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CHILE: The structure and evolution of food retail and its consequences on the food system

Eugenia Muchnik

Introduction

A study by Reardon and Berdegúe on the rapid rise of supermarkets in Latin America indicated that although Latin America is a region with relatively high poverty indexes, supermarkets have helped to transform the agrifood markets of the region. Retail changes which took 50 years in United States were made in only one decade in Latin America. In comparison with other countries in the region, the participation of supermarkets in Chile's food retail is among the 4 highest. The development of supermarkets in Chile started very slowly after the first one appeared in the country back in 1957. It introduced 3 important innovations: a wide variety of products, several register boxes and parking space for the clients. The growth of this segment was very slow during the first decades, but then it accelerated in the 80s and more so in the 90s. Supermarket sales have grown continuously during the 90s and first half of this decade, expanding into new items, both food and non-food, into new neighbourhoods and into medium-sized cities. If the focus is placed on a fixed basket of products such as fresh beef, perishables and other meats, real sales of supermarkets are observed to follow the business cycle, either contracting, as was the case following the Asian crisis, or growing in years of economic rejuvenation, like in recent years.

The Participation and Role of Supermarkets in Chile

There are some discrepancies between different publications and sources of information as to the exact participation of supermarkets in food retail and the value of total food sales in Chile. Statistics used in this report were obtained this year from the Internal Revenue Service of Chile (SII), based on the Value Added Taxes collected for the years 1998 and 2003. In these statistics, firms select the identification of economic activity when declaring incomes. One possible choice in the retail food level, is supermarket. On the basis of this source of information, in 1998, 41, 4 % of food was sold by firms

that classified themselves as supermarkets in Santiago (the Metropolitan Area). This figure increased to 44 % in 2003. A different estimate is obtained based on this same source of information, if instead food retail stores are grouped according to the total value of food sales. The standard classification of firms by size in Chile considers as a large firm, one which in 1998 had annual sales in excess of US \$ 3.2 million and above US\$ 2.4 million in year 2003¹. If one equates supermarkets to large food retail firms, then 54 % of food sales to consumers belonged in this category in 1998, increasing to 58 % in year 2003. In 1994, only 9 years earlier, the participation of supermarkets in food sales was 49 % according to AC Nielsen. According to the SII source, food retail sales in Chile in 1998 totalled US \$ 8.9 billion, which increased to US \$ 11.1 billion in 2003, figures well above those reported by the Association of Supermarkets. These totals have been estimated excluding pet food but including soft and alcoholic beverages, and assuming that food accounts for 40 % of supermarket sales as reported by expert opinions. Outside of supermarkets, more than 30 % of meat sales take place in large stores, and only slightly a lower share in the case of dairy products. In the case of bread and bakery, wines and liquor and fruits and vegetables, more than 80 % of the sales take place in SMEs and micro enterprises

By grouping three Regions of Chile which house the 3 largest cities in Chile (Regions V, VIII and the Metropolitan Area), as the high population density regions, food sales by large firms in these regions was close to 60 % of the total in 1998, with no changes up to 2003. On the other hand, data for the remaining (less densely populated) regions showed a very significant increase in supermarket participation over the period 1998-2003, increasing the market share of large firms in food retail sales from 36 to 53 % during this period. It is also worth mentioning that there is a very high concentration of food sales in the Metropolitan Area, so that in 1998, the participation of food sales in this Area was 59 % of total food sales in the country, and increased to 69.5 % of total national food sales in 2003.

It has been pointed out in the literature (Faigenbaum, 2002 and Reardon, 2004), that the factors behind the rapid rise of supermarkets in Chile are on the demand side,: (i) urbanization, which continues to take place, particularly in the southern regions, (ii)

¹ The difference in firm size in the dollar value of sales is explained by fluctuations in the exchange rate between years and inflation rates as the sizes are defined in Chilean constant purchasing value pesos.

entry of women into the workforce outside the home, with increasing opportunity cost of their time so that they seek convenience and processed foods; and (iii) rapid growth in incomes. Due to lower generalized import tariffs over time and many free trade agreements that have been initiated since the 90s, there is (iv) much greater availability of cars among middle and low middle income groups, the number of households owning a car increased by one-third over the period 1996-2000 and more since then; and (v) many more households with refrigerators to store the perishables for a longer period (in Chile, 52% and 82% of all households had refrigerators in 1987 and 2000, respectively). Also, with the surge of both food exports and imports, a wide variety of foods are available in supermarkets.

