

Cosetta Pepe, Fabio Musso, Mario Risso

**SME Food Suppliers versus  
Large Retailers: Perspectives  
in the International Supply Chains**



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## SME Food Suppliers versus Large Retailers: Perspectives in the International Supply Chains

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# **SME Food Suppliers Versus Large Retailers: Perspectives in the International Supply Chains**

Cosetta Pepe, Fabio Musso, Mario Risso<sup>1</sup>

## **Abstract**

The market share of international retail chains substantially increased from the beginning of the nineties. The supplier's market has been adapted to the evolutions of retailers' market in terms of modified purchasing processes. Due to these changes, the requirements for food industry suppliers grew in number and quality.

The paper shows how the relationship between suppliers and retailers is affected by several important changes, above all at international level. In particular, the analysis is focused on the Italian food SME suppliers related with large retailers. In-depth interviews to 89 Italian food SME suppliers have been conducted in 2008. Results have been analyzed and compared to the retailers' point of view, resulting from public reports (such as Annual report, CSR report, etc.).

Considering the selection criteria used by retailers, one of the main results of the analysis is that the growth of small and medium suppliers is stimulated when they operate with international large retailers. At the same time, the pressure on price and the required organizational qualifications lead to a selection process in which smaller manufacturers seem to be the more vulnerable actors.

**JEL Classification:** M10; M13; L24; L66, L81

**Keywords:** Supplier-Retailer Relations, Italian Food SME, Large Retailers, International Supply Chains

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## Editorial notes

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## **1. Introduction**

Since the early nineties the market share of large retail chains – which include many international chains – has substantially increased. The supply market was dominated by retailers' buyers due to concentration of the large retailers and their increasing power. The concentration of food large retailers has turned out to be too fast for the small and medium enterprise (SME) food suppliers.

Thus it is generally true that the nature of the buyer-supplier relationship in retailing has been undergoing dramatic changes. The requirements which food industry and fresh produce suppliers are asked to comply with have grown in number and quality. Industry observers and researchers have described these emerging relationships as "partnerships" or "strategic alliances," as opposed to the traditional "arm's length" type of associations. But these conditions are likely to change especially in the relationships between small and medium suppliers and large retailers.

This paper is structured as follows: first of all reasons and determinants for the growth of retailer power and retailer-supplier relationships development will be explored. Secondly, the methodology and description of research outcomes will be presented. 89 in-depth interviews to Italian food SME suppliers have been conducted in 2008. Results have been analyzed and compared to the retailers' point of view, resulting from public reports (such as Annual report, CSR report, etc.). The supplier and retailer perspectives will be then considered, focusing on the role of power in the retailer/supplier relationship. Some final considerations are presented and discussed.

## **2. Retail power and suppliers selection criteria**

Increasing retailer concentration (Hammonds, 1987; Howe, 1990 ,1998; Dobson et al., 2001, 2003; Burt and Sparks, 2003; Hollingsworth, 2004), access to ICT technology (Kadiyali et al., 2000), eroding brand loyalty due to increases in price promotions and private labels (Raju et al., 1995; Narasimhan and Wilcox, 1998; Corstjens and Lal, 2000; Ailawadi and Harlam, 2004) are the



commonly mentioned causes of the rise in retailers' power. In particular, the increasing power of retailers in relations with manufacturers is due to:

- increased capability of in purchasing activities, both for retail assortments, on one side, and technical equipment, marketing and financial services, on the other side (Dawson and Shaw, 1990; Musso, 1999);
- augmented skills for managing retail marketing tools (Oliver and Farris, 1989, Buzzell et al., 1990; Blattberg and Neslin, 1990);
- time advantage for understanding consumers taste and behaviour;
- reduced life-cycle of products which allows retailers to better manage products in points of sales (Corstjens and Corstjens, 1998);
- increased involvement of retailers in production coordination activities, related to private label products (Lugli and Pellegrini, 2005);
- increased ability to manage the supply chains (Ogbonna and Wilkinson., 1998; Levy et al., 2005; Brown et al., 2005; Ellickson, 2006);
- more information on local and global procurements' markets that provide retailers with more business opportunities (Risso, 2009);

The literature has widely investigated the relationships between retailers and producers. In particular, authors have addressed the following specific issues within channel relations: power (Beier and Stern 1969; Hunt and Nevin 1974; Frazier 1983; Gaski 1984); interdependence (McAlister 1983; Eyuboglu, Didow Buja 1992]; conflict (Stern and El-Ansary 1988; Schul et al. 1983; Brown et al., 1983); collaboration (Stern and El-Ansary 1988).

In relation to these issues the following elements were examined: the determinants of power (Beier and Stern 1969), the out-comes of power (Perry 1990; Rosenbloom 1973; Stern and El-Ansary 1988), the different stages of power balance in a relationship (Lush and Brown 1982), how power is communicated (Gaski 1984) and perceived (Brown et al., 1983) between channel members.

In particular, with regard to the out-comes of the power, the most critical relationships are in those cases in which conflict between producers and retailers remain unsolved.

In the case of large retailers involved with SME suppliers, the power is unbalanced. In many cases large retailers dominate small manufacturers rather than counteract the power of large manufacturers as proposed by Gailbraith (1952) (Reisman, 1980; Adams, 1987). Profits are restrained by large retailers who may have little incentive to reduce prices to final consumers. Not necessarily this situation brings to a penalization for the supplier because retailers are aware of the need to support a virtuous and efficient relationship through specific investments that require a long-term plan (Hingley, 2005; Amato and Amato, 2009).

