

Executive Summary

JEL: L 15, L 66

Keywords: food chain, relationships, communication

The overall objective of the FOODCOMM project is to analyse the role (prevalence, necessity and significance) of economic relationships and communication in selected European food chains and to identify and analyse the social, economic and cultural factors influencing communication and economic relationships between producers, processors and retailers that are necessary for the long-term stability of food chains in the framework of a CAP with decreasing recourse to market intervention measures.

Pursuing these goals first required a review of the relevant theoretical and empirical literature in order to identify the potential market, social, cultural, economic and political factors influencing communication and economic relationships within food chains. The results of the review were used to construct a coherent theoretical framework which facilitates the elaboration of basic research propositions with respect to the role of communication and economic relationships in the food chain and the factors that impact upon them.

The core concepts of the project are sustainable economic relationships and communication. To conduct the work in WP1, it was necessary that the two terms be defined. Sustainable economic relationships within food chains are defined as longer-term, stable and mutually beneficial interactions and transactions between chain stakeholders. They are based on joint economic interests, such as price stability, profitability of interactions and security of supply. Sustainable economic relationships are characterised by high relationship quality (as indicated by mutual trust, satisfaction and commitment) combined with high relationship strength (as indicated by high switching costs, stability and a positive collaboration history). They contribute to achieving the overall common goal of producing, processing and distributing food effectively, efficiently and consistent with market needs. Economic relationships can be distinguished by their type of governance. Transactions among partners can be organised by spot markets, formal and informal contracts, strategic alliances or vertical integration. Moreover, different patterns of interaction exist. Competitive strategies are based on a zero-sum attitude: i.e. the gain of one partner is the loss of the other; the co-operative strategy is win-win oriented and results in benefits for both parties. Given the freedom to choose, only co-operative strategies will be stable under any type of governance. Accordingly, co-operative supplier-customer relationships receive special attention, as they are expected to promote the sustainable development of competitive food chains.

Communication, the other core concept, is defined as formal and informal sharing of information between chain stakeholders, which facilitates the relationship between organisations and which makes beneficial outcomes possible. In this sense, communication fosters the creation of sustainable economic relationships and contributes to their stability and evolution. Beyond the exchange of information, communication contributes to chain performance and the satisfaction of stakeholders, as well as the quality of the relationship in terms of mutual trust and commitment. Thus, communication is regarded as the glue that holds partnerships together. Three aspects of communication are important to successful relationships: communication quality; extent of information sharing between partners; and participation in planning and goal-setting.

Factors influencing economic relationship and communication: A synthesis of theories

Several theoretical approaches were discussed and their contribution to identifying factors influencing sustainable relationships and communication were presented. The approaches cover a broad spectrum, ranging from socio-cultural and institutional economics to business and management approaches. All the theories highlight different aspects of sustainable relationships and communication, and thus also put varying degrees of emphasis on the individual factors. In principle, the theoretical approaches discussed in the report can be classified regarding the universality of their implications.

Socio-cultural economics

The most abstract approach is socio-cultural economics. Within this context the significance of informal institutional arrangements like culture and conventions and how these guide economic activities is pointed out. This approach distinguishes between national, regional and organisational cultural factors. National cultures can be differentiated into five dimensions: (i) acceptance of inequality in power and wealth distribution (e.g. this influences vertical integration; a nation with low tolerance of inequality may be more concerned with prohibiting integration activities); (ii) individuality or collectivist behaviour, which influence the tendency to build close bonds in economic relationships; (iii) masculinity of a society (negotiations in economic relationships are more aggressive and less aimed toward consensus in a masculine nation); (iv) tolerance of a nation towards uncertainty influences the use of contracts and more regulations; and (v) long-term or short-term orientation of a nation. Regional language, crafts, folklore and landscape are identified as regional cultural factors. Workplace practices, attitudes, norms and power are factors that influence organisational culture. Furthermore, consumers' cultural and social characteristics include factors such as population and demographic change, incomes and quality of life, social change and family work patterns, cultural attitudes to work, increasing consumer awareness of health, animal welfare and environmental issues, etc.

