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## Вплив інтернаціоналізації роздрібної торгівлі на агробізнес: приклад України

*Прихід на ринок іноземних суб'єктів роздрібної торгівлі можна розглядати як важливий фактор структурних змін в агробізнесі країн з перехідною економікою. У зв'язку з цим автори оцінили роль іноземних суб'єктів роздрібної торгівлі для розвитку агробізнесу України як "третьої хвилі" інтернаціоналізації роздрібної торгівлі країни. Питання пов'язані з вивченням зазначеної проблеми згруповані у статті у п'ять блоків. Перш за все, досліджено рівень релевантності вертикальної інтеграції учасників агробізнесу в Україні. Встановлено, що суб'єкти агробізнесу у сфері співробітництва стикаються з труднощами, що походять з несприятливою інституційного середовища. Проаналізовано питання координації поставок продукції та забезпечення її відповідної якості. Визначено обмеження щодо розвитку вертикальної інтеграції за участю іноземних суб'єктів роздрібної торгівлі та описано підходи міжнародних торгово-роздрібних компаній до реалізації управління ланцюгом постачання.*

**Ключові слова:** інтернаціоналізація роздрібної торгівлі, іноземні суб'єкти роздрібної торгівлі, вертикальна інтеграція, ланцюг постачання, агробізнес.

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## Влияния интернационализации розничной торговли на агробизнес: пример Украины

*Приход на рынок иностранных субъектов розничной торговли можно рассматривать как важный фактор структурных изменений в агробизнесе стран с переходной экономикой. В связи с этим авторы оценили роль иностранных субъектов розничной торговли для развития агробизнеса Украины как "третьей волны" интернационализации розничной торговли страны. Вопросы, связанные с изучением указанной проблемы сгруппированы в статье в пять блоков. Прежде всего, исследован уровень релевантности вертикальной интеграции участников агробизнеса в Украине. Установлено, что субъекты агробизнеса в сфере сотрудничества сталкиваются с трудностями, которые происходят с неблагоприятной институциональной среды. Проанализированы вопросы координации поставок продукции и обеспечения ее соответствующего качества. Определены ограничения по развитию вертикальной интеграции с участием иностранных субъектов розничной торговли и описаны подходы международных торгово-розничных компаний к реализации управления цепочкой поставок.*

**Ключевые слова:** интернационализация розничной торговли, иностранные субъекты розничной торговли, вертикальная интеграция, цепь поставки, агробизнес.

## Impact of Retail Internationalization on Agribusiness: the Case of Ukraine

*Foreign retailers entering the market can be considered as an important driver of structural changes in the transition countries agribusiness. In this context, the authors have made the assessment of the role of foreign retailers for the agribusiness of Ukraine as the 'third-wave' country in the retail internationalization process. The issues, that raise interest in this respect, are allocated in five blocks. First of all, the authors have estimated the level of relevance of verticalization issues for agribusiness players in Ukraine. It has been determined that the entities in the field of agribusiness cooperation face difficulties caused by the unfavorable institutional environment. The issues of coordination in the supply of high quality products have been analyzed. The inquiries into the constraints on verticalization have been made.*

*In general, the article provides the evidence of how the introduction of management concepts by multinational retailers gives rise to improvements in the Ukrainian agribusiness.*

**Keywords:** retail internationalization process, foreign retailers, verticalization, supply chain, agribusiness.

*'Supermarkets and direct investments in food companies have more impact than WTO and trade policy on developing and transition country farms' Reardon cited in Swinnen (2006)*

**Introduction.** The collapse of the socialistic central planning system in Central and Eastern Europe left behind an economic vacuum that offered the unique opportunity to establish an entirely new retail system being modeled on Western ideas. The Western retail firms took this opportunity and established subsidiaries all over the countries (Dries et al., 2004). In addition to the investment liberalization and the modernization of retail procurement, internationalization of food retailers is due to the build-up demand factors like urbanization, income growth, infrastructural improvements, etc. (Reardon et al., 2007).

Many recent studies highlight the potentials for retailers in the former Soviet Union (Dries & Swinnen, 2004; Swinnen, 2006; Gorton et al., 2006). They are supported by reports of management consultancies, e.g. AT Kearney. Analyzing such variables as country risk, market attractiveness, market saturation, and time pressure the AT Kearney consultancy states that five of the most attractive countries for retailers are from Central and East-European Countries (CEEC).

