Productivity in the Service Sector: Retail Industry

Recent Trends and Prospects for APO Member Countries[1]

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Chapter 1
Introduction

The service sector is becoming one of the major contributors to the overall GDP of many Asian Productivity Organization (APO) member countries, and even in countries where the contribution of the sector is not large, it is rising sharply. However, the overall productivity level of the service sector in all APO member countries, including the developed ones, is not very high compared with that in the USA. Therefore it is important that APO projects focus on productivity improvement in the service sector. The retail industry is one important sub-sector in terms of value and number of employees.

The retail sector has recently experienced dramatic technological changes and substantial growth. For example, information technology (IT), such as point-of-sale systems and electronic business transactions, enables retail stores to manage inventory more efficiently. However, several studies have pointed out that marketing channels in Asian countries are somewhat different from those in the USA and Europe. Many small, family-owned retailers are in operation, and therefore hypermarket density is comparatively low. In addition, in terms of investment in IT, Asian retail sectors have lagged behind the USA and the EU.

The APO has launched a research project for the international comparison of industrial structure and productivity in the retail sector among APO member countries, including Japan, the Republic of Korea (hereafter Korea), Thailand, Malaysia, Indonesia, the Republic of China (hereafter ROC) and India. The major objective of this project is to analyze in detail the factors hindering improved productivity of the retail sector in the selected member countries. It will also examine various domestic policies and regulations that must be addressed to make this sector more efficient.

This paper consists of five chapters, including this introduction. In Chapter 2 we present basic facts about the industry, employment structure and productivity in the distribution sector for APO member countries in comparison with OECD countries. The share of the distribution sector in total Asian GDP is around 15 percent, which is the same level as that in

OECD countries. On the other hand, employment shares in Asian countries are higher than those in OECD countries, suggesting that the distribution sector in Asia is more labor-intensive. However, we found labor productivity growth rates in Asia exceed those in the OECD. This implies that the productivity level in Asia is now in the process of catching up with that in OECD countries.

In Chapter 3 we investigate why retail density is high in Asian countries. Our econometric model is based on Flath (1990), where the level of store density is explained by households' and distributors' economic incentives. We conclude that high store density in Asia is reasonable given the relatively low number of passenger-cars per head of population, high truck density and smaller country land areas.

Chapter 4 turns to a descriptive overview of emerging retailing formats and related issues in APO member countries in order to capture new formats and techniques which are not covered by national statistics. We present eight country studies and discuss issues related to domestic policies and regulations. The paper concludes with a case study of 7-Eleven Thailand in Chapter 5.

References

Flath, David (1990) "Why are there so many retail stores in Japan?" *Japan and the World Economy*, 2, pp. 365–8.

Chapter 2

Industry Structure and Productivity for the Retail Sector in Asia

Introduction

In general, to make an international comparison of the productivity for a specific industry, it is necessary to pay attention to data availability and quality. It is also important to take account of the differences in industry and employment structure and regulations, as these might affect productivity. For the retail sector, data availability varies from country to country, and each country has specific regulations and a related social environment. Thus it is indispensable to compare the industry and employment structure as well as productivity. In this chapter we compare the indicators between Asian countries and major OECD countries from the perspective of both cross-country and time-series comparisons. Due to the data limitations, our analysis in this chapter mainly focuses on the distribution sector (wholesale and retail) as a whole. However, the tables and figures provide information on the retail sector.[3]

The structure of this chapter is as follows. Related literature is reviewed in section 2, section 3 provides the size of the distribution sector (wholesale and retail industry) and section 4 reviews productivity. Industry and employment structure are described in section 5. Section 6 concludes the chapter.

Related Literature

The productivity of the distribution sector has received much attention from policy-makers in developed countries. One comprehensive study is Pilat (1997), who compares various indicators such as the share of the distribution sector, employment structures and the variables related to regulations. The scope of this study is restricted to OECD countries. Another series of studies was conducted by the McKinsey Global Institute,[4] producing policy recommendation papers that provide not only information regarding productivity but also discussion on institutional factors. The primary focus of these papers is again major OECD countries. All these studies include Japan in their scope; however, other Asian countries are always excluded. Thus, to our knowledge, the present study might be the first attempt to make an international comparison of issues of productivity for the retail sector in Asia.

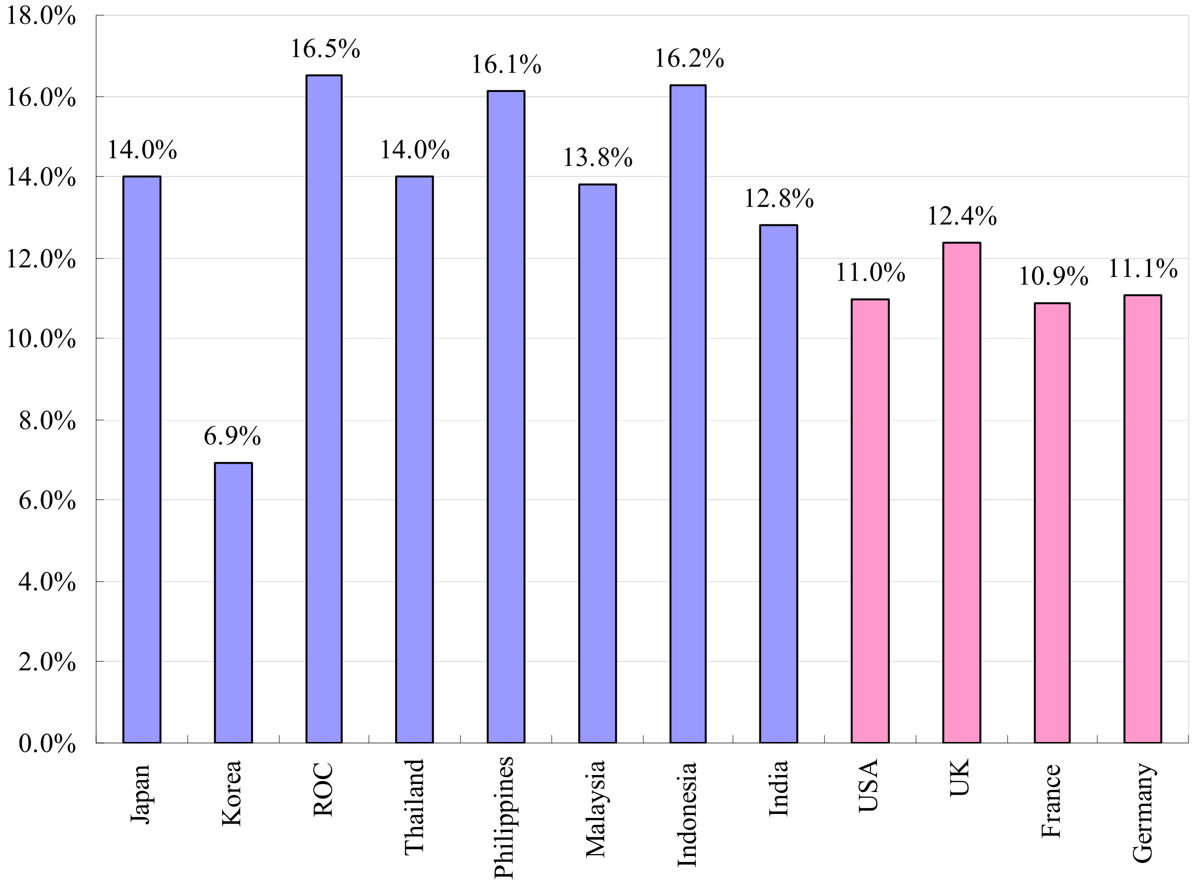
Size of the Retail Sector in Asian Countries

The distribution sector covers a considerable part of the economy. Figure 2.1 presents the share of the wholesale and retail sector in total GDP for APO member countries in 2001. It ranges from 6.9 percent in Korea to 16.5 percent in the ROC. The share of the retail sector is shown in Figure 2.2. Unfortunately, due

[3] The details of data from national statistical resources can be found in the Appendix.
[4] For example, see McKinsey Global Institute (2000) and its references.

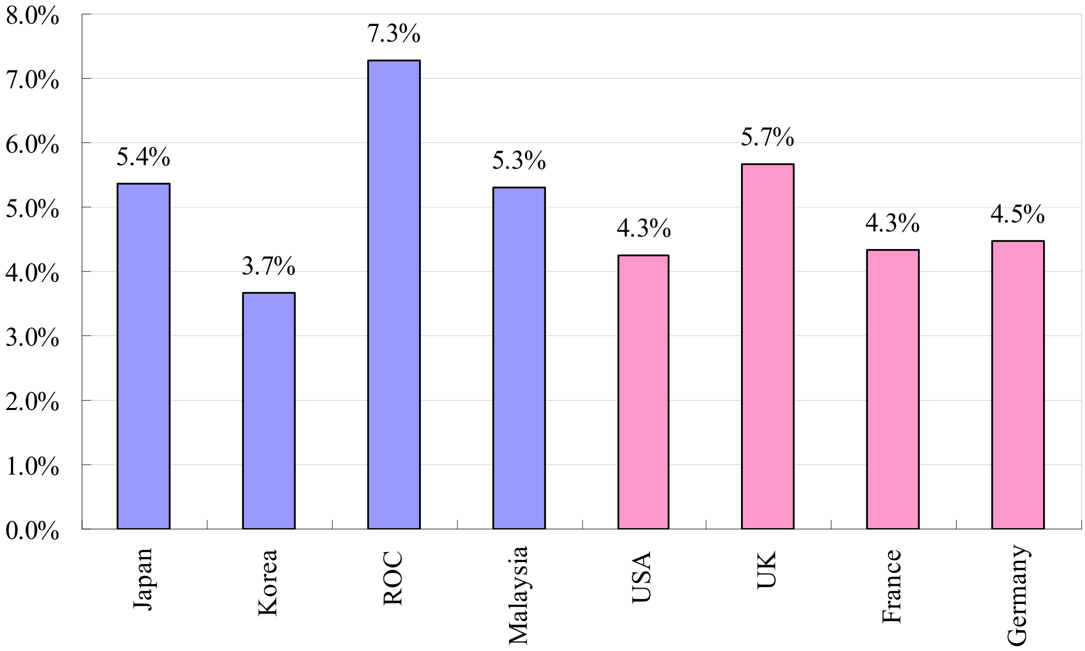
to data limitations, the share of the retail sector is not available for Thailand, the Philippines, Indonesia and India. The retail sector makes up around half the share of the overall distribution sector, ranging from 4 percent of total GDP in Korea to 7 percent in the ROC.

Figure 2.1 Share of wholesale and retail sector in total GDP in 2001



Source: Asian Development Indicators (Asian Development Bank), EUKLEMS database and national sources.

Figure 2.2 Share of retail sector in total GDP in 2001



Source: Asia Development Indicators (Asia Development Bank), EUKLEMS database and national sources.

Since the distribution sector is comparatively labor-intensive, its contribution to employment is even larger. As presented in Figure 2.3, in Japan, the Philippines and India the share of employment in the total economy for the wholesale and retail sector is around 18 percent and the share in the ROC and Thailand is around 14 percent. For retailing employment we can find a similar picture. The shares of retail employment are presented in Figure 2.4. While the shares in Japan and the ROC are 11.1 percent and 10.1 percent respectively, those for Thailand and the Philippines are 15.1 percent and 13.6 percent respectively. Korea is again the exception. The share of the overall distribution sector is as much as 11 percent, and that of retailing is 6.6 percent.

Table 2.1 shows the GDP growth rate of the distribution sector for APO countries and some OECD countries. In most countries the GDP growth rate of the distribution sector is almost same as that of total GDP. In the ROC and Thailand it exceeds total GDP growth, thus in those countries the distribution sector has become important.

Table 2.1 Real GDP growth rate in the distribution sector between 1990 and 2005 (annual average)

	Wholesale and retail (%)	Total GDP (%)
Japan	1.8	1.3
Korea	3.9	5.6
ROC	6.6	6.5
Thailand	6.8	5.4
Philippines	4.6	5.9 [a]
Malaysia	4.9	5.3 [a]
Indonesia	4.9	5.6 [a]
USA	4.3	3.0
UK	3.0	2.5
France	1.8	1.8
Germany	1.8	1.6

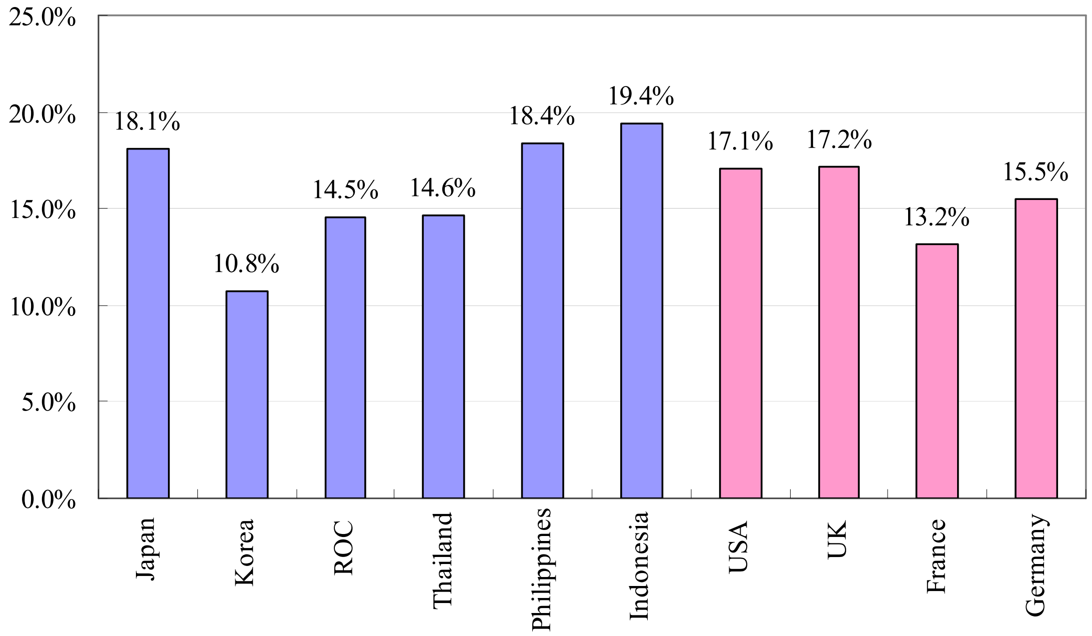
Note:

a. Annual growth rate between 2000 and 2005.

Source: Asian Development Indicators (Asian Development Bank), EUKLEMS EUKLEMS database and national sources.

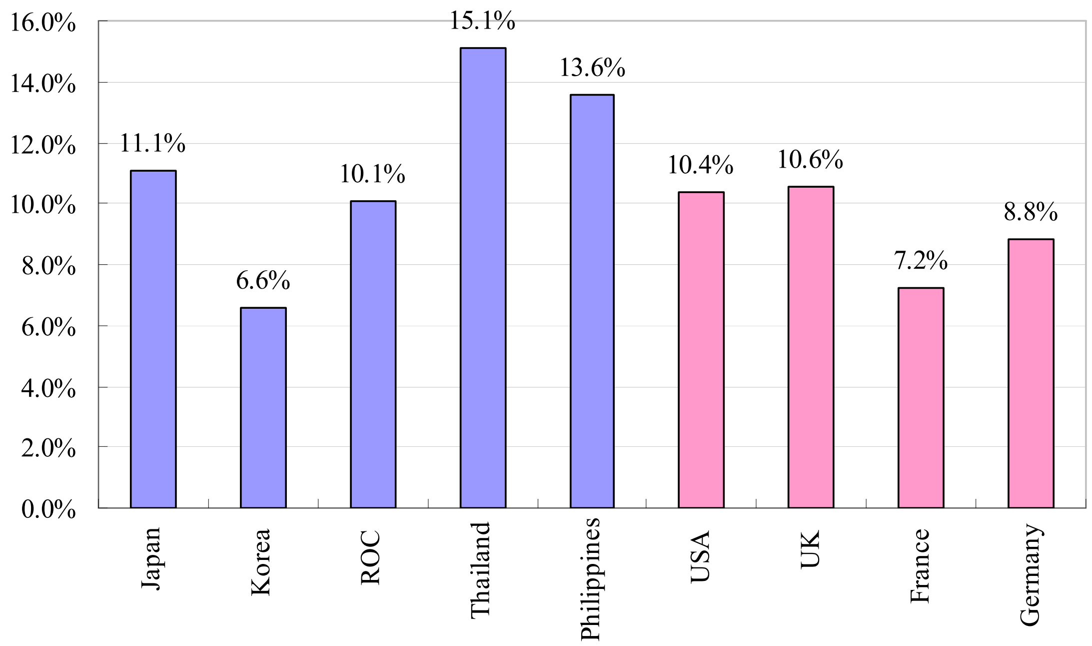
Comparing these indicators with OECD countries, Asian countries have a relatively higher retailing share in employment. In the case of the overall distribution sector, the shares in GDP for OECD countries, such as the USA, the UK, France, Italy and Germany, are from 11 percent to 12.8 percent, which are almost equivalent to those for Asian countries. The share of total employment ranges between 13 percent and 17 percent, which is similar to that of Asian countries (Figure 2.3). However, the share of the retail sector shows a different picture (Figure 2.4). While the share in GDP for both Asia and OECD countries ranges between 4 percent and 6 percent, the shares in total employment for OECD countries are relatively low compared with Asian countries. For the OECD the shares of the retailing sector in total employment are around 9 percent on average. On the other hand, the shares for Asian countries are on the whole more than 10 percent (except Korea). This fact suggests that the retail sector in Asia might be more labor-intensive than that in OECD countries. This point will be discussed later.

Figure 2.3 Share of wholesale and retail employment in total in 2001



Source: Asian Development Indicators (Asian Development Bank), EUKLEMS database and national sources.

Figure 2.4 Share of retail employment in total in 2001



Source: Asian Development Indicators (Asian Development Bank), EUKLEMS database and national sources.

In sum, the retail sector in Asia occupies a considerable part of the economy, especially in terms of employment. And the GDP growth rates for distribution sectors are almost the same as total GDP growth, or can even sometimes exceed the total GDP growth rate. Thus the relative importance of the distribution sector has been growing in APO countries.

While the share of the distribution sector in total GDP for APO countries is almost at the same level as in OECD countries, the share in total employment for APO countries is higher than that for the OECD, suggesting that the distribution sector in Asia has relatively low labor productivity.

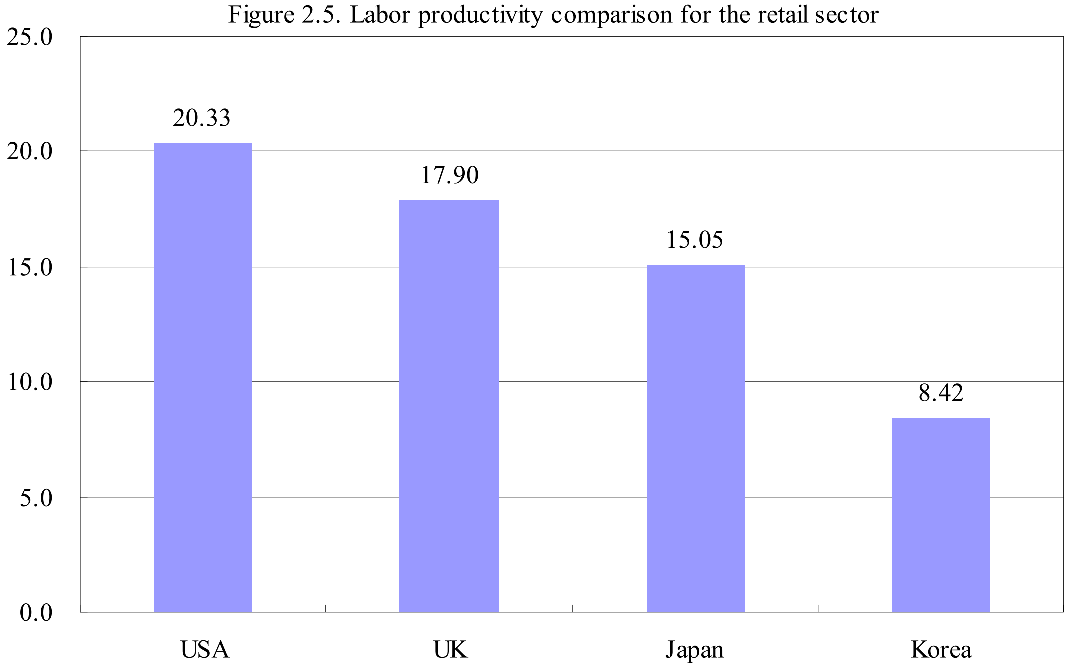
Issues in Productivity Measurement

The retail sector is an important part of the economy. It is the principal link between producers and consumers, and plays a major role in price formation. Therefore, an efficient and competitive retail sector can help to enhance consumer welfare.

However, international comparison of productivity levels involves many difficulties. First, to compare the output value we need a sector-level PPP index. In the case of OECD countries, researchers at Groningen University (Netherlands) have tried to estimate a sector-level PPP index, which covers only Japan and Korea among Asian countries. Second, even if the sector-level PPP index is available, that index does not fully reflect the differences of consumer taste among sample countries. Different countries have different tastes in retailing service characteristics. Accordingly, it is very hard to define the exact same retail service in an international perspective, and we have to keep these difficulties in mind.

For Japan and Korea a sector-level PPP index is available from the EUKLEMS project database, which enables us to compare the productivity level among Japan, Korea, the USA and European countries. Figure 2.5 presents a labor productivity comparison among Japan, Korea, the USA and the UK in 1997. Among these four countries, the USA has the highest productivity level, followed by the UK. Japan and Korea lagged behind; for example, the productivity level for Japan is 75 percent of that for the USA, and that for Korea is less than half of that in the USA. The EUKLEMS database also provides the productivity growth rate by country and industry.

