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The Potential for SMEs to enter into ECR Partnerships through establishing Distribution Networks

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1 ECR in a changing economy without participation of SMEs?

Since 1994, it has been appropriate for the traditional distribution channels for consumer goods in many instances, to be reconstructed radically under the name of '**Efficient Consumer Response (ECR)**' to make it possible for businesses to overcome in a cooperative manner, the existing confrontation between manufacturer and trade (see Ahlert/ Borchert 2000, pp. 5; and Friedrich/ Hinterhuber 1999, pp. 2). Instead of negotiating about prices, conditions and isolated sales promotion, the expectations of consumers could be satisfied faster, more effectively and less expensively by adjusting integrative marketing and logistical processes. In **ECR cooperation**, the legally and economically independent manufacturers and trading companies coordinate their efficient replenishment, assortment, promotion and product introduction. This vertical partnership is intended to prevent inefficiency resulting from uncoordinated or even of conflicting tasks by reconstructing processes, organizational structures and job sharing within the distribution channel.

Even though the integrated concept of ECR partnerships in marketing and logistics in Germany was first initiated in food distribution, the effectiveness threshold of this sector does not yet seem reached: In the sixth year of ECR implementation many food companies have participated in cooperative ventures, but their success has been only moderate according to empirical studies. The survey questioned food companies, producers and retailers (referred to the generic term "grocers" in the following sections) which offer food and non-food items as well as marketing (merchandising), logistics and IT service companies. It reveals that **small grocers with a turnover of less than 200 million Euro a year do not participate in ECR partnerships as frequently as large grocers in Germany and that they also evaluate the ECR partnerships very critically**. „Particularly the small and medium-size firms do not feel represented by the key players [...]. ECR means a handful of dollars inly for a handful of large firms. The others get nothing out of it.“ (Hallier 1999, p. 58).

Are large manufacturers and distributors of brands more heavily represented with respect to successful ECR participation?

A successful and efficient ECR implementation calls for coordination of all participating businesses in the value chain, from the subcontractor and extending to the store shelf. On the one hand the common bilateral transformation of ECR cooperation by *large* brand manufacturers in cooperation with a powerful distributor, neglects the integration of small service and/or complementary manufacturers/ merchants into category management. On the other hand *small and medium sized* manufacturers and merchants in bilateral ECR partnerships do not reach the critical size that allows them to invest in equipment which would make for a viable ECR transformation.

2 Barriers to SME-participation in ECR-Cooperations

2.1 The status quo of ECR implementation in the German food distribution

Some insight into the status quo of food distribution provides a sample of the 108 responding grocers mentioned in the evaluation. The sample includes 70 producing companies with a turnover of 54,2 billion Euro in 1999, 27 retailers (58,6 billion Euro turnover) and 11 marketing, logistics and IT service companies (13,8 billion Euro turnover). Thus 30% of Germany's turnover by manufacturers and merchants is included in the evaluation. 70,7 % of the responding companies are ECR partners (ECR-participation). The employees of these companies give their views to the implementation problems, while the other companies give reasons for not

realizing ECR partnerships. The participating companies can be divided into two specific groups of about the same size: **small and medium sized companies with up to 200 million Euro turnover a year and large companies with more than 200 million Euro turnover a year.** Such a division only considers one characteristic of size, the yearly turnover, but it facilitates the observation of size factors influencing the decision for or against an ECR participation in all links of the grocery value chain.

Against the background of concentration tendencie in German food distribution, it is not surprising that more of the merchants who completed the evaluation form are large companies (73,1% of all answering merchants) while for the manufacturers 40,3 % are SME's and 59,7 % large. Figure 1 shows the ECR participation of grocers according to company size: Compared to the total distribution of consumer goods the participation rates of grocers in ECR cooperations is 8-10% higher than the average (Borchert 2000, p 56). This also shows the initiative within the food industry in terms of ECR cooperations that have been established by manufacturers and merchants since 1994, and that have been extended to other fields of consumer goods distribution. **While only about half of the SME grocers join ECR cooperations, 84,5 % of the large companies do so.**