In the CEEC, the transition process of the retail sector from state-run retail shops, retail co-operatives and farmer markets to western style large format retailers was accompanied by heavy foreign investments and therefore also by changes in the procurement systems. The following six changes are named as the major ones (Dries et al., 2004): i) a shift from local store-by-store procurement to (nationally centralized) large and modern distribution centers; ii) a shift to regionalization of procurement over countries; iii) a shift from traditional brokers to new specialized wholesalers; iv) increasing use of global logistic firms; v) a shift to preferred supplier

systems; and vi) a shift to high private standards of quality and safety.

As a result of these changes, vertical coordination in agri-food chains is an important and growing phenomenon in the countries of Eastern Europe and Central Asia (Swinnen, 2006). Swinnen (2006) also indicates that in these countries vertical coordination is even more widespread in scope and complexity than in western economies. Major reasons for this process are that, firstly, private contractual initiatives are formed in order to overcome disruptions of supply (i.e. marketing contracts); and, secondly, traders, agribusinesses and food companies contract with farms and provide inputs and assistances in return for guaranteed and quality supplies (i.e. production contracts) (Dries & Swinnen, 2004; Swinnen, 2006). In this context, particularly quality can be regarded as the main source that catalyzes the development (Gorton et al., 2006). For example, when in the mid 1990's foreign direct investments entered Polish dairy sector, the milk quality was very poor. Because these foreign processors and retailers demanded higher quality, they had to establish quality enhancement programs. Within these programs the foreign companies were providing inputs as well as financial and consultancy assistance to their Polish suppliers (Dries & Swinnen, 2004; Gorton et al., 2006). Observable effects have been that the Polish processors and retailers were starting to imitate the business practices of the foreign firms so that the overall milk quality was in a short time tremendously increasing. Furthermore, due to the offered assistances, farmers were able to cope with these challenges so that the anticipated rapid consolidation on the farm level was not taking place (Dries & Swinnen,

2004). Studies from other CEEC such as Bulgaria, Moldova, and Slovakia show that in all countries due to stricter and higher quality norms more vertical coordination is taking place but still large differences exist (Dries & Swinnen, 2004; Gorton et al., 2006). One reason for this is that particularly contract enforcement is a big but widely varying problem (Swinnen, 2006).

Alongside with differences in the degree of vertical coordination, large differences can be also detected in the development of modern western style retail structures. Specifically, these differences can be followed by separately analyzing “three waves” of internationalization in the CEEC. Dries et al. (2004) describe the process of retail internationalization in the CEEC by referring to the concept of “retail waves” that gradually “cover” a group of several countries. They characterize the “first-wave” countries as those where the supermarket sector went from a tiny niche of around 5 % of food retail in the mid 1990’s to a 40-50 % by mid 2000’s. Examples are Hungary, Poland, or Czech Republic. As the “second-wave” countries, they define countries where the sector grew to a share of 20-30 %. Examples are Bulgaria or Croatia. The “third-wave” countries are those where the share was still at a “luxury” niche of 5 % in the mid 2000’s. Examples are Russia and Ukraine.

The “first-wave” countries have faster and more successfully than other CEEC started to modernize the retail sector in the 1990’s. Today one can assume that the “first-wave” countries dispose of the best developed retail sector in Central and Eastern Europe (BBE, 2006). For example, in Hungary modern retail formats had around 50 % market share already in 2002. The rapid development of modern retailers was accompanied by heavy investments of western retailers and nowadays all major players are foreign owned. In addition, the first round of consolidation is taking place. A similar tendency is observed in Poland. Due to its heterogeneous market and thereof resulting loosely structured retail landscape, first movers such as the German Dohle Group were able to succeed with hypermarkets. However, despite they had a strong market position, they decided to sell their business to Tesco because the competition is getting very intensive and requires high financial spending (KPMG, 2004). Because the “big players” on retail markets of the “first-wave” countries are more or less identical with those in Western Europe, we believe that today no significant differences with regard to procurement systems and quality demands and thereby vertical coordination can be found between them. Nevertheless, there are still some points to discuss. One of them regards the Pan-European competition of cost-leaders, and another one concerns the integration of farmers in vertically coordinated chains. Today West-European retail brands are starting to include food processors of the “first-wave” countries in their tenders for retail branded products such as pasta and sausages. As long as the food quality is meeting their demands, the most cost competitive West-European processors will get the bit. Due to the cost structures for basic products that do not demand high quality requirements, processors from Eastern and Central Europe gain in advantageous

position. This opinion is shared by several product managers of German processors.

