Retail internationalization and its impact on the Russian agri - food business*

*Jon Henrich Hanf, Vera Belaya***

The internationalization process of the retailing sector is still in its turbulent starting phase. The present process of retail internationalization has created new trends in the agri-food sector such as global sourcing and retail branding. The example of Metro Group Russia underlines this point. The introduction and implementation of supply chain management concepts affect Russian agri-food business. Therefore, the aim of our article is to analyze this development. We outline the internationalization process of the retail business,and then we elaborate on the structural changes. Second, we apply this knowledge to the Russian agri-food business. We also discuss the future prospects and outlook on further development of the Russian food sector in the context of retail internationalization.

Der Internationalisierungsprozess des Einzelhandelssektors ist nach wie vor in einer unruhigen Startphase. Der Prozess der Internationalisierung des Einzelhandels hat Tendenzen wie Global Sourcing und Retail Branding im Agrar- uns Ernährungssektor katalysiert. Es ist zu beobachten, dass im Zuge der Internationalisierung des Einzelhandels die Einzelhändler ihre modernen Managementkonzepte exportieren. In diesem Artikel beschreiben wir den Internationalisierungsprozess des Einzelhandels und die daraus resultierende Veränderungen für die Agrar- und Ernährungswirtschaft. Des Weiteren wenden wir die gewonnen Erkenntnisse auf das russische Agrar- uns Ernährungssektor an. Hierbei zeigen wir zukünftige Entwicklungsmöglichkeiten des russischen Nahrungsmittelsektors im Zusammenhang mit der Internationalisierung des Lebensmitteleinzelhandels auf.

Key words: Retail internationalization, Russia, supply chain management

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** Jon Henrich Hanf, Dr., Senior Researcher, Department of Agricultur Markets, Marketing and World Trade, Leibniz Institute of Agricultur Development in Centrall and Eastern Europe (LAMO), Halle(Saale), Germany. Main research areas: Marketing, strategic management, networks and retail development. Corresponding address: hanf@iamo.de.

Vera Belaya, Ph.D Student, Department of Agricultur Markets, Marketing and World Trade, Leibniz. Institute of Agricultur Development in Centrall and Eastern Europe (LAMO), Halle(Saale), Germany. Main research areas: Strategic management, power and trust in Networks and retail development.

1. Introduction

Less than 20 years ago almost all of the world's retail firms were purely national, with a negligible share in foreign markets. Today however, the opposite is true. The ranking of the world's largest retailers by Deloitte (2005) reveals that almost all players operate in numerous countries, with noteworthy business capacity in foreign markets. However, the process is still rather new one and it is clear that the process will proceed further, but perhaps in a way that is turbulent than in the last decade.

'Western' retailers engaged in retail internationalization, are taking the business models from their home countries into the newly entered markets. Thus, one can say that modern management concepts are exported. The example of Metro Group Russia underlines this point. Since entering Russia five years ago, Metro Group Russia has already installed the Metro Asset Management, Metro Buying Group, Metro Advertising, Metro Group Logistics, and Metro Group IT. The twenty-six cash & carry markets and the three super centres carry 140,000 items that are delivered by 2500 suppliers. Only 5% of the suppliers are foreign manufacturers, and 20 % of the articles are region-specific. Thus, the Metro Group exerts a strong influence on Russian agribusiness in general and on the local agri-food sector in particular because the markets are mostly located in the Moscow region. This example support the idea that when western enterprises are in the fledgling stages they try to impose their procurement and logistic business concepts on the local suppliers.

The aim of our article analyzes this development. First, we outline the internationalization process of the retail business, and then we elaborate on the structural changes resulting from and connected with the internationalization processes that are key to the food industry with specific attention to one of the major consequences of retail internationalization – supply chain management. Second, we apply this knowledge to the Russian agri-food business; i.e., we show the impact of international businesses on post–communist economies. We also discuss the future prospects and outlook on further development of the Russian food sector in the context of retail internationalization.

