Urbanization and the Changing Retail Food Sector in Indonesia

The Pacific Food System Outlook 2007-08

Annual Meeting
Beijing, July 8-10, 2007

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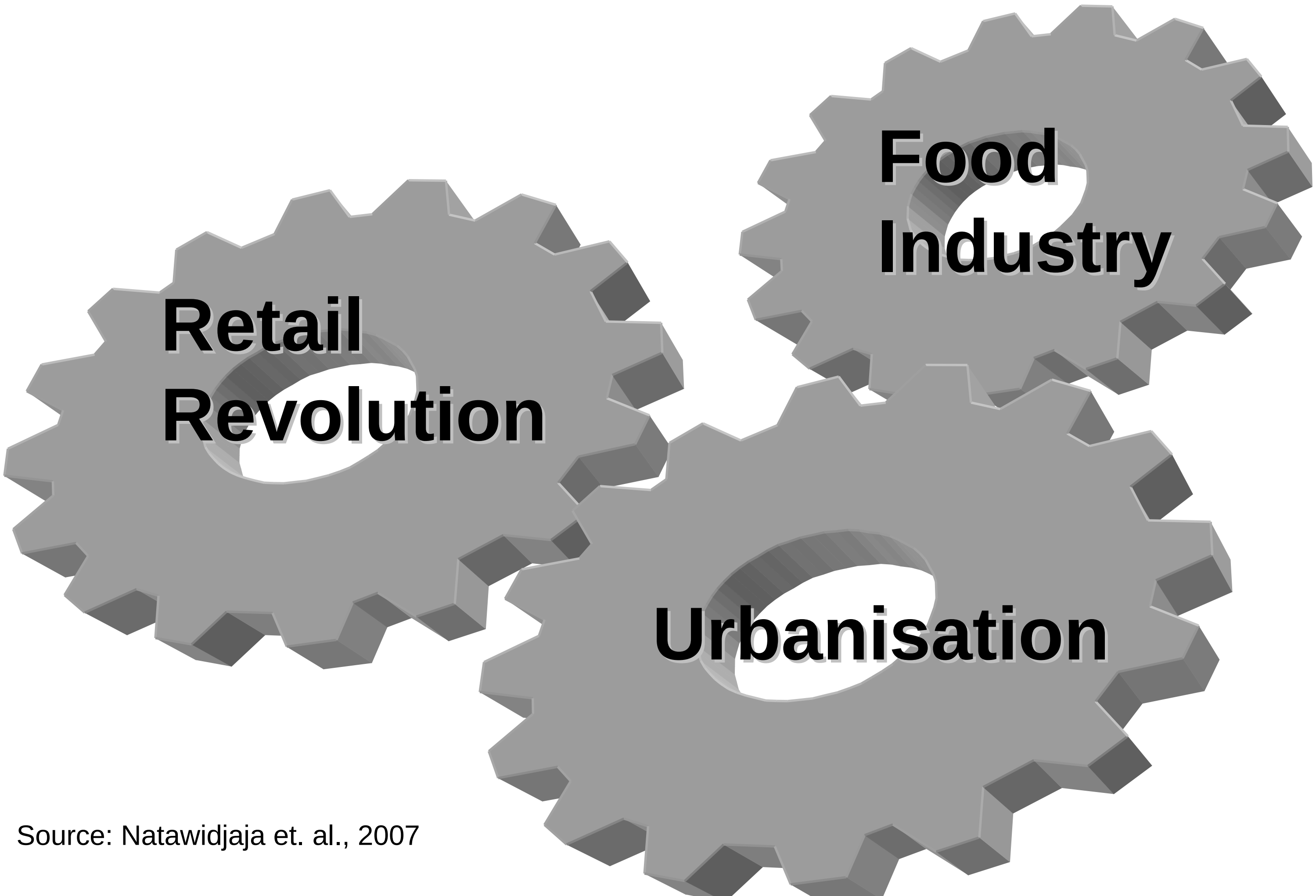
Outline

