When modern distribution owns the piggy bowl

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Abstract

Founded in 1971, Raporal was a venture of 18 pig farmers whose aim was to produce good quality animal food. The success of this venture allowed Raporal to expand down the entire chain of pork and beef production. The focus on a vertical production structure has also contributed to Raporal's ability to respond effectively to the industry challenges and become one of the top players in the sector in Portugal.

Despite its success, the changes in the macro-economic environment that accounted for the leading position of supermarkets in the grocery market and the growth of their private labels, presented a threat to Raporal, which experienced a significant decrease in sales, in 2006. In face of these events, its management looked for ways to establish binding agreements with important distributors in order to guarantee their space in the market. This partnership resulted in a sudden strategic change for Raporal which initiated its path in the production of a differentiated product.

This case illustrates the importance of the producer and distributor relations, and includes themes such as differentiation, vertical integration and the strong growth of private labels, topics which are addressed in the literature review with the aid of some relevant models.

The analysis in the teaching note section focuses mainly on the development of potential solutions to Raporal's current problems. Amongst which is the strong bargaining power of buyers and the effectiveness of differentiation as a means to mitigate such tendency.

Resumo

A Raporal aparece em 1971, resultado da associação de 18 suinicultores com o intuito de produzir ração de alta qualidade para os seus animais. Através de uma gestão dinâmica e ambiciosa a Raporal posiciona-se agora em toda a fileira de carne de suíno e bovino, e com uma estrutura de produção verticalizada, tem respondido de forma eficaz aos desafios da indústria para se tornar numa das maiores empreses no sector em Portugal.

Apesar do sucesso actual, em 2006, as mudanças no plano macroeconómico, com a liderança dos supermercados no sector de retalho alimentar e o crescimento das marcas próprias ameaçavam o sucesso da Raporal, que sentia uma queda acentuada nos seus resultados. Fase às adversidades, a administração da Raporal procurava estabelecer uma parceria com um dos líderes da distribuição moderna, com o intuito de garantir o seu lugar no mercado. Esta parceria resultou de uma mudança no plano estratégico da Raporal que aumentou o seu portfólio de produtos diferenciados.

Este caso é interessante por abordar o tema do relacionamento entre produtor e distribuidor. De uma perspectiva académica a Raporal abrange temas como a diferenciação, a verticalização e o forte crescimento das marcas brancas. Temas que são abordados com o apoio de modelos relevantes introduzidos na revisão de literatura.

A análise final foca-se essencialmente na exploração de potenciais soluções para os problemas actuais da Raporal, entre eles o forte puder de negociação dos compradores, e a eficácia da diferenciação como forma de abrandar esta tendência.

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Because I couldn't have written this Thesis on my own…

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I. Introduction

This dissertation builds up a case study of Raporal, a company operating in the agricultural and food business, focusing on how it has been successfully able to adjust its strategy to the changing industry needs, which include the strong movement of the consumers towards supermarkets and their private label products.

Operating in the markets of animal production, compound feed production, meat slaughtering and meat processing, the case deals with the emerging legislation affecting the sector, but most importantly, how Raporal has been able to dig its ways through supermarket shelves in order to guarantee its sales.

This thesis offers an illustration of today's manufacturers hot topic; that is, how to deal with the increasing bargaining power of modern distributors? It therefore serves as a useful tool for management and strategic courses, as it tests the use of some of the most academically referred strategic models.

The question on "how producers in the animal production sector can overcome the threat of the increasing bargaining power of modern distributors?" is explored throughout the three main parts of the dissertation.

The first section of the thesis will describe both the company's history and its strategy throughout the last years. This part is also an important introduction to the major industry developments in the food production sector.

Secondly the Literature Review will introduce some strategic models that will then be specifically applied to Raporal's case.

Lastly the Teaching Note will examine Raporal's strategic approach with the support of a guideline with essential questions for class discussion.

With time Raporal has experienced major alterations in its strategic direction. As the environment continues to change it is most likely that new routes will be pursued, although only time will let us know. Nonetheless the case invites the readers to forecast and recommend these future strategic moves!

II. Case Study

In September 2013, the board of directors of Raporal, a large Portuguese firm operating in the agricultural and food industry, talked about the day back in 2007 when they set in a meeting with representatives of Jerónimo Martins, a very important client. Although it seemed like another one of many past meetings, huge changes occurred after this conversation, where a JM[1] representative demonstrated his dissatisfaction with the current general quality of pig meat in the market when compared with what was available in his grandparent's time. The challenge was on; Raporal had to produce meat that resembled that of the past when pigs were fed on cabbage!

Background

Raporal started as an animal compound feed factory, in 1971, and had grown vertically since then to become one of the most important players in Portugal, present in the compound feed production, animal production, meat slaughtering and meat processing market. (Refer to Exhibit 1 for the contribution per business unit). Its business had grown gradually over the years and especially during the last 6 years, reaching a business volume of 86,37million euros in 2012. Given the nature of the business, profit margins were generally low, although during 2012 Raporal increased its profit margin to approximately 4.6%[2], a significant improvement from 2011 when the margins were around 3%. (For details on the annual results refer to Exhibits 2 & 3).

The Start of a Big Thing

The origin of Raporal takes us back to the spring of 1971. At that time Sr. Joaquim Sousa, a local pig farmer, in Montijo, in the south bank of the Tagus River, near Lisbon, and 17 other individual pig farmers struggled to find a reliable and affordable supplier of compound feed for their animals.

Together, these farmers decided to start producing food for their animals. The venture was called Raporal, and the plant was built near their pig farms. This same plant has been updated and was still in use 40 years later.

The plant allowed the farmers to feed their animals, while additional production was sold to external buyers. As a result of the success of the venture, the farmers decided almost 10 years later, in 1980, to acquire the first of many, pig farms under the venture ownership.

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[1] Jerónimo Martins, the group that owns Pingo Doce

[2] These figures refer to earnings before interest, taxes, depreciation, and amortization

Later on, driven by the progress of this association, in October 1986, Raporal expanded its presence down the production line by acquiring Stec, a slaughterhouse and meat processing plant[3]. Stec become the name of the business unit related to the meat processing and become the brand name of products sold by Raporal. Later on, due to technological improvements in the industry, Raporal invested in the modernization of this unit, which was still being used almost 20 years later when the company had around 10% of the Portuguese market share for bovine slaughters and 5% for pig slaughters. At that time, Raporal was specialized in the production of compound feed, animal production, slaughtering and transformation of pigs, bovines and sheep, and owned over 40 cattle farms. (Refer to Exhibit 4 for details on Raporal's Values)

The End of an Era

It was in 2006 when Raporal experienced a year of negative growth. The compound feed plant produced around 61thousand tones of animal food, 16% less than in 2005. Moreover, the revenues from the slaughterhouse decreased by 13% in comparison to the previous year. Overall Raporal generated 33 million euros of revenue in 2006, 3% less than in 2005. It was also at that point that the previous management (and current shareholders) invited the present management to take over, recognizing that it was time to change!

The main focus became the optimization of the resources and the technical updating of production units. "At that point the animal feed plant was operating at about 50% of its full capacity while the slaughterhouse at around 20% of its capacity" said Eng. Cristina de Sousa, President of Raporal. (Refer to Exhibits 5 & 6 for the evolution of the productivity of the animal feed plant and slaughterhouse)

Due to the vertical structure of the business one way to boost the capacity utilization was to increase the number of cattle farms through either acquisition or renting. In 2007 the number of cattle farms had gone up from 3 to 14, consequently more animal feed had to be produced and more animals killed. This trend was still true in 2013. (Refer to Exhibit 7 for details on the number of pig farms). Furthermore, as the number of reproductive females increased from 699 in 2006 to 8157 in 2012, efforts were placed on reorganizing the processes at the cattle farms, creating a more efficient production system under the brand Rapfarms[4]. (Refer to Exhibit 8 for information on the number of reproductive female pigs).

Additionally, in 2012, legislation pressures meant that Raporal had to incur an 827 thousand euros investment in the adaptation of its facilities to the animal welfare standards.

[3] The processing plant is where the meat is prepared for consumption
[4] The brand Rapfarms was created to improve the organization and methods used in the livestock creation sector, as well as to highlight the experience and consequently the quality of the operations.

However, the changes were successful, demonstrated through the increase in the productivity of the female pigs over the years. In 2012 productivity per female pig was 27,44piglets, the highest over the last years. (Refer to Exhibit 9 to see the productivity of a female pig per year)

Cristina de Sousa strongly believed that the way was to continue to expand vertically. Since 2006 revenue volume grew from 33 million euros to 86 million euros in 2012. Both the animal feed plant and the slaughterhouse were being used almost to their full capacity.

The Cattle farms however were not the only sector to experience major changes, since a clear priority in the minds of this new generation of leaders was to update the compound feed plant. This came at an investment of approximatly1.6 million euros that was completed at the beginning of this new mandate. The result was an efficient automatized and certified plant that would in the future be able to give enough response to the planned expansion of the cattle farms.

Another urgent concern for the four managers was to change radically the distribution strategy, as the current strategy was ineffective and extremely costly. Large retailers were becoming more powerful and traditional smaller distributors were disappearing. In order to adapt to this trend, Raporal soon started to negotiate with large retailers for the distribution of its products. Amongst these retailers was Pingo Doce.

In 2009 another change occurred as Raporal opened its first store in Montijo, “A Loja da Carne”, selling directly to the end consumer. This was another way to ensure the outflow of its products while at the same time increasing its reputation. Since then the success of the store had been growing, and the sales volume had been increasing steadily, reaching 869 thousand euros at the end of 2012, and with it, the popularity of the meat produced by Raporal (Refer to Exhibit 10 to see the layout of the store).

Market Trends

In 2012 private consumption in Portugal went down by 5.4% (INE), this decline affected the consumption of essential goods. Leading to these results were the increasing unemployment figures that reached 15, 7% (INE), an accentuated decrease in household income and a major break in access to credit.

Additionally to the decrease in consumption, consumers were also changing their buying habits. In 2012 results indicated that shoppers were more sensitive to price. Family shopping bags were generally smaller and increasingly made up of private label products. According to Kantar Worldpanel, the retailer’s private brand had reached a market share of 38.4% in the beginning

of 2012, 11% more than in the same period of the previous year. According to a study by Nielsen, part of this success is due to the fact that private label product were generally 10% to 30% cheaper. This triggered the expansion of private labels and the reduction of the variety of products offered by large distributors.

Another trend observed in 2012 was the priority given to convenience, and hence the movement of modern retailers to urban areas, closer to the consumer, and away from the hypermarket format, typically located away from city centres. In addition, traditional retailing continued to lose market share. In 2012 this trend was aggravated by a 5, 8% decline in sales of traditional retailers in comparison to the same period in 2011, a tendency that is expected to continue. (Refer to Exhibit 11 for the Modern Retailers' Market Share).

As traditional retailers faded away, modern distributors, such as Pingo Doce and Continente saw their market share increase, despite the economic downturn.

For producers, like Raporal, this meant a continuous decrease in their bargaining power and less control over the price of its own product. At that point the phenomenon of dumping[5] was becoming popular amongst the large distributors, who used their bargaining power to push producer's margins below zero.

This trend also resulted in various attempts by the government to regulate these negotiations. While there were some talks about a new law designed to stop supermarkets from exercising dumping, the code of conduct already circulating had been trying to enforce some of the manufacturers' rights. Still there was the need for PARCA[6]a voluntary initiative to facilitate the relations between producers and distributors, which have positively contributed to increasing the transparency between these negotiations.

While the intensity of the competition within the retailing sector kept increasing, the story for the producers was not much different. According to Raporal, the price of meat was, 25% cheaper than it was five years earlier, due to increasing competition in the sector, mainly through imports. Eng. Pedro Lagoa, one of the board members and responsible for the pig farms at Raporal, added that, "almost half of the meat we eat comes from overseas".

This highlights the need for global common regulations in this sector in order to increase Portugal's competitiveness. As numbers show that back in 1970, 100% of the pork meat in the market was produced "at home", while 40 years later, only 60% of the pig meat was nationally produced. 2012 was also marked by a significant increase in exports. However, the figures

[5] Term often used in international trade to refer to "exporting goods at prices lower than the home-market prices" here referring to retailers selling products at extremely low prices, compared to their production costs.
[6] Platform for the support of agri-food relations, translated from Portuguese: Plataforma de Acompanhamento as Relações Agroalimentares

stayed at 67 million euros. This is well below the 217 million euros of livestock imports, enforcing Portugal's deficit position (INE2013).

Changing the Eating Habits

The international tendency in the developed economies for the last 5 years showed a decrease in the consumption of meat. Advocates referred to animal rights, personal health, social status and economic situation. Following this same trend, Portuguese consumers showed a decrease in the consumption of meat, however pork still accounted for the largest percentage of the total meat consumption (Refer to exhibit 12 for the Portuguese meat consumption trends).

For that same period there was a decrease of 5,5% per habitant in the consumption of meat, in Portugal, which represented less 6,2kg of meat per person, of which 2,3kg were bovine meat and 3,2kg were pork meat.

The Agricultural and Food Sector

In 2012 producers were faced with a challenging year, as the average prices of the animals increased by only 1%, against the 6.6% increase in the production costs, mostly due the prices of the animal feed, the major cost in pork production.

