

Power Games in Networks: Allocation Mechanisms in a Neo-Mercantilist Networked Economy

Competitive paper

Abstract

This paper investigates essential aspects of business networks in highly concentrated supplier and retail markets. In particular it discusses the interface between industrial supply network organization and end-consumer markets where a certain type of organization exists: the retail supermarket-organization. We argue that certain kinds of power dynamics emerge when retailers interact with producers in supply networks, which is pertinent due to the implications for the actual development of networked economies. This paper analyses this interplay in order to understand more of the mechanisms and the structures of the power games that impact business network dynamics. We identify three power games; the access to market game, the latitude game, and the price dumping game. We furthermore analyse the mechanisms and the transaction patterns that are implicit in these power games. Jointly, these indicate a development towards a neo-mercantilist economy where access to and participation in market supply may in fact be “taxed” by powerful actors in certain network positions. These outcomes point at aspects of networked economies in highly concentrated economies that represent particular challenges to both market practitioners and policy makers.

***Key Words:** Power, Network Organizing, Interaction, Dynamics, Concentration, Food and Agriculture*

1.0 Introduction

Over the last few decades, the market economy has become much more networked and interacted (Castells, 1998; Håkansson *et al.*, 2009; Marfels, 1992; Busch, 2007). Large tightly integrated supply chains and business networks integrate, coordinate and supply most of the products, services, knowledge and human resources required by firms and individuals. Modern information, communication and control technologies clearly represent major drivers

behind the hugely expanded capacity of networked structures to outcompete or dominate other market structures that are characterized by less interconnected actors, as well as national markets dominated by governments, organized civil society and business counterparts.

The emergence of these dominant forms of market organisation may have significant implications for our societies, e.g. for the abilities of policy makers to control economic activities for the overall benefit of society. That is, even though the networked economy in broad terms may demonstrate itself as relatively hyper-efficient in economic terms, networks also have their “dark sides” (Håkansson & Snehota, 2000; Håkansson *et al.*, 2009, pp 253-254). This is in particular in relation to their implicit internal as well as external power structures, including lack of transparency, and their transnational character. Their overall interests may not correspond to all the individual interests represented within it. Hence, business networks are challenging candidates for political regulation and control.

Over the last three decades, the IMP Group has been instrumental in bringing to the forefront and explaining the dominant existence of as well as the characteristics of the functioning of interdependent networked economies (Håkansson, 1982, 2006; Axelsson & Easton, 1992; Håkansson & Snehota, 1995; Håkansson *et al.*, 2009). Thus rather than further arguing for the existence of networked economies as opposed to competitive markets, this paper aims to explore the mechanisms and structures implicit in the “dark side” of networks. It is therefore part of the current trend (but also a longstanding theme) in the IMP literature of the empirical investigation of dynamics in relationships and networks (e.g., Gadde & Mattsson, 1987; Halinen & Tornroos, 1995; Håkansson & Snehota, 2000; Halinen, Salmi & Havila, 1999; Medlin, 2004; Vagn Freytag & Ritter, 2005; Johnston, Peters & Gassenheimer, 2006; Schurr, 2007). Research issues in this paper include how structures of domination form within the ongoing organizing of concentrated business networks, and how the mechanisms and structures of what we refer to as power games impacting business network dynamics play out.

The single case study we will consider here is from within the Norwegian retail dairy sector. The case exemplifies how not only are concentrated networked systems becoming increasingly dominant per se, but that some parts of these networks emerge as dominant *within* the overall structure. The modern retail organization has control over the interfaces between the industrial supply network and the multitude of end-consumers. This provides the basis for the development of significant power positions within the overall supply system¹.

¹ This issue has recently emerged to the political agenda in several European countries as well as within EU transnational forums.

This is especially relevant for particular areas of economic politics such as agriculture, healthcare, innovation and international trade.

The paper identifies and discusses three different empirical phenomena observed in the data. The first of these is network domination and its self-reinforcing and/or expansionary mechanisms within economic transaction patterns. The second focuses on the interdependency problem in asymmetrical network domination structures, while the third discusses more specifically the mechanisms and transaction patterns associated with price wars in concentrated networked economies. The data is written up as three ‘power games’; the access to market game, the latitude game, and the price dumping game. The objective is essentially exploratory in order to generate preliminary, medium range theoretical propositions about specific economic mechanisms.

2.0 Power in Network Forms of Organizing

Powerful organizations of various kinds have always been part of economic systems. The implication is that we need to understand this organisational form in order for society and the polity to deal adequately with them. In our time, it appears that the networked economy represents new and enhanced challenges that will have to be dealt with in the coming years.

Within the classical economic literature, issues of market power and domination are typically dealt with within a paradigm that assumes the possibility and the appropriateness of a “perfect market” represented by numerous independent buyers and sellers. Power issues are dealt with as deviations from this ideal condition, considered as representations of market imperfections. There is a vast literature on these issues – within what is commonly denoted economic regulation and control theory within the broader area of industrial organization theory. Abstract mathematical models and the use of formal game theory are hallmarks of these kinds of analysis.

Much has been said and can be said about the market power problem from within this tradition – probably also when it comes to the economic phenomena that we discuss in this paper. However, the fundamental concept of a networked economy falls beyond the analytical scope of the paradigm, when networked economies are seen as both more dominant, more realistic and possibly also more efficient than the ideal competitive market. Fundamentally, this efficiency advantage must remain with the advantages of integrated technologies and organizing over the alternative. Under these circumstances, it is not a given that networked powers primarily should be addressed as an economic efficiency problem,

rather than as broader issues of political control, economic fairness and social-political development.