The structure of our paper follows its aims. In the following chapter we deal with the causes and triggers of the globalization and its impact on the organizational structure. Because the creation of tight vertical supplier-buyer relationships is a cornerstone of the strategies of international retailers we pay particular interest to this strand of research. Next, a picture of the Russian agri-food business is outlined, with the focus on the main tendencies of retail development. The resulting consequences of retail development in general and those caused by international retailers in particular are discussed afterward. The article ends by drawing some conclusions and giving a short summary.

2. Internationalization of the retail business

2.1. Causes and impetus of the global expansion

Except for some smaller subsidiaries in nearby countries, the retail firms only began their geographical expansion across the national borders in the 1990s. Whereas in the first half of the '90s the national market share of the largest three retailers in almost all of the West European countries clearly surmounted 50%, the aggregated market share of the five biggest retail firms of the single “Western Europe” market was less than 15 percent. Therefore, further concentration of the national market by merger and acquisition appeared to be impossible in light of the already realized degree of concentration. As a result, the jump over the borders seemed to be the easiest way to avoid the legal prosecution by the Monopolies and Merger Commission.

In many cases the entering foreign retailer really was a newcomer in the respective market, so the antitrust department had no reason to deny any acquisition. Thus, George (1997) concluded that the stagnating trade in the domestic food market was the driving force for internationalization. However, the concentration process in the different national systems was not so strongly synchronized that these factors could be solely responsible for such a simultaneous and explosive internationalization of retailing in several countries. At least three (additional) pull-factors contribute to this development. First, the degree of concentration and the organization structure of the retail sector varies considerably among West European countries despite the proceeding assimilation of consumption habits and food purchasing behaviour. Thus, financially strong retailers can use this adjustment process to successfully install their own business ideas in new market environments on a grand scale (George/Diller 1993). Second, the collapse of the socialistic central planning system in central and eastern Europe left behind an economic vacuum that offered the unique opportunity to establish an entirely new retail system modelled on Western ideas (Rapp 1995). Third, an additional investment possibility for western retailers arose from the financial crises in Southeast Asia and the temporary shortage of money that resulted (Lingenfelder 1996).

As previously mentioned, the internationalization process of the retailing sector is still in its turbulent starting phase, with the first signs of consolidation. The larger retail firms are in fact ‘internationalized’ but only in so far that they are composed of a number of business units that are active in different countries, and often with different business conduct and behaviour. Only a few of the retailers have currently succeeded in internalizing this process and accordingly adjusted their organizational structure.

2.2. Organizational changes due to the internationalization

The different internationalization strategies also imply specific organizational changes. However, it has been observed that retailers stick to their business models when they enter foreign countries (Roberts 2005). In this sense there are at least several developments in common which offer outstanding opportunities for a more efficient use in conjunction with globalization.

The progresses in WTO negotiations in regard to quality and safety standards noticeably facilitate the trade of intermediate and convenience food products across borders (Fieten et al. 1997) so that today retailers are able to procure worldwide. This is said to be *global sourcing*. Even though the retailers have always bought products from all over the world, global sourcing has a wider meaning. Lingenfelder (1996) emphasizes that global sourcing applied as a strategic option can contribute to the added value not only by cost reduction but also by value enhancement. This results from quality differentiation and early adaptation to changes in food trends and fashions. When a national retailer converts to a multinational or even global firm, the procurement situation changes considerably.

Retail firms also try to reach synergy effects by simultaneously introducing centralized procurement divisions for several countries. It is often observed that the number of employees in the domestic, centralized procurement department is more or less stable although the number of countries to be managed and the quantities to be coordinated increase. As a result, retailers take their own suppliers to the foreign countries because the total number of suppliers should be more or less unchanged for the above-mentioned economic reasons. This also means that the quantity delivered by one supplier increases. Hence, the suppliers must continually increase their level of professionalism and their IT-infrastructure.

