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**ANALYSES OF PRIVATE MARKET  
COORDINATION MECHANISMS IN THE  
HUNGARIAN DAIRY SECTOR**

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# **Division of the Presentation**

- 1. Introduction: background and main research aims**
- 2. Possible ways of establishing private (market) coordinating organisations in the dairy sector**
  - 2.1. Private coord. mechanisms in Hungary**
  - 2.2. SWOT analyses of private market coordination mechanisms**
- 3. Case study of Alföldi Milk Selling and Supplying Ltd. (history, development, future)**
- 4. Conclusions and ideas for future researches**

# 1. Introduction

## Starting point of our analysis:

Independent privately owned farm organisations can not countervail the market power of their business partners → coordination seems an appropriate solution

## Two main types of coordination:

- **By the state**
- **By private institutions:**
  - Established by the processors/retailers (by contracts)
  - Producer owned organisations

## Main purposes of the research:

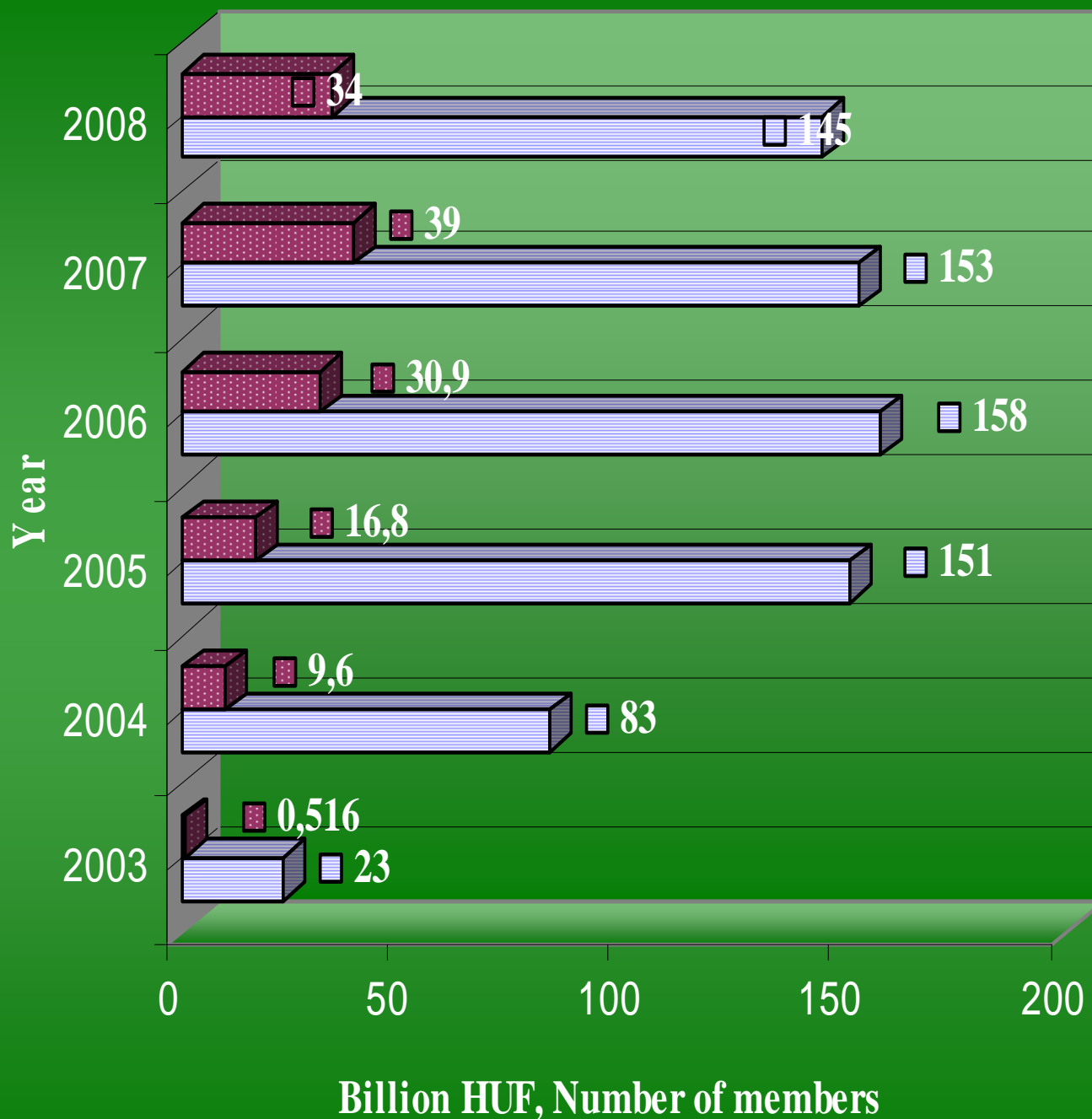
1. Showing possible *theoretical ways and practical reasons of establishing private (market) coordinating organisations*
2. Present a *case study* of a Hungarian „solution” to market imperfections in the dairy sector

## 2.1. Private coordination mechanisms in Hungary

- Establishment of producers' initiated organisations was slow after the change into market economy due to
  - *limitations in human resources and*
  - *the shortage of financial and social capital.*
- Participants at *different levels of the chain* (producers, processors, retailers) have different approaches towards economic benefits
- *Foreign owners of Hungarian dairy processing companies* have been using formal contracts including extending credits, supplying input materials, giving technical advice etc.
- They also *introduced and enforced different* quality control mechanisms and schemes and therefore they have got *key roles in achieving higher raw milk quality*
- To maintain their competitiveness in the enlarged European market, individual *producers have to exploit the* opportunities offered by the integration.
- According to their financial situation and access to credits, as well as due to their human resources available they have two possibilities of (private) coordination.

