Explaining s group's success: a historical case study of a dominant Finnish food retailing group 1985-2005

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Abstract
The purpose of the paper is to explore the connection of organizational action and performance, in order to help our understanding organizational performance as an outcome of intra- and extraorganizational processes. (Steers 1976; Miles 1980; Lenz 1981) As an empirical case this is a study of the S Group between the years 1985-2005. Theoretically the study sheds light on the competitive dynamics and organizational performance (Ferrier 2001;Derfus et al. 2008; D'Aveni et al. 2010), and Red Queen evolution (Barnet & Hansen 1996) by bringing forth empirical evidence from Finnish grocery sector. The results suggest that S Group's success cannot be explained without taking into account performance of the rivals. What the competitors did or left undone influenced S Group's success as much as the actions S Group initiated themselves. The growth of S Group was an outcome of incremental development, influenced by both internal and external factors under different contextual constraints.

1. Introduction

S Group is a dominant Finnish food retailer. It is a consumer's cooperative, comprising of 22 regional cooperatives, which are owned by 1.7 million consumers. Since 2004, S Group has held the leadership position in the Finnish food retailing markets. From the very beginning of the 1990s, S Group started to win market share with the speed of around 1.5 percentage points per year. Its market share rose from 17.5% in 1985 to 35.9% in 2005. Concerning the fact that in the Finnish grocery trade the average of total sales between 1991 and 2005 was worth 9316.49 million euros, a growth of one percentage point meant an increase of 93 million euros in sales. Hence, during the period of 15 years' growth, S Group increased its cumulative sales by a total of 1.5 billion euros.

This paper builds on theories about competitive dynamics (cf. Baum &Korn 1996; Smith, et al. 1992; Chen & Miller 2012; Chen et al. 1992; Miller & Chen 1994; Young et al. 1996; Ferrier at al. 1999; and Ferrier 2001; Lamberg 2009; Luoma 2013) as well as the concept of Red Queen competition (cf. Barnett & Hansen 1996; Barnett &Burgelman 1996; Barnett &McKendrick 2004; Barnett &Pontikes 2004 and 2008; Derfus et al. 2008). These theories provide the basic platform in understanding S Group growth and Finnish grocery market competitive activity.

The purpose of the paper is to explore the connection of organizational action and performance, in order to help our understanding of organizational performance as an outcome of intra- and extraorganizational processes. (Steers 1976; Miles 1980; Lenz 1981)The research depicts chains of events behind the performance development in S Group, and shows the interlinkages between S Group and the rivals, in order to understand the dynamic nature of firm performance.

