The Food Retail System in China: Strategic Dilemmas and Lessons for Retail Internationalization / Modernization

Arieh Goldman and Wilfried Vanhonacker

"Globalizing Retail" Conference
July 17-18
University of Surrey

1. The issue

- Modern food retail formats achieved dramatic success in China.
- Our shopping study (n=1200, 6 cities) finds high penetration of all modern formats.
- The issue no longer modern format "adoption".
- It is their role and future growth.

- Fresh food ***half*** of food expenditure.
- BUT traditional formats dominate fresh.
- ***Wet markets***: 69% vegetables; 64% fish; 61% poultry; 43% meat; 20% fruit.
- ***Specialized stores***: 40% fruit; 35% bakery.
- ***Modern*** :22% vegetables, 35% poultry, 33% fish, 37% fruit, 46% meat, 55% bakery. ***Modern***: 79% packaged/processed; 94% non-food.

- If situation persists dramatic implications for the future direction of supermarkets in China.
- Surprisingly, the issue largely ignored.
- The general belief/working hypothesis :
  - China to follow the global model.
  - The fresh problem is temporary.
  - Reflects the transition stage.
- These beliefs frame the China retail research.
- Research often looks for supporting evidence.

- We disagree and offer a dissenting view.
- We don’t know how fresh retail will evolve.
- BUT ,it will be different than the familiar global development model.
- This means supermarket retailing in China will be different.
- Already we see a weak supermarket sector.
- A weakening in the hypermarkets.
- We discuss our evidence and reasons.

- We conducted two related studies: consumer shopping and fresh supply practices ***.***
- We find:
  - Traditional formats ***entrenched.***
  - Supermarkets ***transfer*** of fresh models failed.
  - Unable to reshape fresh ***demand .***
  - Unable to reshape fresh ***supply .***
  - Unable to use ***transferred capabilities***.
  - Developed few ***new capabilitie***s.
  - ***Adapting*** to the Chinese environment.

2. Outline of presentation

- ***Present Asia/China evidence***:
- show traditional format dominance persistent.
- ***Discuss demand side reasons*** for phenomenon.
  - Show ***limited*** likelihood of ***changes***.
- ***Discuss supply side reasons*** for phenomenon.
  - Argue ***limited*** likelihood of ***change***.
- ***Discuss implications/Prognosis***

3.Persistent situation or transitory?

3.1 The Hong Kong example

- Extensively researched.
- Situation continuously monitored.
- Highly developed. Supermarkets over 4 decades.
- Goldman et al study H.K. in 1995 and in 1999.
- Wet markets continued to dominate fresh sales.
- Supermarkets: investments, SARS, food scares.
- Wet markets: modernization.
- Still ,wet markets persist,highly important.

- Coca Cola Retail Asia study(2005) :
  - ***Wet markets***: 47% of weekly fresh.
  - ***Supermarkets:*** fruit (59%); vegetables (55%); meat (52%); poultry (39%) fish (33%).
  - Minor differences in ***age/income/ education.***
- No expectation of further dynamics.
- Is HK an example to the steady state?
- Probably on the high side of modern performance.

3.2 Other developed Asian economies

- Taiwan, Singapore.
- Supermarkets exist for decades.
- Similar developments as in HK.
- Evidence
  - Weakness in fresh of modern formats.
  - Continued importance of traditional formats.
  - Coca Cola Retail study: similar statistics as HK.

3.3 Cross sectional China evidence I

- Cross sectional shopping data from 6 cities.
- Traditional formats Dominant all over China.
- Beijing/Shanghai: same patterns as other cities.
- Minor age and income differences.

4. The underlying reasons

4.1 Demand side

- Shopping patterns are the key.
- Reflect the ***traditional consumption System***
- Following we discuss:
  - Chinese consumption system.
  - Resultant shopping patterns.