Large retailers generally set up selection criteria of suppliers in relation to the products and they follow an active approach to supply market. Usually, the selection of products precedes the supplier selection. The buying activity is composed by the analysis and selection of the alternatives provided by the markets, and the selection of the most convenient products. However, it is always connected with the retailer's strategy, market positioning and long-term objectives. For retailers, sourcing, evaluation and selection of suppliers are based on a variety of factors, which have been widely investigated in the literature (Schul et al., 1985; Baily 1987; Davidson et al., 1988; Shuch 1988; Dawson et al., 1989; Packard, Winters e Axelrod 1996; Lush and Vargo, 1998; Musso 1999; Silva et al. 2002 Cuthbertson, 2004; Bell and Cuthbertson, 2004; Moore, 2004).

We know that several factors are considered in buying activities. Table 1 shows a comprehensive list of buying decision-making criteria. Literature corroborates this list (Musso 1999; Silva et al. 2002; Varley 2006.).

We can argue for the importance of an "attractive blend of product quality, price and delivery performance," and recognize that these three criteria need to be strengthened by "other variables which will enhance the retailer internal efficiency and/or external saleability". It must be said that the elements do not always have the same importance in a buying decision and can therefore be assigned weights reflecting the relative importance of the retailers, according to their dimension, sector and strategic orientation.

The relationship between large retailer and SME suppliers can be structured in three different relational balances:

- 1) the best case for SME suppliers is when manufacturers manage to counter-balance the contractual power of the retailer with the specificity of the product (innovation, niche product, exclusivity, typical product). Sometimes the product specificity is expressed by a successful brand; the relationship with large retailer allows the supplier to use its competitive advantage beyond the local market;
- 2) more problematic is the case of SME manufacturers that are co-makers of private label products. Here, there is a collaborative climate among partners and a discrete level of interdependence: The supplier is not able to offer the same products to others and the retailer finds it quite difficult to substitute the supplier for another producer;
- 3) the case where the supplier's position is more weak is when products are not of main relevance to the retailer's assortment, or when the supplier's range of products is composed by low price products that are easily available on the procurement markets.

Recent researches on this field [Pepe 1988; Musso 1999] showed that SME suppliers and large retailers tend to manage the relationship in two ways:

- 1) in the short-term, the small supplier is considered with a complementary role within the suppliers management process; key factors in the selection criteria are cost reduction or variety/variability of assortment.
- 2) in a long-term relationship perspective, retailers can support smaller suppliers to improve their qualitative/quantitative performance. In this situation retailers have the objective of increasing their competitive advantage looking for efficiency throughout the whole supply chain.

Market saturation and retail concentration processes brought non-price competition to become increasingly relevant. Non-price competition is based on qualitative elements such as originality, enriched services and values (recently ethical values such as respect of environment, working conditions, fair distribution of profits are becoming issues of primary interest). This also implies a better control of the supply chain, logistics, information and quality systems. The effectiveness of the retail assortments can't be reduced to the last ring of supply chain but involves all the supply network. There is an integration process that starts from shared goals and converges on markets knowledge, information system, improvement of the costs' economies and the guarantee of the products quality.

**Table 1:** Selection criteria of the large retailers

	Selection criteria
C1	Availability to receive visit in the factory and control of production processes
C2	Buying power of the supplier, scale economy, competitiveness potentiality
C3	Communications system (EDI, RFID, etc.)
C4	Contractual negotiations: (discount, payment delay, special prize)
C5	Customer portfolio of the supplier
C6	Exclusiveness or customization of the products provided by supplier
C7	Financial situation of supplier to grant stability
C8	Flexibility of producer: delivery times, lead times, etc.
C9	Investments required : technical dotation, minimum quantity
C10	Level of human resources of the supplier
C11	Potentiality to develop
C12	Promotional support
C13	Quality of the products and services
C14	Reliability with regard to the fulfillment of contractual conditions agree upon by the parties
C15	Respect of Safety and health standards
C16	Typicality of product (as made in italy, IGP)
C17	Stock management: logistics capabilities and communication tools
C18	Supplier reputation: share of market, volumes produced
C19	Technical potentiality: high volumes, innovation, quality control
C20	Value for money of the products
C21	Vendor organizations of the producer (above all after-sale )
C22	Wideness and attractiveness of range products

A whole of supply chain approach tends to increase the total reliability of the supplier's business system. In relational or captive supply chains (Gereffi et al., 2005), retailers often facilitate the suppliers' investments by providing financial

support or assistance and capacity building for new production technologies or improving the efficiency of the procurement system.

This happens more frequently when the object of the relationship is a retail brand product (private label) where the relationship and the convergence of goals are more stabilized.

For SME suppliers, a stable, long-term oriented relationship with retailers can be a source of multiple advantages/benefits such as:

- better access to the intermediate market, in particular at the international level. In fact, large retailers develop all the expertise to relate with all the subjects operating through the international channels (exporters, importers, wholesalers);
- overcoming the hurdles in gaining access to the final markets. Large retailers allow the supplier to improve the quality of products or accommodate the product to the consumers' demand.

Finally, the supplier improves its capability to access a new market and to internationalize its business activities. Large retailer facilitates the access to their international networks but often require from supplier high levels of relational capabilities (such as dedicated commercial offices , ect.) (Risso 2009).

### **3. Methodology and data**

The research has focused on the Italian food SME suppliers operating with international large retailers' chains. The aim was to understand opportunities and limits of the relationship between Italian SME suppliers and international large retailers.

This research builds on former researches of the authors concerning the internationalization process of SME. In particular, in such researches the relationship between large retailers and SME supplier has been analyzed as a central issues for the SME's development and the retailers' supply chain (Pepe 1988; 2003;2006; Musso 1996,1999; Pepe e Musso 1994).

An analysis has been conducted in 2008 on a sample of 89 Italian manufacturers in the food sector which operate as suppliers of large retailers.

Data were collected through telephone interviews with owners and managers responsible for sales and marketing activities, responding to a semi-structured questionnaire.

