A C T A   U N I V E R S I T A T I S   L O D Z I E N S I S
FOLIA OECONOMICA 85, 1988

Tomasz Domański*

IMPLEMENTING A RETAIL INNOVATION BY A POLISH INDUSTRIAL COMPANY (A Case Study)

1. Introduction

The 1981-1983 reform of the Polish economy created conditions for making effective decisions by companies. Microeconomic goals of companies did not constitute previously a basis for selection of directions of development in the market. A negative consequence of the prior situation was lack of adaptation of companies to conditions prevailing in their environment.

The new liberal act on state companies passed in 1981[1] did not solve this problem. Industrial companies were equipped with a wide range of autonomy in the sphere of production and trade but only in a formal, legal sense. In practice, numerous administrative constraints hampering the making of independent decisions by companies continue to exist. These constraints are felt most acutely in situations of shortages in supply. The absence of stable rules of economic operation seen in fluctuations in the range of commands applied by the central authorities and in fluctuating taxation makes developing coherent strategies impossible for managers of state companies. Such instability causes skepticism among many managers of companies with regard to the success of the 1981-1983 reform.

The data contained in this article were collected in the course of interviews conducted with executives of the participating com-

* Dr, senior lecturer, Institute of Marketing, University of Łódź (Poland).

[1] Ustawa o przedsiębiorstwach państwowych z 25 września 1981 r. [Act on State Companies from 25th September 1981], "Dziennik Ustaw" 1981, nr 24.

pany. The adopted case study method permitted for the collection of managers' opinions on factors determining particular decisions. The company's name has been disquised.

2. Description of the Company

The White Birch Company is today an economically independent subsidiary of a major state enterprise, FOREST. White Birch produces canned fruit and vegetables and other products for specific market areas in Poland. These markets are characterized by some degree of competition due to a seasonal surplus of raw materials and differentiation of economic units operating in it.

White Birch operates in a market covering four neighboring administrative provinces, the boundaries of which have been fixed in an administrative way. This is a result of the command system under which such spatial division of the market was carried out. In the past, the economic activity of the White Birch Company was focussed on the purchase of wood, venison, and forest fruit. Production involved small-scale processing of food and construction of wooden packing crates. The White Birch food processing operation resembles traditional, home-type, processing.

A central reorganization of the market structure in Poland carried out in the seventies forced White Birch to take over a number of small and medium-sized production plants, both state owned and cooperative, with obsolete capital equipment turning out fruit and vegetable products, e.g., wines, juices, salads.

At that time, several of the thirty subsidiaries of the parent company, FOREST, took over small plants producing clothing, knitwear or fancy goods, which had nothing in common with their previous production profiles. Thus, diversification of product structure was not an independent strategic decision for these subsidiaries but it was forced upon them by the type of enterprises covered by integration. In the case of the White Birch Company, the new assortment luckily proved to be complementary to that produced earlier.

Before the 1981 economic reform was introduced, products of White Birch had been sent to twenty seven buyers in different administrative provinces. These buyers were branches of cooperative trading company monopolist in food trade. In trade similar to production, monopolies were set up centrally. A trade monopolist received both wholesale and retail margins. Both the buyers and the sizes of the transaction were determined usually centrally. Neither prices nor margins were matters of negotiations. Differences in marketing costs among particular markets were not reflected in the level of prices or margins. Despite these constraints, some producers striving to shorten physical distribution routes of products decided to supply products directly to local wholesale warehouses belonging to the monopolist, eliminating in this way one middleman, namely the central provincial wholesale warehouses. The ensuing reduction of costs did not affect, to any extent, the division of margins between partners to the exchange or the level of prices for these products in the market. The producer, moreover, did not have any possibilities of choosing his buyers, distribution forms, or determining other terms of transaction in practice.

