

Supplier-Retailer Relationships In The Strategy Of International Retailers: Empirical Evidence From Russia

Work-in-Progress Paper

Zsombor Pall¹, Marina Sheresheva² and Jon H. Hanf

*¹Institute of Agricultural Development in Central and Eastern Europe (IAMO),
Halle, Germany*

*²State University - Higher School of Economics, Department of Strategic Marketing,
Moscow, Russia*

Abstract

The purpose of the paper is to analyze the role of supplier-retailer relationships in the strategy of international retailers penetrating Russian market which is now one of the most attractive in the world. This is underlined by the second place of Russia on the 2009 Global Retail Development Index of the consultant A.T. Kearney. Over the past decade, the impressive growth of the Russian retail market was accompanied by numerous changes, among them: increased power of retail chains; fast development of new retailing formats; outpacing growth of retailing operations in most Russian regions away from Moscow and St. Petersburg; emerging of strategic alliances and associations. All these processes were clearly accelerated by recent arrival of foreign retail “heavyweights” (Auchan, Metro et al.) well known for their aggressive marketing strategy and the successful implementation of modern business practices. Their fast growing activity in Russia corresponds to the fact that internationalization is one of the most important trends accelerated in the last two decades (Zentes et al 2007). Taking a look at the top 200 global retailers, almost all players except those in the US operate in numerous countries, having established a noteworthy business capacity in foreign markets (Deloitte, 2006). Internationalization for retail companies is not only an option but rather a necessity to achieve growth due to several push and pull factors (Hanf et al 2009).

The paper is based on the statements that (1) internationalization for retail companies is not only an option rather a necessity to achieve growth and (2) the business trend of inter-firm cooperation is consistently growing. We aim to look at whether there are any trends inherent in the top in the current market context in Russia. This paper takes network paradigm as a main basis of investigation looking at the development of Russian retailing mainly under the of the IMP research tradition. In line with this tradition, the market can be described as networks of multidimensional exchange relationships between business actors. These actors control heterogeneous, interdependent resources and conduct inter-linked activities. Collaborative relationship management and procurement practices are of crucial importance (see, for example, Ford et al, 2003; Gadde and Håkansson, 2001).

The paper is organized around the following topics. Firstly, we give a brief overview of relevant literature. Secondly, we give a brief overview of the developments in the Russian retailing pointing out the main differences in the competitive positions of the local retailers vs. multinational retailers. Focusing on the question whether international retailers export their business models in new countries, we aim to identify the different strategic groups of international retailers. The main attention will be paid to the recent changes in supplier-retailer relationships in Russian retailing and their role in the international retailers’ strategy. Our previous research has shown that there are clear signs of reconsideration of the view of efficiency in customer-supplier relationships in Russian retailing (Tretyak, Sheresheva, 2005; Sheresheva, 2009). In case of foreign retail chains, the relationships with Russian suppliers demonstrate some specific features which probably are proper especially for Russian market.

Results of our survey with retail managers in Russia will be obtained later in 2010-2011 and therefore could not yet be analysed in the paper. Preliminary results presented in the paper are based on the secondary data (journal articles, consultant studies, business journals and case studies) as well as on the in-depth interviews with managers of international retailers and retail experts conducted in 2009. The interviews were explorative, allowing access to respondents’ thoughts, opinions, attitudes, etc. So, the emphasis was on the qualitative methods which are the most appropriate if understanding and explanation are the main target of research.