Agricultural sector in the CEEC is still a mixture of small-scale – even household – production and large-scale farming. In order to lower the complexity of their supply chains, retailers favor large scale production. However, the findings of Dries & Swinnen (2004) show that the small-scale farmers find their place in vertically coordinated chains. Additionally, some international retailers demand that small-scale farmers set up horizontal cooperation to provide products that are meeting the qualitative and quantitative requirements of the retailers. If these requirements are not met, farmers are excluded from the procurement systems.

Comparing “first-wave” and “second-wave” countries, it is recognizable that “second-wave” countries (Bulgaria, Croatia, etc.) are about five to six years behind. Modern retail formats have been introduced but mainly by small local retail chains. Furthermore, the vast majority of the stores are very small (BBE, 2006). In the course of the EU accession, international retailers have lately made their inroads to Bulgaria. However, in Bulgaria most foreign investments are made in the capital Sofia. While international retailers are mainly located in urban areas, local retail chains still exist in rural areas.

In comparison to the other CEEC, the development of a modern retail in “third-wave” countries is still in the fledging stages. For example, while in Russia supermarkets, hypermarkets, and discount stores can be found in almost all cities with over one million inhabitants, the market share of the whole food retail market for the top-10 retail chains constituted 11,1% in 2007 (PMR report, 2008). According to a study of BBE Retail Experts in 2006 leading shopping formats in Russia are still street shops and open markets (32%), small shops (26%), other shops and kiosks (28%). Modern retail formats account for 14% of the whole sales with supermarkets (6%), discounters (6%), hypermarkets (1%), and Cash&Carry (1%). Even in the large metropolitan areas of Moscow and St. Petersburg, retail chains hold 16 - 17% and 18 - 20 %, respectively (BBE, 2006).

French retailer Auchan has exhibited the highest growth of the top-10 retailers jumping to the fourth-largest player as of end 2007. Metro, the second largest retailer in Russia, has opened about 30 outlets and has expanded into central and southern Russia and the Urals (A.T. Kearney, 2008). However, in Russia, the international retailers met with an immediate response from local players that were quick to learn modern retail trade methods and forms. Domestic retailers - such as the market leader the X5 Retail Group - are expanding their operations, building strength in their supply and distribution chains, and working on customer relations to capture a larger and more robust share of the market (Belaya & Hanf 2009).

One of the difficulties which many retailers experience when entering Russia is the uncooperative behaviour of Russian suppliers (Roberts, 2005). Furthermore, Russian supply chains are characterized by distrust and absence of professionalism (Sheresheva &

Tretyak, 2004). Tarnovskaya et al. (2007) describe the generally low level of suppliers' compliance with the norms of the code of conduct. However, the increased competition in global markets has led to the rise of various forms of partnering and interfirm networks in the former Soviet republics (Möller & Svahn, 2006). The number of such networks is growing: in addition to traditional supplier-buyer relationships, firms collaborate within distribution channels (Ford et al., 2003; Möller & Halinen, 1999; Möller & Rajala, 2007).

Therefore, our aim in the current article is to reveal the impact the process of retail internationalization has on the agribusiness of Ukraine as the "third-wave" country. According to AT Kearney consultancy (ZMP, 2006), the situation in the Ukrainian retail is one of the most attractive for the market entry by big international companies. Several of them have already entered the country and successfully installed their businesses, including sourcing and quality management. Although the shares of international retailers at the local food retail market are still small, they grow rapidly (ZMP, 2006). Thus, the peculiarities and the effects of retail internationalization on the Ukrainian agri-food supply chain become of an interest.

To fulfill our aim, we first outline a general course of the process of retail internationalization in Central and East-European countries. Second, the actual degree of internationalization of the Ukrainian retail is derived by analyzing secondary data. Finally, the consequences are elaborated for the Ukrainian agribusiness with regard to its verticalization based on a survey. The survey involved in-depth interviews with the experts in the fields of retail and agribusiness including managers of the retail, food processing and agricultural companies as well as academics and officials.

**Retail internationalization in Ukraine.** In the last five years, the Ukrainian retail has undergone an outstanding upturn due to the increase of the populations' incomes and consumers' accumulated needs. The annual growth rate of the retail turnover accounted for 120-130 % in 2003-2007. Since the highest purchasing power is concentrated in big cities and urbanized regions, the capital Kyiv and the four oblasts of Donetsk, Dnepropetrovsk, Odessa and Lvov account for about 50 % of the retail turnover (Kyiv itself is the most important trade centre with almost 20 % of total retail turnover of the country). These areas accordingly display the highest level of the development of modern retail formats (cash & carry, hypermarkets, supermarkets, etc.). For example, in Kyiv, there are about 15 companies operating in these formats with an annual food turnover of more than \$ 15 million; Dnepropetrovsk is presented by about 10 such companies; and Donetsk, Lvov and Odessa – by three to five. Yet, despite the ongoing modernization, old trade forms (e.g. private kiosks, mobile traders, markets, bazaars, etc.) still prevail in the structure of the Ukrainian retail trade with 55 % of total turnover (ZMP, 2006). Besides domestic retailers, international retailers are also active in Ukraine. In the retail sector, the internationalization process is marked by the presence of such multinational players as Metro's

