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# **Factors Influencing Trust-supporting Mechanisms in European Agri-food Chains<sup>1</sup>**

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# Factors Influencing Trust-Supporting Mechanisms in European Agri-Food Chains<sup>1</sup>

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## Abstract

The role of trust in eight selected agri-food chains in four EU countries is explored. The empirical analysis is based on a qualitative assessment of 28 expert interviews conducted in summer/autumn 2005. The findings suggest that trust is more pronounced among SMEs which are characterised by the existence of personal relationships between business partners. However, as is clear for pork breeders, if a source of distrust exists, trust may not fully develop. Also, if the general economic situation is difficult, the development of trust may be hampered, because all chain participants are struggling to command a share of a diminishing margin within the chain. Finally, if economic power is distributed unevenly, as is the case in Germany, Ireland, Spain and the UK where retailers dominate most chains, trust towards the more powerful may be limited.

**Keywords:** *trust, economic relationships, EU, agri-food chains*

## 1. Introduction

Growing consumer expectations on the safety, quality and availability of food, along with increasing regulatory requirements and intensifying competition, have encouraged European agribusinesses to reorganise in integrated chains or networks. These structures imply increased mutual dependence and potentially add a new dimension to the risk of business

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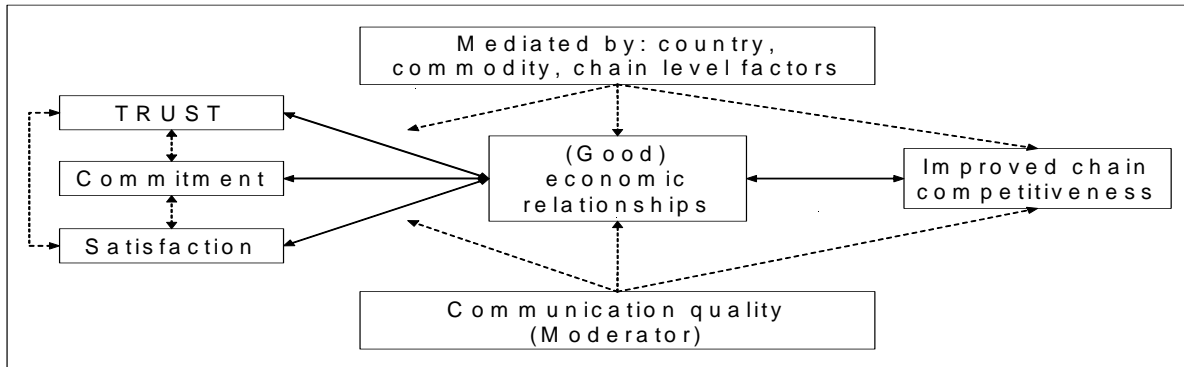
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failure, since the performance of a whole chain/network might be jeopardised by a single chain partner.

A key issue for chain/network performance is that if business partners can have trust in each other, contractual arrangements or other forms of transaction integration may be reduced or avoided, thereby reducing business costs (Chiles and McMackin, 1996; Sodano, 2002) and securing competitive advantage. In particular, transaction cost theory has argued that trust has the important effect of lowering opportunistic behaviour and hence exchange and agency costs (Suh and Kwon, 2003). Chen (2000) argues that trust is widely relied on in transactions involving relatively low monetary value and considerable resources are sometimes used in structuring contracts when the transactions involved have a relatively high monetary value.

Trust, of some level, is a prerequisite for exchange. It is the inter-personal reliance gained from past experience and it differs from confidence because trust requires a previous engagement on a person's account, recognising and accepting that risk exists (Luhmann, 1988). That is, trust is a relationship-based concept, which is created, reinforced, or decreased by bilateral, relational activities in a series of economic exchanges. Trust, therefore is distinctive to something involving goodwill. Trust is frequently defined as a willingness to take risk (Johnson-George and Swap, 1982; Kee and Knox, 1970; Mayer et al., 1995; Williamson, 1993). Trust is warranted when the expected gain from placing oneself at risk by another is positive, and the decision to accept such a risk is taken to imply trust (Williamson, 1993). Trust also involves the sub-dimensions of honesty, benevolence and competence (Anderson and Narus, 1990; Geyskens et al., 1998). Dapiran and Hogarth-Scott (2003) perceive it as a co-ordinating mechanism based on shared norms and collaboration within an uncertain environment.