Having a centralized procurement department additionally creates the desire to negotiate the listing conditions for a greater territory. For example, in the past Schlecker - Germany’s biggest drug store company - bought all of their goods in Germany and distributed them throughout Germany and France. However, in the future Schlecker would like to negotiate on Pan-European terms, with the hope of economizing on cost advantages (Manager Magazin 2004).

One of the most remarkable recent trends in retailing throughout Europe is the steadily increasing dissemination of retail brands. *Retail branding* is used to influence customer perceptions and drive store choice and loyalty. Retailers began to recognize that people are loyal to brands, because brands add value to their purchase. Brands add a unique personality, a true point of difference to the image and products of retailers.

Several empirical studies convincingly demonstrate that an increasing share of retail brands leads to rising profit shares (Mei-Folter/Barber 1991). The positive relation between retail brand and profit holds true for national and international retail groups as well. Global retail firms can offer a retail brand in several countries. The amount that they sell probably exceeds that of a national competitor and the achieved sale volumes are often similar to those of the leading producer brands. If the retail branded products are manufactured under a contracting system, it might be possible to procure the necessary quantities at an incomparably low cost price.

The surge of retail branding is not only characterized by an increase in brands and of the market share, but also by a considerable augmentation of the standard quality. As a focal company, a retailer must accept responsibility for the quality of the products sold under its own label. Therefore, retailers must alter their conventional supply systems from purchasing on spot markets to using cooperative supply chain networks (Hanf/Kühl 2005). As focal companies, retailers must coordinate the product flow as well as the information flow by building cooperative vertical networks. If retailers take over these functions they can be considered to be the major and determining forces in the food chain (KPMG 2001). That can be characterized as the evolution of retail "eco-systems" (Eagle et al. 2000).

3. Supply chain management as a consequence of retail internationalization

3.1. Supply chain networks

The described trends indicate that food products are usually not produced in vertically integrated food chains but rather in vertical cooperating networks, due to the differing sizes of firms along the food chain. We use the term network in the following sense. Networks are "specific properties of the transaction relationships, typified by relational relationships in which formal and informal sharing and trust building mechanisms are crucial" (Zylbersztajn/Farina 2003). Therefore, they address all questions about inter-organizational relationships of more than two firms (Omta et al. 2001). To narrow the discussion on networks we use an approach by Burr (1999), who classifies four typologies, i.e., the spontaneous network, the self-organizing network, the project–orientated network, and the strategic network.