2.1 Patterns of Power and Use of Network Position in Tightly Structured Networks

While much is known from the IMP literature about the organizing of economies into networks; its substances, functions and associated interaction patterns, less is known about the effects of emergent power patterns in them. While recognized early as an aspect of networks and interaction (Johanson, 1966; Kinch, 1974; Wilkinson & Kipnis, 1978; Wilkinson, 1973; Håkansson, 1982) empirical investigations of power and dominance have not been emphasized in contemporary IMP investigations. While exceptions exist that discuss some aspects of power and dominance (Baraldi & Nadin, 2006; Brennan, Turbull, & Wilson, 2003; Bångens & Araujo, 2002; Wilkinson & Young, 2003; Ford & Håkansson, 2002) there is a general paucity of empirical research into the effects of the emergence of power and dominance in concentrated networks.

The patterning of the use of power and existing actor dominance in a network is seen as impacted by two central features. First, it must be connected to the existing network positions – and therefore the roles played – by the actors forming the network of interest. Network positions are a concept that has been used to understand an actor's ability to influence and exert power in networks (Anderson, Havila, Andersen, & Halinen, 1998; Håkansson & Snehota, 2006; Johanson & Vahlne, 2006; Mattsson & Johanson, 1992; Wilkinson, 1979). The concept “describes how the firm is related to other firms in the network” (Gadde & Mattsson, 1987:30) and can be equated to the role of an actor within a network, based on firm and network resources (Mattsson, 1989; Snehota, 1990). A network position therefore develops over time through investments in relationships by the focal actor. It represents a ”market asset” which provides ”access to the assets of other firms in the network.” (Johanson & Mattsson, 1985). The development of a macro position may involve a focal actor attempting to increase market share or the number of customers. The development of micro-positions is concerned with the development of a relationship and how this occurs over time vis-à-vis the macro position (Mattsson, 1989).

The second feature is that the use of a network position (e.g., through influencing, controlling, etc) will vary by the type of network structure in play. The extent of network 'structuredness' – the level of interdependency of positions within a network – affects the degree of interdependence of actors (Ibid.). There are four characteristics of network structure: structuredness; homogeneity (level of similarity of positions of what firms

do, and the nature of relationships between firms); hierarchy (the extent to which a small number of firms are dominant within a network); and exclusiveness (interdependence between positions in the network and positions in other networks). For example, a high level of exclusiveness will equate to a low dependence on positions in other networks. Various combinations of these characteristics are possible for any given network. An actor's ability to influence and exert power in networks is likely to be impacted by the current network structure.

The empirical material below presents an analysis and discussion of essential aspects of business networks in highly concentrated markets. Specifically, it looks at the interface between industrial supply network organization and end-consumer markets. Within this intersection a certain type of organization exists: the retail (supermarket) organization. Where retail and supply networks interact certain kinds of power dynamics emerge.

This paper investigates some of the specifics of this interplay between powerful suppliers and powerful retailers, with the ambition to understand more of the mechanisms and the structures of the power games that impact business network dynamics. As such it links to existing studies of dynamics in relationships and networks. Seminal works here focused on stability and change from a network perspective (Gadde & Mattson, 1987) and network position (e.g., Johanson & Mattsson, 1992). Subsequent research has investigated the role of relationships in mediating the size and extent of change (Easton & Lundgren, 1992); transformation processes (Smith & Laage-Hellman, 1992), perceptions of network change (Abrahamsen, 2009); relationship between role and position (Anderson, Havila, Andersen & Halinen, 1998); change in networks as confined or connected (Halinen *et al.*, 1999); learning processes and network evolution (Lundgren, 1995; Chou & Zolkiewski, 2010); and changes in nets resulting from mobilizing actors (Lundgren, 1992; Hertz, 1996; Harrison, 1999; Mouzas & Naude, 2007).

The paper departs from existing work through a focus on power dynamics at the network level rather than the dyadic relationship level, and because the data focuses on ongoing regular interactions within the backdrop of the existing network structure. Section three below provides a description of the methodology used, before the three power games are presented in section 4.

3.0 Methodology

This paper is based on a rich single case study written from two successive Norwegian court judgements regarding TINE SA versus the Norwegian Competition Authority. Tine SA is a

Norwegian farmer-owned dairy company with an overwhelming dominant market position in the Norwegian consumer market for dairy products. The case centres upon the network structures and dynamics across the interfaces between Tine and its retailer counterparts/partners, as well as on the retailer-business-networks themselves.

The case was selected partly because the Norwegian market for agricultural food products provides a useful opportunity to study the emergence of power and dominance in interdependent networked economies. This is because it combines a system of high import barriers with a modern and highly concentrated supermarket and supply chain organized market system. Only four supermarket organizations control 99 % of the consumer market. It thereby provides a “real life laboratory” for investigations into a market for consumer goods that is highly concentrated and networked.

The documentation offers detailed descriptions about interrelated events and activities across multiple stages of interaction by some of the core actors. It furthermore provides detailed descriptions of internal ‘competitive product funds’ created by the supermarkets in order to mobilize the resources of their suppliers. This is part of a market front stage operation with competitive ‘performances’ of various types planned and organized to compete with their supermarket rivals. The documents provide the court’s interpretations and investigation into what has happened, why, when and who have interacted or not, with whom etc. It is thus a reflection of the complex patterns of interactions among the actors involved. These patterns can be very hard – sometimes impossible – to discern and document without having access to a judicial process in order to explore issues of power and economic network organizing.

Below are three ‘mini’ cases which are used to illustrate three different but related power games that can be identified in the court case data. These are preceded by a background section to frame the background of the case. The data are extracted from the report and the decision by the Norwegian Competition Authority (Konkurransetilsynet) regarding a regulatory case against TINE SA. This document is referred to in the case as “K” followed by page indication when referred to a specific part. Secondly, we used the court ruling from the Oslo District Court (Oslo Tingrett). This document is referred to as “Court Data, OT” followed by page indications where called for. Thirdly, we use the court ruling from the Oslo Borgarting Appellate Court (Borgarting Lagmannsrett) which is referred to as “Court Data, BL” followed by the relevant page references.