Figure 1 summarises some of the overall issues to emerge from a literature review, focusing on socio-cultural aspects (Socio Cultural Economics), organizational collaboration (Relationship Marketing and Transaction Costs Economics), and the business environment (Interaction Approach and Network Theory). Economic relationships are embedded in and moderated by wider social, cultural, economic and political considerations. Trust and commitment are essential to good relationships, and these along with satisfaction are reinforced by good economic relationships. Good economic relationships in turn lead to improved chain competitiveness and vice versa. Communication in various forms is seen as integral to the improvement of both chain performance and trust. This is because it aids transparency in terms of: the business environment faced by the chain; the construction of price in relation to quality and other factors; the costs faced by participants; and what constitutes good practice and performance, thus providing a route to chain improvement. Moreover, regular communication between exchange partners, especially that of a more personal nature, builds a feeling of 'closeness' and 'trust' as well as helping to reduce conflict, improve co-ordination and build commitment.



**Figure 1.** The role of trust in agri-food chains

This paper explores the role of trust in selected agri-food chains in four EU countries. It is based on a qualitative assessment of expert interviews. After this introduction, section two describes the methodology used and discusses the main results. Section three concludes.

## 2. Methodology and results

Desk-based research, using existing literature and data, was undertaken to review and evaluate the four study countries in terms of social, cultural, economic and political factors (potentially) influencing economic relationships and communication, with a focus on the food chain environment of the selected commodities. The countries analysed were Germany, Ireland, Spain and the UK, whilst the agri-food chains analysed were barley to beer, cattle to beef, pig to pigmeat, cured ham and sausage, and cereals to bread. Desk research was complemented by primary data collection involving expert interviews during summer/autumn 2005. Face-to-face interviews were the preferred data collection method, however the telephone was used where the preferred method was impracticable for logistical reasons, or not possible due to constraints on the part of the interviewee. A semi-structured interview guide was used to explore the chain environment, the nature of chain relationships and the influences on their development, the nature and importance of chain communication, the role of institutions in chain regulation and development, and features of chain performance. On average each interview lasted an hour.

Interviewees were selected because of their ability to comment on the organisation and functioning of their sectoral chains. In total 28 experts were interviewed. These were largely senior executives or directors of representative or trade associations and some were senior personnel in significant enterprises in the respective countries. A list of interviewees is presented in the Appendix.

Whilst the interviews produced a wide range of useful information, the focus here is on the role of trust within agri-food chains. The results of two chains are reported for each country, with each product sector examined in two countries with the exception of cereals to bread, which is only examined in Spain and pigs to pigmeat, which is examined in three countries. Partners

selected product sectors for analysis on the basis of importance to their respective national economies. Importance was determined on the basis of factors such as contribution to national agri-food output, export orientation and growth.

#### *Germany – pigs to sausage chain*

Pig farmers in general feature a “healthy distrust” attitude towards their business partners. Upstream, their suspicion towards feed suppliers results from their perception of being “wooded” by commercial feed agents. The main reason for the lack of trust regarding their downstream partners is the limited transparency regarding the grading of fattening pigs and the related invoicing. Processors, in general, fear that hidden information exists regarding the quality (above all the fat content) of the fattening pigs provided by suppliers.

With respect to distributors, processors’ trust in them depends on their overall reputation. For retailers, the political environment regarding health risks and food safety has become more demanding as product liability regulation is enforced more strictly. Thus private label sellers generally aim to reduce liability risks by tending to prefer “control” over “trust” regarding their product manufacturers. As a result, suppliers are increasingly under pressure to comply with the quality specifications of retailers, which does not help to improve strained relationships. Overall, distrust seems to be distributed evenly across sausage chain actors.