Modern microeconomic theory

The next layer comprises modern microeconomic approaches. A large variety of relevant theories were presented in the report, but their common feature is that they elaborate on the economic consequences when one or more assumptions of the perfect neoclassical world are violated.

Incomplete and imperfect information are considered in information economics, institutional economics, and behavioural economics. Information economics recognises the asymmetric distribution of information and investigates the cost and benefits of additional knowledge, e.g. systems of information transfer like signalling. Institutional economic approaches (principal agent theory, transaction cost economics) stress the impact of transaction costs on economic processes. These costs are regarded as the main reason for adverse selection, moral hazards and the hold-up problem. These approaches also provide solutions that help to improve the outcome of an exchange; besides creating incentive-compatibility and internalising the risks associated with a transaction, this includes the choice of appropriate form of governance, such as spot markets, formal and informal contracts, or ownership of resources. Behavioural economics assumes that people are satisfied with acceptable solutions and do not strive for optimal outcomes. In addition, "loss aversion" supports long-term relationships in the food chain as long as the short-term goal (high profit) is exploited. In contrast, relationships may become unstable due to bounded willpower. This refers to situations in which people satisfy short-run needs and do not make choices in their long-run interest (i.e. put their long-term survival at risk). Industrial organisation analyses the links between market power, market behaviour and economic performance. In this context, it points out the possibilities of market

separation through product differentiation, first by satisfying consumer needs more precisely and second by circumventing negative impacts of intense competition.

Business and management theories

These sets of theories rely on the results derived from the microeconomic approaches. However, the reasoning is much more adjusted to the questions which occur in business relationships and chains. Consequently, the business and management approaches choose selected issues from the different microeconomic theories and derive specific and tangible recommendations for the problems under consideration. The questions these theories deal with are: which factors influence the quality and efficiency of relationships; and under which conditions will sustainable relationships develop. Supply chain management (SCM) deals with the optimisation of the interfaces between suppliers and buyers. SCM-concepts can increase the efficiency, effectiveness and customer satisfaction of supply chain activities. The usage of modern and harmonised information technology can give supply chain partners a competitive advantage because it can lead to an information and communication advantage. The interaction approach extends SCM by pointing out that relationships are influenced by the environment within which they occur. Moreover, this approach views supplier relationships as important intangible assets that offer companies a source of long-term competitive advantage. According to network theory, the capabilities of building and maintaining inter-organisational relationships are increasingly viewed as the key to obtaining sustained competitive advantages. In this context, the importance of horizontal relationships supplementing the vertical links is highlighted. Furthermore, this approach stresses the potential role of institutions in forming and maintaining relationships. Relationship marketing emphasises the importance of building longer-term relationships with customers rather than carrying out individual transactions. People or companies stay in relationships due to the existence of switching costs, which comprise transaction, direct, sunk and opportunity costs. Trust, asset specificity and satisfaction are the key factors influencing switching costs and thus the stability of long-term relationships.

Communication theory

Business to business communication and business to consumer communication are discussed from a chain perspective. How communication and relationships are linked and being influenced by the environment (e.g. information technology) is investigated. Since communication allows chain participants to learn of, and react to, changes in chain partners' expectations, superior communication quality, facilitated by modern information technologies, is of key importance to building sustainable relations. It also aids traceability within chains and improved food safety. Communication behaviour is determined by frequency, direction, formality and content. The key factors influencing communication are communication intensity, communication extensiveness, media sensitivity, openness and quality of communication. Marketing information is characterised by the indicators of relevance, accuracy, reliability, timeliness and consistency. Moreover, the appropriate forms of communication vary with respect to the special characteristics of the chain. Thus, communication which considers the different cultural needs as well as those stemming from the organisation of the chain assists in stabilising economic relationships. Moreover, while business to consumer communication in the past dealt mostly with providing information to consumers, nowadays it aims to find out information about consumers and their motivations, habits and preferences (and to establish feedback systems).

