

Network Management in Retailing: Quest for Hybrid Organisation

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Abstract

Hybrid organisations pose important theoretical and managerial questions. We examine a large Finnish retail organisation in order to identify and understand the potential and challenges of hybrids or network organisations in a retailing context. A conceptual framework for understanding the governance processes of hybrid network organisations is proposed and the key managerial challenges of hybrids are discussed.

Introduction

The operating environment of the trading sector has undergone significant changes in the 1990's. New retailing concepts, international purchasing, use of data and information technology, intensified co-operation between industry and trade (ECR), changing roles of the wholesale and retail trade, and the increasing importance of customer relationships are the key factors driving the change.

This change has invited considerable research attention to the organisation of transactions and relationships between large retail chain organisations like Tesco and Wal-Mart and their suppliers. On managerial side the discussion has been very much dominated by the Efficient Customer Response (ECR) movement and studies related to the potential efficiency gains to be received through a closer integration of the material and information flows between final consumers, retailers and manufacturers.

From academic research perspective the issues related to interorganisational management of strategic supplier partnerships, required by the ECR concept, have been in the foreground. Programmatic research based on the transaction cost economics and political economy approach on the one hand and on social-exchange theory on the other hand (see Möller 1994 for summaries of these approaches) has examined the efficient governance forms between retailers and suppliers, and the role of trust and commitment in their relationships (Anderson and Narus 1990, Doney and Cannon 1997, Geyskens et al., 1998, 1995, Heide 1994, Jensen and Skytte 1997, Lusch and Brown 1996).

While the study of interorganisational relationships has flourished little attention has been given to the emerging hybrid organisation of retail firms. Large chains like Wal-Mart and Tesco, that on the one hand are strongly centrally governed and on the other hand have established large supplier networks, represent one mode of these hybrids. In the Nordic countries, especially in Finland and Sweden there exist large co-operative chains that consist of a central unit and a large body of contractually united individual retailers. In this kind of organisation a crucial managerial issue is how to balance the hierarchical control that is required for the efficiency for operation and the autonomy of individual retailers that provides strong entrepreneurial incentive and adaptability for local environment.

We suggest that this kind of organisation is located between markets (each retailer dealing directly with its customers and suppliers) and hierarchies (the central management controlling completely the activities of retailers). As such it is an interesting example of a hybrid type of network organisation, where all the three basic governance modes – market, hierarchy, and networks – are present, Powell (1990). A central managerial issue in this kind of organisation is to try to identify the appropriate governance structures and managerial processes for operating in to-days intensified competition.

Objectives and the structure

This paper is part of a larger study examining the modes and processes governance in a hybrid vertical retailer organisation. Special attention is paid to the management of the network aspects of the retailer organisation. In this pre-study we examine the organisational character and managerial challenges of a specific modern retailing company. Our objectives are:

- To identify and discuss key managerial issues of a hybrid retail organisation.
- To construct a conceptual framework model describing a hybrid vertical retail organisation.
- To derive propositions for future studies and for managerial recommendations.

Tension between retailer autonomy and hierarchical control by a chain management provides focus for our discussion. The framework will be based on the literature of managing hybrid organisations, literature of channel management, and industrial network studies.

To achieve the study objectives we need intimate knowledge of the managerial practices and contractual forms used in retailing companies. We also need access to both the central management and to the retailers. These requirements, together with the sensitivity of the issues examined, emphasize the access aspect of the case. The Finnish K-Alliance containing several chains has agreed to host the study. The lead author is working in the corporation.

We start by describing the managerial challenges a modern retailing organisation using Kesko as an illustrative case. Then a conceptual framework model capturing the hybrid aspect of governance in a retailing organisation is constructed paying special attention to the network perspective. Discussion on managerial challenges concludes the study.

A Retail Corporation as A Hybrid Organisation

In order to identify the core managerial issues of a hybrid retailer company we first describe briefly the structure, organisation and business idea of Kesko, our exemplar company.