#### *Germany – barley to beer chain*

Malting barley farmers in general rate highly the importance of personal relationships. In particular, personal relationships between farmers and barley traders have led to joint economic actions. For instance, besides conducting business with each other, farmers arrange the joint acquisition of costly machinery with traders (i.e., both sides engage in specific asset investments). Overall, farmers’ trust in maltsters varies depending on the latter’s size, past experience and existing relationship management initiatives. As brewers are experiencing a decrease in profits due to an increase in production costs and a reduction in real beer prices, trust is marked by economic tensions.

While upstream “healthy distrust” exists, brewers trust food retailers least. For instance, under-priced kegs sold by food retailers to catering enterprises can undermine existing beer delivery contracts between brewers and pubs. Since beer wholesalers in general do not try to bypass the existing delivery contracts, processors trust them more. For distributors and brewers alike, beer has become an uncertain market as per capita consumption has decreased and global and domestic players have started conducting acquisitions of beer makers and outlet channels in Germany. Therefore, currently, comparatively high levels of distrust exist in the whole chain. However, contrary to the pig sausage chain, overall it appears that trust is more prevalent and personal relationships are more significant upstream.

### *Ireland – cattle to beef chain*

The business environment for Irish beef has changed dramatically in recent years with significant implications for farmer-processor relationships in particular. Historically Irish beef producer-processor relationships were transaction-based with price the main transaction issue. However, with CAP reform and the need to develop alternative outlets to intervention, there is evidence of closer relationships developing between producers and processors as a means of accessing specific commercial markets. These new relationships are based on verbal agreements covering product specifications including production methods, e.g., feeding and management regimes, and price. Specific investments are generally required in these relationships. Such specific investments may include financial investments in housing and feeding equipment by a farmer and investment in providing management and nutritional advice to the farmer on the part of the processor. They depend on past experience involving mutually satisfying past exchanges, so that trust has been developed to a level of trust sufficient to induce these investments. Whilst unbalanced in terms of level of risk, these specific investments create some mutual dependence and trust, and allow the processor to develop sustainable markets abroad. Research for this paper estimates that 10% of Irish beef slaughterings are now based on such types of relationships. This figure is slowly increasing, however, there is still quite a high level of mistrust between farmers and processors in the sector with occasional allegations by farmers of price collusion between processors.

Processor-retailer relationships involving multiple retailers are generally quite exclusive and are frequently called ‘partnerships’ by the trade press and the involved parties. The retail sector in Ireland and in the UK, Ireland’s main export destination for beef, is highly concentrated, which means that such partnerships are generally directed by the multiple retailers who have considerable power, i.e., they act as the chain captain. Switching costs in such relationships tend to be high as processors generally adapt to retailers’ requirements and make specific investments to maintain and develop the relationships. Relationships involving independent retail outlets generally involve processors of much smaller scale than those dealing with multiple retailers. Such relationships are usually long-term in nature, with personal relations having a significant influence in supporting trust.

### *Ireland – pigs to pigmeat chain*

Producer-processor relationships are characterised by a lack of trust in the Irish pigmeat sector. A lack of price transparency is one of the reasons for this. Whilst pigs are sold to the slaughterhouse on a deadweight grading basis (with lean meat percentage within a specified weight range the grading criteria), Tuite (2003) found that the base price for pigs varied between 81% and 89% of the net delivered price paid during a week (mid-August 2003). He believes that there is a need for an industry-wide drive to increase the base price and reduce the size of bonuses, as the latter can be altered by the slaughterhouse without any reference to market conditions. These relationships are also characterised by an absence of contracts. Transaction costs associated with enforcement are a significant barrier to contracts. Scarce supplies mean that processors cannot afford the negative publicity associated with enforcing contracts. Another reason is the high reliance of the industry on the domestic and UK market

(almost 90% of output is destined for these two markets) which have broadly similar requirements. Thus, unlike the beef industry, there is no need for the contract production and associated specific investments to suit specific markets.