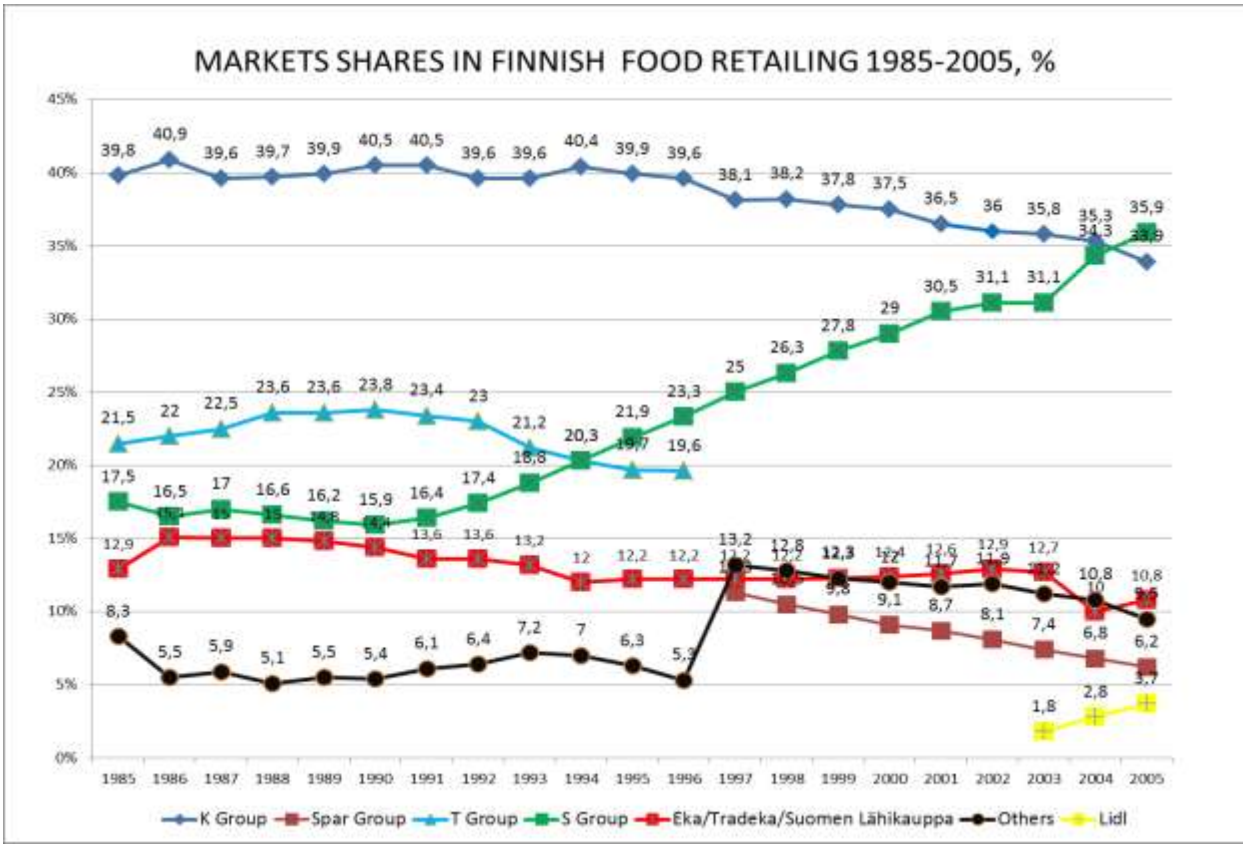

Figure1. Market shares of Finnish food retailing companies 1985-2005

Theoretical background

Following the idea of Barnett & Hansen (1996), an organization facing competition is likely to respond. That response then marginally increases the competition faced by the organization's rivals, triggering in them a search and decision processes, which ultimately increases the competitive pressures faced by the first organization. This again triggers the search for improvements in the first organization, and so the cycle continues. Such a reciprocal impetus, known in evolutionary organization theories as the 'Red Queen' has been claimed to be a central, driving force behind the evolution of competitive success and failure. (Barnett & Hansen 1996)

The Red Queen effect is an important stimulus to strategic evolution, and it emphasizes competition as a force continually upsetting equilibrium by an incremental and constant self-reinforcing process. Such processes can result in important long-term developments even though each individual adaptive change may be small. Incremental change usually is thought to mean small change, but each small change within the Red Queen triggers the next, accumulating over time into a potentially large evolutionary difference. (Barnett & Hansen 1996)

This paper assumes that organizational activity is the key to understand differences in market shares. Hence, following the line of inquiry by Chen et al. (1992), Miller & Chen (1994), Young et al. (1996) and Ferrier et al. (1999) this research describes company growth paths to be an outcome of actions and counteraction and emerging events in the wider environment.

Methodology

The empirical material comprises of several sources. Written material included annual reports, press releases, financial statements, interim reports and other shareholder information. Business magazine articles (Kauppalehti, Talouselämä, Taloussanomat) were used as source as well as companies' customer magazines. A total of 19 interviews were conducted with the CEO's of the food retail corporations (K Group, S Group, Tuko/Spar and Eka/Tradeka), the Directors General of the Finnish Competition Authority and the Managing Director of the Finnish Grocery Trade Association. All interviews were between 60 and 90 minutes in length. The interviews were recorded and transcribed verbatim. The objective of the analysis was to produce a rich narrative explanation that provides descriptions of differences in companies' development paths under competitive action-reaction loops. In-depth statistics were received from A.C. Nielsen, from databases and from company annual reports.

This research is historical case study, using applied historical methods to catch the complexity of the phenomenon under study. As a case study this research is an empirical inquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident and in which multiple sources of evidence are used (Yin 1989, 22).

S Group's strategic change

In the mid-1980s four major grocery trade groups – K Group, S Group, T Group, and Eka Group – were the main competitors in the Finnish grocery trade. In 1985 these four held a total market share of 91.7 % in food retailing. The retailing groups were built on horizontal concentrations of food manufacturing, imports and procurement, and wholesaling and retailing. The well-doing private retailers, K Group and T Group, based their operations and governance on the idea of the grocer-ownership model, combining private entrepreneurship and active ownership. They were contrasted with poorly performing consumer's cooperatives, the "Leftist" Eka and the "Bourgeois" S Group, enterprises which were owned by the consumers, and with democratically arranged governance.

