

**NETWORK GOVERNANCE EVOLUTION AND  
DEPENDENCY BALANCING IN AUSTRALIA -  
REPUBLIC OF KOREA AND AUSTRALIA - JAPAN  
AGRIBUSINESS TRADE.**

**A thesis submitted in fulfilment of the requirements for the degree of  
DOCTOR OF PHILOSOPHY**

**by**

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## ADDENDUM

The aim of this research is to explore the strategy, context and process linkages of some buyer-supplier relationships. Business strategy (and strategic action) is therefore a key concept in this research. It is defined in the thesis Introduction as concerned with the way management matches the firm's resources and capabilities with opportunities or threats it *perceives* in the market contexts. Competing conceptualizations of strategy are discussed, including its use in relation to implicitly realized strategies and strategy as a social construction or rationalization used to give meaning to prior activities (Pettigrew, 1987). Reference is made to Nystrom and Starbuck's (1984) argument that human competencies set the limits to which strategy is developed and realized.

Strategic action has therefore been conceptualized as the result of a rational problem-solving process (Introduction, 7). It is argued that it is the result of the strategic thinking (including objectives and goal setting) of key personnel based on their quite stable abstractions of reality. In turn these abstractions (eg what actor behavior is seen as justifying retaliation or buyer-supplier loyalty) are shared by key personnel across networks who have a number of characteristics in common, including their age, gender, length of time served in the company, employment status, and levels of personal satisfaction with their interpersonal relationships within the trading networks (Research Analysis and Conclusions, 452).

Therefore this research does not exclusively concentrate on or reduce analysis to consideration of the externally-observable behavior of personnel or actors only. Rather, one of the key findings of the research is that the evolving cultural contexts, the enculturation of key individuals and hence their understanding about network norms and sanctions motivates their strategic choices (Research Analysis and Conclusions, 453-454). The analysis found: "... that key personnel were instrumental in formulating or implementing strategies which changed the positions of their firms. The individual's activities and relationships were motivated by a complex of cultural, interpersonal and organizational influences, as well as by their skills and training (Research Analysis and Conclusions, 450).

The findings of other researchers studying strategic managerial behaviors, eg the role of *Guanxi*, and the function and impact of a person's perceived social status within a social network were considered in analyzing the case study data and drawing this researcher's conclusions about the significance of the goals and aspirations of management (ie Luo and Chen, 1997, Alston, 1989, Yau, 1988, McInnis, 1993, Rodrigo, 1998, and Ambler et al, 1996 Research Analysis and Conclusions, 450-454). The influence of culture and relational exchange in strategic decision making as distinct from the influence of the internal capabilities and the external situation of the firm is discussed in the Literature Review on pages 111-114. The literature analysis influenced the data analysis and final model building.

Given the extensive discussion and definition of concepts that proceeds the diagram of the model of the Process of Network Governance Evolution, (page 453) it is felt that the three factors identified as influencing the Actor's Strategic Activity, ie the Actor network position, the Actor's characteristics (internal and external), and Key Personnel Characteristics (enculturation, knowledge, skills, experience, motivation etc) describes both the externally observable factors and the strategic intentions which lead to Actor Strategic Activity.

In all diagrams in the thesis the arrows indicate the flow direction of the exchange (labeled variously as information, social or product exchange). The arrow "head" indicates the recipient of the exchange outcome, the shaft end indicates the "giver" or originator of the exchange. Where an arrow has a "head" at each end, this indicates a two way flow, with both parties giving and receiving.

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Sharman N. Stone

## **Abstract**

This thesis investigates the area of agribusiness industry structure, in particular the form and function of Agribusiness Statutory Marketing Authorities (ASMAs) and their influence on relationships and governance in dynamic export networks.

The networks examined were involved with the Australia-Japan and Australia-Republic of Korea export trade in wheat and dairy products. Network governance and strategic activity were tracked and the changes analysed from the time of the first cross-border exchanges until 1994. The units of analysis were strategic episodes involving ASMAs and seven of their industries' suppliers.

The research proceeds on the premise that the heterogeneous distribution of actors' interests and power asymmetries in agribusiness industrial networks creates imbalances and pressures for change.

The research problem is determine how up-stream suppliers in long-established asymmetrical relationships can countervail dependencies, given the potential for the more powerful buyer to retaliate should the less powerful partner seek to shorten the supply channel or expand the network with additional buyers.

A particular contribution of this research is the identification of the significance of network culture (ie norms and conventions) in facilitating or constraining evolution in the network governance.

An accurate knowledge of corporate histories, cross-ownership linkages and traditional interdependencies was also critical for the selection of appropriate exchange partners. Enculturation and network knowledge is a basis for influence and an important strategic element. Both of these areas of understanding are time and repeated-experience dependent.

In 1994, most key personnel in the networks had more than ten years continuous employment with their firm. But the convention of working for the one employer for many years is rapidly changing in the Republic of Korea, Japan and Australia. This paradigm shift may challenge the way norms and conventions have been used to entrench the status quo, and the way relational exchanges have been traditionally established and maintained.

Finally, a model identifying the evolution of network governance was developed. The constructs and their interrelationships show strategy stimulated by the macro environment which is in turn a dynamic admixture of interdependent demand-competition, production-distribution and institutional factors. These are moderated by the micro context, ie the internal characteristics of the firms the experience and skills of the key personnel and their network position .

The model of network governance developed also offers a workable framework for collecting data and undertaking analysis of dynamic business relationships using case studies.

Using case study method, this research was able to gain insights into complex, dynamic interrelationships, over time and in real life contexts

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This research would not have been possible without the magnificent cooperation of scores of people actively engaged in the export trade networks that link Australia with the Republic of Korea and Japan. Many of these people appear as informants in the case studies. Their generosity in giving freely of their time, making their firm's records available, and the careful attention they gave to my every request is gratefully and wholeheartedly acknowledged.

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## **Chapter 1**

### **INTRODUCTION**

#### **Network Governance and Countervailing Dependency in some Dynamic Agribusiness Export Markets**

##### **1.1 Background to the Research**

International marketing is a growing field of scientific study. There has been a lag however between business practice and academic research. Firms have been internationalising for hundreds of years while research into this activity is comparatively recent. The new academic focus reflects the increasing significance of the international marketplace and the changing composition of and growth in world trade and investment.

The last twenty years has seen significant shifts in the hegemony of regions and the emergence and convergence of new industries, products, services and markets.

Those involved in agribusiness trade must also deal with supply quality and volume fluctuating in line with changing weather patterns, the growing concentration of buyers and multinational food manufacturers, and the strength of national food self-sufficiency sentiments in some places, fuelled by a politically strong primary producer sector. The combination of these factors mean government interventions in food trade have been tolerated long after many economies have ceased to support non-tariff barriers and quotas in other sectors of trade.

Companies involved in international agribusiness trade need to constantly adjust to the socio-economic and political changes that are often beyond their influence, but which

profoundly effect demand and competition in the marketplace.

## 1.2 The Research Problem

Little is known about the long term impacts of different industry structures, collective action and networking processes as up-stream participants strategise to try to reduce the seller dependencies that invariably exist in their part of the agribusiness export system.

Such knowledge is important for Australia, given the proportion of its earnings derived from primary production and sold onto volatile international markets. As well there is public debate about the role and future of Australia's Agribusiness Statutory Marketing Authorities (ASMAs), as deregulation in domestic and international market places proceeds and *competitive neutrality* is embraced by some as a philosophy delivering benefits to all business sectors (eg GRDC, 1995).

## 1.3 Conceptualising Inter-firm Relationships and Networks

A body of theory conceptualises business to business exchange as networks of relatively stable relationships. The concept of business networks is central to this research. The body of work building such a concept along with other literature relevant to the study is reviewed in Chapter Three.

The significance of inter-firm relationships in international business research is now well recognised. For example, see Ford (1980), Thorelli (1986), Johanson (1989), Forsgren and Johanson (1992), Cavusgil and Sharma (1993), Bjorkman and Kock (1995) and Rodrigo, (1998). Such writers have argued that a crucial element of international business strategy is the development and management of effective interfirm relations with trading partners. Such relationships are said to become the means by which competitive advantage is established, key resources are accessed and value created and delivered to customers.

Over time various adaptations may take place between firms that strengthen the relationships as they create technical, logistical and other links. On the other hand, as markets evolve it may be in the interests of one of the firms to loosen or cast off the bonds which previously tied them into a long-lasting supply relationship where one of the party's interests predominated.

## **1.4 The Research Objectives**

The objectives of this research are to develop business to business relationship and network theory through an analysis of the strategic responses of some exporting agribusiness firms (actors) as they attempt to reposition in networks of exchange relationships, over time, where:

Government policies are pervasive,  
the markets are deregulating,  
some of the exporters are ASMAs, and  
the buyer-seller power relationships are highly asymmetrical.

## **1.5 The Research Aims**

Specifically this study aims to explore the strategy, context and process linkages of some supplier and buyer relationships developed to facilitate the export of wheat and dairy product from Australia to Japan, and from Australia to the Republic of Korea (ROK). In 1994 these markets represented the highest value wheat and dairy returns for the respective Australian industries.

## **1.6 Justification for the Research**

Industrial network theory has tended to concentrate on the processes of change in individual firms or dyads, in particular change involving economic and technological factors. This research is concerned with strategic change, content and processes. In particular it focuses on change driven by actors attempting to better balance their dependencies in order to capture new opportunities or protect preferential treatments in deregulating markets.

Agribusiness systems encompass a wide range of participants, from the single grower to the agents, traders, manufacturers, wholesalers, distributors and retailers. All are interdependent. This is fertile ground for researchers seeking to compare and better understand the evolution of strategy/context/performance linkages between differently structured and resourced participants.

It would seem that there have been few attempts to describe and analyse the long-term impact of government-auspiced actors on their domestic industries as they seek to

internationalise. As well, given the logistical problems associated with gathering cross-country data and the complexities of the interacting and multiple variables, few have tracked, over time, the interrelations between actors and their internal and external contexts at the micro and macro levels. Because this research investigates network structure and actor activity over time, it is hoped that the maturation processes of long-term business relationships will become better understood.

This thesis is also one of the first to analyse the long-term strategic activities of Australian ASMA's exporting to Asia. Schroder and Mavondo (1995) also note that while there is a considerable body of literature on agriculture producer cooperatives and some on statutory marketing authorities, this tends not to draw on recent theories of networking or relationship marketing.

## **1.7 Definitions of the Key Terms and Concepts**

### **Actors**

Actor is the term used in this research to denote firms, business enterprises or government agencies that are participating in the exchange activities under discussion. The term is not used to refer to individuals within the firms, businesses, or agencies.

### **Networks**

A network can be described as a set of interconnected exchange relationships between actors performing various industrial production-distribution, regulatory or facilitative activities. This research is concerned with the positions occupied by the actors in the networks as well as the linkages between each participant, ie their relationships.

### **Context**

The actor's environment is conceptualised as including the internal characteristics of the firm and micro and macro level factors which together constitute the complex and dynamic "context" in which the actors are embedded. The environment both influences and may be influenced by the actor. For example some elements, especially within the institutional context, are exogenous to the actor, while others are enacted.

### **The internal characteristics of the focal actor**

These include:

- the enculturation, personality, skills, commitment and experience of the actor's key personnel,
- its corporate history and export experience,
- its scale of operation and value of available resources,
- its product or service characteristics and
- its comparative technologies.

### **The micro level**

This is the focal network consisting of an activity chain including the focal actor and all the other actors it has direct and indirect relationships with in the production-distribution chain reaching ultimately to the consumer.

### **The macro level**

The macro level consists of the other networks involved in the same production-distribution activity as the focal network, who compete, or may sometimes cooperate with it in international markets. In this research the macro level includes the other networks engaged in the production and export of wheat or dairy product to Japan or the ROK. The activities in exporting networks at both the micro and macro level cross international borders.

### **The institutional setting : legal, socio/cultural and political/regulatory factors**

Legal, socio/cultural and political/regulatory factors constitute the institutional setting in micro and macro environments. These factors influence and are influenced by the production/distribution and competition/demand systems. According to Mattsson, Kjellberg and Ulfssdotter the institutional setting can "control, restrain, liberate and expand a firm's possibilities for strategic action on the governance structure as well as impose new production dependencies" ( Mattsson, Kjellberg and Ulfssdotter, 1993:5).

### **Agribusiness production/distribution systems**

These consist of the production and distribution resources and activities that transform the primary production of animals and plants into products for final consumption. Activities

are interlinked into value added chains and resources are interdependent. The interdependencies develop over time as a result of interaction in the network aimed at achieving channel efficiency, and the evolution of technologies.

There is a wide range of organisational structures among the enterprises participating in agribusiness systems. These range from family owned enterprises to public companies, cooperatives and government owned enterprises, statutory authorities and some of the world's largest multi-national corporations (Streeter, Sonka and Hudson, 1991; O'Keeffe, 1993; Schroder and Mavondo, 1995).

### **Agribusiness domestic and export demand settings**

The volumes and type, pricing and presentation of product and associated service demanded in the domestic and export markets will vary over time and place, in response to micro and macro level environmental changes and production/distribution system responses. How actors are aligned and linked to meet this demand is mirrored in the network's governance structure

### **Governance structure**

The network's production-distribution activities are coordinated through direct and indirect exchange relationships between actors. These exchanges include buying and selling and information, technology, social or financial exchange. The exchanges are effected by institutional and demand/competition factors, as well as the actor's internal characteristics.

Heide (1994) defined governance as "a multidimensional phenomenon, encompassing the initiation, termination and on-going relationship maintenance between a set of parties". (1994:72) The arrangement of the network of relationships at any one time constitutes its governance structure. This structure is dynamic. It evolves as relationships develop out of a temporal series of activities and transactions. Thus the governance structure at any one time reflects the contemporary distribution and control of resources in the network and the individual actors' positions.

The governance structures are internationalised to the extent to which exchange relationships span international borders.

### **Position**

Each actor occupies a position in the network it is a part of. This position is determined by the actor's previous exchange activities, its command of scarce and valued resources and the structure of the surrounding network (Mattsson, Kjellberg and Ulfssdotter, 1993). The position of an actor within a network affects its possibilities to influence its strategic long-term orientation (Forsgren and Pahlberg, 1992).

The position of all actors in an interconnected chain of exchange relationships is reflected in the network governance structure. Actor's positions change, with their becoming more or less central as they are negatively impacted by the strategies of others, or they successfully moderate or adjust to take advantage of changing market demand/competition, institutional factors or evolving production/distribution systems at the micro and/or macro levels.

### **Centrality**

A central actor is one that can affect its context to a higher degree than a peripheral one. It does this through the value of resources it can control. Thus the extent to which the actor is the only or major source of a valued resource is a measure of its centrality.

### **Competitive advantage**

Competitive advantage is determined by the position of an actor in its network. This will reflect the value and substitutability of its product/services, information, technology and/or financial resources.

### **Strategy**

Business strategy is concerned with the way management matches the firm's resources and capabilities with opportunities or threats it perceives in the market contexts. At the same time the actor's ability to manipulate the environment is a capability in itself. Competing conceptualisations of strategy include its use in relation to implicitly realised strategies and strategy as a social construction or rationalisation used to give meaning to prior activities (Pettigrew, 1987).

Strategic action in this research is defined as the result of a rational problem-solving process. Strategic actions are the result of strategic thinking based on quite stable

abstractions of reality. Nystrom and Starbuck (1984) argued that internal resources, especially human competencies set the limits to which strategy is developed and realised.

Both the content of the strategy (ie what decisions are made leading to what activity), and the strategic process (ie how and why change takes place and how, when and where decisions are arrived at) are the subjects of this research.

### **Strategic Change**

This research acknowledges that individuals or groups who interpret their environment subjectively, in accordance with their cultural experience and understanding make strategic decisions and actions. A strategic change may be triggered by perceptions of turbulent and hostile elements or positive opportunities occurring in the micro or macro environment (Lorange, Chakravarthy, Roos and Van de Ven, 1990 ; Van de Ven, 1987).

### **Markets**

Markets are an economic exchange system, but as actors come to share a common set of symbols and rules of behaviour, they also become social systems with an evolving cultural context.

### **Culture**

Those who belong to the same culture have learned and acknowledge a set of common values, norms, mores, world views and expressive symbols. Culture supplies systems of meaning and legitimacy for patterned social interaction between those who share that cultural understanding. (For example, what one business culture might disparage as "collusion" between two parties, another may praise, calling it "cooperation".)

### **Agribusiness Statutory Marketing Authorities (ASMAs)**

Primary production units are often small, geographically dispersed and lack power relative to other participants in the network. They face particular problems in organising voluntary collective activity (O'Keeffe, 1993; Caves and Petersen, 1986; Schroder and Mavondo, 1995; Sogaard, 1994).

One strategy aimed at increasing the market power of primary producers throughout the



world has been collective action through the creation of ASMAs. An ASMA is a government sanctioned commercial body with trading, promotional and/or regulatory powers which are funded through compulsory levies paid by growers or from sale of compulsorily acquired produce (Lawrenson, 1991).

A particular characteristic of Australian agriculture has been the prominence of State and Commonwealth ASMAs which developed rapidly after the First World War in response to growing supply surpluses and calls from farmers to protect them from the volatility of international and domestic commodity prices. When many of the early attempts to form voluntary cooperatives failed, some were backed by governments giving them statutory powers. The Australian Wheat Board (AWB) and the Australian Dairy Corporation (ADC) are two such ASMAs.

**ASMAs' objectives typically include to:**

- provide countervailing power
- put a floor under the market price
- reduce price fluctuations
- capture export opportunities
- achieve economies of scale
- undertake market development and promotion
- organise commodity research
- provide information to suppliers
- set grading standards
- provide tariff compensation
- represent the industry to government.

The late 1980s (when competition policy was being actively debated and promoted in Australia) ushered in an era of sustained criticism of ASMAs. For example, the Centre for International Economics (1990) in a report assessing NSW ASMAs concluded:

*The weight of the evidence indicates that the public interest would not be harmed and would probably be helped if the anti-competitive powers were removed from the (ASMA) legislation (CIE,1990:23).*

This and similar reports argued that ASMAs typically lacked flexibility, had an inadequate capital base, separated ownership (ie government) and responsibility (ie suppliers), lacked a profit making incentive, and over relied on coercive power. This, it was argued, removed them from commercial reality, creating inefficiency and a reluctance to change (Langdon, 1991; CIE, 1990; I.C, 1991).

During the period when data for this research was collected (up to 1994) the AWB bought and sold all Australian wheat for export, including to Japan and ROK. The ADC sold designated categories of Australian dairy product to Japan, in particular milk powders and bulk cheeses. It could also trade in any other categories of dairy product if such was judged to be in the interests of the industry. (These statutory responsibilities remained the same in 1999).

In 1994 there were ten Federal Government ASMAs in Australia, with some sixty in the State jurisdictions.

## **1.8 Research Premises**

A number of premises have been accepted in framing the objectives and aims of this research. These have been derived from the findings of the writers who addressed the issues of organisation of long term industrial business transactions, asymmetrical buyer-seller relationships, collective behaviour and the socio/political and cultural aspects of international marketing.

While Chapter Three reviews this literature in detail, the premises directing the choice of methodology and case study protocols are that:

(i) Dyads of firms are bound together in quite stable patterns of ongoing interaction. This interaction is characterised by economic exchange (transactions) information exchange, and social exchange (commitment and trust), (Johanson and Mattsson, 1984; Doney and Cannon, 1997; Cowles, 1997).

(ii) A network of relationships is the framework, which gives firms both the possibilities but also the constraints in their business performance (Jarillo, 1993; Thorelli, 1990;

Hakansson and Snehota, 1989).

(iii) The position of a firm in a network is the location of its power to create and/or influence exchanges in networks (Freeman, 1977; Forsgren and Johanson, 1992; Mattsson, 1989).

(iv) The heterogeneous distribution of actors' interests and power asymmetries in industrial networks creates imbalances and pressures for change (Brito and Araujo, 1993).

(v) An actor succeeds to the extent that it achieves the closest possible "fit" between its internal capabilities and the (usually less easily manipulated) factors it encounters in the micro and macro contexts (Bartlett and Ghoshal, 1991; Schroder and Mavondo, 1994, 1995; Venkatraman and Prescott, 1990; Johansson and Mattsson, 1991).

(vi) Actors both influence and are influenced by their contexts (Cavusgil and Zou, 1994; Mattsson, Kjellberg and Ulfsdotter, 1993).

## **1.9 The Key Questions**

Six key questions guided the collection of data for this research and its analysis.

(i) What attributes, comparative power and product/service characteristics buyers and suppliers sought in their selection of exchange partners;

(ii) the strategic responses of focal firms as each aimed to actualise their ideal exchange relationship and realise new opportunities (or counter increased competition) in the deregulating markets;

(iii) the character of triggers, ie the shocks, watersheds or significant episodes which informants nominated as stressing or otherwise changing their relationships over the duration of their export activity in the focal markets,

(iv) the factors in the micro and macro contexts which mediated the strategic activity of the firms (and which had the potential to cause counteraction and reformation of the network

governance structure).

(v) The fifth question interrogated the case study data to deliver understanding about the activity content and outcomes of the strategic shifts of ASMA and suppliers as they sought to countervail their dependency in asymmetrical relationships in the dynamic contexts.

(vi) This question aimed to generate data which could be used to analyse the impact of the industry structure and ASMA strategy, over time, on their supplier's strategic flexibility, their power balancing efforts, and subsequently, the trading networks' governance.

Data was collected through historical background research largely derived from secondary sources and from the informants from the ten case studies who described forty-three business to business exchange episodes spanning the time over which their firms had been active in the focal export markets up to and including 1994.

The framework developed to deliver the data is presented diagrammatically below:

**Figure 1.1: The Case Data Collection Framework**

Australian Wheat Export Industry		Australian Dairy Export Industry
Background history		Background history
Timelines		Timelines
Case study: AWB-ROK	Case study: AWB-Japan	Case study: ADC-Japan
Case study of one supplier		Case study of six suppliers
Within case analysis		Within case analysis
Cross case and case to theory analysis		

## **1.10 The Development of a Model of the Process of Network**

### **Governance Evolution**

The strategic responses to factors in the micro and macro contexts including the characteristics of key personnel and the firm revealed information about the process of network evolution and the evolving governance of the network. A model was developed to characterise the content and activity of this process.

## **1.11 Study Time Frame**

The evolution of the focal trade relationships were investigated from the time when the industry actors first invested in market entry strategies through to 1994. The Australian industry contexts were tracked from the time of First Settlement (ie 1788). The export market contexts were considered from the time that Australia first exported agriproduct, (ie from the 1860s).

## **1.12 Summary of the Research Methodology: Case Study Method**

The purpose of social science is to attain an increased understanding and insight into what constitutes real life phenomena. This study of strategic action and business to business exchange relationships aims to understand what happens over time in an organisation, and how this action effects relationships between actors, and hence the governance structure of the network.

The research seeks to achieve its aims through the analysis of information collected from case studies tracking the strategic activities of two ASMAs, the Australian Dairy Corporation (ADC) and the Australian Wheat Board (AWB) and seven of their suppliers to the Japanese and Republic of Korea (ROK) markets.

Two pivotal considerations for case-study method selection identified by Bonoma (1985) guided the choice of this research method. The first key phenomenon (the process of strategic change) could not be studied usefully outside its natural contexts and the second (strategic change and network evolution) was not particularly amenable to quantification. A case study methodology was therefore selected as most appropriate to generate the data to explore the strategic responses of ASMAs and other network actors who strive to develop business to business relationships in the complex, dynamic Japanese and ROK

wheat and dairy markets.

Bonoma describes a case as:

*a description, directly obtained, of a management situation based on interview, archival, naturalistic observation and other data, constructed to be sensitive to the context in which management behaviour takes place and to its temporal restraints* (Bonoma, 1985:204).

Case research is well suited to researching the complex macro level issues in marketing. Strategic analysis implies a holistic, multi-dimensional analysis, which can best be delivered through in depth case studies.

The issue of achieving external validity in case studies has been controversial (Alpert, 1989; Yin, 1993). Chapter Four describing the research method deals with this issue.

The aims and premises of this research were grounded in the extant marketing theory. A theory/data/theory cycle of analysis was used as the project was progressed.

### **1.13 The Research Process**

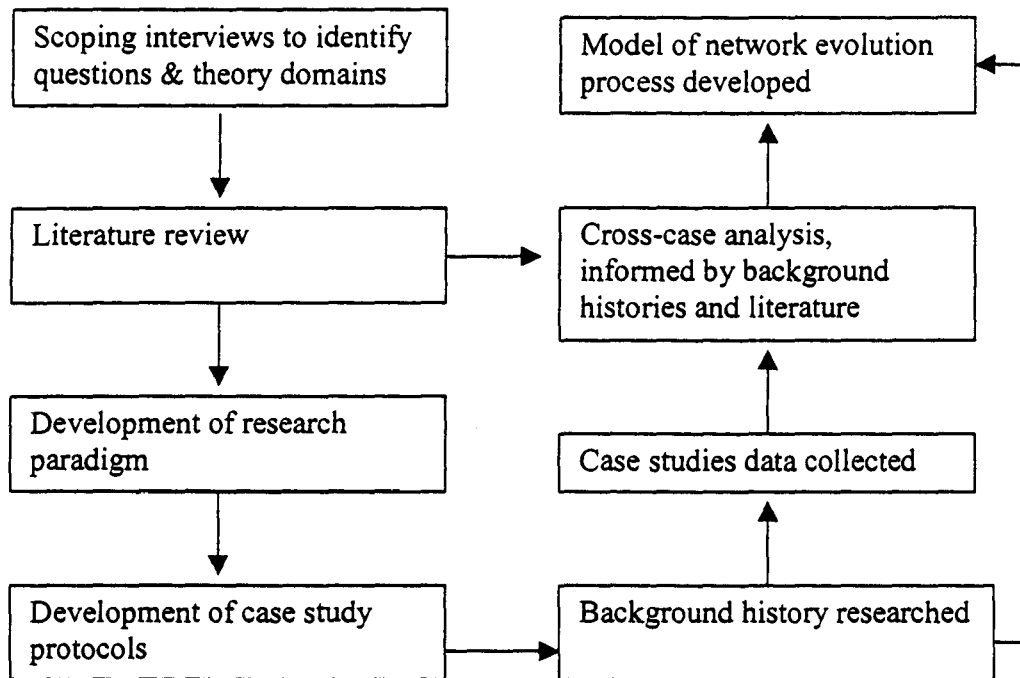
In the first six months of the research scoping interviews were conducted with some forty Australian exporters, buyers, agents, government bureaucrats and research workers. The question directing these interviews asked: "what do Australian suppliers need to do to succeed in international food trade?" The responses to this question helped to identify the theoretical domains, key questions and industry sectors to be targeted.

The following describes the entire research process:

- (i) The scoping interviews
- (ii) Initial literature review
- (iii) Historical research undertaken
- (iv) Research aims, theoretical assumptions and key questions refined.
- (v) Development of case study design and protocols
- (vi) Conduct of case investigations

- (vii) Preliminary analysis of individual case reports
- (viii) Within case, case to theory and cross case analysis.
- (ix) Theory building through development of the model of strategic change and the process of network evolution.

**Figure 1.2: The Research Design**



#### 1.13.1 The selection of the field sites

Over the last forty years the ROK and Japanese wheat and dairy markets have evolved from being small and highly regulated to become more liberalised and competitive market places. The Australian wheat and dairy industries have evolved from being commodity and domestically focussed to become less regulated, more product differentiated and customer responsive. Given the objectives of this research, Japan and the ROK presented as markets that were significant to Australian agribusiness, were deregulating, and were geographically close enough to Australia and each other to make field research efficient.

#### 1.13.2 The selection of cases

The cases were chosen on the basis that they provided multiple sources of evidence of ASMA and firm activity across three markets at different stages of governance, industry evolution and market maturity

While the Japanese and ROK markets have deregulated at a different rate, they have evolved through similar stages of domestic agricultural and imported food consumption policy and institutional arrangements. As well Japan and the ROK have some food consumption patterns in common. Their culinary traditions have their origins in China. Both countries prefer rice as their cereal staple. Wheaten noodles have been the next most important cereal. Bread and bakery consumption dates from World War Two (WW2). Neither country has a tradition of milk production or dairy product consumption. The evolution of the dairy and wheat patterns of consumption in ROK has followed that of Japan. ROK also exports its wheat-based products to Japan.

The focal Australian firms were selected on the basis that their products ranged from commodities to high value retail packs and they have been supplying, directly or indirectly one or both of the focal markets. The focal firm's ownership structures and scale of operation varied, as did the length of time that they had been supplying the overseas market. All of them operated however, within an industry structure where their ASMA had exclusive rights to control the sale of some of their product lines.

The final selection of industries and markets as cases was informed by initial scoping interviews with government agencies, commission agents and manufacturers. The literature combined with these interviews helped to refine the objectives, which finally guided the case research.

### **1.13.3 Case study protocol**

The case study data was collected through semi-structured interviews with personnel who had been directly involved in formulating or implementing the market strategies aimed at repositioning their firm. As well, interested observers of the activities, eg government trade officials and traders and manufacturers in the macro environment were interviewed to add depth to the data and to improve validity. Whenever accessible, documentary material supplemented the interview record. Triangulation was achieved through accessing multiple sources of information about the same issue or episode.

Whenever possible interviews were conducted with representatives from both the buyers



and suppliers in the relationship. This facilitated observation and the documentation of the emotional and cultural content of the relationships. Interviews were conducted over three years in Japan, ROK and Australia between 1992 and 1994. Written records and personal recollections were searched back to the time that the actor had commenced investing resources in order to export product to Japan and/or ROK.

### **1.14 Research Confidentiality**

This research proceeded on the basis of a legally binding written agreement between Monash University, the Victorian Department of Agriculture (DARATECH) and the researcher. This agreement stated that: "At the completion of the scholar's Ph.D. thesis, at the request of any of the parties, public access to such thesis shall be restricted for a further period of three years". This agreement predated any contact with the case study informants, and so was not in response to their stated concerns. However, it was considered necessary to reassure informants of the special measures taken to ensure confidentiality for any disclosure of personally, commercially or politically sensitive material. Informants were told of the confidentiality agreement prior to the commencement of the interview process associated with each case study.

None of the informants requested that their names or the names of their companies be suppressed in the presentation of this thesis. In reality, any attempt to obscure identities would fail given the circumstances of the cases where, for example, there is only one wheat and one dairy ASMA, and the industries' participants are well known to the informed reader. Consequently no attempt has been made to disguise the names of individuals or organisations in this thesis. Instead, to protect commercially sensitive information, the writer will request that the thesis be withheld from public reading for a designated period.

Some informants responded to the writer's reassurances about the confidentiality issues with comments to the effect that they all knew each other's business anyway, and indeed, "we couldn't stay in the game" if such was not the case (VA:AWB).

For the sake of brevity and to focus attention on the activity rather than the firm or individual, initials are used to identify informants and firms, but keys disclose the full identity of the firms, individuals and their associations.

## **1.15 Outline of the Thesis**

The thesis presentation follows the iterative design of the research project:

### **Chapter 1: Introduction.**

The research issues and concepts have been introduced as well as the core constructs in the research problem.

### **Chapter 2: Background: The Evolution of Agribusiness Trade.**

The domestic and export industry contexts effecting agribusiness trade development are considered.

### **Chapter 3: The Literature Review.**

This chapter reviews the scientific literature which contributed to the testing and building of theory in the domains relevant to an understanding of the concept of the market as a network of relationships. The literature includes that dealing with the strategic management of asymmetrical relationships, collective action, the role of personnel, internationalisation, culture and time.

### **Chapter 4: Research Methodology.**

The choice of case analysis and historic research is explained.

### **Chapter 5: Background to the AWB Cases.**

The historic contexts of the domestic wheat and export markets are identified.

### **Chapter 6: Case Study: The AWB export trade to ROK.**

### **Chapter 7: Case Study: The AWB export trade to Japan.**

### **Chapter 8: Case Study: The WANGA, suppliers to the AWB .**

### **Chapter 9: Background to the ADC Cases.**

The historic contexts of the domestic dairy and export markets are identified.

### **Chapter 10: Case Study: The ADC trade to Japan.**

### **Chapter 11: Case Studies: Six Australian dairy export manufacturers.**

### **Chapter 12: Analysis and Conclusions.**

### **Appendix A: List of informants, the location and date of interview.**

### **Appendix B: Statement of ADC's trading role in Japan, 1988 and 1991.**

### **References.**

The cross case analysis of the data is presented along with a further consideration of the extant theory to help build understanding of the effect of ASMAs on network governance. The model of the process of network evolution is distilled from the research analysis.

## **Chapter 2**

### **BACKGROUND TO THE RESEARCH**

#### **2.1 Trends in the Internationalisation of Trade**

International business is a rapidly growing area of scientific interest. There is already a substantial literature on methodological issues (eg Cavusgil and Das, 1997), the internationalisation process of the firm and foreign operation alternatives. (eg. Ohmae, 1985; Terpstra, 1983; Porter, 1986; Luostarinen and Welch, 1990; Cavusgil and Li, 1992; MacInnis, 1993; Hinkelman, 1994, East Asia Analytical Unit (EAAU), 1997)

This growing body of work reflects the fact that in the last thirty years there has been a major increase in both the numbers of firms selling overseas and in the degree and level of competitiveness in the global markets for goods and services. Until recently global business has had to respond to the phenomenon of sustained, rapid, internationally oriented economic growth in Asia, much of it stimulated by the post-war international policies of the United States. The so-called "Tiger" economies of the ROK, Taiwan, Japan, Hong Kong, Singapore and China grew more rapidly compared with any others in global economic history. (Liu, 1992; Garnaut, 1992)

The region's economic ascendancy, of Taiwan, ROK and in particular the economic development of Japan significantly changed the balance of earlier twentieth century international trade. Between 1965 and 1995 North Asia became the most important source of world savings (larger than North America or the EC) and it had the largest source of surplus savings for international investment.

The changing economic fortunes of the East Asian region has influenced changes in

trading blocs and trading arrangements, the emergence of new industries, products and markets and a wave of new business alliances and cooperative ventures.

## **2.2 The Evolution of Trade as a New Form of Social Organisation**

Archaeological research suggests that with the creation of agricultural surpluses came new forms of social organisation (eg bureaucracies) that assisted with the reallocation of the surpluses. Specialist administrators, record keepers and traders facilitated intricate systems of exchange and distribution.<sup>1</sup>

Political organisations including the first nation states mobilised resources and controlled their traffic. While the hunter and gatherer communities were typically egalitarian, stratified societies became the norm for the newly evolving, trading communities<sup>2</sup> (Adams, 1966).

Thus trading systems followed systematic food production as one of the earliest forms of social organisation. (Wilmsen, 1974; Kallinikos, 1989) Markets evolved as groups scheduled contacts and created institutions for regulating exchange relationships, including the administration of specialised sites and involving dedicated persons regularly communicating over wide distances (Jolly and Plog, 1976).

## **2.3 The Characteristics of Agribusiness in the 20th Century**

### **2.3.1 Industry structure**

Twenty years ago, Izraeli, Izraeli and Zif (1977:204) described a "typical" market structure in agribusiness as a large number of farmers dispersed over a wide geographic area, a great number of consumers, linked by a smaller number of intermediaries on whom both are dependent. This dependence they argued was the source of power for the intermediaries

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<sup>1</sup> By Mesolithic - Archaic times 4500 to 4000 years ago regularised food trade was occurring over long distances. In the Indian Knoll sites in Kentucky for example there is evidence that sea shells and copper were traded 600 miles inland, on foot, although local bands did not move far from their accustomed territories (Wilmsen, 1974).

<sup>2</sup> Stratification is evidenced by settlement patterns, the differential distribution of goods within a settlement, and especially in burial sites where there is preferential treatment for some graves. (Struever, 1971; Peebles, 1971). The burial of some infants and children with high status goods shows status was ascribed at birth, not achieved through performance as in an egalitarian society of hunters and gathers.

who were in the position to employ monopsonistic practices in the purchase of the produce and monopolistic practices in the sale of the products to the customers.

Trade in food has always operated in a different socio-political and economic environment compared to that effecting the exchange of other goods or services (Petit and Gnaegy, 1994; Zusman, 1994; Schroder and Mavondo, 1994; De Gorter, Nielson and Rausser, 1992; Krueger, Schiff and Valdes, 1991).

The largest proportion of primary food production (ie crop growing or livestock management) has always been in the hands of family farmers. This is especially the case in Australia where family farm enterprises have always predominated. Australian primary production is a high-risk enterprise and returns on capital are small, often below 5%. This tends to make farm activity less attractive to corporate investment.

As well, new agricultural technology quickly finds its way onto the public domain, where it often originated, and so the ability of firms to capture the benefits of their up stream proprietary enterprise through international expansion is reduced.

### **2.3.2 Legal, socio/cultural, political and regulatory factors**

Schroder and Mavondo (1994:428) argue that two of the distinctive features of agribusiness are the range of alternatives for vertical coordination (which relates to governance) and the pervasiveness of government (an institutional factor).

Numbers of analysts have described the supply and price distortions brought about by the plethora of government production incentive or disincentive policies that are encountered in international food trade (Anderson, 1992a: 290; Goldin and Knudsen, 1990; Lee, Hadwinger and Lee, 1990; Moon and Kang, 1991).

Such writers have identified trends in distortionary policies across countries and over time. These typically show that as economies grow, they change from taxing to subsidising farmers relative to other producers, and from effectively subsidising to taxing food relative to other consumption. Agricultural protectionism is most evident in developed industrial economies and spreads to newly industrialising economies as they grow.

According to political economists like Suh and Tyers (1992) a government's agribusiness policies are not an attempt to maximise national welfare, despite official statements that may be to that effect<sup>3</sup>. While national welfare is the standard by which economists compare policies, political economy analysis stresses instead that economic policies are determined by the political strengths of the various economic interest groups affected, as well as the population's views on such ethical issues as the proper distribution of income.<sup>4</sup>

This view is shared by numbers of researchers: eg Bark and Chae (1991), Krueger, Schiff and Valdes (1991); Peltzman (1976); Anderson (1992a, 1992b) and Blandford (1992). They see agricultural policy evolving in response to the political market as a consequence of political leadership responding to groups with actions they anticipate will maximise their chances to retain power. Thus the level of protection enjoyed by any sector will be a measure of its comparative political strength.

Anderson (1992 b) argues that there are also important international influences that have always affected domestic demand for agricultural policies. And he believes these international factors are increasing. Some are forced on a country, for example, the loss of New Zealand (NZ) and Australia's favoured nation status as suppliers of agricultural goods when Britain joined the European Common Market in 1974; Japan's loss of access to Taiwan and Korea's supply of low cost rice when it was defeated in World War Two.

Some of the international influences evolve slowly, over time, for example: the "greening" of world politics, or the protection-induced growth in subsidised farm exports from the European Community after World War Two. Export competing economies have responded differently to these international forces, depending on the political power of those most effected domestically.

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<sup>3</sup> The ROK policy vis a vis rice was officially stated as meeting three objectives: 1. to achieve self-sufficiency in rice, 2. to protect agricultural income, and 3. to do so while controlling the impact on the cost of living of urban workers (Kim, 1990). However Tyers and Anderson (1992) and Kim, 1990:13 show that in ROK in the 1990s the urban price for low quality rice was 2.5 times higher than world prices while the price for high quality rice was nearly five times higher.

<sup>4</sup> Anderson (1992b) argued that this will hold equally true in a non-democratic state where the support of powerful economic interests is still significant for leadership seeking to retain power.

The European Union subsidising actions led to substantial slumps in food trade prices in the 1980s. In response the USA raised US agricultural subsidies to match. On the other hand, Australia and NZ, (with less powerful agricultural interests, and a lesser ability to transfer the resources required to subsidise their disadvantaged primary producers) instead initiated a forum of fourteen agricultural exporting nations (the Cairns Group). Their agenda called for agricultural trade liberalisation to be agreed through the Uruguay Round of multilateral trade negotiations. They also encouraged non-farm groups in countries with protected agriculture sectors to voice their concern at the high domestic costs of farm support programs.

The institution of the General Agreement on Tariffs and Trade (GATT) was created after The Second World War. It was a response to the increased trade barriers that had been erected by most developed nations before and during the Depression of the 1930s. The political interests of the majority of GATT participants kept agriculture off the agenda for the first seven rounds of negotiations, which commenced in 1947. The last negotiating round took seven years, with an extension of time between 1990 and 1993 needed to gain agreement on agriculture trade liberalisation.<sup>5</sup>

Host countries often constrain foreign investment in agricultural production when compared to other industries. References to a loss of cultural identity and food security issues are often triggered when the popular press reports that foreign interests have "bought the farm".

During the 1986-95 Uruguay round of the GATT ROK was typical of many in arguing that subsidies, tariffs, or quotas were necessary to protect their food self-sufficiency. This they claimed to be critical for national security, environmental protection, equitable national income distribution and the maintenance of cultural integrity (Bark and Chae, 1991; Government of ROK: GATT Council Report 7, 1992).

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<sup>5</sup> According to Anderson the contracting parties to GATT recognised that multilateral liberalisation was less costly politically for a country than an equivalent unilateral liberalisation. As well he argued that a signatory to GATT placed obligations on a contracting party's government which made it less costly for them to resist requests for further protection on the grounds of international obligation (Anderson, 1992a: 298).

Korean Ambassador Park Soo Gil's response to the 1992 GATT review criticism of their progress towards rice market liberalisation is an example of such a rationalisation:

*What some are saying is that we give up our food security by opening our rice market. Indeed, in our part of the world, rice is part and parcel of our culture, and our culture transcends the simple economic nature of this product. Indeed many of Korea's agricultural problems are socio-political, rather than economic issues. Given Korea's low level of agricultural self-reliance, and given our already heavy dependence on imported food, food security will remain an all the more legitimate concern (ROK, 1992:9).*

Since 1950 trade barriers for manufactured products have fallen. There has been a twelve-fold increase in the volume of world merchandise trade, significantly more than the growth of the overall economic activity. Agribusiness however has moved in the opposite direction with substantial tariff and non-tariff barriers to trade in agricultural products remaining (Schroder, Wallace and Mavondo, 1993).

While producer subsidies continue to cost consumers and tax payers in some countries substantial amounts, the price of food continues to fall globally in real terms, farm price is a declining proportion of the retail price, as is food's share of the household budget.

During this century, developed countries like the USA and the EU have simultaneously applied policies which have stimulated agricultural production with market based support, while discouraging it with acreage or other quantitative controls. In developing countries however, producers are more typically heavily taxed both directly and indirectly via subsidisation of the non-agricultural sectors. Sometimes they also receive subsidised credit, fertiliser and mechanisation incentives (Sarris, 1994).

In 1994 barriers to food importation remained significantly higher than for manufactured products in most countries.

The concept of "free market forces" in an openly competitive market applied least when it



came to international (and domestic) trade in agriculture (DFAT, 1994).

### **2.3.3 Recent changes in the political market for global agricultural trade policy**

GATT agreements now require participating nations to produce significant reductions in the levels of agricultural trade protection. The policy instruments to achieve this include the reduction of export subsidy regimes by 21% in volume and 36% in value, reductions in domestic price support levels, and reductions in the volume of internal support and border protection measures (Petit and Gnaegy, 1994). New disciplines agreed to by specific food exporters include, for example, reductions in USA's Export Enhancement Program for wheat from 32 million tonnes and \$US1 billion in 1993 to 14.5 million tonnes and \$US364 million by the year 2000 (Grains Council of Australia, 1997).

Meanwhile, the WTO is addressing the issue of reducing non-tariff barriers, applied, for example through dynamic labelling laws, ad hoc port of entry quarantine actions, distribution system impediments, non-standard phyto-sanitary compliance requirements, or the timing of bureaucratic processes. Such measures can continue to protect a domestic industry against import competition for as long as a society is prepared to pay the opportunity costs and higher food prices for such protection.

### **2.3.4 Changing dimensions of food trade**

Export competitiveness will depend on the actor's ability to change, predict or respond to opportunities arising from the institutional factors in international markets as well as the evolution of food demand, changing patterns of food consumption and domestic food demand and self sufficiency policies.

In research published in 1992, Tyers and Anderson calculated that developed economies were on average 113% self-sufficient for the major food categories, ie. grains, rice, meats, dairy products and sugar. Such countries therefore generated surpluses of over 11.5% of their total production. Formerly centrally planned and developing countries on the other hand were 6% and 2% short of total consumption requirements annually.

The high global self sufficiency ratios in the early 1990s also mean that only a comparatively small proportion of world food production was traded internationally, eg

only 5% of all dairy production. This was a fact developed nation representatives often referred to in justifying delays in having food trade reach the GATT negotiating table. (Bark and Chae, 1991) However, even small increases in export surplus product represent a substantial increase in the volumes internationally traded and supply of agriproduct for trade is highly variable.

The emergence of export surpluses in developed countries is a relatively recent phenomenon. In the early 1960s Western Europe accounted for some 40% of all world food imports. Through their aggressive subsidisation policies aimed at producers and exporters, and justified on the grounds of the need for self-sufficiency. Western European countries accounted for over 10% of the world's exports by the early 1990s.

In 1994 the developed industrial nations, in particular the EU and USA dominated exports of food commodities, eg they supplied 90% of all wheat, 76% of all meats and 95% of all dairy products traded. At the same time from the 1980s about 75-80% of all US wheat exports have been made under some form of US government export assistance program (Australian Government Publishing Service (AGPS), 1996).

#### **2.3.5 Food consumption changes**

Food demand can be defined in terms of calories, protein, or different measures of volume. As per capita income rises individuals respond first by increasing calorie intake, then protein, and finally by adding convenience and services to the food they buy.

Food's share of world merchandise trade has declined from over 50% in the 1950s to much less than 30% today. As incomes rise, people also spend a smaller proportion of their income on food and a greater proportion on manufactured goods and services. For example, according to Japan's Statistic's Bureau Management and Coordination Agency average monthly household food expenditures increased between 1973 and 1990 from 36 thousand to 79 thousand yen while food expenditure as a percentage of total household expenditure fell over that same period from 31.9% to 25.4% (Lee, 1994).

### **2.4 Australian Agribusiness Structure and Government Policy**

Historically, individual agricultural producers at the start of the value chain have felt

powerless to mediate the impact of competitors' pricing or production policy, and their own production and price instability. From late last century one response has been for farmers to act collectively through marketing or processing cooperatives. In some cases the free rider problem and the ongoing organisational effort required to establish the cooperative action has meant producers have harnessed political support to enactment a statutory regulatory framework making fellow producer participation mandatory<sup>6</sup> (Olson, 1965).

The principle that agricultural marketing should not be left to "free" market competition gained popular recognition during the 1930s World Depression. Compulsory marketing schemes were applied to primary products in most English speaking countries from that time. The first marketing authority backed by statutory powers was introduced in Canada in 1927, with Australia following close behind.

The rent-seeking behaviour and performance of producer cooperatives, marketing boards, or statutory marketing authorities (SMAs) have been the focus of analysis in the agribusiness sectors of Australia, New Zealand, Canada, ROK and Japan (George, 1980; Nagel, 1984; Yea, 1991; Martin, Westgren and van Duren, 1991).

The objectives of institutionalised cooperation in agribusiness are typically described as:

- To achieve economies of scale and efficiencies by pooling resources for storage, packaging, transportation, promotion and other marketing functions,
- To strengthen the participant's bargaining position in relation to other sectors through centralised negotiation,
- To reduce market uncertainty (Izraeli, Izraeli and Zif, 1977:205).

Schroder, Wallace and Mavondo (1993: 181) argue however that some of the characteristics of what they have called Producer Marketing Organisations (PMOs) constitute a barrier to their "global activity" They state:

(a) PMOs have little control over the supply of the raw materials because of

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<sup>6</sup> See Chapter 3. The Literature Review for a fuller discussion of concepts of collective action.

the unpredictable quantity and quality of agricultural production, due to its biological nature.

(b) Under their statutory requirements some PMOs are required to market/process all of their members' production, hampering their ability to be truly market responsive.

(c) PMOs are usually located close to the beginning of the food chain remote from the final consumer.

(d) PMOs have the problem of financing growth when primary producer members/ shareholders maintain control and the PMO tends to operate more as a cost, rather than a profit centre.

(e) PMOs tend to have a production rather than a marketing orientation.

(f) A disproportionate amount of time may be required fulfilling government reporting requirements, and seeking continued government sponsorship.

(g) PMO legislation can act as a barrier to the adoption of long term strategy.

These writers argue that the barriers to internationalisation apply to all PMOs at all times, with the exception of the producer control and the sourcing of raw materials issues which they believe become less of a problem as the enterprise matures.

#### **2.4.1 Agribusiness statutory marketing authorities**

Special statutory arrangements have been a feature of the marketing of many agricultural products in Australia since the 1920s. (Industry Commission, 1991) At that time Australian farmers experienced booming agricultural commodity prices. This coupled with the policy of settling ex-soldiers on the land and the building of irrigation systems meant production grew rapidly and outstripped domestic demand. Prices slumped. Solutions included the exporting of the surplus and the introduction of production quotas in many industries.

In the late 1920s Australian Commonwealth export control boards were established for the dairy industry, canned fruit and wine. These were the forerunners to the ASMAs. In 1926 the dairy industry adopted a voluntary plan which imposed a levy on the production of butter to finance export subsidy.

Many ASMAs were consequently established to correct perceived failures in market processes and to make special arrangements to finance seasonal sales, which were difficult at the time because of the regulated finance market. Other measures were designed to stabilise prices in the era of administered exchange rates. A common thread of their arrangements was agreement that producers by virtue of their geographic dispersal and irregular production patterns faced difficulties without statutory intervention.

Typically the Australian ASMAs marketing of primary products included the entire range of activities linking the outputs of primary producers to the Australian and overseas consumers of food and fibres (Industry Commission, 1991). Australian State government statutory marketing arrangements are generally only concerned with domestic market regulation. SMAs established under Commonwealth legislation tend to have one or more of the following functions in relation to export marketing:

- to assist producers in competing on overseas markets by finding new markets and expanding existing ones
- to establish standards and maintain produce packing, grading and general quality control for export markets
- to negotiate the most favourable shipping and insurance rates and
- to license exporters on condition that they sell at specified minimum prices
- to act as a single desk seller in an attempt to achieve the highest returns possible for specified product on specified markets.

#### **2.4.2 New challenges to ASMAs in a deregulating, internationalising environment**

The 1990s have been a time of significant change for those engaged in any aspect of an agribusiness system. In particular, the environment in which Australian ASMAs were created has now evolved to a point where the industries they represent are considerably more export dependent, and their export and domestic markets have substantially

deregulated.

While common interests and output among industry actors prevailed when ASMAs were created, markets for many rural products have matured and industry competitors often now seek price premiums through product differentiation, packaging and brands.

As groups of farmers and processors become more export experienced and respond to expanding export market opportunities, the extent of common interests in their industries is likely to decline. A producer of differentiated branded product is less likely to be willing to fund generic ASMA promotions when compared with those still producing a minimally differentiated commodity.

If the ASMA attempts to set prices across differentiated lines tensions may arise between those expecting a price premium in return for their specific quality attributes while others in marginal areas favour the averaging of returns across all products. If an ASMA enters into value adding or is representative of both producers and processors there may be a conflict of interest in terms of the price at which one sells and the other buys (Davis, 1990:8).

There is potential for an ASMA to block the emergence of competing organisations which could provide marketing services in a more efficient way (Industry Commission, 1991).

## **2.5 Factors Effecting Australian Agribusiness Trade Evolution**

A change of government in the early 1980s saw farm lobby groups facing a more hostile political environment. Industry protection or government subsidy was seen as a barrier to firms becoming globally competitive.

Australia's leading role in the Cairns Group formed to lobby for agricultural trade to be the focus of the final round of GATT negotiations at Uruguay meant that domestic industry policy could no longer be seen to be subsidising or raising barriers to any market participant.

The domestic and international developments that have influenced the contexts in which

the Australian ASMA's function are summarised over page:

- policy decisions to lower tariff protection in the Australian manufacturing and agricultural sectors,
- the adoption of new trade practices legislation,
- the development of business regulation review procedures and accountability requirements for statutory authorities,
- the international linking of financial markets,
- increasing educational standards in the community generally and in the rural sector in particular,
- developments in global communications technology and domestic communications networks,
- Australia's strong support of trade liberalisation and the greater transparency of trade regulations in all nations, as now supported by GATT, and promoted by the Cairns Group when under Australia's leadership.

Having reviewed these changed economic and global trading circumstances, the Industry Commission inquiring into Statutory Marketing Arrangements for Primary Industries (1991) concluded that ASMA's were not necessarily the most effective means of achieving the best outcomes for agribusiness trade. They recommended that they should be kept under close scrutiny and governments should actively seek to deregulate all or parts of their operation (Industry Commission, 1991:7).

## **2.6 Australian Trade with Asia**

East Asian economies are closely complementary to Australia in their resource endowments and in the commodity composition of their trade. This close complementarity has survived the changing of economic structures that have accompanied the economic development in the region. For example, Australia supplied the natural fibres for the early stage textile industries, then mineral raw materials as the countries evolved into a heavy industrialisation phase.

While Australia continues to supply commodities, it also now exports a range of specialised goods and services that typify the changing consumption patterns of

economically developed nations, for example travel-recreation, education, more differentiated food ingredients. While the degree of resource complementarity has remained high, Australia's share of East Asian foreign trade has been declining, however, albeit in line with its contracting share in world trade.

The performance of Australian firms in the international markets has been extensively investigated in a series of studies in the 1980s and early 1990s. These studies have found that Australia's deteriorating export performance can be attributed to:

- over reliance on exports of unprocessed or minimally processed agricultural and mineral products, where Australia is a price taker,
- a manufacturing sector with a domestic rather than an international market orientation.

(Garnaut, 1992; Barrett and Wilkinson, 1985, 1986a,b; Wilkinson and Barrett, 1987; US Foreign Commercial Service, 1992; Miller and Leftpos, 1987; Hughes, 1989; Pappas, Carter, Evans and Koop-Telesis, 1990; Midgely, 1991; Yetton, Davis and Swan, 1992; National Farmers Federation, 1993.)

## **2.7 The Evolving Australian Domestic Industry Environment**

Traditionally Australia enjoyed a high standard of living based on returns from the exports of commodities like raw wool, wheat and meat, and minerals. During the era when Australia enjoyed preferred nation status supplying UK with food, in particular dairy produce and cereals, it had some of the highest living standards and per capita incomes in the world.

The high tariff barriers, which once protected domestic manufacturing from international competition, meant there was little pressure to establish internationally competitive manufacturing, until the 1990s.

The small size and geographic spread of the domestic market and its distance from the huge European and North American markets also retarded the growth of all manufacturing, including food processing.



While the *tyranny of distance* has largely changed as significant markets have opened to the near north of Australia, the development of Australia's food manufacturing industry has continued to be slow when compared to other developed countries. A number of factors have been identified to explain Australia's retarded industry development:

#### **Australia's tax and financial systems**

- the nature of the regulatory environment. For example, the already small domestic markets are further divided into eight states and Territories,
- the high rate of income and corporate tax together with the egalitarian culture reduces economic incentives and drive,
- rules and regulations relating to company investment have not encouraged firm growth,
- it has been difficult to finance long-term investment given the average small business size and lack of long-term venture capital in the markets.

#### **Industry structure**

- the tendency of some agricultural sectors to favour cooperative business structures. These are risk averse and have objectives of short-term return maximisation to share-holder suppliers,
- Most larger firms in Australia are subsidiaries of multinationals with restricted access to all offshore markets due to internal company competition policy.
- Research and development (R and D) spending is also typically concentrated in the home market.

#### **Research and development investment**

- There is not a tradition of close cooperation between industry, universities and other research organisations.
- There is a low level of R and D expenditures compared to other developed countries.

#### **Infrastructure**

- industry infrastructure has been underdeveloped. There are deficiencies in domestic

and international transport systems, inefficient ports, and high-energy costs for industrial users.

### **Management training and education**

- there have been deficiencies in the availability and focus of industry education systems,
- Australian management is less educated and internationally experienced when compared with their counterparts in other developed countries.<sup>7</sup>

(Garnaut, 1992, Barrett and Wilkinson, 1985; Wilkinson and Barrett, 1987: Wilkinson and Mattsson, 1993: US Foreign Commercial Service, 1992: Miller and Leftpos, 1987: Hughes, 1989: Pappas, Carter, Evans and Koop-Telesis, 1990: Midgely, 1991: Yetton, Davis and Swan, 1992):

## **2.8 Conclusion**

Firms wishing to enter and compete in export markets need to look well beyond Ricardian notions of fixed national endowment. Management will also need to consider the distribution of power in the political market and the emerging ideologies in the nation, or groups of nations acting multi-laterally. The society's dominant ideological, cultural and societal beliefs can have a direct influence on the kinds of policy decisions taken or tolerated regarding such things as levels of food self-sufficiency, inter-sectoral income distribution, the use of natural resources, marketing regulation, industry organisation or pricing.

Agribusiness production and marketing systems are particularly subject to government policy intervention. A nation's food production has socio-political and cultural dimensions that extend well beyond its value to the economy and the supply of calories for human consumption. This coupled with the supply variability means food production and trade is often high risk and low return. Those close to the beginnings of the supply chain are particularly vulnerable as price takers, and for generations they have sought to overcome this disadvantage by acting collectively and obtaining protection through statutory regulation of parts of their system.

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<sup>7</sup> In 1992 the percentage of Australian senior managers with degrees was approximately 20% compared with 62% in Germany, 65% in France, 85% in the USA, and 25% in the UK (Financial Times, Nov 1992).

Australian primary producers are export dependent but, with the exception of wool, the volumes of the commodities traded are so small that producers have very little power in the international market place. This research is designed to analyse the strategies that the dairy and wheat industries have used to try to improve their trade performance.

## **Chapter 3**

### **THE LITERATURE REVIEW**

#### **3.1 Introduction**

The literature of relevance to this study relates to the strategic behaviour of actors aiming to improve their position in business to business exchanges in asymmetrical, dynamic international agribusiness markets.

There is a growing field of literature relating to the different elements of such an inquiry, in particular as it relates to the structure, process and content of different forms of exchange relationships (e.g. Forsgren and Johanson, 1992; Luostarinen and Welch, 1990).

This review will trace the development of the body of business organisation or marketing theory which began with the microeconomic maximisation paradigm. This paradigm focused on discrete, competitive, market-driven transactions, usually in consumer (rather than industrial) product channels (see Clark, 1937). The early theoreticians worked predominantly in the USA, with little empirical testing of concepts in the less developed or Southern Hemisphere economies. A brief history of the evolution of global business strategy is given to provide the context in which the later theory is grounded.

The marketing and organisational theory of the 1990s tends to embrace complex conceptualisations, focusing on the delivery of superior value to customers through the creation and management of long-term strategic relationships. Developing economy and cross-cultural empirical studies have informed much of this recent work (e.g. Frazier, Gill

and Kale, 1989; Snodgrass, 1993; Atuahene-Gima, 1993 and Beamish, 1993). This theoretical development is seeking to explain a business world which is characterised by rapid technological development, in particular in communications, a constantly shifting socio-political context and the globalisation of demand in some product/service categories.

The literature to be reviewed in this chapter develops theory related to:

1. The antecedents and function of different governance structures and transactional forms in business.
2.
  - a. the structure, process and dynamics of buyer-seller exchange relations.
  - b. Interfirm power, dependency, cooperation and competition between exchange partners.
3. The influence of environment or context on strategy.
4. Intertemporal influences on strategic relationships.
5. The antecedents and outcomes of collective actions in business networks.
6. Internationalisation processes of the firm

### **3.2 Some Origins of Marketing Management Theory**

According to Webster (1992) the origins of marketing management as a body of knowledge, theory and practice began around 1910 when Midwestern American Land Grant universities focused their business interests on agricultural markets and so researched the processes through which commodities were produced, delivered to markets and prices determined.

At least three schools of theory subsequently evolved. The first focused on the institutions through which the products were transferred to the market, e.g. the brokers, wholesalers and retailers (Breyer, 1934; Duddy and Revzan, 1953). The second focused on functions performed by the institutions, and the third was concerned primarily with the commodities

(or products) themselves. Large, hierarchical, integrated corporate structures were the dominant organisational forms during this era.

The first marketing departments emerged in USA companies around the 1950's. Often these were an extension of the old sales departments. Micro-economic profit maximisation paradigm of marketing management prevailed, with marketing management's task being problem definition, and the development and evaluation of multiple decision alternatives. From these a course of action would be chosen, based on the highest probability of maximum profit. The theory emphasised production and competitive relationships among firms in the same industry, in the sense of perfectly competitive or oligopolistic market structures.

Writers like Henderson and Quandt were still describing firms in technical terms transforming inputs into outputs (commodities) "subject to the technical rules specified by (the) production function" as late as 1971, (1971:52)., However, a broad theory of the firm and industrial economics was developed much earlier by writers like Commons (1925), Coase (1937), Simon (1957), and Bain (1959). They proposed alternatives to the description of a firm as an individual agent, motivated by profit and constrained by a production function.

While the marketing management literature evolved to develop the highly influential but static marketing mix paradigm (e.g. Kotler, 1972), Commons led researchers of economic organisation to consider the three principles he believed made up the "ultimate unit of economic activity" namely: "conflict, mutuality and order" (1925:4). Commons saw that in order to succeed, firms needed to strategically manage competition and mutual dependence at least as well as they managed their production-consumption functions. Commons also argued that the actual transaction was a most significant element of analysis.

### 3.3 Antecedents and Function of Governance Structures and

#### Transactional Forms

In his seminal paper on the nature of the firm, R.H.Coase (1937:398) joined Commons in stressing the importance of transactions. He argued that both the division of labour and a reduction in the level of transaction costs relative to the costs of market exchange were necessary conditions for the emergence of the firm. His transaction cost logic of economic organisation concluded that there were basically two ways to organise economic activity: within companies through cooperation, or in openly competitive markets.

Macneil, writing thirty years later (when a very different economic order was emerging) developed a theory of contracts conceptualising a three tiered typology. His first tier called the "Classical Contract" he described as: "sharp in by clear agreement; sharp out by clear performance" (1974:738). Macneil observed however that this discrete transaction type did not fit the commonly occurring contract processes emerging under the contemporary conditions of uncertainty.

Thus, Macneil's second tier, the "Neo-Classical" contract recognised that increasing transaction costs, environmental complexity and "bounded rationality"<sup>1</sup> demanded some flexibility in contracting. Not all contract elements could be complete. As well he saw that a third party could often play a significant role in facilitation/negotiation. This Neo-Classical contract was said to work as long as there was confidence in dispute settlement machinery.

Macneil believed that his "neo-classical" contract law was also displaced, however, by a third tier he called: "Relational Contracting". This he described as "a mini society with a vast array of norms beyond those centred on the exchange and its immediate processes" (1974). Adaptations in Relational Contracting would not necessarily be referred to in an "original agreement". Indeed a formal contract could be absent or have little status.

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<sup>1</sup> Herbert Simon defined bounded rationality as behaviour that is intendedly rational but only limitedly so (1957, p.xxiv).

According to Macneil, in the Classical and Neo-Classical contractual forms the reference point was the contract, while in Relational Contracting the reference point was the "entire relation as it has developed through time" (Macneil 1978:890). Thus intertemporal factors, context, and the inter-relationships beyond the dyad, ie the buyer and seller, and with third and other parties were being recognised as crucial to the transaction governance. This recognition was also to be focal to the later merging "business as a network" (eg Thorelli 1986) and "relationship marketing" conceptualisations (eg Gronroos, 1990).

### **3.4 Transactional Cost Analysis**

Common's work along with that of Coase (1937) and Macneil (1974, 1978) inspired Williamson (1975, 1979, 1981) to develop the highly influential Transaction Cost Analysis (TCA) framework. Building on Macneil's work Williamson distilled his three critical dimensions for characterising transaction types: ie (1) uncertainty, (2) the frequency of transactions, and (3) the degree to which durable transaction-specific investments are incurred (Williamson 1979 in Williamson 1990:239).

Transactional Cost Economics drew upon organisational theory as well as Macneil's theory of contract law in defining economic exchange primarily as a problem of agencies designing efficient contracting relationships. Unlike Macneil however, Williamson did not see the different transaction (or contractual forms) as evolutionary but argued that the "sharp in sharp out" "classic" contract could continue to be the most efficient in particular exchange circumstances.

Williamson's Transactional Cost Analysis (TCA) aims to predict under what conditions transactions are performed more efficiently. This could be within a firm's boundaries, by means of bureaucratic control and coordination, or across a firm's boundaries by arm's length market coordination (Heide and John 1988:20). In particular Williamson saw "efficiency" in terms of "organis(ing) transactions . (so as to) safeguard them against the hazards of opportunism" (Williamson 1985:32).

Williamson demonstrated how investment in transaction specific assets could lead to a substantial loss should the exchange party defect from the relationship. These losses



represent the costs of switching between relationships, and if sufficiently high, will reduce the tendency for opportunistic behaviour on the part of the investor.

Williamson explained the role of opportunism in the choice between hierarchy and market governance by writing that without it cooperation would be the norm between parties to an exchange, and promise would suffice to safeguard market transactions (1985:31). According to Williamson (1979) the object of governance is:

- (i) to protect the interests of the respective parties, and
- (ii) to adapt the relationship to changing circumstances.

Williamson saw the key factor distinguishing different trading or exchange relationships as the varying levels of transaction specific assets (ie investment idiosyncrasy). Williamson (1979) found that markets will be most efficient for recurrent transactions when assets are non-specific to the trading parties and when uncertainty is held constant. As assets become more specific, contracting will appear, and internal organisation (hierarchies) will be most efficient as assets become highly specific. Thus vertical integration is the safeguard against opportunism identified by TCA Theory.

In his 1985 work, Williamson recognised that there were in fact intermediate or "hybrid" forms of transactions (eg joint ventures and franchises). These were not unlike those forms identified somewhat earlier by Macneil as "Relational Contracting" (1978), and later characterised as cooperative dyads within a "Network of Relationships" by Thorelli (1986).

Drawing on Williamson's model, authors have used transaction costs to explain the configuration of organisational form and a range of strategic phenomena, including diversification, vertical integration, foreign direct investment joint ventures, and business level strategy. Such writers include: Teece (1986); Ouchi (1979); Walker and Weber (1984) and Provan and Skinner (1989).

While the considerable influence of the TCA paradigm is recognised, eg by Robicheaux and Coleman, (1994) and O'Keeffe, (1993), the TCA framework has also been criticised on

the basis that it fails to view exchange relationships as a process in which the nature of the relationship can change over time (Dabholkar, Johnston and Cathey, 1994; Ring and Van de Ven, 1994). These writers believe an understanding of dynamic processes is critical for modern management's strategic decision making.

On the other hand Bradach and Eccles (1989) drawing on the work of Granovetter (1985) and Ouchi (1979), criticised the tendency of TCA to generate mutually exclusive poles on a continuum to describe control mechanisms for structuring exchange relations. They argued that price, authority and trust are other independent factors which can be mixed and brought to influence an exchange in a variety of ways. Boyle, Dwyer, Robicheaux and Simpson (1992), reviewing influence strategies in channels also concluded that the traditional poles of the transaction cost continuum did not adequately model reality.

The concept of hybrid organisations has been used by many, including Thorelli (1986); Borys and Jemison (1989); Wilson and Jantrania (1993), and eventually, even by Williamson, to describe governance structures which fall between TCA's original "markets and hierarchies". Hybrids are said to be networks of interdependent players who develop relationships with different levels of power and trust which facilitates the exchange of influence or resources (Thorelli, 1986). Borys and Jemison (1989:235) define four key elements which typify a hybrid relationship:

- purpose,
- boundary definition,
- value creation, and
- hybrid stability.

Wilson and Jantrania (1993:58) take the first three of these elements and treat them as stages in the development of a relationship. They write that within each stage there are processes that will take the potential partners to a set of end points that will allow them to go forward, to recycle or to terminate the relationship.

In 1985 Stinchcombe wrote about explicit market-based contracts which provided safeguards to firms very like those associated with Williamson's hierarchy and Macneil's classical contracts. Like Stinchcombe, Robinson (1990) noted that if a firm can establish intimate and long-standing relationships with those firms providing it with externalised functions, then it may capture the benefits of both externalised functions and internalised transactions, without incurring the loss of strategic independence and flexibility often associated with vertical integration.

Writing about competitive factors in international marketing Robinson (1990) listed the benefits normally associated with internal transactions which he felt could be captured by the development of long-standing external relationships, ie:

- Less negotiating time and associated legal costs, so the whole transaction may be speeded up.
- The people at both ends of the transaction speak the same language organisationally and technologically, leading to faster and better communication.
- There is little risk of nonpayment due to commercial failure.
- There is little risk of non-performance, hence little need for performance bonds or guarantees.
- The repetition of transactions or functions reduces costs through a learning effect.

### **3.5 Agency Theory**

Agency Theory (AT) which evolved during the 1960s and early 70s added to the repertoire of options which TCA had identified as available to a firm that found itself in an asymmetrical relationship with an exchange partner. Like TCA, this model also assumes that each participant (or agent) seeks to maximise their own welfare (eg Eccles 1985; Eisenhardt 1989).

Whereas Transactional Cost Analysis was concerned with governance structures or organisational boundaries, asset specificity, and transaction costs, AT focused on the contract between two parties regardless of boundaries, and on outcome uncertainty, risk

attitude, incentives and information systems. As a consequence, it has particular relevance to the study of typically high risk export agribusiness where information asymmetry is characteristic of the links in the value chain.

Agency theory treats information as a resource with a cost which can be purchased (Fama, 1980).

Agency theory addresses the problems that arise when:

- (i) the goals of the party they call "the principal" conflict with the party that has been engaged (ie "the agent"),
- (ii) it is difficult to verify what "the agent" is doing, and
- (iii) the agent and principal may have different attitudes to risk.

Eisenhardt (1989) sees the principal having two options to counter the problem of agent opportunism and goal conflict between the parties. The first is to invest in information systems to find out what the agent is doing. The other is to contract on the outcomes of the agent's behaviour, eg pay on commission. Such a strategy aims to transfer the risk to the agent, who it is assumed will tend to be initially more risk averse than the principal. This certainly is not the case in the Japanese market for dairy produce where the sogoshosha is considerably less risk averse than the supplier. (A sogoshosha is a Japanese General Trading Company.)

AT anticipates that over time, as goals between agent and principal become more compatible, the importance of outcome based contracts (eg commission and market governance) will reduce, and risk sharing will become more likely. It would seem that on this point Heide and John's (1988) dependency balancing concepts could be utilised to expand the repertoire of principal or agent's strategies presented by the agency theory paradigm.

Agency theory also proposes that when outcomes are easily measured then outcome contracts will be most appropriate. However, when outcomes are difficult to measure,

behaviour based contracts are more applicable (eg hierarchical governance, salaries etc). Where uncertainty increases AT argues that it becomes increasingly costly to shift risk to an agent despite the motivational benefits of outcome based contracts. Thus outcome uncertainty coupled with different attitudes to risk will influence contracts between agents and principals.

The unique contribution agency theory makes to organisational research is its focus on information as a strategic asset, and its acknowledgment of the impact of dynamic context through its attention to risk and outcome uncertainty. The consideration of risk goes beyond a simple acknowledgement of its impact on the firm's ability to preplan. The theory has particular relevance to agribusiness, where there are often significant risks associated with the supply volume and specificity, due to the seasonality and organic nature of the product (Schroder and Mavondo, 1995). Socio-cultural and political factors also lead to volatile domestic and international agricultural trade policies, strong competitor action, and rapid technological change (Anderson, 1992).

However, Agency theory while acknowledging the dynamic or inter-temporal context does not consider such factors as the development of reputation and the evolution of trust over time. As the game theorists using the iterated prisoner's dilemma note, (eg Axelrod, 1984) risk transfer or opportunism is not a viable strategy if a future exchange is important to the aggressor or principal. The possibility of future interaction, and the importance of an actor's reputation (eg for maximising benefits) when considering future exchanges suggests that there are more factors affecting successful long-term business exchange than those stressed by AT, for example, "the shadow of the future" (Axelrod, 1984).

### **3.6 The Convergence of some Paradigms: when TCA does not Provide all the Answers**

As well as TCA, (eg Williamson, 1981) and Agency Theory, (eg. Fama, 1980 and Eisenhardt, 1989), other models have been developed to assist in the understanding of how firms survive in business in a dynamic environment, how and why they seek to retain or forgo their independence and how they seek to reduce their exposure to opportunism.

These include the resource dependence theories (eg Pfeffer and Salancik, 1978; Thompson, 1967), competitive strategy, (eg Porter, 1980), the political economy paradigm, (eg Arndt, 1983; Benson, 1975; Stern and Reve, 1980) social exchange theory, (eg Anderson and Narus, 1984), network theory (eg Thorelli, 1986; Mattsson, 1987, 1989) and relationship marketing theory (eg Gronroos, 1990). Findings relevant to this research will be referred to.

Empirical studies often need to converge paradigms in order that they make better sense of the real-life complexities or issues and relationships being analysed. For example, Heide and John (1988:24) agree with Williamson (1981) that transaction specific assets can create dependency, which they define as the extent of the replaceability of the exchange partner. However, when they studied the strategic behaviour of small firms with specific investments exposing them to the danger of opportunistic behaviour from more powerful exchange partners, they found vertical integration initiated by the weaker party was rarely an option (1988:22). Rather, they observed the smaller firm seeking to counter opportunism with strategic relationship building behaviour.<sup>2</sup>

Looking to dependence theory to help explain the phenomena, Thompson (1967), Pfeffer and Salancik (1978), Grant (1991), Conner (1991) and Heide and John (1988), adopt Emerson's (1962) early dependence-balancing notions.<sup>3</sup> They propose that when specific assets are at risk in an interfirm relationship, and vertical integration is not feasible, the party at risk will utilise offsetting specific investments in related trading relationships to balance the dependence. Specifically, they predicted that an "agency will reduce its dependence on the principal by engaging in bonding behaviour with its accounts for the principal's lines" (Heide and John, 1988:24).

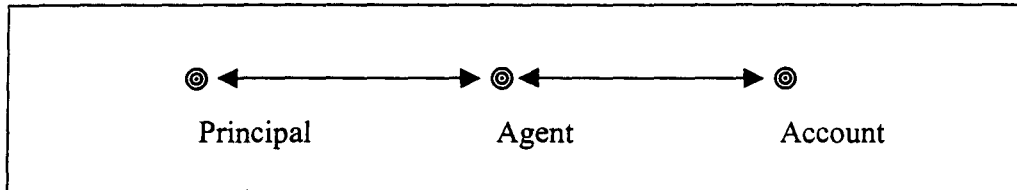
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<sup>2</sup> Heide and John (1988) assume that it will usually be the agent who is in the least powerful. This is not the case with the *sogoshosha* of Japan. Agents like Mitsubishi and Mitsui do not often find themselves outgunned.

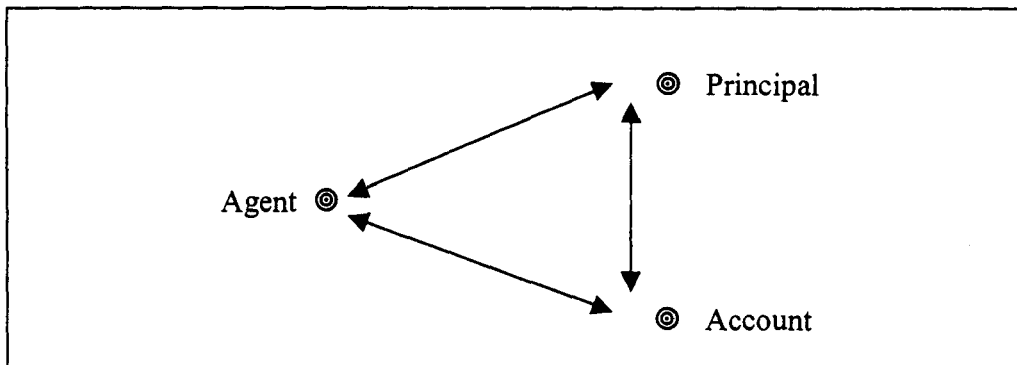
<sup>3</sup> The power dependence framework is a behavioural approach which assumes goal conflicts are inherent in relationships and firms will always seek to maximise their individual gains. (Cadotte and Stern, 1979; Gaski, 1984). The framework does not allow for the analysis of dynamic relationships however.

**Figure 3.1: Heide and John's Small Firm Strategy to Reduce Dependency in Asymmetrical Exchange Relationships**

Before a dependency balancing strategy:



After a dependency balancing strategy:



Such a conceptualisation suggests that the firm has moved beyond a focus on its dyadic partner and could now more accurately be described as establishing a network of relationships (see Thorelli, 1986).

Heide and John's findings have particular relevance for this study of agribusiness relationships which are typically characterised by asymmetrical buyer-supplier relationships (O'Keeffe, 1993). At the same time however, bonding relationships with the accounts of the principal's lines is considered threatening behavior and typically not tolerated by the principal.

### **3.7 Business as Networks: Interactive Approaches to Understanding Business to Business Exchange**

Forsgren and Johanson (1992) are among the growing number of business theorists who see “business networks” as a means of handling activity interdependencies between several business actors. The “network” differs from the market model (the invisible hand) where actors have no specific relationships with each other and the market mechanism transforms the demands and supplies of different actors into market prices. By contrast, in the business network model the actors are linked to each other through exchange relationships and their needs and capabilities are mediated through the interaction taking place in the relationships. If there are productivity gains through joint arrangements within the framework of exchange relationships it is said that business networks will replace a series of arms-length discreet exchanges.

The business network concept differs from the hierarchy (ie the visible hand) insofar as the actors are said to be autonomous and handle their interdependencies bilaterally rather than via a coordinating unit on a higher level. The network is said to be organised by each actor's willingness to engage in exchange relationships with some other actors in the network. The networks are more loosely coupled than are hierarchies, they can more easily change shape.

Business networks emerge over time through interaction between a number of autonomous actors. Formal contracts between the actors are of secondary importance. According to Forsgren and Johanson (1992) any actor in the network can engage in new relationships or break old ones, thereby changing its structure.

Business networks are conceptualised as being more flexible in response to changing conditions in turbulent business fields such as those where technical change is very rapid (Hakansson and Henders, 1992). Network theorists conclude that business networks will emerge in fields where coordination between specific actors delivers benefits and where conditions are changing rapidly.



The contemporary dynamism of export markets in newly emerging markets, for example, the market for dairy products in Japan is based on fast and accurate market information. Hence there is a need for a firm to understand the range of benefits and costs associated with different governance structure alternatives.

The Relational Marketing (RM) perspective developed in parallel with the industrial or business network approach. While the former originated in the USA, (see Wilson, 1978; Gronroos, 1993) the business as a network approach evolved in UK and northern Europe and was largely led by researchers undertaking cooperative empirical cross-border research within the Industrial Marketing and Purchasing (IMP) group (see Hakansson, 1982; Ford, 1990). The research found that supplier respondents consistently stressed the significance of long term and relatively stable exchange *relationships* between themselves and their buyers.

Both RM and the IMP approaches helped researchers redirect their focus away from discrete transactions. Instead they focused on the longer-lasting, cooperative transactions which typified the well established exporting industrial sectors in the European and USA markets.

Cooperation and conflict were seen as characteristic of the buyer-seller interactions, with shared goals and a cooperative orientation acting as engines of growth. Conversely some writers argued that competition, opportunism and antagonistic goals could cause a relationship to falter and die (Wilson, 1978). The RM and IMP theorists also suggested that commitment and trust are a pre-cursor to cooperation.

### **3.7.1 Industrial networks**

Johanson (1989) working within the IMP research framework conceptualised exchange relationships as within networks which he defined as sets of connected exchange relationships between actors controlling industrial activities. He saw the smaller firm's options as members of a network expanded well beyond once off "make or buy decisions" or market versus hierarchical transaction forms.

The industrial network model<sup>4</sup> is based on some assumptions about industrial activities, ie:

- that each activity is a link in one or several more or less extensive and closely linked activity chains;
- the activities are performed more or less repetitively;
- over time, and through experience, activities within an industrial network are modified and adapted to each other; and
- that this adaptation increases the firms' joint productivity, linking them closer to each other.

Joining anthropologists who have systematically studied social organisation, business theorists also came to acknowledge that economic exchange between actors included information, social as well as product exchange (eg Johanson, 1989:67; Thorelli, 1986; Hakansson, 1982; Mattsson, 1989; Miles and Snow, 1986; Spekman and Johnston, 1986; Dwyer, Schurr and Oh, 1987; Jarillo, 1988; Grant, 1991; Kay, 1993; Webster, 1992; Day, 1990; and O'Keefe, 1993). Focusing on the channel of distribution or the "network" these writers acknowledge that social and informational exchange have a strategically significant impact on the strength and endurance of relationships over time, and these relationships often constitute the strategic assets of the firm. Through these relationships a firm can seek to countervail its dependency.

### **3.7.2 The Process of Relationship Building and the Function and Maintenance of Networks**

Writers like Achrol, Reve and Stern, (1983); Thorelli, (1986); Johanson and Dag, (1992); Johanson, (1989); Kinch, (1992); Matheson, (1987, 1989); Forsgren and Johanson, (1992), Axelsson, (1992); Snehota, (1993) and Snow and Thomas, (1993) have examined business to business relationships and have made the following theoretical statements:

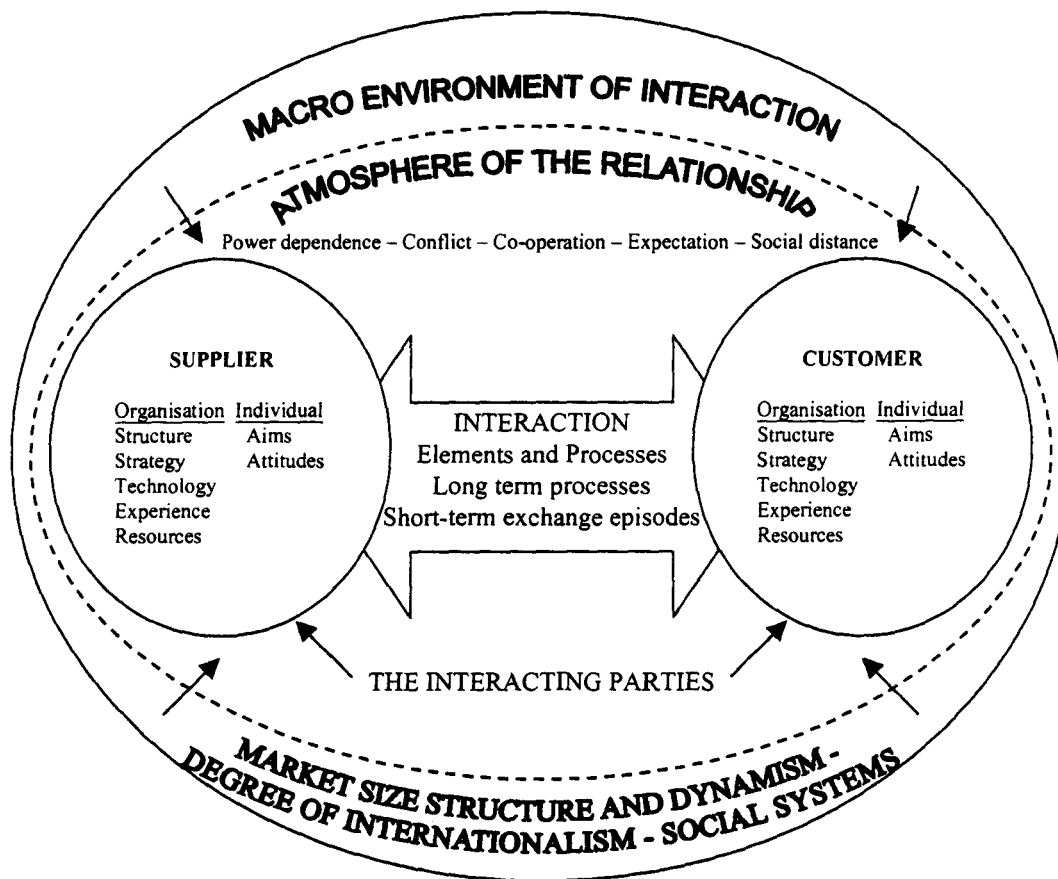
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<sup>4</sup> Johanson saw that industrial networks differed from social and other networks in general in that they were coupled to industrial activities.

1. Any focal market is more or less structured as a network of relationships between a number of different actors. These may differ with regard to the strength of the relationships, the relative importance of competition and cooperation in the relationship, the distribution of each actor's power and influence over the network, the importance of different bonds, stability, transparency, and the number and importance of connections with networks in different countries.
2. Network bonds may be tight or loose depending on the quantity (number), quality (intensity) and type (closeness to the core activity of the other parties involved) of interactions between the positions or members. The complexity of technology will also affect network relationships eg customised products may lead to more adaptations which bind a firm tighter into its output network than if it offers mainly standardised production.
3. The internal interdependencies between network actors generally change over time.
4. Trust is a significant concept in understanding network organisation. Its establishment is time dependent and manifested in expectations of future mutually beneficial actions between network relationships.
5. Power is the central concept in network analysis (meaning the ability of one to influence the decisions or actions of others).
6. Power and information flow along the links of the network. As well as the products and services, information and finance, social values are exchanged in interactions which reduce uncertainties between network participants.
7. Social exchange processes are time-dependent. Exchange relationships have a history, and the outcomes of previous business episodes provide the framework for subsequent interaction. The establishment of network relationships is thus a long term process that should be planned.

8. Firms make important investments in networks of market relationships.
9. The network view assumes that relationships and networks emerge through interaction between many managers at different management levels.
10. The network is the framework which provides firms with both possibilities and constraints in their business.
11. The positioning of the firm in the network is a matter of as great a strategic significance as positioning its product in the market place.
12. Four dimensions can describe network structure:
  - Structuredness (how interdependent positions are)
  - Homogeneity (the extent of bonds of similar nature)
  - Hierarchy (the extent of asymmetry), and
  - Exclusiveness (the interdependence between these positions and positions in other networks) (Mattsson, 1987:241).

The network theorists developed an interaction model to illustrate the relationships between the macro environment, the so called atmosphere of the relationship, and the interaction processes between suppliers and customers. The model is presented below, along with explanations of the constructs.

**Figure 3.2: The Interaction Model of Markets as Networks**

Source: Turnbull, P.W. and Valla, J.P. (1986:5), *Strategies for International Industrial Marketing*

In the interaction model of markets as networks the IMP group of researchers identified and defined the following:

- ***The interaction process***

The four major elements exchanged are the products and services, information, finance and social values.

- ***The participants in the interactive process***

The characteristics of the participants (or actors) are considered in relation to their *comparative technologies, capabilities, size, power and experience*. Asymmetries may give one actor a position of advantage over another as they interact and allocate resources.

The network conceptualisation also pays attention to the characteristics of the individuals in the networking firms as they exchange information, develop relationships and build up

strong social bonds, which in turn influence business relationships. The personality, education, experience and motivation of the actor's representatives helps to create the relationships built between them.

- ***The Interaction Environment***

Rather than draw a sharp line between the firm and its environment this approach focuses on the interaction between the firms in an attempt to understand how through competition and cooperation they shape the future conditions for business.

Aspects of the environment of particular relevance are said to be:

The *market structure*, which includes the concentration of buyers and sellers the rate of change in the market place and the number of alternative relationships available to any one firm. The *dynamism*, or the degree of change occurring in the market which affects the firm's ability to predict the future behaviour of partners in the relationship. It also affects the extent to which an actor could afford to develop close relationships.

The *stage of internationalisation* of the buying and selling market influences the firm's organisation and motivation to develop international relations and trade.

The *social system surrounding the relationship* is conceptualised as the real or perceived barriers to trade between actors in different countries, the protocols, procedures and ways of behaving that are considered the norm when dealing with certain industries.

- ***The Atmosphere***

The atmosphere surrounding a relationship is seen as open to conscious planning as part of the marketing or purchasing strategy of a firm. It can be described in terms of the power/dependence relationship, the degree of conflict or co-operation in the relationship and the overall "social distance" between the parties, arising from the mutual perceptions. The atmosphere is said to be built up by specific episodes and long-term experiences in business transactions. It is a product of the relationship and will mediate the influence of the three other group variables: ie the interaction environment, the participants in the process and the interaction process.

### **3.7.3 Trust and transaction costs in networks**

Thorelli, (1986) one of the early writers developing the industrial network framework, considered how such systems could reduce transaction costs within business to business relationships. He saw that trust was the key. He defined trust as an assumption or reliance on the part of A that if either A or B encounters a problem of fulfillment of his/her implicit or explicit transaction obligations, B may be counted on to do what A's would do if B's resources were at A's disposal.

Thorelli and other network theorists, eg Johanson (1989) and Mattsson (1987), saw trust as overcoming the need to specify unforeseeable consequences, the problem earlier stressed by Macneil (1974) and later identified by the agency theorists. Likewise Jarillo (1993) identified trust as the central concept of what he called a "strategic network". He wrote: it is "the mechanism that lowers transaction costs, thus making the network viable economically" (1993:149). Thus trust can reduce the need to set up costly mechanisms to prevent or retaliate against opportunistic behaviour.

Opportunistic behaviour also quickly destroys reputation. As Jarillo (1993:136) points out, reputation has a significant economic value when establishing relationships. It sustains and is sustained by trust. At the same time however, when a firm has established a good reputation it also becomes hostage to it, losing its investment in such an asset (ie its reputation) if it acts opportunistically.

### **3.7.4 Alternative "network" structures**

There is a number of conceptualisations of what have been called variously "clusters of relationships", "business networks", "market networks", or "strategic networks". The differences center on definitions of boundaries and the coordination or leadership within the "network". Some of the different models are described below:

### 3.7.5 The IMP network model

Mattsson (1987) wrote that the business network is one where coordination does not take place through a central plan or organisational hierarchy, nor through the price mechanism of markets. Rather coordination takes place via interaction between the actors through relationships (1987: 236). Boundaries of networks may never be known to participants, as relationships extend beyond the knowledge of the focal actor.

### 3.7.6 Strategic networks

In evaluating alternative governance structures, Jarillo argues that what he calls "strategic networks" capture the advantages and cancel out the disbenefits of vertical integration and subcontracting. He is concerned that a company may transfer its competitive edge to a subcontractor, or a company may be "hollowed out" if it lets others capture key positions in the business system (1993:69).

Jarillo defines his strategic networks as "arrangements where companies set up a web of close relationships that form a veritable system geared to providing product or services in a coordinated way" (Jarillo, 1993:7). In such a strategic network one company takes the role of "central controller" and organises the flow of goods and information among other independent companies, making sure the final client gets exactly what they want in an efficient way (Jarillo, 1993:6). The ASMA could be compared with the key actor in a key actor in a strategic network as defined by Jarillo - however the ASMA only controls part of the network. (Its main function is to countervail dependency rather than facilitate coordination.)

Jarillo argues that the strategic network is more flexible than vertical integration because each unit is independent. He also argues that the main sources of innovation is a company's customers and suppliers. Thus any business system which continues to give its participants maximum exposure to these sources of future innovation (eg as in a strategic network) must be effective.

Jarillo (1993) concluded that strategic networks are "long-term purposeful arrangements that allow the independent firms in them to sustain competitive advantage vis a vis their



competitors outside the network, by optimising activity costs and minimising coordination costs" (1993:149). Trust is seen as the key to coordination and cooperation in these structures. Jarillo conceded that while in some industries the best strategy may be to vertically integrate the whole business, he found that achieving coordination through vertical integration incurs heavy efficiency penalties.