<b>Strengths</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"> <li>➤ decreasing transaction costs;</li> <li>➤ cost effectiveness of the production stage can be enhanced;</li> <li>➤ more accessible, more secure market through long term contracts;</li> <li>➤ more-or less-balanced prices guaranteed in contracts;</li> <li>➤ the processor takes part in ensuring the current assets of farmers through pre-financing;</li> <li>➤ long term stability, permanent subsistence;</li> <li>➤ bad quality products are filtered out by the system;</li> <li>➤ transportation is usually organized and financed by the integrator.</li> </ul>	<ul style="list-style-type: none"> <li>➤ the different market power causes imbalanced relationship between the integrator and the farmers;</li> <li>➤ the integrator is interested in cost cuts (raw materials, pre-financing current assets etc.);</li> <li>➤ price-asymmetry;</li> <li>➤ the integrator might arbitrary change the contract (causing hold-up problem);</li> <li>➤ the bargaining power and the interest enforcement of farmers remain weak.</li> </ul>
<b>Opportunities</b>	<b>Threats</b>
<ul style="list-style-type: none"> <li>➤ easier technological and product development;</li> <li>➤ better flow of information;</li> <li>➤ food safety is ensured via central control and monitoring.</li> </ul>	<ul style="list-style-type: none"> <li>➤ milk is a perishable product, that leads to opportunist behaviour of the contracting partner;</li> <li>➤ hold-up (relationship) problem based on the vulnerability of farmers because of functional investments.</li> </ul>

<b>Strengths</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"> <li>➤ decreasing transaction costs;</li> <li>➤ cost effectiveness of the production process can be enhanced;</li> <li>➤ lower technological and market risks;</li> <li>➤ more influence on the market and on prices;</li> <li>➤ cost savings through the shortened flow of information;</li> <li>➤ rearranging some of the profit from a certain level of the marketing chain to farmers;</li> <li>➤ better interest enforcement , better bargaining position;</li> </ul>	<ul style="list-style-type: none"> <li>➤ inexperienced management;</li> <li>➤ inexperienced independent marketing activity;</li> <li>➤ members often have to cope with shortage of capital, therefore the invest. structure is not optimal;</li> <li>➤ the current assets of the farmers have to be financed under their own capital;</li> <li>➤ members often cannot recognize that investments serve their interest – internal conflicts (horizon problem);</li> <li>➤ contact with the co-operative, transparency of its operation and practicing their managing and controlling role might cause problems for members (agency problems);</li> <li>➤ ensuring food safety, quality control</li> <li>➤ weak logistics</li> </ul>
<b>Opportunities</b>	<b>Threats</b>
<ul style="list-style-type: none"> <li>➤ accessing and retaining new markets;</li> <li>➤ high value added activities.</li> </ul>	<ul style="list-style-type: none"> <li>➤ shortage of capital;</li> <li>➤ technological and product developments are not materialised;</li> <li>➤ some members might gain benefits without paying-in (“free rider” symptom);</li> <li>➤ the co-operative is sometimes unable to control the quality and quantity of the supplied product;</li> <li>➤ milk is a perishable product.</li> </ul>



- Turnover (Billion HUF)
- Number of the members



## 3.2. Actual situation and future developments: plans

- **30%** of the Hungarian milk market is **controlled by producers**
- **2007: the plant has become profitable**
- **Main export markets:** Italy and Romania, but they are present in some other countries
- **Domestic market:** they are in every big retail chain with 160 products (hyper- and supermarket)
- **Commitment is relatively high** among the owner-members

### *On short term future opportunities and tasks include:*

- Re-creation of financial stability, decrease of banking costs,
- Increase suppliers' trust, saving liquidity of the firm,
- Strengthening market position regarding final products and export,
- Access to some supports from EU and state,
- **Product development**, new packaging design in case of products with higher price margin,
- **Modernisation** of milk delivery and accounting system.



### 3.3. Conclusions of the case study

As a main conclusion, the *above structure is unique, because:*

- **First**, it is a member-controlled business, but not a co-operative.
- **Second**, the above organisation structure is very effective so far and
  - a) offer almost the same *advantages* traditionally co-ops could secure,
  - b) but also *combines efficiency in processing and marketing*, as well as *flexibility* in business (e.g. to open to export markets.) which are usually weak points in case of agricultural co-operatives.
- **Third**, the “owner” of the dairy processing plant *is a producers’ group* which get some supports from the state and EU (apart from using *their own investments* mentioned above and *credits* from the market) thus financing is not a big problem contrary to the practice of traditional co-ops.
- **Fourth**,
  - a) human factors (e.g. trust, power, motivation etc.) and *management abilities strengthens the economic efficiency* of the firm.
  - b) Since they pay higher milk price than the Hungarian average and secure (growing) markets for the owners therefore commitment is relatively high on behalves of the suppliers.
  - c) It is very interesting fact that they are continually trying to increase suppliers’ trust as one the key elements of their success.

## 4. Conclusions and ideas for future researches

- The success story of the Alföldi Milk Selling and Supplying Ltd. is a good example for the vertical integration based on the horizontal coordination of farmers as initiators.
- By co-operation of farmers there is a chance and opportunity to significantly improve their countervailing power and to establish ownership for farmers in the processing stage of the Hungarian dairy chain.
- Better coordination of the whole chain can enhance (consumer) welfare as well.
- Further studies on producer – processors relationship, as well as on *developments of producers' groups* and other coordination structures in the dairy sector would be useful.
- The effect of strengthening trust and social capital has primary importance apart from direct economic aims.