The 89 interviewed SMEs have been identified through the Italian Association of Small and Medium Food Enterprise by random extraction from a list of companies which supply large retailers. In particular, the sample (Tab. 2) is composed by 46% of firms with an overall turnover less than 5 millions euro, 18 % with a turnover between 5 and 10 millions, 9% from 10 to 20 millions, 10,1% from 20 to 40 millions, 5,6 % from 40 to 60 millions, 11,2% more than 60 millions. 87,6 % of firms in the sample are exporters, among them 71% has an export turnover less than 5 millions euro. 59,9 % of firms has less than 30 employees, 15,7% between 30 and 50 employees , 10,1% between 51 and 100, 14,6% more than 100 employees.

Moreover, information from manufacturers has been combined with the relevant, existing, large retailers' documentation (such as Annual report, CSR report, etc.) to understand retail companies' approach to SME suppliers.

**Table 2:** Food SMEs panel description

N. Food SMEs	89
Exporter	81
Suppliers of large retailers	89
-Italian retailers only	45
- International retailer only	3
- Both national and international retailer	41
Geographic area: North Italy	33
Center Italy	26
South Italy	30

SME food suppliers were required to provide data on the characteristics of their relationship with large retailers (above all the criteria adopted for supplier selection), the presence of intermediaries, the way in which the relationships is established, the duration of the relationship, benefits deriving from the relationship, the risks and limits associated with the relationship, the nature of

the investments required (above all for promotional campaigns, logistic tools and innovation).

The distribution of sales within the sample is mainly in the internal market (average 60% of total turnover). The European market absorbs an average of 26% of turnover, and extra-Europe exports (primarily directed to Japan, North America and Australia) are 14% of total sales. 68% of sales is addressed to Italian large retailers. 50% of the firms analyzed have developed relations with International large retailers.

The links with retailers are direct or intermediate: 61% of firms in the sample is connected with international wholesalers, and 40% with national wholesalers. Small retailers are indicated as customers by half of the sample, but the turnover is very modest if compared with the one developed with large retailers.

The questionnaire was focused on supply relations between food SME and large retailers. The issue was divided in three main sections: market dynamics, export strategies and relationships with large retailers, logistic tools.

The questionnaire was planned on two research questions that match the hypothesis based on the results of the desk analysis.

The first research question referred to the behaviours of Italian Food SME in relations with large retailers.

**RQ 1:** What are critical factors considered by SME food supplier in developing relationship with large retailers?

The second research question related to the effects of the large retailers activities in managing relationship with SME.

**RQ2:** Referring to large retailers' selection criteria, how do they affect the competitive advantage of Italian food small and medium manufacturers?

The research questions have been analyzed together with some related variables: firms dimension, weight of sales to large retailers on turn over, degree of internationalization, age of the firm. To better answer to the RQs, a Principal Components Analysis was previously conducted, then a cluster

analysis compared with PCA results was completed.

The questionnaire was semi-structured with items referred to the mentioned research questions. A five-point Likert scale has been used for evaluation of single items (1 = low importance to 5 = high importance). Responses to open questions have been classified and a dichotomic scale of 0/1 (0 not relevant, 1 totally relevant) has been used for each item. The measurement instrument has been developed using a combination of existing scales.

Data treatment has been made by SPSS statistical tool and the results are shown in the following tables with both a simple description of frequencies and a more significant PCA and cluster analysis.

Table 3 shows the weight of retailers' selection criteria perceived by food SME suppliers. Retailers' evaluation criteria are referred, above all, to the ability of suppliers to manage efficient relationships. In fact, apart from the criteria strictly connected with the food sector (such as safety and health standards of products and quality), respondents mainly indicate factors linked to efficiency of the relationship, as Confidence on contractual conditions, Flexibility of producer and Availability to receive visits in the factory and control of production processes.

A cross analysis of evaluation criteria and turnover classes shows meaningful differences. The most significant deviation concerns commercial organization and the implementation of communication systems. In particular, firms who record higher turnover (more than 20 mln €) consider sales organization one of the most important criteria in order to be selected by retailers. This criterion is far less important in smallest firms, though.

Communication systems are highly considered by big suppliers but their importance is rather underestimated by smaller ones. The same trend has been recorded in the management of logistics capabilities.

With the increasing dimension of the firms, the less important criteria are the specificity of products and the customization of the offer.



**Table 3:** Weight of retailers' selection criteria perceived by food SME suppliers

Assesemnet criteria	N	Mean	Std. Deviation	t	df	Sig. (2-tailed)
C 14. Reliability with regard to the fulfillment of contractual conditions agree upon by the parties	88	4,59	0,689	62,527	87	0,000
C 15. Respect of Safety and health standards	87	4,57	0,923	46,230	86	0,000
C 13 Quality of the products and services	87	4,46	0,913	45,587	86	0,000
C 8. Flexibility of producer: delivery times, lead times, etc.	81	4,38	0,995	39,659	80	0,000
C 20 Value for money of the products	88	4,31	0,975	41,435	87	0,000
C 19. Technical potentiality: high volumes, innovation, quality control	88	4,27	0,881	45,520	87	0,000
C 4. Contractual negotiations: (discount, payment delay, special prize)	80	4,08	1,188	30,673	79	0,000
C 1 Availability to receive visit in the factory and control of production processes	81	4,07	1,340	27,372	80	0,000
C 18. Supplier reputation: share of market, volumes produced	81	3,93	1,282	27,553	80	0,000
C 16. Typicality of product (as made in Italy, IGP)	88	3,90	1,232	29,675	87	0,000
C 11. Potentiality to develop	80	3,80	1,205	28,195	79	0,000
C 17. Stock management: logistics capabilities and communication tools	87	3,74	1,243	28,027	86	0,000
C 10 Level of human resources of the supplier	81	3,73	1,285	26,121	80	0,000
C 7 Financial situation of supplier to grant stability	81	3,60	1,262	25,714	80	0,000
C 6. Exclusiveness or customization of the products provided by supplier	88	3,58	1,544	21,746	87	0,000
C 3. Communications system (EDI, RFID, etc.)	80	3,51	1,273	24,683	79	0,000
C 22 Wideness and attractiveness of range products	88	3,50	1,390	23,627	87	0,000
C 9 Investments required : technical dotation, minimum quantity	81	3,25	1,410	20,724	80	0,000
C 21 Vendor organizations of the producer (above all after-sale )	81	3,20	1,495	19,247	80	0,000
C 12 Promotional support	81	3,0741	1,42107	19,469	80	0,000
C 5 Customer portfolio of the supplier	83	2,96	1,338	20,175	82	0,000
C 2 Buying power of the supplier, scale economy, competitiveness potentiality	81	2,9753	1,30360	20,541	80	0,000