The strategic network concept differs from that adopted by the early writers in the Industrial Marketing and Purchasing (IMP) school who did not stress a controlling hub or centre as imperative (for example see Mattsson, 1987, and Forsgren and Johanson, 1992).

Forsgren and Johanson (1992) write that business networks should not be confused with strategic networks such as franchising networks or subcontracting networks where one central actor contracts a number of franchisees or subcontractors. Instead they use the concept of *strategic network* to describe one usually built by a single actor. *Business networks* are defined by these writers as emerging over time through interaction between several autonomous actors. Forsgren and Johanson allow that strategic networks may well be sections of business networks. Typically they are based on formal contracts between the actors.

Sydow (1991) develops a concept of network structure which is not hierarchical but acknowledges division of labour and a "hub". He writes that while networks are very decentralised, polycentric and an outcome of collective strategies, a strategic network is usually led by a focal or hub organisation, although some other network organisations also participate in the network's strategic decision making processes. The boundaries of the network organisations as well as the boundaries of the network itself are therefore complex and reciprocal, rather more cooperative competitive, and relatively stable.

Sydow also sees multinational companies (MNC) as sometimes organised in a form which comes close to that of a strategic (international) network. He also describes a *heterarchical MNC* which he sees as having several centres playing a strategic role for the network, built on different organisational principles, having unique abilities, sustaining cooperative relationships and residing in different countries (1991:2).

### 3.8 Theories of Interfirm Power and Dependency, Conflict and Cooperation

The twin concepts of power and dependence have been widely studied in the fields of political science, economics, anthropology, sociology, and organisational theory. Power and dependence are commonly viewed as inseparable concepts with power residing implicitly in the other party's dependency

Consistent conclusions about the determinants and effects of dependence levels in channel or network relationships are difficult to draw from the literature. The most consistent finding seems to be that a target firm's dependence in a channel relationship is related positively to the *source* firm's level of control (Etgar, 1977; Brown, Lusch and Koenig 1984). Empirical evidence on the determinants and effects of dependence levels in channel relationships is mixed.

Reviewing ten field studies of dealer dependence and reciprocal actions in distribution channel relationships undertaken between 1972 and 1986 Frazier, Gill and Kale conclude that levels of dependence have been related to very few constructs in the channel literature and measured dependence associations are often conflicting and unclear. For example, Brown, Lusch and Koenig (1984) found that dependence was related positively to the frequency of interfirm disagreements, while Frazier (1983) reported dependence was positively related to interfirm agreement on marketing strategy.

Thus the role of dependency in buyer and seller relationships remains problematic. There seems to be agreement however that successful collaboration requires a high level of *purposeful cooperation* aimed specifically at maintaining a trading relationship *over time*, eg Day, (1994:44); Frazier, Spekman and O'Neil, (1988) and Spekman, (1988).

The concept of power and dependency is central to this research. The challenge for agribusiness suppliers is how to develop buyer's loyalty, while at the same time, not

becoming dependent on a single or dominant buyer who may then use its power to control market access and the distribution of resources in the network.

### **3.8.1 Interdependency and its influence on performance**

In their definition of "a relationship" Hakansson, Hakan and Snehota (1993) saw interdependence as a feature of the interaction, over time, of two parties. They made it clear however, that interdependency was a two way street:

*A relationship may arise between two parties because of interdependence of outcomes or for any other reason..As it entails mutual commitment over time a relationship creates interdependence which is both positive and negative for the parties involved...A relationship creates interdependence as much as it reflects interdependence. (Hakansson et al, 1993:3).*

Many theorists studying interorganisational cooperation have stressed the impact of interdependency, arguing that parties cooperate when they depend on each other or share assets (eg Pfeffer and Salancik, 1978; Williamson, 1975). However writers like Macneil (1978), and Van de Ven and Walker (1984), write that over time the two "players" come to care for one another, develop social bonds, and cooperate out of altruism, not dependency.

### **3.8.2 Factors influencing power**

In the earliest analyses of power, influence and authority are conceptualised as dimensions of the power concept (eg Max Weber, 1947; Charles Loomis, 1960; Richard Schemerhorn, 1961; Emerson, 1962). Authority is based on the formal right to control while influence consists of informal attempts to affect other's behaviour indirectly. Authority is thus the formal aspect of power and it flows from a hierarchical level downwards while influence can flow up, down, or horizontally (Larsson, 1985; Forsgren, 1980; in Forsgren and Pahlberg, 1992).

Writing in 1977 Etgar defined "power" as the ability of a channel member to control others and affect their decisions. "Control" was used to denote actual compliance. Thus power could be defined as "potential control" and control as "exercised power" (1977:69). Etgar then summarised the extant literature on power relationships in distribution channels. He found most writers (eg Stern and Beier, 1969; Hunt and Nevin, 1974; and El-Ansary and Stern, 1972) explored whether specific channel positions, patterns of behaviour and the economic and social forces of particular channel members allowed them to accumulate power and exercise control over other channel members (Etgar, 1977). Etgar was critical of the failure of such research to shed much light on the questions posed.

Etgar (1977) then joined Stern and Beier (1969) in concentrating research on the extent to which a distributive channel is administered by a channel leader who then controls all or some of the other member's decisions and activities. This question has also been explored by those using exchange and interorganisational theory to conceptualise the significance of the "position" or "centrality" of a firm in a channel or network of relationships (eg Frazier, 1983; Cook and Emerson, 1978; Forsgren and Pahlberg, 1992). Etgar, Stern and Beier agreed that without a channel leader the administration of a channel depends on the price mechanism of intermediary markets to achieve cooperation and coordination.<sup>5</sup>

Numbers of the early writers (eg El-Ansary and A and L Stern, 1972; Etgar, 1976; Hunt, and Nevin, 1974) argued that channel leadership is a consequence of a set of social, economic, and psychological resources that are used in a process of exchange. French and Raven (1959) listed these sources of power as:

*Reward*: B's perception that A can mediate rewards for them.

*Coercive*: the perception that A can mediate punishments for B.

*Legitimate*: the perception that A has a legitimate right to prescribe behaviour for B.

*Referent*: B's identification with A.

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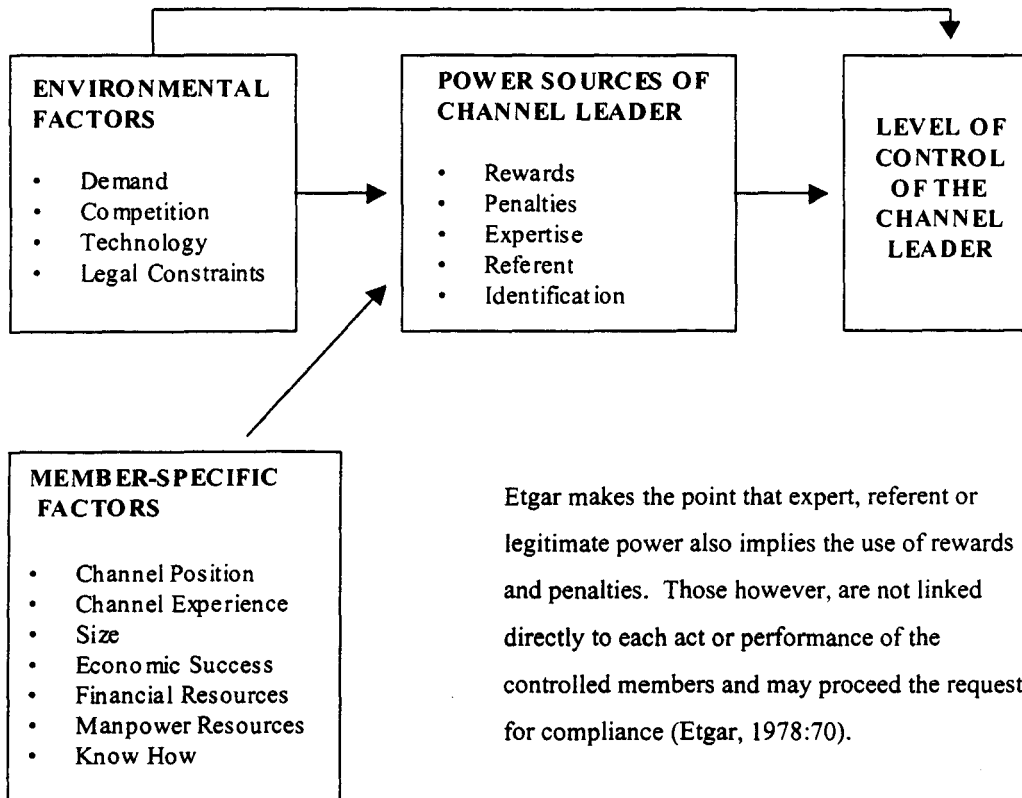
<sup>5</sup> This debate foreshadowed the later interest in differentiating between business networks coordinated by the market, by long term trusting relationships or in the case of "strategic networks" with a coordinating hub (eg Jarillo, 1988, 1993).

*Expert:* B's perception that A has some special knowledge or expertise.

These conceptualisations of the sources of power indicate the importance of the past performance or reputation of the firm A in influencing the perceptions of B, ie. what the game theorists call the shadow of the past creating the shadow of the future (Axelrod, 1984). Since reputations take time to establish, clearly studies of power relationships in channels (or networks) cannot be static. An understanding of past performance is requisite.

Reflecting his era's interest in channel member power and dependency, Etgar (1977) also sought to identify general environmental factors leading to the emergence of leaders in distributive channels. Etgar extended French and Raven's "power sources of the channel leader" model by including other dimensions that were channel member specific, and environmental factors. He argued that together these three dimensions determined the level of control of the channel leader (1978).

In exploring power relationships, this research takes a longitudinal approach, and it considers the context in which the interactions take place. In emphasising the environmental context as well as the firm's characteristics Etgar's conclusions foreshadowed those which came into focus in the political-economy paradigm (eg Arndt, 1983) and in industrial network theory (eg Mattson, 1989).

**Figure 3.3: Etgar's model of power and control (modified)**

### 3.8.3 Power and competitiveness

The Profit Impact of Market Structures studies (PIMS) of the 1970s emphasised the achievement of market power as a precursor to better market performance. Following on from this point, Porter (1980) hypothesized a link between power and competitiveness in considering USA industrial markets. In his view the bargaining power of customers and of suppliers represents the two main forces acting upon focal firms and constituted drivers of industry competition. Porter's criteria for evaluating the intrinsic power of a customer embraced such factors as:

- the proportion of a supplier's output bought,
- the availability of qualified alternative supply sources and
- the shipping and transaction costs involved in changing suppliers.

validity over time (Cunningham, 1993). Instead Cunningham (1993:5) found that the following factors influenced a customer's dependence upon one of its suppliers:

- low cost of supplies
- flexible credit arrangements
- regular and dependable supplies
- technical advice whenever needed.

Young and Wilkinson argue that marketing's emphasis on power and conflict as key concepts for studying channels has distorted the understanding of how channels function. They write: "The emphasis (is) on *sick* rather than healthy relationships" (1989:109). Morgan and Hunt (1994) agree that instead of succumbing to superior coercive powers a "healthy" partner of a relationship acquiesces because of their desire to remain committed to a long term relationship. They found that the continuing exercise of power in order to achieve partner acquiescence destroyed trust and commitment, which decreased cooperation and inhibited long-term success (1994:33) Lusch's research reported in 1976 also showed that the use of power resulted in dysfunctional conflict.

Conflict is not always seen as dysfunctional in a network of relationships however. Mattsson (1987) refers to it as a driving force for network development and increased efficiency.

While game theorists have used the "prisoner's dilemma" to conceptualise the significance of cooperation and retaliation in business to business relationships, researchers of distribution channel and network relationships have focused their work on the analysis of determinants of buyer-dealer dependence levels, and the linkages between dependence, coercion and control, intrachannel conflict and dimensions of power (eg Emerson, 1962; El-Ansary and Stern, 1972; Bonoma, 1976; Lusch, 1976; Etgar, 1977, 1978; Cook, 1977; Gaski, 1984, 1986; Frazier, 1983; Frazier, Gill and Kale, 1989; and Cunningham, 1993).

#### **3.8.4 Power and dependency viewed in an interactive context**

Cunningham, using an interactive model (1993) showed that competition is a dynamic process which may involve active rivalry between firms engaged in exchange or where there is the prospect or perceived threat of rivalry. This rivalry may be constructive or destructive. It can apply to numbers of suppliers competing against each other but also to rivalry within a buyer-seller relationship. Cunningham argued that rivalry may not preclude dialogue or exclude collaboration. Supplier-customer relationships may be characterised by rivalry, the exercise of power, the use of bluff, or a prevailing atmosphere of cooperation (Cunningham, 1993:2).

Researchers using an interactive relationship approach also conceptualise sources of power emerging from changes in the network "positions" of other firms in the industry and from new entrants into the competitive arena. These network re-arrangements, they argue, result from the continuous process of selecting partners, and the accessing of new sources of resources, know-how and consequently, market power (Forsgren and Pahlberg, 1992).

### **3.8.5 The concept of centrality and position in a business network**

Cook and Emerson (1978) propose that a firm's *centrality* has to do with the possibilities of exchange of specific resources with other units and the extent to which the unit is the only source available for others to get these resources. Centrality thus highlights the firm's relative *position* in a network of resource flows. A reasonable approximation of centrality is the number and intensity of the unit's connections.

Others argue that centrality is related more to collective dependence and less to dyadic and relative dependence between two units. Their measure of a unit's centrality takes into account the consequences for the unit or system if the focal unit is taken away (Forsgren and Pahlberg, 1992).

Forsgren and Pahlberg (1992) stress the fact that access to resources includes control of information and knowledge, as well as close or extensive links to other important actors in the network (eg government units, trade associations, competitors, etc). These socio-



political and economic contacts take time to establish and are built up and sustained by mutual trust and adaptation.

Forsgren and Pahlberg (1992) also argue that power in a network not only accrues to those who occupy central positions, but also to those who have an accurate perception of the network. Thus knowledge about actual structures, actors and relationships is a base for influence.

Accordingly these writers saw that network position is a consequence of:

- the firm's importance relative to others in the network, (ie. what happens if it is not there),
- the accuracy and extent of their knowledge about others,
- their socio-political and economic relationships with others in the network.

Thorelli (1986) and Mattsson (1985, 1987) also saw a firm's network position as a structural concept indicating the location of power holders who can create and/or influence networks. Thorelli's measures of a company's position varied only slightly from the conceptualisation above and from those of Mattsson (1987). Thorelli extended his definition by reference to a firm's position in other networks. The following table compares the concepts of Thorelli and Mattsson:

**Figure 3.4: Measuring an Actor's Position**

According to Thorelli (1986) and Mattson (1987), the actors' position can be a measure of the following factors:	
<u>Thorelli:</u> <ul style="list-style-type: none"> <li>- the role of the firm in the division of labour of the network</li> <li>- the power of the company relative to other participants in the focal network</li> <li>- economic base (ie market share, absolute size, share of buyers purchases, the centrality of the seller's products to the buyer's core capacity, the firm's relative liquidity)</li> <li>- technology</li> <li>- expertise</li> <li>- trust, (based on reputation, past performance, friendship)</li> <li>- legitimacy, (derived from long-term contracts, government auspice, being "local", having patents, interlocking directorates, joint ventures, etc).</li> </ul>	<u>Mattsson:</u> <ul style="list-style-type: none"> <li>- the functions performed by the firm for other firms,</li> <li>- the relative importance of the firm in networks</li> <li>- the strength of the relationship (ie the kinds of bonds) with others</li> <li>- the identity of the firms with which it has direct relationships and its role.</li> </ul>

Mattsson (1987) saw the firm's position as characterising its role in the network. He stressed that the firm's present position influenced its development opportunities as well as its restrictions. The present positions of all firms are the network structure, and the specific firm's present position describes its strategic position (1987:241). All of these positions are constantly changing.

Thus in summary, managing international business is seen as a matter of establishing, developing and maintaining the firm's positions in international business networks (Forsgren and Johanson 1992).

### **3.9 Commitment**

Wilson and Mummalaneni (1986) saw mutual commitment as the main predictor of the future stability of a relationship. They developed a formula that proposed that commitment to the relationship is a function of satisfaction, the quality of available alternatives and the level of investment in the relationship. This they reduced to the formula:

$$\text{Commitment} = \text{satisfaction} + \text{investment} - \text{alternatives}$$

Thus they argued that a business might be committed to a relationship that it is not satisfied with, while satisfaction with a relationship does not guarantee commitment to it. Presumably such circumstances would not lead to a stable, long term relationship, but rather, the less than satisfied or committed partner would be vulnerable to the advances or opportunities presented in an alternative more symmetrical, less dependent relationship.

### **3.10 Forming Alliances and Achieving Cooperation**

In writing about the changing business world Kenichi Ohmae (1990a and 1990b) challenges writers (like Porter, 1990) who talk about the need for firms to pursue a policy of seeking to individually control domestic and export environments. Ohmae wrote that in stable competitive environments this allergy to loss of control exacted little penalty. Not so, however, in a changeable world of rapidly globalising markets and industries – in a world of converging consumer tastes, rapidly spreading technology, escalating fixed costs, and growing protectionism (1990).

He goes on to say: "In the past, you tried to build sustainable competitive advantage by establishing dominance in all of your business system's critical areas. You created barriers to entry where you could, locked away market share whenever possible, and used every bit of proprietary expertise, every collection of nonreplicable assets to shore up a wall

separating you from your competitors..." However, he argues, the fixed costs of entering and growing a global market share are now so great, customers preferences so converged and new technology so short lived that "globalisation mandates alliances, makes them absolutely essential to strategy" (1985).

Writers like Ohmae, (1985,1990a and 1990b); Mohr and Spekman, (1994); Bleeke and Ernst, (1991); and Powell, (1987, 1990), all agree that alliances, coalitions, partnerships, joint ventures and other cooperative arrangements give firms access to information beyond their boundaries, help to share the risks and give them access to complementary skills. These writers focus on the relationships between two or more firms who have long or short term, formal or informal agreements to achieve some objective in concert.

### **3.10.1 Are all alliances in the interests of the firm?**

Many writers have concluded that prescriptions for the formation of alliances and partnerships often overlook the drawbacks and hazards of such relationships and the numbers which fail.

Williamson (1975) and Provan (1984) highlighted the increasing complexity, loss of autonomy and information asymmetry which can result from a loss of strategic independence. While there has been exponential growth in strategic alliances, partnerships, joint ventures, coalitions and cooperatives, Sherman (1992) reports that one third of strategic alliances are outright failures. Stafford (1994:64) reported studies that claimed seven out of ten strategic alliances in USA fell short of participants' expectations and/or were disbanded. Two-thirds of the Silicon Valley firms partnering Asian companies claimed to be less profitable after joint venturing, sixty percent claimed that their operating expenses had increased. Harrigan (1988); Kanter (1988); Levine and Byrne, (1986) also comment on the low success rates of partnerships or alliances. Thus the practice of alliance management would seem to pose a significant challenge.

In 1990 Heide and John's review found that closer relationships were seen as a universally desirable strategy (1990:33). Like Williamson before they argued that bilateral governance is not a universally efficient strategy for a business. They argued that in the absence of

specific asset investment and uncertainty, joint action not only fails to have beneficial effects, given its costs it is likely to be detrimental to performance (1990:34).

Heide and John (1990) also found that buyers and suppliers have different incentives for developing closer relationships, and their approaches to developing alliances differed. They wrote: "continuity may be more important or desirable from a suppliers than a buyer's perspective." The case studies reported in this research typically have highly asymmetrical relationships with their buyers. Joint ventures have been the means that some have chosen to counter all their dependency.

### **3.10.2 Defining a strategic alliance/partnership**

According to Webster (1992:8), Bleeke and Ernst (1991), Powell (1990), and Sporleder, (1993:5) the emphasis in strategic alliances is on longer term positioning where the strategic partnering is of greater importance to the firm than short-term gain. Accordingly strategic alliances designed to enhance vertical coordination are the participant's attempt to optimise among the economic factors of idiosyncratic investment, opportunistic behaviour, bounded rationality and vertical control.

Wilson and Jantrania (1993) identify key constructs which they call "the glue" of a strategic alliance or partnership. This list of constructs is typical of those in models proposed by the network theorists (eg Thorelli, 1986; Hakansson, 1982; Ford, 1990).

They include:-

#### *Goal compatibility*

Some significant part of each partner's goal must be seen as being met only through collaborating in a relationship (Wilson and Jantrania, 1993).

#### *Trust*

Those using the RM and IMP network approaches tend to agree that trust is "the groundwork supporting all acts of cooperation", (eg Wilson and Jantrania, 1993; O'Keefe,

1993:29; Young and Wilkinson, 1989). They have found support for trust being positively related to relative power among trading partners.

#### *Satisfaction*

This relates to performance of the key elements of the exchange process. Buyers may be prepared to work with specially chosen suppliers to improve their performance, otherwise, a relationship will not endure if the supplier is unable to meet the buyer's expectations.

#### *Investments*

TCA refers to these as transaction specific investments. They affirm the partners trust in each other and create a barrier to exit from the relationship.

#### *Social bonding*

Individuals who must interact with each other within the context of the relationship need to have some positive level of social bonding for the relationship to reach its full potential. (Wilson and Jantrania, 1993).

#### *Structural bonding*

According to Wilson and Jantrania (1994) structural bonds are a richer version of the TCA framework. They may include social pressures, Transaction specific investments, or entwined technologies.

These writers argue that the above elements are interdependent. For example dependence and trust are critical dimensions of structural bonds and have a significant impact on investment and ultimate levels of satisfaction in the relationship.

### **3.11 Cooperation**

In 1992 Heide and John defined cooperation as flexibility and joint problem solving between at least two exchanging parties.

The concept of cooperation in business to business interaction has been discussed in Western marketing/business literature for decades. It was a critical part of Macneil's 1974 relational contract typology. However, marketing theory has only recently embraced the notion that successful on-going buyer-seller interactions tend to involve significant cooperative relationships.

Blau (1964), was one of the many social scientists studying the foundations of cooperation in human behaviour. He argued that cooperation and social order is created when people need each other. In other words, if A needs B's assistance, he/she must first gain and keep B's cooperation. B's response in turn will be determined by how much they need A or by the benefits they can derive from the association.

The achievement of cooperation then begs the questions:

Who needs whom?

Who is dependent on whom?

What resources do the parties have for social and/or economic exchange?

What are the alternative sources of exchange available to the parties?

How do these alternatives compare with those in the focal dyad?

Thus dependency and reciprocity would also seem to be key conditions which affect the extent of cooperation and what form it will take.

The early social scientists also recognised a difference between casual or market reciprocity and the kind that sustains a pattern of interaction. (This has also been the subject of close analysis by the Transactional Cost Economists.) Buying cigarettes from a vending machine may be a purely economic transaction. Buying the same items from a corner shop may constitute a meaningful, sustained interaction if the purchase is part of an established relationship between a regular customer and the long established shop keeper (Broom and Selznick, 1973:26).

Social scientists have long recognised that a social exchange is not necessarily evenly balanced: it may be oppressive and exploitative (Weber, 1947; Loomis, 1960; Emerson,

1962). If A has many exchange alternatives and B has few or none, then B is the more dependent and may have to submit to harsh or humiliating terms. In other words the idea of exchange does not imply that the partners enter into an interaction with equal resources or power. Asymmetry is frequently the norm in human exchanges and in business.

Relatively long-term contractual commitments have been typical of a great many Western economy industrial buyer-seller relationships, but in the past these relationships were often at arms length and adversarial, designed to pit the customer against the vendor in a battle focused on obtaining the lowest price possible. For example a traditional practice amongst large manufacturers in the USA in the first 80 years of this century was for buyers to maintain lists of qualified vendors who would be invited to bid for a tightly specified product. The expectation was that the successful tenderer would be the lowest bid (Webster, 1992).

While the largest share of sales was allocated in this way, several others would be given enough share to keep them in business to maintain pressure on the lowest price vendor. Such smaller suppliers were also a potential alternate supplier in the event of delivery or quality problems (Spekman, 1988; Porter, 1980). Incoming inspection and return of rejects was the key to quality control (Webster, 1992). Such purchasing policies are still common in areas such as the international buying and selling of simply transformed <sup>6</sup>agricultural commodities, eg skimmed milk powder. The Japanese car industry is structured in a similar way. Thus while such transactions may occur over a long period of time and be frequent, cooperation is not necessarily the inevitable outcome (Heide and Miner, 1992). Blau (1964:26) saw cooperative relationships as always potentially unstable.

The work of researchers in trying to identify the antecedents to or consequences of channel cooperation relationships shifted the focus from the earlier, simpler treatments of channel length or intensity to the more complex treatment of the structure and content of dyadic relationships. In particular this interest was fostered by the identification of apparently new forms of highly competitive production systems, (eg Just In Time (JIT) which echoed

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traditional Japanese practices of long-term business cooperation between closely inter-dependent firms)

The Japanese *kanban* or JIT system provided a new model of supplier - buyer relationships for American automobile manufacturers to consider when they found their vehicles losing market share to the imports. The Japanese had developed different manufacturing systems where quality and low cost depended heavily on strategic partnerships with a small number of vendors. In particular higher quality and lower inventory costs resulted from reliance on a network of sole-source vendors in a system of total interdependence (Frazier, Spekman and O'Neil, 1988). These suppliers also participated in the early stages of product development (Womack, Jones and Roos, 1991). These relationships were always asymmetrical in terms of market power buyers and suppliers were able to wield.

The earliest USA studies of interaction in channel structures were mainly concerned with levels of title transfer and function. Along the way however, there has been a paradigm convergence, with the study of interactions enriched by a consideration of the environmental context, as conceptualised in the political economy paradigm (eg Mohr and Nevin, 1990, Rosenbloom, 1991; Sharma and Dominguez, 1992; and Robicheaux and Coleman, 1994), by game theory, (Axelrod, 1984) by TCA, (Williamson, 1985) by relationship marketing (Dwyer, Schurr and Oh, 1987) and by the closely related network theory (eg Thorelli, 1986; Mattsson, 1987; Hakansson, 1992).

These writers agree that non-discrete exchange relations can endure over time, benefits and burdens will be shared and the partners can be mutually trusting, planning together for future transactions. A common heritage of these theoretical approaches, as already discussed, is Macneil's contracting model which he described as ranging from discrete to relational contracting.

Reviewing the governance structure and other organisational behaviour theories in the light of the 1990s boom in cooperative business relationships, (Ohmae, 1985, 1990a; Mohr and Spekman, 1994; Powell, 1990; Ring and Van de Ven, 1994) suggest that firms now pursue a diverse set of business objectives requiring *closer cooperation* because they involve

reciprocal dependencies (ie the exchanges are more likely to be symmetrical). These business objectives include accessing new technologies or markets, creating economies of scale in research and development, production and/or marketing, or gaining complimentary skills by gaining access to resources beyond the scope of the single organisation. As well, many firms cooperate in order to manage an environment that is more uncertain or turbulent than each alone can control (Cummings, 1984). Such objectives commonly lead to a strategic alliance, joint venture, or other form of strategic cooperation.

Business to business marketing literature has focused on commitment, coordination, interdependence and trust as important attributes of successful alliances, joint ventures or partnerships (see Frazier, Spekman and O'Neal, 1988; Anderson and Narus, 1990; Mohr and Spekman, 1994; Dwyer, Schurr and Oh, 1987). Mohr and Spekman's 1994 definition of partnerships adds interdependence as a dimension, ie purposeful strategic relationships between independent firms who share compatible goals, strive for mutual benefit and acknowledge a high level of mutual interdependence<sup>7</sup> (1994:135). Mutual dependence and goodwill are implied in these characteristics.

Mohr and Spekman (1994) noted that while the rationale and the decision to form strategic partnerships is well documented in the marketing and strategy literature, there is little guidance as to the processes required to develop and nurture the partnership. They consulted the literature to isolate the following variables, then tested them to determine their contribution to partnership/alliance success.

### *Commitment*

The willingness of trading partners to exert effort on behalf of the relationship. Commitment suggests a future orientation. More committed partners can be expected to overcome short term problems with a view to long term achievement.

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<sup>7</sup> One of the problems in this area of organisational behaviour research is the lack of agreement on nomenclature describing the same or similar phenomena.

### *Coordination*

This relates to boundary definitions and reflects the tasks each expects the other to perform. Pfeffer and Salancik (1978) suggest stability in an uncertain environment can be achieved through greater coordination.

### *Trust*

Trust is a construct in most long term relationship models. Deutsch (1973) an experimental psychologist using Prisoner Dilemma games assumes the presence of trust to be the groundwork supporting all acts of coordination. Williamson (1985) states that other things being equal, exchange relationships which exhibit trust will be able to manage greater stress and will display greater adaptability. Lack of trust will hamper information exchange.

### *Interdependence*

According to Cummings (1984), interdependence occurs when firms join forces to achieve mutually beneficial goals and they acknowledge that each is dependent on the other.

### *Communication quality*

Macneil (1981) found that such aspects as the accuracy, timeliness, adequacy, and credibility of information exchanged assisted partnerships to survive. The problem of asymmetrical information is a main plank in Agency Theory. Glazer (1991) developed a framework for operationalising the value of information in marketing contexts. He listed the main attributes of information as: (1) it not being divisible or appropriable, (2) it is not inherently scarce, (3) it does not decrease returns with use but rather it often increases in value with use, and it is essentially regenerative in nature.

### *Participation*

Participation refers to the extent to which the partners share in joint planning and goal setting. Dwyer and Oh (1988) suggest that input to decisions and goal formulation are important aspects of participation and help partners to succeed.

### 3.12 Conflict Resolution

The impact of conflict resolution can be either constructive or destructive (Assael, 1969). Thus the manner in which partners resolve conflict will have implications for partnership success.

Defining success within the context of their study, ie as a measure of the sales volume flowing between dyadic partners and the satisfaction of performance expectations, Mohr and Spekman found that trust, commitment, good communication quality, joint planning and problem solving all serve to better align and satisfy partner's expectations, goals and objectives. *Interdependence*, however, was not found to be significantly related to any of the measures of partnership success (1994:147).

Gronroos (1993) argued that the buyer and seller attempt to develop synergies through cooperation. Both approaches (RM and industrial networks) accept this, advancing the concept that developing cooperation between members of the value chain system/network improves both the position of the firm in the system/network, and the system/network itself relative to other competitive systems/networks.

#### 3.12.1 Prisoner's dilemma, game theory and cooperation

The use of The Prisoner's Dilemma (PD) in Game Theory (Luce and Raiffa, 1957; Kreps, Milgrom, Roberts and Wilson, 1982) helped to bring cooperative behaviour to the attention of business strategy researchers. In particular, Axelrod's *The Evolution of Cooperation* (1984) has been highly influential. In the basic PD two players have two choices: to cooperate and trust each other or to act opportunistically and expropriate the composite quasi rent. Each player must make a choice without knowing what the other will do. Thus the structure of the Prisoner's Dilemma closely resembles the structure of a once off exchange relationship.

Axelrod (1984) reported however, that in iterated PD games, cooperation was the most successful strategy over time, where the player's past performance was known, their

reputation gave a window to the future, and when the game appeared unending. Where there is repeated play and an indeterminate ending point, mathematical analysis showed that the players may arrive at stable cooperative outcomes through many different mechanisms (Radner, 1986). Game theorists like Axelrod found swift "tit for tat" or the immediate reciprocation of opportunist behaviour was one of the most effective ways to ensure future cooperation between two "players" of an iterated game.

Reciprocity, is a fundamental principle guiding any human exchange, according to social anthropologists. Bendor (1987) has explored "punitive" reciprocal strategies (or sanctions) and has found that such reciprocity (or tit for tat) may need to be tempered when with some tolerance for occasional defections when there is some performance ambiguity.<sup>8</sup> Reciprocity may be a positive exchange ( a gift or favor) or a sanction. Rodrigo (1998) has explored the concept of *guanxi*, a Chinese reciprocal business exchange concept. Some dependence theorists have also sought to understand reciprocal actions in channel relationships (ie Stern, 1969; Lusch, 1976; Frazier and Summers, 1984).

Both Axelrod and Bendor agree that reciprocity strategies only work to the extent that the "players" value the future of their relationship/interactions together. Axelrod referred to this phenomena as having a "sufficiently long shadow of the future" (Axelrod, 1984:124). Ideally the game should be seen by the players to be indeterminate to stop final game defections that would destroy cooperation. Thus iterated game theory suggests that the time context which allows reputations to be established in turn affects the future interaction expectation which sustains cooperation.

### 3.12.2 The role of trust in exchange relations

Axelrod (1984) takes a somewhat different view of the antecedents of cooperation compared with that of, say, the network theorists (eg Young and Wilkinson, 1989). Based

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<sup>8</sup> According to Heide and Miner (1992:270) performance ambiguity is when it is difficult for a participant to evaluate the outcomes or products received from another party...When cooperation is based on observing the other party's actions and responding to them, performance ambiguity can make cooperation more difficult.

on observations of the Prisoners Dilemma game he argues that the foundation of cooperation is not really trust, but the durability of the relationship. When the conditions are right the players can cooperate with each other through trial and error, learning about possibilities for mutual rewards, through imitation of successful players or even through the blind process of selection of the most successful strategies and the weeding out of the less successful ones. He even goes so far as to say that the cooperating parties may not have their exchange conditioned by social exchange, eg friendship. He gives the reported observations of between British and German troops as an example.

Axelrod argues that whether or not the players trust each other is less important in the long run than whether the conditions are ripe for them to build a stable pattern of cooperation with each other (1984:182). Many network theorists counter, however, that without trust (built through social interaction as well as repeated exchanges of product or information), firms typically do not invest in or make adaptations to partners in long-term relationships, and without the bonds created by such asset commitment, the costs incurred in protection against opportunistic behaviour would remain (eg Johanson, 1989; Sandstrom, 1992; Turnbull and Valla, 1986; Webster, 1992; Forsgren and Johanson, 1992; Brito and Araujo, 1993).

### **3.12.3 Planning for future cooperation**

Axelrod treats cooperative behaviour as an organically derived trait, like red hair, that can be passed on to offspring and spread among a population, or it may become extinct. Such an analysis has the effect of diminishing the role of planning. In developing his theory Axelrod draws heavily on concepts from the field of evolutionary biology. He co-authors chapter 5 of his *Evolution of Cooperation* with a biologist with the explicit purpose of demonstrating that foresight is not a necessary precondition for the evolution of cooperation. Nevertheless, in "The Evolution of cooperation; Axelrod's chapters 6 and 7 provide detailed advice on how to improve future cooperation (1984).

#### **3.12.4 Limitations to the real-life application of PD games**

Axelrod's models of cooperation and conflict disregard the role of player's ideology and power factors in decision making, even though they acknowledge that some issues, eg nuclear proliferation, crisis bargaining, and military escalation are examples whose realistic understanding"... would have to take into account many factors not incorporated into the simple prisoner's dilemma formulation, such as ideology, bureaucratic politics, commitments, coalitions, mediation and leadership" (1984:190). Besides assuming all power is equal, the Prisoner's Dilemma paradigm has generally not included any kind of bargaining or joint decision making capacity for its players. This significantly reduces its real-life applicability.

The typical PD subjects are not asked to apply a real-life imaginary context to their games. The question then arises: would player's behaviour differ, reflecting different norms and values if they were asked to imagine different real-life contexts in the experimental situation?

And finally, the PD games described by Axelrod (1984) do not have an exit option for the players. It would obviously increase the parallel with real life situations if one of the options open to players was for them to drop out and actively rebel against the system and its competitive "game".

A basic assumption of the standard prisoner's dilemma game is thus its isolation from other surrounding games and the context within which the interactions are embedded are not taken into consideration. Important variables which may influence decisions to cooperate are therefore excluded. Other frameworks, for example business network models, reflect the more realistic situation where exchange relationships are subject to multiple and complex interdependent variables, and the players are connected in various ways.

Noting the different theoretical stances of those studying interorganisational cooperation including the interactive theorists, Heide and Miner (1992) tested an alternative view, namely, that cooperation may arise as a consequence of the interaction patterns themselves, or exogenous requirements. (Iterated game theory on the other hand allows that anticipated

future interaction may be sufficient to promote cooperation.) Heide and Miner employed an iterated games framework in the formulation and testing of their hypotheses as the PD does not assume commitment is required for cooperation.

The *four domains of cooperation* subsequently hypothesised as arising between industrial buyers and suppliers (Heide and Miner 1992:266) were:

- a flexible response,
- information exchange,
- shared problem-solving, and
- restraint in the use of power.

They then predicted (Heide and Miner, 1992:266) that *cooperation would be enhanced or curtailed according to:*

- the degree of open endedness/extendedness of a relationship,
- the frequency of contact as embodied in product deliveries, and
- performance ambiguity.

#### *Extendedness*

Heide and Miner defined the *extendedness* of a relationship as the degree to which parties anticipate that it will continue into the future with an indeterminate end point. Heide and Miner's hypothesis is that extendedness in a relationship will have a positive effect on the level of cooperation between the interacting firms in a PD context (1992:269).

#### *Frequency of contact*

According to Axelrod (1984), with extendedness controlled, the frequency of interactions should have a positive effect on cooperation. Frequency of contact will also increase where there is increased specialisation in the product exchange. The greater the number of likely future interactions, the less important the payoff in a current period relative to the number of potential opportunities for reward or retaliation (Heide and Miner 1992:269). In other



words, the players cooperate in the present because they know they can retaliate for a defection by defecting later themselves.

Heide and Miner (1992) note that conflict resolution processes have often been deliberately designed to break conceptual issues into smaller segments to increase the concrete opportunities for interaction to help resolve them.

They reason that if cooperation only arises from fixed interdependencies or commitment, we could not expect frequency of contact to affect it. Frequency of contact would be irrelevant. To the degree that anticipated interaction is an engine of cooperation, however, frequency of interaction would predict cooperation. Thus they hypothesised that frequency of contact will have a positive effect on the level of cooperation between the two organisations interacting in a PD context.

Analysing the impact of interaction episodes between firms will be an issue of significance in this study.

#### *Performance ambiguity*

When cooperation is based on observing the other player's actions and responding to them, performance ambiguity can make cooperation difficult. Axelrod (1984), Bendor (1987), Axelrod and Dion (1988), all show that if there is uncertainty about what move the other player made it is generally difficult (although not impossible) to sustain cooperation. (They share this focus on the impacts of performance ambiguity with the Agency Theorists.) Heide and Miner hypothesise that ambiguity in performance will have a negative effect on the level of cooperation between two organizations interacting in a PD context (1992:270).

Three control variables were identified which the researchers felt could also have an impact on cooperation between two parties:

(i) *Customisation of products*

As already noted, Emerson, 1962; Pfeffer and Salancik, (1978); and Williamson, (1975) share a perspective which assumes that partners are more likely to cooperate if they are interdependent. Technological factors are one of the important potential sources of such interdependence. So if product customisation increases the chances of relationship-specific assets, and the asset specificity is linked to increased collaboration then customisation should increase the chance of cooperation. It should be remembered however that other writers (eg Hakansson et al) emphasise that customisation can also have the negative effect. In an asymmetrical relationship the dependency may not be reciprocal. Exploitation rather than cooperation may result.

(ii) *The time needed to replace a trading partner*

Heide and Miner (1992) used the term "boundedness" to refer to the degree of difficulty one organisation would have in replacing another.

(iii) *The length of the prior relationship*

Heide and Miner (1992) considered it likely that prior history effected cooperation.

Testing their hypotheses in a study of industrial suppliers and original equipment manufacturers, Heide and Miner found quite mixed results. A statistically significant relationship between length of relationship and cooperation emerged, even after product customisation and time to replace partners was controlled for. (The researchers acknowledged that there were alternative explanations for this finding for example, some firms could develop a commitment to each other that could produce both cooperation and expectations of future interaction.)

The "frequency of delivery-cooperation" hypothesis was less strongly, but nonetheless supported. Commitment theories would predict that in personal relationships commitment may lead to increased contact, however it is less expected that firms will deliver produce more frequently as a result of psychological commitment. Thus, the hypothesis that increased transaction frequency leads to greater commitment would seem to have few rival explanations.

While they predicted that increased performance ambiguity should reduce cooperation, their findings showed little support for this. A flaw in their methodology may have led to this outcome ie they only asked firms how hard it was to detect/measure the performance standards of their partners, not whether or not they did undertake the inquiry and were satisfied with the results.

Among the control variables, Heide and Miner's results found customisation had weak effects and duration of past relationships had no effects on their four dimensions of cooperation (1992).

The *conclusion* drawn from this research is that if cooperation only results from fixed organisational traits or the development of long-term commitment, then to increase cooperation, partners must change fixed traits or invest the time and resources to develop commitment. In contrast if cooperation can be increased by enlarging the anticipated future interaction or frequency of contact the chances of cooperation could be increased.

The case studies in this research will analyse the development, over time, of relationships between agribusiness suppliers and buyers where strategies include the customising of offerings, transferring of technology, the maintenance of off-shore offices to facilitate information gathering and communication, and regular episodes of social exchange. Observations along with direct questions about management's preferred supplier/buyer characteristics should help to shed more light on the concepts of cooperation researched by Heide and Miner.

### **3.13 Realistic Conflict Theory (RCT) and Theories of Competition**

Unlike Freud's (1921) psychological concept of group action, which saw it largely from the perspective of an individual's personal characteristics, Realistic Conflict Theory (RCT) is essentially an economic theory which sees conflict between groups arising from competition for scarce resources.

Deutsch (1973) one of the fathers of RCT was motivated by a desire to develop strategies for achieving cooperation and peace between the East and West Superpowers of the day. This was understandably a research priority in the Vietnam and cold-war era. Thus in RCT there is an emphasis on conflict resolution between large groups of equal strength and power. Conflict is assumed to always arise when subjects try to gain rewards at the expense of others, ie conflicts of interest cause conflict. The competing nature of interests is assumed to be the most important factor determining such social phenomena as the attitudes of the parties involved (Sherif, 1966). However, Deutsch (1973), believed that misperception or biased perception between the parties can also lead to conflict escalation.

Taylor and Moghaddam (1987) contend that so called "gaming research" shares the theoretical and normative underpinnings of RCT, since both adopt the assumption that conflict is bad, and in a typical gaming experiment it is assumed that subjects try to maximise their own profits. There is no room for sentiment. Thus most gaming research follows the tradition of peace researchers who see the psychologists task as helping to avoid war (eg Deutsch, 1973) in contrast to the "war gamers" who adopted the goal of making warfare more efficient (eg Billig, 1976).

As with Freud's (1921) work there has been a tendency in RCT to suggest that conflict at the interpersonal level has the same characteristics as conflict at the intergroup and international levels. The first edition of the Journal of Conflict Resolution published in 1957 made this assumption quite clear: ie "Many of the patterns and processes which characterize conflict in one area also characterize it in others...Price wars and domestic quarrels have much the pattern of an arms race. Frustration breeds aggression both in the individual and in the state." (Journal of Conflict Resolution, 1957:1).

RCT has been criticised on the grounds that the tendency to categorize all conflict as bad and to be avoided lends support to the maintenance of the inter and intra national current balance of power, status or access to resources. Thus if minority groups try to avoid conflict then the status quo may never be challenged. However as already stated, RCT writers (eg Sherif, 1966) and some Gaming Theory researchers (eg Axelrod, 1984) see the optimal solution for subjects is for them to perceive that they are better off cooperating

than fighting. Realistic Conflict Theory proposes that intergroup cooperation emerges when there are superordinate goals: ie a situation where groups can achieve a mutually desired goal only by combining their resources.

Muzafer Sherif wrote his pioneering work: *Group Conflict and Cooperation* (1966) after developing much of the RCT theory from experiments with groups of school aged boys in Summer camps in the USA. These experiments took place between 1949 and 1953. Groups were given competitive tasks to achieve, but sometimes too they needed to cooperate to achieve a mutually desired outcome, eg the rescue of the camp food truck. Sherif found cooperation emerged in previously hostile groups after the identification of the common (superordinate) goal and joint activity to achieve it. A series of situations did gradually lead to more harmonious relations between the previously hostile groups. Others (eg Heide and Miner, 1992) have argued that it was the increased opportunities for face-to face interaction bringing about a change in sentiment between individuals which helped reduce the conflict.

Sherif also found that the presence of a negatively valued and threatening outgroup increased in-group solidarity. A threatening out-group also caused a tendency for subjects to refer to notions of justice and fairness. Sherif was working in the functionalist tradition of Durkheim and other social sciences so to him it followed that competition between groups for scarce resources led to perceptual and attitudinal biases towards the out-group.

In summary, RCT assumes that:

- people are selfish and will try to maximise their own rewards;
- conflict is the outcome of incompatible group interests; and
- the social- psychological aspects of intergroup behaviour are mainly determined by the compatibility or incompatibility of group interests.

### **3.14 Equity Theory, concepts of Justice and shared value systems.**

Justice can be viewed as a socially-defined standard for the evaluation of resource distribution in human relationships. Research in social justice tends to be dominated by equity theory which deals with two main questions: 1. What do people think is fair and equitable and 2. How do they respond when they are getting far more or far less from their relationships than they think they deserve? Blau (1964), Adams (1966), and Deutsch (1973) built on formulations dating back to Aristotle to make potentially valuable insights into social behaviour generally and intergroup relations in particular.

Equity theory proposes that as a result of discomfort generated by the perception of inequity by one or both of the parties, steps are taken to restore equity. This may be done, according to the theory, in two ways, through:

- (i) the actual restoration of equity, whereby the inputs or outcomes of one or both parties in the relationship are adjusted, or
- (ii) there is a psychological restoration of equity. This is where the reality of the inputs and outputs is cognitively distorted so that the ratios are then seen to be equal. (In reality a third option is available, where the disadvantaged party opts out of the relationships, terminating it.)

Equity theories provide a further insight into the assumptions of individual self interest supported by Olson's (1965) logic of collective action. Equity theorist Billig (1976) argues that people need an agreed-upon set of norms for exchange precisely so they can maximise their own rewards. Thus if individuals or groups are unfamiliar with the contingencies in their universe they cannot direct their behaviour to ensure they are not being exploited. This could be the case of a firm operating in a new market or joint business relationship.

On the other hand, a disadvantaged party may fully understand but may challenge or reject the social norms prevailing and seek fundamental social change in what they perceive to be a non-equitable relationship. Either way, detailed understanding of the context within which the relationship is embedded, and an accurate knowledge of the inputs and outputs

of the relationship partner is essential to avoid feelings of inequity, which would, predictably, destroy a business relationship.

### **3.15 The Influence of the environmental contexts on relationship between the actor and "the environment"**

According to Hakansson and Snehota (1989) the two most significant trends in business research since the 1970s have been:

- (i). a determination to understand the strategy of business and its management, and
- (ii). a shift in organisational theory away from the internal processes of organisations towards the analysis of the organisation as it relates to its environment.

The coalignment between strategy and "environment/internal and external forces",<sup>9</sup> or context/channel "domain", has only recently been given detailed empirical attention (eg Cavusgil and Zou, 1994). This is despite the fact that research in sociology (Aldrich, 1979), in marketing (Belk, 1974), in organisational behaviour and microeconomics (Porter 1980) long ago presented the view that the "context" of the transaction is likely to have a significant impact on the existence and functioning of exchange relationships.

Early organisational theory researchers aiming to understand the environment-strategy-performance fit have tended to fall into three camps:

- (i) the environmental determinists,
- (ii) the strategic choice advocates, and
- (iii) those who argue that firms not only adapt to their environments they also shape and influence them.

Writers have used a range of concepts to define "the environment", or "the context" of the firm: The supporters of *environmental determinism* argue that the environmental forces are

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<sup>9</sup> Definitions: *Internal forces*: organisation and product characteristics; *external forces*: industry and export market characteristics (Cavusgil and Zou 1994).

essentially unmanageable so firms must use adaptive strategies to survive (eg Varadarajan and Clark, 1992; Hofer and Schendel, 1978 and Pfeffer and Salancik, 1978).

An inventory of environmental variables used by environmental determinists typically includes the state of supply, state of technology, barriers to market entry, market growth rates and political dimensions, including the regulatory environment.

*Strategic choice advocates* tend to use a proactive approach for studying the potential strategy-structure-environment fit. They argue that a business can enact an environment to fit a desired strategy (see Weick, 1979). For example, the organisation may choose the markets in which it will compete. It may take actions to alter the structure of the environment, by erecting entry barriers for latecomers in the market (Yip, 1982), or it may lobby for more favourable government/industry regulation which will favour its activity (Schroder and Mavondo, 1993:123). Thus the organisation is seen as possessing a capacity to change its environment.

Cavusgil and Zou (1994) typify the third approach by seeing the environment both influencing the firm's strategy, and in turn, being influenced by it. They argue that export performance is determined by the coalignment between export marketing strategy and the internal and external environments of the firm. In their words: "Exporting can be conceptualised as a strategic response by management to the interplay of internal and external forces" (Cavusgil and Zou, 1994:3).

### **3.15.1 The political economy framework**

The political economy paradigm also falls into the third category of environmental conceptualisations. The antecedents to the framework which found its clearest expression in the work of Stern and Reve (1980) and Arndt (1983) can be found as far back as in the work of Alderson (1957), Palamountain (1955) and Thorelli (1964). This is a dyadic approach to channel behaviour that attempts to identify the interplay between economic and sociopolitical factors external to the channel (ie the environment) and internal channel structure and function. The economic and political nature of the market system is



accentuated using this framework (See Zald, 1970; Stern and Reve, 1980; Achrol, Reve and Stern, 1983; Arndt, 1983; Dwyer and Oh, 1987; Kaynak, 1991)..

Causal links between the polity and economy are postulated. Arndt (1983) for example proposed that the internal polity is affected by its relations to the external polity and to some extent to the relations of the external economy. In turn the internal policy transmits rules and allocates resources to the internal economy.

In developing the paradigm, Stern and Reve (1980) argued that the external economic and socio-political forces interact and define environmental conditions for the distribution channel. For example the external political economy influences the internal political economy through adaptation and interaction processes. Thus they conceptualise channels not only adapt to their environments but also shape and influence them.

Understanding the factors that give rise to differences in channel structure in different countries, at different times, in "lean" or "rich" supply environments, and the forces that may induce or hinder channel evolution is considered among the fundamental tasks of such channel research. Any external economic or political factors which influence channel length or governance structures are strategically important for the firm.

Hutt, Mokwa and Shapiro (1986), picked up on the earlier work of writers like Thorelli (1964) who stressed the importance of studying the political ecology of marketing. Combining considerations of a political dimension with the then emerging network conceptualisations, Hutt et al (1986) extended the original four celled political economy framework to add what they called the "Parallel Political Network". This they saw as operating in the same organised market domain as the distribution channel. Together with the distribution channel internal economy and polity their parallel political network made up "the Parallel Marketplace" (1986:40). This political marketplace included for example the regulatory bodies, consumer groups, lobby groups of all kinds, trade unions and relevant government infrastructure.

Hutt et al argue that the development of proactive marketing strategies rests critically on the understanding of the nature of exchange dynamics within this parallel political marketplace (1986:42). Consideration of the parallel political marketplace has implications for defining the relationship between marketing and other boundary spanning functions of the firm, such as public relations. Hutt et al (1986) argue that boundary spanning sub-units mostly derive their power from their ability to obtain information directly from the environment.

Political market transactions centre on exchanges involving information, social legitimacy, and authority rather than the exchange of goods or monetary resources. Power and authority are fundamental to participation in the parallel political marketplace. Hutt et al, no doubt reflecting the realities of the growing influence of consumer advocates in markets in the mid 80s, argue that it is critical for firms to understand the bases of power utilized by actors within the political marketplace under different sets of conditions.

They also stress the need to understand the incremental nature of the public policy decision making process, which can be masked by an exclusive focus on the immediate area of conflict. This could hinder a full appreciation of the range of societal effects of emerging public policy. The broader range of exchange relationships among external stakeholders also needs to be understood. These relationships may lead to powerful coalitions able to affect public policy.

Food self sufficiency policies in highly regulated markets like Japan and ROK can be better understood using the concepts of the parallel political marketplace. Political market transactions have a major impact on food importation policies.

While many have called for a more holistic approach to thoroughly understand the significance of the interplay between "inner and outer context", the economy and polity, the content and the process of business relationships (eg Pettigrew, 1987; Mattsson, 1987;

Dabholkar, Johnston and Cathey, 1994), <sup>10</sup> few have successfully operationalised the conceptual complexities or overcome the methodological problems associated with delineating and measuring the multitude of variables in the all-inclusive Political Economy paradigms. This case-based research faces the same dilemma: how to evaluate the effects and interplay between the so called internal polity and economy, the external economy and polity, and the parallel political network.

Kaynak and Rice (1991) in Pettigrew (1987), believe they successfully applied the political economy framework to analyse fish distribution channels in Nova Scotia. They acknowledge however, that their study did not include collection of data for formal measurement of power, dependence, cooperation or conflict in the distribution channels, ie the "internal polity" was not dimensionalised (1991:234). Thus they could not comprehensively address the causal formulations postulated within the political - economy framework (eg as in Arndt, 1983).

### 3.15.2 Environmental munificence and its impact on supplier-buyer relationships

Pfeffer and Salancik (1978) were amongst the first to designate *munificence* (ie the availability and abundance of critical resources) as one of the key elemental characteristics of a marketing channel environment. They propose that munificence affects conflict within a social system and that in general organisations can be influenced by those who control the resources they need.

Dwyer and Oh (1987) surveyed what they judged to be the "scant" literature on channel environments before agreeing that interorganisational systems are sensitive to *dependence* positions in the environment. They argued that "Environmental munificence affects the nature of the interdependencies in an exchange relationship and hence the manner in which the relationship is administered, eg the extent of its bureaucratisation" (1987:348).

### *Munificent Markets*

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<sup>10</sup> **Inner context:** the structure, corporate culture, and political context within the firm through which ideas for change have to proceed. **Outer context** refers to the economic, business, political and societal formations in which firms must operate (Pettigrew 1987: 5).

Dwyer and Oh (1987) wrote that munificence increases the criticality of resellers to suppliers, allowing resellers to garner a measure of power in the channel (1987:349). The implication is that munificence may constrain relationship management processes for suppliers and give resellers opportunities for more favourable exchange structures (which they referred to as reduced bureaucratisation). Rich markets thus lead to a downstream shift in the distribution of power.

The results of Dwyer and Oh's research (1987) showed that the most "dramatic consequences" of environmental munificence are its effects on the supplier's tendency to centralise and formalise relations with dealers.

Suppliers are much more mechanistic with their exchange partners in lean than in munificent environments. This, they argued, is to do with the distribution of power in the channel relation ie suppliers manage their dependence positions in relation to dealers in rich environments by judicious use of authority and reference to coded procedures to attain organisational goals. Because of their criticality to suppliers in rich markets dealers have a measure of power to extract procedural and fiat exemptions. Suppliers in turn relinquish a measure of bureaucratic control to secure the continued support of dealers who hold key positions for access to high spending and growing markets.

#### *Lean Markets*

In contrast, Dwyer and Oh (1987) found that in lean environments, manufacturers cannot afford to involve dealers in customised program development and decision making. Instead they rely on rules and command to administer the exchange relationship efficiently. Dealers must generally accede to supplier-imposed administrative structures because they only have access to lean markets (1987:356). Supplier's power over lean market dealers arises from the dealer's dependence on supplier expertise and information.

For the purposes of their research Dwyer and Oh (1987) delineated the construct: "Bureaucratic Structuring" according to *formalisation* (rules and procedures), *participation* (consultation in decision making) and *centralisation* (of manufacturer authority). The

Relationship Quality construct incorporated "satisfaction" (with the relationship with the manufacturer), minimal opportunism, and trust.

They found the "centralisation" and "non-participation" factors jeopardised relationship quality. This was consistent with the findings of John (1984), Stern and Reve (1980). However their findings in relation to "*formalisation*" were less clear. In reviewing this outcome, Dwyer and Oh (1987:356) found that other research had yielded similarly mixed results: eg John's 1984 correlation was supportive, while Reve's 1980 research was nonsupportive. Dwyer and Oh discussed alternative explanations for this finding, included the possibility that dealers, "lacking the munificence leverage for shared authority (and the trust, satisfaction, and minimal opportunism it nurtures) may still find benefits (relational quality) in the order and certainty of formalised rules" (1987:356).

Brown, Lusch and Koenig (1984) also argue that *variability* in the *output sector* has dependence consequences that prompt suppliers to use less complex and more integrated systems, as they try to consolidate their influence downstream (eg with dealers). They see that greater uncertainty for channel members is most successfully dealt with through decentralised and informal decision making structures, rather than bureaucracy. Like Etgar they found that channel leaders emerge in channels facing threatening environments (Etgar, 1977:75).

The concepts developed to help explain the relationship between market munificence and channel or network governance has considerable significance for this research. It considers the evolution of governance, ie the structure and function of supplier-buyer relationships in case studied markets with characteristics which fluctuate between "lean" to "rich" but are predominantly munificent over time. One response of the case studied suppliers initially entering these markets is to organise into monopolistic statutory marketing collectives. Analysing the impact of these structures and their strategies as they attempt to ameliorate their dependencies and adjust to the dynamic markets is the focus of this research.

### **3.15.3 The markets and the political economy framework**

Matheson (1987) (like Cavusgil and Zou, 1994) integrated the environmental determinist and strategic choice approaches when he argued that a firm is both impacted by environmental forces (which he defined in a rather circumscribed way as another firm's strategic activity) or it can itself enact the environment. Thus he saw management being both responsive and proactive in relation to the "environment" (1987:235).

In what has become the classic interaction model of "markets as networks" Johanson (1989) embedded inter-firm relationships within an "interaction environment" which he defined as the market structure, dynamism, stage of internationalisation, and the social system surrounding the relationship (see earlier section of this review).

Regardless of the models used to describe the environmental impact of firms, and on firms researchers findings suggest that the characteristics of the environment influence decision making through managerial perceptions. According to Snow and Miles however "those factors that go unnoticed or are deliberately ignored are not part of the organisation's enacted environment and thus do not affect managerial decision making and action" (1983:239).

In the introductory sections of this thesis the environmental contexts peculiar to agribusiness markets are described. In particular the socio-political policy-regulatory environment of international food markets is all - pervasive. It is clear that the focal firm's industry, domestic, international and export market environmental contexts are likely to be considered by their management to be significant variables to be countervailed or ameliorated by the firm's adaptive or proactive strategies. Even if the focal actor is not contentious of some factors influencing demand for product in the target market (eg growing consumer advocacy denigrating imported food) the performances of the act and its competitors will be affected.

Writing specifically about agricultural marketing channels, Sporleder (1993) considered the forces influencing managerial choice among alternative arrangements for enhancing vertical coordination. Endemic to the economic concept of vertical coordination is risk.

Transactions involving agricultural commodities exhibit high levels of risk due to the unpredictable variability of the weather and / or the biological nature of production. Such causes for transaction-based risk are not often encountered to the same degree in the manufacturing sectors of the economy.

As well, Sporleder found that choice in commodity marketing, food processing and distribution channels may be influenced by factors such as, the inherent risks of alternatives, trade customs within a particular marketing channel, the degree of perishability, the particular end-use market being served and/or the influence over the production process for inputs to minimise internal costs of production. (Sporleder 1993:1.) In particular Sporleder argued that agricultural commodity marketing channel's risk effected price, quantity, quality, and timing of delivery, storage and inventory control.

This research identifies the timing and triggers for the changes in some agribusiness channels. Typically the most significant changes were not due to seasonal or biological factors. For example, the UK joining the EU created new opportunities in the demand and supply of dairy product in the Southern Hemisphere.

### **3.16 The Role of Time in Interfirm Relationships**

The delineation or conceptualisation of time in studies of industrial markets has implications for how theories and models are constructed, what kinds of concepts are chosen to describe reality, as well as how the research is conducted methodologically.

Writers developing relationship marketing and industrial network approaches (eg Wilson, 1978; Hakansson, Hakan and Snehota, 1993; Thorelli, 1986) conceive of business market relationships as interaction *processes*.

In defining a relationship Hakansson, Hakan and Snehota write: "Every relationship ... has a history and a future that are unique ... The forces shaping the behaviour of companies in market exchange cannot be fully appreciated without introducing explicitly the time dimension" (1993:2). Thus actors cannot escape the past. Their aims and expectations will

be based on their past experiences, and their reputation, built up through their past performance, will either enhance or hinder the development of their future relationships.

Researchers using a relationship marketing or network approach argue that firms need time as well as resources to establish and develop relationships. They need time to learn about and experience other actors' needs, capabilities, organisation and strategies. Interfirm communication channels need to be developed to facilitate the flow of information.

It takes time for the supplier to demonstrate the strength of its commitment to a customer and to win trust. It may take time to match a supplier's capability and the customer's needs. Adaptations of products, processes and procedures may be required. Over time the actors will invest resources in the relationships and a network of interfirm investments and dependencies will develop.

The business network is conceptualised as dynamic and developing all the time. New relationships are established, and old ones change or are sometimes disrupted. These relationships may restrain the potentialities of the individual firm in forging new relationships, perhaps with those who compete with their partners, or they can create new exchange possibilities for the actors.

### **3.16.1 Reputation, Cooperation and time**

Kay (1993:14) integrated the past and future in what he referred to as the firm's "reputation", a time related concept he identified as one of the three distinctive capabilities of a firm, along with its "innovation" capacity and what he called its "architecture" (ie a system of relationships which effect its flexibility and speed of information transfer).

Axelrod's iterated game theory research (1984) found that the past was as important as the future in the establishment of cooperation. He claimed it was essential that players could observe and respond to each other's prior choices. Without this ability to use the past, reputations could not be built, defections could not be punished, and the incentive to cooperate would disappear. He also argues that "..without the shadow of the future,



cooperation becomes impossible to sustain. Thus the role of the time perspectives is critical in the maintenance of cooperation. When the interaction is likely to continue for a long time, and the players care enough about their future together, the conditions are ripe for the emergence and maintenance of cooperation" (1984:182).

Writing from the perspective of the social psychologist when analysing the outcomes of the prisoner's dilemma game, Hardin (1982) stressed the significance of the future: "More important than the past in many dynamic explanations (of behaviour) is the future because such explanations are based on the strategic implications of present choices... When such incentives motivate action, generalisation from static analyses of only the incentives in the present interaction (or single play of a Prisoner's Dilemma game) will often be fallacious" (1982:3).

In considering the performance of firms in networks of relationships Hakansson, Hakan and Snehota take the view that the past and future are equally significant. They write: "As the outcomes of exchange are a function of the interaction between the two parties, ie of their relationships, they are related to how they experienced the mutual interaction in the past and expect to experience it in the future" (1993:2).

As we have seen, researchers in the area of organisational theory and economics have arrayed governance structures on a continuum of relationalism ranging from the market to relational exchanges (eg Macneil, 1980). More recently in the marketing literature researchers like Dwyer, Schurr and Oh (1987); Kaufman and Stern (1988) and Noordewier, John and Nevin, (1990) have attempted to extend our understanding of the characteristics of relationalism. One characteristic proposed by Noordewier, John and Nevin is "expectations of continuity of a relationship", which captures the probability of a future interaction between a retailer and vendor. Axelrod would agree, given the importance he places in "the shadow of the future".

### **3.16.2 The duration of employment, commitment and cooperation**

According to Axelrod the time perspective has important implications for the design of institutions. For example, in large bureaucratic organisations managers are often expected to transfer to another position every few years. This increases pressure to perform in the short run, regardless of long term implications. A result of such rapid staff turnover could be a lessening of cooperation within the organisation (1984:182). (In this case-based research, a feature of all actor's personnel was long-term employment commitment to be organisation. Buyers talked about the benefits they perceived flowing from what had been a stable workforce.

### **3.16.3 The timing of response to provocation**

One of the important concepts to emerge from the Prisoner's Dilemma/Game Theory tournament was the importance of the speed and intensity of provocation. The results show that it was better to respond quickly to a provocation. Waiting for one turn could send the wrong signal to the defector (Axelrod, 1984:185).

Obviously the speed of response depends on the time required to detect a given choice by the other player. Presumably the shorter this time, the more stable the cooperation can be. A rapid detection means that the next move in the interaction comes quickly, thereby increasing the shadow of the future (Axelrod, 1984:185).

The need to have one's policies and retributive actions swiftly and accurately communicated led to Axelrod's conclusion that a firm should not be "too smart", ie it would be counterproductive to make it too difficult for others to detect or understand a firm's past punitive actions and their likely response to opportunism or defection in the future (Axelrod, 1984).

This need to be "transparent" and to know exactly what is going on in a trading relationship poses some difficulties for firms operating in new relationships, across borders and in a multi-cultural environment, where the possibility of mis-reading signals is potentially high. The firm's two way information systems must be fast and accurate if opportunism is to be

kept in check. As earlier reported in the literature however, trust develops over a long period, and person to person communication with a strong social bond can assist in the provision of timely and complete information disclosure, or the diminution of opportunistic behaviour.

While a dynamic view of business interaction is considered very important to understand the emergence and maintenance of cooperative relationships, few have conceptualised relational time and time perspectives. An exception has been the work of Aino Miettala and Jan-Ake Tornroos (1991) who explored the significance of time consciousness in industrial marketing studies, and then described some longitudinal approaches. They acknowledged time as a complex and varied concept before offering the following delineations:

1. *Time as a concrete and metric concept*, eg minutes, days, years.
2. *Time as a subjective concept*; ie time is experienced by humans through their own existential realities, it cannot be treated as anything absolute or exact. It has a different meaning for everybody, ie it may seem "short" to a young person, or "long" to a prisoner.
3. *Time as a cultural concept*. The cultural time concept is bounded by the time-consciousness inherent in every culture. For example, tribal Australian Aborigines talk about their existence in the "Dream Time" as simultaneously in the past and present (Meggitt, 1962). Urban Aborigines tend to believe their life time ends at death. Sharp (1974) talks about circular and linear time concepts in different cultures.
4. *The concept of business time*. This also has a strong cultural dimension. Business time conceptualisation influences a firm's strategic behaviour in many ways. For example, it has been said that Japanese businesses have longer planning horizons than Australian counterparts (Yetton, Davis and Swan, 1992). What is an "unacceptably late" delivery of product or service in one culture may be acceptable in another.

5. *The relational notion of time.* Time is not a single dimension perspective. It needs to be considered in relation to other times, (ie the past and future), and in relation to a specific cultural and situational context. For example, marketing plans may be aligned with concepts of time compartmentalisation eg "peak season", "slow season". Tourism operations typically adjust prices and offerings in such a way. Thus time can have different levels of meaning simultaneously, and the pace of change may differ (1991:4-5).

The time dimension in the business life-cycle models is uni-dimensional separating out different phases of the "life cycle." Time does not have a central position in Williamson's 1975 seminal work on transaction cost economics, or in Eisenhardt's 1989 agency theory perspective. It is only implicitly embedded in these theories.

In 1979 Arndt's categorisation of markets from classical competitive to more regulated or domesticated paid some attention to the different time perspectives of exchange, however this focus was still largely implicit.

Some researchers have used phase models to show a dimension along which successive steps can be identified. This time notion is linear and physical. Ford (1980) studied the impact of experience, uncertainty, distance, commitment and adaptations over time before dividing relationship development into pre-relationship, early, developing, long term and final stages. Such linear phase models have been criticised however. Smith demonstrated that relationships show great diversity in their relationship developments within and across commodity groups. Easton and Araujo (1989) showed that the time - length of a relationship cannot be used as a measure of development stages or to categorise interaction.

Having reviewed the extant literature on the evolution of channels Sharma and Dominguez (1992:5) wrote that while a number of studies found unidirectional and deterministic models of channel evolution shortening as economies developed, others found that a unidirectional evolution was reversed or did not hold at all. They concluded that channel length could only be understood when it was recognised that channels of distribution are

highly complex organisational forms that are expressive not only of the degree of economic development in the nation, but also of other social, political and historic factors.

Thus phase models based on *a priori* definitions of stages or absolute time cannot improve our understanding of the dynamic nature of buyer-seller relationships. What is needed according to Ford (1980) is a model of relationships which shows evolution without a deterministic view of development.

The interactive marketing and network approaches take a dynamic perspective. These argue that markets evolve over time. Relationships have their present situations and future goals and later also their own histories and reputations. All episodes may contribute to the future of the relationship and each episode also takes place in a context created by the present and past circumstances. In other words, firms establish relationships and bonds develop between them over time. Adaptations and understanding may create closeness, mutual trust and an improved competitive position. Alternatively, dependencies may develop leading to entrapment. How much time is consumed in these processes depends on the contexts of the relationships, the problems encountered and the type of adaptations required (Hakansson, 1982; Turnbull and Valla, 1986; Ford, 1990; Wilson and Mummalaneni, 1986).

The interaction and network approaches see individuals as well as organisations as key to the processes under study. Therefore the perceptions, beliefs, attitudes and behaviour of the actor's key personnel is considered. This is especially important in cross-cultural interaction where the actor's time consciousness between actors may vary.

Clearly, when undertaking studies of the process and dynamics of long-term business relationships, time should be treated as a relational and multi-dimensional phenomenon. For example:

- (i). relationships should be considered in terms of their past, present and future characteristics and activity (Hakansson and Snehota, 1993; Kay, 1993; Axelrod, 1984; Heide and Miner, 1992), and
- (ii). the evolution of relationships should be viewed in their cultural (or cross-cultural) context

#### **3.16.4 Managerial implications**

The research findings on expectations of continuity in a relationship eg, (Noordewier, John and Nevin, 1990) suggest that it is important to know if the buyer has a short or long term orientation. Short-term customers are likely to switch from one supplier to another, so short term inducements like price may be the best strategy. Alternatively technological investments and technological transfers could be appropriate for long-term orientated customers.

The vendor strategy could help to change the retailer's time horizon from short to long term. For example, it is suggested that a major determinant of time orientation is the extent to which customers trust the vendor and the extent to which the customer is locked in with the vendor eg through transition specific investments. These often induce substantial reciprocity investment actions and thus create exit barriers. Clearly developing a long term orientation requires commitment in the form of increased specific investments in the relationship. For example, sale of wheat to RoK could only take place when mills had re-set their machinery and dedicated separate storage facilities to the new types of grain.

In particular, this research considers how parties interested in a long term orientation can signal their commitment without becoming dependent, or losing their strategic flexibility.

Such issues need to be addressed through longitudinal studies that highlight the evolving dynamics in a relationship. While the process orientation is one of the crucial cornerstones of the interaction approach, in a majority of interaction studies it is still only included as an implicit dimension. One of the problems in this theoretical development has been the reliance on cross-sectional, rather than longitudinal research methods. Few studies have used dynamic conceptual tools like cycles, duration, and simultaneity, shocks watersheds or breakpoints.

### 3.17 Theories of Groups and Collective Action

Early collective action theory concentrated on the personality and behaviour of the individuals joining groups, and their leadership. Only much later did it start to consider the characteristics of collectives of organisations.

Sherif in his volume *Group Conflict and Cooperation* (1966) defined a group as "....a social unit that consists of a number of individuals:

- (i). who, at a given time, have role and status relations with one another, stabilised to some degree, and
- (ii). who possess a set of values or norms regulating the attitudes and behaviour of individual members, at least in matters of consequence to them" (1966:12).

Sherif defined intergroup behaviour as "... relations between two or more groups and their respective members. Whenever individuals belonging to one group interact, collectively or individually with another group or its members in terms of their group identification we have an instance of intergroup behaviour" (1966:12).

### 3.18 The Freudian Legacy of Intergroup Research

Sherif's definition of groups and intergroup behaviour fits Freud's analysis of groups and collective action (Freud, 1921). Freud's was typical of the social scientist response to the community and political upheavals in Western societies in the late 19th and early 20th Century. He was amongst the many who viewed any collective action in a negative light. Freud argued that in the group context the minds of "lower intelligence" bring those of "higher intelligence" down to their level. He also believed that collective action led to a lower sense of responsibility for individual members.

Taylor and Moghaddam, (1987:52) found that under certain conditions people tend to be more competitive in the intergroup than when in the inter-individual context. This finding is in agreement with a number of experiments by Sherif (1966) using Prisoner's Dilemma

Games. He compared responses of subjects playing the games as part of a team and playing alone against a single other.

### 3.18.1 Free riding or the tragedy of the commons

The so called *logic of collective action* (Reisman 1990) which has been debated for centuries suggests that the most efficient or rational response of an individual may be to free ride at the expense of the group for as long as the group continues to have a collective response. For example –

*If all individuals refrained from doing A (eg dropping rubbish) every individual as a member of the community would derive a certain advantage. But if all individuals less one continue to refrain from doing A, the community loss is slight, whereas the individual doing A makes a personal gain far greater than the loss that he incurs as a member of the community* (Hardin, 1982:8).

What one can do, all cannot. Thus as every individual chooses whether or not to free ride, each choice has its own costs and benefits.

Paul A. Samuelson wrote of the public goods dilemma in the 1950s and his work informed political economist, Mancur Olson's *Logic of Collective Action*, published in 1965. Olson proceeded deductively from the two axioms of self-interest and calculative rationality to derive propositions that could be applied to market and non-market organisations. Olson's central conclusion is stated in terms of group size: ie large groups are more likely to fail and small groups are more likely to succeed. However it should be noted that when Olson speaks of group size, he defines it as depending not only on the number of individuals in the group but also on the value of a unit of the collective good to each individual in the group.

Olson acknowledges that large groups do persist, and are often effective. Thus he looks at the role of coercion (eg as in the case of a democratically imposed export market



monopoly, or compulsory taxation), and selective incentives (eg when social opportunities are created for participants in a protest rally, or increased status for the individual.)

Using Olson's logic of collective action Reisman (1990) considers the case of a large group of producers in a perfectly competitive market where the going price is a public good available to all. An example of such a situation would be where 500,000 Australian wheat growers annually competed to maximise their profits.

Should the demand curve for his supply be infinitely elastic, and taking the price as a constant, each producer will wish to increase his profits by expanding output. However the unintended effect of a collective increase in quantity supplied is a depression of price. It is not rational for a single perfect competitor to respond to this situation by restricting rather than increasing his own small proportion of the total output of the country. It would not make a perceptible impact on the price, and it would reduce his profits.

Thus unilateral action in the collective interest cannot meaningfully be expected from a group of perfect competitors who are self-interested and calculatingly rational as well as numerous. Nor, according to Olson (1965) and Reisman (1990) is there much likelihood of such producers spontaneously clubbing together in order to resolve the problem of their common welfare: "for the larger the group the smaller the fraction of the total group benefit any person acting in the group of interest receives, and the less adequate the reward for any group-oriented action". (Reisman 1990: 153)

Public goods are increasingly provided where groups are large. Olson accounts for this phenomenon in terms of two explanatory variables:

#### **(i) Coercion**

Recognising that the economically rational individual "has no incentive to sacrifice any more than he/she is forced to sacrifice," (sourced in Reisman 1990:157) each can be compelled by a democratically institutionalised authority to do their share for a large group like the nation. Thus national voting may be made compulsory, taxes must be paid etc. It follows that a smaller group like a trade union or marketing authority could also employ

coercion effectively when it was seen to have the same democratically institutionlised authority. Thus Olsen argues for the need for a more than minimal State role through his emphasis on collective coercion, democratically institutionlised, since without coercion we cannot presume that a group will be able to organize and act to perform any function. What all can have, one cannot, without leadership and compulsion. (Reisman 1990:160)

## **(ii) Selective Incentives**

According to Olson's (1965) "by-product" theory of collective action, the organisation may provide positive incentives for participation or membership by providing not only the collective good but also a range of private goods which are exclusive to the group membership. This private good could be access to market intelligence, special insurance rates etc. The individual has no reason to join however if the benefits can be enjoyed as a non-member free rider.

Such incentives may also be negative. Social incentives work especially through the mechanism of criticism and shunning by the other members of the group.

Reisman argues that Olson should have incorporated at least five other dimensions to help explain the dilemma of the individual choosing to participate in collective action: These are respectively: Convention, Morality, Sentiment, Sanctions and Formalisation (Reisman 1990:164).

Each of these is considered briefly in turn:

### **Conventions**

In a replicated, iterated, repeated interaction, where there is a future and a past, there is a tendency for patterns and customs to emerge. The benefits of these conventions is that they serve to create a basis for legitimate expectations and reasonable predictions. Thus the player can better coordinate expectations and actions. It is necessary that the precise convention is accepted by all members of the relevant group as the behaviour to be adopted in the sequential replays of a patterned game. The shared convention derives its legitimacy

from its efficacy – ie from the fact that once established it is in the interests of each and every member of the group to adhere to it. The appeal is to individual utility.

Conventions save scarce resources otherwise expended on the collection of information and the making of decisions. However conventions are typically conservative. In rapidly changing environments convention becomes blurred and is less likely to generate accurate predictions about the behaviour of others. In this research conventions observed in long standing market relationships were seen to be used to maintain or challenge the status quo.

(In this research conventions observed in long standing network relationships were used to maintain or challenge the status quo at the same time reducing the likelihood of retaliation)

### **Morality**

The moralist believes in the concept that what “is” prevailing in society is not necessarily what “ought to be”. Thus they would not be simply satisfied with conventions, but rather with what they construed to be the legitimate “moral” convention of that society. Whatever may be the source of their legitimization, the shared moral conventions by their very nature provide externally-imposed discipline which circumscribes and restricts an individual’s freedom of choice.

### **Sentiments**

Reisman (1990) and many others argue that it is a human characteristic that close interactions between individuals come to be characterised by strong personal elements (ie sentiments). Totally non-generic sentiments may develop ranging from friendship, gratitude, and obligation to jealousy, bitterness and anger.

The well known traditions of North Asian (especially Japanese and Korean business culture supports these observations. Large corporations are broken down to small closely interacting teams, and relaxed after hours drinking and joking away from the office is expected to be critical to the achieving of agreement on negotiations started formally in the office across a table. New business relations are expected to take time to mature given the need to develop close interpersonal relationships between the participants.

## **Sanctions**

Social and legal sanctions are sentiments which relate to shared conventions which they reinforce. They are specific to a particular reference group whether large or small. In a small group social sanctions, like ostracism may have a particularly forceful effect on the behaviour of the individual.

The introduction of legal sanctions to enforce shared conventions represents a loss of individual freedom, but as Reisman (1990:192) points out, in the logic of the tragedy of the commons this may not be in the interests of the individual or the collective.

While legal sanctions represent an infringement of individual freedom, the freedom of individuals caught up in the logic of the commons it brings on universal ruin (Hardin 1982). Once participants embrace the necessity of mutual coercion and accept it as legitimate, they become free to pursue other goals (Reisman, 1990:192). Hardin (1982) did not believe that self-policing strategies, peer group pressures or appeals to morality would convince free enterprisers not to “foul their own nest”. Being rational those independent free enterprisers will, according to Hardin, choose coordination via coercion and compulsion. The only kind of coercion he saw as effective was “mutual coercion, mutually agreed upon by the majority of the people affects” (Reisman, 1990: 192).

## **Formalisation:**

William Baumol wrote extensively of this collective action problem in his *Welfare Economics and the Theory of the State*. His work provides economic argument for the existence of the state and coercion through Acts of Parliament and the like and state intervention in particular circumstances.

One of classical statements relating to the need for formalised/legalised action to solve the problems of the commons type collective action is by J.S.Mill. He is quoted in Hardin (1982:52) saying:

*There are matters in which interference of law is required, not to overrule the judgement of individuals respecting their own interest, but to give effect to that judgement; they being unable to give effect to it except by concert, which concert again cannot be effectual unless it receives validity and sanction from the law.*

Thus the logic of collective action suggests voluntary cooperation cannot be guaranteed.

Mill continues with his discussion:

*there might be no means of their attaining (their) object but by converting their supposed mutual agreement into an engagement under penalty, by consenting to have it enforced by law (Hardin, 1982).*

Statutory Marketing Authorities typically represent the type of outcome described by Mills: coercion by consent and a pre-commitment to collective action, democratically imposed.

Thus the concepts of Convention, Morality, Sentiments, Sanctions and Formalisation need to be added to Olson's original conceptualisation of Coercion and Selective incentives to make his theory of rational choice more comprehensive.

### **3.19 International Transactions and Interfirm Relationships**

Despite the evident globalisation of many markets, for example in automobiles, beverages, aircraft; national differences continue to exist and have a profound effect on the way business is conducted in various nations (Cavusgil and Ghauri, 1990). The tension between the need to think of the world as a single market and the need to be responsive to differences between countries is today considered fundamental in international business. Those writing about international transactions (eg Robinson, 1990) also note that choices between internalising each link in a firm's value added chain and externalising such links are very different when comparing domestic with international operations.

### 3.20 The internationalisation Process of the Firm

International business literature has considered the firms' choice between different modes of international operation. It is generally assumed there is choice based on carefully collected information about the potential foreign markets and their macroeconomic environment, including such factors as geographical, socio-cultural, political, and economic conditions (see Root, 1987; Cavusgil and Ghauri, 1990). It is also assumed that the choice of entry mode is made simultaneously with marketing mix decisions about positioning promotion, price, and products. Different entry modes may include direct involvement or the use of sales or production representatives or subsidiaries, and a variety of contractual arrangements.

Lorange et al (1993) stress the need for firms to remain flexible in their international strategy arguing that in particular they must have a dynamic, evolutionary view of any cooperative venture development. Strategies and processes may be inadequate if they cannot be adjusted to meet changing circumstances. They claim that in order to succeed an organisation "must possess self-organising properties in order to cope with evolutionary pressures". Thus even if a firm is in a joint venture, it must "adapt and evolve on its own" and have sufficient adaptive properties to cope with emerging environmental turbulence.

Empirical studies by the IMP industrial network school of business research concluded that international management and research questions should consider exporting as an internationalisation *process* whereby firms do not consciously stage their moves but gradually commit themselves to an international market relationship and learn about foreign markets and operations. Their industrial system model shows the firm's activities as a cumulative processes by which *relationships* are established, maintained, developed or disrupted, with the aim of achieving long term economic returns, development and survival. New opportunities and problems in the foreign market are discovered as a consequence of operations, not forward projections (Forsgren and Johanson, 1992:11).

The firm's internationalisation thus results from an interplay between two separate but closely related processes: experiential knowledge development and commitment.

Commitment often precedes as well as reinforces investments (Johanson and Mattsson, 1984, 1991).

The network approach thus implies a move in international business research away from the firm as the unit of analysis to exchange between firms and between firms and other organisations as the main object of study. It implies however also a move away from transactions to more lasting exchange relationships constituting a structure within which international business takes place and evolves.

To gain an insight into the differential market power of the different actors in these relationships and how one relationship is connected to others are important issues for every firm with international business.

Network theory has an underlying perspective that managing in reality is not a unidirectional process controlled by and ultimately derived from the top level but rather a multi directional process covering every level and corner of the organisation (Johanson and Mattsson, 1991).

Young and Wilkinson (1991) and Gronroos (1993) challenge such all-encompassing assumptions and make the point that the IMP researchers were observing the "organic-like" growth of inter-firm relationships more typical of past decades. They agree that the slowly evolving relationships between international buyers and sellers which survived typically display stable and strong bonds. They draw attention to the fact however, that in today's dynamic international business environment, franchise or Joint Venture decisions are typically made quickly, and as a result of deliberate strategy. (They also have much higher attrition rates - see earlier discussion on strategic alliances).

### **3.21 Role of the Domestic Market**

Forsgren and Johanson (1992:11) argue that because of a lack of resources and knowledge about foreign environments the firm first develops its home market operations. Because of internal factors eg a need to expand operations in order to be more profitable, or a surplus

of resources that must be used, the firm eventually starts to export. Or the first export order may appear as a consequence of initiative from the market side.

In his "Competitive Advantage of Nations" Porter (1990) argued that the competitiveness of the domestic environment will also play a crucial role in preparing a firm for the rigors of international competition. Cavusgil (1994) observing the Australian small business environment has commented, however, that some firms are "born to export", and do not, therefore, fulfil the typical expectations of a large firm moving on to export markets having generated experience and surplus resources in a highly developed domestic market (Yetten, Davis and Swan, 1992). Australian Government financial support in the form of Export Market Development Grants, the financing of facilitators who help identify and foster inter industry linkages and State Government Strategic Partnering Services may substitute for some of the individual firm's own resources and experiential learning time.

This research also points out that middle management is often responsible for operations in the various markets. Different parts of the international firms, the relative control of those parts and the power bases on which they act are important for understanding the internationalisation of the firm.

### **3.22 Internationalisation and Cultural Distance**

The exchange between actors does not take place within an emotionally neutral setting. Sandstrom, writing about the influence of culture on international business relations (1992) argues that any cultural distance is relationship specific. She believes that the interaction between a buyer and seller leads to the development of an atmosphere in which the cultural distance is one component. The atmosphere is dependent on the character of the specific relationship rather than on general differences at a country level.

Sandstrom (after Williamson, 1975) argues that what she calls the atmosphere is the emotional setting in which the interaction takes place. It is influenced by culture but not determined by it. The atmosphere is the combination of the feelings of both parties. She believes atmosphere is the tool needed for the analysis of cultural influence on







This research aims to analyse how dependent agribusiness suppliers and their ASMA's strategise over time, as they aim to countervail dependency in dynamic contexts, and the impacts of their ASMA's on individual supplier strategic flexibility.

Boyle, Dwyer, Robicheaux and Simpson (1992), Heide and John (1990, 1992), Johnston and Benton (1988) and Bonoma and Johnston (1978), are amongst those who have addressed organisational relationship development and process issues. However, they have typically focussed discussion on dyadic buyer-seller interaction. This research will analyse the interrelationships between industry structure, firm relationship formation, strategy, content and activity.

This review has found few empirical studies that have considered the inter-temporal and contextual issues in exchange relationships in export agribusiness. No doubt this is because the methodological difficulties and costs encountered when data needs to be collected over time, and across a wide range of variables is considerable. Rae (1986) noted this difficulty some time ago. This research hopes to overcome the data collection and analysis difficulties in order to advance our understanding of the activities of actors in real-life contexts.

## Chapter 4

# RESEARCH METHODOLOGY

### 4.1 Achieving the Research Aims

The research purpose was to build theory through examining the strategic shifts of ASMAs and some of their suppliers in the contexts of the relationships within which their activities take place. A process model was then built out of an analysis of the activity patterns or trends which could be observed between the strategic activities and the factors in the micro and/or macro levels.

The aim was to generate a model, not to test *a priori* hypotheses. A deeper longitudinal and processual understanding of the dynamics of change in business to business exchange is sought. The longitudinal emphasis helped to uncover the sequences of strategic changes, the cause and effect of relationships between them and the environment, and the pace at which the overall change process evolved.

The contexts under study included where the markets were deregulating or deregulation was anticipated (eg the wheat market in Japan) and the buyer-seller relationships were highly asymmetrical.

Organisational change and business policy literature continues to pay little attention to the nexus between content, context and processes of change.

An investigation of historic and contemporary phenomena in real life contexts was therefore required, where the boundaries between the phenomena and context were blurred

and where there were multiple changes to every variable.

There were once commonly understood dichotomies between facts and values, the objective and subjective, the normative and positivist, and the physical and social sciences.

While positivism in economics has led to a more disciplined research, this has often been at the expense of problem solving and relevance to real life issues. There is also a recognition that despite its aim to become objective and impersonal, positivist economic inquiry is, like any other science time bound, culturally dependent, judgemental, and subjective (Halfpenny, 1982; Giddens, 1976; Lally, 1976; Harr'e, 1981).

With respect to "value-free" positive knowledge, all methods used in acquiring knowledge involve subjectivity of sense impressions. It is necessary that the researcher interprets the sense impressions, in order to identify reality, and achieve insights, and intuition. No scientist's report on studied objects (eg cultures) so much as they report on their interaction with the objects. It is therefore no less possible to be **objective** in the examination of organisations than it is to investigate the physical environment. This will hold for all research, whether it is based on qualitative or quantitative data, collected through experiment, survey, and historical analysis or case study techniques. The success of the research effort at achieving objectivity is measured in terms of its validity and reliability (Yin, 1989; Bonoma, 1985; Kaplan, 1964; Glasser and Strauss, 1967; Miles and Huberman, 1984; Parry and Coote, 1994).

## 4.2 Achieving Objectivity in Research

Two kinds of objectivity in research can be distinguished: the objectivity of propositions or concepts and the objectivity of investigators. According to Johnson (1986) a proposition or concept can be regarded as objective in a particular context if it has survived tests of coherence, correspondence and clarity sufficient for the purposes at hand. Following Rudner (1953), what is "sufficient for the purposes at hand" depends on the marginal cost of getting better evidence for the statement in question. This in turn depends on the importance or value of the consequences of accepting and acting on a false statement or of rejecting and not acting on a true one.

The extent to which the decision taken is acceptable to fellow scientists depends on the level of agreement with the choices of the researcher. This is influenced by the extent to which others are able to fully understand the parameters of the options and choices by the researcher. Thus full and accurate disclosure of the research method and data sources is essential. The research method must be sufficient to allow others to interrogate the data and replicate the work (to the extent that such replication is possible given its time and context dependence).

There was no opportunity in this research for an experimental approach for establishing, manipulating or controlling independent variables within the contexts. There is no pre-existing body of research or theory, which is directly applicable to the evolution of ASMAs in exporting networks and their impact on their industries or suppliers. The role of ASMAs in developing international markets is virtually unexplored (Schroder, Wallace and Mavondo, 1993; Industry Commission, 1991).

Strategic analysis requires a holistic, multi-dimensional analysis. The issues cannot be studied out of their natural context and are often too complex to meaningfully quantify. Surveys, with their focus on contemporary events, standardised questionnaires and encoded responses would not adequately capture the process aspects of evolving networks.

### **4.3 Justification for the Method Selection**

The method selected to achieve the research purpose was a combination of historical research combined with a qualitative in-depth multiple case study analysis. As Bonoma (1985); Eisenhardt (1989) and Alpert (1989) state, case research is well suited to provide a solution for researching some of the difficult, especially macro-level issues in marketing. While the results of multiple case study analysis will be suggestive rather than definitive, this is considered appropriate given the need to understand the interplay of the multiple factors influencing firm behaviour in real life contexts.

### **4.4 Historical Method**

Historic research method was used to explore the industry contexts in the eras pre-dating the formation of the first trade networks involving the focal actors. Gardiner (1952) in

discussing methods of historical research refers to the broad scope of historical inquiry and the fact that historians have to work with complicated masses of interrelated factors, the relative importance of which is difficult to determine. Nevett (1991:16) added that while "the evidence is complex and often conflicting, yet full understanding of what happened demands that all the sources be reconciled to permit an assessment of the influence of the various factors on the eventual outcome."

The process of historical investigation in this research followed the protocol advanced by Nevett (1991:14):

1. Assembling the evidence (from documents, photographs, artefacts),
2. Internal criticism (ie establishing the authenticity of the evidence collected),
3. External criticism (testing the credibility of the authenticated evidence by comparing it with other evidence available), and
4. Synthesis (organising the credible evidence into a logical and meaningful account).

#### **4.5 Documents as Data**

Analysis of primary and secondary source documents helped build information where there was no access to a first hand reporter of past activities. The documentary evidence also supplemented and helped to triangulate individual recall in the case studies. The richness of documentary evidence varied from virtually no supportive material being available in the case of WC to access to every memo, telex, facsimile and letter written from the AWB to ROK millers and millers to the AWB over a period of twenty years. Documentary sources are referenced in the body of the report in a way that is consistent with the references to the academic literature.

Formal Content Analysis (CA) was not used in the documentary analysis. This is a method of quantifying the frequency and intensity of use of certain items, themes or symbols in communication. Researchers typically use CA to investigate thematic content in order to make inferences about the values, sentiments, intentions or ideologies of the authors; or they wish to identify group or societal values, or their aim is to evaluate the effects of communications on the audience.