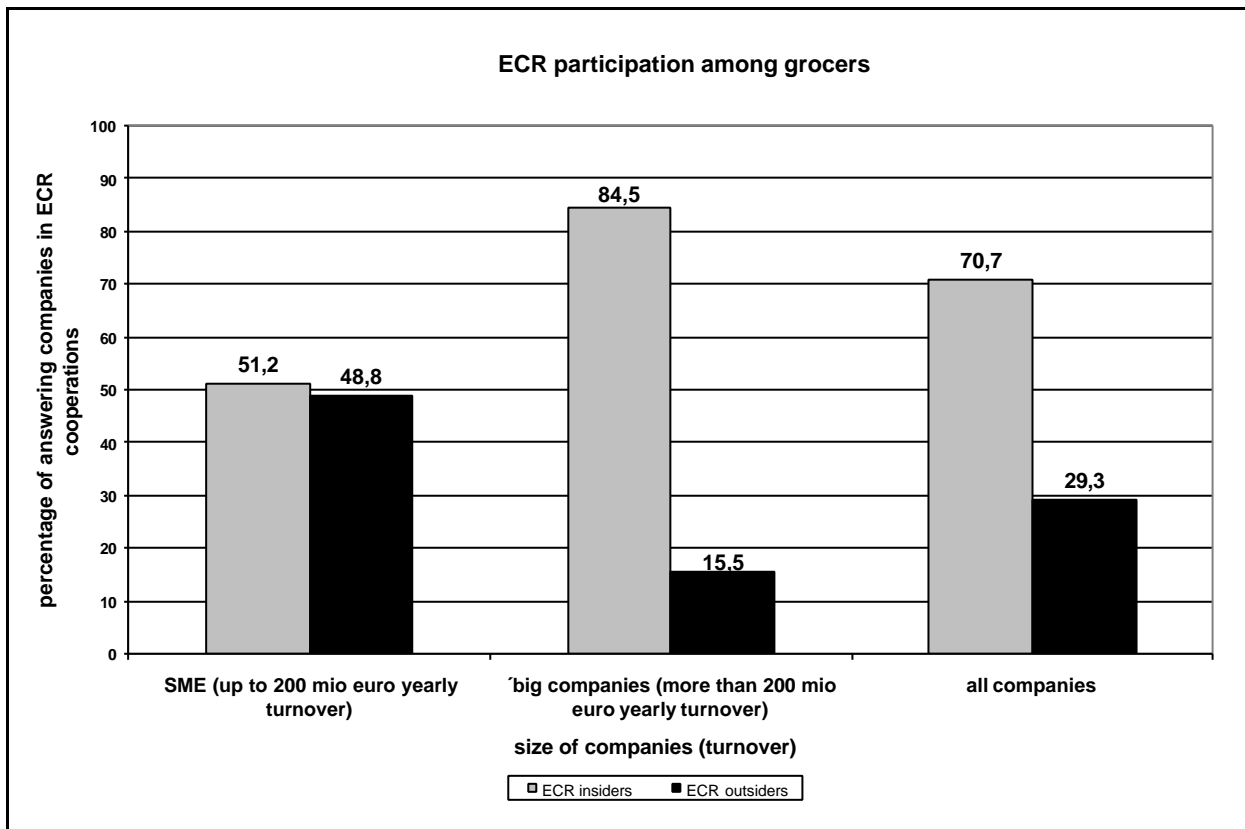


Figure 1: Participations of grocers in a test of ECR cooperations by company size (n=99, Source: Borchert 2001)

Three out of four of the responding ECR experts state that they belong to the five leading companies in terms of competitive position amongst ECR grocer participants. 53,3 % of the *non-participating companies do not include in the 10 leading companies* within the market. These results show that **ECR cooperations are achieved especially by large and leading companies within the German food distribution market.**

These results are supported by the ECR project experience of the responding companies as shown in Figure 2: **While SMEs have participated in an average of 7,6 ECR projects, large companies have an average experience of 19 projects.** All companies together have an average experience of 14,1 projects.