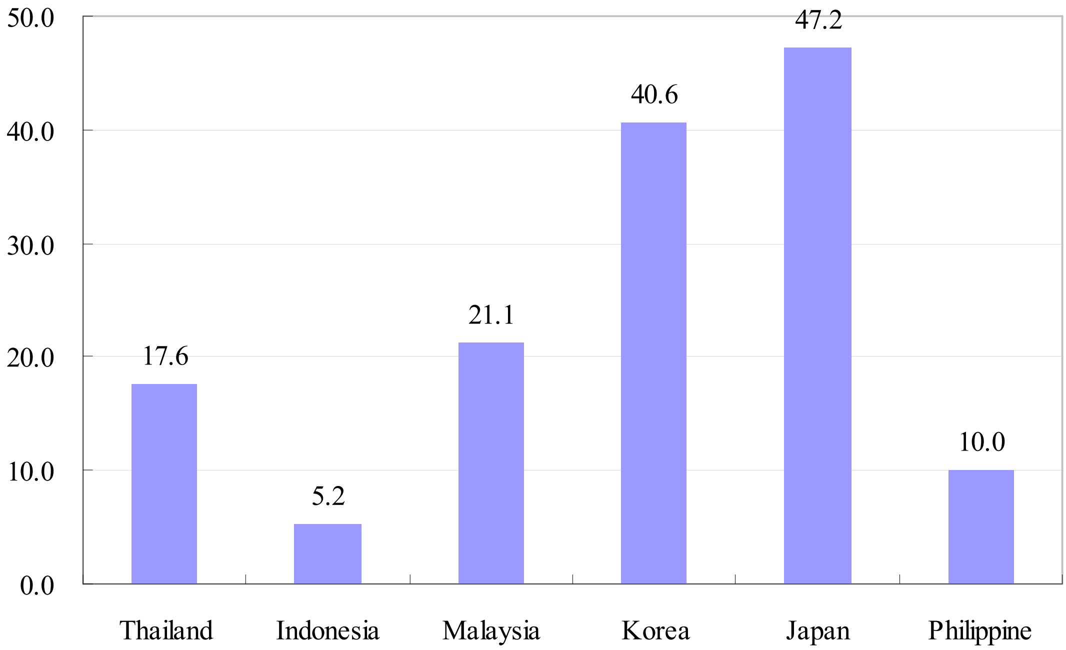
Figure 2.5. Labor productivity comparison for the retail sector



Source: Author's calculation.

For other Asian countries, we calculated a labor productivity index based on a macro-level PPP index provided by the World Bank. Note that macro-level PPP is affected by each country's industry structure, thus international comparisons of sector-level productivity with macro-level PPP have some distortion. However, since there is no alternative, we tried to capture the image in Figure 2.6. The order of productivity levels for the distribution sector is as same as that for per capita GDP: Japan (47.2) and Korea (40.6) are highest, followed by Malaysia (21.1), Thailand (17.6) and the Philippines (10.0).

Figure 2.6. Labor productivity comparison for the distribution sector in 2000



Source: For GDP and employment for the distribution sector, Asian Development Indicators (Asian Development Bank). PPP indices for per capita GDP are from World Development Indicators, World Bank.

In terms of productivity growth, we have a different picture. The labor productivity index for the wholesale and retail sector in the USA, the UK and some Asian countries is presented in Table 2.2. This index is defined as the ratio of wholesale and retail sector GDP to employment, and normalized at the year 2001 level. Comparing the index for 2005, while productivity for Japan (1.05) and Korea (1.05) is lower than that for the USA (1.16) and the UK (1.12), the ROC (1.15) and Indonesia (1.20) are as high as the USA and the UK. Looking carefully at Korea, there is a steady increase in productivity between 1996 and 2002. Obviously, our sample period is too short and the index may be affected by diffusion caused by business cycles. Nevertheless, except for Japan, the retail sector in Asia has been in a process of productivity improvement.

Table 2.2 Trends in labor productivity index (distribution sector, 2001 = 1)

	USA	UK	Japan	ROC	Korea	Indonesia
1995	0.80	0.88	0.95	0.77		
1996	0.81	0.91	0.99	0.86	0.82	
1997	0.83	0.89	1.00	0.90	0.87	
1998	0.85	0.92	0.98	0.94	0.74	
1999	0.90	0.95	0.99	0.99	0.95	
2000	0.95	0.97	0.99	1.02	1.02	
2001	1.00	1.00	1.00	1.00	1.00	1.00
2002	1.05	1.04	1.01	1.03	1.13	1.09
2003	1.09	1.06	1.01	1.04	0.98	1.14
2004	1.12	1.11	1.03	1.11	1.00	1.27
2005	1.16	1.12	1.05	1.15	1.05	1.21

Source: Asian Development Indicators (Asian Development Bank),
EUKLEMS database and national sources.

Business Structure and Employment Characteristics

Why has productivity in Asia lagged behind that in the USA and the UK? One may speculate that, in Asian countries, the presence of so many small and family-owned outlets hinders productivity growth.

Table 2.3 indicates the store density – in other words, the number of outlets per head of population in Japan, Korea, the ROC, Thailand and some non-Asian OECD countries. It shows that countries with lower standards of living tend to have higher retail density. However, despite their economic success, densities for Japan, the ROC and Korea are unnaturally large. For example, while outlet densities for Turkey, the Czech Republic and Mexico are 5.0, 6.7 and 13.0 respectively, those for Korea, the ROC and Thailand amount to 13.3, 17.4 and 18.5. Since the data for non-Asian OECD countries are little bit outdated, the gap in outlet density between these countries and APO member countries might be larger if we compared the latest figures for non-Asian OECD countries. This point will be further explored in Chapter 4.

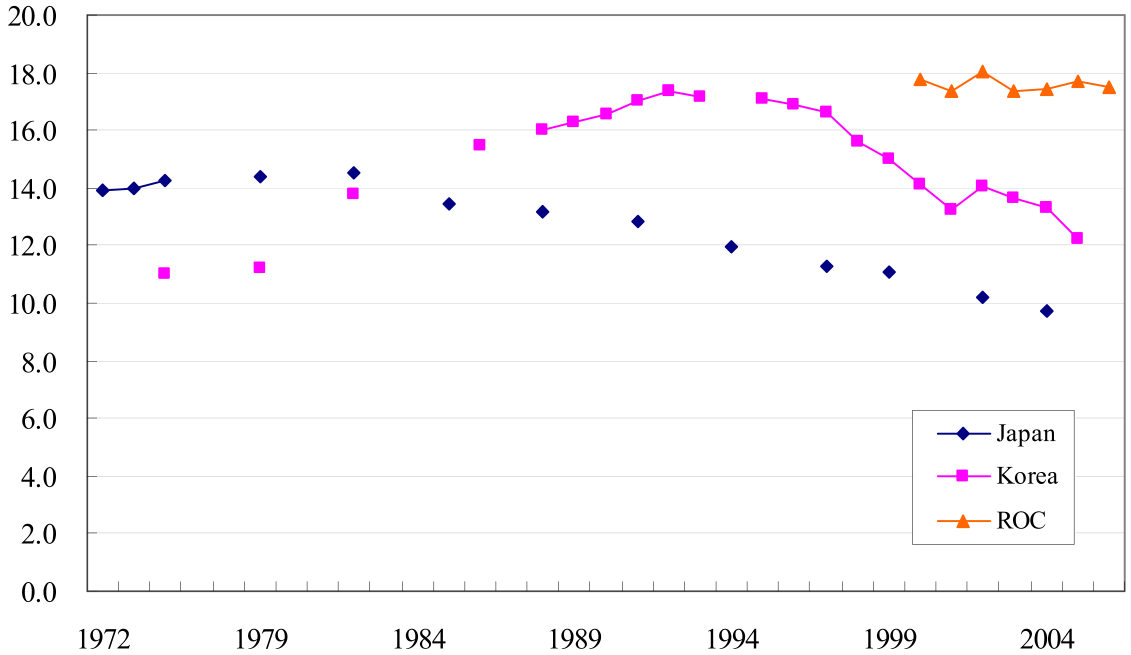
Table 2.3 International comparison on outlet density

	Retail density	Year of data	GDP per capita (constant 2000 US$)
Japan	9.7	2004	37,409
Korea	13.3	2004	10,890
ROC	17.4	2004	
Thailand	18.5	2004	2,021
Selected OECD countries			
UK	3.7	1993	24,445
Germany	4.9	1996	22,750
USA	5.7	1992	34,599
France	6.6	1996	22,217
Italy	9.8	1996	18,630
Canada	6.8	1985	23,198
Turkey	5.0	1996	2,956
Mexico	13.0	1993	5,934
Hungary	12.1	1997	4,655
Czech Republic	6.7	1996	5,423

Note: Retail density is defined as the ratio of the number of outlets per 1,000 population.
Source: For Asia, national sources; for OECD countries, Flath (2003).

Although the level of Asian store density is higher than in European countries, the situation has been gradually changing. Figure 2.7 shows the trends in retail outlet density in Japan, Korea and the ROC. Downward trends are found in all countries. These trends of modernization suggest that large shops like super-centers and shopping malls have replaced traditional small stores in each country.

Figure 2.7. Trends in outlet density



Note: Outlet density is defined as the ratio of the number of outlets per 1,000 population.

Increases in the number of large stores can be seen in Table 2.4. It indicates the superstore density – in other words, the number of superstores per head of population – for Japan, Korea, the ROC and Thailand. In this table one must note that the definition of "superstore" varies from country to country. However, all four countries have witnessed gradual increases in superstores. The ROC has experienced exponential increases between 1997 and 2006: while the density in 1997 was 0.073, it approached 0.338 in 2006, thus it has grown more than fourfold in these 11 years.

Table 2.4 Supermarket density

	Japan	Korea	ROC	Thailand
1980				
1981				
1982	1.19			
1983				
1984				
1985	1.11			
1986				
1987				
1988	1.17			
1989				
1990				
1991	1.24			
1992				
1993				
1994	1.57			
1995				
1996		0.80		
1997	1.51	0.82	0.073	
1998			0.152	
1999	1.66		0.147	
2000			0.157	0.02
2001		1.24	0.200	0.03
2002	2.58	1.38	0.234	0.03
2003		1.40	0.272	0.04
2004	2.87	1.44	0.297	0.04
2005		1.37	0.322	0.05
2006			0.338	

Source: National sources.

Table 2.5 presents an international comparison on superstore density for Asian and European countries in 1995. Unfortunately, due to data limitations, the densities for the USA and the UK are not available and figures are somewhat outdated. However, it seems that the superstore densities for Japan and Korea are not extremely low: the density level for Japan (1.57) is comparable with those for France (1.26), Germany (1.21) and Denmark (1.73). Korea (0.80) is almost equivalent with Italy (0.74). Therefore, considering the fact that density has been increasing for Asian countries, superstore density in Asian countries is now in the process of catching up with that in European countries.

Table 2.5. Comparison of supermarket density

	Supermarket density	Year of data
Japan	1.57	1994
Korea	0.80	1996
ROC	0.07	1997
Germany	1.21	1995
France	1.26	1995
Italy	0.74	1995
Austria	2.20	1995
Belgium	1.98	1995
Denmark	1.73	1995
Finland	2.06	1995

Note: Figures for OECD countries are from Pilat (1997); figures for Asia are from national sources.

Modernization of the retail sector in Asia can be seen in business structure and employment characteristics. Table 2.6 presents the ratio of single stores in total outlets for Japan, Korea and the ROC. The ratio for Japan and the ROC has gradually decreased, reaching 69 percent in 2004 in Japan and 75 percent in 2006 for the ROC. On the other hand, the ratio in Korea has been decreasing slightly, but was still 97 percent in 2005. Compared with the USA, Germany and France, the single store ratios for Asia are not always lower. For example, while the ratio for Germany was 81.5 percent in 1990, that for Japan in 1991 was 75.8 percent.

Table 2.6 Share of single stores in total retail outlets

	Japan (%)	Korea (%)	ROC (%)	USA (%)	Germany (%)	France (%)
1982	81.2					
1985	80.1					
1988	78.1					
1989						
1990				68.8	81.5	71.8
1991	75.8	98.8				
1992		98.8				
1993						
1994	74.4					
1995		98.8				
1996						
1997	72.8	97.2				
1998		98.4				
1999	73.1					
2000			81.1			
2001		97.9	80.4			
2002	71.8		80.3			
2003			78.0			
2004	69.0		76.8			
2005		97.4	76.0			
2006			75.0			

Source: Figures for the USA, Germany and France are from Pilat (1997); figures for Asia are from national sources.

Table 2.7 shows the ratio of business proprietors and unpaid family workers in total employment for Japan, Korea and the ROC. This ratio also represents the size of pre-modern retail outlets. The ratios for Japan and the ROC show downward trends, having gone from 36.4 percent in 1982 to 11.5 percent in 2004 for Japan and from 49.8 percent in 2000 to 43.7 percent in 2006 for the ROC. For Korea, while the ratio is higher than for Japan and the ROC (e.g. 57.2 percent in 2005), it has experienced substantial decreases. In contrast, the share of part-time workers has been growing substantially (Table 2.8); especially, Japan witnessed a rapid increase from 32.4 percent in 1991 to 54.5 percent in 2004. In comparison with major OECD countries, the ratios for both family workers and part-time workers in Japan have already reached the same levels as in the USA, the UK and France. For the ROC the figures in 1990 are not available; however, both family worker and part-time worker ratios have been catching up with those for OECD countries. It suggests that in terms of employment structure, the retail sector in Japan and the ROC has succeeded in modernization as in other OECD countries. So why do Japan and the ROC have higher retail outlet density compared with non-Asian countries? One plausible explanation is that, in countries with lower outlet density, new small stores have emerged through cooperating in franchise agreements or being part of a large chain of shops. This point will be further investigated in Chapter 4.

Table 2.7 Ratio of business proprietors and unpaid family workers in total employment

	Japan (%)	Korea (%)	ROC (%)	USA (%)	UK (%)	France (%)	Italy (%)
1982	36.4						
1985	33.4						
1988	24.9	81.6					
1989		81.0					
1990		81.4		7.4	15.8	25.9	61.3
1991	22.8	73.1					
1992		73.9					
1993		72.4					
1994	20.3						
1995							
1996		62.6					
1997	16.9	68.7					
1998		68.7					
1999	13.1						
2000		61.9	49.8				
2001		59.3	49.9				
2002	14.2	52.8	50.2				
2003		61.3	49.9				
2004	11.5	58.6	49.6				
2005		57.2	48.1				
2006			43.7				

Source: Figures for the USA, Germany and France are from Pilat (1997); figures for Asia are from national sources.

Table 2.8 Part-time worker ratio

	Japan (%)	Korea (%)	ROC (%)	USA (%)
1988		1.5		
1989		1.7		
1990		1.1		33.5
1991	32.4	3.1		
1992		3.8		
1993		2.9		
1994	33.6			
1995	36.3	4.5		
1996	38.0	5.0		
1997	40.6	4.8		
1998	44.0	4.8		
1999	45.5	8.5	90.0	
2000	48.9	9.0	99.6	
2001	50.0	6.9	107.1	
2002	52.2	9.8	114.2	
2003	53.6	9.3	119.3	
2004	54.5	10.6	132.0	
2005		11.4		

Source: Figures for the USA, Germany and France are from Pilat (1997); figures for Asia are from national sources.

Conclusion

The purpose of this chapter is to examine the characteristics of the retail sector in Asian countries and the differences compared with OECD countries. Specifically, using various indicators of industrial structure, such as share in the total economy, outlet density and employment characteristics, we highlighted the characteristics and trends of modernization in the retail sector in Asia. The main findings in this chapter can be summarized as follows.

• The share of the distribution sector (wholesale and retail) in total GDP is around 15 percent, thus it contributes substantially to the macro economy. The share is as same as that in major OECD countries.

• However, the share of total employment for Asia is higher than in OECD countries, suggesting that the distribution sector in Asia is more labor-intensive compared with OECD countries.

• Labor productivity indices for Japan and Korea are lower than those for the USA and the UK. As for other Asian countries, comparison by a macro-level PPP index implies that ASEAN countries are lagging behind Japan and Korea.

• The labor productivity growth rate exceeds that for major OECD countries, which means the productivity level in Asia is now in the process of catching up with OECD countries.

• Retail outlet density and outlets per head of population for Japan, Korea and the ROC are higher than those for OECD countries, and have been gradually growing through the 1990s and 2000s.

• Although productivity is low and outlet density is high in Japan, Korea and the ROC, the employment structure has already modernized compared with OECD countries. This fact suggests that, in Asian countries, small chain stores are more prevalent compared with OECD countries.

This chapter provides a comprehensive picture of retail industry structure, but it has two limitations. First, most studies cover only Japan, Korea and the ROC due to data limitations. Considering the fact that ASEAN countries and India have achieved rapid industrialization, issues regarding the productivity of the retail sector in those countries will become important in the near future. Thus, the development of a new survey will be indispensable for further investigation of the retail sector in those countries. Second, constructing an international industry database is also required. In our study, international comparisons heavily depend on Pilat (1997). Unfortunately, most indicators in presented in Pilat are those in around the early 1990s. Therefore, for further investigations it is necessary to construct a comprehensive database in the perspectives of both cross-country and time-series comparisons.

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Chapter 3

Is Retail Store Density in Asian Countries Too High?

Introduction

As we saw in the previous chapter, most Asian countries are now in the process of modernization: single-store ratios are decreasing and the numbers of large-scale stores are increasing in Japan, Malaysia, Thailand and the Philippines. However, retail store density is still high compared with OECD countries. Table 3.1 presents the retail store density and some key indicators for Japan, Korea, the ROC, Thailand and various OECD countries. Although the ROC, Korea and Thailand have nearly the same level of per capita GDP as Spain, Portugal and Turkey, retail store densities for these Asian countries are higher than those for the three OECD countries. As we discussed in Chapter 2, higher retail density implies that average store size is smaller. Considering the fact that average productivity in the retail sector is proportional to store scale, the productivity level of the retail sector in Korea, the ROC and Thailand might be inferior to that in these OECD countries.

Table 3.1 Retail density and key indicators for Japan, Korea, Taiwan, Thailand and some OECD countries

	Store density	Rooms	Car density	Urban population	Population density	Length	Truck density	Per capita GDP
Japan	11.2	0.6	395.1	79	343	19.4	163.8	32,380
Korea	18.5	1.1	163.4	84	483	10	46.1	7,970
ROC	17.7		207.4		632	6	30	14,721
Thailand	12.7		27.4		125	22.7	47.1	2,009
UK	3.4	0.5	374.2	89	246	15.7	47.1	21,400
Austria	3.7	0.6	479.9	65	96	9.2	38.3	26,850
Australia	4		472.3	85	3	88	110.5	20,300
Germany	4.9	0.5	507.6	87	231	18.9	28.9	25,850
Sweden	4.9	0.6	426.1	83	20	21.2	38	25,620
Turkey	5.1	1.3	63.8	73	91	27.8	15.7	3,160
USA	5.8	0.5	480.6	77	30	96.8	280.9	29,340
Denmark	6.3		354.2	86	125	6.6	56.2	33,260
France	6.6	0.7	455.8	75	109	23.5	92.1	24,940
Iceland	6.7		510.9	92	3	10.1	62	28,010
Canada	6.8	0.5	440.8	77	3	99.9	121.2	20,020
Czech Rep	6.8	1	358	66	129	8.9	41.1	5,040
Netherlands	7.4	0.7	566.3	89	392	6.4	100.6	24,760
Finland	7.6	0.7	388.7	64	15	18.4	54	24,110
Switzerland	7.7	0.6	476.5	62	179	6.4	37.6	40,080
Norway	9.3	0.6	405.9	74	12	18	88.9	34,330
New Zealand	9.5	0.5	440.5	87	15	16.5	99.7	14,700
Italy	9.8	0.8	538.2	67	193	17.3	50.7	20,250
Hungary	12.1	0.5	234.2	66	109	9.6	32.2	4,510
Mexico	13	1.4	97.8	74	54	44.2	45.9	3,970
Belgium	13.7	0.5	437.1	97	341	5.7	45	25,380
Spain	14.2	0.7	389.2	77	84	22.5	81.6	14,080
Ireland	14.4		266.8	58	58	8.4	31.1	18,340
Portugal	15.2	0.7	308	61	114	9.6	36.3	10,690
Greece	17.6		254.9	60	84	11.5	93.2	11,650
Poland	24.8	2	229.7	65	122	18	40.8	3,900

In this chapter we explore why Asian countries have higher store density and judge whether these countries are outliers or not. Our analytical framework is based on the econometric research by Flath (1990), Flath and Nariu (1996) and Flath (2003), which investigates why there are so many retail stores in Japan. The model is based on the so-called social optimal model determining the most efficient level of retail density. Previous studies reveal that Japan's high store density is explained by small dwellings, a low car-ownership ratio and high commercial vehicle density. In this study we analyze other Asian countries in the perspective of international comparison.

The rest of this chapter is organized as follows. Section 2 explains the social optimal model proposed by previous studies. In section 3 the data and econometric approaches are discussed. In section 4 we present econometric analysis, and section 5 concludes the chapter.

The Model: Shopping and Storage Costs of Households, and Reorder and Storage Costs for Retailers

Households are uniformly distributed with density *m*, and *n* retailers are evenly spaced around the perimeter of a circular market that has a circumstance of unity. Also, assume that each household buys from the nearest retailer, so that each retailer has *m*/*n* customers. Suppose that each household consumes *q* units of a standardized good, meaning that household demand is independent of the good's price. Furthermore, suppose that consumers incur shopping (transport) costs and a fixed inventory (storage) cost. In the Baumol-type inventory model, consumers' transportation tasks involve going shopping and bringing goods home. Denoting the frequency of shopping trips by *x*, the combined shopping and storage costs of an individual household that is a distance of *z* from the nearest retail store are:

$$C_h(z) = azx + sq/(2x) \qquad (1)$$

where $a/2$ is the cost of a shopping trip per unit distance to the store, and therefore azx indicates the total cost of shopping trips; *s* is the cost per time period of storing one unit of the goods. The consumer buys q/x units of the good *x* times per period, and maintains an average household inventory $q/(2x)$ of units of the good. Therefore $sq/(2x)$ indicates total inventory cost. To minimize the combined costs, $C_h(z)$, each household determines the following optimal frequency of trips:

$$x^*(z) = (sq/2az)^{1/2} \qquad (2)$$

From equation (2) we can see that an increase in a or z or a decrease in s will result in a decrease in x. Substituting equation (2) into equation (1) yields $C_h(z) = (2azsq)^{1/2}$. Accordingly, the combined shopping and storage costs of all households, C_H, are:

$$C_H = 2n\int_0^{1/(2n)} C_h(z) f(z)dz = (2/3)m(asq/n)^{1/2} \qquad (3)$$

where $f(z) = m$ is the density of households.

Each retailer serves m/n households, and therefore sells $Q = qm/n$ units of goods in each period. We denote the reorder cost per delivery, which is the cost of transporting one batch of goods from producer to retailer, by b, the reorder frequency by y and the retailer's storage cost per unit of average inventory by t. Similar to the cost for households, the retailer's combined reorder and storage costs, C_r, are therefore:

$$C_r(y) = by + tQ/2y = by + tmq/2ny \qquad (4)$$

Minimizing $C_r(y)$ with respect to y yields the following optimal frequency:

$$y^* = (tmq/2bn)^{1/2} \qquad (5)$$

Therefore, as the cost of a single reorder increases, the retailer economizes by restocking less frequently. Substituting equation (5) into equation (4), we can see that the combined storage and reorder costs of the retailer are $C_r = (2btmq/n)^{1/2}$, and all the retailers' costs combined are:

$$\mathbf{C_R = nC_r = (2btnmq)^{1/2}} \qquad (6)$$

The total distribution costs of households and retailers from equations (3) and (6), respectively, are:

$$C = C_H + C_R = (2/3)m(asq/n)^{1/2} + (2btnmq)^{1/2} \quad (7)$$

From the first-order condition (dC/dn = 0), the optimal density of stores is:

$$n^* = (2asm/9bt)^{1/2} \quad (8)$$

The number of stores per household is therefore:

$$\mathbf{n^*/m = (2as/9btm)^{1/2}} \quad \mathit{(9)}$$

This result implies several hypotheses that suggest the relationship between retail density and its underlying determinants. When a household's average cost of a shopping trip, a, or average storage cost per unit, s, is high, then a greater density of stores is optimal. In contrast, the higher the average restocking cost of retailers, b, or the average storage cost per unit, t, the lower the optimal density of stores. Furthermore, an increase in population density, m, lowers the optimal number of stores per household. We test the hypothesis that each of the explanatory factors significantly affects store density, based on cross-country data.