The documents in this research were used to establish time lines and activity and emotional

content of various strategies. Encoding and quantifying themes was not appropriate.

## **4.6 Case Study Method**

### **4.6.1 Multiple case studies combined with historic research**

To further strengthen the resultant theory it was decided to combine historic research with comparative case analysis. This approach allows data from a number of cases to be examined in an iterative process - one which constantly compares theory and case data to seek a close fit between theoretical assumptions and the data. The historical research provides the context which allows the focal actor's and network's activities to be better understood in their emergent and contemporary phases.

In addition, the comparison of similarities and differences across cases allowed the researcher to suggest explanations for possible trends or linkages which emerged. Multiple case studies used in an inductive approach enables the questions of how and why to be asked and process to be better understood.

Multiple case study method was therefore chosen to:

- deliver well grounded, detailed descriptions and explanations of processes occurring over time,
- preserving chronological flow;
- facilitate the assessment of causality and the delivering of new theoretical integrations;
- be both inductive and deductive, emphasising theory building as well as theory testing;
- achieve internal validity through information richness, coherence and insight from triangulated sources,
- providing analytical rather than statistical generalisation

(Miles and Huberman, 1984; Walker, 1985; Yin, 1989; Easterby-Smith, Thorpe and Lowe, 1991; Yin, 1989; Tsouka, 1989; Ragin and Becker, 1992; Parry and Coote, 1994.)

The case study data will be assimilated from interviews, archives, documents, statistics, artefacts, and participant or non-participant observation.



#### **4.6.2 Inductive and deductive method in case studies**

There is some debate about where case study research should be placed along an induction-deduction continuum (Patton 1990). At one end there is support for inductive theory building, involving a search for indigenous concepts using flexible and opportunistic data collection methods (eg Glasser and Strauss, 1967 and Eisenhardt, 1989 in her earliest writings). At the other pole is a writer like Yin who insists on almost pure deduction (1989) with the use of sensitising concepts from prior theory.

Inductive research advocates expect the conceptual framework will emerge from the field during the course of the case study. They argue that the most important research questions only become clear well into the research and the most meaningful settings and actors cannot be predicted prior to the fieldwork. Instruments should then be derived from the properties of the context and from the constructions actors themselves evolve (Miles and Huberman, 1984:27). Such researchers advocate a loosely structured, emergent, inductively grounded approach to gathering the data.

Others argue that inductive research methods are best used in situations where there is a relatively underdeveloped theoretical base or where complex observational tasks are required (Parkhe, 1993; Romano, 1989; Parry and Coote, 1994).

Yin (1989) and Richards (1993) argue that it is impossible and undesirable to "go theory free into any study." The researcher can have difficulty comparing cases where there is no systematic questioning and may end up "discovering" existing theory. Chalmers (1976) observed that in any case pure inductionist's observational statements "are inevitably theory laden."

Yin argues that prior theory should have a pivotal function in the design of the case study and analysing the data. The prior theory when detailed and expanded is expected to progressively inform the questions, propositions, units of analysis, logic connecting data to propositions and criteria for interpreting the findings (Yin, 1989). Yin argues that the research should never change direction after it has commenced and a consistent interview protocol should be used in all interviews.

The position taken in this research is a blend of induction and deduction. We agree with Miles and Huberman's conclusion that they are dialectical and not mutually exclusive research positions. (1984:134) This approach is consistent with "grounded research" (Van Maanen, 1979). As Eisenhardt (1989) points out a key feature of theory building is the freedom to make adjustments during the data collection process, to probe emergent themes.

#### **4.6.3 Limitations of case study method**

Case studies typically involve field research, where face to face interviews and participant observation become the main means of collecting data. Often limitations include a concern about the potential lack of rigour, research bias (internal validity) and difficulty of replication and generalisation to other situations (external validity), (Yin, 1989; Miles and Huberman, 1984) Building theory from cases may result in narrow and idiosyncratic theory due to the fact that case theory builds from below from the specifics of data to the generalisations of theory.

The strengths of the case approach include its likelihood to extend or generate new theory; the emergent theory is testable and the researcher is answerable to the data from the beginning of the investigation (Eisenhardt, 1989 and Mintzberg, 1979). Careful case design and protocol can overcome the problem of lack of vigour and research bias (Yin, 1984). The use of replication logic (as opposed to sampling logic) in the conduct of comparative case studies assists in overcoming the limitations of generalisation and replication, as the theoretical propositions suggested by one case are tested against existing theory and the other cases in the study. This comparison of case to case and case to theory enhances internal validity, generalisability and theoretical level (Eisenhardt, 1989).

Since face to face interviews are the most commonly used means of gathering data in case studies there are two possible sources of bias in the data collection process: (i) the effects of the researcher on the site, and (ii) the effects of the site on the researcher.

Informants will often craft their response in such a way as to be amenable to the researcher and to protect their self-interests (Miles and Huberman, 1984). Interviews are subject to bias, poor recall or inaccurate articulation (Yin, 1984). The researcher of strategy and relationship building is usually interested in analysing the kind of information that is

sensitive to the individuals involved, and so must assume that some respondents will inadvertently or deliberately put the most favourable light on past events and corporate behaviours.

#### **4.6.4 Verifying data**

An important part of the internal validation process is checking a new item against other already validated measures of the same construct. Webb, Campbell, Schwartz, and Sechrest, (1966) borrowed a term from the field of surveying to describe a multiple validation procedure, ie triangulation. Webb et al spoke of validating a finding by subjecting it to a "series of imperfect measures." They are imperfect in that they are often achieved by the same instrument. For example the observations may be made from conversations recorded by the researcher alone. When the same instrument, in this case the researcher, is both establishing and corroborating the finding, there is a potential cognitive conflict of interest.

It is important to recognise this potential conflict, and to overcome it by using analytical induction only after hearing and seeing multiple instances of the same information collected from different sources.

This research used triangulation to achieve data validity through the systematic interviewing of numbers of different participants or observers of the same phenomena, in order to reconstruct then analyse events and interactions. Whenever possible contextual data was also obtained through direct observation, with visits and interviews conducted on site in Korea, Japan and in the Australian states of Victoria, Western Australia and Tasmania.

All interview dates, places, contexts and contents were carefully documented. Each informant is identified by name, company and position in the case study texts. After the initial full reference initials are used to source quotes and comments in the text.

The circumstances under which data may be more or less valid have been commented on by Bogdan and Taylor (1975), Becker, (1970), Sieber, (1976) and Miles and Huberman (1984). They agree on the following:

More valid data is produced when:

- Data is collected later in the research process or after repeated contact
- The activity is seen or reported first hand
- The researcher is trusted
- The information is volunteered to the researcher
- The informant is alone with the researcher
- Data is collected in an official or formal setting
- The researcher is considered knowledgeable, expert, and/or qualified in relation to the issues

The validity of the data is also strengthened using the qualitative techniques of ethnographers whose work depends on them watching people in their own territory and interacting with them in their own language<sup>1</sup>, on their own terms (Bohannan, 1989).

The following steps were taken to improve the internal validity of the data:

1. With the exception of two telephone interviews, where the respondent was sick and elderly, all interviews were conducted face to face in places of the respondent's choosing, usually in offices, but on two occasions (in Australia) in informant's homes. In Japan and ROK three late afternoon interviews were adjourned to a Karaoke Bar. One proprietor of a very small mill in ROK requested that interviews take place in the coffee lounge of a nearby international hotel.

Long train journeys taken with informants across ROK and Japan provided excellent opportunities for prolonged interviews. Interviews lasted from two to four hours. The numbers of face to face interviews with each informant ranged from five or six with key participants like MS:AWB and VA:AWB supplemented by phone calls and faxes, to only one interview with some observers. The number of interviews, their time and place are listed at the commencement of each case study.

2. Although the most accurate transcript of conversations can be obtained by taping,

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<sup>1</sup> While the researcher had learned some Japanese and Korean all but three interviews were conducted in English. The informants were either native English speakers or had good English understanding after years of work in an English speaking environment.

respondents were not asked for permission to use a recording device, given the potential distraction and inhibitions associated with its use<sup>2</sup>. Instead detailed notes were taken. Immediately following the interview the notes were re-read and any additional explanatory material added. The field notes were then typed into a draft and a copy sent to the informant to check for inaccuracies. Additional written or verbal information was often added by the informant at this stage. Over 500 pages of interview notes were ultimately collected.

3. The anonymity of all informants was assured.
4. Care was taken not to guide the respondent to avoid data elicitation. Open-ended questions were used and a passive role taken by the interviewer.
5. The background and training of the researcher was made known to the informants.
6. Interviews typically occurred after several months of written communication.

#### **4.6.5 The influence of gender**

Given that international agribusiness trade is almost exclusively an all-male activity and Confucianism assigns inferior status to women, the potential impact of the gender of the researcher was considered. A negative consequence could have been the withholding of access to high-ranking informants, or withholding of information regarded as particularly commercially sensitive. However a combination of other factors resulted in requests for interviews being agreed to at every level, and no perceptive withholding of information.

These factors included the good-will generally extended towards Australians in ROK and Japan; the high regard/tolerance accorded "academics" in Confucian influenced societies; and other characteristics ascribed higher status: ie the researcher's (middle) age, married status and adult children<sup>3</sup>.

As well, being female and an academic appeared to reassure informants that there were no commercially competitive motives behind the questions asked. Information of a

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<sup>2</sup> Only four of the interviews (all in Australia) were tape-recorded when the respondent volunteered that such was permissible and indeed was expected.

<sup>3</sup> Initial interviews in Japan and ROK typically commenced with wide ranging personal questions, which established the researcher's personal interests, marital, and family status.

commercially confidential nature appeared to be freely given.

#### **4.7 The Case Study Protocols**

The following summarises the steps taken:

1. The selection of cases for study.
2. Access to firms and cooperation of initial interviewees obtained (with procedure dictated by country, type of informant and business to business relationships between informants).
3. Initial informants nominate others as participants or observers of the phenomena under study.
4. Semi-structured interviews conducted, case by case, guided by the key questions related to ASMA, supplier and buyer interrelationships and change episodes.
5. Interview notes typed and circulated back to informants for checking.
6. Documentary evidence collated and analysed to deepen and validate interview data.
7. Case study prepared from participant and observer interviews and documentary evidence.
8. Cross case analysis undertaken to provide responses to the key questions, the research objectives.
9. Model of network governance process developed.

#### **4.8 Case Study Analysis Procedures**

Case study analysis consists of three concurrent flows: data reduction, data display, and the analysis or conclusion drawing and verification.

#### **4.9 Data Reduction**

This refers to the process of selecting, focusing, abstracting and transforming raw data that appears in transcribed field notes or is derived from primary and secondary documentary sources. Data reduction continues continuously throughout the qualitatively oriented project. It is a result of analytical choices. It is a form of analysis which sorts and organises data in such a way that final conclusions can be drawn and verified.

#### **4.10 Data Display**

The most frequent form of data display in case study method has been narrative text (Yin, 1989). The displays chosen for this project's data also include diagrammatic representations and time lines.

#### **14.11 Data Analysis**

The episodes were analysed through the identification of recurring causal factors and processes. The factors and processes were multi-stranded and interrelated. They had a long history of evolution and their individual impacts were difficult to identify or measure in a precise manner. The final analysis is the result of a series of iterations which identify the complexities and interrelationships between the factors in the micro and macro environments.

#### **4.12 Criteria and Process for Selection of Informants**

Identifying informants with the most relevant experience and information, then obtaining permission to interview the selected informants is a task critical to the success of case study research.

Two categories of informant were interviewed:

- (i) These were the focal firm's personnel who actively participated in the episodes under discussion, ie who could give first hand descriptions of the strategy formation and its implementation. These informants tended to be long serving middle and senior management. Also in this category of active informants were the scientists from the government research institutes like the Agriculture Department in Perth.
- (ii) Observers of the strategic shifts and activities of the focal actors were also interviewed. These included such people as trade counsellors in embassies or managers of firms and ASMAs who were not participants in the focal nets, but who traded or participated in the macro context.

An active participants in one case study was typically also a willing observer of someone

else's strategic episodes. Their commentary helped to validate or triangulate the date of the active participants in each case.

The status of each informant is identified at the beginning of each case where his or her position is described.

#### **4.13 Gaining Access and Informant Cooperation**

In order to gain access and informant cooperation and to better understand the phenomena under study, the researcher became a participant-observer, adopting patterns of behaviour and expectations relevant to the prevailing business culture in each country. Thus the method of initially approaching the different categories of informants varied according to their nationality and their relationship to the others also being targeted as potential informants.

Observers, for example, were typically outside the micro business network. Often they were not buying or selling from anyone. They were public servants working for governments, or employed by firms in the macro environment. It was acceptable that observers be approached independently by the researcher in Japan, Korea or Australia, and in every instance cooperation was forthcoming.

In Australian business, "cold-calling", (ie without a third party introduction) is considered acceptable behaviour. Therefore, potential participants in Australian firms were approached directly by the researcher, first by phone, then by follow-up letter, and finally, in a face to face interview. The manager of international marketing, the CEO or equivalent was first contacted. He usually then suggested alternative or additional informants who fitted the direct participant criteria from the company. Independent contact was then made with each of the others nominated. The number of informants from each firm ranged from two to six in the supplier firms, and up to twelve in the ASMA's. Only one firm's management (an Australian dairy manufacturer) declined the request for interviews/information.

The different business conventions related to introductions in ROK and Japan influenced the researcher to approach the potential informant through a "sponsor", ie someone who



was already in an established close and respectful relationship with the target.

The researcher first approached the ADC and AWB in Australia and developed a cooperative relationship with their Managers of International Trade who were responsible for the overseas offices in Japan. These informants then contacted the ADC and AWB officers in Japan, who in turn arranged the initial contacts and introductions to the firms the researcher wished to interview. Protocol required that the "introducer/sponsor" accompany the researcher to the first, and often subsequent appointments. The research observed that the AWB and ADC "sponsors" adhered to the conventions of the networks, and never directly approach a customer of their buyers to arrange an interview. Instead, the researcher was "handed-on" to the buyer who in turn organised the initial introductions with their own customers down-stream.

The ADC Japan Office advised that it was most appropriate that requests for appointments with the largest *sogoshosha* (MTC) be organised through MTC's Office in Melbourne. The researcher then made contact independently with this office and the Manager in charge then arranged interviews with his Japanese colleagues in Tokyo. TN: MTC, Cheese Team Leader in MTC then introduced the researcher to MTC's downstream customers who they supplied with Australian dairy product. TN:MTC also volunteered to sponsor the researcher's access to the MTC wheat and barley buyer informants. TN:MTC accompanied the researcher to all of the interviews he arranged, including those at locations held many hours train journey from Tokyo.

The Australian Manager of the AWB Office in Japan accompanied the researcher to one of the three interviews with Japanese millers which he sponsored. The Japanese millers then sponsored access to their customers. This included much sampling of noodles at their restaurant chains and visits to research centres.

Interview access to ROK mill managers was initially sponsored through a written introduction from VA:AWB, the Australian AWB Senior Technical Adviser based in Melbourne. VA:AWB sent faxes and made phone calls on behalf of the researcher, explaining the project and seeking cooperation. The researcher was not accompanied to interviews with mill personnel in ROK, but initial interviews began with inquiries as to the

health of VA:AWB, and gifts to be passed on to VA were sometimes given. Millers accompanied the researcher to interviews they arranged with their manufacturing customers downstream. These interviews were organised by the millers at the request of the researcher.

All interviews with the observers (ie non-participants in the episodes) were arranged and conducted independently by the researcher.

Thus the protocol of introductions mirrored the etiquette of the business cultures where contact between all but the immediate buyer and seller was regarded as potential customer poaching.

By conforming to the business conventions the researcher gained greater cooperation with the ROK-Australia and Japan-Australia dairy and wheat trading networks. It also enabled a greater insight into the quality of relationships, in particular the social exchange dimensions and differential power of suppliers and buyers.

The researcher was fully aware of the impact of, for example, a supplier informant accompanying the researcher to an interview of their buyer where the relationship between them was asymmetrical. However these dependencies were of great relevance to the study, and the observable interactions at the interviews added greatly to the understanding of the trade relationships.

To overcome potential information bias, where the informant's answers could be effected by the presence of their trading partner, the researcher ensured there was adequate triangulation by asking other informants not present at the interview to describe episodes, or to provide documentary information.

#### **4.14 Case Selection**

Case studies do not establish the prevalence or frequency of phenomena in a particular population of organisations. Each case is chosen so as to yield data that is generalisable to theoretical propositions.

Patton (1990) listed fifteen strategies of purposive sampling (in contrast to random sampling) which could be used to select cases. Among these is maximum variation selection. Pettigrew (1987) argues that because of the restricted number of sites that can be effectively investigated in case study research, it makes sense to select "extreme situations and polar types" of cases in which the process of concern is translucently observable. Gersick (1988) agrees that diverse sampling can enhance or improve any generalisations from the findings.

Parry and Coote (1994) argue that whatever selection strategy used, the underlying principle that is common to all is the selection of information rich cases, worthy of in-depth study.

In this research the selection of the cases was purposive and entailed replication rather than sampling logic. The choice was driven by the conceptual framework and prior theory related to the research.

The number of field sites selected for the research was influenced by:

1. The human resources and the time available, ie the larger the number of cases the larger the volume of data to be collected and analysed.
  2. Richer data would be delivered through multiple sources of evidence at each field site.
- Therefore the number of sites was managed according to the resources available and the depth of data needed.

#### **4.15 The Field Site Selection Criteria**

The ADC dairy trade to Japan and the AWB wheat trade to Japan and ROK were selected to provide data on the structure and function of ASMAs in agribusiness trade, and their impact on network governance.

Six Australian dairy manufacturer suppliers and the only wheat grower supplier collective exporting or aiming to export product to Japan or ROK were then selected to represent export objectives, output, product value and stages of internationalisation. One manufacturer refused to cooperate when approached. All others offered unlimited access to

their staff.

#### **4.15.1 The ASMA cases**

The dairy and wheat industries were selected because of their industry structures: both were regulated by ASMAs. Both had been exporting from Australia to deregulating North Asian markets for decades. Japan and the ROK were chosen as the focal markets given the length of their engagement in wheat and dairy trade with Australia. The ADC does not however have statutory powers in relation to sales of Australian dairy product to ROK and in 1994 dairy imports to ROK continued to be largely restricted. Thus the three case studies of the ASMAs export activities include:

Case 1. ADC dairy sales to Japan,

Case 2. AWB wheat sales to ROK and

Case 3. AWB wheat sales to Japan.

#### **4.15.2 The manufacturer-supplier cases**

Six Australian owned dairy manufacturer case studies were selected using the criteria stated. The single wheat industry example of a supplier preparing to export<sup>4</sup> was included. To achieve maximum diversity the dairy industry cases range from large to small output, skimmed milk powder (SMP) to cheesecake suppliers, privately owned to cooperatives, long established to export newcomers. The data from each of these cases was analysed focussing on the core constructs and key questions identified from the extant literature. Cross case analysis was finally undertaken.

#### **Dairy Industry cases**

Case 4. Charada

Case 5. Lactos

Case 6. Murray Goulburn

Case 7. Peters Browne

Case 8. Tatura Milk Products

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<sup>4</sup> As the AWB continued to have a total export monopoly over wheat in 1994, only one grower group, a collective, was attempting to manufacture or export.

Case 9. Warrnambool Cooperative

#### **Wheat Industry case**

Case 10. Western Australia Noodle Growers

An analysis of the two ASMA cases was preceded by researching the history of the evolution of both industries in the domestic and international market place, in order to better understand their contemporary micro and macro contexts.

Data from the three ASMA cases was analysed using the key questions, in order to better understand how these actors attempted to countervail their industry's dependencies and the impact they had over time on their suppliers.

### **4. 16 Ethical Considerations**

Potential informants were told precisely and in writing what the research objectives were, how, when and where the report was to be finally presented, its restricted public access and the measures to be taken to preserve confidentiality. Only one informant asked that his identity remain confidential. All written communication was undertaken in English, although translations were offered. In one case a key informant (TN:MTC) had the introductory letter translated into Japanese and circulated to other informants in his company. The Japanese was re-translated back into English for verifying accuracy.

### **4.17 Confidentiality**

The researcher sought to resolve one of the confidentiality issues by never revealing any data disclosed by one respondent to another, even within the same organisation where it could be assumed the knowledge was shared. This non-disclosure undertaking was given to each informant. When information verification was sought, informants were asked to describe a particular issue or episode. The initial source of information about the issue or episode was not revealed, nor the activity content. This "rule" was given the most severe test in Japan, particularly where informants worked for the large *sogoshosha*. Details of the information sources informing the questions and the opinions of other informants were often asked for. Reasons for withholding such details were respected and always accepted.

## **Chapter 5**

### **BACKGROUND STUDY:**

### **THE AUSTRALIAN WHEAT INDUSTRY**

#### **5.1 Establishment of the Wheat Industry in Australia:**

##### **Institutional, demand-competition and production-distribution factors.**

The 18th and 19th Century structure and culture of the early Australian wheat industry evolved from the domestic and international contexts prevailing during the establishment of New South Wales (NSW) as a British penal colony in 1788.

The colony was to be self sufficient with convicts transported for terms of several years to life in exile. Consequently the government sector dominated the economic and social organisation of the new colony until convict transportation ceased and the free population became the majority sixty years later.

While the NSW Governor created regulations and decrees to control all social and economic relationships, his special instruments, the officers of the NSW Corps<sup>1</sup> exploited the economic opportunities created by the Crown's monopoly over food provisioning. For example all grains, whether grown by free settlers or convicts on public or private farms had to be purchased at fixed prices and re-distributed via the King's Store.

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<sup>1</sup> The NSW Corps was specially created and recruited in Britain after the regular army officers who accompanied the First Fleet refused to be engaged in the management of convicts. Officers for the Corps volunteered in expectation of developing "business" opportunities.

For the first fifty years the officers<sup>2</sup> of the NSW Corps controlled the limited storage in the granaries and allocated themselves the choicest land and convict work force. They employed the grain buying agents and lent monies to private growers at 50% interest rates (Dunsdorf, 1956).

In 1798 Governor Hunter complained to the Executive in London that the government stores were:

*...so completely monopoliz'd that they (the settlers) cou'd have but few opportunities of getting the full value for their crops ....they had, from their poverty and distress, been often obliged to dispose of their grain for less than half its value. ... (1798 HRA, ii p.213)*

In 1807 growers attempted to improve their fortunes by colluding on price and selling collectively. The Executive of Van Dieman's Land<sup>3</sup> countered by issuing a General Order:

*It having been represented to the Lieutenant Governor that such of the Settlers who are possessed of Wheat the growth of this Season have combined together and entered into a Resolution to raise the Price of their Grain from four to six Pounds per bushel. It is hereby ordered that no person whatever, in or belonging to this Settlement, shall offer to give a greater Price than Four Pounds for One Bushel of Wheat. (HRA, 1807 vi:552)*

By 1810 government run farms were so unproductive that they were abandoned. Free settler's farms were to be the means of producing food self-sufficiency. By 1820 however the ex officers of the NSW Corps had left grain growing to the small farmers on the fringes of the settlements and had moved inland to pioneer the more lucrative wool industry.

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<sup>2</sup> NSW Governor Macquarie abolished the NSW Corps after the officers kidnapped and humiliated his predecessor Governor Bligh. The ex-officers continued to dominate the economic life of the Colony as civilians.

<sup>3</sup> Van Diemen's Land was the second Australian convict settlement established. It later became the island State of Tasmania.

After the first twenty years of grain growing the fertility of the thin NSW coastal soils had declined, but the small domestic market was still often glutted with grain. As well, the government price interventions and merchant sharp practices, the poor English seeds' response to Australian conditions, seasonal fluctuations and crop disease made grain growing a highly risk venture.

## **5.2 Changing Global Market Trends: the 19th Century Industrial Revolution**

A number of factors led to an increased wheat for international trading in the mid 19th Century supplied from Australian colonies, USA, Canada, Argentina, South Africa and Russia. The market's growth reflected changing demographics, in particular the growth of urban populations which swelled in response to work available in newly mechanised industries. Changing gender roles and food consumption patterns meant a growing market for manufactured foods. In particular, the internal migration and overall population increases created a greater demand for the European food staple, bread.

The industrial revolution's new technology and transportation systems were also applied to cereal growing and grain distribution. The new mass produced iron mowers, twine binders, reapers, threshing machines and combine harvesters ushered in an era of land-extensive cereal farming.

Unlike Europe, Australia never had a peasant society farming in self sufficient communities. After the cessation of the public farms, Australian farmers were typically individual family entrepreneurs aiming to produce a surplus for profit. Thus they were reliant on capital intensive agriculture and were first domestic then export market dependent.

Gold discoveries compounded the effects of the industrial revolution to create a boom in population and prosperity in Australia. The area sown to wheat doubled between 1850 and 1860. By the 1870s the area had trebled. (Robinson, 1978) By the 1870s South Australia (SA) had advanced mechanical harvesting and was exporting grain to other Australian colonies, UK, Mauritius and South Africa (Whitwell and Sydenham, 1991). The growth in areas of wheat under cultivation in NSW illustrates the trends in the industry's development



in all Australian colonies:

**Figure: 5.1: Increases in Areas Sown to Wheat in NSW**

1880	43,000 acres
1890	54,000 acres
1900	600,000 acres.

(Source: Robinson, 1978)

Oversupply of grain led to falling wheat prices by the 1860s. As well the very success of the infant industry created conditions which triggered the spread of wheat diseases like rust.

By the 1860s this disease had taken hold in the densely cropped monocultures and decimated the yields. Since rust was most prevalent in areas of higher humidity near the better watered coast, wheat growing areas spread inland into less humid but more drought prevalent zones (Robinson, 1978; Dunsdorf, 1956).

The push into the inland areas exposed growers to thinner soils significantly deficient in phosphorous and nitrogen and to cycles of drought and heavy transportation costs. To reduce their dependence on a single source of income farmers typically also ran flocks for wool growing. This required paddock fencing and stock watering infrastructure.

In the 1890s drought, falling wheat prices and rabbit plagues brought disaster to NSW wheat growers. In 1887 600,000 acres of wheat growing country were abandoned between Hillston and Lake Cargelligo in NSW (Shaw, 1990).

### **5.3 Wheat Farmer Indebtedness**

Many wheat growers entered the industry with little capital. The Victorian 1869 Grants Act exacerbated this situation when it introduced a system of deferred payments so farmers with no up-front capital could go on the land.

The 1934 Royal Commission into the Wheat, Flour and Bread Industries (Commonwealth of Australia Parliamentary Papers, (CAPP) 1935) exposed the level of indebtedness of growers and their difficulties in obtaining credit. At that time it was estimated that two thirds of the 150 million pounds of grower debt was owed to non-government lenders.

It became standard practice for farmers to purchase fuel, wheat and wool jute bags, fertilisers, fencing materials, stock, machinery and other consumable goods with credit provided by agents of suppliers and general merchants. Wheat merchants took advances on the security of the wheat harvest.

The chronic indebtedness of wheat growers had risen well before the Great Depression of the 1930s. Dunsdorf (1956) found that the interest on growers debts rose from 1.4 million pounds in 1920-21 to 8.4 million pounds in 1928-29. He also calculated that if you included interest on capital there were only four years between 1914-15 and 1940-41 when Australian wheatgrowers on average enjoyed a profit.<sup>4</sup>

## 5.4 The Evolution of Production Systems

1920 to 1929 saw the last great surge of government sponsored wheat area expansion into arid lands in all states, with acreages increased from nine to 14.97 million acres (Whitwell and Sydenham, 1991:16).<sup>5</sup> Typically the new cropping areas were allocated to inexperienced Returned Soldier Settlers with few financial reserves.

## 5.5 Grain Over-Supply and the Export Market

In the early 20th century a revolution had occurred in the wheat industry with the introduction of better yielding varieties, the application of fertiliser. The decline in yields per acre was temporarily halted and reversed.

Despite problems of indebtedness, overcropping and persistent drought in the 1920s the

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<sup>4</sup> If interest on capital is excluded, the number of years showing a profit still only increased to eleven out of the total of twenty-seven years.

<sup>5</sup> The ill-fated Federal Government *Grow More Wheat* campaign of 1930 stimulated crop acreages to soar to 18.16 million acres. The government then reneged on payment of the bonuses, ruining many.

increased yields lead to a persistent problem of over supply. The industry depended on exporting over 70% of the crop. This exposed growers to the unpredictable world grain trade. However, while the grower was a price taker on the world market, his costs were inflated by a protected and expensive domestic market.

Wheat growers began to call for protection from the vagaries of prices generated from export markets. However output volatility was greater than price volatility.

Victorian pioneer wheat grower Bill Boyd's harvests were typical of the fluctuating yields. In 1916 sixteen inches of rain fell on the 200 acres where Bill hand cleared the mallee scrub<sup>6</sup> off the paddocks. That year they harvested over 1000 bags (180 pounds weight per bag). In 1917 another 200 acres were cleared and the wheat sown. The 1919 harvest produced only 100 bags of wheat. Bill Boyd wrote in his memoirs that he:

*remembers the sound of the stripper "boom-booming" across the parched earth, the sound broken only by an occasional click in the back of the box where a few heads of good wheat had been sustained by a bit of bullock dung. Occasionally there was a genuine rattle as the stripper crossed the rare places where there had been solid growth. In these good spots (I) had to take care that the offside horse did not suddenly grab a mouthful. Families would also go hungry in that up and down world. But, the following year was magnificent. (Bate, 1989:70)*

The Australian grower's success was measured in his ability to reduce costs and increase yields. There was nothing he thought he could do about prices, and he viewed the markets and the merchants who represented the buyers (and lent the money) with great trepidation.

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<sup>6</sup> "The Mallee" is a low rainfall region in southern Australia. The name *Mallee Scrub* also applies to the region's characteristic vegetation, a small, tenacious eucalyptus tree with multiple stems and large, woody roots. Although cut to ground level it reshot each year, often regrowing as fast as the crop.

Australian wheat farmers were aware of the different characteristics of varieties of wheat available to them. In particular they valued a variety's resistance to the diseases rust or bunt, its yield, and the strength of its straw which meant it could resist winds, provide feed for bullocks and sheep, and it burnt well. Milling characteristics other than water damaged or broken grains were not a consideration.

Bill Boyd explained the problem of trying to grow good yields of wheat in country recently cleared of the mallee scrub. The year was 1920:

*The stumps are still underneath and any machinery that you've got jumps over them and then it comes winter time, and these stumps produce "shoots" as we call them - mallee shoots. They start growing about June, and you put the crop in over the top of them and then you've got to start in July shoot cutting. That checks them until they start growing again, and then hopefully they won't be growing as high as the crop is when you are going to harvest it. ... (Bate, 1989:17)*

Even when grown under such conditions, yields continued to increase well beyond the needs of the small domestic market.

## **5.6 The Cultural Expectations that Evolved in the Early Wheat Industry**

The initially unskilled and poorly equipped Australian wheat growers had not only faced some of the harshest wheat growing conditions in the world, they also raged against what they perceived to be their exploitation in the market place. The hardship experienced during the era of early grain industry development was not quickly forgotten.

Some fundamental understandings about the cultural context of the Australian grain industry were already entrenched by the time Australia had moved from the era of penal to free settlement (Shaw, 1990:2). These understandings were reinforced and became the industry norms by the 1950s. For example:

1. It was believed that cropping was a simple occupation requiring only "common-sense" and hard work for success. Consequently generations of government policy makers assumed that any ex-convict, ex miner, ex-soldier, or newly arrived immigrant could become a self sufficient grain grower on a few acres of land.
2. Australian soils were poor and rainfall erratic. A bust-boom cycle of yield fluctuations and disaster was to be expected.
3. Wheat farmers needed to bolster incomes with wool growing. (However this required fencing and stock water infrastructure which reduced the efficiency of broad acre machinery use.)
4. Free markets for Australian agricultural produce were corrupted, unreliable and the grower was at the mercy of the merchant<sup>7</sup>. Government intervention was desirable and necessary for grower protection.
5. Wheat growers were poor and struggling. "Cockies" was the term of bemusement or derision commonly used by the public and media to refer to them<sup>8</sup>.
6. The sparse population and huge size of the country encouraged the view that internal communications and transport required government building, ownership and operation.

## **5.7    Factors Influencing the Evolution of the Production-Distribution System of the Australian Wheat Milling Industry**

In the late 18th century water replaced wind power in European mills. This allowed milling in a more efficient, continuous shift.

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<sup>7</sup>    In the 1930s Steele Rudd wrote about "Dad an' Dave" a hugely popular book series adapted to early radio plays. Rudd immortalized the poor, stupid wheat grower always being cheated and lurching from one crisis to another.

<sup>8</sup>    Cockatoos (ie cockies) are very loud, screeching white native parrots seen in huge flocks around wheat paddocks.

Prior to the 1870s the global milling industry relied on simple grinding stone technology. The 1870s ushered in another milling revolution. The mill stone was replaced with faster, cleaner, iron roller technology.

### **5.8 The Impacts of New Milling Technology on Flour Specification**

The new roller technology yielded substantially better quality flours. Since the rollers did not powder the bran like the grinding stones, the final colour of the flour (and the bread) was clearly related to the variety of grain used. Colour became an important grain specification. The expensive hard, high protein, red wheats of the colder climates (USA, Canada, France) produced a dark flour but with superior bread making qualities. However it was found that the addition of a little cheaper (poorer bread quality) Australian white wheat improved the flour colour<sup>9</sup>.

### **5.9 Pre-Milling Technology and its Relationship to Wheat Quality**

Australian milling machinery technology had reached a standard comparable with international competitors by 1910. However the Australian "pre-mill" wheat handling, storage and blending techniques had changed little. This significantly reduced the quality and consistency of the flour produced.

By 1900 bulk wheat infrastructure in England provided the means of storing and blending grain to produce consistent quality flours from the wide range of imported wheats. In 1907 milling complexes like the Kimptons at Kensington, Victoria had a throughput requirement of 200 tons of wheat per day to maintain three shifts of continuous milling. However the grain was still hand tipped from hessian bags "lumped" from towering stacks of 30,000 to 50,000 bags.

These bags had already spent weeks in open stacks on farms and railway sidings. Mice, insect and bird damage was inevitable. In the worst years of the weevil and mice plagues up to a third of the grain was destroyed and stacks were manually rebagged. The sound of weevils moving in the bags of grain was a feature of the stacks (Winterbottom, 1922).

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<sup>9</sup> Australian wheat was bred from soft-white, lower protein English seed with poor bread making qualities, while Canada and US seed originated from harder French varieties with higher protein and better bread making qualities.

Few mills differentiated wheat in their stockpiles, and then usually only according to month of delivery. While there was some knowledge of the role of gluten (or protein) in wheat, millers were not able to make use of this knowledge to improve flour performance or consistency without an ability to segregate or blend their stockpiled grain. As well pre-milling visual or other appraisal was not possible when wheat was tipped from the bag directly down the chutes into the milling process.

Thus bakers had to contend with flour that varied in quality from day to day. However, problems caused by this variability may have been masked by the variable quality of the baker's live yeast which had to be kept at a constant dough temperature during the twelve or so hours of fermentation. Consistently good bread was virtually impossible to achieve in Australia, even by the most experienced and skilled bakers.

### **5.10 The Development of the Flour Export Trade**

Flour sales to England commenced in the 1870s.<sup>10</sup> By the 20th Century Australian mills depended on exports to remain viable.

By 1928 two thirds of Victoria's flour production was exported (Australasian Bakers and Millers Journal, Sept 28, 1928:106). From the early 1930s to the 1960s exports accounted for some 54% of total production.

### **5.11 Establishing the Asian Flour Export Markets**

With the domestic market for flour matured, in 1909 Victor Kimpton, grandson of a mill founder identified the Dutch East Indies as a potential market (Australasian Bakers and Millers Journal, xiii, 1909:91.). The soft, low protein Australian flour was found to be ideal for making the traditional flat breads and noodles preferred by the Indian, Chinese and indigenous populations.

Networks of Australian mill management, Chinese merchants, small shop retailers and their customers were established. The merchants' names, addresses and "brands" were printed on

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<sup>10</sup> While the Australian colonies were independent of each other until Federation in 1901, for the purpose of clarity "export" only refers to trading of flour beyond Australia.

the calico flour bags, along with prominent lettering announcing *Kimptons*, or "Australian Flour", "Australian Roller Flour", or "Finest Australian" (Jones, 1984).

Cooperative long term relationships were reinforced by the joint branding. The flour merchant networks extended across South East Asia. For example *Frog* brand *Kimptons* flour was sold in Indonesia, Singapore, Malaysia, Philippines, New Guinea, Thailand, Taiwan and China. Three brands went to three different merchants in Penang.

Between 1930 and 1960 *Kimptons* the biggest Australian mill exported flour to twenty-one merchants in twenty-one Asian locations (Jones, 1984).

### 5.12 Growers Knowledge of the Market

While the quality of the season's wheat was not described in the milling industry Journals, any grower attempts to manage supply into the market was reported<sup>11</sup>. Conversely the only market information received by growers was the price the agent negotiated.

By the 1940s issues of government intervention and market regulation, debt moratoria, rural adjustment assistance and subsidisation consumed the energies of wheat industry leadership. Wheat quality and differentiation, better handling and storage requirements were not developed as issues to resolve until well into the middle of the twentieth century. Growers looked to government regulation to protect their interests in the market place. They were ill equipped and unprepared to compete on the basis of quality. In the 1930s some merchants or mills tested wheat samples from growers or agents before purchase, the majority did not.

By the 1940s, wheat price stabilisation and other market regulations meant that relationships between industry leadership buyers, millers or consumers were restricted to negotiations about industry regulation.

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<sup>11</sup> For example in 1904 *The Millers' Journal* reported: "Cowra ..Many farmers are holding reserve stocks in anticipation of substantial increases in prices" .. " Molong: Many farmers being disinclined to incur the risk of holding are selling at the present values. Others, however, are determined to store. " (*The Millers Journal*, Feb 24, 1904)



### 5.13 The Export Market Positioning of Australian Flours

After one marketing mission, Victor Kimpton, a Victorian mill manager strongly criticised the presentation of Australian flour he had seen in the UK. He reported the product was:

*badly marketed .. and consigned to unsuitable companies such as banks and soft-goods houses* (Australasian Bakers and Millers Journal, (xiii) January, 1910:55).

He reported that the Australian flours had an inferior reputation and were sold at bargain prices (Australasian Bakers and Millers Journal, (xiii) January, 1910:56). Prices quoted in the English journal *Milling* in 1904-05 listed Hungarian flour with the highest prices followed by American patents from Minneapolis and Kansas at 5% to 10% lower. Australian flour was 15% to 30% below the USA price while the lowest price in that season was for flours made from English wheat.

With the European flour market demanding hard, high protein pan bread-making flour. The Australian soft, low protein product performed poorly in all categories except in colour and moisture content (ie as low as 12% to 13% despite the extra washings needed to remove mice excreta). English and American flours had 14% to 16% moisture. Lower moisture flours could absorb more water during milling, increasing the bread yield. Thus millers bought the cheap Australian flours for blending to lighten the colour as well as to extend the stronger USA, Canadian or Hungarian premium priced flours.

Demand for imported flour in the Dutch East Indies ceased during their wars of independence in the 1960s. The new Indonesia quickly established its own flour mills using imported, subsidised grains from the USA.

Sales to other pre-war Asian region markets declined as new mills were constructed in their port cities as a part of new industrialisation processes. Milled flour was no longer imported.

The AWB formed in response to the emergency of WW2 took over the flour export marketing work of the mills however by 1975 Australia was no longer a flour exporting

nation and the relationships developed between the Chinese merchants in South East Asia and the Australians were permanently dislocated.

In 1977 the AWB launched the first of a series of off-shore milling and baking seminars and offered baking and milling personnel from Singapore and Malaysia courses at the Australian Bread Research Institute. The AWB shifted its marketing focus to more differentiated, higher value niche market grains for noodle and flat bread production in North Asia and the Middle East.

**Fig 5.2: Victorian Flour Exports 1950-89**

Decade	Mean Exports (tonnes)
1950-59	231,848
1960-69	167,424
1970-79	54,000 (estimated)
1980-89	6,000 (estimated)

Source: (CAPP, 1990)

### 5.14 Conclusion

Bread and other bakery products have always been staple Australian foods. However for years the quality of the output of Australian mills was hampered by a failure to invest in modern pre-milling technology, in particular grain bulk handling and blending facilities. Lack of pricing signals or other information to encourage the growing of higher protein flours compounded the problem. Price fixing schemes for the bread and baking industry removed millers from quality based competition.

The efficiencies gained from continuous milling low cost grain meant wheat flour production invariably outstripped domestic consumption. Exporting became necessary for the Australian milling industry and grain growers' survival.

The British markets consigned the dirty, low protein soft Australian wheats to an inferior market position. However in the 1930s Australian millers found low-protein flours were well suited for Dutch East Indies and Middle Eastern markets.

The South-East Asia flour export trade developed to make Australia one of the world's largest flour exporters. However the success was short lived. By the 1970s new governing regimes in the markets saw the Chinese merchants displaced, and subsidised wheats and flours compete successfully with Australian product.

In 1977 the AWB concentrated its marketing efforts on the supply of grain.

### **5.15 The Australian Wheat Industry Structure: The Evolution of the ASMA**

Australian wheat growers saw socialism as a malediction but at the same time they demanded that governments built and operated the railways, wharves, grain handling facilities and rural lending institutions (Graham, 1966:39). Like their counterparts in USA and Canada they were sure that merchants and their agents exploited them, and they looked to the government for protection (Harper,1928; Lowenstein, 1978; Lake, 1987).

### **5.16 The Early 20th Century Structure of the Wheat Industry**

Middlemen had been powerful participants in the grain market system in Australia since 1780 when the monopolist NSW Corps controlled access to the King's Store. Until WW1 farmers continued to sell their surplus through mills' or international merchants' agents.

According to P.G.Stewart founder of the Victorian Wheat Growers Association, the farmers felt that:

*.. banks fixed the price of money; the manure combines, the price of superphosphate, ... implement manufacturers took full advantage of the high tariff duties; government departments arbitrarily fixed the price of freight and water charges. Wherever they turned the wheat growers were up against capital and labour -all organised with one objective, one policy -the right of the seller to fix the price of his services to the community. (Ouyen and North West Express, 22 March 1929)*

In the 1920s farmer owned cooperative pools were established in an attempt to replace the middleman. However these voluntary state wide pools did not necessarily offer higher prices than agents and could not always offer immediate cash payments. Being voluntary and having adequate storage capacity also presented a problem. From the second half of the 1920s the pools were declining and the merchants had re-emerged as the largest group of buyers (Harper, 1928; Smith, 1969).

### **15.17 The First World War (WW1) and the Formation of the First AWB**

The WW1 emergency in 1915 interrupted exports, reduced shipping and introduced the possibility of food rationing. The Federal Government formed an ASMA which took over wheat transportation, storage and marketing. A compulsory wheat pool was established and administered by what was called the Australian Wheat Board (AWB) consisting of the Prime Minister and ministers from each of the wheat growing states. The AWB liaised closely with the government of the UK to ensure on-going flour supply for defence force and civilian UK population needs.

The AWB continued to rely on the services of the pre-war private trading firms. Merchants cooperated on the understanding that the pool was a temporary war time measure. Growers were paid a government guaranteed advance on delivery of the wheat to one of the Board's nominated (private) agents. The price was determined by the Board.

In 1918-19, 1919-20 and 1920-21 growers were being paid the highest prices ever. They had a greater sense of price security and lobbied through their State grower associations to see the ASMA and pooling system continue on a permanent basis with the Board under grower control after the war (Harper, 1928; Dunsdorf, 1956; Graham, 1966).

The Board and the pooling system was disbanded after the 1920-21 season however, as per the agreement with merchants who resumed their buying and selling activities (Smith, 1969).

Following the AWB's dissolution growers in NSW, Vic, SA and WA organised voluntary cooperative pools in an attempt to recapture the advantages of the compulsory system operating during the war (Wheat Pool WA, 1950; Spenceley, 1981).

QLD however, established a compulsory pool under the control of a State Wheat Board. This operated continuously between WW1 and WW2. The voluntary pools in all states except WA soon languished, due to free rider problems and poor price performance (Whitwell and Sydenham, 1991). The pools made deferred payments while merchants paid cash. As well, agents often offered higher prices than the pools (Dunsdorf, 1956).

The 1930s brought chronic wheat oversupply and price collapse. The Royal Commission of 1934 was established to investigate ways to alleviate the debt burden in the industry and the financial distress of growers, in particular those on marginal lands (CAPP, 1935). In their second report the Commissioners documented what they saw as the advantages and disadvantages of a compulsory pooling system, and a national marketing authority:

**Advantages:**

- The farmer was lacking in technical information and could not see the "big-picture".  
A national wheat board would be better informed,
- Savings could result from a centralised handling, receiving and marketing system.  
It could charter ships cheaper
- The net profits enjoyed by merchants would be returned to growers,
- Liaison between a central authority and state railway departments would improve railway transport efficiency,
- There were political difficulties in being seen to subsidise farmers directly.  
However, a centralised authority could implement less visible means of transferring funds to growers,
- An ASMA could reward better farmers for superior product, and reverse declining quality. (Agents were said not to discriminate between different qualities),
- A centralised agency could help formulate common industry policy and coordinate

state research efforts.

**Disadvantages:**

- An ASMA could push up domestic prices,
- Management might be autocratic or inefficient,
- Differences in wheat quality grown in different states might not be recognised (CAPP, 1935:171-179).

## **5.18 World War Two (WW2) Impacts on Wheat Marketing Arrangements**

Before the Royal Commission recommendations could be implemented, on September 21, 1939 the Australian Wheat Acquisitions Regulations were gazetted in response to the outbreak of war. A new authority, once again called the Australian Wheat Board used war time emergency powers to purchase, handle and market the Australian crop with the cooperation of the State handling authorities. The AWB dealt directly with the British Ministry of Food to ensure supply to Imperial troops.

When the war ended three different types of market structure emerged in the major wheat importing nations.

Some importing countries returned to an open market system. This was the case in UK and most Western European countries. Some developing economies continued a system of government controlled buying, for example India and Pakistan. The third group combined elements of market regulation and open access. For example the government called for tenders in which private traders participated (as in Japan) or they issued import licences for specified wheat imports (as in ROK).

The major exporting nations also retained some form of central selling control in order to try to reduce the wild fluctuations in world wheat prices.<sup>12</sup> In Canada their ASMA, the CWB continued in its role as the sole marketing authority (Morriss, 1987). In

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<sup>12</sup> For example: in the 1930s the export price for Australian wheat dropped as low as two shillings and four pence per bushel. In 1948 it was sold on average at 18 shillings, although the domestic price was still pegged at six shillings and three pence (Wheat Pool of WA, 1950).

Argentina marketing was in the hands of the Argentine Grain Board. In the USA the American Commodity Credit Corporation was established to control stocks of surplus grain (and other commodities) and to assist in coordinating their marketing.

After a transitional period in 1948 the AWB was given the statutory power to remain the sole marketing authority for Australian wheat both domestically and overseas, and for flour overseas. The AWB appointed receivers of wheat in each State (usually another statutory monopoly or in the case of WA, a grower cooperative). These came to be called the bulk handling authorities (BHAs)(GEB, NSW, 1972).

Advance payments were made to the growers financed by annual government borrowings of some \$4billion. The AWB became one of the world's biggest annual borrowers.

### **5.19 The Transition to and Impacts of Bulk Handling**

The AWB inherited a technologically backward system where wheat was stored in enormous stock-piles of hand stacked bags often exposed to the weather and liable to insect and rodent infestation. The jute bags were filled and sown shut on the farms, making pre-sale wheat inspection very difficult. The cost of the bags was also escalating, given the jute sources in India and Pakistan had been disrupted by the war (Winterbottom, 1922; Harper, 1928; Clark, 1950). <sup>13</sup>

In the 1930s in WA it was reported that one quarter of the value of the crop was being spent in bagging, handling and transporting the wheat on the first portion of its journey to market (CAPP, 1935).

The bagged wheat marketing system persisted in Australia for fifty years after it had been replaced with bulk handling in the USA and Canada. Bagged wheat made grain decontamination, sampling, blending and aggregation virtually impossible (Winterbottom, 1922). It was not until the 1960s that the last of each State's bagged

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<sup>13</sup> In 1940 jute bags cost nine shillings and eight pence per dozen. In 1951-52 this cost rose to more than seventy shillings per dozen.

wheat storage and transportation systems were replaced by wheat harvested, stored and transported in bulk via a system of closed concrete silos, chutes and elevators.

The infrastructure cost of introducing bulk handling may have been more easily justified had there been a strongly discernible demand for a more finely graded, cleaner Australian product. However, there was little evidence that the agents buying for export or domestic markets would pay any more for wheat purchased in bulk, not bagged. Therefore when buyers opposed the introduction of bulk handling facilities, and the cost of the infrastructure was to be born by governments, the governments procrastinated. Finally, farmers failed to apply pressure, since the cost of buying the bulk bins and other new or modified on-farm equipment could not be passed on.

The cost of bags, the success of WA bulk wheat bunkers built with second-hand railway sleepers and corrugated iron finally spurred the eastern States to progress the transition to bulk wheat marketing (W.P of WA, 1950; AWB Gazette, 1957).

With the transition to bulk storage in all states by the 1960s, changes to the two grade wheat classification system became possible. The old system had perpetuated the low-grade, unhygienic Australian wheat image for more than fifty years after bulk handling had allowed Canadian and USA wheats to charge premiums for their more tightly specified product. The old system had contributed to the delivery of such low prices to Australian farmers that consistent investment in sustainable farming practices had not been possible.

## **5.20 A New Wheat Classification System Follows the Introduction of Bulk Handling**

Prior to 1974 all Australian wheat was sold in two crude classifications: Fair Average Quality (FAQ) and Offgrade (OG)(ie damaged or sprouted). The state of origin of the wheat and the year of the crop were added to the FAQ or OG designation. Any varieties of wheat grown were included into these two classes for sale.

Such crude classification combined with the system of payment that averaged export prices to all growers meant signals for growing better quality strains were not



transmitted. Likewise the state employed wheat breeders concentrated on developing strains with better disease resistance and yield, rather than end-use performance (Jones, 1984).

The early 1970s saw international prices for wheat soar (when USSR bought up global supplies to compensate for crop failures). There was thus an incentive to try to refine Australian wheat grade differentiation in an effort to capture better prices. As well, with bulk storage established it was possible to test and better segregate wheat pools for marketing.

An August 1974 an AWB circular posted to every wheat grower announced changes to the Australian wheat classification system.

FAQ was to become four classes:

- Australian Prime Hard (APH) (with three grades reflecting protein levels),
- Australian Hard (AH) (with two protein levels),
- Australian Standard White (ASW) and
- Australian Soft (AS) (with one protein grade).

OG was to be replaced with two classes: "General Purpose Wheat" and "Feed Wheat".

Reference to the State of origin and crop season date continued. (AWB Circular 1993)

The numerous different wheat varieties were delivered into whichever class their characteristics matched<sup>14</sup>.

For the next twenty year, until 1994, the AWB maintained the four class wheat grade system based on protein levels. Over this time however, some of the larger flour mills had moved to computerised systems demanding more finely disaggregated in-puts with minimal variation (JW:AWB).

By 1975 a number of markets specified a minimum protein level in the ASW wheat

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<sup>14</sup> Canada and USA had their own wheat grading systems with substantially more disaggregation than the old or new AWB system.

grades delivered to them. These included Japan, Iraq, Thailand, and Malaysia. AWB tested the grain after it was delivered to the pool to determine protein levels. No minimum or maximum protein level was specified to the ASW growers however, nor were higher returns for higher protein wheats passed back to them to stimulate the production of the preferred varieties. The bulk of the crop (ie 70%) in the new ASW grade continued to be only minimally differentiated.

The 1979-80 season saw the AWB respond to market demands and attempt to stimulate higher value wheat production with price premiums and discounts for particular wheat varieties known to deliver the preferred protein levels. However in the largest ASW class the AWB still accepted a wide range of qualities with no specific protein specification (AWB circular VAC 5980, 1993-94).

By the 1980s large Japanese mills maintained their own laboratories and test kitchens and were testing for a range of characteristics which they understood effected flour quality. In addition to protein levels they measured test weight, thousand kernel weight, hardness, starch levels, amylase activity, foreign material, unmillable material, ash content and flour extraction levels. Variations in the flour dough's development time, water absorption and stability (ie mixing tolerance) also became critical (GRDC,1995).

Price premiums on imported grain sales began to reflect these characteristics in the 1980s. Knowledge of the performance of different blends of grains became an important function of mill technologists in North Asia.

### **5.21 Australian Wheat Industry Deregulation**

Costs associated with Australian grain storage, handling and transport rose by more than 50% between 1979 and 1985. (I.C.,1991) As a consequence a Royal Commission was established to investigate the logistics and efficiencies of the grain marketing system (CAPP, 1990).

After examining the layers of institutional arrangements and agreements among the BHAs and the AWB, the 1988 Commonwealth Royal Commission Report on Grain

Storage, Handling and Transport ushered in a new era of de-regulation that created some competition in the domestic market for the AWB. This freed it to operate in a more commercially competitive way internationally. Specifically:

- Payment options were to be introduced to growers,
- The Federal Government's underwriting of each season's guaranteed minimum and advance payments to growers was announced as due to be phased out,
- The AWB could form more than one pool for selling each season's wheat crop (for example, noodle wheat could be separated),
- Varietal and protein level bonuses were to be introduced to create closer links between market returns and grower performance

### 5.22 Grain Classification System Refinements

With grower demands for higher returns, in October 1992 the Chairman of the AWB announced the first major wheat grading revision since 1974. ASW was to be further segregated. The Chairman explained there had been:

*changes in market demand, and declining protein levels around Australia ... The AWB considers that for future successful marketing, grades should contain fewer varieties and/or varieties of more similar quality attributes. The cornerstone of future wheat marketing will be the ability to have a uniform product, and the flexibility to alter the quality of that product in line with market needs. ... (AWB Circular, NSW, VAC 93-94)*

Thus in 1992 the AWB flagged a new era of market driven wheat production, with segregations according to wheat end-use and market responses signalled to the grower through price. The first disaggregation within the ASW class was to be *noodle wheat*. Premiums were to be paid according to specified protein levels of named varieties.

### 5.23 Conclusion

Without statutory regulation, grower efforts to achieve cooperative pooling of the annual harvest failed.

The two World War food supply emergencies provided the Government impetus for wheat market regulation, long demanded by growers. After WW2 the AWB maintained its monopoly on all domestic and export sales until 1989 when the domestic market sales were deregulated. (In 1994 it still handled 65% of this market).

With bulk handling infrastructure finally in place in the 1960s the AWB was in a position to respond to growing demand for better quality and better segregated product. However until 1989 the AWB continued to preside over a system where price signals and the classification system discouraged quality consciousness or market driven production.

In 1992 with its monopoly on domestic wheat trade gone and some market deregulation occurring internationally, the AWB sought to become more responsive to its suppliers and buyers. Further disaggregation of the classification system occurred ushering in an era of price premiums for quality suppliers, in particular for noodle wheat growers. Cooperation within the market place was to be sought to help identify buyer's preferences.

#### **5.24 Evolution of the Global Grain Trading System**

Sixty years after the 1844 repeal of the British Corn Laws that had restricted grain trade, Britain was the biggest market for food in the world.

There were a number of factors which made the exporting of wheat from Australia more risky compared with USA or Canada. For example, sales were made on a cost plus basis and so could not be finalised until shipping arrangements were completed. Chartering transport was cheaper arranged months before the harvest. If demand was overestimated the ship was still loaded and sales were (hopefully) negotiated during the seven or eight weeks voyage to Europe. It served the interests of merchants if the Australian wheat or flour was low priced and not too difficult to sell in the international markets.

Ultimately as supply began to outstrip demand globally, farmers had less influence over farm gate prices. The greater margins of profit were extracted downstream, along the railroad lines, at the storage terminals and as value was added through processing. Wheat had assumed the characteristics of a globally traded commodity.

### **5.25 World War, Domestic Market Regulation and Global Grain Trade**

Like most governments of major grain producers during WWI the United States Food Administration Grain Corporation assumed the administration of all the sales of grain to their allies and armies abroad.

The US government decontrolled prices in 1920 and the Grain Corporation was disbanded two years later. The Australian, Canadian, French and British governments also withdrew from their grain trading involvement following the war and the old private system of independent merchants was reinstated.

All grain export growers were adversely affected by the surpluses created by the recovery of European agriculture in the 1920s. World wheat overproduction and glut prevailed. However, memories of the effects of war on food production and importation in Europe were still fresh. Protectionism was a common European agricultural policy response and in particular governments intervened to expand grain production.

### **5.26 The 1930s: The Impacts of The Great Depression**

Below production costs, and the escalating indebtedness of growers in the 1930s saw all governments in grain exporting nations become involved in regulation of trade and domestic wheat production. These included the New Deal farm programs in the USA and the establishment of statutory authority marketing Boards in Canada (1935) France, Norway, Italy and the Netherlands (Schedvin, 1971; Morgan, 1979; Morriss, 1987).

### **5.27 Grain Policy Response to the Second World War (WW2)**

As in the first World War governments resumed control of grain trading during the national emergencies. Australia's AWB was re-formed in 1939 and continued after the war. At the end of WW2 there was little grain surplus but unmet demand in Europe. By 1948 the USA farmers had responded to government inducements and were annually growing a significant surplus of wheat. However the opportunities for developing new commercial markets were limited by the poor state of foreign economies.

Given the USA government-grower interdependencies, the strategy chosen to deal with the

overproduction was not exposure to free market forces. Instead the USA government subsidised a substantial international food aid program (Higgott, 1989).

### **5.28 USA Public Law 480 (PL 480)**

The US food aid Bill (PL 480) was passed by Congress in 1954. PL 480 welded farm policy to foreign policy and was promoted as food aid for under-developed countries. Military clients of the USA also received substantial assistance, for example Pakistan, South Korea, Israel and Turkey. The two most independent Eastern European Communist countries: Poland and Yugoslavia, received aid, as well as Brazil, Indonesia and Portugal.

Established suppliers to targeted grain markets saw their share eroded and prices fall. In the 1950s the USA received official complaints of wheat dumping from Canada, Argentina, Australia, New Zealand, Denmark, Mexico, Uruguay, Burma, Italy, Spain and Peru, (Morgan, 1979:104; Whitwell and Sydenham, 1991, Higgott, 1989; Dunsdorf, 1956).

The PL 480 made the US government the principal American financier of the grain trade from the 1950s until PL 480 was superseded decades later by other forms of market intervention for example, the Export Enhancement Program (EEP), (Boyce and Angel, 1992; Benedict, 1953; Rasmussen and Baker, 1972; Morgan, 1979; Marder and Berger, 1971).

The USA's use of financial incentives to expand their share of the international market helped to grow demand for human and animal wheat consumption. This occurred in particular in Japan, ROK, Taiwan, Iran, and the Philippines.

### **5.29 The 1960s: An Era of Global Over-Supply**

In the 1960s new seed varieties, irrigation, chemical fertilisers and new farming methods meant the annual wheat output of developing countries rose from 50 to 80 million tonnes (Morgan 1979:137).

In the late 1960s and early 1970s the USA, Canada, Australia and Argentina all had programs for reducing domestic wheat acreages (Hadwiger, 1970; Morgan 1979).

### **5.30 The 1970s: An Era of Global Short Supply**

The drought of the early 1971-72 meant hugely populated countries like India and Russia which had been exporting needed to become big grain importers. As well, developing countries in Asia, Africa and Latin America used their increasing affluence to satisfy changing dietary preferences, importing wheat for the first time. In many countries the diet was changing to include more grain fed beef, pork and poultry at the expense of potatoes and rice. By the early 1970s animals consumed as much globally traded grain as humans (Morgan 1979:9; Whitwell and Sydenham, 1991).

### **5.31 1973: The Japan Soy-Bean Crisis**

In 1973 the USA government imposed price controls and devalued the dollar in an attempt to deal with soaring US food prices and housewife demonstrations. When the price for soy beans soared, the US government placed a temporary embargo on exports. This embargo caused a crisis in Japan which relied on USA imported soybeans as a dietary staple.<sup>15</sup>

While the embargo was removed by September the risks associated with dependence on a single supplier were obvious. The Japanese Food Agency determined that it establish a three country supplier policy for grains. Canada and Australian suppliers came to be the "insurance" against future US wheat crises. The soy-bean crisis also gave Japanese farmers leverage to fight for continued protection to achieve and maintain a reasonable level of national food self sufficiency.

### **5.32 Conclusion**

In 1994 Australia produced some 3% of the world's wheat. It exported some 85% of its wheat crop which accounted for 11% of the world's exports of wheat. The wheat exports returned some \$2billion to Australia in export earnings.

The global wheat market is highly competitive, with prices substantially distorted by government involvement and subsidies. Most governments subsidise grain exports through

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<sup>15</sup> The oil crisis of the 70s also helped to reinforce the message of Japan's exposure to interruptions in the supply of essential commodities.

grower support schemes and some support consumption. Centralised buying agencies are long established in major importing regions.

Two important determinants of the institutional factors in global (or macro context) food trade have been the domestic agricultural policies adopted by the United States and the European Union since the 1960s. In 1991 it was estimated that the EC spent US\$38billion in supporting its farmers, and the US some US\$11billion (Lawrenson, 1991).

While high levels of producer subsidies increased production, they did not increase domestic consumption. Foodstuff staples are usually relatively inelastic. In 1994 world wheat prices were low and trending lower. While US food aid had disrupted demand for Australian product in developing countries, it ultimately grew demand for wheat based foods for human and animal consumption.

In 1994 soil fertility, drought and debt continued to be major problems confronting the Australian wheat grower. (GRDC, 1995; I.C., 1991) A landmark report into the condition and sustainability of the Australian wheat industry was commissioned by the AWB in that year. It reported a scenario that echoed the outlook of "wheat cockies" from generations before:

*Many wheat farmers and their farms are exhausted in terms of both the soils and finances and no longer have the strength to withstand repeated blows such as the current drought. The industry's institutional arrangements which have been in place for many years are now in flux. ... Furthermore many of the key industry indicators are not encouraging - real prices, once the effects of inflation are removed continue to decline;<sup>16</sup> farm productivity growth is low relative to other wheat producing nations; and market positions in many critical markets are under active assault primarily from Canada and to some extent the US. The relief expected*

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<sup>16</sup> Compounding the wheat farmers' problems were persistently low prices for wool.



*from GATT remains a promise we believe is a long way from realisation, despite an agreed schedule of implementation. Finally, there is a real question mark over the long-term sustainability both economic and agronomic, of the industry. (GRDC, 1995:1)*

Equally concerned about their long-term survival, the growers of noodle wheat varieties in WA acted collectively in 1991 to insist on better pricing policy and greater returns through vertical integration. Initially actively resisted by the AWB, by 1994 they were considered "the way of the future", (TF:AWB).

### **5.33 Wheat Industry Timelines**

The following timelines summarise development markers as the Australian wheat industry evolved from the commencement of European Settlement until 1994.

#### **1788-1830**

- NSW Colony established. The King's Store controls all food procurement and distribution. Prices are set. The NSW Corps monopolises the grain trade.

#### **1860s**

- Area grown to wheat doubled but yields decline.
- First major outbreaks of rust wheat disease.

#### **1870s**

- Area grown to wheat trebled.
- Australia becomes a net exporter of wheat and flour.

#### **1880s**

- Severe drought, many leave their land. Domestic supply outgrows domestic demand.

#### **1890s**

- Rabbit plagues, falling prices.
- Agriculture Department of NSW visits USA to investigate bulk handling systems.

**1895**

- Combine Harvester invented. Where Super Phosphate fertiliser introduced, yield decline arrested.

**1901**

- New *Federation* wheat-high yielding variety released.

**1905**

- Bare summer fallowing adopted to help retain soil moisture. Topsoil lost through wind and water erosion.

**1906**

- Select Committee on Grain Handling, NSW Parliament finds bulk handling not cost effective.

**1908**

- Royal Commission on Wheat Marketing, SA Parliament recommends not to proceed with bulk handling due to infrastructure costs, grower apathy, and antagonistic wheat shippers.

**1914**

- Government financial assistance given to overcome drought impacts.

**1915**

- Establishment of a compulsory wartime Wheat Pool, administered by an *Australian Wheat Board* using private agents.
- Federal government offers financial incentives to States to introduce bulk storage and handling.

**1920s**

- Last surge of wheat expansion into less viable growing areas in Australia.

- Each State replaces wartime regulation with voluntary wheat pooling scheme, few survived.
- Global grain glut, prices depressed.

#### **1930**

- Federal Government launches "Grow More Wheat" Campaign.
- Commonwealth Wheat Advances Act 1930 passed to provide a guaranteed minimum price (GMP) of three shillings for the season.
- Commonwealth Bank refuses to finance the GMP. Act is thus ineffectual. Farmer's financial position deteriorates.

#### **1930-31**

- Victorian State Government introduces a moratorium on repayments of worst cases of wheat grower debt.

#### **1931**

- Major international wheat price collapse.
- Commonwealth Wheat Bounty Bill (No.2.) provides a bounty of fourpence halfpenny per bushel for the 1931-1932 season.
- Establishment of the Australian Wheatgrowers Federation (AWF) to fight for better prices.

#### **1931-32**

- Attempted introduction of Second Commonwealth Wheat Bill to achieve compulsory pooling.

#### **1932-33**

- Flour tax introduced to cover the cost of financial assistance to growers
- Special wheatfarmer debt adjustment Acts introduced in each State. Funds inadequate from flour tax so Federal consolidated revenue used for supplementation.

### **1933**

- The Canadian Wheat Board formed.

### **1934**

- Australian Commonwealth Royal Commission on the Wheat, Baking and Milling Industry. First Report recommendations: To continue the flour tax and introduce a home consumption price scheme.

### **1935**

- The Commonwealth Loan (Farmer's Debt Adjustment) Act passed. 12 million pounds over seven years promised, 1.8 million pounds delivered.
- Second Report Royal Commission on Wheat, Baking and Milling Industry tabled. Recommendations: Controlled marketing; a compulsory national wheat pool; administration by Federal and State Authorities. Recommendations rejected when wheat export prices rise in 1936-37.

### **1937-39**

Global wheat prices declining sharply.

### **1938**

Wheat Industries Act aims to introduce long range planning and industry regulation to stabilise prices. Strategies include a flour tax to finance direct relief, buy-outs for the most indebted.

- quotas and differential prices introduced to reduce glut.
- September: WW2. Federal Government introduces National Security Regulations to take control of food staples and exports, especially to UK. Wartime AWB reformed with nine members to undertake all storage, shipping, marketing and payment of advances to growers.

### **1941-42**

- Delivery quota system delivers higher price for grower's first 3000 bushels, remainder discounted. This disadvantaged largest growers. (30% grew 68% of the grain.)
- Policy aims to reduce WA wheat production by one third.
- Introduction of subsidy of six pence per bushel for feed wheat to reduce carry-over

stockpiles and to stimulate pig meat and egg production.

#### **1944**

- Severe drought lasted to 1947. Wheat yields drop.

#### **1945-46**

- Quota system suspended due to drought, WA grower restrictions removed.

#### **1946**

- First Federal government attempt to establish an industry price stabilisation scheme failed.

#### **1947-48**

- Record breaking wheat season - bumper harvest.

#### **1948**

- Australian wheat price stabilisation introduced.

#### **1952**

- Federal government "Grow more Wheat" campaign to address current account deficit and declining export income.

#### **1960s**

- Massive Australia and global wheat glut. Government heavily subsidises growers to compensate for low returns. Production controls introduced world-wide.
- Bulk wheat silos built and last of wheat bag system replaced with bulk handling.

#### **1962**

- AWB office opened in Tokyo.

#### **1968**

- Guaranteed minimum export price uncoupled from domestic price.

USA Baking School established in the Philippines.

- Introduction of state based delivery quotas, so a cross border black market develops.

**1969**

- Quotas on wheat acreages grown to reduce domestic and international wheat glut.

**1972**

- Canadian International Grains Institute established.
- Drastic drop in wheat supply due to severe drought in Australia, USSR and China. Leads to food price riots in USA - USA ban on soy bean exports to Japan.

**1974**

- FAQ/OG grade system replaced with new classification system.

**1975**

- Establishment of Central Grains Research Laboratory within the Bread Research Institute, (BRI) Sydney.
- Thailand, Iraq, Malaysia and Japan specify minimum levels of protein in their ASW wheat purchases.

**1976**

- AWB creates separate pools for different wheat grades
- First publication of detailed guidelines on quality classification for Australian wheats.

**1977**

- AWB launches a series off-shore baking and milling seminars, and Asian baking and milling personnel offered courses at the BRI.
- Two twelve month research fellowships fund Japanese milling technicians to study in Australia and teach Australian technicians about noodle grain manufacturing requirements.

**1979**

- Federal Wheat Marketing Bill aimed at introducing disincentives for the growing of inferior wheat varieties.
- First advance and stabilisation of prices policy replaced by Guaranteed Minimum Delivery Price (GMP) payment.
- Different state's rail transportation charges made transparent, ie no longer pooled and averaged to all growers.

- Senate Standing Committee on Finance and Government Operations finds major inadequacies in AWB accounting and financial management systems.

#### **1980**

- Trust based system introduced where growers declare name of varieties they deliver to receival points. Only certain varieties allowed at specific receival points.
- AWB introduces new bulk handling charges - changing from national price pooling to state by state.

#### **1983**

- AWB allowed to borrow offshore in line with new Federal government deregulation of the financial system and floating of the Australian dollar.
- IAC report on the Wheat Industry recommends that the AWB lose its domestic marketing monopoly.

#### **1987**

- IAC Report on the Wheat Industry recommends that the AWB loses its export as well as its domestic marketing monopoly.

#### **1989**

- AWB loses its domestic marketing monopoly.
- AWB allowed to deal in other grains and value added product.
- Introduction of payment options for growers.
- Price signals for quality introduced. Growers receive \$3 bonus for each extra protein percentage delivered of ASW over 9.5% and up to 11.5%.
- AWB loses its grower domination on its Board.
- Introduction of bonus for two varieties of noodle wheat (grown for Japanese and Korean markets in WA)

#### **1991**

- Noodle wheat bonus price increased.
- WANGA formed to lobby for better returns for their membership.

#### **1993**

- AWB replaces bonus with a separate noodle pool price reflecting market returns.
- WANGA visits ROK and Japan to promote their product and to build relationships.

## **Chapter 6**

### **CASE STUDY:**

### **THE AWB WHEAT TRADE TO SOUTH KOREA**

#### **The actors participating in the evolving network:**

AWB

The Korean Flour Millers Industry Association (KOFMIA)

Daehan Flour mills

Daesun Flour Mill

Daesung Flour Mill

Dongah Flour Mills (Pusan and Seoul)

Cheil Flour Mills (Pusan and Seoul)

Shin Han Flour Mill

Young Nahm Flour Mill

Shinkukdong Flour Mill

Hankuk Flour Mill

Western Australia Noodle Growers Association (WANGA)

University of Korea (UK)

Nhongshim, ROK noodle manufacturers.

Haitai, ROK noodle and bakery product manufacturer

The ROK Ministry of Agriculture, Fisheries and Forests (KMAF)

USA Wheat Associates (USWA)

Canada Wheat Board (CWB)

Citizens' Alliance for Consumer Protection of Korea (CACPK).



(NB: Korean names are reversed with given names first and family names last)

### **The AWB**

#### **Informants**

Vincent Alisauskas, (**VA:AWB**) Senior Milling Technical Adviser, Joined AWB in 1965. Qualified in milling technology. Responsible for initiating and building relationships with millers in ROK from 1985-

John Bunn, (**JB:AWB**) Flour Milling Adviser AWB. Joined AWB in 1985. Australian qualified miller, previously worked in Middle East mills.

John Wischer, (**JW:AWB**) Senior Coordinator, Customer Services. Previously journalist. Joined AWB in 1965. Organised first trade seminars in Australia, Singapore and ROK.

Nigel Officer, (**NO:AWB**) Senior Manager, International Marketing AWB. Director of AWB Tokyo Office from 1989-92, From 1993 responsible for overall ROK market development in Head Office, Melbourne.

John Holland, (**JH:AWB**) Director of AWB Tokyo office 1970-87

Steven Felletti, (**SF:AWB**) Director of AWB Tokyo office, 1992-

### **University of Korea**

#### **Informant**

Professor Cherl Ho Lee, (**CHL:KU**) Professor of Food Technology. Began researching characteristics of Australian noodle wheat in 1981.

### **Yonsei University**

#### **Informant**

Dr Horace Underwood Snr, (**HU:Y**) .Director of University. Son of University founder, and Director of Yonsei Dairy Company, a university owned commercial enterprise.

### **KOFMIA**

#### **Informant**

Won Chul Oh, (**WO:KOF**) Manager, Business-Purchasing Department. Prior to market deregulation, KOFMIA purchased wheat on behalf of ROK mills. In 1994 it still organised USA wheat tenders at the request of the four smallest mills.

### **ROK Flour Mills**

(Listed from largest to smallest in output.)

### **Daehan FMs**

#### **Informants**

Joong Jin Kim, (**JK:DHFM**) Assistant Manager, Business Dept.

Y.S.Kim, (YK:DHFM) Director General Manager, Business Dept.

**Cheil FMs** owned by Samsung

**Informants**

Jung Ho Song (JS:CFM) Senior Manager, Wheat Section Seoul

J.H.Jeong, (JJ:CFM) Manager, Wheat Section, Pusan

S.Ch.Won, (SW:CFM) Wheat Section, Seoul

In Bum Heo,(IB:CFM) Manager, Technical Service Team .Pusan

Yeong-Mog Yoo, (YM:CFM) Senior Manager, Laboratory Department. Pusan.

**Dongah FM**

**Informants**

Wan P. Hong, (WH:DoFM) Deputy General Manager, Trade Department.

B.Y.Han, (BH:DoFM) Director.

Dong Hwan Roh, (DR:DoFM) Assistant Manager, Trade Division.

**Dongah FM**

**Informant**

Sang H.Cho, (SC:DoFM) Executive Managing Director, Pusan. SC:DoFM worked for KOFMIA from 1971-83.

**Hankuk FM**

**Informants**

Bong Kyu Sun, (BS:HFM) Business Department.

Yong Kee Kim, (YK:HFM) Assistant Manager, Business Department.

Sun Koo Park, (SP:HFM) Manager, Business Department.

**Daesun FM**

**Informants**

Se Jung Park, (SP:DSFM) Chairman.

Kwan Hei Park, (KP:DSFM) Executive Director.

**Shin Han FM**

**Informants**

Jung Keun Moon, (JM:SHFM) Manager, Wheat Department.

Joung Bae Ahn, (JA:SHFM) Manager Research and Development Department.

Kwan-Dong Kim, (KK:SHFM) Executive Director, Plant Manager.

**Young Nam FM**

**Informants**

Jae Jin Yoo, (JY:YFM) President.

Young So Lee, (YL:YFM) Executive Director.

**Shinkukdong FM**

**Informants**

Sang Moo Park, (SP:SKFM) Executive Director and Plant Manager

Sung Il Ji, (SJ:SKFM) Chief of Quality Control, Manager.

**Daesung FM Pusan** (smallest ROK mill)

**Informants**

In Sung Koh, (IK:DFM) Executive Managing Director .

Ho Sung Koh, (HK:DFM) Director, Director.

**Consumers Action-Advocacy Groups**

**Citizens' Alliance for Consumer Protection of Korea (CACPK)**

**Informants**

Soon Kim, (SK:CACPK) President,

Jai Oh Kim, (JK:CACPK) Executive Director

**YWCA**

**Informant**

Professor Sook He Kim, (SK:YW) President YWCA of ROK and Head of Nutrition Department, Ewha University.

**United States Embassy, Seoul, ROK**

**Informants**

Charles Alexander, (CA:USE) Director, Agricultural Trade.

Myung Haeng Rhee, (MR:USE) Promotions Specialist, Agriculture Trade.

**Australian Embassy Seoul, ROK**

**Informant**

Peter Buckland, (PB:AE) Counsellor Agricultural Trade.

**ROK Ministry of Agriculture, Forestry and Fisheries (KMAF)**

**Informant**

So Il Lee, (SL:KMAF) Director General of the Food Policy Division, 1977-81

**ROK Food import agents and traders**

**Bysal Importers**

**Informant**

Honki Bae, (HB:B) Importer of grain fed beef, was based in Australia for six years.

### **Won Hee Trading Company**

#### **Informant**

Won Hee, (WH:WH) Importing agent for GFW, Kraft, MG.

### **I and J Imports**

#### **Informant**

I. Lee, (IL:IJ) Owner-Director. Importer of Australian frozen pastry meals and fish products.

### **Manufacturers ROK**

#### **Unilever, Korea.**

#### **Informant**

Jean Pierre Brehan, (JB:U) Director. importer of flour based pre-mixes and bakery products. Their manufacturing JV with an ROK partner ended in litigation and dissolution.

## **6.1 Evolution of Agricultural and Food Policy in the ROK**

In the 15th Century the Chosun Kingdom was established over the Korean Peninsula and the population was converted from Buddhism to Confucianism. Meat and cereal were then combined in the diet. While rice was preferred, the mountainous terrain, especially in the south meant that corn, millet and barley were also staples (CHL:KU).

In the era of Japanese colonisation, the Peninsula was developed as a rice bowl for Japan. By 1955, WW2 followed by the Korean War had destroyed what industrial infrastructure had existed in the South, including the flour mills.

By 1955 ROK was one of the world's poorest economies. The infrastructure and productive capacity of the largely agrarian society was destroyed and a large proportion of the population was homeless.

## **6.2 The Industrialisation and Urbanisation of ROK**

Until the 1960s almost half of the GNP was generated by agriculture and most of the population was engaged in farming. The vigorous industrialisation and export drive began in the early 1960s and rapidly transformed the character of the economy. Between 1960 and 1986 the share of agriculture in the GNP declined from 36.5% to 12.7% and agriculture's total share of employment declined from 60.2% to 22.7%. While the GNP

expanded at a rate of on average 8.2% in 1962-86 the agriculture sector grew at 3.6%, well below the capacity to meet demand for increased self-sufficiency for major food categories (Moon and Kang, 1991).

In 1980 the new President Chun initiated a series of institutional reforms to restructure the economy to maintain strong growth with more price stability. These reforms were reflected in the policies of the Government's 1982-1986 five-year plan.

According to the Korea Trade and Business Journal the new five-year strategy aimed:

*To liberalise the economy both internally and externally and to introduce greater competition in all sectors ... by relying more on market mechanisms. In the domestic market the government introduced and enforced anti-monopoly and fair trade practices. Externally the government adopted a program of accelerated import liberalisation and tariff reductions to increase the international competitiveness of Korean products ( KOTRA, July 1992:47).*

From 1985 to 1988 (the year of the Seoul Olympics) ROK achieved rapid economic expansion, accompanied by a huge increase in demand for better quality and more manufactured western style foods.

The spectacular levels of national economic growth then began to slow. Critical factors included the increasing labour costs and prices and real rates of inflation running close to 20%. The Korean government attributed the slowing growth to the increasing pressure from countries like the USA calling for greater market access and a correction of their trade imbalance (KOTRA July 1992).

In summing up the era however, the Director General of the Small and Medium Sized Industries Bureau, Ministry of Trade and Industry, Hwang Doo-Yun stated:

*The 90s can be classified into the three general trend categories of internationalisation, regionalisation and liberalisation (KOTRA, May 1992:12).*

In 1992 ROK depended on imported agricultural products for 62.5 percent of its domestic consumption. Most staples were imported, for example; wheat (99.9%), sugar (100%), soy bean (81.0%), corn, mainly used to feed livestock (97.9%) and beef (56%). Imports of agricultural, forestry and fishery products amounted to US\$9.8 billion or 12.0% of the total national imports in 1991, making the ROK the world's sixth largest net importer of agricultural produce (ROK:GATT Report, 1992).

Trade liberalisation schedules for nearly 85% of agricultural products were in place in 1993. However achieving self-sufficiency in rice, barley and beef production and the maintenance of farm incomes continued to be central objectives of the government's agriculture policy. (ROK:GATT, 1992) Regional family ties were being maintained. For example on days dedicated to visiting ancestral homes and maintaining graves some fourteen million people move out of Seoul to visit the regions (SK:YW).

Non-tariff barriers, in particular those relating to phytosanitary and safety regulations served a number of domestic agricultural policy objectives (JB:U, PB:AE, CA:USE). In some instances the authority to approve imports has been delegated to agricultural industry associations,(eg the National Livestock Cooperative Federation), giving scope for discretion to highly interested parties (CA:USE).

Despite their declining competitiveness, and the official moves towards import liberalisation, in 1994 the ROK farmers continued to receive one of the world's highest levels of agricultural sector subsidisation reinforced with an array of non-tariff barriers restricting food importation.

### **6.3 Achieving Rice Self Sufficiency**

Adults in ROK vividly recall the era from the 1950s through to 1970 when food shortages, food rationing and hunger were a reality for most. (SK:YW, MR:USE). The country depended on food aid, for example sugar, flour and milk powder from the USA. In 1953 a government school lunch program helped overcome the children's poor nutrition. The lunch included donated milk and bread (SK:YW).

In 1955 the Rhee Government signed the U.S. Farm Surplus Importation Agreement which

allowed PL 480 shipments of grains, soy beans, raw cotton and tallow to enter the ROK at minimal cost to the country.

SK:YW a Professor of Nutrition at Ewha University<sup>1</sup> and President of one of the largest consumer advocacy groups was a teenager at the time and recalled:

*PL 480 gave us a lot of USA flour and wheat as aid so there was lots of noodle restaurants started between 1962 and 1970 (SK:YW).*

In particular the ROK government's food supply policy focused on achieving self-sufficiency in rice production. They aimed to achieve this through the substitution of other less desirable grains for rice.

MR:USE recalls:

*In the 1970s we had major frugality government campaigns because we were not self sufficient in rice, so we had to mix it with boiled barley. To get people to do this, so the rice harvest could be eked out to cover the year, the government insisted on 30% barley mixed in. At the elementary school our teachers had to inspect our lunches to make sure our parents hadn't cheated. I can remember posters on the walls showing mixed grains were best for you (MR:USE).*

Homes and commercial outlets were also required to substitute rice based lunch meals for noodles two days per week. By mid 1975 this requirement was reduced to one noodle meal per week. All noodles were made from imported USA flour, and later, flour made from imported US wheat milled in ROK (KD:DSFM; CHL:KU; SK:YW; MR:AE).

## 6.4 Changing Food Consumption Patterns in ROK

The ROK government officially discouraged the consumption of Western style or imported foods for nationalist as well as balance of payment reasons. Until the 1990s overseas travel

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<sup>1</sup> Ewha is the oldest, largest and most prestigious women's university in ROK.

was strictly controlled, as was advertising through all media. However, dairy products, a range of frozen foods, processed meats (eg hot dogs, spam), extruded cereal breakfast, snack foods, bread, peanut butter, coffee, alcohol, fruit juices, cigarettes and cheap rice, were readily available to the population in Seoul and Pusan through the US army commissary supplied black-market.<sup>2</sup>

The 1989 US Senate inquiry into the size and impact of the US Army Commissary black market found that 75% of the US\$250 million worth of product, mostly food, imported for US defence force personnel and their families was diverted straight onto the black market (US Senate, 1990). Black market products still in their original containers were prominently and openly displayed for sale in the open air and super-markets. The inquiry found that the 75% diverted on to the ROK domestic market in 1988 was typical of the volume of previous decades.

This black market meant that even though the importation of western style foods and their advertising was officially strictly limited, ROK urban populations had a close familiarity with and ready access to US branded products as well as some fast food chains located on US army bases. Assessing the impact of this black market in ROK the Director of Agricultural trade (CA:USE) at the US embassy felt:

*A lot of American companies have been able to come in on the back of military supplies to the US forces here, Kraft and the spam manufacturers, the fast food chains, donuts and so on (CA:USE).*

The US Senate inquiry (1990) concluded that the black market constituted a victimless crime which had delivered substantial advantages to both countries. By tacitly condoning the US product access the ROK government of the day saw the demand for western style products satisfied, while at the same time officially holding the line on food importation restrictions, thus avoiding confrontation with their rural constituency.

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<sup>2</sup> The US commissaries on the army bases were designed to provide the 70,000 US servicemen and their families stationed in ROK with 'State-side' goods at "State-side" prices.



## **6.5 Changes in Family Structure and Food Consumption Patterns**

From 1980 women joined the salaried workforce, urban one- generation apartment dwellings replaced multi-generation homes, and children attended cram schools after school classes, returning home late to eat a meal specially prepared just for them. Improved technology in the food processing industry made "store bought" foods more acceptable. Thus single serve meals, snack foods and fast foods became acceptable substitutes for traditional labour intensive and time consuming women's work in the home (Palley, 1990; JK:CA, SK:CA, HB:B).

Young women were taught how to make western style food in school cooking classes, and brides were typically presented with recipe books featuring western style food preparation. (MR:USE and SK:YW) Home use of flour for noodle preparation fell from 18.8% in 1981 to 4.8% by 1990 (SK:YW).

The Seoul Olympic Games provided a major impetus for increased wheat consumption, in particular of bakery products. The quality of processed food also substantially improved. Consumption of flour per capita peaked at 39.5 kg in the year of the Games (1988) with consumption boosted by the record number of international visitors.

Bread Flour as a proportion of flour production rose from 6.7% in 1981 to 15.5% in 1990. Over the same period flour specifically for cakes rose as a ratio of total flour production from 4.6% to 14.2% (SK:YW).

In line with home-use restaurants also reduced flour purchases, from 14.6% of total sales in 1981 to 3.9% in 1989. These figures do not represent a reduction in flour consumption but rather a shift to commercially manufactured noodles. The use of wheat flour for commercial noodle manufacture nearly doubled over the period to represent the largest proportion of wheat flour consumption. Most noodle manufacturers aim to export instant noodle type products, in particular to Japan.

## **6.6 The Legacy of the Colonial Era and Korean Wars**

### **6.6.1 Relationships with the USA**

ROK has needed to maintain a strong defence force capability given the continued threat of

war from the North. The cost of maintaining such a force was initially beyond the capacity of the small country's economy. The USA has responded to this need with on average 45,000 US troops (70,000 including dependents) based in the ROK to assist with defence. This assistance has been seen by many South Koreans as an undesirable dependency and form of enculturation (Choi, 1987; Goldsworthy, 1991)<sup>3</sup>.

USA pressure on the ROK government to liberalise their food trade in the late 1980s was described as "*more bullying*" by KP:DSF. According to VA:AWB3:

*The fact that the USA is hated in ROK helped us to pick up sales and customers initially. The ROK millers will often do anything to upset the USA (VA:AWB3).*

#### 6.6.2 Relationships with Japan

Relationships with their old colonial rulers, Japan continued to be distant and hostile in 1994. Memories of the suppression of Korean language and culture, food shortages and loss of independence meant that bans on the sale of Japanese films, books and recorded music were only lifted in 1993. The issue of Japanese government compensation and an official apology to the "Korean comfort women" forced to work as prostitutes for the Japanese army during WW2 was a most keenly debated issue during the early 1990s, fanning old hostilities.

While Japanese milling and baking technology was known to be more advanced, little cooperation was observed between the smaller mills and Japanese firms, and only the beginning of some social and technological exchanges between one of the biggest Japanese and ROK mills. Competition rather than cooperation typified most exchanges. KP:DSFM owner of a medium sized mill explained:

*Even now my company would ask the AWB or the USA Wheat Association to arrange a visit for me to a Japanese flour mill (KP:DSFM).*

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<sup>3</sup> CHL:KU gave expression to the typical ROK response to the food aid donated by the USA in the 1950 and 60s: "Around 1950 the ROK population had a lactose intolerance but they were forced to drink the milk because of their hunger. It made them very sick"

First grade ROK flour mixes milled from the same wheat sources as those used by Japanese mills sold for substantially less on Japanese and South East Asian markets in 1994. Japan's mills saw the larger ROK mills as strong competitors in their fastest growing markets (SF:AWB).

## 6.7 Domestic Grower Competition

In contrast to Japan, virtually no wheat has been grown in the ROK since the 1960s. Wheat growing was discouraged given the land capability, the low cost imports available from the USA and the government subsidies directed to other cereal production, in particular rice and barley<sup>4</sup>.

## 6.8 The ROK Flour Milling Industry Structure

In 1945 four small Japanese built roller type flour mills remained in South Korea. These were soon after destroyed in the Korean War. By 1954 two small mills on sites that had been owned by Nippon (NpF) and Nisshin (NF) were rebuilt by the government.

In 1955 KOFMIA was established under the direction of (KMAF). Until 1983 KOFMIA's role was to buy all ROK milling wheat and equipment, to arrange credit for the mills, to organise all promotional activities designed to increase flour consumption, and to collect and analyse statistics on international grain markets, prices and trade practices (KOFMIA 1991). Typically the president of the largest mill was chairman. All mills belonged to "their industry association".<sup>5</sup>

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<sup>4</sup> Informants from KMAF stated that their 1993 official agriculture policy included re-establishing a domestic wheat industry. No resources had been committed to the objective however

<sup>5</sup> KOFMIA differed from the Japanese Millers Association in that all mills were members and KOFMIA bureaucrats organised the tenders and purchasing under KMAF policy guidelines. Trading Houses did not influence KOFMIA. In Japan the Millers Association consisted of the four biggest mills who advised the FA annually as to the industry's import needs. The FA conducted the tenders, using the 28 sogoshosha of the Grain Importers Association to purchase the wheat on their behalf.

**Figure: 6.1: ROK Flour Mills: Approximate Market Share of Biggest Mills in 1994**

<b>Mills</b>	<b>Market share 1994</b>
DHFM	30%
CFM	25%
DoFM	16%
HFM	9%
DSFM	7%
Other mills	13%

(Source: KP:DSFM, NO:AWB)

## 6.9 The Second Period of Expansion: 1963-71

By 1971 24 mills had been privately established under strict government regulation. All wheat was supplied by the USA under quota, with very generous credit terms. Flour extraction rates were set at over 70%. Flour prices were pegged. Mills were allocated a quota of grain to process, which did not necessarily reflect market demand.

Until late 1983 when the ROK government began to remove controls the flour quality produced was very poor, with the set market prices and prescribed flour grades stifling competition, despite demands for better quality from the manufacturers trying to enter export markets with instant noodles (JH:AWB memo 6.9.83).

Until 1985 virtually all wheat was supplied by the USA. Thereafter mills were free to import fifty percent of their needs directly from any suppliers. ROK then evolved with Japan into a premium paying, quality oriented market.

ROK and Japanese noodle wheat requirements differ. While Japan paid the highest premium for a medium to low protein soft wheat for their highest priced fresh udon noodles, ROK preferred a higher protein harder wheat for instant "ramen" noodle manufacture. The ROK higher protein wheat specifications meant white wheat from USA, AWB or CWB was more readily substitutable (VA:AWB2).

## 6.10 Post Deregulation

In ROK in 1994, 13 mills were operating with a combined capacity of 3,141,000 M/T per year. While wheat flour consumption had increased at 2-3% per annum since 1986, wheat flour for bread and confectionary consumption was increasing at a faster rate than for noodles (NO:AWB).

