THE REGION'S CHANGING RETAIL FOOD SECTOR

The Case of the Philippines

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Importance of the Philippine Retail Food Industry

Over the past decade, the Philippines witnessed a substantial growth in the retail industry. Although there is a dearth of recent literature and statistics to support this observation, a reconnaissance of places especially in the urban areas can attest to this. Growth is seen not only in terms of numbers but more visible in terms of size, investment on structure and modernization in operation.

Digal (2001) pointed out that the Philippine retail industry's performance comprises about 11 percent of the Gross Domestic Product (GDP) in 1997. There are clear indications that this magnitude has been more or less maintained in the past 3 years. Total retail sales in 2002 increased by 11.1 percent and its GVA contributed 10.6 percent to GDP in the same year (www.euromonitor.com/Retailing in Philippines). About seventy-three percent (72.84 %) of this share was in the trade sub-sector while 25.43 percent was in the services sector. From 1981 to 1997, the industry grew by 5.83 percent annually, outpacing the average annual GDP growth rate of 2.27 percent over the same period.

Combined with the wholesale sector, the industry absorbed 15 percent of the country's employed labor in 1998 (Digal, 2001). The food, beverage and tobacco industry contributed 37 percent of the total employment in the wholesale and retail industry in the Philippines in 1995. Within the food sector, 87 percent of the total employment comes from small food retailers with less than 10 employees (Digal, 2001).

In the Philippines, food retailing industry involves a wide array of sellers from the sidewalk vendors, wet and dry markets, sari-sari stores, groceries, supermarkets, hyper marts, warehouse and discount clubs and convenience stores. Food means brisk business. Food is intricately linked with its culture and traditions. In the family, food accounts for 43 percent of total expenditures. Outside the home, eating has become lucrative for the retail business. Expenditures for dining out, excluding corporate representation registered an average growth rate of 15 percent to 20 percent per annum in the last 10 years. In the quick service or fast food segment, the total market in 2000 was over PhP 30 B. (Palma, 2005). According to the Family Income and Expenditure Survey (FIES) of the National Statistics Office(NSO), household spending on food increased by 26 percent from 1997 to 2000. Personal consumption expenditure (PCE) on food and beverages in 2002 reached about PhP 448 B from PhP 401.7 B in 1998, or an average annual growth rate of about 3 percent (Omaña, 2005).

Supply Condition

In general, the retail sector has continuously increased its value-added in the last decade. However, the food retail sub-sector had a declining share of this value-added as compared to the other retail sub-sectors. While the total retail floor areas occupied by the large retailers in Metro Manila have increased by 13 percent annually from 1994 to 1998, the selected respondents for this paper reported a decline in space rental especially in 2004-2005 owing to lower demand for retail items.

However, it was seen that the large retailers such as the supermarkets largely enjoyed the growth in productivity of the sector. In terms of sales per worker in 1988, large retail outlets generated more than twice that of the small ones. In 1995, the gross valued-added of a single supermarket was 31 times larger than the smaller retail outlets. For the supermarkets, total sales per worker increased by an enormous 117 percent, while for the small retail outlets it has decreased by 60 percent in 1995.

The success of these supermarkets was reinforced by their use of high-tech facilities such as the point of sales (POS) scanner system, value-added networks (VANs), and the electronic data interchange (EDI) (PASI, 1995). The latter has significantly reduced the inventory costs of retailers. This was because this technology has allowed them to automatically purchase from their suppliers electronically. However, due to the high capital requirement of this system, only the large food retailers, which have access to credit, were able to take advantage of this.

In the Philippines, “sari-sari” stores dominate the retail market as they account about 70 percent of the total. “Sari-sari” store is defined as small grocery or convenient store that serves the basic food and grocery essentials of the households. Sari-sari stores are usually constructed as an extension of the owners’ house. Their dominance, especially in rural areas, is due to geographical convenience, intimate customer service and payment flexibility (Philippine Food and Beverage Retail industry: Opportunities for Canadian Exporters, 2000).

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Strategic Partnerships and Vertical Integration

Large manufacturers are establishing strategic partnerships with retailers. These partnerships have been facilitated with the development of information technology and its adoption in retailing. Such strategic partnerships, however, have implications in the balance of power in the marketing system. By having access to better market information, large retailers are able to increase their bargaining power relative to wholesalers and farmers. Large food manufacturers, on the other hand, also benefit by tapping the rich market information which retailers are able to source out from their POS system. However, these strategic partnerships may reinforce the dominance of large retailers in the input and output markets.