In sum, the economic theories reveal the importance of economic and market factors – such as transactions costs, competition, price relations and product differentiation – in influencing efficiency and strategic effectiveness. The business theories add to the economic factors influencing relationships, such as cost of the relationship, optimisation of the interfaces

between the suppliers and buyers, acquisition of information, and also business aims and strategies. Socio-cultural economics shows that both internal and external actors are engaged in common networks and have the potential to influence each other. The notion of social embeddedness encapsulates the idea that economic behaviour is embedded in, and mediated by, a complex and extensive web of social relations. The culture and power relations exhibited by the firm are also shaped by the macro-regulatory environment (EU and national policies, such as consumer protection policy and competition legislation) within which it operates.

The different factors can be classified according to whether they are exogenously given or determined through the choice of relationships. The external factors comprise cultural, social, technological and political, as well as overall economic, factors. The latter may include the unemployment rate, inflation, exchange rates and others and directly influence the price relationships within the food sector and the individual chains. Their common feature is that they are not or only marginally affected by developments in the food sector. The external factors affect the cost and benefits of transaction and organisational choices. Internal economic factors include prices and market structure, etc. These factors have consequences for the inception and stability of relationships, since price stability, profitability and security of supply are directly concerned. Obviously, the internal factors interact.

Relationships and communication strategies

The interaction of these various factors produces different types of relationship. These can be distinguished according to the degree of interdependence, focus of control, transaction relations and exclusivity. Relationships range from transactional exchanges (spot market) to those characterised by complete collaboration and integration (vertical integration). The former include anonymous encounters as well as ongoing transactions where the actors involved focus only on timely exchanges of standard products at competitive prices. The latter includes very close information exchange between the actors, social and process connections, and mutual commitment due to expectations of long-run benefits and shared asset ownership. In between are value-adding exchanges, often termed “alliances”, which can involve equity and non-equity forms of governance, and can include organisational forms ranging from equity joint ventures and R&D consortia, to longer-term joint marketing and sales contracts, to collaborative supply chain planning and forecasting programs.

With regard to frequency, direction, modality and content, two communication strategies can be distinguished. Low frequency, unidirectional communication, formal modes and indirect content can be subsumed in the autonomous communication strategy. The collaborative communication strategy is characterised by bi-directional information flow, informal modes, indirect content and high frequency. Since communication allows chain participants to learn of and react to changes in chain partners’ expectations, high communication quality is of key importance for building sustainable relations. Congruent relations between chain conditions and communication strategies exist. The collaborative strategy is typical for situations with relational structures, a symmetric distribution of power and high importance of trust and loyalty. The autonomous strategy matches the conditions fostering market exchange and/or vertical integration and is observable in situations with these kinds of governance.

Chain outcome and sustainable relationships

One basic proposition which can be deduced from the theoretical considerations is that when communication strategy is consistent with the chain's conditions, the outcomes will be enhanced. The qualitative outcome consists of satisfaction, coordination and commitment. All three factors strongly influence the trust of the individual partners in the relationship. Trust reduces the perception of risk associated with opportunistic behaviour, encourages effective communication and information sharing, and might create strong social bonds. Qualitative output constitutes the atmosphere of the relationship. More generally, this describes the power-dependence relationships among the companies, the state of conflict or co-operation and overall closeness or distance of the relationship, as well as the companies' mutual expectations. Besides market, political, economic and socio-cultural factors, the qualitative outcome is mainly affected by the performance of the quantitative outcome of the relationship measured by profits, efficiency, etc.

Though dependent on the outcomes of the chains, feedback mechanisms exist which may strengthen and/or weaken the economic and communication relationships within them. Sustainable relationships require a positive feedback mechanism. Relationships and communication strategies adjusted to a chain's conditions increase the likelihood of higher performance compared to competing organisational forms. This is expected to increase satisfaction, commitment and trust in the relationship and also to allow the creation and appropriation of relationship-specific rents by all partners. Thus, such a situation results in a stable and sustainable relationship among the partners of a chain.