The S Group's inferior state of affairs in the 1960s and 1970s had led to a financial heritage in which solvency and the profit was considered poor. Inevitably S Group faced a fundamental crisisin the early 1980s. As a counterreaction to elevated and concentered challenges S Group started a massive reorganization in 1983. The so called S-83 plan established the guiding principles for the transformation of the whole S Group. The reorganization was initiated and led by the central corporation SOK's CEO JuhaniPesonen. A total of 183 independent local or regional cooperatives were merged into 34 regional units. The branches of business, which needed heavy investments like departments stores, hotels, hardware stores and agrimarket business were organized as nationwide chains and were transferred under SOK's responsibility.

S Group's structural change was bipartite. On the other hand tighter central management took over chain business in S Group's food retailing, but on the other hand regional cooperatives gained more autonomy in operations and investments. A key element was the amassing of resources into the regional cooperatives.

The next strategic guidelines, the S-90 plan was accepted in April 1986. The primary focus was on the creation of the chain operations, based on a vertically integrated business model. According to the plan, four of the seven distribution centers operated by SOK would be abolished. The number of regional cooperative was to decrease. The local cooperatives were ranked into five classes according to their profitability, solvency and adequacy of the cash flow. If the local cooperative wanted to stay independent, it meant being left outside of the S Group's business unit strategy. Additionally this meant being excluded from the integrated chain management concept, and the S Group also refused to take any financial responsibility of the badly performing local cooperative. (Herranen 2004, 260-261) Each of the SOK's branches of business were to focus and invest in strategic chains. In food retailing Citysokos stores, S-markets and Prisma hypermarkets were the intended strategic chains. (Herranen 2004, 260)

At the same time the basic fundaments in the S-cooperative community were clarified: It was declared that the member of a cooperative was a customer-owner, whose needs were principal. On top of the service portfolio a bonus card system was built, which helped the Group to obtain a better prognosis of customer buying habitsand produced a deeper understanding of customer needs.

Amidst of the mergers of the local cooperatives into larger regional units, SOK sold off its textile and food industry units. Numerous other industrial units were merged or hived off into subsidiaries. An industrial joint venture Meira, established in 1987 was to combine productive units of Eka and S Group. An important step was the deal on merging agritrade units of SOK and its larger competitor Hankkija. (Herranen 2004, 267)

To strengthen the S Group's foothold in the Greater Helsinki region SOK bought in 1987 the soft discounter chain Alepa, which possessed a total of 34 stores in Greater Helsinki region. The S Group's Alepa mission was to "win the K-grocer in cost efficiency and the Siwa-chain in perishable goods". Two years later regional cooperatives in the S Group started to build up a nationwide discounter chain called Sale. (Herranen 2004, 266)

S Group's regrouping, the integration of local cooperatives into larger regional cooperatives lasted until the beginning of the 1990s. The integration made the S Group a strategic alliance consisting of the regionals together with their central purchaser, administration and support unit SOK. The timing of the reorganization was fortunate, as the major changes in S group were initiated before the deep depression of the early-1990s. (Lahti 1996, 29)

In June 1989 S Group's third strategy program was approved - the so called S-94-plan. It was designed around the key idea of the customer-owner satisfaction. The customer-owner was seen as a key asset to the strategies of the whole Group. The task of the S Group was to offer the cooperative members, the owners, such benefits which they would not get anywhere else. (Herranen 2004, 259) The goal was to increase customer commitment, concentration of purchases and to mobilize internal motivation, and underline the emotional bondage to be a member in the S cooperative. The concept combined the concentration of purchases, increased customer loyalty with product and service offers with lowered campaign prices and bonuses according to the amount of purchases. The members of the cooperatives, the potential of committed customers, were tied to the Group by offering them special benefits in form of purchase rewards. In 1994, all the regional cooperatives were involved in the customer-owners service system. (Lahti 1996, 36-37; Lahti &Lehtinen 1990, 44)

The S-94 plan also focused on chain units. This was supported by the division of work and tight cooperation between the SOK and the regional cooperatives. The operational business was taken care by the regionals, while SOK concentrated in chain management. The coordinating organs were the Chain Boards, where the regionals held a majority. (Herranen 2004, 291) SOK's main function as a central corporation was to produce the necessary commercial and supportive services, needed by the competitiveness of the trade group. (SOK Annual Report 1993) The S-94 Plan included also a tighter commitment to increase the number of Prisma hypermarkets, to move into a new series of competition.