Data and Econometric Specification

Unfortunately, the only observable variable in the model is store density. The remaining variables are not directly observed; only proxies are available. For household and distributors' transportation, we used passenger-cars per head of population (car_density) and commercial vehicles per capita (truck_density). The square root of a country's land area (length) is also a measure of transportation costs for distributors. In countries with low numbers of passenger-cars per capita, people prefer small stores nearby; thus store density will increase. As for the distributors, in countries with high transportation costs, distributors avoid frequent restocking to small stores and store density will decrease. We used the average number of persons per room (rooms) as a proxy for households' storage costs. People will go shopping more frequently when living space is crowded.

The equation to be used for estimation is:

$$STORE_i = \beta_1 \cdot ROOMS_i + \beta_2 \cdot CAR\_DENSITY_t + \beta_3 \cdot TRUCK\_DENSITY_i$$
$$+ \beta_4 \cdot LENGTH + \beta_5 \cdot Pop\_DENSITY_i + u_i$$

STORE: log of density of retail stores

ROOMS: log of average number of persons per room

CAR_DENSITY: log of number of passenger-cars per person

TRUCK_DENSITY: log of number of commercial vehicles per person

LENGTH: log of square root of the country's area (1,000km)

Pop_DENSITY (or *U_pop*): log of population density (or urban population as percentage of total population)

u_i: error term.

Population density is a control variable. Its effect on store density is unclear. The expected signs of the coefficients are $\beta_1 > 0, \beta_2 < 0, \beta_3, > 0, \beta_4 < 0$. Population density is a control variable for national or regional heterogeneity. Store density and number of passenger-cars per person are simultaneously determined: in countries where store density is high, consumers tend to choose not to own a car. Accordingly, Flath and Nariu (1996) check the simultaneous bias by replacing car_density with per capita GDP. In line with their procedure, we checked the robustness by using per capita GDP.

Most of the data are obtained from Table 3 in Flath (2003). However, his dataset does not cover Asian countries; therefore we added data for the ROC, China and Thailand from various sources. As mentioned before, the store densities for Malaysia, Indonesia and India are not available, so we omitted those countries. For the Philippines, the number of retail stores is available only for stores with more than five employees. This definition is not consistent with that for other countries; thus the Philippines was excluded as well.

For population density, Flath and Nariu (1996) argue that the degree of urbanization is more appropriate than the population density. However, urbanization indicators are not available for Asian countries, therefore we used population density.

Table 3.2 presents the data we used and their sources.

Table 3.2 Data sources

Variables	Definition	Source
Store density	Number of stores per population	Flath (2003) and national sources
Rooms	Average number of persons per room	Flath (2003)
Car density	Number of passenger-cars per population	Flath (2003) and national sources
Urban population	Ratio of urban population	World Development Indicators (World Bank)
Population density		World Development Indicators (World Bank)
Length	Square root of country	Statistics of the World (Ministry of

	land area	Internal Affairs and Communications of Japan)
Truck density	Number of commercial vehicles per population	Flath (2003) and national sources
Per capita GDP		World Development Indicators (World Bank)

To test whether Asian countries have higher store density levels regardless of whether social and economic characteristics are controlled or not, we checked the stability of the coefficients by excluding Asian samples, such as Japan, Korea, the ROC and Thailand. We also estimated models with country dummies for Japan, Korea, the ROC and Thailand. If the coefficients for country-dummy variables become statistically significant, we can conclude that a country has exceptionally high store density.

Tables 3.3 and 3.4 present basic statistics for the variables used in regression analysis. From the correlation matrix, there are strong correlations among some countries. For example, correlations between car density and truck density, and length and truck density, are 0.456 and 0.487, respectively. With these relatively high correlations among independent variables, we were concerned there might be some bias on the estimated coefficient due to multi-colinearity. Thus we conducted a robustness check by dropping some independent variables which might bring multi-colinearity.

Table 3.3 Basic statistics

	N	Mean	Std dev	Max	Min
store_density	30	2.178	0.523	1.224	3.211
rooms	23	0.765	0.371	0.500	2.000
car_density	30	5.658	0.822	3.186	6.339
u_pop	28	75.679	10.999	58.000	97.000
pop_density	30	148.033	153.735	3.000	632.000
length	30	2.782	0.789	1.740	4.604
truck_density	30	4.128	0.716	2.754	5.935
per_capita_GDP	30	9.536	0.846	7.605	10.599
Japan	30	0.033	0.183	0.000	1.000
Korea	30	0.033	0.183	0.000	1.000
ROC	30	0.033	0.183	0.000	1.000
Thailand	30	0.033	0.183	0.000	1.000

Table 3.4 Correlation matrix

		[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
[1]	store_density	1.000							
[2]	rooms	0.473	1.000						
[3]	car_density	–0.264	–0.666	1.000					
[4]	u_pop	–0.140	–0.308	0.155	1.000				
[5]	pop_density	0.218	0.018	0.030	0.448	1.000			
[6]	length	–0.170	0.061	–0.155	0.008	–0.540	1.000		
[7]	truck_density	0.038	–0.349	0.491	0.241	–0.060	0.451	1.000	
[8]	per_capita_GDP	–0.401	–0.733	0.817	0.278	0.087	–0.031	0.494	1.000

Estimation Results

Table 3.5 presents the base line results. Models (1-1) and (1-2) include all the variables. In model (1-2), in place of U_pop, we include pop_density. The signs of estimated coefficients are as we expected. All coefficients except for car_density and U_pop are estimated statistically significantly. Countries with higher than average numbers of persons per room (rooms) have higher store density. Since higher truck_density or larger length implies higher distributors' transportation costs, this result suggests increases in distributors' transportation costs induce higher store density. Conversely, in countries with lower transportation cost for households, represented by car_density, store density becomes higher.

Since seven countries have missing values for rooms, we excluded it from models (1-3) to (1-8). In this case, the coefficients for car_density became significant, probably due to the increase in samples and multi-colinearity. Other variables are still significant, and their signs are as expected.

In model (1-4) we estimated model (1-3) without Asian samples. Coefficients are slightly changed, but the sign and statistical significant level are unchanged. In models (1-5) to (1-8) we included country dummies for Japan, Korea, the ROC and Thailand. If Asian countries have higher store density, we expect positive and statistically significant coefficients for dummy variables. However, this is not true. The coefficients for Korea and the ROC are positive but not significant. Therefore, we conclude that Asian countries are not outliers.

Table 3.5 Baseline results

Model	(1-1)	(1-2)	(1-3)	(1-4)	(1-5)	(1-6)	(1-7)	(1-8)
rooms	0.673	0.7177						
	[1.92]*	[2.12]**						
car_density	–0.2891	–0.2792	–0.4081	–0.5847	–0.4093	–0.3931	–0.4092	–0.6431
	[–1.05]	[–1.00]	[–2.72]**	[–2.39]**	[–2.66]**	[–2.56]**	[–2.70]**	[–3.01]***
truck_density	0.4947	0.4881	0.3285	0.4379	0.335	0.323	0.3483	0.446
	[2.28]**	[2.14]**	[1.71]*	[1.88]*	[1.60]	[1.66]	[1.78]*	[2.20]**
length	–0.3578	–0.3708	–0.3029	–0.3771	–0.3032	–0.3084	–0.3185	–0.358
	[–2.24]**	[–1.83]*	[–1.98]*	[–2.31]**	[–1.94]*	[–1.99]*	[–2.03]*	[–2.33]**
urban_pop	–0.0043							
	[–0.43]							
pop_density		–0.0002	0.0004	–0.0004	0.0004	0.0002	0.0001	0.0003
		[–0.17]	[0.63]	[–0.37]	[0.61]	[0.32]	[0.12]	[0.39]
Japan					–0.0482			
					[–0.09]			
Korea						0.3404		
						[0.64]		
ROC							0.4045	
							[0.67]	
Thailand								–1.0207
								[–1.51]
Constant	2.6541	2.3225	3.9745	4.8661	3.9552	3.9411	3.9769	5.0586
	[1.39]	[1.35]	[4.44]***	[3.99]***	[4.21]***	[4.34]***	[4.39]***	[4.47]***
R-squared	0.438	0.433	0.326	0.28	0.327	0.338	0.339	0.385
Adj R-squared	0.273	0.266	0.219	0.143	0.186	0.2	0.201	0.256
N	23	23	30	26	30	30	30	30

Notes:

1. t statistics in parentheses (*, ** and ***) are 10, 5 and 1 percent significant levels.

2. Model (1-4) excludes Asian samples, such as Japan, Korea, Taiwan and Thailand.

Tables 3.6 and 3.7 present the results of the robustness checks. In Table 3.6 we replaced car_density with per_capita_GDP. As Flath and Nariu (1996) discussed, one may question whether store density and car_density are simultaneously determined, and this might bring about endogenous bias. However, the main results are quite robust; truck_density and length are estimated as expected and at statistically significant levels. In Table 3.7 we excluded pop_density since it has relatively strong correlation with length (–0.54). The results show that the coefficients are quite stable and our conclusion that Asian countries are not outliers still holds.

Table 3.6 Robustness check: replacing car_density with per_capita_GDP

Model	(2-1)	(2-2)	(2-3)	(2-4)	(2-5)	(2-6)	(2-7)	(2-8)
rooms	0.5518	0.5542						
	[1.52]	[1.51]						
per_capita_GDP	–0.2626	–0.2655	–0.4159	–0.4451	–0.4163	–0.4053	–0.4265	–0.4631
	[–1.43]	[–1.44]	[–3.63]***	[–3.27]***	[–3.56]***	[–3.44]***	[–3.71]***	[–3.52]***
truck_density	0.4868	0.4724	0.3972	0.4177	0.3853	0.3921	0.4327	0.4213
	[2.49]**	[2.37]**	[2.24]**	[2.14]**	[2.03]*	[2.17]**	[2.39]**	[2.31]**
length	–0.3274	–0.3087	–0.3209	–0.3814	–0.3215	–0.3254	–0.3467	–0.3274
	[–2.28]**	[–1.75]*	[–2.30]**	[–2.60]**	[–2.26]**	[–2.30]**	[–2.45]**	[–2.33]**
urban_pop	–0.0022							
	[–0.24]							
pop_density		0.0001	0.0006	–0.0006	0.0005	0.0004	0.0001	0.0006
		[0.17]	[0.99]	[–0.64]	[0.86]	[0.66]	[0.20]	[0.97]
Japan					0.1043			
					[0.21]			
Korea						0.2693		
						[0.55]		
ROC							0.5686	
							[1.03]	
Thailand								–0.3781
								[–0.75]
Constant	3.3801	3.2202	5.3795	5.873	5.4351	5.3233	5.456	5.7674
	[1.72]	[1.74]*	[5.17]***	[4.80]***	[4.97]***	[5.02]***	[5.23]***	[4.93]***
R-squared	0.466	0.465	0.428	0.393	0.429	0.435	0.452	0.441
Adj R-squared	0.308	0.307	0.336	0.277	0.31	0.317	0.338	0.325
N	23	23	30	26	30	30	30	30

Notes:

1. t statistics in parentheses (*, ** and ***) are 10, 5 and 1 percent significant levels.

2. Model (2-4) excludes Asian samples, such as Japan, Korea, Taiwan and Thailand.

Table 3.7 Robustness check: excluding pop_density

Model	(3-1)	(3-2)	(3-3)	(3-4)	(3-5)	(3-6)	(3-7)
rooms	0.7162						
	[2.18]**						
car_density	–0.268	–0.4254	–0.5971	–0.4236	–0.3984	–0.4122	–0.6633
	[–1.01]	[–2.92]***	[–2.52]**	[–2.82]***	[–2.66]**	[–2.81]***	[–3.25]***
truck_density	0.4735	0.3472	0.4429	0.3405	0.3309	0.3535	0.4622
	[2.30]**	[1.85]*	[1.94]*	[1.65]	[1.75]*	[1.88]*	[2.37]**
length	–0.349	–0.3512	–0.3526	–0.3491	–0.3326	–0.3281	–0.3893
	[–2.25]**	[–2.68]**	[–2.41]**	[–2.57]**	[–2.49]**	[–2.46]**	[–3.02]***
Japan				0.0447			
				[0.09]			
Korea					0.4071		
					[0.85]		
ROC						0.4474	
						[0.92]	
Thailand							–1.0633
							[–1.62]
Constant	2.2326	4.1934	4.805	4.2027	4.0391	4.0133	5.2355
	[1.40]	[5.15]***	[4.06]***	[5.02]***	[4.81]***	[4.78]***	[5.14]***
R-squared	0.432	0.316	0.276	0.316	0.335	0.338	0.381
Adj R-squared	0.305	0.237	0.177	0.206	0.228	0.232	0.282
N	23	30	26	30	30	30	30

Notes:

1. t statistics in parentheses (*, ** and ***) are 10, 5 and 1 percent significant levels.

2. Model (3-3) excludes Asian samples, such as Japan, Korea, Taiwan and Thailand.

Discussion

Our findings are quite similar to those of Flath (1990), Flath and Nariu (1996) and Flath (2003). They suggest that even when we include developing countries, such as Thailand, and middle-class developed countries, such as Korea and the ROC, in the econometric model, the results are quite robust. And our claim that high store densities for Korea and the ROC are outliers is not true. Possible explanations based on the estimation results are as follows. First, numbers of passenger-cars are relatively small compared with countries with similar economic development levels. As we mentioned, per capita GDP for Korea and the ROC is similar to that of Portugal and Spain. However, car densities for Korea and the ROC are lower than in Portugal and Spain. Second, in the case of Korea, truck density is higher than that of Portugal, which also contributes to higher store density. Third, in comparing the ROC and Spain, smaller country land area (length) for the ROC again contributes to the ROC's higher store density.

Conclusion

We conducted econometric analysis to test the hypothesis that high store density in Asian countries is due to government regulation or national preference. We employed the model proposed by Flath (1990), where the level of store density is explained by households' and distributors' economic incentives. Because of data limitations, we used the samples of Japan, Korea, the ROC and Thailand plus OECD countries, but the econometric model has satisfactory explanatory power. From the estimation results, we concluded that high store density in Asia is reasonable given the relatively low number of passenger-cars per capita, high truck density and smaller country land areas.

What will store density in Asia look like in the future? As we confirmed in Chapter 2, Japan's store density has been declining since 1982, from 14.5 in 1982 to 9.7 in 2004. According to Flath (2003), the reason for this rapid decrease is a surge in car ownership ratio and a gradual decrease in the number of persons per room. The ratio of the number of passenger-cars per head of population is still low compared with the USA, but it has drastically increased in recent years. In 1985 the number of cars per 1,000 persons was 230, but it had reached 394 by 1998. For size of dwellings, the number of persons per room decreased from 0.71 to 0.59 between 1983 and 1998. If similar phenomena happen in other Asian countries, we can expect that the store density will decrease.

Although the current analysis provides meaningful findings, it leaves a more comprehensive debate to a wider study of the retailing market in Asia countries. First, due to the data limitations, our analysis is restricted to Japan, Korea, the ROC and Thailand. These countries are relatively developed compared with other ASEAN countries and mainland China. It is worth including these other countries and conducting econometric analysis. Second, in Asian countries motorbikes are more popular than cars for local transportation. If the number of motorbikes is included in car density, the results might be different. In the current study, due to the data limitations we could not obtain the number of motorbikes for sample countries; but in future it should be included.

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Chapter 4

Evolution of New Retail Formats: Country-specific Study

Introduction

We have reviewed the market transition of the retail sector in Asian countries by comparing it with OECD countries in Chapters 2 and 3. Since our research so far has been heavily based on international comparison, our discussion is restricted by data availability. However, evolution of new retailing formats and techniques is sometimes not captured by national statistics. Therefore, in this chapter we will review country-specific issues on emerging retailing formats and related topics.

This chapter is composed of eight country studies, each of which consists of two parts: a descriptive overview of the retail market, and an analysis of sales share by retail format. The overview covers four topics: evolution of new retail formats, the presence of MNEs, features of and issues surrounding regulations relating to retail business and best practice in new retail formats. Evolution of new retail formats reviews the history of market transition in the retail sector in each country. And considering the fact that new retailing formats and techniques are frequently brought by MNEs which have succeeded in the USA or Europe, we will discuss the presence of MNEs in Asian countries. In features of and issues surrounding regulations relating to retail business, we will explore restrictions on retail activity by governments. In best practice in new retail formats, we turn to micro evidence on features of emerging retail companies. In the case of Thailand, in Chapter 5 we will introduce a case study of 7-Eleven Thailand as best practice in a convenience store business. The analyses of sales share by retail format review changes in market share, emphasizing the growing share of new retail formats.

India

Descriptive Overview of Retail Market

The Indian retail industry is not only one of the most fragmented in the world, but also the most challenging due to its unorganized nature. The nature of the Indian retail market is in sharp contrast to the global situation. According to Images retail report 2007,[5] retail sales in India amount to $320 billion and account for 10–11 percent of GDP. The Indian retail market has around 15 million outlets – the highest retail outlet density in the world. However, most of these outlets are basic mom-and-pop stores with very limited offerings, fixed prices and no ambience. They are highly competitive, due to low land and labor prices. There are a significant number of new competitors in the retail market, and the established players are seeking opportunities to expand rapidly.

Sectoral Classification

Research published by McKinsey[6] classified the various retail sectors in India into three categories based on their future growth potential. The first “ready-to-go” category comprises several sub-categories in which determined retailers can build positions immediately. This is a highly attractive market because ease of sourcing, the proliferation of products and consumer acceptance have reached a level that permits the exploitation of size and range. The ready-to-go sectors include dry groceries (grains and cereals, packaged foods, toiletries and household items), electronics, certain kinds of men’s clothing, books and music. Dry groceries

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5 See Images Multimedia (2007).

6 For details see Fernandes Michael et al. (2000).

are particularly attractive because the proliferation of brands and products has helped improve retail margins on two levels: packaged goods companies have to offer retailers better terms to obtain shelf space, and retailers can trade consumers up to goods of higher value. The second category of retailing, “shape/adapt,” includes fresh groceries, women’s clothing, do-it-yourself products, fast food and furniture. It is a challenging category, as retailers in these sectors must invest substantially to shape the supply chain and persuade consumers to change their buying behavior. The third category of retail segments, “wait and watch,” comprises undeveloped sectors that provide no immediate opportunity for retailers. Pharmacy products and retail liquor are two examples of such sectors. Low levels of over-the-counter drug purchases and complicated regulations make pharmacy chains unattractive. Liquor retailing is not expected to take off because of the stringent and varying regulation of alcohol in each Indian state.

The Independent Grocer

Independent grocers/kirana stores comprise more than 66 percent of all forms of retail outlet in India, but in the last few year outlets for all formats of store-based retailing have grown, with hypermarkets witnessing the fastest growth and almost doubling in numbers. The geographical expanse of the country combined with preferences among Indian consumers for outlets close to home offering customized service have enabled these independent retailers to survive the onslaught of modern format retailers.

Pace in Retailing

According to Euromonitor International’s[7] latest report on Indian retailing as of

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7 For details, see Euromonitor International (2007)

2007, the last few years have been remarkable for Indian retailing and have seen amazing pace of growth. The government also brought changes in legislation in the form of the opening of single-brand retailing and international retailers entering the country through joint ventures. Apart from older players like RPG, Future Group, etc., new players like Reliance Group, Aditya Birla Group and Bharti Group have committed huge amounts of money to organized retail and have already started new formats.

Presence of MNEs in the Retail Sector

In India, FDI in retailing is not allowed, but it is permitted in franchising and wholesaling. Franchising is the preferred route by which foreign players have entered the Indian market. Many fast-food chains like Pizza Hut, McDonald's and KFC, as well as fashion and apparel brands like Lacoste, Nike, Marks & Spencer, Mango, Hugo Boss, LVMH, etc., have started operations.

A few players like Metro AG and Shoprite have entered the market using a cash-and-carry/wholesale route and established a presence in a few cities. Wal-Mart has entered a joint venture with Bharti Group and Woolworth's with Tata Group; Carrefour might enter this market with partners like MGF/DLF. Some other players already in this market are Amway, Oriflame, Reebok, Lee Cooper, Landmark, Levi's, etc. Others who are evaluating the market are Auchan, 7-Eleven, J. C. Penney, etc.; as and when the government eases norms for entry, they might tie up with local partners.

Features and Issues Surrounding Regulations Relating to Retail Business

Government Norms

In January 2006 the Indian government permitted up to 51 percent of foreign direct investment in single-brand retailing in the country. This allowed companies with brands sold under a single name internationally to invest, open outlets and sell their brands in India. In the government's view such brands cater to premium or niche consumers, and hence would not affect the domestic kiranas.

FDI in Indian Retailing

The Indian government is paying increasing attention to the country's retail industry and the impact the opening up of retailing would have on domestic retailers. There is increasing international pressure on India to deregulate its retailing industry, with prominent retailers sending their senior executives to meet with Indian industry as well as political leaders to convince the government of India to allow FDI in multi-brand retailing.

FDI in retailing remains a widely debated and heated issue within India's economic and political scene. While the more liberal wing of the government has adopted an amenable stand towards the opening up of retailing in India, there is strong opposition from the left-wing communist parties against any entry by international retailers. This has led to the government opening up retailing incrementally. While the first such move involved the opening up of cash-and-carry retailing to 100 percent FDI, the more recent move in 2006 allowed 51 percent FDI in single-brand retailing.

Legislation

Government policies on FDI aside, retailing operations in India are mainly governed by the

Shops and Commercial Establishments Acts of the various states. These prescribe registration, opening and closing hours, working conditions, holidays, leave, and health and safety measures, with the Acts varying from state to state. Where relevant, local and/or municipal employment and contract labor legislation also applies. In the case of private-label products, these fall under the particular legislation which addresses specific products, such as the Standards of Weights and Measures Act 1976 and the Prevention of Food Adulteration Act 1954, which are applicable to packaged food.

Best Practice of Future Group in India

As an example of best practice in the retail sector in India we take a look at the case of the Future Group. It is a group holding company of various path-breaking retail ventures in India; Pantaloon Retail is one of them.