Keywords: relationships, retail internationalization, supply chain network, Russia

Introduction

Internationalization is one of the most important trends in retailing today. The CIES (International Committee of Food Retail Chains) Food Business Forum has questioned top managers of the food industry about this economic topic, which will probably dominate the professional discussions. The prevailing answer with almost 70% was “the internationalization of food retail business”. If the majority of business people in the food industry agree that the internationalization of the retailing system is a serious topic for their discussions and reflections, it is logical to assume that firm managers believe that the respective development entails either a dangerous and general threat or a great and promising opportunity. Retail internationalization is not new, however has accelerated in the last two decades (Zentes et al 2007). It was less than 30 years ago that almost all of the world’s retail firms were pure national firms with a negligible share in foreign markets. That scenario has changed dramatically. Taking a look at the top 200 global retailers, almost all players except those in the US operate in numerous countries, having established a noteworthy business capacity in foreign markets (Deloitte, 2006). Today, many retail companies earn a significant share of their revenue in international markets. For instance, over 50% of the sales of the German retailer Metro and over 80% of the sales of Dutch company Ahold come from the foreign operations. Internationalization is driven by several push and pull factors (Hanf and Dautzenberg 2009). The main pull factors are the increasing purchasing power of Eastern European and Asian consumers and the underdeveloped retail sector of these countries. The most important push factors are the saturated markets in Western Europe and in the United States. Therefore internationalization for retail companies is not only an option, but rather a necessity to achieve growth. It can be observed that by going abroad retailers export their business model into new markets, having a serious impact on the entire chain.

The direction of retail internationalization, the selection of countries retailers choose to expand their markets, and the degree of adaptation is influenced by the competitive strategy of retailers. However retailers often export their business model in new countries.

The fall of communism in the 1990s saw the Eastern Block countries become the focus of research attention, with Russia emerging as a key market for international retailer expansion (Myers & Alexander, 1997; Roberts, 2006; Alexander & Doherty, 2009). Actually, the key markets for retailers internationalizing their concepts are Russia, India, and China, but “academic research is still trying to keep pace with the rate of these practical developments” (Alexander & Doherty, 2009). That’s also the point concerning supplier-retailer relationships in Russia. There are few relevant publications (Radaev, 2003, 2008; Tretyak, Sheresheva, 2005; Salmi, 2004), still there is an obvious lack of analysis of interaction processes and changing connections of business relationships in Russian retailing.

The paper is structured in the following way. It starts with a literature review on retail internationalization and then presents a view on markets that is based on the conceptual developments within the IMP Group. empirical evidence is presented, discussing changes in the Russian retail sector. The

Enablers of Internationalization and Market Behaviour of International Companies

It is a fundamental issue in the international business research; for a long time scholars have been engaged in the question as to why international companies can be successful in other countries. The market imperfection (Hymer, 1976), resource advantage (Hunt, Morgan, 1995, 1996; Hunt, 2002) and eclectic (Dunning, 1980, 1981, 1988) theories argue that firms should possess internationally-exploitable, firm-specific advantages in order to compete in foreign countries and to compensate the costs of these the new conditions. Rugman and Verbeke (1993) distinguish between location-bound and non-location-bound, firm-specific

advantages. The former can be used mainly in a specific location. In the context of FDI, these location-bound, firm-specific advantages cannot easily be transferred and require significant adaptation in order to be used in other locations (Rugman, Verbeke, 1993). In contrast, the non-location-bound, firm-specific advantages can easily be taken into new markets; hence they can be exploited globally without substantial adaptation. These advantages, such as efficient management skills, explain the competitiveness of multinational firms in new markets. Firms internationalize if they can exploit their non-location-bound advantages. Therefore, they are major drivers of internationalization. The firm-specific advantages are asset specific (ownership of specific assets such as financial capital, specific brand name) and transaction specific advantages (the advantages as a result of multi-nationality, e.g. the ability of a multinational enterprise to decrease the transaction costs compared to their competitors and external markets) (Dunning, 1981, 1988). Other enablers of internationalization are imperfect markets (Hymer, 1976): Imperfect markets enable companies to exploit their firm-specific advantages.