Given relationships with Japan, the bulk of wheat was imported through international agents like Andre, Continental and Dreyfus. In 1989 however, the biggest ROK flour mill (DHFM) requested that the AWB supply them through Mits. They had developed a special relationship with NpF whose mill had been rebuilt as DHFM after the Korean War. NpF were always supplied through their sogoshosha Mits, and with DHFM in their network, they expected this sogoshosha to also supply the ROK mill (NO:AWB).

## 6.11 The ROK Milling Industry

In 1994 only whole-wheat grain (not flour) was allowed to be imported.

The *chaebols*, (ie privately owned but government supported conglomerates engaged in heavy industry, high technology and infrastructure development) were barred from involvement in food manufacturing (CHL:KU). Thus smaller (less well-resourced) companies tended to dominate the food manufacturing sector.

With the exception of Cheil, one of the biggest mill companies, there was little vertical integration in the industry. In 1994 Noodle manufacturing was dominated by Nhongshim, one of the biggest noodle manufacturers in the world, with some 70% of domestic market share (VA:AWB2). Nhongshim had joint ventures with USA companies, including Kelloggs. The bakery industry was fragmented into hundreds of small "window" bakeries who tended to produce sweetened soft dough breads and buns with an assortment of fillings.

KP:DSFM explained their customer dependency:

*The noodle factories are now bigger than us flour mills in ROK. In 1975 when wheat milling began bakers were very small. They came and*

*begged for flour. But after the 1970s the market was much bigger, consumption increased and now there is over capacity in the mills ... No ROK flour mill owns a noodle company. .. Before 1985 the government had to give permission to someone to build a flour mill. In 1985 there was a big change and you were free to build mills and to buy factories making noodles, but there was not enough capital to do this (KP:DSFM).*

Although the ROK government ceased to regulate flour prices in 1985, unofficially the government retained pressure on the mills to peg prices at the 1985 levels. The mills were price takers, despite their buyers demanding ever finer segregations of flours so they could compete in export markets.

The large mill managers stated that the government would not allow a price rise. The smaller mills complained that the large mills deliberately failed to pressure the government to allow flour price increases knowing smaller mills were having difficulty staying in business. As flour prices were informally pegged, competition for buyer loyalty was based on product quality and customer service, rather than price.

In 1990 KOFMIA estimated that the flour mills were operating at only 64.8% capacity. Industry restructuring was inevitable.

There had been a steady decline in the milling ratio allowed from the peak of 74.5 % in 1987.<sup>6</sup> This decline was attributed to increased competition from imported ready made flour products, growing competition (eg from China) for their exported noodle and other flour based products to Japan, Taiwan, and USA markets.<sup>7</sup>

One of the biggest problems facing all mills was a lack of grain or flour storage capacity, given the cost of land, especially close to shipping terminals. Limited grain storage made

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<sup>6</sup> The higher the milling ratio the more ash and bran in the final flour, making it a darker colored, lower quality (but more nutritious) product.

<sup>7</sup> Chinese noodle manufacturing had benefited from technology transfer and investment from Japan (VA:AWB).

the segregation of wheat (eg of different specification or sources) costly or impossible.

## 6.12 Post Mill Deregulation Market Conditions in the ROK

In 1990 there were thirteen flour mills controlled by eleven companies. ROK milling continued to be dominated by three large enterprises: Daehan, Dongah, and Cheil who together supplied over half of the ROK milling capacity (1.929 MMT out of 3.141 MMT). (KOFMIA, 1991).

The manufacturers continued to exert strong pressure on the mills. For example Daesung management complained in January 1992 that Nhongshim had rejected 1400 bags of their flour because it was 0.1% over the protein specified (Meeting notes AWB Jan 1992).

In January 1992 Daehan, the biggest ROK mill's management complained to the AWB that:

- *International wheat prices were up 40%.*
- *AWB wheat prices were too high.*
- *All but one or two ROK mills were losing money.*
- *ROK labour costs were up 10%.*
- *The government was concerned with inflation with wholesale price rises of 9.5% in 1991.*
- *The government was prohibiting flour price increases.*
- (JW:AWB meeting notes Seoul, 22 Jan 1992).

Cheil, the second biggest flour miller reported that: (as well as AWB prices being too high)

*The market for traditional soft wheat products was not growing.*

*The western style wheat based snack food market was diversifying into more potato and corn chips. Cheaper potato flour was being substituted for some wheat flour products.*

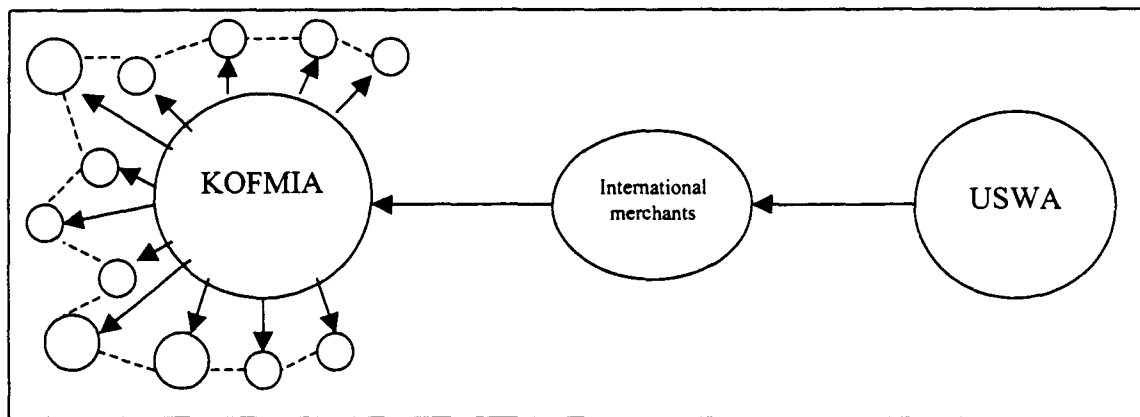
*Large bakeries were losing business to small "window" type bakeries using cheaper imported pre-mixes to make "oven-fresh" bread (JW:AWB meeting notes Seoul, 22 Jan 1992).*

In 1994 the mills aimed to survive by extracting the maximum levels of flour possible, cost savings through improved efficiency, better quality output and exporting.<sup>8</sup>

### 6.13 Industry Relationships

While flour milling was highly competitive within the ROK industry, the decades of close cooperation as members of KOFMIA meant that there also existed long established close and cooperative relationships between big and small mills. This cooperation served the mills well when they chose to share shipments in order to cut wheat transport costs, and in times of joint action when the mills challenged the government, the media and consumer advocates during the wheat contamination scares.

**Figure 6.2: ROK Wheat Trading Network pre 1984**



**Key:**

Small mills ○

Product exchange →

Big mills ○

Information exchange - - - - -

### 6.14 The AWB Strategy to Enter the ROK Market

During the 1970s when ROK wheat market regulation required that all grain was imported from the USA, JH the director of AWB Japan office visited ROK at least annually. He met with the directors or presidents of KOFMIA, KMAF, the Korea Feed Association, the larger mills, the trading houses (Dreyfus and Continental) and the office of the Seoul USWA. The aim of these meetings was to promote the quality and price of AWB wheat (JH:AWB).

<sup>8</sup> Three mills referred to their experience with low grade flour exports to China, where they all "lost money".



In Nov 1979 the CWB held a seminar for millers in Seoul. Japanese millers reported to JH:AWB in Tokyo that the event included "*wide ranging lectures and banquets*" (JH:AWB telex Nov.79).

In that same year IL:KMAF the Director General of the Food Policy Division of KMAF asked that he be offered an AWB sponsored mission to Australia (JH:AWB). This visit was subsequently organised for 1980. During his stay Mr L indicated that the ROK single wheat source policy could be negotiable if AWB credit and other terms of trade were comparable with those offered by the USA. The AWB responded then and a year later in the negative:

*...the Board's view has not altered from what (was) stated (in 1980) ... we are not keen to make credit terms available to the ROK ... However we are not averse to discussing with KOFMIA the possibility of another party, (ie a bank) organising credit terms, but obviously ... KOFMIA would be looking at commercial interest rates (TELEX AUSWHEAT J22839 21.8.81).*

### **6.15 The Role of Technology Transfer in Market Deregulation**

In December 1980 JH:AWB personally farewelled the KOFMIA delegates on their first sponsored mission to Australia. The tour included an inspection of training facilities at the BRI in Sydney.<sup>9</sup>

In January 1981 KOFMIA made its first formal request to the AWB to obtain sponsored places for their milling members to undertake short courses at the BRI. JH:AWB stated in his telex from the Japan office that the President of (KOFMIA):

*... considers that sending trainees to attend this course will be helpful to the future business relationship for both countries.*

(TELEX WHEATBD AA30196 12.1.81)

However, the AWB responded:

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<sup>9</sup> The government at this time strictly controlled overseas travel from ROK. Such overseas travel opportunities were only for those with close government connections and support.

*Places at this training course are very limited and Board yesterday confirmed that these should be offered first to our regular buyers. ... KOFMIA's request will be considered again at a later date in light of developments. Meantime we will send copy of training course information booklet to KOFMIA for background only (TELEX AUSWHEAT J22839 27.2.81).*

The AWB Chairman and JH:AWB visited ROK together in August 1981 and the issue of gaining fully sponsored places at the BRI was again raised by KOFMIA members. The telexed reply sent via JH:AWB in Japan after the return of the AWB Chairman made the conditions for free places clear:

*We would likely require a positive indication from the Korean Government, indicating that they are genuinely interested in obtaining alternative to US wheat before committing a position on a BRI Course over the next twelve months (TELEX copy 10.81).*

Meanwhile, the Canadian Government on behalf of the CWB pursued access to ROK wheat markets through bi-lateral negotiations which included power plant options:

*Canada and South Korea have reached an agreement in principle to expand their trade and economic cooperation in the near future, a source close to President Chun Doo Hwan said Monday. During a parallel meeting, Canadian Ministers ... said they sought to sell nuclear reactors and gain entry into South Korea's market for grain (Telex from JH:AWB Japan to AWB Melbourne 31.8.82).*

In March 1983 Japanese mill management reported to JH:AWB in Tokyo that:

*KOFMIA was very active preparing for the 1988 Seoul Olympics, similar to their (Japan's) activity before the 1964 Tokyo Olympics. (JW:AWB memo to AWB 23 March 1983)*

It was a time of rapid growth in the ROK economy. The first moves towards wheat importation and flour market deregulation were made in the context of:

*The growing dissatisfaction with the quality of ROK inputs for processed foods as manufacturers tried to build export markets, in particular for instant noodles;*

*a concern about improving national food standards in preparation for international scrutiny during the Seoul Olympics;*

*the fact that no wheat was grown in ROK;*

*and growing political pressure from the USA, which was demanding ROK address the trade imbalance (JH:AWB).*

### **6.16 Partial Wheat Market Deregulation Commences: 1983**

In 1983 50% of all wheaten flour was used for noodles, 20% for bread and cakes and 14% for wheat liquor. Flour price was half that of Japan, consumer's incomes were half that of Japan, however prices for bread and cakes were similar, reflecting their status as "luxury" foods (JH:AWB memo 82/76).

In early 1983 the US initiated a much publicised challenge to Japan's market access regulations in the so called GATT - 12 products case.<sup>10</sup>

On June 3rd 1983 an "Urgent" Telex from the Tokyo AWB office to AWB Melbourne informed them of the ROK Government announcement that from July 1983 fifty percent of the wheat import market would be liberalised, with ROK mills permitted to buy this 50% by private negotiation.<sup>11</sup>

While flour prices were to remain under government control mills were permitted to produce any type of flour. The compulsory three grade system was abolished. The extraction rate of 77% was no longer to be fixed, allowing mills to produce better quality flour.

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<sup>10</sup> In 1987 this challenge was upheld by GATT and Japan agreed to replace some import quota with tariffs

<sup>11</sup> Fifty percent of the imports of soybeans had also been liberalised.

In a memo to Head Office JW noted the changed competitive environment in the ROK milling industry:

*... as they faced the new era of domestic sales and grain import deregulation. (They) have commenced study individually to modernise their mills in order to gain efficiency and flour quality advantages by installing new machinery from such as Buhle (JH:AWB Memo 6.9.83).*

The AWB milling technicians recognised that without adjusting their milling machinery and timing for the conditioning of Australian ASW grain, ROK attempts to use the soft, brittle wheats would produce an inferior flour with high ash levels and poor dough characteristics.

Until 1983, communication between the AWB and the ROK industry had been at the most senior management levels. However, the new era of deregulation required that milling technicians learned how to achieve superior quality flour from the different ASW, and management became convinced that the quality was worthy of the premiums asked.

In order to educate the millers VA:AWB1, senior technical adviser set out to develop close, trusting relationships with his counterparts in each of the ROK mills.

VA:AWB1 described the strategy he adopted in 1983:

*The AWB had been visiting the ROK market ... in the 1960s and 1970s. Then we came in heavy one year before deregulation. The message I gave was that it did not matter how long it took to get sales, my object was to find out exactly what the market wanted. I was the technologist so I did not have to talk money. In fact I refused, saying they were a different set of people. I emphasised that I was learning, time had no meaning to me. So the push into ROK was technical, not political <sup>12</sup>...*

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<sup>12</sup> VA visited ROK 27 times to see millers in the five years between 1983 and 1988 (VA:AWB). In 1992 VA was married to an ROK woman.

*Capturing the hearts and minds of the millers was the key thing ... Most of the trips we ended up drinking and not mentioning wheat, but you had to pick up who you did this with. At the end of some meetings you would have a quiet cup of tea. With others there were fifteen bottles of whisky and fifteen Korean hostesses (VA:AWB1).*

VA:AWB1 aimed to remain non-aligned and independent in his field visits:

*I never accepted an offer of transport to and from any meeting in ROK. If you go there independently you show you are perfectly capable of getting around and you can be in control of your departure. Otherwise you are in their hands (VA:AWB1).*

VA evaluated the AWB's performance in the first few years after market deregulation:

*You can't afford hiccups in the first one to five years of exporting to a new market. We have been lucky. No major producer downturns, no stuff-ups in blending, or shipping. We have built up a hell of a reputation as a trustworthy supplier - we have been lucky ...*

*If a miller can be supplied reliably for three to five years then they tend to become loyal. Once you are in the market you have to ensure you are in there for the long term. The first two mills supplied we watched very closely (VA:AWB2).*

KOFMIA staff were offered supplies of AWB seasonal crop reports and other literature for distribution to their members. In 1984 and 1985 information seminars were conducted by the AWB in KOFMIA premises in Seoul.

VA:AWB1 refused to accede to KOFMIA management's request that his visits be sponsored by them.

*KOFMIA was very wary. They tried to obstruct us. They said I could only visit "their members" if they went along too. I saw this as a complete waste of time. I approached the millers directly, stressing the mutual technical interests. I said I wanted to learn what they wanted (VA:AWB1).*

In 1985 as USA pressure for greater market access for other goods mounted, the ROK government retaliated by issuing a strong message of support to ROK importers seeking to be supplied from countries other than the USA:

*Minister of Trade and Industry Kum Jin-Ho said yesterday that the government may consider importing from other countries aircraft, wheat, corn and coal that are now coming from the United States. Kum was responding to Law Makers' questions before the National Assembly Trade Industry Committee.*

*Focusing their questions on the trade friction with the United States, committee members of rival parties urged the government to cope effectively with the US protectionism and pressure for more access to Korean Markets (Korean Times, 6.11.85).*

In March 1986 in response to KOFMIA's offer to assist the AWB to hold a third miller seminar in Seoul, the AWB management responded:

*Notwithstanding your kind offer of assistance, the AWB has established very good direct relationships with each of the member mills to meet their own specialised requirements (AWB Telex to KOFMIA 3.3.86).*

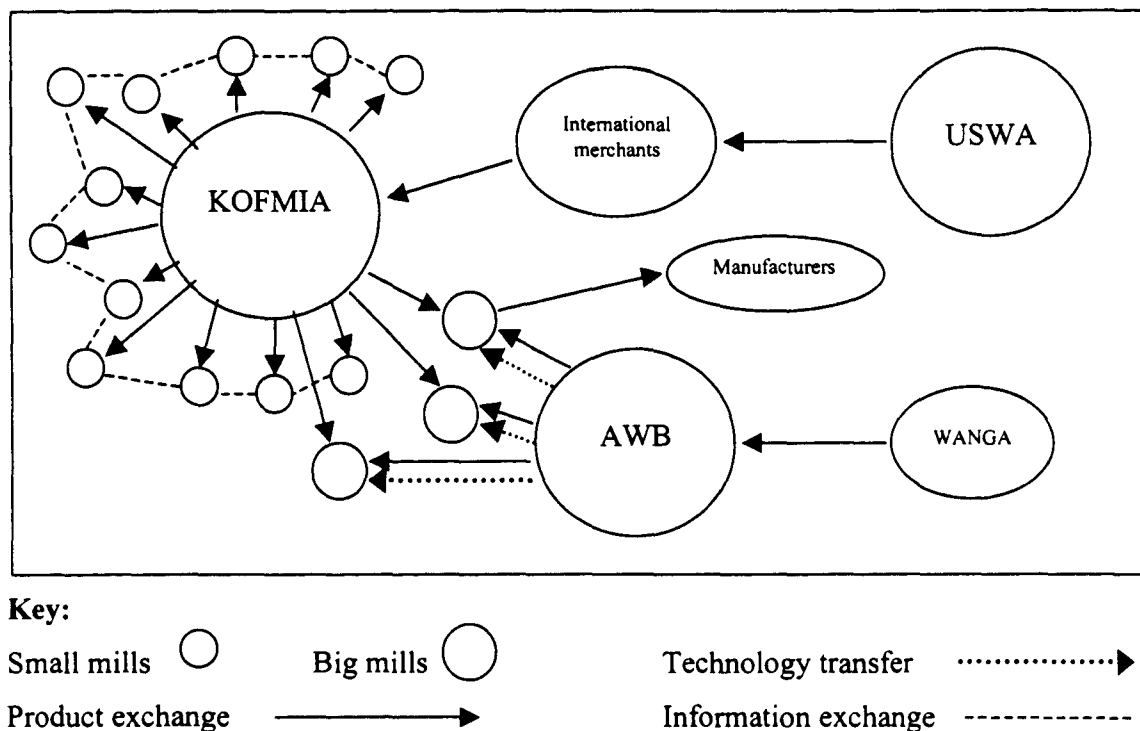
KOFMIA management was powerless to do other than offer their services, given their own membership were choosing to deal direct with the AWB.

The first three mills placing orders with the AWB in 1994-5 were the largest. They included the KOFMIA President's mill. AWB adopted a strategy of inviting the Presidents of each mill making their first purchase to a first class, all- expenses paid trip to Australia. The invitations read:

*I have noted with pleasure that your flour mill has recently purchased a quantity of Australian milling wheat ... Naturally the Australian Wheat Board is keen to ensure that all its customers have a first hand knowledge of the wheat industry in this country and that they have the opportunity to meet senior wheat industry people ... (Correspondence 16.8.85 DS:AWB).*

Thus close personal relationships were developed at the most senior management as well as at the milling technician levels.

**Figure 6.3: ROK Wheat Trading Network 1989 – 1991**



### 6.17 Developing a New AWB-ROK Wheat Import Network

As well as the inducement of executive travel, the mill buying for the first time was offered the free services of an AWB miller technician for as long as it took to help them adjust the machinery to the different characteristics of Australian grain. Copies of the telexes offering and accepting this service reflect the mill's appreciation of this support. In each case, prior to the first purchase, the AWB technician had established a relationship with the millers via the mill calls which commenced in 1983. All mills accepted the offers of free technical

support to help adjust their mills to the first shipments.

KP:DSFM reflects on this AWB strategy:

*Guys like VA came every two or three months. We found out that ASW was very good for noodles, and we found out the Japanese were also using it and had been for about five years. So the trade developed quickly, quicker than anyone expected. The AWB people worked very hard - that was different to the USA and Canada. People like VA visited every mill every time they came. Canada invited every one at once to a seminar. That is not as effective as personal contact. The USWA has an office in ROK with a Korean working there. They expected us to come to them (KP:DSFM).*

In 1990 the AWB milling technician (MM:AWB) assisting VA:AWB was replaced by JB:AWB, a technical adviser with fifteen years milling experience. JB recalled his first contact with the ROK mills:

*They have to know you however before they will trust you to mention their difficulties. On my first visit Vince (VA:AWB) took me around and introduced me to all the millers. All but one mill was visited. They tested me with questions about technicalities to see if I knew what I was talking about. Vince was greeted as a long lost brother. I just tagged along (JB:AWB).*

Between his first and second visits to ROK JB:AWB conducted advanced milling courses at the BRI in Sydney, each lasting two weeks and attended by six AWB sponsored ROK millers from six different mills:

*So I ended up with extended contact with six of them and knowing them well and they in turn knew my experience (JB:AWB).*

JB:AWB explained the significance of understanding best milling techniques for different grain varieties:



*An advantage of Australian wheat is that you can extract a higher percentage of flour despite the .4 ash when compared with USA or CWB wheat. That extra 5% of extraction rate can make or break some of the mills currently going to the wall. There has not been a price rise in flour in the ROK for a great many years (JB:AWB).*

JB believed there was a need for on-going technical advice from the AWB even after the ROK millers became experienced in the general characteristics of ASW:

*Each season the wheat will differ somewhat in response to seasonal conditions. The job of the technical adviser is to convince the ROK customer that they can still produce a superior noodle flour. Every year is a new year in terms of productio (JB:AWB).*

According to VA:AWB, every ROK mill knows it has free access to technical advice at any time:

*they just have to pick up a phone or send a fax. (VA:AWB3)*

VA:AWB3 explained further:

*If there are any problems in supply or quality we have brought over the Koreans immediately to see it for themselves. They will find out anyway. Honesty is the best policy. At the same time we have to set up a certain mystique about the product and its special characteristics.*

*Immediately after we have tested the quality of the season's crop I go to each mill to tell them personally what the quality is like (VA:AWB3).*

## **6.18 The Role of an “Independent” Food Authority, Academic**

CHL, a Professor of Food Technology taught at the prestigious University of Korea. In 1981 CHL was asked by an ROK importer of lupins from the WA Grain Pool to

investigate them as a substitute for soy beans. Consequently CHL:KU received a \$25,000 grant from the WA Grain Pool for a two year study.

In 1983, while travelling in Australia, CHL:KU read about ASW wheat and offered his services to the AWB to test it's suitability for ROK type noodles. CHL's visit to the BRI in 1984 coincided with the study tours of the Japanese mill technicians from NpF and NF who were identifying the ASW characteristics most suited to Japanese noodle manufacturing.

CHL subsequently wrote scientific papers praising ASW wheat, he addressed baking and noodle manufacturers at courses at Korea University and made great use of a dough mixer donated to the University by the AWB. The AWB sponsored CHL to make several study tours to Australia. One of his PhD students was awarded a fellowship by the AWB to undertake three years research in Australia. Well respected in ROK, CHL came to champion the AWB and the noodle making quality of ASW wherever he went.

The AWB Telex of 6.11.85 from MM:AWB to VA:AWB illustrates the value of support from CHL:KU:

*Re:Dongah complaint, Prof CHL organised taste evaluation trials at University to demonstrate problem not with flour. He plans to visit noodle customer with Mr P (Dongah) to check for microbiological and drying problems. Excellent support for AWB by Prof CHL (Telex Wheatbd AA30196 6.11.85 MM:AWB).*

## **6.19 Relationships Between Millers and Their Customers**

KP:DSFM described the evolution of the relationships between mills and manufacturers before and after deregulation:

*Up to 1985 KOFMIA controlled all wheat buying and selling and at that time everything was dominated by human relationships. Good friends would buy from each other. ...*

*Quality was not the main issue in the early days. Price was the main issue, and that was affected by government decisions. Since 1985 however, it is still government policy which effects price but we are freed from government control. We can import wheat flour even. We are free as wild deer.*

*Now our customers ask for more varieties of flour or different specifications. Even though 99% use the same flour for everything, they want something different. Now we also have to give them technical advice and free samples and arrange visits with the AWB or the USA wheat Association and these visits are 50% technical and 50% sight seeing.*

*Nongshim is one of the biggest noodle manufacturers and they buy from five or six millers in Korea. The biggest companies buy from at least three flour mill companies.*

*There is less than 10% difference between flour prices in the mills. There are no contracts with customers.*

*DSFM has 40 different flours which it makes now. This is too much differentiation. It creates storage and transport difficulties which add costs and this is too bad. We have to build more laboratories and do more research and development work (KP:DSFM).*

## **6.20 Building Relationships with the Mill's Customers**

In 1985 VA:AWB aimed to extend his contacts from millers to manufacturers in an effort to reinforce the customer's commitment to ASW.

*The ideal is to deal directly with the flour mill and customer together... The mill in ROK has virtually no flexibility. ... The customers tend to be very rigid in their requirements. ... The end-user factory controls the supplier and sets unreal expectations for the mill. The relationship between the research and development technical branch and the factory dominates the mill (VA:AWB1).*

VA:AWB was aware of the pressure smaller mills like SHFM were under from manufacturers who preferred the higher priced ASW, however the mill was unable to pass on the higher cost of the wheat to the manufacturer:

*The ROK noodle companies, especially Nhongshim ... recognises that Australia ASW is the best for noodles so they put pressure on the mills to buy it (JM:SHFM).*

In visiting the manufacturers, VA:AWB observed the network conventions. He was always accompanied by the millers supplying the manufacturer's:

*We never visit a mill's customer alone. This is sacrosanct. There are a lot of complexities we do not know about. If we tried to go around the mills we could get a phone call from someone saying that such and such is very angry with us and we would never even find out why. ...*

*Sometimes the AWB gets a direct contact from a mill's customer. We try to job them off. We have to be wary about commercial ventures which will take away from our buyers. You have to be very careful about allying with anyone. You must make sure that you visit in the right order, give the right sized present. Some try to monopolise your time so you have less time to deal with their competitors (VA:AWB2).*

By 1987 four ROK mills had purchased part-shipments of flour<sup>13</sup>. There had been numerous executive level visits to Australia, millers had been sponsored to courses at the BRI, there had been two executive seminars at KOFMIA, and one at Singapore with ROK millers invited as sponsored participants.

All mill informants were asked to identify a particular episode or circumstance that had a major effect on their relationship to their supplier, the AWB. Every informant nominated

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<sup>13</sup> The first orders of Australian wheat were shipped on the same vessels carrying feed wheat to ROK. The AWB also subsidised the cost of this initial shipping.

the crisis caused by the chemical contamination scare in 1993 as a testing time for the industry. However, a majority also stated that the 1987 AWB Cheju Island seminar was a defining moment, when the AWB cemented its place into the wheat market of the ROK.

## **6.21 The Cheju Island AWB Seminar: A Defining Moment**

In 1987 the AWB conducted a seminar with a format, location and participant mix that set new standards for the ROK milling industry. Senior management and technicians from every mill, from MAF and management from the biggest bakeries and noodle manufacturers were invited together.

The venue was the best hotel on Cheju Island, an expensive holiday resort favoured by honeymooners off the South coast of ROK. Wives were invited and treated to mountain climbing and other side tours. Senior staff at Cheil FMs stated that this was the first holiday they had taken with their wives in many years, given they worked twelve hour shifts with only every third Sunday free (JJ:CFM).

The Cheju Island Seminar was timed to stimulate and meet the demand for information already heightened by the awareness of a need for improved food quality for the 1988 Seoul Olympic Games. As well, mills and their customers were in transition, shifting from bagged to bulk flour storage and transportation. Thus, Australian specialists in bulk storage facilities, blending and logistics were a feature of the program, offering some of the first specialist advice available to the industry on bulk flour handling.

Professor CHL:KU was the key note speaker, adding prestige and "independent" commentary which strongly supported the AWB <sup>14</sup>. He distributed scientific papers with the results of his testing which claimed Australian ASW was superior to CWB and US grains for a range of ROK products, from noodles to cookies and bread.

The AWB was careful to cultivate close relationships with MAF senior officials. Thus they were invited to the Cheju seminar as well as on regular good will tours to Australia. The ROK government owned a number of grain silos located on the wharves, in particular in

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<sup>14</sup> Confucian based societies ascribe particularly high status to education and scholarship, professors and teachers.

Pusan close by the medium and small sized mills. These had been built during the era when ROK wheat importation was totally regulated. It was essential that the mills continued to have access to these government owned silos post-deregulation to store their grain purchases while they awaited processing.

By 1993 both USA and Canada were offering ROK miller seminars at home and sponsored placements in courses in institutions in Canada and USA. ROK millers YK:DHFM and SP:DSFM always faxed copies of these invitations with details of the courses offered to JW:AWB in Melbourne. Daehan manager JK evaluated the different countries support:

*Technical support is very important. This is important for millers and manufacturers and you can have seminars and other things. Canada and Australia now give about the same level of technical support, Canada in bakery lines, Australia in noodles. (However) Canadians are not as Orientalised as Australians. The USA does not have the equivalent of the AWB technical support team. Kansas University helps but different people come each time so there is no continuity. They have an International Grain Program (JK:DHFM).*

While the AWB courses and technical support offered during the early export market evolution were enthusiastically received by the mills, by 1993 not all were satisfied with the advice or content being offered. YL:YFM, Executive Director of one of the smallest mills complained that the AWB was not assisting him to gain a competitive advantage:

*I need more information than Mr VA is providing. He just shows us catalogues, we have drinks and dinners. I want more information. We are planning to make a pre-mix in 1995. Our goal is to make our own branded products. We want to make the same quality as Cheil and Daehan. So we need more information on pre-mixes. We want to know exactly what Cheil is buying so we can buy the same and achieve the same quality as them.<sup>15</sup> Then we will do our own pre-mix (YL:YFM).*

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<sup>15</sup> During the era that KOFMIA purchased wheat on behalf of the industry, mill orders were aggregated for efficient shipping. Every mill knew what others had purchased.

KP:DSFM, Executive Director of a middle sized mill described the character of the relationships between him, his mill and AWB milling technician JB:AWB:

*JB can give the ROK an independent assessment of the Swiss machinery. He comes to the factory. I like JB personally very much, he does not criticise, but gives very good advice, and over the last four years he has been very diplomatic.*

However, KP:DSFM went on to say that his mill's needs had grown beyond that level of support:

*Now why doesn't the AWB go more into management efficiency as well as technology. The millers are very conservative. The AWB could help them to understand how to change management styles. We need information about how to handle consumer lobby groups, management issues and quality assurance etc as well. We need regular seminars using very successful mill companies in Australia as role models to copy off. We have done the hullo how are you visits now, and tours. We want detailed information now (KP:DSFM).*

These mill managers believed that the AWB technical support strategy needed revision in the light of the industry's evolution.

Between 1984 and 1990 while AWB mill technicians were visiting all ROK mills the AWB marketing managers maintained relationships with KOFMIA and MAF in anticipation of the deregulation of the last fifty percent of the wheat trade that was held for the USA.

The small ROK mills however, with their very limited storage and financial resources depended on KOFMIA to aggregate their orders for shipping. Given capital for import financing was scarce and expensive in ROK, they also enjoyed the very generous US credit terms offered with the sales.<sup>16</sup>

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<sup>16</sup> This tender continued to be offered exclusively to the USA until full market deregulation in 1990.

## 6.22 The Role of Credit in the Market Place

Generous credit terms had always been a feature of wheat trade with the USA. Typically, in 1991 the US Government extended credit of US\$155 million for wheat purchases to the ROK millers through their GSM-102 Credit Program (WO:KOFMIA). However in 1991 ROK wages increased sharply for the third year in succession. The ROK Government forecast a real growth rate of 7.0% in GNP, a trade deficit of US\$8.5 billion and an inflation rate of 9%.

With the monthly trade deficit predicted to be 28% higher than the previous year the ROK Government insisted that importers repay foreign debts within two months to reduce the balance of trade problems (July 14, 1992:1993 Annual Marketing Plan Report, American Embassy, Seoul). The benefits of the US GSM-102 credit program were therefore nullified. AWB and CWB wheat became more competitive.

## 6.23 Full Market Deregulation 1990

The ROK government announced the total deregulation of the wheat import and domestic market in 1989, to come into effect in 1990. Unfortunately for the USWA this coincided with a season of poor Western White Wheat quality when protein levels fell below 9.5%. It was also the time of the introduction of AWB varietal bonuses designed to stimulate soft wheat production. The AWB doubled its sales volume to ROK.

**Figure 6.4: Sales and Tonnes of Wheat**

<u>Year of sales to ROK</u>	<u>Tonnes of AWB sales</u>
1987/88	54,000
1989/90	119,822

(AWB Market Report, 25 Jan, 1990)

However, while the AWB market share increased, the size of the 1989 ROK wheat market contracted, and many mills faced serious financial problems.

In 1989 the ROK government held huge stockpiles of rice in a still fully regulated market.



Manufacturers of Ramon noodles were therefore directed that 30% of the wheat flour content had to be substituted with rice flour. Thirty percent of the biggest mill's production was Ramon flour. Rice flour was more expensive and manufacturers complained, but complied<sup>17</sup>.

The Government also directed Makoli liquor manufacturers to use rice as their main ingredient. Manufacturers had substituted cheaper wheat some years before. To offset the higher price of rice the government offered tax benefits to the liquor producers (AWB market report: 5 Jan 1990).

In response, ROK wheat imports declined 12% from 1988 to 1989. Mills became less profitable, just at the time that cheap loans were not available and they needed to upgrade to compete with higher quality instant noodle manufacturing from China.

From 1990 AWB service contacts with mills invariably reported complaints about the cost of AWB wheat and low mill profitability (SC:DoFM, YM:CFM, SP:SKFM, YK:HFM).

In 1990 the largest mills were also complaining that:

*having to buy one full cargo of Australian wheat (means) the mill does not receive final payment for flour until five months after payment to the AWB*  
(Meeting notes Daehan-AWB 22 May, 1990).

## 6.24 Small Mills and the Constraints of Storage Space

Management of Daesung, one of the smallest and last mills to order AWB wheat described the storage problems:

*There were major difficulties in introducing new varieties because we only had two silos, and one held US White Wheat and the other US Red Hard Winter. Last year we built three more silos so now we can buy different types of wheat ...* (SK:DSFM).

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<sup>17</sup> Discussing the incentives to comply with government directives: JB:U an importer and manufacturer of bakery products explains: "the law is very loose and subject to interpretation. ... for example ... It is completely up to customs officials to determine whether or not your product is a sample and so not liable to tax ". Tax laws are such that the bureaucrat largely determines what rate you pay, or whether or not you are audited. As CA:AE noted: "The tax laws are so murky that you cant fight it."

Daehan, the biggest ROK mill reported developing a new wheat with the CWB, but storage constraints had made further differentiation a major cost:

*We have helped develop a new Canadian Prairie Spring wheat which is a new noodle variety. But it is not very easy to add a new variety because of the segregation of storage needed. USA is always wanting us to try Hard White Wheat, another new noodle variety, but we say "interesting, but not very interesting". We tested the American Hard Winter White for two years but you would need a different vessel coming from California. It is difficult to import small quantities so I do not want to increase the number of varieties (YK:DHFM).*

While the large mills moved to full shipment orders with market deregulation in 1990 (with an AWB incentive of \$5 per tonne discount for their first full shipment) the seven smallest mills did not purchase AWB wheat until 1991. Their orders followed attendance at a special AWB seminar held at Serak Mountain where overcoming the problems of wheat/flour storage were specifically targeted.

Prior to 1990 small mills had overcome their small order and storage problems by buying via KOFMIA tenders. These delivered US shipments to ROK government owned silos at the wharfside. The small mills needed to agree to be supplied with the same grain however.

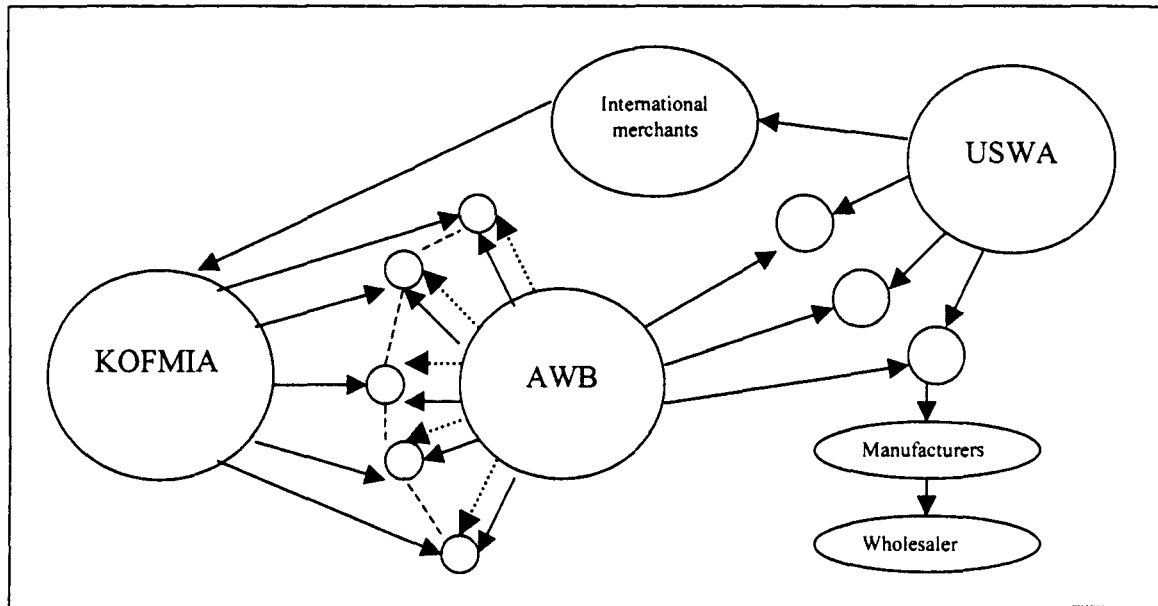
In 1991 the AWB effectively replicated the role of KOFMIA by assisting the seven smallest mills to coordinate their AWB purchases into a single order.

By 1993 the medium sized mills had also worked out how to achieve shipping economies through the type of cooperation that had been the norm when they all purchased through the KOFMIA. JW:AWB had been instrumental in facilitating the cooperation. SP:DSFM explained:

*One ship carries between 15,000 and 20,000 tonnes. The Daesun FM processes about 15,000 tonnes per month whereas Daehan is three times bigger. One cargo is too much money for one mill. (Middle sized) mills like*

*Daesun like to spread their importation over three shipments per month. So now we buy cooperatively between the mills, whereas of course we sell competitively (SP:DSFM).*

**Figure 6.5: The Re-Organisation of the AWB Network Including Small and Medium Mill Clusters of Co-Operators**



**Key:**

Small mills ○ Big mills ○ Information exchange - - - - -  
 Product exchange → Technology transfer . . . . .

### 6.25 Manufacturers' Demands for Quality Escalate

By 1993 Nhongshim was demanding consistently higher quality flour to satisfy their growing export markets for instant noodles and pre-mixes, in particular to Japan. AWB sales reached 20% of ROK market share with premiums paid on average of \$5 to \$10 per tonne. This was despite domestic flour prices continuing to be kept artificially low by the ROK Government.

The viability of mills and manufacturers was strongly challenged. Food contamination allegations<sup>18</sup>, rice substitution requirements and an economic downturn saw some mills

<sup>18</sup> In 1989 an ROK noodle contamination scare sent demand for noodle wheat plummeting 20% in the second half of the year. It was widely publicised that some noodle manufacturers were using non-edible tallow in their product.

bankrupted. In 1989 only DHFM, ROK's biggest mill recorded a profit, with the small mill Keum Sung placed in the hands of receivers. The AWB market report of Jan 25 1990 predicted two more mills would be out of business in 1990.

## **6.26 Market Shocks The Australian Wheat Chemical Residue Contamination Scare**

With support for their actions heightened by consumer concern for food safety on the 14th of December 1990 the ROK Government advised that maximum residue limits for six agricultural chemicals were to apply to wheat imports from the 1st Jan 1992. Routine testing was to start from that date, undertaken independently by the two ministries: MAF and the Department of Health and Social Affairs. On the 18th of Dec. 1991 an additional eighteen chemicals were added to the maximum residue list (AWB Delegation Report 17-24 August 1992).

In March 1992 the US Embassy ROK Post Report noted that:

*As the standard non tariff barriers such as import quotas and bans are removed, US and third country exporters are encountering a wide variety of regulatory requirements that unnecessarily restrict trade. For example, in three different stages the Korean government has announced new pesticide residue tolerances for many agricultural products which are much stricter than US of CODEX standards. These tolerance levels have been set without adequate analysis of the risks involved for the consumer and appear to bear no relationship to serious food safety concerns. At the same time Korean farmers have one of the highest pesticide application rates in the world (US Report Code KS9224001).*

In August 1992 a medium sized mill HFM was advised by the Mokpo Quarantine Authority that they had detected heavy concentrations of the chemical Thiophanate methyl in 2201 tonnes of their Australian wheat loaded at Geraldton and Albany WA on the 14th and 18th May 1992.

The AWB immediately dispatched their Quality Control Coordinator to HFM at Mokpo to investigate the allegation. Samples of the wheat were taken by the AWB and HFM and tested independently, but no traces of the chemical were found. The policy of the ROK quarantine service however was not to release their own samples for retesting, nor to accept independent assessment of their own testing procedures or data.

HFM was ordered to recall all flour milled from the AWB consignment. HFM then revealed to the AWB that some of the wheat had already been blended with US grain and the flour exported as a premix to Japan, labelled as of US origin. HFM was most anxious that the AWB take a low profile, leaving all dealing with the ROK government to them. The AWB acceded to their request.

On the 19th of October an opposition member of Parliament, Mr KBO raised the issue of the alleged contamination during an Estimates Committee Review of the annual activities of the Ministry of Health and Social Affairs. He subsequently issued a public statement to the media escalating the issue. The media also alleged that DHFM (the biggest in ROK) and DSFM a medium sized mill had received some of the contaminated Australian wheat shipment.

Two weeks later, by the end of October, HFMs sales had dropped from 25,000 to 3000 bags of flour per day. Senior representatives from all mills met on the 28th of October to:

*"discuss what support they could provide to HFM"* (AWB file notes, JW:AWB, 22.10.92).

An information paper to the Board of the AWB advised that:

*Despite intensive investigations ... and retesting of many samples ... no evidence of the chemical ...was detected. ... It should be noted however that during Mr. Bs' visit (AWB Quality officer), HFM was not prepared to allow him to visit the appropriate government departments due to their concern that his visit may inflame the issues. In addition the AWB purposefully adopted a low key approach to the issue following strong requests from the ROK Flour Milling companies ... that they be allowed to liaise directly with the Korean*

*quarantine authorities and Ministry of Health and Social Affairs officials ...*  
(AWB Board Information Paper 261DAK.JP).

The AWB then invited a delegation of officials from the ROK milling industry, the Ministry of Health and Social Affairs, the Quarantine Department and the Opposition Member of Parliament Mr KBO to visit Australia to inspect the grain handling, storage and shipping procedures in WA. Only The Korea Times accepted the "goodwill-industry orientation tour" invitation, on the 12th of December 1992 (AWB file notes, JW:AWB, 29.7.93).

In late December SP:DSFM told NO:AWB in the strictest confidence that the AWB wheat contamination was believed to be the result of careless fumigation by ROK government officers who exercised a monopoly on chemical use in and around the Pusan and Mokpo shipping terminals (NO:AWB) .

In 1993 VA:AWB reflected on the aftermath of this contamination allegation:

*AWB wheat sales to the ROK have not suffered as a result of the recent chemical scare. In fact sales have gone up (VA:AWB2).*

The demand for AWB wheat grew through the 1990s to 1994 when it plateaued, constrained by the ability of the AWB to supply increased volumes of noodle wheat varieties.

### **6.27 US Wheat Contamination Allegations: 1993**

In January 1993 ROK authorities alleged that a shipment of 11,000 tonnes of US wheat was contaminated with thio-phenate methyl. Four of the smallest mills in Pusan: SHFM, SKFM, DSFM and YFM had purchased this wheat. Several months later a second

allegation was made of a different chemical contamination, again in USA wheat shipped to Pusan.

Commenting on this new crisis, KP:DSFM explained:

*When we had the first contamination problems with wheat, Australia was able to resolve it quickly. Now it is OK. However, with the USA wheat contamination scare problem, it became much more government to government and we still have not resolved all the problems<sup>19</sup>. All the milling companies in Pusan were mixed up in the US wheat contamination trouble. It was the first time that we millers in Korea fought back. We are not saying that we are the most clean gentlemen. What we are saying is this: "it is the beginning of democracy and the government officials think that we millers are making a lot of money. So when the government released all this wrong information to the newspapers, they really hurt us." But they had no thought of us at all. When you chase a mouse, there has to be a small hole or the mouse might turn around and bite you. We had no chance to hide or find a small hole.*

*Later on when we went to the courts they said that the millers and the silo people and the Health Department had better all take new samples. Then the government said that the chemicals had disappeared over time. They would not agree that there were no chemicals in the wheat right from the beginning.*

*... We rented an auditorium and we attacked the ... consumer's groups. Nowadays however we are listened to and many think we millers are not always wrong. ... But the media still says the mill companies are bad (KP:DSFM).*

HU:Y comments on the role of the rural lobby in this episode:

*The National Agriculture Cooperative<sup>20</sup> eggs on protectionist activities and there is a genuine nationalism in the country which in fact has seen a tremendous resurgence over the last ten years. The government no longer censors the media and it is very irresponsible. If someone picks up a story there is no real investigative journalism in the Western sense of the word. So often*

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<sup>19</sup> Interview conducted in October 1993, Daesun was one of the mills said to have received the contaminated wheat.

<sup>20</sup> An ROK government established and controlled service provider to rural sectors.

*quite unfounded stories get wide media attention. ... Farmers in Korea still have a majority of regional seats, giving them some four or five times over representation in government (HU:Y).*

PB:AE of the Australian embassy in Seoul was responsible for government liaison during the AWB wheat contamination scare. He compared the AWB strategy with that of the US embassy:

*... we took a very low profile and made several presentations to government trying to prove that contaminated wheat had not left Australia. (But) we never said the ROK officials were wrong. The scare occurred in about June 1992. By October the product was in the market place without too many difficulties.*

*In the later problem in February 1993,<sup>21</sup> when USA wheat was said to be contaminated, the ROK Ministry of Foreign Affairs became involved. The Americans chose the big stick approach and upfront confrontation. This involved the US President.*

*Because of the huge losses involved with the US scare, four small and two large milling companies were encouraged to combine to take the issue to court in ROK. They initially had the US behind them. In court the ROK Institute of Science and Technology found zero chemical traces in sixteen samples and four samples with chemicals below the permitted level.*

*However the victory won in court was very hollow, since the millers still can't dispose of the wheat ... The judge said the wheat could be sold for stock feed but the consumer groups said they would track it down and boycott the feed grain companies using it (PB:AE).*

In November 1993 CA:USE the US Embassy official involved in the government to government negotiations commented:

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<sup>21</sup> ROK quarantine officials accused two US wheat shipments of being contaminated in Feb 1993, and May 1993 (JB:AWB).



*There are big hassles importing things which the ROK government sees as non-essential or in competition with local stuff. ...*

*In relation to the chemical scare in wheat ... We have pulled back now. We put it on the President's agenda etc for six months and really hit it. Now we have pulled right back (CA:USE).*

SP:SKFM, Executive Director and Plant Manager of a mill directly affected evaluated their critical situation:

*We cannot use 11,000 tonnes of USA wheat. It is still in the silo locked up. This chemical scare is still a big problem for us. There is a law suit. The Oregon Department of Agriculture and the Korean Industrial Export Study Centre was involved, and so was CHL:KU, but we are basically on our own now (SP:SKFM).*

IB:CFM, Manager of one of the biggest mill's Technical Team reflected on their vulnerability:

*The Government can kill us or it can make us survive. Millers want to be guaranteed that there are no chemicals at the unloading points, with monetary compensation if there is a problem. But this guarantee is not possible (IB:CFM).*

SP:HFM commented on the additional cost implications of the new chemical residue checks:

*Our silos hold a month's supply. It takes three weeks to test now with the new quarantine procedures caused by the chemical scares, so it is now very expensive for us- we have to pay for the ship's time while they wait to have the cargo tested (SP:HFM).*

DHFM management considered the on-going cost to their operations:

*The residue issues are still causing us problems. One year after the incident the issue is still alive. We are now having to do a lot more testing in our laboratories. We used to just test for 24 chemicals. Then the government added 41 and deducted two so now we are left with 63 to test for. ... It takes twenty days now to clear quarantine and DHFM has to pay storage all of that time, so it costs (JK:DHFM).*

Management of DFM, the smallest Pusan mill summarised the episode:

*In January 1993 the ROK government found chemicals 136 times above the legal limit in USA wheat stored in Woosing (the government owned silo) in Pusan. Some of it was supplies purchased by our mill. The American Embassy was involved. President Clinton came in May and talked to the government about it ... We have had to sell a building in Pusan to the Government to help pay for the frozen storage. Our company is in a very bad state. ... We have almost paid the price of the wheat one time over. At first the USA government said the tests were wrong and the wheat was not contaminated. Now they are backing off. ... We have sent samples to Japan and USA. All said the wheat was ok. We want compensation <sup>22</sup> (HK:DFM).*

## 6.28 Motivating Consumers to Resist Imported Product

Meanwhile the president of the largest consumer protection organisation, the CACPK, reflected on the work of hers and the other consumer advocacy groups in the ROK in 1993. She deplored the building of fast food outlets:

*... near apartments where all the families are housed. So young mothers are tempted to buy fast food especially when they are going out of the home to see friends and when the mother-in-law is not watching.*

*...*

*These foods (eg kimchi) and their accompanying sauces are no longer prepared in the home and our culture is dying with this. ... The family*

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<sup>22</sup> The DFM was bankrupted in 1994.

*traditions are breaking down. Our organisation is trying to slow down this rate of change. For example fast food is not traditional and it is not part of our cultural lifestyle. So we invite professionals and frame resolutions which we want to use to tell mothers and the government of the dangers that are coming.*

*We also do a lot of testing of imported vegetables. ... We have tested wheat from the USA for post harvest chemicals. This is a very big job. We have six paid workers helping us in our organisation, but the four executive members are voluntary. ... There are ten organisations that we often work with, for example the YWCA, YMCA, Catholic Women's Groups etc. We now have an association and we will work on consumer issues under the one umbrella (SK:CA).*

KP:DSFM reflected on the newly emerged consumer groups and their role in the US chemical scare:

*The big lady consumer associations were a problem. KOFMIA wanted to invite all of the women and health and hygiene officials to a TV debate but they could never win. The Catholic farmers association is also very powerful. KOFMIA tried to get to the YWCA and have CHL:KU do some research on chemicals for them, but the big ladies cant be convinced (KP:DSFM).*

## **6. 29 Millers Aim to Build New Business with Manufacturers:**

KP:DSFM described the typical process of meeting a manufacturer's needs for a new flour product. Long-standing supply agreements or networks of loyal buyer-supplier relationships were not in evidence. Each manufacturer preferred to source their supplies from three or four mills.

*There are a number of factors involved in a company like Nongshim the noodle manufacturer deciding who will supply a new flour for their new product. The first they will do is call three or four millers together and then they will say that they want to make this new product, perhaps a cookie, or something like that. They will explain the special characteristics of this new product, and they*

*may supply a sample. ... If the four millers who are all trying to get this new flour business have a very similar flour at the end of the day, then personal relationships will be important in choosing who gets the business. If one of the people is clearly producing the better product, that person gets the business (KP:DSFM).*

### **6.30 AWB Attempts to Achieve "Insider Status" in the ROK Market**

In 1991, the closeness of the relationship between the AWB and DHFM ROK's biggest flour mill was illustrated by a joint venture formed between them to sell Australian sourced field peas as stock feed in ROK. This JV was ended at the request of DHFM in 1992 when Chinese supplied peas undercut the AWB price.

In 1993 the AWB attempted to build closer network relationships through an alliance with a medium sized mill and their customer Nhongshim, the biggest ROK manufacturer with some 70% of the noodle market: VA:AWB3 explained:

*We are looking at a three way project. The end user will try out fourteen or seventeen different varieties of wheat with a consistent protein level. They will make the products and tell the AWB what they think of them ... This collaboration is very difficult to get going because of the potential to upset the miller. When we first approached a larger mill ... it coincided with the chemical scare so they got cold feet and drew back. The opportunity was then taken up with a middle sized mill (VA:AWB3).*

In 1995 VA:AWB4 reported their lack of progress:

*I feel like saying to Nhongshim "up yours". We have tried to crack them via a particular mill. The trouble is that mill went through the R and D section of Nongshim and then another section got its nose out of joint so there was a row. We tried to get round them through another mill but didn't have any luck there either. The trouble is Nhongshim is in the pockets of the USA and Canadians. They have a division called Nhongshim Kelloggs USA (VA:AWB4).*

Meanwhile mill owner and director KP:DSFM described his strategy to stay competitive:

*I have been contacting USA people to help form premix joint ventures with my company. I think our flour mill will need a sales force in the future if it is going to succeed (KP:DSFM).*

### **6.31 Timeline: The Development of the ROK Domestic Market for Wheat**

**1910**

- ROK Peninsula is colonised by Japan in an oppressive regime.

**1945**

- End of WW2, Japanese surrender Korean Peninsula. South comes under USA administration.

**1948**

- Republic of Korea (ROK) established.

**1950-1953**

- Korean Civil War.(North against South) Massive disruption of food supply. Population displaced and malnourished.

**1956**

- First shipment of USA wheat under PL 480.

**1961**

- Military rule under President Park Chung-hee.
- USA army base Commissaries begin to supply black market USA food to urban populations.

**1962**

- First of the government's five year plans for industrialising ROK.

**1970**

- ROK population reaches 32 million.
- "Saemaul Undong" a rural community development movement financed to relieve rural poverty and modernise agriculture.

**1973**

- New constitution by President Park gives president unprecedented power.

**1980**

- Students demand democracy.
- New constitution limits President's term to seven years.

**1981**

- Commencement of export market liberalisation.

**1986**

- First ROK trade surplus recorded.
- First recorded surplus of ROK rice produced.
- ROK wheat market liberalised, creating competition for USA supply.

**1987**

- President Roh Tae Woo elected, with export market deregulation on the agenda.
- Japan's restricted trade access challenged by US through GATT.

**1988**

- Seoul hosts Olympic Games, stimulating demand for Western foods

**1990**

- Trade deficit recorded.

## **Market Development in the ROK-Australian Wheat Trade**

### **1980**

- KOFMIA mill presidents visit Australia.

### **1983**

- The ROK wheat import trade was 50% deregulated:
- 50% to continue to be purchased from the USA by tender.
- VA:AWB first visit to ROK.

### **1984**

- Dr CHL:KU commenced testing of ASW for ROK noodle manufacturing
- KOFMIA delegation of mill presidents visit Australia.

### **1985**

- Feb: First Australian wheat purchased by Dongah FM who accepted offer of AWB technical advice.
- May: KOFMIA, Seoul is venue for AWB noodle quality seminar CHL:KU takes AWB sponsored study trip to Australia.
- Senior mill technicians do short course at BRI sponsored by AWB.
- Nov: CWB offers mills 16 funded places at their International Grains Institute for 18 day course.
- Presidents of mills who purchased ASW make sponsored visit to Australia.

### **1986**

- July: CHL:KU conducts miller's course with donated AWB equipment and Australian rapid dough techniques with 88 bakers, assisted by AWB.
- Wheat sales from Australia to ROK: 100,000 M/Ts.
- USWA conducts seminars throughout ROK for first time.
- Daehan introduce Koala and Kangaroo brand flour lines.

### **1987**

- April AWB Seminar at Cheju Island attended by millers, bakers, noodle makers and wives.

- Mills start marketing flour in bulk, tech advice needed.
- Shortage of supply of AWB soft wheats limits sales.
- A GATT panel reviews Japanese market access rules for 12 products.

#### 1989

- End of US GSM credits for wheat sales to ROK.
- Complaints about falling protein levels of ASW.
- USA threatens trade retaliation if Japan does not address non tariff barriers.

#### 1990

- ROK wheat imports **totally deregulated**.
- Government campaign to replace wheat with rice consumption due to rice glut.

#### 1991

- AWB has 20% of the ROK wheat market
- Sarak Mountain seminar aimed at small mills and noodle manufacturers
- Last seven small mills buy AWB wheat by aggregating orders.
- AWB forms JV with Daehan to sell AWB field peas.

#### 1992

- AWB wheat chemical contamination allegation.
- Field pea JV between AWB-DHFM not successful (They could not compete with PRC prices).

#### 1993

- USA wheat chemical contamination allegation.

#### 1994

- The USA wheat share dropped to 76%.

### 6.32 Preliminary Analysis

In 1994 the ROK population had a living memory of food shortages and continued to live with the threat of invasion from the North. The population maintained strong emotional



links with their regional communities. The democratically elected government depended on rural votes making it responsive to calls for the on-going protection of domestic food production and the communities which produced it.<sup>23</sup>

The ROK relationship with the USA was one of strategic dependence, but the continual presence of US troops and the pervasiveness of Western culture left many, especially consumer advocacy groups antagonistic towards the hegemony of the USA.

In 1983 the US was bringing pressure to bear on Japan to deregulate its food market access and ROK was under US pressure to address their persistent trade deficit. In that year the ROK government allowed fifty percent of wheat importation to be deregulated. Mills were freed to develop quality milling from any source of wheat.

The ROK noodle manufacturers export drive had brought them into contact with the wheat varieties Japanese mills were purchasing for their premier noodles, ie AWB WA ASW. They sought flour with the same characteristics.

Initially unwilling to learn from the more advanced Japanese milling industry, the ROK millers sought out and readily accepted AWB technology transfer. The ROK industry's need coincided with those of the AWB which wanted to train millers to understand the different milling characteristics of the soft, brittle WA ASW.

The tradition of cooperation fostered during the forty years that ROK mills were supplied together through KOFMIA meant collaboration between the smallest to the largest mills was easy to maintain. Collectively the mills organised to order AWB wheat in a quantity that was economical to ship. The long-standing institutional arrangements also meant that industry information was quickly disseminated. When the first big mill purchased AWB wheat, others quickly followed.

The AWB chose to build relationships with all the mills at the same time, inviting all to the courses and seminars, offering the same incentives and technology transfers. As a

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<sup>23</sup>

In the early 1990s when ROK farmers called for signatures for a petition demanding a ban on rice imports more than half of the country's population signed.

consequence, when the ROK government made USA credit terms less attractive, the small mills were already familiar with AWB wheat and the mill adjustments required. They immediately turned to the AWB as an alternative supplier.

The close emotional bonds that developed between millers and their AWB counterparts during the early phase of technology transfer (1985-1990) later facilitated cooperation when they combined to place orders for shipments of AWB wheat and when they worked together to overcome the AWB wheat contamination allegations.

Cooperation with the ROK millers, allowing them to liaise with the relevant government departments ensured the AWB wheat contamination scare of 1992 was dealt with quickly and quietly, with minimal impact on the mills, their manufacturer's exports and AWB sales.

A different strategy, involving widely publicised US government intervention and litigation left bankrupted mills calling for compensation and boosted support for ROK consumer advocacy groups. Long standing public antipathy towards the USA and western foods was fuelled<sup>24</sup>.

While ROK wheat market imports were fully deregulated in 1990, agricultural and economic policies continued market interventions in the form of downward pressure on flour prices, rice substitution requirements and austerity campaigns targeting the consumption of imported foods.

Their inability to pass on rising costs, their surplus milling capacity and lack of vertical integration left mills under great financial pressure. Manufacturers increasingly demanded AWB noodle wheat in order that they compete with Japanese udon production. This saw mills prepared to pay the premiums for AWB grain.

While a price premium over USA wheats was achieved on average annually, special

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<sup>24</sup> Such enmity had influenced the ROK Government to assert its independence when it ended USA's exclusive access to ROK wheat markets in 1983.

discounts were also a feature of the AWB pricing strategy.

Australia's market share grew from 0 to 26% between 1984 and 1994. However, sales then plateaued as noodle wheat consumption declined in proportion to the increasing demand for bread and bakery flours.

ROK mill profitability fell in the face of increased costs of production, increasing competition from imports, the government's flour price setting, market disruptions caused by government rice policy and consumer concerns about imported food safety. The AWB could do little to influence or ameliorate most of these factors.

Networks of close and loyal relationships extending beyond the mills to manufacturers were underdeveloped however, with manufacturers like Nhongshim buying from four or five different mills and offering new flour lines to any mill able to meet their quality and price requirements.

Attempts at forming strategic alliances with selected mills and their customers, for example the biggest ROK noodle manufacturer were unsuccessful. Nhongshim had long established joint ventures with companies like Kelloggs. With US white wheat emerging as a cheaper and satisfactory substitute for WA ASW, Nhongshim felt no pressure to trial new wheat varieties or secure supplies of Australian product through a special relationship.

## **Chapter 7**

### **CASE STUDY: THE AWB WHEAT TRADE TO JAPAN**

#### **The actors participating in the evolving network:**

AWB (Offices in Melbourne, Perth and Tokyo)

The Western Australian Noodle Wheat Growers Association

The Western Australian Department of Agriculture

Mitsubishi Trading House

Tomen Trading House

Nisshin Flour Mills

Nippon Flour Mills

The Japanese Food Agency

Goodman Fielder Japan

(NB: Japanese names are reversed with given names first and family names last)

#### **The AWB**

##### **Informants**

Trevor Flugge, (TF:AWB) Chairman (and WA wheat grower)

Nigel Officer, (NO:AWB) Senior Manager International Marketing. Director of AWB Tokyo Office from 1989-92.

John Wischer, (JW:AWB) Senior Coordinator, Customer Services, Previously a journalist.

Steve Feletti, (SF:AWB) Director of AWB Tokyo Office 1992-.

Geoff Hollands, (GH:AWB) Manager of the Tokyo AWB office and responsible for Japan

market development, 1960-1964 and 1967-1980.

Takako Miya, (TM:AWB) Executive Assistant, Japan Office 1985-.

St John Dick, (StD:AWB) Senior Public Affairs Officer AWB WA Perth 1992-.

Bruce Watkins, (BW:AWB) State Manager, WA AWB, Perth 1990-.

Grant McDougal, (GM:AWB) ex field Officer northern growing areas of WA and policy officer, AWB Perth 1983-.

#### **Western Australian Noodle Growers Association (WANGA)**

##### **Informants**

John Hawkins, (JH:WANGA) President and wheat grower 1991-.

Lindsay Olman, (LO:WANGA) Vice President and wheat grower 1991-.

Ken May, (KM:WANGA) member and wheat grower 1991-.

#### **Department of Agriculture, Western Australia (DA)**

##### **Informants**

Graham Crosbie, (GC:DA) Officer in Charge, Grains Products Laboratory, Perth, 1980-.

Gillie Brown, (GB:DA) Manager, Wheat Market Project, 1990-.

#### **Nisshin Flour Milling Co. Ltd (NF)**

##### **Informants**

Japan's largest flour mill conglomerate producing some 30% of the market's flour from five million tonnes of imported wheat. It also manufactures pet food, chemicals, pharmaceuticals, milk preparations. Eighteen percent or 900,000 tonnes of their wheat is imported from AWB. Of this some 600,000 on average was from WA and used to manufacture udon noodles. MTC had a 2.1% shareholding in NF in 1994 and was its long established sogoshosha.

Dr Seiichi Nagao, (SN:NF) Research Director and General Manager, Cereal Research Centre.(visited GC: DA)

Ryuji Nakamura, (RN:NF) Deputy General Manager, Flour Milling Division.

Naoto Masujima, (NM:NF) Assistant Manager, Overseas Business Section, Flour Milling Department.

Akira Kondo, (AK:NF) Operations Section, Flour Milling Department.

#### **Nippon Flour Mills Co. Ltd (NpF)**

##### **Informants**

Oldest and second largest wheat mill conglomerate in Japan with twelve mills. Slow growth in mainline wheat milling of less than 1% in volume per annum. Licensed to

produce Italian brand pasta and pre-mixes for donuts with a USA company. Also developing pharmaceuticals. A member of the Mitsui group with Mitsui shareholding at 2.6% in 1994. Its long established sogoshosha was Mitsui.

Katsutaro Nishihara, (KN:NpF) Manager, Administration Section No.1

Toshibumi Horiuchi, (TH:NpF) Administration Section No.1.

**Tomen Trading Corporation (TC)**

One of Japan's largest sogoshosha.

**Informants**

Hiro Hashizume, (HH:TC) General Manager, Produce Department

Kazu Saotome, (KS:TC) Wheat Barley and Wheat Flour Produce Department.

**Mitsubishi Trading Corporation (MTC)**

**Informants**

One of Japan's largest sogoshosha.

Masato Kondoh, (MK:MTC) Officer, Wheat and Barley Team, Produce Department.

Satoshi Koyama, (SK:MTC) Assistant General Manager, Produce Department, Manager, Wheat and Barley Team, Tokyo.

Toshikazu Mitoma, (TM:MTC) Senior Manager, Produce Department, Melbourne Office, Australia.

**Goodman Fielder (GF) Japan**

Has flour mills and bakeries in Australia producing pastry products. GF imported Australian mixes into Japan, as well as manufacturing product in Japan using a majority of grains from USA and Canada and some ASW from WA for udon noodles.

**Informant**

Nobuhide Kotake, (NK:GF) Representative Director.

## **7.1 Background Information**

### **7.1.1 Traditional wheat use and food self-sufficiency policy**

Japanese traditional wheaten foods were various kinds of noodles manufactured from locally grown soft wheats. By far the most important cereal in the diet however was rice.

Rice riots followed Japan's defeat in WW1, triggered by rising rice prices and grain hoarding. The riots lasted for fifty days and involved some one million people in forty-one prefectures. Fifty thousand troops had to be mobilised to restore order, coal miners threw

dynamite at the troops, and many lives were lost.

The Rice Law subsequently enacted in 1921 was designed to adjust and maintain the supply-demand balance of the food staple through government regulation and control.

The Food Control Law was enacted in 1942 in response to the second wartime emergency. It aimed to put rice and other crops more firmly under government control to supply troops and to better manage civilian needs.

Mirroring the war-time emergency food regulations of Australia, USA and Canada the Food Control Law of Japan put the government in charge of cereal buying, storing, transporting, pricing, rationing, exportation and importation. It also dictated milling extraction and rice polishing levels to maximise the yield of the grain processed.

At the end of WW2, while most of Japan's bureaucracy collapsed, the food administration system survived. There were severe sanctions for farmers who refused to supply their produce for distribution by the government.

The significant food shortages in Japan following WW2 saw the Occupying Forces importing US wheat and flour. In 1946 bread was made using American milling and baking technology and equipment. The bread was distributed free or at minimal cost through government sponsored school lunch programs and to civilians.

As the Japanese urban populations expanded into previously rural areas, incomes rose, women's roles changed, and the dietary preferences of western nations became better known, the status of rice and noodles was challenged by bread and other bakery product consumption. The per capita consumption of wheaten products grew from 30 pounds before WW2 to almost 90 pounds by 1965 (Morgan, 1979:104).

Despite the diet changes that saw greater consumption of western style foods, the regulatory environment and role of the Food Control Laws in protecting traditional domestic food production remained largely unchanged. A commentator explained why:

*Japan is no longer an agrarian economy, and farming households today only account for 15% of the total population. Yet the farmers and their associated groups remain too formidable a force to be ignored by politicians. ... One eligible vote in a rural district is in many cases worth three votes in an urban district (NK:GF).*

## **7.2 Market Overview**

In 1994 Japan purchased only 8% of Australia's wheat exports but it was the AWB's highest returning market. Most wheat imports were sourced from the USA followed by Canada, with Australia holding the smallest market share. The market share between the three suppliers had remained virtually constant since the 1960s, with USA typically supplying around 60%, CWB supplying 25% and AWB some 15% of the total.

Japanese demand for wheat plateaued around five million tonnes over the years between 1990-1994. Noodle and bread flour used approximately equivalent volumes of the flour, with instant and fresh noodles sharing the noodle flour segment.

The Food Agency was the sole importer and distributor of wheat, except for small volumes of grain imported by mills through their sogoshosha in a volume equal to their flour exports. Flour imports were still prohibited in 1994, except for some sugar and butter mixes. These accounted for less than 2% of the market.

## **7.3 Characteristics of the Japanese Market for Noodles**

Noodles are a traditional Japanese food staple, eaten by all ages and socio-economic groups. Only rice in Japan is eaten in greater volumes and has greater symbolic status as a nationally significant food.

Noodle ingredients are basically wheat flour, salt and water. The characteristics of the flour determines the quality and the cost of the final product. The volume of wheat flour used in noodle manufacturing in Japan in 1992 was 1.45 million tonnes, just over 1.2 times that which went into bakery use (NO:AWB).

Traditionally noodles had required time consuming preparation. Two manufacturing



innovations increased the convenience of noodles for both the domestic and retail trade. The first innovation was the introduction of frozen boiled noodles, the second was the mass production of dried instant noodles. In 1992 noodle flour demand was split evenly between fresh and instant noodle production, while instant noodle sales were the more rapidly growing market sector (NO:AWB, SF:AWB).

Ownership was concentrated in the pasta and instant noodle manufacturing sector which had high technology and initial investment requirements. The fresh Japanese noodle market was more fragmented with three companies producing some 11% of the noodles and over 2000 companies manufacturing the remainder. One company dominated the bread market with almost 37% market share (AWB, 1993).

Noodle manufacturing in Japan has always been highly competitive. In 1994 a growing oligopoly of major producers were wanting highly specified flours for a market demanding high hygiene standards and regular "new" styles of product presentation (Nakazawa, 1993). There were several hundred brands of wheat flour on sale for noodle manufacturing at home or in the service industry. Responding to the manufacturers, Japanese millers were sophisticated purchasers of grain with well defined qualifying and differentiating criteria.

Canadian Prime Soft Wheat (CPSW) and Australian Soft Wheat (ASW) with some blending of harder wheats were preferred for the most popular noodle styles. Eighty-five percent of wheat used in noodle making was imported.

The "Japanese" or fresh udon noodle was the highest status, highest priced noodle sold in Japan. Australian medium protein ASW noodle wheat along with Japanese domestic wheat was considered most suitable for its manufacturing. Thus Australian soft wheat competed in the same segment as the domestic wheat supply which had, however, poorer noodle making characteristics. Nakazawa, a noodle manufacturing expert comments:

*for the right softness, viscoelasticity, smoothness and beautifully white appearance. ... mostly wheat flour from ASW or local wheat is used in making Japanese (udon) noodles (Nakazawa, 1993).*

## 7.4 Characteristics of the Domestic Supply

Since WW2 and the government's official pursuit of a food self-sufficiency policy, Japanese growers of rice have alternated their crops with wheat whenever the government subsidies signalled which product would receive the greatest returns.

Hokkaido wheat farmers have made several study tours to WA sponsored by the AWB, where they have in particular studied on-farm wheat storage technology.

## 7.5 The Japanese Wheat Market System

In 1994 milling in Japan was dominated by four big companies: Nisshin (NF), Nippon (NpF), Showa and Nitto. There were altogether 146 flour mills with 189 associated factories (AWB:memo 2/93).

Earlier this century Japanese mills became familiar with small volumes of low priced wheat from Australia. Sales were negotiated via the London office of an international wheat trader.

The Australian wheat was not immediately used for noodle manufacture:

*Chinese style noodles use high protein wheat so the SE Asia and Japanese mills used USA and Canadian wheat for these noodles long before Australia came into the market with a wheat that could be used for Japanese type noodles. Domestic wheat had always been used for that (HH:TC).*

In 1948 the Japanese government's newly created Food Agency (FA) nominated twenty-eight Japanese trading houses for its Grain Importers Association. In 1994 the membership still retained exclusive rights to sell imported wheat supplied by tender to the FA. The only countries allowed to tender for the wheat supply to Japan were the USA, Canada and Australia.

In 1956 Australia and Japan signed their first annual trade agreement which referred to the purchase of a certain quantity of FAQ grade wheat. (GH:AWB) According to GH:AWB

this agreement also stated that future purchases would show a slowly rising trend. In 1960 the AWB opened a two roomed office in downtown Tokyo in what had been the Naval Officer's Club. When the Flour Millers Association opened their new premises the AWB accepted their offer of office space, rent free, reflecting their embassy type status.

## 7.6 Growing the Market for Imported Wheat: The Senkan System

In 1958 the Japanese Ministry of Agriculture, Forestry and Fisheries (MAFF) responded to USA offers of technology and financial support to help establish modern livestock and poultry industries. MAFF devised a scheme which saw twenty-three special feed mills (senkan) built with USA support. Their aim was to facilitate the import of grain, but in such a way that it would not be actively opposed by the domestic wheat growers. MAFF was able to argue that the senkan scheme was designed to bolster agribusiness in Japan. As well, some of the profits made through grain importation were to be passed back to farmers as subsidy (NO:AWB).

However, MAFF regulated the extraction levels required in the senkan mills, therefore effecting the quality of the flour remaining <sup>1</sup> after the bran was isolated. Because low extraction levels were required, the flour "by-product" was of high quality. This flour was then available to be sold via the FA to general mills for blending (AWB memo 2/93).

Between 1960 and 1994 the vast majority of APH<sup>2</sup> wheat exported to Japan under the annual AWB/FA supply agreement was processed in senkan mills. Despite the high quality flour "by-product", wheat imported to produce bran in the feed mills was priced lower than that imported for general milling.

The general flour mills (zosan) were also allowed some limited time milling grain imported for animal feed. Senkan and zosan mills were required to market their bran to eight government designated bran user organisations at controlled prices and for hand feeding to animals only.

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<sup>1</sup> Thus the senkan scheme supported Japanese livestock farmers but did not directly antagonise the wheat/rice growers who grew grain for human consumption. In reality however, the very low extraction levels of flour nominated by the FA meant that the Senkan (and Zosa) mills also produced very high quality flour for human consumption.

<sup>2</sup> Australian Prime Hard (APH) represents the higher protein grade of Australian wheat.

The 1991-92 patterns of grain usage per sector revealed the pattern typical of the Japanese market share of each supplier:

**Figure 7.1: Source of Wheat Supplied by FA to Mills for Human Consumption:1991-1992**

<u>Source</u>	<u>Metric tonnes</u>
Japan	0.713
USA	2.482
CWB	1.180
AWB	0.403
<hr/>	
<b>Total</b>	<b>4.778</b>

(Source of data: AWB:memo 2\93)

**Figure 7.2: Source of Wheat Supplied by FA to the Senkan/Zosan Mills Supposedly for Bran Production/Animal Consumption: 1991-92**

<u>Source</u>	<u>Metric tonnes</u>
USA	0.569 M/T
AWB	0.527 M/T
<hr/>	
<b>Total</b>	<b>1.096 M/T</b>

(Source of data: AWB:memo 2\93)

Consequently most of the flour produced from Australian wheat reached manufacturers after blending via the stock feed mills.

The Japanese Government also allowed zosan mills to import wheat from the three supplier countries directly through their sogoshosha at a volume equivalent to the flour they exported (eg to Hong Kong, China, Singapore or Thailand).

**Figure 7. 3: Source of Wheat Imported Directly by Mills: 1992-93**

<u>Source</u>	<u>Metric tonnes</u>
USA	226,271 M/T
CWB	163,669 M/T
AWB	55,384 M/T
<hr/>	
<b>Total</b>	<b>445,324 M/T</b>

(Source of data: AWB:memo 2\93)

**Figure 7.4: The Total Market Share of the Three Supplier Countries to Japan in 1992 was approximately:**

<u>Source</u>	<u>Market share</u>
USA	58.4%
CWB	22.9%
AWB	18.7%
<hr/>	
<b>Total</b>	<b>100%</b>

(Source: AWB memo 2/93)

A 1992 AWB internal memo noted:

*The senkan scheme is of major importance to the Australian wheat industry. It is currently the largest single outlet for APH and is a market sector that continues to demand premium quality wheats not only for producing a high feed value bran for livestock/poultry but also for the production of a strong and extremely fine flour highly demanded for particular end uses in Japan (AWB Memo Dec 14 1992).*

## 7.7 The FA Buying Process

In 1994 the AWB-FA selling process had remained unchanged for over thirty years: the Japanese Miller's Association consisting of the four biggest mills and their sogoshosha informed the FA of their wheat needs. The FA compared this with the availability of domestic supply. An annual agreement of approximate volumes was then negotiated with Canada and the AWB. The USA long term agreement did not require annual renewal.

GH:AWB explained the buying process from the perspective of his twenty years experience as manager of the Tokyo AWB office:

*The Food agency supply people would get together and discuss a monthly program. They would have had talks with the four big mills: NF, NpF, Showa and Nitto<sup>3</sup>. They all have factories of course. Then the FA calls the weekly tender for a specific wheat grade and volume from USA, CWB or AWB. For example, so many tons of WA ASW and so on.*

*We would then simultaneously offer on the tender day to all of our exporters, say Dreyfus or Carghil. Then they would make an offer to the Japanese trading houses, members of the Importer's Association, say Toyamenka. The Japanese would then submit their tender price to the FA who would choose the successful tender.*

*We used to say that it seemed to be done on rotation. This will be Mitsui's turn, we would say. Of course there were no secrets. We always told the FA what our first offer was to the traders. They would always ask.*

*The FA then added about 40% loading to the wheat to sell on to the mills. The profit then went back to the Japanese rice and wheat growers who'd get a huge subsidy for the poor stuff they'd grown and were selling to the FA. In the end they got a lot more than our growers (GH:AWB).*

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<sup>3</sup> Nisshin for example supplies some 35% of all flour to the Japanese market.

GH:AWB who later occupied the same position as GH:AWB in the Tokyo office also described the annual negotiating ritual:

*Everything was settled long before when they usually pretty well accepted our offer. Once they had stated their official offer they never changed. Never. Sometimes in the negotiations before the annual meeting we would try to get a bit tough with them, try to get them to commit to a bit more, but then you would have to think, well really, what can we hold against them. We are the beggars, really (GH:ADC).*

SF:AWB made observations about the same FA meeting process:

*They will have twenty-six on their side and six or seven on the Australian side. There are little flags on the table symbolising the government of Japan and the Government of Australia. They will make an opening speech and they will mention our involvement in the Cairns Group and ask us to remind Australia that agriculture is in a very precarious state in Japan so we should not press up against their traditional farmers. On the other side we will say that we have very healthy, hygienic, big crops that year and we look forward to the usual traditional good business.*

*I've never known them to change their offer after it has been made. Sometimes the offer is in the form of a punishment if we have been unreliable in supplying the agreed quantities the year before. Typically the actual delivery is 10% more each year than the actual agreed to volume ...*

*What they are looking for is consistency or a reliability in being able to deliver as ordered, and secondly, the quality or hygiene of the grain. Finally, price is an issue. ...*

*1,000,000 tonnes of wheat is sold to Japan and we are able to get the price which we name usually. This is the highest returning market in the*

*world and we get a premium over the USA and often a decent premium higher or the same as that paid for Canadian Wheat (SF:AWB).*

With the exception of "punishment" through price if the previous year's delivery was not as specified, the annual "negotiations" were conducted without reference to the end-user's response to the product. Interaction between millers, manufacturers or consumers and the AWB and its suppliers were not a part of the annual agreement process. The annual agreement process had a ritual quality with an emphasis on government to government interaction. The development of a network of relationships with membership extending beyond the FA and AWB bureaucracies was stymied by the formalities and non-negotiating stance traditionally taken by the FA.

### **7.8 A Personal Relationship Facilitates Technology Transfer**

The formal FA-AWB annual negotiations did not result in close personal relationship development between management of the AWB and millers (or sogoshosha). However, one close Japanese mill-Australian wheat industry relationship had become established in the late 1970s. This relationship linked a key WA Agriculture Department wheat breeder (GC:DA) and a Japanese mill manager (SN:NF). Their friendship and shared scientific interests facilitated noodle wheat information exchange and technology transfer from Japan to the WA Department of Agriculture. The relationship was strengthened by the long standing arrangements that saw SNs mill, NF, embedded in and supplied through MTC's grain trading network which included exclusive Japanese access to the WA Grain Pool<sup>4</sup>.

In 1975 the Bread Research Institute (BRI) in Sydney established a Central Grains Research Laboratory. SN:NF a food chemist then in NF middle management and GC:DA a WA cereal chemist began to correspond about WA noodle wheat variety development.

SN:NF talked about his close personal and professional relationship with GC:DA:

*GC has the most expert knowledge of noodle wheat in Australia as required for the Japanese market. He has written several papers on it. He has been*

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<sup>4</sup> The WA Grain Pool, an ASMA, aggregated and sold WA grown grains (e.g. barley and oil seeds) but not wheat which the AWB had monopoly rights to export.



*very important in developing relationships with Japan. He is my friend (SN:NF).*

## **7.9 1984: Repositioning the AWB in the FA Dominated Network**

SF:AWB described the AWB in the first twenty years of its existence as an arm's length exporter of a grain commodity:

*In the 1950s and 1960s the AWB was a gentleman's type of operation. It provided a comfortable perception of the Board as reliable, steady, and not money hungry. It presented itself as a bulk food supplier (SF:AWB).*

In 1984 however, with sales volumes to Japan declining, the AWB brought the Japanese sogoshosha into a direct exchange relationship for the first time. GH:AWB described the repositioning process and their rationale:

*When the Food Agency originally insisted that only Japanese Trading Houses could sell to them, our Board insisted that only Australian merchants could buy from us. That was silly really, because the so called Australian companies were almost all internationals, like Dreyfus. They were non-Japanese, not Australian.*

*I remember very well in 1984 when the Board saw how stupid it was and said to the Food Authority that from then on they would sell direct to the Japanese Trading Houses. They thought we would sell more that way. Personally I was very doubtful<sup>5</sup>. The Japanese Trading Houses were quite amazed. They kept saying, what's the catch? (GH:AWB).*

The large Japanese mills were each embedded at the centre of long standing networks where they were closely connected to the one sogoshosha who sourced their wheat. From time to time these old allies participated together in joint developments in domestic and

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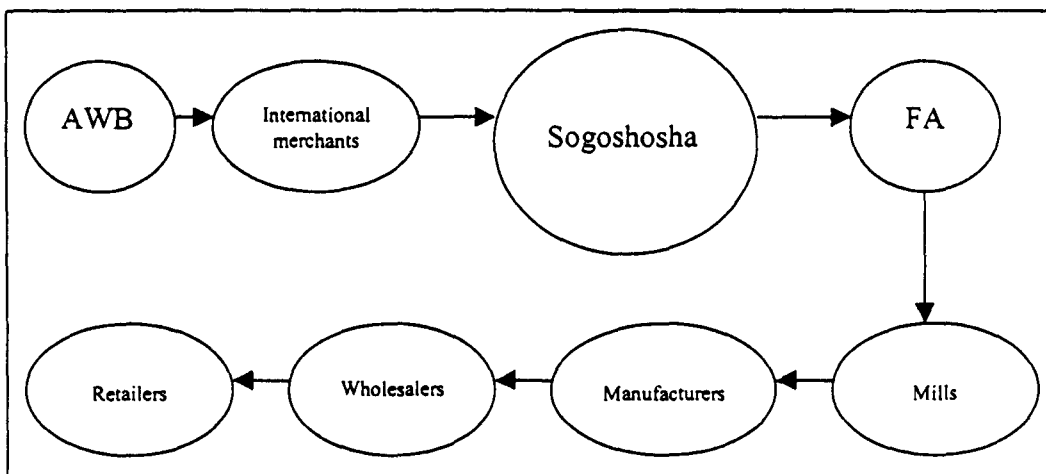
<sup>5</sup> The volumes and market share of wheat sold by the AWB to the FA fell from 1985-86, only rising to exceed the pre-1984 levels in 1989. This was due to supply shortages in Australia. (AWB memo, FA agreement and purchases 1986-93.)

offshore manufacturing. Typically the ties were strengthened by some cross-ownership. The big mills had vertically integrated into bakery product and/or noodle manufacturing, and some restaurants.

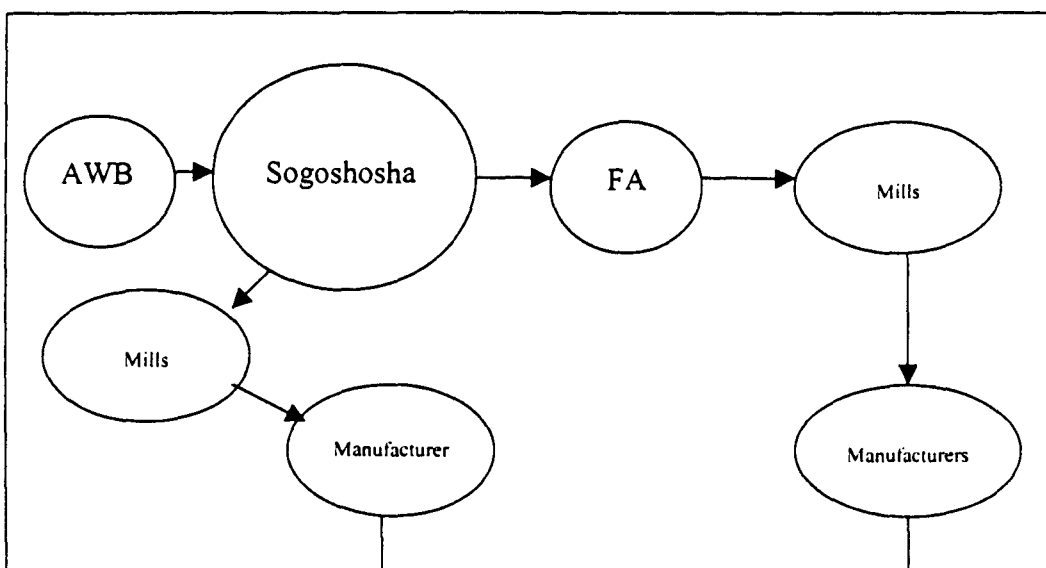
NpF, the oldest and second largest mill conglomerate was supplied by Mits, the largest sogoshosha. NF the biggest Japanese mill conglomerate was supplied by MTC (GH:AWB, NO:AWB).

Given the AWB's monopoly over the export of wheat from Australia and the market power of the sogoshosha, there was little potential for retaliatory action by the international traders who were perfunctorily removed from the networks, even though some had been agents for the AWB since 1938.

**Figure 7.5: The AWB – Japan Wheat Distribution Channel pre 1984**



**Figure 7.6: Network Restructure after 1984**



The network contractions facilitated a new era of faster, more accurate information exchange.

While the networks included the intermediary international agents, the Japanese sogoshosha adhered to the network conventions and did not communicate directly with these agent's suppliers (ie the AWB). Nor did the FA communicate detailed information about the mill's response to the grain during annual supply agreement renewals. The approximate proportion of each supplier nation's share of the wheat market was fixed, and the price offer never negotiated. Market signals were therefore muted.

If the international trading houses knew that the Japanese customers found the quality of Australian wheat was deteriorating, this information was apparently not passed on to the AWB. When the sogoshosha did come into a direct exchange relationship with the AWB however, the Japanese mills' response to the product was immediately and directly communicated.

TF:AWB, Chairman of the AWB (and a WA grain grower) described the era:

*Prior to the late 1970s the Japanese were getting about twenty different varieties in ASW. But there was a preponderance of Gamenya and Eradu. Then the WA Agriculture Department developed some higher yielding varieties which had poorer starch. At the time no one took much notice of starch. Then after 1985 the Japanese started complaining about the grains' quality because apparently they were using it for noodles (TF:AWB).*

GM:AWB an AWB field officer employed in WA wheat growing areas in the late 1980s also recalled the events of the season that followed the contraction in the trading network:

*In the 1985-86 season the Japanese started to complain that the quality and characteristics of the wheat they were after had deteriorated. We didn't know, but it turned out that the wheat was being used for noodles and the best varieties for that, apparently Gamenya, Eradu and Cadoux were being grown less because growers were getting better returns for*

*returns for higher yielding varieties. South Australian varieties like Spear were taking over, and with no price signals to encourage the lower middle range protein level wheats, these varieties were declining. Spear was suitable for Middle East flat bread but not for noodles.*

*So we (the AWB) responded ... by trying to work out which receival points<sup>6</sup> were getting the most Gamenya, Eradu and Cadoux. We wanted to target these to make sure the grain was sent off to the Japanese. In 1991-92 the first bonuses were paid for noodle varieties. The quality push was on from then on. In 1993 we dropped the bonus. There is now a separate noodle pool price (GM:AWB).*

In an effort to understand more about noodle manufacturing and the characteristics of wheat considered suitable for noodles, the AWB called on GC:DA. They asked him to contact his Japanese mill-manager friend SN:NF with a view to SN:NF organising the visit of some Japanese milling technicians to come the Bread Research Institute (BRI) in Sydney. These technicians were to teach the industry all about the wheat requirements for Japanese noodles. SN:NF, who by 1994 was a senior NF mill manager recalls the episode:

*More than ten years ago (in 1984) the BRI and GC:DA asked me to send a person to their laboratories. I consulted with the Flour Miller's Association and so NpF sent one person for one year, Mr S, and then NF sent Mr O also for one year. They stayed in Sydney. The BRI paid all their expenses. These two showed the BRI how to test Japanese noodles and they also tested many varieties of wheat for noodle production. After these visits great progress was made between Australia and Japan. So now we get the best varieties of noodle wheat coming from Australia and these varieties have been carefully segregated (SN:NF).*

The second strategy employed by the AWB to address the sogoshosha's concerns was to

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<sup>6</sup> The bulk storages, all ASMA's or Cooperatives are located at railway sidings where farmers deliver grain for sample grading and transportation to the wharves.

identify the areas where the noodle varieties were being grown. All these areas were found to be in eastern WA. Receival points in these areas were then dedicated to the exclusive supply of Japanese (and ROK) markets.

Between 1983-84 and 1989-90 the noodle wheat proportion of the WA crop continued to fall, declining from 45% to just 5% (AWB, 1994). Unable to supply the orders as specified, sales to Japan continued to fall.

The noodle wheat varieties were lower yielding and harder to grow compared to other ASW varieties (GB:DA; TF:AWB). As well, Gamenya, Eradu and Cadoux wheat varieties needed good to average soils and rainfall. Given volume was rewarded above grain specification, it made commercial sense for growers to plant the higher yielding, higher protein wheats in their more arable and better watered areas. With the domestic market deregulated in 1989 and demand for feed wheats growing to supply the Australian feed-lot industry expansion, growers had no economic incentive to grow the low yielding noodle varieties.

In 1989-90 noodle wheat varietal bonuses with a specified protein level were offered by the AWB for the first time. The bonuses were so small however the growers did not respond. Bonuses were increased in 1990-91, and again in 91-92 in an effort to stimulate production. The size of the bonus needed to stimulate the plantings was calculated by the WA Department of Agriculture, but the AWB never agreed to offer the full equivalent of this estimated cost (StD:AWB, GB:DA). Each annual bonus increase proved to be too small to stimulate additional noodle wheat plantings.<sup>7</sup>

It was in this context that JH:WANGA emerged as an industry leader amongst the WA noodle wheat growers. JH was an innovative, pioneer farmer who worked closely with Department of Agriculture advisers, in particular GC:DA. Through GC:DA he came to learn about the Japanese demand for WA noodle wheat. In 1991 he established the WANGA to lobby the AWB for a separate noodle wheat pool and the prices needed to adequately compensate them for the growing of the preferred varieties.

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<sup>7</sup> The varietal bonuses did however stimulate the seed breeders in WA Dept of Agriculture to turn their attention to developing new higher yielding noodle wheat varieties (GA:DA).