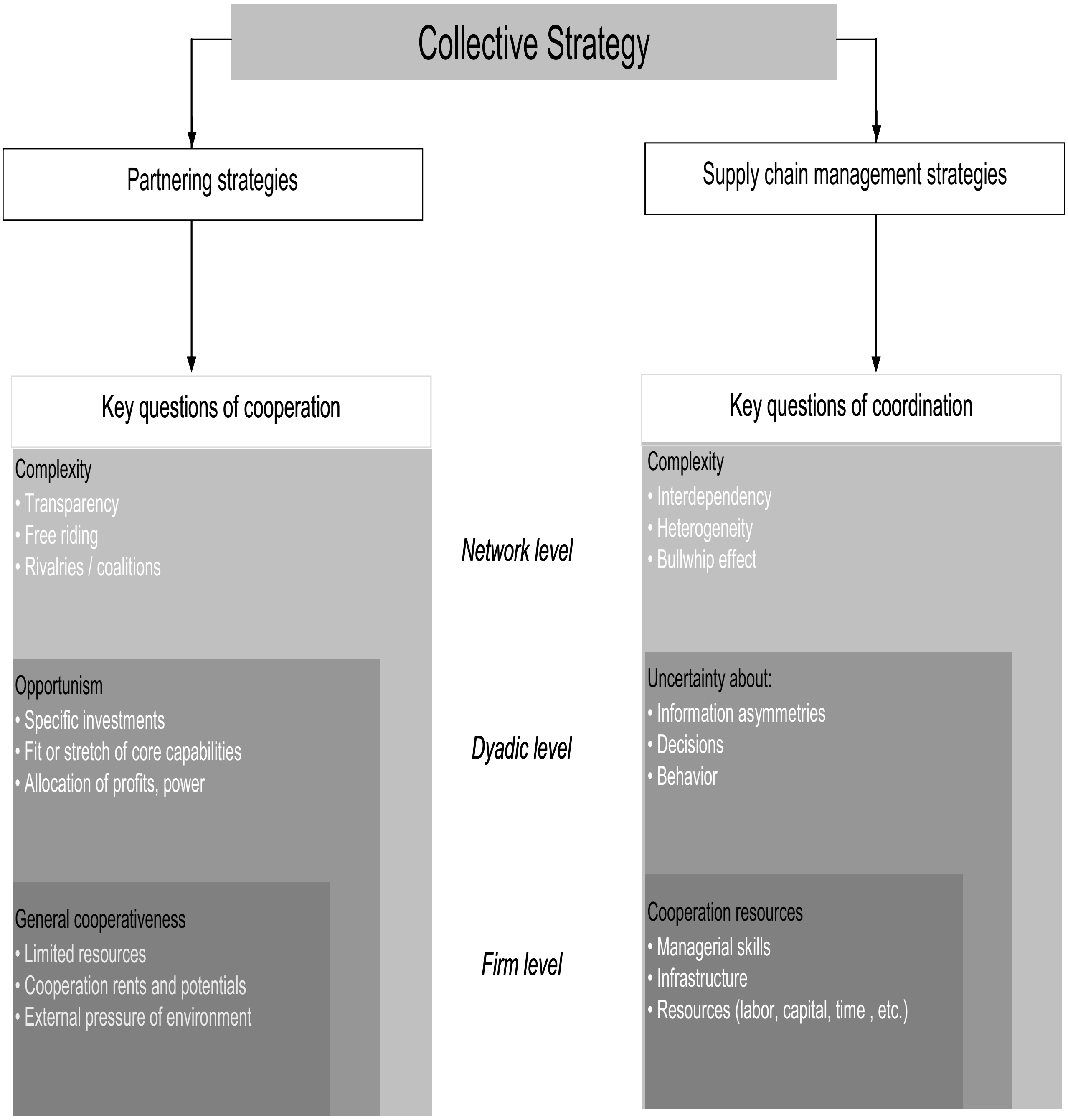
In the context of retail internationalization, strictly coordinated vertical linkages are relevant because they guarantee the quality of attributes such as organic production but they also help retailers to gain cost advantages. Therefore, these networks generally are strategic networks that are defined by various authors as "supply chain networks" (SCN) or netchains (Lazzarini et al. 2001; Hanf/Kühl 2004). Strategic networks can be characterized as pyramidal-hierarchic collaborations (Jarillo 1988) and they include a focal firm that coordinates the network firm in a hierarchical style. The intensity of the relations in strategic networks is rather high, and recurrent interactions are inherent (Burr 1999). The focal firm is generally that firm which is identified by the consumers as being ‘responsible’ for the specific food item, e.g. the producer in the case of a producer brand and the retail firm in the pyramidal-hierarchic case of a private brand. The other network actors are more or less heavily dependent on the focal company because of (long-lasting) explicit or implicit contracts. The level of dependency is usually higher for vertical ties than for horizontal ties (Wildemann 1997). Because the focal company is the core element of the SCN in the agri-food business, it coordinates the network partners to realize the strategic objectives.

3.2. Supply chain management

Due to the tightening of quality standards and the need to work together with “old” suppliers, we believe that one of the main consequences of retail internationalization is the establishment of tightly coordinated chain organizations. Because retailers themselves are thought of as guaranteeing of the quality of the food products throughout the whole chain, we assume that the trend of retail branding also fosters the establishment of tightly coordinated chain organizations. Therefore, we consider the resulting need to steer and manage such chain organizations, also called supply chain networks, as one of the most important trends of retail internationalization. In this context it is obvious that ‘western retailers’ export their business models of *chain management* both in the sense of enhanced efficiency as well as ‘global’ chain quality concepts.