Cash & Carry and Real (Germany), Rewe Billa (Germany), Auchan (France), Perekrestok (Russia/former SPAR Ukraine), Pyaterochka (Russia) and Paterson (Russia). Additionally, such companies as Okay (Russia) and Mosmart (Russia) have officially proclaimed their intention to enter the Ukrainian retail market. Today they are intensively working to successfully launch their businesses in Ukraine. However, among international companies only Metro attained a stable success in the last five years being a leader of the Ukrainian retail.

Alongside with big national retailers, multinational companies gradually contribute to the development of modern forms of retailing or so-called "organized retail" (ZMP, 2006). In the structure of food turnover by modern retail formats, the share of cash & carry markets is 16.4 %, supermarkets – 37.2 %, and other formats – 46.4 %. Overall, the share of "organized retail" accounted for about 10 % of total food turnover in 2005 with an increasing tendency. Of these, 47 % belongs to top five retailers. It is reasonably expected that in the next few years the concentration of the sector will deepen. Whereas big chains still grow through opening new outlets, there is also a room for merger and acquisition activities. Furthermore, international enterprises are planning to enter the market or expand their current presence (ZMP, 2006).

Thus, the competition in the sector is intensively increasing and displaying different strategies the retail companies employ to deal with the competitors. While national players continue to compete mainly through expanding to regions with the use of their knowledge of local specifics, international ones find their own business models as an important prerequisite of successful competition. Particularly, they use their capabilities for retail branding and global sourcing. In the process of competition, retail branding activities yield in some positive outcomes including brand awareness and quality of products. However, national retailers successfully use imitating strategies with regard to branding. Some forecasts claim that totally the biggest players of the Ukrainian retail will sell about 25 % of products under their own brands in 2010. The use of global sources by multinational retailers is less pronounced indicating the ability of local suppliers to catch up and comply with the least retailers' requirements. For example, about 90 % of the Metro's assortment is supplied by local producers, distributors and importers.

Because retailers are responsible to end consumers for the quality and quantity of the needed products, they have to maintain undisrupted supplies and minimize the risk of scandals. This especially concerns the retail-branded and globally sourced products. Therefore, the arrangement of well-functioning cooperative supply chain networks is being undertaken by international retailers. Thus, the process of verticalization is in action. In particular, this process is evident in the agri-food business where the products with short life span are developed. As known, satisfaction of the end consumers' requirements towards these products demands that the whole food chain works together (Hanf and Hanf 2005).

For retailers, it is obviously more beneficial to work with large scale suppliers (Swinnen 2006). However, in Ukraine, most enterprises are small- and medium-sized (SME) at the processing and farm levels. There is, nevertheless, some evidence of consolidation at these stages of the supply chain. The food processing sector is currently represented by several distinguished actors. For example, market shares of ten biggest players in the meat processing, milk processing, flour-milling and sunflower-seed processing are 40 %, 40 %, 50 % and 70 %, respectively, with increasing tendency (Dragon Capital 2006). Accordingly, these sectors exhibit some backward vertical integration tendencies in agriculture. At the same time, a specific feature of the Ukrainian agriculture in transition is that over 60 % of gross agricultural output is produced by households.

In particular, the share of animal production is high in households (about 70 %). After restructuring of large Soviet-type collective farms in 1990s, the capital-intensive animal production has experienced a huge downturn. As a result, Ukraine is now highly dependent on imports of meat and meat products as well as of milk and milk products. On the contrary, the country is export-oriented in crop products, especially grain and sunflower oil, which causes positive balance in agri-food trade.

In general, the Ukrainian agri-food business includes more than 85,000 agricultural producers, about 22,000 food processing companies, and about 60,000 food retailers (including small enterprises). Nowadays, the agri-food business is being internationalized at a growing rate. In the structure of total FDI, the retail sector, processing industry and agriculture account for 18.7 %, 13.5 % and 2.7 %, respectively. Nominal amounts of FDI increased in retail by 2 times; in food processing – by 1.4 times; and in agriculture – by 26 times in 2004 compared with 2001 (State Statistics Committee of Ukraine, 2004). It is noteworthy that the retail sector and processing industry are the most attractive sectors for FDI. There are regional disparities in the scope of FDI with greater shares of inflows in big urbanized regions.

