Crossfire: 'Is the growth of supermarkets in developing countries to the detriment of small-scale producers?'

THOMAS REARDON and MIKE DILLON

In our debate between two experts, Crossfire invites Thomas Reardon and Mike Dillon to argue the case 'Is the growth of supermarkets in developing countries to the detriment of small-scale producers?'

Dear Tom,

I am writing to highlight a number of points which support the positive role of supermarket chains in sourcing from small producers internationally and to highlight how this impacts their in-country growth in a beneficial manner. Historically, retailers have always sourced from developing countries and under new business models are increasingly opening new stores closer to demand and supply sources. The retail sector and their suppliers have driven the development of food standards within numerous small producers and have been feeding international supply chains and their national stores. These standards are designed to deliver safe, consistent quality food products and have assisted these small producers in becoming more efficient and innovative.

Without higher retail standards many small-scale producers, and in fact their countries, would not have been able to access more profitable international markets. The only real technical expertise for many of these small producers and often their home countries resided in the retailer's technical teams who visited them and supported their business growth. Moreover, when at the later stage the environmental standard's era began; it was the retailers who provided the real guidance on the issues e.g. the Tesco Nature's Choice was used to guide numerous small producers. The retailer demand for better environmental control was the critical factor that drove down business costs through less water, chemical and energy usage.

The expanding middle income sector and increasing populations have attracted retailers such as Wal-Mart, Tesco and Metro to open stores in many developing countries including India and China. The benefits to local suppliers are significant, with Metro looking to take 20,000 local product lines per store. In Egypt the food safety capabilities

Mike Dillon is Vice Principal, The Grimsby Institute, UK; and Tom Reardon is Professor in the Department of Agricultural, Food, and Resource Economics at Michigan State University, USA.

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developed through a donor programme was used by a retailer as a building block to improve the profitability of a significant number of small producers accessing the new local retail market. The demand for traceable product by this retail network resulted in several appropriate food safety and technical standard model systems which were transferable to other developing economies as they faced similar problems. In short, without the retail sector pull this would have taken generations instead of 18 months.

METRO has also converted the GAP programme into an approach to develop local suppliers for their stores – this is delivered through their STAR brand – this 'Good Agricultural Practice' standard was originally devised through a wider retail network. This is now provided commercially to aspiring local producers wishing to supply to Metro stores. This step-wise system will engage producers in initially supplying local markets, then their national Metro stores before a three-star producer can finally access the wider international market. This programme originally began in China, is now being extended throughout the globe and as I write this from Pakistan it is already being piloted here as well.

Hence, we can see that retail know how is driving economic development in many of these countries. It assists the small producers to meet commercial standards in their own country and then advance to the international market. They catalyse the development of logistic businesses as well as forcing many small producers to recognize the business reality when entering competitive markets. Increased standard will equal increased performance and profitability in these retail supply chains. The retailers of course benefit from securing supply but their technical support allows the small-scale producer to make more money. Finally, without retailer pressure many countries will never adopt better labour conditions and create better working conditions for their people.

Regards
Mike Dillon

Dear Mike,
I see the essence, with some added generalization, of your points as being three: (1) supermarkets differentiate products and quality attributes at the retailing end, and thus can charge higher prices for higher quality (implied, than the lower quality products sold by traditional retailers); (2) the higher prices charged by supermarkets can potentially translate into higher prices to farmers, if the farmers can meet the quality (and sometimes also safety and labour) standards needed by the supermarkets; (3) supermarkets sometimes help farmers meet the higher standards (compared

to traditional market standards) via technical assistance and other programmes.

I agree with the essence of your three points. Indeed, I also agree that the rise of supermarkets can be an opportunity for farmers in developing countries, either in terms of development of supermarkets in developing countries, or in the development of export markets for farmers in developing countries to supermarkets in developed countries.

My argument is rather to indicate various qualifications of your points, which in turn point to challenges for farmers who supply supermarkets. I focus on my main experience (supermarkets in developing countries) and follow the structure of your three points.

First, in the early stages of the spread of supermarkets, they tend to focus on processed products, on big cities and on richer consumers. As they spread and compete among themselves and with traditional retailers, they gradually penetrate the markets for semi-processed products, such as meats and dairy, and then fresh produce; the markets of medium cities then small towns; middle class then the working poor.

These 'diffusion paths' of penetration and competition lead to intense pressure to reduce costs – of the products from producers, of moving the products along the supply chain, and of retailing the products. The good news is that supermarkets usually pass on these cost savings to consumers in order to increase their market share. We found in a study of 11 developing countries (including for example India and Mexico) that supermarkets charge lower prices than do traditional shops. The challenging news to farmers and small processing enterprises is that supermarkets eventually require their suppliers to reduce costs through efficiency-raising investments. I return to this below.

Secondly, the diffusion paths and competition noted above also involve differentiation of products and raising of quality and safety attributes (relative to rivals and to traditional retailers) and thus raise the requirements imposed on suppliers. You note this can mean more reward for farmers – but it also involves challenging 'threshold investments' for farmers and small enterprises. Farmers need to make investments, costly in money and time, in irrigation, greenhouses, packing materials, vehicles, cooperative organizations, knowledge about growing and harvesting techniques. These 'quality investments' join with 'efficiency investments' to represent substantial membership dues for farmers to join the club of supermarket suppliers. The reward is higher pay and often lower risk than the traditional market. We find from studies in a number of countries that the membership in this club is often exclusive: it excludes the mainly asset-poor smallest farmers, but includes the elite of small farmers who have sufficient non-land assets like irrigation and education, as well as medium/large farmers, as we found recently in India, Nicaragua, Mexico and Indonesia.

Thirdly, you rightly note … sometimes … supermarkets have programmes to help farmers make these investments. I posit that this is more common for export schemes to supermarkets in developed countries, where quality and safety demands are very high relative to what local farmers could bear. So they need help in order to supply at all. But for the vast majority of the food economy (95 per cent of which is domestic, as international trade is but 5 per cent of the developing country food economy), I posit that the normal situation is that supermarket chains are not able to afford to equip the thousands or millions of farmers to supply them. In that case, gradually, as supermarkets spread and dominate markets, yes, a broad class of farmers will win, but alas, a substantial group of asset-poor farmers will be challenged, and many will fail. Alternatives for them and a transition need to be in place.

Yours
Tom Reardon