The 1993-94 AWB Varietal Control Circular posted to all Australian wheat growers in October 1992 reported their first move to further differentiate the Australian Soft Wheat (ASW) class, in order to better meet market needs. For the first time they also identified an intention to involve buyers in varietal selection:

*The ASW class which makes up 70% of all Australian wheat deliveries ... has basically remained unaltered since the 1974-75 season. In that season the FAQ classification was altered to the current ASW category. ... However in general terms the ASW class still accepts a relatively wide range of qualities and has no specific protein specification. This type of classification has suited the marketing system well for many years, but changes in market demands and declining protein levels around Australia are at least two of the compelling reasons to review the ASW wheat class.*

*The AWB recently took the first steps towards segregating wheats previously classified and binned as part of the ASW class and established a noodle wheat segregation in the 1991-92 season. ... There will be a strong market involvement in the selection of the varieties for these segregations. The AWB together with the market will identify varieties with suitable qualities for various end products. This will require cooperative research, principally overseas (AWB publication No VAC 5980).*

In 1993 the AWB also agreed to meet WANGA's demands for market returns less costs for the growers who produced the specified varieties and protein levels segregated in the noodle wheat pool.

## **7.10 AWB Strategies to Survive Deregulation: From a Commodity to a Niche Market Focus**

SF:AWB anticipated problems as Japan's flour markets were inevitably deregulated:

*The AWB can charge a very healthy premium on the Australian soft wheat*

*wheat sales to Japan. But at the moment the market is regulated. When it opens up we will have more competition and prices will probably fall. That's a problem because we really can't just compete on low price because of the subsidies other countries pay producers. And I don't know that we could expect to sell more. Most mills have some serious spare capacity. Our other problem will be maintaining supply security<sup>8</sup> (SF:AWB).*

From the mid 1980s the AWB attempted to build product loyalty in the regulated market by:

- *consistent over-delivery on specification (in terms of percentage of dockage and foreign material in the shipment);*
- *by holding stocks to supply the most valued customers;*
- *by guaranteeing hygiene and chemical residue levels from the place of loading; and by actively seeking joint research activities with buyers and their customers* (NO:AWB).

However, given the subsidised prices of competition in most of the world's wheat export markets, in the 1990s the AWB determined that supplying a tightly specified<sup>9</sup> grain into a niche market was the best prospect for maintaining buyer loyalty and obtaining price premiums post Japanese market deregulation (SF:AWB, NO:AWB, TF:AWB).

Despite ongoing problems with reliable wheat supply and the possibility of advanced milling technology compensating for poor wheat characteristics, the AWB strategy post-deregulation was to build and dominate a branded noodle wheat market niche. The Director of the AWB Tokyo Office explained:

*The differentiation of the noodle species and creating of a branded image of noodle varieties are together the two very important parts of future marketing strategy for wheat for Japan.*

*The noodle research program is the foundation for our competitive*

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<sup>8</sup> "Some growers will only try out a new variety for one season. Others will give it two seasons before deciding whether or not it will perform. It's hard to get new varieties going"(GM:AWB).

<sup>9</sup> Differentiation can be based on wheat grades, specification or preserved identity.

*advantage in Japan ... Through five years of trialing we have come up with three distinct varieties of noodle wheat (SF:AWB).*

SF:AWB described the strategy which was expected to deliver competitive advantage in this niche market:

*We are doing a lot of legal leg work in trying to brand the varieties, to use branding as a marketing tool...We want to establish the brand names in the mind of the industry. In other words if you want noodle wheat you have to go into Australia to get the best. We also want to solicit joint venture arrangements (SF:AWB).*

SK of MTC described what he saw as the advantage of offering more highly differentiated wheat.

*The objective of the manufacturer is to have more value added goods to supply to the market. This leads to a demand for greater diversity of wheat, in particular, higher grade wheat. The customer can make special products when supplied with special wheat. In this way it is a win win situation for the supplier and manufacturer (SK:MTC).*

A further post-deregulation challenge recognised by the AWB was having flour mills pay price premiums in an openly competitive, transparent system (SF:AWB).

In 1994 the FA tenders and regulations continued to obscure the three supplier countries' different prices for wheat, in particular when manufacturers purchased flour blended and sold through the senkan system.

Competition for market share between USA, CWB and AWB was not price based, even though there was a level of substitutability in some areas of medium protein wheat (NO:AWB, SF:AWB). Instead, the share of the market was allocated by the FA according to historic and on-going strategic considerations, ability to meet specification and supply reliability.



Given the conventions of the FA buying process provided little opportunity for the AWB to build relationships with the mills, even after thirty years<sup>10</sup> the chairman of the AWB, TF described how they aim to demonstrate their long term commitment to buyers:

*In the Japanese selling system we have been allocated a million tonnes of wheat, so much prime hard and so on, so there is no flexibility in the current system. We cannot increase our sales. There are lots of benefits for us in the present system. Our daily price is accepted.*

*As we go into deregulation however, we have to become more differentiated and more influential. ... We need to be recognised as a player with insider status. ... We just want to spend a few million dollars to demonstrate that we have a genuine long term interest in the market (TF:AWB).*

In particular the AWB aimed to "demonstrate" their commitment and achieve insider status by building research links with the zosan mills with a quota to import grain outside the FA tender system (SF:AWB). These mills had long been supplied with AWB wheat via the FA and their sogoshosha.

SK of MTC agreed with the AWB management's assessment that research cooperation could build special buyer-supplier relationships.

*Where there is a direct export/import situation with no FA involvement between a manufacturer in Japan and a supplier of grain, this can lead to a special research and development closeness (SK:MTC).*

In 1994 the AWB had the smallest share of this direct supply market. Their largest volume of sales continued to be in the stock feed senkan system.

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<sup>10</sup> While volumes from each supplier have followed a slowly rising trend in the long term, market share between the three suppliers has remained virtually static.

### 7.11 Building Relationships Beyond the Sogoshosha in the Network

SF:AWB acknowledged the dimensions of the task in establishing alliances, given their position and the power of the sogoshosha and the mills in the network structures.

*We can't talk to the noodle makers because they are the customers of the millers . ... Obviously we have to talk to them, and we are trying to do this, but there are real difficulties. There is an annual noodle manufacturer's get-together but we can't talk freely to them there. ...*

*Most of the udon noodle consumers in Japan ... believe that all the wheat in these noodles comes from Japan ...*

*We have to get out of this office and crack into the end users. We have to explore the chance to form up more JVs. We are looking for strategic alliances. We have a JV in China with a mill there (SF:AWB).*

Unlike their sogoshosha (MTC) however SN:NF argued that wheat supplier-manufacturer contact was unnecessary (even though he personally enjoyed a close relationship with GC:DA). For the AWB to "crack on to end users" in the MTC-NF network, network conventions would clearly need to be flouted, especially where mills were vertically integrated into noodle manufacturing:

*Manufacturers do not need to talk to the countries of origin of their wheat. The flour milling companies are doing a great deal and spending a lot of effort communicating with the manufacturers. That means the wheat supplier does not need to do this.*

*Generally we adjust our flour in the mills so that it is the same each year delivered to manufacturers. Generally manufacturers trust flour millers.*

*Most customers do not change over the years. We advise them on technical aspects, also on management. Some exchange of equity has gone on in the past between flour millers and manufacturers.*

*Flour millers do not tell their customers what country of origin is related to which varieties of wheat (SN:NF).*

## 7.12 Technical Transfer as a Means of Building Buyer Loyalty

AWB technology transfer as an inducement to forming a joint venture with a manufacturer or mill had been considered and rejected by the AWB on the basis that it was:

*... not an argument that holds water in Japan (SF:AWB).*

According to AWB managers:

*Japan has the most sophisticated millers in Asia. They could teach us a thing or two. There's no use us offering them a course.<sup>11</sup> (JW:AWB)*

*We really can't advise them except in the area of having them try new varieties of wheat suitable for noodles. ... We know what varieties are good but we don't know why (NO:AWB).*

RN:NF Deputy General Manager of the biggest buyer of AWB grain described the information exchange between them and the Australian grain industry:

*Every year we send staff to the USA to study everything. We only go to Australia when there is a problem, and once a year to inspect the season's crops in WA. We go to the WA (the Agriculture Dept) laboratories to talk to the people about improving the quality of the varieties. Ten years ago we sent a technical engineer to see Dr GC. He stayed one year. Three years ago we sent another technical staff to WA for six months. Now he is the GM of a mill in Japan, and he and GC are very good friends. The WA AWB staff come many times to Japan. They come to know the quality required and to check on starch quality (RN:NF).*

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<sup>11</sup> The AWB has less technological skills in milling and baking compared with USA, Canada and Europe (SF:AWB). For example NpF's staff trained in Switzerland, USA and at the new International Grain Institute in Canada (KN:NpF).

### 7.13 Joint Research as a Means of Building Buyer Loyalty

While SN:NF and RN:NF had dismissed the value of the AWB meeting with their noodle manufacturers, they were nonetheless supportive and confirmed SK:MTC's view of the usefulness of the mill's interaction with the AWB, and the potential for a JV to develop new wheat varieties:

*There is two-way information flow with new varieties of wheat. Sometimes the AWB asks us to try new varieties. We always communicate with the Tokyo office of the AWB. It takes very little time to get information. The AWB has asked us to form a JV with them. We would like to do that (RN:NF).*

In 1994 the AWB undertook a small cooperative research project trialing the potential of a single "pure" noodle wheat variety. MTC and NF provided technical support.

However management at the second biggest mill conglomerate, NpF, saw little value in the further differentiation of wheat varieties or in a research relationship with AWB. While they visited USA regularly, their last visit to Australia was two years earlier to inspect the effect of seasonal conditions on the harvest.

*The Japanese Milling Association brings samples to Japan where they have their own testing mill. So NpF gets the results of these tests along with everyone else. There is therefore no incentive to do R and D work alone with just one country. It would cost a lot of money buying special wheat which could not be mixed in transport.. This would be very expensive. It makes no sense to further differentiate different varieties of wheat. Transportation is most cost effective when it is in large bulk volumes. We have a number of NpF factories but they do not talk to the AWB.*

*Mills order every four months. Usually we get what we order through the FA. We order similar specifications year in year out (KN:NpF).*

KN:NpF's attitude to the problems associated with further wheat segregation/differentiation was echoed by JW:AWB who held a view different to that of his own senior management:

*You can make life impossibly difficult when you are a bulk commodity supplier if you differentiate too much. It's all very well to look at exactly what the customer wants and try to supply it, but to do it economically you have to remember there are segregation costs, and you have to make sure the segregation does not add to the costs. ...*

*The buyer can blend wheat himself, or the buyer can blend flour. ... Although normally noodle flour is not blended, but bread flour is blended. There is a blend of a few different wheat varieties in what we sell as noodle wheat (JW:AWB).*

SN:NF also referred to the costs of further differentiation:

*Japan now imports durum wheat from Canada and USA. There is no space in our silos for Australian durum wheat (SN:NF).*

Thus by 1993 the NF and MTC had participated in a small new noodle wheat variety breeding project with the AWB, despite the inconvenience of further wheat desegregation. On the other hand, NpF management had stated there was little value in such cooperation. In fact, because of the long standing informal agreements between sogoshosha, NpF (and its sogoshosha Mits) could not have become involved in WA noodle wheat research with the AWB without challenging long standing trade territory agreements with other sogoshosha, in particular NF<sup>12</sup>.

#### **7.14 Traditional Grain Trading Zones and their Impact on Network Relationships**

By the 1940s some of Japan's largest sogoshosha had allocated Australia's four State Barley or Grain Marketing Boards between themselves for exclusive supply access. Thus price competition between Japanese buyers was eliminated. MTC's grain trading territory was agreed to be the WA Grain Pool, an ASMA handling all cereals other than wheat (SK:MC). Mits's territory became the so called Australian Barley Board covering the two states of South Australia and Victoria. Western Australian grain growing regions thus

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<sup>12</sup> The AWB wheat classification has always identified the state of origin of the wheat along with its hardness, e.g. WA ASW, or NSW PH etc.

became the exclusive trading territory of the MTC network.

SF:AWB described the agreements:

*Seven or eight years ago the SA barley suppliers developed a linkage with Mits. The Australian Barley Board in SA and Victoria only sell via Mits. The Grain Pool of WA only sells through MTC. It sells canola and lupins as well as barley (SF:AWB).*

SK:MTC described the same long-established arrangement:

*In each state in Australia barley is locked up with different trading houses from Japan, so MTC does not operate in any other state except WA. ... MTC has been buying from the Grain Pool now for more than 30 years. ... Now the WA Grain Pool is trying to sell more of its product to Asia. MTC is hoping to be the trading house into South East Asia and China too for the Grain Pool. China is especially difficult for the WA Grain Pool to penetrate. MTC wishes to help them (SK:MTC).*

While the anti-competition conventions at first only applied to the Barley Boards and non-wheat grain pool of WA, the conventions were extended over the years to include wheat grown in the same territories but sold exclusively through the AWB. For example, MTC was the only sogoshosha who offered AWB WA noodle wheat to the FA for purchase through tender (SF:AWB).

WA grain growers were familiar with the grain buying activities of MTC and their Melbourne based Japanese managers. WANGA office bearers had strengthened that relationship through their mutual friend GC:DA. Thus network conventions dictated that it was only appropriate for MTC and their customer NF to respond to the overtures when AWB offered research and development partnerships in noodle wheat breeding or manufacturing.

TF:AWB, chairman of the AWB understood the reality and expressed concern about the

territorial agreements restricting price competition between sogoshosha networks:

*There are four to five major Japanese traders out of Australia. If we are not careful these big boys will corner it all, and they do not have the interests of the Australian grower at heart (TF:AWB).*

Meanwhile WANGA leadership, not familiar with the conventions of the trading networks sought MTC sponsorship for their overseas market visit, and offered MTC a WA based manufacturing joint venture. (See the WANGA case study for a description of their other strategies designed to achieve WANGA objectives.)

### **7.15 Preferred Buyer Characteristics.**

Informants from NpF, NF, MTC and Tom were asked to identify and prioritise preferred wheat supplier characteristics. All nominated supply security as most important, where the detailed specification was consistently delivered. The second ideal was high and consistent standards of grain hygiene (SN:Nf, KN:NpF, KS:Tom, SK:MTC). Price was nominated as the third consideration by three of the four informants.

Management from NpF who with NF supplied 50% of Japan's flour market stated "price is not relevant", when specifically prompted after failing to mention price amongst the characteristics "preferred" (KN:NpF). NM:NF described the emphasis on quality needed to keep manufacturer loyalty given the lack of price competition:

*... because the price is stable then the millers must get improved quality all the time to make a profit (NM:NF).*

### **7.16 Wheat Hygiene and Competitive Advantage**

Amongst the preferred supplier characteristics was the high standards of wheat hygiene required (KN:NpF).

Using its regulatory powers and in cooperation with the other State owned bulk handling ASMA's the AWB was able to monitor and impose standards of hygiene from farm gate to ship hold. In WA the AWB required the sealing of every on and off farm wheat storage and

assiduous testing of the grain loaded at the wharfside. (StD:AWB) The level of grain chemical residue was able to be guaranteed by the AWB in writing at the time of loading.

SK:MTC assessed the AWB's wheat hygiene standards:

*Australia is the most advanced in chemical analysis in their wheat products, in particular they look at cleanliness and they supply very reliable analysis reports. Canada is a little behind in this. It gives us assurances but it is slower. USA cannot give assurance at all because of the various suppliers in the market (SK:MTC).*

### **7.17 Shocks or Defining Moments Challenging Supplier-Buyer Relationships**

Japanese informants were asked to identify any episodes over the years which had produced substantial change or strain in their relationships with the AWB. NF management recalled that 1982 there was a severe drought in Australia when only 40,000 tonnes of a 280,000 contract were supplied to the FA. They had to import extra tonnages from the USA. As well,

*... seven or eight years ago there was severe rain damage in the WA crop (SN:NF).*

But in both cases:

*... the AWB was very honest about it and very good to the FA (AK:NF).*

NpF managers recalled the impact of the drought of 1982 but did not feel that relationships with them were affected, given that the FA found alternative sources of supply. None of the informants referred to the decline in noodle wheat availability in mid 1980s as a problem effecting their relationships or signalling a change in relationships with the AWB.



## 7.18 Timeline: Development of Australian-Japanese Wheat Trade

### Pre 1918

- Japan's traditional cereal foods were rice and noodles made from locally grown wheat.

### 1918

- Following WW1 food shortages and inflated prices led to nation-wide rice riots. Many were killed.

### 1921

- The Rice Law introduced to control the price and supply of food staples.

### 1942

- The Food Control Law enacted in response to the national war emergency to regulate food supply.

### 1946

- Following WW2 food shortages eased with food aid. Bread was supplied to the school lunch program.

### 1948

- **The Food Agency (FA)** nominates twenty-eight sogoshosha to supply wheat to them. They become the **Grain Importers Association**. Wheat flour is a prohibited import.
- **The Japanese Millers Association** consisting of four leading mills consult the industry and inform the FA of Japan's annual wheat import needs.

### 1956

- AWB-FA sign first annual trade agreement for wheat supply.

### 1958

- The MAFF establishes the **Senkan Scheme** with twenty-three feed mills to supply bran to new feed lot industry.

**1964**

- The Tokyo Olympic Games stimulate demand for western foods, especially bread.

**1965**

- Consumption of wheaten foods had grown from thirty pounds in 1930s to 90 pounds per capita.

**1972**

- USA temporarily halts export of soy bean to Japan in response to food price riots in USA. Canada and Australia then join USA as the three invited to tender for the supply of wheat to the Food Agency.

**1984**

- The AWB chooses to trade directly with the sogoshosha, by-passing the international traders.
- Japanese specialists teach Australian technicians about noodle grain manufacturing requirements at the BRI.

**1987**

- GATT Panel-12 rules that Japan's market access regulations must be liberalised.

**1989**

- USA initiates the GATT Structural Impediments Initiative in order to force Japan to address non-tariff barriers to trade.

**1993**

- The AWB, MTC and NF undertake some limited joint research into noodle wheat variety performance.
- WANGA offers joint venture in noodle manufacturing to MTC. The offer is rejected.
- AWB aims to develop a branded noodle wheat niche in Japan.

### **7.19 Preliminary Analysis**

Australia, the fourth largest wheat exporter is heavily dependent on exports. Japan is the best returning market for the AWB.

The FA centralised control of most wheat imports and in particular its senkan scheme has meant that:

- (i) the Japanese manufacturer and consumer have not been aware of their flour's country of origin, making it difficult to establish brand recognition or product loyalty.
- (ii) the FA wheat buying system has created additional links in the chain of activities extending from grower to consumer, reducing the chance of speedy and accurate information and technology exchange across the network.
- (iii) the price differentials being paid to the three nation suppliers for different wheat varieties and standards have been muted by the FA system (SF:AWB).

Anticipating Japanese market deregulation and the loss of the three country preferred supplier agreements, the AWB identified the need to build loyalty for a more differentiated product as their post deregulation survival strategy.

However the extent of vertical integration between sogoshosha, mills and manufacturers made forging relationships directly between the AWB and the end consumer difficult to achieve without antagonising the established network participants.

MTC's monopoly on Japanese access to WA grain saw the AWB in a highly dependent position in a network in the market where it estimated it had the greatest prospect for survival or growth post-deregulation. The cooperative research ventures they hoped would give them greater "insider status" only managed to further cement them into the highly dependent MTC-NF-AWB relationship.

Publicising the Australian country of origin of the bulk of the flour used in making Japanese udon noodles had the potential to antagonise the Japanese grower whose wheat competed in the same niche. Japanese preference for home grown foods, especially of such cultural significance as rice or noodles was also a barrier to ready acceptance of the

Australian product's position in the market place.

While the AWB had hosted Japanese farmer visits to Australia to observe on-farm storage technology, no other strategies were in place to counter potential grower-consumer backlash, or to forge mutually beneficial alliances.

A decrease in Japanese agriculture subsidies could also see the senkan system contract in line with the demand from domestic poultry and livestock industries. The bulk of AWB wheat was sold through this senkan system.

Anticipating the changes, forming closer relationships with the Zosan mills, in particular those with a direct supply wheat quota had become an urgent AWB priority (NO:AWB). The network's most powerful actors saw any re-positioning a threat counter to their interests and monopolies and to be actively discouraged. As well, the cost of adding to or switching wheat blends in mills was a substantial barrier to change.

Finally, the need to further differentiate wheat to create new products may be over-taken with advancing technology<sup>13</sup>. For example, a protein deficiency or poor starch characteristics may come to be adjusted with additives to the flour or through special processing.

This may mean individual grain characteristics become less, rather than more significant in the future. There may be more value in developing buyer loyalty to service, (eg reliability of supply and hygiene), rather than further grain differentiation if processing technology can substitute for any advantage in tighter varietal specification.

Such a development would require an even greater need for the AWB to form closer relationships with other network participants.

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<sup>13</sup> Wheat breeding programs typically take ten to fifteen years to produce a successful new variety.

## **Chapter 8**

### **THE WESTERN AUSTRALIAN NOODLE-WHEAT GROWERS ASSOCIATION (WANGA)**

**The actors participating in the evolving network:**

WANGA

Department of Agriculture Western Australia

The Australian Wheat Board (AWB)

Mitsubishi Trading Company (MTC)

Nisshin Flour Mills (NF)

#### **WANGA**

An association formed in 1991 to achieve better returns for WA noodle wheat growers.

#### **Informants**

John Hawkins (JH:WANGA) President and wheat grower.

Lindsay Olman (LO:WANGA) Vice President and wheat grower.

Ken May (KM:WANGA) Member and wheat grower.

#### **The AWB**

#### **Informants**

Vince Alisowskis (VA:AWB) Senior Milling Technician

Trevor Flugge (TF:AWB) Chairman, AWB and WA wheat grower..

Nigel Officer (NO:AWB) Senior Manager International Marketing. Director of AWB  
Tokyo Office, 1989-92

Steve Feletti (SF:AWB) Director AWB Office Tokyo, 1992-

StJohn Dick (StD:AWB) Senior Public Affairs Officer AWB, WA.

Bruce Watkins (BW:AWB) State Manager, WA AWB.Perth.

Grant McDougal (GM:AWB) ex field Officer northern growing areas of WA and policy officer, AWB Perth.

**Department of Agriculture WA (DA)**

**Informants**

Graham Crosbie (GC:DA) Officer in Charge, Grains Products Laboratory, Department of Agriculture Western Australia (DA) 1980-.

Gillie Brown (GB:DA) Manager, Wheat Market Project, DA, 1990-

**Nisshin Flour Milling Co. Ltd.(NF)**

Japan's largest flour mill conglomerate.

**Informants**

Dr Seiichi Nagao (SN:NF) Research Director and General Manager, Cereal Research Centre.(visited WA Dept of Agric)

**Mitsubishi Trading Corporation (MTC)**

One of Japan's largest sogoshosha.

**Informants**

Masato Kondoh (MK:MTC) Officer, Wheat and Barley Team, Produce Department Tokyo.

Satoshi Koyama (SK:MTC) Assistant General Manager, Produce Department, Manager, Wheat and Barley Team. (Tokyo)

## **8.1 Background Information:**

### **8.1.1 Domestic industry context**

In 1989 the Australian domestic wheat market was deregulated. The AWB lost its buyer monopoly and had instead to compete with agents for wheat supply. AWB field officers were appointed for the first time in WA and a grower newsletter was initiated which referred to the destination of the grain and the need for greater varietal control.

At the same time the Minimum Price Scheme (MPS) was abolished. This had delivered a price using an averaging formula taking into consideration prices paid over the previous five years. GM:AWB recalls:

*A lot of the growers did realise that the MPS had finished but in 1990-91 there was a \$15-\$20 per tonne drop in the price and so the message was sheeted home. Many growers realised for the first time that the government was not always going to be there (GM:AWB).*

## 8.2 The Formation of WANGA

The WANGA was formed at the end of 1991. Its establishment was a response to the sudden drop in wheat prices, better<sup>3</sup> information about who constituted the market for their product; their experience with the deregulating domestic market, and a fading distrust of traders (JH:WANGA). One hundred and seventy of the 300 noodle wheat growers in WA paid a small membership fee to launch the association<sup>1</sup>. In return they received a newsletter and the promise that WANGA would deliver a better deal for them.

Their leader, JH:WANGA was a charismatic, innovative and successful pioneer grower. He had come to Australia as an Empire Orphan<sup>2</sup>. Like many other WANGA farmers he had cleared his own block. He was the winner of the WA's 1993 Rural Achiever of the Year Award.

With their motto "Excellence in Production and Reward for Quality" WANGA established close relationships with a State Government Department cereal chemist GC:DA<sup>3</sup> the special friend of SN:NF, and the most experienced WA Agriculture Department wheat breeder. GC became their official technical adviser. WANGA meetings were held in his office in Perth.

WANGA's aims were to:

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<sup>1</sup> There were 8000 commercial growers of wheat in WA in 1994 (StD:AWB).

<sup>2</sup> Empire Orphans where British children sent to help increase the population of Commonwealth countries following WW2. Some sent to Australia were raised in missions in the wheat growing country of WA. JH began growing wheat on his own property at the age of nineteen.

<sup>3</sup> In 1993 GC was embroiled in a serious dispute with AWB after the Japanese Flour Millers Association had attributed inferior qualities to a new variety he had submitted for their consideration. The AWB sided with the Japanese testers. (NO:AWB; GC:DA) GC demanded a retest. GC's support of the WANGA was perceived by the AWB as "another way to have a go at us" (TF:AWB).

*represent the interests of noodle wheat growers in WA;  
develop close relationships and understanding between growers and  
end users;  
encourage its members to produce the quantity and the quality required  
by customers;  
support quality improvement in wheat for various types of noodles  
through improved production techniques, grain receival arrangements  
and the breeding of new wheat varieties; and  
encourage value adding of noodle wheat in WA*  
(Noodle News Vol 1 No 1 March 1994).

*Association spokesman JH said the group was formed to put direct  
pressure on the AWB to form a separate noodle wheat pool and give  
growers a greater say in the marketing of their product*  
(Countryman, February 27 1992).

WANGA agitated for a full net return of the price premium the WA noodle wheat earned the AWB (KM:WANGA). They resented the averaging of this premium across all Australian growers via the mechanism of the single wheat pool. They demanded a separate WA noodle wheat segregation. In a media interview in 1992 JH:WANGA presented the views of his membership:

*The national pooling system has ruined some farmers and will prevent  
WA eastern district farmers from getting enough finance for this year's  
crop, according to JH spokesperson for the WANGA. ... "Unless a  
decision is made now pressure will come from people wishing to go  
away from the Wheat Board and asking other players to market the  
wheat (Countryman, Feb 27 1992).*

KM:WANGA explained his view of the preferred future of the WA wheat industry:

*A single desk authority is too easy to take over. What we want is a WA  
single desk. We want a Farmer Coop with expert marketers. Growers*



*can elect their own council. The world markets are now so corrupt that WA has to go it alone. ... We can go it alone in WA because we have 44 of the 46 known minerals in this state. We want our state bank to have the same powers as the Reserve Bank and it should have interest free loans to agriculture (KM:WANGA).*

In the *Countryman* newspaper of Feb 27 the AWB management argued that only a small proportion of the so called noodle wheat delivered to the market was from the preferred varieties of WA's Erudu, Gamenya and Cadoux. The product delivered as noodle wheat was a blending of many varieties of soft medium protein wheats including some grown in other states. (NO:AWB) The AWB stated that they were concerned that a reliance on one growing area or a commitment to the supply of a single variety exposed them to a potential supply failure in a drought year:

*BW, AWB State Manager said it was inevitable that a separate noodle pool would be set up but that to do so now would be chopping at the industry's backbone of support too soon ... storage, and handling constraints made it almost impossible for the board to segregate, market and sell individual wheat varieties. ... The AWB stated in a position paper midyear that "as much as the Board is committed to returning to growers the value of their wheat in the case of the Japanese and Korean Noodle markets, the exposure to market forces and the resultant boom or bust situation is surely not in anyone's interest (Countryman, Feb 27 1992).*

In interview the Director of the Japanese AWB East Asia office (SF:AWB) explained the concerns he had with the WANGA members call for a separate WA pool:

*There is a problem if Japan only wants wheat from WA, because WA might have a drought. So we have to drought-proof the supply with grain from the east coast. We also have to improve the overall grain supply from WA (SF:AWB).*

TF:AWB Chairman of the AWB and himself a WA grower concurred:

*If the growers want to go down the track of producing a particular product exclusively, what happens when they cant provide it in a bad year? If you guarantee quality then you increase risk (TF:AWB).*

A substantial proportion of the noodle wheat grown annually did not meet the specifications required by the AWB for the Japanese market. In the 1994 season 1,300,000 tonnes of noodle wheat varieties were produced but only 700,000 tonnes were within the protein specification, making it into the segregation. In that year the Korean and Japanese orders were for 1.0 to 1.2 million tonnes (BW:AWB). The total area of wheat sown in WA was an estimated 4.2 million hectares in 1995 with the noodle varieties Cadoux making up 17%, Eradu 12% and Gamenya 2% (GC:DA).

### 8.3 Repositioning in the Network

During the 1994 Annual General Meeting of the WANGA members complained about the difficulties of growing noodle varieties and the AWB's failure to capitalise on the 1985 complaints about volumes and quality:

*We have to be paid for a higher quality. Cadoux<sup>4</sup> is too hard to thrash. Growers need a good header to thrash it. There is so much disenchantment in the north with Cadoux that Eradu<sup>5</sup> will probably come back. The AWB missed an opportunity to put up the price when the Japs said where's all the Gamenya gone? We should have said you have to pay for it if you want it (LO:WANGA).*

Despite the well understood problems associated with producing enough noodle wheat annually to meet demand WANGA relentlessly pressed the AWB for the creation of a separate WA noodle wheat pool. A newspaper reported the campaign headed by President JH:WANGA.

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<sup>4</sup> WANGA members jokingly called Cadoux (pronounced Cardoo) "Cadon't".

<sup>5</sup> Eradu has a lower yield characteristic compared with Cadoux (GB:AD).

*JH believes the AWB has been prolonging debate to delay the setting up of a separate pool for political, not economic reasons. "They're waiting for the eastern states to develop a noodle variety of similar quality because they are frightened of the eastern states hostility if WA heads the market with its own separate regional pool." ...*

*Mr JH said "changes must be made now to give growers incentives to switch to noodle wheats or WA will lose the opportunities to "stitch" up the entire Asian noodle market (Countryman, WA, February 27 1992).*

In 1992-3 the AWB once again increased the noodle wheat varietal premium paid to farmers. However they continued to resist WA growers demands for a separate pool. Relationships between WANGA and the AWB continued to be confrontational:

*Wake up farmers-whose side is the AWB on? ... it is time we went it alone in WA and marketed our own grain crops and wool, through either a farmer's coop ... or with grain through the Grain Pool of WA..To the knockers who say it can't be done have a good look at New Zealand ... Finally a word of warning Mr. W. (AWB State Manager) smarten up your performance and start working for us or go (KM:WANGA Letter to the editor, July 27 1995, Farmer's Weekly WA).*

## 8.4 WANGA Strategies to Shorten the Channel

According to JH:WANGA:

*We push the Wheat Board around a bit. They miss opportunities that we see in marketing. We have a lot of contacts, in the AWB, overseas, in the Ag Department of WA. We have had our own overseas mission and we contact the market regularly via the fax. We have contact with the Trading Houses. We are going to go one further. We are going to join with the WA Agriculture Department to do some research. ... We send*

*secret samples to Tokyo via GC:DA to a milling company in Japan<sup>6</sup>. They want to make an independent assessment of some varieties for a new line. ...*

*In the last 100 years growers lost touch. We lost a lot, we lost our way when the growers lost contact with the markets. We can tell the market when he buys our product at a particular price that we can do it now but in two years we will be broke, because we do not have any subsidies. We can tell them the cost of production, chemicals, what pesticides we use (JH:WANGA).*

The WANGA 1993 market familiarisation tour saw the growers aiming to communicate with the actors in the networks beyond their buyers, the AWB. This caused considerable tension between the AWB, GC in the WA Department of Agriculture and MTC (BW:AWB; SF:AWB; GC:DA). Initially MTC had offered to host the mission in response to a request for support from WANGA, supported by GC:DA (JH:WANGA). MTC had agreed to host mill and manufacturer meetings and to subsidise the cost.

In particular WANGA wanted to attend the large Japanese Food Fair, FOODEX:

*When we went overseas to Korea and Japan in 1993 MTC was going to pay for our trip. Then MTC was going to pay 80% while the State (WA) paid 20%. We were going to take a stand at Foodex<sup>7</sup> and let people sample Australian noodles, and then we would tell the Japanese that most of the noodles they were eating were actually made of Australian grain. MTC was going to be part of that. Finally MTC did not pay for any of it. The GRDC<sup>8</sup> and the WA State shared the cost. And the AWB took us around everywhere (JH:WANGA).*

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<sup>6</sup> All export related R and D requests from buyers were supposed to be directed through the AWB (SF:AWB).

<sup>7</sup> Largest annual food manufacturers/agents/distributor's trade show in Japan.

<sup>8</sup> GRDC: The Australian Grain Research and Development Corporation, funded largely through industry levies.

The timing of the WANGA visit to the ROK market coincided with the AWB wheat contamination episode. JH:WANGA was concerned that the AWB had apparently not cooperated fully with the market's demand for detailed production information.

*... they asked us again and again: what chemicals do you use? Especially in the ROK they asked us. ... We can tell them everything: the cost of production, chemicals, what pesticide we use. We can tell the people exactly what we use. We were horrified that the AWB does not tell them overseas what we use. We got these questions all the time in our overseas mission (JH:WANGA).*

VA:AWB, a milling technician with the closest relationships with the ROK millers and their manufacturers evaluated WANGA's attempts to form closer relationships in the market place:

*They are a pain in the bloody neck. I don't want to use my time and expertise on domestic politicking. (They) have been meddling in things that have already been organised. They are trying to play political games. They actually visited the ROK mills, but they saw nothing. It was a bloody waste of time. I did not go with them, couldn't be bothered. ... You should never take people who are irrelevant into the market. I'm always trembling. They can do you in. You don't know what they are going to say or promise. They promise the undeliverable. I have a great fear of the well meaning delegation. You have to stroke people there (in the ROK market). You have to spend time with them (VA:AWB3).*

By taking control of the WANGA mission out of the hands of MTC the AWB re-asserted its position in relation to the growers and sogoshosha in the network, minimising any disturbance of the buyer-supplier relationships. They also avoided the potential Japanese grower anger at having the volume of imports and the real source of wheat for udon noodles exposed. Japanese and ROK farmers may have welcomed a boost to their mobilisation of consumer opposition to imports just at the time when

chemical contamination scares and market deregulation were a matter of considerable public debate.

At the Annual General Meeting (AGM) of WANGA on the 12th July 1995 held at the Perth DA offices, the president JH reflected on their failure to attend FOODEX in 1993. He indicated a continued interest in confronting the Japanese consumers with information about the origins of their noodle flour. He also believed WANGA could more actively help the AWB find new customers:

*... at that time (1993) the AWB preferred we didn't attend Foodex because we could have embarrassed the Food Agency. But now we are closer to this market and have got a closer relationship with the AWB<sup>9</sup>. Now we would be commended for doing things like this (JH:WANGA).*

After responding to questions from members asking about the difference between FOODEX and the Food Agency, the minutes noted:

*The general feeling of the meeting is that FOODEX should be on our agenda in the near future and if WANGA gets any new markets as a result of our efforts then WANGA will ask the AWB to pay us a commission (JH:WANGA AGM notes).*

## 8.5 WANGA seeks Alliance with MTC

WANGA aimed to capture greater returns to growers by encouraging value adding through local noodle manufacturing for export. Despite two small noodle manufacturers operating unsuccessfully in WA in 1993-94, WANGA was undeterred. It considered Mitsubishi an ideal partner in a new noodle making venture. Relationships with Mitsubishi's Melbourne based Wheat Team Manager were strong,

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<sup>9</sup> In 1993-4 the AWB in WA did not have the names of its growers, only their registered property numbers and addresses (StD:AWB). After employing a special officer to produce a schedule of names of growers focus groups were held with the top 100 producers. Relationships and communication between the AWB and growers subsequently improved (StD:AWB).

built on social exchange over many visits to farms and through written correspondence.

In April 14 1994 JH:WANGA wrote to the MTC Head Office, Tokyo and invited them to become joint venture partners in a noodle making operation in WA.

In August 1994 they received a written reply:

*I would like to hereunder express our perception and strategic plan on noodle wheat.*

*Firstly we have to excuse ourselves for not being quite positive for setting noodle manufacturing facility in WA at this stage of the game, or more precisely we feel it too early to make this true.*

*Since we are holding excellent customers both in flour milling industry and processing industry in Japanese market, we can not ignore their interests, or rather, what we aim is to go hand in hand with these customers on this type of project. But we feel the time has not yet matured for them to start such operation in overseas location (SK:MTC correspondence August 23, 1994).*

TM:MTC also suggested they take notice of the fact that there already was at least one noodle manufacturer struggling to survive in the State.

Not satisfied with this response, TH:WANGA wrote to the Melbourne MTC Office Manager in 1995, enclosing a copy of their noodle venture scoping study. They received a similar response:

*We have duly passed your study to our related customers and will convey any interesting feed back from them in a timely manner. ... Anyway we would like to keep watching this project with keen interests but at the same time we would like you to understand our situation that we need to protect our customers, wheat flour mills and noodle manufacturers position in Japan and therefore to seek a mutual benefit for all parties. We are now looking for the best approach*

*for this project without causing any conflict with our customers. Best regards, Tommy (TM:MTC, Faxed message, 16 June 1995).*

Thus WANGA's preferred joint venture partner was not prepared to disturb their established buying-supplying relationships. In his 1994 letter SK:MTC did suggest some new activities for WANGA however. These proposals had the potential to deliver considerable benefits to MTC in the form of a greater variety of grains to purchase from the State where they enjoyed a Japanese buyer monopoly.

*Japanese millers put the same reliance on the quality of Australian prime hard wheat as ASW noodle type, and yet supply of prime hard wheat is not so stable in the Eastern States.<sup>10</sup> So, if WA will become able to produce good quality prime hard wheat WA agriculture will gain further reputation as well as economical advantage. We hope we can assist on this in any ways. ... Likewise we are also very interested in barley breeding program for various purposes. ... We hope WANGA will play an important role in diversification efforts such as above (SK:MTC ).*

At the AGM of 1995 JH displayed his level of understanding of the bargaining power of their position in the market network when he tabled this correspondence with the comment that he:

*could not really understand where MTC was coming from and would talk privately with them (JH:WANGA).*

NF's management was asked to describe the role of WANGA in relation to themselves. SN:NF conveyed a sense that they related to the Association as suppliers to the AWB, who in turn could be helped in communicating a clearer message about the customer's needs:

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<sup>10</sup> As well MTC did not have a monopoly of access to the Eastern State's PH wheat supplies



*NF sees it as very important to speak to the WANGA people to get information directly to these growers. If we talk to them directly then it is easier for the AWB to get some messages across to these farmers. When I was in WA I spoke on the radio hoping to get across the important messages about the quality of wheat needed (SN:NF).*

After the difficult period of their earlier relationships, AWB Chairman TF:AWB described what he saw as the ideal relationship between the ASMA and WANGA:

*WANGA think marketing is just selling ... We are trying to get them to understand that they are part of the marketing now. Especially now we have differentiated wheat ... one of the tasks of the next few years is going to be how to get the growers to understand where they stand. ... Margins for wheat have been so small, you have to build a risk factor in, you need fat in the system, most farmers just go from year to year ... We employ as much farm advice as possible ... we have to get management of farms up. I think the AWB is going to have to get more extension officers since the number of agronomists in WA Ag Department has dropped from three to one. We really have to think more and look a lot harder at more sophisticated information technology. We have to contact 50,000 growers two or three times a year.*

*WANGA is the way we have to go. We cannot be paternalistic towards them (TF:AWB).*

## 8.6 Preliminary Analysis

Wheat quality characteristics, in particular those inherent in the grain, for example: protein, hardness, colour and moisture were created by the grower's activities. To a lesser extent cleanliness, safety (eg dockage and chemical residues) as well as availability were also created by the grower on the farm. The AWB depended on these qualities to maintain or expand their sales.

After the domestic market deregulation in 1989 the Australian wheat growers had other buyers competing for their product. In response the AWB more actively sought their loyalty, supplying newsletters and field officers for the first time. Growers became better informed about the markets. The DA sought the best growers' cooperation in wheat seed breeding programs. Growers became better informed about market niches.

Stimulated by this new information and below the cost of production prices the WANGA was formed. It aimed to capture higher returns for growers by vertically integrating into the manufacturing of value added product in association with the AWB's sogoshosha MTC.

They also attempted to expand their sales by building new relationships in the market place with manufacturers via trade mission and trade fair contacts.

Defending their position as the monopoly exporter of Australian wheat, the AWB thwarted the plans of MTC to host and sponsor WANGA's first trade mission. It then acceded to WANGA's demand to form a separate noodle wheat pool, with full market returns, despite the threat this disaggregation posed to noodle wheat supply security.

MTC ultimately rebuffed the alliance offers from WANGA, deferring to the obligations and loyalties to their own buyers, the Japanese mills and manufacturers long established in the network.

## **Chapter 9**

### **BACKGROUND TO THE ADC CASES**

#### **9.1 The International Dairy Market Environment**

Key elements in the structure of international dairy trade have a major bearing on international market returns. These include:

In 1993 less than 10% of the total world manufactured dairy product has traded internationally. In particular export markets were residue markets for the major producers, eg USA and the EU.

In 1993 almost 70% of the product exported was supplied under government funded subsidy arrangements, a result of domestic policy rather than international market returns. For example in 1993 the EU had a surplus of 20 million tonnes of milk to be disposed of through subsidised sales or stockpiling. This volume accounted for 60-70 % of all world trade in dairy product (ADC, 31st joint meeting of the Australia-Japan Business Co-operation Committees Oct 1993).

While some trade liberalisation post GATT has occurred, tariffs and non-tariff barriers continued to limit market access.

International dairy markets are volatile with prices and volumes varying between years due mainly to changes in policy in the key producer countries.

## **9.2 Australia and Japan Dairy Market Development**

In 1994 Australia and Japan's dairy production was similar in scale. However the structure of the two industries and their respective relationships with the international dairy market, differed. While the Australian per capita consumption of dairy product was high by world standards, the domestic market was small and mature. Consequently Australia exported a growing proportion, which on a milk equivalent basis was some 40% of local milk production in 1993. Individual products ranged from the export of almost 90% of SMP and WMP to 40 % of cheese (ADC, 1993).

On average in 1994 Australia supplied less than 10% of world butter and cheese exports and between 8% and 15% of milk powders. This, combined with the fact that Australia predominantly supplied commodities and was competing with more heavily subsidised product meant Australia's influence on international markets was limited. Australian firms tended to be price takers in all export markets.

In the 1980s Australia's dairy trade quotas and high tariffs impeded access to most markets.

Its dairy export trade was concentrated in Asia and the Middle East. Japan and the Philippines, Saudi Arabia. Singapore and Thailand were the major destinations in 1992-93 (ADC 1993).

## **9.3 The Evolution of the Dairy industry in Japan**

### **9.3.1 Japanese industry structure and support policies**

The first half of this century saw demand, consumption and manufacturing of Japanese dairy product limited by cultural influences as well as the population's general lactose intolerance. Milk and dairy products did not form part of the traditional diet. Rapid change came when the Occupation Administration introduced a school lunch program based on skim milk and bread. This, coupled with population growth, rising real incomes, and increased consumer exposure to Western dietary influences saw the consumption of milk and dairy products expand rapidly from the late 1950s.

The earliest Japanese dairy production began close by the cities. With improvements in milk storage and transportation Japan became self sufficient in drinking milk by the early 1960s.

In 1961 the Japanese Government established a long-term policy of maintaining parity between farm and non-farm income and achieving self-sufficiency in all dairy products. It introduced domestic and trade policies geared towards these ends. These included the establishment of a domestic price stabilisation schemes, state quota controls on imports and direct income support for farmers through deficiency payment schemes.

These high levels of support saw the Japanese dairy industry share of agricultural output treble from 2.6% to 7.5% between 1960 and 1980.

Throughout the 1960s and 1970s the major Japanese dairy companies (eg Snow Brand, Morinaga and Meiji) capitalised on rising domestic demand and protectionist government policies to boost output and strengthen their respective market positions. This process was facilitated through technical and information exchanges with northern European dairy industries and later through integration with the domestic food service and retail sectors (ADC, 1993). Direct household expenditure on cheese increased by around 40% in the 1980s.

### **9.3.2 Milk utilisation in Japan**

Dairying in Japan is geared towards domestic drinking milk which utilises 60% of the production, compared to some 27% of the milk used for drinking in Australia.

During the first half of the 1980s the production of milk increased at a faster rate than the growth in demand for drinking milk, leading to a one third increase in the amount of milk available for manufacturing. By 1994 this trend had reversed, generating increased demand for imported dairy product.

The new era of trade liberalisation demanded of signatories of WTO, the high cost associated with dairy support schemes and the slowing in the growth rate of demand for fresh milk brought about modifications to the government support targets in the 1980s.

One hundred percent self-sufficiency was no longer the objective.

Milk production in Japan is based on concentrate feeding with cows maintained in barns for much of the year. This production regime results in high costs but high milk yields. Japanese production costs per litre are over four times those of south East Australia, where feeding regimes are pasture based, and animals remain unshedded at all times.

The Japanese dairy farm sector was undergoing considerable structural change with the number of households with dairy cattle halving between 1980 and 1990. Typically dairy farmers received at least one third of their income from returns from their cattle sold into the beef market. Dairy beef supplies traditionally accounted for 65% of the beef market. Consequently, changes in domestic beef policy in 1991 allowing more competition from imported beef significantly impacted on the profitability of Japanese dairying.

### **9.3.3 Institutional factors**

Dairying is the only Japanese agricultural commodity other than rice which has nationally based production planning.

The Livestock Industry Promotion Corporation (LIPC) is a semi-government agency established in 1961 to develop and promote livestock and related industries to improve the national diet. Its principal function is to stabilise domestic prices for designated dairy products (ie butter, SMP, WMP and condensed milk) through the purchase, storage and release of stocks. Thus the LIPC is vested with monopoly powers over imports of designated products (until 1989 the LIPC also controlled the sales of imported beef).

## **9.4 International Factors Affecting Japan's Dairy Export Demands**

### **9.4.1 A market shock: 1972-73**

In the 1970s the leading Japanese dairy manufacturers like Snow Brand (who at that time controlled 55% of the market) were purchasing their ingredients (via Trading Houses) from Northern European countries like Norway, Sweden and Finland. Trade with Australia was minimal, although a close relationship had developed between Lactos and Snow Brand. Snow Brand had assisted Lactos to build a factory extension to supply Gouda (HS:Ch 1993).

In 1972 the UK became a member of the European Community. Australia (and to a lesser extent New Zealand) lost their preferred dairy supplier status. Instead UK accessed the discounted and surplus product from the EC's Northern European suppliers.<sup>1</sup>

Australia and New Zealand had to find new markets at the same time the EC had less surplus dairy product to sell outside the EC, to Japan. Japanese trading houses were instructed by their buyers to find replacement low cost, good quality and stable suppliers of dairy manufacturing ingredients (HS:Ch 1993). The market needs of Japan, New Zealand and Australia were from that point in conjunction.

Snow Brand's response to this situation was to seek a stable supply through some joint ventures with their Trading House Mitsubishi and Australian manufacturers like Murray Goulburn Cooperative, Lactos and Murrumbidgee Milk Products (MMP) (NL:TMP 1993; TN:MTC 1993).

## **9.5 Japanese Export Market Regulation**

The maintenance of Japan's domestic dairy policies required strict control over imports of manufactured products. However, 1988 saw two trade policy developments with major implications for the Japanese dairy industry:

### **(i) Japan's agreement to a phased liberalisation of beef import quotas by 1991**

Given that LIPC beef trading profits helped fund the dairy support schemes, beef market liberalisation meant fewer dollars for government funding for such subsidies, and reduced demand for the Japanese dairy cows sold into their beef trade.

### **(ii) The GATT-12 products case**

In 1983 the USA sought a GATT Trade Panel ruling on the legality of Japanese market access restrictions for 12 agricultural products including SMP, cheese and ice cream.<sup>2</sup>

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<sup>1</sup> Unlike Australia, NZ did manage to forge an on-going agreement to supply the EC with some butter. This was equivalent to 58,170 tonnes in 1991 (ADC 1993).

<sup>2</sup> While not a direct participant in the case Australia reserved its right to seek compensation from Japan under the GATT for any access arrangements which the panel deemed to be illegal and adversely affecting trade opportunities (ADC briefing paper: Australian Dairy Mission to Japan 1990).

In 1987 the GATT Panel ruled that Japan's access arrangements for these products was illegal under the GATT charter. Subsequently in 1988 the following reforms were agreed:

- The replacement of import quotas on processed cheese by a tariff with the rate of tariff phasing down to 40% over three years.
- The phased removal of import quotas on ice-cream, frozen yoghurt and whipped cream in pressurised containers by 1990 and their replacement with tariffs and the phased expansion of quota entitlements on whey powders, infant formulations and a general "Other dairy product" category.

While these reforms potentially liberalised access to the Japanese markets, in the case of ice cream and processed cheese domestic factors such as distribution costs and practices continued to have an important chilling influence on trade volumes.

**(iii) The introduction of a Japanese Consumption Tax: 1988**

Introduced in 1988, the 3% consumption tax increased retail prices for dairy products, contributing to the slowing of demand growth for manufactured products in 1989-90.

It also acted to reduce industry support at both the farm and wholesale level. This occurred because while support prices were maintained at nominal levels in 1989, these returns were made liable to the consumption tax, which effectively reduced real farm incomes. To assist returns of small producers were exempted from the new tax arrangements.

**(iv) The Structural impediments initiative (SII) 1989**

In 1989 the USA specifically cited Japan's distribution system as a non-tariff barrier to trade and threatened bilateral retaliation unless structural reforms were enacted.

Negotiations on the form and extent of distribution reform were held between the USA and Japan under the SII Talks of 1990. Australia maintained interested party status to these talks.



The principal outcomes were a Japanese commitment:

- to improve distribution by speeding up customs clearances.
- to speed up approvals for major retail store projects (which had previously taken many years).
- to discourage restrictive trade practices through the Fair Trade Commission.
- to ensure fair competition between domestic and foreign companies.
- to keep price disparities between Japan and other countries under review so as to minimise them where appropriate (ADC Australian Dairy Mission 1990).
- to invest the equivalent of \$AU4000 billion in public investments from 1991-2000.
- to review the land tax system which favoured landowners who used urban land holdings for agricultural purposes.

Following this new emphasis on distribution reform the major dairy manufacturer Snow Brand developed a centralised depot system to distribute its own and other companies products to larger retail supermarkets. At the same time major supermarkets like Daiei began to invest in distribution companies as well as international purchasing offices through which they aimed to deal directly with importers, rather than through the traditional trading house and wholesaler routes.

Thus the Japanese dairy industry and the market for dairy product have undergone significant change since the ADC started trading. From a small base, in 1994 the Japanese market for dairy product was bigger than that in Australia, with annual retail sales totalling over \$AU20 billion.

## **9.6 Factors Influencing Japanese Cheese Consumption**

While consumption of milk and dairy products in Japan expanded rapidly over the past 20 years it remains low by world standards on a per capita basis. Dairy products account for less than 4% of annual household expenditure on food compared with 8% in Australia (ADC Aust Dairy Mission 1990). Lactose sensitivity continues to mean older Japanese cannot easily digest dairy foods.

Processed cheese such as cheddar was the first variety to gain acceptance in Japan given the colour, taste and odour could be modified to suit the early market development stage

when consumers preferred a mild tasting, mild smelling product that had a long shelf life, necessary for a slow selling product.

In 1989 the first natural cheese specialty shop was opened in Hiroo, Tokyo. The creamy, milder tasting natural cheeses have since gained market share, in particular creamed cheese, quark and canned camemberts.

Shredded mozzarella gained a significant market share with pizzas and melty cheese on toast promoted as a healthy and quick to prepare snack food. Western Style fast food chains increased the demand for sliced and shredded cheeses. In 1990 direct consumption of cheese accounted for some 50% of all consumption with the majority being in shredded form. Some 70% of the natural cheese imported were used in the production of processed cheese. (Jetro 1990) The main natural cheese consumed in homes was sliced for sandwiches (11%) shred cheese for cooking (52%) cream cheese (11%) camembert (11%) and small snack packs (ADC 1993).

#### **9.6.1 Nuclear family changes**

Family size declined this century with more than 50% of married women in full time employment. High disposable incomes for families has also fuelled Japanese consumers demand for fresh, high quality, quick to prepare product. Up to 40 % of male household heads were at any time on a one to two year regional assignment where they lived away from their family and often require single portion, pre-prepared food for meals. Children often returned home late after cram school, and at different times, requiring individual meal preparation (MS:ADC).

#### **9.6.2 Ice cream consumption and manufacturing**

Ice cream sales were stimulated by observing Western food styles during the era of increased international travel and the introduction of western style ice-cream parlours in 1987-88. In 1990 the import quotas were relaxed, which had previously stipulated only one tonne consignments could be imported.

Long established dairy manufacturers such as Snow Brand, Meiji Morinaga and Lotte strongly competed for market share. In particular these manufacturers competed with new

product lines, requiring extensive promotional activity. Companies ran up to 150 different retail lines concurrently.

Japan's Food Safety Laws required technical specifications which far exceed the standards acceptable in Australian icecream manufacturing.

## **9.7 Japanese Food Market Characteristics: 1975-93**

### **9.7.1 Food enjoyment orientation**

By 1994 high levels of personal disposable income, overseas travel and education had motivated a wide interest in new taste experiences.

### **9.7.2 Simplicity and convenience**

There was a growing demand for quick, easy to prepare meals using frozen, packaged, dehydrated, or canned product.

### **9.7.3 Health orientation**

Consumers wanted to be able to monitor the level of fats, sugar, salt and other additives in their food.

### **9.7.4 Family oriented segment**

The mother was increasingly preparing or purchasing single serve meals to meet the demands of individuals in the household.

### **9.7.5 Mood eating**

There was a growing trend towards eating out, trying foods from different cuisines, and snacking on western products like pizza, melty cheese, dairy deserts etc.

### **9.7.6 Shopping patterns**

Japanese household heads preferred to shop frequently for food making regular small purchases, even daily, to ensure freshness, and to meet the constraints imposed by limited storage space in the home.

### **9.7.7 Country of origin labelling**

With the exception of some branded, luxury imported western foods and beverages, eg Swiss chocolates or Chivas Regal whisky, domestic consumers preferred Japanese sourced foods. They perceived "home-grown" food to be fresher, safer, and its purchase the right thing to do for the welfare of the nation (ADC 1993).

## **9.8 Characteristics of the Distribution System**

With primary, secondary and tertiary wholesalers who carry small quantities and make frequent local deliveries. In 1994 the distribution links between firms were still often based on arrangements going back several generations.

### **9.8.1 Consignment sales and sale or return practices**

Return of unsold goods was commonplace between consumer and retailer, and wholesaler and retailer.<sup>3</sup> Consignment sales were common with some new products to minimise risk. Wholesalers often provided credit as well as risk free consignment sales.

### **9.8.2 Product churning in Japan**

The concept of "product churning" (Jones and Ohbora, 1990; Ohbora, Parson and Riesenbeck, 1992; Barranger, 1993; Kilburn, 1995) describes the dynamic that drives Japanese consumer product companies to strive to create and introduce new products. This has facilitated or reflected the fad purchasing by consumers which in turn has had an important influence on the marketing and distribution costs and strategies of manufacturers in recent years.<sup>4</sup>

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<sup>3</sup> Cheese and margarine purchases are returnable, and butter can be exchanged for cheese or margarine.

<sup>4</sup> In 1990 the ADC reported 1800 new consumer pack food products launched in the year. Many of these products are marketed for less than six months. Snow Brand for example distributes some 400 processed cheese lines and 150 ice cream lines.

## **9.9 The Role of General Trading Houses (Sogoshosha)**

In 1994 the nine major general trading houses traditionally control some 70% of Japan's import business and a further 45% of all export trade. As well these companies account for some 17% of domestic wholesale trade in Japan (ADC 1993).

The major trading houses importing dairy produce were in order of volume of trade:

- Mitsubishi,
- Toshoku,
- Tomen (previously Toyamenka),
- Mitsui.

Mitsubishi in particular had investments in and was closely associated with key domestic dairy produce manufacturers.

In addition to the general trading houses, there were a number of **specialist traders**, such as Chesco who imported and distributed cheeses. Firms like Chesco undertook contract packaging of imported cheese for domestic retail trade.

Because of the multiple channels through which the imported product passed, the retail price of imported cheese in Japan was often over five times its landed CIF price after margins were added for agents, packers, wholesalers and retailers.

## **9.10 Manufacturer's Market Share**

While there are over 80 companies involved in the processing and production of milk and milk products in Japan the industry is dominated by three major companies:

- Snow Brand,
- Meiji and
- Morinaga.

These manufacturers collectively purchased over 40% of all domestic milk. Snow Brand purchased some half of this 40% (Jetro 1992, ADC 1990).

Snow Brand is the largest of the three companies with a turnover in 1990-91 of around \$AU 6,100 million. Meiji's turnover for the same year was \$AU 5000 million, and Morinaga \$AU4,100 million (ADC Country Briefing 1993).

These three companies produce yoghurts, ice cream, recombined milk products, pizzas, processed cheese products and dairy deserts, infant formulae and some pharmaceutical and health products. Snow Brand for example has produced over 400 processed cheeselines and 150 ice cream lines in some years. The three have long established strong national brands and franchises.

As part of their processing and retailing activities these companies were also the principal direct buyers and or end users of imported dairy product.

### **9.11 Australia's Position in the Japanese Dairy Market**

By 1994 Australia was vying with New Zealand as the largest supplier to Japan of butter, cheese, SMP for human consumption and whey powders. Denmark was the third largest supplier. Strong competition also came from other EC countries, eg Norway, Germany, Holland, UK, and North America. Given the heaviest subsidisation of EC dairy exports, these tended to set the prices.

The principal product traded by Australia was cheddar cheese for processing. Australia's share of this market was some 40% in 1993. Between 1986-87 and 1990-91 Australia's market share of the growing creamed cheese market doubled to 5,300 tonnes (ADC 1993).

With the growth in demand for natural cheeses Australian manufacturers have tended to loose market share, given their limited experience in manufacturing varieties like brie and camembert.

Most of the imports entering Japan were bulk product for use as ingredients, or for local cutting, or shredding and repackaging. In 1993, of the total of 450,000 tonnes of dairy

product imported into Japan, only 5000 to 7000 tonnes of cheese, 500 tonnes of butter and some icecream was sold directly to the retail or food services sector (ADC 1993).

Given Australian dairy exports are typically used as ingredients by institutional users or repackaged for retail sales, Australian brand recognition is minimal, and its recognition as a quality source of product is also generally low. (MS:ADC) The ADC's creation of an Australian Dairy Mark logo has been an attempt to build consumer recognition.<sup>5</sup>

## **9.12 The Japanese Manufacturer's Response to Domestic Market**

### **Liberalisation and Increasing Costs of Local Supply**

Since the 1990s major Japanese dairy manufacturers have internationalised by establishing overseas purchasing offices close to their overseas suppliers. They rely less on market intelligence and supply through General Trading Companies. They have developed commercial licensing arrangements with overseas dairy companies. They are targeting the expanding markets of SE Asia with retail pack products, supplied through their new overseas joint ventures and acquisitions.

Australia's foreign investment regulations are such that it offers the easiest access to joint ventures or direct acquisition by foreign interests, when compared with New Zealand, the EC or USA.

## **9.13 The Australian Dairy Industry Marketing Regulation**

Prior to 1986 there was little incentive for Australian dairy companies to maximise their export returns, only to participate in the market. The export returns for product sold by the ADC were pooled and re-distributed to all who had supplied product. This policy failed to encourage quality consciousness or the development of relationships with buyers.

The pre-1986 prices were fixed through Australian industry levies and the equalised return was boosted by the fixed domestic price premium. After 1986 the system was reversed with the domestic price reflecting the export market returns. Drinking milk prices and inter-state regulation remained to stabilise wholemilk returns.

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<sup>5</sup> From 1990 to 1994 the EC, NZ and Australia each spent between \$1 million and \$2 million per annum in *country of origin* promotions. In contrast the major Japanese dairy companies spend around US\$250 million each year mainly on local TV brand name advertising (ADC 1993).

### **9.14 Competition in the Marketplace**

It was during the mid 1980s that NZ forged its joint ventures in Asian markets, for example in Malaysia and Korea. NZDB had ownership links with 47 firms in 26 countries in 1993 (ADC, 1993b). Many of these were offshore repackaging and distribution companies. The ADC had only one or two joint ventures at this time.

In 1986 the Closer Economic Relations (CER) Agreement between NZ and Australia allowed dairy product from either country access to home markets without any quota or tariff barriers. Australian markets had to adapt quickly to substantially increased competition in the domestic market.

In 1994 the NZDB had monopoly control over all of NZ's export sales and producer returns for manufacturing milk, while the ADC's regulations excluded some products, in particular retail ready product. The NZDB also had greater access to higher returning quota markets.

Thus the NZDB was able to derive commercial premiums from this access allowing it to cross subsidise trading activities in less commercially viable markets.

### **9.15 Australian Industry Supply Characteristics and the ADC**

Under the Dairy Produce Act the Australian Dairy Corporation acts with industry approval as the sole seller of Australian product in markets "where Australia will benefit from restricting supply competition" (ADC, 1993). The ADC's trading operations were predominantly the EU quota market for cheese, the Japanese bulk cheese for processing market and import tenders for butter and SMP operated by the Livestock Industry Promotion Corporation of Japan. However the ADC may perform an agent function for any Australian manufacturer requesting such a service.

The Australian Dairy Corporation established an office in Tokyo in 1964, when government to government tendering via the *sogoshosha* was the most common form of market access. The all-Japanese staff reported to the ADC office, Melbourne. The Tokyo Office operating costs were recovered from trading proceeds and service fees. The ADC staff did not operate on commission.



Increasing liberalisation of market access in Japan meant that the ADC's government to government liaison role was diminishing. For example, Snow Brand and Meiji were increasingly importing product direct without using trading houses. Some large Japanese supermarket chains had opened offices in Australia.

In line with these developments the ADC had begun to develop business direct with end users for selected items and to establish direct links with import distributors and contract packers. This required the management of the risk of disrupting their traditional marketing channels.

### **9.16 The Australian Dairy Industry Structure**

Most Australian dairy companies are cooperatives. As well multi-nationals such as Nestle and Kraft export, but are not via the ADC. The two largest Australian companies, Bonlac and Murray Goulburn together contributed some 60% of the product exported. The five largest dairy manufacturers together utilised about 60% of the domestic milk production. Thus dairy manufacturing and exporting was relatively concentrated. The following table illustrates the relative volume and value of company's exports in relation to the ADC.

**Figure 9.1: The Comparative Value and Volume of Dairy Exports from Australia: 1990-1991**

Commodity shipments by type of exporter: 1990-1991				
Type of firm	Volume '000 tonnes	share %	Value \$ million	share %
Twelve Cooperative companies: - direct exports	153	46	290	43
Nine Propriet'y companies: direct exports	79	24	184	28
Sixteen Trading Houses	39	12	96	14
ADC	59	18	98	15
<b>Total</b>	<b>330</b>	<b>100</b>	<b>667</b>	<b>100</b>

(Source: ADC Market Profile 1990-91.)

While the ADC accounted for only 12 % of overall export sales in 1990-91, this was 40% of all Australian cheese exports in that year. Most of the proprietary companies were multi-nationals. The ADC's trading activities involved Australian owned manufacturers only.

On a volume basis only 22% of Australia's dairy exports in 1990-91 were sold in retail consumer packs. Therefore, the majority of Australia's dairy exports were shipped in bulk. Bulk product may, however be matched closely with end use specification and there may be long term contracts.

Some 20% of Australia's bulk export sales in 1990-91 were sold in what the ADC described as premium return markets (ADC 1993) (where they attracted a price premium). Of the 354,000 tonnes of dairy product exported and valued at \$703 million in 1990-91, 330,000 tonnes was shipped in a minimally transformed state (ADC b1993).

## **9.17 Time Line**

### **9.17.1 Dairy industry contextual changes and industry development markers**

**Location:** Australia

**1788**

- Dairy product considered a dietary staple for NSW. Four cows and two bulls shipped with First Fleet.

**1800**

- 1040 cattle in colony. First purebred bull imported an English Devon.

**1820**

- First farmer cooperative dairy established at Berry NSW to rationalise production and transport. Butter and cheese sold in Sydney.

**1844**

- Butter and cheese exported to California gold rushes.

**1861**

- Gold rushes in Victoria. Dairy cow population at 197,000 head. Strong demand for dairy product.

**1870s**

- Many small farmer cooperative cheese factories established in colonies of NSW and Victoria.

**1881**

- First use of a commercial cream separator in a NSW factory (invented in Sweden).

**1883**

- First export shipment of refrigerated butter (to UK). Refrigerated transport boosted export opportunities.

**1890**

- Rapid Fat Test developed in USA measured milk and cream fat content. New system allowed suppliers to be paid according to milk quality.
- Pasteurisation improved dairy product hygiene internationally. However boracic acid continued in use in Australia as a preservative.

**1900**

- 168 dairy factories and 187 creameries in Australia. 82% of butter consumed in domestic market is factory made.

**1900**

- Exports of butter valued at 650,000 pounds.

**1901**

- Butter production 18,891 imperial tons.

**1905**

- Dept of Agriculture of NSW appoints first Dairy Division to promote excellence in dairy farm production.

**1908**

- Introduction of commercial ice cream manufacturing using equipment invented in USA.

**1912**

- Establishment of the first training in English style butter and cheese manufacturing at Hawkesbury College.

**1924**

- Establishment of the Australian Dairy Produce Board (ADPB) Forerunner to the ADC to regulate interstate marketing of higher priced fresh milk. NSW and Qld protected from competition from higher volume producing farmers in Victoria.

**1926**

- The ADPB's Paterson milk marketing plan aimed to give dairy farmers better returns than parity prices in London. Scheme was voluntary and failed.

**1931**

- NSW Milk Board established under the NSW Milk Act (1931) to regulate quality and supply of bottled milk.

**1934**

- Victorian Milk Board created for quality and supply regulation including pricing control at farm gate through to consumer. Licensing of factories introduced with 300 factories immediately delicensed due to inadequate hygiene standards.
- Commonwealth Dairy Produce Price Equalisation Scheme introduced. Export returns for manufacturers averaged.

**1938**

- Annual factory production: butter 192,000 imperial tons, cheese 25,000 imperial tons.
- CSIRO established a dairy research group.

**1942**

- Formation of Australian Dairy Farmers Federation
- Government provides incentives through Dairy Industry Assistance Act to stimulate production of cheese and condensed milk using war time regulations. Milk volumes used for butter decreased by one third.
- UK enters into annual contracts during the five war years for butter and cheese, contracts extended up to 1955.

**1943**

- Dairy Industry Assistance subsidies extended to all processed milk products.

**1947**

- The Australian Casein Manufacturers Association formed to introduce stability into marketing by equalising returns from domestic and export markets.

**1950**

Two-thirds of milk production still used for butter manufacturing. Farmers begin to send more whole milk, not just cream to factories.

**1954**

- Australian Cheese Manufacturers Federation formed to stimulate collaboration in research and trialing new technology.

**1956**

- Australian Dairy Industry Conference (later Council) formed. Task: to advise government on dairy policy.

**1958**

- Introduction of a compulsory research levy, administered by the ADPB.

**1959**

- First exports of Australian dairy product to Japan.

**1960**

- Cheese production 8% of milk manufacture, butter production rises by 14%. Larger factories install evaporators for SMP production to meet growing ingredients market needs.
- Increase in casein production to cope with influx of whole milk off farms to factories. However, twenty-seven tonnes of whey and whey contaminated water residue by-product from each one tonne of casein.

#### **1961**

- The Australian Butter Maker's Federation formed.
- The CSIRO develops rindless cheddar and the use of plastic film packs for cheese.
- Rokko applies rindless cheese and film technology to make processed stick cheese for school lunch programs (CSIRO scientist is consultant to Rokko).

#### **1964**

- ADC opens marketing office in Tokyo, Japan.
- 1965 Stable export market for specialised milk powders established in the new milk reconstituting-recombining factories built in Singapore.

#### **1972-73**

- UK joins the EC and previous preferential tariff arrangements for Australian dairy products cease. Main exports had been butter.
- The Australian Agricultural Council approves an increase in domestic margarine production, a direct competitor with butter.
- Butter drops in domestic and export sales volumes 24% between 1971-72 and 1972-73 and a further 41% in 1973-74.

#### **1980**

- 250 plants for recombining milk worldwide create a demand for one million tonnes of SMP annually.
- Between 1970 and 1980 Australian butter production reduced by 62%, cheese production doubled, and there was a three fold increase in WMP production.

#### **1986**

- The Export Pricing Equalisation scheme was replaced by a levy on all milk with the object of increasing returns on exports to avoid dumping surplus domestic production on the domestic market.
- Returns for commodity exporters no longer averaged.
- Increased competition on domestic market with NZ and Australian dairy product given free access to each domestic market through the Closer Economic Relations (CER) agreement. Australian product's share of domestic market contracts.

- Manufacturers faced with an extra imperative to export.
- Many cooperative factories amalgamate to achieve more efficient production.

#### **1994**

- Of the nine kgs of cheese per capita annually consumed in Australia, nearly 45% was fresh and other European style cheeses (ie not cheddar or processed cheese).

#### **Location: Japan**

#### **1900-1945**

- Dairy product was not a traditional Japanese food.
- Population generally suffered lactose intolerance.
- Demand negligible.
- No supermarkets. Many small family shopkeepers.
- Many layered system of wholesalers linking supplier and retailer.

#### **1949-60**

- End of World War Two leaves Japan dependent on foreign food aid.
- Dairy product introduced via food aid from the USA. School lunch program includes reconstituted milk and processed cheese. Lactose intolerance diminishes.

#### **1961**

- LIPC formed to facilitate the development of a Japanese dairy industry aimed at producing self-sufficiency in drinking milk. LIPC control imports, domestic pricing and subsidies.

#### **1970**

- Family size declining, higher disposable income, western foods becoming more popular.

#### **1972**

- UK joins the EU. Japan loses access to some of the surplus EU cheese now purchased by UK. (Australia and NZ lose preferred nation supplier status of dairy product to UK.)



- First JVs in dairy manufacturing with NZ and Australian dairy companies.

#### **1980**

- Cream cheese cake introduced to Japan

#### **1983**

- USA initiates challenge to Japan's market access regulations in the GATT-12 products case.
- Rapid growth of the western style fast food industry and family style restaurants in Japan

#### **1985**

- Myalla developed by Rokko and Mitsubishi with UMT.

#### **1986**

- Long-life milk distribution without refrigeration allowed in Japan

#### **1987**

- The GATT Panel ruled that Japan's access arrangements for the 12 products were not consistent with the GATT charter. Japan agreed to the replacement of import quotas with tariffs for some cheeses, ice-cream, frozen yoghurt and whipped cream.

#### **1987**

- Special Milk pricing system to stimulate cheese manufacturing in Japan with 17 billion yen budgeted for five years.

#### **1988**

- Japanese government phases in liberalisation of beef import regulations by 1991. Cheaper beef imports impacts on dairy industry viability.
- Reduced LIPC beef trading profits reduces funding for dairy industry subsidies.
- The introduction of a Japanese Consumption Tax helps slow demand for manufactured products.

**1989**

- USA initiates a challenge to the non-tariff barriers to trade in Japan: ie the Structural Impediments Initiative. (SII) USA threatens bilateral trade retaliation unless significant structural reforms enacted.
- Deregulation of importation of processed cheese in Japan begins. Substantial market growth.

**1990**

- SII's agreed and include distribution system simplification and supermarket planning approval acceleration.

**1990**

- Deregulation of frozen yoghurt, ice creams and retail packs of cheese.

**1992-93**

- Japan economy in recession, growth in cheese sales (especially for home snacks) continues.

## **9.18 In Summary**

### **Australia**

**1788-1923**

- Dairy industry developing in Australia to meet domestic consumption needs.

**1924**

- First regulation of dairy industry marketing to counter inter-state competition for fresh milk market.

**1925-72**

- Exports of dairy product to Britain stable. Australia receives favoured nation status until Britain joins EU in 1972.

### **1973-1980**

- Margarine production in Australia deregulated. Butter sales drop more than 60% between 1971 and 1980. Cheese and powders to Asia and middle east largely replaces butter to UK as main exports,

### **1986**

- Australian manufacturers loose some domestic market share to NZ due to CER deregulation.
- ADC abolishes averaging of returns to exporters of dairy commodities. Quality focus stimulated

## **Japan**

### **1945-61**

- Japan consumers develop demand for dairy products.

### **1961-88**

- Japanese dairy industry developed with subsidies and government regulation protection from retail-ready import competition. Dairy manufacturers depend on lower cost imported ingredients.

### **1988**

- The demand for a new range of fresh cheeses and dairy ice confections grew in Japan.
- Deregulation of food imports commences.
- Cost of Japan's domestic supply increases.

### **1990**

- Deregulation of the distribution system, especially growth in supermarket outlets in Japan escalates.

## **Chapter 10**

### **CASE STUDY:**

### **THE AUSTRALIAN DAIRY CORPORATION (ADC)**

#### **The actors participating in the evolving networks**

ADC-Australian and Japanese office

Murray Goulburn Cooperative

Mitsubishi Trading Company

Mitsui General Trading Company

Rokko Butter Dairy Co. Manufacturer

Toshuku General Trading Company

Meiji Dairy Manufacturer

Snow Brand Dairy Manufacturer

Koiwa Brand Dairy Manufacturer

Tomen General Trading Company

JC Foods.

Itochu Trading Company

MK Foods

Livestock Industry Promotions Corporation, Japan (LIPC).

#### **The Australian Dairy Corporation (ADC)**

##### **Informants**

Murray Sayers, (MS:ADC1-4) General Manager, International Sales, Melbourne.

Chris Phillips, (CP:ADC) Manager, Planning International, Melbourne.

Campbell Jeffrey, (CJ:ADC) Manager, Planning, Melbourne

Minoru Shimizu, (MSh:ADCJ) Chief Representative, Tokyo.

Katsu Suzuki, (KS:ADCJ) Trade Representative, Tokyo.

Shuichi Kameyama, (SK:ADCJ) Sales Manager, Tokyo.

Jens Krysel, (JK:ADC) Assistant Marketing Manager, Austdairy, Melbourne.

#### **Murray-Goulburn Cooperative**

##### **Informants**

Peter Erwin, (PE:MG) General Manager, Industrial Sales-Export Marketing

Jack Maquire, (JM:MG) Ex Managing Director of MG 1952-81.

Wayne Sanderson, (WS:MG) Manager Technology

#### **Rokko Butter Co**

##### **Informant**

Haruyuki Tsukamoto, (HT:Rok) Managing Director, Rokko Butter

#### **Mitsubishi Trading Company**

##### **Informants**

Toru Nakagawa, (TN:MTC) Cheese Team Leader, Tokyo.

Toshihiko Tachibana, (TT:MTC) Chief Manager, Produce Department, Mitsubishi  
Melbourne.

#### **Mitsui Trading Company**

##### **Informant**

Yuichiro Yoshikawa, (YY:Mits) Cheese Team Manager, Food Materials Division

#### **Meiji Dairy Manufacturers**

##### **Informant**

Kazuo Endo, (KE:Mei) Manager Purchasing Group Meiji Milk Products Co.

#### **JC Foods**

I Hidaka, (IH:JC) Deputy General Manager, JC Foods.

#### **Koiwa Dairy Manufacturer**

##### **Informant**

Kiyoshi Yamasaki, (KY:K) General Manager of Production Control.

#### **Tomen Sogoshosha**

##### **Informant**

H. Komeiji, (HK:Tom) Manager, Foodstuff No. 2 Section cheese

**Australian Embassy, Tokyo**

**Informant**

Jim Short, (JS:AE) Trade Counsellor

**MK Foods**

**Informant**

Kazuhisa Kikuchi, (KK:MK) Director and General Manager, Purchasing Department.

**Toshuku Sogoshosha**

Jun Ishi, (JI:TSS) General Manager Dairy Products: Cheese Group

## **10.1 The ADC Described**

The ADC was established in the 1960s as an ASMA to regulate the export of dairy commodities to some countries. The ADC implements industry policy developed by the Australian Dairy Industry Conference (ADIC) whose membership is elected from Australian suppliers and manufacturers. Under Section 53 of the Dairy Act the ADC receives directives from the ADIC setting out its role in marketing activities each triennium.

The ADC is funded through compulsory levies on milk suppliers and manufacturers. Any profits are paid into a market support fund or the general dairy industry funds. Staff in Melbourne and Tokyo included marketing, shipping, legal and technical specialists.

Key activities of the ADC are the exporting of most of Australia's dairy market share to Japan and filling the small EC quota for Australian product. The ADC takes title to the produce it has the monopoly rights to sell. It charges commission when contracted to sell any dairy product which is outside their monopoly charter (eg finished retail packs). (Office of Trade and Investment, 1991.)

ADC manager MS:ADC describes the difference in scale of operation of Australian and Japanese dairy manufacturers:

*The three biggest manufacturers of dairy product in Australia each turn over about \$600 million. Japan's biggest dairy companies turn over*

*about \$6000 million. They are ruthless. One Japanese dairy company now has an office in Melbourne (SB). They have also bought a small factory in their own right in NSW. It manufactures camembert. The Japanese are getting ready for the total liberalisation of their market (MS:ADC1).*

The ADC has tended to sell bulk commodities into Japan, with very limited activity in retail ready sales. An ADC's technical manager explains:

*The bulk products have always been exported through us via the big trading houses. And there is general agreement that that is the way it will continue. New business can go outside and make new arrangements. But in general we have not wanted to go beyond the wharfside in Japan because it becomes an expensive exercise. And distribution in Japan is very tricky. The people we sell to in the case of cheese tend to be the large users, like Tokyo Dairy. They have a huge distribution system so they don't want us to go beyond the wharfside. The other products like SMP and butter are sold in bulk to the LIPC and you can't go beyond the wharf with them (CP:ADC).*

MSh:ADCJ Chief Representative in Tokyo adds:

*NZDB's objectives are to promote its Anchor brand, while the ADC objective is to have the Australia Good logo<sup>1</sup> used as extensively as possible with other companies' brands (MSh:ADCJ).*

## 10.2 The Evolving Domestic Regulatory Environment

In 1986 Australian dairy export pricing policy changed, with averaging returns to all manufacturers supplying export product abolished. At that time it became obvious to the ADC management that:

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<sup>1</sup> To qualify to use the Australia Good logo and to be eligible for the promotions budget the product must contain at least 60% of Australian ingredients.

*The ADIC who directs us is owned 50% by manufacturers and 50% by farmers. Our job is to maximise returns to them, so if we aren't doing a good enough job for them out there in the market, they will simply put us out of business (CP:ADC).*

In 1993 the ADC aims were:

*To ensure continuity of supply of quality products to Japanese buyers;  
To maximise returns to Australian suppliers;  
To act as the sole seller of bulk cheese for processing and shredding, thereby providing a unified Australian position in price negotiations;  
To maximise returns to suppliers from sales of butter and SMP through LIPC tenders and sales to the School Health Council (SHC) Japan  
To undertake sales of specialty cheese products on a non exclusive basis;  
To assist Australian product development;  
To provide a service which assists Australian companies to exploit market opportunities for dairy products in Japan; and  
To promote the image of Australia as a reliable source of quality dairy products.*

(ADC Australian Dairy Mission to Japan Briefing, 1993.)

TN the cheese team leader of the Sogoshosha purchasing at least 70% of ADC's product describes his definition of the ideal relationship between a sogoshosha and its suppliers:

*Stability is the key word in a relationship.  
And it is cooperation in the relationship that makes the whole thing work through thick and thin (TN:MTC).*

MS:ADC reflects on the issue of cooperation when the supplier is offering unique product:



*MTC puts up with a lot from Lactos because they are important suppliers to them. The commercial considerations will over-rule the quality of the relationship in the short term.*

*For example, Lactos started to supply Bongrain France (its parent company) Long-Life camembert in Japan without telling MTC. However, Lactos avoided getting into trouble because the product over-ruled the relationship. People wanted the product. At the time there were no reasonably priced substitutes. But as soon as there is competition there, MTC probably won't bother with them (MS:ADC3).*

### 10.3 Australian Supply Characteristics

In the 1990s a number of factors continued to present the ADC with major challenges in achieving the reliability or stability of product required by their industrial buyers:

(i) Australia's dairy production is highly variable throughout the year. Cows are typically "dried off" when the pastures have lowest nutritional value. Dairy manufacturing peaks and troughs in response to the supply variations. An ADC manager explains:

*The peak cheese production season differs in each state. ... The Japanese like young cheese so we get a commitment for sales of the old season's product before we sell the new to them. Otherwise we would have losses (MS:ADC2).*

This strategy solves the supplier's problem but leaves the buyers complaining. Chief buyer for Mei, Japan's second largest cheese manufacturer comments:

*You have to go for three or four months with no cheese from Australia so we have to stockpile over this period. This affects freshness. It is also very difficult to get additional product if you run short (KE:Mei).*

JC Foods, suppliers of pizza cheeses complain:

*Australia has off-season problems... they should use supplementary feed to keep up quality supply all year round. ...From August to October Australia supplies old mozzarella. It is produced in April and May ... this is a big problem. ... Young mozzarella has good stretch but heavy gummy. Old mozzarella, four to five months old, has no stretch but less gummy. When we can't get fresh we have to get final users to take a different brand. ... If we have to supply Danish to make up the difference then this is a loss to JC. ...We should have a right to claim compensation, but we cant get it. And once we supply the Danish product to the end-user they often see that it has better taste and flavour. Then they often ask for Danish next time (IH:JC).*

Another large Japanese manufacturer comments:

*Australian winter quality and supply in not stable. It is a problem (KK:MK).*

The variable seasonal production also creates inefficiencies in the Australian dairy industry:

*We are over capitalised in manufacturing in Australia because we need to have enough equipment to deal with the huge supply that we have for just a few months. The rest of the year we have under-utilisation (WS:MG).*

(ii) Equalised returns from the export dairy markets encouraged a *commodity/quantity* rather than a *quality* emphasis amongst Australian dairy manufacturers in the first twenty years of dairy trade with Japan. An ADC manager explains:

*You could ship your product for next to nothing, as long as you were exporting you got a share of the pool. It encouraged people to dump on the export market (CP:ADC).*

(iii) Until the growth in cheese consumption in Japan in the late 1980s, commodity type powders and butters tended to return more than bulk cheddar cheese. MS, the ADC General Manager, International Marketing comments:

*We have been begging and borrowing to get the supplies we need to fill our cheese orders for Japan. The problem is that SMP and butter have historically offered a higher return. Today SMP prices are firm, and butter, you can't give it away. So our manufacturers have to reappraise the situation (MS:ADC2).*

#### 10.4 The Japanese Market Context

Dairy trade between Australia and Japan commenced in 1958 with the Australian CSIRO scientist (JC)<sup>2</sup> assisting Rokko to use Queensland Butter Board (QBB) product and CSIRO plastic film technology to make some of Japan's first processed cheddar stick cheese.

In 1960 Japanese cheese consumption stood at 1432 tonnes with Australia holding a 10% and NZ an 18% market share. Northern European countries supplied the remainder (MSh:ADCJ). The potential for market growth stimulated by the Tokyo Olympics saw the ADC to open an office in Tokyo with six Japanese staff in June 1964.

Three Japanese sogoshosha, (MTC, Toyamenka and Toshuku) were buying from some Australian dairy manufacturers before the ADC was established. Given the network culture that emphasised respect for already established exchange relationships and the fact that the LIPC would only allow tenders to be supplied through sogoshosha, the ADC succumbed to the Trading House pressure to only trade with the original three. Consequently Toshuku was appointed an agent in August 1964. In February 1965 Toyamenka, (later known as

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<sup>2</sup> See further reference to this development in the Lactos Case Study

Tomen) became the second agent, with Mitsubishi signing its first annual agent's agreement in April 1965 (MSh:ADCJ).

For more than twenty-five years the ADC did not sell to any other sogoshosha. This convention was formally referred to as the ADC's three trading house policy (MS:ADC; KS:ADCJ).

The market share between these three remained comparatively stable over the years. The 1992-93 share was typical:

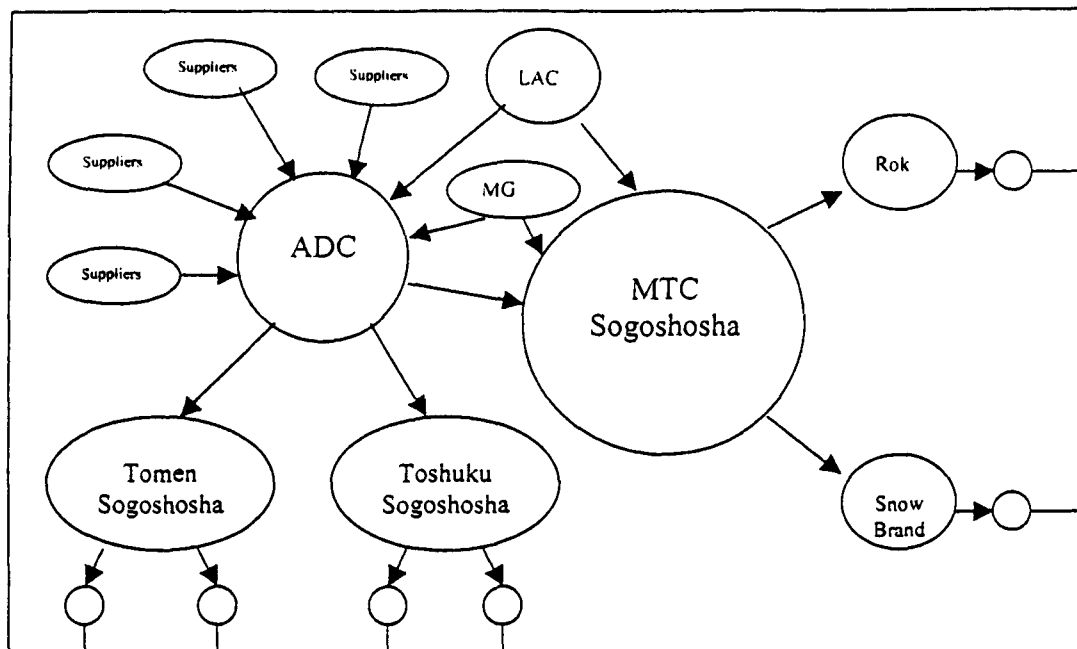
**Figure 10.1: 1992/93 Sogoshosha Share of the ADC Sales to Japan**

Trading House	Approximate share of the ADC sales
Mitsubishi	74%
Toshuku	18%
Tomen	7%

Source: MS:ADCJ

The ADC's three agent policy remained in place until the Japanese and Australian dairy market deregulation gathered pace. By 1989 some of MTC's buyers had grown sufficiently in size and international experience to want to deal directly, first with the ADC, and then with its suppliers. At the same time some of the ADC's manufacturers were also gaining international experience.

This case study traces the evolution of these network transitions.

**Figure 10.2: The ADC Network 1966-1986**

### 10.5 The Powdered Milk Tender System

Between the 1960s and 1994, almost all Japanese imports of butter, SMP for human consumption, WMP and whey powder were managed by an LIPC tender process where potential suppliers had to respond within twenty-four hours of the tender announcement.

To participate within the time frame, those who had traditionally supplied these tenders (ie ASMAAs and sogoshosha) negotiated well in advance of a tender announcement to decide amongst themselves who should make the lowest price offer, and for what volumes.

Such negotiations were based on the full knowledge of each potential supplier's intentions and their adherence to the network conventions (ie who traditionally supplies the market and who buys). The following episode, described by MS:ADC, the manager responsible for the tender bids for the ADC illustrates the patterns of behaviour and typical negotiating that takes place when an official LIPC tender is called:

*There hadn't been a Japan SMP tender for a while. Then a small*

*one was offered, only 10,000 tonnes or so. The problem with these tenders is that the product actually has to be on the water before the successful tender is announced, or you can't get it there in time. That means that you really have to have it worked out between you in advance.*

*On this occasion we (the ADC) said that we only had 5000 tonnes, but we really only had about 4500. NZDB said they had 5000 tonnes. We agreed to drop 1000 tonnes. Then Toshuku said they had some SMP in Singapore and they said they wanted to offer that. We said, no, you shouldn't, you have to drop it, because you are our customer. They were very upset because they were really going to make a killing.*

*Mitsui had bought SMP from the UK from a firm that was going broke. They got it for a very good price on the condition they paid for it in so many days. Mitsui said they would only drop part of their offer if NZDB dropped its offer by a 1000 tonnes, like we had. Mitsui's SMP was already on the water so they could not be put in a position where they would lose face. In the end we did quite well (MS:ADC3).*

## 10.6 Relationship Disruptions

Informants were asked to describe any defining moments, shocks or disruptions to their trading relationships, and the causes and consequences.

Those who were buying product before 1985 (MTC, Rok, Tom, TSS, Mei) all recalled the "disaster" of 1982. The ADC also reflected on this episode which left their reputation damaged, and gave their competition new market entry opportunities. An ADC manager speaks first:

*In 1981-82 there was a drought in Australia and suppliers to the ADC*

*chose to support their domestic market first. This was a disaster. We still suffer from that decision. But at the time you took what was left over from the domestic market. Manufacturers were only supplying bulk product so it was natural that they protected their own brands' positioning in the domestic market (JK:ADC).*

TN of MTC recalled the year, condemning the decision of the ADC and praising the loyalty of MG:

*1982 was the year that the ADC lost credibility as a supplier, which meant in turn that the credibility of MTC suffered. We could not supply our customers in Japan. We had a contract with the ADC but they neglected it. Mei, a major customer of ours got very angry and did not rebuy until the year of Haley's comet. Instead it took NZ, EC and Canadian cheese.*

*Even though the ADC banned cheese exports from Australia MG still supplied SMP to Mei saying it was a special case for infant formula. MG negotiated the business direct with Meiji and us. They did not go through the ADC but notified the Australian Government. This was an extremely sound and loyal move to make. We always remember it' (TN:MTC).*

Rok had been the first Japanese buyer of Australian cheese and had built its brand differentiation and recognition around their product being 100% Australian sourced. Senior Rok management describe the impact of the interrupted supply.

*In 1982 there was a drought in Australia and ADC stopped the supply of cheese. So we had to replace Australia with Europe and NZ. Up till then we had imported 100% Australian. This was even though we*

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<sup>3</sup> In 1995 Mitsubishi and Meiji formed a JV with MG to build a new infant formula factory at Cobram, Victoria.

*always had problems adjusting the final product because of the stop start season, and the fact that the cheese was not fresh all year round, or was softer or harder compared with SB which has year round supply and is consistent. We never went back to 100% Australian. Now we try to keep the minimum 70% (HT:Rok).*

JS from the Australian Embassy, Tokyo repeated what he considered "common knowledge" in the Japanese dairy trade circles:

*In 1981-82 when Rok did not get supply as promised from the Australian end it was thought the Rokko Chairman would have a heart attack (JS:AE).*

Management at the ADC acknowledged the short and long term consequences for their reputation and relationships, even though some exchanges had been regular for twenty years before the drought.