In relationships between processors and retailers/catering there are moderate to fairly high degrees of trust, stable networks and regular and repeated streams of transactions. The large volume traded by the big retailers creates a mutual dependence, where the processor becomes dependent on a few large customers, but the retailer depends on its preferred supplier for safe, reliable and timely deliveries. Retailers regard their relationships with processors as close and quite open. Some retailers share information on end users based on their sales data with processors, especially in cases where processors supply products to the retailer's private labels. Information flow may also be high where value-added products are being produced, as dealing in value-added pork products typically requires the processor to conform to retailers' specific quality assurance schemes and to invest in retailer specific processing and product development. The trust and commitment in the relationship can ensure that such transaction-specific investments are being carried out, the effect of which is higher switching costs.

#### *Spain – pigs to cured ham chain*

In the swine to cured ham chain in Spain, reputation is an important source of trust, and becomes more relevant upstream, at the producer and processing level. Farmer-to-farmer relationships are based on friendship. Farmers tend to concentrate and consolidate into fewer and larger farms, organised either as private corporations or co-operatives. Many swine producers belong to professional associations; they all know each other and defend common interests and goals. Farmers in co-operatives exchange information and have personal contact with other co-operative farmers. As Spain has a system of reference prices for hogs, with price fixed by the Mercorleida Board<sup>1</sup>, farmers do not compete on price. Thus there is a co-operative atmosphere and strong associative bonds between farmers. The outbreak of livestock-related diseases, and their possible transfer to humans, has underlined the necessity for a reliable system to trace individual meat products back to its animal of origin. Many large processors are vertically integrated with hog producers to ensure traceability of the animals. Meat industry pressures for assurance on traceability and production techniques will help to promote confidence in the integrity and origin of their products.

Processors believe that their relationship with producers is more stable and trust driven than their relationship with the retailing sector. The bargaining power of retailers affects the relationship with processors, who feel pressured to comply with retailer demands. The retailing sector is driven by economic factors. Retailers seek to offer a homogeneous product to their customers and therefore maintain stable relationships with a reduced group of suppliers. Retailers trust the integrity of this selected group of suppliers. New food safety and traceability measures have increased co-ordination along the chain, favouring a process of

1. The Mercorleida Board is the main institution that sets reference prices for pigs. Prices are negotiated by an equal number of designated buyers and sellers of hogs. They meet once a week and fix a price considered representative of the actual supply and demand conditions. This price serves as a reference for more than 90% of pig transactions.



vertical integration and co-ordination. Also, the domestic market shows a clear upward trend in the demand for higher quality and priced cured hams. All actors in the chain seek to produce a marketable product complying with the safety and quality standards. This common goal helps to build commitment and trust between partners in the chain.

### *Spain – cereal to bread chain*

The cereal to bread supply chain in Spain is very fragmented at the producer level, which complicates communication and business relationships from farmer to farmer and farmer to processor. Spanish production of wheat is highly variable in terms of quantities, but also in terms of quality. Climate variability is one factor influencing the lack of homogeneity in final production, however, another is the low level of certified seed use in Spain. Such variability affects the market negatively and creates a climate of insecurity for the milling industry. In the last few years there has been increased integration of farmers into 1<sup>st</sup> and 2<sup>nd</sup> degree<sup>1</sup> co-operatives, as a way to assure product quality and quantity.

Processors tend to have stable suppliers, with trust-based exchanges being important. The lack of homogeneity of Spanish wheat production requires steady relationships between millers and a reduced number of producers to assure the quality of wheat produced. Interactions between big importing companies and millers are more distant; personal interrelationships become less relevant and exchanges are bound by written contracts. Bakers seek to assure continuity of wheat flour supply. Since profit margins are very low all along the chain, personal relationships become important for bakers to establish verbal agreements with millers. The increasing size of the retailing sector makes the relationship between bakers and retailers more impersonal, and trust shifts from being interpersonally constructed to more based on reputation.

### *UK – malting barley to beer chain*

In the UK barley to beer chain the business environment is characterised by considerable uncertainty. Grain prices can fluctuate markedly and the chain operates within a very competitive international trading environment. Excess malting capacity exists in Europe (80% utilisation), and barley typically represents 60-66% of malt production costs (SAC, 2004). Businesses operate on very tight margins at all levels. In this environment, maltsters and brewers seek supply security, cost predictability and assured quality in their purchasing activities. Consequently, they issue contracts to upstream suppliers to secure a significant proportion of their raw materials.

