18th Annual IMP Conference:

5-7 September 2002

Dijon-Burgundy Graduate School of Management

Group ESC Bourgogne, Dijon, France

'Greening' Relationship Marketing: The Case of Organic Foods

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Introduction

Interest in organic food has developed progressively over the last two decades. Purchase behaviour is interlinked with environmental concerns, animal welfare and claims of negative environmental and human health impacts of high agrochemical input based agriculture reliant on artificial pesticides, herbicides and hormone based animal growth promoters. Additionally, major 'food scares' such as that of *bovine spongiform encephalophathies* (BSE) and concerns over Genetically Modified (GM) foodstuffs have increased interest in organic production and food. Markets for organic produce vary greatly in their state of maturity and to some degree by the motivations of consumers. Emergent markets are often driven by ethical, personal and family health and a whole raft of 'green' concerns, whereas more mature markets settle down to mainstream product marketing issues of pricing and supply. Nevertheless the market for organic food is growing (although at different rates in different countries). Research carried by the leading grocery retailer Tesco, in the UK, found that 63% of their customers would buy more organic food if it were available in store and 60% cited that they were buying more organic produce (Tesco 2001). This investigation seeks not to discuss what motivates people to buy organic produce, nor the environmental or ethical issues and claims with regard to health; but how the market may develop in a country once the emergent stage of development is past and how issues of pricing, availability and supply management will be resolved. Investigation will focus on the UK, which has a long history of niche and specialist production and supply and where only recently have organic products reached the mainstream and become the predominant preserve of the country's powerful supermarkets.

Organic market development

Against a background of market saturation in the European food industry, the demand for organically produced foods has shown phenomenal growth in recent years, with a current European value of £14 billion and predictions are that this growth will continue by 25 per cent in the next four years (Taylor Nelson Sofres 2002). In the UK, the market is worth £800 million (Taylor Nelson Sofres 2002), but Germany has the largest market value for organic food in Europe at £1.6bn (Slaley *et al* 2002; Wier and Calverley 2002), which is as much as three or four times larger than most other European countries. It is the Danes, however, who are the largest *per capita* consumers of organic food in Europe (Slaley *et al* 2002; Wier and Calverley 2002). Given such encouraging market predictions, growth projections do, however, vary markedly by European country. In the UK for example, growth projections are at the top of the European growth figure cited above, but in Denmark and Germany the market is more mature and therefore growth predictions, for example, for Denmark are in single figures (Slaley *et al* 2002).

Tesco – the UK market leader in food retailing (including organic foods) have set themselves and their suppliers a target to achieve a £1 billion Tesco market value by 2005/6 (Tesco 2001). Tesco claim to have 30% of the UK organic food market in the UK, with a current value of £240m (Tesco 2002). Enthusiastic advocates of organic production systems would like to see 30 per cent of the UK farming organically by 2010 (The Organic Food and Farming Target Bill 1999; Jones *et al* 2001). Some people predict, however, this to be much less; at this time, a mere 1.5 per cent of land in UK is farmed organically, and subsidy arrangements for arable crops tend to favour 'conventional' production. In terms of market share, in the UK, for example, organic food accounts for only about 1.5% of the market as compared with 3% in Denmark (Taylor Nelson Sofres 2002; Wier and Calverley 2002). The Tesco aspiration of £1bn sales in their stores, would mean 5% of their food being organic (Tesco 2001). Currently across Europe, and notably in the UK, the situation is one of demand outstripping supply, in fact, in the UK some 80 per cent of organic foods is imported (Tesco 2001). Mindful of this and the unrealised market potential of organic foods, Tesco have set the UK farming and food industry a '£1 billion challenge' from which the retailer aims to substitute at least some of the imported food products for home-produced organic foods (Tesco 2001). Jones et al (2001) cites similar initiatives from UK retailers Marks and Spencer and Asda in their respective bids to source direct from UK organic farm suppliers. Tesco claim to be already realising some success through this policy, whereby they have been able to 'repatriate around £15m of products back to the UK'.