Table 1: Enablers of retail internationalization

Retailer specific	Market specific
Strategy	Market liberalization
Management/marketing : Supply chain management Relationships	Demand for high quality goods Need for fast and flexible response to individual consumer preferences
Synergy	Demand for well known brands
Brands	Retail structure

Source: Elaborated by the authors

The enablers of retail internationalization can be grouped as market specific and retailer specific factors. The market specific factors are, for example the market liberalization, underdeveloped retail structure, and demand for well known brands. The retailer specific factors are the internationally exploitable strategy, advanced management and marketing skills, brands, financial resources, experience, and relationships.

The collapse of the socialistic planning system in Central and Eastern Europe offered a unique opportunity for western retailers: the underdeveloped retail structure did not impose a strong competition. The modern formats were nearly absent and the national retailer did not operate efficiently. Modern retailers brought new concepts, a new way of doing business. Therefore these firms were able to become key players of these markets. Another enabler of retail internationalization was the rising demand for well-known brands and overall quality products. Foreign retailers were able to meet this demand better than the domestic competitors. Still, there is some specifics in Russia which prevents coming to market some of the well-known retailers and makes it hard for foreign newcomers to 'import' their strategy as it is and thus to gain dominant position.

The retail specific factors are firm-specific competitive advantages: concepts, supplier relationships brands, and experience. The concepts are their business model and the knowledge how to internationalize. International retailers have advanced strategies, management and marketing expertise. They have concepts which are internationally transferable. As the former Metro CEO told, retailers should have a success story or formula to become successful in foreign markets (Bell 2004). It is the advanced cash and carry concept by Metro, hypermarket format by Carrefour. Aldi and Lidl base their internationalization on the strict application of the discount concept. The management skills are also essential source of competitive advantage. Their advanced supply chain management

enable them to procure high quality at very competitive prices. Also through their efficient store management, they can reduce costs significantly.

Another enabler is the knowledge to internationalize. After years of experience, some companies have made plans for internationalization. This plan consists of all phases, from the country selection to the store operation. They learned how they can build supply chains and establish their core concepts in emerging countries. For example Metro has a process: the potential country is chosen if all steps are automatic (Bell, 2004).

The supplier relationships are also valuable resources for retail internationalization. Companies bring some key suppliers in new markets and the existing long-term and efficient cooperation enables retailers to offer very good prices and differentiated products and they do not have to invest much in new supplier relationships; for example, when Metro considers entering a new country, the company talks with its key suppliers with regards to their expansion. Big international companies have also more financial resources compared to the domestic retailers. They are able to buy larger volumes and therefore bargain better prices.

Regarding internationalization it is a main question how international companies behave in international markets. In the strategic decision of international companies there was always been a tension between *globalisation and adaptation* to individual customers (Ghauri, 1992). The advantages of globalisation are cost based (e.g. maximising economies of scale and scope and reducing duplication), while the advantages of adaptation are revenue based (eg. responsiveness to different consumer segments) (Buckley, Ghauri, 2004). Bartlet and Goshal (1989) identified three international orientations, namely the multinational, international and global firms.

The specific consumer needs and market conditions stimulate international companies to adjust to the local conditions and develop strategies of national responsiveness. This group is classified by Bartlet and Goshal as multinational firms. The international companies replicate their business model in foreign countries without important adjustment. The parent company transfer knowledge and expertise to the subsidiaries. The global strategy takes advantage of the convergence of consumer preferences, and as a result the standardisation of products and processes. This strategy can be characterised by tightly controlled management and centralised operations. The processes are globally integrated. Barlet and Goshal (1989) proposed a fourth strategy, the transnational company, which can integrate the advantages of the global integration and local adaptation.

The experience shows that retailers try to establish their home business model when the infrastructure and the quality of the suppliers make it possible. The procurement strategy is a deciding factor; companies who have more decentralized procurement (e.g. Carrefour) are more likely to enter developing countries, where the infrastructure does not make centralized procurement possible. In contrast, the resource-based retailers tend to enter mature market, where the infrastructure is developed, and where there is an efficient supplier base; there they can exploit their firm specific advantages, without substantial adaptation.