*It was the 1982 problem when we failed to supply that the EC product first really kicked off in Japan (MS:ADC2).*

*1982 was when the Japanese realised that they could not rely on Australia. NZ did not have an interrupted supply. That gave the New Zealanders a hell of a boost. The major customers came back eventually, but the smaller players never did (JK:ADC).*

*It has taken twelve years for some to re-order. SB decided to buy less for a while to make us do penance (CP:ADC).*

MTC informant TN nominated 1985 as another year of "crisis" when the ADC failed to assist them to reduce losses when a volume of product could not be sold in Japan. TN:MTC recalls:



*This crisis was due to a one year contract which the ADC used to have with MTC. One year in advance we had to agree on a volume to be traded. This was six or seven years ago in 1985. We could not sell the cheese as agreed to be supplied in Japan ... so we had to re-export it. This gave us a great loss, but the ADC would not help us. Now we only have a six month contract with them (TN:MTC).*

Four years later, with a new manager, MS:ADC in place, and a sharper focus on exports stimulated by the abolition of the price averaging schemes, MS:ADC recalled a different response to a call for a price renegotiation:

*In June 1989 the ADC had negotiated the price with Japan and the suppliers for product to be supplied in July-December. We had fixed the price and had issued the contracts. But suddenly the Europe price collapsed. The Japanese said we would have to renegotiate. Sogoshosha have a firm commitment with suppliers but not with customers. If customers refuse the product the trading house will have to buy it. We had negotiated over \$400 per tonne initially. In the end we had to come back to \$200. ... In that six months the ADC lost about \$1million. So, then when we did the agreement for the next six months with our suppliers we squeezed them and recovered much of the loss (MS:ADC3).*

Potential interruption to supply also caused intensive negotiation in an incident in late 1989. MS:ADC was the key trade negotiator. As in 1982, MTC who was buying for SB stood to lose their customer's loyalty if the ADC did not fulfil its order.

*In 1989 we had a run in with SB. When I first came here that year people simply did not know how to do business with Japan. .. During December R.R.(ADC) was negotiating with SB to be supplied with*

*product from MG. But he made the mistake of failing to lock in supply from MG for a fixed period of time. ... MG committed the product elsewhere. We had finalised the deal but we were 2000 tonnes short, and no one else would commit anything to us. There was a terrible fuss with SB. They said there was no way we could withdraw due to the agreement.*

*G the ADC's Chief Executive Officer flew to Japan to officially apologise to Snow's President. I went too, with MSh from the ADC Japan office.*

*It was appalling. G actually read the apology out. I was watching the SB people closely. While G was reading the SB President turned and spoke to the person beside him in Japanese, loud enough to be quite clearly heard. This really worried me, you don't often see that.*

*So immediately afterwards I said to MS: "what did the President say?" ... MSh told me: "The President said that if this man keeps reading this apology instead of saying it from his heart, then I will walk out of this room". So clearly we still had a lot more work to do.*

*I put it to G that since there was no other supply available in Australia we should get it from another country for Snow. He bought that. I then found 2000 tonnes with our equivalent in the UK. This satisfied Snow. But G wanted a personal guarantee of its quality from me. This was not possible. I sat round the table with MSh (ADCJ) and Terry (TN MTC) and we said how are we going to get round this problem? Terry then said what if we say that the UK company's trading house guarantees the quality. This was really a sham, but G accepted it. Faces were saved all round (MS:ADC2).*

## 10.7 Evolving Australian Dairy Export Regulation

Section A of the 1988 ADC Circular NO.D3/88 stated that ADIC agreed that for the next three years the ADC should be

*the sole seller to the Japan market of Australian cheese for processing and cheese for shredding.*

Section B of the same circular dealt with trade in other cheeses. It stated:

*Consent for export of mozzarella and pizza cheese, camembert and brie and gouda will be provided if the corporation is satisfied that the activities of the exporter will not and do not pose a risk of prejudicing the interests of the dairy industry and in particular the industry's marketing efforts in Japan for the specified varieties (Circular NO.D3/88).*

Those wishing to export the Section B cheeses had to supply information to the ADC on their pricing, volume, quality, source of supply and end usage in Japan.

Consent for export of cheeses other than those in section A or B was to be provided by the ADC.

*except where the ADC believes they would compromise its marketing of cheese for processing and shredding (Circular NO.D3/88).*

Three years later, the 1991 ADIC directive repeated that:

*Under Section 53 of the Act the ADIC agreed that the ADC should be exclusively responsible for marketing bulk cheese for processing and shredding in Japan (ADIC letter to the Chairman ADC, 10th May 1991).*

However, it continued that this was subject to:

*the understanding that the ADC will not withhold permission for companies to trade in cheese in Japan in areas where the ADC does not have control (ADIC letter to the Chairman ADC 10th May 1991).<sup>4</sup>*

The ADC Chairman was informed that

*the ADIC may withdraw this trading authority after giving the ADC reasonable notice,*

and the final paragraph admonished the ADC for providing only a brief report on the Japanese cheese market. The ADIC chairman requested instead a full report of the ADC activities:

*including past results and future projections. This report should also address the future likely benefits from the ADC's continuing involvement in the Japanese cheese market (ADIC Chairman's letter 11 May 91 file no.213).*

The ADIC 1991 directive for the triennium reflected the growing pressure on the ADC to facilitate its owner/suppliers' direct access to Japanese markets.

Both the Australian and Japanese manufacturers were challenging the traditional role of their ASMA and trading houses as their turnover grew, the domestic and export markets deregulated, telecommunications improved, travel became cheaper, and the exporting experience of the Australian and Japanese dairy manufacturers increase (JK:ADC).

WS of MG, one of Australia's biggest manufacturing dairy cooperatives describes the transition:

*I mean the thought of anyone dealing directly with us five or ten years*

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<sup>4</sup> The original 1988 agreement was detailed in ADC Circular NO.D3/88

*ago would have been unthinkable. The change in the culture taking place is really amazing. We have gone from not even being allowed to know who the final user was, to some of those final customers looking to maybe doing some business direct with us (WS:MG).*

### 10.8 The ADC's Strategies to Expand the Networks

With market opportunities expanding the ADC management aimed to add new buyers to their networks to reduce their dependency on MTC, and deliver a bigger share of the higher value, expanding natural cheese markets. They needed to build Australia's reputation as a good quality, reliable producer of more differentiated goods. At the same time the Japanese and Australian ADC staff wanted to ensure the survival of their corporation (and their jobs) in a deregulated domestic environment (KS:ADCJ).

The competing interests of the ADC and MTC is expressed by the MTC cheese team leader (TN:MTC):

*I see the ADC as a problem. We don't really need them now. They get in the way of relationships. USA and the EC have organisations that only do promotions in Japan. They don't do trading like the ADC. The USA and the EC organisations simply help MTC do business.*

*The NZDB is totally different again. It is a totally committed trader. It works in some sense as a competitor to us (TN:MTC).*

The attitudes of the strengthening Japanese buyers who wanted to deal direct with the overseas supplies is illustrated through the observations of the General Manager of Ch, one of the biggest distributors of shredded and sliced dairy product in Japan:

*In the past the Japanese dairy industry did not have enough power and capital so it needed Trading Houses. But today every company has enough power to purchase, so they do not need them. Of course they give us some sort of information. But the Trading Houses do not know*

*about the Japanese market situation. Their job is to supply manufacturers, they do not know enough about the consumers. So they disturb the order of the market. For example MTC. They can supply industrial materials OK. But if they go after the consumer then there is embarrassment in the market.*

*In general the role of the ADC is better because their support for promotions is good, and they support the cost of our trainees going to Australia - Chesco pays one third, ADC pays one third and NZDB pays one third (HS:Ch).*

The Deputy General Manager of JC, a distributor supplying a pizza chain and the Japanese agent for Sara Lee products also wanted to shorten the channel:

*Many Japanese companies want to do direct business cutting out the Trading Houses and the ADC, but the ADC has regulations giving them a monopoly on cheddar and shredded cheeses. We have asked ADC to sell to us direct, not via a trading house, but ADC is still considering this. It is quicker and easier to make changes with a direct relationship like we have with Sara Lee. When we have to contact an Australian dairy company there is a trading house in between (IH:JC).*

A manager from K however, a member of the MTC family and the twelfth largest dairy manufacturer in Japan, displayed his company's loyalties to its established relationships, as well as a practical evaluation of the benefits of the use of a trading company:

*If we had to employ a trading section in the company then it would cost us 20-30 million yen per year. This would be too costly, so a trading house like Mitsubishi saves us the staff costs. Also they get us best price, good information, they can insist on the agreed volume, quality and timeliness, and they cover for any fluctuations*

*in temperatures during transport. Some small manufacturers have had problems dealing direct with claims. ... A supplier would be foolish to marry a company other than Mitsubishi because they could get cut off from some customers (KY:K).*

One of the biggest Australian suppliers of product to the ADC reflects on the ADC's role:

*I think that there is enough competition out there to say: why compete against yourselves, you have a bad enough time competing against everyone else. So therefore for large commodity type activities the ADC has an important role to play.*

*However, there is this equalisation issue - and that is why I believe a company our size has to be the ones up there making those market developments. We can't use the ADC to a great extent, because anything the ADC does, it does on behalf of the dairy industry. ... So if I develop a market opportunity, why should I involve the ADC who will then give that information to all our Australian competitors, so its of no value at all. ...*

*But a very significant part of our business is still through the ADC (85%). But the other areas are growing all the time and these are the areas where we are often discussing potentially higher value markets (WS:MG).*

### **10.9 The ADC Dilemma: Facilitating Channel Shortening and Protecting their own Position**

The ADC General Manager of International Sales (MS:ADC) describes his efforts to improve supplier response to market needs by facilitating direct communication with the Japanese manufactures:

*The ADC has been encouraging a more customer oriented Australian manufacturer by getting more of them to visit the Japanese markets...*

*Another thing I have done since I took over, I have sent details of the*

*customers to all our suppliers. They must know what their customers are like and what the product is being used for so they have a better idea of what's wanted (MS:ADC2).*

However, the Japanese staff in the ADC Tokyo office interpreted closer links and information exchange between the suppliers and customers as weakening their own position in the networks, and ultimately sowing the seeds of their agency's destruction:

*All who voluntarily use us as an agent are entitled in their own right to deal direct. But the Japanese ADC staff want all the category B and C product to go direct through us too. In fact they get quite annoyed when I say to an Australian company when they come in that if they want to, they can go direct with some sales. They (the Japanese staff) say no, no you must tell them something different (MS:ADC2).*

*In Australia we encourage it (ie "going direct") but the staff in the Tokyo office' discourage it, given it is their livelihood. They say they understand how to do business with Japanese better than us foreigners and they have long established links into the trading houses. They don't want us to interfere with the old order at all (CP:ADC).*

### 10.10 Countervailing Dependency

By the end of the 1980s the narrow product range in the Australian dairy industry was limiting their potential to supply the expanding, higher value Japanese market for soft, shredding, stretch mozzarella type cheeses. As well, their three trading house policy, dominated by MTC, meant minimal price competition.

The strategies to expand product range and buyer access were devised by the ADC's

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<sup>5</sup> All ADC staff in the Tokyo office are Japanese nationals paid a salary, not commission. Individual expense accounts reflect sales volumes however.



marketing management (ie MS:ADC, CP:ADC; JK:ADC) and depended for their success on their apparent compliance long-established, accepted network conventions.

These conventions include acknowledgment that it is acceptable and legitimate to offer new products to new customers. However, long established supply relationships with buyers of continuing lines should not be disturbed, unless there has been some exceptional breach of good faith (eg like the 1982 ADC failure to supply).

MS:ADC describes the ADC objective to expand the number of buyers in the network to increase competition and countervail dependency, while avoiding breaking the conventions, which could trigger sogoshosha retaliation:

*..we have been trying, and have succeeded in increasing the number of trading house buyers from three to six recently. This is very important to do, but it is also very dangerous because it is terribly easy to get into bed with the Japanese but terribly difficult to get out of bed. Borden is an example where they were killed\* (MS:ADC2).*

Given the increased and more differentiated demand which coincided with the growing manufacturing and export experience of Australian manufacturers, the ADC was not granted a marketing monopoly over the "soft" cheeses when they were first mentioned in the ADIC triennium directive of 1988. Instead, manufacturers could export mozzarella, pizza cheese, camembert brie and gouda direct, if they had the permission of the ADC<sup>7</sup>.

Rok and MTC sought to take advantage of the initial non-regulation of the "soft" cheeses by establishing a JV with an Australian manufacturer, assisting it through technology transfer to become a reliable, low cost supplier of a variety of new stretch,

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<sup>6</sup> See reference to Borden's experience in the Peter's case study.

<sup>7</sup> The first reference to shredding cheese is made in the ADC circular NO.D3/88 of 1988.

shredding cheese. TN:MTC explains how their strategy was later derailed by the ADC:

*Prior to 1984, the ADC had no shredded type cheese, only cheddar cheeses to offer the Japanese market. The EC had Gouda and NZ had Egmont type cheese. We asked the ADC to supply a shredded type cheese but they could not do it.*

*Then we heard that UMT (a Tasmanian dairy manufacturer) was trying to make a shredded type so we formed a cooperative agreement with them. Rok helped UMT develop this new product up, via MTC. It took several years to get right. We called this new product "Myalla", to sound like mozzarella. It was the first cheese specifically developed for the Japanese market.*

*Later the ADC came to us and said they had to be in the arrangement too. So we had to add the ADC to make a four way marriage: UMT, Rok, MTC and ADC (TN:MTC).*

Rok Managing Director recalled this same episode, nominating it as another serious disturbance in their long standing relationship with the ADC:

*We helped UMT to develop Myalla. This was in 1985, before the marriage of MTC to Rokko, but MTC was also involved. At first UMT was only selling Myalla through MTC but then the ADC transferred the technology to MG and Bonlac. It took them three to four years to develop it up to the right standard. They tried to cover it with a new name, "Goshred". We were very unhappy. We lost exclusive dealing in a unique product (HT:Rok).*

According to MS of the ADC however, their involvement saved UMT from a low price dependency on a single powerful buyer, it increased UMT's supply reliability, and they were able to help other Australian manufacturers to enter the

new cheese networks:

*UMT asked us (ADC) to get involved with Myalla <sup>8</sup> because the prices were too low and they were having trouble with supply in the off-season, between June and October. LH and NS (from the ADC) helped with some of the technical development. Cheese for shredding still needs further processing so we really had a right to sell it all anyway. We got MG, Dairy Bell and Bonlac involved. We also started to sell to Snow Brand direct, because it was a new product. We called it Goshred, but it really about the same as Myalla.*

*There had only been 2% growth in cheddar sales before this, but shredding cheese had a 7% growth.*

*It was also our chance to start to break open the three agent strangle-hold. Myalla and Goshred are now nearly 50% of the cheese exports from Australia, the rest is mostly cheddar (MS:ADC2).*

### 10.11 Expanding the Three Agent Policy

MS of the ADC had been the chief architect of the 1989-1994 strategies designed to reduce MTC dominance and increase buyer competition in trading networks. He explains his 1990 strategy designed to give Itochu fourth trading house status with access to the new Australian soft cheese trade networks.

*I went to Itochu and I said: can you give me a customer that MTC can't touch. I said: I want to break open the three trading house policy.*

*I also got MG to put pressure on the ADC, so they (the ADIC) knew that their own manufacturers were backing opening up the system.*

*Itochu came back with Tolono, or Chicago Pizzas, an American franchise which had been buying shred cheese from the USA, then from the UK. Itochu had shares in Tolono so of course they had to be the*

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<sup>8</sup> Myalla is a type of cheddar developed as a cheap cheese filler for pizza toppings. Mozzarella gives stretch, gouda gives the taste.

*agents. Then MG set to work with this pizza chain developing up a special shredding cheese, a sort of mozzarella (MS:ADC3).*

*MSh:ADCJ explains:*

*Itochu is the biggest rival to MTC supplying imported food to Japan. They have been buying from China. They have the biggest turnover of any trading company. They mostly import mozzarella. They had connections with the Tolona Pizza chain because the president went to university with a most senior Itochu person. In the end we said Itochu was in, but it cannot sell to old customers and it cannot deal in cheddar or shredding cheese (MSh:ADCJ).*

PE of MG comments on this pizza chain-mozzarella development:

*After 18 months of negotiations and at least eight to ten visits to the pizza company in Japan, as well as visits to Australia, the Japanese were beginning to feel comfortable with the product. Then Itochu, their usual agent started to handle it to on-sell to them. MTC contacted us but there was no way anyone could interfere with the long standing ties between Tolona and Itochu. We had pulled it off (PE:MG).*

The 1988 ADC regulations had allowed manufacturers to sell gouda, mozzarella and camembert direct to Japanese buyers but only with the approval of the ADC. This gave the ADC access to information on all new negotiations. It could then decide whether to intervene or offer the ADC's services as alternate agents. Given their monopoly control over the sale of the powders and cheddar that continued to be the bulk of the dairy product bought by Japan, their leverage with the sogoshosha continued to be substantial. When invited by an Australian manufacturer to intervene, they were in a position to exert some influence over the network buyer-selling relationships.

Lac successfully utilised the statutory power and status of the ADC when it sought to reposition itself in a long standing network that was denying them access to buyers offering better returns in an expanding market. They managed to reposition, but in such a way that MTC blamed the outcome on the (less vulnerable) ADC.

TN of MTC complains:

*For five years Lac sold this cheese (gouda) at a loss to MTC and we also sold it on at a loss to our customers. We expected to make a profit soon. Then in 1987 the ADC came in and said that all of this trade should go through them. So now the ADC is acting as the agent for all this gouda and camembert cheese. Of course we would still prefer direct access to Lac (TN:MTC).*

In 1994 MSh:ADCJ observed that having overcome their domination by MTC six years earlier, Lac was adding buyers to their networks at the expense of ADC's market share, and it was once again selling direct to MTC, presumably with better prices negotiated:

*Lac supplies gouda via MTC, Tom, ADC and Toshuku. We used to have 100% of their business in gouda, but now Lac has moved closer to some customers (MSh:ADCJ).*

### 10.12 Expanding the Network

The Lactos case study details the ADC strategy to assist them to move closer to distributors and retailers when establishing sales for the new product, long-life camembert. Retaliation from MTC saw this strategy fail. However, the moves did establish "long-life" camembert as a "new" product, distinct from traditional camembert. This gave Lac and the ADC some flexibility in seeking new relationships beyond their established networks.

### 10.13 Expanding the Networks: Mitsui is Admitted

On the 1st of January 1992 ADC granted the Mits Sogoshosha official trading house status, where it became the fifth agent licensed to buy Australian product. By 1993 Mits had only 3% of the ADC sales, but some 40% of their imported dairy product was sourced in Australia (YY:Mits).

ADC was willing to negotiate Mits' access to Australian dairy product when the lifting of Japan's icecream import quotas in 1991 enabled it to be argued that Mits was establishing new relationships to trade a new product. The intended supplier PB had no previous relationships with other sogoshosha. To convince ADC however, in addition to the offer of the icecream sales, Mits promised a \$4m investment in an Australian manufacturer, Tasmania's UMT, for unspecified expansion.

YY of Mits explains:

*Mits approached the ADC five or six times to become the fifth official Trading House. But Australia rejected this. So we imported from Norway, UK, Holland, Canada. We got to the stage where we had to have Australian product. Buyers really wanted it. So about two years ago, in 1991 we knocked on the door again and this time we could offer the Bordens-Peters and the UMT deal (YY:Mits).*

The Deputy General Manager of JCs, a Japanese manufacturer complained about the restricted network membership:

*We would like to buy mozzarella through trading houses other than MTC, Tom and Toshuku. We would like to use Mits. We would like to see a totally deregulated market with no trading houses or ADC required (IH:JC).*

Mits understood that in accordance with network culture it was not supposed to poach established business from established relationships.

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<sup>9</sup> For details of these deals see the Peters case study.

Given the late entrance of Mits into the trading networks of the ADC, the range of genuinely "new" products available for "new business" was limited. The General Manager International Trading at the ADC (MS:ADC) therefore devised a strategy to grow Mits share of Australian product sales, thereby increasing buyer competition. The strategy depended on acknowledgment of the concept of the "customer as king":

*At the end of the day the "customer is king" so if it means saving your customer you will do so even at a loss to yourself (MS:ADC3).*

To avoid being seen to be breaking conventions, MS:ADC made use of the customer, MK to articulate demand for a new product and supplier in the established networks. This strategy delivered a large new dairy manufacturer buyer to Australia at the same time as it potentially reduced Australia's dependency on MTC and gave more product to Mits, albeit at the expense of another trading house: Toshuku.

MS:ADC explains his tactics:

*We want to dilute MTC's position. They are too powerful. One solution is to negotiate with MK who buys a lot off NZ and is traditionally mainly Toshuku's customer. We said to Mr. S the Managing Director of MK, that we wanted to win them off NZ.*

*We then had a top level mission here. We took them (MK management) to the key factories to meet senior management. We showed them some new lines. We said they could have first access to these lines but Mitsui had to be the agent.*

*Toshuku was then told by MK: we want to increase our purchases from Australia, and this is new business and we will be doing it through Mitsui. Toshuku can't do a thing about it because "the customer is king" and if the customer says, then that is what must happen (MS:ADC4).*

### 10.14 Creating Extra Business for Tomen

Tomen received a wind-fall of additional custom from a traditionally MTC supplier when CCC was assisted by the ADC to reposition itself with "new" product. It needed to enhance its position in a network where their dependency on a single buyer left them only marginally viable<sup>10</sup>.

### 10.15 Resisting the Supplier Challenge to ADC's Position

While encouraging some closer links between suppliers and manufacturers, the ADC management also aimed to remind the network of the conventions that along with their statutory authority, gave it a close to central position in Australian trading networks. MS:ADC explains:

*SB is now looking at a strategic alliance with someone (the biggest Australian manufacturer). They said they wanted to get all their stuff from them. We said, "no you can't, you can only do new business with them". ... If Snow wants specialised product from them, that's OK. We don't care about that. But they can't go direct for all of it. That's no go. We've got to be in there somewhere (MS:ADC3).*

Anecdotes told about the problems caused by "rank amateurs" in the trading networks also served to remind the listeners that the ADC was experienced and really was needed by the industry in the future. For example, MS:ADC laments:

*The biggest problem we have is when the individual companies go messing around in the Japan market. We had an incident a little while ago when I was away. Some newcomer smart arse from ... who says he has had a lot of exporting experience insisted on eighty separate sets of documents for eighty containers. He reckoned that in his experience that meant that if one container was rejected the other*

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<sup>10</sup> The Charada case study details this strategy



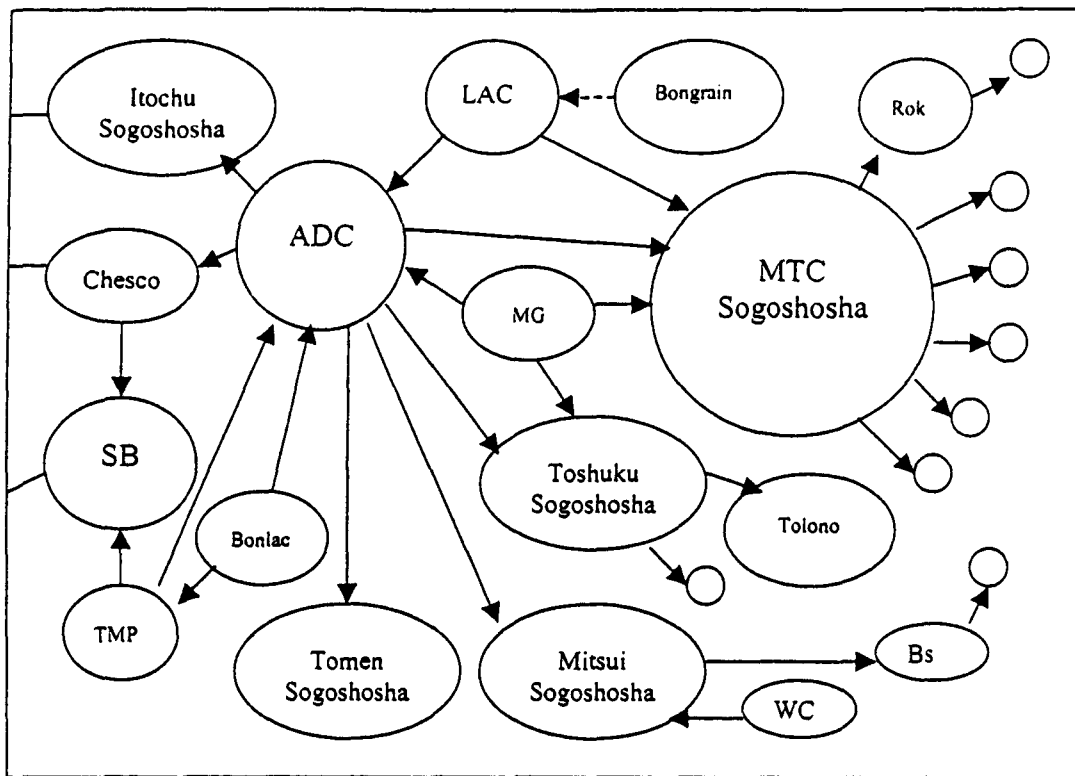
*seventy-nine would not automatically be caught up. That's rubbish. They contacted me from Japan and said for god's sake fix this up. The paperwork will cripple us. Of course we had to fix it. It was just hopeless (MS:ADC2).*

Finally MS:ADC talks about strategies designed to placate the oldest participants in the network who demand special consideration commensurate with their long-standing status, while he also strives to meet the expectations of the newly emerging larger customers:

*It is understood in the industry that because Rok was the first to use Australian cheddar and for a long time used all Australian product, it should always be given equal to best price. But we can't let our biggest customer SB drop below them. SB makes 90% of Japan's processed cheddar and most of the shredded using imported ingredients. It refuses to buy unless it gets best price. So what has happened, for the last three years, MTC, who supplies both of them from us has done the SB business without commission so SB can have equal to best price. Then we charge SB a little bit more for some other small orders to help MTC make up for it. That way everyone's happy (MS:ADC2).*

In an interview twelve months later as SB moved beyond their dependency on MTC and began to import direct from the ADC and other Australian manufacturers MS:ADC's response reflected a new governance structure where MTC has lost its central position and some of its retaliatory powers.

*MTC is desperate to hold on to SB as a customer, even though they haven't been making money on some deals with them in recent years. MTC have come to the ADC and asked us to help them out with this but we have refused on the grounds that it is between SB and them (MS:ADC3).*

**Figure 10.3: ADC Network Governance in 1994****Key**

Product exchange flow →

**10.16 Preliminary Analysis**

The ADC had evolved since 1964 from a transactionally focused commodity supplier to a trader with management closely attuned to the needs of customers. They had managed to re-establish a reputation for reliability of supply after a major supply crisis in 1982. Their management had become enculturated and understood the network conventions. They used these conventions to negotiate new supply deals for Australian manufacturers, always with the aim of reducing their dependency on the big buyer, MTC, while at the same time shoring up their own position within the network. As the Australian manufacturers became more internationalised, the future of the ADC became less certain.

The ADC's strategies to expand networks saw the Itochu sogoshosha become the fourth ADC licensed trading house in 1990, Mits followed in 1992 and Nozowa in

1993. Manufacturers like SB were buying deregulated imports through the ADC as well as direct from manufacturers. MTC, Toshuku and Tom remained the only sogoshosha used in the LIPC tendering process but this business was declining in line with deregulation and competition from cheaper Eastern European product.

ADC's aim to reduce its dependency on MTC had succeeded to the extent that MTC's market share of ADC sales had declined in volume from 83% in 1980 to 70% in 1993-94. It remained in a powerful position. By 1994 Australia was the biggest supplier of dairy product to Japan with just over 30% share of the market, marginally ahead of NZ.

As large manufacturers in Japan and manufacturing suppliers in Australia formed strategic alliances, the ADC's own long term future as a means of leveraging outcomes in unevenly matched "marriages" was less appreciated. MS:ADC was concerned:

*Some of them don't seem to understand that the ADC offers manufacturers the benefits of central price negotiation and some greater supplier power" (MS:ADC2).*

PE:MG, from one of Australia's largest exporting dairy cooperatives evaluated the future of the ASMA:

*The ADC was able to survive when the market for cheddar cheese was largely undifferentiated. Now because of the growing sophistication of demand for different types of cheddar, with a lot of different variations being asked for, you would expect the ADC to fall by the wayside in the future - their staff can't keep up with the technological innovation or sophistication now required. The information flow is not fast enough. Messages get diluted. Language is a problem because every time it is translated some of the meaning is lost or misinterpreted. The ADC has*

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<sup>11</sup> MS:ADC left the ADC in 1996 to work as international trade manager with MG.

*survived in an artificial demand environment, one where everything was strictly controlled. We don't need it to go on for ever"* (PE:MG).

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<sup>12</sup> In 1996 MS:ADC left the ADC to join MG

## **Chapter 11**

### **AUSTRALIAN DAIRY MANUFACTURERS CASE STUDIES**

- **11.1 Charada Case Study**
- **11.2 Lactos Case Study**
- **11.3 Murray Goulburn Case Study**
- **11.4 Peters Browne Ice-Cream Case Study**
- **11.5 Tatura Milk Products Case Study**
- **11.6 Warrnambool Cooperative Case Study**

## 11.1 The Charada Cheesecake Company Case Study

### **The actors participating in the evolving network:**

The Charada Cheesecake Company

Mitsubishi Trading Company

Sky Lark Family Restaurants

Tatura Milk Products

The original Japanese cheesecake supplier

The Australian Dairy Corporation

### **Charada Cheesecake Company (CCC)**

In 1992 the CCC employed twelve people. Before its entry into the export market to Japan it had 18% of the fresh commercial cake market in the city of Melbourne. The Managing Director of Charada (DH:CCC) bought out his founding partner's share in the business in 1993 for \$170,000. DH had trained originally as an engineer, migrating from South Africa years before. DH:CCC had been in the commercial cake manufacturing business for eight years before attempting to export. Staff numbers and personnel had been stable for five years when the export development began.

#### **Informant**

Diarmuid Hannigan (DH:CCC) Owner and MD.

### **Mitsubishi Trading Company (MTC)**

Japan's largest Trading House, 9850 employees in 1993.

Long term supplier of coffee and other inputs to Sky Lark Family Restaurant Chain.

#### **Informant**

Toru Nakagawa (TN:MTC) Cheese Team Leader of MTC Japan. Previously head of MTC, Produce Department, Melbourne, Australia (1989-91). This service corresponded with the development of the CCC export business. TN was personally responsible for the development of the new cheesecake supply Sky Lark.

Toshihiko Tachibana, (TT:MTC)

Chief Manager Produce Department, Melbourne Branch 1993-.

### **The Sky Lark Family Restaurant Chain**

One of the biggest Japanese owned family restaurant chains with 600 restaurants in Japan and forty in Taiwan. Annual turnover \$1.5 billion.

**Tatura Milk Products (TMP)**

Supplier of creamed cheese to CCC. Long established supplier of creamed cheese to Sky Lark's previous supplier of cheesecake, supplied through MTC.

**Informant:**

Neil Lowe (NL:TMP), Managing Director

**The Australian Dairy Corporation (ADC)**

Regulated authority does not include cheesecake or creamed cheese sales to Japan. Biggest buyer: MTC.

**Informant:**

Murray Sayers, (MS:ADC 1 and 2) General Manager, International Sales. Melbourne.

**New Zealand Dairy Board (NZDB) Japan**

**Informants**

Joel Glasser, (JG:NZDB) Regional Financial Controller, North Asia Regional Office, NZDB, Tokyo, Japan.

Mark O'Connor. (MO:NZDB) Food Ingredient Manager, Milk Products, NZDB, Tokyo, Japan.

**Koiwai Dairy (KD)**

**Informant**

Kiyoshi Yamasaki, (KY:KD) General Manager of Production Control Group, Production Department, Koiwai Dairy Products, Tokyo, Japan.

**11.1.1 Changing patterns of consumption in Japan**

Japanese diets and patterns of food consumption changes in the 1980s created a growing demand for western style deserts and snack foods. This included dairy-based chilled foods and confections consumed in Western Style medium priced family restaurants (TT:MTC; TN:MTC).

**11.1.2 Economic changes in Japan post 1990**

The high price of labour and the limited space in commercial kitchens in Japan meant food preparation was increasingly being kept to a minimum, especially in low and medium priced restaurants.

*Restaurants are trying to reduce their costs, in particular the space requirements ... and staff needed. Ideally they just want to microwave the product. This means they want much more finished or almost finished product (TT:MTC).*

Manufacturers of dairy product in Japan also faced high prices in the cost of both domestic and imported materials, labour and land, making their output less competitive compared to fully manufactured imports.

*(Sky Lark) was being sourced from a Japanese maker who was getting the creamed cheese from TMP, but there were quality problems and price hikes (DH:CCC).*

### 11.1.3 Japanese market regulation

As a result of USA pressures to reduce Japan's high tariff and quota regimes some trade regulation was relaxed in the early 1990s to allow the importation of frozen and chilled dairy confection, including cheesecakes.

*Most of the product which ends up in front of customers in these types of restaurants (ie Western Family Style) is imported. At the moment there are quotas but we should see the market opened up for substantially more product in the future (TT:MTC) .*

### 11.1.4 Changing competitive forces

In response to some import deregulation Sky Lark's closest competitor introduced Sara Lee Cheesecakes, manufactured in USA. These proved very popular. Sky Lark then asked their long term supplier MTC to help them find a new more competitive supplier of low cost, higher quality cheesecakes<sup>1</sup>. TN of MTC explained:

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<sup>1</sup> Koiwa Dairy Products, another Japanese dairy manufacturer comments: "When we are seeking a new product we ask Mitsubishi in Tokyo to find us a new supplier. They (Mitsubishi) then identify the supplier and make sure the product comes up to standard for us" (KY:K)



*Our Japanese restaurant chain customer was buying a whole lot of other products from us, coffee and do on. They were a very good customer of ours. Sara Lee had cheesecake in the market place so our customer wanted us to find a better supply of cheesecake for them (TN:MTC).*

The level of protection afforded by international copyright and patent protection regulations continued to be inadequate in some developing nations. TN:MTC explained his view of the advantages of manufacturing in a nation that had adequate intellectual property law.

*On our advice they (Sky Lark) chose an Australian Company (for the new supply of cheesecakes). There are problems in choosing a company from Taiwan or Korea in them stealing technology. If you go through a manufacturing company then there has to be a licensing agreement. A Japanese company simply does not give technology away (TN:MTC).*

#### 11.1.5 The role of the MTC personnel stationed in Melbourne

MTC established close relationships with TMP management twenty years before, in the early 1970s, when a joint venture between TMP and MMP involved cream cheese manufacturing technology transfer from SB via MTC to the Australian dairy manufacturers.<sup>2</sup> The TMP supply of creamed cheese to MTC dated from this time (NL:TMP).

TN:MTC was stationed in the Melbourne Office of MTC at the time of the Sky Lark request for MTC to find a new cheesecake supplier. He remained in Melbourne for the two years of the major new market development.<sup>3</sup>

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<sup>2</sup> See further details in the TMP case study

<sup>3</sup> TN was then given a significant promotion to head of the Cheese Team in Mitsubishi's Head Office in Tokyo.

TN:MTC was on close, friendly terms with the management of TMP. He visited them regularly to discuss supply of the products sold direct, for example creamed cheese (TN:MTC; NL:TMP). TMP had been supplying MTC with creamed cheese for the Japanese manufacturer supplying cheesecake to the Sky Lark Family restaurants for a number of years.

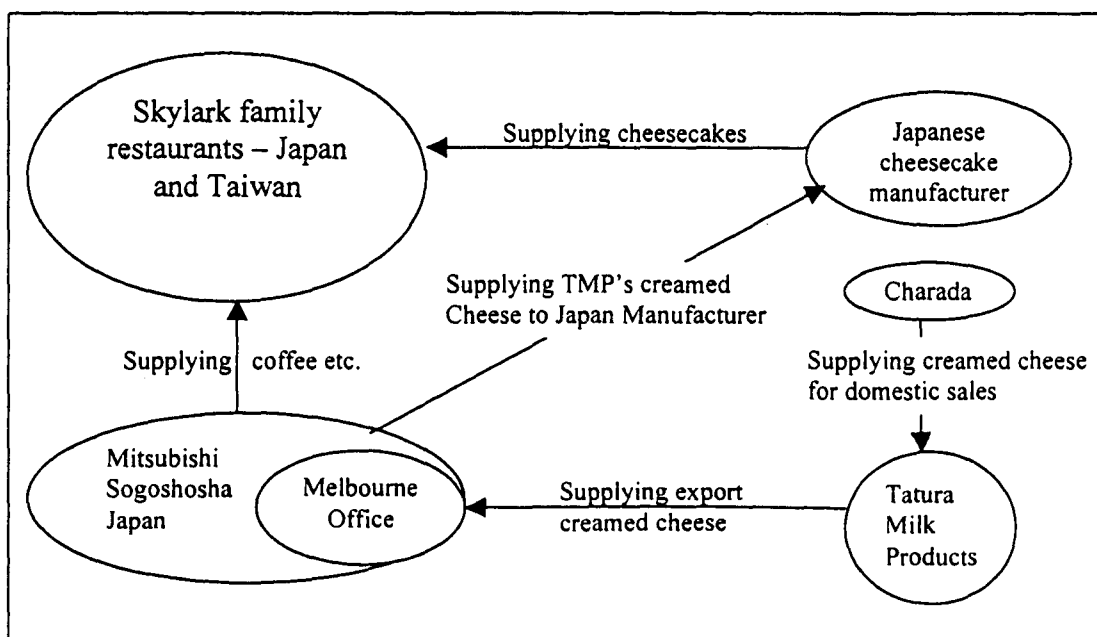
MTC aimed to find Sky Lark a new cheesecake manufacturer, which, ideally did not disturb its traditional and satisfactory suppliers in the creamed cheese network (TN:MTC).

TMP, on the other hand had a long standing creamed cheese supply relationship with CCC, whose output was sold into the domestic market.

Approaching a potential new business partner in Japan is rarely a "cold call". Rather, the approach is made after reference checking, advice and careful assessment of the past performance and reputation of the potential new associate. A *nakodie*, ie "a matchmaker" or *aisatsu*, meaning an "introduction" is frequently used. A bank with dealings with both parties will often perform these functions (JG:NZDB).

EH acted as the *nakodie* or matchmaker in recommending CCC to TN:MTC as a potential new supplier of cheesecake. Thus MTC and TMP referred to their existing networks to maintain or enhance their own positions in linking Sky Lark with a new supplier.

**Figure 11.1: The Initiating Network 1990**



### 11.1.6 Developing the new relationship 1991-94

DH (CCC) was contacted by TN: MTC in Melbourne in 1991 and asked if he thought he could produce a cheesecake of the right quality and price to meet their customer's requirements. DH explained his motivation in responding to the invitation:

*I thought if I could get my brand name into Japan then I could sell my company for massive amounts of money. So I said yes (DH:CCC).<sup>4</sup>*

*Over the next couple of years of development of that one product, using a recipe we got out of the Women's Weekly, using one agent (MTC), and working for just one customer (Sky Lark), we finally convinced them to take one container. The key players did not change over that time. The buyer had invested over 300 hours in time, the agent at least the same, all to squeeze the Japanese opposition by getting the cheesecake at \$3.20 Aust per box.*

*There is two hours between Japan and Australia time so I would ring them between 7.00 and 9.00 pm most days and we slowly worked it out by trial and error. ...*

*We had to throw away \$20,000 worth of cakes in the first shipment. They were not up to scratch. It took another six months to get another lot together and approved.*

*Sky Lark never dealt directly with us, but always via an interpreter at MTC. ...*

*After the order for six containers the price was settled. Then I visited Japan to buy machinery. MTC organised everything*

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<sup>4</sup> In fact the CCC cheesecakes were never sold as a Charada branded item through Sky Lark, nor were customers aware of their country of origin: TN:MTC.

*with ten hours of work a day over four days. The trouble was we had an order for six containers but no spare cash.*

*Things were getting pretty desperate. We asked the Victorian Government for financial help. We were offered a grant of \$30,000 up front and another \$60,000 if we got another six containers ordered, but the first money was actually too late to help. By the time we got the equipment in we had invested \$300,000 and the Government had put in \$90,000.*

*Then they (Sky Lark) found that the aluminium came off on the cakes and made a grey mark. We got only six complaints out of 20,000 cakes, but that was enough. Two containers in Japan had already been paid for, but we had to stop production for eight weeks. During that time we had to keep paying the staff \$30,000 a week with another \$6000 per week overheads. We were down about \$60,000 by the second container. We told Mitsubishi we would go broke. They said then that they would send a cheesecake expert to help us with the grey from the aluminium problem. MTC paid for the Japanese expert to stay for three weeks at the Windsor.<sup>5</sup> The MTC guy was there each day. There were fights on for young and old.*

*The Japanese guy said we needed a thousand stainless steel tins at \$13 a tin. They had to be specially made. We found a bloke in Clayton<sup>6</sup> to do it. MTC said they would buy them and give them to us rent free. So they paid \$13,000 for the tins.*

*Altogether we were held up eighteen months in buying the equipment we needed because of the lack of money for R and D.*

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<sup>5</sup> The Windsor is one of the most expensive Hotels in Melbourne.

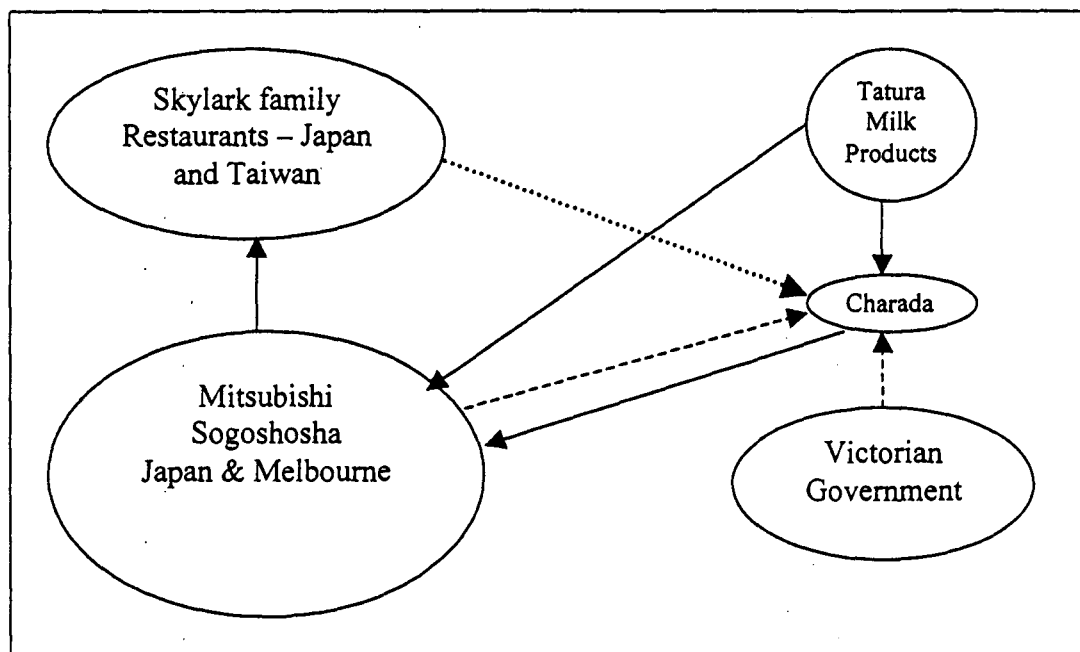
<sup>6</sup> A suburb in Melbourne not far from the Cheesecake factory.

*We had 18% of the fresh cake market and cheesecake market in Melbourne before all this started. This fell to 12% over the two years of export development (DH:CCC).*

The cheesecake venture had only achieved sustained production with the intensive efforts of the agent (MTC) in organising and helping to fund technology transfer and the purchase of some essential equipment. At all times however, MTC maintained control of the exchange of information between the supplier (CCC) and the final buyer.

*DH: The agent MTC was imperative for the relationship to happen. It was not feasible for us to drop the agent (DH:CCC).*

**Figure: 11.2: New Network after the establishment of Charada supply to Skylark: 1993**



**Key:**

- Product exchange
- Technology transfer
- Financial exchange other than product payment

#### 11.1.7 Network Repositioning: 1994. Strategies to Countervail CCC's Dependency

Three years after CCC's export market development began, and with regular orders established, CCC found itself locked into a network in a highly dependent and financially vulnerable position.

MS:ADC explains:

*MTC was screwing CCC. The original agreement with Sky Lark meant that they could stop buying at any time. There was no long-term security. The pricing agreement had been two tiered. After a certain volume, the price was meant to go up to the second level. DH tried to charge this higher price after a while, but MTC refused. They (CCC) held out and did finally get the higher price, but DH is so abrupt and tackless. He just sent a fax saying "no more supply at the old price" (MS:ADC1).*

MTC's new Australian based product manager gave his company's version of the relationship:

*A considerable amount of investment, technological development and effort has been required to bring the product up to the required standards and characteristics. At this stage the Japanese customer is still disappointed ... however the price is still a little cheaper than the locally (Japanese) produced product (TT:MTC).*

Nor had there been any opportunity for CCC to develop brand recognition in Japan. Asked if the restaurant identified the brand name or country of origin of the cheesecake served TT:MTC responded:

*Our restaurant customer does not want to advertise that the cheesecake is made in Australia (TT:MTC).*

### 11.1.8 Repositioning strategy: The role of the ADC

In 1993, DH of CCC asked MS of the ADC to help him find a way to recruit additional Japanese buyers for his cheesecake. MS:ADC helped devise a strategy to expand CCC's network, at the same time avoiding retaliation from his long established buyer.

*DH wanted to go to FOODEX<sup>7</sup> Japan in March 1994 to find some new customers. I talked to him and explained what he had to do. I said he had to say to MTC that he would protect his old customer's position and only offer to new customers if they wanted a new product (ideally a new specification, but of course this can mean very minimal difference), and if they would guarantee six months of orders. DH had to say all of this to MTC before he went*

*When he came back from FOODEX in March, TN:MTC demanded that DH give him all the new customer's names from the exhibition so MTC could be the agent. So I said to DH: go and lay your cards on the table to Tomen.<sup>8</sup> Say you are vulnerable because of your exposure to MTC. Say all you want is a regular customer base that you can be loyal to. That appeals to the Japanese. Then I told him he had to say: please look at my list of new customers who came out of FOODEX and tell me who you want to supply as agent. Then of those left over, take these to MTC and say: you deal with these, the others already have agent arrangements with other parties.*

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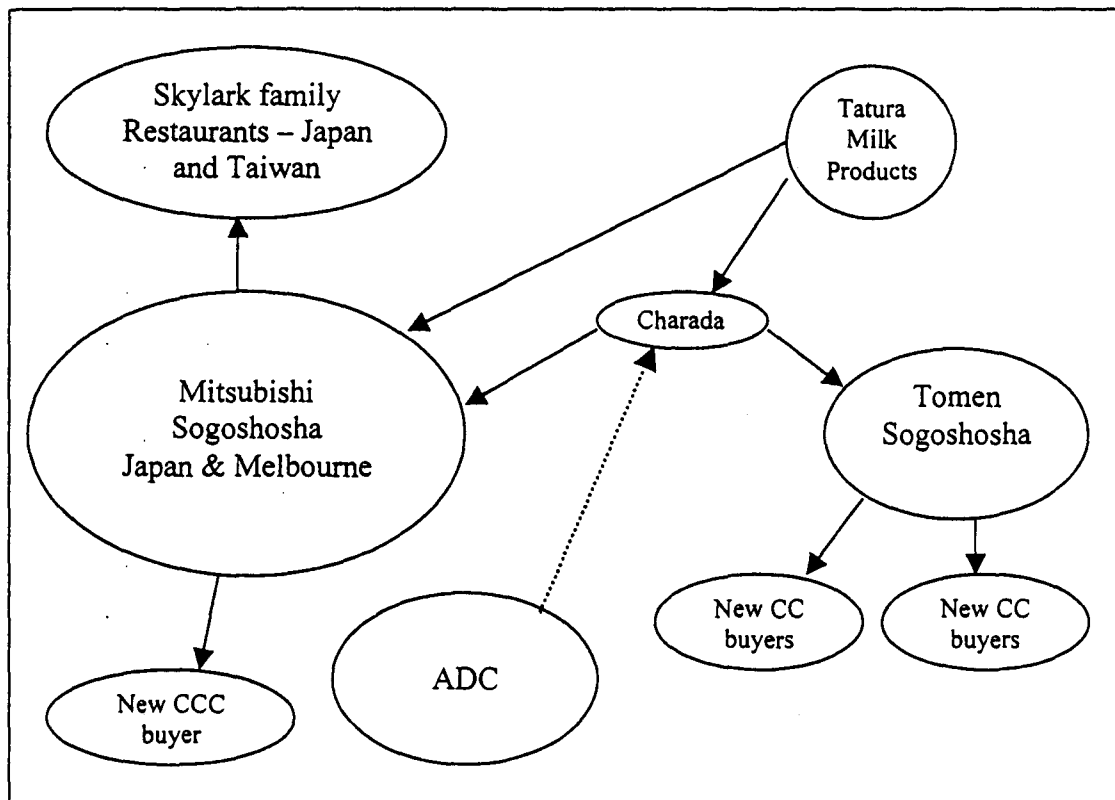
<sup>7</sup> A major food trade fair held annually in Japan where suppliers and wholesalers exhibit their products in a search for new markets.

<sup>8</sup> Tomen is major general trading house in Japan, rivaling Mitsubishi in size, and so not subject to intimidation from them. Tomen has only recently begun to import dairy product. In 1993 it had only 8% share of Australian dairy exports to Japan, although over 50% of all dairy product imported by Tomen was from Australia (KS:ADC).

*DH went through a rough time with Sky Lark. He had been screwed too hard originally with price. And the volumes never got up so he could legitimately charge the higher price as agreed. We at the ADC did the faxes for him and at the end of the day DH got what he wanted (MSb:ADC).*

**Figure 11.3: 1994; The Network after Foodex when CCC**

**Repositioned**



**Key:**

Product exchange —————→  
 Information exchange .....→

With the faxes from CCC to MTC sent via the Manager of International Marketing in the ADC, MTC was made aware that the ASMA understood the extent of the asymmetry in the relationship. While the ADIC 1988-93 agreement (ADIA circular D3/88) did not give the ADC authority to market creamed cheese to Japan their ASMA status gave them a watching brief to safeguard the interests of a small operator member in the Australian dairy industry.



### 11.1.9 Role of the ASMA

MO:NZDB a Director of the NZDB office in Tokyo comments on NZ's dairy industry rationale in the creation of a single desk marketing body, the NZDB:

*The Japanese buyers are so powerful that small supplier firms would be eaten alive if they tried to survive alone in Japan. Single desk sellers produce some sort of a critical mass and at the end of the day that is what the NZ dairy farmers want (MO:NZDB).*

### 11.1.10 Preliminary analysis

The ADC's position in the trade networks gave leverage to the inexperienced CCC locked into its small creamed cheese market niche. MS:ADC's knowledge of the cultural mores governing the networks also meant that a network expansion was executed "within the rules". Even though he had ostensibly obeyed the rules, CCC's alliance with the ADC also diminished the likelihood of retaliation by MTC.

While the 1994 strategy allowed CCC to forge new agent and end user linkages, the company's new position still kept them at arm's length from the Japanese retailers. The new buyers did not deliver the more direct access to market information, or direct linkages with the retailers who had expressed interest in the CCC products they sampled at FOODEX.

While delivering some of the outcomes sought by CCC, their repositioning also served an important strategic objective of the ADC.

In 1992-93 the market share of Australian dairy exports traded by the MTC was 74%. An objective of the ADC was to diminish this dependency (MS :ADC2).

Tomen, the Trading House recommended to DH was one of those being targeted to increase their ADC buying activity. Thus the CCC strategy also served ADC's goal to reduce MTCs buying power.

The strategy appeared to have worked to the extent that MTC's market share of Australian total dairy product sales fell to 70% in the following year, 1993-94 (MS:ADC2) while overall sales increased.

## 11.2 The Lactos Case Study

### **The actors participating in the evolving networks:**

Lactos Pty Ltd Cheesemakers  
 Mitsubishi Trading Company  
 Australian Dairy Corporation  
 Snow Brand Dairy Manufacturers  
 Tomen Trading Company  
 Toshuku Trading Company  
 Bongrain International Cheese Manufacturers  
 Rokko Dairy Manufacturers  
 Chesco Distributors  
 Tokyo Dairy Distributors  
 JC Foods Wholesalers  
 Koiwa Dairy Products  
 LITS

### **Lactos (Lac)**

In 1993 Lac had the largest share of Australia's branded specialty cheese retail market. It was also a market leader in branded retail pack long-life camembert in Japan, commanding prices equal to the French and above the Danish competition.

Lac was established in 1955 as a "Continental" retail portion cheesemaker, specialising in soft-ripened cheeses. The company began exporting to Asia, UK and USA in 1965.

However, given the limited access to the European markets and the immature demand for

specialty continental cheeses in Asia and Australia, Lac survived by exporting bulk cheddar and gouda for the first 25 years of its exporting activity.

Significant technology transfer in 1980 followed the company's purchase by the French owned Bongrain International. This enabled Lac to refocus and target the growing Australian and Japanese fresh cheese markets.

Lac supplied Australia's largest share of exports of specialty cheeses to Japan in 1993. Export sales doubled between 1990 (\$6million) and 1992 (\$12.1 million). Japanese sales accounted for \$7 million of this share in 1992. Turnover in 1993 was some \$35 million and they employed some 230 people (RW:Lac; RP:Lac a).

Exports represented 20% of all Lactos' sales in 1990 and had grown to 35% of all sales in 1992. By 1993 Lactos had 8% of the total Japanese market for long life brie and camembert (RP:Lac a).

#### **Informants**

Milan Vyhnaek (MV:Lac) Founder and owner of Lactos from 1955 to 1980.

Russell Patterson (RP:Lac) Managing Director of Lactos 1985-

Michael White (MW:Lac) Technical Manager 1990-

#### **Mitsubishi Trading House (MTC)**

MTC had been buying Lac product directly or via ADC for nearly 30 years in 1993.

#### **Informant**

Toru Nakagawa, (TN:MTC) Cheese Team Leader MTC Tokyo.

#### **The Australian Dairy Corporation: (ADC)**

The Australian dairy industry owned exclusive trader of a range of dairy commodities into Japan, with a permanent office of Japanese staff in Tokyo.

#### **Informants**

Murray Sayers, (MS:ADC 1,2,3,4) General Manager, International Sales, Melbourne.

Katsu Suzuki, (KS:ADCJ) Sales Manger, ADC Tokyo.

Minoru Shimizu (MSh:ADCJ) Chief Representative, ADC Tokyo.

#### **Snow Brand (SB)**

Largest dairy manufacturer in Japan. Originally dependent on MTC for its imported supplies but in recent years SB has become more independent in its trading relationships.

**Informants**

Hideyuki Sanza, (HS:Ch) International Division, Chesco, Tokyo, formerly senior manager with SB for 25 years, including in the 1970s when SB formed an alliance with Lac.

**Chesco (Ch)**

The oldest and largest Japanese wholesaler, repacker and distributor of cheese products. Part of SB family.

**Informant**

Hideyuki Sanza, (HS:Ch) International Division, Chesco, Tokyo. **JC Foods (JC)**  
Established in 1964, Since 1987 have been seeking to replace EC suppliers with Australian and NZ product. Importer of ingredients for pizzas.

**JC Foods, Japan**

Importer of ingredients and manufacturer.

**Informant**

I.Hidaka, (IH:JC) Head Business Coordination Manager, Tokyo.

**Murray Goulburn Dairy Cooperative (MG)**

Second largest dairy manufacturing cooperative in Australia.

**Informant**

John Nagae (JN:MG) Japanese national, consultant to MG for nearly twenty years (ex SB employee).

**LITS (Leave it to Samantha)**

Small Japanese Trading company run by an ex-Australian young woman specialising in Australian food and furniture imports.

**Informant**

Samantha Sutherland (SS:LITS), founder-manager, Tokyo Japan.

**Koiwa Dairy Products (KD)**

Medium sized milk producer and manufacturer, close member of the MTC family.

**Informant**

Kiyoshi Yamasaki (KY:KD) General Manager of the Production Control Group, KD,

**Published sources:**

MV:Lac reference: Senator Jindich Nermut, *"Lactos, 1955-1990: Its only the Beginning"*. English edition 1991. copyright: M.Vyhnalek. Published by Lactos Pty Ltd, Burnie, Tas.

**11.2.1 Lactos Pty Ltd master cheesemaker (Lac)**

The Managing Director of Lac (RP:Lac) described the company's objectives in 1993:

*We aim to move into the branded higher value packaged product market. Michael's (the new technical manager) position is expected to raise the Lac profile as a high quality technologically advanced company geared to developing special products for the Japanese market (RP:Lac).*

Lactos was unusual in the Australian dairy industry context in that an individual, not a cooperative of suppliers, established the business in 1955. MV the founder was a Czechoslovakian trained dairy technician who immigrated to Australia in 1950. He began his dairy technology studies in Europe in 1943.

In 1949 VH escaped communist Czechoslovakia crossing into West Germany. In 1950 he immigrated to Australia as a "displaced person" where a condition of his sponsorship was two years of employment as directed by the Australian Government. He was assigned to clearing forest in Tasmania.

At the end of this contract, VH applied for dairy technology work at the various Tasmanian factories but was rejected on the basis that his European qualifications were not recognised (Nermut, 1990). He eventually found employment as a butter wrapper. In his first tour of mainland Australia's dairy manufacturers in 1953 he found his inquiries about making non-English style cheeses unwelcome:

*No one was interested in what they called "strong, mouldy, or stinky cheese," given that at the time the only "edible" cheese recognised was Kraft Blue Pack, (a foil wrapped processed cheddar), or an honest chunk of dry matured cheddar cut by the grocer at the counter. Roquefort, Camembert, Brie, or Limburger created panic in the minds of the local cheese technologists (Nermut, 1991:56).*

The majority of Australia's consumers in the 1950s preferred British style cheeses. As well, the limited domestic, transport and retail food refrigeration meant the long shelf life of the foil wrapped processed cheddar was particularly important.

Another European dairy technologist, a Polish Army Major immigrated to Australia in 1947. Dr JC's postgraduate dairy qualifications were recognised and he was employed to take charge of the Commonwealth Science and Industry Research Organisation's (CSIRO) Dairy Section<sup>9</sup>. In 1959 JC became a consultant to Rok, transferring cheddar technology to them at a time when European cheesemakers were not accessible to the Japanese manufacturers (MS:ADC2). JC befriended and advised VH encouraging him to establish a European style cheese factory.

In 1954 VH applied to the Agricultural Department of Tasmania for the licence to establish his plant. Such an application required an industry inquiry and then a special court hearing to determine whether it was in the best interests of the Tasmanian dairy industry to grant a new licence. The magistrate ruled that it was "not in the interests of Tasmania to produce non-cheddar specialty cheese". The application for a licence was therefore rejected.

With the use of another company's licence and using their surplus milk, in 1955 VH leased a portion of land for 99 years for five pounds a year and commenced production.

The name for the company was chosen as easy for Australians to pronounce but still sounding "Continental".

Within three years Lac was producing twenty-one different cheese varieties, including blue veins specially developed by JC at the CSIRO. However there was limited domestic demand for this range of product which also had to compete with European imports.

At the time Australian Dairy Colleges only trained their graduates in making milk powders, casein, butter and cheddar cheese. Thus VH had to recruit his cheesemakers in Europe. Low staff turnover became important, with VH travelling to Europe to interview

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<sup>9</sup> Rok later employed JC as a technical consultant to help establish their cheese manufacturing in Japan.

wives of applicants to assess whether they were likely to resettle and stay happily in Tasmania.

As well according to VH:

*We always have considered the human element to be most important. With dairy farmer milk suppliers we had the closest relationship through Lactos, employing their children in preference. We assisted annual visits by our farmers to New Zealand dairy farmers. We sponsored a young farmer to visit prominent dairy countries around the world (Nermut, 1990: 97).*

### 11.2.2 Developing the export markets

In 1964 the year the ADC established an office in Tokyo, VH visited export markets looking for buyers for his surplus specialty cheese production.

Five months later, with two agents arranged in each market, Lac dispatched its first 500 tonnes of cheese to six different countries. The orders were not for the continental style cheeses however, but for cheddars for markets in England, Malta and the Philippines. As well Lac had annual orders for small consignments of up to ten tonnes of cheddar for Rok to be supplied through the MTC. Cheddar was also supplied via the Trading Houses Toyamenka and Toshuku to manufacturers in the still highly regulated markets of Japan<sup>10</sup>.

In 1970 the threat of UK joining the EC was imminent. Japanese manufacturers began to look to the Southern Hemisphere for alternative low cost dairy manufacturing supplies:

According to IH:JC of the business coordination department of JC Foods, at that time:

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<sup>10</sup> Dr Czulak had introduced his old friend to Rokko and Mitsubishi who were employing him as a consultant in their new school lunch stick cheese development.

*the first consideration in looking beyond Europe for cheese was price, and Australia was cheaper than Europe, but they had to bring the quality up (IH:JC).*

While on his annual visit to Japan in 1970 to negotiate the next year's orders with MTC, Tomen and Toshuku, SB senior managers contacted VH at his hotel directly (without the knowledge of MTC) and asked him to extend his visit so they could talk to him about their interest in Lac supplying some patented dairying equipment, ie the Lactomatic cheesemaker<sup>11</sup>.

At that time SB supplied nearly 55% of the Japanese market and had a twenty year old relationship with a Norway manufacturer which involved supply of some 5000 tonnes of gouda annually, via MTC. As well Sweden supplied some 1000 tonnes and Finland 500 tonnes annually (HS:Ch; MV:L). SB was Europe dependent and concerned at the looming move of the UK into the EU. It had also accumulated sufficient international experience to begin to feel the services of a trading house were superfluous.

Within a month of the initial meeting with SB in Japan where VH encouraged the relationship development, the SB founder visited Lac in Tasmania where he committed his company not to equipment purchase but to an annual minimum supply of 1000 tonnes of bulk Gouda for the next five years. There was not to be any direct SB investment in the Lac company but technology transfer from Japan was promised.<sup>12</sup>

At the same time (and initially without the knowledge of Lac) SB formed a JV with MG and MTC<sup>13</sup> on the mainland with the objective of manufacturing at least 5000 tonnes of gouda per year. SB also undertook to transfer technology to MG, as well as to a NZ JV they negotiated to produce gouda (HS:Ch).

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<sup>11</sup> Given the culture of the networks, it was provocative for SB to make a direct approach to Lac, without the sponsorship of their agent MTC. However, since they claimed to be interested in buying a new product, ie equipment, not cheese, their initial approach did not challenge the accepted order.

<sup>12</sup> Lactos also sold some 1000 tonnes of Romano cheese per annum in the 1970s to Snow Brand (HS:exSB).

<sup>13</sup> See reference to this JV in the MG Casestudy.



The Lac SB order for gouda required the construction of a new building at the cost to them of \$1.5 million. During the construction Lac staff learnt Japanese, and VS, the technical manager trained at a SB factory in Hokkaido for four months. A SB technologist returned with VS to Lac where he stayed for six months to oversee the start up of the gouda production.

By 1977 Lac exported 4000 tonnes of Gouda to SB Japan and 1250 tonnes to the USA<sup>14</sup>. SB was the biggest customer, but Lac also supplied their long established customers Tomen and Toshuku.

Lac management explained:

*Having more trading partners in the Japanese market eg MTC, ADC and Tomen is valuable as this situation gives us access to more sources of the same market information as well more buyers leads to a better bargaining stance when we are negotiating price (MW:Lac).*

By the late 1970s Japanese manufacturers preferred cheddars over gouda for further processing, and consumers were beginning to demand stretch, shredded or melty cheese for Western style snack foods<sup>15</sup>.

In 1980, with drought causing supply constraints and industry opposition to subsidies supporting only some manufacturers, an Australian government support scheme subsidising the manufacturing and export of gouda was withdrawn.

Lac saw its levels of profitability decline. It had become dependent on a few buyers of a low returning line of bulk gouda.

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<sup>14</sup> Lac exported cheese to USA after 1966 when it won awards in the World Cheese Competition. Future market development was halted when the USA introduced cheese quotas in 1976. Lac then secured 35% of the Australian quota of 3500 tonnes.

<sup>15</sup> Japanese technology developed by Rok was transferred to the UMT dairy factory in Tasmania to develop "Myalla", a cheese for pizza toppings (HT:Rok).

In 1980 a third fire destroyed part of the Lac factory. After trying to sell the factory to his suppliers as a cooperative, VH sold the company to a privately owned French dairy manufacturer, Bongrain.<sup>16</sup>

M. Bongrain had also established his business in 1955. With access to the huge subsidised markets of Europe, by 1980 Bongrain was twenty times the size of Lac and had retained its original commitment to supplying high quality specialty cheeses. Bongrain also had established export business in Japan. In Lac Bongrain found a manufacturer with reliable, high quality milk suppliers, a loyal and basically skilled workforce, located close to the growing Asian and Pacific rim markets.

However, at the time of purchase Australian dairying areas in South Eastern Australia were experiencing severe drought. Prices for raw milk were escalating. In 1980 the Australian government removed the domestic gouda production subsidy (JN:MG). Lac was caught with a factory geared to gouda production taking days to make compared to the several hours required to make cheddar.

By 1981 SB had ceased to take bulk orders of gouda from Lac:

*the generic product was priced out of the market (RP:Lac c).*

MTC then stepped in to buy up the surplus production at Lac.

According to TN:MTC:

*Since 1981 there had been no gouda cheese supplied to us from Australia after the end of the JV between MG, SB and MTC.<sup>17</sup> In 1984 MTC heard that Lac had unsold stocks of gouda and edam cheese. So we decided to purchase a regular order of this edam and gouda from*

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<sup>16</sup> In 1982 the MG-SB Gouda JV ceased. It had become nonviable (HS:Ch).

<sup>17</sup> As noted before this had proved uneconomic.

*Lac. For five years Lac sold this cheese at a loss to us and we also sold it on at a loss to our customers (TN:MTC).*

Thus Lac's networks had contracted to a dependence on Japan's biggest trading house whose prices threatened their long-term viability.

In 1982 Bongrain attempted to diversify the Lac lines by transferring technology to enable them to produce creamed cheese for the domestic and Japanese markets. Unfortunately Kraft Philadelphia Brand had already established loyal customers and was a retail pack market leader. Nor could Lac penetrate MTC's established creamed cheese networks. RP explained:

*Lac is the sole supplier of gouda to MTC but it (MTC) has a number of suppliers of creamed cheese. We came into the cream cheese export market fairly late. Consequently MTC already had loyalty to another supplier, TMP, even though they are 10% more expensive than the Lac produc (RP:Lac b).*

In 1987-88 the ADIC approved ADC regulations including pizza type cheese trading as an optional ASMA activity. Lac used the regulation changes as an "excuse" to have ADC take over its bulk gouda and fresh camembert sales. This expanded their network, introducing some more price competition and reducing their dependency on MTC. CP:ADC explains Lac's strategy at the time:

*There are a couple of line ball cases like camembert and mozzarella where we must ok the companies to go ahead (ie sell direct). With Lac we have organised the sales of these cheeses and gouda to Ch but if RT (Lac MD) organises something with another buyer direct then that's up to him (CP:ADC).*

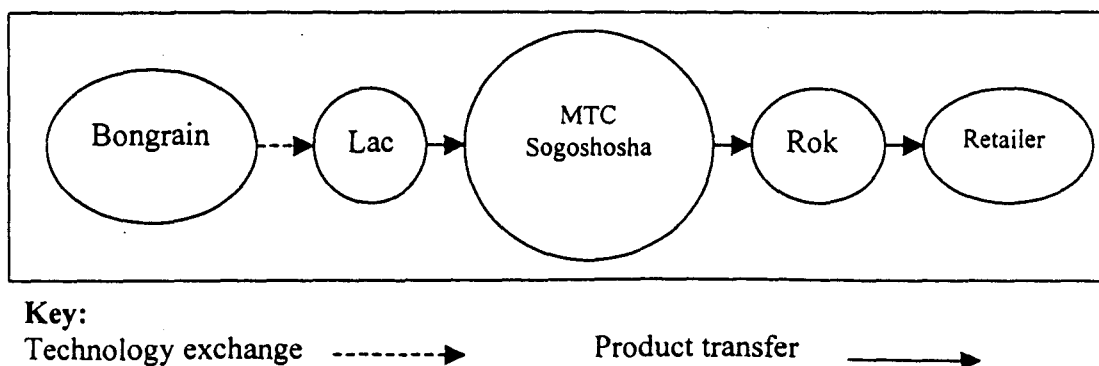
MTC complained about the new network development in 1987-88, blaming their loss of direct exchange with Lac on the monopolistic behaviour of the ADC, (not the behaviour of Lac).

*They (the ADC) can do it (ie act as agent), but it was much better when we went direct to them (Lac). We had done a lot of good developmental work with them over a long time (TN:MTC).*

MTC tried to lock in the loyalty of Lac in 1988 by nominating the company as their sole supplier of Australian gouda, camembert and brie. Letters of agreement between MTC and Lac were exchanged (RP:Lac c). The relationship was reinforced by episodes like the following in 1990 when the LITS trading house in Japan tried to import Lac product without the services of MTC:

*Madisons in Sydney said we (LITS) could be supplied with fourteen tonnes of Lac cheese bought through them. Lac then stepped in and stopped it saying that any importing of their product to Japan had to be done through MTC. ... We were so angry when we found out what we had to do, because no one had told us we could not import direct. So we went to Ch and got them to supply us with a very cheap price for some other cheese as a special urgent one-off order (SL:LITS).*

**Figure 11. 4: Network Prior to Development of Long Life Camembert**



In 1984 construction of a new building and technology transfer from the parent company had made it possible for Lac to commence production of high quality brie and camembert. Lac soon took the biggest share of the Australian market for soft ripened cheese and the company sought to reposition itself away from bulk cheese and supermarket sales to target the delicatessen market.<sup>18</sup>

In 1984 Lac lost \$6million, by 1985 it was back in profit (RP:Lac b). The capacity of the factory was doubled, and a new variety of specialty cheeses "Heart of Brie" was created for the Japanese market. In 1987 XC a skilled technologist was sent from the parent company in France to assist with further technology transfer.

The 1989-90 further expansion of the plant and more staff exchanges with the parent company saw sufficient upskilling for the development of Long-Life soft ripened cheeses<sup>19</sup>:

By 1990 Lac was ready to market the unique, high value Long Life Camembert into the Asian markets. At the same time they planned to phase out their less profitable cheddar, edam and gouda lines (RP:Lac).

The 1988 MTC-Lac preferred supplier agreement created problems for Lac on two fronts: Firstly: in 1993 MTC was still buying 1000 to 2000 tonnes annually but at prices too low to generate reasonable returns. An ADC manager observed:

*MTC wants more (gouda) but Lac wants to stop because of the costs and additional supply means additional losses (KS:ADCJ).*

The Japanese buyers of the cheap Lac gouda supplied through MTC had become aware of this reluctance but complained that historic patterns of supply should not be disturbed:

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<sup>18</sup> Of the negligible amount of fresh cheeses consumed in Australia in the mid 1980s 95% were imported.

<sup>19</sup> Lac in turn developed "True Blue" cheese (based on the early work of JC). This technology was transferred back to Bongrain France production lines.

*Lac does not want to supply gouda any more but Japanese customers want it to continue. Mr P (the Manager) wants to quit making gouda, but if there are long term customers in Japan who still demand it then there is a problem. They should not just stop (IH:JC).*

Secondly, three years after the preferred supplier agreement, the unique Long-Life Brie and Camembert was developed by Lac:

RP explains this development:

*The long life camembert and brie were developed for the Japanese market but it is now also sold on the domestic market. MTC was consulted in the new product development as was the ADC but the innovation was driven from Lac. The product is branded in Japan as Lac and sells for the same price as the French product and more than the Danish (RP:Lac b).*

Given their agreement, the fact that the ADC did not have a regulatory right to monopolise the sale of Camembert, and in line with traditional network behaviour, MTC demanded exclusive access to Lac's new product.

Lac however sought to maximise returns through an expanded network of buyers for their long-life camembert.

### **11.2.3 The strategy to introduce new buyers into the Lac Long-Life camembert network: 1989-1990**

Camembert with its white colour, mild taste and small portions had become a new cheese fashion in Japan. It was also ideal for small stores or supermarkets that could risk stocking long-life quantities in tins or foil wrap.

MSH:ADCJ<sup>20</sup> of the ADC in Tokyo describes the market testing and the evolution of the strategy devised by ADC and Lac in an attempt to sideline MTC and capture greater benefits for themselves in a new Ch dominated network.

*After Lac asked to us to help them sell to supermarkets, in August 1989 we introduced them to Seiju, a chain of 265 supermarkets. They trialed samples of the new camembert in 20 or 30 stores. They found it was too salty, the skin too thick, it did not soften after cutting and had too much mould.*

*In September we reported the consumer reaction to Lactos who modified its next shipment and the product was much better.*

*In October there was a problem with freight temperature control and the cheese melted on the way. The container was poor, only fan cooled in airfreight. (The product was left out on the tarmac in Singapore, MS:ADC.)*

*In June 1990 ADC suggested Ch be invited to act as an agent for Lac /Seiju so it could help with transportation because there were too many problems for Seiju to handle direct.*

*In August 1990 Lac visited ADC Japan, Ch and Seiji. Together we agreed on a marketing plan including brand names promotions etc. The camembert was to be called "Australian Brand".*

*We agreed that Lac should sell via ADC to Ch who should wholesale to Seiju's 265 supermarkets, 2000 Family Marts and 22 Seibu Department Stores  
Altogether they would be supplied twenty metric tonnes.*

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<sup>20</sup> MS:ADC was also one of the architects of the strategy.

*Lac should also supply another twenty tonnes via ADC and Ch to hotels, restaurants and other department stores.*

*Lac should sell another 100 tonnes direct to Ch who would distribute through SB to 8000 additional supermarkets and retail shops.*

*This was agreed.*

*However in the same month, August 1990, MTC and Tomen both approached Lac asking for supply of the new product.<sup>21</sup> Lac then supplied MTC with camembert, which they then labelled "Tasmania Brand" and sold to Rok and Tokyo Dairy.*

*Rok then approached the same retail outlets we had agreed on and were supplying, supplying them repacked, rebranded Lac product, underselling Ch's "Australian Brand".*

*Lac also sold the camembert to Bongrain France for direct on-selling in Japan.*

*In 1992 listeria was found in some imported cheese, not Australian, but the image of imports suffered. At the same time Seiju's buyer changed so they no longer felt personally obligated to the deal with us and Lac.<sup>22</sup> They started to sell domestically produced camembert. But Ch continues to buy Lac cheese and tries to expand sales.*

*We (ADC) argued with MTC because they said they wanted to supply Ch. We agreed because Ch was in trouble with the*

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<sup>21</sup> The request was based on their long-standing agreements and relationships.

<sup>22</sup> MS:ADC stated that the Seiju supermarkets "were being pressured by MTC for selling the competing brands of long-life camembert" (MS:ADC2).



*camembert, but MTC still did the dirty. It went ahead and got direct supply from Lac which they then repackaged to compete with what Ch was supplying.*

*Meanwhile Lac is OK because it sells more cheese. We complained to MTC and Lac about what was going on but Lac did nothing to fix the problem. They could have refused to supply MTC (MSh:ADCJ).*

MS:ADC describes this same episode:

*We developed a plan with Ch where they handled the camembert direct, not through a trading house, distributing it into the Japanese market via a number of supermarkets. SB was also involved. We got the jump on MTC by getting in first, moving some containers through Ch into the supermarkets.*

*Then MTC retaliated by introducing three additional camembert brands through Rok and Tokyo Dairy. They got Rok to repack and relabel Lac's tins, and they got plain tins too.*

*Ch alerted us to it and asked what MTC was doing because there were now four brands in the market. ADC complained to Lac who said they did not know that the re-packaging was going on. But they didn't do anything to stop it. Then the key supermarket lost interest.*

*Then Lac started to supply Bongrain France in Japan without telling MTC. But the product has over-ruled the relationship in this case because people want the product and there are no reasonably priced substitutes (MS:ADC 1).*

When asked whether any episode had tested the strength of any of their relationships the MD of Lac (RP:Lac) volunteered that:

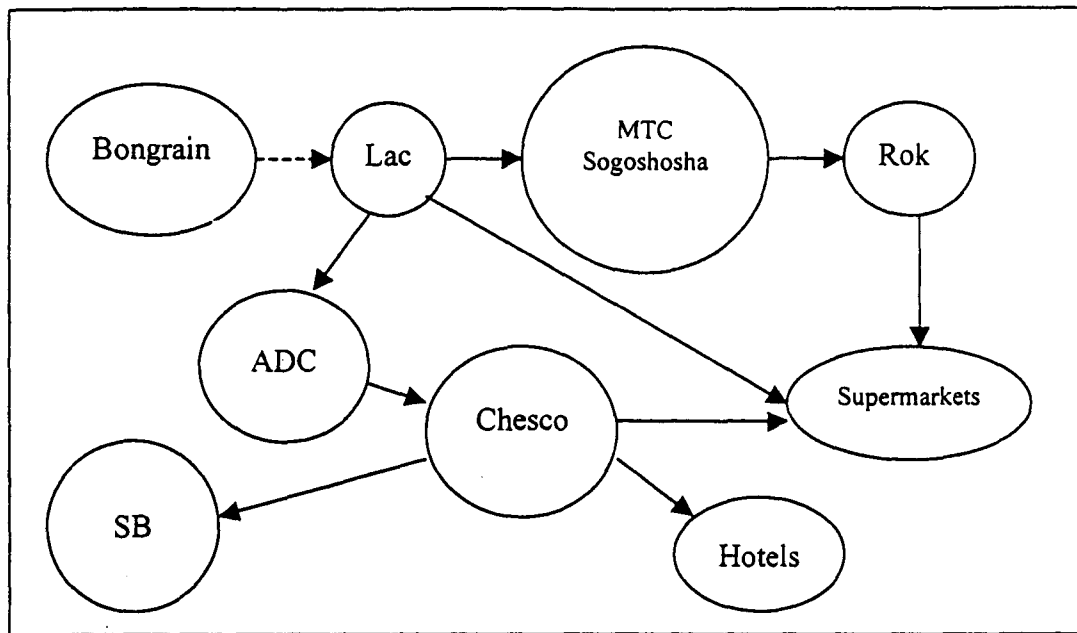
*Some 18 months ago we had a problem with a MTC buying our camembert and reboxing and branding it with their own label. Some time in the future they could substitute the Lac cheese for someone elses. We expressed concern to MTC but they went ahead anyway. There is a short-term benefit for Lac in increased sales but a long-term problem if our brand image and our position is eroded.*

*Retailers have tried to buy direct from Lac. We did not initiate this, a point understood by MTC (RP:Lac).*

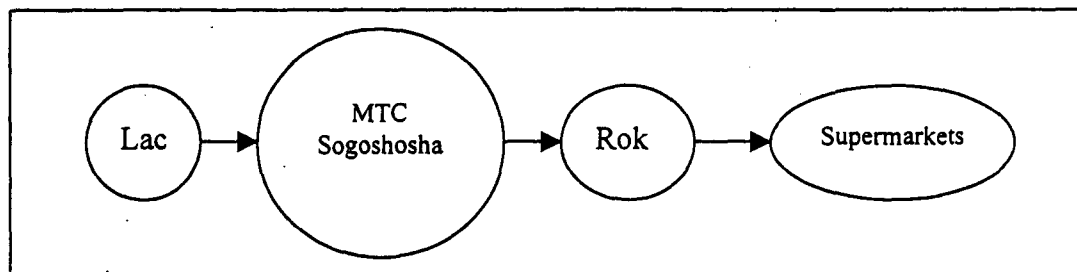
HS:Ch reflected on the network culture that allowed a new buyer to be introduced into a network to handle what could be defined as a new product (eg Long-Life camembert). At the same time HS:Ch acknowledged the risks if the new arrangement challenged the order of relationships where another potential or actual buyer was in a central position:

*Whenever we make new business then there is not a great problem but if they have already locked in with say MTC then it is a real problem (HS:Ch).*

MTC reacted to the ADC strategy to circumvent them in the marketing of Lac Long-Life Camembert with a counter- strategy which gave them and their buyers equal access to the product, and damaged the reputations of ADC, Ch and ultimately, Lac.

**Figure 11.5: Network Repositioning after Long Life Camembert Introduction****Key:**

Technology exchange -----&gt; Product transfer -----&gt;

**Figure 11.6: Network counteraction after MTC – Rok counter strategy****11.2.4 Preliminary analysis**

Introducing Ch (via ADC) into the network was a high-risk strategy, with the potential to erode the reputation of Lac as a fair, reliable supplier. Some supermarkets had subsequently been caught up in a retaliatory attack, having purchased *Australian Brand* camembert only to find their opposition offering the same product, differently branded and at a lower price. The key supermarket chain, Seiji dropped out of the deal (using food safety issues as their explanation).

Lac took advantage of the ASMA's status when it asked for the ADC to help find it new buyers.

In turn, the ADC's commission as an agent for Lac Long Life camembert was a bonus, given Lac was not obliged to sell such a product through the ADC. The ADC's aim to diminish MTC's overall market share of Australian dairy product (MS:ADC 3) was also an incentive to them to assist.

Lac's attempt at repositioning away from the bulk industrial to the high value branded retail sector in Japan did succeed with its "Australian Brand" cheeses on supermarket shelves. And price competition and sales volume had increased. However, the strategy employed had not succeeded in diminishing the power of MTC in controlling activities in the network. MTC and its buyer's retaliatory actions had eroded retailer confidence in Lac, Ch and the ADC. As well, by complying with MTC when it asked for supply and then relabelled, Lac damaged its own chances of retaining market leadership with self-branded product.

Ch management's observation about the Japanese market for specialty cheeses emphasises the difficulties faced by the small Tasmanian company trying to sustain a lead as a high priced branded retail pack product:

*Hotels and restaurants prefer to use European cheeses, especially when they want to promote the image of European cheeses. Australia's only selling point is price (HS:CH).*

### 11.3 The Murray Goulburn Dairy Cooperative Case Study

**The actors participating in the evolving networks:**

Murray Goulburn Dairy Cooperative

Australian Dairy Corporation

Mitsubishi Trading Company

Itochu Trading Company

Meiji Dairy Manufacturing

### **The ADC**

#### **Informant**

Murray Sayers, (MS:ADC 1,2 and 3) General Manager, International Sales, Melbourne

### **Murray -Goulburn (MG)**

#### **Informants**

Peter Erwin, Murray Goulburn (PE:MG) General Manager Industrial Sales-Export Marketing, Melbourne. Had been with the company for six years in 1993.

Jack Maquire, (JMc:MG) Ex Managing Director of MG 1952-81.

Wayne Sanderson, (WS:MG) Manager Technology, MG. Had been with the company three years in 1993, previously with the NZDB.

John Nagae, (JN:MG) Consultant (ex Snow Brand senior staff) with MG since 1978.

### **Mitsubishi Trading Company**

#### **Informants**

Toru Nakagawa, (TN:MTC) Cheese Team Leader, Tokyo, Japan.

Toshihiko Tachibana (TT:MTC) Chief Manager, Produce Department, Melbourne Office.

### **Meiji Dairy Manufacturers**

#### **Informant**

Kazuo Endo (KE:Mei) Manager, Purchasing Group Meiji Milk Products Co.

### **JC Foods Pty Ltd**

#### **Informant**

I Hidaka (IH:JC) Deputy General Manager, JC Foods Co Ltd.

### **Koiwa Dairy Manufacturer**

#### **Informant**

Kiyoshi Yamasaki (KY:K) GM of Production Control, Koiwa Dairy Products

### **Tomen Sogoshosha**

#### **Informant**

Mr H. Komeiji (HK:Tom) Manager, Foodstuff No. 2 Section cheese

### **Australian Embassy, Tokyo.**

#### **Informant**

JimShort (JS:AE) Trade Counsellor

**Toshuku TC**

**Informant**

Jun Ishi (JI:TSS) General Manager Dairy Products 3rd Group (Cheese group)

**11.3.1 The Murray Goulburn Dairy Cooperative (MG)**

MG was established in 1951 in Northern Victoria, to process milk being produced from rich pasture land on newly established irrigated Soldier Settler farms. By the 1960s MG was the biggest dairy company in Australia. It had six factories located around the State of Victoria with a staff of 1300. Turnover was \$740 million in 1993. Their general merchant trading stores associated with the factories had a record turnover of \$56 million in the same year (NL:MG).

JMc:MG the Managing Director appointed in 1952 was typical of the very stable management culture at MG. After retiring in 1979, he returned to the company in 1981 to help close down the gouda making joint venture sapping company profitability.

MG had some of the most successful branded retail ready products in the domestic market, including cheeses, butters, deserts and long-life milks. In 1994 55% of its production was exported. Nine to ten percent of these exports were sold to Japan.

Cheese export sales to Japan commenced in 1954 when MG sent cheddar to Rokko at the request of the ADPB, forerunner to the ADC. The agent handling sales was MTC. According to JMc who liaised with MTC at the time:

*MTC was not the most enthusiastic buyer of our surplus casein and powdered milk so we sold it through others in Japan. This was only after the alternative arrangements were discussed with MTC however. They gave tacit approval to the other agent (JM:MG).*

**11.3.2 Market positioning**

According to their 1993 company objectives:

*MG aims to be a reliable high quality supplier of food ingredients (PE:MG).*

Their rationale for not attempting to market their successful domestic brands in Japan is explained by PE:

*The Japanese, especially Snow Brand are now targeting other Asia markets with finished goods from their JVs and they see the New Zealanders as their competitors. Any competition is the enemy. ... Australia is seen as less competition because it is mainly positioned as an ingredient supplier. That's good (PE:MG).*

As well, according to WS

*We are loosing money out of our own retail brands in this market (ie Australia). There is no way we can sell our Devondale products for anything like the returns we get on SMP in the bulk commodity markets, because of the costs. ...*

*We will make most money out of tailor made bulk product. We don't have the dollars to invest in the infrastructure to sell retail. ... The costs offshore are horrific. ... The biggest single problem co-ops have is access to finance (WS:MG).*

*It takes four to five years to establish a new product in Japan so you need a lot of capital to sustain you during that time. The only way for a small company to get in is through piggy-backing a larger player (WS:MG).*

### 11.3.3 The international context

The Joint Venture between SB, MG and MTC to produce Gouda: 1978-1980

In the early 1970s Japanese manufacturers were concerned to find alternative stable low cost industrial supplies to replace an expected decline in availability and higher

prices for product from the EC. New Zealand and Australia presented as potential replacement suppliers.

JN a Japanese national who worked for Snow Brand in Japan, before joining the joint venture in Australia describes the context at the time of the JV:

*The UK was joining the EC. The EC price was increasing and production levels were not high. ...*

*It took four years of negotiations before agreeing on the JV in 1972. MTC invested 5%, MG and SB invested the rest equally. Three years later ... there was still no satisfactory gouda production, so I<sup>23</sup> was sent by SB to find out what the problem was. I discovered the equipment was not good enough. So I went back to Japan and presented the case that money should be borrowed to invest in better equipment and factory upgrading. I was told that I was literally putting my job on the line if the venture failed.*

*With the improved technology the first 2000 tonnes of gouda was produced in 1976, this rose to 7000 tonnes in 1978.*

*In 1980 the Australian Government removed the subsidy for making gouda and the JV folded despite me recommending that there could be contamination by irradiation in Europe or war in the Middle East. ... The Japanese Government asked the Australian Government through the embassy to continue the cheese subsidy but this did not happen (JN:MG).<sup>24</sup>*

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<sup>23</sup> According to PE:MG " After WW2 Mr JN was one of the key people in SB. In the 1950s he was sent by SB to learn dairy technology in Europe."

<sup>24</sup> Snow Brand also set up a similar JV in New Zealand with a manufacturer. This venture also proved not to be cost effective and closed around the same time. This was the last JV of its type, with overseas investment in production facilities in NZ. At the same time SB transferred technology to Lactos to make and supply Gouda. This venture also ended when it proved uneconomic.



MG Manager PE continued:

*This venture ended up with significant problems. The JV cost MG a lot of money. The Australian Government reduced the gouda production subsidy at the same time that the Dutch increased theirs. It was after this (when the JV ended) that Jack Maguire offered JN a job because he was no longer welcome in Snow. ... consequently he is not always welcome in high level discussions between MG and SB. (PE:MG).*

MG Manager WS comments on the failure of the JV:

*I suspect for a while there was some animosity because the company (SB) thought it had been let down. ... But it was to do with the pricing policies of the cheese going into Japan. ... and there was a swing away from Gouda to cheddar (WS:MG).*

Substantial technology transfer from Snow Brand to MG occurred with the making of the gouda. As well, MG obtained the exclusive services of JN, one of the most experienced dairy technologists at the time in Japan. JN did not loose his contacts with Japan after his permanent removal to Australia. Skilled in the practice of Kendo he continued to travel regularly to Japan for lessons from his master. Reflecting on almost twenty years of service with MG, PE considered:

*We could not have succeeded without him. He is respected in Japan, he can arrange access and appointments to critical places (PE:MG).*

#### 11.3.4 The changing industry regulation context

According to the General Manager Industrial Sales, 1986-87, was the "watershed year" in the Australian dairy industry when the export price equalisation scheme was abolished. MG then targeted the Japanese market, aiming to move away from a reliance on LIPC bulk tendering for powders and butter sales, towards more differentiated, higher value industrial product. PE comments:

*Under the old system ... returns were very much geared to quantity not quality... The legacy still lingers, with the focus on quantity sometimes - sales are called disposals rather than sales and so on (PE:MG).*

In 1991 MG stopped offering ADC product for the LIPC tender. In 1992 they began committing marketing, research and development dollars towards identifying Japanese market needs.

*We did not do it this way before. It's only in the last couple of years. ... Everything now is market development. It means getting out there in the market place looking for where opportunities might be (WS:MG).*

### **11.3.5 Technology transfer via the ADC: The case of Myalla and Goshred:1985**

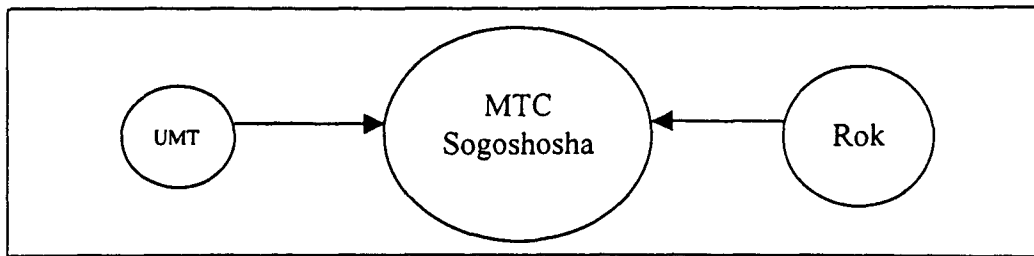
*Myalla* a type of pizza cheese had been developed through a joint venture between Rok, MTC and UMT. ADC management had intervened in this relationship at the invitation of UMT by insisting on their statutory right to sell all Australian bulk cheese to Japan.