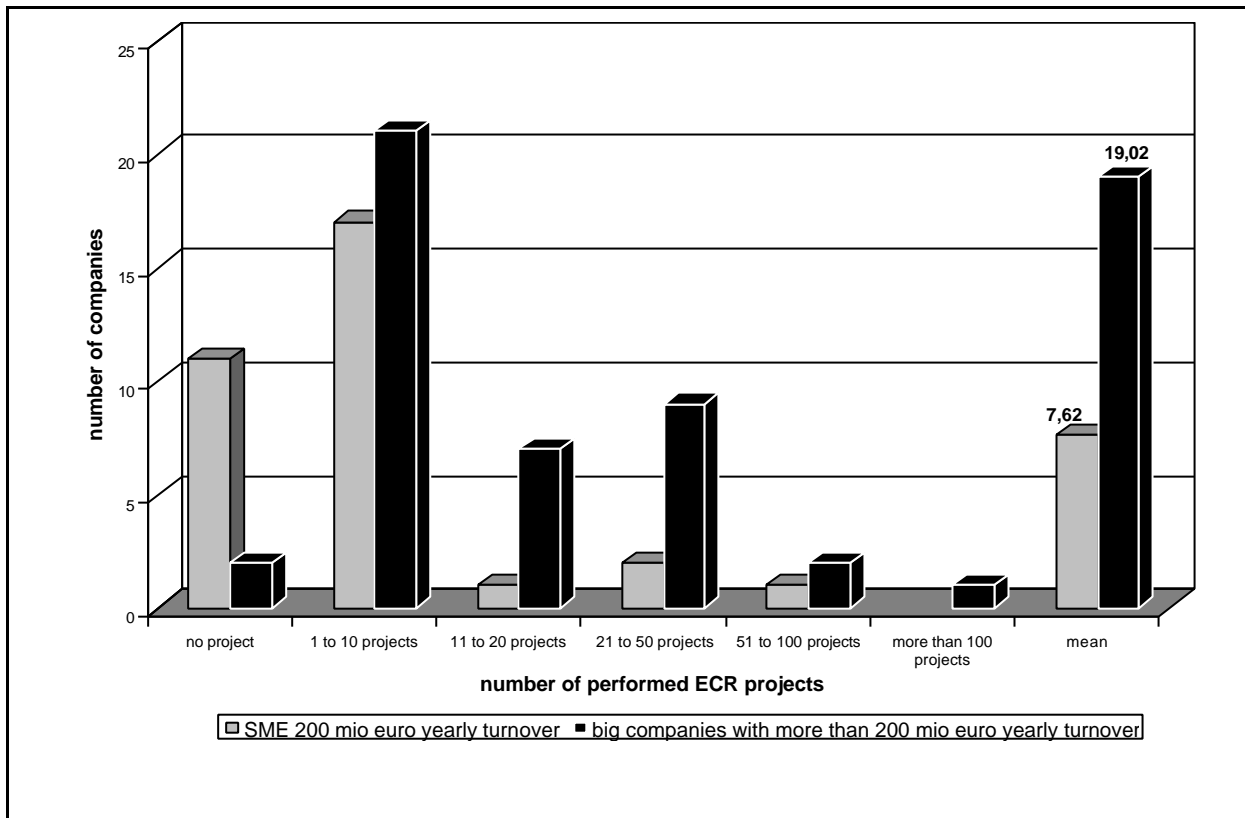


Figure 2: Number of projects of the responding companies by size (until April 30th, 2000, n=74, Source: Borchert 2001)

Those companies that were in an ECR cooperation at the time of the evaluation in spring 2000, implemented the strategy components with varying degrees of intensity. The explicit level of non-accomplished ECR strategies varies considerably as shown in Figure 3.

The operative ECR-strategy components such as product replenishment/ administration, assortment and space management were not carried out by at least every sixth ECR participant. The more strategic marketing instruments like product development, product introduction and promotions were not executed by every second or fourth company in an ECR partnership. The SMEs reveal a level of non-completion of all parts of ECR strategies (except for the similarly non-implemented supply-side strategies) that are on average 4 percent points higher than those of the large grocers. A direct comparison of the extend of transformation reveals positive results for retailers. These companies omit on average fewer strategy components in ECR partnerships, than manufacturers or service companies. This corresponds with the concentration function of product and information flow of ECR strategies and the higher contact frequency with more leading ECR suppliers.