There are several aspects of the rapid growth of supermarkets in Chile which are worth mentioning. In the first place, unlike other countries, the fast growing supermarkets were domestically-owned supermarkets, each developed as a family business. Only in the second half of the nineties did a few foreign firms come into the scene in Chile, two of them well-known multinationals, Carrefour and Ahold, which came to control about 10 % of supermarket sales in the early 2000s. Perhaps due to the fact that the domestic competitors had taken control of the strategic land properties for the business, (plus the problems experienced by Ahold worldwide) and had become highly efficient and competitive, these foreign supermarket chains sold their businesses in Chile between 2003 and 2004, so that once more, supermarkets in the country are completely under the control of Chilean firms. Secondly, there is a very rapid concentration of property. The two largest supermarket chains are D & S, with 34.4 % of market share, followed by CENCOSUD with another 24.1 %. In 2004, 6 supermarket chains controlled 71 % of supermarket food retail sales. A third characteristic is that the hypermarket format is increasing within the supermarket category, now making up for 35 % of total supermarket sales. These companies have announced plans to increase the points of sale and available surface for retail in important amounts. They have also expanded their business into pharmacy chains, hardware stores, and shopping malls. They have created credit cards for use in their supermarkets as well as in affiliated stores including gas stations or shoe stores, just to give a few examples. Another phenomenon observed is the effort by regional or local supermarkets in medium-sized and smaller cities to survive, having to invest in modernizing their infrastructure and introducing hard and soft logistics for retailing and management.

But the participation of supermarkets in food retail is quite different depending on the type of food. As mentioned earlier, the participation of supermarkets in retail sales of beef and dairy products fluctuates between 20 and 40 % and is much lower in fresh produce, for example less than 10 % in fruits and vegetables, according to data published by ODEPA (Ministry of Agriculture). It is observed that in fact the more specialized smaller stores have also undergone important improvements in presentation and management, adding other products to their main items.

Another change taking place in the food retail system in Chile is the increasing importance of self-service drugstores, gas marts and convenience stores in general. Self-service stores have gained importance within the drugstore business, and the pharmacy industry has experienced an explosive expansion and transformation in itself. Only 3 retail drugstore chains have concentrated a very high participation in this business and have taken over a net of strategic locations in all medium-sized and large urban cities. As with the main Chilean supermarket chains, pharmacy chains which now include self-service stores with food items, mainly snack and beverages have gone international, opening branches in neighbouring countries such as Argentina and Peru, and also in Brazil and Mexico.

Consumer Preferences in Chile

According to AC Nielsen (2005), Chile displays differences with respect to what it is that influences the preferences of the consumer. Compared with consumers in Brazil, Argentina, Colombia and Mexico, they are less concerned with proximity of the store, or being offered low prices, and more with product quality and service. Nielsen has detected that Chileans give more credit to brands (excluding private brands), and also choose supermarkets because they offer more items that are practical, have larger formats and offer healthier products, specially “light products”, that is products of the same types than the conventional ones but with less calories. The largest supply of light products is offered by the dairy industry. In surveys, consumers declare that the most valued benefit from specific items are health and security, and in second place “convenience”. On the other hand, one of the aspects that conceit attraction in convenience stores, according to Nielsen, is that self-service stores offer a higher proportion of new products than the traditional stores. But, as indicated by the experts

on food retail, the educational level of consumers is still low, so consumer choices may be driven in any direction.

In summary, Chile offers today a modern, highly competitive retail sector, dominated by Chilean-owned aggressive and competitive chains. The sector continues to have a significant growth potential, as has been indicated by reports from the FAS/ USDA representative in the country.

The impact of changes in food retail on the food industry

The fast and successful development of some Chilean supermarket chains led two of them to open stores abroad, specifically Jumbo (from Cencosud) in Argentina, and Santa Isabel in Peru².