Historically raw material price fluctuations have always been a source of uncertainty to producers. Lately the constant upward trend and future perspective of the prices of these raw materials dictated an increase in the cost of animal food. This imposed an additional challenge to many producers who increased their working capital needs but at the same time had less access to credit. The situation was further aggravated by the unbalanced relationship between production and retailers which has not allowed producers to pass on the increased costs on to the final consumer. According to INE, Portuguese supermarkets sold pork meat at lower prices than anywhere else in Europe.

Another major trend was the general increase in the regulations, to comply with food safety norms as well as obey to animal welfare rules. Amongst many measures, producers were required to have a minimum light amount and maximum noise level, as well as give their animals' permanent access to materials for rooting and playing. Moreover producers had to have a minimum amount of land available per animal for waste disposal. In addition, for pig producers a minimum weaning age of four weeks was established. These changes meant a significant increase in production costs both in Portugal and in the rest of the EU. However the same was not true for other parts of the world that at the same time competed directly with EU producers.

This called for the attention of the need of a more competitive environment, with less bureaucracy, but more importantly with world common legislative norms.

"From Farm to Table"

Historically Raporal used to distribute its products through three main channels; namely door-to-door selling, exports and its own store. While the first targeted mostly restaurants, small retailers, and individual households, exports were mostly done to Spain and Venezuela.

Especially in the case of door-to-door selling, Raporal assumed all the costs associated with the transportation of the meat. Additionally, it required a large number of full time equivalent (FTE) to undertake the related functions, and the payments were never guaranteed. Moreover due to the unpredictability of the sales, the operations were less efficient as planning was hard.

While the potential customer pool through exports was significant the same could not be said about the other channels used by Raporal which basically did not manage to reach enough customers.

Most recently, in 2010, given the current market conditions and the management ambition to change this distribution method, it started to move more intensively towards the modern distributors. Immediately some issues were raised since using large retailers meant giving up the control over the positioning and even price of their own product. In addition the products were mostly sold under the retailers' private label, which meant that Raporal's brand would not be associated with the products sold. Nonetheless the upturns were substantial, payments were done on time, transportation costs were reduced, and as sales were predetermined, production could be planned allowing for significant improvements in production efficiency. Ultimately Raporal gained access to a much larger number of consumers which triggered a large sales volume.

While modern retailers became an important focus of Raporal's distribution strategy, exports remained a significant channel. 2012 was marked by the continuation of the internationalization process, as sales to foreign markets reached € 3 million, of which €878 thousand resulted from a one-shot operation to Venezuela. Eng. Pedro Lagoa stated the importance of expanding its markets in order to minimize the dependency on the internal market that has shown clear signs of weakness. Moreover he referred the need to establish new partnerships in order to guarantee a sustainable growth.

Additionally to the modern distribution and foreign markets, Raporal had yet another channel to distribute its products. It started soon after the acquisition of Stec, when a number of buyers would gather in the dispatching area to buy the meat products. Clients were mostly restaurant

owner's butchers and private consumers, but as these increased in number Raporal encountered a logistics problem, with people circulating in the dispatching area. In order to continue to satisfy these customers, in 2009 Raporal opened its store, strategically located near the dispatching area. Later on, driven by the success of the small store it rebuilt the store investing in a more customer friendly format.

In 2013 Raporal had overcome the period of transition, and was working together with the large distributors. "Pingo Doce was responsible for more than 50% of the sales" referred Sr. Mário Guarda, one of the board members of Raporal and responsible for the meat slaughtering and meat processing units. The percentage of sales through small sellers was becoming more and more irrelevant. And although most of the sales through, Pingo Doce were made under its private label, Raporal kept selling some differentiated products such as the cracklings[7], canned sausages, and ready to consume "bifanas", amongst others, under the brand Stec. (Refer to Exhibit 13 to see some of Raporal's branded products) Moreover, Raporal kept exploring its foreign opportunities as well as maintaining its store.

A Powerful Distributor

Pingo Doce was one of the largest supermarket operators in Portugal, owned by the Jerónimo Martins's group. In 2012 its sales revenue reached 3, 9 thousand million euros. (Refer to Exhibit 14 for the evolution of sales revenue) Other than Pingo Doce the group also operated the cash and carrier Recheio. Its international operations included chains in Poland and Colombia.

In 2012 it had 372 Pingo Doce stores spread over Portugal. This represented 452,588 m2 of selling area. Its stores were strategically located ensuring proximity to the client.

According to a study by Kantar, Pingo Doce has managed to grow its market share which equally translates into a decrease in the market share of almost all competitors with the exception of Continente, which did not seem to be very affected.

Its main competitor, Continente, belonged to the Sonae group; together these represented more than 50 % of the total food retailing market. (Exhibit 15 shows the top ten Portuguese retailers market share)This concentration resulted in tough competition, "if we choose to supply Pingo Doce we automatically will not be able to supply Continente" says Eng. Cristina Sousa when talking about negotiations with their distributors.

Globally JM occupied the 76th position amongst the 250 largest world retailers according to the 2013 Global Powers of Retailing ranking, by Deloitte.

[7] The Torresmos Soltos (Pork Cracklings) was Awarded "Sabor do Ano 2009" ("Taste of the Year 2009")

Pingo Doce started back in early 1980's when Jerónimo Martins's group started to operate in the supermarket industry. Since then it continued to grow, mostly through acquisitions of existing stores, ventures with important retailers, and opening of new stores.

In 2004 it started to heavily invest in the development and of its private labels, following a 22% decrease in the number of products offered in the supermarkets and a general shift towards low prices. Additionally the private label concept was further developed. In 2013 conditions allowed for the growth of the supermarket private labels while product variety continued to decrease. Estimates suggested that in 2016, 50% of the sales will be from private label product, increasing the pressure on producers like Raporal to ensure their space in the market.

The Story

Raporal had become an important player in the Agricultural and Food business. It was estimated that revenues for 2013 would reach €100 million of which around 5% would be profit. In 2012 Raporal produced over 100,000 hundred thousand tons of animal compound feed and slaughtered over 300.000 animals. Pigs still accounted for about 80% of its business, although the bovines business was also growing.

This success was ultimately anchored to the partnership with Pingo Doce, which resulted from the project "pig with more flavor", that allowed both Raporal and Pingo Doce to offer consumers a differentiated and better quality product.

A Pig With More Flavour

"Pig with more flavor" was the project for developing a type of meat that would have more flavor but that at the same time could be produced efficiently in large quantities. The challenge was on since the meetings back in 2007, between Raporal's management and JM representatives. For three years investigations on how this could be done were carried on and finally in 2010 the meat was tested and approved by Pingo Doce.

This new meat meant that Raporal no longer competed with a standardized product, but instead managed to differentiate its pork meat.

Additionally it meant that Raporal and Pingo Doce would celebrate a 6-year contract, where Pingo Doce guaranteed the distribution of this new product.

The decision to take on this challenge was unanimous amongst the board of directors, looking at it as an opportunity to strengthen the relationship with Pingo Doce, an important client with whom negotiations had always been very tough. Additionally Raporal saw in this "partnership"

a chance to reach large numbers of consumers and ultimately reach a larger sales volume that would trigger its growth.

While the 6-year contract increased the dependency on an already very important client it also reduced the uncertainty in terms of sales volume and impaired payments.

What Changed?

When back in 2007 the administrative board decided to take on the project “Pig with more flavour” they also decided to implement some general business changes.

The development of this project took over 3 years to be completed, during this time investments had to be made in R&D and implementation.

The project was not only a change for Raporal but also an innovation for the entire industry. Given the desired characteristics, the breeding of the pigs had to be altered, as well as their eating habits and the environment where the animals were raised. Given the structure of Raporal, these changes affected the three units of the business[8].

Essentially what was desired was a pig with a higher fat content in order to make the meat tastier. Although this might appear contradicting, as recent trends show a general preference for lean meat , "In this new product, we have intramuscular fat, which avoids the need to add oil or other fats," explained Sr. Nuno Ramalho, administrator and responsible for the bovine business at Raporal.

So in order to achieve this, the first challenge was to develop a particular breed of pig that would produce the meat with the desired characteristics. This part of the process required the partnership with PIC[9], a genetic company.

Additionally the pigs had to be castrated in order to avoid the more intense flavor associated with older male pigs. This was only one of the changes in the production line. The facilities where the animals were raised had to be upgraded and the pigs were slaughtered later than usual to increase their fat content.

The animal feed plant was also directly affected as the pigs' diet was changed to include more vegetable fat. Indicators demonstrated that this new diet would be an important factor in making the meat taste better.

At last the slaughterhouse was also modified, so that the meat could be treated and kept at the appropriate conditions.

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[8] Here the three main business units refer to the animal production, compound feed production, slaughtering and processing unit

[9] PIC is the international leader in providing genetically superior pig breeding stock and technical support for maximizing genetic potential to the global pork chain.

Other than the investment made to accommodate these changes, it was clear that the added flavour came at a cost, essentially due to the fact that these pigs ate more. Although this might sound like a minor detail, the feeding of the pigs represented around 80% of the costs associated with their production; therefore this characteristic of the new pig represented a significant increase in the production costs.

The price of the animal feed was directly related to the price of the commodities used. Historically this market showed constant fluctuations which introduced a certain degree of uncertainty in the animal feed business. Eng. Cristina de Sousa, also responsible for the animal feed factory, ensured that the process was highly optimised as the combination of cereals used in the feed varied according to their price and availability, although never compromising the quality and nutrient content of the animal food. Nonetheless this remained as a challenging area because there was little or no control over the price of these raw materials.

Despite the fluctuations in the prices of raw materials, in 2013 Raporal was supplying around 19 million kilos of meat every year to Pingo Doce. These quantities were previously agreed at the time the contract was signed. Also at that time Raporal became aware that it would not be able to supply the full amount demanded by Pingo Doce because of its insufficient production capacity.

In response, Raporal decided to find other producers who would be willing to sign a contract ensuring the production of a certain amount of meat under the exact same conditions. Additionally these partners had to purchase the animal feed from Raporal to ensure that the quality of the meat matched the standards. Together, Raporal and these other 9 smaller producers would be able to supply the quantities required by Pingo Doce.

The result of this partnership was an immediate success; in 2011 the “Pig with more flavour” was awarded the national “The Portugal Winner”[10]prize. In terms of annual performance until 2013, sales were largely made under the umbrella of this contract, which allowed Raporal to continue to grow despite the economic downturn and decreasing consumption of pork meat.

The Cost of Fame

In spite of the success of Raporal´s strategic decision to differentiate its product in order to meet the needs of Pingo Doce, the sustainability of such agreement was an issue for Raporal.

While the contract implied that the meat would be of superior quality in terms of flavour and tenderness, it also guaranteed that this meat would be sold exclusively under the Pingo

[10] Award for animal production and health sponsored by Intervet Schering-Plough

Doce[11]brand. In summary Raporal was essentially producing private label products, which meant that consumers were not able to relate the better product to Raporal, but instead associated it to Pingo Doce. Moreover it soon became evident that the differentiated product was not having as much impact as desired in the negotiations with the retailer. As a result, with almost its full production and distribution dependent on Pingo Doce, Raporal felt the pressure of a buyer with a very high bargaining power. This not only made negotiations harder, but also generated a degree of uncertainty towards the future as most of its sales were dependent on the will of a single buyer.

The end…

By 2013, the contract was half way through, and the board of directors used this “free flow” time to evaluate the agreement and the future of “Pig with more flavour” upon the end of the contract.

At this point it had become clear that the initial aim of the differentiation, which rested in the ambition to improve the relationship with a client, was not achieved, as negotiations remained very tough. Moreover Raporal did not create enough brand awareness, with the differentiated product, although this was never its main objective. Nevertheless it did succeed in increasing its sales volume, and more importantly the growth of its business.

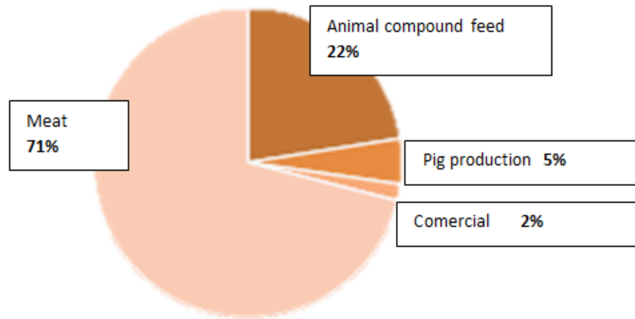
In the eyes of Cristina de Sousa, large sales volumes were fundamental to Raporal’s growth. This in turn highlights the strong dependency on Pingo Doce, and predicts yet again another challenging turning point.