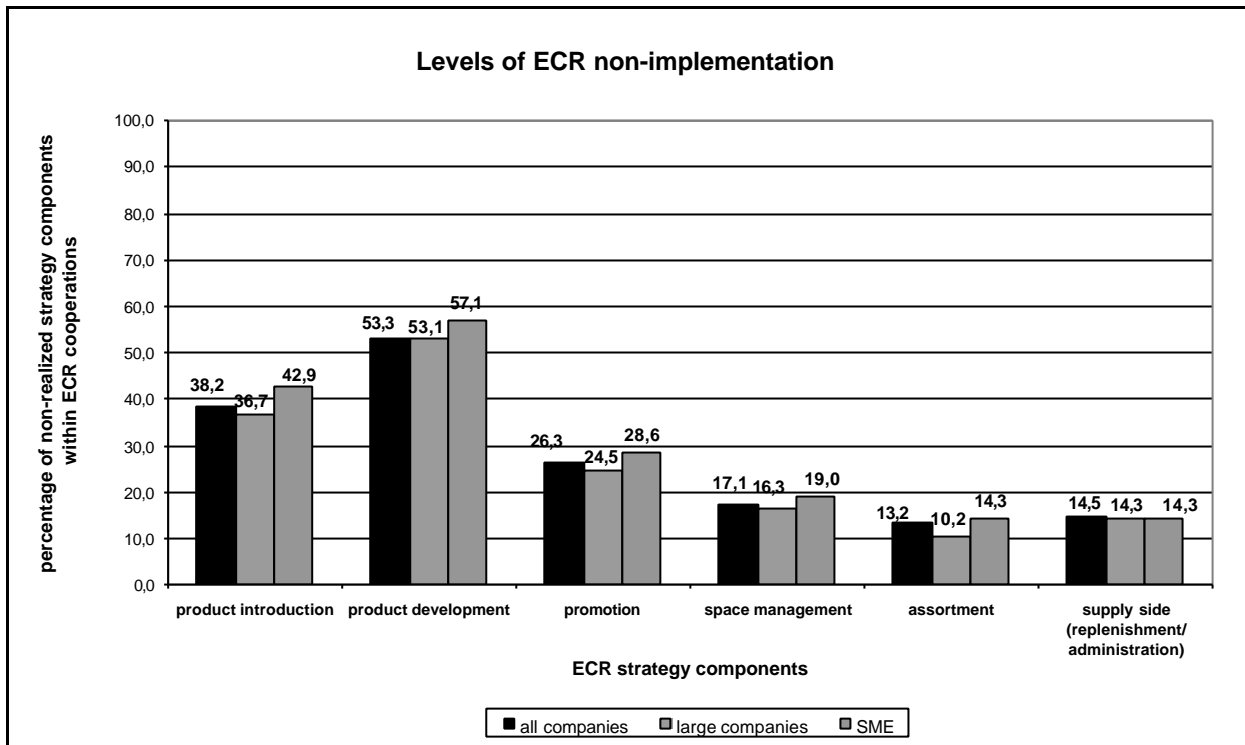


Figure 3: Level of non-implementation of partial strategies of the grocers within ECR cooperations (n=77-98, Source: Borchert 2001)

The success rating of carried out strategy components by ECR experts with respect to goal achievement of proves to be quite varied in all value added stages of food distribution. The following Figure 4 shows that success rating of operative strategy components is mostly positive especially of the supply side (arithmetic mean of 2,4 to 2,7 on a scale of 1= very successful and 5= failure). The more strategic-marketing-oriented instruments of sales promotion, product introduction and especially of product development were only rated as average with tendency towards failure (arithmetic mean of 3,1 to 3,5). Viewing the success rating in terms of size, one can see the evaluation of the ECR strategies by small and medium sized grocers. **The estimates of almost all partial strategy components prove to be more negative when judged by a SME agent than by an agent of a large company.** Altogether the ECR transformation in SMEs, with a mean of 3,3 and the tendency towards failure are classified more negatively than in large companies (2,7) which reveals a tendency to succeed.