3. Beginnings of Economic Reform in Poland

In the initial phase after the 1981 reform was introduced, the management of The White Birch Company evaluated the profitability of its supplies to previous buyers. Due to plentiful availability of fruit and vegetable products in Poland, White Birch did not experience any pressure from the central authorities toward maintaining the previous structure of buyers. Because fruits were not considered to be necessities by the central authorities. White Birch had autonomy in the sphere of distribution. Thus, the company's situation was quite exceptional in Poland. Other studies conducted by the author show that only in very few companies did analyses of profitability lead to a change in the structure of buyers[2]. The continued interference of the central authorities, mainly the Ministry of Trade and Services, in the distribution process hindered the undertaking of independent decisions by companies. Shortages in supply are the most commonly applied argument for continuation of command-type distribution methods.

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[2] The same results were obtained by the author in the study of textile industry in 1982-1983.

Simultaneously, local[3] administrative authorities began to exert pressure on White Birch to open its own store. Previously, the company did not maintain its own retail sales network. This pressure was not accompanied by any incentives granted to White Birch such as a favorable location for a new store or any tax reliefs. Differentiation of local taxation levels does not serve as an instrument motivating companies to undertake a specific production, trade, or service activity in a given area. This situation coincided with plans of some managers in the White Birch Company to open such a store. Pressure was applied, meanwhile, by the local authorities for a local retail store in an attempt to increase the favorable image in the population that the local administration was well managed.

The beginnings of the 1981 economic reform in Poland coincided with a difficult socio-economic situation, the organization of Solidarity and its confrontation with the central authorities.

The imposition of martial law on December 13, 1981 was followed by deterioration of the White Birch Company's financial marketing situation. Due to the reduction of Polish exportation of machines and equipment to several capitalist countries, the previous buyers of wooden packing pallets and cases withdrew fifty percent of orders agreed upon earlier on. These buyers continued only insignificant exports to third world countries. This new situation was of major importance for White Birch because production of wooden packaging represented about fifty percent of it entire production value. Resignation of regular buyers posed a necessity of searching for new sources of revenue. The economic blockade of Polish companies to embark upon such a search.

White Birch's exports to developed capitalist countries decreased as well, especially meats, fruits, and processed vegatables. There was also a conviction in the White Birch management for a long time that it was more profitable to supply its products to the domestic rather than foreign markets. Hence, economic motivation to search for new foreign outlets was missing. The financial situation of the White Birch Company was largely aggravated by its statutory obligation to purchase many products meant for export from the domestic market, such as venison. Purchase

[3] The "local" city is a town in Poland with a population above 100 000.

prices for these products were fixed at a very high level by the Ministry of Home Trade. Consequently, although White Birch was declared autonomous by the 1981 reform act it could not stop purchases of these products.

A drop in the exports of the White Birch Company led to failure in covering its fixed costs, mainly the costs of storing large inventories. Other costs included energy and product losses. Many of these products were stored for almost one year. The company was not allowed to sell these products in the domestic market in spite of the high costs of maintaining excessive inventories. Under the binding regulations, the producer may sell only products of the second class, regarding quality, to the domestic market. Products of the first class are for export only. It could be said that in practice, formal autonomy of companies was restricted by detailed regulations of executive acts passed before the economic reform was introduced.

The White Birch Company suffered a loss of three million zloty about 30 000 U.S. dollars in the first six months of 1982 due to the external constraints of the central authorities.

4. Marketing Alternatives

The White Birch Company management had to make a choice from among a number of decision alternatives. These were as follows:

1. Expand the market for manufactured products. This alternative was not very realistic because export restrictions greatly reduce the possibility of finding new buyers for wooden packing material.

2. Change the target market. Exchange of domestic goods on the foreign market was profitable for White Birch but also impossible due to administrative constraints. For example, a ban was placed on delivery of specific products of high quality to the domestic market, which previously had been exported to capitalist countries. This was the case with prepared venison products.

3. Widen the assortment of manufactured products, develop new products for new buyers. This alternative envisaged diversification of the White Birch product line. The management planned to launch production of processed venison adapting the available plant,

which had previously been used only seasonally about one month in a year. The cost of such an investment would amount to only five million zloty (50 000 U.S. dollars). This alternative was eliminated because White Birch could not negatiate a loan with a bank and the Ministry of Finance raised objections. Although the White Birch Company transfers approximately ten million zloty to the central budget annually as amortization it could not obtain the necessary tax reliefs to equip it venison processing plant. The granting of loan is still of a discretionary-bargaining nature.