Case Company – Kesko Corporation – in a nutshell

Kesko Corporation, one of the leading Nordic retailers, is formed by a wholesale company Kesko and Finnish K-retailers and K-store chains. The K-Alliance has 16 chains, operated by a total of 1,650 retailers. In public, the K-Alliance is often seen as a homogeneous group hierarchically led by Kesko. In reality the K-Alliance is a network formed of independent businesses and entrepreneurs. This network consists of 2,184 K-stores; 1,871 K-retailers; 24,093 K-store employees; 20,000 major wholesale customers; 42,000 suppliers and other co-operating partners, and the personnel of 11,172 of the Kesko Corporation. We will use Kesko to describe the central unit and K-alliance and K-Group to describe the whole entity.

Kesko is in charge of the strategic corporate planning of the K-alliance. The central unit develops business concepts and is also involved in creating store concepts and operating models. Its profit divisions develop store types and the store network. The K-retailers are independent entrepreneurs who are entitled to use the K-logo or other marketing symbols of the K-Alliance. In their entrepreneurial capacity, the K-retailers are responsible for customer satisfaction and the profitable performance of their stores. The K-retailers are Kesko's shareholders and members of the K-Retailers' Association. The turnover of the Kesko Corporation in 1999 totalled EUR 6,111 million and the sales of the K-stores in 1999 amounted to EUR 6,773 million.

There are also several daughter companies, which are producing services to K-Alliance and its customers and also competing in open markets, for example Kespel (transportation company) and K-institute (training company). In brief, K-Group is a very complex 'mega-organisation' including aspects of a traditional hierarchical organisation, network relationships, and even internal markets. Similar features characterise also many other large retailer companies like Sainsbury and Tesco in the United Kingdom. Because of this we contend that the K-group forms a valuable "laboratory" for examining the management issues of hybrid retail organisations in general.

Hybrid Management in Retailing: Levels and Issues

One way of investigating the management challenges of any complex organisation is to try to identify the different levels or layers of the major decision domains, the actors involved in these domains and their relatedness, and the governance mechanisms or processes through which the organisation is directed and controlled.

In large retailing corporations one can generally discern four major management levels: the corporate level, general chain management level, chain management level, and retailer level. These are described in the proposed Retail Management Framework in Figure 1. The Corporate level contains such high-level decisions as policy about in which retailing sectors to operate – resulting into chain portfolio, and corporate finance and ownership policies.

Management Levels & Decision Domains

External actors

Level 1: Corporate Management
 * Corporate policy including decisions about

Level 2: General Chain Management
 * Policies involving the joint management of chains (e.g. chain concepts, centralised purchasing, site portfolios, management)

Level 3: Chain Management
 * Chain management, retailer and site portfolio decisions, implementing coordination and incentive systems, developing chain concept, and store concepts including assortment decisions

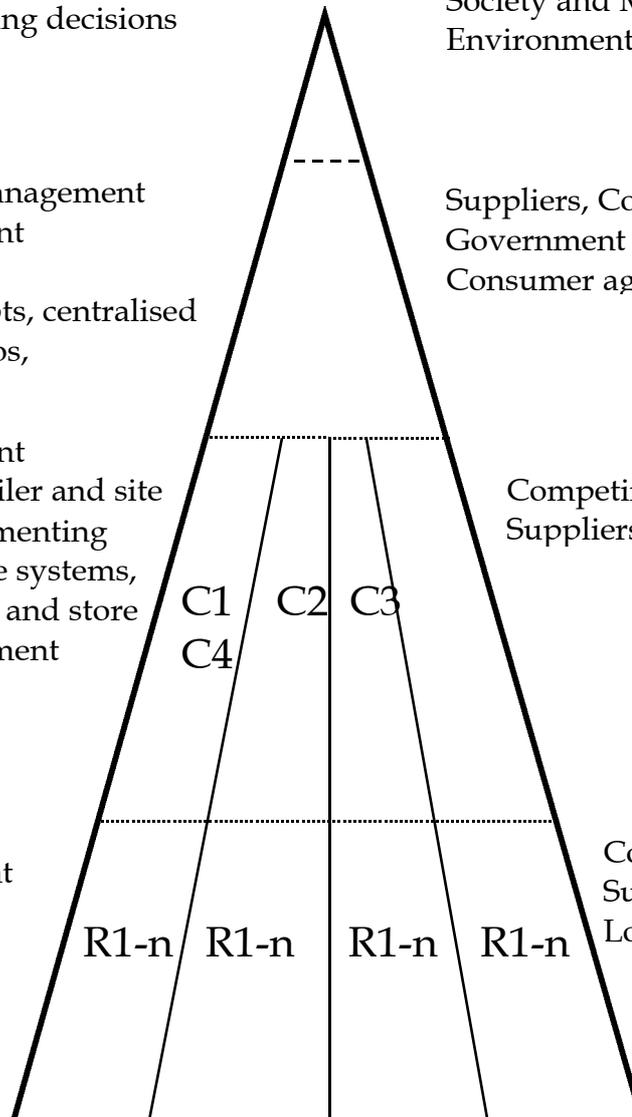
Level 4: Store Management
 * Managing a single store, personnel management, customer care, fine-tuning the store concept in local competition