[11] The contract allowed for the selling of the meat through Raporal’s own stores but restricted any other channel including foreign markets where Pingo Doce would already be present such as Poland and Colombia

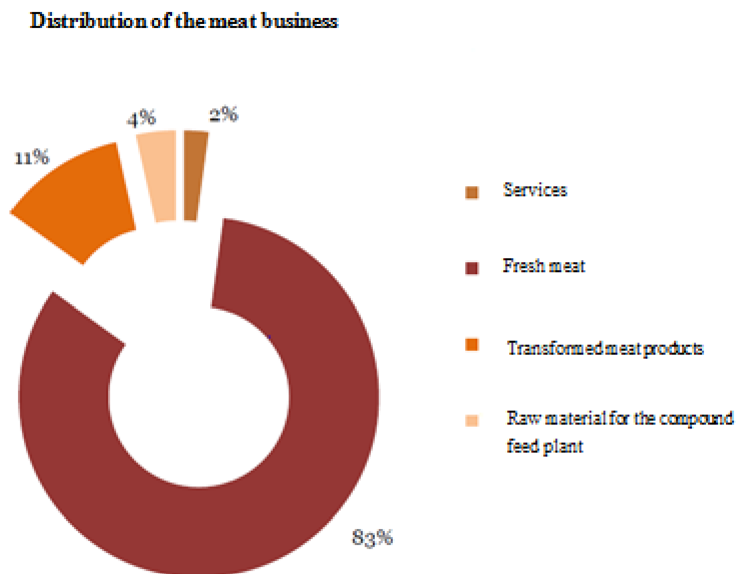
EXHIBITS

Exhibit 1 – Raporal's Business Units

Sales Revenues - % contribution per business unit (2012)

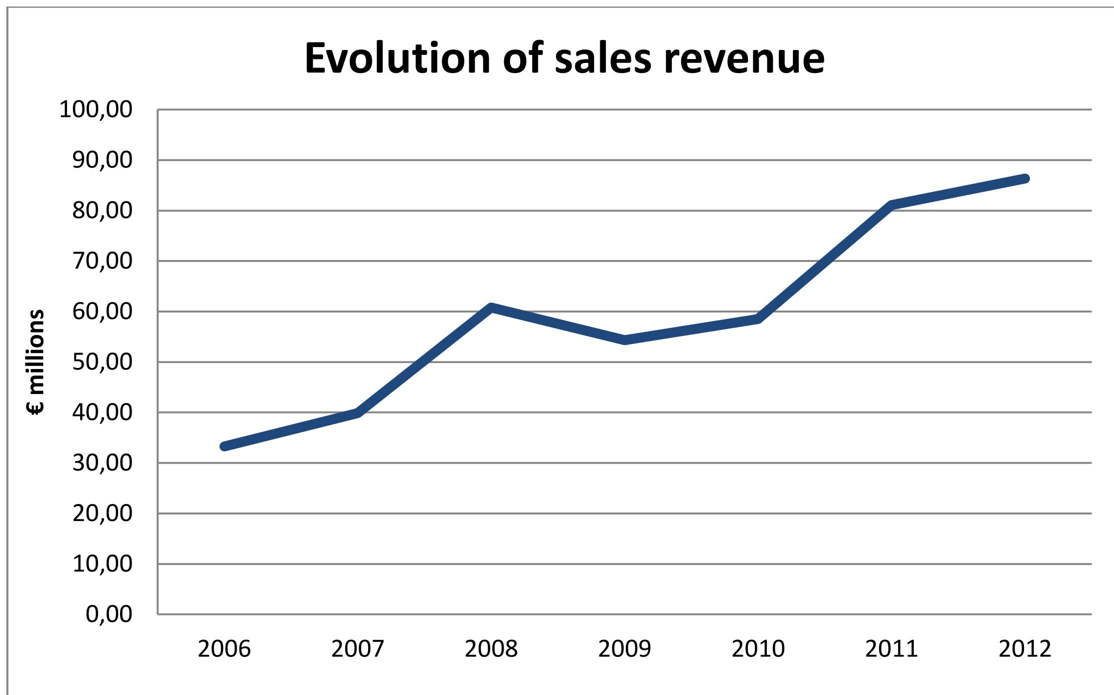


Note that "Meat" refers mostly to the sales of fresh meat, although other categories are included as illustrated in the graph below.



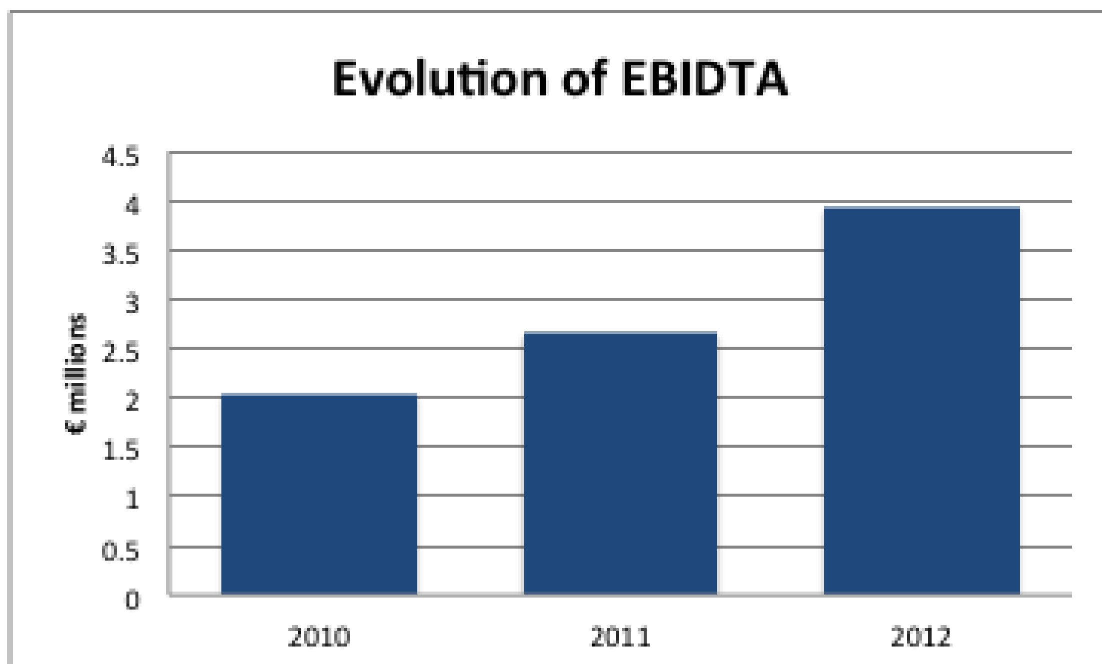
Source of graphs: Raporal annual report (2012)

Exhibit 2 – Raporal Sales



Source of data: Raporal annual reports (2006-2012)

Exhibit 3- Raporal's Earnings



Source of data: Raporal annual reports (2006-2012)

Exhibit 4 – Raporal's Mission; Vision & Values

MISSION

Positioned in the whole chain of pork and beef production, we assume that the investment in a vertical production structure is the most adequate course for the success of our company. Therefore, we guarantee the full traceability of our products, thus reinforcing the quality seal by which our products are recognized in the market.

Our mission is to assure the irreproachable quality of each product produced by us and represented by our brands, in order to satisfy the needs of all our clients and partners..

VISION

We face the future opportunities with responsible optimism, basing our action on the flexibility and ability to adapt to Global Market. Because we assume a commitment of innovation and constant evolution in our sector.

The creation of a mentality aimed at high levels of exigency makes RAPORAL a high productive performance company. We seek to be a reference of quality and trust.

Everything we do is done thinking of the end consumer: The one who demands more quality, a better service and more trust in the contact with our brands..

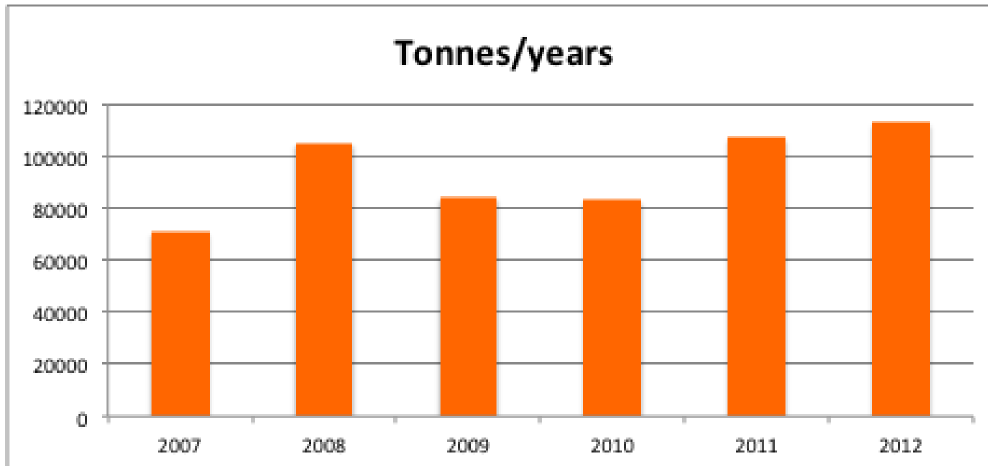
VALUES

- Ambition
- Flexibility
- Tradition
- Thoroughness

Source: Raporal official web page

Exhibit 5 – Raporal's Compound Feed Factory Production

Evolution of quantity of animal compound feed produced



Source of data: Raporal annual reports (2006-2012)

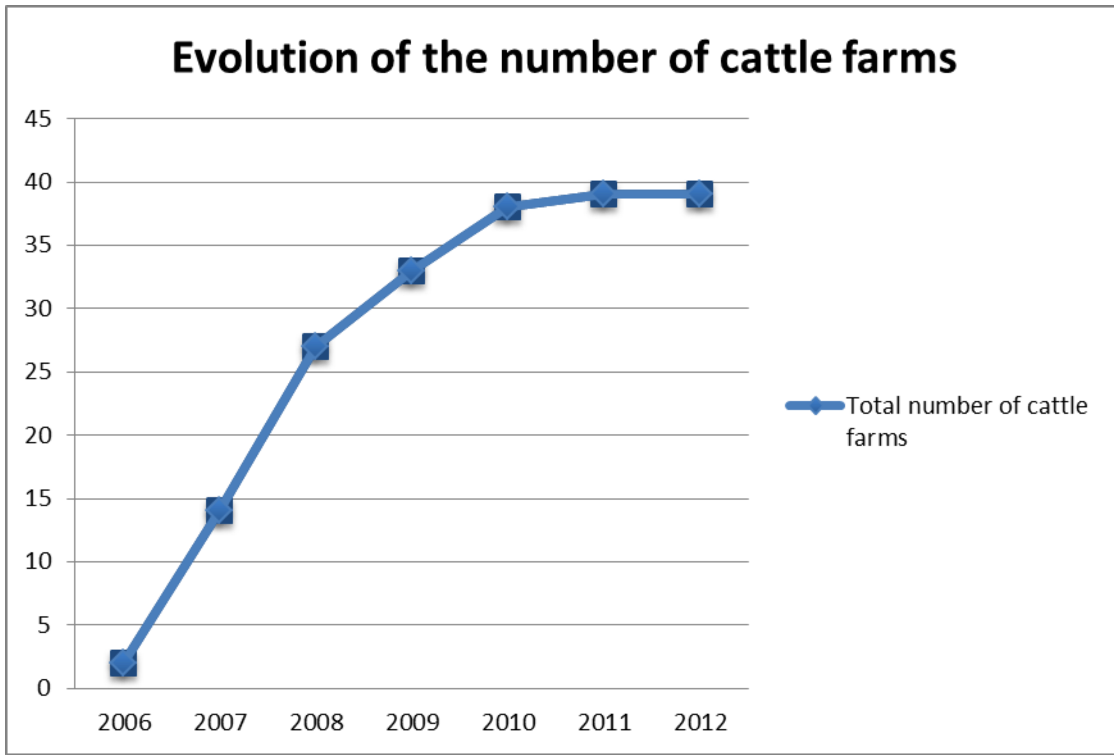
Exhibit 6 – Raporal's Slaughterhouse Activity

Change in the number of animals killed in the slaughterhouse

Year	#slaughters /year	pigs	bovines	%pigs (internal)	%pigs (extrenal)	%bovines (internal)	%bovines (external)
2006	120368	89567	23638				
2007	162199	127012	20251	93%	7%	7%	93%
2008	283640	221341	36943	95%	5%	6%	94%
2009	283648	221478	40748	97%	3%	10%	90%
2010	282869	222514	37202	97%	3%	17%	83%
2011	356983	286657	44623	97%	3%	17%	83%
2012	345716	291439	42869	99%	1%	20%	80%

Source of data: Raporal annual reports (2006-2012)

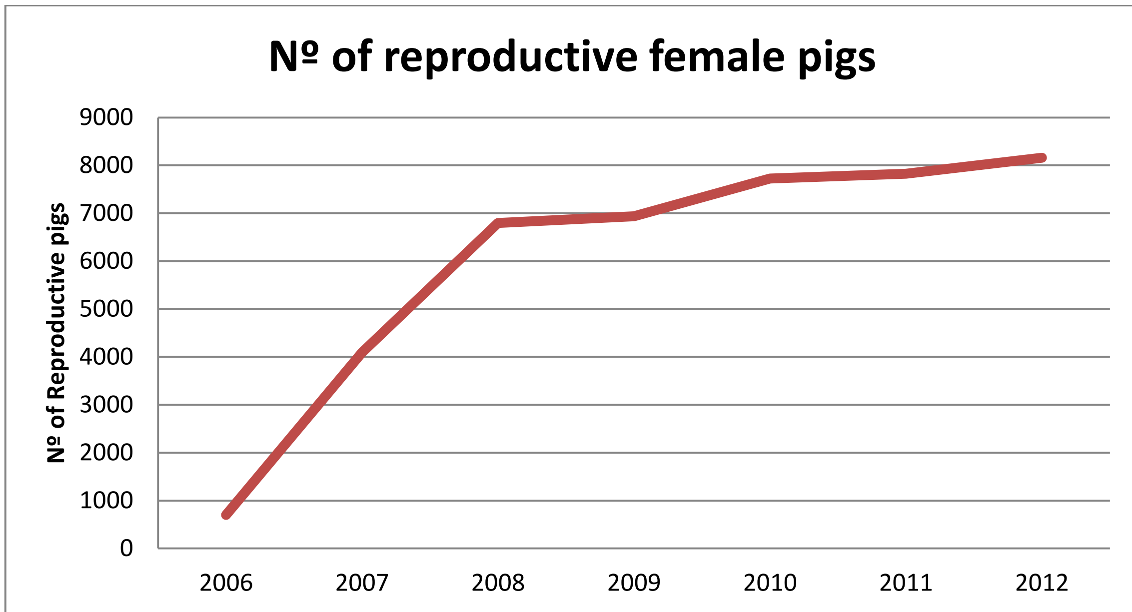
Exhibit 7 –Raporal's Growth of Cattle Farms