4.0 The Norwegian Dairy Sector and Supermarket Retail Chains

4.1 The Emergence of Tine SA

The Norwegian dairy sector has its historical roots in the traditional agro-cooperative movement. The first dairy cooperative was established in 1856, but the breakthrough for supplier-owned dairy companies came during the period 1870-1900 with the establishment of the first larger scale cooperative *Christiania Meieribolag* in 1871 as a landmark example. In 1905 there were 810 dairy companies in Norway among which 694 were in the form of cooperatives, and in 1930 the numbers were 643 and 575 respectively following a period of consolidation (Espeli, 2006, p. 21, 27).

From the 1930s onward, the development of the Norwegian dairy cooperatives shares its history with a number of regulatory measures in a state-agro cooperative spirit that circumscribe much of the developmental paths that emerged. In a sense, the dairy cooperatives became the children of regulatory ambitions to create an effective yet local agricultural industry, not at least when it came to the dairy sector (See Espeli [2006, chapters 1-3]).

This national dairy cooperative organization became institutionalised in 1931 with the emergence of NML (*Norske Melkeprodusenters Landsforbund*) as an umbrella organization for the many dairy companies and milk centrals across the nation. It was this reshaping based on a new regulatory regime with the “Sales Law” (Omsetningsloven) at its core, and in conjunction with the NML’s merger with *Norske Meierier* (NM), which caused the development of the cooperative movement to take off. This meant that dairy cooperatives became district organisations coordinated by NML /NM.

This model was in effect until the early 1940s when a regionalized monopoly system (Riksoppgjøret) was established and eventually became part of NML/NM. In a short period of time the dairy sector had become monopolized under the reign of NML using the regulatory tools that the regionalized system created. This model of market regulation would last until 1997 when a new market order for milk was launched (Espeli, 2006, p. 60).

The next important stage in the developments of the dairy sector was the reduction in the number of district dairies in the 1980s from 132 in 1982 to only 19 in 1984 (Bergh, 2006, p. 122, 155). This reform eventually paved the way for the emergence of a centralised coordination unit with significant powers and regulatory mandates. The next step came in the 1990s with the process of regionalization in which the number of dairy companies was reduced to 10. This was the situation in 2002 when the then national dairy cooperative *Tine*

Norske Meierier moved to form a unified corporation under the name *Tine BA*. *Tine* had been launched as a brand name in 1992 which marked the start of a significant and successful brand creation and development process.

The most significant change was that all producers of milk now became direct owners of *Tine BA* rather than indirect, via one of the ten regional independent dairy cooperatives, as was the case before the incorporation. Although being a corporation with a number of subsidiaries, *Tine* was also a cooperative. The parent company and its subsidiaries were thus named the “Cooperative Corporation TINE Group” (*Samvirkekonsernet TINE Gruppen*).

On January 1, 2008 the new Law of Cooperatives (*Samvirkeoven*) came into effect in Norway. It represented a completely revised legislation to better answer to the modern situation with many types of cooperatives, some of which are incorporated and organized as any other larger corporation, and others which are operated as traditional supplier, producer or purchasing cooperatives. In accordance to this new law, in 2010 the mother company *Tine BA* was formally changed to *Tine SA* - using the legally specified label “SA” to denote its character as a cooperative. In the company by-laws the company’s goals are specified thus:

“TINEs objective is to run effective, quality- and market-oriented food-operations on a cooperative basis. TINE shall work towards giving the owners the best possible economic results from their milk production, and ensure the safeguarding of the owners other common interests.” (Excerpt from TINE by-laws, 2010², translated from Norwegian.)

Tine SA (hereafter denoted “*Tine*”) has developed into a large modern dairy cooperative with a dominant market position. It also serves as an operational market regulator assigned by the state regulator for agricultural markets. The court case which is our empirical data source centres around the question around whether or not *Tine* as a dominant market actor within the market for dairy products has used its dominant market position to squeeze it’s smaller competitors out of all the Rema supermarkets.

² Available from *Tine*’s web-page: <http://www.tine.no/binary?id=331107&download=true>. Accessed on 2011-04-18.

4.2 The Norwegian Retail Sector

In the early 1980s there were approximately 700 independent supermarket and other retail organizations in the Norwegian grocery market. Today it is four integrated chain-organizations. In the late 1970s two ‘hard discount’ supermarket organizations, Rema and Rimi, started to expand. They were using a business model based on German hard discount stores such as Aldi Markt and gradually grew to become nationwide chains. In the late 1990s Rimi ended up being sold to the Swedish grocery retail conglomerate ICA, while Rema is still owned by the original entrepreneur family as part of the conglomerate Reitan Group.

In response to these developments, the traditional consumer cooperatives reorganized, developed and streamlined into national organization, and formed Coop Norway with a central purchasing and marketing function. Coop Norway became part of the Pan-Scandinavian cooperative Coop Nordic coordinating sourcing in international markets. Another response came from a group of independent wholesale distributors in Oslo who started to organize the remaining small supermarket chains and independent stores into one orchestrated purchasing cooperative. This cooperative eventually evolved into a dense and well organized corporation: Norgesgruppen ASA (NG).

These developments can be traced to the global development in retail world-wide based on the developments of ICT and information handling (Olsen, 2010). Now, the Norwegian food production and distribution system is among the most concentrated in the world, and also among the most delineated as it is protected by toll barriers and import and export restrictions. In Norway, the “big four”; NG, Rema, Coop, and ICA cover a full 100 % of the Norwegian market amounting to 138.5 billion NOK (approximately 21.5 billion EUR) in 2010 and with a growth of 3.2 % since 2009 (Nielsen 2011³). NG is the largest actor with a 40 % market share, followed by Coop (23 %), Rema (22 %), and ICA (15 %) respectively (K, p. 3-5).