Background

Pantaloon Retail India Ltd. was established by Kishore Biyani, who managed a family textiles and yarn business. In 1987 Biyani set up Manz Wear Pvt. Ltd. to manufacture and sell trousers for men, using Pantaloons as the brand name. A chain of franchised Pantaloons shops was later created. In 1992 the name of the company was changed to Pantaloon Fashions (India), and it became a public limited company.

The first company-owned and -managed 1,200 m^2 Pantaloons department store was opened in Kolkata in 1997. In 2001 the company ventured into the hypermarket sector by setting up its Big Bazaar hypermarkets in Kolkata. In 2002 the company launched the Food Bazaar chain to sell fresh fruit and vegetables, bakery products and grocery items. By the end of 2006 Pantaloon Retail India was present across a number of different formats and channels (Table 4.1), with its businesses classified under the two broad divisions of value retailing and lifestyle retailing.

Table 4.1 Pantaloon Retail India: operational indicators, 2004–2006

	2004	2005	2006
Net sales (Rs million)	6,596	10,559	18,720
Net profit (Rs million)	198	386	642
Outlets	9	79	129
Selling area (000 m^2)	94.1	153.7	212.3

Note: Financial year ends 30 June.

Source: Euromonitor International from company reports.

The benchmarking points of Pantaloon Retail are set out below.

Unique Formats

The group’s value retailing formats sell mainly grocery and other household items and normally offer volume-based discounts. Outlets included under lifestyle retailing mainly deal with non-grocery products. Outlets such as Big Bazaar, Food Bazaar, Depot, Fashion Station and Health Village are included under value retailing; others like Pantaloon, Central Malls, All and Blue Sky fall under lifestyle retailing. Pantaloon Retail India also has a number of subsidiary companies which conduct a host of other business activities. Prominent among these is Home Solutions Retail India Ltd., which retails furniture and furnishings, consumer durables and other electronic items under the brand names Collection-I, Furniture Bazaar, E-Zone and Electronics Bazaar; and Future Bazaar India Ltd., which manages the company's internet retailing business.

Private Label

Pantaloon Retail India has a wide range of private-label products, from food items and clothing to consumer durables (Table 4.2). The company follows a very exhaustive strategy with regard to private labels, adding new products and launching new varieties in order to raise the sales of private-label products over those of other brands, since this gives the company much better returns in comparison to manufacturer brands. In 2005–2006 Pantaloon Retail India added to its private-label portfolio by launching a slew of new products under both existing and new private labels. These included the clothing brands Ctee, Knighthood and DJ&C, and new products such as wheat flour, ghee, chips, butter and cheese added to the Fresh & Pure portfolio of existing packaged food items. Private-label products are most important within the Pantaloon department stores, where they contributed 75 percent of the retail sales value of clothing during the financial year 2005–2006.

Table 4.2 Pantaloon Retail India: private-label products

Sectors	Private-label products	Notes
Clothing	John Miller, Lombard, T2000, JM Sports, F Factor, Scottsville, Bare Leisure, Knighthood, Shatranj, Studio NYX	Men's clothing ranges
	Annabelle, Honey, Mix & Match, Shyla, Srishti	Women's clothing ranges
	Bare Denim, Rig, Akkriti, Ajile, Ctee, DJ&C, DJ&C Sports	Unisex clothing ranges
	Chalk, Bare 7214, Pink n Blue	Children's clothing ranges
Packaged food	Tasty Treat	Jams, pickles, sweet and savory snacks
	Fresh & Pure	Tea, butter, ghee, cheese, wheat flour
	Premium Harvest	Rice, cereals, pulses
Durable goods	Sensei	Air conditioners, steam irons
	Koryo	Microwave ovens, air conditioners, multimedia speakers
Household care	Cleanmate	Cleansers
Toiletries	Caremate	Soap, shampoo
Watches	Cube, Koenig, RIG, Lombard, UMM	
Books	Colouring Masti	Coloring books for children

Source: Euromonitor International from company reports.

Cost Competitiveness

Pantaloon Retail India was the leading retailer in India during 2006 in terms of retail value sales, enjoying a 0.25 percent share that year, well ahead of LG Electronics India Ltd. in second place. Pantaloon Retail India also had the most expansive spread in terms of presence across different formats and/or channels. Retailing is the company's main business interest, with a presence in store-based retailing, non-store retailing and also consumer foodservice and duty-free outlets through tie-ups and subsidiary companies. Pantaloon Retail India does not target any specific income segment among Indian consumers; rather, the company believes in offering anything and everything that the consumer needs. That said, most of its retail outlets cater more to the needs of the middle class than to those of the premium or upmarket Indian consumer, by virtue of their positioning and the competitive pricing of the products on offer. While Big Bazaar and Food Bazaar are clearly positioned as offering price advantages, Pantaloon department stores offer products which straddle different price categories. With 50 outlets added across the different formats in 2006, Pantaloon Retail India improved its retail value share that year from 0.16 percent to 0.25 percent.

Innovative Ways to Attract and Retain Customers

The company is considered to be one of the most innovative retailers in the country. For example, in order to attract the crowds with an offer of the best prices it celebrated Sabse Sasta Din (Cheapest Day) on 26 January 2006 (Republic Day) in its Big Bazaar outlets, offering products across different categories at the lowest possible prices. This initiative was a huge success for the company, as the footfall on that particular day was 10 times the average and led to a huge increase in sales. Another such initiative was the Great Exchange Offer conducted in February–March 2006, when customers could exchange old household items for purchase coupons. This move was an attempt to push sales in the months of

February and March, generally seen as a slack time for consumer spending. Pantaloon department stores also have a customer loyalty program, the Green Card, which has over 200,000 members and includes reward points, special offers, discounts, cinema tickets etc. among its benefits, based on purchases at Pantaloon outlets. Pantaloon Retail India is poised to do well in the forecast period. Its presence in fast-growing channels such as hypermarkets and supermarkets combined with the expansion plans in place are likely to enable the company to increase its turnover and share of retail value sales at a rapid pace. The turnover of Pantaloon Retail India has in fact been growing at over 45 percent per annum every year since the financial year ended June 2003, and the company seems poised to continue on this growth trajectory between 2006 and 2011.

In summary, Pantaloon Retail has been a pioneer in the Indian retailing scene, has uniquely fulfilled the needs of Indian consumers and has tried to supply the lowest price as well as high quality in goods and services. Pantaloon has emerged as one of the best Indian retailers and has met with public support and approval (Table 4.3).

Table 4.3 Pantaloon Retail India: competitive position, 2006

Format/channel	Share (%)	Rank
Retailing	0.2	1
Hypermarkets	65	1
Supermarkets	7	3
Department stores	14	4

Sources: Euromonitor International from trade press (*The Economic Times, Business Standard*, *The Financial Express*, *The Hindu Business Line*, *The Times of India,* domain-b.com, *Retail*

Biz, Images Retail, *India Retail Report*, *Inside Franchising*), company reports, trade interviews.

Key Trends and Developments

Growth in Second-tier Cities

The metro cities of Delhi, Mumbai, Kolkata, Bangalore and Chennai were the center of activity for most retailers over the review period, and most retail developments focused upon these. Hypermarkets, supermarkets and department stores were opened mostly in these cities during the review period. As retailing has taken off in India, from early 2006 retailers began to look at second-tier cities and towns in order to attract more consumers, since most big cities had already been covered. Retailers are looking at cities such as Ahmedabad, Jaipur, Lucknow, Amritsar, Pune and Hyderabad to expand their coverage.

The Young Indian Shopper

As the Indian economy has continued to flourish, the profile of the Indian shopper has changed over the years, and in the process has encouraged the retailing revolution across the country. There has been a steady decline in the average age at which Indians are employed, with industries such as call centers and business process outsourcing centers taking on increasingly younger employees. According to trade sources, the employed population in India increased from 397 million to 431 million between 2001 and 2006, with the bulk of new employees being younger, and there has been a corresponding increase in the average annual disposable income of Indian consumers, from Rs 15,000 to Rs 20,000 per month.

Private-label Penetration

Unlike in the more developed markets such as Germany, the USA and Australia, where private-label products constitute a significant proportion of value sales, in India these are at a nascent stage of development. For example, private-label products accounted for a mere 1 percent of the total value sales of packaged food in 2006. Though a miniscule proportion of total retail sales, private-label products are slowly but steadily increasing their presence across various product sectors, and in the process improving their value sales. Retailers have been careful in implementing their private-label strategies in India. Within groceries, private-label presence has been mainly confined to commodities such as rice, sugar, cereals, fruit and vegetables, where the unorganized market has hitherto dominated. Within non-grocery, clothing is the most popular category for private-label products, especially among department stores. For example, private-label items contributed 19 percent of the value sales of department store Shoppers' Stop and a much higher 80–90 percent for Westside during the financial year 2005–2006.

Emergence of New Rich and Demand for Luxury

While almost 30 percent of the population live below the poverty line as defined by the government, the country is seeing unprecedented demand for luxury goods. This cuts across sectors such as cosmetics and toiletries, clothing and accessories, jewelry, watches etc., all of which are seeing the emergence of premium retailers. According to trade sources, there were an estimated 20,000 families in 2001 with an annual income in excess of Rs 10 million, an income level considered to be that of the very rich.

Indonesia

Descriptive Overview of Retail Market

Evolution of New Retail Formats

Like other markets in Southeast Asia, Indonesia is a transitional market where modern retail structures are on the rise while traditional distribution networks are still the dominant channels, catering to the majority of people. Especially in the large cities of the Indonesian archipelago, modern retailing is developing fast.

Indonesia's rapid development of modern retail formats is happening against a background of a strongly developing fast-moving consumer goods (FMCG) market. According to AC Nielsen's Shopper Trends research,[8] the Indonesian FMCG sector increased its value sales by 14 percent in 2004 (in 2003 the growth rate was 7 percent), whereas in neighboring countries the 2004 growth rates were lower.

Modern retail structures like hypermarkets, supermarkets, convenience stores and discount stores represent some 25 percent of the market in Indonesia. In value terms, PricewaterhouseCoopers[9] (PwC) expects the modern retail market in Indonesian to reach Rp 80.7 trillion in 2007 (US$7.9 billion at the 2005 exchange rate), with an average annual growth of Rp 9.5 trillion (US$930 million).

Traditional retail structures like street markets and kiosks still cater to the vast majority of Indonesians, especially people living in the countryside and low-income groups in the urbanized

[8] See Kuipers (2006).
[9] See PricewaterhouseCoopers (2005).

areas. But traditional retailing is gradually declining as modern retail formats develop. They increasingly cater to people living in urbanized areas, who make up 40 percent of Indonesia's population of 230 million.

Local and Foreign Retailers

Before the first foreign retailers entered the Indonesian market, local retailers were already actively developing modern retail formats. Since the 1970s Indonesian retailers have established a network of supermarkets all over the Indonesian archipelago, and currently most Indonesian towns and cities have at least one supermarket with a sales area between 1,000 m^2 and 4,000 m^2 at their disposal.

A leading local retailer is Matahari, which set itself an ambitious task in 2005 to become the number-one grocery retailer in Indonesia within five years. Other retailers are Alfa Retailindo, Ramayana, Indomarco and Hero. Matahari operates department stores, supermarkets, hypermarkets, discount stores and drugstores. Like Matahari, Alfa Retailindo has a multi-format strategy (convenience stores, cash and carries and supermarkets). Its majority shareholder is local company Sigmantara Alfindo, which owns 56.6 percent of the shares. Recently the US company Altria became the retailer's second-largest shareholder after its subsidiary Philip Morris acquired the Indonesian cigarette manufacturer Sampoerna, which holds 23.4 percent of the shares. Ramayana operates department stores and supermarkets, usually on the ground floor or basement of its department stores. Indomarco focuses on its Indomaret convenience stores and has a leading position in this sector. This is in contrast to Hero, a company which started as a supermarket operator but developed into a multi-format retailer (supermarkets, hypermarkets, convenience stores and drugstores) under the influence of its main foreign shareholder, Dairy Farm.

According to PwC, domestic retailers represent some 75 percent of the modern retail market, while foreign retailers account for 25 percent. PwC expects that by 2007 foreign retailers will have a share of over 31 percent of the modern retail market, because they have the funds needed to finance market penetration.

A first mover was the Dutch company SHV that entered Indonesia via its subsidiary Makro Asia, opening its first Makro cash-and-carry store in 1992. Catering to small entrepreneurs, the cash-and-carry format suits an emerging market well. Foreign retailers really started to affect developments in Indonesia after the government began facilitating foreign investment in 1998. In that year, Indonesia's retail industry was opened to foreign investment following a letter of intent signed by the Indonesian government and the International Monetary Fund. Immediately, foreign retailers began to invest in the country; a commitment which was shaken – but not destroyed – by the 1998 riots and financial crisis that hit Indonesia's economy.

Delimmo, the investment arm of Belgian retailer Delhaize, converted a convertible bond into a 51 percent stake in the local retailer Superindo in December 1998. In February 1998 Hong Kong-based retailer Dairy Farm acquired a 32 percent stake in local retailer PT Hero. Currently it holds a 44.55 percent stake in PT Hero, and Dairy Farm has a right to increase this to a 69.1 percent majority share at will.

Both are examples of foreign retailers acquiring a share in a local supermarket retailer to gain a foothold in the Indonesian market. When French retailer Carrefour entered the Indonesian market in 1998, its aim was to develop a network of hypermarkets organically in collaboration with its joint-venture partner Tigaraksa. As hypermarkets were at the time an almost unknown phenomenon in the market (in 1995 local retailer Matahari had started with its Mega M hypermarket format), acquisition of an existing network was not an option. French retailer Promodès followed the same strategy, establishing a joint venture with local group Sinar Mas to operate Continent hypermarkets in Indonesia; this venture was included in Carrefour's Indonesian operations following the merger of both French groups in 1999.

Debenhams Retail plc, the UK's second-largest department store chain, opened its second outlet in Indonesia in 2006. The store, located in south Jakarta's new Senayan City shopping mall, offers a 20,000 m^2 shopping experience for customers. It is managed by local retail franchise company PT Mitra Adi Perkasa (MAP), and will become Debenhams' new flagship store after its first 4,000 m^2 outlet, which opened in October 2004 at Plaza Indonesia. In September 2008 Debenhams opened its third outlet in Supermal shopping mall, Lippo Karawaci, Indonesia.

Formats of Growth

Indonesia's supermarket sector is performing below average, and dealing with this gives a new impetus to the modernization of Indonesia's retail structures. Matahari is modernizing its network by closing underperforming stores and repositioning other supermarkets in its MarketPlace format, which is targeted at a middle- and higher-income clientele. PlanetRetail links other local retailers that also want to invest in modern retail structures. Ramayana intends to invest some US$45 million to open 10 new stores, mostly in areas outside Java. Alfa Retailindo announced in August 2005 that it would invest US$4.1 million to open two new stores in Makassar and Bekasi. This investment, which equals 5 percent of total revenues, brings the retailer’s store number to 36. Hero announced an investment of some US$16.2 million in five Giant hypermarkets, six additional Hero supermarkets, 20 drugstores (Guardian) and 20 convenience stores (Starmart).

Hypermarkets and convenience stores are Indonesia’s main growth formats in modern retailing. Carrefour is the uncontested leader in the hypermarket sector with 20 stores, mostly situated in the Jabotabek region, and total sales exceeding US$600 million. Contrary to its experience in the difficult and saturated Japanese market, Carrefour managed to put its stamp on the hypermarket sector in the emerging Indonesian market.

At Carrefour’s market entry in 1998 hypermarkets were almost non-existent in Indonesia and the existing outlets were run by department store retailers. They could not compete with the French hypermarket expert. When the local retailer Matahari decided in 1999 to reformat its Mega M hypermarkets to a one-stop-shopping concept (a combination of a Matahari department store and a supermarket), it did not go head to head with Carrefour. Matahari did not abandon the hypermarket sector, but developed Hypermart, a compact hypermarket format with sales areas between 4,500 m^2 and 9,000 m^2. Currently there are 14 Hypermarts, and Matahari plans to have a network of some 50 stores by opening new outlets and converting larger Matahari supermarkets to the Hypermart banner.

Carrefour, Matahari and Dairy Farm are large enough to invest the funds needed to develop the hypermarket format. Other retailers are looking for alternatives to offset declining sales levels in traditional supermarkets and grocery stores. Investing in the convenience store sector (also referred to as “mini-markets”) is recognized as a cheaper option in the search for growth. These stores are rapidly growing in popularity, as they are often conveniently located in housing estates and residential areas.

Asia is Carrefour’s real engine of growth, and this is the main reason why half the stores Carrefour opened in 2005 and 2006 were in Asia. China will probably be the focal point of its Asian ambitions, but Carrefour is also represented in the ROC, Thailand, Malaysia, Singapore and Indonesia. In Indonesia, Carrefour benefits from an early-mover advantage, as besides Dairy Farm no other large multinational retailers have set up shop here. Wal-Mart was in Indonesia at one stage, but was loss-making. While operated in Indonesia, Wal-Mart partnered with Lippo Group, which is now a majority Matahari shareholder.

India is an even more promising market in South Asia, but there the rumored massive entrance of multinational retailers has not yet materialized. In this respect, the wait for such things to happen in Indonesia will be even longer.

Retail Property

In 2008 retail property supply in Jakarta, the capital of Indonesia, is estimated to rise by 400,000 m^2, or a 47.6 percent hike from the previous year. This will increase retail property supply in the capital to a total of 3.2 million m^2, or a 15.7 percent hike. In the third quarter of 2007, retail space supply recorded a twofold increase. However, demand for retail space will decline. Consumer saturation in the domestic market is suspected to be the factor behind the market slowdown.

This situation paralleled the growth of the national retail industry, which was estimated by the Indonesian Retail Merchants Association (Aprindo) to grow by 15 percent in 2008, the same as in 2007. However, this estimate does not tie in with the optimistic prediction of the Indonesian Shopping Center Developer Association (APPBI), which estimates that in 2008 the retail market will grow above the 2007 growth level, because many foreign retailers will enter Indonesia.

Moreover, the government has given a green light to foreign investors wishing to open supermarkets of above 1,200 m^2 in size and department stores of above 2,000 m^2. A domestic retail market with such big potential – and with a population of 230 million people – will surely develop even further.

So far, people have worried about foreign retailers “eating up” local players. But perhaps, in the current era of free competition in regional and global arenas, the government has no choice other than to issue new policies to allow foreign investors to enter the country’s retail industry. However, the government is expected to be more consistent in giving broader opportunities for local retailers so they can better develop their businesses, because these retailers employ more local workers and sell more domestic products.

It is calculated that Indonesians spent Rp 6 trillion per year on branded goods from foreign countries, accounting for 10 percent of total turnover of the domestic retail industry, which was estimated at Rp 60 trillion last year.

Reliable sources say foreign retailers ready to enter Indonesia include Tesco Supermarkets from the UK, which had targeted several locations in Jakarta; Central Department Store (Thailand); and Takashimaya and Isetan (Japan). In addition, several world giants were also planning expansion to Indonesia. Given this situation, developers have started building property in 2007–2008.

Presence of MNEs

Entry and Exit of Foreign Retailers

There are some foreign retail brands in Indonesia, such as Carrefour (hypermarket and Alfa supermarket), Dairy Farm (Hero supermarket, Giant hypermarket, Guardian drugstore, Starmart convenience store), Makro (hypermarket), Metro (department store), Sogo (department store and supermarket), Best Denki (electronic superstore) and Debenhams (department store).

Major Retail Players

In terms of market share, modern retailers account for around Rp 35.5 trillion, based on a network totaling 2,815 outlets which spans the whole of Indonesia. Modern retail outlets are still mainly concentrated in Java (87.5 percent or 2,595 outlets), with the remaining 12.5 percent (378 outlets) widely spread outside Java. The biggest concentration is in Jabotabek, where there are 1,633 outlets (54.5 percent).

The largest retailers are estimated to take around 70 percent of the modern retail market on a national scale. Matahari holds the biggest share of the market with 13.5 percent, followed by Makro (12 percent), Alfa (8.5 percent), Ramayana (8.5 percent) and Carrefour (7.6 percent).

Figures for market share and sales at this scale are estimates (Tables 4.4 and 4.5).

Table 4.4 Top 10 retail companies in Indonesia, 2006–2007

				2006				2007			
Rank	Outlet type	Brand(s)	Retailing company	Outlets	Sales (Rp bil.)	Sales area (000 m^2)	Sales per m^2 (Rp mil.)	Outlets	Sales (Rp bil.)	Sales area (000 m^2)	Sales per m^2 (Rp mil.)
1	Various	MatahariDS, Hypermart, Foodmart, etc.	Matahari Putra Prima	194	6,131	594	13.7	189	9,533	603.1	15.8
2	Hypermarket	Carrefour	Carrefour Indonesia	29	7,141	200	35.7	38	9,100	258	35.2
3	Various	Starmart, Guardian, Giant, Hero	Hero Supermarket	311	4,708	275.6	17.1	340	5,186	314.4	16.5
4	C-store	Alfamart	Sumber Alfaria Trijaya	1,704	3,134	224.9	13.9	2,424	5,015	357.5	14.0
5	Department store	Ramayana	Ramayana Lestari Sentosa	93	4,478	418.8	10.7	98	4,747	441.3	10.8
6	C-store	Indomaret	Indomarco Prismatama	1,857	3,131	244.7	12.8	2,228	3,914	322.9	12.1
7	Various	The Athlete's Foot, Oshkosh B'Gosh, etc.	Mitra Adi Perkasa	567	3,120	393.7	7.9	625	3,707	437.8	8.5
8	Various	Alfa Midi, Alfa Supermarket	Alfa Retailindo	32	1,969	63.2	31.2	43	1,726	57.8	29.9
9	Bookstore	Gramedia	Gramedia Asri Media	63	1,487	79.4	18.7	70	1,710	92.6	18.5
10	Hardware	Electronic City	Graha Sudirman Centre	8	1,004	65.3	15.4	11	1,431	91.5	15.6

Source: Euromonitor International (2008).

Table 4.5 Sales in retailing by sector: percentage value growth, 2002–2007

	% current value growth		
	2006–2007	**2002–2007**	**CAGR 2002–2007 total**
Store-based retailing	8.7	10.0	61.4
Non-store retailing	13.4	14.8	99.2
Retailing	**8.8**	**10.1**	**61.6**

Source: Euromonitor International (2008).

Regulatory Environment

Foreign Direct Investment

Foreign direct investment (FDI) started to make significant progress in Indonesia in the 1970s. Over the period the value of foreign direct investment reached US$30 billion per year. This subsequently increased to around US$100 billion per year during the 1980s, and by the year 2000 FDI had reached US$1,167 billion.[10] Rapid growth in FDI is attributable to significant expansion in the international economy, trade and domestic investment. In the 1980s the world GDP based on market prices was increasing by 3.5 percent per year, while services and exports were growing by 6.4 percent per year and FDI flows by 40 percent per year. Due to the significant increase in consumer demand for goods and services in industrial countries, around 90 percent of foreign direct investment went to developed countries.

[10] See World Bank (2005).