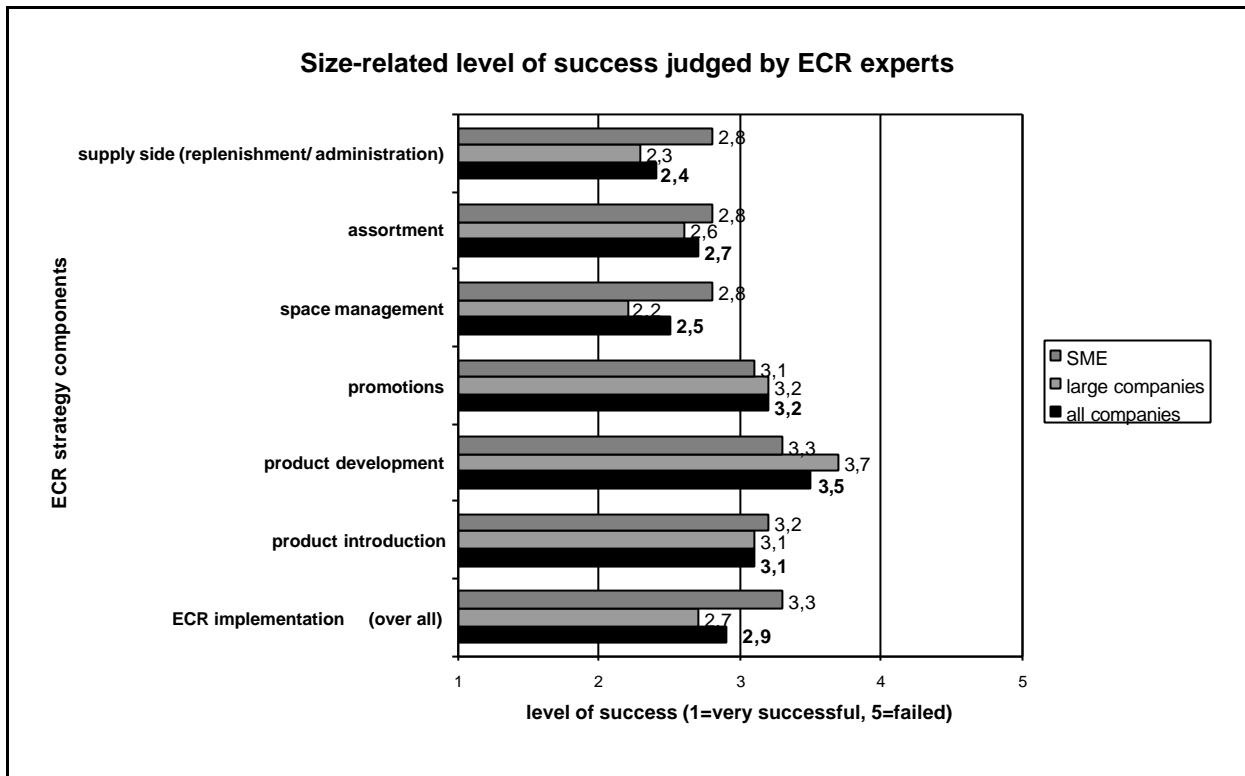


Figure 4: Success level according to ECR experts with respect to company size (n=42-85, Source: Borchert 2001)

2.2 Size-based reasons for non-implementation and for implementation problems in ECR cooperation in the German food industry

With respect to non-participation in ECR partnerships by grocers (ECR outsiders), even though one could expect potential for greater efficiency in distribution strategies and channels because of industry concentration, we first of all consider the reasons for non-implementation and the transformation problems of ECR cooperations. For this purpose, the responding companies which do not participate in ECR cooperations (28,3 % of all grocers) were asked to give reasons for non-implementation. Secondly the companies within ECR cooperation (ECR insiders) were asked to specify transformation problems. This makes it possible to examine transformation problems and the reasons for size-based non-implementation.

With this background, we screened deficit items from the instrumental application of ECR partnerships, as well as the interorganizational/ coordination of the company units. The following figures show the values for deficiency items, based on the arithmetic mean on a scale of 1 = very strong to 5 = very weak. Therefore, a low mean indicates a high level of significance of the deficit item for non-implementation or for implementation problems.

Figure 5 shows the **five most important reasons for non-implementation and for transformation problems in ECR cooperative ventures**. This provides a ranking of various problems determined by the arithmetic mean and by the percentage of the rated aspects from high to very high significance (first and second marking on the scale): ECR partnerships are often not implemented, because of the coordination problems between the participating companies, experienced by ECR experts. This is revealed by the insufficient standardization of

category management tools, inadequate institutionalization of interfaces and of communication infrastructure among more than 55 % of respondents.