A cross analysis of the criteria on export turnover confirms and underpins the illustrated difference. The manufacturers with higher turnover abroad consider the reliability to the compliance with the negotiated conditions a fundamental requirement in order to be selected by retailers. The same criterion is less important in firms with a more limited share of export turnover. Even, producer's availability to be visited and controlled by retailers is a factor that export oriented firms consider more important, while terms of

negotiations (such as discount, annual prize, payment conditions, etc.) become less important.

A lot of manufacturers interviewed declared that an increased retail power creates dependence among smaller suppliers. Therefore, they are forced to accept a high control from retailers, quality test on products and they must respond to product and packaging adaption to retailers' requirements. Also a higher level of involvement in logistics is more often required to suppliers.

### **3.1 Principal Component Analysis (PCA)**

Principal Components Analysis was conducted to identify a concise way for evaluation assessment criteria. PCA is a method that reduces data dimensionality by performing a covariance analysis between factors (Jolliffe, 2002). It is suitable for data sets in multiple dimensions, such as supplier assessment criteria. PCA on assessment criteria provide a way to identify predominant criteria expression patterns. When applied on conditions, PCA will explore correlations between samples or conditions. The goal of PCA is to 'summarize' the data, it is not considered a clustering tool. PCA does not attempt to group firms by user-specified criteria as does the clustering methods.

The overall assessment from Table 4 is that the four main components explain 53,09% of variance. Therefore, we used a PCA rotated matrix which allows to enhance the more significant correlations among the four components (s. table 5).

First component includes the assessment criteria and is strictly related to the internal characteristics of SME supplier. Therefore, first component was named "Firm". Second component contains the criteria which explain the ability to create and sustain tight relations with retailers. This component was named "Relationships and Development". Third Component mainly identifies negotiation terms and, hence, it was named "Agreements". Last component is highly correlated with the typicality of products and the exclusiveness or customization of products provided by supplier, and it was called simply "Product".

**Table 4:** Total variance explained

Component	Initial Eigenvalues			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	6,151	27,960	27,960	3,662	16,648	16,648
2	2,509	11,405	39,365	3,557	16,170	32,817
3	1,594	7,245	46,611	2,591	11,779	44,597
4	1,425	6,476	53,086	1,868	8,489	53,086
5	1,133	5,149	58,236			
6	1,102	5,009	63,245			
7	0,996	4,528	67,772			
8	0,963	4,375	72,148			
9	0,879	3,997	76,144			
10	0,680	3,090	79,235			
11	0,631	2,866	82,101			
12	0,559	2,541	84,642			
13	0,526	2,389	87,031			
14	0,513	2,331	89,362			
15	0,469	2,132	91,494			
16	0,435	1,975	93,469			
17	0,329	1,497	94,966			
18	0,273	1,243	96,209			
19	0,255	1,157	97,366			
20	0,230	1,046	98,412			
21	0,208	0,948	99,359			
22	0,141	0,641	100,000			

Extraction Method: Principal Component Analysis.

The four principal components explained the critical aspects of the relation between food SMEs and large retailers. These findings are consistent with the literature regarding relationships between manufacturer and large retailers. Analysis the components with some simple characteristics of firm (i.e. size, export turnover, location) some general trend are illustrated (s. Annex). In particular, we found a positive correlation among size, Relationships and Development and Firm characteristics, between export turnover and Relationships and Development. The correlation is negative between size and Product, export turnover and Agreements. Analyzing principal component with geographical location of the firm, it is evident a positive correlation

between southern Italian firms and the Relationship and Development of supply chain while northern and central firms are less sensible to create a collaboration relation with large retailer (in particular international retailer) and there is a positive correlation with these geographic locations and Agreements.

**Table 5: Rotated Component Matrix\***

Assesment Criteria	Component			
	1	2	3	4
Wideness and attractiveness of range products	-0,103	0,481	0,24	0,382
Customer portfolio of the supplier	0,162	0,457	0,254	-0,185
Value for money of the products	0,739	-0,065	0	-0,118
Supplier reputation: share of market, volumes produced	0,567	0,117	0,541	0,094
Technical potentiality: high volumes, innovation, quality control	0,035	0,726	0,148	0,019
Communications system (EDI, RFID, etc.)	0,457	0,513	0,082	-0,164
Stock management: logistics capabilities and communication tools	0,451	0,371	0,267	0,055
Financial situation of supplier to grant stability	0,569	0,344	0,185	0,051
Potentiality to develop	0,252	0,589	0,228	0,333
Buying power of the supplier, scale economy, competitiveness potentiality	0,363	0,159	0,431	0,466
Vendor organizations of the producer (above all after-sale )	0,18	0,566	0,091	0,013
Typicality of product (as made in italy, IGP)	0,038	-0,247	0,265	0,589
Level of human resources of the supplier	0,48	0,321	0,118	0,162
Contractual negotiations: (discount, payment delay, special prize)	0,107	0,088	0,707	-0,198
Promotional support	-0,243	0,134	0,699	0,274
Exclusiveness or customization of the products provided by supplier	0,102	0,135	-0,097	0,793
Investments required : technical dotation, minimum quantity	-0,011	0,189	0,786	0,198
Flexibility of producer: delivery times, lead times, etc.	0,276	0,651	-0,003	-0,084
Quality of the products and services	0,671	0,154	-0,253	0,283
Reliability with regard to the fulfillment of contractual conditions agree upon by the parties	0,561	0,345	-0,163	0,08
Respect of Safety and healthy standards	0,736	0,255	0,021	0,046
Availability to receive visit in the factory and control of production processes	0,313	0,695	-0,07	0,231

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. \* Rotation converged in 6 iterations.