Despite the significant increase in global FDI, FDI flows into Indonesia decreased drastically due to the monetary crisis. Having stood at around US$8.7 billion in 1990, the level subsequently increased to US$33.9 billion in 1997 before plummeting back down to US$9.7 billion in 2002. As a result, the government declared “Investment Year 2003” to stem the significant decrease in foreign investment during the monetary crisis and to collect development funds at the end of the working contract with the International Monetary Fund (IMF).

Property Regulations

The government has enacted a number of policies and regulations with a view to regulating and controlling modern retailers and market formats and protecting small retailers and traders. But so far the implementation and supervision of these regulations has not been strong enough. Legal permits to establish new modern retail/market formats are continuously being issued even in areas where their issue is ostensibly prohibited. As a result, government regulations are in many ways failing to control the existence of modern markets and retailers, and small domestic traders are becoming vulnerable.

Reference for Managing Markets and Stores

The Minister of Industry and Trade issued a decree on 13 October 1997 to act as a reference for managing markets and stores (Pedoman Penataan dan Pembinaan Pasar dan Pertokoan). This is intended to protect small and medium-sized traders. Some items stated in this decree are as follows.

• Modern markets can be developed in every provincial capital.

• Their location must comply with either the Local Landscape Plans (RTRWK, Rencana Tata Ruang Wilayah Kota) or Detailed Local Landscape Plans (RDTRWK, Rencana Detail Tata Ruang Wilayah Kota).

• The establishment of modern markets within a secondary area (i.e. outside the provincial capital) requires RTRWK and RDTRWK authorization based on location criteria. Retailers must also obtain Ijin Khusus Pasar Modern (legal permission for modern markets) from the Ministry of Trade and Industry.

• Without RTRWK and RDTRWK authorization, modern markets cannot be established in secondary areas.

Operating Hours

Local DKI Policy (Perda DKI) No. 2 Year 2002 regulates opening hours for non-governmental markets (store, malls and groceries) in Jakarta.

• Opening hours for non-governmental markets are from 10:00 to 22:00.

• Stores wishing to open outside these hours require special permission from the DKI governor.

Some retailers want the local government of DKI Jakarta to issue licenses allowing retailers, malls and groceries to serve the residents of Jakarta 24 hours a day. The DKI government seems in favor of such a plan as long as the goal is to improve service quality. An approval-based scheme now seems to be in operation. So far 24-hour licenses have been awarded to owners of convenience stores such as Circle K, Starmart and AM/PM.

Tax for Service Charge

The Indonesia Tax Directorate (Dirjen Pajak) issued circular letter (Surat Edaran) SE 14/PJ.S3/2003 on Tax for Service Charge. The letter announced a rise from 4 percent to 10 percent in value added tax on services in shopping centers. Bearing in mind that 60 percent of the charge boils down to electricity, which already carries tax obligations, shopping and retail centers feel they are being treated unjustly and believe they will suffer as a result.

Area Sizes

In Indonesia a new presidential regulation is imposing restrictions on foreign retailers, allowing them to operate only in the hypermarket sector in order to protect the local retail industry. Under Presidential Decree No. 111 declared in 2008, which revises Presidential Decree 77, foreign retailers are not allowed to operate supermarkets with floor space of less than 1,200 m^2 or department stores with floor space of less than 2,000 m^2.

The new decree also prohibits foreign investors from entering the mini-market, community store and convenience store sectors. The decree defines mini-markets as those with a size of less than 400 m^2. Supermarkets are defined, under another presidential decree on modern retailers, as those with areas ranging from 400 m^2 to 5,000 m^2, and hypermarkets as sizes of over 5,000 m^2.

Best Practice of Matahari in Indonesia

Indonesia's Multi-format Modern Retailer

With a vision “To be consumers’ most preferred retailer” and a mission “To consistently bring value fashionable products and services that enhance the consumers’ quality of lifestyle”**,** the Matahari Group is a leading Indonesian multi-format modern retailer with core businesses in fashion and household groceries targeted at middle and upper-middle consumers throughout the nation.

Founded in 1958 by a living Indonesian retail legend, Mr. Hari Darmawan, in 1996 Matahari's majority ownership changed hands from Mr. Darmawan to Lippo Group – a well-respected Indonesia group with leading domestic and international multiple businesses in various industries.

With the primary goal to be the leader of the retail industry in Indonesia, Matahari has undertaken innovative measures to expand, integrate and create a demand for a full range of retail needs. It predominantly focuses on fashion, food and beverages, health and beauty supplies and entertainment centers. Matahari continuously expands its core businesses with other related units, such as distribution centers and channels, as well as customer loyalty cards

Bringing the Indonesian Retail World to International Recognition

Matahari provides for Indonesians' daily needs, especially in fashion and food, through its nationwide stores in three major business formats: Matahari Department Stores, Hypermart and Foodmart. Matahari has substantially increased its outlets in Indonesia to a total of 80 department stores, 39 hypermarkets, 29 supermarkets, 47 pharmacies, 90 family entertainment centers and an international bookstore. It was actively operating in more than 50 cities across Indonesia at the end of June 2008.

Figure 4.1 Hypermart Puri Indah

Hypermart opened its thirty-eighth store, located in Puri Indah, west Jakarta, on 19 March 2008 (Figure 4.1). With a compact store design and 6,287 m^2 of sales area, Hypermart Puri Indah has 36 checkouts and 194 employees ready to serve customers.

Matahari's head office is based in Lippo Karawaci, Banten, Indonesia. Its store chains cover major cities and provinces throughout Indonesia, and it has an impressive reputation domestically and internationally, including receiving the Gold Award in the Retail Asia Pacific Top 500 Awards in 2007, 2006, 2005 and 2004. In 2007 Matahari also received the most prestigious award for the first time – Best of Best, Retail Asia Pacific Top 500 Awards, which represents the highest recognition within the retail industries in the Asia Pacific region for the company's outstanding milestone achievements. It is recognition that firmly puts Matahari on the map among the region's leading and most dynamic retail corporations.

The operational activities of Matahari Group comprise nine core retail businesses: Matahari Department Stores, Parisian, Hypermart, Foodmart, Times, Matahari Club Card, Food

Junction, Timezone and Bintang Sidoraya Group. The nine pillars are interrelated and support each other in providing services to investors, customers and business partners.

Strengthening the Company's Core Strategy

PT Matahari Putra Prima Tbk (Matahari) in July 2008 announced its 2008 half-yearly financial results. Total consolidated sales grew by 24.6 percent to Rp 5.2 trillion, while net earnings increased by 20 percent to Rp 60 billion for the period. The strong sales achievement was supported by continuing growth from its two core businesses: the Department Store Group charted 15.1 percent total sales growth to Rp 2.3 trillion, while the Food Business Division posted 33.5 percent growth, reaching Rp 2.7 trillion for the first half of the year. The performance of comparable stores[11] played a pivotal role in Q1 and Q2 in both the company's core business units: the Department Store Group successfully charted an above-industry-average standard at 18.3 percent (Q1) and 23.9 percent (Q2), which led to compound growth of 21.2 percent; and the Food Business Division posted an equally positive comparable sales performance within its FMCG industry at 14.8 percent (Q1) and 13.2 percent (Q2), which led to compound growth of 13.9 percent.

With limited new store expansion activity in 2008, the favorable sales growth in both business units was mainly derived from existing stores' performance, demonstrated by their respective comparable store sales. This is attained by management's continuing focus on

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[11] "Comparable store sales" is a measurement of productivity in revenue used to compare sales of retail stores that have been open for a year or more. Historical sales data allow retailers to compare this year's sales in their stores to the same period last year. In the case of January–December 2008 performance, stores which are counted as comparable stores are those which opened in 2006, because those which opened in 2007 may not have a full year of sales data.

further strengthening several aspects of the company’s core strategy: stronger promotion, better merchandise selection and a procurement strategy with vendors’ overall support, etc.

In the second half of 2008 Matahari will continue to execute its expansion plan, but must anticipate cautiously but optimistically the potential declining market trends and reduced purchasing power as the result of ongoing inflationary prices and an anticipated further increase in fuel prices within the year.

"Quality Products and Services Straight from Our Hearts"

"Quality Products and Services Straight from Our Hearts" is a sincere declaration that works to demonstrate Matahari's way of doing business, and can be seen throughout its store chain. As Matahari continues to garner support and loyalty with a growing regional presence, the qualities that have come to stand for the best of Matahari remain the same: unparalleled store networks spread in over 50 cities in Indonesia, great service and, most importantly, an understanding of what it takes to please each and every customer.

As a leading retail chain that prides itself on offering the best products and services in customer relations and suppliers’ associations, Matahari delivers a message of wide product options and impeccable shopping that can be experienced at each store.

The Vendor, the Customer and the Employee: The Key to Matahari’s Future Success

Matahari has formed a strong, mutually beneficial relationship with over 6,000 long-standing vendors. The Association of Matahari Suppliers Club issues a quarterly update to give information to suppliers about Matahari’s strategy or other hot issues, such as food safety or quality control.

Matahari's management realized that the big challenge is to monitor and anticipate change – changes in the demographics that impact buying power, changes in competition, changes in consumer trends worldwide and changes at home. The ability to anticipate change in fashion and lifestyle trends will help to move merchandise off the shelves. For this reason, Matahari has had an in-house design team since 2004; with this team, its response time to changes in fashion trends is faster.

To increase customer loyalty, Matahari pioneered a loyalty card program in Jakarta in 2000, and at the end of December 2007 had more than 4.8 million members in its Matahari Club Card (MCC) program.

At the heart of Matahari's operations are its staff, which stood at more than 17,500 at the end of 2007 and will grow from strength to strength as new stores open. The company has an intensive ongoing training program for all levels, from product knowledge and customer service training for frontline staff to management trainees. Its CDP (Certified Development Program) initiative is proving to be a successful tool in developing future leaders to support its aggressive expansion plans.

Analysis of Sales Share by Retail Format and Variation

Hypermarket Leadership

The modern retail market is predicted to reach Rp 80.7 billion in 2007, representing growth of Rp 9 billion per year in value terms. The biggest contributor to this growth is the hypermarket segment (36.7 percent), which emerged as the main format in 2003 (Table 4.6).

Table 4.6 Market share of modern retailers in Indonesia (Rp billion)

Year	Super-market	Share (%)	Hyper-market	Share (%)	Mini-market	Share (%)	Dept. store	Share (%)	Total	(+/–) (%)
2001	11,783	34.7	10,108	29.8	2,212	6.5	9,824	29.0	33,928	
2002	12,808	33.2	12,292	31.9	3,002	7.8	10,471	27.1	38,573	13.7
2003	14,330	32.2	14,678	33.0	3,693	8.3	11,782	26.5	44,483	15.3
2004	16,320	31.7	17,426	33.9	4,353	8.5	13,324	25.9	51,422	15.6
2005	18,689	31.1	21,093	35.1	5,171	8.6	15,178	25.2	60,131	16.9
2006	21,363	30.7	25,108	36.0	6,146	8.8	17,072	24.5	69,688	15.9
2007	24,429	30.2	29,659	36.7	7,308	9.0	19,371	24.0	80,767	15.9

Source: PricewaterhouseCoopers (2005).

In Indonesia most hypermarkets are located strategically in heavily populated areas in big cities. Consequently, hypermarkets attract many customers every day and compete directly with supermarkets and mini-markets. In the near future the hypermarket business is expected to expand significantly, as many major players are planning to open more outlets all over Indonesia.

In terms of total sales turnover, mini-markets do not contribute significantly to the Indonesian retail industry. However, franchised mini-markets have enjoyed substantial growth in recent years. With a comfortable shopping ambience, a complete range of products, competitive prices and easy accessibility, the mini-markets have been gaining popularity and establishing a solid presence in residential and business areas.

Specialty shops have also been gaining in popularity in Indonesia, as they provide opportunities for customers to compare products from many different suppliers prior to making a purchase. They usually attract serious customers, display their products in an attractive fashion and maintain reasonable prices. Most specialty shops employ ample and knowledgeable sales staff who are ready to assist customers. With the proliferation of malls into Indonesia's secondary markets, specialty shops are expected to expand rapidly and gain market share from other retail competitors. Specialty shops operate in many sectors; examples are Electronic City (electronic products), Toys 'R Us (toys), Guardian (pharmaceutical products) and many others.

Increasing Market Share of Foreign Retailers

As foreign retailers continue to penetrate the Indonesian market, the major domestic retailers are stepping up efforts to compete. Competition is likely to get fiercer as global retailers enter Indonesia following the 2004 general election. At present, domestic retailers represent 74.3 percent of the modern retail market, while foreign retailers account for 25.7 percent. Based on estimated growth of around 19–23 percent, foreign retailers could represent as much as 31.1 percent of the market in 2007, while domestic retailers look set to see market share slide to 68.9 percent, with average growth of 14 percent per year (Table 4.7).

Table 4.7 Retail sales of Indonesia retailers, 2004–2006 (US$ million)

	2004	2005	2006 (est.)
Local retailers	2,100	2,739	3,261
Foreign retailers	1,400	1,826	2,174
Total retail sales	3,500	4,565	5,435

Source: Unofficial estimates, based on annual revenues of 72 Aprindo members.

While many business sectors are slowly recovering from the economic crisis, the retail sector has rebounded. This rapid recovery has been driven mostly by strong domestic consumption, serving as a primary factor to improve Indonesia's economy. In 2006 total Indonesian retail sales were expected to reach $5.44 billion, mainly generated by approximately 5,000 large retail outlets throughout the country (Table 4.8).

Table 4.8 Indonesia retailing sales by sector value, 2002–2007

	Annual sales (Rp billion)					
	2002	2003	2004	2005	2006	2007
Store-based retailing						
Hypermarkets	4,611	6,333	8,403	10,174	13,415	16,708
Supermarkets	12,852	14,394	16,554	19,450	21,882	24,070
Discounters	–	–	25	57	155	136
Small grocery retailers	135,119	146,134	158,161	171,660	184,858	196,920
Food/drink/tobacco specialists	4,169	4,502	4,908	5,374	5,911	6,532
Other grocery retailers	176,884	198,994	225,261	256,798	287,614	316,375
Total grocery retailers	*333,635*	*370,358*	*413,312*	*463,514*	*513,834*	*560,741*
Mixed retailers	12,367	13,578	15,162	17,133	19,175	21,337
Health and beauty	18,368	19,711	21,260	23,076	25,110	27,485
Clothing and footwear	52,543	57,534	63,288	66,832	70,841	75,446
Furniture and household goods	10,530	11,289	12,211	13,163	14,240	15,467
Durable goods	18,660	20,003	21,703	23,657	25,833	28,287
Leisure and personal goods	18,035	19,297	20,740	22,383	24,151	26,099
Other non-grocery retailers	35,244	38,064	41,185	44,768	47,902	51,016
Total non-grocery retailers	*165,747*	*179,475*	*195,549*	*211,010*	*227,252*	*245,137*
Total store-based retailing	**499,381**	**549,833**	**608,861**	**674,524**	**741,086**	**805,878**
Non-store retailing						
Home shopping	8	8	9	9	10	10

Direct selling	3,446	3,934	4,533	5,219	6,056	6,869
Total non-store retailing	**3,454**	**3,943**	**4,542**	**5,228**	**6,066**	**6,880**
Total retailing sales	**502,835**	**553,776**	**613,402**	**679,752**	**747,152**	**812,757**

Source: Euromonitor International (2008).

Competition in the Indonesian retail industry has been very sharp, especially since the entry of foreign retailers. While some foreign retailers failed and closed down their outlets, many are successful and expanding their businesses. In Indonesia there is no regulation governing where a retailer can establish outlets; as a result, many large retailers are strategically located in the heart of Indonesia's big cities and compete directly with smaller retailers.

Repositioning of Domestic Retailers

Some domestic retailers have begun to reposition. The strategies being implemented by Matahari, Hero and Rimo are aimed at confronting tight competition in the lower-middle-class market, which is an exceptionally large segment. Rimo, which had previously been cultivating the upper-middle-class market, is now focusing on the middle-class segment

Matahari, for example, has been repositioned as a multi-format retailer: its operations are not only in department store format (Matahari Department Store for the middle class and Parisian for the upper class, launched in 2007), but also in supermarkets (Foodmart – rebranded in 2007 from Matahari Supermarket), hypermarkets (Hypermart, 2004), convenience stores (Foodmart Express, 2007), health and beauty stores (Boston) and a bookstore (Times, 2008). This multi-format strategy aims to cater for consumers of different classes and with varying needs.

Japan

Descriptive Overview of Retail Market

Evolution of New Retail Formats

In this section, we review the evolution of retail formats in Japan dating back to the 1950s. The history of Japanese retail formats can be described as "diversification."

General Superstores

Japanese first self-service superstore, in Kinokuniya, was established in 1954 by Tokyo's Aoyama. Since then, the number of superstores has drastically increased. In 1958 the Self Service Association and the Association of Japanese Supermarket Chains were instituted. The 1960s saw the arrival of general superstores, the retailing format which handles wide assortments of merchandise. Its pioneer, Daiei, expanded market share in the 1960s. The growth of general superstores was remarkable in this period. For example, while the market share of apparel superstores remained unchanged between 1964 and 1974, that of general superstores increased from 4.7 percent to 10.6 percent. However, the phase was ended in 1974 by the introduction of the Large Scale Retail Store (LSRS) Law. The number of superstores has increased again since the abolition of the LSRS Law in 2000.

Convenience Stores

The pioneer of convenience stores is 7-Eleven Japan, operated by general superstore Ito Yokado. The first store was opened in 1974; since then, the sector has grown its share. The strength of the format lies in its distinctive services. For example, advanced information systems, such as POS, enable convenience stores to implement advanced merchandising. 7-Eleven Japan, the largest convenience store operator, sells own-brand merchandise and accounts for 50 percent of the sector by sales.[12]

Long business hours and additional services are also fundamental to convenience store operation. In Japan most convenience stores operate 24 hours a day and offer additional services, such as photocopying, photo developing, postal package handling and payment of utility bills.

Finally and most importantly, Japanese convenience store chains have well-organized distribution and supply systems. These days, major chains make deliveries to each retail outlet from three to five times a day, since Japanese consumers prefer fresh, sometimes

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[12] For details of Japanese convenience stores, see Chapter 8 in Larke and Causton (2005).

highly perishable, food products. While the sales share of convenience stores is still low compared with specialty stores, their profitability is competing with the US level. According to the McKinsey Global Institute (2000), the profitability of stores operated by 7-Eleven Japan is 50 percent higher than the average US level.

Other New Retail Formats

In the 1990s and 2000s, while consumer spending has been decreasing, some retailers have managed to set up new formats and experienced surprising growth. For example, Fast Retailing, an apparel chain store, has utilized POS data very efficiently to monitor its stock closely and reduce the losses caused by excess stock. Another example is Daiso-Sangyo, an operator of one-price stores. One of the unique features of this company is flexibility of store size and concept. It adopts different store formats according to location: in city centers it operates relatively small stores, but in suburban areas it has huge outlets.

Presence of MNEs

FDI to Japan in the retailing industry substantially increased in the late 1980s and 1990s. The reasons for slow internationalization lie in the entrance restrictions for large-scale stores and numerous barriers to import. After these restrictions were removed in the 1990s, the number of overseas companies entering the retail market expanded in the early 2000s. However, most businesses failed due to poor service quality, operational failures and lack of price competitiveness. Exceptions are Gap and Toys ‘R Us, both of which gained substantial market share in Japan. International general merchandise store (hereafter GMS) chains, such as Carrefour, Wal-Mart, Costco and Metro, have entered the Japanese market, but some have already left Japan and others have been struggling to survive. The following are some examples of international chains entering the Japanese retail market.[13]

Carrefour

One of the largest retail chains, Carrefour opened a store in the Tokyo suburb of Makuhari in December 2000. Initially it planned to operate 13 stores by the end of 2003. Carrefour tried to offer the lowest prices in Japan. However, Japanese consumers regard the Carrefour brand as a second-tier brand and suspiciously cheap. Although Carrefour succeeded in expanding sales of some specific products with surprisingly low prices, Japanese consumers felt disappointed on

[13] For details of International retailing in Japan, see Larke and Causton (2005); Aoyama (2007).

the whole (Larke and Causton, 2005).

In 2005 Carrefour sold its stores to Aeon, Japan's largest GMS chain, primarily because the low profitability of the stores made expansion in China an easier option.

Wal-Mart

Wal-Mart entered Japan by acquiring a 6 percent stake of the fourth-largest GMS chain, Seiyu, in 2001. Wal-Mart then formed a strategic alliance with Sumitomo Trading and purchased a 34 percent share of Seiyu in 2003. In March 2005 it announced that Seiyu would be a 50 percent owned subsidiary by the end of year.

However, Seiyu's performance has been getting worse: it has lagged behind its competitors and is now down to being the fifth-largest retailer. The mistake Wal-Mart made lies a strategy which has succeeded in oversea markets; in the USA and other countries, Wal-Mart has collaborated with manufacturers and adopts a factory-direct model, which enables it to undercut competitors' prices. However, in Japan the manufacturers refused to cooperate and it could not adopt this model, thus Wal-Mart had no cost advantages.

According to Aoyama (2007), taking advantage of huge floor areas, Carrefour and Wal-Mart stick to strategies for low-cost operations, such as the stack-them-up-and-sell-them-cheap strategy, where products are displayed without being taken out of corrugated boxes. However, bulk purchase is not familiar with Japanese consumers, and the strategy failed to lure customers.

Costco

Costco, one of the major US warehouses, entered the Japanese market in 1999. It started business at Fukuoka, and by the end of 2007 it had eight stores nationwide. According to Larke and Causton (2005), Costco offers products with similar prices to those in the USA. However, in the categories where domestic suppliers have strong market power, such as beer and some packaged food, its range of products is limited.

Features and Issues Surrounding Regulations Relating to Retail Business

Entry Regulation for Large-scale Stores

In Japan, the business of large-scale retailers has been highly restricted by law to protect the smaller-sized retailers.[14] Protection for small retail businesses originated in the Department Store Law established in 1937. Although the law was repealed after the Second World War by General Headquarters of the Allied Forces (GHQ), it emerged again in 1956 in almost the same manner as before. In 1974 the LSRS Law was enforced, targeting not only department stores but also large superstores. At the same time the new law had another purpose: to restrain new entrants with large capital from abroad. The law not only protected smaller businesses but also restricted the competition among large retailers through controlling the entry of new businesses.

In 1978 the law was reinforced. When a large-scale retailer starts a new business in a certain area, it first has to notify the Minister of International Trade and Industry. The minister investigates the effect of the new entry on smaller retailers in that area. If a significant negative effect is found, the minister urges the entrant to modify its business plan regarding such items as floor space, business days, closing times or the number of holidays. The role of the minister is just to illustrate guidelines. Representatives in regional business districts carry out substantial adjustments. Furthermore, local governments have been allowed to impose additional entry regulations on large stores.