We conclude that the role of FDI for the national agri-food business is growing. The foreign enterprises employ their own business concepts to gain competitive advantage over the local firms. In order to compete with the foreign companies successfully, local firms use imitating strategies and their knowledge of local situation. In addition, the importance of branding has substantially increased. Importantly, for the development of branded products, the existence of a well-organized supply chain network is necessary (Hanf and Kühl, 2005). As a consequence, verticalization of the agri-food business is being put into practice. We further analyze the process of verticalization of the Ukrainian agribusiness as the result of retail internationalization.

**Impact of retail internationalization on the Ukrainian agribusiness.** In order to reveal the characteristics of verticalization in the Ukrainian agri-food business, the study includes in-depth interviews with experts (managers, academics, and officials) in the field of Ukrainian agribusiness. Interviews were conducted in the period from April 18<sup>th</sup> to July 19<sup>th</sup>, 2007. Totally, nine

telephone interviews and four personal interviews (with duration from 20 to 30 minutes) have been conducted, each including about 15 questions addressing current tendencies in the Ukrainian agri-food supply chain. The interviewees (interviewed by phone) were first informed about interviews via email. After receiving their consent, the calls were given at time appointed by interviewees. The interviewees were asked based on questionnaire prepared in advance.

In the process of sampling, we have conducted deliberate (purposeful) selection of the interviewees (e.g., Patton, 1990; Blankertz, 1998; Merckens, 2000). Specifically, we employed an expert (concentration) sampling (Patton, 1990; Fritsch, 2007), i.e., the persons were chosen who are in positions with a high level of concentration of appropriate information. Given our research interest in the impact of retail internationalization on the Ukrainian agribusiness, we have assembled a sample of experts whose experience and expertise in this area can be regarded as valuable. More specifically, our interviewees are at the highest positions in their organizations and represent the sectors of retail, food processing, agriculture, agricultural equipment as well as research and non-governmental institutions.

The questions used in interviews can be grouped into five general blocks as follows:

1. *The level of perception of verticalization by agribusiness actors.* An overall aim of this group of questions is to find out to which extent the agri-food actors address vertical inter-firm collaboration and its coordination. Specifically, the first objective is to define whether there are common interfirm goals that enable actors to work together in the food chain. The aim is to inquire whether it is reasonable to proceed with the analysis. Each of the conducted interviews provides such an opportunity. Adjacent, questions of how agri-food chain actors work together, who initiates this work, and how actors perceive this work are asked.

2. *Cooperation mechanisms being used.* Since the task of supply chain networks is to achieve certain goals by a strategically driven but also divergent interfirm environment, the network members' interests have to be aligned so that they do not impede the fulfillment of this task. For that matter, a number of cooperation mechanisms exist. On account of this, questions of this block aim to provide information about tools used for cooperation in the sector. Additionally, the differentiation between formal and informal mechanisms is addressed. Actual mechanisms in use are questioned including the characteristics of their use (e.g. normal duration of contracts, a type of sanctions being imposed, the level of general cooperativeness among actors, etc.).

3. *Existing solutions to coordination problems.* The objective of this group of questions is to explore how the actions of different network actors are aligned to achieve the network goals. Therefore, formal coordination mechanisms in use, e.g. quality standards, brands, etc., and informal ones, e.g. unofficial meetings and discussions are questioned. Furthermore, the description of the use of coordination mechanisms is inquired.

Particularly, the focus is on how the quality of supply chain is fulfilled (e.g., setting up of quality labs, introduction of international quality systems, contract specification including credit support, input support, etc.) and whether it is fulfilled in general.

4. *Constraints on verticalization.* Country-specific problems that hamper the introduction and implementation of supply chain management concepts have to be revealed. Particularly, the issues of partnering, infrastructure, marketing and quality are addressed.

5. *Use of known supply chain management concepts by the agribusiness actors in Ukraine.* This block is represented by questions about the extent to which the agri-food actors are informed about and aware of such business models as Efficient Consumer Response, Total Quality Management, etc. Another aim is to detect the actors that use these models.