The challenge for chain management concepts is that the interests of the involved partners and their actions must be aligned simultaneously. Thus, cooperation – the alignment of interests - and coordination – the alignment of actions - are two sides of the same coin (Gulati et al. 2005), so both aspects must be integrated in chain management concepts (Hanf/Dautzenberg 2006). In the context of chain management, Duysters et al. (2004) have shown that collaborations must be analyzed on three different levels, namely the firm, dyadic, and network levels. It can be said that the focal company that wishes to construct a strategic chain management system must work out a collective strategy that addresses cooperation aspects (partnering strategy) as well as coordination aspects (supply chain management strategy), allowing for the demands of the three different network levels (Hanf/Dautzenberg 2006).

Figure 1. Framework of chain management (Hanf/Dautzenberg 2008)



4. Retail internationalization and its impact on Russian food retail development

4.1. Development of food retail in Russia

The Russian retail market is dominated by small and medium-sized traditional stores, open markets, kiosks or other specialized stores with convenient locations, and consumer goods markets that offer low prices. Household spending habits for Russia's urban population, particularly for food, illustrate the role of the primary retail channels in Russia's grocery stores, produce markets, and supermarkets[1]. As table 1 shows, at the moment only about 14% of sales take place in 'modern, western style' retail outlets such as hypermarkets, supermarkets, discount stores, or cash &carry outlets. The majority of purchases, 32%, is still conducted at "wholesale" produce markets (or farmers' markets). The remaining share is divided between small shops (26 percent) and shops of other formats (28 percent) (BBE 2006).

However, the dynamic growth of retail commodity circulation in Russia, caused by the increase in population incomes, the sharp increase in volume of export transactions, and consumer credit, has strengthened the developing tendency of trading business as a whole, and its most quickly developing sector: retail trade. In this context, an increasing tendency of shifting toward modern forms of distribution such as super and hyper markets of large retail chains is observed. The most visible sign of growth in the retail food sector has been the rapid introduction and expansion of supermarket chains[2]. Now retail trading systems of modern formats are in a stage of active development, and commodity circulation of the largest of them surpasses turnovers of the majority of the domestic enterprises - manufacturers of consumer goods. Thus, the market influence of retailers steadily increases, and their requirement standards for suppliers become more and more rigid in terms of quality and price.

Table 1. Importance of retail formats in Russia (BBE 2006)

Retail format	Russia %
Hypermarkets	1
Supermarkets	6
Discounters	6
Cash & carry	1
Small shops	26
Street vendors / markets	32
Others	28

[1] In Moscow, retail chains hold 16 - 17 % and in St. Petersburg 18 - 20 %. However, no retail chains operate throughout Russia. Nevertheless, some of the larger chains from Moscow and St. Petersburg are expanding to other regions of Russia; some are even expanding to neighbouring countries such as Ukraine (BBE, 2006).

[2] Supermarket chains first appeared in Moscow in 1994, when the first Sedmoy Kontinent store was opened. By the end of 2002, there were 28 retail food chains comprising a total of 384 supermarkets; and by the end of 2003, the number of stores rose to 550, an annual increase of 45% (for 2003).

An example of this development is the rise of discount supermarkets, such as Pyaterochka and Kopeyka. Today, Pyaterochka is one of the largest local food retail chains in terms of sales and number of stores (260 stores in Moscow, St. Petersburg, and several regional cities). Unlike Sedmoy Kontinent and other high-end Russian food retailers, focuses on the rapidly emerging Russian middle class.

This indicates that the growing middle class will be increasingly targeted by retailers. Moreover, we expect that retailers will promote retail own branded products and their own brands. Therefore, we expect that the demand on product and process quality will increase significantly in the future. The following table shows the ten biggest food retailers in Russia in 2005.