Statement: According to the degree of global standardization, integration and local adjustment international firms develop multinational, international, global or glocal strategies.

Hypothesis 1: Foreign retailers coming into Russia have different strategies and therefore it is possible to identify the different strategic groups of foreign retailers.

Hypothesis 2: The non-location-bound firm-specific advantages being the most important enablers of internationalization correlate with the way retailers design and develop relationships with foreign and local suppliers.

Customer Value Creation: SCM or DCM?

In line with the IMP research tradition, the market can be described as networks of multidimensional exchange relationships between business actors. These actors control heterogeneous, interdependent resources and conduct inter-linked activities. Co-ordination and control are needed between buyer and seller, for instance, for efficient handling of flows of goods, services, information and payments; for effective innovative behaviour; and for reduction of uncertainty (Salmi, 2004). The main point is that coordination can be considered as a key to achieving the main marketing goal: creating superior value for customers (Shrivastava, Sudhir, 2003; Vargo, Lush, 2004).

It is now widely acknowledged that the customer value is created more and more through integrating various functional areas (Jüttner, Christopher, Baker, 2007; Snow, Miles, Coleman, 1992). While more discrete functions are now outsourced being spread beyond the boundaries of organization, coordinating functions and activities become the foundation for customer orientation. Long-term relationships leading to better coordination may determine competitive advantage and are often crucial to achieve the goal of creating superior value for customers (Piercy, 2002; Jaworski, Kohli, 1993).

Supply Chain Management (SCM) synergy is widely acknowledged (cf. Oliver, Webber, 1982; Christopher, 2004; Ellinger, 2000; Martin, Grbac, 2003; Svensson, 2002). Still, *Demand Chain Management* (DCM) emerges as a new theoretical base to explain demand-supply coordination. DCM's starting point is not a supplier/producer and activities to promote its goods and services through the supply chain, but certain customer demands, which are to be satisfied through a chain of relationships (Heikkilä, 2002). This kind of integration seems to be valid for today's marketplace, where customers take advantage of real-time access to their accounts, are able to co-create and to make changes in configuration of products and services adapted to their individual use, and can also make individual requirements for service (Tretyak, 2008). Analyzing world-famous examples of successful companies that employ DCM philosophy, such as Dell in computer industry or IKEA in retailing help us to understand that it's possible gain competitive advantage based on DCM. Firms which have chosen such a strategy increase their ROE by improving goods accessibility, delivery accuracy, flexibility in adapting to customer needs, tightly linking activities *to coordinate demand and supply*. Thus, DCM is necessary to employ customer orientation for value chain.

Hypothesis 3: Supplier-retailer relationships are now of growing importance in the Russian retail sector.

Hypothesis 4: The level of supplier-retailer relationships depends on the strategy of dominating partner; coordination scope and intensity differ across the market segments.

Hypothesis 5: DCM model is not yet accepted not only by local but also by foreign retailers in Russia.

The Recent Developments of the Russian Retailing

Russia having become relatively stable politically, is now a fast-growing market. Increasingly many retail firms are turning their attention to Russia, since market potential is nowadays the key driver of internalization. The top tier cities of Moscow and St.Petersburg tend to attract foreign retailers in the first instance before they move (is so) to second tier cities such as Kazan, Perm, Ekaterinburg, Novosibirsk, Chelyabinsk,

Russian retail market remains relatively immature and under-consolidated. As with China or India, the incoming retailer faces significant challenges, despite the increasing retail growth rate that is estimated at 14-16% (Alexander, Doherty, 2009). In particular, There is a scarcity of professional, loyal middle managers, and the road network is poor. The local complexity in terms of consumer behavior, human resources, importation regulations, and logistics, keep foreign retailers at bay. That's why many of the large hypermarket operations such as Tesco and Wal-Mart are not operating in Russia, although both have indicated their interest in the market (Willoughby, 2007). An international hypermarket retailer has only two entry mode options available: to build its own hypermarkets as Auchan does, or acquire an existing chain (Kuipers, 2006).