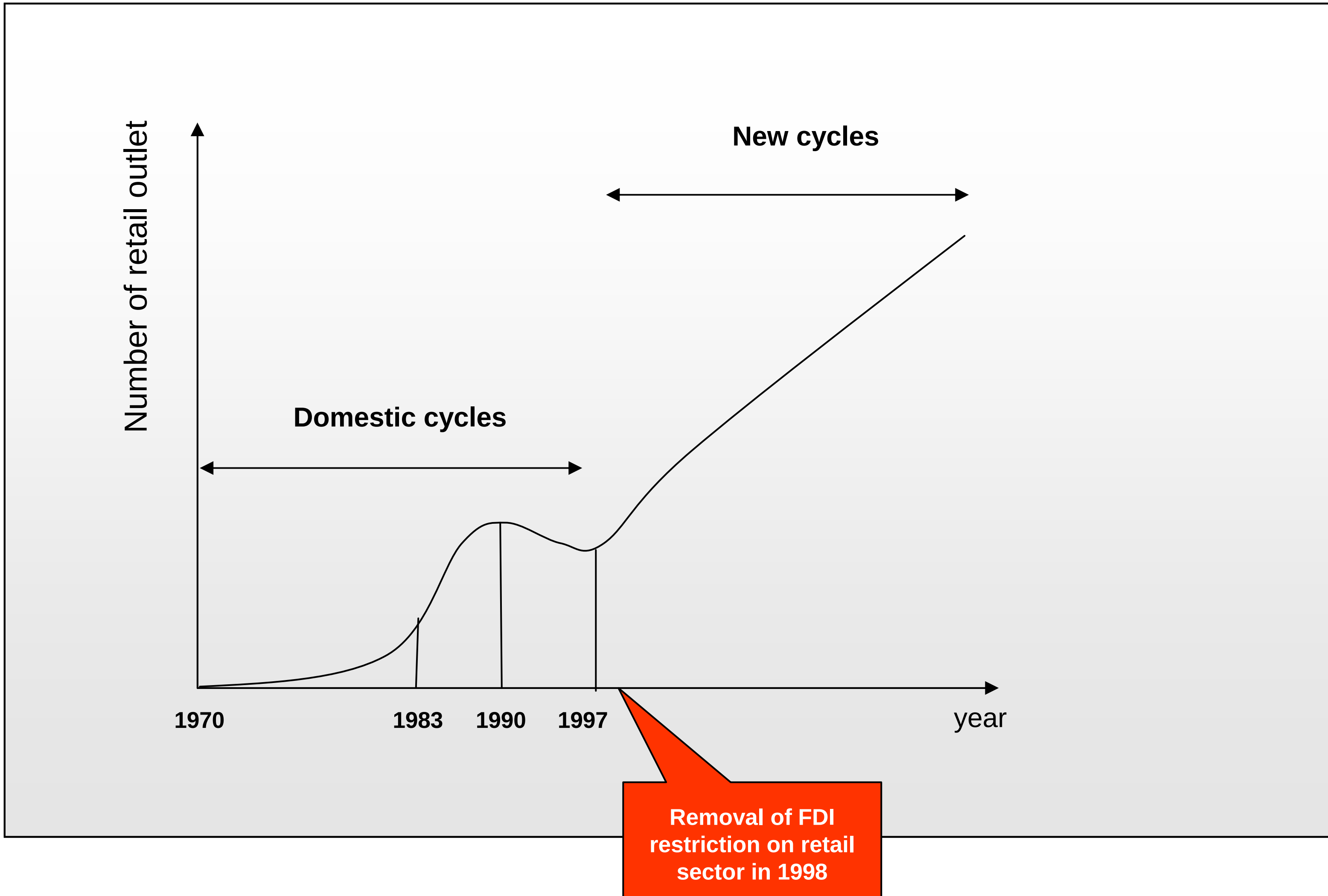
- Implication of urban-demand driven changes on the economy's agriculture and rural areas?
- Is there evidence of small farmers are adapting to these changes or they losing ground to large technologically advanced farms and foreign trade?
- What institution are facilitating the interface between modernizing food systems and more tradition-based sectors?
- What is the role of policy in enhancing the linkage between rapidly growing urban areas with rural areas?
- What role is infrastructure playing?
- Are the resources of isolated rural urban areas being better utilized in the development process or are they being by passed?