4.1.1 The Chinese “consumption system":

- ***Cuisine traditional*** (***89%*** : only Chinese dishes).
- Main daily meal ***cooked at home*** (***6.4*** per week)
- Traditionally defined meal ***preparation methods.***
- Traditionally defined ***roles*** for each ***fresh ingredient***.
- Unique, Chinese ***definition of "fresh***".
- ***Complex cuisine:*** fresh ingredients in each dish.
- Ingredients, meals, preparation ***culturally defined.***

4.1.2 The result:shopping patterns

- Shop ***frequently*** for fresh .
- 62% buy in wet markets at least daily .
- ***25.8 monthly*** wet market ***visits.***
- Buy ***small amounts*** in each shopping trip.
- same patterns ***across the 6 cities.***
- same across ***Socioeconomic segments***.
- Similar patterns in HK, Taiwan, and Singapore.
- Similar patterns in Chinese enclaves.

4.2 Perceptions :modern and traditional .

Based on our study :

- ***Supermarkets*** viewed as ***inferior*** on
  - Price
  - Variety
  - Depth/selection
  - Freshness
  - Accessibility
  - Service

- ***Wet markets*** perceived as ***inferior*** on
  - Hygiene
  - Trusted supply sources
  - Climate control
  - Cleanliness
  - Shopping environment
  - Honesty
  - Opening hours
- ***Price, freshness, selection*** are the important.
- ***Food safety*** increasingly important.
- ***But*** effect confined to ***meat.***

4.3 Hypermarket response

- ***Two pronged approach:***
  - ***Copy*** wet market appearance, ambiance, merchandizing.
  - Change/shape fresh ***supply arrangements***.
  - Transfer advanced supply concepts and methods.
- Copying did made hypermarkets ***players*** in fresh.
- Supermarkets mostly excluded from the fresh game.
- Hypermarkets lag in price, freshness, variety/depth/selection.
- The problem remains the supply arrangements.

5.Hypermarket Fresh Buying

5.1 Introductory comments

4.1.1 The study

- Interviews :***buyers, suppliers, government.***
- The major /largest ***foreign/domestic*** hypermarket/supermarkets.

5.1.2 Earlier studies

- ***Our starting point*** : earlier supply studies***.***
  - Hu, Reardon, Rozelle, Timmer, Wang, Berdegue, Bi, Dong, Huang, Vorley, Gale; Cook, Shepherd, Zhang, Fu, Yang, Chen, Da Silva.
- Their reports largely optimistic.
- Believe hypermarkets are advancing.
- Modernizing traditional fresh supply practices.
- Moving them towards the modern arrangements.

- Typical *summary statement* from

Hu et al. 2004 ," *The Emergence of Supermarkets with Chinese Characteristics*". Development Policy Review *(p.581).*

- "*in sum there are signs of the emergence of **innovative supermarket procurement systems**-with a shift away from the traditional wholesale system towards **use of large, centralized distribution centers, specialized/dedicated wholesalers** operating **preferred supplier systems, joint venture with global logistics firms, new farmers' associations** acting as intermediary organizations to resolve the issue of efficient aggregation of product over many small farmers, and **private standards for quality and food safety***" .

- *In fairness: these authors hedge these conclusions in the paper's last paragraph. But this statement is ad-hock, not explained/discussed and not compatible with the argumentation throughout the paper.*

5.1.3 Our findings

- Our conclusions different.
- Hypermarkets have operated over a decade.
- All experimented with new supply concepts.
- Most modern supply concepts were tried .
- The important issue is wide spread acceptance.
- We find hypermarkets have concluded that most are not viable .
- We find hypermarkets to be pessimistic about the prospects of changing fresh supply arrangements.

- Hypermarkets do not believe
  - In ***dramatic developments*** in fresh supply system.
  - In their ability to ***change and reshape*** the system.

- Their present focus ,instead ,is on
  - ***Adapting*** to the system.
  - Executing ***minor improvements***.
  - ***Avoid*** bold moves and major investments.

5.2 Fresh buying practices

- ***Local wholesale markets (WM)***
  - Hypermarkets rarely buy there directly.
  - Mostly used as a supplementary mechanism.
- ***Direct contracts with growers***
  - Most did experiment, but abandoned.
  - Limited to fruit and pork .