At the same time, the retail infrastructure in big Russian cities is now much better developed being represented by hypermarkets, supermarkets, retail chains etc. All the main retail formats, including cash&carry, shops, malls, speciality stores are well represented not only in Moscow and St.Petersburg but in many other regions. Even the retail park format is now introduced in Russia (as an example, Urals retail park in Ekaterinburg).

The main features of the modern Russian retailing are as follows (Radaev, 2003, 2008; Roberts, 2006; Sheresheva, 2005; Tretyak, Sheresheva, 2003):

- increasing share of retail chains,
- increasing number of specialized retail chains,
- growing power of foreign retail chains,
- major retail chains moving into the regions.

External firms often find it difficult to compete with regional companies because of the protectionist policy run by regional authorities. The personal relationships with regional authorities appear to be crucial. Potential newcomers into a region who establish good relations with the local authorities, to discuss their plans with them, stand to receive support for their projects.

Research Methodology

Preliminary results presented in the paper are based on the secondary data (journal articles, consultant studies, business journals and case studies) as well as on the in-depth interviews with managers of international retailers and retail experts conducted in 2009. Our study is rather exploratory, therefore they consisted of open questions.

The managers were involved in strategic decisions. It was essential since internationalization is a strategic question. To get an independent view we also interviewed retail experts. They include journalists, scientific researchers and management consultants.

All the interview respondents asked that they be kept anonymous in the research. The interview guide was prepared which helped to discuss all the needed topics with every respondent and still to allow respondent as much freedom in their answers as possible. To improve the quality of the analysis, all the secondary data available were used to verify the general market situation and some questionable statements of the respondents.

So, the emphasis was on the qualitative methods which are the most appropriate if understanding and explanation are the main target of research.

Preliminary Results

Our interviews had shown some trends common to retail internationalization all over the world. Foreign retailers are intended to apply the same supply chain management concept in each market, and it is so in Russia. The differences are mostly a result of the underdeveloped infrastructure and supplier base of the country. However, if the conditions improve, the managers say, the preferable way would be to use their original business model.

Our interviews had also shown that retailers with centralized procurement list more international products, while their counterparts with decentralized buying units have more national and regional food. This reveals that the sourcing of national products is not always the result of market adjustment, but often it is motivated by the nature of the procurement type.

Our interviews confirmed that the enablers of retail internationalization are both market and retail specific. The market specific enablers are mainly related to the retail structure; the important retail specific enablers of retail internationalization are the advanced management and marketing skills, experience, knowledge transfer, and brands.

As in other markets, multinational retailers import their private brands to several countries. Therefore, they can buy higher quantity of these private branded products and sell them at much better prices, hence, private brands are important assets which enable successful internationalization. Foreign retailers have well-known manufacturer brands, in transition countries sometimes they are the only source of them. As was told by one manager, when they entered Russia, consumers went to them to buy products like Nutella, because they were the only source.

Concerning supplier-retailer relationships, there is some specificity of local mindset, side by side with the typical (for many firms all over the world) reappraisal of long-term inter-organizational relationships, regarded now as one of the main factors of success. Almost all interview partners stated that the management, especially the supply chain management skills are among the main enablers of retail internationalization. So, in retail sector in Russia there is now an obvious trend toward greater integration of supply chains, but mainly in terms of supply management. New approach of Demand Chain Management (DCM) is not familiar to respondents.