Year	Own cattle farms	Integrated cattle farms	Total number of cattle farms
2006	2		2
2007	3	11	14
2008	3	24	27
2009	4	29	33
2010	5	33	38
2011	5	34	39
2012	5	34	39

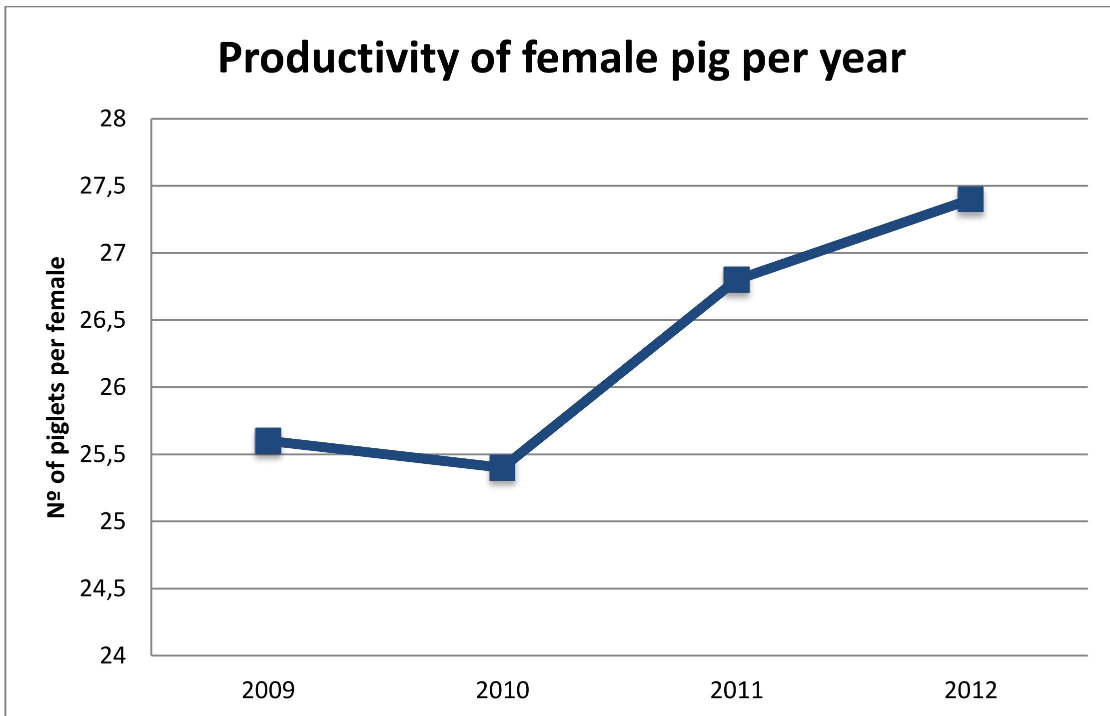
Source of data: Raporal annual reports (2006-2012)

Exhibit 8 –Raporal's Reproductive Pigs



Source of data: Raporal annual reports (2006-2012)

Exhibit 9- Raporal's Female Pig Productivity



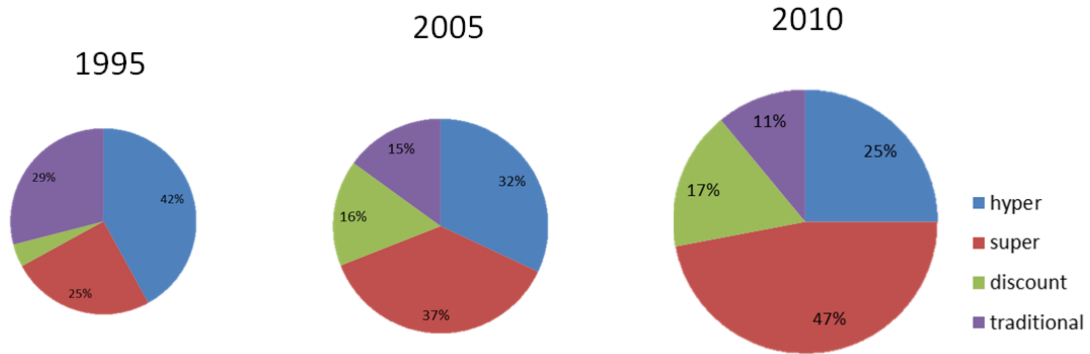
Source of data: Raporal annual reports (2006-2012

Exhibit 10 - Meat Shop

Loja da Carne, Montijo - Shop layout

Source of images: Raporal annual report 2012

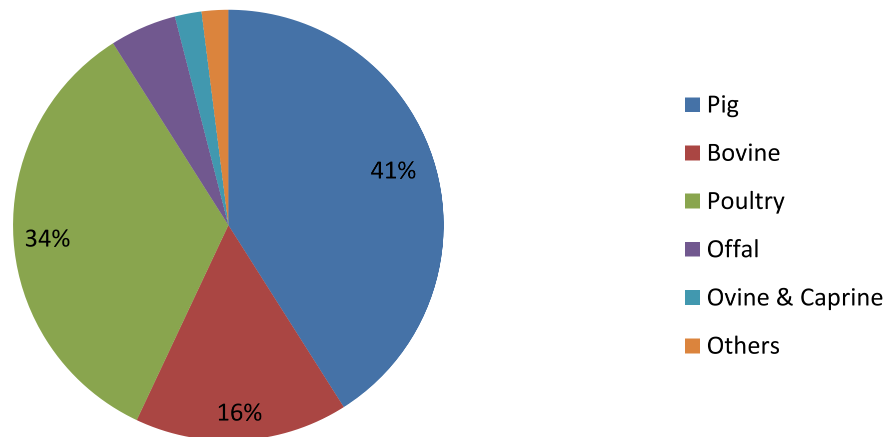
Exhibit 11 – Changes in the Portuguese Grocery Retailing



Source of data: Nielsen

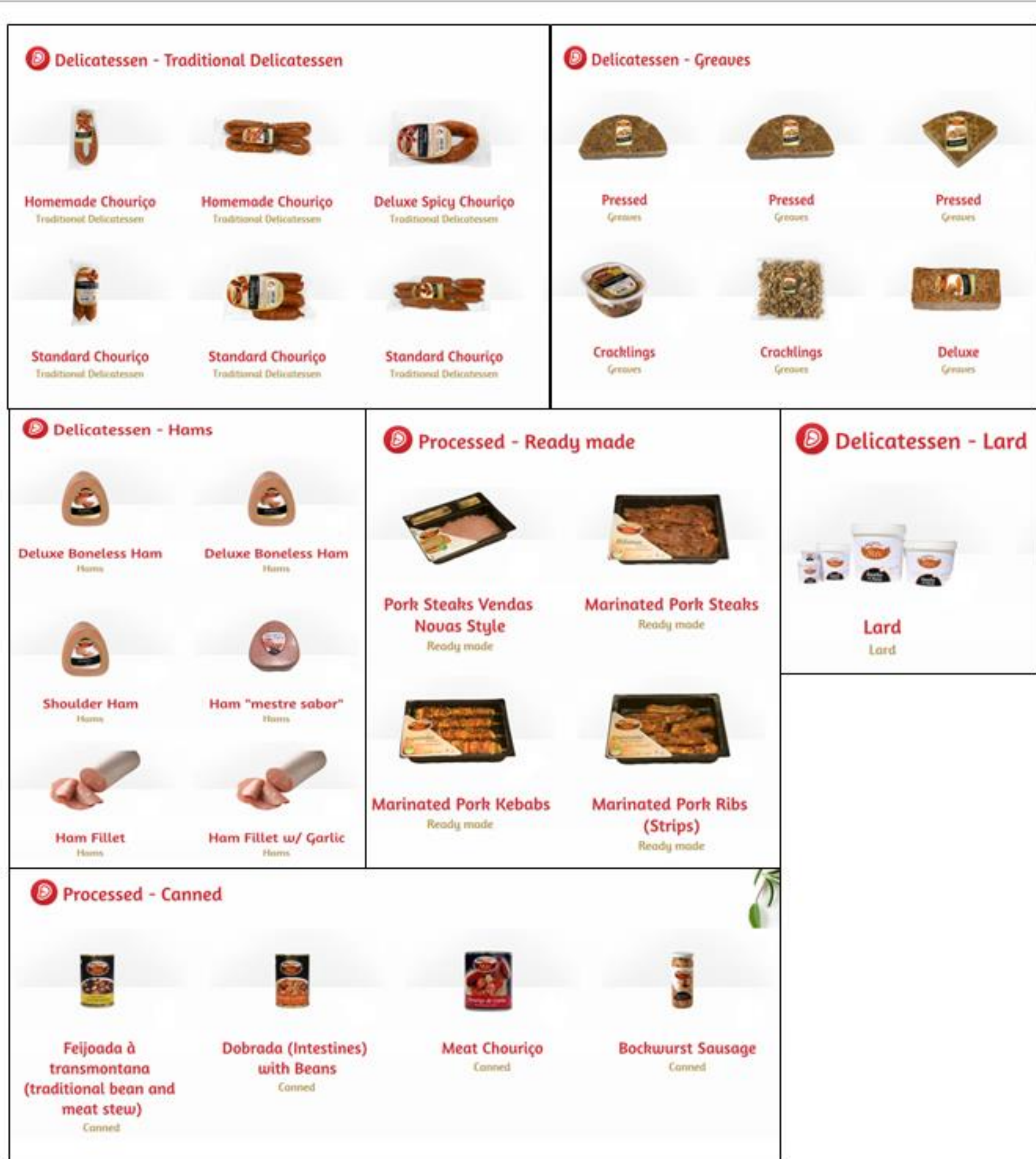
Exhibit 12 – Portuguese Meat Consumption

2012 Meat Consumption trends in Portugal



Source of data: Raporal annual report 2012

Exhibit 13 – Raporal's Products

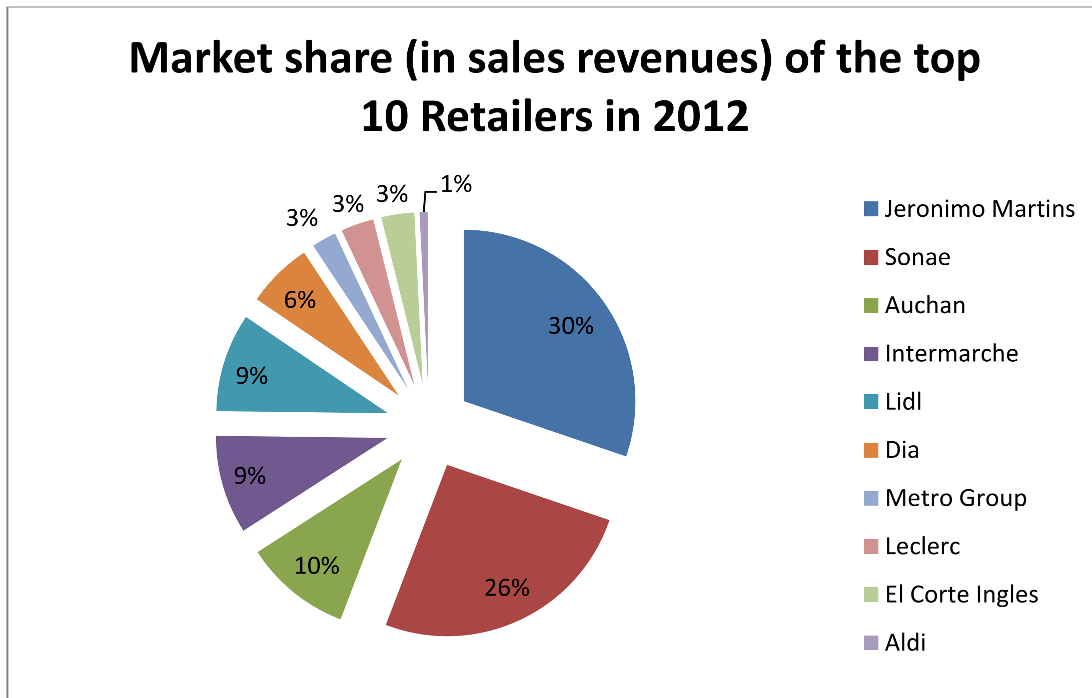


Source of image: Stec official website

Exhibit 14 – Jerónimo Martins Sales

Source of data: Kantar retail analysis (2013)

Exhibit 15 – Grocery Market Concentration



Source of data: Kantar retail analysis (2013)

III. Literature Review

This chapter is designed to introduce some of the theoretical notions and concepts that will aid in the development of the teaching note.