4.3 Market Regulation in the Norwegian Dairy Sector

The dairy sector in Norway is heavily regulated by Norwegian authorities. The background to this is a political ambition to increase competition. One way to achieve this goal is to implement and enforce a regulatory system to ensure a steady transfer of production capacity and market shares to Tine’s small competitors. There still exists a substantial popular support for a highly regulated dairy sector in interaction with budget subsidies for dairy farmers.

³ *Dagligvarerapporten 2011*. (The Report on Grocery Retail). The Nielsen Company, Oslo. www.nielsen.com. (In Norwegian).

Tine is the dominating actor in the sector although its market share varies across various product categories. For example, in the category milk with no additives or flavorings, Tine holds a 96 % market share. The main competitor is Kavli with its brand “Q-melk”, accounting for the remaining 4% market share. In the hard cheese category the picture is slightly different. Tine’s market share for brown cheese is 90-100 % (K, p. 33) and the main competitor Synnøve Finden has a market share of 5-15 % (K, p. 33). In the market for yellow/white hard cheese, the numbers are 70-80 % for Tine and 15-25 % for Synnøve Finden respectively (K, p. 33). There are some imports of cheese to Norway, especially in the specialty cheese category with some French and Italian products, such as *Brie* and *Parmesan* etc. This import amounts to around 0-10 % of the market of both brown and yellow hard cheese (K, p. 33). In other dairy product categories the main actors are Tine, Kavli and Synnøve Finden.

5.0 The Norwegian Dairy Power Games⁴

In this section, we outline the three power game mini cases. The first – *the access to market game* – relates to how prices are negotiated and how access to the end consumer market is controlled, in particular the transaction patterns that result from these negotiations. The second game is *the latitude game*. It relates to how actors, in a situation of tight interdependences between the network actors, engage in ongoing negotiations to create latitude. The *price dumping game* is the third game, and it relates to the use of a critical position to allocate flows of resources across supplier networks to fund “price wars” with the other retail organizations.

5.1 The Access to Market Game – the Autumn Hunt

Access to the end consumer is part of the overall annual negotiations between the production and retail parts of the network. These negotiations are called the “Autumn Hunt” and are at the core of the business of the sector. On the retail side, the actors are the big four, that is, NG, Rema, Coop and ICA with its associated stores and branded chains. The supply network is made up of the major producers and importers of fast moving consumer goods and food stuff, both national corporations such as Tine, Nortura, Orkla, Rieber & Søn, and Mills as well as international MNCs such as Coca-Cola and Procter & Gamble.

⁴ This section is based heavily on the court case data and is indicated in the text when appropriate following the annotation described in the methods section. Where the text is complemented with data from other sources, this will be indicated in separate footnotes.

The centralized purchasing functions in the retail organizations enter into negotiations with the account managers and marketing functions of the suppliers. These negotiations usually start in October and carry on throughout December. The “Autumn Hunt” is a hectic and important part of the business for the actors involved. For example Rema 1000 estimates to complete around 2000 rounds of negotiations. These negotiations usually encompass the conditions for supply of consumer goods to the retailers for the coming year. The “Autumn Hunt” negotiations are centralized and comprise two parts. First, prices for each separate product are negotiated. Secondly, the prices of the delivery contracts are agreed upon.

The first kind of prices relates to the role of the supermarket chains as a negotiator on behalf of a large number of consumers. But it is also a matter of negotiating as good a competitive position as possible in relation to the other three supermarket competitors. The second kind of negotiation is one where the retailer negotiates on behalf of his own organization. As such, the contract price in part works as a levy on the supplier.

The price of a contract to deliver broadly depends on the overall market share of the retailer organization. One component of this price is quite simply a result of the larger number of products sold by the supplier through a particular retailer. The second component has to do with the size of the tax (levy) for a given quantity. The higher the market share of the retailer, the higher the levy as measured in percentage points. As a result, the income profile shows exponential growth in relation to linear market share growth. Hence income differences to retailer-chains will become much greater than what corresponds to the differences in market share per se. Table one below shows the level of the compensations that Tine paid to the ‘big four’ supermarkets in order to gain access to the market in 2005, as a result of the Autumn Hunt in 2004.

The table shows how the largest retailer, NG, achieves an increase in compensation of about 30 % and with the compensation in per cent of the chain’s turnover increasing 1.09 percent from 2004 to 2005. This is clearly the highest increase of all the chains. This is despite that fact that NG already from the outset had the highest absolute as well as relative compensation level of them all – more than double the total compensation as compared to number two; ICA (143.622 M NOK vs. 65.800 M NOK). While Tine’s larger turnover in NG as compared with ICA in itself represents some of the difference, it does not account for all of it as the compensation in per cent of turnover in Table 1 shows. Whereas NG in 2004 received a levy of 3.71 % of turnover with Tine, Coop as number 2 received only 2.77 %. In 2005 NG increased its level to 4.85% where as Coop remained at the same. None of them had significant changes in their total turnover with Tine in any of these years. We can

conclude that NG manages to gain most from this first game, even though Tine is not permitted to favour any one buyer and must try to rebalance compensations to the retailer chains, in its role as a market regulator for dairy products.

---- Please insert Table 1 about here ----

5.2 The Latitude Game

In September 2004, negotiations between Tine and Rema 1000 were initiated. In the background of these negotiations was the fact that Rema 1000 had experienced problems with the deliveries of milk from Kavli under the brand *Q-melk* (Court Data, OT, p. 52, 53, 57). Rema was therefore interested to discuss with Tine if such shortages could be avoided with Tine as a supplier (as Rema had to supplement their deliveries of milk from Tine whenever there was a shortage from Kavli). A part of these discussions was the alternative for Tine to become the exclusive supplier. This implied the delisting of *Q-melk* from the assortment of Rema 1000 and terminating the Rema-Kavli relationship (Court Data, OT, p. 53).