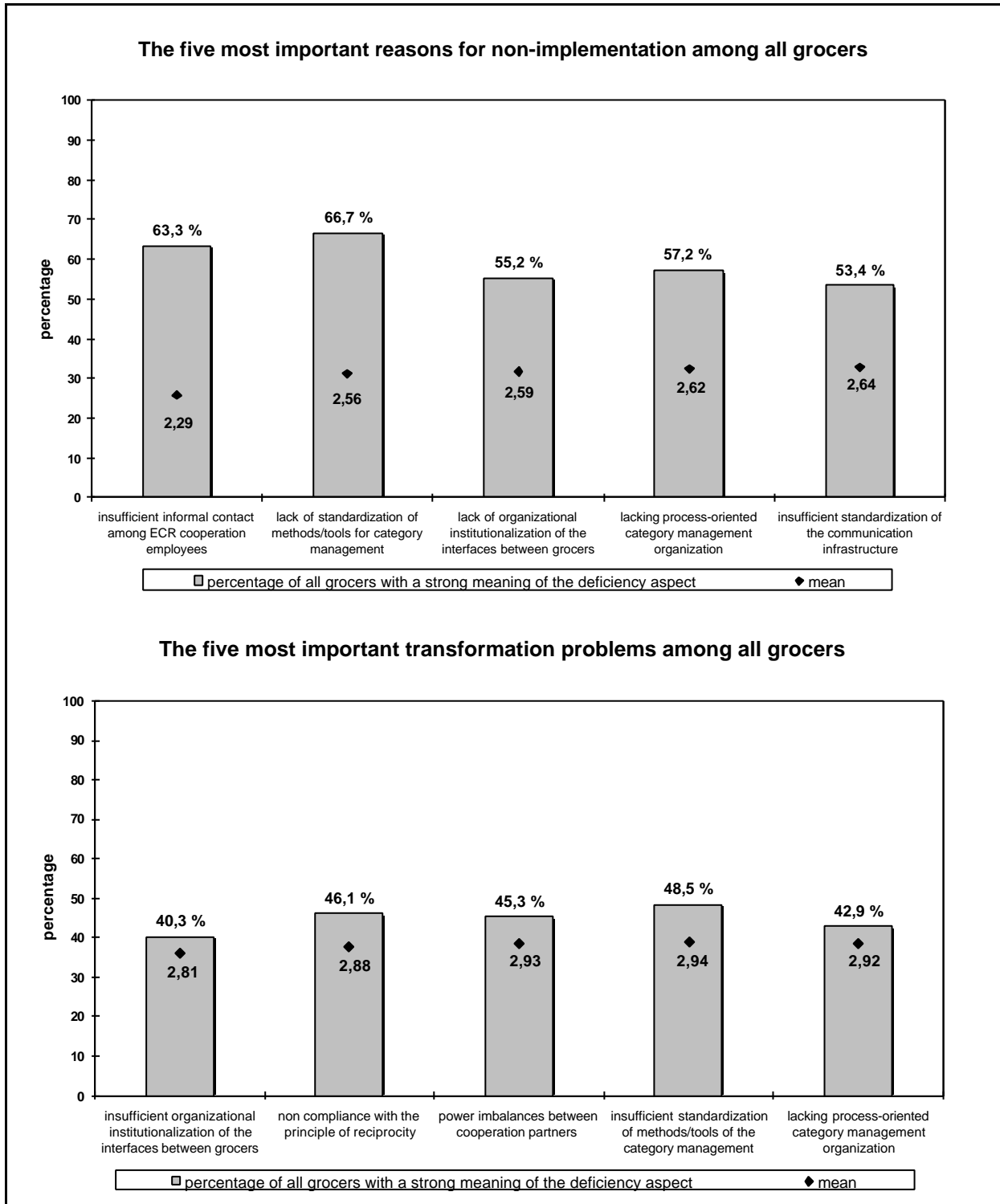


Figure 5: The five most important reasons for ECR non-implementation and for transformation problems of all grocers (n=83-104, Source: Borchert 2001)

The importance of a lack of informal contacts among employees of cooperating companies may explain the existence of supposed coordination problems among employees of non-participating companies. On the one hand the **transformation problems of companies in ECR cooperations** relate to organizational coordination, lack of institutionalised interfaces, a lack of process-oriented category management organization and lacking standardized category management methods and tools. On the other hand one has to consider transaction problems between ECR cooperations such as a lack of reciprocity (exploited) and power imbalances between the partner. Almost every second grocer considers these problems to be significant in terms of implementing an ECR cooperation (see Figure 5).