Alongside with the transformation of the group structure, also the question how to distribute investments within different geographical units of the Group was to be defined. In the 1980s the financial power was held by the central corporation SOK, and most of the local cooperatives were economically in a poor condition. In the 1990s the cooperatives were moving towards tightly conceptualized chain management. The seizure of the market potential during the advancement phase, however, required more stores and a wider store network with improved features.

S Group's chains were transformed into different brands, emphasizing distinct characteristics by marketing and sales promotion, with price level image and by restricted assortment within each chain. This was connected to region-wide marketing, conjoined commodity sourcing done by the SOK and consistent price level with uniform assortment in every regional cooperative.

Restructuration of the competitive field

In 1990 the boom in the Finnish economy came to an end. Annual GDP growth declined extremely rapidly from +5.4% in 1989 to -6.5% in 1991. Domestic private investments, private consumption and net exports of goods and services fell sharply. The decline in economy continued through 1992 and most of 1993. (Honkapohja&Koskela 1999, 405) The former super power Soviet Union and the communistic Eastern Europe accelerated to fall down, and the so called clearing trade with SEV-countries was coming to an end. At the same time a consensus agreement of the European Union was reached in the European Council meeting in Maastricht on 9.-10. December 1991. (Euroopanyhdentymisenkronologia 2003, 17)

Finland joined the European Union on January 1, 1995, along with Austria and Sweden. The full EU membership was preceded by the EEA deal in 1992. Conforming to the European legislative and business structures was a major political, financial and economical juncture for the future development in grocery trade. The internal regrouping and restructuring in the Finnish grocery trade was executed by the gradual liberation from regulation towards free competition. Until the Finnish EU membership, Finland was a controlled and regulated market area. Foreign companies could not import their own merchandize or assortment without proper permissions from the Finnish governmental authorities.

The substantive change in the 1990s brought along the disappearance of the bank groups and the system of corporate governance was renewed, and the previous dominance of the diversified corporations diminished. Large and liquid financial markets emerged. (Tainio&Lilja 2005, 62-63)

The establishing of a joint logistics company Inex Partners Ltd in cooperation with Eka Group was to improve the both parties' position in the procurement process and to generate economies of scale against the leading K Group. Inex Partners' volume in purchasing and logistics rose to near 30%, balancing Kesko's equivalent figure of 41%. Increased purchasing volume meant better buying conditions and lower prices, which in turn were transferred to consumer prices and earned marginal. The Inex Partners cooperation also strengthened S Group's commitment to invest in grocery chains, the volume was achieved by uniform assortment within the Groups' chains plus combining the two Group's joint volume.

During the recession S Group continued on its chosen path to establish new stores and to invest in larger scale store network, the Prismas. Positive signs of the past decisions were becoming visible. S Group's market share rose from 15.9% in 1990 to 16.4% in 1991. S Group was lucky enough to have started thorough structural changes before the recession. The rivals' businesses were starting to stumble because of poor economic conditions of the falling consumer demand. Tuko and Eka faced a full scale crisis.

In the late 1980s and early 1990s Tuko was driven forward by its desire to define itself in the market as "Investors' Tuko"; a company that would awake awareness among investors and whose stocks would have been traded in the Helsinki Stock Exchange. Tuko's odyssey in the fields of investment business came to a dead-end in the early-1990s. Step by step with the recession and national banking crisis in the Finnish economy Tuko encountered a severe financial crisis. Tuko suffered from lack of equity, and the owner-wholesalers were concentrating more in getting ownership benefits than developing the central corporation. The group lacked also a vision and a roadmap; there was no master in the house. (Vihma 1994, 26-27)

Tuko's credibility to cope with its obligations was questioned by its creditors. T Group did not have clear retail concepts, and T Group's shops were located in poor and bad commercial venues. Additionally, during the 1990s T Group was not able to invest enough, and its operations started to stall due to lack of resources. Hence, T Group had to be reorganized in autumn of 1992. As a result, the ineffective three-layered structure was abandoned and the changes abolished the conventional division into the central corporation and the wholesalers. The old T Group was radically renewed to a chain of Spar stores.