Drivers of Changes

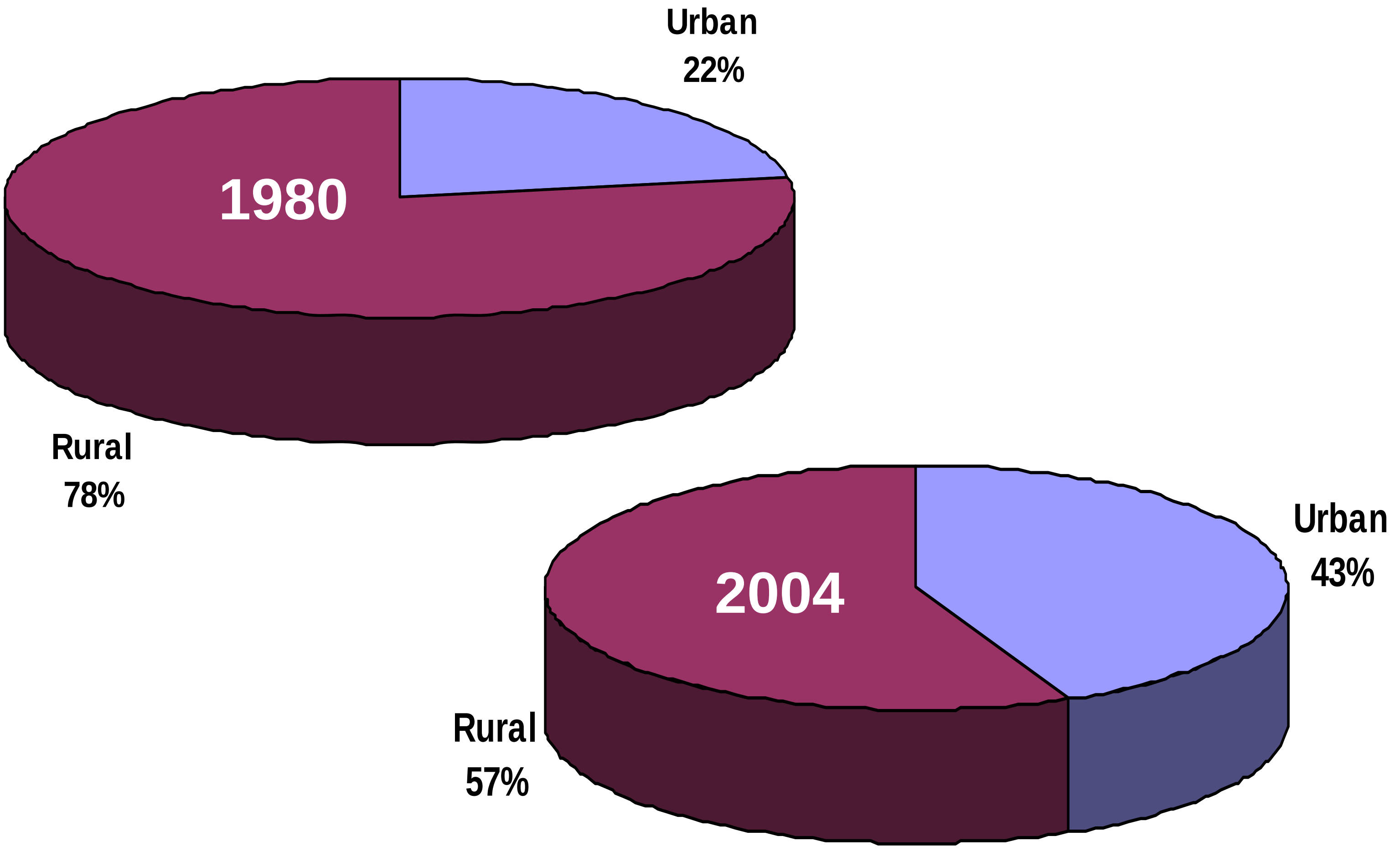


Source: Natawidjaja et. al., 2007

Modern Retail Development in Indonesia

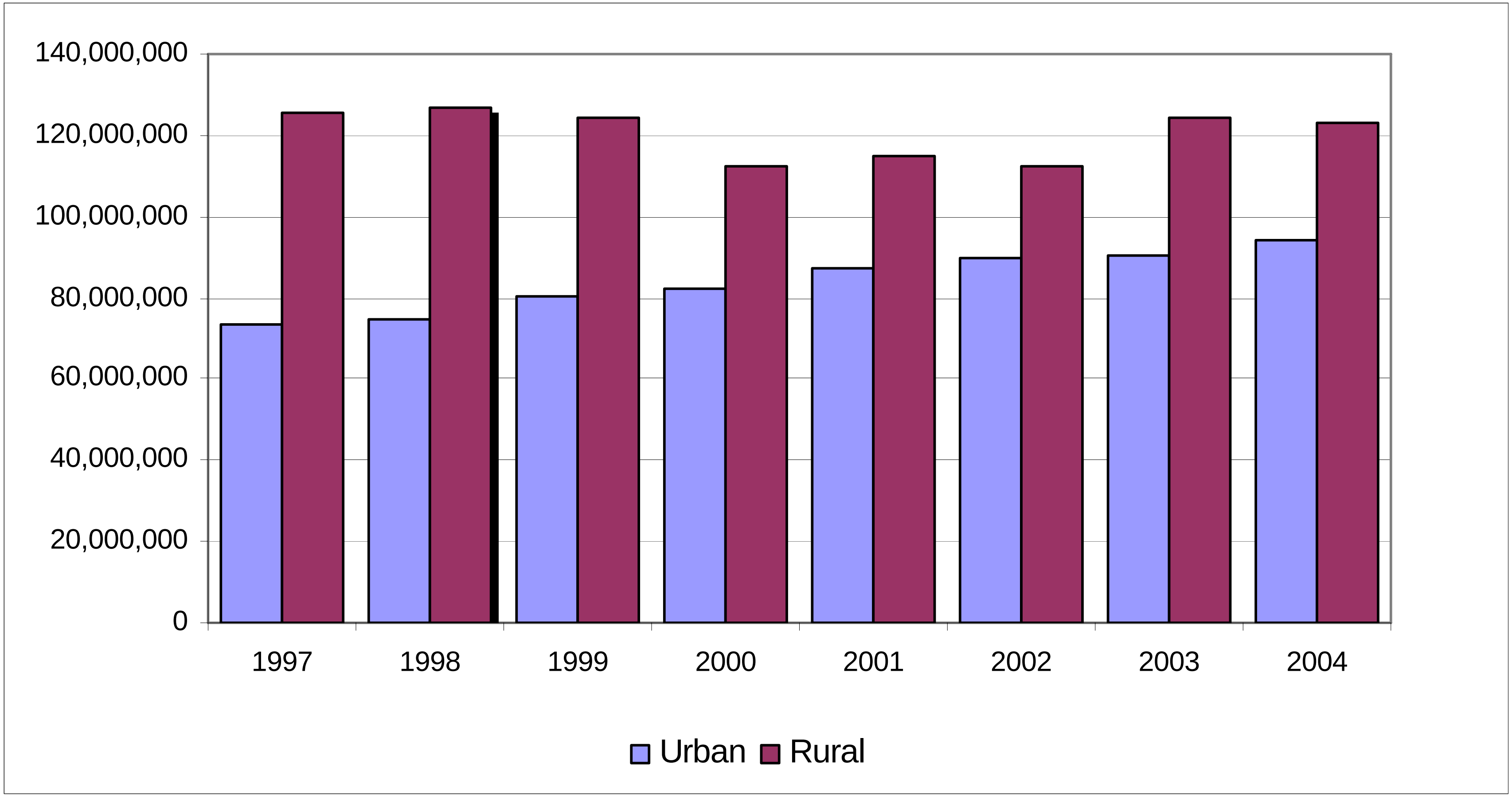


Urban and Rural Growth 1980 and 2004



Source: BPS, 2005

Urban and Rural Growth 1997-2004



Source: BPS, 2005

Growth of Modern Retail

- Supermarkets occupied a tiny **niche** in the food market through the 1980s → confined to an urban upper income tiny niche by the mid 1990s
- After 1998, spurred by liberalization of FDI in retail complemented by **income growth** and **urbanization** and their concomitant changes supermarket has grown very quickly → occupy roughly **30% of overall food retail**.
- Traditional retail loses about 2% of its share each year.
- Informed observers believe within a decade it will dominate the majority of the food market in Indonesia.