Having taken over the trading of *Myalla* the ADC technologists then transferred technology to assist the three biggest Australian owned manufacturers (including MG) to manufacture "Goshred" a copy of the very successful *Myalla*.

Goshred became one of MG's most valuable exports. ADC introduced them to Chesco, a powerful participant in the new Goshred network. Chesco was the biggest specialist cheese importer, packer and distributor in Japan<sup>25</sup>.

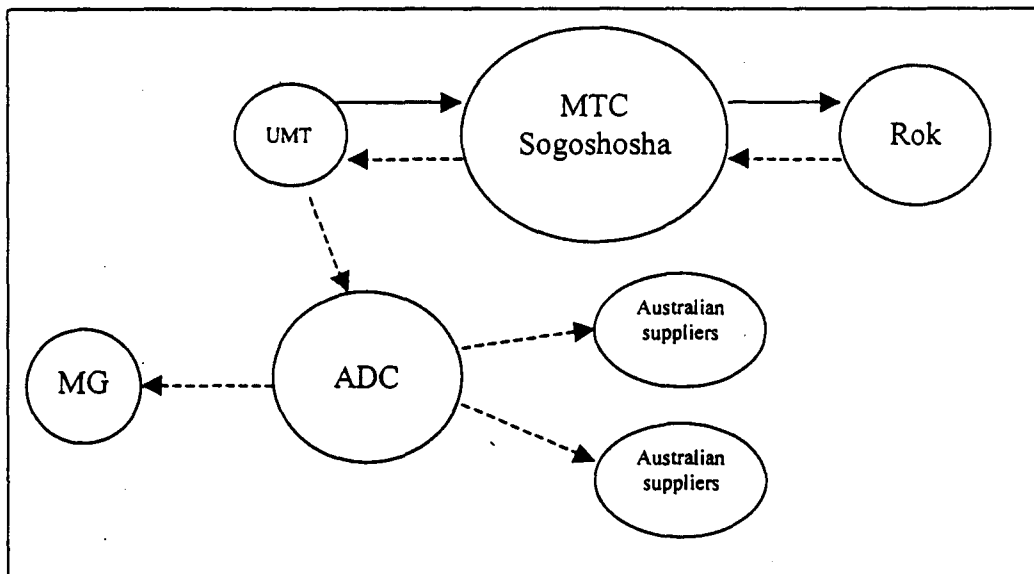
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<sup>25</sup> For a more detailed discussion of this market development see the ADC case study.

**Figure 11.7: UMT – MTC – Rok JV to Produce Myalla****Key:**

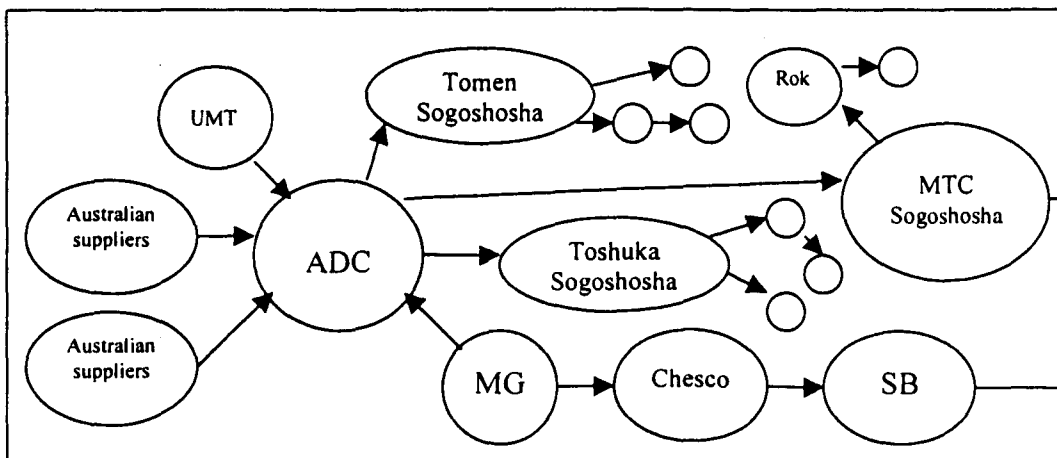
Technology exchange -----&gt;

Product transfer -----&gt;

**Figure 11.8: ADC Transfers Technology from Joint Venture to Australian Suppliers Including MG****Key:**

Technology exchange -----&gt;

Product transfer -----&gt;

**Figure 11.9: Network Expansion and Re-positioning**

### 11.3.6 The alliance to produce Mozzarella: 1990

With the matchmaking assistance of the ADC, MG embarked on a three year product development in order to replace UK and USA imports of mozzarella for a Japanese pizza chain: Tolerno.<sup>26</sup> GM's mozzarella was sold on to Tolerno via ADC through another new network dominated by the Itochu Trading Company, a major competitor with MTC. Thus the ADC weakened MTC's position in Australian export networks, while helping MG reposition.

### 11.3.7 Managing their admission to new networks

The goshred and the mozzarella developments were undertaken without the involvement of their first JV partner, MTC. Both strategies did in fact weaken the position of MTC in ADC's networks. MG management recognised the difficulties in managing their relationships with trading partners like MTC:

*companies like ours who rely on exports may well have to look for alliances with overseas companies. But you see if you ally yourself with one you can cut your throat with others. You have to be very careful of these things. The competitiveness between some of these companies is such that they would not be too happy about you getting too close to another and they would cut you off. ...You are dealing with that power play all the time. ...*

*The over-riding factor that controls everything in this exercise is the relationships and network of ownership between the traders and companies- who owns who- I mean its like working yourself through a minefield. You find that these trading houses have substantial ownerships in various companies, not that they are an exclusive supplier ... but they have an awful lot of control. Superimposed on top of that is the pecking order of the trading houses. And some of the trading houses that show a little sign of fire in the belly from time to*

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<sup>26</sup> See also the ADC case study

*time, when you actually sit down and challenge them to be a little more aggressive in the market they back off. They are not going to upset that pecking order. ... at all times you have to be aware of it. Lets face it, MTC is the largest of them ... (although) some are still very big... they are not going to do something that maybe MTC might feel upset about because of their total network (WS:MG).*

MG management reflected on the new sensitivities of trading houses:

*The trading houses ... now feel very threatened because of deregulation*

...

The need for direct communication with the trading houses customers was seen as a matter of survival for MG: PE commented:

*the most awesome thing for us, is trying to move out of the commodity market into the customer specific market (WS:MG).*

*We want to develop new products in conjunction with the end user. It is therefore essential to have direct access to the end user so we know exactly what is wanted now and in the future (PE:MG).*

*We have screaming matches here in my office and in Japan with them. We say we must have access to your buyers. Of course they always fear that we are trying to go round them (PE:MG).*

WS, technical manager detects a changing attitude:

*However, I think there is now a realisation by the Japanese that they are not going to make progress unless the manufacturer and the user can at least talk to one another about particular technical issues, for example, how that product has to perform. Because communication at the best of times is never good, and if it has to go through six different hands along the way and maybe several translations then by the time*

*you get the message it does not bear too much relationship to what the customer really wanted. ... Twenty years ago the trading houses would not have let you get past the front door ... They wouldn't even have told you who their buyer was...*

*We know what our capabilities are. We need to eye ball the customer, in particular when you have a language barrier. This does not just mean when you are talking about fancy new products, most often it is just a line distinction. It still means talking to them to find out what the customer actually wants (WS:MG).*

In 1993 PE also noted the growing opportunities:

*There are now about seventy other manufacturers besides the very big ones who are allowed to get a licence to import a few tonnes. MG is in touch with most of these. With liberalisation coming up most companies are trying to get direct access to the supplier or vice versa (PE:MG).*

Trying to gain access to the Japanese manufacturers via their agents was considered an important strategic task by MG management. They acknowledged the need for their agent to trust them in "eye-balling" the end-user. WS and PE of MG explain how they try to build up the appropriate relationships:

*... through personal contact. It is the only way to cultivate it (ie trust) (WS:MG).*

*Trading products into Japan is a political game. You have to behave like a political animal. ... Probably 50% of our effort is spent on analysing who we are dealing with in the company. We do this through frequent visits to Japan ... (I go) seven or eight times a year (PE:MG).*

The trading houses however strive to maintain the status quo in the supplying-buying-selling relationships in the networks. They aimed to keep any conversations between suppliers and users restricted to technical issues.

*It is a rare occasion when we visit a customer in Japan in the absence of either the ADC or a trading house. It happens, and the frequency of it happening is increasing. But always only at the customer's request. They are coming to us directly now... (But) we will not even talk to them about something not already existing because then you really stand the risk of treading on someone's toes. (But) at least you can say, well, they came to us (WS:MG).*

Such compliance with the codes of conduct expected of an industrial supplier help to explain why the only significant new networks entered by MG between 1980 and 1993 were those the ADC initiated.

#### **11.3.8 A new alliance: Mitsubishi-MG and Meiji**

In 1992 Tatura Milk Products and Snow Brand entered an alliance to produce infant formula for re-export to South East Asia<sup>27</sup>. Bonlac, MG's main competitor in the domestic market also undertook to invest some \$10 million in new plant as part of this alliance. Meiji, previously a buyer of TMP product through MTC no longer purchased TMP product after this alliance.

In 1994 MG, MTC, and Meiji (a member of the MTC family) formed an alliance to manufacture infant formula for export to South East Asia (ie in competition with Snow Brand) A \$40 million investment created a new factory near the site of the original gouda JV in Cobram. The product was branded Meiji and distributed by MTC.

MG was fully aware of the potential for retaliation and loss of sales to manufacturers like SB and Chesco (a member of the SB family). To overcome this they aimed to

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<sup>27</sup> See Tatura Milk Product case study for details of this development.

retain an independent factory status, supplying powder to the separate Meiji-MTC entity.

The Meiji-MG relationship brokered through MTC went back to the 1960s. MTC had imported MG product for Rok at that time. In 1981 during the drought MG had defied the ban on export of product to Japan to supply Meiji with powders for its infant formula. The relationship between the alliance partners was therefore acknowledged to be long standing by other Japanese buyers.

### 11.3.9 Preliminary Analysis

The challenge, enunciated by MG management in 1993, was how to manage their trade relationships in such a way that they gained access to end-users, and were not cut off from opportunities presented by the new generation of internationalising manufacturers in the deregulated and diversifying Japanese markets.<sup>28</sup>

## 11.4 The Peters Browne Ice-Cream Case Study

### The actors participating in the evolving network

Mitsubishi Trading Company

Bordens USA

Bordens Japan

Meiji

Peters and Browne Pty Ltd

Mitsui Trading House

ADC

Morinaga

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<sup>28</sup> In 1996, MS left ADC and became the new international marketing manager for MG. There he felt his first task was to convince Japanese manufacturers that the MTC-Meiji venture was not a marriage but a simple association, which posed no threat to other buyers (MS:ADC:MG).



**Peters & Browne Group Ice cream (PB)**

PB grew from a small farm dairy started near Perth (WA) in 1886. By 1992, PB was the largest producer and distributor of frozen and chilled foods in WA. Fifty percent of its business was in liquid milk supply. The Group employed 1100 people in enterprises including the manufacturing and distribution of ice cream, dairy and meat products. turnover in 1993 was approx \$300 million. In 1992 the PB accounted for 80% of all Australian ice cream exported to Japan while WA was responsible for generating only some 4% of the total milk production of Australia (Dept of Ag WA 1994). In 1993 PB was also licensed to export ice cream under various brands to Hong Kong, Singapore and Malaysia. They export 50% of production.

**Informant**

Stuart Johnson (SJ:PB), Manager, Research and Development, PB, Perth WA.

**Bordens**

A multinational manufacturer of dairy products, including premium single serve ice creams with its head office in the USA.

**Informant**

Kazuo Matsuyama (KM:B), President, Tokyo, Japan. (KM:B)

**Meiji**

A major manufacturer of dairy product in Japan with 28 plants. Major shareholder: MTC Trust Bank, main business: milk and dairy products (ice cream is 12% of their sales), soft drinks, agricultural products and animal feeds, pharmaceutical and cosmetics, the management of recreational facilities, restaurants and real estate. Number of employees: 1500, with turnover in 1990 of \$3,877million (ADC 1993).

**Informant**

Kazuo Endo (KE:Mei), Manager, Purchasing Group, Purchasing Department Meiji Milk Products, Tokyo, Japan.

**Mitsubishi Trading Company**

Established in 1950. Japan's biggest General Trading Houses with 52 offices in Japan and 104 overseas offices. In 1993 they also maintained 69 main offices and branch offices in their overseas subsidiaries, including four in Australia. Worldwide turnover was some \$185 billion with 9,852 employees.(Japan Company Handbook, 1993) Their Australian food division contributed some \$300million to MTC turnover in 1993.(JA:MTC)

**Informant**

Toru Nakagawa (TN:MTC), Cheese Team Leader Tokyo, Japan.

**Mitsui Trading Company (Mits)**

Established in 1947, vied with MTC to be Japan's biggest general trading house. In 1993 it managed nearly 170 overseas offices, was second largest trader in foodstuffs after MTC, but was leader in chemical and steel trading. There were 8,929 employees.(Japan Company Handbook, 1993)

**Informant**

Yuichiro Yoshikawa (YY:Mits), Cheese Team Leader, Food Materials Division, Tokyo, Japan.

**The Australian Dairy Corporation**

**Informants**

Murray Sayers (MS:ADC )General Manager, International Sales, Melbourne.

Katsu Suzuki (KS:ADCJ), Senior marketer, ADC, Tokyo, Japan.

Shuichi Yameyama (SY:ADCJ), Sales Manager, ADC, Tokyo, Japan.

**Koiwai:**

Dairy manufacturer part-owned by the MTC founders family, Koiwai had some 8% of Australia's dairy exports in 1993

Kiyoshi Yamasaki, (KY:K) General Manager of Production Control Group, Production Department, Koiwai Dairy Products, Tokyo, Japan.

**Other case study informants:**

**NZDB Japan**

Joel Glasser (JG:NZDB); Regional Financial Controller, North Asia Divisional Office, NZDB, Tokyo Japan.

**Rokko**

Haruyuki Tsukamoto (HY:Rok) Managing Director, and General Manager, Rokko Butter Co. Kobe, Japan.

**11.4.1 Factors bringing PB into the Japanese ice cream supply network**

Bs, a market leader in high quality ice cream in the USA established a plant for manufacturing dairy product in Japan in 1971. This move to insider status overcame the Japanese import quota barriers imposed on cheese at the time (KM:B). As well, Bs did not have a west coast plant, making transportation of finished product or ingredients to Japan expensive. Over an eighteen month period, and with the approval of the Japanese

government Bs formed a JV with Mei, one of Japan's largest dairy manufacturers and distributors and a member of the MTC family. Bs then licensed Mei to manufacture product including margarine and their premium ice cream for domestic sales and distribution (KM:B). Most of the raw material for this production was imported from NZ, EC and Australia. The manufacturing licences were for a specified duration and renewable at the end of each period.

In the early stages of Japanese ice cream market development consumers were prepared to pay high prices for well established European brand names. The brand names created a sense that the product was "the real thing" (HT:R).

*Common ice cream usually cost about 250 yen per quart but Bs cost 850 yen per quart so it was absolutely at the premium end of the market. .. Carnation and other USA and Japanese companies all tried to copy Bs success but they failed. Haagan Vaas was the only other one that had a similar super quality (KM:B).*

In 1989 Japan liberalised market access for processed cheese and ice cream, removing quotas and imposing tariffs of 40% and 28% respectively (ADC 1993). Thus the original motivation for manufacturing in Japan became less potent.

Since the 1970s eating ice confections in public and in the home had become more common in Japan.

The Bs-Mei JV had captured some 80% of the premium ice cream market, 15% of the processed cheese, and was increasing share of the margarine market. Growth in sales had been a steady 5% on average (JG:NZDB). Commenting on the "divorce" JG, himself a veteran of a Japanese-US company JV explains:

*The fundamental issue was the growth of the business. Mei wanted slow, steady growth at three to five percent, while Bs*

*wanted a much more aggressive market approach and a much more aggressive profile.*

*Ultimately Bs management said we can't talk anymore, it is divorce. They were able to separate from Mei in stages because each of the product lines, processed cheese, ice cream and margarine were under three separate agreements dated to expire about a year apart. As each agreement expired they were not renewed by Bs.*

*Bs could have salvaged the JV if they wanted to, but instead it left Mei with no brands to manufacture and a huge uncommitted production capacity in their factories.*

*So Mei introduced their own premium ice cream brand to take up the production capacity no longer needed for the Bs product. Bs immediately took Mei to court in the USA for breach of technology- information agreements.*

*They were airing their dirty linen in public and this is absolutely against Japanese business customs.*

*In the end Bs did terrible damage to themselves. Only rarely in Japan is litigation used to resolve problems. ...*

*Japanese Inc responded to the messy situation by saying they would not do business with people like Bs. So they had them unofficially "delisted". They had their product taken off the shelves or out of the freezers in the supermarkets. This was brought about by people like MTC and companies like SB.*

*After the divorce Bs hired about 100 people as sales staff. They also built a new factory at a cost of 4-5 billion yen. This*

*was about four years ago (ie 1990) and it was a huge investment. It got into trouble straight away. The plant is now up for sale (JG:NZDB).*

MS:ADC4 explained further:

*Bs had problems buying the land for their new factory in Japan, and then they had problems setting it up. No one wanted to cooperate. They finally got the factory going but their continuity of supply to the Japanese supermarkets had been broken. And there were other things going on.*

*At the height of the problem, after they had missed a season and were desperate, the Bs President from USA flew to Japan and got the USA ambassador for Japan to invite all the presidents of the supermarket chains to a dinner. Because it was an invitation from the ambassador they could not refuse. The embassy pleaded with the supermarkets to put Bs product back in their shops. In other words they were trying to use their muscle, but it did not work. When the supermarket buyers were told about it they were furious. But they were under an obligation to take some product. So they did, but only for three or six months, then it was dropped.*

*Unfortunately Bs thought these orders were permanent and used them to make their forward projections of 50% of previous sales but the best they ever did was 25%.*

*Tip Top NZ had been given orders for ice cream by Bs based on their 50% market share projections. But when they reduced orders to reflect the 25% Tip Top was left with spare capacity. So MTC offered to buy it and they supplied the same ice cream but different*

*brand to Daiei supermarkets at about half the price. This was advertised as being the same recipe and ingredients as Bs. So that really finished them off (MS:ADC4).*

The new Japanese president of Bs Japan, KM:Bs explained the off shore manufacturing arrangements that were initiated following the dissolution of their JV and the failure of their new Japanese factory. At the time of interview PB was still manufacturing their product.

*Unfortunately three years ago we divorced Mei ... so we now manufacture in NZ and Australia. We found only one company in NZ able to supply the ice cream (TipTop) and two companies in Australia (PB and Unilever). Japan requires very strict sanitary requirements for food imports. The bacteria count in ice cream must be zero. To make ice cream to this standard is completely different to how Australian ice cream is usually made so they had to learn.*

*Unilever could do it but they did not want a licence agreement, they wanted to export their own product. So in the end only PB in WA was acceptable.*

*We sent technical people to PB, partially rebuilt the plant and helped them finance a new filling and packaging machine. Everything except the milk was supplied virtually. We also organised USA flavouring and transportation from Australia.*

*At first we imported from NZ as well as from Australia. But then NZ used the same recipe and exported the same product at half the price to Japan supermarkets. It was even advertised as having the same ingredients.*

*About every second month we visit PB in Perth. We brought their technical people to Japan.*

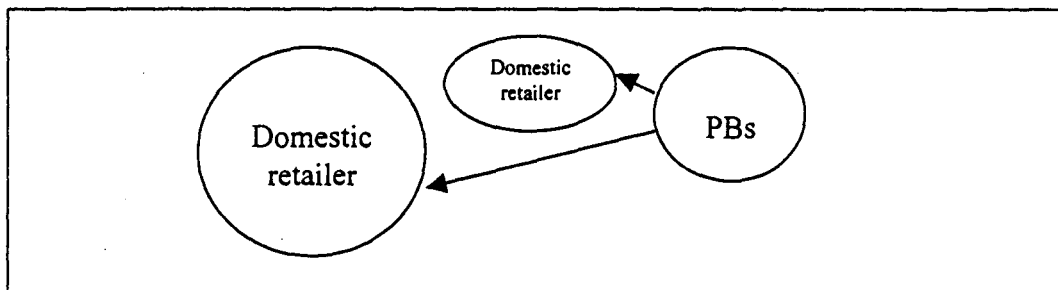
*Bs do not have a huge investment in PB. They have a written agreement to make Lady B Classic. Bs ice cream production now takes up two thirds of the capacity of one PB factory and one third of another.*

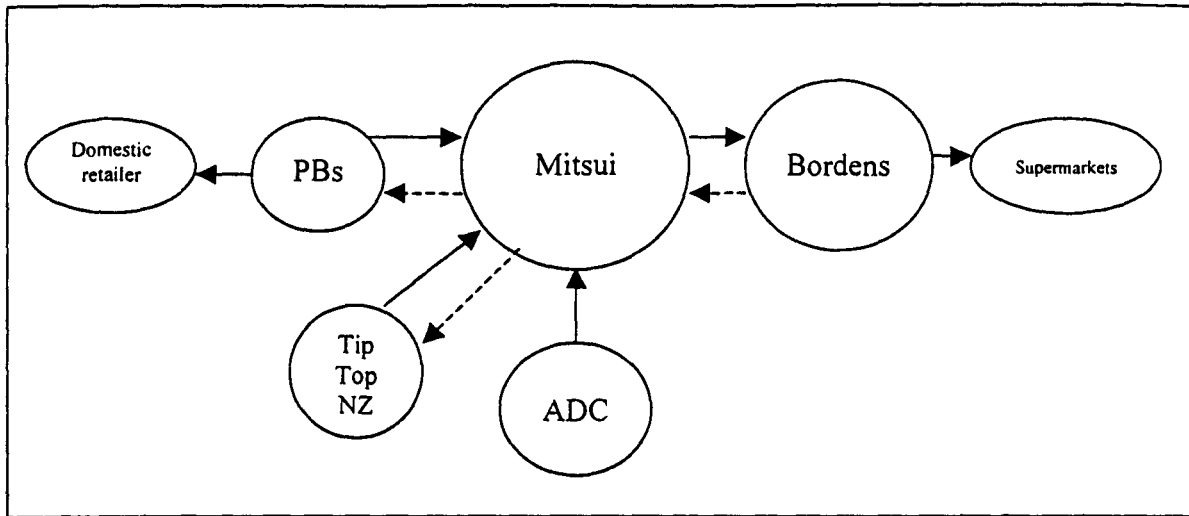
*Other Japanese companies have also rushed to Australia and NZ to try to get good suppliers to rival us. But PB always asks us if they may talk to others (KM:Bs).*


Divorce from their main JV partner Mei brought Bs into head-on conflict with Mei's family member, MTC. Their response was retaliation. TN of MTC explained:


*We do not do any business with Bs since their divorce and the trouble with Mei. We may recommence after a few years if things have settled down (TN:MTC).*

**Figure 11.10: Initiating Channel PB before Exporting**



**Figure 11.11: The Network Expands with a PB-Mits-Bs Alliance****Key:**

Product exchange    

Technical exchange   

When Mei and MTC severed their exchange relationship with Bs, Mits saw an opportunity to convince the ADC to admit them as the fifth official ADC trading house. While such a move may have been high risk for a less powerful trading house, SM:ADCJ made the point: *Mits is strong enough to deal with MTC. It had nothing to loose* (SM:ADCJ).. YY:Mits explains their interest in assisting Bs to find suppliers:

*Mits first imported some Australian butter fifty years ago. However, MTC had tied up most of the overseas markets since. Six or seven years ago there was no Cheese Leader in Mits but we were always seeking opportunities. One person was key to Mits. He was head hunted to Morinaga<sup>29</sup> but he was still considered an employee of Mits with the special task of strengthening relationships between us. The Morinaga president liked him a lot and he was always very keen on dairy imports.*

<sup>29</sup>

Morinaga Milk Industry Co. Ltd was established in 1917 and is Japan's third largest dairy manufacturer. It has production and ownership links with around 60 domestic subsidiaries. Morinaga is one of Japans leading suppliers of ice creams (ADC 1993).



*This person literally tapped on doors looking for places for Mits that were not already tied up. No one had Norway. Toshuku and MTC had tied up Denmark and we had to respect their ownership of this territory.*

*In the first instance very early in the piece Mits was offered official Trading House status by the ADC but we rejected it. Then after we tried to get in. ... two years ago (in 1991) we knocked on the ADC door again and this time we could offer the Bs and the UMT deal.<sup>30</sup> So we set up the special arrangement with Bs in Japan to use PB.*

*Six years ago our total volume was 1000 tonnes of imported cheese per annum. Now it is 7000 and we are aiming for 10,000 tonnes per annum.<sup>31</sup> We are building to three in the cheese team.*

While the UMT and Bs-PB deal delivered the long awaited ADC official trading house status to Mits, they did not have sufficient cool storage, distribution channels, transport or equipment to immediately handle the new and specialised business of ice cream importation. Their old friend Morinaga stepped in and supplied these services, depending on the protection of Mits to ensure no retaliatory action from MTC.

#### **11.4.2 Network repositioning 1993**

The Mei-Bs divorce brought substantial changes in membership in Bs ice cream market network. The manufacturer Mei was replaced with PB and Tip Top and MTC was replaced by their rival Mits. With the removal of Tip Top as a supplier and the failure of the Japanese Bs factory, the network evolved further to give PB exclusive

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<sup>30</sup> In 1991 Mitsui invested \$4million in UMT a Tasmanian Dairy company

<sup>31</sup> By 1993 Mitsui had achieved a 3% share of Australia's dairy exports, which constituted 25% of their dairy product trading (MS:ADC).

supplier status. This left PB highly dependent on Bs with nearly 40% of their output dedicated to their licensed production.

In 1995 SJ:PB reflected on their experience with Bs during the growth and collapse of their trade relationship.

*We were exporting small volumes of ice cream to Japan before the quotas were lifted (ie 1990). Prior to that only one tonne per shipments were allowed.*

*In 1990 when Bs split with Mei we picked up half of Bs business, with Tip Top in NZ supplying the other half. It was a three year deal.*

*About half way through the three year period Bs decided to source all their ice cream from PB in Australia, and to drop the NZ supplier.*

*Bs wanted to milk the cow and make the ice cream within 24 hours. We accommodated them. Two technical people would come from Bs for two weeks at a time to advise on technical issues.*

*Forty percent of our production was going to Bs, when they had the 50/50 deal between us and NZ Tip Top supplying them.*

*Mits handled the shipping for Bs. They specially selected containers just for us. Specially washed them, put on special plugs, modified the trucks bringing the containers. They actually put the generator on the truck. We changed the loading system so that instead of taking two hours it only took ten minutes to load a container. That meant that the ice cream did not have time to melt at all and start crystallising.*

*By mid 1994 it was all over. No more ice cream was going to Bs in Japan. They were bought out by Lotte which now manufactures Bs Brand (SJ:PB).*

#### **11.4.3 The effect on the reputation of Peters WA**

Bs only survived eighteen months in Japan after they had licensed PB to supply their "classic" premium quality ice creams. However, PBs preparation for that supply required them to become a substantially more technologically sophisticated food manufacturer. The technology transfer and direct supervision of Bs and Mits had transformed the ice cream maker into Australia's most efficient and quality conscious producer. According to SJ:PB:

*PB is the best ice cream in the world. We are the most modern ice cream factory in Australia. We have the only laboratory in Australia registered with Japan which means you can conduct tests on the product here in our factory.*

*We have high quality ice cream - and a new factory built around TQM. We have world's best practice with a demonstration program. We got funding for that from the Federal Government.*

The management at Koiwai however reflected on the demise of Bs and the reputation of their supplier in the Japanese market.

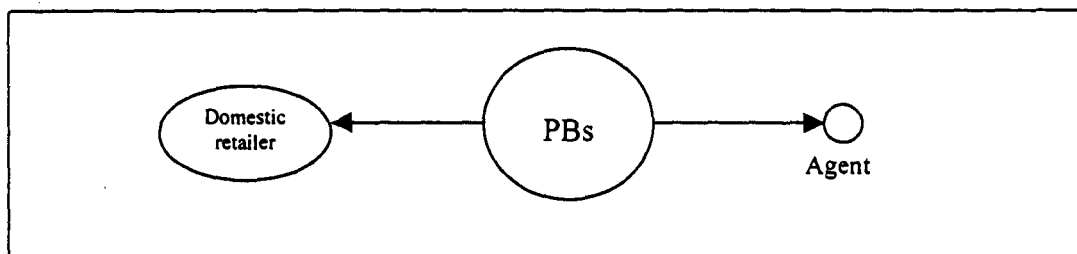
*Bs has crash landed on the Japanese Market. Last month they were importing ice cream from Western Australia but they had to stop because of supply, cost and quality problems. Mits who is helping out Bs is in trouble with it (KY:K).*

In 1995 PB reported on their exporting performance since Bs collapse:

*We have learned not to put all our eggs in the one basket.  
 We have been exporting to ROK in the last twelve months.  
 We have three to four small main customers now in Japan. Mits  
 found these.*

*Due to the recession we are selling cheaper lines there now.  
 We may be able to supply Lotte in the future perhaps (SJ:PB).*

**Figure 11.12: Network Contraction after 1993**



#### 11.4.4 Preliminary Analysis

The evolution of ice cream marketing networks following the dissolution of the twenty-year Bs-Mei JV relationship repositioned PB in the Australian export and domestic ice cream market. The transferred technology made them more competitive. Their dependency on Bs had also brought them close to financial ruin when forty percent of their sales were suddenly lost. As well, their short lived association with Bs tarnished their reputation as a reliable supplier of quality product in Japan.

Mits used the opportunities created by the Bs-Mei divorce to access a better supply of a range of product demanded by its customers. At the same time it assisted in reducing the power and centrality of MTC in the Australian dairy product export networks.

### 11.5 The Tatura Milk Product's Case Study

**The actors participating in the evolving network:**

The Tatura Milk Products Ltd  
The Mitsubishi Trading Company  
Snow Brand Pty Ltd  
The Australian Dairy Corporation  
The Murrumbidgee Milk Products  
The Bonlac Dairy Cooperative  
Key West  
Nestles  
Conga (An Italian trading company)  
Toppa Icecream  
Life Guard Milk  
Streets Icecream

**Tatura Milk Products (TMP)**

Tatura Milk Products is one of the smallest but oldest dairy exporters in Australia. TMP was established as a butter factory cooperative in a small town in irrigated dairying country in Northern Victoria in 1907. TMP remains at the original site with various additions to factory buildings over the years, including the construction of a farm merchandise store.

Butter production grew from 230 tons per annum in 1930, to 501 tons in 1940, 1106 tons in 1950, 2146 tons in 1964, to 5000 tons in 1984 (History of TMP:1992). In 1962 the company name was changed to Tatura Milk Products (TMP) to reflect their diversification into cream and powder production. In 1992 TMP's after tax profit was \$3.115 million, a 15.1% increase over the previous year (Annual Report 1992).

TMP exported 50% of its product in 1994, which represented approximately one third of their turnover.

The company takes pride in its low turnover of staff. In 1992 25% of the 160 employees had been with the company more than ten years (TMP:1992).

In 1960 JF became Manager of TMP, a position he held for 20 years. In 1970 JF made his first trip to Japan seeking overseas sales for butter and milk powders, given the expected

loss of sales to UK. ADC introduced him to MTC and members of their "family", SB and Mei. In 1974 NL then a technical officer accompanied JF on his second trip to Japan. In that year the first sales of SMP to MTC took place, with ADC acting as agent.

**Informants**

Neil Lowe, (NL:TMP) Managing Director, 1959-.

NL became GM in 1980. His role included marketing and sales. NL was one of the Cooperative's five directors, the others being dairy-farmer suppliers.

Barry Lieditch (BL:TMP) Assistant Manager. 1974-

BL had spent his working life with TMP.

Paul Hansen (PH:TMP) Production Manager. 1968-

PH had spent his working life with TMP.

**Mitsubishi Trading Company**

**Informant**

Toru Nakagawa (TN:MTC) Cheese Team Leader, MTC, Japan. TN spent two years in the Melbourne Office of MTC.

**Koiwa Dairy**

**Informant**

Kiyoshi Yamasaki, (KY:K) General Manager of Production Control Group, Koiwai Dairy Products, Tokyo, Japan. Koiwa is a substantially owned by MTC.

**Snow Brand**

Biggest dairy manufacturer in Japan, once close to MTC.

**Informants**

Masahiro Dantsuji, (MD:SB) Managing Director, Melbourne Office, SB.Australia.

Hiroshi Ishikawa, (HI:SB) Procurement Section, International Department: Snow Brand, Tokyo, Japan.

**Toshuku Trading Company**

Toshuku imports 25-30% of its needs from Australian manufacturers and the ADC.

**Informant**

Jun Ishii, (JI:TSS) GM, Dairy Products Division, Japan.

**The Australian Dairy Company**

**Informants**

Minoru Shimizu (MSh:ADCJ) Chief Representative, ADC Japan.

Murray Sayers, (MS:ADC) General Manager, International Sales, ADC Australia.

Chris Phillips, (CP:ADC) Manager, International Planning ADC, Australia.

Jans Krysel, (JK:ADC) International Research Melbourne

### Rokko

A dairy manufacturing close member of the MTC family,

### **Informants**

Kohji Hotta, (KH:R) General Manager, Rok Butter Coy, Kobe, Japan.

### Meiji

Second biggest dairy manufacturer in Japan, and a close member of the MTC family.

### **Informants**

Kazuo Endo, (JE:Mei) Manager, Purchasing Group, Japan.

### **Documentary Sources:**

Tatura Milk Industries (1992) The History of the Tatura Milk Factory, Tatura.

Tatura Milk Industries, 1992, Annual Report.

NL explains the aims of TMP:

*Our mission statement says that we are a flexible low cost supplier of fine food ingredients. We don't believe in total integration into the market place (NL:TMPb).*

TMP does not have a significant product research and development capacity. It maintains one employee in a small laboratory who fine-tunes product specifications, for example checking powder blends ordered by buyers. TMP has always relied on technology transfer for new product line development, usually via joint ventures or long term agreements. As well, TMP has always prided itself on low staff turnover, and the "hand on" experience and leadership of its senior executive. NL:TMP feels his personal involvement is one of the keys to their success in developing loyal relationships:

*Another thing is that when Bonlac goes to talk to SB, for example, they would just have their marketing person go along, but I go as the MD. And this is important (NL:TMP).*

### 11.5.1 The first domestic joint ventures (JVs) in 1951

TMP diversified from butter to milk powder production with the assistance of a JV with the Australian companies Toppa Ice Cream and Life Guard Milk. These companies rented a section of the TMP factory and installed their own roller drying plant. TMP staff and management were then introduced to new technology and product lines.

Streets Ice Cream then bought out Toppa and Life Guard, but were not particularly interested in maintaining the low profit production of the line of powders produced with TMP. In 1958 TMP purchased the old JV partner's equipment in their buildings and the relationship was amicably dissolved.

### 11.5.2 The Murrumbidgee Milk Products (MMPs) and TMP JV:1975

TMP diversified into cream cheese making through technology transfer via a JV with SB and MMP. This gave TMP an export product that needed direct negotiations with buyers. Creamed Cheese was not regulated to be sold via the ADC.

MS of the ADC describes the evolution of the MMP-TMP JV:

*In the 1970s MMP based at Wagga Wagga<sup>32</sup> was given creamed cheese technology by SB, so it could get good, low cost product through to Japan. MMP then got into trouble because of milk supply problems so we suggested to SB that they ask MMP to get TMP to help them. They had a much more secure milk supply. When MMP and TMP formed the JV, TMP naturally also got the creamed cheese technology.*

*Then Bonlac bought up 60% of MMP and after a while it started to make and export creamed cheese. This was despite an agreement between SB, TMP and MMP that theirs was an exclusive arrangement (MS:ADC).*

<sup>32</sup>

Wagga Wagga in New South Wales is a less well watered, hotter, and hence less productive dairy supply area compared with the Goulburn Valley where TMP is located.



NL:TMP describes the MMP-TMP JV evolution, including the early matchmaking role of the ADC.

*The ADC Japan office identified that there was a creamed cheese market in Japan<sup>33</sup>, and Snow was going to need it, so ADC and Snow Japan got together and came back to the MMP in Wagga and said are you interested in manufacturing this type of product for Japan. And Snow actually had a technical input into that. Snow actually had people down to help them, although Wagga now says that's bullshit.*

*And then what happened, three years later, because Wagga was in NSW, they could not get enough milk to meet demand so MMP approached us and we set up a JV here with them. It was our second cheese plant. We called that: Tatura Cheese Industry.*

*SS: Why didn't Snow simply go to Kraft and get some of their creamed cheese.<sup>34</sup>*

*NL: Well, basically ADC does not like to deal with a multi-national. <sup>35</sup> So, we had two plants. Then, what happened, Keywest made a takeover bid for MMP. This was the mad 1980s. And then Key West came to us and said why don't we buy the Wagga business, and we said we don't want it all, (they also had a milk plant) but we said we were prepared to buy the creamed cheese business.*

*So we brought everything down here, that included the cream cheese brand and everything. But I was naive in those days and I said that they*

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<sup>33</sup> The food fad of eating an Italian inspired confection *Tirasimu* had creamed cheese as a key ingredient.

<sup>34</sup> Kraft has factories in Victoria which produce Philadelphia Brand Creamed Cheese, the biggest selling brand internationally and domestically in Australia.

<sup>35</sup> Note the role of the ADC as a matchmaker between Snow Brand and the Australian suppliers.

*(Key West) were not to set up in opposition selling creamed cheese for two years, and I should have said not for five.*

*And then Key West sold off the milk processing part to Bonlac. At that time Bonlac was just formed and they were buying up everything. So they bought the processed MMP milk plant and two years later they started up the cream cheese making in Wagga again.*

*And then they went to SB and said they wanted to sell them creamed cheese again. But they shit their nest. SB argued that, look, we started you up (ie MMP) and gave you technical advice and then you went and sold it off to Key West. We gave it to you for \$3 and you sold it off at \$6 a share. You made money out of SB. Now you are coming back and you want a second dip. Anyway, the relationship between TMP and SB was well and truly formed by then.*

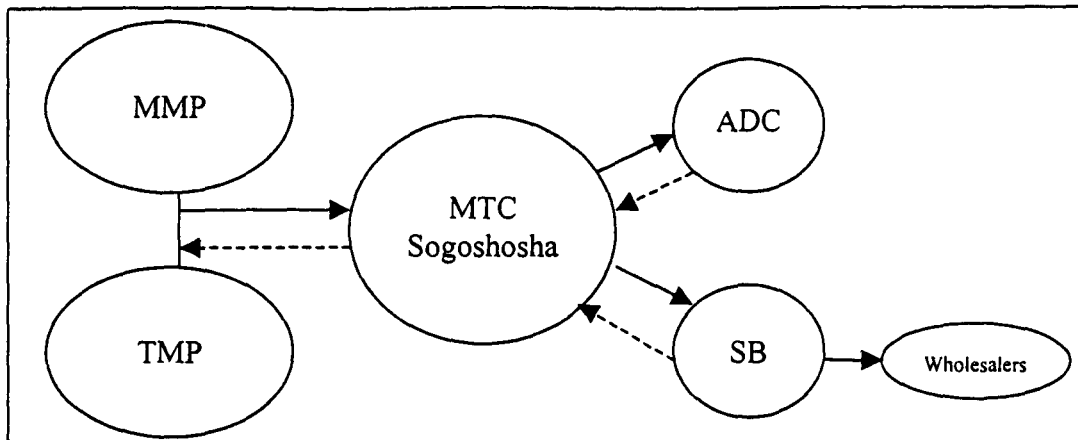
*SS: So SB didn't think you were also taking advantage of their technology?*

*NL: No. This is why TMP survives. People like Bonlac say people like TMP can't survive because we haven't got brands. But they don't realise, and its pretty elementary, that TMP has built bridges. And this is just one example (NL:TMP).*

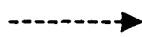
While MMP had not broken the two year agreement imposed by TMP, SB still refused to consider their offer reminding the new entity of their failure to respect the earlier relationship that had delivered valuable technology and long term sales to Japan's biggest manufacturer<sup>36</sup>.

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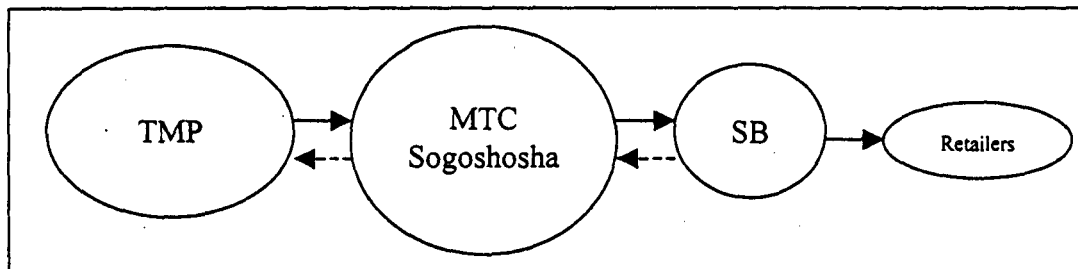
<sup>36</sup> Lactos Managing Director, (RW:Lac) has observed (see Lactos case-study) that despite Lactos offering a cheaper but similar quality creamed cheese product to Mitsubishi, the Trading House continued to buy from TMP at 10% higher prices because of its long standing relationship with TMP.

**Figure 11.13: Cream Cheese Strategic Alliance 1970's****Key:**

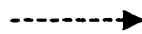
Technology exchange



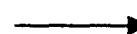
Product transfer

**Figure 11.14: Network Contraction: Strategic Alliance after MMP Sold Out****Key:**

Technology exchange



Product transfer

**11.5.3 Cooperating with domestic manufacturers**

NL of TMP explained that strong cooperative relationships with other dairy manufacturers in Australia had provided long-term benefits:

*We've built bridges with Yoplait, we've built bridges with Nestles, I mean, we've been taking milk off Nestles at peak time for five or six years when they cant handle it. We turn it into milk powder. This is doing them a favour. We've been working together for ever... you get really close to one another after a while.*<sup>37</sup>

<sup>37</sup>

Nestle is located at Strathmerton and Kraft is at Tongala other small towns also located in the

#### 11.5.4 The TMP-MTC-C joint venture 1988

TMP's venture with MTC and an Italian wholesaler C failed when neither the huge Japanese trading company or the Italian partner had the technological expertise to transfer to ensure sufficient quality in TMP's new product. The JV's aim was to supply a mozzarella type cheese to the newly emerging Western style fast food chains in Japan. The partners jointly funded a new section of factory and equipment at TMP.

TN:MTC of MTC was personally involved in this JV's establishment while based in the Melbourne office. He describes the consequences where the technological expertise of the manufacturing partner did not match the distribution and marketing power of the other two participants:

*There was once a JV between TMP and MTC and C (an Italian trading house). C also owned a wholesale winery in Australia, Mitcheltons.*

*The JV was a cooperative agreement which lasted from 1988 to about 1991. We named the JV company Tyldon Valley. It failed because there were no technical people to achieve the right quality of product at the Tatura factory.*

*The objectives were to produce Italian type cheeses for the Australian market. I knew the C people because they were selling us instant type noodles. They were also the major importer of Jarlsberg into Australia so they had some experience of cheese trading.*

*Tyldon Valley also owned the Scoop Icecream Brand™, but we had a series of cold summers and that stopped icecream sale*

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Goulburn Valley, within 20 ks of Tatura.

<sup>38</sup> This brand had been left over from TMP's first JV with Australian Toppa and Life Guard.

*expansion. So we concentrated on the Italian style cheese manufacturing.<sup>39</sup>*

*TMP was to manage the production. That was to be their job. However there were always fluctuations in quality. It was just not good enough. This was TMP's fault. We could not help because there was no Japanese technology expertise in making this new sort of product. We then sold out of it and the proceeds of the sale have been redistributed back, 25% to MTC and 75% to TMP and C (TN:MTC).*

MTC blamed TMP for the enterprise failure and as a consequence allowed this smallest actor in the JV to carry its debt exposing it to the gravest financial consequences (NL:TMP). This episode remained as a beacon in the shared corporate histories of the companies, to be raised by NL when MTC accused TMP of opportunistic behaviours and a lack of loyalty.

*And I say to MTC how we have been a third shareholder in a cheese factory venture including them, some Italians<sup>40</sup> and us. We sold milk to this venture and it got into cash flow problems and we carried the bill for \$420,000 for twelve months and MTC and the other company never paid us. We could have sent it bankrupt but we carried it. And I say: "but you don't trust me but I carried you for twelve months and I went through all this". And then when it is all finished we go out and we all drink grog together, and we all tell each other how wonderful we are, and we're all friends and forget about business (NL:TMP).*

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<sup>39</sup> This was the time of the explosion of demand for the mozzarella and other Italian melt-stretch type fresh cheeses for fast foods in Australia and Japan.

<sup>40</sup> This reference is to the JV between TMP-MTC and C to produce Italian style cheeses.

### 11.5.5 The consequences for TMP as SB seeks to reposition

TMP's first export trading relationships with SB were established when SB was supplied through their agent MTC. With deregulation and more international experience SB later sought to buy directly from its suppliers. TMP management expressed their appreciation of the dangers of responding to the direct overtures from SB, but at the same time NL wanted to accept the new supply opportunities presented.

NL describes his efforts to placate MTC when he is accused of breaking the network rules. He appeals to SB in an effort to reduce their vulnerability:

*They (MTC) turn around and say to me "you should not do that." And I argue: "you have got MTC, one of the biggest companies in the world and SB, one of the biggest companies in the world, with little Tatura in between, so why kick Tatura, you sort it out between you. "*

*We have had this three way relationship: TMP-MTC-SB. We've sold creamed cheese that way, we've sold milk powder that way. Its been ok. Now SB have set up a trading arm in Melbourne and they want to take some product direct. They are now saying any new development or product they will take direct. That's their sneaky way, and that's what frustrates me, for two reasons: One, I say to SB: "you sort it out with MTC and then you tell me what to do." But then MTC applies enormous pressure on me. Like two trips ago when this SB thing was announced, this new infant powder TMP-SB deal. I said: "have you talked to MTC?" And they said, "oh yes".*

*And then I end up with eight MTC executives on one side of the table and me by myself on the other and they talk about distrust and all this rubbish. ... Its just unbelievable.*

*..Its just a game, and last time I was there, first of all I went with SB to MTC. Then we told MTC that we had some private business to do*

*alone- something to do with the new infant formula project. But then when we were alone they (SB) said they want to buy more cream cheese direct Lowe San and I said, "yes, I accept."*

*Then we went out to dinner, a Chinese restaurant about an hour later, with MTC, SB, ADC, and TMP and I paid a third of this Chinese restaurant bill. And my share for nine people was \$500. And the big boss from MTC was there, and the big boss from SB was there, and I was sitting inbetween, and the guy from SB who an hour before had said we are going to do more business direct, he toasted the relationship between TMP and them and MTC, and then we toasted the relationship between SB and MTC, and he said "do you know Lowe San that Mitsubishi is the biggest supplier to Snow Brand of things", and the MTC man thanks the SB man very much and all that. And I'm sitting there looking across the table and thinking, you bastard, an hour before you tried to break this link, and here you are all drinking up telling one another what good people you all are. So you just have to wind your way through it. You shouldn't get upset and you have to be persistent.*

*SS : When you were setting up your new deal for infant formula with SB was MTC still saying "you need us too"?*

*NL : Yes, and SB was saying "no" to MTC. And I am saying: "for goodness sake, fix it up with them", but they wont do that.*

*SS: Why not?*

*NL: They reckon they don't need them.*

*SS: Difficult isn't it?*

*NL: No, its not difficult, its just understanding the business and knowing when to roll with the punches (NL:TMP).*

SB never invited MTC into the cooperative agreement between themselves and TMP to manufacture, market and export infant formula powders despite NL's pleading.

#### **11.5.6 Selecting a new alliance partner: SB and TMP**

MD:SB, based in the Melbourne office at the time of the forging of the new alliance explained the criteria used in selecting their partner for the production of infant formula. The significance of the asymmetry was apparent:

*Infant formula is a very high value added product. We looked at NZ where the NZDB has a monopoly marketing situation. That means if they produced our product they would also market it on our behalf. They already have two strong brands of their own, Anchor and Fern Leaf. They also produce our competitor's product, Mead Johnsons, Keritane and Bordens (USA) so we are concerned that they would not necessarily push our product.*

*Also NZ is more export orientated, and has more advanced technology than Australia so they are in a more competitive position with us.*

*The same company in NZ produces different infant formulas in the same factory, so we were also concerned about the security of our formula.*

*Even if we formed a joint venture with a NZ company we would still need the approval of the NZDB. They are getting stronger all the time. So SB is scared of them. ...*

*It is better to have highly confidential products sold through small companies. This means that the number of people exposed to the*



*confidential information is limited. We also look to a company that has long term, stable staff, like they have at TMP. It is very difficult to enforce a non-disclosure agreement if there is a high staff turn-over.*

*The investment of \$25 million or so by SB at TMP is not as big as the commitment of \$10 million by TMP. They are probably only 1% of the size of SB so that makes their risk and commitment far higher. This means they have a very high level of commitment to the project.*

*We have also agreed to supply technical know-how to TMP. At the moment we are the university grades and they (TMP) are the primary school grades, so we teach them. We are very happy to receive their production people in our Japanese factory to let them study (MD:SB).*

NL:TMP describes their efforts to have SB trust them with full product information disclosure:

*You see the thing you have to understand is that basically if you are in the dairy industry you know what's going on. Like with the SB formula. At the beginning we had to drag it out of them bit by bit. Now they've come good but we both know when we are playing tricks because we are in the same business. ...*

*With this baby food plant SB was going to do all the technology, but we found that they have more modern techniques in Denmark, the Japanese at SB weren't quite up to it (NL:TMP).*

#### **11.5.7 Strategies to countervail dependency**

TMP aimed to minimise its dependency on SB by not committing too much of their milk supply to the venture. SB purchased land adjoining TMP and built new premises. TMP expanded their plant independently. The infant formula powders were manufactured by TMP, purchased and blended, packed, marketed and distributed by SB next door. A long term supply agreement bound them together. TMP agreed not to ever sell infant formula into any market place.

TMP management understood that because of their arrangement with SB they ran the risk of losing orders for product from MTC.

In 1990 Mei and TMP had entered a special supply agreement for Whey Protein Concentrate (WPC). Mei's Purchasing Group Manager observed in 1993 that special supply relationships could interfere with other buyer's intentions:

*If the product is a commodity like cheddar, then there's not really a problem, but if you want a special product you would not get someone to do it who already had a marriage with a special agreement to make a similar product. For example we would not get TMP to make us an infant formula because of their deal with SB. There would be a problem because they (eg SB) would have staff located in Australia (KE:M).*

NL was also aware that the SB-TMP arrangement could disturb long standing domestic supply arrangements with multi-national SB competitors like Nestles.

*We cant tie ourselves up too much with one buyer outlet, we cant let a company like SB get 50% of our milk because they could screw us, so we only give them 10%.*

*... Another thing is our connection with Nestles. It would appear that on the infant formula SB and Nestles are head to head, and we do a lot of business with Nestles. But because I can go to Switzerland and talk to the top people there, they said to me, well, we have an agreement with SB in Japan for the distribution of our pasta, so we know the same people in SB that you are talking to in Japan, so we should all be able to work in together.*

*If I could only talk to the Tongala Nestle guys" they might have got upset because locally people are all running around saying: "ah, bloody TMP, they're all Snow Brand's now and all that", but in a much larger field Nestle and SB are working together, so it is very important to bring that mentality and understanding into it.*

*We are seen as a raw material supplier to SB and Nestle and they are both comfortable with that. And the reason why they are comfortable with that is because they will never see us on a shelf with a branded product competing against them (NL:TMP).*

TMP was not able to supply all of the components of the SB infant formula. NL then assisted SB to negotiate with some other manufacturers it had long established relationships with, in order that they supply the additional ingredients. NL:TMP explains:

*(SB) needed a product called DWP. Now we spoke to MG and we spoke to Bonlac. I went to the first couple of meetings, and now SB and Bonlac have an arrangement to produce whey at Stanhope. TMP does not produce demineralised whey. We do a small amount but not enough.*

*SS: So you helped them make the initial contact with Bonlac and gave recommendations?*

*NL: Oh yes, definitely, we talked to the MD of Bonlac with them, and MG.*

While the SB-Bonlac agreement was initially for the supply of DWP, Bonlac had the technology and capacity to produce all the other ingredients required. They therefore constituted a potential alternative supplier from a position within the new network. In entering the SB-TMP relationship Bonlac had required an undertaking from TMP:

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<sup>41</sup> Tongala is a neighbouring small town in the same region where the Nestle factory is located.

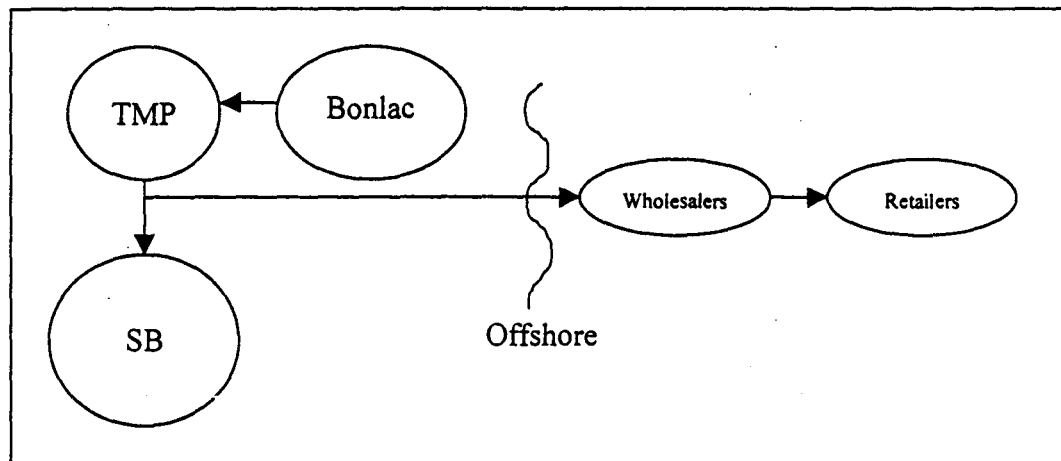
*Bonlac wanted us to guarantee that we would not pinch their farmers. We said we wouldn't"<sup>42</sup> (PH:TMP).*

Like TMP, Bonlac also invested in factory expansion to accommodate the needs of SB:

*Bonlac has invested \$6 million in DWP production for the infant milk deal between us and SB. They have guaranteed SB 50% of their new output. SB put money into their whey plant. It is a major ingredient in the infant formula (PH:TM).*

Bonlac, a major supplier to MTC was therefore also at risk should MTC choose to challenge SB's new position in the supply of branded infant formula to South East Asia.

**Figure 11.15: SP –TMP Infant Formula Strategic Alliance**



#### 11.5.8 MTC responds to the challenge of SB's independence

In 1993, the year following the TMP-SB agreement for infant formula production, MTC cancelled their annual supply agreement for powders for their big customer Mei. TN:MTC told NL that Mei did not want to continue to be supplied with their product due to their new "marriage" to their main competitor (NL:TMP).

<sup>42</sup> The new manufacturing capacity in the region increased demand for milk supply, increasing competition between factories for milk supplier loyalty.

In 1996 a new infant formula factory with a bigger capacity than the SB-TMP plants was opened as a joint venture between MTC, Mei and MG. This new plant was located some 40 kms from TMP and depended on attracting milk suppliers from the same region. The JV aimed to export branded infant formula into export markets in direct competition with the SB product.

In 1993 Kraft invested \$90 million to expand cheese production at its two factories in the region, drawing additional milk from this same farmer supply pool. Consequently TMP's ability to rely on access to surplus milk from Nestle and Kraft has ceased. Their undertaking not to tempt away Bonlac's suppliers began to have special significance in their network relationship.

#### **11.5.9 Analysis**

TMP's challenge was how to maintain long standing relationships with buyers in order to achieve technology transfer and sales, in a situation where buyers were seeking to shorten supply chains in defiance of accepted network rules.

Between 1970 and 1993 TMP had been involved with two JVs and six long term supply agreements with Japanese buyers. (NL:TMP) After their agreement with SB in 1992, there had been no new long term supply agreements, they lost MTC and Mei as buyers, and have had to offer higher prices to keep their suppliers loyal.

While their profits had grown TMP was in a less powerful position in the supply networks than before their alliance with SB.

TMP's management understood the problems associated with their dependency on few buyers with more central positions in the networks.

Having suffered losses in earlier JVs, TMP chose to retain maximum independence, investing in capital expansion in its own factory with only a long term supply agreement linking them with SB. While such an arrangement did not deliver the protection a JV may have provided in ensuring TMP was not readily substituted as preferred supplier, the looser

alliance still exposed TMP to retaliation from MTC, which was delivered in the form of lost sales and a rival strategic alliance just up the road.

## 11.6 The Warrnambool Cooperative Case Study

**The actors participating in the evolving network:**

Warrnambool Dairy Cooperative

Kraft

UMT

Lavery International, Agents

### **Informants**

#### **Warrnambool Cooperative (WC)**

##### **Informants**

Ron Gillen, (RG:WC) Factory Manager.

RG had been working for WC for nine years.

Greg Lemmons, (GL:WC) Technical Manager.

GL had been working for WC for three years.

#### **Lavery International (Trader)**

##### **Informant**

Richard Spieler, (RS:L) Senior Agent, Lavery International.

ADC.

Murray Sayers, (MS:ADC) General Manager, International Sales.

#### **Murray Goulburn Coop.MG.**

##### **Informant**

Wayne Sanderson (WS:MG)

#### **Warrnambool Dairy Cooperative**

Warrnambool Dairy Cooperative (WC) is a small, long established enterprise in the high rainfall area of South West Victoria. In the late 1980s the Cooperative took over another

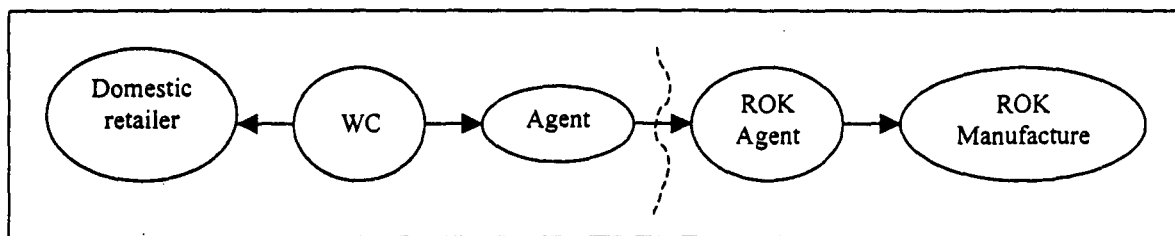
small dairy cooperative in the area. In 1994 WC was located next door to a Kraft cheese factory. WC has specialised in butter, powders and cheddar cheese production for the domestic retail and industrial market.

In 1990 WC's board of management consisting of seven local suppliers supported the management's first attempt at exporting, to Japan and ROK. In 1993 WC distributed through Australian based wholesalers and agents. In 1994 no board members or management at the factory had visited export markets.

The objectives of the company were:

*To export to small niche markets, too small for the larger companies to take an interest in. We have a competitive advantage over big companies like Bonlac or MG because we are prepared to supply smaller than full container lots (RG:WC).*

**Figure 11.16: The Initiating Network 1990**



**Key:**

Inter/ nation boundary ~~~~~

### 11.6.1 The development of the exporting network

WC exports its product through some five different Australian based small trading companies/consolidators. These include Lavery International, Agrifood, Ballantynes, Ausfine Foods, and Bemcos. Agrifods has received tentative inquiries for WC product from Snow Brand and Agrifoods have had inquiries from Toshuku SS. The Australian trading companies initiated the orders for all product exported in 1992-3. Manager RG describes the typical market development process:

*The agent contacts us with an inquiry for a particular mix. Then our R and D person does some experiments. We produce say a five kilogram lot and ship that off for trialing. These new mixes have led to some potential new products for our domestic market. For example the bakery industry could use some of the dairy sugar mixes, or you could use them for icecream.*

*Ballantynes brought us an idea they saw in NZ. It is butter-flour blended bakery sheets for croissants and so on. NZDB is exporting these sheets all through Asia. They got their machinery from Europe. We had someone in Ballarat<sup>43</sup> build the special equipment prototype. It took nearly fifteen months to build. First we want to sell the sheets on the domestic market. The Food Research Institute is going to help us when they get the right equipment. We will have to wait till December to do the further trials with them (RG:WC).*

### 11.6.2 Exporting to Japan

In November 1991 agent Lavery International passed on an inquiry for blended products. "The Japanese buyer wanted to get around customs with it"<sup>44</sup> (RG:WC). The first sale was satisfactory, and the wholesaler visited the Warrnambool factory following the first satisfactory purchase. However, sufficient trust had not developed for the buyer and supplier to share critical information about the end-use of the product. RG:WC explains the consequences:

*We filled the first order, then got follow-ups. The containers arrived in good order. Everyone was happy. The wholesaler then visited our factory and brought a second recipe with him. We quoted on the spot.*

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<sup>43</sup> A nearby regional city in Victoria.

<sup>44</sup> Imports of certain ingredients were prohibited or subject to quota in Japan, for example flour and sugar. However blended into a "dairy" product could facilitate custom's clearance.



*He sent us an order when he got back to Melbourne. He ordered preliminary eight containers and paid up front.*

*When they got delivery and opened the first one, there was a problem with the product. It did not match up with what they wanted it for. Apparently it was supposed to dissolve, but it didn't. They cancelled the last container (still to be dispatched).*

*We did some more R and D with no input from Japan, and still with no idea of what the end use was. We worked out how to make it dissolve. We sent samples and they ordered one more container. They have since ordered another container.*

*Normally we would have supplied a one kg sample first. They would have made up a batch and then ordered. The trouble was, neither Lavery or us could find out what they wanted it for (RG:WC).*

### **11.6.3 The Agent's choice of supplier: WC**

According to the senior manager of Lavery (RS:L) he chooses suppliers on the basis of their willingness to attend to small orders, quick response, and their price:

*Price is the bottom line. If the price is not right then it is no go.*

*I do trial shipments of butter to ROK through WC because they are small enough to worry about a very small trial sample. They will try a new mix in their R and D section and produce just a five kg sample. ... Bonlac or MG have to have a full container shipment before they will even think about it. They are not flexible (RS:L).*

According to RS:L he has been exporting to the USA:

*for 30 years, and I have never met an end user of the product. Japan is like the USA and ROK, you don't get to meet the end user (RS:L).*

In April 1992 RS:L ordered supply of a new export product for WC: bulk frozen cream. The initial order was for three containers for a buyer in ROK. Three months later RS:L was able to notify RG:WC that the first of the containers had arrived and had "moved into the quarantine stage" (RG:WC).

WC management (RG:WC) was hoping to receive further progress reports, in particular the response of the ROK buyers. They presumed they would not receive this information. Ballantynes and Agrifood then made inquiries about the supply of bulk frozen cream. A second order was then received from a third Australian agent (RG:WC).

While still not having heard the buyers response to the cream supplied to the ROK, GL:WC comments:

*We have heard that another Sydney company is exporting frozen cream out of Australia, but we don't know who it is (GL:WC).*

Factory manager RG comments:

*It's a matter of getting the information out of the market. Its what we are depending on. We are driving RS:L to get more feedback. He gets terribly frustrated (RG:WC).*

#### **11.6.4 Stable supply via cooperation between WC and its neighbouring manufacturers**

According to RS:L there is no problem associated with a manufacturer the size of WC proving to be a reliable or stable supplier:

*If you do get a big order then you find that a small company can always buy in extra milk or cream to make up the container, so providing the bulk is not a problem (RS:L).*

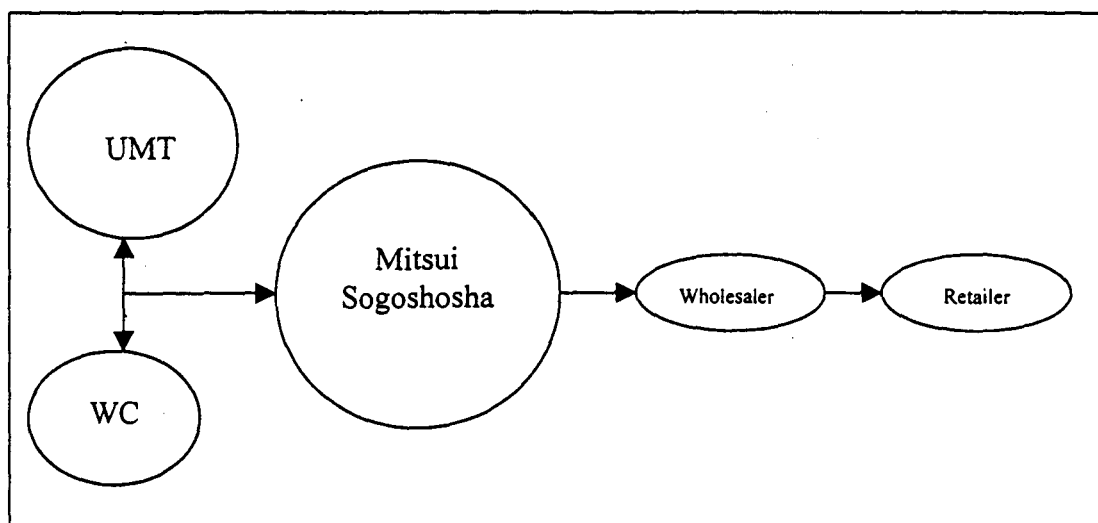
According to GL:WC:

*If there is a problem in supplying enough product to fill an order we top up with purchases from Bonlac. Cooperation improved five years ago when there was a rationing of pickups so companies were not competing in the same areas for suppliers<sup>45</sup> We have developed a close relationship with Bonlac by helping them out of a fix when their UHT plant blew up. We also network closely with Nestles and Murray Goulburn in the Western District (GL:WC).*

An attempt to expand their product line using a by-product from the neighbouring Kraft Cheese Factory was not successful:

*We have been trying to use the whey from the cheese factory next door. Until recently Kraft leased the factory but owned all the equipment. But we couldn't guarantee the quality of the whey all the time so the concept died (RG:WC).*

**Figure 11.17: Network Expansion in 1993-94: WC and its JV with UMT**



**Key:** product transfer: →

<sup>45</sup> This type of cooperation, where manufacturers rationalise transport and collection of milk used to occur in Northern Victoria, but has since ceased with increased competition for supplies.

In 1992-3 Mits was making another bid to gain access to ADC traded product for Japan<sup>46</sup>. Their strategy included bringing a new customer, Bordens into the Australian trading networks, and the investment of \$4 million into the UMT dairy company.

According to RG:WC:

*UMT wanted a foothold on the mainland so they have joined with WC in a 50/50 JV and together we have bought out the cheese making from Kraft next door. UMT used some financial backing from Mits (RG:WC).*

The JV has two components:

- 1: the production of cheddar cheese, two thirds to be sold to Kraft for the domestic market, one third to be exported via Mits.
- 2: a whey concentration plant designed to produce WMP for export via Mits (RG:WC).

MS:ADC comments on the JV formation and the outcome:

*Mits invested about \$4 million in UMT which gave them about 2% of the company. They do not have any voting rights. UMT put this money into WC I think. It was this investment that helped us to make up our mind about adding Mits to the ADC Trading House team.*

*There is now a problem with UMT-WC. They still had to accept all the milk from their farmer co-op suppliers and they ended up with a huge stockpile of cheese; 24,000 tonnes of cheddar. UMT have been trying to dump this surplus all round Asia for US\$1650 when the ADC price is US\$1925. MG and Bonlac are ropable (MSc:ADC).*

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<sup>46</sup> For elaboration see the ADC and Peters-Browne case studies.

#### **11.6.5 Preliminary analysis**

The UMT-WC JV linked one of Australia's smallest dairy coops with the fourth biggest Australian dairy manufacturer. UMT had just become a part of the fledgling Mits dairy trading network. Thus WC was catapulted into high volume export trading.

The small traders who had previously spot purchased WC's product no longer had access to this supplier. They were not a part of the new network. With little leverage in the form of established customer loyalty or reputation, they had no recourse other than to find another "flexible" supplier.

As a part of the new Mits-UMT network WC exchanged its independent search for a stable, loyal customer base for dependency on the giant Mits whose buyer networks for cheddar cheese and powders were still to be developed. Their cooperative relationships with other Australian manufacturers was replaced by head-on competition with them and their powerful trading houses, MTC, Tomen, Toshuku and Itochu.

## Chapter 12

# RESEARCH ANALYSIS AND CONCLUSIONS

### 12.1 The Research Objectives

The objective of this research was to develop business to business relationship and network theory through an analysis of the strategies some exporting agribusiness firms used as they attempted to countervail their dependency in dynamic export networks.

In particular the research aimed to identify the role and influence of some ASMAs in positioning themselves and their suppliers in networks of exchange relationships in deregulating North Asian markets. The tracing of the history of the industries (wheat and dairy manufacturing) and the markets' evolution assisted in the delineation of the linkages and interrelationships between the micro and macro environment, seller-buyer strategy and network governance.

Ford (1982) wrote that only a partial understanding of relationships is achieved through the analysis of individual or single episodes. As well he considered that an incomplete picture of evolving relationships was revealed if the analysis was confined to an examination of what the network theorists have called the *atmosphere*, ie power-dependency, and conflict-cooperation relationships (Hakansson, 1982).

Ford argued that single episodes could conceal the escalating or compounding impact of what in themselves may be minor influences, but which cumulatively influence or trigger a strategic response (and subsequent network counteraction). Likewise, Stern and Reve (1980) in developing their framework of distribution channels as political economies saw that complex socio-economic interrelations involved multilateral interactions as opposed to

"simple" cause-effect mechanisms, such as those between power use and conflict or between channel design and costs.

Layton (1998) and Parvatiyar and Sheth (1997) have written of the marketing literature's recent emphasis away from transactions to relationship interdependence. Likewise Stabell and Fjeldstad (1998) and Besanko, Dranove and Shanley (1996) follow this emphasis, writing from the strategic management and economist's perspective respectively. Heide (1994) wrote about the shifts away from market based or hierarchical governance towards more non-market forms, and the antecedent conditions.

This study supplements the analysis of individual episodes of substantial relationship change or supply shocks (which are the case study informants' most vivid or readily recalled events) with data describing all case episodes as well as data from the backgrounding research. Thus the study seeks to capture the "complex socio-economic interrelationships" and the evolution of particular governance structures by comparing the timing of actor's strategic activities, the role of key personnel, firm characteristics and changes in the three domains identified as constituting the micro and macro contexts.

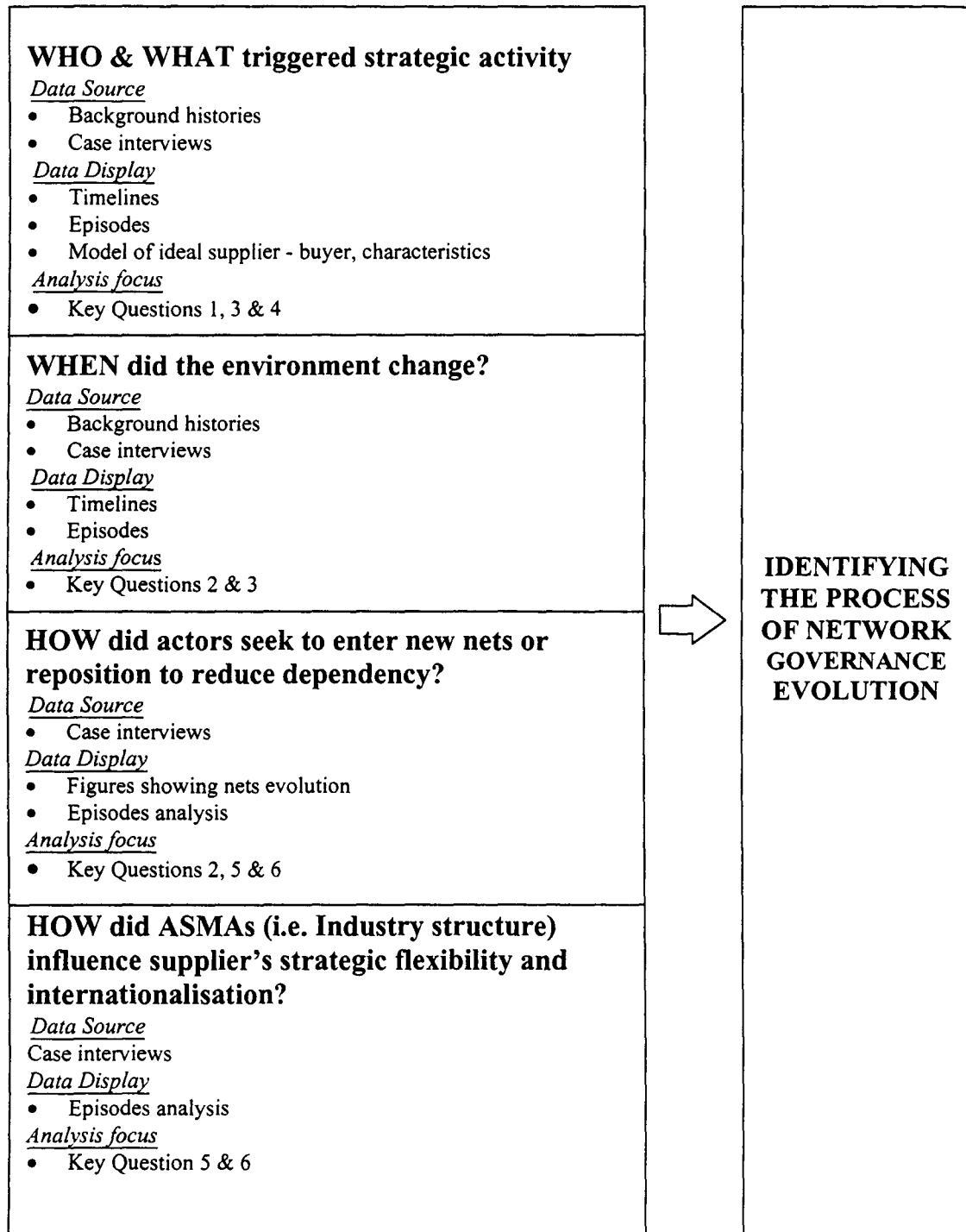
The data analysis is guided by the set of six key questions which were derived from the scoping interviews and literature analysis.

## **12.2 The Data Analysis**

The data was first analysed to identify who participated in the focal networks and when and what stimulated or triggered strategic repositioning episodes.

The second stage aimed to develop a greater understanding about how firms seek to reposition to countervail the dependencies they invariably encounter as suppliers in agribusiness networks. Figure 12.1 illustrates how the data was interrogated, displayed and analysed.

Figure 12.1 The Data Analysis Framework



### Constructs

**Who:** Actors in the micro and macro environments

**What:** institutional, production/distribution, demand competition factors, key personnel and actor characteristics

**When:** time, shocks defining moments, watersheds, sequences



**How:** actor strategies, including industry structure

### **12.3 The Key Questions Guiding the Data Generation in the Case Studies**

1. What attributes, comparative power and product/service characteristics did buyers and suppliers seek in their pursuit of an ideal exchange partner?
2. The strategic responses of focal ASMAs and suppliers as they aimed to achieve their ideal relationship in dynamic environments.
3. The character of the triggers, ie the shocks, watersheds or significant episodes which informants nominated as stressing or changing their relationships over the duration of their export activity in the focal markets?
4. The factors in the micro and macro contexts which mediated the strategic activity of the firms, (and which impact on the network's governance).
5. How do agribusiness ASMAs and suppliers seek to countervail dependency in asymmetrical relationships in dynamic contexts?
6. What impact did industry structure have on the focal suppliers' internationalisation, strategic flexibility, relationship development and positioning in the export markets?

### **12.4 Question One**

**What attributes, comparative power and product/service characteristics did buyers and suppliers seek in their selection of ideal exchange partners?**

When the episodic information was coupled with the informants' responses to the question asking them to identify the most important factors they looked for in choosing a supplier, a three part model of preferred supplier characteristics was obtained. The informant's responses included product/service quality, price and relationship criteria. Informants were asked to rank the importance of the characteristics they nominated (see figure 12.2).

In ROK, wheat market price was a concern equal to quality-relationship characteristics, reflecting the deregulation of imports but continued official downward pressure on flour prices. In Japan wheat price was of little concern to buyer informants, given their inability to influence price through the FA's tender process. In Japan dairy market price was given importance equal to product quality, delivery and relationship characteristics, reflecting the strengthening competition in the deregulating market.

In both ROK and Japan, quality and relationship characteristics were considered symbiotic. Informants explained that it was impossible to have a loyal, trusting, friendly relationship with personnel from a supplier where the product quality or service was poor (TN:MTC, JN:MG, HK:Tom). Such a response reflected the very close identification of the employees with their firms. In Japan and ROK it was made clear that the interests of their company were synonymous with the interests of the informant. At that time (up to 1994) the Japanese informants still anticipated a job from graduation to retirement with their *sogoshosha* or manufacturer. Japanese informants (TN:MTC, KY:K, IH:JC) still talked disparagingly about JN:MGs transfer from SB to MG as a "defection" fifteen years after his change of employment.

**Figure 12.2: Informants' Ideal Buyer or Supplier Characteristics**

The Criteria	Preferred supplier characteristics	Preferred buyer characteristics
Product/service quality and delivery	delivers security of supply according to specification; product has consistency, cleanliness/ minimal chemical residue, safety, freshness.	offers long term buying commitment
Price	low processing costs; high yield; competitive FOB and freight costs.	premiums paid, on time.
Relationships	Treats you, the customer, as King. Supply maintained even when product is scarce; provides technology training if needed; invests more in the relationship than you; unlikely to compete with you or your customers; good country relations.	provides technology-training if needed, provides good market information and product information, allows access to their customers, is loyal despite supply problems.
Source: (MS:ADC, VA:AWB, TN:MTC, NO:AWB, WS:MG, YY:Mits, DH:CCC, JW:AWB)		

## 12.5 Question Two

**This question sought to identify the strategic responses of focal ASMA's and suppliers as pursued their ideal relationship in dynamic environments.**

The episodes described by key informants were distilled to reveal the context and outcomes of the strategy adopted.

Forty-three episodes in all were identified. These were then compared through cross-case analysis to determine what if any patterns of response emerged (see figure 12.3 and questions five and six). Information given about each episode was verified through a triangulation process which saw at least three (or more) informants describe the same episode.

### The Case Study Episodes

#### 12.5.1 The dairy industry ASMA: the ADC

##### Episode ADC1. ADC strategic activity :1964-81

###### **Context**

Until 1974 the Australian dairy suppliers had long term supply agreements with the UK. Other export markets were considered residual (MS:ADC, JK:ADC, PE:MG).

###### **Marketing strategy**

Sales to Japan were negotiated with the three sogoshosha who purchased Australian dairy product from individual Australian dairy companies prior to the establishment of the ASMA. Returns from all exports markets were averaged back to manufacturers in proportion to product contributed.

###### **Outcome**

Australian manufacturers were volume, not quality focused.

###### **Analysis**

The exchanges were transaction rather than relationally focused. Contact down-stream, beyond the sogoshosha was minimal. Over the thirty years the ADC developed a reputation for the supply of low cost, dependable, bulk commodities.

### **Network episode ADC2: 1981-82**

#### **Context**

Severe drought effected Eastern Australia.

#### **The strategic response**

The ADC cancelled Japanese orders to ensure supply to the domestic market. No attempt was made to find an alternative source of supply for the Japanese customers.

#### **Outcome**

Japanese manufacturers dependent on Australian product contemplated factory closure. The ADC lost its reputation as dependable. The ADC lost market share to the NZDB and the EC. Networks contracted. Some Japanese manufacturers permanently cancelled long-term supply agreements.

#### **Analysis**

The ADC continued to be transaction not relationship focused. It demonstrated little regard for, or an understanding of, the network conventions and dependencies.

### **Network episode ADC3: 1985**

#### **Context**

The EC prices of dairy product offered to Japan fell. MTC asked that the twelve month contract price negotiated with ADC be revised down, to bring it in line with EC prices.

#### **The strategic response**

ADC refused to cooperate with MTC.

#### **Outcome**

MTC reduced their twelve month contracts to six months. MTC considered ADC less trustworthy and cooperative. ADC's longer term planning potential and security of sales for suppliers was reduced.

#### **Analysis**

ADC continued to be transaction focused. Its reputation as a non-customer responsive supplier was reinforced.

### **Network episode ADC4: 1987**

#### **Context**

Demand for fresh cheese was expanding in Japan. For five years Lac had been bound by a contract to MTC to supply bulk gaud. Prices were below the costs of production. Lac was

in a highly dependent position. It looked for a more realistic price or to reduce gouda production in favour of cheddar.

#### **The Strategic response**

Lac invited their ASMA, the ADC to replace MTC as their sole agent for the sale of gouda. The ADC complied and Lac then wound down production.

#### **Outcome**

Lac reduced its dependency on MTC and for a time the ADC gained additional product to sell. Both avoided retaliation.

#### **Analysis**

Using its statutory authority as a justification, the ASMA cooperated with supplier Lac to supplant its long-standing agent, allowing the supplier to exit a long-standing exploitative agreement. The supplier could then reposition while seemingly complying with network conventions.

### **Network Episode ADC5: 1985-1989**

#### **Context**

Japanese demand for pizza type cheeses was expanding. In 1985 MTC, Rok and UMT (in Tasmania) formed a JV to transfer technology and develop a reliable low cost supply of a suitable new stretch cheese product (Myalla). In 1989 UMT asked the ADC to help them overcome Myalla off- season supply shortfalls and their dependence on low priced Myalla agreements with MTC-Rok.

#### **Strategic response**

With UMT's cooperation the ADC technicians transferred the Myalla technology to other Australian manufacturers. This cheese was named "Goshred" to create a "new" product. The ADC then used its regulatory powers to supply all Australian Myalla and Goshred to MTC and a number of new buyers in the Japanese market.

#### **Outcome**

The ADC's network position was strengthened at the expense of MTC (and Rok). Cheese trading networks were expanded to include more Japanese buyers and additional Australian products.

#### **Analysis**

With industry agreement, the ADC used its statutory authority to intervene and transfer a JV's Japanese technology to others, which expanded the Australian product range and

reduced dependency on MTC.

#### **Network episode ADC6: 1989**

##### **Context**

EC dairy export prices were again falling. In 1989 MTC negotiated a price with the ADC which was subsequently undercut by competing EC suppliers. MTC asked ADC for a price reduction.

##### **Strategic Response**

The ADC matched the EC price, despite the contract. ADC then reduced the price to its suppliers in the next season recovering the losses of more than \$1 million.

##### **Outcome**

ADC cooperated with MTC. The substantial losses were recovered upstream from suppliers locked into ADC supply because of their industry's regulation.

##### **Analysis**

A new customer-oriented international sales manager (MS:ADC) was now in charge of strategy. Consequently the ADC demonstrated long-term commitment, loyalty and reliability to a major customer in a circumstance where it previously had chosen not to cooperate (see episode ADC3:1985).

#### **Network Episode ADC7: 1989**

##### **Context**

There were production shortfalls in Australia. There was insufficient product available to fill an order for MTC to supply to Japan's biggest manufacturer, SB.

##### **Strategic response**

MTC and ADC key personnel worked cooperatively to protect their firms' respective positions in the network. They found an alternative source of product for the ADC to supply in the UK, and contrived to guarantee its quality.

##### **Outcome**

The cooperation between ADC and MTC appeased MTC's biggest buyer, SB, whose down-stream loyalty was pivotal for the well-being of the network.

##### **Analysis**

The close interpersonal relations between MTC and ADC key personnel (especially TN:MTC and MS:ADC) facilitated the finding of a solution that served their mutual

interests and built their respective reputations as dependable.

### **Network Episode ADC8: 1992**

#### **Context**

Market deregulation in Japan stimulated Mitsui to renew efforts to gain access to ADC supplied Australian product.

#### **Strategic Response**

Mits offered ADC an "entry" package including a \$4 million investment in an Australian dairy company, a new major customer (Bs), and a commitment not to disturb pre-existing relationships.

#### **Outcome**

The ADC accepted the package and the Australian industry gained a new buyer, potentially strengthening price competition.

#### **Analysis**

ADC-Mits mutual understanding of the network conventions vis-a-vis what constituted predatory and acceptable behaviour ensured minimum disruption to Australia's existing networks, despite the entrance of a new *sogoshosha*.

### **Network Episode ADC9:1993**

#### **Context**

Demand for dairy product in Japan was growing along with deregulation. ADC sought to grow market share, improve price competition and reduce their dependency on MTC.

#### **Strategic Response**

ADC asked Japanese manufacturer MK to cooperate by nominating Mits as their agent for ingredients for a "new" product to be supplied from Australia, despite MK's long-term relationship with *sogoshosha* Toshuku.

#### **Outcome**

MK cooperated, with the inducement of first option to manufacture the "new" product with the Australian supplied ingredients.

#### **Analysis**

The ADC colluded with a downstream customer whose activities remained consistent with the network convention that allowed customers to initiate buying relationships, in particular involving new product. Mits network membership grew and the ADC achieved



its objectives.

### **Network Episode ADC10: 1993**

#### **Context**

With deregulation, growing demand for dairy product and the internationalisation of the biggest Japanese dairy manufacturers, actors like SB sought direct relationships with suppliers offshore. MTC sought to retain the loyalty of customer SB by supplying ADC product below cost. MTC asked ADC to assist them with discounts.

#### **Strategic response**

ADC chose not to cooperate, leaving MTC to continue incurring losses in supplying SB.

#### **Outcome**

MTC continued to take losses in some of its large volume exchange relationships. With an office established in Melbourne, SB had become capable of handling direct exchange relationships and ADC was prepared to cooperate directly with them, shortening the supply channel.

#### **Analysis**

SB had come to rival MTC's central position in Australian dairy export networks. Institutional changes (eg further deregulation) created opportunities for more direct customer-supplier exchange that served the interests of the ADC, (as long as it avoided retaliation from the MTC and its own suppliers did choose to follow the same channel shortening strategy).

## **12.5.2 An analysis of the strategies of the dairy ASMA suppliers: WC, MG, Lac, CCC, PB, TMP.**

### **Case study: Warrnambool Dairy Cooperative (WC)**

#### **Network episode WC1: Pre 1991**

##### **Context**

North Asia's demand for dairy product was growing, but imports were regulated, in particular in Japan and ROK. WC's objective was to develop stable export sales. A small Australian agent passed on an order from the ROK for a dairy powder mix. The product was supplied as specified but the agent was told it was unsatisfactory because the powder

failed to dissolve. No new orders were received.

**Strategic response**

WC attempted to gain more information about the intended end-use for the product, via the agent. The agent's efforts failed to penetrate downstream beyond the ROK agent. WC continued to experiment with dissolving powder mixes, hoping for a further order that they might better satisfy.

**Outcome**

The desire to evade ROK customs regulations (which for example allowed importation of some mixes but not 100% milk powder) stymied open information exchange. The agent could not identify the manufacturer. Consequently WC could not adapt their product to meet the customer's needs. Regular orders and an ongoing relationship were not established.

**Analysis**

Without a trusting information exchange the product exchange could not progress from a purely transactional basis.

**Network episode WC2: 1991**

**Context**

Demand for dairy product and confectionary expanded in ROK.

A small Australian agent ordered frozen cream to be supplied in bulk to ROK. WC had not exported cream before.

**Strategic response**

WC dispatched the containers.

**Outcome**

Orders for cream from other agents were obtained. Without knowing the customer response to the first product dispatched, WC could not be confident about the performance of their product or its transportation. Regular sales of cream were not established.

**Analysis**

WC remained outside any networks of stable export trading relationships. It could not add value by refining or adapting its product to the end user's needs. It could not add a service dimension to build customer loyalty or to differentiate its offerings.

### **Network episode WC3: 1993**

#### **Context**

The market for imported icecream was deregulated in Japan. Demand in Japan strengthened.

#### **Strategic response**

Mits offered a package to the ADC in return for supply access to Australia. (The offer included a \$4million investment in UMT). UMT then offered a JV to WC in order to secure a better milk supply in Victoria. The JV then bought the cheese manufacturing component of the Kraft factory next door. Mits was to be the sogoshosha. WC accepted the JV offer that committed the bulk of their production to the new export venture.

#### **Outcome**

WC lost capacity to supply the domestic market. They became dependent on the inexperienced Mits for sales generation. Mits' networks, in particular its distribution linkages, were underdeveloped. The JV's surplus product was "dumped" on export markets, bringing them into head-on competition with other Australian suppliers (who may have cooperated in taking surplus product).

#### **Analysis**

WC became dependent on a joint venture with relationships not sufficiently developed to be efficient. Dumping was reputation damaging and a short term solution. It antagonised the established networks, including the ADC who had encouraged export expansion through Mits.

### **Case Study: Murray Goulburn (MG)**

#### **Network episode MG1: 1972-80**

##### **Context**

With the UK joining the EC, Japanese buyers sought to secure alternative supply. At the same time the Australian Government offered gouda production subsidies.

##### **Strategic Response**

SB and its sogoshosha MTC formed a JV with MG to manufacture gouda.

##### **Outcome**

SB technology was transferred to MG. With the withdrawal of Australian subsidies the JV

was not viable. MG suffered the greatest financial risk and exposure.

### **Analysis**

In the short term MG was nearly bankrupted, but in the long term it gained export experience, new technology and the services of an ex-SB (Japanese) key person JN:MG. JN:MG helped MG to interpret and understand the culture of the dairy trading networks.

### **Network episode MG2: 1985 (This is the same episode as described in ADC5)**

#### **Network Episode MG3: 1990**

##### **Context**

Deregulated market opportunities stimulated ADC to seek to increase the volume and value of their exports. The ADC aimed to introduce an additional (fourth) sogoshosha to the networks, without triggering retaliation from the other three sogoshosha whose market share could be correspondingly reduced.

##### **Strategic Response**

ADC asked the sogoshosha Itochu to introduce their pizza chain customer to MG (whose product was usually purchased by MTC) with a view to the chain being supplied with a "new" pizza cheese. After technology transfer the "new" product was developed.

MTC asked to act as agent for the new product but were refused on the grounds that the customer had a long-standing sogoshosha relationship with Itochu, the MG product was "a new business line" and customer initiated.

##### **Outcome**

Buyer competition was expanded, a new network was initiated, retaliation was avoided and the MG product range and technology was expanded.

##### **Analysis**

ADC used its statutory authority and status to "matchmake" a new alliance that operated within network conventions, thereby avoiding retaliation from the long-established and powerful trading partner, MTC.

### **Network episode MG4: 1993-94**

#### **Context**

The post-deregulation environment saw large Japanese dairy manufacturers seeking joint ventures offshore to export to third countries.

#### **Strategic Response**

MG formed a joint venture with MTC and their long standing customer, Mei. MG produced the milk powder that MTC-Mei further processed and distributed as market infant formula into SE Asia. This product sold in direct competition with the TMP-SB JV product developed two years earlier when MTC unsuccessfully applied to be the third venture partner.

#### **Outcome**

MG increased sales of milk to the JV but jeopardised its long-standing relationship with SB. Additional competition for domestic milk supply saw prices rise. The product competed with SB in SE.Asia markets beginning to experience a contraction in demand.