Table 1 shows with regard to differentiating by business size, that the transformation problems of SMEs overlap with those of large companies and therefore with the transformation problems of all grocers. **The fact that such problems show a level of significance of 0,6 scale units of the mean higher for SMEs than for large companies, is, however, important.**

However, various **reasons for non-implementation** were accorded a high ranking by representatives of SMEs and large companies. Table 1 shows that reasons for non-implementation given by SMEs are communication deficiencies within the corporate infrastructure. Also organizational and instrumental coordination deficiencies rank high. The main reason for non-implementation of large companies is a lack of informal contact. Other important reasons for non-implementation are the inclusion of all companies of the value chain into ECR cooperations as well as the exploitation power imbalance by the cooperation partner.

<p>The five most important reasons for non-implementation of <u>small and medium sized enterprises</u> (arithmetic mean, percentage of stated factors accorded the lowest significance)</p>	<p>The five most important reasons for non-implementation of <u>large companies</u> (arithmetic mean, percentage of stated factors accorded the lowest significance)</p>
<ul style="list-style-type: none"> Insufficient standardization and communication infrastructure (2,10/ 59,9 %) 	<ul style="list-style-type: none"> Insufficient informal contacts among employees of companies in ECR cooperations (2,0/ 88,9 %)
<ul style="list-style-type: none"> Insufficient informal contact among the employees of companies in ECR cooperations (2,42/ 52,7 %) 	<ul style="list-style-type: none"> Non-integration of all companies participating in the value chain into ECR cooperations (2,25/ 62,5 %)
<ul style="list-style-type: none"> Inadequate process-oriented category management organization (2,47/ 58,8 %) 	<ul style="list-style-type: none"> Disregard of the principle of confidence in ECR cooperations (2,38/ 62,5 %)
<ul style="list-style-type: none"> Lack of standardization of methods/ tools of category management (2,53/ 58,8 %) 	<ul style="list-style-type: none"> Lack of organizational institutionalization of the interfaces (2,50/ 62,5 %)
<ul style="list-style-type: none"> Lack of organizational institutionalization of the interfaces (2,63/ 52,6 %) 	<ul style="list-style-type: none"> Exploitation of power imbalances by the cooperation partner (2,56/ 55,5 %).

Table 1: *The five most important reasons non-implementation of ECR cooperations according to company size (n=83-104, Source: Borchert 2001)*

All in all the size-dependent coordination problems and transaction-related problems among the companies are conspicuous reasons for non-implementation of ECR cooperation ventures.

3 Distribution networks for SMEs as an implementation platform for ECR co-operation

3.1 The Characteristics of distribution networks

Conceptually, distribution networks are subset of the generic term “company network”. Company networks are cooperative commitments of more than two legally independent, but partly economically dependent companies. This certain degree of dependency arises from existing commitments and exchange relationships (see Sydow 1992, p. 79, p. 103f.; Semlinger 1993, p. 347): „Networks are ubiquitous. Perhaps the most obvious example is distribution channel systems. [...] The resurging practices of barter, countertrade and other forms of reciprocal dealing will often qualify as networks “ (Thorelli 1986, p. 44).

In order to differentiate between other types of company networks with functionally different objectives (e.g. production supply networks) we will use the term **distribution network** if the companies participating in the distribution of one or more consumer goods coordinate their distribution activities within a cooperative company network. For this purpose more than two legally independent companies with explicit agreements (contract) get together voluntarily to coordinate their activities so that they can earn profits through cooperation in the form of rationalization and develop competitive advantages by a joint distribution of consumer goods. A distribution **network** comprises a specific number of vertically and/ or horizontally linked companies, enabling firms to “jump” at least one level of the distribution or transformation in the value chain of goods/ services. By contrast distribution manufacture’s **systems** especially those contracted to suppliers and clients (contracted distribution systems) allocate goods-specific distributional tasks between a single manufacturer and his distributors (see Ahlert 1996, pp. 34; Ahlert 1981, pp. 45). Within these bilateral systems there is no regular goods and/ or performance-related coordination on a horizontal level between several manufacturers and/ or several distribution companies.