The changes observed in food retail have also contributed to the modernization of the food manufacturing industry but it has been one of several factors, the most important of which seems to have been provided by an earlier take-off of the food export business, and secondly the technologies introduced by foreign food companies that set foot in Chile. Also important for the transformations in terms of food standards, norms, and labelling have been the laws and regulations introduced by the government, for example the Law of Food ("*Ley de los Alimentos*"), the Meat Law and very recently a Law on Food Labelling. Good Agricultural Practices and Good Livestock Practices, required to be applied at farm level for exports to Europe of fresh produce and meats respectively, at the request of European Supermarkets, but not yet in Chile, have been introduced by the export sector and by the Ministry of Agriculture. Strong support has been provided by several institutions both private and public, to adapt the protocols for the implementation of these norms and to train both professionals and workers. In fact, the first plant of packed meat (Procarne) was created in 1984 when supermarkets were still selling unpacked fresh meat. This year, Fundacion Chile started implementing a new service, which is a world class innovation, the Certification of Good Environmental Practices for salmon farming³, at the request of Walmart in the USA for their global purchases of salmon. The Code for this service was developed in 1998-2000

² Santa Isabel was later sold both in Chile and Peru to the Dutch group Ahold.

³ Salmon exports are today one of the major food exports of Chile, being the country one of the 2 top exporters of salmon in the world.

by Fundacion Chile with Chilean public funds, in anticipation of future requests for it from the world market. The salmon industry was not eager to request this service once it became available on a voluntary basis, until it was imposed by Walmart this year for the first time. The Chilean Code is now being adopted in Europe as well. Again, the request for this norm is coming from the retail sector in the developed countries.

Nevertheless, it may be considered that the rise of supermarkets within the country has helped the process of spill over of innovation in food processing and food marketing to other participants in the food sector, and to the food retail sector itself. But this was not the case as mentioned above with fresh fruits, the main agricultural export sector of Chile, where the standards have been set by fruit importers in developed countries, and mainly by supermarkets in the northern hemisphere. It has not been the case either for fresh vegetables, where again quality standards in supermarkets are quite basic, mainly based on physical inspection. Only in the last couple of years can one observe the appearance in supermarket shelves located in high-income neighbourhoods of some innovative fresh vegetables, ready to consume (for example, baby artichokes or baby green leaf vegetables combined in trays with edible flowers). These are really being pushed by innovative farmers rather than driven by requests from supermarkets. In the case of organic produce, there was an important effort by a local producers of organic vegetables, to open a marketing channel in supermarkets but it failed when it did not get any special support from the supermarkets, and the firm went out of business. Organic production in Chile is so far an export-driven activity, and includes fruits, vegetables and wines for the most part.

As for fresh vegetables, the main customers in supermarkets are ABC1 consumers, on the basis of a perceived cleaner produce but not due to a higher intrinsic quality of the produce. Middle income and lower income consumers consider that the quality, and particularly the freshness is much higher in the “ferias libres”, street markets. In meats, again the high quality standards achieved in terms of food safety have been the consequence of regulations by the food authorities. Supermarkets have been the main importers of beef from Mercosur, bringing lower-priced and highly standardized frozen and refrigerated beef to Chilean consumers. Also, supermarkets are now offering small amounts of brand beef, seeking to offer a higher quality beef, obtained from specific group of farmers, usually on the basis of special cattle breeds. In other products such as

dairy products and poultry or pork, the technical innovations are the consequence of multiple factors, many of them supply-driven, so that one cannot attribute all of them solely to supermarket developments (e.g. introduction of tetra pack packaging and UHT processing technology for liquid milk).

The Conflicts between Supermarkets and Suppliers

As mentioned in previous reports for Latin American food retail markets, there are constant conflicts and frictions between the large supermarkets and the food industry. In Chile, these conflicts have twice already reached the Anti-Trust Commission during the last 3 years, presented by Nestle, one case still undergoing scrutiny by the Commission. The accusations by providers of supermarkets have centered on the following issues:

- Abuse, instability of prices and conditions, copy of products, actions that inhibit sales or free competition;
- Charge of commissions, discounts, devolution of products, losses;
- Sales under cost, unilateral extension of payment dates, cross subsidies;
- Loss of credibility among consumers and buyers from other marketing channels (e.g. traditional stores) that consider to be charged higher prices by suppliers compared to supermarkets.