In the 1990s the trend changed from protectionism to deregulation as a result of the Japan-US Structural Impediments Initiative, which was aimed at creating a Japanese open market and promoting competition. In 1994 the LSRS law was eased to give more freedom to new entrants to the retail industry with less than 1,000 m^2 of floor space. And, finally, in 1998 the law was completely repealed.

Tax Distortion

The tax system in Japan has many provisions favoring the continuation of small stores even if the business is not profitable. Many economists have pointed out that the tax distortion might act as exit barriers for small stores (Nishimura and Tachibana, 1996; McKinsey Global Institute, 2000).

• *Income tax*. For owner-proprietors there are several loopholes in the existing tax reporting system. For example, owner-proprietors are allowed to submit a white-form report, which does not require examination by a licensed tax accountant. This enables them to over-report business expenses and under-report sales.

[14] For a historical survey on this issue, see Larke (2005); Meyer-Ohle (2003).

• *Inheritance tax*. Most Japanese mom-and-pops enjoy a special provision that allows small landowners to deduct 40 percent of the value from the taxable amount of an asset liable to inheritance tax. Since other assets like securities are evaluated at the market value, small business owners who wish to avoid inheritance tax will keep their business even if it is not profitable.

• *Property tax*. The average effective tax rate is substantially low compared with the USA or European countries. According to the McKinsey Global Institute (2000), while the tax rate in the USA is around 1.7 percent, the tax rate for Japan is around 0.3 percent. This is also an exit barrier for traditional stores.

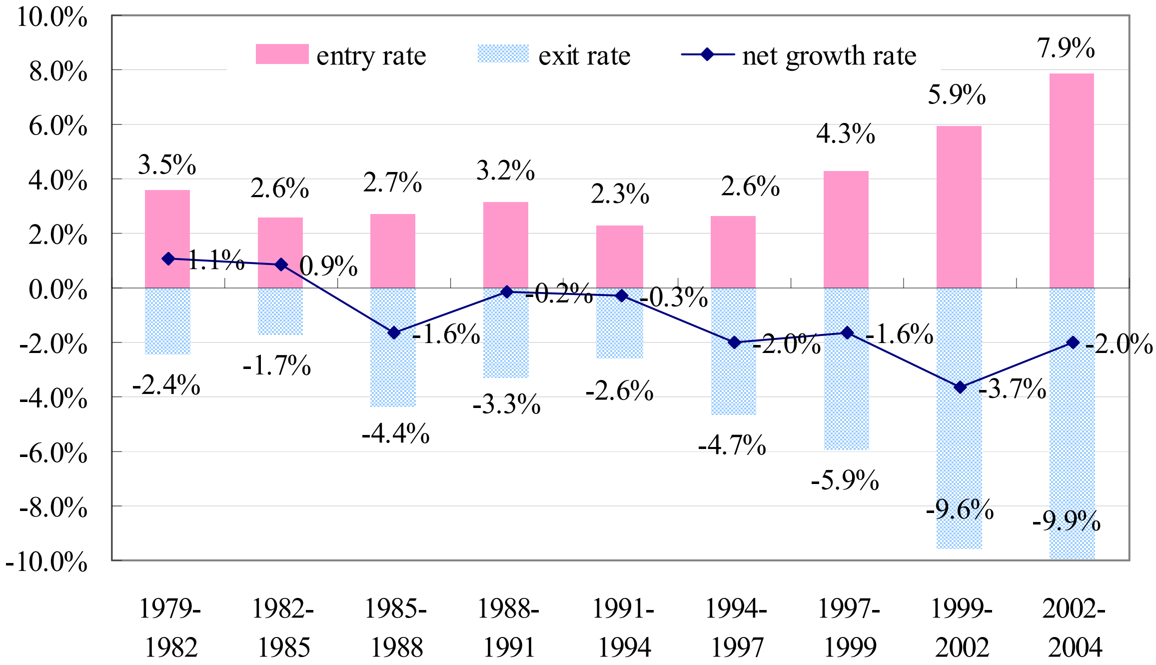
Best Practice: 7-Eleven Japan

7-Eleven Japan is the largest retail convenience store chain, with 10,826 outlets and sales of ¥2,440 billion in 2004 – twice as large as Lawson, the second-largest convenience store chain. Its profitability is also distinguished: sales per outlet for 7-Eleven are 30 percent higher than those of other convenience store chains.

7-Eleven Japan connected all its outlets to the Ito-Yokado headquarters in Tokyo by digital network (POS system) by the end of the 1980s. That system enables headquarters to monitor sales data, items and customer characteristics, such as sex and age group. Using the detailed sales data, convenience stores can reduce inventory in each outlet; and these data are also used for merchandise development.

Analysis of Sales Share by Retail Format and Variation

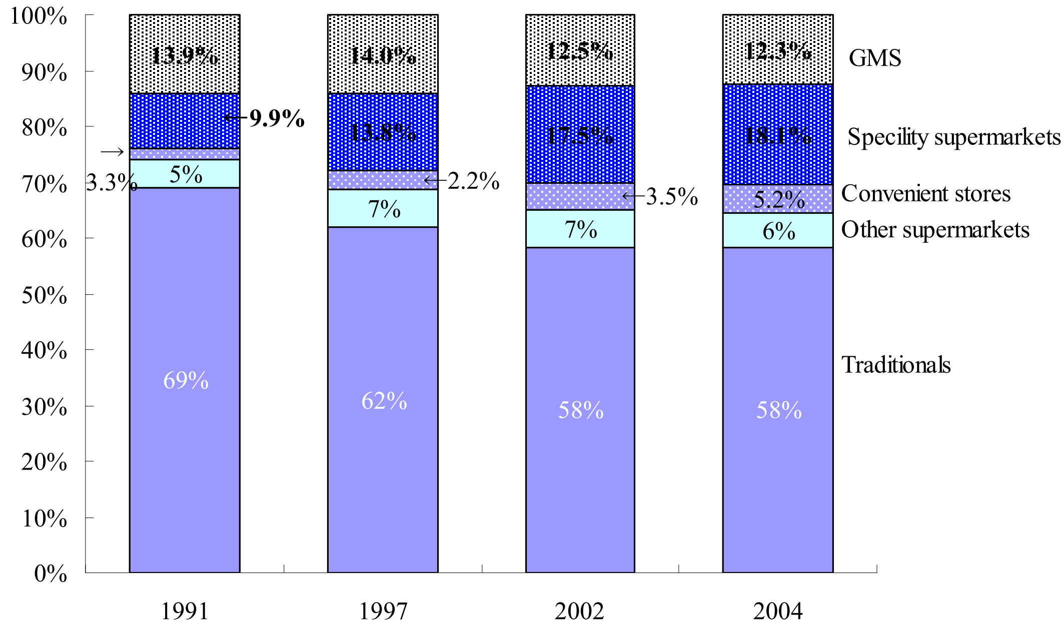
Due to the deregulation of entry restrictions for large-scale retail stores, the entry and exit rates increased in the late 1990s. Figure 4.2 presents annual average entry and exit rates of retail outlets from 1979 to 2004. Since 1997 both entry and exit rates have been increasing substantially.



Source: Census of Commerce

Figure 4.2 Annual average entry and exit ratio

From the viewpoint of international comparison, the share of small retailers, such as convenience stores and traditional stores, still remains large despite increased competitive pressure. Compared with the USA, the UK and France, we can see the share of Japanese traditional stores in food retailing is the highest (Figure 4.3).



Source: Census of Commerce

Figure 4.3 International comparison of share of food retailing by store type

However, although there are a substantial number of small stores, new retail formats and non-traditional stores emerged through the 1990s. Figure 4.4 indicates the transition of the sales share among retail formats. While the share of traditional stores has been shrinking, from 70 percent to 58 percent, specialty supermarkets and convenience stores have substantially increased their market shares. Specialty superstores are defined as retail formats with floor space of more than 250 m^2, and specializing in food, apparel or furniture and appliances. Thus specialty superstores are relatively small compared with general superstores. Convenience stores are defined as stores operating more than 16 hours per day and with a sales area between 30 and 250 m^2. Thus, despite the deregulation of the LSRS Law, Japan saw increases in numbers of small and middle-size stores.

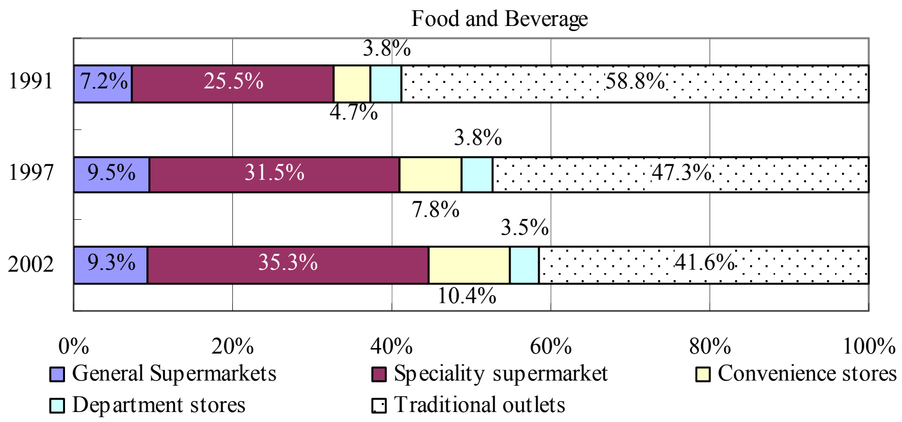


Figure 4.4 Transition of sales share by retail formats

Korea

Descriptive Overview of Retail Market

Evolution of New Retail Formats

As a result of different environments in different countries, there is no single definition of the retail sector; the situation is more complex. But in terms of goods and services, relative price, operational method and growth strategies, the retail format at present can be generally divided into six types: discount store, hypermarket, membership wholesale club, supercenter, category killer and outlet store. Discount stores feature low prices and sell non-food necessities. Hypermarkets combine non-foods with general supermarket goods. Membership wholesale clubs offer warehouse discount goods to members. Supercenters combine foods with discount store goods. A category killer specializes in a specific category. Outlet stores combine inventory with discount prices. The evolution of these retail formats in Korea, Japan and the USA is shown in Table 4.9.

Table 4.9 The evolution of retail formats in Korea, Japan and the USA

Period	Korea	Japan	USA
1950		GMS	Discount store
1960			Home center
1970		Discount store	Warehouse store
1980		Category killer	Membership wholesale Category killer Outlet store Hypermarket
1990	Discount store Membership wholesale Outlet store	Membership wholesale Outlet store	Supercenter

Source: Yeon Sung (2001).

The new retail formats can move in three directions. One is non-store marketing, such as network sales, TV home shopping, internet shopping, etc. The advance of ICT technology such as the internet and cable TV and changing consumer trends in terms of satisfaction, enjoyment, safety, personality and digital preference have affected the growth of this retail format.

Another direction is a fusion type called con-super (convenience+supermarket) in Japan; a similar retail format has started in Korea (GS25). This type is a result of mixing retail formats;

thus we can expect mixes such as a combination of supercenter and category killer. Such innovation in retail formats will speed up in the near future in a drive for competitiveness.

The third format is the entertainment shopping mall satisfying all consumer needs in a one-stop location: a compound shopping mall linked with entertainment and business. This type can maximize effectiveness by massing consumers and triggering their interest by focusing on entertainment.

Presence of MNEs

Entry and Exit of Hypermarkets

In Korea there have been four foreign retail brands: Wal-Mart, Carrefour, Samsung Tesco and Costco Wholesale. Wal-Mart and Carrefour entered the Korean market in 1996 when it opened freely to foreigners, but they exited from Korea at the same time in 2006. Samsung Tesco has operated in the Korean market since 1999, and Costco Wholesale started in 1994.

Number of Outlets

The numbers of outlets of foreign retails brands are shown in Table 4.10.

Table 4.10 Number of outlets of foreign retail brands

Year	Costco Wholesale	Samsung Tesco	Carrefour	Wal-Mart	Total
1994	1	–	–	–	1
1995	1	–	–	–	1
1996	1	–	3	2	6
1997	2	–	3	4	9
1998	3	–	6	4	13
1999	3	2	11	5	21
2000	4	7	20	6	37
2001	5	14	22	9	50
2002	5	21	25	15	66
2003	5	28	27	15	75
2004	5	31	27	16	79
2005	5 (5.4%)	40 (43.5%)	31 (33.7%)	16 (17.4%)	92 (100.0%)
2006	5	53	–	–	58

Source: Korea Chainstore Association (www. koca.or.kr).

Total Sales for Each Foreign Brand

The total sales of each foreign brand in retail are shown in Table 4.11.

Table 4.11 Total sales of foreign brands (billion won)

Year	Costco Wholesale	Samsung Tesco	Carrefour	Wal-Mart	Total
2002	439	2,147	1,375	747	4,708
2003	448	2,575	1,460	787	5,270
2004	511	3,036	1,604	776	5,927
2005	622 (7.8%)	4,600 (57.5%)	2,000 (25.0%)	780 (9.7%)	8,002 (100.0%)
2006	767	5,700	–	–	

Source: Korea Chainstore Association (www.koca.or.kr); Financial Supervisory Service (englishdart.fss.or.kr).

Features and Issues Surrounding Regulations Relating to Retail Business

Regulations on the distribution industry mainly concern new entry, operational activities, price control etc., and can be generally divided into economic regulation and social regulation. The former is designed to avoid market failure and raise the economic efficiency of authorities; the latter is for consumer safety and to control some pollutants.

In Korea the infrastructure of both law and systems was deficient, because until 1980 the strategy of economic growth primarily focused on manufacturing rather than the distribution industry. Various systems related to the distribution industry have been established since 1990: the Law of Development on Distribution Industry was passed in 1997 after annulling the Law of Promotion of Modernization of Distribution Industry in 1980. This law is designed to open the Korean distribution market to more foreign investors, and the creation of new large stores has been basically changed from a system of permission to a system of registration. Thus new establishments by foreign investors have become easier than before.

Following the Law of Development on Distribution Industry in 1997, planning and enforcement of the law is basically charged to the Minister of Commerce, Industry and Energy. After talking with other related ministers for five years, the Minister of Commerce, Industry and Energy has to put the law into force.

Regulation on opening hours has been liberalized, so it is possible to operate all day. But working hours must not exceed eight hours a day and 40 hours a week, and overtime is limited to 12 hours a week, according to labor standards.

The distribution industry has been characterized in general as concerning location and installation, so the regulations have basically focused on land, location, zoning and construction. In Korea there are many laws related to the use of land, planning of metropolitan areas, transportation and parking, etc. In principle the zoning and location for the distribution industry are restricted strictly to business areas, and the building to land ratio is restricted to 70–90 percent according to area. Moreover, stores of over 25,000 m^2 in size are levied for the purpose of limiting excessive inflows of people into metropolitan areas. Thus new entries of large retail stores in metropolitan areas have been regulated.

Social regulations include environmental preservation, health and safety and customer protection.

Best Practice of E-Mart in Korea

For best practice in the Korean retail sector we can look at E-Mart, which was set up originally in 1955, funded only by Korea investors. It gained success in the retail sector through vigorous enlargement of outlets and differentiated marketing, and ultimately took over Wal-Mart in 2006. E-Mart's benchmarking points are set out below.

Predominance in Location

The retail trade is a kind of location industry: it is most important to have an efficacious and preferred location. Because E-Mart has the largest outlet network in Korea, with 107 outlets in 2007, it has the greatest buying power. The purchase bargaining power of E-Mart has been promoted to manufacturers, enabling it to supply goods and services at a better price than any other retailer.

MD Differentiation

E-Mart has met consumers' needs by extending the number of stock-keeping units (SKUs) by 10 times, from 15,000 SKUs in 1993. And it has scaled up MD (merchandising) to include lifestyle and cultural goods as well as the basic necessities. Moreover, E-Mart has developed new products continuously to match consumers' needs, in association with manufacturers. E-Mart has opened up PB (private brand) goods in Korea, and now offers up to 3,500 products. As a result of these efforts, E-Mart has created common interest between consumers, sellers and manufacturers.

Consumer-oriented Marketing

Apart from its lowest-price policy, E-Mart has pursued better services for shoppers: not only standardized shopping windows, enhanced lighting and quick checkout counters, but also convenience facilities such as family restaurants, play areas for children, branch offices for civil appeals, etc. Such consumer-oriented marketing has been an important factor in enhancing loyalty to E-Mart.

Advanced Systems

In advanced information systems, domestic retailers have certain disadvantages compared to foreign retailers. E-Mart has established advanced information systems such as POS (point of sale), EDI (electric data interchange) and JIT (just in time) for distribution efficiency.

Standardized Construction

The high cost of land and construction for outlets is burdensome for retailers. E-Mart has standardized design and reduced construction cost by incorporating its own specialized construction company.

In summary, E-Mart as a long-term investor has matched the needs of Korean consumers, and has tried to supply the lowest prices as well as a high quality of goods and services. E-Mart ultimately has met with public approval.

Analysis of Sales Share by Retail Format and Variation

The share of supermarket sales in retail has shown an increasing trend except in 1999 and 2000, affected by the financial crisis in 1998 (Figure 4.5). The supermarket share was 4.9 percent during 1988–1998 and 7.0 percent from 1999 to 2005. On average the share of sales of supermarkets in retail is 5.7 percent during 1988–2005 (Table 4.12).

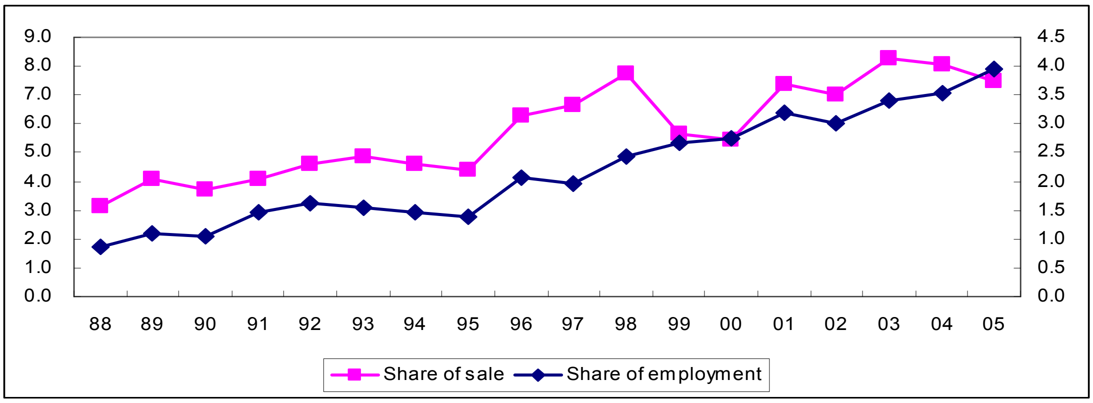


Figure 4.5 Share of sales and employment of supermarkets in the retail sector (%)

Note: Retail sales in 1994 and sales of supermarkets in 1994, 1998–2000 and 2002 are estimated by interpolation.

Table 4.12 Share of sales and employment of supermarkets and department stores in the retail sector

Period	Supermarkets		Department stores	
	Share of sales (%)	Share of employment (%)	Share of sales (%)	Share of employment (%)
1990–1999	5.3	1.8	10.9	3.7
2000–2005	7.3	3.3	12.3	2.0
1988–2005	5.7	2.2	10.8	2.9
1988–1998	4.9	1.5	10.0	3.4
1999–2005	7.0	3.2	12.0	2.1

Notes:

1. Data on hypermarkets are not available, and the definition of hypermarket does not exactly match with the industrial classification.
2. Supermarkets cover between 165 and 3,000 m^2.
3. Department stores cover 3,000 m^2 and over.

Sources: Annual Report on the Wholesale and Retail Trade Survey, Korea National Statistical Office, 1988–2004; Report on Census of Wholesale and Retail Trade, Korea National Statistical Office, 1996, 2001, 2005.

On the other hand, the average number of self-service stores during 2003–2005 was 9,473 and their average share was 1.5 percent (Table 4.13). In Table 4.14

the average share of self-service stores in total retailing sales is 2.5 percent. So the contribution of these stores in terms of number and sales is insignificant, at 1–3 percent or so.

The share of supermarket employment in the retail industry also has an increasing trend (Figure 4.5). The share of employment is 1.8 percent during the 1990s and 3.3 percent during the first half of the 2000s. On average the supermarkets' share of employment in the retail industry is 2.2 percent during 1988–2005 (Table 4.12).

The trend of department stores in share of sales is similar to the supermarket trend (Figure 4.6): it dropped in 1999–2000 because of the financial crisis, and recovered after 2000. The share of sales of department stores was 10.0 percent during 1988–1998 and 12.0 percent during 1999–2005. On average the share of sales of department stores is 10.8 percent during 1988–2005 (Table 4.12).

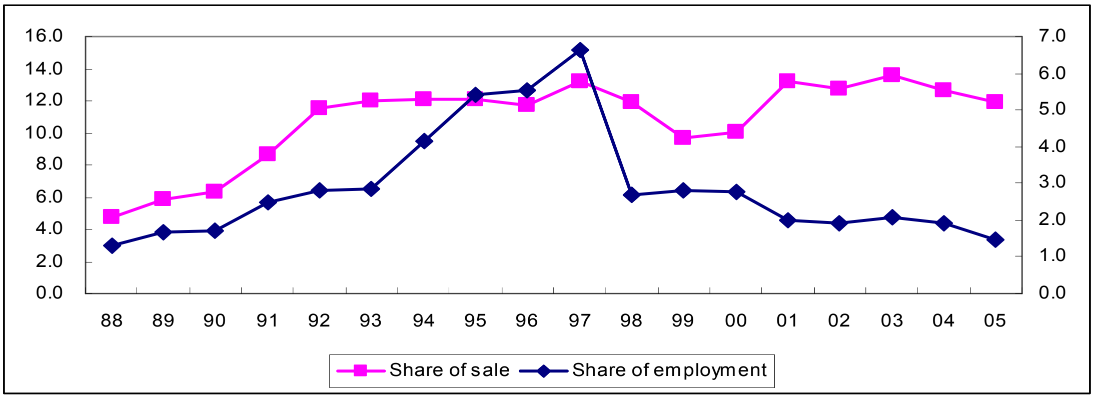


Figure 4.6 Share of sales and employment of department stores in retail sector (%)
Note: Retail sales in 1994 and sales of department stores in 1994 and 1999 are estimated by interpolation.

But the trend of employment in department stores is different to that in supermarkets. After 1997 it shows a continuous decrease. The shares of employment of department stores are 3.7 percent during the 1990s and 2.0 percent during the first half of the 2000s. On average the department stores' share of employment in retail is 2.9 per cent during 1988–2005 (Table 4.13).

Thus the contribution to the aggregate retail industry of large establishments such as supermarkets and department stores is not great in Korea, and it means that the role of medium-sized and small enterprises is relatively important in retail. In 2005 the share of retail sales in non-specialized stores, including department stores, supermarkets, etc. among total retail trade by the Korean Standard Industrial Classification is 43.5 percent in sales and 24.3 percent in employment.