The chain involves close personal relationships at all stages. Although contracts are issued by grain merchants and cooperatives (to secure 30-60% of maltsters' requirements), trust in the competence and integrity of the grower is very important, because the transaction costs associated with contract enforcement are significant. Thus trust and the use of contracts are

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1. 1<sup>st</sup> degree co-operatives are co-operatives between individual farmers. 2<sup>nd</sup> degree co-operatives are co-operatives formed by groups of 1<sup>st</sup> degree co-operatives.

complementary phenomena. Generally speaking, farmers exhibit limited trust in the prices offered by maltsters. This is largely due to the sector's low profitability and limited transparency in the economics of the chain, or integration in its working. At the brewer-retailer end of the chain a degree of trust prevails, but contracts and supply agreements are used extensively to secure supplies, particularly of important brands.

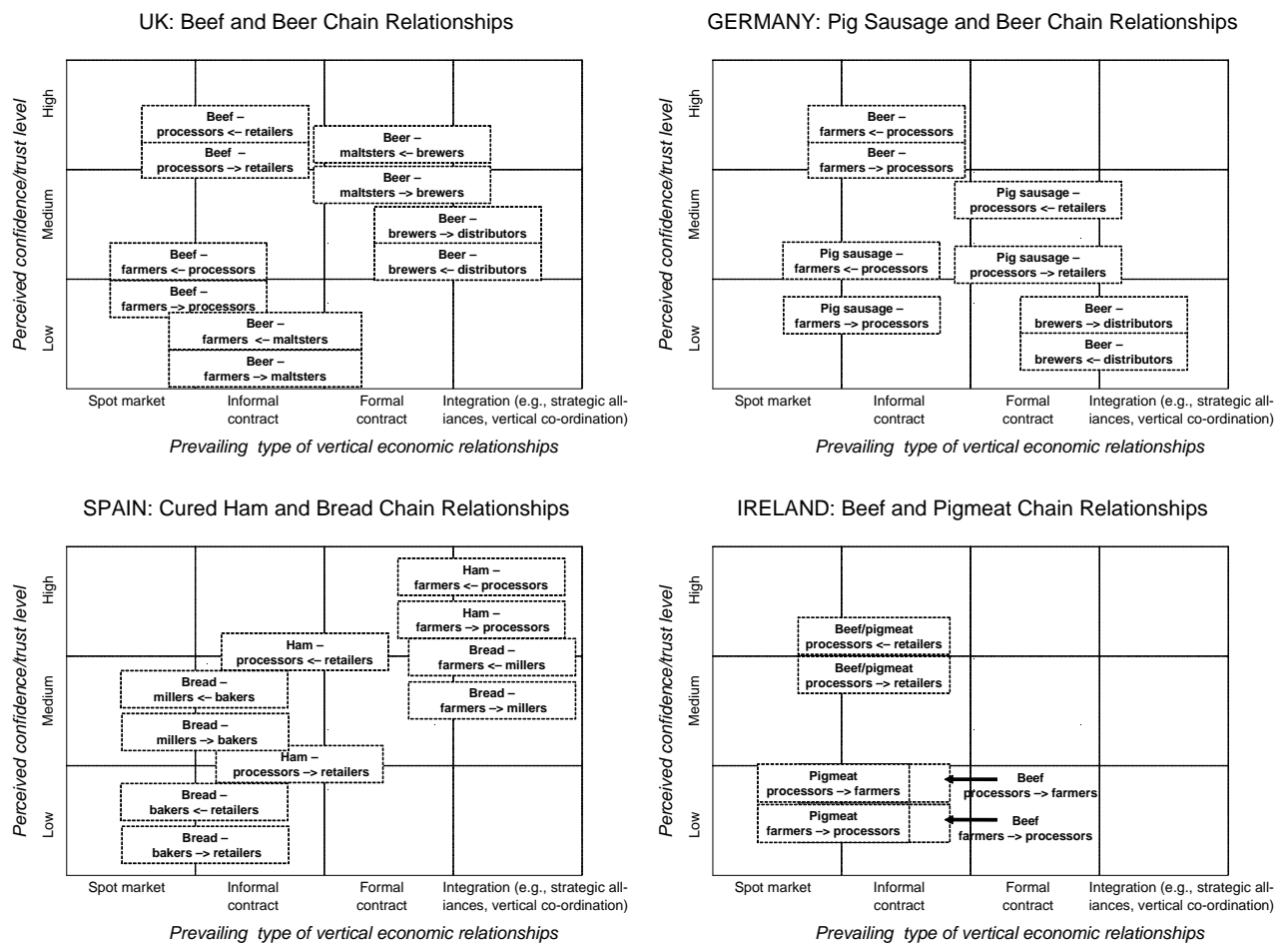
#### *UK – cattle to beef chain*

The UK beef chain also operates in a very competitive environment, in which there are significant imports (30% of supplies) and UK exports are very restricted. There is also marked excess slaughtering capacity. Whilst liveweight auction markets provide transparency to price setting, they cover only 23% of finished cattle marketings (MLC, 2005). The majority of cattle are sold direct to slaughterers on a deadweight basis (price depends on carcass weight and quality), whilst the retail market (70% of domestic market) is dominated by multiple retailers (>75% of sales). Large retailers seek competitive beef prices, appropriate quality for the segment concerned, supply continuity, efficient supply chain performance and innovation at reasonable cost.

There is considerable mistrust at the farmer-processor level, which centres on price. Farmers widely consider that multiple retailers are depressing their returns (e.g., capping prices by importing beef and taking disproportionately high margins). Such retailers believe, however, that many farmers do not understand the economics of the entire chain, and seek to drive chains in which all parties can benefit. Chains involving independent butchers generally have good personal relationships, considerable trust at all stages, and a reliance on spot market transactions. Multiple retailer chains are integrated through partnerships; retailers with slaughterer/processors, and slaughterer/processors with farmers through producer groups or clubs (Fearne, 1998). Such chains are highly directed and regulated by the retailers, which generates trust with respect to competence, but there are few contracts. Mutual benefit and necessity bind the partners. Contracts are most evident in the supply of caterers and food manufacturers, where supply continuity and cost predictability are important.