The Antitrust Commission has ruled so far in favor of the food industry, recommending that several of the practices by supermarkets mentioned above be discontinued. It has proposed that both parties agree on a Good Business Practices manual that could be developed and approved privately between parties.

Supermarkets and the Farm Sector

A recent study of small farmers' economic organizations in Chile by Berdegúé found that many of them are having a hard time meeting the demands of the supermarkets, while at the same time generating higher incomes for their families compared with their sales to traditional markets. The scale of operations of even 50 to 75 associated small farmers in fruits or vegetables is often not sufficient to offset the cost of such supermarket procurement practices as long-term payments, high rates of rejected produce (not sold within one or two days), and supermarket costs such as shelf fees and special discounts usually offered to consumers once a week. In addition, in order to sell to supermarkets, these smallholder organizations have difficulties to ensure

product homogeneity, coordination of harvest, centralized grading, sorting, packaging and delivery. There have been deliberate assistance policies by the agencies from the Ministry of Agriculture (INDAP) to help small farmer associations with technical assistance and suppliers' input credit to integrate them as suppliers of agroindustries and supermarkets, but in most cases these activities have not been sustainable in the long-run.

The lack of a contract policy with suppliers of fresh produce and other products such as beef, the instability and unplanned purchases of fresh produce by the supermarkets, coupled with price uncertainty, has led to the survival of a limited number of farmers as suppliers, only those that have excelled in logistics and management, mostly mid-sized or larger producers, with some others quitting or even going bankrupt (in vegetables). The long period of time to pay providers of supermarkets, also acts as a barrier to entry to many potential providers to supermarket chains

In fruits, supermarkets are not an important retail channel so far; and suppliers have the options of exports, as well as traditional stores and open markets. Because of the lack of contracts or long-term supply agreements with farmers, there is so far little chance of improving the quality of fresh produce. In beef, 80 % of the beef sold by the largest supermarket chain is imported, more than the share of beef imports nationwide. The reason according to supermarkets are the easier logistics, lower prices and availability of large volumes. But many consumers prefer domestic beef, while the provision of local beef is complex, and is still handled generally as direct purchases from farmers. Supermarket officials in charge of local beef purchases would want to engage in programs to develop providers, and contract farming, particularly to improve cooking beef quality. But the decision has still to be made by the higher administration within the companies.

Conclusions

Supermarkets allow the food industry to achieve economies of scale and thus, to improve their management, logistics, and stimulating innovation in products, including packaging in order to respond to lower prices as demanded by the supermarkets. Nevertheless, excessive concentration in retailing generates uncertainty and risks (e.g. own-brands of supermarkets have copied products; supermarkets also exhibit unstable

purchasing policies). It has been accepted that there is a need to develop and agree on a protocol of Good Business Practices between suppliers and supermarkets. An effort is underway on this matter, but progress has been very slow so far. There is also the view that with poor consumer education, the negative consequences of retail concentration such as imitation of products by own-brands of supermarkets are more probable to occur. On the other hand, food exports have proven to be a very good option for achieving leverage by agribusiness and farmers vis a vis supermarkets. Further modernization and growth of the supermarket segment is expected in Chile, especially in smaller towns. But it will be convenient to establish a contract system between supermarkets and farmers, to improve product quality and decrease risk and uncertainties to both supermarkets and suppliers of fresh produce and meats. Although these areas of business represent a small fraction of the total business for supermarkets, they are considered to be the “window” for customers, and thus are important for the future of this retail channel.

The importance of food sales by convenience stores, especially pharmacies and gas marts is growing fast, and the differences between the different retail channels is blurring.

Smaller traditional food shops may subsist but require supports with policies such as access to credit, capacity-building in management, use of new technologies of information, logistics and so on. The traditional stores will also have to adjust to an assortment of products that complement those of supermarkets, in services as well as quality, and opportunity of sales.

With respect to convenience stores, these are also expected to continue to grow rapidly due to changing patterns of food preferences such as for prepared dishes, and because the group of consumers that look for innovative products is expected to grow.