European consumers are attracted to organic foods primarily for reasons of health (with respect to issues of pesticide residues, animal growth promoters, food additives, BSE and so forth), taste, and additional claims of environmental and animal welfare gains, including issues such as whether products are free of genetically modified material (Slaley *et al* 2002; Wier and Calverley 2002). Squires et al (2001) concur with this, but also conclude that purchasers of organic food do so because of their desire to identify with express 'green' credentials. Consumers are prepared to pay premiums, but as the market has become more established the supermarkets have taken a larger share of the market. In the UK, for example, 80 per cent of the organic market is in the hands of the supermarkets (Slaley *et al* 2002; Mintel 2000), with the remainder split relatively evenly between direct sales outlets (such as through farm gate sales or farmers' retail markets) and sales through the independent sector (specialist 'health' shops and specialist outlets such as fruiterers and butchers). Latacz-Lohmann and Foster (1997), in drawing comparisons between the development of the organic food markets in the UK and Germany, contend that because in the UK the market is dominated by large supermarkets, the UK is 'not effectively meeting demand because of structural differences between organic farming and supermarkets'. Likewise, Wier and Calverley (2002), identify problems of 'insufficient sales infrastructure', whereby organic foods have to pass through a numbers of stages and channels in order to reach the market. This lack of infrastructure was identified too in the fledgling Irish organic market in Roddy et al (1994). In Germany, by contrast, where the market is supplied on a much bigger scale from small-scale, decentralised 'specialist' food outlets, the, to date, far larger German market is suffering form the lack of cohesion and standardisation that supermarkets bring. There is certainly an argument to suggest that the UK has been late in the development of the organic market in comparison, for example, with Germany. This in respect to mainstream marketing, as opposed to 'grassroots' interest, which is long-standing in the UK. In the UK the market is highly concentrated in the hands of large supermarkets, and this has meant that once those supermarkets identified a huge latent consumer demand and championed the organic sector, then growth in very recent years has been rapid. However, the issue of 'structural differences' between traditional (and perhaps 'ethically' motivated suppliers, is serious and perhaps the motivation behind initiatives such as the Tesco one, where such large retailers are facing shortfalls in supply as they try to 'bring on board a new generation of suppliers'. These suppliers may not necessarily be primarily motivated by environmental and ethical concerns, but by emerging commercial opportunities.

Immature and disjointed supply chains have brought further problems. In the UK, organic milk supply has had a roller-coaster ride throughout its early development. Over-confident market estimates encouraged a surge in interest from producers wishing to cash in on 'dizzying growth figures' (Anon 2002), based on the preconception that committed organic milk buyers were prepared to pay excessive margins in the early days of interest in organic food products in the UK in 1998/9. This led to unsustainable growth projections, an oversupply situation and crashing producer prices in 2001/2. Anon (2002), places the blame for this on the lack of consumer market research. This is certainly also a case of a lack of co-ordination between members of the supply chain, leading to supply 'bottlenecks'; an issue also noted by Wier and Calverley (2002), who regard the number of stages and channels that organic products need to pass through as 'not always sufficient stable or flexible enough' and see this as a barrier to large scale production and consumption. As retail competition in the UK has become more intense, and farm gate prices and price premiums have already become eroded, some organic suppliers are fearful that returns to farmers will be rapidly reduced as their supermarket customers compete fiercely on price. Dowding (2002) acknowledges farmers' weak negotiating position with their powerful multiple retail customers, but sees the need to adopt a relationship based approach, in which producers should 'reconnect' with food supply chain in order to 'build consumer relationships'; but also that relationships with retailers should be 'equitable'.

Slaley *et al* (2002) summarise the following as the most significant supply and demand factors with respect to organic food purchases:

Demand:

- Price (including price relative to conventionally produced equivalents)
- Quality (appearance, taste)
- Availability (range and continuity of supply)
- Credibility of the 'organic' industry (conforming to national and EU standards and endorsement by certification bodies / sector bodies)
- State of the economy (periods of recession do have an impact in slowing conversion rates)

Supply:

- Conversion rates (2-4 years for producers to convert to organic status)
- Subsidy levels
- Organic standards (changes to)
- Infrastructure (levels of processing, marketing and technical support)

The relationship that consumers' have with price is complex, there are those 'greener' and more committed consumers who will seek out organic alternatives across the range of food and drink products, whereas others will be deterred by what they see as excessive differentials between conventionally produced and organic products (Slaley *et al* 2002). This difference is noted by Latacz-Lohmann and Foster (1997) in a study of the different attitudes of UK versus German shoppers; where UK buyers (used to intense supermarket competition) perhaps view organic foods like any other and are therefore less prepared to pay what they see as excessive margins above conventionally produced equivalents. German consumers traditionally appear to be prepared to pay more for organic produce. This is confirmed in Wier and Calverley (2002), where the willingness of German (and Dutch) consumers to pay up to 30 per cent premiums is cited, whereas British and Scandinavian shoppers are much less likely to be prepared to pay such premiums (Wier and Calverley 2002; Magnusson *et al*. 2001). Once again there is a link here with the strength and market concentration of supermarkets in Britain and in the Scandinavian nations, for example in the UK, Denmark and Sweden where supermarket penetration is high and markets shares concentrated in the hands of few, large retail groups. British and Scandinavian consumers, of course, are much more likely to make purchases of organic produce in supermarkets rather than specialist retail outlets.