Table 4.13 Number of self-service stores and their share

Year	Total retail outlets	Number of self-service stores (convenience stores)	Share (%)
2003	653,752	8,584	1.3
2004	638,017	9,802	1.5
2005	587,358	10,034	1.7
2003–2005	626,376	9,473	1.5

Table 4.14 Share of retail sales of self-service stores

Year	Total retail outlets	Retail sales (self-service stores, convenience stores), million won	Share (%)
2003	127,867,645	3,141,906	2.5
2004	131,403,330	3,297,964	2.5
2005	146,319,868	3,876,455	2.6
2003–2005	135,196,948	3,438,775	2.5

Notes:

1. Self-service convenience stores and large retail self-service outlets are not defined firmly in the Korea Standard Industrial Classification (KSIC), and they are not available in terms of floor area.
2. According to the KSIC, convenience stores are defined as those outlets which deal mainly with foods, beverages and tobacco etc. and operate 24 hours.

Malaysia

Overview of New Retail Formats

Evolution of New Retail Formats

The retailing industry in Malaysia has undergone tremendous change over the last decade. Retail space increased from 1.2 million m^2 in 1992 to almost 8 million m^2 in 2006. More new retail developments are taking place, not only in the central Kuala Lumpur/Klang Valley area of peninsular Malaysia, but also in other metropolitan areas like Johor Bahru in the south and Penang in the north.

In terms of retail formats, new, bigger and more modern formats are taking over from the traditional mom-and-pop sundry shop outlets. Hypermarkets have been very popular among consumers in recent times. This Western hypermarket concept is easily accepted by most Malaysian consumers living in urban and suburban areas. Hypermarkets are popular to the middle-income population due to the wide range of products available and generally low prices. Hypermarkets' popularity can also be attributed to high car ownership by middle-income customers, which makes shopping in large quantities more convenient. Hypermarkets also act as suppliers to small retail vendors that purchase merchandise in cash for their small businesses. Most of these hypermarket operators are foreign-owned by companies such as Carrefour, Tesco and Giant.

Large shopping centers or malls are making headway in city centers and suburban areas, and are popularly patronized by customers, particularly among the younger population. Well-known large malls are basically located in Kuala Lumpur and the surrounding areas; examples are Suria KLCC, 1-Utama, Mid-Valley, Sunway Pyramid and The Curve. Recently more new, upmarket malls have been launched, including The Pavillion and The Gardens. More are being planned in the pipeline. The Japanese Aeon Group has also been successful in managing the shopping center business. Most of its Jusco GMS outlets are located in its own shopping centers.

The department store in Malaysia is an old concept which has been around for 20 or 30 years. Recently the department store has been given a new lease of life by retail players such as the local Parkson Group and Metrojaya. Their new outlets are much more relevant to the younger population with higher disposable income. These higher-end outlets are situated in city centers or high-end suburban areas, and are located mainly as anchor tenants in large modern shopping malls.

Convenience stores have also been making good progress in the retail industry of Malaysia. The well-known 7-Eleven is the market leader with almost 50 percent market share. Convenience stores offer high-level customer service 24 hours per day, seven days a week. The success of 7-Eleven in recent years has encouraged other local independent operators to enter this sector. Of particular importance to this sector is the establishment of convenience store outlets in almost all newly built or newly refurbished petrol stations in the country. These include Mesra Store by Petronas, Tigermart by Esso, Shell Select by Shell and BHP by Boustead Petroleum.

Other new retail formats which are becoming popular with customers are “category killers” which specialize in certain product groups. such as IKEA for furniture and Courts Mammoth for electrical items and furniture. It is expected that this new format will make headway in the Malaysian retail industry in the future.

Presence of MNEs

Foreign retailers have been conducting their businesses in Malaysia since the 1970s: retail companies like Fitzpatrick’s, Cold Storage, Kimisawa and Printemps became part of the Malaysian retail scene. In the 1980s and 1990s more foreign retail companies, especially from Japan, made their way into the country, including Jusco, Isetan and Sogo. Other foreign retailers entering during that period were Makro, Tops, C. K. Tang and later Carrefour. After the year 2000 the hypermarket concept became more important. New foreign retail giants like Tesco and Dairy Farm established their presence in the form of hypermarkets to compete directly with Carrefour and several other local hypermarket operators. Other foreign entrants since 2000 are Courts Mammoth and IKEA in the “category killer” sector.

Makro’s cash-and-carry concept, which started in Malaysia in the 1980s, failed to continue in business. In late 2006 all Makro outlets were taken over by Tesco. Tops supermarkets, which took over the stores previously owned by the local Parkson Corporation, also were not able to continue in business for long. In 2003 all Tops outlets were taken over by Dairy Farm Group, which operates Giant hypermarkets and Cold Storage supermarkets.

Currently the four large foreign retail companies still in operation in Malaysia are Aeon Group, which runs Jusco supermarkets and department stores, Carrefour hypermarkets, Tesco Hypermarkets and Dairy Farm Group (Giant hypermarkets, Cold Storage supermarkets and Guardian pharmacies). Other foreign retailers of notable size are Courts Mammoth and IKEA. Multinational retail enterprises’ presence in Malaysia is part of their expansion plans in Asia.

In the convenience store category, 7-Eleven, which is held by a local franchisee company, is the largest in terms of sales and number of outlets. 7-Eleven has been around in the country for 20 years and has changed hands several times among local franchisees.

Based on figures extracted from "Who's Who in the Retail Industry" by *Retail Asia Business* magazine, published in July 2007, the number of outlets and sales value of large foreign retailers in 2006 are shown in Table 4.15.

Table 4.15 Number of outlets and sales value of large foreign retailers, 2006

	Number of outlets	Sales value (US$ million)
Dairy Farm Group (Giant)	285	1.09
Aeon Group (Jusco)	16	0.56
Carrefour	10	0.36
Tesco	11	0.29

Note: In the latest report, Tesco has increased its outlets to 18 stores and will have 27 stores by the end of 2008. Other hypermarket operators are also establishing several new outlets in the coming years.
Source: Retail Asia Publishing Pte. Ltd.

The presence of these large retail conglomerates has adversely affected the survival of local retailers. Based on complaints made by these local retailers, the Ministry of Domestic Trade and Consumer Affairs in 2002 stopped issuing hypermarket licenses to foreign hypermarket operators. However, recently the ban has been lifted and permits will be issued on a case-by-case basis. It has since been reported in the press that applications to set up retail businesses in Malaysia have been submitted to the ministry by US Wal-Mart and Germany's Metro AG.

Issues on Regulation

Since the 1970s and 1980s Malaysia has been a liberal country in the retail industry. From that time, any foreign company can set up retail businesses in the country with little regulation – proven by the fact that foreign retailers like Printemps, Kimisawa, Fitzpatrick's and Cold Storage operated in Malaysia.

The issue of regulations and guidelines arose early in the new millennium due to the influx of large hypermarket operators. The presence of these large retailers, while well received by consumers, has adversely affected local retail entrepreneurs who do not have the capital and technology to compete with the multinational enterprises.

The government, through the Ministry of Domestic Trade and Consumer Affairs, has provided guidelines on the opening of foreign hypermarkets, which are summarized as follows.

• The opening of hypermarkets in Kuala Lumpur/Klang Valley, Johor Bahru and Penang has been frozen for five years from 1 January 2004. However, all proposed developments which have already been approved will not be affected.

• The sales floor area for hypermarkets has been set at 5,000 m^2.

• Hypermarkets may not be opened in municipalities with a population of less than 350,000.[15]

• All hypermarket developments must submit plans to the Ministry of Domestic Trade and Consumer Affairs two years in advance so their proposals can be evaluated.

• For "stand-alone" outlets, an impact study on existing local retail businesses must be carried out by the development company.

• If the floor area of non-stand-alone hypermarket premises is more than 5,000 m^2, the operator must also carry out an impact study on existing local businesses.

• Hypermarkets are not allowed to operate 24 hours: allowable opening hours are from 10 am to 10 pm. However, at weekends and in special promotional periods such as festivals, store anniversaries, etc. hypermarkets are allowed to open up to midnight.

Besides these guidelines, foreign hypermarket operators are also subject to regulations imposed by the Foreign Investment Committee (FIC). Of particular importance here is that the paid-up capital of foreign hypermarket operators has been set at a minimum of RM 50 million. Granting land for development into hypermarkets will also be subject to approval by the relevant authorities, particularly the various state governments.

Very recently the ban on the opening of foreign hypermarkets has been lifted. Permits will be issued by the ministry on a case-by-case basis.

Best Practices in Retail

Jusco stores of the Japanese Aeon Group are one of the leading retailers in Malaysia. Aeon came to Malaysia in 1984 to incorporate a retail company. The following year it started

[15] Recently the ministry has decided to reduce this figure to 150,000.

operating the first general merchandise store in Kuala Lumpur. Since then the company has been very successful in launching many more general merchandise stores and supermarkets all over peninsular Malaysia. In 2008 Aeon Group has 20 stores nationwide, with sales in excess of RM 2 billion (approximately US$0.6 billion) per annum.

Customer First

The success of Aeon Group is based on its philosophy of "customer first." The company places great emphasis on product mix, based on ever-changing customer needs and preferences. Aeon stores provide a wide range of quality products at reasonable prices. In addition to international and local brand names, Aeon stores offer in-house private labels to suit different customer groups. The development of these in-house brands involves locally sourced merchandise which offers quality and value-for-money products.

Constant Refurbishment

To provide fresh-looking stores for the more demanding customers, Aeon stores are refurbished or redecorated constantly, particularly the interiors. This regular effort is also designed to combat the new competitors that come into the market at a fast rate, launching new, bigger and better stores all the time. One important aspect of Aeon's newer stores which gives an advantage over most competitors is the ample parking spaces provided by the company, well above the number required by law. With this advantage, Aeon stores are able to draw more people, as most Malaysian shoppers prefer to drive rather than use public transport.

Image Building

Aeon Group has spent large amounts of funds and efforts to build a positive image of the company. One example is a tree-planting program, which aims to raise awareness among the community about Aeon's mission of greening the environment for future generations. Another example is the charity foundation called With All Our Hearts – an initiative where Aeon Group donates a percentage of its profits to deserving charitable bodies. These image-building activities have given a positive impetus among Aeon's customers to remain loyal, and have also attracted new customers to shop at Aeon stores.

Staff Training

Realizing the importance of human resources and the shortage of skilled manpower in the retail industry in Malaysia, Aeon places great emphasis on training its own staff. For management personnel, the company for many years has run a Japan Management Training

Program, where management trainees are sent to Japan to expose them to an overseas working environment. This program teaches trainees to be more independent, so that they can be better leaders of the company in the future.

Sales Share Analysis by Retail Format

The retail industry in Malaysia has seen tremendous change over the last decade or so. There has been a strong shift from the traditional small provision/sundry shops to bigger, more modern outlets such as supermarkets and hypermarkets. These bigger outlets offer a wider range of products and low prices. At the same time, convenience stores are also becoming more important due to their clean, modern format and convenient 24-hour opening.

From the figures in Table 4.16, there has been a reduction in the number of supermarket outlets, from 349 in 1993 to 220 in 2001. This could be due to the closure of several supermarkets as a result of the 1997–1998 Asian financial crisis, which affected Malaysia quite badly. At the same time a number of large foreign retail players, especially hypermarket operators, were entering the Malaysian retail market or expanding their existing operations.

Table 4.16 The role of large establishments in the retail sector

	1993	2001
Total retailing sales (RM million)	66,160	71,651
Number of supermarkets	349	220
Supermarket sales (RM million)	3,823	3,297
Share of supermarket sales in total (%)	6	5
Hypermarket, supermarket and department store sales (RM million)	1,974	6,190
Share of hypermarket, supermarket and department store sales in total (%)	3.0	8.6

Sources: Survey of Wholesale and Retail Trades and Catering 1993, Department of Statistics, Malaysia; Census of Distributive Trade 2002, Department of Statistics, Malaysia.

Hypermarket development since the year 2000 has been tremendous. From a mere 12 outlets in 2001, numbers grew to 50 by 2006. This growth is continuing further, with the Malaysian government relaxing the regulations on the opening of foreign hypermarkets in the country. In terms of sales turnover, the hypermarket category has been chalking up much higher sales compared to other retail categories. In 2001 hypermarkets sales were at a low level of only RM 1.3 billion; in 2006, only five years later, hypermarket sales were at RM 4.1

billion. And this sales development is still continuing at an even faster rate.

The development of convenience stores is keeping pace with the development of large self-service outlets. In 1993 there were only 116 convenience store outlets in the country; by 2001 there were 537 outlets. In 2008 the number is expected to surpass 1,000 outlets. This development of convenience stores was brought about by the urban working population that patronize the outlets at late hours, since convenience stores are open 24 hours a day, seven days a week. Another reason for the fast development of the convenience store was the opening of 24-hour petrol stations. The new, larger and more modern petrol stations, in almost all cases, have convenience stores to provide shopping services to their customers. In terms of sales value, there has been a tremendous increase in the convenience store category, from a mere RM 145 million in 1993 to RM 395 million in 2001. According to a Euromonitor International forecast (Euromonitor International, 2008), by 2008 the sales of convenience stores are expected to reach almost RM 1.5 billion per annum.

Table 4.17 Breakdown of retail outlets and sales by sales format

	1993	2001
Total retail outlets	154,080	153,660
No. of large self-service outlets	429	793
Share in total retail outlets (%)	0.3	0.5
No. of convenience stores/mini-markets	1,651	3,851
Share in total retail outlets (%)	1.1	2.5
Total retail sales (RM million)	66,160	71,651
Sales of large retail outlets (RM million)	5,788	9,487
Share in total retail sales (%)	8.7	13.2
Sales of convenience stores/mini-markets (RM million)	1,394	2,019
Share in total retail sales (%)	2.1	2.8

Sources: Survey of Wholesale and Retail Trades and Catering, 1993, Department of Statistics, Malaysia; Census of Distributive Trade 2002, Department of Statistics, Malaysia.

Another phenomenon in Malaysia is the fast development of the retail industry in the southern region, besides the central Kuala Lumpur area. The southern region, more specifically known as Johor Bahru, is located opposite Singapore. Over recent years there has been an influx of Singaporean customers to Johor Bahru due to the much cheaper prices, even for the same products, compared to Singapore. As a result, new, large retail outlets are booming in this area to cater to rich customers from across the straits separating Malaysia and Singapore.

Thailand

Descriptive Overview of Retail Market

Evolution of New Retail Formats

The development of retail formats in Thailand can be summarized into six stages. The first period, 1950–1970, was the age of traditional retail. The traditional stores are small mom-and-pop shops which emphasize product variety and easy service. The trade relied on convenience and familiarity between the stores' owners and the customers in the community.

The decade 1970–1980 is the period of the department store, when the trade shifted to a new service that offered a place where customers could find new products. New foreign investors such as Daimaru Department Store entered the market, while the local investor was Central Department Store. This format brought more systematic management to the Thai retail industry. At that time there was a nationalism trend that encouraged Thai department stores to compete fiercely, and no fewer than 100 department stores opened: The Mall, Robinson and other small department stores expanded nationwide, while foreign department stores were Jusco, Tokyo, Yaohan and Isetan. The Thai retail industry changed to meet the stiff competition, and created a new format to offer a different service to the market: supermarkets or mini-marts such as Foodsland and Central Mini Mart.

In 1980–1990 competition in the industry drove retailers to develop a new format, the complex department store. Intending to offer a complete service in one large place, retailers combined department store, plaza, rental area or amusement park within a complex, such as Seaconsquare, World Trade Center and MBK.

Again, stiff competition and a change in customers' lifestyle drove the retailers to offer a more trade-style format that provided more convenience and clearer positioning. Discount stores and cash and carries started to pop up with low prices, like Siam Makro, Lotus, Big C and Carrefour. The supermarket started to split from the complex – examples are Tops, Villa Market and Foodsland. Moreover, convenience stores sprouted up too, such as 7-Eleven, Family Mart and AM/PM. This split-out concept started in 1995.

In 1997–1998 there was a recession period, which led to the acquisition of Thai retail businesses by foreign investors. The entry of foreign investors brought the new hypermarket retail format to Thailand, such as Tesco, which took over Lotus from CP Group. With better capacity and sufficient funds, the retail system was shifted to another level. This recession not only affected Thai retail but also Japanese investors. Many Japanese department stores faded away from the market; only Isetan and Jusco are left.

Competition always causes a revolution in the Thai retail industry. Since 2002 the development and expansion of retail businesses have focused on spreading branches to cover the market and provide more convenience to customers. The specialty store format that provides a complete range of products in a specific line, such as Home Pro (home and furnishing), Boots and Watson's (health and beauty), has emerged in the market on both large and small scales, while the department store has slowly faded away from the market.

Presence of MNEs

Table 4.18 MNEs in Thailand

Name	**Year of entry**	**No. of outlets**	**Total sales 2006 (million baht)**
Tesco Lotus	1998	295	14,785
Carrefour	1996	25	23,881
Siam Makro	1994	42	57,407
Boots	1996	121	2,497
Watson's	1996	144	4,392
Daiso	2003	15	152

The entry of the multinational enterprise in the Thai retail industry started in 1994 with Makro, the only cash-and-carry retailer in Thailand (Table 4.18). Makro led grocery retailing for a short while before the penetration of Carrefour and Tesco Lotus. Since then the competition in the grocery sector has been intense. Hypermarkets offer comparatively low prices for single products and allow customers to buy singly; cash and carry focuses on bulk sales and accepts only cash. It is hard to fight with other grocery retailers in the market, so Makro decided to be clear on its position as a wholesaler, aiming to cater to both independent grocers and small restaurants and food-trolley owners.

Lotus is a Thai hypermarket founded by CP Group in 1995 and taken over by Tesco in 1998. Tesco Lotus is the most threatening player in grocery retailing given its rapid expansion from small to large scale, with Lotus Express (small size) and Lotus Market (medium size). The rapid expansion of the hypermarket in Thailand gradually put a lot of independent grocers out of business. This failure affects cash and carry directly, as independent grocers are its major target group.

In the health and beauty retail sector, the giant players are Boots and Watson's. Both use a private-label strategy to generate more margin. Watson's tends to offer more beauty products, as the brand is not very pharmaceutical-oriented, unlike Boots. Watson's focuses on outlet expansion into highly populated areas or high-traffic shopping centers and hypermarkets. Advertising and price promotions are also deployed to strengthen brand awareness and increase foot traffic to stores.

Boots offers a wider selection of private-label products, including dietary supplements, generic drugs, beauty products and other toiletries. Boots' private-label ranges became one of the major selling points for customers to shop in Boots, regardless of pricing.

Regulation in Retail Markets

Before 1997, retail business was reserved for Thais. Foreigners could not run a business except by partnering with Thais; examples are Makro, Tesco partnering with CP Group and Tops partnering with Central Group. After the 1997 crisis, however, Thailand opened more to foreign investment. Changes in Thai law and regulations support investment from overseas, such as the change in the Town Planning Act adjusting the distance between large-scale retail stores and a city from 15 km to 2 km.

On 14 November 2007 Thailand's National Legislation Assembly accepted the draft Retail and Wholesale Business Act, which is the first Act dealing directly with retail and wholesale businesses in Thailand. Currently the Act is not yet effective, as it needs to be approved by the parliament. Its main objectives are to protect traditional trades which are affected by stiff competition from modern stores and large-scale foreign retail firms, and also to help the local retail and wholesale businesses to survive in the modern business environment.

By this Act, any business that falls into one of the following categories has to get permission to operate.

• Retail or wholesale units that cover 1,000 m^2 upwards (the size including all floor space both inside and outside the building, rental area and inventory area in the same area or connecting to the selling area).

• A retail or wholesale business that has more than 100 million baht of revenue per year. This amount includes the revenue of every branch in the previous year or estimated revenue of the first year of a business plan.

• A retail or wholesale business that is granted the right to use the intellectual properties or other rights to run a business within the specific time and area detailed above; and such business is under the control and support of the granter and the grantee has to pay for the grant.

Who Controls the Regulations?

The Retail and Wholesale Business Committee consists of the Minister of Commerce as president, eight members from government, four specialists assigned by the cabinet and five representatives of a separate private institution or organization assigned by the cabinet. This committee is responsible for standardizing stipulated policies and regulation for the control, support and development of business.

Other Related Acts and Laws

The Town Planning Act 1975 sets the commercial/trade area and habitat area, and limits the number of the large-scale retail stores in each area. The Building Control Act 1979 controls areas where construction is not permitted, and also modification of buildings. The Consumer Protection Act 1979 protects consumers in terms of advertising. The Product and Service Pricing Act 1999 prevents unreasonable lower or higher prices from retailers or wholesalers. Finally, the Trade Competition Act 1999 prevents monopolies

Best Practice in Thai Retail

Central Retail Corporation (CRC) can be introduced as best practice in the Thai retail industry. It has won two top awards: Top Retailer 2005 Golden Award, Thailand, and Best of the Best Award, Asia Pacific, in the Second Retail Asia Pacific Top 500 Awards organized by Retail Asia, Euromonitor International and KPMG.

Founded in 1947 by a Thai-Chinese family, Jirathiwat, Central Trading was a pioneer retail store providing both local and international goods, including a variety of garments, shoes and cosmetics from Europe and the USA. Nowadays it has many retail business formats and more than 300 subsidiaries, and enjoys net sales of more than US$1.5 billion per year. The key success factors for CRC can be described as follows.

Initiative

CRC was the first department store in Thailand to introduce price labels, a cashier system and barcodes. It is also the first to combine a supermarket with a department store, and offer one-stop shopping to Thai consumers.

Learning from Mistakes

CRC's path is not entirely scattered with rose-petals: it had to close one of its branches in Chinatown because of misunderstanding the consumers. But after that mistake, it started learning about consumer behavior and continues to do so, leading to successful site selection. No other branch of Central has been closed to date.

Segmentation

When the department store market was saturated by other competitors, Central started a new retail concept that focused on the niche high-end target and offered a new modern shopping experience, named Zen. It is also acquired Robinson Department Store in 1995.

Broad Expansion Strategy

Due to the high competition in the department store market, Central looked for new areas to expand its business and spread out into many retail formats, including Tops (supermarket), Power Buy (electric appliances), Supersports (sports-related products), B2S (bookstore), HomeWorks (home and furnishings), Office Depot (office appliances), Watson's (health and beauty joint venture), Big C (hypermart joint venture) and Central Online (e-business). With this expansion strategy there is some sales cannibalization, but the risk is distributed as well.

Beside these factors, CRC's business philosophy to offer "Quality products at reasonable price and excellent service" is implemented in every branch. Offering exclusive brands that customers can only find at Central and also a free repair service are key to ensuring customer loyalty and corporate image.

Currently, CRC's 382 outlets consist of Central Department Store (13 stores), Robinson department store (20), Zen department store (1), Tops supermarket (91), Supersports (40), Power Buys (82), B2S (108), HomeWorks (8) and Office (19).