Like distribution systems, distribution networks can be defined from different perspectives: suppliers, manufacturers, retailers, logistically service companies and goods specific. The rationale of all distribution networks is to achieve a cooperative and competition-combatting coordination at one or more value added levels as necessary to convey the product or service from the manufacturer to the consumer. The more extensive the coordination of distributional, organizational and informational steps and support-systems, the lower the level of autonomy and the higher the level of corporate integration within a distribution network.

With respects to distribution networks in particular, a focal firm assumes the function of the system leader coordinating the participating companies. This company has ongoing control of certain organizational resources or it manages several companies in terms of one goal: successful ECR implementation. The company with the highest level of competence with respect to managing of the cooperative ventures and the greatest knowledge and experience of the ECR approach will be the system leader. Such a company can provide a coordinated coaching function.

3.2 The Potential of distribution networks for SME-participation in ECR partnerships

Establishing distribution networks with a system leader as coordinator, enables SMEs in ECR cooperations to find a solution to the implementation barriers earlier in the paper. For instance grocers feel that a *lack of coordination of value-chain phases by a central coordinator of all*

participating companies in ECR cooperations is a major reason for non-implementation. Especially the SMEs need system management within ECR-orientated value chains (mean is 2,88 to 3,67 of large companies). This kind of system management makes it possible to overcome the transformation problem of a *lack of control and sanction with respect to partner companies* (mean 2,34).

Especially the coordination deficiencies within ECR cooperation can be solved by system management in SMEs distribution networks, by effective integration of participating companies. The system leader, as a focal firm, coordinates informational 'threads' which control the goods-specific, multilateral value chains, which comprise the participating companies at a specific value chain. The leader formulates guidelines and principles (network purpose, mission) of the cooperation in the distribution network.

A lack of informal contact among the employees of companies within ECR cooperations and a lack of standardized methods/ tools of category management (see Table 1) in SMEs, can be eliminated through network partnerships. Distribution networks as a communications arena, are suitable for a mutual competence extension of skills and for an exchange of knowledge of ECR concepts, beyond the borders of SMEs. The system head can encourage the actors to exchange information and knowledge. It can build experience curves and also distribute ECR knowledge to partners. Ideally the focal firm can promote rapidly and extensively the diffusion of ECR know-how in terms of 'learning races'.

Organizational and technical implementation problems and reasons for non-implementation within ECR cooperation, can also be solved by cooperative entry for SMEs merge into distribution networks. The mutual achievement of network effects also helps overcome an *insufficient standardization of the communication structure as well as the implementation of the missed process-orientated category management organization through institutionalizing interfaces*. Furthermore, the size advantages of network effects prove to be comparative transaction-cost advantages for SMEs, as opposed to single ECR cooperations.

Especially in the operative ECR strategy components, such as efficient replenishment, there are bundling effects of risk diversification and the opportunity of e.g. investments compared with bilateral, non-leded ECR partnerships: 'A major driving force for relationships formation [i.e. category management relationship, (remark of the author)] is the reduction of environmental uncertainty and risk, and the pooling of scarce resources, [...]. The relationships under discussion here [...] are hybrid relationships occupying the middle ground between pure market transactions and joint ventures or vertical integration.' (Hogarth-Scott 1999, pp. 671). Therefore, system management in network like ECR partnerships, especially in SMEs, can encourage ECR participation by minimizing risk.

4 Conclusion

This paper demonstrated empirically prevailing reasons for non-implementation and problems of implementation within ECR partnerships in the German food distribution industry. Closer observation of size-related issues, shows the relative weakness of SMEs compared to major grocers. At the same time SMEs lack know-how with respect to ECR implementation, a process-orientated organization and standardized communication structures. The majority of the problems discussed, can be solved by entry of SMEs into distribution networks. Coordination by a system leader would provide an efficient solution, particularly to coordination and standardization problems.

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