Surge Increase Demand of FFV

- Horticulture is becoming more important to consumers – balance diet
- in **1999** the average Indonesian consumer spent **49 rupiah** on fresh fruits and vegetables (FFV) for each **100 rupiah spent on rice**
- in **2004** that ratio was 77 to 100 on average:
  - For urban consumer it is **95 to 100**
  - For Rural consumer it is 60 to 100

Huge Gap between Local Supply base and Supermarkets' needs

- As recently as early 2000s, leading chains relied on (and smaller chains still do)
  … pasar induk for local sourcing – mainly
  … import wholesalers for imports
- **Retailers cite huge problems** of availability, quality, consistency of local supply, postharvest

Problem with The Traditional Wholesale Market System

- **The very poor (compared to comparable countries…) wholesale market structure adds another constraint on the supply side…**

  … poor infrastructure, congested, dirty

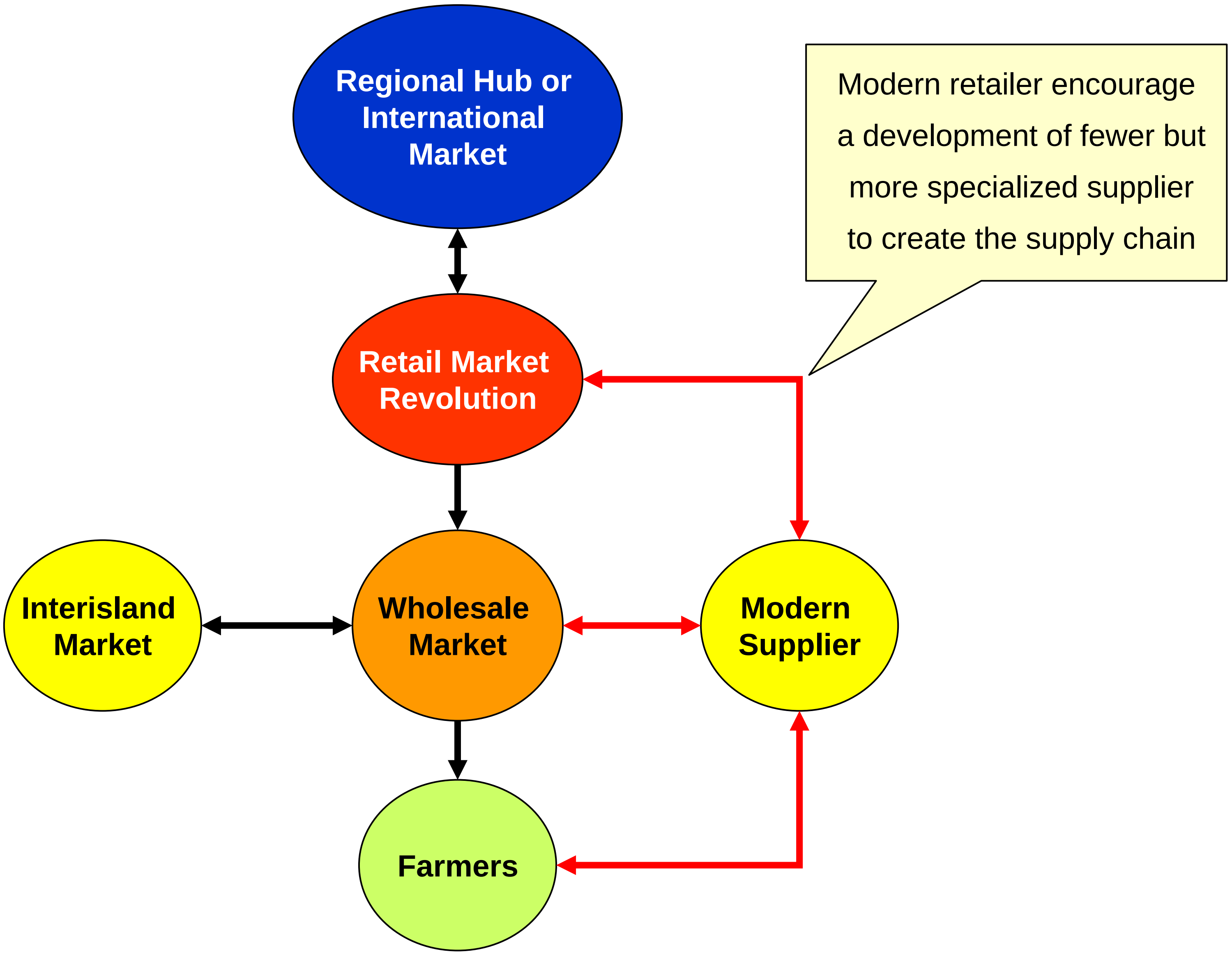
  … huge availability fluctuations except in key fruit

  … wholesale markets here similar to those in similar-income countries… 25 years ago

The Extremely High Transaction costs to source locally

- high cost of bribes
- high cost of fuel
- poor roads
- added to the inter-island distance…
- severe lack of cold chain
- institutional problems (contracts, trust)