### 3.2 Cluster analysis

The analyzed firms do not have evident homogeneous characteristics suitable for a classification the four identified main components in a unique way. It is useful to enhance the analysis with a cluster analysis which can allow a better identification of firms behavior in their relationships with retailers.

PCA allowed a condensed classification of the assessment criteria suitable to compare with some relevant issues of the firms. The cluster analysis is useful to identify specific categories of manufacturers inside the sample, as the results of the empirical research showed inhomogeneous behaviours.

A K-Mean methodology has been followed for the analysis, which allows minimized inertia within single groups and between clusters. The number of the singled-out cluster is 3, that results after a series of tests that show it as the value that returns the clearest differences.

The variables used to divide the sample into more homogeneous groups are: overall turnover, export turnover, importance of national large retailers as customers (as % of turnover) and importance of international large retailers as customers (as a % of turnover).

Table 6 shows the variables that contributed to define the clusters within the sample. F-test shows that turnover, importance of national retailers in turnover and importance of international retailers in turnover are the more significant variables.

Data on the importance of large retailers in turnover was not available from all the manufacturers. Considering their insignificant number, missing values are treated as with the option “exclude cases pairwise” that allows assignment of single cases based on distances from the variables of those that are not missing values. Cluster 2 is the more numerous one, with a total of 51 units. Cluster 1 has 24 units and Cluster 3 has 14 units (s. Table 7).

**Table 6:** ANOVA analysis with different significance levels

	Cluster		Error		F	Sig.
	Mean Square	df	Mean Square	Df		
Turnover	16,916	2	2,770	86	6,108	,003
Export turnover	4,275	2	1,807	76	2,366	,101
Importance of national large retailers	23797,128	2	208,918	74	113,906	,000
Importance of international large retailers	6682,549	2	73,808	67	90,539	,000

F-tests should be used only for descriptive purposes because the clusters have been chosen to maximize the differences between cases in different clusters. The observed significance levels are not corrected for this, and thus, cannot be interpreted as tests of the hypothesis that the cluster means are equal.

In Cluster 1, turnover shows an average value between 10 and 20 mlns euro, export turnover an average value between 5 and 10 mlns euro, sales to national large retailers an average weight of 71,45% (Tab. 8), and sales to international large retailers an average weight of 4,78%.

**Table 7:** Number of units per cluster

Cluster	Number of interviews
1	24
2	51
3	14
Total interviews	89

In Cluster 2, average turnover is between 5 and 10 mlns euro, the same as export turnover; sales to national large retailers have an average weight of 15,51%, and sales to international large retailers an average weight of 5,7%.

Cluster 3 shows an average turnover between 20 and 40 mlns euro, an export turnover between 5 and 10 mlns euro, sales to national large retailers

has an average weight of 27,25%, and sales to international large retailers a weight of 35,2%.

The three clusters differentiate from each other mainly for overall turnover and weight of large retailers (both national and international) on turnover. Cluster 1 has a distinctively higher weight of national large retailers on turnover and a lower weight of international retailers. Manufacturers of Cluster 1 are mainly between 10 and 20 mlns in terms of overall turnover. Cluster 2 is characterized by lower sales to large retailers and smaller size of firms than Cluster 1 (mean of 5 to 10 mlns turnover). In Cluster 3, firm size is higher (mean of 20 to 40 mlns turnover) and large retailers are more important to turnover, particularly international retailers (35,2% on total turnover) as compared to Italian ones (27,25%).

**Table. 8:** Weight of large retailers on turnover by cluster

Cluster	Weight national retailers %	Weight international retailers %
1	71,45	4,78
2	15,51	5,70
3	27,25	35,20

Differences in means within clusters are due to variance in responses and to different consistencies of single clusters. Figure 1 shows the precise clusterization of the sample that allows the analysis of the four factors emerged by PCA. In particular, Figure 1 matches the weight of large retailers on turnover and the weight of international large retailers on turnover.