Society and Market Environment

Suppliers, Competitors, Government agencies, Consumer agencies

Competing chains, Suppliers, Institutions,

Competing stores, Suppliers' sales agents, Local authorities and



C indicates the chains in a chain portfolio, R indicates the number of store in each chain.

Figure 1. Management Framework of A Retail Corporation

The second level covers decisions related to the joint management of retail chains (e.g. chains of hyperstores, supermarkets, footwear stores, sportswear stores, farming and gardening products, hardware and home decoration etc.). A key managerial problem is to identify what tasks and activities should be decided and controlled centrally and what decisions should be left to the discretion of chain management. In principle, activities that can be standardised across multiple chains, leading to scale economies and efficient use of resources should be controlled at this level. Whereas activities that need chain-specific knowledge and adjustment belong to the chain management level. Development of chain concepts, general management of the store site portfolios, supply management of cross-chain products and services, and the development of managerial principles and programmes for chain management (incentives, coordination tools including financial planning and IT facilities) are generally managed in an integrated fashion. An important issue is the selection of chain directors.

The management of specific chains takes place at the third level. It includes the development and fine-tuning of the chain concept and store concepts including assortment decisions, pricing, marketing communications, and customer programmes. These activities are guided by the segmentation and positioning decisions, which form the basis of the competitive strategy of the chain. Other major activities include the development and care of retailer portfolio (selection, training and management of the retailers), allocation of store sites among the retailers, and implementing the coordination and incentive systems of the chain. Again, a major issue is what activities and decisions to standardise across the stores and what to leave at the discretion of the retailers. Again, an important issue is what activities to centralise and what to leave for the retailers to decide.

Store management constitutes the final level. It covers the activities related to management of the personnel, customer service, and fine-tuning the store concept in response to the local competition.

Next we discuss the identified management issues from the perspective of the basic governance modes and processes. For a more detailed description of retailing management in general see e.g., Pelton et al., (1998), and Stern and El-Ansary (1992).

Governance Modes and Mechanisms

The term of governance has been defined in slightly different ways in previous studies. In a broad sense governance refers to the mode of organising transactions (Williamson 1975, Williamson and Ouchi 1981). Håkansson and Johanson (1993) classify the governance modes into network, market, hierarchy and culture/profession. Ouchi (1980) has dealt with organisation of transactions in a closely similar way; he categorises the basic modes into classic market, bureaucracy, network structure, and clan. Both these categorisations share the same key elements of governance structures: external and internal competition and cooperation, organisational solution, and management modes. We use governance to refer to (1) the modes by which firms are carrying out business with the actors of their business environment, and (2) to the organisational and managerial arrangements of their internal government.

Williamson (1985) pointed out, that intermediate governance forms, which are neither hierarchy nor market, represent hybrid structures. Powell (1990) argued that most organisations are actually hybrids and described the basic characteristics of a hybrid organisation, which he actually called a network organisation, where all the three basic governance modes – market, hierarchy, and networks – are present. Håkansson and Johanson

(1993, p. 46) argued, “that network governance should not be viewed not as some kind of intermediate governance mode on a unidimensional scale between market and hierarchy, but as a unique type”.

We adopt Powell’s perspective as we are primarily interested in how a specific hybrid organisation uses simultaneously all three governance modes. This is in line with how hybrids as governance structures are seen by Bradach and Eccles (1989) who consider them to be ‘plural forms’ - arrangements where distinct organisational control mechanisms are operated simultaneously for the same function by the same firm. They also emphasise that we must create more understanding of how price, authority, and trust, that form the basic and generally intertwined control mechanisms, are employed.