**Empirical results.** In general, a pattern of current verticalization in the Ukrainian agribusiness is similar to findings of other authors with regard to different CEEC. An affirmed fact is that the verticalization process is initiated by foreign retailers and supported by big foreign food manufacturers. Additionally, spillover effects on local retailers and export-oriented agri-food enterprises are being observed in individual cases. This does not necessarily imply that most local agri-food actors undervalue the importance of verticalization. However, they rather perceive it as a distant perspective. A reason for this is that the majority of companies are primarily trying to cope with infrastructural issues including building of access roads, construction of warehouses, search for qualified labor, provision with transportation facilities or even basic inputs, etc. In other words, they are arranging prerequisites for sound operation of the supply chain by dealing with the consequences of the transition period such as outdated infrastructure.

As one of our interviewees, the managing director of an international standardization body, noted, *"Quality issues in the Ukrainian agribusiness are mostly addressed by foreign investors. However, they face significant problems because local supply chains have old, rudimentary features"*. To this effect, another respondent, the managing director of the local dairy, added that, *"The dairy production seems to be in a horrible situation. Stables, houses and warehouses are run down. There are no preconditions for any quality scheme. Even basic quality requirements are not in place because the whole dairy chain lacks appropriate infrastructure"*.

One of the infrastructural constraints on verticalization is the scale inefficiency of most agri-food enterprises. Given by planning in times of the command economy, production facilities appear to be inconsistent in market conditions. As a result, production capacities are often underutilized. Additionally, due to the prevalence of households in agricultural production, modern IT-infrastructure is seldom used. Such circumstances substantially impede procurement relationships between actors. In order to overcome these difficulties, the implementation of outsourcing strategies is necessary. However, these strategies require a

sophisticated logistics management and specific investments by firms. At the same time, supply chain management practices are in the process to be installed by multinational retailers. One of our respondents, the assistant to management board of an international retailer, stated that, *"Our company follows an uniform strategic framework to work with suppliers all over the world. Ukraine is not an exception in this respect. We are installing our global IT-standards and supply chain management techniques."* Generally, introduction of these practices differentiates international retailers from competitors and promotes outsourcing and concentration on core competencies by agri-food actors. As the majority of agri-food enterprises are small- and medium-sized, they face a financial burden for introduction of logistics management concepts. Therefore, outsourcing results in the emergence of logistics service providers. At the peripheral level, logistics firms are independent organizations, whereas they are business units of big retail and processing companies in the cities and urbanized regions. To develop such procurement relationships, long-term cooperative ties between existing actors and specific coordination tools are highly important. While long-term vertical cooperative relationships are still loosely formed, the coordination tools like cross docking are already implemented by such multinational players as Metro.

In turn, cooperation is paid not less attention than coordination because it provides operational as well as strategic advantages for retailers. On the operational side, the dispose of appropriate partners makes the introduction of supply chain management less costly and time consuming. However, the main purpose of vertical partnering invoked by retailers is the achievement of long-term competitive advantage consisting in a sound chain quality. Therefore, one of the main goals the partnering pursues is quality standardization among local farmers and food processors based on international quality standards. Talking about this issue, the purchasing director of an international retailer operating in Ukraine indicated that, *"We are introducing quality standardization in Ukraine based on such international quality schemes as GLOBALGAP, ISO 9000, and HACCP. Currently, GLOBALGAP is being translated by a working group at one of the local universities. Additionally, the university spreads information about the standard."* Another effect of such activities is that retailers indirectly educate new managers that are in demand to work in the verticalization setting. Because of prevalent production-oriented education established in Soviet times, the management inability to working in market conditions is an important issue for most agri-food companies. As one of our interviewees, the expert for supply chain management of the agricultural equipment company, stressed, *"Qualified labor is difficult to find, especially this concerns supply chain managers"*. To this effect, the managing director of an international meat processor, told that sometimes his company faces specific attitude of local employees towards work, e.g., *"My computer is broken down. So I am going home"*. In the view of such problems, many

agricultural enterprises prefer to concentrate on production as a core competency and outsource the managerial function. To a great extent, the emergence of huge agri-holdings is a consequence of such strategies. In agri-holdings, the responsibilities of the enterprise management are related mostly to production operations. At the same time, agri-holding management works on planning, procurement, marketing and sales. According to one of our respondents, the managing director of an international standardization body, *"Such structures exhibit a certain degree of feasibility in the current conditions. Local supermarkets serve as the main sales markets for agri-holdings; in this way, their products are successfully marketed."*

Additionally, a number of consulting services deals with the management's inadaptability in SME. Consulting companies provide SME with information on marketing requirements, in most cases on quality of supplies. These findings are similar to those of Klerkx & Leeuwis (2006) indicating that consultancies substitute to some extent the focal actor and work as "knowledge brokers". Furthermore, via consultancies, high transaction costs related to marketing are avoided. The Ukrainian horticultural sector is a good example of such tendencies.