**Figure 1:** Comparison of the firms in relation to weight of the large retailers on turnover

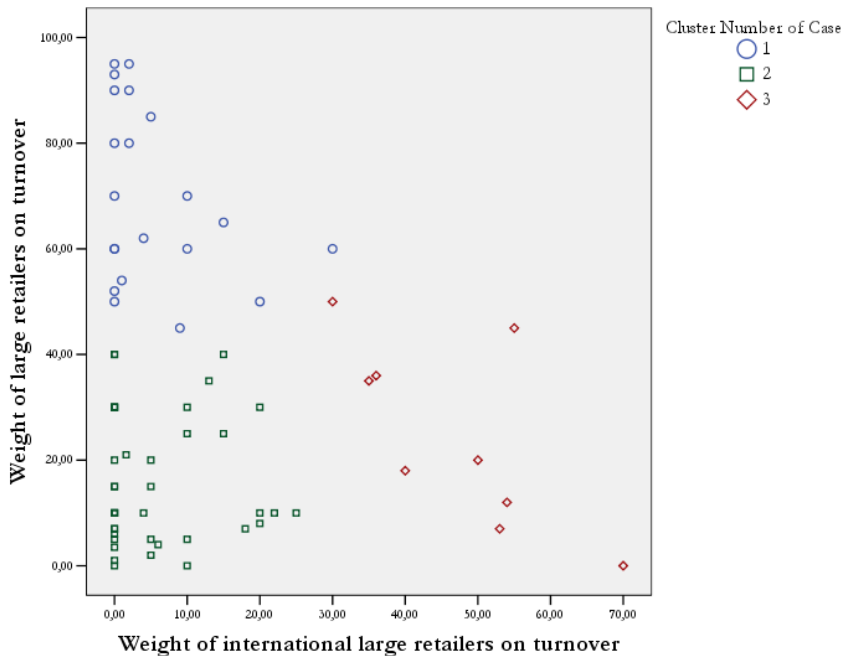


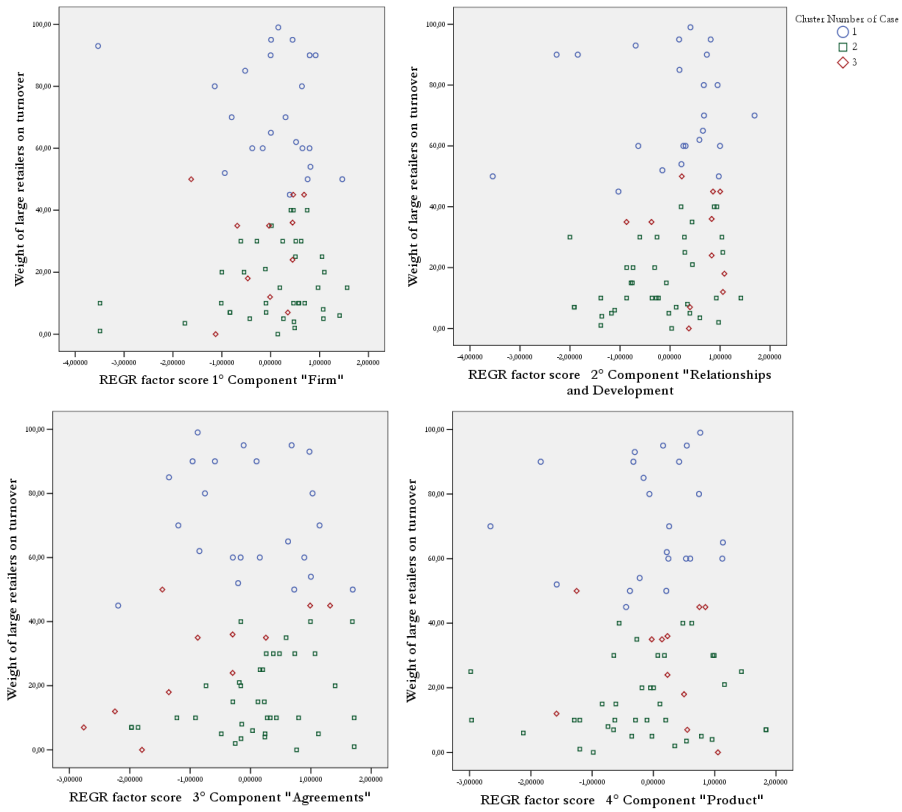
Figure 2 shows the positioning of firms (considered by clusters) in relation to the four components identified by PCA. Indications from the PCA are confirmed by the cluster analysis. All firms are positively correlated to first component (*Firm*). In fact, all firms are aware of the importance of the internal characteristics of the company to achieve competitive advantages on the market.

Analyzing the second Component “*Relationships and Development*” we identify its positive correlation with cluster 1 and 3. A negative correlation is recognized between “*Relationship and Development*” and the firms of the cluster 2.

The third component *Agreement* is more important in cluster 2 than cluster 3 and 1. *Product* is positively correlated with all clusters.

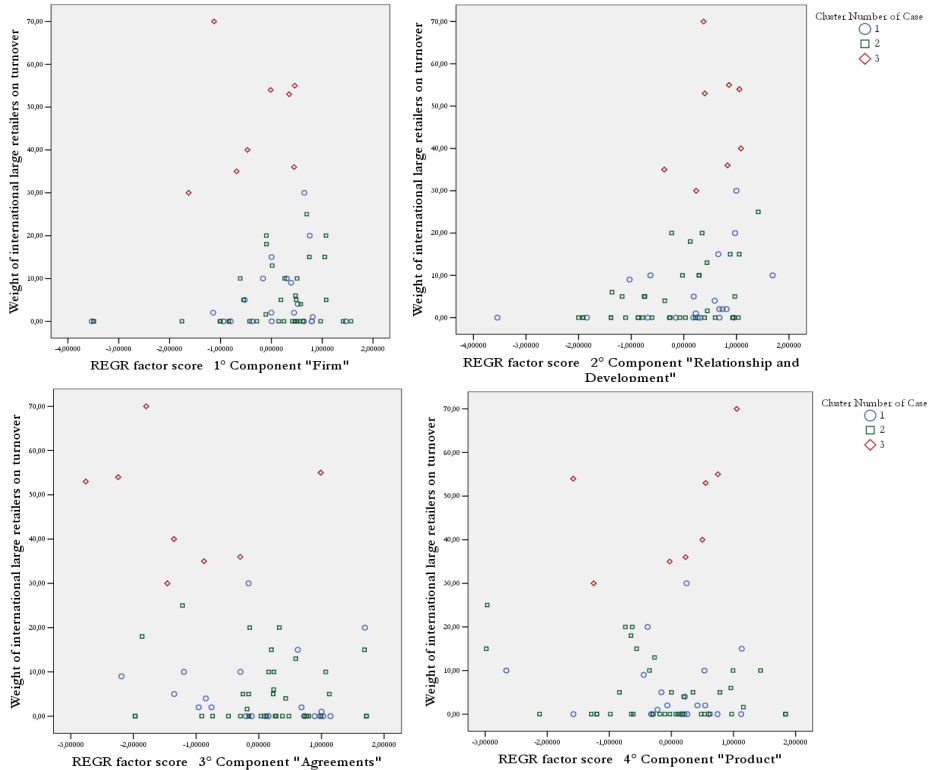


Figure 2: Components and weight of large retailers on turnover within clusters



Considering the weight of international large retailers on turnover and the principal components examined, the data are more evident (Fig. 3).