Underground Economy

The contributions of the retail industry to the economy are said to be underestimated due to the exclusion of the micro enterprises, which comprise the informal sector, or the so-called “underground economy”. Based on the NSO-SHOA 1988, it was found that the 835,729 unaccounted enterprises had a total value-added contribution of $376 million, which was 65% of the total value-added contribution of the retail trade sector.

These data support the idea that more households are engaging in retailing activities. According to the 1991 FIES, one out of five families acquires income from either retailing or wholesaling activities. Paradoxical situations persist during the economic crises in 1985 and 1991, and during the 1988 economic recovery. In the former, the industry experienced positive growth, while it decreased in the latter. These must be because retailing has become an employment opportunity for unemployed individuals.

Another important observation was that more women are engaged in the retail/wholesale industry. Almost 66 percent or 2.36 million women were employed in this sector as of 1994 (NSO).

As for the rural areas that are dominantly agriculture-based, farm produce are either brought to the public market and sold to retailers and wholesalers, or are sold directly to consumers. Moreover, because agricultural products are used as raw materials for retail food production, the agricultural sector has become significantly dependent on the retail industry’s performance. Recently, however, many farmers expressed concern on the entry of agricultural commodities from abroad. The more liberalized trade regime compounded by minimal efficiency gains in domestic production put them at a comparative disadvantage.

Policies

Over the past two decades, the Philippine economy witnessed radical changes in its policies from monopolies, cronyism, and excessive government intervention under Marcos to more liberalized markets under Aquino and Ramos (Gonzales, 1999). During the Marcos era, the main economic policy toward industrialization was import substitution. However, its success rate was low as traders experienced high tariffs, quotas, and an overvalued exchange rate. The government became dependent on regulatory controls, public enterprise, investment incentives, and trade restrictions. The goal of the government to undergo industrial development resulted into the concentration of industries, sheltered domestic markets, and distorted price signals (Patalinghug, 1997).

Under the Aquino administration in 1986, most of the unfavorable economic policies were removed. It was during this regime that foreign investment liberalization laws, such as the Foreign Investment Act of 1991, were implemented. However, although there were a number of policy reforms, the implementation was highly constrained by the lack of adequate financial resources.

During the Ramos administration starting 1992, the policy of less government intervention was sustained. To promote competition and efficiency, the foreign exchange market, banking, transportation, and telecommunications were all liberalized. Build-operate-transfer schemes were also implemented to fill in the gaps in the infrastructure investments. Also, with the government's aim to promote competition, it opened up duty-free shops in the country.

In summary, the protection given to large food-processing firms, particularly those producing highly advertised branded food products reinforces their market power and weakens the bargaining power of food retailers and farmers. Also, domestic concentration was triggered by the presence of government incentives, such as those offered by the Board of Investments on duty-free importation. The capability of foreign investors catering to the local market to advertise and to offer lower prices, erect barriers to entry and exit (Abenoja and Lapid, 1991). On the other hand, due to the inadequate and unorganized marketing support facilities, the bargaining power of farmers relative to the traders weakened.

Regulatory Issues

To prevent the occurrence of unfair trade practices, the government has implemented a series of policies to govern the retail trade sector. Some of these policies include: The Price Act of 1991 (RA 7581) which protects consumers from price manipulation such as hoarding, profiteering, and cartels; the Consumer Act of the Philippines (RA 7394) which penalizes certain acts such as deceptive, unfair, and unconscionable sales practices in both goods and credit transactions. It is the Department of Trade and Industry (DTI) which is tasked to implement these policies through their consumer protection program.

Demand Side Drivers

Demand side drivers of the Philippine retail food industry include population growth, overall economic growth, consumer education, fast changing lifestyle and higher awareness of food quality and safety. The rate of increase in the country's population is considered one of the highest in the region, notching annual increase of no less than 2 percent over the past decade. Since the growth is skewed towards the youth, this trend will represent a higher potential demand for food (Palma, 2005). The remittances from abroad continue to contribute significantly to income of many households. This translates to higher personal expenditures particularly on retail food and non-food commodities. Recently, however, the inflation-adjusted estimates showed a decrease of 10 percent in average income and 8 percent decline in average expenditure from 2000 to 2003 (NSO, 2005).