The structure of this section is based on the idea of environmental layers (Johnson, G., K. Scholes, R. Whittington, 2008, p.64). In summary the notion is that in order to be strategically aware of the broad environmental factors, managers should understand that these belong to distinct layers.

The Environment

PESTEL Analysis

The macro – environment is the first layer. It is essentially made up of various wide environmental factors that may or may not affect the organization. The PESTEL analysis is considered by many as a central tool to identifying these factors.

In essence the PESTEL divides the environment into six categories, namely; political, economic, social, technological, environmental and legal, as illustrated in the picture below, and suggests that the trends identified will result in the clear understanding of the overall picture surrounding the company. (Johnson, Scholes, and Whittington 2008).

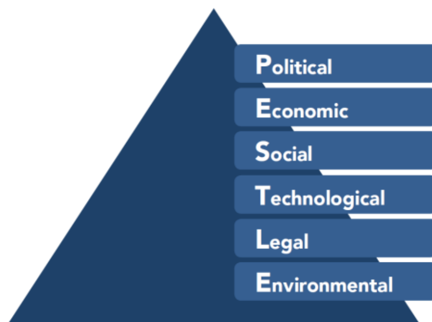


Figure 1 PESTEL Analysis (Team FME (2013) PESTEL Analysis: Strategy Skills, FME, p.6)

The understanding of these forces will also allow managers to predict certain changes that may occur, and therefore perform the most adequate management strategy. Although simple and easy to apply, many argue that the model is too broad. And if on one side, O'Brien (2004) argues that this model will hardly result in the generation of new ideas, Burt et al. (2006) defended that the classifications proposed by the PESTEL are too generic and fail to deliver valid information that will help prepare for future changes.

The Industry

Porter's Five Forces Model

The next layer is the industry, which according to Porter (1979), consists of firms "assumed to be alike in all economically important dimensions except for their size". (Porter M. 1979. P. 214). Porter (2008) introduced the five forces model as a tool to evaluate the industry's overall attractiveness. Porter(2008) believed that it is important to look at; threat of new entrants, threat of substitute product, bargaining power of buyer, bargaining power of supplier and the rivalry amongst existing competitors to understand the industry. The diagram below illustrates these forces.

He goes on to say that being able to understand the competitive forces and ultimately their underlying causes, leads to the true understanding of the industry's profitability. Furthermore he supports that this model is useful when anticipating competitor's moves and therefore valuable for the management of profitability over time.

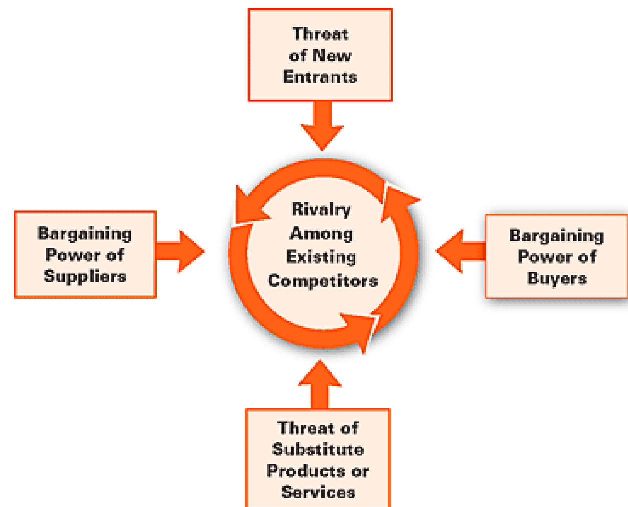


Figure 2: The Five Forces that Shape Industry Competition (Porter, M. E. (2008) "The Five Competitive Forces that Shape Strategy", The Harvard Business Review

Bargaining Power of Buyers

The bargaining power of buyers "refers to the ability of consumers/buyers to exert pressure on the selling entity to get it to produce higher quality products/service at a lower price" (Wilkinson J. 2012). Obviously these conditions represent higher costs to the seller that will compromise its profits. It is also referred that industries with high bargaining power of buyers are more competitive whereas the opposite results in less competition. (Wilkinson J. 2012).

When analyzing the industry and consequently the determinants of these forces it is important to understand what influences them.

When it comes to the bargaining power of buyers, Porter (2008) refers the need to look at buyer concentration in comparison to that of the seller. He argues that when there are fewer buyers than sellers, bargaining power of the consumer is likely to be high. Furthermore he identifies high switching costs as power reducers since the buyer will have less bargaining power. In addition the buyer's ability to integrate backward means high power to the buyer and the existence of substitute products tend to increase buyer's bargaining power as well.

Overall what Porter is suggesting is that once managers have the complete understanding of these forces, they will understand the industry and in turn be able to strategically position their companies.

The difficulty however lies in the measurement of these forces, it is not always clear which force is actually the strongest, (which will most limit the firm's profitability) and therefore will have the most impact in the company's strategic choices. (Porter M. 2008)

The Competitors

Private Labels

The competitors are the third layer of the business environment. For this purpose we will not be directly speaking about other firms operating in the same industry, but instead we will be looking at modern distribution and their private labels which have become important participants in the competition for market share.

With the changes that have been occurring in the food distributing sector over the years, so have consumer standards. Consumers, now look for **low prices**, **product diversity and convenience.** (Ferreira, Manuel P., Reis, Nuno R. & Santos, João C., 2011). Moreover it is suggested that the growth of the discount stores demonstrates that the low price factor is becoming the most influential. (Ferreira, Manuel P., Reis, Nuno R. & Santos, João C., 2011). In response to these changes retailers have been continuously developing their private labels. However there is still debate on how beneficial private labels have become to supermarkets over the leading national brands.

In summary private labels provide higher margins than national brands and in addition may also generate a certain degree of customer loyalty, which national brands fail to do. (Pauwels K. & Srinivasan S., 2004).

Most importantly, private labels provide retailers with strategic bargaining power over manufacturers' brands. (Meza S. & K. Sudhir 2009). During negotiations retailers are able to achieve better supply terms, which could include lower wholesale prices and better trade deals. (Pauwels K. & Srinivasan S., 2004).

In addition retailers benefit from competitive knowledge of the national brands which allows them to easily imitate the leading brands, more so when they set the marketing mix (price, shelf space position and promotion) of both national and private labels. (Pauwels K. & Srinivasan S., 2004).

In conclusion, private labels bring to retailers certain advantages that allow them to gain additional bargaining power over manufacturers. That being the case it is most likely that the development of private labels will continue.

In face of this trend, Hock (1996) suggests six strategic reactions, based on the dimensions of price and quality, for national brands to consider.

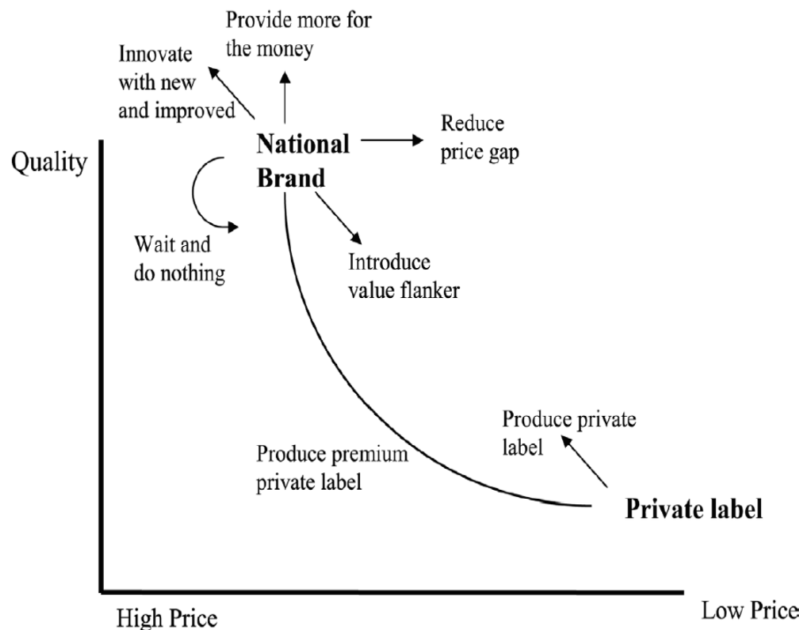


Figure 3: Strategic Options (Verhaef, P. C. & Nijssen, E.J. & Sloot, L. M., 2000. “Strategic Reactions of National Brand Manufacturers towards Private Labels”, *European Journal of Marketing*, p. 1311)

1) **Innovate** Focus on the development of improved innovative product.
2) **More for the money** keep to the same prices, but offer more
3) **Reduce price gap** offer products at lower prices
4) **Me – too strategy** introduce a value flanker
5) **Wait and do nothing –** do not decide on any strategic move
6) **Produce private label –** supply retails with their own products

The first strategy suggests that national brands should develop new and improved products in order to win competition with product differentiation. According to Glémet and Mira (1993) there is a negative correlation between manufacturer’s level of innovation and private label penetration.

Another strategy also identified by Hoch is the more for the money approached which essentially focuses on keeping the same price level but offering something more. Ashley (1993) believes that advertising and brand strengthening are possible ways to offer something additional to consumers.

When reducing the price gap, however, Hoch (1996) is suggesting reducing price but maintaining quality, while this might seem promising it is obvious that profitability of the firm will be hurt as well as the relationships with suppliers.

The fourth strategy proposes offering a low price and low quality option; however it is important to understand that the introduction of a value flanker is expensive and that it will be very hard to get shelf space from retailers, more so when relationships will most likely be hurt.

A different approach is the wait and do nothing strategy, which as the name suggests implies doing nothing. The benefits of such approach are related to the fact that no investment is required. However, according to Porter (1996), not choosing a strategy can be very dangerous.

Ultimately the sixth strategy proposes producing private labels, therefore increasing sales and improving relationship with retailers.

In conclusion the model considers that increasing the gap by innovating and strengthening the brand image is the most effective strategy. However for products where private labels represent a large part of the market share, the strategy to produce private labels is most adequate. (Verhoef P.C. & Nijssen E.J. & Sloot L.M., 2000)

In summary, the model highlights that the viability of these strategies will depend on the degree of product differences between national brands and the private labels in each category. It is also apparent that the model lacks specificity in terms of product type which limits its applicability.

The Company

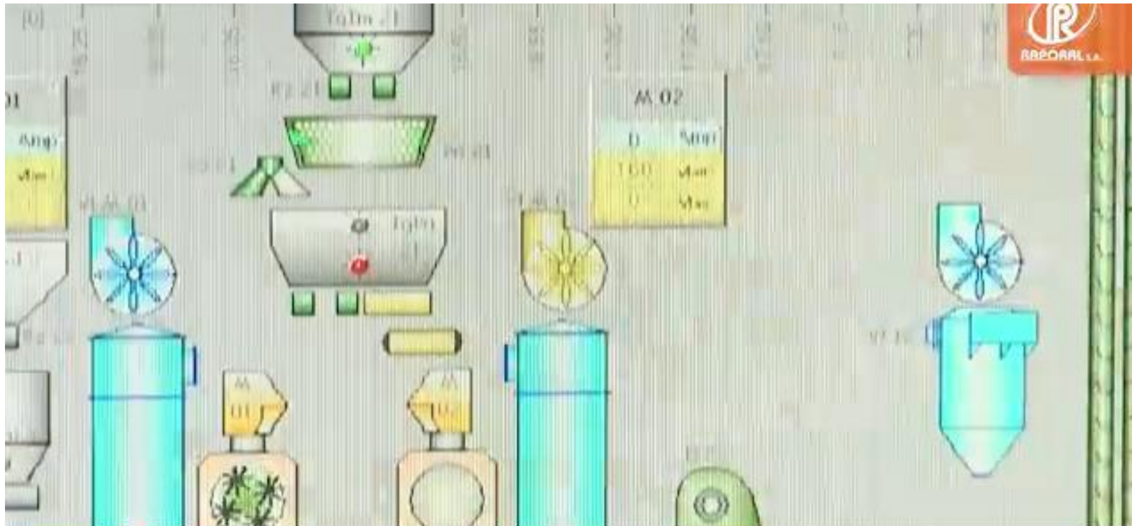
Competitive Advantage

The last layer is about the company. The crucial question at this point is why do some firms in the same industry show different growth levels during the exact same period? Some believe that the difference is on the main strength and strategic advantages that different organizations will choose differently. (Prahalad C.K., 1993). This is also often referred to as core business competencies. The term core competencies is often confused with technical capabilities, however while these are simple isolated aspects of a firm, the other is a bundle of all technologies, customer knowledge and management intuitions combined together. (Prahalad C. K., 1993). In simpler terms a core

competency must be something that is hard for competitors to imitate, in addition it must be applicable to many products and markets and finally it must give something additional to consumers. (Prahalad C. K., 1993).

In essence these characteristics of the concept of core competencies take us to believe that ultimately these will allow organizations to achieve a sustainable competitive advantage. Barney (1991) emphasizes "that firms obtain *sustained competitive advantages* by implementing strategies that exploit their internal strengths, through responding to environmental opportunities, while neutralizing external threats and avoiding internal weaknesses". (Barney J., 1991, p. 99). The issue with this approach is that the environment is not static and therefore the sustainability of this competitive advantage must be carefully addressed. With this in mind the Resource Based View (RBV) suggests focusing on both firm's performance and its internal features to identify a competitive advantage and a sustained competitive advantage. (Barney, 1991). He suggests that for a firm to achieve competitive advantage it must implement a value creating strategy that its current and potential competitors are not able to duplicate; where a sustained competitive advantage implies an even stronger inability of competitors to imitate both the strategy and its benefits. (Barney, 1991).