This conclusion is confirmed by our previous research (Tretyak, Sheresheva, 2005; Sheresheva, 2009) as well as secondary data, including results of the survey conducted in 2007 by SU-HSE researchers. Data were collected from 500 managers of local and foreign retail chains and their suppliers operating in food and electronic sectors of the consumer market in five Russia's cities including Moscow, S.-Petersburg, Yekaterinburg, Novosibirsk, and Tyumen (Radaev, 2008). In this study two groups of factors were attracted including positional and relational parameters. The *positional parameters* indicate the place of a given firm in the organizational field of the market. As for *relational parameters*, they describe contractual and non-contractual relations of a given firm with the other firms including both direct competitors and exchange partners. These parameters are as follows:

- Firm's position in supply chain
- Market sector in which a given firm operates
- Firm's market position
- Firm's market power
- Market competition among firms

Analysis of data collected in 2007 shows that suppliers develop their social ties with the competitors more intensively than retailers do because the suppliers' position in the commodity chain is more vulnerable at present. This vulnerability of suppliers originates from the development of the buyer-driven commodity chains, in which retailers (the buyers) normally have an upper hand [Gereffi, Korzeniewicz 1994].

Further investigation

Focusing on the question whether international retailers export their business models in new countries, we aim to identify the different strategic groups of international retailers. The main attention will be paid to the recent changes in supplier-retailer relationships in Russian retailing and their role in the international retailers' strategy. This research will be conducted in 2010-2011, starting in 2010 investigating the case of the Metro Group, a German-based retail conglomerate. It operates in many countries including Russia and comprises the Metro/Makro cash-and-carry operation, food retail in the form of Real hypermarkets, the non-food consumer electronics specialty stores Saturn and Media Markt, as well as the department store Galerias Kaufhof (Metro Group, 2008).

We aim also to use additional opportunities for empirical studies, i.e.:

- To conduct more interviews with expert and representatives of retail companies operating in different regions of Russia
- To include our own set of questions in the regular Russian economic barometer panel survey
- To conduct survey in several Russian regions (regions) with support of the Network of Excellence members and research partners in HSE regional branches (St. Petersburg, Perm, Nizhny Novgorod)

Conclusions

Our main conclusions are as follows.

The literature review and the interviews confirmed that international companies have to possess unique advantages. The business model and management are the essential firm specific advantages. Retailers are intended to stick on business model in new country and to adapt only in operational issues. The differences are mostly a result of the underdeveloped infrastructure and supplier base of the country. Since the strategy is their main advantage, they try to replicate it without extensive modification.

We can conclude that internationalization strategy is part of the overall strategy of a retailer. Therefore, first we have to know the retail strategies and business models in order to understand retail internationalization. This strategy defines how the business model of a retailer can be internationalized.

Foreign retailers coming into Russia have obviously different strategies. Still, further research and gathering more data is needed to identify the different strategic groups of foreign retailers. Lack of data at this stage of research makes it impossible to make any conclusion concerning Hypothesis 2 and Hypothesis 4.

The combination of theories can give useful insights into retail internationalization. However the theories have to be compared to the practice. Some theories are not applicable today as a result of social, technological and political conditions.

The interviews clearly confirmed that supplier-retailer relationships are now of growing importance in the Russian retail sector. Most local companies in the Russian retailing still consider selling firms as adversaries, not collaborators, and therefore prefer to emphasize

on optimizing single transactions instead of creating win-win situations and building long-term connections. Few local managers really understand the role of intangible assets, and relational assets in particular, as an essential factor of their competitiveness and profit-generating capacity. On the other hand, Russian companies are now facing the new reality. They have to struggle with foreign retail chains having coming to the local market with advanced management and marketing skills, experience, knowledge transfer, and brands. Thus, Russian chains are strategically committed to building long-term exchange relationships with their suppliers. At the same time, DCM model is not yet accepted not only by local but also by foreign retailers in Russia.

Critical questions for foreign retailers on the Russian market are where to find strategic business partners and how to establish relations with them, since the suppliers demonstrate much less readiness to long-term win-win collaboration.

Nevertheless, there is already some positive experience of gaining additional advantages from such collaboration in Russia.

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