Finally, governance should always have a goal. A key issue in any organisation is the achievement of organisational effectiveness and efficiency. Using Pfeffer and Salancik’s (1978) definition: “Organisational effectiveness is an external standard of how well an organization is meeting the demands of the various groups and organisations that are concerned with its activities. The effectiveness of an organization is its ability to create acceptable outcomes and actions. Organizational efficiency is an internal standard of performance. The question whether what is being done should be done is not posed, but only how well is it being done. Efficiency is measured by the ratio of resources utilised to output produced.” An important point is that different governance modes probably vary in their usefulness of achieving efficiency versus effectiveness oriented organisational goals, Powell (1990). This poses a challenge of identifying a balance between the efficiency and effectiveness, and further, of identifying and mastering a combination of governance through which that balance can be managed. We contend that these questions form the core of hybrid management.

Kesko Group as A Hybrid Organisation

We will discuss the issues of managing complex hybrid organisations by using our case company Kesko as an illustration. In this phase only a concise description of the major issues is feasible. The discussion is structured by examining what kind of governance mechanisms/management modes are relevant for elaborating the managerial issues identified in the framework model in Figure 1.

Competition and Prices

Competitive processes exist at several levels of the organisation. There is competition between the current and potential news chains about corporate investment funding. Chains may compete about suitable store sites as good sites are both scarce and costly. Retailers as independent entrepreneurs compete between themselves about good sites within the chains. Retailers want to buy their merchandise with as good terms and prices as possible and to realise that they oppose centralised purchasing and want to compare Kesko’s centralised prices against suppliers’ direct offers. This provides a market-based control on Kesko’s centralized purchasing and logistics. On the other hand, completely free purchasing would lead to loosing the economics of scale that can be reached through centrally governed supply management.

Retailers, who own their premises pay a percentage of their sales as a fee for the use of the chain and K-alliance concepts, they also pay a percentage fee marketing support. Those retailers who rent their premises from Kesko pay a market-based rent in addition. These prices can be, in theory, regarded as market-related governance in the sense that the retailer

has an option to join another alliance or sell out. The prices are agreed through a negotiation process. If the central organisation tries to force too high charges it will start to lose its retailers.

Many chains have overlapping assortments, especially groceries and other daily shopping goods. If the chain concepts and their site portfolios are not well planned there can be severe inter- and intra-chain competition between retailers in local markets. This reduces individual retailer's sales and revenue but can actually increase the total market share of the K-Alliance. The phenomenon creates tension and mistrust between both the competing retailers and between them and the chain management and the K-Group as a whole.

Power, Authority, Control and Incentives

Chain management has several sources of power that provide it authority. In practice this authority is employed through various control and incentive mechanisms. Chain management exercises its power in the selection of retailers, in allocating store sites, and in negotiating the contractual terms with retailers. Here the underlying dimension of power is the possibility to provide and withhold resources. Kesko's power is also based on the expertise and managerial support that the chain management and the whole K-alliance can provide for its retailing members. These are embodied in the chain and store concepts and in the managerial programmes provided for the retailers including store management and accounting systems, educational programmes, and marketing support. Through store site planning the chain can also control the competition between retail sites discussed under "competition and prizes."

The managerial support systems include also devices that can be employed to control the performance of the retailers, such as financial and sales objectives and their indicators, and customer satisfaction and retail personnel satisfaction measurement. The chain monitors also the compliance of the retailer to the agreed chain concept.

Many of the discussed characteristics of sources of power and modes of control are also sources of incentives. Good store sites and well functioning chain-concepts and store-concepts are sources of revenue and social esteem for the retailers. Receiving a good store site not only enhances an entrepreneur's earning capability but provides him or her esteem from peers and social recognition in general.

So far we have adopted the perspective of the centralised K-management, obviously the retailers have their own power base, too. Experienced and motivated retailers are the key sources of success for the K-Alliance. Its core business concept is based on the idea of co-production of value for end customers. In this production process the retailers play a crucial role. The more professionally competent and successful a retailer is the stronger position he or she has in the Kesko-system. Retailers possess also institutionalised power in the K-Alliance. As a major shareholder group they have their representatives in the different executive bodies of the K-Alliance and can influence the formation of policies and programmes of the entire K-Group. Retailers are also organised through K-Retailers' Association. This institutionalisation provides a strong negotiation position for the retailers within the organisation.