However, reference must be made to the fact that a sustained competitive advantage will most likely not last forever. In fact with unexpected changes in the industry, it may happen that what was considered to be a source of sustained competitive advantage loses its value as the industry changes. (Barney, 1991). Barney (1991) also explains that firms will only achieve sustained competitive advantage if its resources are **valuable**, in the sense that they allow the firm to outperform its competitors. In addition these resources must also be **rare, hard to imitate and in-substitutable**.



Source of image: Raporal official website

While core competencies are in the center of a firm's competitive advantage, it is also arguable that businesses functions that enhance these competencies should be **vertically integrated**. (Prahalad C.K. & Hamel G., 1990)

"By their 'make or buy' decisions firms decide their degree of **vertical integration"**. (Balakrishnan, S. & Wernerfelt, B., 1986, p. 347). Essentially vertical integration can help companies reduce costs and improve efficiency. Additionally when understanding vertical integration it is important to remember that there are various types of vertical integration, namely; backward and forward. (Harrigan, K. R., 1983).

The concept of vertical integration has itself evolved over the years. Currently "The image of vertical integration as operations that are 100% owned and physically interconnected and that supply 100% of the firm's needs is outmoded" (Harrigan, K. R., 1983, p.1). Now the question is on the degree of scope of the integration. In other words, the key to a successful vertical integration is determined by how broadly integrated the firm should be at a particular time. Although these will vary, the same author purposes the following model to suggest some alternatives:

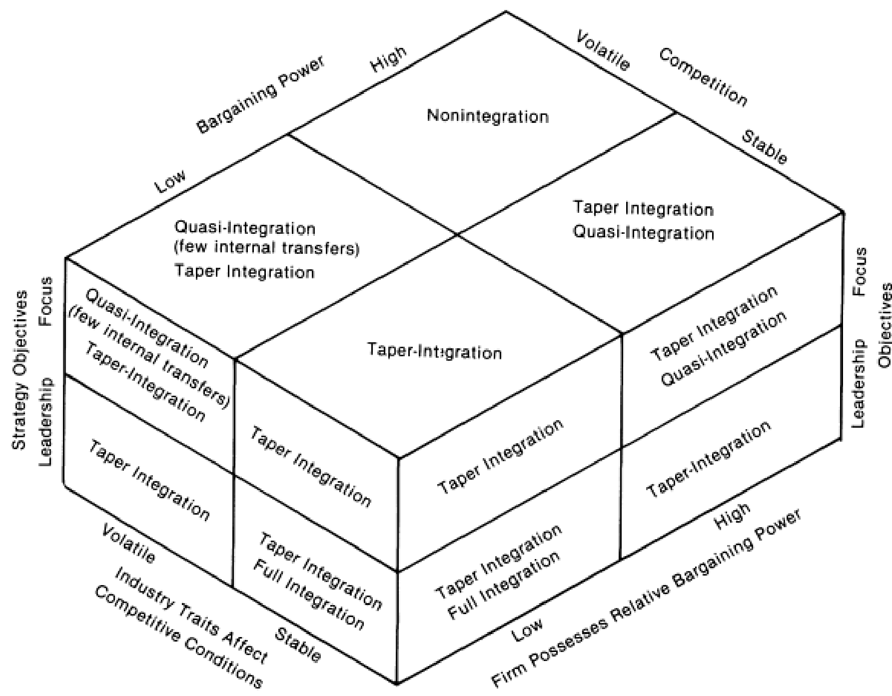


Figure 4: The Model of Vertical Integration Strategy (Harrigan, K. R., 1983. Vertical Integration, Outsourcing and Corporate Strategy, Beard Book Washington D.C., reprinted 2003, p. 45)

Note: this model is designed for firms operating in an established industry; the strategic move will vary depending on the industry's development.

In the case of the illustration a company that is in an established market, has low bargaining power, stable competition and strategically aim for leadership, should engage in taper-integration, that is, integrate partially.

In summary vertical integration is the result of two forces:

1) Internal and cost benefits
2) Effects of competitive pressures

When looking at the first factor it is clear that what allows for these cost benefits is the improved coordination of activities. Moreover a certain degree of integration will mean that the firm can avoid time consuming tasks that include negotiations.

(Harrigan, K. R., 1983).

In regards to the second force, it is suggested that it is mostly a result of marketing and technological intelligence as well as strong product characteristics that avoid replication from competitors. (Harrigan, K. R., 1983).

Although there seems to be little involved when deciding to vertically integrate, it is important to understand that there is a certain degree of risk, mostly because the integration may have been more costly than the actual returns. On another perspective the risk with integration is related to the fact that too much integration will most certainly hurt the strategic flexibility of the firm, and that is fundamental to deal with the industry changes. (Harrigan, K. R., 1983).

This raises the importance of the industry to the success of the firm's performance. Under this line of thought is the concept of **strategic dimensions** introduced in 1996 by Michael Porter.

Although we have been looking at the firms resources as a way to overcome competition and increase profitability, Porter (1985) believes that organizations can achieve *above average performance* by positioning themselves strategically within the industry. He suggests that companies can choose between perusing a cost leadership strategy or a differentiation strategy in order to achieve a competitive advantage. Later on he further divided these categories by introducing "cost focus" and "differentiation focus" strategies.

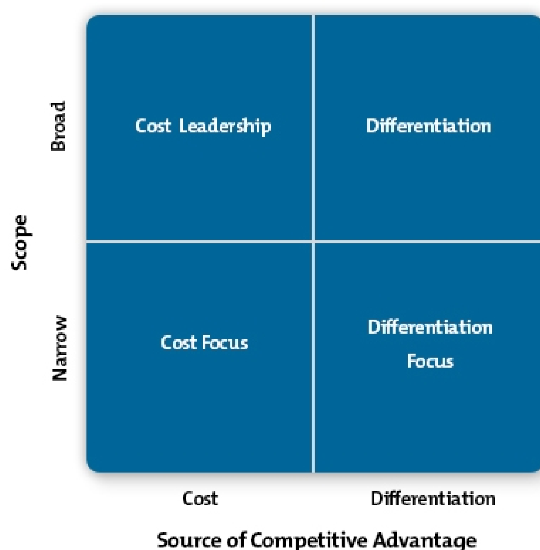


Figure 5: Porter Generic Strategies (Porter, M. E. (1985).Competitive Advantage: Creating and Sustaining Superior Performance, New York, NY: The Free Press, p. 12)

The Cost Leadership Strategy

This strategy can be applied by either focusing on increasing profits by cost reduction and industry – average prices, or by reducing prices while increasing market share.

It is important to realize that cost leadership is about minimizing the cost to the organization of delivering products and services, and not necessarily offering the lower prices to customers. In summary, the cost leadership strategy involves being the leader in terms of cost in your industry or market. When deciding to peruse this strategy it important that managers are confident that they can not only achieve number one position but sustain this position. (Porter, M. E., 1985).

Studies have demonstrated that in general companies with access to capital are more likely to be successful in this strategy as they can invest in technology that may bring costs down. In addition the success of this approach will be directly related to the efficiency of the company's logistics, as again this will bring costs down. Ultimately cost leaders must have a low cost structure that allows them to suitably cut costs below those of the competitors. (OECD, 2012, *Mindtools*).

The greatest risk in pursuing this strategy comes from the fact that these sources of cost reduction are not unique to a single firm, and therefore other competitors can easily copy these cost reduction strategies. (Porter, M. E., 1985).

The Differentiation Strategy

Differentiation, on the other hand, involves "making your products or services different from and more attractive than those of your competitors". (OECD, 2012, *Mindtools*).There are many roots to differentiation which will most likely depend on the product and in the industry. In general however a successful differentiation strategy involves; "good research, development and innovation, and the ability to deliver high-quality products or services". (OECD, 2012, *Mindtools*). In addition to this it is argued by the author that this strategy requires "effective sales and marketing" in order for the consumers to understand the benefits of the different products.

The Focus Strategy

"Companies that use Focus strategies concentrate on particular niche markets and, by understanding the dynamics of that market and the unique needs of customers within it, develop uniquely low cost or well-specified products for the market". (OECD, 2012, *Mindtools*). The article further suggests that the benefit of this approach lies on the fact that it is targeting a smaller group of customers; in turn this allows companies to

perfectly know their customers and build strong brand loyalty. In addition, given this relationship, other competitors seem to be less keen on entering these markets.

Once deciding to pursue a focus strategy, managers should equally decide whether they will be cost leaders or differentiators.

Finally, it is fundamental that when choosing which of the strategies to pursue, managers take into consideration the organization's competencies and strengths. (Porter, M. E., 1985).

IV. Teaching Note

Overview of the case

Raporal started as an animal compound feed factory, in 1971, and has grown vertically since then to become one of the most important players in the Portuguese market, with a 2013 expected annual turnover of 100 million euros. It expanded gradually to become present in the compound feed production, animal production, meat slaughtering and meat processing markets.

It was founded by 18 pig farmers who got together with the view to produce good food for their animals.

After a period of significant growth, in 2006 Raporal experienced a bad year which triggered major administrative and management changes. In 2007 Raporal focused on the optimization of its resources and invested in technology as well as in the acquisition of new pig farms, in order to become a cost leader and successfully face the ever more competitive business environment.

The changing industry trends, that showed an almost 100% shift towards modern distribution dictated the need to adjust its distribution strategy. In 2013 Raporal had overcome the period of transition, and was working together with the large distributors. "Pingo Doce was responsible for more than 50% of the sales", while the percentage of sales through small sellers was becoming more and more irrelevant.

While sales volumes kept increasing Raporal could not help but see its profit margins go down, mostly because of the tough negotiation with modern distribution agents. In the attempt to improve these relationships, Raporal decided to invest in the differentiation of its product which later was sold exclusively under Pingo Doce's brand. Although sales figures were very promising, negotiations did not get any better.

With a challenging period ahead, Raporal's management was forced to continue to develop strategies that would gradually decrease the dependency on this modern distributor although clearly understanding that the market conditions dictated the need to sell to these agents if the aim was to maintain large sales volume.

Learning Objectives

Raporal’s case was specifically designed to serve as a teaching tool, valuable in management courses with emphasis given to strategic management topics.

Being a large national producer, Raporal’s story illustrates the challenge that producers face with the increasing bargaining power of modern distribution. Additionally the case exemplifies the impact of different strategic approaches used as an attempt to overcome this problem.

Although there are several approaches to look at this case, I suggest particular focus on the topics listed below:

A. Importance of understanding the business environment

Applying a PESTEL analysis

B. The impact of the industry characteristics

Applying Porter 5 forces model

C. Understanding the Company’s strategic positioning

Identifying sources of competitive advantage and its sustainability, as well as applying porter’s generic strategies

D. Outlining the major sources of threats and opportunities as well as the company’s strengths and weaknesses

Applying a SWOT analysis

E. Considering supermarket trends and their private labels and how these affect the industry players

Underlying the alternatives to modern distribution

F. Recommending strategic alternatives

Assignment Questions

These suggestions are designed to help students prepare for the in-class discussion of the case.

Which factors shaped Raporal's growth over the years?

What were the major challenges that Raporal was facing in 2013?

What recommendations would you suggest, to Raporal's management?

Class plan

1) Which macro-economic factors did affect Raporal's performance?

2) What industry trends did shape Raporal's development?

3) What was the company's major competitive advantage and how sustainable was it?

3.1) What is the common source of these core competencies and how does it shape Raporal's strategy?

4) Summarize the opportunities and threats that resulted from the general context and identify Raporal's strength and weaknesses.

4.1) What strategic alternatives were available?

5) How did the development of supermarkets and their private label affect the animal production sector?

5.1) What was Raporal's strategy and what were its major implications?

6) Identify and recommend possible strategic directions considering the above findings.

Analysis

1) Which macro-economic factors did affect Raporal's performance?

The business environment is fundamental to the true understanding of the company's decisions. As described in the previous chapter, this environment is the result of various external factors that although not controlled by the company will determine its performance. The PESTEL analysis will be applied to identify these factors.

Political – Two years after the external rescue package; Portugal sees its economy slowly recovering. However the food sector could not avoid the need to recur to international markets to sustain its growth. Overall despites the international growth, Portugal maintained its deficit position, importing much more livestock than exporting. In addition the Portuguese bureaucracy has been heavily criticized for having a negative impact on the competitiveness of national producers. The year has also been marked by several attempts to regulate the negotiations between modern distributor agents and producers, which nonetheless had little effect.

Economic – The economic environment has been marked by the decrease in consumption, which reached even the sales of food products. Also on a negative note the prices of raw materials, such as soy and corn demonstrated an upwards trend that brought additional difficulties to producers, who couldn't recur to credit.

Social – As families see their income go down, their consumption also decreased. As described previously figures for meat consumption decreased over 5 %, which meant that each person consumed less 6kg of meat than in the previous year. Additionally, the social environment has been marked by a general change in consumer habits as consumers become more price sensitive, and move towards cheaper substitutes. Consequently modern distributors gain market share over the traditional formats, and experience growth of the sales of their private label products. In response, producers have been forced to adjust their cost structure to the consumer's economic capabilities, and are therefore not able to pass on the additional costs of production.