Although the share of food in total spending had declined, expenditures on food continued to increase. Household food expenditures increased by 26 percent from 1997 to 2000. For the same period, personal consumption expenditure on food and beverages grew by 3.4 percent per year. Moreover, food consumed outside the home has been in an upward proportion (Palma, 2005).

The DTI and a number of concerned consumer groups have been active in promoting consumerism. Consumers are now being educated about their rights and on how they can get the best vale for their money. Improved communication systems have also triggered this consciousness. Through the ownership of television sets and radios, information is now more accessible to the consumers. As a consequence, there is increased competition among retailers to improve their service (Digal, 2001).

With higher disposable incomes, fast changing lifestyles and the growing number of dual-income families, the need for mobility have made convenience food a necessity. Preference for supermarkets has gone up both in urban and rural areas. This is because supermarkets, as compared to the other types of retail outlets, are usually cleaner, comfortable, spacious and well-maintained. Moreover, supermarkets offer a wider range of choices for the consumers, including both perishable and non-perishable goods.

This growth translates into competition. The entry in the industry has been more profound with new fast food chains and more branches joining the bandwagon. The dominant players include McDonald's, Wendy's Kentucky Fried Chicken, Kenny Rogers and Pizza Hut. However, it is the Filipino-owned company, namely, the Jollibee Food Corporation, that has cornered a bigger share of the pie as it accounts for about 52 percent of the total fast food market (Omaña, 2005).

Due to the consumers' increased quality consciousness, retailers are now mindful of providing high quality food, which conforms to the taste of the consumers, as well as the speed and efficiency of service in a clean environment. The high rate of competition has made these factors necessary for the growth of the retail food industry (Palma, 2005).

Also, food safety has become one of the major issues of today. With this, the government has established reasonable standards of quality for food products. The Department of Health (DOH), together with the Bureau of Foods and Drugs (BFAD), was mandated to ensure the safeness of the food being sold and distributed to the general public for their consumption. Moreover, the DOH, with authorization from the owners, enters and inspects the equipment, raw materials, containers and storage facilities being used by these firms to ensure that the food they produce are safe for human consumption (Palma, 2005).

Investment in the Retail Food Sector

In 1993, a bill was proposed to open the retail industry to foreign investors. In October 1996, former President Ramos signed an executive order advocating the full liberalization of the Philippine retail trade sector. It was in March 2000 that President Estrada signed RA 1180, or the Retail Trade Nationalization Act for implementation. However, due to the dominance of large food retailers, which is believed to raise the possibility of market power, RA 1180 was amended and was replaced by RA 8762, or the Retail Trade Liberalization Act of 2000.

The last five years saw a phenomenal growth in the food service business with the entry of large retailers. Local store chains, particularly convenience stores are expanding in major urban areas. In 2000, more than one third (35%) of foreign franchises are in the food business. Local franchises, on the other hand, have also gone international, such as Red Ribbon Bakeshop, Max's Fried Chicken, Josephine's Restaurant, and Jollibee (Palma, 2005).

Impacts on Traditional and Small Retail Outlets

*Distribution of Retail Outlets***.** In the Philippines, the distribution of the retail outlets is influenced by the size of its market, which is dependent on the consumers' number and purchasing power. In 1994, 80 percent of the 210,301 retail outlets in the country were sari-sari (neighborhood) stores; 17 percent were market stalls, and less than 1 percent were supermarkets. It is argued that the large number of sari-sari stores in the country suggests the extent of low-income earners. These outlets are popular among low-income earners particularly those who have no regular jobs or those who need to supplement their incomes (Digal, 2001).

Displacement of Small Retailers. Output contribution-wise, sari-sari stores are now being displaced by large food retailers in spite of their number. While there are only a few supermarkets in the country (1%), they have the largest share of gross value-added among the retail outlets. In 1995, the supermarkets had a 68.2 percent share of the total value-added.

Output. The small retail outlets increased their output contribution by 2.14 percent from 1975-1995, while the large ones, particularly the supermarkets continued to expand by 46.3 percent.