Retail Transformation Linkage



Modern "Supplier"

- **New-generation wholesalers** who are specialized, capitalized, and dedicated to modern food industry segments like supermarkets, and fast food chains, restaurant and hotels
- **Backward integration: wholesale cum contract farming.** Grower/packer/shippers using outgrower schemes

New Generation Wholesaler

- **Example: "Bimandiri"**
  - Specialized on fresh vegetables since 1998, starting with other items since 2003
  - Arranged linkage in 2004 among Carrefour, Bimandiri, Mekar Buah group, and Syngenta…
  - Baby black melons in 2005, for Indonesia and other countries via Carrefour network… (pending)
  - Gurame fish in 2007, for Indonesia and other countries via Carrefour network… (just started)

Backward integration: Wholesale Cum contract Farming

- **Example 1: “Putri Segar”**
- Started in 1992, saw higher prices in emerging supermarket-market
  - about 65% to supermarkets, rest to hotels, fishing boats, and pasar induk
  - In 2004, asked by Carrefour to set up in Surabaya and develop supplier program there
    - About 1.5 million dollar a year operation with two warehouses, trucks
    - sources from 50 “leader-farmers” (about 2 ha each) who in turn supply half and subcontract with about 30 farmers each for the other half
    - some assistance to farmers (technical, crop calendar programming, some credit)

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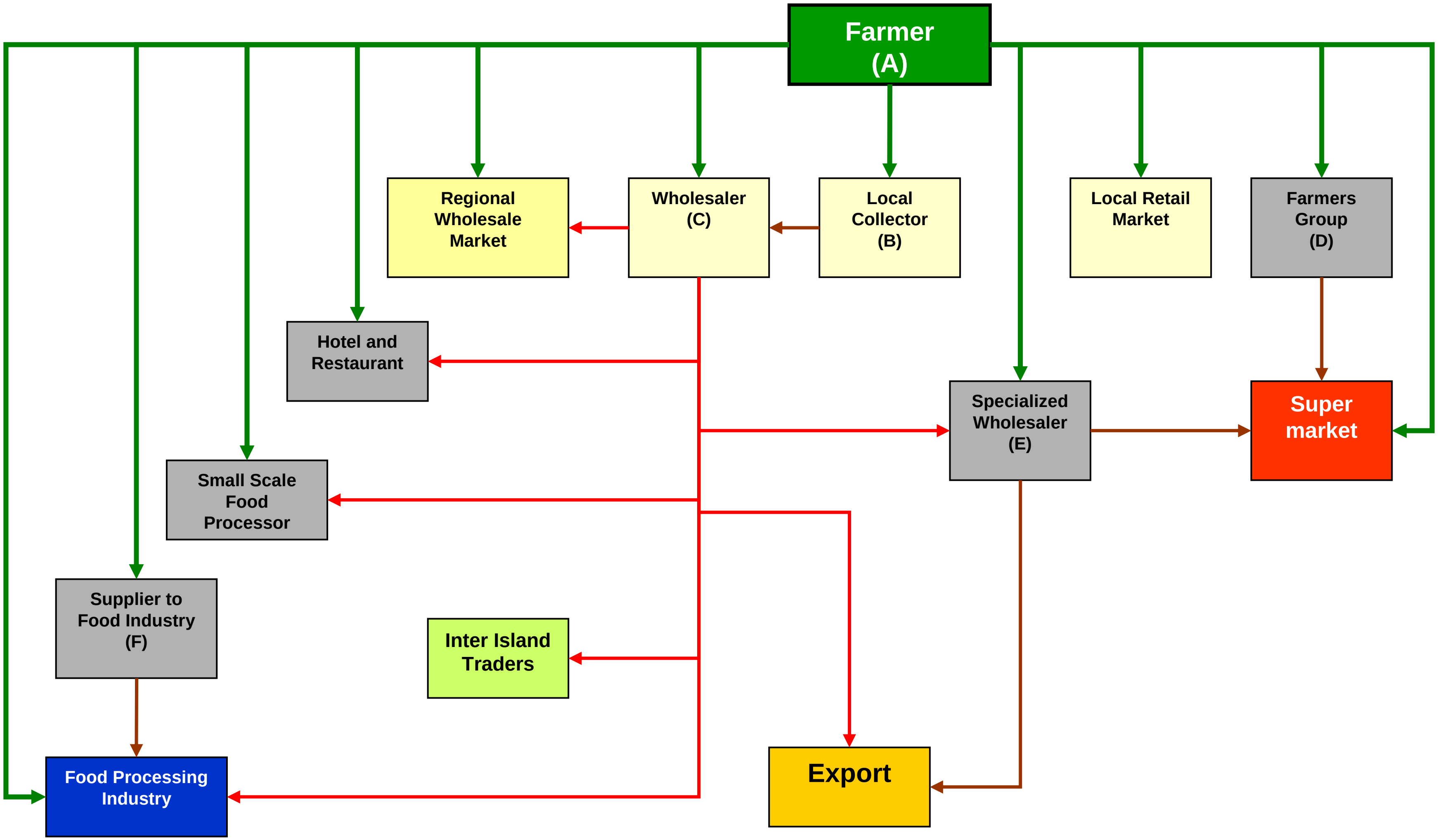
Backward integration: Wholesale Cum contract Farming