The reason for the shortages in the supply of milk from Kavli to Rema had a very simple explanation: Kavli had a contract with one of the other actors among the big four, namely NG. NG exerted some amounts of power in this relationship and argued that they had an exclusive deal with Kavli to supply only to NG.

“The background [...] was especially Lidl’s entry to the Norwegian market, and the fact that Rema 1000 had problems with deliveries of *Q-melk*, due to the fact that NG had pushed hard on *Q-meieriene* [the dairies owned by Kavli] stating that they were committed by contracts to not supply to anyone else but to NG.” (Court Data, OT, p. 52, translated from Norwegian).

This pressure from NG on Kavli creates problems for Rema 1000 as they experience repeated shortages. This is one of the reasons why Rema in the negotiations with Tine considers several alternatives. Among these are the negotiation of as good conditions as possible on supplementary deliveries from Tine. The negotiations involved not only milk, but also the hard and soft cheese categories. Rema 1000 had contracts with Synnøve Finden for the supply of cheese. In their negotiations with Tine there were many discussions about this

segment, and calculations of what it would mean to have Tine as a single supplier of cheese. This was recognized by Tine thus:

“During the past year, Rema has prioritized Q and also partly Synnøve. The chain is, however, facing a shift in its product lines. One goes towards fewer suppliers and focuses heavily on the largest brands. This opens up opportunities for us, but it will of course cost.”(Rune Jenssen, Sales manager and chief negotiator, Tine, Court Data, OT, p. 56, translated from Norwegian).

Rema on their side considered the implications of using Tine as a sole supplier and used this as leverage in their negotiations with Synnøve Finden and Kavli, which are undertaken in parallel with the negotiations with Tine:

“Tom [Tom Høidalen, Key Account Manager in Rema 1000 and responsible for the Tine account] will take a round with Finden and ‘pin them to the wall’ ” (Tor Høylye, Key Account Manager, Rema 1000, Court Data, OT, p. 56, translated from Norwegian).

These quotations illustrate the intensity of the influencing game that goes on. It could be considered as a big chess game with several players, with moves and counter-moves using other players to put pressure on the counterpart. Furthermore, the consequences of the outcome of the game can be significant for some players and important for most. That is, very few are unaffected by the outcome of this significant negotiation round.

5.3 The Price Dumping Game – the Cabbage Fund

This power game involves four actors and two product segments. Kavli with its brand Q-milk and Tine are the actors competing in the milk segment whereas Tine and Synnøve Finden competes in the hard cheese category. As detailed above, Rema prompted Tine to develop a scenario whereby Tine would become the sole supplier of milk and hard cheese to Rema 1000. One central implication would be to squeeze out the main competitors Kavli with its Q-milk product and Synnøve Finden’s hard cheese products (Court Data, BL, p. 2). Tine was also requested to assess the possibilities for producing Rema’s private label cheese. This was also associated with increased compensations from Tine and these numbers were used in Rema’s

financial models to calculate the economic effects that this would have in terms of profitability, efficiency gains and increased volumes (Court Data, BL, pp. 28-29).

These calculations included effects of having Tine as a sole supplier on the so-called “Cabbage Fund”. This Fund is used by Rema to subsidise popular products in order to, among other things, come first in the influential newspaper *Verdens Gang (VG)*’s price comparisons of various foodstuffs (Court Data, BL, pp. 2-3; OT, p.10). This is a clear manifestation of the power game in the sector, or a device in the game. It is used by Rema as a tool to exert power, in order to keep the position with the consumers as the retail chain with the lowest prices. The Fund therefore emerged as a response to media attention around comparisons among food retailers to choose the cheapest bag of groceries. Retailers soon learned what products that were included and realized that they needed to come out well in these kinds of comparisons⁵. So the cabbage fund came to pass.

The Cabbage Fund has its name from the Norwegian “*Kålrotfondet*”⁶ implying something that is sold with a very low value, which is ubiquitous and has low margins. It was initially established by Rema based on a similar fund at a Belgian retailer whose name sounded like the Norwegian “*kålrot*” (Court Data , OT, p. 10). It is a fund that is built up by the retailer and used to subsidize certain products during certain periods enabling Rema to sell them at a hard discount at an extremely competitive price. The fund dealt with here is related to Rema, but it is possible that the same type of system is in use with the other main retailers in the Norwegian network.

“Rema 1000 operated with something they called the “Cabbage Fund”. [...] This means that Rema 1000 calculates a small extra margin on all items, which is used as a fund to subsidize certain products that are especially important in the competition with the other chains. These can be various items having various effects... for example... an important issue in the price competition [among the chains] during this period was the journalistic investigations made by VG to disclose which of the chains that were the cheapest, based on a basket of items where they bought the cheapest item in each category. It could therefore, for example, be profitable to subsidize a

⁵ This interpretation was reaffirmed in an interview with top managers at the Norwegian meat cooperative Nortura SA, 2010-10-06.

⁶ A direct translation would be the “Swedish Turnip Fund” or simply the “Swede Fund”. For various reasons, we have chosen not to call it this, but rather call it the “Cabbage Fund” as this better conveys the meaning of something that is ubiquitous and of little value, without any (erroneous) connotations to nation states or nationalities of any kind.

cheap yellow hard cheese of poorer quality so that Rema 1000 comes out as the best in VG's test, but which costs little to subsidize because only VG and a few of the very most price conscious customers will buy it. On the other hand, the Cabbage Fund was also used to keep prices down on some items that was sold in large volumes, and which were especially important for the average price conscious customer, such as ribs during Christmas or Pizza Grandiosa all year round" (Court Data, OT, p. 10-11, translated from Norwegian).