Wholesale food distribution companies (there are 2 major ones in Chile) favor a market with more players, and thus is a natural ally for strengthening traditional and convenience stores.

A Few Lessons

- Avoid excessive concentration of food retail. It could result in higher prices.

- Develop behavioral rules between suppliers and supermarkets for a win-win situation
- Support modernization of traditional retail stores with training, credit, finance, logistic.
- Promotion of food exports provide leverage to the food sector.
- Consumer education programs are important to foster the demand of high quality foods and better product selection, while aiming to keep prices low.
- In urban areas, the consolidation of neighborhood convenience stores would increase consumer satisfaction through complementary smaller and more frequent purchases.
- Small farmers may be left outside of the supermarket system without the help of special supplier development programs with the active participation of supermarkets and agribusiness.

CHILE: The food retail structure and evolution and its consequences on the food system

**Eugenia Muchnik
Fundación Chile**

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A very brief introduction about Chile needed

A country of only 15 million people, with economic growth well above population growth for last 2 decades

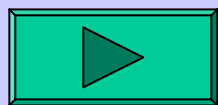
Highly urbanized, 84 percent urban, 3 cities concentrate 60 % of population, but small domestic market

Early and radical economic liberalization in the second half of the 1970s and many FTA since 1990

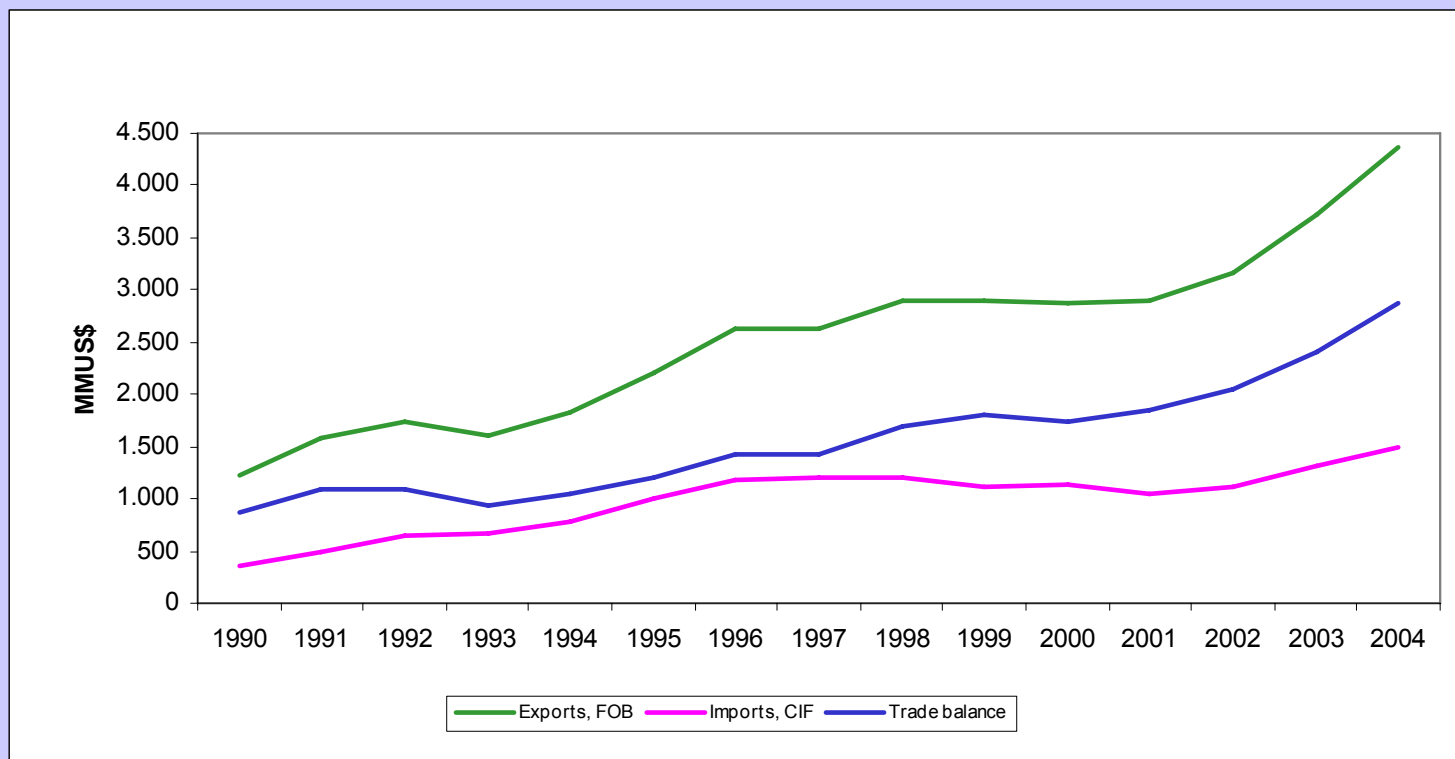
trade in global market became the “business plan” for Chile since the reforms