- **Example 2: "Saung Mirwan"**
  - start in 1984 as hydroponic vegetable exporter in Puncak
  - shift in 2000 into flower export from Punjak
  - add in 2000 commodity & niche vegetables for supermarkets… from Garut (cheaper land)
  - add food service (KFC, McD's, airlines) in 2005 ("much better payment terms than supermarkets")

Backward integration: Wholesale Cum contract Farming

- **Example 2: "Saung Mirwan"**
- 5 to 50 contract farmers in Garut in 5 years
- 1 to 7 own-hectares (including hydroponics) in 5 years
- Shift from only own-farming → to contract farming → to contract (niche) + wholesalers (commodity)
- technical assistance and credit to farmers ("public system… not relevant..")

Impact on Production Zone Market



Horticulture market change linked with land distribution and market change

- Extremely active land rental market → **rapid growth in the land rental market**,
- Horticulture farmers **renting a third of their land** mainly from tiny rice farmers and large urban speculators
- **Medium-sized farmers are emerging** to dominate the sector → were small rice farmers who started into vegetables a decade ago and then began renting
- Phenomena of the "**agricultural ladder**" seen in other countries, shifted from renting or sharecropping to land purchase.

Value Ladder Effect of Retail Transformation

- Many farmers switching out of rice into
  - **high value vegetables**
  - Investing in irrigation
  - croping multiple seasons
- Climbing a “value ladder”, shifting from

  → **low-value commodity** vegetables (like cabbage)

  → **intermediate-value products** (tomatoes and potatoes)