**Figure 3:** Components and weight of international large retailers on turnover within clusters



## 4. Results

From the Italian food sector perspective, we can argue that small and medium manufacturers have different behaviours in their relations with large retailers. All firms investigated are conscious of their structural and internal capabilities and resources and the importance their typical products. A lot of firms interviewed declared that increased retail power (who dominates the supply chain) creates dependence and forces SMEs to receive control, quality test and adaption of product and packaging to retailers' wants. Also the suppliers' involvement in logistic management is increased.

Therefore, the level of pressure that manufacturers perceive in retailers' selection criteria differs depending on the supplier's dimension and the importance of its products for retailer's assortments. By PCA we have identified four principal components that in comparison to the cluster analysis allow to understand the differences among SMEs' behaviours.

The limited size of firms and their main focus on the domestic market bring them to concentrate their efforts on the objective of remaining in retailers assortments by managing contractual conditions and reducing their margins. Bigger firms are less influenced by retailers in the negotiation for contractual agreement and they can better play their relational capabilities (cluster 1). The more internationalized firms, even if smaller, reveal major capabilities in managing relationships with large retailers (cluster 3). In this case, those firms that are part of international supply chains have the necessary capabilities to manage relations with international partners. Moreover, they follow a middle-long term perspective that brings them to recognise the need of relation-specific investments. Adaptation and collaboration seem to be the two main elements that characterized the presence of food SMEs in the international supply chains of large retailers.

From the large retailers' perspective, more attention is paid to relationships problems with SME suppliers. Large retailers prefer to link with small and medium suppliers because:

- it is easier to control the supply chain; (due to asymmetry of power);
- it is possible to make assortments more flexible and better characterize the retail formula combining standard assortments with a mix of unique-typical products such as organic, ethnical, ethical products. This brings to a better market positioning

Large retailers guarantee small and medium suppliers with wider space on assortment. In the case of private labels products the weight of SME suppliers within a single product line can reach 80% of total. This situation is common to European large retailers, that are adopting several initiatives in order to ensure more spaces to SMEs. At a national level, there are both private and public organizations aiming at improving the coordination, information

exchange, and shared tools among SME suppliers to reduce costs and increase the quality of products. Some of such initiatives are private certification systems, like BRC (British Retail Consortium)<sup>2</sup> in UK, or trade unions organizations, like AVE (Außenhandelsvereinigung des Deutschen Einzelhandels e.V.)<sup>3</sup> in Germany, and FGD (Fédération Générale de la Distribution)<sup>4</sup> in France. At European level there are institutions that offer social quality certification systems for products provided by foreign suppliers involving FTA (Foreign Trade Association)<sup>5</sup> and EuroCommerce<sup>6</sup>.

In spite of what large retailers declare, not all SME food suppliers can benefit from a long term approach within supply relations of the large retailers. In many cases suppliers are asked to guarantee structures, resources and communicational tools to manage advanced relationships.

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2 The British Retail Consortium is the lead trade association for the UK retail industry representing the whole range of retailers, from the large multiples and department stores through to independents.

3 The Cologne-based Außenhandelsvereinigung des Deutschen Einzelhandels e.V. (AVE) is the Foreign Trade Association of the German Retail Trade which was created in 1952. Since then it represents the foreign trade interests of the German Retail Trade which, within the scope of its worldwide buying policy, depends on smooth imports of consumer goods of all kinds and which continues to increase its international trade activities within the framework of globalization.

4 The Fédération des entreprises du Commerce et de la Distribution, FCD, is the lead trade association for the French retail industry in particular food or specialty retailers and their suppliers. The FCD represents and promotes the general and common interests of its members.

5 The Foreign Trade Association (FTA) is the association for European commerce specialized in international trade issues. Its members are national trade associations and companies from all over Europe.

6 Established in 1993, EuroCommerce represents the retail, wholesale and international trade sectors in Europe. Its membership includes commerce federations in 31 countries, European and national associations representing specific commerce sectors and individual companies.

## 5. Some final considerations

This paper analyzed the main drivers of change in the relationships between large retailers and SME suppliers, focusing on the selection criteria adopted by retailers in organizing their supply chain.

Large retailers' requirements are influenced by increasing competition in the food sector. In particular, competitive environment suggests more attention to economies of scale, prices, times and innovation along the whole supply chain.

What SME suppliers have to offer to big clients is, above all, prices, flexibility to face markets changes, a quite wide variety of products and additional "values" to enrich the assortment and make the retailers' position stronger on the market. SMEs represent the "local aspect" of global procurement processes of large retailers. They are involved in international delocalization of the supply processes to reduce costs for private label products, but also to meet the demand of local products in the international stores network. In fact, small manufacturers can guarantee lower costs from logistical proximity and a closer links to territories.

The analysis of SME suppliers' perception of the selection criteria of the large retailers was conducted by a Principal Component Analysis and a Cluster analysis. The results of the statistical analysis were then compared to public documentation of large retailers. In particular, we recognized three clusters of SME suppliers and four main drivers which orient them in the relationships with large retailers. Cluster 1 is composed of biggest SMEs which are suppliers above all of Italian large retailers. Cluster 2 is formed by the smallest SME of the sample and cluster 3 groups supplier which operate with international retailers. For SME suppliers the main drivers are: firm characteristics, typicality of products, agreement conditions and relational and development opportunities. These drivers have different significance in the three clusters considered. The results of the study show as suppliers of Cluster 1 and 3 pay more attention to the relationships with large retailers. They give less importance to the negotiations and the typicality of the product, whereas they give more consideration to collaborate with large retailers to improve efficiency of their business. The smaller suppliers (cluster 2) orient their relationship with large retailers considering more closely contractual aspects, promotional

conditions, price and margins and they use, where possible, the typicality of their products as leverage to increase their relational power.