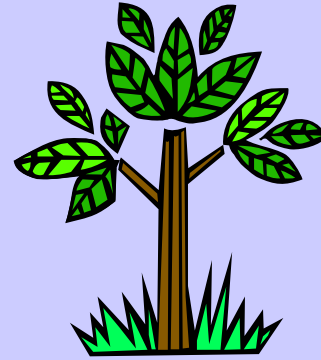


Rapid growth of agricultural exports to all regions of the world; the Americas, Europe and Asia, since the 1980s



1 out of 3 dollars of ag. production is exported





Main agricultural exports are fresh fruits such as grapes, apples, avocados, kiwis, plums, pears, peaches, now cherries and berries are increasing fast

LAST NIGHT IN CARREFOUR we saw grapes, apples and kiwis... ALL THE WAY FROM CHILE

**Exports of processed products are important too,
....since the mid 80s, before the take-off of
supermarkets in Chile**

Wines, also in CARREFOUR last night !!

**tomato pastes, frozen vegetables and fruits, fruit
juices, raisins, canned peaches, etc.**

**In this decade initiated exports of livestock products
(pork, poultry, dairy products and even beef !!)**

so supermarkets in Chile were less important a factor in the modernization of the food industry;

exports

were the driving force !!... + government and private regulations on food and industrial sanitary and environmental conditions

Code of Good Environmental Practices for Salmonid Farms and Wal-Mart as an example

Other differences

- **Supermarkets in Chile are controlled 100 % by domestic companies (Carrefour and Ahold for a short time with 10 % share).**
- **The development of Chilean supermarkets prepared them to compete both internally with foreign multinationals and internationally in the region; they have invested abroad in L.A.**
- **The same is true with chains of pharmacies with self-service stores on premise**

Other differences

- **In fruits and vegetables, supermarkets are not important as a retail channel so far (less than 10 %); suppliers have other options, particularly exports in the case of fruits**
- **In dairy products, between 20 and 40 % share depending on the product**
- **In beef, less than 40 % sold in supermarkets**
- **But supermarkets are not the only types of modern retail stores today**

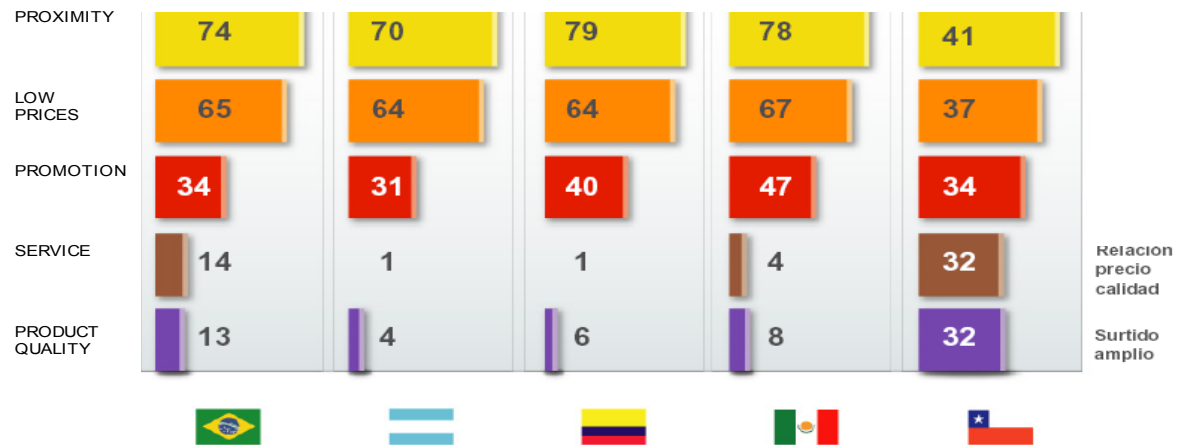
The borders between the different retail channels are blurring (drugstores, supermarkets, department stores)