The competition between the large supermarkets and the small retailers could be seen on their relative share in consumer expenditures. The share of supermarkets in consumer expenditures grew from 37.3 percent in 1989 to 57.4 percent in 1994. In contrast, the shares of sari-sari stores dropped from 17.3 percent to 10.7 percent during the same period. Then in 1994, the share of supermarkets is already 57.4 percent, while that of the sari-sari stores decreased to only 10.7 percent. Similarly, the share of market stalls declined from 22.1 percent in 1989 to 10.8 percent in 1994.

The dominance of large retailers is more pronounced in the Greater Manila Area where supermarkets controlled 79 percent of the total food market. In terms of employment, the share of sari-sari stores dropped from 66.59 percent in 1975 to 32.58 percent in 1995. As these trends are expected to continue, there is a threat that the market share of sari-sari stores will continue to decline. Supermarket revenues have been projected to grow by 18.6 percent per year between 1996 and 2000 (Digal, 2001).

The trend contradicts assumptions that the two types of retail outlets have different target markets.

Concentration

Although large food retailers appear to dominate the retail food industry, these retailers argued that they face stiff competition especially among supermarkets and have to practice loss –leader pricing to maintain their market shares. They practice giving discounts, regular bargain sales, reduction in margins, expansion of target markets, bigger store space, and good product quality (Patalinghug, 1996).

One possible way of proving this claim is through the computation of the concentration ratios. Available data on these concentration ratios showed that supermarkets are actually not concentrated even in Metro Manila. Rather, the top four supermarkets only have a 1.08% concentration ratio and that they only have about 1% share of total sales.

Generally, data on concentration ratio support arguments that the retail industry is fairly competitive. One of the arguments in the retail industry is that it is not the retailing sector but the food manufacturing sector that is highly concentrated. Canning and processing vegetables, vegetable juices, smoking of fish and other marine products, wine manufacturing industries among others have 100 percent four-firm rations (Digal, 2001). Eleven of the 53 industries under this sector have four-firm concentration ratios of 100 percent. Almost half of the 53 industries sectors in the country are extremely concentrated, having ratios of at least 90 percent.

Impacts on Domestic Agriculture

The growing competition within the convenience food industry has important consequences for the agricultural sector. First, the industry has become a lucrative market for agriculture. However, certain conditions must be satisfied. For instance, because of stiff competition the players in the food industry must be ensured of quality and freshness of raw materials. Also, they must tie-up with reliable suppliers of raw materials for smooth operations.

Atomistic farmers and wholesalers are the primary sources of vegetable and fruits by the retailers. However, due to the geographical characteristics of the Philippines, distribution of these goods has become costly. This situation is further complicated by the poor infrastructure facilities, primitive sea and air transportation systems, and the lack of a grading system for these goods. Due to these inadequacies in the distributional system, trading between buyers and sellers has been greatly constrained (PASI, 1995). In addition, grading system is sometimes based on subjective judgment of size, quality, and variety, rather than on well-defined and objective standards (Lantican, *et al*., 1996). Altogether, these have limited the integration of markets and have provided an environment that is conducive to exercising buying power among the wholesalers, food processors and retailers directly buying from primary producers.

Farmers usually receive lower prices due to the agriculture products' high perishability and the lack of adequate infrastructure facilities in the country. They have lost their bargaining power, which on the other hand is being enjoyed by the retailers and wholesalers who have the resources and better knowledge of the market situation. However, this advantage of both retailers and wholesalers are not absolute, for they are deprived of such power when they are into processed goods.

Impacts on Trade

In some cases, the agriculture sector has limited carrying capacity to provide the industry's bulk requirements. In turn, many agricultural raw materials and ingredients have to be imported. These include beef, potato, cheese and other dairy products (Palma, 2005). In particular, the local livestock sector cannot provide enough beef supply. On the other hand, local potatoes do not meet the quality required for production of French fries, a major food item in the fast food industry.

In a more recent study, Macabasco (2004) pointed out two essential attributes that make imported vegetables more attractive to the institutional markets and the supermarkets who cater to the high-end consumer markets. First, imported vegetables are cheaper by 30% to 50% compared to some of the locally produced ones. Second, they are better packed and generally of better quality. In turn, importations of vegetables have grown sevenfold since 1996 to 2002.

However, the local food chains seldom export. What they just usually get from other countries are the cooking equipment and utensils that are specifically made for their products, and which will be used in their overseas branches (Palma, 2005).

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