#### **Analysis**

MTC sought to punish SM-TMP and gain control of supply by a strategic alliance with MG. MG aimed to benefit from the security of sales while retaining independence by not integrating production units. SB countered by cancelling long standing orders from MG.

## **Case Study: Lactos Cheesemakers**

### **Network episode Lac1: 1970-81**

#### **Context**

The UK was joining the EC, Japan was looking for alternative suppliers, Australia needed alternative buyers. The 1970s -1980s saw the Australian Government impose and then remove an export subsidy for gouda.

#### **Strategic Response**

1970:SB formed a strategic alliance with Lac to supply bulk gouda. Technology transfer brought production up to standard. 1980-81 SB ceased to buy gouda from Lac, the JV lapsed.

#### **Outcome**

Lac was left with surplus gouda (and edam) production.

#### **Analysis**

Lac gained technology transfer but was locked into a dependent relationship. When the JV sales cease it was in financial difficulty.

### **Network episode Lac2: 1982-83**

#### **Context**

With the gouda subsidies abolished, the other Australian joint venture producing gouda (MTC-SB-MG ) also ended. MTC then had to look for a replacement source of reliable, low cost bulk gouda.

#### **Strategic Response**

Lac entered a series of five-year low priced agreements to supply their bulk gouda to MTC.

#### **Outcome**

Lac became dependent on MTC for purchases of high volume, low priced, bulk product.

#### **Analysis**

Lac was in a vulnerable dependent position with a reputation becoming firmly established as nothing more than a low cost commodity supplier.

### **Network episode Lac3: 1987-1988**

#### **Context**

The Japanese market demand for fresh cheese (not gouda) grew. The commitment to supply low-cost bulk gouda to MTC was jeopardising Lac's strategic flexibility and viability.

#### **Strategic Response**

Lac's new French owner (Bongrain) transferred technology to reposition Lac as a fresh cheese specialist. Lac asked ADC to replace MTC as its agent for bulk gouda and other commodities. MTC counteracted by offering Lac an exclusive supply agreement covering gouda, camembert and brie. Lac signed agreement with MTC in 1988.

#### **Outcome**

MTC continued to dominate the networks but ADC as additional agent gave Lac some price competition. The network membership was expanded.

#### **Analysis**

Lac used the status and statutory authority of the ADC to gain some leverage over MTC.

### **Network episode Lac4: 1989-90**

#### **Context**

Japanese demand for fresh cheeses grew. Through French technology transfer, Lac developed a new unique product: Long Life Camembert. It aimed to supply branded small serve retail packs to Japanese supermarkets.

#### **Strategic Response**

ADC, Chesco and Lac cooperated to exclude MTC in supplying the new product to a range of new buyers and SB. Lac then responded to pressure from MTC, supplying it with the same product at a lower price. This camembert was reboxed and positioned in the same retail outlets to compete against the ADC-Chesco supplied product.

#### **Outcome**

Orders for the higher priced ADC-Chesco-Lac product were cancelled. MTC's position as dominant in the Lac networks was preserved. Lac's reputation as supplier of a quality unique product was eroded. The reputation of Chesco, Japan's biggest cheese distributor was eroded.

#### **Analysis**

MTC successfully stymied the development of a new Lac-ADC-Chesco camembert supply network. Lac sold more product, but it also damaged its reputation as a dependable supplier of quality product in potential new networks of relationships.

## **Case Study: Charada Cheesecake Maker**

### **Network episode CCC1: 1991**

#### **Context**

Deregulation allowed the importation of cheesecake to Japan. A long-standing and important MTC customer asked them to find a new source of cheesecake for their Japanese restaurant chain. CCC subsequently agreed to develop the product with some technology transfer and financial support from MTC. It then became dependent on MTC, locked into a low priced agreement.

#### **Strategic response**

CCC asked ADC to assist them to become less dependent. Under instruction from the ADC, CCC offered new buyers a "new" cheesecake product. CCC then asked another sogoshosha to act as agent for these new customers.

### **Outcome**

The CCC expanded its network of buyers, was able to increase price competition, and avoided retaliation from MTC. The ADC achieved its objective of boosting competition in Australian supply networks, at the expense of the MTC.

## **Case Study: Tatura Milk Products**

### **Network episode TMP1: 1951-1958**

#### **Context**

TMP aimed to diversify its lines away from butter making.

#### **Strategic Response**

TMP formed a JV with an Australian icecream manufacturer who installed equipment in the TMP factory. Technology was transferred.

#### **Outcome:**

When the icecream company was taken over by another firm, TMP bought the equipment and the JV was amicably dissolved.

#### **Analysis**

TMP gained strategic alliance management experience and a reputation for innovation. It had diversified and had access to new equipment and technology.

### **Network episode TMP2: 1975-1985**

#### **Context**

Production problems associated with reliable milk supply plagued the SB-MTC-MMP JV which produced creamed cheese in NSW.

#### **Strategic Response**

The ADC recommended to MTC that a more reliable supplier (TMP) join the JV. SB then transferred the cream cheese technology to TMP. TMP bought the creamed cheese component of the enterprise when MMP sold out to another Australian company.

#### **Outcome**

SB-MTC rewarded TMP's loyalty by continuing to purchase creamed cheese even when offered cheaper product from Lac. TMP was admitted into an experienced, efficient export network. It diversified into a new product range. Technology was transferred. TMP forged close, direct exchange relationships with MTC and the manufacturer, SB.



### **Analysis**

Cooperative horizontal linkages between TMP and MMP were facilitated by their ASMA in response to the needs of MTC and SB. Subsequently TMP's management team developed embedded skills in the management of relationships in a sogoshosha dominated JV. They gained exporting knowledge and experience in the most successful Japanese-Australian dairy trade network.

### **Network episode TMP3: 1988-91**

#### **Context**

Demand for stretch cheeses in Japan grew.

#### **Strategic Response**

TMP-MTC-C formed a JV to produce mozzarella for the new, growing market. TMP was to produce the cheese. The marketing, sales and distribution was to be the task of MTC and C, an Italian wine trading company.

#### **Outcome**

Neither MTC or C had mozzarella cheese technology to transfer to TMP. The product never achieved acceptable quality. After heavy losses, MTC and C withdrew from the JV, leaving TMP to carry accumulated debts.

#### **Analysis**

MTC and C misjudged TMP's level of resources and capabilities to manufacture the product. The acrimonious "divorce" left the most dependent partner, TMP in financial difficulty. Relationships between MTC and TMP were strained.

### **Network episode TMP4: 1992**

#### **Context**

Markets grew for infant formula powders in South East Asia. SB had developed considerable international experience.

#### **Strategic Response**

SB formed an alliance with TMP to supply the powders for a formula SB would blend, package and distribute from a plant built next door to TMP. SB chose not to include their old sogoshosha MTC in the new network, despite its request for inclusion and TMP's concern about the potential for retaliatory action

#### **Outcomes**

TMP increased its sales of milk powders, but aimed to countervail dependency on SB by insisting SB take title to the powder at the gate of the factory, and by not committing the majority of its milk to SB product.

### **Analysis**

Denied membership of the strategic alliance, MTC established a rival infant formula factory nearby through a JV with MG and Mei. MTC (and Mei) cancelled their long standing orders of product from TMP (see also episode MG4).

## **Network Episode TMP5: 1992**

### **Context**

Their small scale meant TMP could not supply all of the specialised powders required for the SB infant formula.

### **Strategic Response**

TMP introduced SB to Bonlac, one of Australia's biggest dairy manufacturers who agreed to supply the missing ingredients, upgrading their plant and equipment substantially to meet the demands of SB.

### **Outcome**

SB asked TMP to find the additional supplier. By allowing TMP to choose and "introduce" the additional supplier to the new network relationship, SB kept Bonlac in its place as secondary in status to TMP, but still benefited from the more reliable supply of ingredients.

### **Analysis**

TMP used its long-standing, horizontal, cooperative relationship with Bonlac to help provide all the needs of SB. Bonlac, one of Australia's largest producers of finished retail ready product had greater potential to become a future competitor to SB and so was kept at arm's length from the venture by SB.

## **Case Study: Peters Brown (PB)**

### **Network episode PB1: 1990**

#### **Context**

The imported icecream market in Japan was deregulated.

A twenty year JV relationship between Bs and Mei in Japan ended acrimoniously. Bs needed to find a replacement manufacturer of high quality icecream, so it looked offshore.

#### **Strategic Response**

Mits used the opportunity to introduce Bs as a potential new buyer to Australia as leverage in gaining admission to the ADC's supply networks.

**Outcome**

Mits was given access to the ADC commodity supplies. Bs assisted its new supplier PB to manufacture their icecream through extensive technology transfer.

**Analysis**

PB was catapulted into a new exporting relationship, heavily dependent on Bs for purchase of 40% of its factory's output.

**Network Episode PB2: 1993**

**Context**

Bs market share in Japan contracted. Bs sold out to Lotte. PB sales to Bs were lost. Mits networks were not sufficiently developed to find alternative buyers for PB icecream. Their relationship had been short, and loyalty had not developed. They parted company.

**Strategic Response.**

To recover sales PB refocused on supplying the domestic market and the lower priced segment of the Japanese market. They also attempted to sell into ROK.

**Outcome**

After a financial struggle, PB survived the loss of Bs' sales and retained a legacy of high quality production lines, quality assurance systems and Japanese laboratory certification.

**Analysis**

PB's association with the failed Bs left it with a reputation for supplying a poor quality product in Japan. It had been tainted by its association with Bs who was punished for a serious breach of conventions (it had taken a dispute with a JV partner to court).

The ADC gave Mits access in anticipation of it delivering extra pricing competition and sales volume. Instead Mits damaged the reputation of Australian product in Asian markets when it dumped surplus. It did not have sufficient influence to protect Bs or PB from MTC-Mei retaliation, and their dependency on Mits and Bs nearly destroyed PB when export sales collapsed.

### **12.5.3 The AWB and the Japanese wheat market**

#### **Episode AWB1: 1938-1960**

##### **Context**

The AWB offered a low priced commodity with minimal differentiation. The use of bags to transport and store wheat persisted until the 1960s (fifty years after overseas competitors changed to bulk handling).

##### **Marketing strategy**

The wheat was graded into a two tier system: Fair Average Quality (FAQ) and Offgrade. International merchants sold the annual crop. Relationships were not developed with manufacturers or end users.

##### **Outcome**

The AWB was positioned in the market as a supplier of low cost average to poor quality filler for blending with higher quality USA or Canadian grain. Poor returns to growers, often below the costs of production, were compensated for with government subsidies. Gluts were discouraged with quotas or differential pricing.

##### **Analysis**

The AWB was a price taker, selling a commodity with a "disposal" or transactional marketing focus.

#### **Network Episode AWBJ1: 1984**

##### **Context**

The value and volume of sales to Japan were declining. An IAC report recommended the AWB be deregulated to increase buyer competition.

##### **The Strategic Response**

The AWB aimed to increase returns by eliminating one link in the supply channel, the international traders, who on-sold to the sogoshosha in the FA tendering process.

##### **Outcome**

For the first time the sogoshosha came to have direct exchange with the AWB. They transmitted their mill customers' response to the AWB product. This exchange revealed the end-use of the wheat in Japan (ie noodles) and the critical shortage of the wheat with the preferred characteristics.

### **Analysis**

The shortening of the channel created the possibility for relationship development with the sogoshosha. With information exchanged, the ADC began to move from transaction to relationship focused trade.

### **Network episode AWBJ2: 1985-91**

#### **Context**

The production of noodle wheat varieties continued to decline.

#### **Strategic response**

The AWB introduced small and inadequate varietal bonuses to stimulate plantings. The WA Department of Agriculture worked closely with selected WA growers to breed higher yielding noodle wheat varieties.

#### **Outcome**

The growers became better informed about the demand for noodle wheat. They became increasingly dissatisfied with the marketing activities of the AWB and their returns. They cooperated and organised to advance their interests, facilitated by the WA Department of Agriculture.

#### **Analysis**

The AWB wheat buyer monopoly was challenged, driving it to become more supplier-responsive. Growers were collectivising to promote and defend their interests as they became aware of the uniqueness and demand for their product.

### **Network episode AWBJ3: 1993**

#### **Context**

The AWB anticipated deregulation of the Japanese wheat market where they could lose preferred supplier status, and cheaper grains could compete for sales. The market was already vertically integrated, from sogoshosha to mill to manufacturer and retailer.

#### **Strategic response**

The AWB aimed to enter or build new networks, developing buyer loyalty with niche market manufacturers by offering a range of branded, finely segregated noodle wheats.

#### **Outcome**

With the exception of MTC and their customer mill NF (who dominated the AWB WA noodle wheat network), other sogoshosha and their mills rebuffed the AWB's attempts to

build relationships with their customers, arguing that further product segregation increased the costs.

#### **Analysis**

Market conventions saw MTC-NF in a position of exclusive access to WA ASW. Overtures made by the AWB downstream were interpreted within the context of the widely understood convention, as predatory.

### **Network Episode AWBJ4: 1993**

#### **Context**

The AWB sought "insider status" in order to achieve greater buyer loyalty prior to deregulation.

#### **Strategic Response**

AWB offered alliances in WA noodle wheat research and development to sogoshosha and millers.

#### **Outcome**

Only MTC and its customer NF accepted the offer thereby increasing the AWB's dependency on MTC who monopolised WA grain buying.

#### **Analysis**

Japanese sogoshosha acquiescence to long-standing market access arrangements left the AWB in a comparatively powerless position to challenge the dominance of MTC and its mill NFM. Offers of joint research activity reinforced the position of MTC in the network.

### **12.5.4 Case study analysis: WANGA, suppliers to the AWB.**

### **Network episode WANGA1: 1993**

#### **Context**

Noodle wheat growers in WA formed an association with the aim of increasing the market returns to their membership.

#### **Strategic response**

Strategic objectives included: forming a separate noodle wheat pool; attempting to capture more value via vertical integration (eg noodle manufacturing); developing product loyalty through a direct relationship with end users; finding new buyers for their wheat.

### **Outcome**

MTC rejected WANGA's offer to displace their existing network buyers through a WANGA-MTC JV; AWB agreed to a separate WA noodle wheat pool and pay market returns, increasing price volatility and supply security risk.

The AWB thwarted WANGA's attempts to contact buyers independently or through MTC at FOODEX. The AWB (and consequently WANGA) continued to be dominated by MTC through their informal buyer monopoly.

### **Analysis**

While WANGA strengthened its position in comparison to other wheat suppliers to the AWB, it remained dependent on MTC or the AWB, unable to build relationships with a range of competing end users. With a separate wheat pool WANGA also exposed themselves to the risk of supply failure.

## **12.5.5 Case study analysis AWB-ROK wheat sales**

### **The Network episode AWBK1: 1963-1980**

#### **Context**

The ROK wheat milling industry was regulated and dependent on low cost imports sourced via KOFMIA from the USA.

#### **Marketing strategy content**

The AWB aimed to keep product price and quality information before the market via annual visits to the MAF, KOFMIA, the mills and international merchants.

#### **Outcomes**

The market remained fully regulated, but Australian wheat information was regularly presented to the industry.

#### **Analysis**

Millers had limited knowledge of Australian wheat characteristics. ROK wheat purchases were made according to subsidised price, low cost loans and political factors. The AWB was however positioning itself, in readiness for deregulation.

### **Network episode AWBK2: 1980**

#### **Context**

The ROK economy enjoyed sustained growth. ROK manufacturers demanded an

improvement in flour quality. In particular noodle makers aimed to compete with the Japanese in their domestic and export markets.

### **Strategy**

A sponsored visit to Australia exposed the ROK industry and government officials to BRI training facilities in Sydney.

### **Outcome**

KOFMIA requested that AWB provide sponsored training places for their millers at the BRI. AWB made training access conditional on wheat purchases.

### **Analysis**

The technologically backward ROK industry meant access to training and technology transfer became a potent incentive for AWB purchases at the same time that wheat supply deregulation was gaining momentum.

## **Network episode AWBK3: 1983**

### **Context**

Demand for better flour quality grew. The US instigated GATT challenge to Japan's regulated market access was well reported in the ROK media. ROK wheat imports were subsequently partially liberalised, with 50% to be purchased from any source.

### **Strategy**

AWB commenced technology transfer with intensive visiting by milling technicians who aim to assist and advise all mills on adjustments required to mill Australian wheat.

### **Outcomes**

Millers developed close personalised relationships with AWB technicians and a familiarity with the characteristics of ASW, independent of commercial interests.

### **Analysis**

AWB key milling technician personnel became enculturated. Customer service became a major factor in the marketing strategy, delivered in the form of information and technology transfer, well in advance of the first purchases of wheat.

## **Network episode AWBK4: 1984**

### **Context**

ROK millers sought technology transfer. AWB supported and encouraged an ROK academic, CHL:KU to assist in the promotion and information dissemination about ASW.



### **Strategy**

AWB provided CHL:KU with sponsored research, overseas visits and equipment donations. Free millers and manufacturers courses were run by CHL at KU.

### **Outcomes**

A positive, highly respected academic, "independent" commentary on AWB wheat was available to ROK mills.

### **Analysis**

Confucian respect for the scholar enhanced the CHL:KU message about ASW. The collaboration between CHL and AWB was mutually rewarding.

## **Network episode AWBK5: 1987**

### **Context**

The ROK milling industry aimed to improve flour quality in preparation for the international scrutiny related to the Seoul Olympic Games. GATT delivered outcome of investigation requiring Japan to liberalise some imported food access. US pressure on Japan to further liberalise market access was widely reported.

### **Strategy**

Mill management and millers, manufacturers, government officials and wives were invited to attend an all expenses paid AWB seminar/holiday on Cheju Island.

### **Outcomes**

ROK Milling industry-AWB relationships received a major boost with important technology transfer, just at the time when free market access issues were prominent in the media.

### **Analysis**

Attendance of AWB, MAF officials, mill management and technicians, manufacturers and KOFMIA representatives ensured close personal relationships flourished across the industry.

## **Network episode AWBK6: 1989-90**

### **Context**

The ROK government responded to their balance of trade problems by effectively curtailing access to US GSM credits for payment for US wheat sold to ROK mills.

### **Strategy**

AWB targeted smaller mills with seminars about bulk storage technology. It also offered to assist them to aggregate their small orders to purchase AWB shipments collectively.

### **Outcomes**

The last seven small mills purchase wheat in combined shipments in 1991.

### **Analysis**

Horizontal linkages had developed between small (and larger) mills over the decades of market regulation when KOFMIA aggregated orders to achieve economies in shipping. The AWB had targeted small as well as large mills since its market entry, developing relationships and the mills' knowledge of ASW characteristics in readiness for full deregulation. When the commercial incentive to buy USA wheat was removed, and with bulk storage problems resolved, the small mills cooperated to purchase volumes of ASW from their friends at the AWB.

## **Network episode AWBK7: 1992**

### **Context**

ROK quarantine services alleged that AWB wheat was contaminated with harmful chemicals.

### **Strategy**

The AWB cooperated with the ROK millers, allowing them to quietly liaise with the ROK government officials. The AWB did not accuse the ROK government of wrongful analysis, but stressed that the wheat was clean when it left Australia.

### **Outcomes**

The allegations were dropped by the ROK government, mills had minimal disruption to sales. Sales of AWB wheat to ROK mills increased.

### **Analysis**

Network conventions were observed. The AWB's behaviour in cooperation with the mills minimised market disturbance. Face was saved.

## **Network episode AWBK8: 1993**

### **Context**

Sales of flour contracted as a range of food contamination allegations and rice substitution requirements impact on demand.

### **Strategy**

AWB attempts to build customer loyalty through strategic research and development alliances with ROK mills and their manufacturers. Their aim was to further segregate wheat for special products.

### **Outcomes**

Manufacturers failed to respond. The largest ROK noodle manufacturer (with over 70% of market share) had long established alliances with USA firms.

### **Analysis**

Technology transfer to ROK mills was no longer a competitive factor. Mill closures were occurring. Increasing price sensitivity suggested competition would emerge from lower cost suppliers. The concentration and power of manufacturers meant mills continued to be pressured for quality flour.

**Figure 12.3: Summary of Episode Strategic Activity**

<b>Episode Strategic Activity</b>	<b>Number of episodes</b>
Exchanges are transaction focused	5
ASMA transferred technology and to suppliers	4
ASMA intervenes to help supplier reposition without retaliation	8
ASMA uses technology transfer to build customer loyalty	1
ASMA cooperates with sogoshosha to support customer down-stream	2
Supplier receives technology transfer through Japanese JV	5
Horizontal linkages help secure supply reliability	3
Repositioning attempt leads to sogoshosha retaliation	4
Market conventions used to help repositioning without retaliation	8

## 12.6 Question Three

**What did informants nominate as the *shocks*, *watersheds*, *defining moments* or *strains* that had effected relationships over the duration of their export activity in the focal markets?**

### Definition of the constructs:

**shock** : a sudden and negative impact on the focal actor.

**watershed** : the point at which a significant change in the quality of the relationship was realised after a period of building of momentum towards that change. The qualities included feelings of shared commitment, respect, and mutual understanding.

**defining moment**: the point at which exchange relationships acquired new dimensions, without necessarily the same building of momentum implied in the term *watershed*. The new dimensions included expanded or new product lines offered or the penetration of new markets.

**strain**: negative tension placed on exchange relationships, which tested buyer-supplier commitment or loyalty.

### **Timelines**

The time-lines derived from the background research were matched with the data derived from the trading network informants who nominated and described episodes that they believed shocked, strained or otherwise substantially changed their relationships. Triangulation of the data occurred when different informants employed by the same actor or working for others in the network nominated the same episodes and described their significance.

### **The Japanese Australian dairy trade**

Japan-Australian dairy trade informants nominated three episodes as a shock to their relationships with the ADC:

#### **1981-82 Episode ADC2**

Japanese buyers nominated the ADC's failure to supply product in the 1981-82 drought as the greatest shock in their thirty year relationship (TN:MTC; HT:Rok; KE:Mei).

ADC informants attributed a significant contraction of market share, some permanent loss of buyer accounts, loss of reputation and the entrance of some new competitors (eg EU, NZDB) to this failure to supply (MS:ADC; CP:ADC; JK:ADC). ADC management attributed the ADC strategy at the time to their treatment of the export market as residual and their failure to understand the supply imperatives for the buyers.

#### **1985 Episode ADC5, MG2**

The ADC's intervention in the MTC-Rok-UMT JV and takeover of their "Myalla" sales and technology was nominated by the MTC and Rok informants as a shock straining their relationships with the ADC (TN:MTC; TT:MTC, HT:Rok).

ADC (and MG) management described this episode as a watershed for the Australian dairy industry. The new technology was transferred to a number of Australian manufacturers who could then enter the deregulating and expanding Japanese fresh/shred cheese market (MS:ADC, CP:ADC, JK:ADC JN:MG).

#### **1993-4 Episode PB2**

PB management referred to the shock of losing sales for 40% of its production when Bs premium icecream market in Japan collapsed (SJ:PB).

Mits management did not make reference to the negative impact of Bs' collapse on PB's sales. Rather, they recounted the opportunity the B's supply requirements had created in giving them leverage to gain access to ADC product .

#### **The Japanese-Australian wheat market.**

Only one episode was nominated by the AWB as significantly impacting on the Australian-Japanese wheat trade relationships. Neither the sogoshosha nor their mills recalled any episode of particular strain or shock. By 1994 the Australian-Japanese market had experienced the least deregulation and networks were the least changed in membership and governance.

#### **1984 Episode AWBJ1**

The AWB management recalled 1984 as a defining moment when direct exchange with the *sogoshosha* revealed to them the Japanese market's response to their product. This information triggered a new era of information exchange, product differentiation, relationship and customer focus, and pricing signals rewarding quality (NO:AWB, SF:AWB).

#### **The ROK-Australian market for wheat.**

AWB and ROK wheat trade informants nominated two episodes as significantly impacting on their relationships in the ROK market for wheat:

##### **1985 Episode AWBK5**

The AWB and ROK mill industry informants nominated the Cheju Island Seminar as a defining moment in their relationship evolution. Close social bonding, respect and acceptance of the AWB product technology reached maturation after three years of intensive technology exchange (CHL:KU, VA:AWB, JB:AWB, YK:DHFM, KP:DSFM, DR:DoFM).

##### **1992 Episode AWBK7**

The AWB and ROK mill management nominated the Australian wheat contamination allegations as a shock when their close relationships were tested and strengthened (JK:DHFM, YK:HFM, CHL:KU, VA:AWB, JB:AWB).

This question delivered more understanding about the long-term relationship between the firm and its environment, in particular the persistence of a governance structure where institutional changes were minimal (eg. Japan wheat buying). The informants recall and nomination of particular episodes as shocks or defining moments also reinforced the selection of the “ideal” qualities as these were the aspects of the buyer or supplier relationships tested in the selected episodes (see figure 12.2). For example, failure to supply and quality failure were considered critical events but not necessarily damaging in the long term in the case of the wheat chemical contamination episode. In the case of the AWB and ROK millers and government, the trust and cooperation that had been built over a few short years ensured that the supply contamination allegation did not damage the AWB reputation for clean dependable supply.

Clearly firms grow in their knowledge and understanding of, for example, how to negotiate and survive supply failure. There was evidence of this growth in both the ADC and the AWB. However, this corporate knowledge was dependent on key personnel becoming enculturated, and developing trusting relationships with key representatives in the buyer firms. Developing trusting relationships between individuals was time and repeated experience dependent. In 1994 employees in buyer and seller dyads tended to be long serving in their respective companies. In 1999, this trend is less likely in Japan, ROK and Australia.

When combined with the outcomes of the analysis of all episodes identified by the informants, factors impacting on network governance were identified.

These are described and analysed below:

## 12.7 Question Four

**What factors mediated the strategic activity of the firm, and impacted on the network's governance ?**

Mattsson, Kjellberg and Ulfsdotter (1993) adapted Johanson and Mattson's (1991) industrial network model to show network governance responding to two contextual domains: the production-distribution systems and institutional settings.

However, this research revealed that the impacts of the micro and macro contexts were also substantially moderated by the internal characteristics of the firm including the skills and experience of the key personnel. Competition-demand factors, in turn influenced by institutional factors, stimulated actors to attempt repositioning.

The framework developed in this research therefore adds competition-demand and key personnel/actor characteristics to production-distribution and institutional factors as additional important components impacting on strategic action, which in turn determined network governance evolution.

The micro and macro environments conceptualised through this research includes the elements that Stern and Reve (1980) used in their description of the external political economy of a distribution channel. They wrote that:

*The environment of a distribution channel is a complex of economic, physical, cultural, demographic, psychological, political and technological forces. (Stern and Reve,1980:41)*

Figure 12.4 presents a model of the factors and interrelationships which this research has found influences the actor's strategic activity and ultimately the governance of the network. The context constructs in the model are defined and discussed below:

### **12.7.1 The model constructs**

#### **The Macro environment:**

##### **(a) The Institutional Setting**

This includes the political-regulatory and socio-cultural factors:

##### **(i)The political-regulatory factors**

Many writers have identified food trade as historically subject to more market distortion through government intervention than any other product or service category (eg Tyers and Anderson, 1992; Valdes 1981; Yetton, Davis and Swan,1992; Wilkinson and Barrett, 1987; Schroder and Mavondo, 1994; GRDC,1995; CCPs, 1997).

Mattsson, Kjellberg and Ulfsdotter (1993) also noted the particular significance of the institutional setting in agribusiness trade (which they defined as social norms, legal, political and financial institutions) when they studied the internationalisation process amongst European food manufacturers.

Chapter two of this thesis noted the justifications commonly advanced for food market regulation. Governments include reference to the need to maintain cultural integrity, environmental protection and food self sufficiency for strategic independence when



accounting for barriers to food market access.

It was evident from the episodes that the political-regulatory aspects of the institutional settings constrained, liberated or expanded the actor's possibilities for strategic relationship building. In particular the political-regulatory settings in the focal networks created relationship dependencies and stymied the evolution of supplier's relationships from a transaction to more relationship based. For example, for forty years the Japanese FA had required that the AWB supply through their formal tender process. This formalised process inhibited supplier-manufacturer interaction, in particular direct exchange of information about customer response to product. It also made brand loyalty difficult to establish given manufacturers were supplied with blended flour that had long since lost such defining characteristics as country of origin, price and quality.

Changing institutional factors, in particular import deregulation created opportunities in ROK wheat sales and in the Japanese dairy market that could not otherwise have been realised by the supplier or buyer actors.

Some examples of institutional change had an immediate and direct effect on aspects as important as market access, (eg the deregulation of access to ROK wheat sales allowed AWB product to be considered by ROK mills). Other instances of institutional change only impacted when combined with other factors. For example, the MTC led retaliation which "killed" Bs represented a new Australian supply access opportunity for Mits only after Japan's icecream importation regulations were lifted<sup>1</sup>. Mits then used Bs' new supply needs to leverage access to ADC's nets.

The anticipation of institutional change (in this case political regulatory factors) can also stimulate a strategic response from actors who may try to reposition themselves in the expectation of a need to withstand new competition or to make the most of new opportunities in a future expanded market. AWB anticipated that the deregulation of the Japanese wheat markets would increase lower priced competition, given their preferred supplier status. They therefore set about trying to build or shore-up buyer loyalty

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<sup>1</sup> The potential for retaliation against any who aimed to assist Bs meant an alternative supply of icecream from within Japan was not available (TN:MTC, MS:ADC).

downstream with branding and new strategic alliances (that were mostly rebuffed).

Some, eg the Grains Research and Development Council (CPPs, 1997) have argued that institutional change, in particular market deregulation is more likely to be a result of domestic rather than bilateral pressure. The case study evidence supported this observation in that both Japan and ROK were subjected to bilateral and multi-lateral pressures to deregulate. However both ROK and Japan responded to such pressures in ways that still best served their domestic interests. For example, in responding to USA pressure to open all food market access, the ROK government chose to deregulate fastest and first the one market where USA had exclusive supply access (ie wheat).

This deregulation gave the internationalising ROK noodle manufacturers access to ROK milled flour made from the same wheat that the Japanese preferred for their premium noodles ie WA ASW. They could then compete more effectively in the lucrative Japanese udon markets.

While deregulation allowed the AWB to enter the ROK market, the first product exchanges were dependent on successful technology transfer. However socio-cultural factors discouraged ROK millers from seeking information from neighbouring Japanese miller counterparts with thirty years experience of WA ASW processing.

Given ROK sensitivities about appearing technologically backward, a precondition for AWB information-technology transfer was the development of close communication and trusting relationships between the key personnel in ROK milling and the AWB technical specialists. The intensity of ROK visits to mills (approximately every six weeks for the first two years) facilitated this development, as did the AWB technicians' open espousal of anti-Japanese sentiments (e.g. VA:AWB, JB:AWB).

The inclusion of the AWB in ROK wheat trading networks saw the buying power of KOFMIA and USA sellers reduced proportionately. The biggest ROK mills supplanted their own ASMA, KOFMIA, at the buying centre of the networks, with the AWB moving each year closer to USA's position as largest supplier. By 1993 the small mills were also importing AWB wheat from a position independent of KOFMIA. The ROK government's

continued regulation of flour prices ensured however, that the manufacturers buying power grew to eclipse that of the mills in the marketplace.

The background studies and case study episodes also showed how the trigger of an international event could stimulate a wave of institutional change. For example, both Japan and ROK wanted to improve western-style and traditional food quality and quantity in preparation for their international scrutiny during their respective Olympic Games. This had occurred in Seoul in 1988 and in Tokyo in 1964.

The episodes showed institutional change in markets for the same product occurring at different rates and times. For example, the 1994 Japanese wheat market structure and regulation remained similar to that in place thirty years before, in 1964. The ROK wheat market had evolved from no access to partial deregulation of import access in 1984 to full deregulation by 1992.

The dairy market in Japan had been progressively deregulated from the mid 1980s, with the ADC, domestic and export manufacturers strategising to take advantage of the increased demand and competition for new product, eg through strategic alliances, channel shortening and attempts to build brand loyalty and strong trusting relationships downstream. Dairy market access to ROK remained strictly limited, with actors like PB and WC not able to build relationships on shore.

The Australian wheat and dairy industry deregulation occurred progressively from the 1960s.

Thus while identical wheat or dairy product was sold to these two markets, for virtually the same end-use, and in both markets networks showed a mixture of non-market and market governance, very different strategies were required to capture and grow market share.

The pace of domestic and export market/industry deregulation, peppered with the shocks, watersheds and defining moments created complex and dynamic environments that needed to be carefully interpreted and responded to by the actor's key personnel (Brewer, 1993; Schroder and Mavondo, 1994) ).

Timely and accurate knowledge of the dynamic political-regulatory contexts was a precondition for actors mediating the impacts to the advantage of the firm through appropriate strategic activity. Key personnel with such knowledge were therefore a major asset to the firm.

## **(ii) Socio-cultural factors**

The twentieth century growth in international trade led to increased attention being paid to cross-cultural marketing research. However, no consistent theoretical perspective on the impact of cultural forces on business behaviour has yet been developed.

Hofstede (1983) found that national cultural differences have an impact on organisational effectiveness, and many are aware of the impacts of social aspects of business relationships, eg Bjorkman and Kock(1995). However Cavusgil and Das (1997) have noted that cross cultural business studies often do not include issues relating to the cultural context in all areas of the research.

On the other hand, cultural influences have been the subject of numerous sociological studies where there are as many definitions of culture as there have been studies ( eg. Douglas and Dubois, 1977; Rodrigo, 1998). Despite the diversity in definition there is broad agreement that central to any society is a set of common values shared and transmitted by its members inter-generationally which define what is "appropriate" behaviour for that society.

Poor communication exchange or inexperience in a network of relationships can mean a lack of comprehension of the history of the linkages and the positions of all members. For example, if one of the actors seriously affronted a powerful other, violating network conventions, there could be repercussions spilling over to impact on all associated with the miscreant. The antecedents to the new Mits-Bs cooperation meant inevitable exposure to possible retaliation for new network member PBs. As Deutsch (1975, 85) said long ago, if individuals are unfamiliar with the contingencies in their universe they cannot direct their behaviour to ensure they are not exploited.

In the case studies, export industry and network cultures had developed to include both cross-national (eg Japanese-Australian or ROK-Australian elements) as well as industry specific content (eg the convention that allowed MTC to retain exclusive access to WA grains, the convention that required Rok to always receive “best price” because they were the first to buy ADC product some thirty years before, and established routines like the FA tender process which provided the temporal and ritual setting in which consumption and purchasing activities and other interchange occurred between the buyers and sellers).

The cultural setting with its routines and conventions thus provided a conservative framework for social interaction, introducing some greater measure of predicability into the complex and dynamic contexts. Founded around a core of accepted values and behavioural norms, transmitted over decades from one set of key personnel to another, the cultural setting also created an important sense of community.

A shared enemy, or “outgroup” helped to identify and strengthen the relationships between those who did belong. In ROK the “outgroup” was USA and Japan. VA:AWB for example communicated his agreement with the ROK millers that USA demands should be resisted, and Japanese millers had “less integrity” compared with those in the ROK. The fact that VA:AWB only worked in ROK, not in Japan and had married an ROK woman made him a more trusted and empathetic colleague in the eyes of the ROK milling community.

Many have observed that shared value systems play a significant role in relationship formation which delivers such benefits as increased loyalty, a dedication to long-term profits rather than short term goals and better economic performance. Such are the anticipated benefits that companies make transaction specific investments in order to form stronger relationships with their exchange partners (Jarillo, 1988; Gronroos, 1993; Ballantyne, 1995; Fontenot, Vlosky, Wilson and Wilson, 1997; Rodrigo, 1998).

However, the episodes in this research demonstrated that the network conventions can constrain strategic flexibility as much as they can provide opportunities, in particular for those with less supplier or buying power in a munificent agribusiness environment.

**(b) Agribusiness production-distribution systems**

As Porter observed in 1979, every industry has an underlying structure or a set of fundamental characteristics that gives rise to competitive forces. Knowledge of these underlying sources of competitive pressure provides the groundwork for a strategic agenda of action on the part of the individual actors in the system.

Agribusiness systems consist of the production-distribution resources and activities that transform the primary production of animals and plants into products for final consumption. The range of activities therefore extends from "paddock to plate". Activities are interlinked into value added chains and resources are interdependent. Like other industrial systems the interdependencies develop over time as a result of interaction through product, technology, information, finance or social exchanges.

However, agribusiness systems have to take into account a higher level of product and supply variability given their dependence on less predictable biological-organic factors. This element of risk combined with the market interventions and influences of the institutional factors serve to make agribusiness production-distribution systems highly risk averse (Streeter, Sonka and Hudson, 1991; Schroder and Mavondo, 1994; O'Keeffe, 1993).

Typical of most agribusiness systems a range of organisational structures was found among the focal and other actors in the cases studied. These included family owned enterprises (WANGA) supplier cooperatives (MG,TMP,WC), privately owned companies, (Lac, CCC, PB) ASMAs (ADC, AWB, GEB, CWB) and some of the world's largest corporations (MTC, Tom, Mits, SB).

The historical backgrounds and case studies revealed the close association between production-distribution technology, product differentiation, quality and industry performance. For example as long as Australian wheat was transported, stored and sold in hessian bags it was not possible to supply an hygienic, carefully segregated product. Correspondingly, the AWB wheat classification system was crude, with only two grades, helping to reinforce the product's reputation as a low-cost filler. Transition to bulk storage

in the 1960s precipitated a finer grading system (1970s), product segregation and price signals rewarding quality (1980s) and a customer responsive focus (1990s). By 1994 the AWB had been sufficiently successful with its strategies to have created a reputation in Japan and ROK for offering a good quality, clean, safe, reliable supplier, worthy of some premiums.

Production-distribution systems are internationalised to the extent to which activities are interlinked across national borders and resource development and resource utilisation is dependent on resources in other countries. Amongst the cases WC and CCC made their first export sales in 1994, while Lac, MG and the ASMAs had been exporting since the 1960s. SB, MTC, and Rok had been transferring technology or investing in Australian JV enterprises since the 1970s.

As the international experience of the focal ASMAs deepened, their management became aware and then responsive to down-stream buyer expectations, in particular the supplier reliability imperative. The ADC's response to the drought of 1982 had been consistent with their domestic and transaction specific focus. At the time key personnel were unaware or unconcerned about the impacts of loss of reputation, the strength of likely retaliation, and the immediate down-stream problems caused by their failure to supply manufacturers 100% dependent on them.

By 1989 however, when a similar supply crisis occurred, a new ADC manager was sufficiently experienced to understand the significance of guaranteeing replacement product. The 1989 episode thus strengthened, rather than damaged the ADC reputation as a loyal, dependable, customer responsive supplier.

The AWB had been unaware of the end-use of WA ASW and deteriorating quality of its product in 1984. It took another six years for them to successfully address the supplier problems with a mix of price incentives and product differentiation. (Unfortunately however the most important supplier quality, that of reliability, had been jeopardised by their bowing to WANGA demands to segregate the WA ASW wheat pool).

By 1994 AWB strategies had shifted from transaction to relationship focussed as customer

service was added to AWB product exchange in the form of written guarantees of chemical levels, over supply of specification (in the case of wheat), technology transfer and social exchange through officially sponsored visits.

**(c) Competition-Demand factors.**

Changing patterns of food consumption and origin reflecting institutional (socio-cultural) and production/distribution changes constitute a dynamic competition/demand environment for most agribusiness systems and food trade networks. In the twentieth century regulatory factors had significantly influenced demand and competition in the international trade of dairy and wheat products. Both ROK and Japan had also been subject to sustained bilateral and international pressure to reduce food market access barriers <sup>2</sup>.

By the late 1980s the largest Japanese dairy manufacturers and retailers had evolved in line with their market deregulation to become internationally experienced. Retail outlets and distribution systems had become more accessible in line with the liberalisation of domestic planning laws. With the beef market liberalised and subsidies to the dairy industry reduced, domestic milk production contracted at the same time that demand for manufacturing milk grew to meet the increased consumption of Western style dairy product. Thus the institutional change triggered cost pressures which profoundly affected supply to meet changing demand.

By 1994 the lean supply environment had prompted the largest Japanese manufacturers to seek more direct information and product exchange by shortening channels to buy directly from the suppliers who had long been linked to them via the *sogoshosha*. Japanese manufacturers like SB and Mei sought to lock in suppliers with transaction specific investments in strategic alliances designed to produce exports for third countries. However while SB (Japan's largest dairy manufacturer) was sufficiently confident to chose to build its network without a *sogoshosha*, Mei (Japan's second largest dairy manufacturer) chose to remain allied with MTC.

Political-regulatory factors also conditioned demand-competition. For example the ROK

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<sup>2</sup> High tariffs and low quota regimes have tended to be replaced with non tariff barriers, eg stringent phyto-sanitary requirements (CA:UE)



government's condoning of the US Commissary black market stimulated and met demand for western style foods. This allowed the government to appear to officially support the protection of ROK farmers' interests, at the same time that its middle class demands for different foods were met.

In 1993, allegations of wheat contamination gave ROK consumer advocates a platform for mobilising national food self-sufficiency sentiments which, combined with government interventions drove down demand for imported foods during a time of balance of payment concerns.

Over time demand for better quality and more variety in foods grew. Suppliers were able to respond because of the growing international experience of the key personnel, and closer relationships that fostered faster, more comprehensive market information exchange. As buyers downstream also gained greater international experience and volume of turnover, some found the agent's services redundant, an impediment to free flow of information and an additional cost. However as they sought to shorten the chain, they exposed the more dependent supplier to the risk of retaliation from the more powerful, displaced buyers.

In summary, the volumes, pricing, presentation of product and associated services demanded in the focal markets varied over time, in response to institutional (political-regulatory and socio-cultural factors), production-distribution as well as demand-competition factors).

## **The Micro Environment**

### **(a) The Internal characteristics of the firm**

Characteristics of the actor that influenced their ability to design or implement strategies and moderated the impacts of the micro and macro contexts included:

- its corporate history, (including its reputation)
- its export experience,
- scale of operation,
- available resources,

product and service characteristics,  
comparative technology,  
the cross-country experience, commitment and skills of its staff, and  
its ability to leverage referent power (eg through association with an ASMA)

### **Comparative Technology**

None of the focal firms had strong R and D capabilities. All of the Australian dairy manufacturers depended on technology transfer from strategic alliances, joint ventures, overseas owners or trading partners to develop new product lines or standards acceptable to the focal markets. However this history of technology transfers had also created dependencies that had locked some Australian actors into vulnerable positions (eg CCC, UMT and PB). One of the functions of their industry's ASMA had been the loosening of the links tying suppliers into dependent buyer relationships, and the transfer of Japanese technology between Australian owned cooperatives.

The value of technology transfer wanes over time unless competencies continue to be developed that are scarce and valuable to the transferee. The AWB lost its significant advantage in transferring milling technology once the ROK milling industry had developed and competitors offered similar services. The AWB needed for new strategic mix to build loyalty in the era of more powerful manufacturers down-stream of the mills.

### **(b) Key personnel factors**

In their model for understanding buyer behaviour Webster and Wind (1972) argued that all organisational buyer-seller behaviour was individual behaviour. The individual's activities and relationships were motivated by a complex of cultural, interpersonal and organisational influences, as well as by their skills and training. Key personnel were constrained by policies and information filtered through the formal organisation and they were influenced by other members of the buying (or selling) centre.

It was evident from the case study informants that key personnel were instrumental in formulating or implementing strategies which changed the positions of their firms. As well it was their understanding of the accepted or conventional ways of doing business in the

networks which ensured that they could develop close inter-firm relationships which facilitated product exchange while maintaining some flexibility. For example VA:AWB worked closely with the largest and medium sized ROK mills. But at the same time he also developed close relationships with the smallest mills, eventually coordinating their orders to allow the AWB to deliver their small orders in a cost effective way in the last phase of market share expansion six years after the first big mill had ordered.

Although many have recognised that close interpersonal relationships between individuals affect overall interorganisational relationships ( eg Iacobucci and Ostrom 1996; Mummalaneni and Wilson, 1991) researchers have tended to concentrate on the interorganisational rather than interpersonal relationships between individuals in companies.

However, a number of studies have considered the special Chinese relationship concept of *guanxi* and its role in doing business successfully in China ( eg. Luo and Chen,1997; Alston,1989; Wu, 1994; Yau, 1988; MacInnis, 1993 and Ambler et al, 1996.) Japanese and Korean society share a Confucian cultural heritage. While *Guanxi* is seen as uniquely Chinese, (Rodrigo, 1998; Wu,1994) this research showed one particular *guanxi* element, that of face saving, as significant in the focal relationships.

"Face"as defined in the *Guanxi* (Chinese business culture) literature (eg Wu, 1994; MacInnis, 1993; Rodrigo, 1998) is a term used to describe an individual's social status or prestige that is recognised by others and acquired through successfully performing specific social roles. *Face* is thus the function of a person's perceived social status within his or her social network. Hofstede's (1983) power-distance concept has similarities to the concept of *face* in that it refers to a culture's acceptance of inequality.

Japanese informants in the case studies (eg TN:MTC) referred to a "loss of face" to describe one of the consequences of being outmanoeuvred by a less powerful partner in a long standing business transaction.

Industry "gossip" was regularly exchanged during after hours drinking sessions in Japan (and ROK). Given the close identification of the individual with his firm's performance, a

widely known and serious "loss of face" caused by the actions of a less powerful actor required retaliation to restore the reputation of the firm/individual. The imposition of sanctions and their widespread discussion in the trading nets also discouraged opportunistic behaviour from others who could be contemplating following suite.

In this research the critical role of key personnel and their interpersonal relationships became evident. The individuals who were key in helping to achieve their firm's aims included CHL:KU, NO:ADC, VA:AWB, GC:DA, MS:ADC, NL:TMP, TN:MTC and JN:MG. They displayed some characteristics in common: all were male, over fifty years old, and they gained great personal satisfaction from their business to business trade work. With the exception of MS:ADC,<sup>3</sup> all had at least ten years of continuous employment with their firm or research institution. Six of the eight had spent all of their working life with the same firm/institution.

Iacobucci and Ostram (1996), Mummalaneni and Wilson (1991) and Granovetter (1973) recognised that social relations are relevant to commercial exchange in that they create continuity in a relationship, and it is the medium through which social bonding occurs. Hakansson and Johanson (1988, 1990) found that the development of social bonds between companies in international industrial networks led to increased commitment. Social bonding supports the existence of shared values and discourages opportunism leading to trust and further commitment (Morgan and Hunt, 1994).

The combination of VA:AWB's knowledge of acceptable ROK behaviour, the personal commitment he demonstrated through frequent visiting, his egalitarian behaviour and technical skills combined to such an extent that he was considered "a long lost brother" in the ROK networks (JB:AWB). Consequently when the AWB wheat contamination crisis arose, the trust and mutual respect that typified the relationships meant the issue was quickly resolved between key individuals in the mills, the AWB and government officials, some of whom had enjoyed AWB hospitality.

ROK millers evaluated USWA seminars and courses as inferior to those offered by the

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<sup>3</sup> MS:ADC had only spent some four years with the ADC in 1994, but had a long history of Asian export experience from his previous employment with another food manufacturing and exporting company (Plumrose).

AWB on the basis that they always were conducted by different individuals. The CWB was also criticised for not visiting personally, but expecting millers to attend together at a seminar in a central location. Being invited to an AWB officer's home during a visit to Australia was recounted as evidence of the especially close relationship between some individuals in the ROK mill industry and the AWB.

ROK millers described AWB staff as more "orientalised" compared with CWB or USWA individuals. They used this expression to describe why they felt the AWB had achieved rapid growth in ROK market share (ie from 0 to 30% in five years.)

### **(c) The Actor's Position**

Each actor occupies a position in the network it is a part of. The actor's previous exchange activities and its command of scarce and valued resources relative to others in the network determine this position.

### **(d) The Actor's Strategic Activities**

According to Porter (1979) the essence of strategy formulation is coping with competition. According to FitzRoy (1998) areas of strategic importance to the firm include decisions about preferred positioning (including alliances), competitive advantage, the determination of actor capabilities and the focus of the Research and Development effort.

Strategic decisions about actions were made by individuals or groups of individuals whose status in an organisation put them in a position of authority and influence. Individuals interpret a strategic response to the micro and macro contexts through a filter of cultural experience and understanding. Not all activity is deliberate strategy however. As Mintzberg (1978) and Aldrich (1986) maintain, a realised strategy not only contains elements of intention but may also have been conditioned by necessity and chance.

In the case studies, strategic action was taken by an actor in order to change how it related to others in the network in order to capture additional scarce resources. In particular, changing the content and value of the exchange relationships determined the actor's

position, ie who was dependent on whom in the network. The relationships took time and resources to establish and maintain. The costs included sponsoring frequent visits, meals, gifts, golf games, and investing in relationship specific assets (for example, TMP allowing SB to build on their land next door, MG allowing MTC and Mei to build on their land next door, both companies buying new dedicated equipment for the strategic alliances).

Changing relationship dependencies involved risks of sanctions or retaliation, especially if a long established buyer had been shown a lack of respect, and so had "lost face". Avoiding sanctions was possible however if network norms did not appear to be violated (eg the new sales could be seen to be customer initiated.).

It was evident in the cases that successful strategies depended on the key individual's understanding of the network culture, the quality of their interpersonal relationships, and timely and accurate information exchange about changes in the micro and macro contexts. For example to successfully tender for FA milk powder sales to Japan MS:ADC had to know in advance of the FA's announcement who intended to offer what volumes, and at what price.

#### **(e) The Network Governance Structure**

Network firms face two main problems: how to achieve access to the production and distribution resources needed to reach end-consumers and how to develop and maintain efficient production-distribution systems. Firms must consider what to supply and how to supply it. The actors solve these problems through the establishment, development, maintenance and divestment of exchange relationships.

However, relationships can constitute a barrier to new market entrants at the same time that they lock the more dependent partner into an asymmetrical relationship. The dependent actor's flexibility in being able to respond to new market opportunities or to exploit their own growing knowledge and capabilities may be restricted.

The strategic mix may include product or service buying and selling, information, technology, social or financial exchange. These exchanges are effected by institutional,

demand-competition and production-distribution factors.

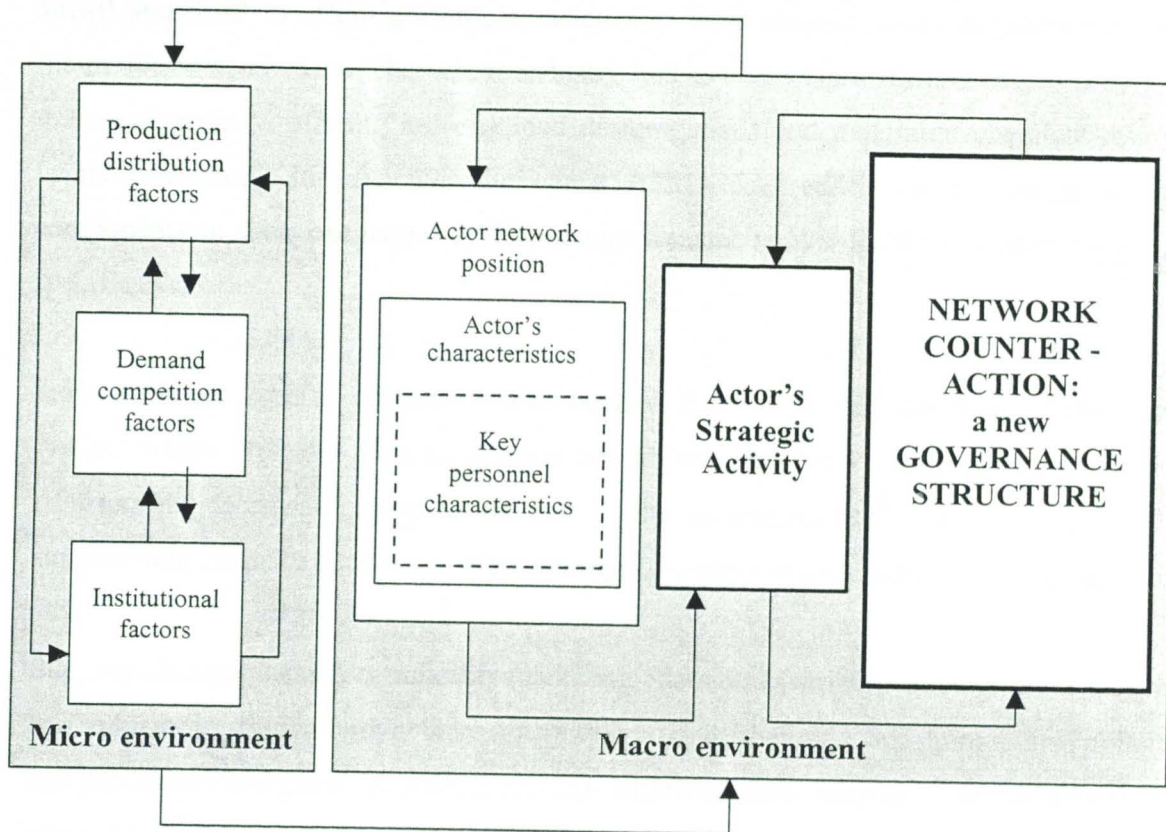
The value of the elements exchanged reflected the power-dependency relationships between actors trying to gain or retain better command of production-distribution resources. The governance structure reflects at a given point in time the actors' linkages and control of resources relative to others in the network.

The efficiency of the network (in terms of its productivity) and its effectiveness (in terms of customer satisfaction), is a product of the characteristics of the exchange relationships between actors. Relationships develop out of a temporal series of transactions with a history that has built or lost reputations that will impact on their future access to resources.

### **12.7.2 The model**

A review of the episodes show significant stages in the evolution of wheat or dairy production-distribution technology and domestic and/or export market institutional factors (in particular deregulation) responding to changing demand-competition factors. The interrelationships between the factors, their interdependencies, influences and counter-influences constitute the dynamic and complex micro and macro environments.

The conceptual model developed is displayed below in Figure 12.2. It aims to make a contribution to our understanding of network governance evolution. It encompasses institutional, production-distribution, demand-competition and firm characteristics as interdependent factors in the micro and macro contexts, mediated by key personnel who enact strategies which impact on network governance. The case study data supplemented by the background research has shown that the model is conceptually appropriate.

**Figure 12.4: A Model of the Process of Network Governance Evolution**

Questions five and six seek to further understanding about strategic activity content and the impact of industry structure on strategies, network governance, and the change processes, in dynamic markets.

### 12.8 Question Five

**How did agribusiness ASMAAs and suppliers strategise to overcome dependency in long-established asymmetrical relationships in dynamic contexts?**

As the Japanese and ROK wheat and dairy markets deregulated and demand for better quality and a greater variety of product grew, Australian exporters were stimulated to attempt to move from the production and sale of commodities to the more differentiated



end of the product continuum.

By 1994 the Australian dairy industry had evolved from exporting bulk butter, cheddar, WMP and SMP to offering multiple varieties of fresh cheeses, dairy confectionary and infant formula powders. The wheat industry had evolved from differentiating only two grades of grain to offering more refined disaggregations and maximum chemical residue levels guarantees. In particular the wheat ASMA had added value through service components in their exchange, eg technology transfer (AWB-ROK) and over-supply of specification.

Such evolution created customer value beyond that of the old commodity marketing systems where typically the total channel margin was fixed and increased profits for one firm implied decreased profits for the rest. In the commodity market zero-sum game the supplier was the price taker with little opportunity to pass on cost increases to the end user.

Suppliers in agribusiness commodity marketing channels invariably came to feel exploited and vulnerable. Typically they were not able to mediate the impact of protectionist policies and production and price instabilities through individual firm strategy. Vertical integration was seldom a choice for the individual producers who were usually much smaller with less market power compared to the buyers.

Oliver argued that:

*the contingencies of asymmetry and reciprocity will interact when cooperative relations are formed for the purpose of exerting power over either a third organisation or other members of the organisation's task environment. (Oliver, 1990:244)*

This research supports Oliver's contention in that the strategic response of Australian wheat and dairy primary producers over time echoed that of their counterparts in most developed countries. For example, in USA, NZ, Canada and the EC, they took collective action to form manufacturing cooperatives, and/or single desk sellers. To overcome the problem of individual freeloading (or "the tragedy of the commons") suppliers agreed that the

marketing collectives be given statutory powers to enforce marketing monopolies.

The ASMAs responded to more differentiated product demand and domestic and export market deregulation by expanding their strategic options beyond a reliance on discrete contractually based commodity transactions. They added to their suite of activities so that in the same markets they maintained concurrently both contractual type as well as more complex relationship dependent exchanges (eg ADC tender sales to Japan).

Through the relational exchanges they aimed to lock in or grow loyalty with higher paying customers and to gain better information to assist with product development to increase their competitive position in the market place

For example:

#### **The AWB-Japanese wheat market**

The AWB anticipated greater competition after the Japanese wheat market deregulated. They planned to retain buyer loyalty by increasing their switching costs through joint ventures in research and development, by branding and further differentiating product offerings in market niches. They aimed to improve customer service and they tried to minimise the threat of backward integration by discouraging or sponsoring (ie controlling) their suppliers interaction with sogoshosha and downstream manufacturers.

#### **The AWB-ROK wheat market**

The diminishing rates of return for ROK millers, their technology catch-up, the ROK government's continuing downward pressure on flour prices meant AWB premium priced market share was unlikely to continue to grow at the rate of the first few years of market deregulation. The AWB's strategy was to create new customer loyalty downstream through joint venture R and D with manufacturers. The first tentative overtures were rebuffed. The manufacturers had long before forged alliances with huge US companies with internationally strong brands.

#### **The ADC-Japan Dairy Market**

As markets deregulated the ADC, some of their more internationally experienced suppliers

and Japanese manufacturers sought out direct exchange and strategic alliance relationships. With market growth for more differentiated product the ADC aimed to survive by selling more retail ready product closer to the retail end of the channels. Their earliest attempt with long-life camembert failed when Lac capitulated under pressure from its old sogoshosha, MTC and supplied a cut-price product to compete with that sold to ADC.

The establishment of successful new relational exchanges (ie avoiding retaliation) depended on a detailed knowledge of and commitment to culture bound principles related to acceptable buyer-seller behaviour, trust, and acceptance of responsibility and commitment to the on-going relationship.

Some long established formally contracted sales (eg Japanese FA tenders for milk powders) continued to be officially contractual exchanges. However, over the thirty years informal protocols had evolved that saw the key personnel of competing suppliers and agents determine between them who could participate and the size of the share of the tender to go to each "eligible" supplier.

This informal process was dependent on the key personnel having detailed knowledge about which actor was likely to tender and the volume and price to be offered. Mutual respect for long-standing network positions (ie Axelrod's shadow of the past) was also a prerequisite, along with compliance, or acquiescence, induced by an expectation of future episodes of product exchange between the competing suppliers and agents (ie Axelrod's shadow of the future). Observation of the market conventions not only represented a barrier to market entrance for newcomers, they reduced opportunistic or price cutting behaviour.

Axelrod's "shadow of the past" (ie past strategic choices and exchange relationships) was an important element in the shaping of the reputations of firms which he saw as effecting the opportunities and constraints placed on their future relationships (Axelrod, 1984). For example, the AWB-ROK wheat contamination allegations could have produced longer lasting and more serious demand contraction if the ASMA had not already established a reputation as a supplier of clean product. To this was added the fact that they had also invested heavily in and established close, cooperative and respectful relationships with ROK government departments and mill management.

With increasing internationalisation suppliers and buyers aimed to bypass the agents, ie the sogoshosha and the ASMAs in their networks. SB for example by passed MTC, and WANGA and MG were questioning the need for an industry ASMA in a future where close relationships had developed between them and a manufacturer.

Suppliers and manufacturers expected the elimination of the "middle man" sogoshosha or ASMA to deliver higher prices, higher volume, higher value sales. They anticipated stronger buyer loyalty for their "brands" and better market intelligence from an exchange partner whose product/demand trend information needs coincided with theirs. The Japanese consumer's preference for new product lines, or "so called product churning"(Ohbora, Parsons and Riesenbeck, 1992; Kilburn, 1995; Barrager 1993) meant timely and accurate market intelligence was of particular significance when trying to grow a share of the market for more differentiated product.

However, dealing the powerful agents out of the networks was a dangerous strategy with retaliation a very real threat (see ADC, TMP, Lac, PB, CCC and MG case studies).

The ASMAs and sogoshosha aimed to maintain the status quo where for more than thirty years their close to centre or central positions in the networks delivered to them a comparatively reliable supply of low cost, easy to sell product. They sought to counter the pressure from immediately up or down stream by one or both of the following strategies:

**(i) Minimising direct contact between the buyers and suppliers.**

The ASMAs and sogoshosha (ie the agents) aimed to achieve this by controlling all supplier-buyer information and social exchange<sup>4</sup>. The ASMAs or sogoshosha arranged the itinerary, accompanied and interpreted for their suppliers' or buyers visits to the market places. (When MTC offered to host WANGA's visit to ROK and Japan, AWB intervened and took control).<sup>5</sup> The agents aimed to reinforce the cultural norms of the network (and therefore the status quo) by mutually accepting that it was an act of gross disloyalty to visit

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<sup>4</sup> MS:ADC shocked ADC Japanese staff by wanting to tell suppliers who was buying their product. (see ADCJ case study)

<sup>5</sup> Sogoshosha (in Japan) and mills in ROK cooperated with the ASMAs by designating these missions "hullo visits", ensuring they had an entertainment rather than an information gathering outcome (VA:AWB).

a buyer's customers without the prior knowledge and consent of the buyer.

**(ii) The formation of strategic alliances**

The agents aimed to lock in supplier-buyer loyalty through the formation of strategic alliances down or upstream by initiating and dealing themselves into formalised arrangements with their long-term suppliers and buyers where they contributed financial resources, market intelligence or access to distribution systems.

The problem for the ASMAs was that they operated in a munificent supply environment and buyers hardly needed to compromise their flexibility in pricing strategy or country or origin of supply by committing to alliances. In the one case where the AWB could offer a unique product (ie WA noodle wheat) long established network conventions restricted the competition for supply from this source ( ADCJ and WANGA cases).

Both the case episodes and the responses to the question about preferred supplier-buyer characteristics showed an important variable influencing exchange partner choice was transaction costs. These costs and the likelihood of opportunistic behaviour were well understood by the actors to be negatively correlated.

Many writers have identified that transaction costs are reduced by generating trust (eg Thorelli,1986; Jarillo, 1988; Ganesan, 1994). Salmond (1994) argued that the level of trust was positively related to the balance of power between partners, environmental uncertainty, experience of previous trustworthy behaviour (ie the history of the relationship) and the support of custom or law. Analysis of the forty-three strategic episodes identified in these cases showed strong support for Salmond's contention.

Resource dependency theory (eg Pfeffer and Salancik, 1978) focused on the development of a close relationship as a strategy for diminishing the consequences of uncertainty and asymmetry for a less powerful firm. Porter (1990) and Hughes (1992) are amongst the many who join the resource dependency (and network theorists) in support of the concept that cooperation tends to benefit individuals and firms. However this research showed close cooperation (and asset specificity) in asymmetrical relationships commonly created dependencies which diminished the less powerful partner's strategic options.

The research showed powerful actors deliberately sought out asymmetrical alliances where they felt assured that in the short and long term the new partner would possess comparatively less power to influence them adversely. The Melbourne based SB management (MD:SB) clearly enunciated his company's preference for alliances with smaller companies who were never likely to compete with branded product, and whose investment represented a substantially greater commitment to the alliance than their own. On this basis a small Australian cooperative supplier (TMP) was chosen over a larger Australian (Bonlac) and a NZ enterprise with more differentiated product lines. Even when the supply of inputs from Bonlac was essential for the survival of the TMP-SB alliance, and Bonlac invested more money into factory modifications than TMP, SB chose to have TMP negotiate with Bonlac, keeping them at a distance from the dyadic relationship.

#### **12.8.1 The function of market conventions.**

While the ADC had their industry's approval, sufficient market power and the statutory authority to intervene in supplier-buyer relationships, successful avoidance of retaliation was often a combination of market power leveraged through the ASMA and a strategy deliberately enacted to appear to "play within the rules". For example in 15 of the 43 case study episodes, a knowledge (or lack of knowledge) of market conventions was the critical factor in achieving, or failing to achieve a repositioning. These "rules", or normative expectations, were similar in both the dairy and wheat export market networks that extended across borders from Australia to Japan and ROK.

Playing within the rules or compliance with the conventions presupposes knowledge of the culture. Abiding by the rules depended on the successful socialisation or enculturation of new members to the networks. The networks accepted normative behaviour had to be successfully transmitted to new members. Deutsch (1975) wrote that if individuals or groups are unfamiliar with the contingencies in their universe they cannot direct their behaviour to ensure they are not exploited. This research found that the contingencies of significance in the universe included network culture.

In the absence of shared formal "education" systems, the socialisation of new members

depended on experiential learning, with management staff dedicating the time and commitment to learn from those who have succeeded in the network before them.

The key personnel were socialised and enculturated to the extent that they had internalised the values, norms and expectations of their respective industries, domestic and export markets. They accepted the network routines and trading partner's expectations as legitimate, which was reflected in their knowledge of likely consequences, attitudes and preferences for particular patterns of strategic behaviour. This knowledge, for example, meant that MS:ADC could design a strategy which he accurately predicted, if faithfully enacted by DH:CCC, would allow his firm to reposition without retaliation in a highly dependent relationship.

VA:AWB understood when to anticipate "a quiet cup of tea" and when to be prepared for celebrations with many bottles of alcohol and hostesses. He was comfortable in either situation. He knew when and what sized gift was appropriate on each occasion. Like JB:AWB, he understood the concept and consequences of a "loss of face" and so he managed to offer advice to technically less skilled ROK millers without giving offence.

#### **12.8.2 The norms governing the export networks' strategic behaviour:**

In Japan and ROK the case study episodes revealed the following as "conventional" behaviour:

(i) An established supplier-buyer relationship, even if it is markedly asymmetrical, should not be disturbed. However the supply of a "new" product to a "new" buyer (even your own buyer's long established customer) is legitimate.

There was evidence in some episodes that the definition of "new" was manipulated to cover little more than a product name change (eg Myalla was called Goshred), or repackaging (eg the reboxing of Lac camembert). By calling a product "new" however, "face" could be saved when opportunism in a long-standing buyer-supplier relationship could otherwise have triggered a reputation-saving counteraction.

(ii) The network rules acknowledged that the "Customer was King". When a seller supplied

a new product to someone else's long standing customer, the supplier was less likely to be reproached and experience retaliation if the new relationship was represented as initiated by the customer. Hence, MS:ADC managed a number of network expanding strategic episodes by representing the activity as a customer initiated request for new product.

Abiding by the network conventions allowed adversely repositioned network participants to "save face" (MS:ADC). This in turn reduced the likelihood of direct and/or immediate retaliation of the type that put Bs and ADC-Chesco out of the icecream and camembert distribution business (episode PB2).

The case study episodes revealed how corporate knowledge achieved through the learning experience of key personnel grew over time. For example it was only when the ADC management better understood the consequences of failure to supply that they regained some of the market share losses resulting from their 1982-83 actions.

The AWB decision to sever their ties with the international traders and move to a closer supplier-buyer exchange with the sogoshosha in 1984 placed AWB management in a position where they could begin to learn the expectations and conventions of the Japanese and ROK trading networks. From that point on they became more market responsive, although it took another five years for them to closely adapt product and service to their customer's needs.

Social interaction and information exchanges in the form of regular visiting, phone calls, fax and e-mail exchanges, golf, karaoke, drinking and eating together kept buyers and sellers regularly informed of network activities. The Japanese ADC management used a generous entertainment budget to host elaborate monthly dinners for their network sogoshosha and biggest manufacturer-buyers.

## **12.9 Question Six**

**How did industry structure and ASMA strategy influence the focal suppliers' internationalisation, strategic flexibility, relationship development (and hence positioning)?**



The cases showed strategic alliances delivering some benefits to the smaller actor, for example technology transfer, knowledge of the networks, international experience, and regular orders. However many actors became trapped into dependent positions where prices remained low (eg CCC, Lac; PB). The more powerful partner's strategies could also negatively impact on other long-standing relationships in the nets of the smaller partner. For example TMP begged SB to negotiate with MTC when it found the powerful *sogoshosha* was to be excluded from their new strategic alliance. SB refused this request and MTC retaliated by cancelling its annual contracts with TMP and setting up a rival strategic alliance to compete with the same product.

#### **12.9.1 Dependence balancing options in dependent relationships**

The strategic options for the smaller less powerful actors seeking to balance their dependency included:

- (i) attempting to spread the risk by seeking out a range of buyers and not committing too great a proportion of production or resources to the supply of just one customer (eg TMP and MG)<sup>6</sup>. and
- (ii) checking the identity and characteristics of others already in stable relationships with the future exchange partner, in order to calculate whether they were in competition with the smaller partner's established buyers.

The Australian dairy manufacturers and wheat growers had long before supported the formation of ASMAs to protect and defend them in "corrupt" global markets. For example, the suppliers could:

- (i) grow the "shadow of the past" and the future by being mentored by their ASMA whose reputation was longer established, and who exercised market power through monopoly marketing powers.

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<sup>6</sup> Both TMP and MG aimed to quarantine most of their milk for manufacturing from their strategic alliances with SB and ME-MTC respectively. Such strategies did not protect them however from losing sales to their long established buyers who resented the new "marriages" to competitors or buyers they once supplied.

(ii) less powerful suppliers could avoid costly mistakes and speed the enculturation process by taking advice from the more experienced ASMA.

(iii) they could request the ASMA use its monopoly and regulatory powers to intervene in a dependent relationship to take over the role of agent being exercised by some-one else.

Its statutory authority gave the ASMAs the legitimate right to intervene and supplant any industry exporter in a buyer-seller relationship, including joint ventures. The industry directed the policy of the ASMAs however, (and could request that the government deregulate them out of existence). In the case of the dairy ASMA, relationship interventions were all confidentially supplier initiated. In the case of WANGA however, the AWB intervened when it saw MTC aiming to sponsor an overseas mission, thereby seriously challenging the network conventions.

By allowing the comparatively more powerful ADC to take the blame for network relationship interventions, the Australian dairy manufacturers could posture as mere pawns, subject to industry regulation. They had thereby reduced the risk of sogoshosha sanctions. Following a successful ADC intervention (eg in episodes CCC1, MG2 and Lac4) the supplier was free to abandon the old relationship or rebuild it from a less dependent position.

Etgar identified power sources of channel leaders as including the ability to give out rewards or penalties and the possession of expertise, referent and identification power (Etgar, 1978). It was evident that the ASMAs could exercise all of these aspects of power to leverage a better deal for their industries.

For example the ADC and the AWB marketing monopolies meant they could award access to Australia's wheat or dairy commodities, or they could penalise buyers by with-holding access. Over time they had developed considerable expertise in the supply of the product as per specification and they had insider status in a number of networks where they were close to the centre of the net. As "representatives" of the Australian Government with statutory status and legitimacy, they had both referent and identification power. (In Tokyo the AWB

did not pay rent on its offices in recognition of its “ambassadorial-official” type status.) ASMAAs were also able to achieve positions closest to the biggest sogoshosha or manufacturers by commanding considerable financial resources and economies of scale through compulsory industry levies and the exercise of their monopoly marketing powers.

With the exception of expertise, none of the focal dairy suppliers or WANGA was able to marshal the collective resources or achieve the authority that gave power to their ASMA. Thus in 1994 the Australian ASMAAs were serving an important function in assisting their suppliers to leverage more market power than was possible for individual entities acting alone.

Evidence from the episodes showed however that the two ASMAAs had not always strategised to achieve the best outcomes for their industries. Indeed in the 1980s, both had reputations for supplying largely undifferentiated, often poor quality, low-priced product. Both the AWB and ADC had also experienced episodes of serious supply problems.

Thus the ASMA status and their regulatory powers were not in themselves sufficient to improve the positions of their suppliers. The ASMAAs had to leverage the advantages of special status with key personnel expertise, enculturation and appropriate strategic activity fine tuned to suit the contexts of each market.

### **12.9.2 Market evolution and ASMA survival**

For thirty years the ADC's network position had depended on its control of access to bulk Australian dairy product (eg bulk cheeses and powders). However, as the Japanese market demand for fresh cheeses grew, market access deregulated, and Japanese manufacturers became more internationalised, the sogoshosha found their buyers (like SB) competing for direct access to ADC's supplies and their suppliers.

As long as it maintained the right to intervene in the marketing of any product the ADC could still use its authority to support suppliers wishing to increase price competition or shorten their supply channels. At the same time however, the ADC, like the sogoshosha, tried to shore up its own survival by forming alliances with Australian and Japanese manufacturers and distributors.

This research also showed that while they could assist their suppliers in an emergency or at critical times in their relationships, ASMA market power could not substitute for the small firm continuously, actively and effectively managing its entire portfolio of relationships. This necessitated an accurate knowledge of who traded with whom in the micro and as far as possible, the macro context, where cross-investment existed, the history of their network's relationships, the identification and characteristics of their buyer's customers, in particular their relative power.

For example, if PB had understood the history of B's experience in Japan and the context of the entry of Mits into the Australian dairy market, they may not have exposed themselves to the extent of dedicating forty percent of their production to fulfil the Mits-Bs supply agreement. While the ADC had agreed to the Mits entrance into Australian nets, this did not protect PBs from its own failure to spread risk and be better informed about the history of Bs divorce in Japan.

An actor's choice of exchange partners is therefore a crucial strategic decision for every network participant. Douglas and Craig (1992) concluded after a review of the international literature that channel management is a neglected area,

*and interest has focused on influence and control with little consideration of issues such as... the selection and motivation of channel members (Douglas and Craig, 1992:308)*

This research showed an appropriate selection of exchange partners was a critical factor in the actor's success in the short and long term. This included their decision to engage, or not engage their ASMA in their buyer-seller relationships.

## **12.10 CONCLUSIONS**

### **12.10.1 The significance of strategic flexibility**

The buyer-seller relationships described in the case study episodes often involved substantial initial investment in time and resources to establish both interpersonal rapport and economic fit (eg AWB-ROK). In five of the Australian dairy manufacturer-sogoshosha JVs, technology transfer significantly assisted the manufacturer to realise their ambitions to internationalise and diversify their product range. JV and other strategic alliance relationships were obviously important and valuable at the early stages of the manufacturers venturing into exporting. However in time, as these relationships became entrenched and well known in the market place, they formed a barrier to new buyers seeking to enter the network (where they could provide price competition). Over the years the less powerful partner tended to become locked into a price-taking dependent relationship. Maintaining or achieving strategic flexibility was therefore of vital concern to the actors in the less powerful position in an asymmetric relationship.

Flexibility demonstrates the bilateral willingness of parties to adapt to environmental changes affecting their circumstances (Heide and John, 1992). Nielson and Wilson (1994) compared flexibility to an insurance policy that ensures relationships can be modified to cope with changed circumstances (like a fall in prices offered by competitors). Channel theorists have defined flexibility as the reaction of suppliers to unforeseen and unforeseeable changes, contingencies that could not have been predicted beforehand (Noordewier et al, 1990: 83).

The challenge for Australian wheat and dairy suppliers was to develop close and long lasting relationships that delivered fast and accurate market information and technology transfer while maintaining sufficient strategic flexibility so they could respond to market opportunities as they emerged. Lorange et al (1993) stressed the need for firms to be flexible with a dynamic evolutionary view of any cooperative venture development. However flexibility was most likely to result from a balance of power. Unfortunately, agribusiness suppliers were often in highly asymmetrical buyer-supplier relationships. They were price takers in a distribution channel where market power was increasingly concentrated at the retail level.

The ASMAs were an institutional response to the asymmetry typical of agribusiness channels. They succeeded in countervailing some dependencies through the use of statutory powers that gave them the status and authority to aggregate product, through controlling supply and price offerings through a single desk, and through legitimate interventions in long standing supplier-buyer relationships. ASMA status, market power, scale and history meant newcomers could enter the market with some reflected reputation by association. They were not alone. ASMAs could assist in ending exploitative relationships without triggering retaliation. ASMAs sped up the slow process of enculturation through direct instruction, matchmaking and mentoring new market entrants.

#### **12.10.2 Horizontal cooperation**

Both an alternative and an adjunct to leveraging market power through the industry ASMA was horizontal cooperation with fellow suppliers (eg manufacturers in the dairy industry or an industry association of noodle growers in the case of wheat). Such cooperation could improve access to and security of essential inputs. Horizontal cooperation was shown to contract however when resources become scarce and competition for these resources intensified (eg TMP, WC).

ASMAs and their suppliers did not evolve unilaterally away from contractual commodity style sales to more relationship driven exchanges of differentiated product offerings laced with additional services. Rather ASMAs and firms needed to be able managed an admixture of transactional and relational transactions for exchange of the same product concurrently. Even where the market was rigidly regulated, (eg FA wheat tenders) some relational elements had evolved. For example, suppliers were allocated market share after informal negotiations that reflected long-established market share conventions and network positioning.

#### **12.10.3 The evolutionary process of network governance**

Evolving network governance reflected the changing relationships and hence the repositioning of firms in the network. The strategies reflected the key personnel's perception of the network position of their firm at that point in time, and the opportunities or threats they perceived in the micro and macro environment. Where the pace of change in

the competition-demand, production-distribution and/or institutional factors was rapid, and some actors successfully entered the nets or repositioned, network governance was most dynamic.

Thus strategic activity was stimulated by the macro environment which was a dynamic admixture of interdependent demand-competition, production-distribution and institutional factors, moderated by the micro context, ie the internal characteristics of the firms, the experience and skills of the key personnel and their network position.

#### **12.10.4 The significance of network conventions**

A particular contribution of this research is the identification of the significance of network culture ( ie the norms and conventions) in facilitating or constraining changes in network governance. In particular "playing by the rules" could reduce the likelihood of retaliation by allowing an actor dealt out of a deal to "save face". The episodes revealed that ASMA strategists succeeded in repositioning themselves and their suppliers on a number of occasions by ostensibly "playing by the rules", while all the time manoeuvring to cut a more powerful agent out of future transactions.

#### **12.10.5 Key personnel and knowledge of the network relationships**

Key personnel who had successfully negotiated a greater share of the market for their firms, (e.g VA:AWB, MS:ADC and TN:MTC), saw the market as a temporal series of inter-connected relationships, and each transactions' history was well known and a source of considerable interest to them. The Japanese, ROK and Australian key informants' recall of the details of episodes occurring decades before were always closely consistent, reflecting the time they have spent in their positions and the extent of the informal exchanges between key personnel.

Forsgren and Pahlberg (1992) argued that power in a network accrues to those who have an accurate perception of the network. Thus knowledge about actual structures, actors and relationships is a basis for influence. To this understanding can be added knowledge about the network conventions. Such knowledge is another important strategic element. Given the convention of a job for life is rapidly changing in Japan, ROK and Australia, the anticipated loss of in-house detailed knowledge of the networks may cause a paradigm

shift in the way relational exchanges are established and maintained in the future.

#### 12.10.6 Interdependence, commitment and performance satisfaction

Many writers have argued that fundamental to the establishment of a successful exchange relationships is actor interdependence and commitment. This research showed that interdependence is not necessarily a pre-condition for voluntary commitment. Rather, interdependence can mean exploitation and a loss of strategic flexibility for the poorer resourced partner in the exchanging dyad (in agribusiness systems this is invariably the up-stream partner).

Wilson and Mummalaneni (1985) developed what is now a well-known formula for measuring *commitment*:

$$\text{Commitment} = \text{satisfaction} + \text{investment} - \text{alternatives.}$$

This research indicates an extension needs to be made which encompasses the concept and consequences of asymmetry and network convention. Therefore:

$$\text{Commitment} = \text{satisfaction} + \text{investment} - \text{alternatives} \\ - \text{fear of retaliation.}$$

Wilson (1995) has more recently argued that:

$$\text{Commitment} = \\ \text{Performance satisfaction} + \\ \text{structural bonds} + \text{social bonds} \\ - \text{alternatives} \\ + \text{trust} + \text{cooperation} + \text{power} + \text{adaptation.}$$

This research indicates that Wilson's model of performance satisfaction could be more accurately reflect reality by extending it to include cultural bonds – fear of retaliation - strategic flexibility.



Therefore:

$$\begin{aligned} \text{Commitment} = & \\ & \text{Performance satisfaction} + \text{structural bonds} + \text{social bonds} - \text{alternatives} \\ & - \text{fear of retaliation} + \text{trust} + \text{cooperation} + \text{power} + \text{adaptation} \\ & - \text{strategic flexibility} \end{aligned}$$

### 12.11 Methodology issues for future business research

Alpert et al (1997) suggest that gaps in the literature to do with product branding in Japan stem from the difficulty of gathering valid data from Japanese firms. Using participant observation and case study methodology this research has been able to gather commercially sensitive data from business informants in Japan, as well as in ROK and Australia. Triangulation of the data has shown a high degree of consensus in episode reporting, which in turn has been checked against historical background built from secondary sources. Thus the problem of verifying data and providing historical data has been overcome in this research.

The model of the process of network governance evolution developed also offers a workable framework for collecting data and undertaking an analysis of dynamic business to business relationships using case studies. Case study analysis has long been plagued with the difficulties of distilling theory from the mass of highly complex and variable data that emerges from real life observation and information gathering. Using the constructs, the data can be distilled and organised to assist in understanding dynamic processes.

This research therefore provides an example of case study method successfully applied to gain insights into complex, dynamic interrelationships in real life contexts

## **12.12 Implications for Australian Government Policy**

The creation of a statutory authority with a market monopoly does not in itself guarantee the success of collective action in countervailing dependency in agribusiness markets. However, when combined with the employment of key personnel with a detailed knowledge of the market place, and customer-responsive and adaptive strategy, this research has shown that ASMAs can and have helped balance market dependencies.

As well, the compulsory aspect of ASMA industry levy collection counters the problem of free loaders and can create the scale of financial resource required for long-term market development and promotions. ASMAs can use their authority to control product and associated service standards across an industry. Finally, in a marketing system where continuity of supply is a critical competitive advantage, the ability of the ASMA to pool and blend product from widely dispersed geographic regions has helped counter the problem of variable seasonal output which has long plagued Australian primary production.

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## Appendix A

<b>Informants</b>	<b>Location</b>	<b>Date of Interview</b>
TF:AWB	A	6.94
NO:AWB	A	6.93
JW:AWB	A	6.94
SF:AWB	J	9.93
GH:AWB	A	11.93
TM:AWB	J	9.93
StD:AWB	A	6.94
BW:AWB	A	6.94
GM:AWB	A	6.94
VA:AWB1	A	8.93
VA:AWB2	A	6.93
VA:AWB3	A	9.94
VA:AWB4	A	2.95
JB:AWB	A	4.93
JW:AWB	A	5.94
NO:AWB	A	5.93
JH:AWB	A	6.94
SF:AWB	J	9.93
CHL:KU	ROK	9.93
HU:Y	ROK	9.93
WO:KOFMIA	ROK	7.94
JK:DHFM	ROK	8.93
YK:DHFM	ROK	9.93
JS:CFM	ROK	9.93
SW:CFM	ROK	8.93
IB:CFM	ROK	8.94
YM:CFM	ROK	8.93
WH:DoFM	ROK	7.93
BH:DoFM	ROK	8.94
DR:DoFM	ROK	8.94
SC:DoFM	ROK	7.93
BS:HFM	ROK	6.93
YK:HFM	ROK	7.93
SP:HFM	ROK	7.93
SP:DSFM	ROK	6.93
KP:DSFM	ROK	6.93
JM:SHFM	ROK	7.93
JA:SHFM	ROK	7.93
KK:SHFM	ROK	7.93

JY:YFM	ROK	8.94
SP:SKFM	ROK	8.94
SJ:SKFM	ROK	8.94
IK:DFM	ROK	11.94
HK:DFM	ROK	11.94
SK:CA	ROK	12.94
JK:CA	ROK	12.94
SK:YW	ROK	7.93
CA:USE	ROK	11.94
MR:USE	ROK	11.94
PB:AE	ROK	10.93
HB:B	ROK	6.92
WH:WH	ROK	6.92
IL:IJ	ROK	7.93
JB :U	ROK	7.93
JH:WANGA	A	7.94
LO:WANGA	A	7.94
KM:WANGA	A	8.94
GC:DA	A	9.94
GB:DA	A	8.94
SN:Nf	J	9.93
RN:Nf	J	9.93
NM:Nf	J	9.93
AK:Nf	J	9.93
KN:NpF	J	10.93
TH:NpF	J	9.93
HH:TC	J	10.93
KS:TC	J	10.93
MK:MTC	J	9.93
SK:MTC	J	9.93
TM:MTC	J	9.93
NK:GF	J	5.94
DH:CCC	A	11.92
TT:MTC	A	7.93
TN:MTC	J	9.93
NL:TMP	A	6.93
JG:NZDB	J	10.93
MO:NZDB	J.	10.93
KY:KD	J	10.93
MS:ADC 1	A	6. 93
MS:ADC 2	A	10.93
MS:ADC 3	A	1.95
MS:ADC 4	A	10.94
CP:ADC	A	7.93
KS:ADCJ	J	9.93

SY:ADCJ	J	9.93
MSH:ADCJ	J	10.93
JK:ADC	A	7.93
JI:TSS	J	7.93
HT:Rok	J	10.93
PE:MG	A	4.93
WS:MG	A	5.93
JMc:MG	A	5.93
JN:MG	A	5.93
JS:AE	J	9.93
KK:MK	J	9.93
JI:TSS	J	10.93
HK:Tom	J	10.93
SJ:PB	A	7.95
KM:Bs	J	10.93
KE:Mei	J	10.93
YY:Mits	J	10.93
JG:NZDB	J	10.93
KY:K	J	10.93
NL:TMPa	A	8.92
NL:TMPb	A	6.93
NL:TMPc	A	7.93
PH:TMP	A	7.93
BL:TMP	A	7.93
KH:Rok	J	10.93
KE:Mei	J	9.93
MD:SB	A	7.92
HI:SB	J	9.93
RG:WC	A	7.93
GL:WC	A	7.93
RS:L	A	6.93
WS:MG	A	6.93
JI:TTC	J	9.93
RP:Lac	A	7.93
MW:Lac	A	7.93
SS:LITS	J	11.93
KY:KD	J	10.93
HS:CH	J	7.93
KK:MK	J	9.93

21 December, 1988

CIRCULAR NO.D3/88

To: ALL LICENSED EXPORTERS

Exports of Cheese to Japan : Direction

The Executive Council of the Australian Dairy Industry Conference and the Australian Dairy Corporation agree that for three years from the date of this direction the export of cheese from Australia to Japan is prohibited, except with the consent of the Corporation.

The Corporation's guidelines for provision of its consent to export are set out below.

A. Cheese For Processing and Cheese For Shredding

The Executive Council of the Australian Dairy Industry Conference has agreed to the Corporation continuing to be the sole seller to the Japan market of Australian cheese for processing and cheese for shredding.

Consequent to this agreement, it is not envisaged that the Corporation will consent to exports of this type of cheese.

B. Mozzarella and Pizza Cheese, Camembert and Brie, Gouda

Consent for export of mozzarella and pizza cheese, camembert and brie, and gouda will be provided if the Corporation is satisfied that the activities of the exporter will not and do not pose a risk of prejudicing the interests of the dairy industry and in particular the industry's marketing efforts in Japan for the specified varieties.

In satisfying itself that the exporter's activities will not and do not pose such a risk, the Corporation will require the following information to be supplied.

The exporter's policy with respect to:

- \* pricing; (including the relation to competitor price ranges)
- \* volume;
- \* quality;
- \* source of supply; and
- \* end usage in Japan

The Corporation will be best able to assess the merit of an application if it is accompanied by a clear marketing strategy. Minimum information to be contained in the application are:

- \* the form(s) of product on shipment from Australia;
- \* intended packaging/processing after shipment from Australia and hence form(s) of product at the Japan wholesale or retail level. That is, a clear definition of end usage in Japan;

- \* for each major form at the Japan wholesale or retail level, identification of major competitive brands and/or products, and assessment of the competitive pricing structure for that market segment;
- \* the applicant's pricing policy with respect to the above market pricing structure. This policy should be expressed as a relation to major competitor brands/products; and
- \* source of supply and expected volumes, both for business nearing contractual fulfillment and for target business.

The Corporation will require evidence that source(s) of supply will provide product which comply with Food Sanitation Laws currently in operation in Japan.

As guidance to licensees, it is noted that:

- \* each application for consent should be made for a particular varietal class. Licensees may be granted consent to export more than one varietal class but consent will be provided on a class by class basis;
- \* if consent is granted, the said consent will be conditional on:
  - the continuing operation of this direction;
  - the performance of the licensee in the Japan market remaining consistent with the information provided by the licensee in support of its application for consent; and
  - the cooperation of the licensee with Corporation reviews of the industry's marketing efforts in Japan for the cheese varieties relevant to the consent;
- \* Information supplied in support of applications will be confidential to the Australian Dairy Corporation.

#### C. Cheeses Other Than Specified in A. or B.

Consent for export of cheeses other than those varietal types listed above will be provided except where the Corporation believes they would compromise its marketing of cheese for processing and cheese for shredding.

Applications for consent to export to Japan should be made to:

General Manager  
Planning and Information  
Australian Dairy Corporation  
P.O.Box 5000,  
Glen Iris, Vic.3146.

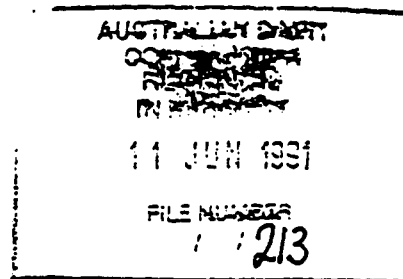
This direction supercedes and cancels all Section 53 directions previously issued with respect to control of exports to Japan.

  
N.C. Armour  
Acting Managing Director.

**ADIC**  
AUSTRALIAN DAIRY INDUSTRY COUNCIL INC.

10 May, 1991

Mr J Frearson  
Chairman  
Australian Dairy Corporation  
1601 Malvern Road  
GLEN IRIS 3146



Dear Mr Frearson

#### **ADC'S TRADING ROLE IN JAPAN**

Further to your letter of 9 April, 1991 the ADIC has now had an opportunity to consider the Corporation's trading role in Japan beyond 30 June, 1991.

As you have noted, in accordance with the requirements of the Dairy Produce Act, the ADIC previously approved the Corporation's role for a period of three years from 1 July 1988 to 30 June 1991.

Under Section 53 of the Act, the ADIC agreed that the Corporation be exclusively responsible for marketing bulk cheese for processing and shredding in Japan, and that it be responsible for the "control" of other cheese exports to Japan. The appropriate direction under the terms of Section 53 of the Act was issued by the Corporation on 7 December 1988.

Following consideration of the matter on 3 May, 1991, and in accordance with Section 53 of the Dairy Produce Act, the ADIC Executive determined to advise the ADC that the ADIC agrees to continue the Corporation's current trading role in Japan in line with existing parameters from 1 July, 1991 subject to -

- . appropriate provisions remaining in any revised legislation after July 1, 1992, and
- . the understanding that the ADIC may withdraw this trading authority after giving the ADC reasonable notice
- . the understanding that the ADC will not withhold permission for companies to trade in cheese in Japan in areas where the ADC does not have control.

The ADIC notes that you have provided a brief report on the Japanese cheese market in your letter, but would appreciate receiving a full report on current ADC Japanese operations, with details provided of past results and future projections. This report should also address the future likely benefits from ADC's continuing involvement in the Japanese cheese market.

Yours sincerely

  
P D Rowley, CMC  
CHAIRMAN