4. Increase profits by organizing a distribution network for White Birch. Due to the inability to overcome external barriers within a short period of time, the White Birch management selected a decision that resulted in immediate financial effects. The decision was to open the company's own retail store. The White Birch management could not implement this decision but informal contacts with local administrative authorites carried a hope for the success of the initiative.

The Cooperative Trade Organization, CTO, a monopolist in the distribution of products manufactured by White Birch, was plainly against the retail store innovation. The CTO was trying to impede the decision to open a retail store by White Birch using its own informal links with local authorities. The previous distribution system was more favorable for the middleman at the cost of the producer.

Sales of only one out of an assortment of some two hundred products manufactured by White Birch could contribute to a rapid growth of profits. The product was fruit wine with an annual production of about three million bottles. Profit obtained so far by White Birch amounted to only fifteen percent of the costs of production. This resulted in a very small profit because of the low cost of fruit wine production. Consequently, the position of the distributor-monopolist was much more favorable. With the applied system of percentage margines being imposed centrally, the CTO's profits were much higher than those of White Birch. These profits amounted to fourteen percent of the retail price retail margin of nine percent plus wholesale margin of five percent. For example, with a price of 145 zloty per bottle, White Birch obtained a unit profit of 2 zloty, that is, ten times less than the distributor's profit 20 zloty. An alternative that would include an increase in prices for the White Birch products was out of question.

For alcoholic drinks, all prices were fixed by the government ministry. A simple economic calculation showed that supplies of about fifteen percent of the annual production of wine to the White Birch store, about 300 000 bottles, would bring a profit for White Birch of approximately six million zloty, which wolud cover the company's loss recorded in 1982.

Theoretically, the opening of a store by White Birch should afford a possibility of offering a wide range of complementary products for the consumer. However, it was known from the beginning that this decision was strictly of a tactical character. It would not be very profitable for White Birch to perform functions of a distributor of products coming from other suppliers. One stare with a small scale turnover, high transportation costs especially for deliveries over 200 km, and high prices imposed by other suppliers excluded any possibility of additional profit that would be needed to cover additional costs. Nonetheless, White Birch agreed to sell products supplied by other subsidiaries of the parent company, FOREST, with a very small profit margin as a means of obtaining additional profits from sales of its most profitable item, fruit wine.

The management of the White Birch Company developed three argruments in favor of the new distribution system.

1. Profitability would be realized in a short period of time. This would be realized by reducing costs of trade middlemen.

2. Promotion and advertising campaigns could be supervised by White Birch's own management.

3. Creation of a unique trademark and advertisements of the brand would increase brand loyalty among consumers.

Counterarguments included the following:

1. The assortment of products is too narrow. White Birch is not interested in offering complementary products coming from competitive suppliers outside the parent company, FOREST.

2. Maintenance of a constant year round sales volume is crucial. The output of White Birch, food products, is strongly seasonal. The White Birch management is interested in prompt bulk sales to wholesale units. Operating it own store, White Birch would have to have sales throughout the year of seasonal products. This would involve gaining appropriate storage capacities for large inventories. Lack of continuity of sales is typical for most companies and stores operating in the seller's market environment of Poland.

3. Transportation capacities are underdeveloped. White Birch's production plants operate in a . local market but that is away from the company retail store.

4. A supply system to insure availability of complementary products would have to be developed.

5. Auxillary departments of the White Birch Company procurement, sales, and accounting would have an increased range of duties. These employees would not receive any financial compensation. In naturally would arouse some resistance among employees assuming such an alternative is accepted without growth in the work force.

6. Costs to be considered are those to the organization, costs for equipment, and the cost of operating the retail store.

