Agriculture Department
Food and Agriculture Organization
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Farmers and supermarkets in Asia

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The good news for Asia's fruit and vegetable growers is that the region's rapidly expanding supermarket chains are particularly keen on selling fresh produce. In marketing jargon, fruits and vegetables are a "destination category", one that attracts consumers and builds customer loyalty. The bad news is that modern food retailing brings with it fierce competition, reduced profit margins, demanding quality standards and procurement systems that focus increasingly on an elite group of "preferred suppliers". In this sink-or-swim environment, many traditional fruit and vegetable wholesalers - and millions of small-scale producers - must either adapt or face exclusion from the market.

The opportunities and risks posed by Asia's "supermarket revolution" are analysed in a recent study by our Agricultural management, marketing and finance service (AGSF). It finds that while most Asian consumers still prefer traditional outlets when shopping for fresh food, modern food retailing is already altering the structure of fruit and vegetable supply chains in many parts of the region. "There is a growing concern that modern supermarket procurement arrangements might result in unfavourable terms of trade for small-scale farmers," says FAO marketing economist Andrew Shepherd. He points out that little large-scale research has been done on the impact of supermarket development on Asian farmers' incomes, and many policymakers are "ill-equipped to help farmers make informed decisions about their eventual fate in the marketplace."

"Wet markets". FAO estimates that Asian growers produced more than 600 million tonnes of vegetables and 200 million tonnes of fruit in 2004. Marketing of this fresh produce involves many vertical linkages: a large number of farmers sell their output to a relatively small number of traders who supply wholesale markets which, in turn, supply retail (or "wet") markets and other outlets. But that traditional way of doing business is changing: rapid economic growth, increasing urbanization and accelerated integration into the world economy has led to a surge in the number of supermarkets and hypermarkets across developing Asia.

"Most households use traditional retailers for fruits and vegetables even though they may use supermarkets for other products," says Andrew Shepherd. "There remains the perception - and possibly the reality - that wet market supplies are fresher and often cheaper. Nevertheless, supermarkets continue to make inroads because of their competitive prices, more reliable quality and the fact that they offer 'one-stop' shopping."

The emerging role of modern retail chains in fresh produce sales is most evident in Malaysia's major cities, where they accounted for as much as 60 percent of fruit sales and 35 percent of vegetable sales in 2002. Close behind is Bangkok, where 40 percent of fruits and 30 percent of vegetables were sold through supermarkets and hypermarkets. Although growth in sales of fresh fruit and vegetable by supermarkets tends to lag behind that of processed food products, they have already had a significant impact on the region's food distribution system. Supermarket chains in Asia are adopting practices common in the West and Japan, including the use of centralized procurement systems, "dedicated" wholesalers who sometimes act as sole suppliers, "preferred supplier" systems, and demanding private standards for fruit and vegetable quality.

Impact on farmers. The report says that fierce competition among supermarket chains forces them to seek ever lower product and transaction costs and to minimize risk. For producers, this means that the chains will not contribute to the kind of farm-level investments needed if small farmers are to participate in new markets. The squeeze on farmers' margins is likely to tighten as supermarkets become as concerned with safety and quality as they are now with cost - small farmers usually lack the capital needed to invest in hygienic infrastructure and the bookkeeping skills that "traceability" requires.

Many small farmers face hurdles even before the challenge of meeting sophisticated safety standards and good commercial practices. Stores insist on delivery at early hours. Farmers committed to supplying supermarkets 365 days a year must renounce traditional religious or social obligations, which can stop most on-farm operations for a couple of weeks annually. They must also accept that buyers will reject some of their produce, without compensation. "Small farmers tend, for very sound reasons, to be risk-averse," Shepherd says. "But supplying supermarkets successfully requires a willingness to make risky investments."

In traditional marketing systems, farmers often receive loans from traders during the production period. While some supermarket chains do arrange input advances, they are generally unwilling to become involved in financing farmers. The cash flow problems this creates are exacerbated by the fact that chains can delay payment for up to 90 days. The difficulties farmers experience in supplying supermarkets in Asia are reflected in the fairly sharp declines in the numbers involved, as companies de-list suppliers who do not come up to expectations. In Malaysia, for example, one chain had 200 vegetable suppliers in 2001 - by 2003 this number had fallen to just 30 "preferred suppliers".

The market forces unleashed by supermarkets also threaten traditional wholesalers: there is an emerging trend in supermarket procurement toward centralized systems involving a central buying office, with distribution to stores through a network of distribution centres. This reduces coordination costs, generates economies of scale through high volume purchases and fewer transaction costs, and gives the supermarket outlets tighter control over product quality. Many chains are shifting from traditional wholesale markets to "dedicated wholesalers", who are regarded as more responsive to quality, safety, and consistency requirements than traditional wholesalers, who aggregate produce from many producers and may also be unable to supply the quantities required. Experience in supermarket development in the US and Europe indicates that the next step will be fusion or joint ventures between chains and dedicated wholesalers, and a move to contracting production directly from preferred suppliers, thus bypassing traditional wholesalers.

Role of government. One thing is certain, says Andrew Shepherd: "Supermarkets are here to stay. Governments need to recognize the trends and identify ways of supporting farmers to meet the needs of modern supply chains and also to help existing marketing systems to compete with the supermarket sector." For example, governments could provide incentives - including stricter enforcement of regulations - to encourage modernization of traditional markets. Extension services could be better geared to meeting farmers' needs for information on markets and on quality issues. Since the new "supply-chain modalities" do not encourage supermarket investment in suppliers, governments could foster funding arrangements between banks, supermarkets, suppliers and input companies.

Attention also needs to be paid to legal and regulatory frameworks governing the horticulture sector. Governments can advise on contractual arrangements, set up arbitration schemes, develop quality certification, and establish laboratories and sampling procedures to meet safety concerns. Since small farmers will find it very difficult to compete with large farmers in supplying supermarkets, governments could also encourage cooperative ventures that link either directly with supermarkets or to intermediary wholesalers. Ministries of agriculture could help supermarkets and agro-processors locate farmers who have the capacity to supply what buyers need. Finally, one good defensive strategy for producers and wholesalers in a time of declining market share is to increase the total size of the market: several Asian countries have launched "five-a-day" promotions that encourage people to enjoy five healthy servings of fruits and vegetables a day.