Technological- Technological evolution has greatly contributed to the growth of this industry as it allowed for the production to be more efficient, both due to genetic and machinery changes. Nonetheless it was also this evolution that has been forcing smaller producers to exit the market and larger players to become more competitive. Another trend is the continuous growth of the internet that created additional opportunities to both producers and retailers.

Environmental and Legislative – The industry has been continuously affected by environmental and animal welfare norms that generally increased the production costs, especially when compared to countries outside the EU who do not experience such tough legislation but at the same time can benefit from the EU market potential.

2) What industry trends did shape Raporal's development?

The world's population will grow from almost 7 billion now to over 9 billion in 2050. Will there be enough food to go round?

John Parker[12]

That being said it is important to carefully consider the industry. For the purpose of this case we will focus on the livestock production sector, which despite the general perception that consumer needs will continue to grow, will face a number of challenges.

Porter five forces framework, will help identify these challenges and ultimately the overall attractiveness of this industry.

Threat of New Entrants ------- Low

As developed in the Literature Review, when evaluating the threat of new entrants it is necessary to look at the barriers to entry. For such industry, economies of scale are a significant barrier. These are achieved through vertical integration and binding contractual agreements with large distributors, such as the case of Raporal and Pingo Doce. It is therefore clear that for a new entrant the capital risk is very high. Moreover, given the general trends towards modern distribution channels, the access to these may be difficult for a new player, who will most likely experience a great cost disadvantage.

Although these factors result in a relatively low threat of new entrants, it is important to note that given the world integration of markets, industry specific trends are no longer limited to one country. That means that although the likelihood of a new player entering the market is low, there is the possibility of existing players entering new markets. In fact the Portuguese market has shifted from 100% self-production in 1974 to 60% in 2012. This means that 40% of the meat consumed in the country comes from overseas.

Threat of Substitute Products ------Moderate

Given the homogeneous characteristics of pork and bovine meat, it would appear at first that there are no substitutes. However during the 21st century the general tendency towards the consumption of bovine and pork meat is decreasing, as consumers are moving towards healthier options such as poultry meat, fish and other substitutes such as soy and seitan, which in many

[12] The economist, 2011, *The 9 billion - people question.*

cases are offered at a lower price. This results in a moderate threat of substitute goods, which may be partly the driver for differentiation in such industry.

Bargaining power of suppliers ----- Moderate

As previously mentioned, in the case of Raporal, 80% of the production costs come from animal feed needs. That being the case Raporal is highly dependent on the prices of cereals, needed to produce the animal feed. However, because these are homogeneous commodities, easily available on the open market, the supplier has little bargaining power.

Nonetheless to animal producers this does not mean that they have much power over suppliers, as this too is moderate given the market price constant volatility. In fact in 2012 the cost of production increased more than the selling price of the animals, due to the price variation of major cereals.

Bargaining power of Buyers ------- Very high

With the development of the modern distribution channels, the number of buyers is continuously decreasing. Buyers are becoming larger and responsible for purchasing a sizable percentage of the industry output.

Additionally buyers have little switching costs, as there is still little differentiation in the sector. Moreover as retailers become closer to producers with their private labels, it raises the threat of the buyer's backward integration.

That being said it is easy to understand that due to a lack of alternative distribution channels, the bargaining power of buyers is very high and most likely will keep increasing. In addition the buyer's price sensitivity will probably keep on pressurizing the wholesale prices and as a result the sector's profit potential for the seller continues to decrease.

Rivalry ------- High

Although differentiation for pork and bovine meat products has started to develop, these products are still essentially perceived as homogeneous. That implies that all players are direct competitors, increasing the rivalry in the industry. Additionally, rivalry increases when the demand for the product is growing at a slower rate, such as in the case for the EU market.

When trying to access the base of the competition it becomes clear that price is the most

determinant characteristic. In fact competition is so tough that experts say that prices are 25% cheaper than 5 years ago. This is worse when consumer switching costs are very low.

Overall, the moderate threat of substitute products, low negotiation power and high rivalry dictate the industry's unattractiveness. Additionally for companies operating in this industry, such as Raporal, these forces present an increasing challenge that will shape the firms development and limit its profitability. Although all forces will affect the companies in this industry, it is the high bargaining power of buyers that is most responsible for the limitations in profitability and therefore should be in the center of the strategic decision.

3) What was the company's major competitive advantage and how sustainable was it?

Prahalad, C. K. & Hamel, G. (1990) suggested that a company's long term growth is dependent on the development of the key areas of expertise that are unique to that specific company. They argued that these are defined as core competencies and further suggested that these are the critical aspects to achieving a competitive advantage.

When applying this model to Raporal it is possible to conclude that its core competencies lay on the following:

- **Expertise in production**[13] **technique** – ability to minimize the production costs without compromising the quality or production capacity
- **High production and delivery quality** – ability to produce reliable products on time, responding to all of the client's needs.
- **Large production capacity** – capacity to meet large volume demands and offer different products

These characteristics add value to the final product and give Raporal a certain degree of competitive advantage. Although not fixed, it is still important to consider the changing market conditions. For this purpose the RBV model, previously introduced, will be used to access the sustainability of these core competencies as a means to reach and maintain a competitive advantage:

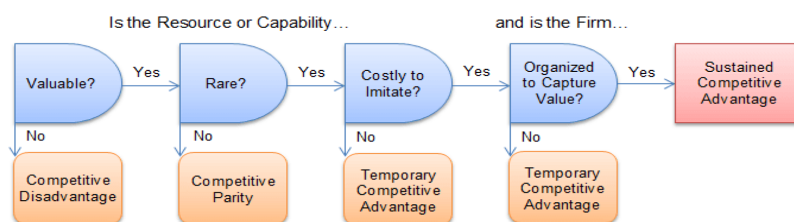


Figure 6: VRIO framework (Jurevicius, O. (2013), "VRIO analysis")

Valuable – Raporal's infrastructure and highly technical equipment are fundamental resources that allow it to produce good quality products at relatively low prices. Additionally, Raporal has been able to develop know how that allows it to outperform its competitors.

Rare – Raporal has reached a size that is almost unique amongst national producers. However,

[13] Here production refers to all stages that result in the final product; including: animal feed production; animal production; slaughterhouse; meat transformation

its resources are not that rare, especially in the industry where vertical integration and high technical investments are almost necessary.

In-imitable – It is easily understood that in the case of Raporal little emphasis is placed on the brand creation, mostly because it has achieved large sales volume by selling its product under supermarket private labels. This also means that it is not able to rely on customer loyalty. Additionally it means that its strategy is more easily replicated, even if at a higher cost.

Substitutability - Pork and meat products can be substituted by other products; in fact figures suggest that consumers have started to change their habits as it has been previously discussed.

Raporal's continuous growth is a clear indicator that it has been able to maintain a value creating strategy. Its resources are valuable and somehow rare; however its strategy can be replicated. Overall it is possible to say that Raporal has a temporary competitive advantage.

3.1) What is the common source of these core competencies and how does it shape Raporal's strategy?

The competencies identified above are essentially the result of the investment that Raporal has incurred to obtain a vertically integrated structure.

Raporal started back in 1971 as an animal feed producer. As its size grew it started to expand down the production chain, first with the acquisition of livestock farms, later the slaughterhouse, and finally the meat processing unit. If we simplify the entire process we can easily identify that Raporal is a vertically integrated company. It has control over every stage of the animal production, from conception to packaging.

According to Harrigan, K. R. (1983), a company like Raporal should peruse tapper integration, which is integrating to a certain degree. Essentially what this vertical structure implies is investments, in technically improved production systems, general improvements in the facilities and additional management and coordination expenses. These however, have also become essential for the competitiveness of the firms in this industry.

This behavior is mostly the result of production technological developments such as improvements in feed formulas, production facilities and equipment, nutrition and disease control. These advances allow for greater efficiency in animal production, leading to economies of scale and larger operations.

Simultaneously Raporal has been undergoing some degree of backward integration through the acquisition and or integration of other pig farms. This expansion allows Raporal to maximize the capacity utilization of its vertical structure.

As a vertically integrated company Raporal is essentially able to reduce its transaction costs. Furthermore it is able to better combine demand and supply which result in a more efficient management. For instances Raporal knows how many animals it needs to feed before the decision to produce animal feed. Another important aspect of vertical integration is related to the control over the quality of the products. After the 1997 classical swine fever (CSF) and bovine spongiform encephalopathy (BSE) outbreaks, quality become an increasingly important issue for meat producers.

Joseph W. Luter, founder of Smithfield[14] and supporter of a vertical production structure defended that; *"Vertical integration gives you high quality, consistent products with consistent genetics. And the only way to do that is to control the process from the farm to the packing plant".*

Ultimately the ability to create these economies of scale that reduce the production costs, also allow Raporal to practice low costs and position itself as a **cost leader**, gaining market share through charging low prices. Looking at the industry in which Raporal operates, the high bargaining power of the buyers tends to hurt the suppliers ability to charge average prices, in which case the low cost structure becomes fundamental in order for the company to increase its market share.

[14] Smithfield is one of the largest pork producer and processor in the United States

4) Summarize the opportunities and threats that resulted from the general context and identify Raporal's strength and weaknesses.

The following SWOT analysis summarizes the most important elements that need to be considered when adjusting Raporal's business model.

Strengths	Weaknesses
• Supply chain integration • Animal production expertise • Animal compound feed production expertise • Technologically advanced equipment • Innovative facilities • Control over pig genetic line (due to vertical structure) • Quality certifications • Economies of scale • Easy access to capital • Relation with one of the largest distributors in Portugal	• Heavy cost structure (due to nature of business) • Weak brand • Low bargaining power over suppliers and buyers
Opportunities	**Threats**
• Rise of new product categories • Closing of small competitors • Easier access to foreign markets • Further technological advances, that may lead to new and more efficient forms of production • Growth of fast food chains, such as Prego gourmet, H3 • Changing consumer habits towards convenient store formats • Growth of internet • Deficit in national production	• Volatility , price, quality and availability of raw materials • Low negotiation power with distribution channels • Changing consumer habits to substitute products • Increasing level of concentration which increases competition between larger organizations • Legislation, which may increase production costs and hurt competitiveness of firms • Differences in world legislation

4.1) What strategic alternatives were available?

Given the above scenario producers find themselves dependent on modern distribution to achieve large sales volumes. However, it is possible to identify some other strategic approaches that mitigate this dependency, at the cost of other implications.

Alternative Distribution Channels

In face of what is an increasing powerful distributor producers might find that the only alternative is to develop other channels or even create their own, bearing in mind that initially these will represent significantly lower sales volume and additional costs. Possibly in the case of Raporal, this could be achieved through **forward integration** in which case Raporal would merge or acquire store spaces that would allow it to distribute its own product directly to consumers, without such a powerful intermediary. However for this approach Raporal would also need to invest in the development of its own brand as this would overcome one of its weaknesses and reinforce the success of the stores. Another alternative channel would be to use **food chains** to distribute its product; essentially this strategy brings the benefits and the drawback of recurring to supermarkets although at a smaller scale, as these are not as powerful. One example of this approach is CarneAlentejana that is distributed through many restaurants. Ultimately, producers could choose to distribute its product to **foreign markets**, benefiting from an enlarged market potential, and once again avoiding the dependency on a large distributor.

Market Growth

Another strategy aimed at managing the bargaining power of distributors is to gain market size. In simple terms this might be achieved through **horizontal integration**. In this case, Raporal would purchase another company that would be at the same level of production and consequently gain market size. In return it would benefit from a range of economies of scale as well as gain bargaining power. This approach would be much more efficient if the market was limited to Portuguese producers, but the fact that distributors have access to foreign markets makes this strategy more risky as it is harder to grow enough in order to gain significant size in the market. Additionally the costs associated with such alternative are very high. Another, less effective way of gaining market size is through **vertical (backward) integration** in which Raporal would merge or acquire existing animal farms and consequently increase its production capacity. This strategy is especially efficient when there are many small producers, which is still the case in Portugal. We can see that Raporal has been over the years engaging in this growth by acquiring or integrating pig farms, and this way it has increased its production capacity while at the same time increasing its efficiency through economies of scale.

Brand Definition and Product Differentiation

This strategy suggests investing in brand equity and product differentiation. Possibly Raporal could place more emphasis on the enforcement of its brand by distributing own brand goods, and investing in the communication of its superior quality products. While this approach clearly removes the dependency on the distributor, more so when the buyers switching costs are higher due to the product differences, it also removes the pressure on price as in theory products perceived of higher quality lead to higher willingness to pay. However it is important to highlight that given the current market conditions, the producer of this higher quality branded product still needs modern distribution to reach consumers. Additionally consumers still tend to look at these FMCG as generic and therefore might be less willing to value product differences. In the Portuguese market there are little examples of strong brands in this product category, however Nobre is the case of a leading brand for transformed meat products, and most recently CarneAlentejana is increasing its brand strength for fresh meat products, amongst the Portuguese consumers.

Modern Distribution and Private Labels

In face of these market conditions, most distributors, however, have decided to adapt their strategy, choosing to distribute through supermarkets and producing private label goods. Raporal is a case of a producer who is selling retailers private label products. By producing private labels, they are taking advantage of excess production capacity, as well as managing the relationship with important clients. The issue however is the same as identified previously; producers lose their bargaining power and consequently see their profit margins go down.