Table 2. Top 10 Food Retailers in Russia by Turnover in 2007 (Kommersant, April 2008)

№	Name of network	Format	Turnover, USD Million
1	X5 Retail Group (Merger of Pyaterochka and Perekrestok)	Multi-format	5.284
2	Metro	Cash & Carry	4.801
3	Magnit (earlier Tander)	Discounter	3.676
4	Auchan	Hypermarket	3.400
5	Lenta	Discounter	1.559
6	Kopeyka	Discounter	1.490
7	Dixy	Multi-format	1.431
8	Sedmoi Continent	Multi-format	1.400
9	Migros Türk	Multi-format	770
10	Marta (Rewe)	Multi-format	493

The development of 'organized retail' has received some further impulses since international retailers entered Russia in 2000. Today, retailers such as Metro and Auchan operate in Russia and the entrance of Carrefour, Wal-Mart, and even some German discounters is expected soon. Thus, even though Metro is one of the top retailers in Russia, the market leader as well as the majority of food retailers are still of Russian origin, as table 2 shows. We now elaborate on the extent of retail internationalization in Russia.

Russia represents the largest and fastest growing retail market opportunity among the central and eastern European economies. This, combined with the sensible fiscal and monetary management of Russia's economy, has made the country quite attractive to foreign investors. Global retailers have accelerated their activity in Russia. Although Russia's government has taken steps that scare investors about the country's commitment to the rule of law and protection of property rights, these issues have mainly involved the resource sector. The consumer sector has been left alone. However, investment risk resulting from poor infrastructure, corruption, and regulatory hurdles has discouraged many retailers from investing in Russia until recently. Continued efforts to reduce investment risk will attract more foreign retailers looking to tap the country's huge potential (Deloitte 2006).

According to the A.T. Kearney 2007 Global Retail Development Index, Russia remains strong and retains the second position on the index among the top 30 emerging markets worldwide, which it has held over the past two years. Consumer spending has risen rapidly for the past two years, fuelled by an income growth rate of 10% last year and 11% the year before. More spending by Russian consumers has led to the overall retail growth rate of 13% last year and is expected to grow by at least 10% this year (Kearney 2007). The importance of foreign-owned retailers in Russian food retailing is mirrored by the fact that Metro is already the market leader and other retailers such as Auchan and Marktkauf are heavily investing in this market (KPMG 2004). The example of Metro shows that foreign retailers are exporting their business strategies and concepts and are being supplied mostly by Russian companies.

4.2. Impact of retail internationalization on Russian Agri-food Business

Changes in the retailer-supplier relationships are already occurring. In the past, Russian suppliers dictated the rules of exchange to domestic retailers (Roberts 2005). Suppliers were so powerful that they could afford to keep retailers waiting for 72 hours for ordered goods (Corstjens/Corstjens 1995). However, it is essential for Western retailers to stick to their original business models (e.g. chain management) when entering a new market (Roberts 2005). International retailers have been able to gain some market power by applying global sourcing strategies and providing interesting new markets (BBE 2006). Thus, in the long run, they expect their suppliers to meet the retailers' global requirements for food quality and safety as well as delivery terms.

When retailers enter a new country they often take some of their 'home'-suppliers abroad. For example, when Metro entered Russia, Hochland AG followed and built a dairy planet near Moscow. Hochland AG was initially protected; however, over the course of time, as local producers started to reach equal (chain) quality and process management standards, Hochland AG has become 'normal competition' with the local Russian suppliers. Furthermore, because the import of goods by foreign companies is complicated by the existing tax and customs regulations in Russia, some of the international supermarket chains are forced to use locally produced resources and goods. Therefore, the majority of suppliers of the international retailers are Russian.

Because these suppliers are currently forced to produce according to the retailers' private (global) standards, they have the opportunity to supply not only the Russian market but also the global market. Thus, the global sourcing policy of international retailers enables Russian producers to internationally expand if they can achieve cost efficient - better to say cost advantage – production.