The use of the Fund as a way to influence market shares amongst the retailers began during the early 2000s and culminated in autumn 2004 with the establishment of the hard discount chain *Lidl* in Norway. The Lidl chain would compete head-on with Rema 1000 and its low-cost profile. Indeed, this competition was so fierce that it forced Lidl out of the Norwegian market after only about a year of operations and massive losses. Lidl's entry formed a significant back-drop to the negotiations during 2004 as Rema was looking at every possible way to cut costs (Court Data, OT, p. 14).

In order not to lose market share due to bad positions in the price comparisons in media, Rema used the Cabbage Fund to counteract the increased competition. This is a real competitive challenge in which the development points towards increased market shares for the hard discount stores while the supermarkets and hypermarkets lose out. This means that today, in a growing total market, the hard discount stores come out as winners (Nielsen, 2011; *Aftenposten*, 2011-03-02). One important tool to achieve this has been the Cabbage Fund.

The Cabbage Fund is funded by the producer side through their contracts to deliver (Court Data, OT, p. 10). Over some time and across a wide range of products and a vast amount of product categories, the fund quickly became sizable. It gave Rema a tool to handle the increased competition and the price comparisons in media. In addition, the Cabbage Fund could be used to lower the prices on seasonal food such as lamb and ribs during the important Christmas season. Hence, any changes in supply of a product or product category, such as the negotiations with Tine to possibly become an exclusive supplier to Rema, had to be considered based on the effects such a change would have also on the Cabbage Fund. Such calculations were made by Rema. Tine's suggested compensations were entered on the plus side of the calculations and changes in the Cabbage Fund were also included.

“The calculations also comprise changes to the financial strain on the ‘Cabbage Fund’... The numbers for Synnøve Finden’s products were taken out and the units sold of these were transferred to Tine’s products, and then the consequences for this to the ‘Cabbage Fund’ were calculated. In the calculation, it was first made an estimate based on the prices of Tine’s yellow and brown cheeses to be the same as Synnøve Finden’s at in this case 50 and 66 NOK per kg, which would charge the Cabbage Fund with 7.856.202 NOK. Tine’s suggested increase in remuneration was slightly lower than this (7.771.000 NOK) so that the calculation at the outset showed a small loss when choosing Tine as a ‘single supplier’. Høylye [Key Account Manager for the Tine account at Rema] suggested, however, to keep the [higher] outgoing price on *Norwegia* [a branded yellow cheese with a higher price from Tine], and then choose a less popular cheese than *G 35* as the cheapest brown cheese from Tine, which would result in a smaller strain on the Cabbage Fund (2.062.160 NOK). The improvement on profit from such an arrangement was estimated to about 5.708.840 NOK. “ (Court Data, BL, p. 28-29, translated from Norwegian).

It is clear that Rema used the Cabbage Fund to evaluate the effects of changes in supply using alternative calculations as scenarios both with status quo prices as well as with strategic pricing of some particular branded cheeses from Tine. These calculations are used in the negotiations with both Tine and Synnøve Finden.

6.0 Analysis: The Retail Power Nexus and its Consequences

6.1 What Can We Learn from the Access to Market Game?

The compensations made by producing actors such as Tine are partly motivated by special marketing activities, etc. However, most have no real corresponding service allocated to it. It must thus in part be seen as a charge to gain access to the consumer market – hence reflecting a capacity on the side of the retail chains to privately tax access to customers. The facilitation of front-stage horizontal competition among the supermarket retail chains provides consumers with an image of market competition that is rather different from the characteristics of the ‘real’ competition as well as the collaboration orchestrated back-stage. The consequence of

this is that agricultural food producers which are subject to government subsidies are forced to re-distribute some of these subsidies to other parts of the network due to the emergent distribution of power.

Table 1 shows the fact that NG, already from the start the largest retailer, receives the largest compensations, despite Tine's attempts to countervail this from happening. This is a manifestation of a mechanism that is in effect in this game. It is a mechanism of concentration which drives towards increased concentration of power, wealth and benefits in the economic system and which generates increasing returns to scale (in this case market size). The impact is that actors are being compensated with exponential returns with respect to scale.

One central implication of this pattern is that the dominant retailer is able to generate exponential economic returns to growth, as compared to its rivals. These resources are allocated to the top of the organization, and serves both as core strategic resources to top management and as a source of extraordinary economic returns to owners – which in this case primarily is a family deeply engaged with the business. These advantages in terms of ability to allocate over-proportional financial resources act explicitly as a mechanism to strengthen and expand market dominance. This is because these resources are being deployed to 'fight off' the smaller rivals.

It is equally clear that the funding of this strategic advantage is based on contributions from the suppliers, which for the most part have an interest in maintaining a balanced market among its customers. So, effectively, they finance a mechanism that seems to work against their basic interests. This mechanism will severely constrain the ability of the smaller retail chains to gain market shares over time, via for instance investments in marketing, new facilities or engaging in more aggressive 'price wars'. The largest will grow even larger, and the smallest will tend to decrease – unless the disadvantage is not countered by external resources to support its position.

6.2 What Can We Learn from the Latitude Game?

The latitude game shows that actors are not interacting at arms' length distance in this network. Actors are looking for ways of getting into and out of contracts with other actors. However, within this setting of a tightly interdependent industrial network, latitude – room for action – is hard to find. Both exits and intros will have indirect effects on other actors, and may therefore prove difficult to make in practice. Actors are not independent, not even if they want to, or try to be. For example, the data above shows how Kavli tries to act independently by supplying Rema with milk, but this is problematic because of the company's relationship

with the largest retailer NG. It impacts the negotiations between Rema and Tine during 2004 as Rema looks for alternative sources of supply.