5) How did the development of modern distribution and private labels affect the animal production sector?

The concept of modern distribution essentially refers to the economic activity that assures the intermediation between products and consumers. This is common to supermarkets, grocery stores, clothing stores, amongst others. In simple terms, through various transactions and logistics operations, modern distribution is able to deliver the products under the necessary conditions of time, place, price and convenience, satisfying consumer needs.

As previously addressed, for the last two decades, traditional distribution channels have been watching their market share being progressively stolen by what we know of supermarkets[15]. Expectations are that modern distribution will own nearly 80% of the total grocery market. This trend is mostly the results of the supermarkets ability to offer products at prices lower than traditional stores; additionally their stores tend to be conveniently located and are known for offering a variety of products.

Following the same direction is the retailers' private label sales, which market share has been continuously growing. While some experts suggest that the performance of these products is linked to economic cycles, and therefore in recession periods these brands tend to grow, as explained in the Deloitte and Tauche 2003 report, others defend that this trend is expected to continue. In fact in some product categories the retailers' brand dominates, which is the case of meat and poultry in most EU countries.

To supermarkets private labels are an efficient way to gain more control over shelf space, achieve higher margins on the sales of these products, but also very importantly these are becoming a source of differentiation against competitors.

In the case of Pingo Doce, private label products represent around 40% of the sales; consequently, shelf space available to national brands is on a continuous decrease. In some cases the supermarket only distributes the market leader and its private label product. Despite this evident decrease in market share from the manufacturers side it is important to note that there remain some very strong national brands that distributors must include amongst their product variety, such as the example of Coca-Cola.

To firms in the agri-food sector this represents a change, and offers them some opportunities as well as threats. The below analysis aims to identify these major alterations.

[15] For simplicity I will refer to supermarkets as modern distribution although as previously identified this term extends to all retailing sectors.

Modern distribution offers an organized and integrated distribution channel, which allows producers to avoid extra costs associated with traditional distribution. Furthermore these channels give producers access to a large pool of consumers, which in turn is reflected in the sales volumes achieved through this method that result in economies of scale. The contractual agreements with such distributors also guarantee the payments and the sales volume, preventing default payments and allowing for an adequate production planning. Ultimately this extra production will give producers financing means to invest in R&D, which may result in more product innovation.

On the other hand it is important to note that although tempting, these benefits come at a cost to producers. Essentially, this can be summarized in the dependency that producers create when distributing through modern channels. This dependency is also what empowers the distributors during negotiations, and what allows them to set the prices amongst other terms, that are most convenient to them. Note that the modern distribution market is extremely concentrated and price competition is very tough.

Overall these factors tend to put distributors in a challenging situation, as the benefits of modern distribution channels are becoming almost necessary to producers. However the concern rests on the sustainability of these benefits, and whether or not the implications of this dependency will end up hurting the producer.

This debate extends to the decision to get involved in the supply of private label products. Essentially, the question remains whether producing private label products is a beneficial long term strategy, or simply a short term approach.

According to the model of the six strategic reaction (introduced in the previous chapter), proposed by Hoch (1996), Raporal should produce private label products. He highlights that in such industries, where retailer's private labels represent a large market share, the strategy to produce private labels is the most adequate. In part because the decision to not produce a brand with a high market share will ultimately lead to a significant decrease in sales of that product category.

When producing private label goods, producers are generally benefiting from the same conditions as when distributing through supermarkets. Additionally it can be seen as a mean to manage and improve relationships with important clients as well as guarantee a shelf space in the most important distributor stores and avoiding the costs associated with the development of a distinct brand.

There are however some implications that in the long term may appear to be more relevant. The

first implication for producers is the loss of products as a marketing tool. Their brand will not be present on the packages and so, in this case the consumer will be oblivious to the investment in quality and animal welfare. Hence, the higher quality products will hardly be associated with the producer. In simple terms, only the distributor will be able to identify a higher quality producer. This also means that producers are increasing the dependency on the distributors, consequently decreasing their bargaining power.

5.1) What was Raporal's strategy and what were its major implications?

As previously identified in this chapter, Raporal had initially pursued a cost leadership strategy, benefiting from an intensive production system that allowed it to speed up the process of the animal growth, making the operation more cost effective.

Initially, like most of its direct competitors, Raporal used to breed the "industrialized pigs". This genetic line is the most profitable allowing for very low competitive prices.

However, given the current market conditions and especially the almost 100% shift towards modern distribution, Raporal has been challenged with an increasing difficulty to reach consumers that has had significant impact on its profitability. That being the case it decided back in 2010 to sign a contract with one of the Portuguese largest distributors (Pingo Doce).

With this contract Raporal assured the distribution of a large part of its production under private label, provided that the quality of the supplied meat would be significantly improved. As explained before this was achieved through the breeding of a different breed of pigs that was more costly to produce. In addition, the contract presented extra limitations for Raporal on the distribution of this better quality product, which could only be distributed through Pingo Doce.

Essentially this alliance means that Raporal has changed its strategy from a cost leadership to differentiation.

With this contract, Raporal is focused on producing higher quality meat, different from the generic pork meat, which is expected to meet customers' requirements. The concern however is that according to Porter a differentiation strategy is successful when the firm is then able to apply a premium price for the valuable product characteristic, which is clearly not the case for Raporal as it is subject to negotiations with very powerful buyers. More so when the success of private label products is directly related to the fact that these products are offered at a lower price.

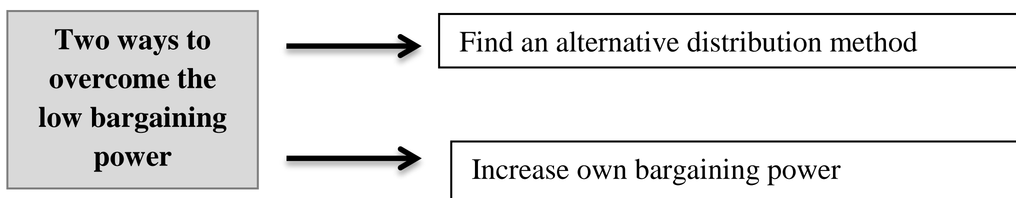
6) Identify and recommend possible strategic directions, considering the above findings.

Half way through the contract the question on what future strategic directions to embrace starts to appear on the horizon.

The contractual agreement with Pingo Doce has certainly brought many advantages to Raporal, similarly to those previously identified. More so when it is impossible to separate Raporal's expected success of 100 million euro annual turnover from Pingo Doce who is responsible for over 50% of Raporal's sales. This takes us to the next aspect of this agreement; the "decision" to sell to a very powerful buyer.

While before the agreement, the challenge was an inefficient distribution strategy, currently the distribution is very efficient but the adjacent negotiations are not. In simple terms, the high bargaining power of the buyers is resulting in lower profit margins.

There are two ways to overcome such problem; the first is cutting the production costs, which we can assume is already at its optimum level[16]; the second is to increase its bargaining power. Given the lack of substantiality and limitations of the first suggestion, we will pursue the second alternative.



Alternative 1#:

The first root alternatives suggest a certain degree of *buyer selection*[17]; however it is important to point out the limitations of such approach, when as previously identified, an almost 100% shift towards modern distribution is characterizing the industry. This trend dictates the limits of all alternative channels, even though the product has been differentiated. With this in mind some strategies are proposed:

- Forward Expansion

While maintaining its strategic positioning as a differentiator, Raporal would acquire or

[16] Given current production specifications
[17] Buyer selection is introduced as a way to mitigate the power of buyers, by choosing buyers with less power to negotiate.

integrate small stores in the center of Lisbon. These stores should follow the same format of the existing store[18], but in a smaller scale. Operations should focus on offering clients convenience, quality, and product variety (amongst meat products) at a competitive price. This way Raporal would take advantage of the emerging new product categories such as low salt sausages or gluten free ham and expand its store variety.

There is however one strong implication of this approach, which is the need to invest in brand equity. One way would be to open stands in locations close to many of its competitors, that way benefiting from the customer inflow. Possibilities include; Mercado de Campo de Ourique, Mercado da Ribeira, El Corte Inglés, or other food courts. This would allow Raporal to increase its brand awareness, which is necessary for the success of the stores. Additionally Raporal could maximize the potential of current clients, through online sales and online communications.

The drawbacks of such approach are evident, Raporal will have to make a capital investment and at the same time reduce its sales volumes, as this distribution method will never be able to achieve the size of the modern distribution today. This might represent a significant financial challenge.

- Internationalization

Continue to differentiate to foreign markets. In 2013 the exports reached 3 million euros, a good indicator of these markets' potential. Raporal is already well connected to many important external markets, namely Venezuela; the success of these partnerships may be an effective way for Raporal to reduce the dependency on a large distributor without reducing its sales volume.

- Food Chains/ Restaurants

By taking advantage of its production flexibility, Raporal could look at food chains as a way to distribute its product. The growth of food courts in shopping centers and with it the emergence of new food chains and restaurants offers an opportunity for producers. This way Raporal is selecting a less powerful buyer that at the same time may be able to provide large sales, although again these sales would not achieve the same size as with modern distribution.

Alternatives 2#:

The second root options look at ways to increase the producer's bargaining power. Because these alternatives focus on large scale operations, they are binned to potent buyers. Additionally, although in theory, differentiation is positively related to higher bargaining power,

[18] Refer to case study exhibit 10 for the current store layout

this alternative will not be proposed. For the next suggestions a cost leader approach is recommended, therefore abandoning the differentiated meat products. This is because the success of product differentiation is greatly dependent on the industry, and in this case, the industry has failed to differentiate. A strong indication of that is Raporal's inability to create switching costs that locked the buyer, even more when the product has been almost tailored to the buyer's needs. With this in consideration the following strategies are proposed:

- Increase size / grow

Continue the process of lateral expansion, and gain further production capacity, which will help gain power both with suppliers and with distributors. Additionally and more effectively, engage in horizontal integration through the acquisition of direct competitors. This way, by increasing its production capacity Raporal is able to supply other important distributors and effectively decrease the dependency on Pingo Doce. Furthermore, by covering a higher market share, Raporal is guaranteeing its importance in the national market and with this increasing its bargaining power.

The risk of this approach lies mostly on the high capital requirements that it implies. In addition, the trend towards a global market and with it the easy access to foreign producers may limit the effectiveness of such approach, as the increase in size may be insufficient relative to the international market size.

- Increase sales volume

What the market has demonstrated so far, is that producing private label products, especially in this product category is an efficient way to achieve large sales volume. Given that, this strategy proposes producing private label goods, but simplifying the production process. In this case Raporal would have to go back to producing an undifferentiated product. This way it would become more price competitive and more likely to resist the distributor's tough conditions. Essentially the risk is that this will decrease Raporal's bargaining power, and increase the level of competitions, as more producers are likely to offer the same product.

Recommendations

My personal recommendation is based on the above findings and expectations of future trends.

According to these I understand that it is necessary to combine a number of the above strategies in order to maintain economic growth and at the same time decrease the dependency on the distributors.

With this in mind Raporal should simplify its production process by moving again towards a **cost leader**, essentially exchanging the production of the better quality pig for the "industrialized" pig. This would allow Raporal to cope better with the distributor's conditions, understanding that these will remain in the foreseeable future important "business partners".

Moreover I suggest that Raporal increases its production capacity by engaging in both **horizontal and vertical integration**. This is the central part to actually decreasing the dependency on Pingo Doce. Only by sufficiently increasing its production capacity, Raporal will be able to supply other important clients. In a first stage approach the initial suggestion to simplify its production, is fundamental as it will allow Raporal to reach that increased production capacity significantly faster, as well as generate additional economies of scale.

Ultimately I suggest that as Raporal focuses on gaining size in the home market, it should also focus on **internationalization** as an important way to achieve large sales without leaning on the same distributor and therefore reducing this dependency. Noting that again for this to be efficiently put in place, Raporal's production capacity needs to be expanded

V. Conclusion

This thesis has been developed to understand some of the major challenges affecting the food sector in Portugal. The findings account for the increasing bargaining power of distributors as well as the growth of their private label. The purpose of Raporal's case is therefore to best recognize how in practice firms operating in this sector are responding to this threat.

The elaboration of this work has given me valuable knowledge about the agricultural and food business, especially through the understanding of Raporal's strategic directions. Additionally it has allowed me to gather important information about the Portuguese grocery market and its most important players.

As a consumer I have learned the importance of the relations between these industries, and consequently become concerned about the future of product variety and quality available.

With the aid of some academic models combined with the practical search for alternative channels, I have concluded that in fact the best direction, for this company, is to produce private label products to powerful retailers. These findings also suggest that such approach limits the viability of a differentiation strategy, as a private label product is bound to low prices. However, as in any area, the best way to mitigate risk is through portfolio differentiation, in which case I suggest the adoption of more than one alternative. And the research evidence suggests the importance of a vertical structure as the solution to coping with this threat, as well as to increasing the company's bargaining power.

Nonetheless it is important to note that the generalization of these results is subject to some limitations. Therefore if I had more time and additional means I believe it would be very interesting to investigate other major players in the industry in Portugal in order to understand their strategic direction.

However regardless of the extent of the research, the outcome is dependent on the future development, and although everything indicates that the trends identified will continue, only time will actually be able to evaluate such findings.

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