However, on the flipside of the coin, one can also observe that retailers are trying to bring their established supplier relationships with them to new countries. Thus, foreign food processors are establishing plants in Russia to produce international brands as well as the retailers' own brands.

In their efforts to become recognized retail brands in Russia, international retailers are carrying some international brands such as Nestle and Danone as well as their own brands. These retailer-branded products must be produced according to the global quality standards of the retailers and they are mostly positioned in the lower price segments. In addition, because local brands are currently perceived as high quality and a good value, and because they benefit from Russians' patriotic impulses to buy "Russian-made" products, international retailers also carry national Russian brands.

One can conclude that international retailers must work hard to build functioning chain (quality) management. However, because today quality management of food products demands efforts along the whole food chain, one can easily see that international retailers must establish a chain quality and supply management concept. As the example of Metro Russia shows, they are establishing all of the elements of the 'western' supply and quality chain management in Russia in all of their suppliers. This means that Russian suppliers must be willing to accept that Metro is the "chain captain" that sets the process standards throughout the whole supply chain.

Because modern chain management (both supply chain and quality management) demands significant investment in IT and technology infrastructure, only a minority of Russian suppliers will be able to remain in the chain in the medium and long term. However, this development also demands that Metro, as the focal company, must motivate its Russian suppliers to comply with its rules and standards. Incentives for the cooperation can include an opportunity for both international and national growth, the prompt payment for the supplied goods, reputation, etc. Additionally, Metro must work out mechanisms to coordinate its suppliers. In this case, the long distances combined with bad road infrastructure (even Siberia has to be delivered) are major challenges. Because IT infrastructure is just developing, Metro has the significant task of meeting its IT demands. For example, Metro has already established its supplier portal (enables e.g. electronic data interchange (EDI)) in Russia (LZ 2007).

5. Conclusions

The present process of retail internationalization has created new trends in the agri-food sector such as global sourcing and retail branding, which has automatically increased the demand for quality goods and demonstrated the importance of vertically coordinated food chains. This process, also called verticalization, implies that vertically coordinated supply chains of independent firms are being formed. Such chain organizations are characterized by a pyramidal-hierarchical structure, i.e., the existence of a focal company. This central firm organizes the supply chain via chain management.

In our case we assume that this focal company is the international retailer. We also observe that international retailers usually export their business concepts, such as supply chain management. As the Metro example shows, the introduction and implementation of such "western" style supply chain management concepts affect many Russian agri-food businesses.

Recent developments in Russia's agri-food business sector, such as the increase of sales levels of consumer goods, growth of per capita income, demand for high-quality retail outlets, and entrance of foreign investors in the country's consumer goods market, bring with them new technologies and name brands and create the conditions for large-scale changes in the wholesale and retail infrastructure. The changes in the retail sector have been most evident, since this sphere is the most visible one. One can safely say that supermarkets, hypermarkets, and discounters are now becoming an integral part of Russian life, at least for the European part of Russia.

Although the growth in large-scale chains may eat into the nominal market share of wholesalers, this will be more than offset by even greater growth in the consumer goods market as a whole. Regional distributors should not see the recent growth of large retail chains as a threat. Russia is geographically too large, and there are too many variations in local conditions, to allow one company to take on the role of a true national player. Even the most formidable chains in Moscow and St. Petersburg do not have sufficient resources to undertake large-scale expansion into the various regions. In the provinces, local – as opposed to national or international - retail chains are most common, and even their total market shares are relatively small. Despite the fact that retail growth in Russia is expected to continue in the coming years, some difficulties arise caused by bad extent of roads, railroads, and other infrastructure that connect these markets with food-producing areas in the country. In spite of this, sophisticated distributors have good opportunities for growth even if the market structure changes substantially. The market itself is growing larger, and there is sufficient room for everyone. In addition, small and uncompetitive players are also being weeded out. Therefore, despite the rapid development of retail chains that try to eschew wholesalers, flexible distributors can in fact benefit from this growth as well.

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