### **3. Conclusions**

Figure 2 summarises the pattern of relationships and trust observed in the eight chains under review. It should be recognised that these figures represent a generalisation of the situations observed, and that there will be specific supply chains and relationships which fall outside the patterns presented. Several general points are apparent.



**Figure 2.** Agri-food supply chain relationships and trust levels in 8 analysed chains.

*Note: Trust levels within a relationship may not be equally held. The direction of the trust perception is indicated by the arrow. Thus 'farmers → processors' indicates the trust of farmers in processors.*

### Trust levels

Considerable mistrust is apparent at the farmer end of many of the observed chains, with numerous farmers having limited confidence in the fairness of their treatment by downstream customers (e.g., UK malting barley and beef, Irish beef and pigs, and German pigs). Several factors seem to play a major part in this generation of mistrust, including:

- price pressure in a very competitive international trading environment which means that supply chain participants are competing for a share of the chain's margin which itself is under pressure (e.g., UK beef, Irish pigs and German beer);
- a lack of transparency in the quality achieved by agricultural products and the resultant price consequences, and of the economic pressures facing others in the chain (e.g., Irish and German pigs); and,
- an imbalance in the scale and market power between farmers and many of the downstream supply chain participants. A small scale of production, combined with chain fragmentation, may create a feeling of insecurity amongst those concerned (e.g., Spanish wheat producers and millers, UK malting barley producers).

Further downstream the pattern of trust between chain participants is quite varied. Regulation with respect to food safety and traceability has driven considerable chain integration in all countries, providing standards which set a minimum threshold for chain involvement. Major chain players, such as multiple retailers, have sought to add further supply conditions, narrowing their supply base and building closer relationships with relatively few suppliers. These developments might be regarded as assisting the development of trust in the competence of suppliers. Goodwill trust, where a party goes beyond contractual requirements to the mutual benefit of chain participants, is not generally apparent, although it may be constrained by inadequate communication on issues such as quality and price improvement. Moreover, in very competitive chains, with margins under pressure, goodwill trust is likely to be suppressed by self-interest.