However, as another interviewee, the managing director of an international retail institute, claimed, *"Evidence of international quality standardization is still rare because of atomistic structure of agriculture. Most agricultural suppliers do not focus much on achieving even basic quality due to the first priority of infrastructural issues. Taking into account that most retailers possess their own quality control and distribution divisions, many farmers may experience problems with marketing if they want to supply for retailers. In order to overcome such problems, a horizontal cooperation between farmers is necessary at least to provide them with appropriate information about requirements retailers place on food products."* Undoubtedly, cooperation among farmers is advantageous also for retailers because it provides benefits of less costly information transfer. Yet, the farmers' cooperation is hindered by some developments of the last decade as noted by one of the interviewees, the project manager of IFC. *"In transition period,"* he said, *"efforts on horizontal cooperation between farmers resulted in creation of so-called service cooperatives to which farmers supplied their products. However, lack of liquidity in most of cooperatives caused farmers' supplies outside the network. By-passing cooperatives, they sold their products to other structures that offered prompt payments or better prices. As a result, trustful relationships between cooperative members failed. Furthermore, the formation of majority of such cooperatives was initiated by local authorities that caused mistrust of the potential members."* Thus, the absence of a price premium or even prompt cash payments was the one of the factors of cooperation failure. Another important point is that a strong focal actor with enough power to promote trust among other actors and make them cooperate was missing.

It can be, thus, posited that the installation of formal incentives for cooperation must go along with the arrangement of informal ones and vice versa. On account of this, informal incentives may play even greater role in such transition countries as Ukraine. Such evidence is provided by the example of reputation effect of big multinational brands on local partners. As one of the purchasing directors of an international retail company told, *"Small- and medium-size suppliers are proud to work with us. Furthermore, in my opinion, they like to cooperate with our company because they are confident that we will not renegotiate a contract."* As known, a greater freedom in forming contracts has been obtained in the Ukrainian agribusiness after 1991 (Swinnen, 2006). However, today a great deal of transactions is still coordinated via the price mechanism. One reason for this is that contracts can not be realized due to poor contract enforcement mechanisms. As a result, *"business environment is highly volatile and it can be difficult to find a reliable partner,"* as the expert for supply chain management of the agricultural equipment company told. This result coincides with that obtained by Gorton et al. (2003) who report that medium-sized processing enterprises have suffered most of all in Ukraine, facing about 12 % of existing contracts not realized by suppliers in 2001. At the same time, small enterprises do not use any contracts at all. Similarly to Swinnen (2006), our respondents emphasize that there are two reasons for contract breaching in transition countries. First, producers mistrust their buyers and are afraid of not being paid for production. Second, they may not be able to fulfill a contract because they cannot access basic production factors. Therefore, farmers can perceive the prompt cash payments as a benefit obtained from relationships with international retailers. The argument is that before they have had to wait long for payments or even faced the risk of non-payments due to their inability to fulfill the contract with local companies. Thus, the reputation effect of a well-known foreign company is strong. Additionally, being engaged in cooperation with multinationals is perceived as an advantage because farmers believe they minimize their perceived income risk by working together with foreign companies as opposed to local ones.

Besides, another respondent, the managing director of an international retail institute, stated that, *"Foreign retailers show that they are worldwide presented and are able to use their global sources to substitute inconsistent local supplies. In turn, suppliers try not to lose such favorable sales markets. They, therefore, are working hard to comply with the requirements of retailers."* A substantial part of this work is dedicated to the achievement of appropriate product quality because international retail chains reflect the growing consumer demands towards quality. Process quality must be achieved based on quality standards and systems used by international retailers as a part of their business concepts. Except for vertical implications, business concepts of international retailers have spillover effects on their local competitors that also enforce their suppliers to improve quality. Retailers, thus, act as focal companies exercising

powerful position to form networks of firms that can conform to their requirements.