With regard to support mechanisms for organic production in the EU, there does appear to be an 'unlevel' playing field. In the UK, the Organic Aid Scheme launched in 1994 did provide some incentive for farmers to convert to organic, but only provided a very small budget to support the initiative, whereas in Germany, for example, 'generous conversion payments' have been made (Latacz-Lohmann and Foster 1997). Similarly, Squires *et al* (2001) attribute the 'high level of development of the Danish organic food sector' to strong support and direction from government as well as to a strong relationship between a concentrated retail industry and farm suppliers. Subsidy levels are made (on a comparable basis across EU countries as general enterprise production payments as, for example, livestock headage or arable area payments) however, specific subsidies are applied on a more uneven basis between countries, as conversion subsidies and stewardship schemes (Slaley *et al* 2002). This has an effect on conversion rates to organic production, with long lead times it could be some time before a producer realises profit from his venture and this is made all the more difficult by insufficient support mechanisms from national government. Similarly organic standards do vary between European countries; there are common European-wide and nationals standards (for example in the UK the *United Kingdom Register of Organic Food Standards*, UKROFS), however, there are subtle differences in standards between the 10 different UK registered organic certification bodies. This high number of certification bodies and potential issues of 'infighting' between them may itself be a matter for confusion for consumers when selecting organic produce endorsed by so many different and competing certification bodies. Another difference, between the approaches of European countries is in the sophistication of marketing and technical/ advisory support on offer. In Gemany for example, there is a more established channel of producer co-operation via, for example, influential co-operatives such as Demeter, Naturland and Bioland (Latacz-Lohmann and Foster 1997). Further, in Germany, certification bodies have a much wider role in the marketing and advisory process than in the UK (Slaley *et al* 2002).

Methodology

Previous studies have focused on consumer attitudes to organic production and foodstuffs, as well as ethical issues and alternative distribution systems (e.g., Davies *et al* 1995; Jones *et al*. 2001; Magnusson *et al*. 2001; Mintel 2000). However, this exploratory study proposes to determine the nature of the supply chain for organic foods and the relationships of key supply chain members with the principal retail marketing organisations, namely the supermarkets. The focus of the study will be in the UK, where the market is still in a growth phase. The rationale behind this is that as supermarkets are clearly the most significant players in the food market in the UK, it is their relationship with (organic) food producers that will determine the course and development of the future market. This approach of investigating principal supplier-retailer relationships follows on from traditional IMP research and specifically from previous work conducted into supply chain relationships between fresh food suppliers and powerful multiple retail buyers (Blundel and Hingley 2001; Hingley 2001).

The methodology for gathering evidence which will be used to answer the research questions, is the case study approach, in the first instance involving a principal UK retailer, as well as suppliers of UK-based diverse organic food products. The principal UK retailer, which was chosen, is Tesco, the market leader for food (and specifically organic produce) in the UK.

Tesco is also known to be interested in gaining a deeper understanding of how its business operates and is co-operating with a number of research institutions in the UK (e.g. at Harper Adams University College and Newcastle University). Among several research projects that Tesco has been involved with is a project on supply chain relationships in UK food and farming industry (Hingley and Lindgreen 2001). It is, therefore, believed that Tesco and its suppliers will be prepared to invest enough time in investigating the research questions together with the researchers.

An interview protocol will be developed for the research purposes and questions designed to elicit responses with regard to 'relationship factors' explored in the previous literature on existing business-to-business and supply chain relationships (e.g., Anderson and Narus 1990; Fontenot and Wilson 1997; Lindgreen 2001a; Wilson and Vlosky 1997). All interviews will be recorded and transcribed. For all stages of the research, the analysis of case study data will be carried out according to 'guidelines' suggested in the literature (e.g., Miles and Huberman 1994; Lindgreen 2001b). Following this interview summaries will be sent to each participant for review. This review process and the use of multiple sources of evidence will help to improve the validity of the data (Eisenhardt 1989; Yin 1994).

Principal research questions that will be addressed include the following:

- How, if at all, do supplier-retailer relationships influence the organic food supply chain?
- How, if at all, do the relationships between Tesco and its traditional food suppliers differ from the relationships between Tesco and its suppliers of organic foods?
- What, if any, effect do national and EU subsidy arrangements have upon the ability of food producers to supply the market with organic foods?
- What, if any, is the role of influential standards and regulatory bodies in the marketing of organic foods?

Any available preliminary findings will form the basis of presentation of this working paper at the conference.

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