Eka Group rushed into reorganizing its structures and basic philosophies together with the E-cooperatives in early 1990's. The politically leftist cooperative attitude, tied to working class consciousness, was overshadowed by the efficiency and profitability of the other retailing groups. The loss of identity as part of the Finnish working class movement together with the simultaneous bankruptcies of Eka's insurance and construction businesses lead to a crisis, which was magnified by the deep recession in early-1990s Finland. The collapsed financial situation after a bank run in October 1993 lead to Eka Group adjudication to a reorganization process by its creditors on October 20, 1993 to avoid bankruptcy. The corporate structure was renewed as Tradeka Group Oy was established as a subsidiary of the Eka cooperative. The crisis emptied the pockets of the Group, annulled the investments possibilities and created an "on-the-edge" situation of death or survival. Several large scale mergers, set forth by Eka in the early-1990s, were disbanded by Eka's creditors, because they were related to other ownership struggles within the industry. Industry restructuring should have been done in benefit of the Finnish banks, not taking into consideration the optimal best of the merging companies or their business efficiency.

However, as S Group's market share grew, it became a significant competitor and created later a duopolistic situation between K Group and S group. A new logic of centralized chain management of branded store networks boosted the trade. The dualism between chain operations and entrepreneurship in K Group started to shear off in the favor of the latter. This meant increasing pressure to move from entrepreneur logics towards centralized chain management logic in Kesko Plc and the whole K Group. Consequently, the structure of the K Group was altered two times successively to align it with the competitive demands of the grocery trade market and the S Group success. The first alteration, the store format change (1993) and the succeeding K1 (1995) were targeted at reaching a balance between horizontal business model and the interests of the K retailers. This led to conflicts in governance and ownership structures. A new form of operating, the chain management, was introduced to the side of the entrepreneurial logic, which in turn had effects on the ownership and control of the Group, and resulted in a conflictual situation within the K Group governance. However, traditions and organizational rigidness, due to the dualism between the central corporation and the retailers' power in the administration of the group, created tension and resistance to large scale changes.

At mid-1990s, Kesko stepped out of the organic growth path by acquiring Tuko Ltd with a vision of restructuring the grocery business sector in Finland. Tuko was battling for its existence among frustrated owners, economic pressures, unsatisfactory store network, and declining market share. Tuko's creditors and owners liquidated Tuko in 1996 by selling the shares to Kesko on May 27, 1996. However, competitive authorities considered Kesko-Tuko merger to create a dominant market position for Kesko, and made it a precedent. The European Commission decided that Kesko was obliged to dissolve the arrangement and sell of part of Tuko.

In 2002 both the threat of newcomers to Finnish markets and the outbound internationalization of the Finnish retail chains sculptured the competitive landscape. Lidl entered Finland. However, despite of the hype around the German newcomer, the entrance of Lidl did not greatly affect the total situation in competition. The greatest effect of a Lidl outlet was usually on sales at nearby stores of similar size. Competition from Lidl reduced the gross profit margins of neighboring stores by just over one percentage point. (Kiuru et al. 2004, 50)

S Group – the new Master

After a severe recession at least the exporting sectors the Finnish national economy turned into a recovery around 1993. The domestic sector remained relatively depressed until 1995-1996, and unemployment continued to rise, and in 1999 it still stood at 11%. (Honkapohja&Koskela 1999, 406) Large competitive reorganizations had occurred in the grocery trade during the 1991-1996 era: Tuko had gone bankrupt and fallen apart. Spar had started from scratch, Tradeka and Elanto were in mandatory reorganization, Kesko's maneuver to acquire Tuko had foundered utterly.

In the later part of the 1990s S Group continued in the previously established growth path. In 1997 S Group's market chains produced daily consumer good sales worth of 2272.56 million euros. (SOK Annual report 1997, 35) In 1998 The S Group grocery business market share rose from the previous year's 25.1 per cent to 26.3 per cent. (SOK Annual report 1998, 36)

Following this strengthening trend of internationalization, the Baltic markets seemed attractive also to the S Group. In 2000 SOK opened two Prisma hypermarkets in Tallinn, Estonia and following an opening of two additional Prismas in 2002. Quite quickly SOK gained nearly 15% of the market share in the Estonian food market, and reached a 30% share in Tallinn area. Going to the Baltic food retailing was one step in increasing the accumulated volume of the S Group. SOK started to aim for foreign countries, especially the St. Petersburg area. The reasons for going abroad related to getting know-how, market knowledge and relations with suppliers.