These developments largely contribute to overall improvements of the food chain quality which has considerably decreased in the former times due to the lack of necessary inputs, expertise and know-how. In transition period, initial vertical ties did not aim to resolve this issue with most contracts omitting the point of food quality. Food processors offered commodity credits to farmers just to utilize their production capacities and not to improve the quality. Such developments can be also found in Swinnen (2006). Today, however, big processors become more interested in quality. Similarly to retailers, processing companies start branding implying that they recognize the importance of quality issues. To cover branding costs, processors have to expand their businesses into regions. Alongside with territorial expansion, they also expand the range of their suppliers so that not only large farms but also small ones become strategically embedded in the value chain of different product groups. However, by doing so, food processors face the problem of quality more sharply because most small farmers have limited possibilities in sorting and calibrating their products, quality expertise and logistics. Therefore, on one hand, it can be more complicated for small farmers to meet the requirements of their buyers. On the other hand, they are in advantageous cost position when being provided with necessary inputs by the downstream partners. In fact, processing firms have no choice except for working with small farmers and supporting them to deal with quality problem. For example, the managing director of the local dairy company told that big dairies organize their own collecting stations with expertise facilities. By doing so, they cope with both, multiplicity of suppliers and (randomly conducted) quality testing. Furthermore, dairies assure quality supplies by leasing cooling tanks to farmers as part of their contracts. These findings correspond to those of other authors in other transition countries, e.g. Gorton et al. (2006) in Moldova, and Swinnen (2006) – in Bulgaria and Romania.

Effective vertical coordination provides big processors with an improved position on the market. Such development, however, brings some threats to small- and medium-sized processors because they are not strong enough to compete. Therefore, they have to maintain a particular cooperation with both, big processors and retailers. This cooperation becomes apparent in two surviving strategies: small processors either become collecting points of big processing companies or produce under retail brands. In both cases, quality requirements must be fulfilled. Thus, private imposing of quality requirements serves as an effective mechanism while appropriate public institutions are missing. Specifically, it enables food chain actors to organize their cooperation so that more value is added along the supply chain – from producer to end consumer.

**Summary.** Despite the effect of different business environments, the entry of foreign retailers can be considered as an important driver of structural changes in the agribusiness of transition countries. In this context,

we have addressed the role of foreign retailers for the agribusiness of Ukraine as the “third-wave” country of the retail internationalization process. Given that the impact of retail internationalization on modernization and sophistication of the procurement systems in the “third-wave” countries is still little disclosed, we have generated five blocks of issues that raise interest in this respect.

First of all, we have inquired the level of relevance of verticalization issues for agribusiness actors in Ukraine. A general conclusion in this context is that a tighter collaboration among agri-food supply chain actors is initiated by foreign retail companies followed by foreign food processors and, partially, by local retail chains.

Second, we have addressed the cooperation issues in the Ukrainian agri-food chain. Overall, cooperation faces difficulties originating from unfavorable institutional environment: bank loans are unsafe, corruption is present, property rights are weakly protected, contract enforcement is poor, etc. Therefore, foreign companies that invest on a long-term basis are obliged to properly consider possible short-term risks. Thus, a conflict between long-term orientation of supply chain management and the need to produce high returns on investments in short terms must be considered. To solve this dilemma, foreign retailers try to establish long-term relationships with local suppliers based on their general cooperativeness and reputation quests. Tighter relationships with local partners help minimize risks of business environment and provide substantial feedback to newly installed business models.

Third, we have questioned the coordination issues. Foreign retailers perceive well-functioning supply chains as an important prerequisite of their competitive advantage. In particular, their quest for quality becomes apparent in the implementation of international quality systems in the Ukrainian agri-food chains. Where standardization faces difficulties, quality is achieved through branding. This solution to coordination issues is also widely adopted by local retail chains and food processors. However, substantial improvements in quality are expected in a long run since the larger share of agricultural output is produced in households that are unable to meet even basic quality requirements.

Fourth, inquiries into the constraints on verticalization have been made. One of the major problems the foreign retailers face in structuring of the local procurement system is outdated infrastructure. Another very important barrier to implementation of supply chain management is low qualification of labor. Foreign retailers and manufacturers actively participate in dealing with such infrastructural problems to create appropriate conditions for vertically cooperating networks. Obviously, solutions to these problems require additional investments.

Fifth, we have asked about the use of known supply chain management concepts in the Ukrainian agribusiness. Since international retail companies are the main initiators of supply chain management, they accordingly implement sophisticated logistics management concepts. By using their own business models, foreign retailers exhibit strong efficiency orientation as well as increased attention to quality issues.



However, the intensive implementation of supply chain management is still little evident due to the lack of FDI as a main driving force.

Summarizing, this article provides evidence of how the introduction of management concepts by multinational retailers gives rise to improvements in the Ukrainian agribusiness. In order to mitigate a rather hypothetical disposition of this study and achieve higher generalizability of the results, the effects of retail internationalization require further investigation with the use of more sophisticated methods and the focus on more "three-wave" countries. Although the establishment of well-functioning supply chain networks in "third-wave" countries is at its early stage, the potential consequences for local business environments cannot be neglected. As a proof, one observes overall increase in the supply chain quality based on network externalities in form of spillover effects and adoption of quality systems in the Ukrainian agribusiness.

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