The same is true for Synnøve Finden when it comes to the hard brown and yellow cheese categories. Both Kavli and Synnøve Finden have linked up tightly with NG. The result is that they are less independent with regard to supplying other retail organizations such as Rema, while at the same time being dependent on their ability to supply many retailers in order to maintain sufficient volumes. Being delisted as a supplier to Rema would be a significant blow to both producers and would impact the profitability of the companies. This is a threat under which these companies act and which also impacts the negotiations of other actors in the system, as we have seen. This threat arises as a result of a linking mechanism which connects actors to each other in certain ways, which ensures that the particular economic resources can in fact be utilized and exploited. When de-coupled, the given productive capacities cannot be utilized, as there is no free access anywhere. Alternative access depends on another contract – which will have to wait until the next Autumn Hunt.

As a result of this interlinking, the level of complexity in the system increases and it becomes difficult to single out isolated effects of actions among actors in the network. It also means that the task of regulating such a system becomes difficult as there are always indirect network effects that were perhaps neither perceived nor wanted by those who actually decide. This indicates that suppliers are generally highly vulnerable to strategic decisions on the side of the retailers – due to their control of access to the consumer market.

Access to alternative suppliers or alternative retailers in case a given negotiation does not lead to a contract, obviously become core to all the actors. This two-way negotiation dynamic between suppliers/producers and purchasers/retail plays out via the development of two types of leverage: First, it is in the purchasers' interest to develop and maintain excess capacity on the supply side. Hence, they seek to stimulate actual as well as potential producers to invest in and maintain excess production capacity, e.g. by indicating potential contracts exceeding the present capacity of a producer (as in the Kavli case). In market theory, such capacities would rapidly disappear from the market due to the immediate financial losses. However, the purchasers want this excess capacity to remain in the system in order to maintain a higher degree of latitude. But this basically means that there are production and logistics activities going on that are not used, it is waste, hence adding costs to the overall production system. A core issue, and a vital part of the ongoing negotiations and indirect influencing, is therefore who will carry these costs. Second, for the producers/suppliers to be able to respond to this challenge, they are forced to integrate their negotiations to limit the

latitude of the purchasers. In this way they can develop some degree of leverage in the ongoing, repeated negotiations.

Hence, the ability to generate excess capacity and alternative network constellations among suppliers is a matter of core interest to the retailers. Hence, the more powerful they get, the more they will execute their powers to induce the establishing of excess production capacity and alternative supply networks. Concentration on the retailer/market side will hence induce suppliers to collaborate to maintain strict capacity constraints – if possible – in order to stabilize their businesses.

The latitude game reveals two different mechanisms that are opposing one another. One is a mechanism that through potential future contracting stimulates growth and maintenance of excess supply capacity to increase the latitude of those in control of market access. The other mechanism is one that through organizational integration and coordination supports supply side integration aimed at rebalancing the drive towards excess supply capacity. In an effective networked economy, these powers and interests somehow need to be balanced in order to maintain a fair distribution of returns to capital and labour across the networked activities.

6.3 What Can We Learn from the Price Dumping Game?

This game illustrates how price wars work in a highly networked economy. Rather than marginal cost based product competition as analyzed in classical market theory, this competition is about integration of strategic competitive resources across the entire supply networks on the one hand, and a sophisticated staging of front stage and back stage arrangements and price communicative actions aimed at influencing consumers perceptions. Price wars in networked economies are not marginal cost related, but is rather front stage marketing campaigns supported by particular back stage organized accumulations of structured financial resources. Product price competitions partly becomes a structured instrument to fight for overall market share (which have implications for the market access game above) and partly a market segmentation device aimed at positioning branded sub-chains in the perceptions of consumers. Effective and massive market communication is core to this activity.

The underlying mechanisms of the price dumping game is accordingly partly one that stimulates the mobilization of financial resources across the supplier networks, and partly one that moves more of these resources towards strategic communication activities in which strategic “price wars” is one out of several strategic weapons.

While the origin of the Cabbage Fund is to be found in the horizontal competition among retailers for overall market share, its effects are not limited to that part of the system only. In fact, some of the most intriguing effects are to be found mainly in the vertical industrial system of production and processing.

It is noticeable that Rema's price cuts are fully financed via the Cabbage Fund. It is not actually a price cut, even though it looks like it at first glance; instead it is a planned price adjustment fully financed by the suppliers. Some of these may be a supplier only to Rema, in which case incentives will be aligned with Rema to participate in the operation. Others may be suppliers also to the other retailers, in which case there is little to gain from a reallocation of market shares among their retail-customers. Hence, incentives are not aligned and they are in fact forced to participate. All the suppliers contribute to these funds. Hence, over time, one may expect the dynamics of these mechanisms to drive developments towards restructuring of supply chain operations to conform to the retail-chain market structure over time.

7.0 Discussion

The court data offers rich illustrations of the types of power that some actors (retailers) currently exert in the Norwegian food sector. It is however not unique to Norway. The same retail concentration and power nexus can be seen in the rest of Europe and the Scandinavian countries, including, for example Germany and Sweden⁷. An analysis of the court data that we have access to therefore may bring insight into some of the power dynamics that could be expected to be present in most economies like the Norwegian dairy sector and food retail system, such as the ones in the other Nordic, European and North American countries displaying similar conditions.

Our cases clearly show that some actors in certain positions can exert powers and influence in the Norwegian food production and retail system in such a way so that they achieve a favourable redistribution of the values and wealth that the system produces. These actors are first and foremost the retail organizations. Their power lies in their position in the network controlling the interface to the Norwegian end-consumers. Occupying this position means that they can control the mechanisms of value and wealth generation and distribution. This control has developed with the retail organization over the past two-three decades.

⁷ In Germany, for example, the competition authorities are looking into the need of possible intervention and regulation, as are the Norwegian authorities through 'Matkjedeutvalget' – the Food Chain Committee which was appointed by the Ministry of Agriculture and Food in March 2010. See also Aftenposten 2011-03-23; 2011-03-16, and <http://www.regjeringen.no/en/dep/lmd/aktuelt/nyheter/2010/Mars-10/Matkjedeutvalget-Forste-mote-i-dag.html?id=595099>

While the production side is not without power in this system, the significant power apparently sits with the retailers. Here the industrial network meets the consumer, and here is the source of power and influence in the entire production system.

