.
- Premier Fruits are also reinventing themselves. They realize that:
- The traditional central market wholesale business has a limited life span.
- Confining their business operations to one location - Melbourne has limited growth potential
- There is a real danger of being left out of the loop as supermarkets build closer direct relationships with larger growers.

Mulgowie Farms face a different challenge. They already have access to the major markets for pre-packed sweet corn through their existing supply arrangements with the three supermarket chains. They also have good relations with their existing suppliers and their agents. They realize that:

- They have to develop new markets for their products - possibly export markets. An alliance with Franklins offers this opportunity through its parent company Dairy Farms International.
- They have to continue with their product innovation as a source of revenue creation. To do this they need to get closer to the final consumer.

All three potential partners are committed to a growth strategy based on creating superior consumer value. They recognize that their current business practices will not deliver on this commitment in a satisfactory way. The potential benefits of the alliance in terms of market growth and improved margins are sufficient for each of the partners to consider the proposition seriously.

How different is this alliance from how they have done business historically?

The answer to this question will indicate the extent of the paradigm shift that the partners will have to make? Is their culture, strategy and structure flexible enough to permit this leap of faith? How will the alliance effect their other business relationships?

Franklins Ltd. have had time to develop a 'fresh' culture. In this respect they don’t carry any historical baggage and they have the opportunity to build something different. They have hired an outsider who has an inclusive management style to develop and implement their fresh produce strategy. Michael recognizes that they haven't their consumer scan data well enough and that there is little communication between his buyers and the produce managers in their retail outlets. He is moving to rectify these problems.

In the Australian fresh fruit and vegetable markets, merchants have operated in an environment where asymmetric market information and opportunistic behavior are perceived to be the keys to success. These perceptions of behavior have resulted in the development of low levels of trust between producers and agents. Premier Fruits are attempting to develop relationships with key growers, but this will be a slow process.

Primary producers perceive themselves as 'price takers' who have very little market power. Historically, they have managed the risks associated with a lack of market power through diversification of their agent and retail base. They are used to receiving little market information outside of price quotations. Consequently producers focus on price and engage in opportunistic behavior whenever possible. Mulgowie Farms have developed cooperative relationships with their grower-suppliers. In addition they have developed relationships with key agents which they value.

What are their core capabilities that the alliance can leverage to create consumer value?

The answer to this question will identify what each partner brings to the alliance and the potential for these capabilities to deliver competitive advantage to the alliance. Who is bringing what to the alliance? Where is the power in this alliance? Why is it better to work together?

Franklins Ltd.:

- They have access to consumers nationally.
- They have access to check-out scan data.
- They have access to international outlets.
- They have demonstrated a commitment to the development of the fresh produce category.

Premier Fruits:

- They have experience in the handling, storage and transport of fresh produce.
- They have had experience in developing relationships with key fresh produce growers.
- They have experience in servicing the fresh produce needs of national retailers.
- They have demonstrated a commitment to change from the traditional role of a merchant.

Mulgowie Farms:

- They have experience in growing a range of fresh produce lines.
- They have experience in coordinating contract suppliers of fresh produce.
- They have had experience in post-harvest grading, value-adding and packaging of fresh produce
- They have demonstrated a commitment to the supply of quality fresh produce on a year round basis.

What are their biggest fears?

These answers should help identify the fragile areas of the alliance. Will their partners 'walk the talk'? Will the benefits of the alliance be equitably distributed?

Franklins Ltd.:

- Will our partners meet our quantity and quality requirements on a consistent basis?
- Will our partners be able to assist us in innovative market and product development?

Premier Fruits:

- Will our partners cut us out of the loop?
- Will our partners share sensitive consumer, production and financial information with us?
- Will we get a 'fair' deal from Franklins?

Mulgowie Farms?

- Will our partners stick by their word and not revert to opportunistic behavior?
- Will our partners be open with us?
- Will we get a 'fair' deal?

Should they proceed with the alliance?

Does sufficient synergy exist? Do the benefits outweigh the risks?

An alliance has been formed. In the first six months of its operation the volume of pre-packed sweet corn in Franklins Ltd. New South Wales outlets has increased by 68 percent without any change in its pricing strategy. Consumer value has been created through the availability of a consistent quality product on a consistent basis. All partners have benefited from the increased volume of sales and the fact that the project has delivered early 'runs on the board' has consolidated the alliance.

Summary

This case is all about creating more consumer value in a fresh produce chain. Creating consumer value is more than reducing costs through better communication and operational efficiency. Value is created through better product, packaging, promotion and pricing decisions that are achieved by aligning the whole chain to the needs of the consumer It is extending the concept of category management downstream from the retail outlet to include the procurement, distribution and production functions of the chain. Consequently, we describe this process as value chain management rather than supply chain management.

It requires:

- The commitment of the strongest partner to relinquish power. This means the ability of the retailer to share risk and equitably redistribute gains that result from the alliance.
- Investment by all partners in the alliance and a commitment to build on the core capabilities of each partners.
- The willingness by all partners to share information - transparency of customer data, costs and margins
- A paradigm shift, not incremental adjustment, in how each of the partners undertake their business dealings with each other. This means that the alliance is driven by innovation and a commitment to co-operation

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