Source:
ACNielsen

Chilean consumers are not identical to consumers in other LAC countries, as shown by ACNielsen: for example

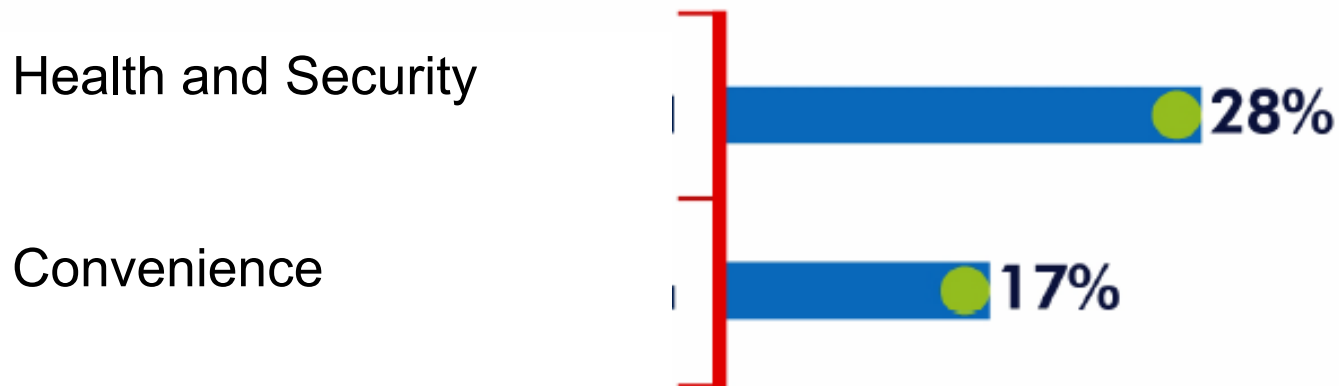
Chile displays structural differences with respect to which it is what influences the preference of the consumers