Social Institutionalisation, Trust and Norms

The K-Alliance has developed several mechanisms that aim at creating trust-oriented relational norms (Heide and John 1988, Heide 1994) in the organisation and at enhancing the commitment of the members to the K-Alliance. The integration of the retailers into the

governance of the corporation through ownership and representation, discussed above, represent a fundamental commitment of the whole organisation in co-operative governance. This as such is expected to support an open and trusting organisational climate.

A set of norms emphasising the retailer autonomy and entrepreneurship on one hand, and the joint co-production of value, mutuality, interdependence, and open communication on the other hand, are communicated through several media. This rhetoric combining individualistic performance and voluntarism, and co-operation pervades all organisational levels and bodies. Besides these meta-norms, values like trust and commitment to the business concept of the K-Alliance and to the members of the organisation (peer retailers, chain management) are emphasised, as well as honest mutual professional behaviour.

The adoption and following of these institutional norms are monitored through membership behaviour. There exist both institutional and peer pressure to comply the norms as well as formal and informal sanctions for non-conformists. Enduring 'rule-breaking' like dishonesty and openly opportunistic behaviour, obvious personal greed, etc., will lead to peer-pressure, and hinder or destroy one's future career in the organisation. It is important for the K-Alliance not to let the rhetoric of the values of the organisation and real managerial and retailer practises to become too widely apart. If norm breaking, especially opportunistic behaviour, is not sanctioned it demoralises the committed retailers. This may decrease motivation and, if spread in the organisation, lead to severe problems for the entire business concept underlying the hybrid organisation.

Discussion

We have used K-Alliance as an illustrative case for examining the principles and practises of a hybrid organisation in a retailing context. Our case represents what Powell (1990) calls a network organisation combining aspects of 'markets' (prises & competition), 'hierarchies' (centralised authority, hierarchical control mechanisms), and 'networks' (interdependence, co-operation, mutuality and trust-oriented norms). We believe that the identified managerial implementations of these governance modes and processes help us to understand also other hybrid organisations and the management of hybrids in general. A brief discussion on the core issues concludes the paper.

A rationale for the hybrid organisation – at least in the Kesko case – is to try to find a solution for achieving both organisational efficiency and effectiveness simultaneously. Let us elaborate this proposition. Hierarchy can be argued to be an efficient governance mode for achieving high organisational efficiency when scale economies can be gained through centralising the activities. It can also be effective if the operating environment is relatively stable and the organisation can develop an incentive system that allows it to develop and maintain an adequate level of adaptive capability. In reality large hierarchies are known, however, to turn into bureaucracies that have severe difficulties in adjusting to the environmental changes and in maintaining the motivation of their personnel. This leads us to the following propositions.

- A hybrid organisation should employ hierarchical governance processes for managing such value activities the centralisation of which can lead to scale economies. Supply management is an obvious example. The potential for centralisation is, however, dependent on the complexity of the activities or resources. Management of complex

resources/ activities generally require localised expertise and tacit knowledge that are better developed and maintained through network governance.

If we illustrate this proposition with Kesko it means that it is easier to develop unified chain concepts in business areas where the operations are reasonably simple. Fast food chains provide typical examples, where the rapid diffusion of the core concept has been mastered through both centralised ownership and through franchising. These can be very cost efficient compared to the more complex hybrids like Kesko. In fact, we believe that a Kesko-type of organisation has a better competitive edge on the retailing of more complex products with a higher margin.

- The business(es) of a hybrid organisation should be relatively complex in the sense that it is difficult to carry out the value activities, and they should be able to earn such revenue that justifies the more costly hybrid governance. Environmental change is favourable to such hybrids that focus on maintaining their adaptive capability.

Examples retailing businesses where the Kesko-type of governance maybe more competitive are agricultural machinery and farming products and services, machinery and services for small builders and DIU customers, and home decoration chains.

- The previous points can be crystallised into an optimisation problem: how to find a right balance between centralised control and localised autonomy in an organisation?, and through what kind of governance processes?

In other words, an organisation must find solutions for accommodating both strong control systems for centralised activities and a network governance for maintaining the motivation and capabilities of their personnel. Although the potential solutions for the posed problems are very context dependent we believe that a careful analysis of the business concepts and the value activities involved can provide reasonable guidelines. We are pursuing these questions more in-dept in the next step of our study.

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