### *Trust and relationships*

With respect to the nature of transaction relationships, it is evident that spot-market transactions feature at all levels within the chains. For many farmers this is associated with maintaining their independence (this is particularly apparent in the UK and Germany). The findings to date suggest that while the development of trust based on personal relations can offer (transaction) cost advantages in business relationships, it may be complemented by formal contracts or other forms of integration as the involved stakes rise. The role of contracts in competitive environments is not so crucial for those firms with extensive bargaining power, as they may be able to create partnerships which offer benefits such as a regular large volume outlet, and/or a share of a relatively good marketing margin. The exact level where the switch occurs from trust based on social relations to the use of formal contracts or institutional systems, depends on a variety of chain (business), cultural, social and personal characteristics.

Overall, it seems that trust is more pronounced among SMEs, which are characterised by the existence of personal relationships between business partners. This is above all the case in the farm sector. However, as is clear for pork breeders, if a source of distrust exists, such as the lack of a clear definition of carcass quality and thus fair financial compensation, trust may not fully develop. Also, if the general economic situation is difficult, as is the case in many agri-food markets, the development of trust may be hampered, because all chain participants are struggling to command a share of a diminishing margin within the chain. Finally, if economic power is distributed unevenly in an agri-food chain, as is the case in Germany, Ireland, the UK and Spain where retailers dominate most chains, trust towards the more powerful may be limited.

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## Appendix

### Key Informant Interviewee Details

<i>Country</i>	<i>Interviewee Name</i>	<i>Job Title</i>	<i>Organisation</i>
Ger-many	Herbert Siedler	Head of Section	Bavarian State Dept. of Agr. and Forestry, Wuerzburg
	Michael Starp	Managing head of dept. for livestock & meat	German Farmer's Association (DBV)
	Roland Demleitner	Managing Director	German Association of Middle-Sized Private Breweries
	Thomas Vogelsang	Managing Director	German Association of Meat Product Manufacturers (BVdF)
	Günther Guder	Managing Director	German Federal Association of Beverage Wholesalers
	Angela Schillings-Schmitz	Meat sector specialist	European Retail Institute (EHI)
Ireland	James Brady	Exec. Sec. to Piguemeat Comm.	Irish Farmers Association
	Brendan Lynch	Head of Pig Advice & Research	Teagasc
	Kevin Kinsella	Exec. Sec. to Beef Committee	Irish Farmers Association
	Michael Barry	Meat Industry Executive	Irish Assoc. of Piguemeat Processors
	Cormac Healy	Meat Industry Executive	Meat Industry Ireland
	Pat Brady	Chief Executive	Irish Association of Craft Butchers
	Michael Murphy	Manager of International Markets	Bord Bia
Spain	Rolando Pola	Cereal Sector Manager	Arento (cooperative)
	José Oliván	General Manager	Llograsa, S.A.
	José Villamayor	General Manager	Harineras Villamayor, S.A.
	Isidro Martín	General Manager	Turolense Ganadera, S.A.
	Mario Moreno	General Manager	Panishop, S.A.
	José María Rubio	Meat Sector Manager	Sabeco, S.A.
UK	Lisa Webb	Livestock Policy Manager	National Farmers' Union Scotland
	John MacIntosh	Group Chairman and farmer	ANM Group Ltd.
	Alan McNaughton	Sales Director	McIntosh Donald (Grampian Country Food Group)
	Bill Dobson	Strategic Sourcing Manager	Coors Brewers
	Elaine McCrimmon	Senior Policy Adviser - Brewing	British Beer and Pub Association
	Christopher Ling	Buying Mgr (Beef and Lamb)	Tesco
	Pamela Bates	Snr. Policy Adviser - Pubs & Leisure	British Beer and Pub Association
	Duncan Sinclair	Economic Manager for Beef	Meat and Livestock Commission
	Chris Barnes	Manager - Cereals Industry Forum	Home Grown Cereals Authority