Due to the narrow assortment of its product line, the management of the white Birch Company decided to expand its new product line with goods coming from other subsidiaries of the parent company. The expansion was not restricted to a complementary criterron, but was caused by the structure of production in the other subsidiaries. The assortment sold in the store was quite differentiated. Products included foodstuffs, venison, wine, plaited willow products, and furniture; the latter two products coming from other suppliers. This assortment resembles a conglomeration and is not subjected to any market segmentation criteria. Nonetheless, the sale of products supplied by other subsidiaries in the White Birch store is an original concept. This form of distribution may prove to be competitive in relation.to trade companies operating in the same market segment.

At the time the store was opened, the management in the White Birch Company could not speculate about the profitability of this form of distribution. This was due to the absence of comparable data and lack of experience in such an application.

The concept of a producer's own store could be successfully developed by most firms grouped in the parent company because of their differentiated assortment of products. Such a solution would strengthen the solidarity effect among suppliers from different subsidiaries who would be simulataneously playing the role of buyers purchasing products coming from other subsidiaries. Such a concept would contribute to better promotion of the trademark of the whole parent company. Consolidation of brand names and development of brand loyalty among consumers would result. Moreover, such a form of distribution combines characteristics of integration of corporate type, own store, with integration of contractual type. The producers from other subsidiaries could also play the role of solidary suppliers on the basis of an agreement on joint venture or association.

The attitude of the management in the White Birch Company to establish a bigger network of retail stores is skeptical. They also wish to promote fuller utilization of integration forms based on concluded contracts. Within the framework of the parent company, FOREST, franchising agreements have been conducted with only two trade companies. The entire enterprise had only two producers' retail stores, which was a result of a weak interest taken in development of vertical integration in the distribution sphere.

5. Conclusion

This case study shows diffeculties faced by a typical company in the Polish marketplace. Practical application of solutions that should allow the White Birch Company to obtain or raise profitability of operations is discussed. Making a specific decision always involves a compromise between the management and central authorities. The authorities continue to encompass the distribution sphere and pricing principles. The White Birch Company is not always able to make an optimal decision from its own point of view or from the point of view of the consumers' requirements.

The opening of manufacturers' retail stores allows many manufacturers a chance to improve their financial situation within a relatively short time. Profits obtained in this way are often treated as "unjustified" by the central authority, which undermines possibilities of a wider application of such a distribution form. Other companies have at best one or two retail stores while the value of sales effected through them does not exceed one percent of their overall turnover. Trade companies display a negative attitude to this form of integration initiated by producers.

Most manufacturers do not treat distribution as an important element in the marketing strategy. Conditions have not been created that would promote changes in this field. In a seller's market, there is usually little, if any, motivation for manufacturers to develop contractual forms of vertical integration in the sphere of distribution. Primacy of tactical decisions over strategic decisions can be observed in most Polish companies today. Favorable conditions for the implementation of truly strategic decisions have not been created. The main goal of many companies seems tobe "wait and see" as long as an uncertain crisis situation lasts. A fundamental source of uncertainty is absence of stable and coherent rules of the economic and taxation system. This unstable environment does not generate any motivation to expand production. The rules that do exist are subject to unexpected and inconsistent changes. As a result, many producers deliberately reduce their level of obtainable profit. Interesting concepts developed by managers usually remain unexplored ideas because of constraints placed on the autonomy of Polish companies.

Tomasz Domański

WPROWADZANIE INNOWACJI W HANDLU DETALICZNYM
PRZEZ POLSKIE PRZEDSIĘBIORSTWO PRODUKCYJNE
(studium przypadku)

Celem artykułu jest opis i analiza działań rynkowych średniej wielkości przedsiębiorstwa produkcyjnego w pierwszym etapie reformy gospodarczej 1981-1983. Artykuł ukazuje wpływ ograniczeń zewnętrznych na wybór przez przedsiębiorstwo taktyki działania, umożliwiającej szybką likwidację powstałego deficytu finansowego. Stworzenie własnej sieci sklepów stanowi dla przedsiębiorstwa środek pozwalający uzyskać dodatkowe zyski w krótkim okresie. Autor analizuje konsekwencje bezpośredniego oraz pośredniego udziału producenta w sprzedaży wytwarzanych produktów.