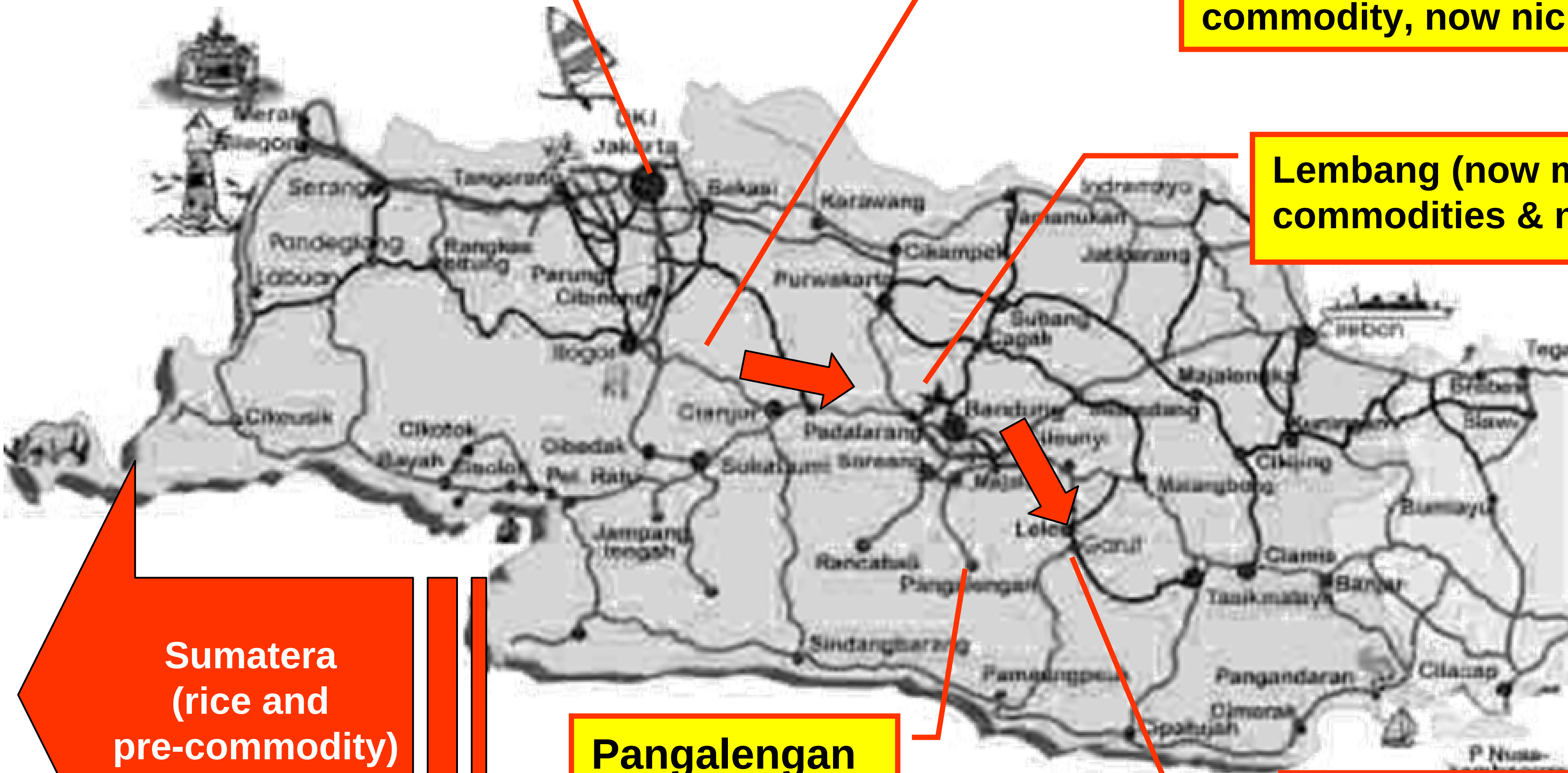
  → **high-value vegetables** (brocoli, specialty vegetables)
- Some lead actors are shifting commodity vegetable production to islands where land and labor are cheaper (low oportunity cost of land)

Value Ladder Effect of Retail Transformation

Jakarta

Puncak (was commodity, now niche)

Lembang (now mix of commodities & niche)



Sumatera (rice and pre-commodity)

Pangalengan (commodity)

Garut (commodity)

Farmer Participating in Supply Chain to Modern Market (based on 600 samples)

- At the current condition, only 15% of farmer participating in supply chain to modern market
- Farmers participating in supply chain to modern market **are small farmers**:
  – but are **the upper stratum** of small farmers in terms of landholdings, and in terms of capital, such as irrigation tanks and education.
- Their farming costs (per ha) are actually **below the costs of other farms (more efficient).**
- Their **profit rates are from 10 to 30%** higher than farmers in other channels (better prices from supermarkets).

Farmer Participating in Supply Chain to Modern Market (based on 600 samples)

- There is a clear "horticulture boom" occuring in West Java modern techniques are diffusing throughout the strata, even to farmers in traditional channels.
- Quality differentiation is not yet systematically rewarded by merchants to farmers in the zone, farmers still sell ungraded produce to wholesalers.
- Farmers get very small support from the government:
  - Get technical assistance from agro-chemical company and modern supplier
  - Received nearly all their credit from agro-input kiosk, wholesalers, modern supplyer, and family.
- Government and NGO financial services and extension play a miniscule role in the tomato boom in West Java

Role of Infrastructure

- Good road infrastructure up to the farm level is a must:
  - To keep the market remain competitive, removing oligopoly, information and market control
  - To reduce transportation cost → Increase competitivness of local products
    - Citrus from Medan become more expensive than imported from China because a bad road
- It is also equally important to develop market infrastructure → market institution

Key Policy Issue

- To ensure the link between urban retail development and rural agricultural area, we need to have :
  - Necessary condition: good road infrastructure and market information
  - Sufficient condition: Supply chain champion (Modern supplier) an agent who organized and link farmers to modern market
- To support farmers with appropiate technology needed to supply dynamic market generated by retail transformation.
- To give farmer more access to formal financial system.
- To improve (facilities, sanitation, loading zone) and increase the efficiency of **traditional wholesale market system.**

Thank You