S Group's repertoire of business concepts was widened by the entrance into the convenience store category. S Group's spotted a promising area for food retailing and started to experience with the ABC concept, which combined restaurant and convenience shops together at the facilities of a gasoline station.The first ABC was opened in 1998. The main services offered at ABC service station stores were versatile and moderately priced cafés, restaurants, supermarkets and convenience stores as well as fuels. ABCs were open for service every day of the year and that on a single stop; customers could eat a meal, do some shopping and fill up their tanks during the long opening hours. (SOK Annual Report 2004, 18)

S Group continued with earlier momentum and after successful years acquired more sales points and volume by merging both Elantoin 2003 and Spar Group in 2005. Elanto had been a wildcard in the industry restructuring scheme, and it had a long history of independence. It was also ideologically tied to the workers movement cooperatives, so the merger between a bourgeois S Group and the leftist Elanto was also reconstituting Finnish political heritage. At the end of the year 2003 Elanto run down its existence, and in the beginning of the year 2004 a new cooperative Helsingin Osuuskauppa Elanto (also known as HOK-Elanto) begun as part of the S Group's regional structure.

Spar was born after the T Group was digested by Kesko and the competition authorities of made an intervention to deny the deal. The new food retailer and wholesaler Spar started lumbering with difficulties, poorly located stores, unsuitable retail store network, and smaller volumes of purchase, non-existing investments, and a decline in the number of stores. However, despite the lack of competitive strength, , Spar aimed at building up a third competitor to the food retailing markets in Finland with the help of foreign venture capital investors. In 2005, Spar Group was sold to S Group. The former Spar stores were split among SOK, Tradeka, K Group the so called M Group, which consisted of small scale independent entrepreneurs.

Conclusions

The S Group's "saga", where the company increased its market share from 16% to 36% within 14 years is one prominent manifestation of firm performance. The increase in market share began in the early-1990s, but the roots of the growth lied deeper in the history. One of the main explanations for the continuous growth was the assets reconfiguration within the S Group which set the agenda for the Group evolution and expansion. At first stage the agenda consisted of the reconfiguring of the distribution of profit and reorganizing the management structures of the S cooperatives and the whole S Group. Rivals' effect on S Group activity remained limited. S Group was in the middle of structural change when K Group, relying on their financial abilities, started to run a wide investment program. Eka Group and T Group were in a severe crisis and were not able to influence the markets with massive competitive maneuvers. Step by step S Group became a good example to others. With dedicated market moves it made the others follow and copy S Group's initiatives, such as the vertical business model and chain management, investment in hypermarkets, customer bonus system, and service station stores. Such like competitive actions intensified the competitive situation, as proposed by the Red Queen theory. (Barnett & Hansen 1996)

The performance development of Finnish grocery trade companies during the years 1985-2005 was dependent on internal improvement: a result of heavy capital investment, proactive store development, tight control of distribution and logistics, innovative supply chain management, own-label product development, and integrated information management systems. (cf. Wrigley 1997, Lamberg et al. 2009) In addition to this, adjusting to the new emerging industry logic of chain operations (vertically integrated business model) was crucial in obtaining superiority in the market, assisted by Efficient Consumer Response (ECR), centrally controlled selection of products and standardized methods and procedures and economies of scale. Hence, the growth of the S Group was mainly due to a balancing of amassing capacity to the growth, and elaborating the uniform chain operations. This strengthens the notions of Lamberg et al. (2009) about the organizational capacity as a result of the firm-market interrelationship. As the S group's case shows, the level of capacity changes along with the proceeding of time, together with the actions it enables and by the action taken by others in the surrounding contextual arrangements and environment.

S Group and its success was also influenced by and associated with the events in the outer context. Besides the recession in 1991-1992, Finnish EU-membership and its effects in 1992-1996 created contextual constraints and their second-order consequences. Kesko's growth by merging Tuko was blocked by the Finnish Competition Authority. Hence, sudden and large scale changes in the competitive field were not possible without the interference of the competitive authorities or the government and their interpretation about the terms of reference of proper market behavior. By the ban of the Kesko-Tuko merger the markets were split into two categories: by the elimination of the T Group there emerged a competitive market for the big companies, eg. K Group; the emerging S group which was having a strong growth. Additionally, there was a group of smaller retailers – Tradeka, Spar Group and a bunch of independents – making the second level competition, that of the smaller companies.

This study has proposed that market share development is a dynamic evolutionary phenomenon that produces reciprocal responses in form of competitive action. (Cf. Metcalfe et al. 2003; Lamberg et al. 2009) In such atmosphere, performance is not absolute, rather than relational measure: "performance of one company is always affected by the performance of other companies" (Rosenzweig 2007, 112) and in that sense, not a property of a firm. (Metcalfe et al. 2003) It is situational and connected to one's aggregate position relative to actual competitors.

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