Taking into account the level of internationalization of enterprises, our study shows that by increasing the weight of large retail in suppliers' turnover, the importance of relational skills increases and, at the same time, the importance of negotiations decreases, especially in suppliers which maintain mainly relations with international large retailers (cluster 3). Indeed international large retailers require suppliers to build capacities to facilitate relationship, innovation and development of the assortments, strengthening internal organization and competencies. Suppliers which provide exclusively Italian large retailers (clusters 1 and 2) are less educated to develop collaboration to improve the overall efficiency of both partners. In particular, they are more exposed to the risk of sudden interruption of relations with their big customers, even if they cooperate with them especially in organizing logistics. Thus both Italian large retailers and suppliers are more oriented to manage relationships focused on price competition following a transactional approach.

Despite of the declarations of the large retailers, their relationships with SME suppliers is still problematic. On the one hand, large retailers are giving more attention to smaller producers than in the past (the total number of suppliers is sometimes very high, although their overall impact on the sales of retailers is then naturally lower). On the other hand, SMEs feel the power of large retailers and their pressure for margins and investments. SMEs need to invest more in facilities, certifications and to improve their processes and controls.

In a hyper-competitive climate, it is unclear whether the large retail companies can maintain and develop the relationships with SMEs. In this context, the availability of large retailers to assist smaller suppliers could be minor. Thus retailers could apply a process of selection that preserves only SMEs more dynamic, innovative and capable to build relationships (Pepe, 2006). In particular the selection in the relationship between small suppliers and large customers, could be twofold: in terms of quality (considering the implications of technological innovation, organization and marketing) and in

relation to the size of the supplier and its capacity to engage international markets.

As emerged from this study, many SMEs seem to understand this trend and are working to improve logistics management and overall business system. They aim to tailor their processes and products to customer needs and, at the same time, they want to reduce their dependence from one large retailer expanding their markets and customers.

Actually, we can identify a range of situation. The first relates to a supply relationship where the quality and specificity of the product ensure a positive role of large retailers which are protective for small suppliers that characterize their assortments (cluster 3). In such case we can talk about shared growth and dynamic business support, where rules, reliability and compliance of the supplier are always oriented by international large partners. The second regards a supply market where price competition makes the relationship increasingly difficult and in which large retailers become more aggressive and tend to standardize requirements and support price competition in their relationships with suppliers. In this case it possible identify a dual orientation. Larger suppliers belonging to cluster 1 (which provide mainly Italian large retailer) invest in economies of scale and logistics favoring a value for money approach. Smaller suppliers that belong to cluster 2 are oriented versus quality and typicality of the product. They are especially focused on optimization of the internal process and they do not build up the relationship with large retailers considering less the opportunities for development of their roles in the assortments of large retailers.

This study highlights some trends in the supplier-retailer relationships and consider above all the suppliers' perceptions of large retailers' requirements. Thus a complementary analysis focused on international large retailers involvement in the relationships with Italian SME food suppliers would be desirable. In addition, for future research on food supplier-retailer relationships in Italy, an important topic would be also find out the way to make these supply chains more effective to manage cross-border activities. A comparative cases analysis between different successful relationships will underscore which strategies, tools and operative processes would be suitable to improve the SME supplier development in international context.

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## Annex

**Table 1:** Turnover and components of the analysis

Turnover		Firm	Relationship and Development	Agreement	Product
Less of 5 mns.	Mean	0,338257901	-0,217227561	0,263232388	0,37605207
	S.D.	0,965051314	1,010489911	0,842261767	0,88747111
From 5 to 10 mns.	Mean	0,289511981	-0,210460858	0,308428307	0,15060234
	S.D.	1,456433687	0,940521518	0,843410169	0,77484218
From 10 to 20 mns.	Mean	0,224849239	0,130830329	0,152900373	0,02923862
	S.D.	0,639337709	1,110516138	0,675769167	0,81377868
From 20 to 40 mns.	Mean	0,204643549	0,136191389	-0,523076134	0,01834071
	S.D.	0,709253036	1,042771566	0,976053769	0,81104956
Over 60 mns.	Mean	0,133506348	0,596004848	0,089727249	-1,08493230
	S.D.	0,699586197	0,860250832	1,161621677	1,33429234

**Table 2:** Export turnover and components of the analysis

Export Turnover		Firm	Relationship and Development	Agreement	Product
Less of 5 mns.	Mean	0,248178545	-0,174138458	0,360089167	0,12060400
	S.D.	1,010103016	0,894352720	0,960198752	0,95865567
From 5 to 10 mns.	Mean	0,243900263	0,407539035	-0,464631514	0,43728221
	S.D.	0,544210234	0,814015048	1,992773615	0,35541027
From 10 to 20 mns.	Mean	0,071949246	0,72608047	0,178793447	-0,17161143
	S.D.	0,624863096	0,633469129	1,00610641	1,34662621
From 20 to 40 mns.	Mean	0,420023522	0,872658933	-0,4664357	-0,58232706
	S.D.	0,790793084	0,745772985	0,739625251	1,19262216
Over 60 mns.	Mean	0,6952245086	1,416676586	-1,219094666	-2,96726364
	S.D.				

**Table 3:** Area and components of the analysis

Area		Firm	Relationship and Development	Agreement	Product
North Italy	Mean	-,0874659	-,2045201	-,0233014	-,2377195
	S. D.	1,18137750	1,07818800	,97753003	,92113947
Centre Italy	Mean	-,2322161	-,0115150	-,2207944	,1599877
	S. D.	1,08349139	,92641565	1,08693177	1,01071007
South Italy	Mean	,3709448	,2436135	,0335622	,0778522
	S. D.	,45074233	,90530353	1,04801231	1,15992577

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