Fuente: ACNielsen encuesta consumidores 2004

Health and Convenience: the most Valued benefit

- Preoccupation with respect to the health and security
- Convenience necessity

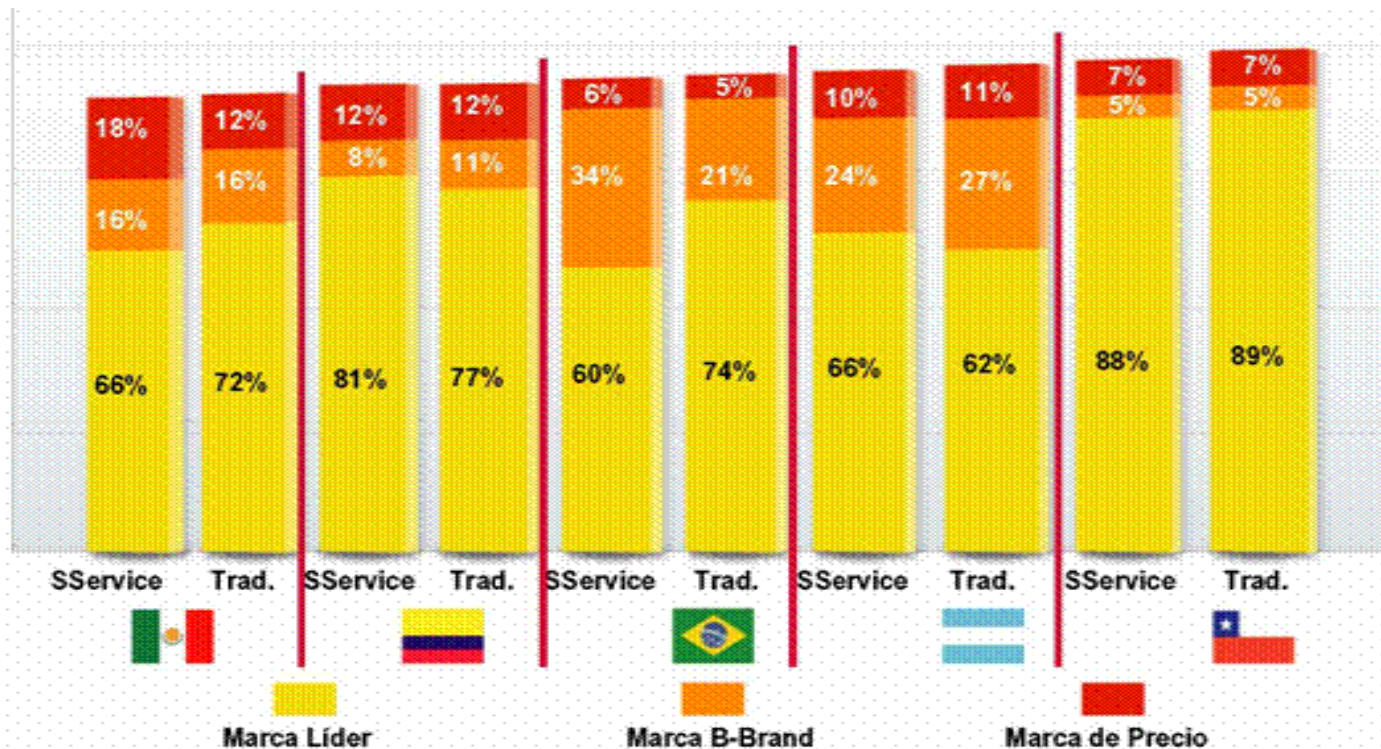


Base 29 marcas

Fuente: Retail Index ACNielsen

Brands (including own-brands) are very important in Chile, more so than in Brazil or Argentina.

Brand weight in sales (Excluding own brands)



Fuente: ACNielsen NRF

The Impact of Supermarkets on Farmers

- **Limited impact so far as explained above**
- **No supply contracts or long-term supply agreements with supermarkets. Thus, quality of produce is not optimal. Have “preferred” suppliers but purchases fluctuate and are requested on the spot ! Suppliers with good management skills are those that remain**
- **Lack of a contract policy and instability and unplanned purchases of produce coupled with price uncertainty has led to bankruptcies of some suppliers of vegetables.**
- **Period of time to pay providers is long, acting as a barrier to entry of many providers, specially small farmers.**
- **In beef, supermarkets go for beef imports but because consumers prefer domestic beef they have to sell some (20 %) with difficulties because no contracts yet wanted by the supermarkets. Quality of domestic beef difficult to improve in this way**

The Impact on the Food Industry

- **There have been important conflicts between the large supermarkets and the food industry, reaching twice already the Anti-Trust Commission during the last 3 years.**

The accusations by providers have been:

- **Abuse, instability of prices and conditions, copy of products, actions that inhibit sales or free competition;**
- **Charge of commissions, discounts, devolution of products, losses;**
- **Sales under cost, unilateral extension of payment dates, cross subsidies;**
- **Loss of credibility among consumers and buyers from other marketing channels (e.g. traditional stores) that consider to be charged higher prices by suppliers compared to supermarkets as an abuse.**

Distinctive characteristics of the Chilean food retail sector

- **Controlled by Chilean highly competitive companies. These have gone international within the LAC region**
- **Role of supermarkets was not as important for modernization of the food industry as elsewhere but equally relevant for the modernization of the food retail sector**
- **Participation of Supermarkets in sales of fresh produce is still quite low**
- **Supermarkets lagging behind in terms of Supplier Development Programs**
- **Conflicts between supermarkets and suppliers from the food industry have been taken to Anti-trust Commission (both parties very well organized)**

Supermarket participation will continue to grow

Consolidation now in place, investments announced this year by leading chains add to US\$ 490 Million

- **Continue to create hypermarkets**
- **Also adopting convenience store format**
- **Getting into the business of shopping- malls, providing the anchor store**
- **Introducing their own pharmacy chain within premises**
- **Introducing their own credit cards**