7.1 The Emergence of a Neo-Mercantilist Model of Organizing in Networks

Network position is a concept that has been used to understand actors' ability to influence and exert power in networks (Anderson, Havila, Andersen, & Halinen, 1998; Håkansson & Snehota, 2006; Johanson & Vahlne, 2006; Mattsson & Johanson, 1992; Wilkinson, 1979). Our results show that the positions of actors in a network are crucial for the allocation of resources so as to distribute wealth and accumulation of financial resources to specific actors. Our analysis indicates manifestation of the distribution of power in the network and it relates to how it is concentrated to this particular retail organization. In our case, both Rema and NG used their positions at the interface between industry and mass consumer markets to privately tax their suppliers for market access, and then mobilized these resources to grow their market dominance further. One could say that they apply a new mercantilist model using powers stemming from the interface position in a specific way.

This new mercantilist model enhances some actors' ability to centrally aggregate resources from the network and use them to increase their margins and profits. It is a model of resource mobilisation derived from these actors' specific power positions at the interface between end consumers and the industrial network. This is a finding that complements prior understandings of power and positions in networks as reported by IMP scholars. This study extends our knowledge by pointing at the involvement of mechanisms which drives dynamics towards even more concentrated networked structures, and mechanisms that drives towards "unproductive" activities like excessive supply capacity and marketing activities, but also at mechanisms that counteracts some of these.

A concrete example of the combined effect of this is what we see in the Price Dumping Game. It is not always the most effective actors that can direct this, but those that are best at identifying and controlling these mechanisms through significant integration in a mobilised network. These actors are the strongest in these particular power games as they can use centrally mobilised network resources to win market shares and increase profits. As a result the large becomes ever larger. It may not be a coincidence that the world's largest company; Wal Mart is a retailer. It has developed its position for a long time. This points to a new form of mercantilist network organization in which the domains – the "territories" – for trade are being increasingly concentrated and controlled by private organizations.

Historically during the mercantilist era market places in cities and villages were taxed by governments based on geographic jurisdiction and control. In the new mercantilist model the market is also taxed by private retailers based on economic and financial concentration and power derived from the elaborate interactions in networked economies.

7.2 Managerial and Policy Implications

From a managerial perspective, being able to identify and participate in network power games is crucial in order to create long-term prosperity. The mechanisms indicated in this study represent keys to understanding these games and how firms and organizations can utilize them to gain influence, exert power and develop positions. However, these things are neither quick nor easy. It is costly and takes time because in essence it requires the ability to control and access key resources – resources which usually lie outside the direct organizational control of any single actor. But by departing from an analysis of the mechanisms in a given network and then identifying the relevant resources required to utilize them, a systematic approach can be established in which an actor's interaction patterns can be long-term systematic, purposive and strategic. However, as with all strategizing in networks such efforts are always moderated by unforeseen events and unexpected developments which calls for a continuous re-evaluations. The basic mechanisms in a networked economy such as the ones indicated in this paper will remain relatively stable, also over time and these things change less rapidly as does the “surface” micro-interaction patterns among the actors. This is why using them as a point of departure for the establishment of a systematic interaction strategy is useful.

From a policy perspective, the challenge is both to understand and to govern in the face of the new dominance of extended networked economies. It is necessary to analyze the power structures within these economies, the economic mechanisms that are at work that may drive the system in particular directions – possibly away from important political objectives. There is potentially a need to develop new regulatory approaches and techniques, to ensure transparency in new ways, fairness and reasonable behaviors in business affairs and support a balanced and efficient economy in the age of interacted business networks.

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Appendix: Main Data Sources Used

1. The Norwegian Competition Authority (2007). (Konkurransetilsynet). Vedtak V 2007-2: *TINE BA – overtredelsesgebyr etter konkurranseloven § 29, jf. §§ 10 og 11 – konkurransebegrensende eksklusiv leveringsavtale*. Ref. 2005/58 – 230. (In Norwegian).
2. Court Ruling Tine BA vs. Staten v/Konkurransetilsynet (2009). Oslo City Court (Oslo Tingrett). Dom Saksnr.: 07-063120TVI-OTIR/07. 25.03.2009.
3. Court Ruling Staten v/Konkurransetilsynet vs. Tine BA (2010). Borgarting Appellate Court (Borgarting Lagmansrett). Dom Saksnr.: 09-089085ASD-BORG/02. 07.09.2010.

Table 1: Tine's compensations to and shares of turnover in the big four in 2005. The 2004 figures are contained within parenthesis for purposes of comparison (Adapted from Court Data, BL, p. 40).

	Compensation in M NOK	Compensation in M EUR*	Tine's turnover in the chain in M NOK	Tine's turnover in the chain in M EUR	Compensation in % of turnover	Compensation increase (%)	Compensation increase in relation to average turnover (%)
NG	143.622 (110.488)	16.900 (13.000)	2.995.000 (2.981.660)	351.939 (350.371)	4.80 (3.71)	29.98	1.1
Coop	60.300 (60.750)	7.086 (7.139)	2.170.000 (2.192.136)	254.994 (257.595)	2.78 (2.77)	- (n.a.)	- (n.a.)
ICA	65.800 (46.587)	7.732 (5.474)	1.989.000 (1.806.235)	233.725 (212.248)	3.31 (2.58)	41.24	1
Rema	36.600 (23.550)	4.301 (2.767)	1.605.000 (1.629.822)	188.602 (191.518)	2.28 (1.44)	55.4	.8

* Based on an exchange rate of 1 NOK = 8,51 EUR in January 2005.