- ***Specialized intermediaries.***
  - The single most important development..
  - Different from European “category managers”.
  - Most small , weak financially and professionally.
  - Impressive sourcing knowledge.
  - Often source over most China
  - Source opportunistically.
  - Rely heavily on WM(in other provinces and local).
  - Contractual arrangements exist but relatively unimportant
  - Some integration to growing (tax, not quality or supply reasons)
  - Most own/rent logistics infrastructures.
  - Facilities often small, basic, low technology, low cost.
  - Most are not “dedicated” they supply competing chains.
  - Many sell in WM.

- ***Consignment/leasing***
  - Many hypermarkets consigned all/parts of fresh.
  - Lost control over prices, presentation and quality.
  - Consequently, most droped the practice.

- ***Fresh buying centralization***
  - Varies across hypermarkets .
  - Across fresh categories.
  - Even centralized firms buy only "regionally".
  - Most firms buy at the city level.

- ***Fresh distribution centers (DC)***
  - Firms experimented with the concept(Carrefour, Century Lian -Hua, Trust Mart , Lotus)
  - Others(Walmart, Auchan)considered the idea.
  - All these rejected/abandoned the DC idea.
  - Concluded concept not economically viable.
  - Only 2 of the 15 firms interviewed (Hymall/Tesco; Wumart) report plans for a fresh DC.

5.3 China fresh business model

- What are the reasons for the limited progress*?*
- Is the current state transitory?
- The prospects for Western fresh supply model*?*
- The key : understanding the fresh business model.
- The key : fresh remains a low margin business**.**

- The fresh business model elements :
  - ***Wet markets*** a simple, effective, low cost format.
  - Enjoying substantial tax and flexibility advantages.
  - Fit well existing demand and supply environments.
  - ***Hypermarkets*** unable to counteract these advantages.
  - Unable to get substantial scale/operation economics.
  - Wet markets' prices remain the reference price.
  - Consumers *unwilling* to pay premium
    - **For *product quality/safety.***
    - ***For shopping environment..***

- Hypermarkets forced to adapt to the low margin/low price regime.
  - Report single digit gross margins (5-6% vegetables, 8% fruits, 10% meat).
  - Must match wet market prices.
- Hypermarkets concluded: fresh not a contributor to profit.
- Hypermarkets report: losing money on some fresh.
- Fresh categories viewed as only store traffic generators.
- The resultant strategy:
  - ***Avoid large moves, commitments and investments.***
  - ***Focus on adapting to the existing system.***
  - ***Introduce minor/marginal improvements.***

6. Implications

6.1 The Strategic Role of Supermarkets

- Supermarkets led fresh food transformations.
- Growers, wholesalers , government are facilitators.
- Supermarkets succeeded because they reshaped the environment to fit their systems.
  - Shaped consumer consumption and buying habits.
  - Restructured the supply arrangements.
  - Restructured growing and logistics

6.2 The China dilemma

- Only supermarkets can lead supply system change.
- Supermarkets lack motivation to lead .
- The transferred strategies do not work well.
- China needs new, innovative and risky solutions.
- Supermarkets pessimistic, unenthusiastic.
- Unwilling to commit, invest, take risks.

6.3 The future/ prognosis

- ***Scenario 1: consumption/shopping patterns remain unchanged.***
- Consumers require local fresh format ***near*** home.
- Hypermarkets are not the solution.
  - At present hypermarkets locate in inner city.
  - In the future will locate further from consumers.
- ***Option 1***: modernized wet markets.
- ***Option 2***: local “fresh focused“ supermarket.

- ***Scenario 2: dramatic changes in consumers' consumption/shopping.***
  - New definition of "fresh" (chilled, frozen, packaged)
  - Westernization of food preparation/eating.
  - The result: simpler, standardized assortment.
  - Willing to pay high premium for value added fresh items.

Discussion

- ***Scenario 1*** is more likely.

- ***Option 2*** is a general challenge .

- A growing dilemma in Europe/North America.
- many experiment with fresh-local formats.
- The issue is most pressing/visible in China.
- Some local governments in China prefer option 2.
- Naïve and not realistic position.

- ***The DC issue***
  - Hypermarkets can operate without fresh DC.
  - A fresh DC is a must for local supermarkets
  - DC not viable in the low margin regime.
  - Viability of local –fresh depends on solution.
  - If not , only option is modernized wet markets.
  - Wet market modernization will increase margins.
  - Will start a value added increase process.