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Chapter 5

Case Study: Convenience Stores in Thailand

Figure 5.1 Map of Thailand

Background

Definition of Convenience Stores in Thailand

In Thailand, convenience stores can be defined as neighborhood grocery stores: small self-service retail outlets with 50–300 m^2 of floor space, stocking mainly fresh food and open 24 hours per day and seven days a week. Convenience stores balance price positioning with value added to match customer demand; these popular stores are used by 85 percent of shoppers at least three to four times a week.

History of Convenience Stores in Thailand

Convenience stores developed from a variety of sources early in the twentieth century. They drew upon characteristics of many retail establishment types, such as supermarkets and hypermarkets. The convenience stores aim to make neighborhood shopping easier and more complete, in line with shoppers' needs. Shoppers, increasingly pressured for time, start using convenience stores for top-ups and impulse purchases. Convenience stores thus stand to do well in markets with busier lifestyles, an aging population, more numerous snacking occasions and smaller households.

How About the Mom-and-Pop Shops?

The mom-and-pop (M&P) grocery stores have long been traditional features of the Thai grocery market. They operate by lower costs; they do not hire professional managers and are thus generally less efficient and do not set goals or targets, nor undertake the strategic planning that is crucial for growth and survival in the highly competitive retail environment. Most lack access to credit from financial institutions, networking and partnership in business. This is primarily due to the traditional way of running a business.

Convenience stores, with an emphasis on higher-margin products to counterbalance their intrinsic lack of scale and other value-added elements, still leave a space for M&P shops to survive in the market. M&Ps have a tacit knowledge that enables them to serve their customers; they know every customer and his/her family personally. This is the charm of M&P shops, and it will enable them to stay in the market despite the fierce competition.

Business Environment

The business environment can also significantly impact a retailer's ability to develop, operate and compete with certain formats in the marketplace. It includes the following:

• cost and availability of real estate
• regulatory environment
• state of distribution infrastructure
• state of technology.

Understanding Format Success

Convenience shoppers highly value three main factors (Figure 5.2): flow up (convenience), easy access to daily necessities (service) and easy to reach (location). The convenience format occupies a niche position in the Thai grocery market (Table 5.1).

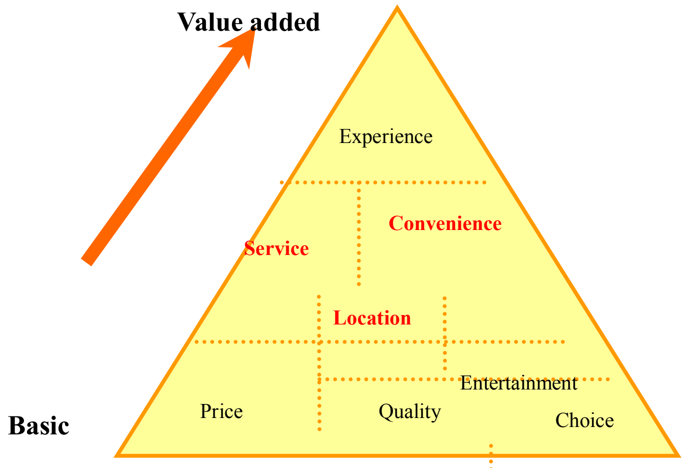

Figure 5.2 Convenience shoppers' attribute focus: consumer needs in their implied hierarchy, from "basic" to "value-added" in Asia

Table 5.1 Current format overview in Thailand

Format	Location	% of food	Space	Opening	Price
Hypermarket	Can be built no closer than 15 km to commercial town centers	45–60	>1,000 m^2	7am–12pm every day	Low price
Supermarket	–	70	500–3,000 m^2	10am–10pm every day	Value price
Mini-mart	–	20	100–300 m^2	7am–10pm every day	Value price
Convenience store	High-traffic locations and neighborhoods	40	100–300 m^2	24 hours a day, seven days a week	Above-average price compared to supermarket

The Emergence of Convenience Stores in Thailand

Convenience stores emerged in Thailand in 1991, as a result of efficient logistics management that allowed lower prices than in M&P shops. With competition among hypermarkets increasing, convenience stores are seen as an important growth format for the future. These stores serve metropolitan customers' needs to buy groceries and pay bills in a location near their homes, schools and offices. In 2003 zoning regulations took effect; the regulations, which apply to all provinces outside Bangkok, limit large formats (over 3,000 m^2 of retail space) to locations at least 15 km from an urban center. Since then the numbers of small-size convenience stores (50–300 m^2) have increased every year nationwide; there are now approximately 7,700 convenience stores in Thailand, representing sales of 45,000 million baht in 2007 (Figure 5.3).

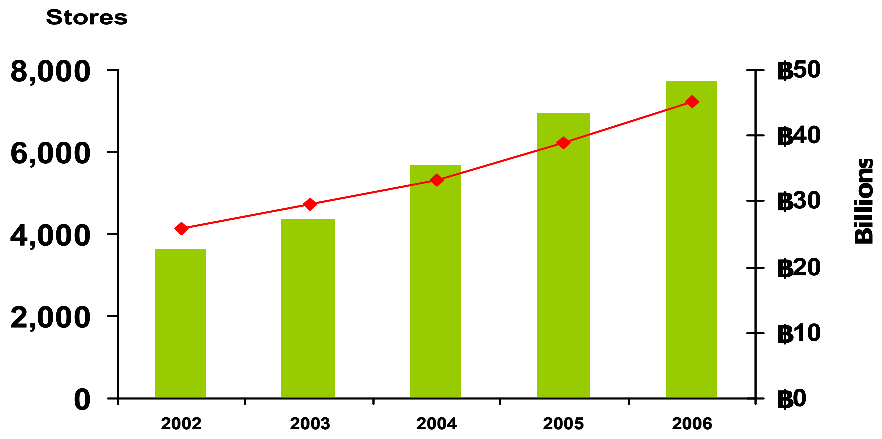

Figure 5.3 Number of convenience stores and sales in Thailand, 2002–2007

Source: Market Report, AC Nielsen (Thailand).

Market Conditions and Competition

In 2007 the retail market experienced a slowdown due to many external factors that affected purchasing power and consumer confidence, including high oil prices, the political situation, flooding, bird flu and unrest in the south of Thailand. Thus the retail industry in the tax system is expected to grow 3.4 percent, or 2.4 trillion baht in terms of value, amid intense competition, especially in modern chain-store retailing, in terms of both store expansion and marketing tactics employed to attract customers. Presently, consumers are more careful in buying products and give more consideration to value for money. Higher oil prices have affected consumption behavior, causing consumers to reduce purchasing frequency, buy more at one time and buy from retail outlets near home or the office. Serving the changing trend in customer behavior, and due to the zoning law, large-scale retailers have changed their business concept and focused more on small-scale stores (Figure 5.4). Consequently, convenience stores have become an interesting segment for investment by both current players and retailers from other segments. Convenience store expansion has been accomplished through both corporate stores and franchise stores.

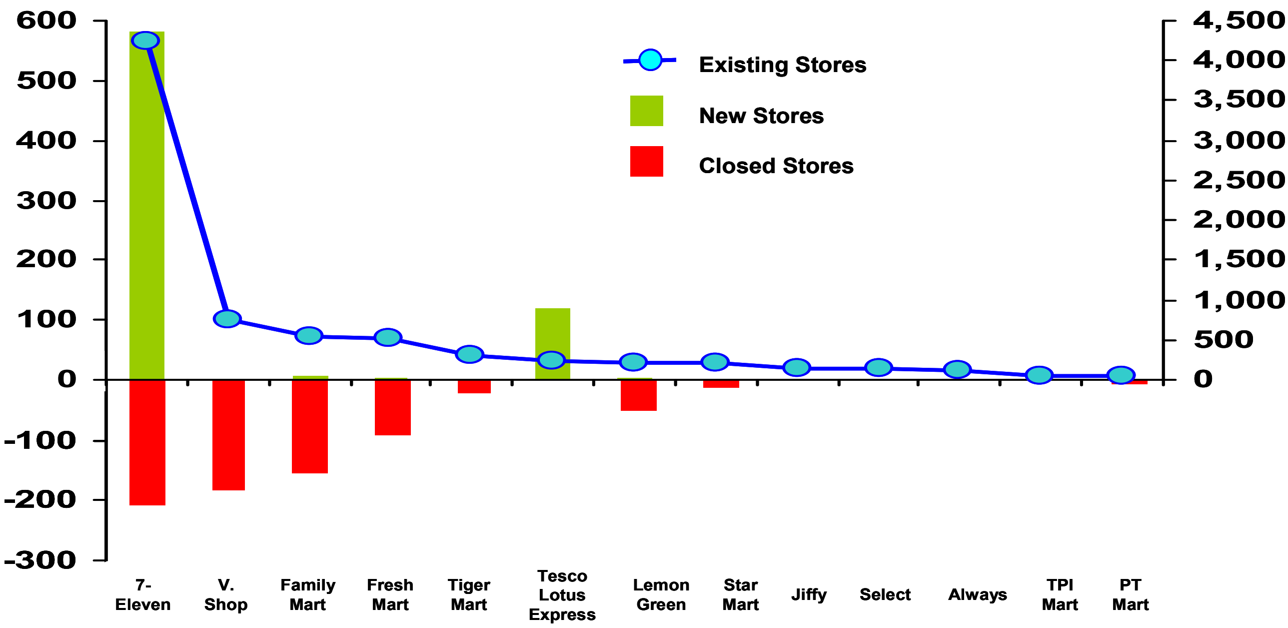

Figure 5.4 Convenience chains by store numbers, number of new stores and closed stores, 2006, and planned new stores for 2007

Source: C.P. 7-Eleven annual report (2007).

Case Study of 7-Eleven in Thailand

Business Objective

The purpose of 7-Eleven is to be the leader in the convenience store business in Thailand, serving customers according to changing demand.

Business Characteristics

C.P. All Public Co. Ltd., formerly C.P. 7-Eleven Public Co. Ltd., was set up in 1988 by the Charoen Pokphan Group to conduct convenience store business in Thailand under the 7-Eleven trademark. It was granted a license to use the trademark from 7-Eleven Inc. USA. In 1989 the first 7-Eleven outlet in Thailand was opened on Patpong Road.

The business began by managing a network of stores scattered in communities across the country. In 2006 7-Eleven expanded the network of stores to all 76 provinces, covering 49 percent of the total 920 districts. At the end of 2006 there were 3,784 7-Eleven stores nationwide in Thailand, giving it the fourth-largest 7-Eleven network in the world after Japan, the USA and Taiwan.

Features of 7-Eleven Stores

There are three types of 7-Eleven stores: corporate, franchise and sub-area license (Figures 5.5 and 5.6).

• *Corporate stores*. This type is handled by 7-Eleven: the company invests in the retailing equipment, store decoration and inventory.

• *Franchise stores*. This type gives an opportunity for any person, including employees, to operate their own 7-Eleven stores under a state-of-the-art franchise system. The company offers close assistance in management and administration, product assortment and the financial system; it runs regular nationwide promotional and advertising campaigns and provides personal advice on new management techniques. A franchisee can choose either a new location or an existing store. In the case of a new location, the company will help with a feasibility study without charge. The terms and benefits of the franchise agreement depend on the type of franchise.

• *Sub-area license stores*. The company has sub-area license agreements with third parties to operate 7-Eleven stores in regions where the licensees themselves are responsible 7-Eleven store management. The company provides assistance and support. Today there are four sub-area license agreements, in Phuket, Yala, Chiang Mai and Ubon Ratchathani.

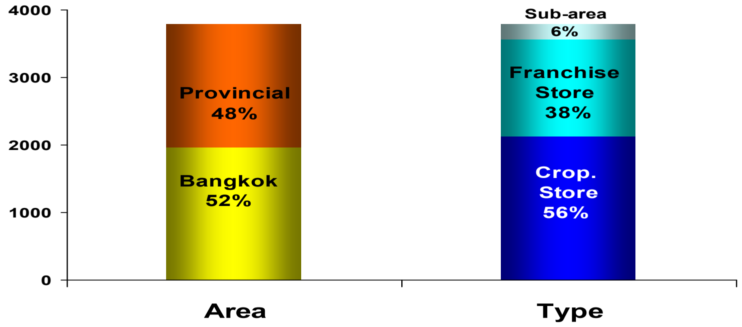

Figure 5.5 The features of 7-Eleven stores separated by area and type, 2006

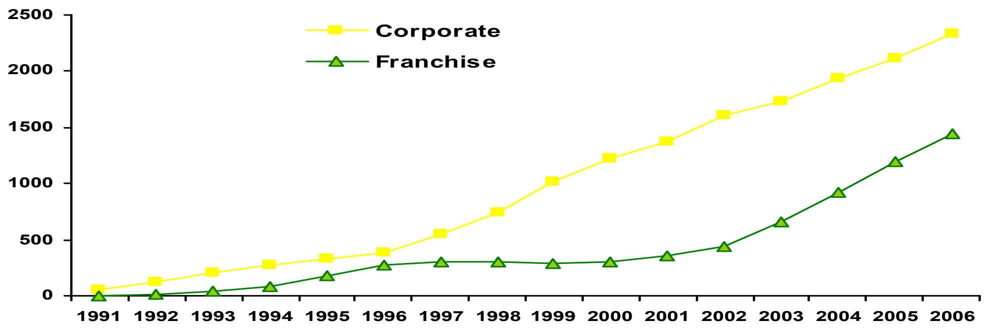

Figure 5.6 Increase in numbers of corporate and franchise stores over 16 years

Source: C.P. 7-Eleven (2007) *Annual Report*.

Company History and Business Expansion

The company has continuously invested in businesses supporting the convenience store sector in Thailand. Other milestones are as follows.

1998: Granted the 7-Eleven license from 7-Eleven Inc. USA. Established a company to operate convenience stores in Thailand under the 7-Eleven trademark.

1990: Changed the company name from C.P. Convenience Store Co. Ltd. to C.P. 7-Eleven Co. Ltd., and opened the first 7-Eleven outlet at Soi Patpong, Bangkok.

1994: Established a bill payment collection service under the name Counter Service Co. Ltd. (CS).

1996: Established a business for the manufacture and sale of frozen foods and bakery products under the name C.P. Retailing and Marketing Co. Ltd. (CP RAM).

1997: Officially opened DC4, a distribution center in Pathumtanee province.

1998: Became a public company and changed the company name to C.P. 7-Eleven Public Company Limited. Opened the 1,000th 7-Eleven store in Thailand.

1999: Established the business of sale and maintenance of retail equipment under the name RetailinK (Thailand) Co. Ltd.

2001: Incorporated Thai Smart Card Co. Ltd., with eight alliances to offer product and service payments through the Smart Purse electronic cash card.

2002: Celebrated the 2,000th 7-Eleven store in Thailand. Received ISO 9001: 2000 certification from SGD (Thailand).

2003: Established a business of information and technology support under the name Gosoft (Thailand) Co. Ltd. Established a business of advertising support under the name MAM Heart Co. Ltd. Offered shares to the public (IPO) and listed the company on the Stock Exchange of Thailand under the trading ticker CP7-11. Dynamic Logistics Management Company Limited (DM) was established to provide logistics services.

2004: Established Suksapiwat Co. Ltd. to provide educational services through Panyapiwat Techno Business, a retailing vocational school, with the objective of supporting the government's policy to reform education and fulfill demand for expansion of the retail industry for the country's future development. Awarded the Thai Quality Class (TQC) by the Thailand Quality Awards 2004.

2005: Panyapiwat Techno Business officially opened, the country's first vocational school for retail education. Became the first convenience store in Thailand to offer payment for products and services by Smart Purse, a digital cash card.

2006: Established Panyatara Co. Ltd. to provide training and seminar services. Officially opened a new distribution center (DC5) at Lat Krabang. Officially launched the Smart Purse card with 500,000 current cardholders. Received ISO 9001: 2000 certification in quality management from the Management System Certification Institution. Received QSS Standard under ISO 9001: 2000 certification in convenience store management from the

Management System Certification Institution. Received ISO 14001: 2000 certification in environmental management systems at CD4 and CDC from Environmental Management System Management. Received OHSAS 18001: 2000 certification in occupational health and safety systems at CD4 and CDC from Environmental Management System Management.

Marketing and Competition

7-Eleven targets a wide range of customers and has been expanding its store network to local residential and business areas. Customers are segmented into three groups: children and teenagers; working people and adults with low or medium income who prefer convenience and trendy products; and motorists and passengers who frequently use PTT gas stations (where 7-Eleven stores are being located). On average, a total of 4 million customers nationwide per day purchased products and services from 7-Eleven stores in 2006. 7-Eleven also uses geographic segmentation to divide the market into Bangkok, its vicinity and provincial areas. Thus the 7-Eleven target market depends on store environment and back-up; so, for example, if a 7-Eleven store is located near a school, the target must be students and teachers.

The company's direct competitors are modern small-scale retailers, both existing stores and shops under a chain-store format, while its indirect competitors are fast-food outlets, coffee shops and stores that provide an alternative for customers. Although increasing numbers of small retail stores have been opened by both existing players and newcomers, there is still opportunity for continued outlet expansion to serve consumers who increasingly demand convenience and speed. Government policy supports investment in public utilities, and expansion into communities is another factor aiding small-scale retail store development.

Product and Service Development

7-Eleven continuously attempts to source and select products and services that are of high quality, are different from those of competitors, satisfy the demands of different target groups and are in line with new trends and market changes. Products in 7-Eleven stores are categorized into two major groups: food and beverages, accounting for 47 percent, and non-food products, including phone cards, accounting for 53 percent. 7-Eleven stores try to cater to customers' convenience needs in a variety of different ways, such as payment facilities for as many as 300 services, ATM machines in 2,400 branches, money transfer through Love Link cards, catalog orders and distributing life assurance.

Different demands of various customer segments have led to the selection and development of products and services to satisfy each segment. The process begins by recognizing customers' needs, creating a product concept, developing the taste and pilot testing in stores; after that, feedback helps to confirm successful store management techniques and solve management problems before actual implementation.

The company selects more than 3,500 churning items and adopts an FBO product strategy (first sold at 7-Eleven stores; best selection of products; or only sold at 7-Eleven stores). Team merchandising researchers and specialists work with suppliers to develop good-quality, differentiated products which correspond to customer demand.

In terms of business innovation, 7-Eleven has developed new businesses, services and store models with numerous products and services to provide customers with greater choice. An example is the Third Room Project, which combines 7-Eleven and Book Smile.

7-Eleven has made progress in improving the supply chain and lifting manufacturing standards in order to deliver the best products to customers. It has been involved in the development of production processes, raising hygiene and safety standards in factories and allaying customer safety concerns. The quality process involves product selection, delivery and storage, to comply with global good practice. In distribution centers, 7-Eleven uses the GMP (good manufacturing practice) standard to control quality.

Delivery of Products and Services

7-Eleven intends to develop the value chain to deliver the best to customers continuously. Product distribution is an important part of the value chain. 7-Eleven has expanded the number of distribution centers in strategic areas to accommodate new store expansion and distribute products efficiently and effectively. In addition, it has introduced new technology, such as a digital picking system and accurate and fast data inventory management.

7-Eleven has distribution centers in Bangkok and the provinces for both general merchandise and products requiring controlled temperature. Every process has very strict quality control; on-time delivery and increased delivery frequency ensure complete, correct and timely supply of products to stores, and product quality is maintained until reaching customers. Also, 7-Eleven has achieved GMP standard certification at the distribution centers to guarantee products in terms of quality and safety before delivery to customers.

In 2006 7-Eleven started up a chilled distribution center (CDC) in Bangkok and bought a delivery truck with temperature control in order to keep chocolate products in good quality during delivery. CDCs were also set up in Chiang Mai and Surat-thani in order to support efficient delivery now and in the future. These innovations have improved sales of chilled products (Figure 5.7).

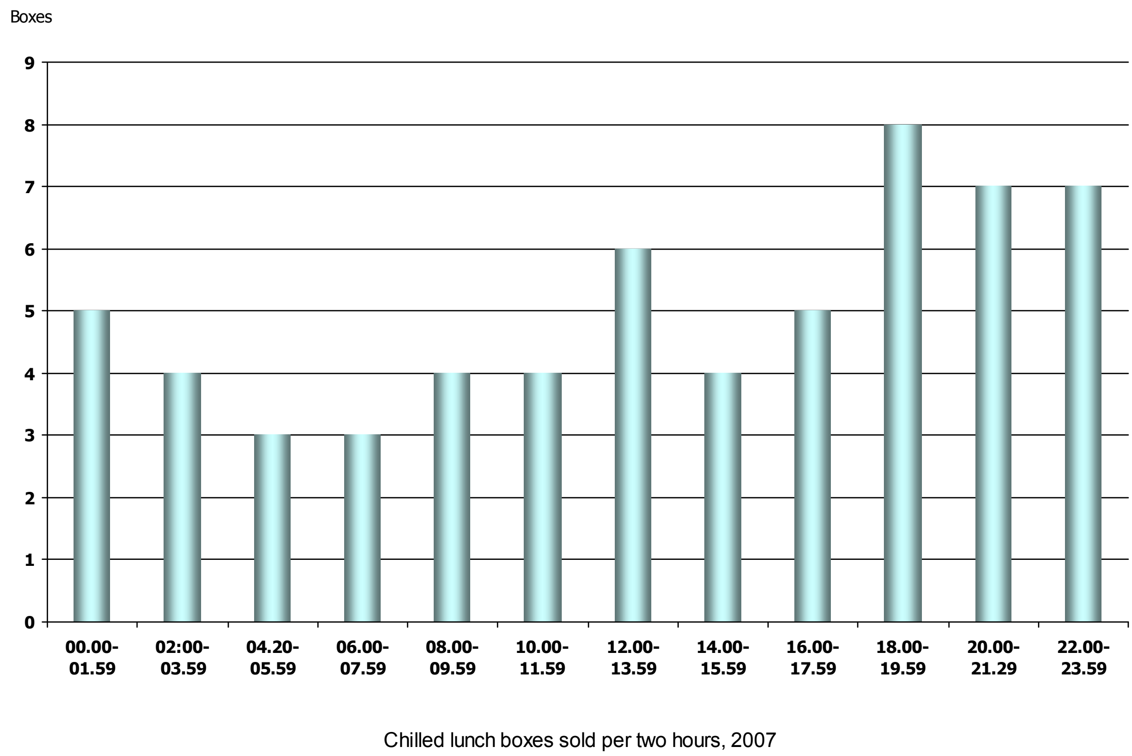

Figure 5.7 Chilled lunch boxes sold per two hours, 2007

Information Systems

As in Japan, the use of information systems for ordering, inventory control and merchandise development is fundamental to convenience stores in Thailand, including 7-Eleven.

Apart from sales data, 7-Eleven instigated the recording of each customer's profile (gender and estimated age) before a sale is completed in the POS cash register. This information is useful to estimate sales trends and forecast sales volume in the future (Figure 5.8).

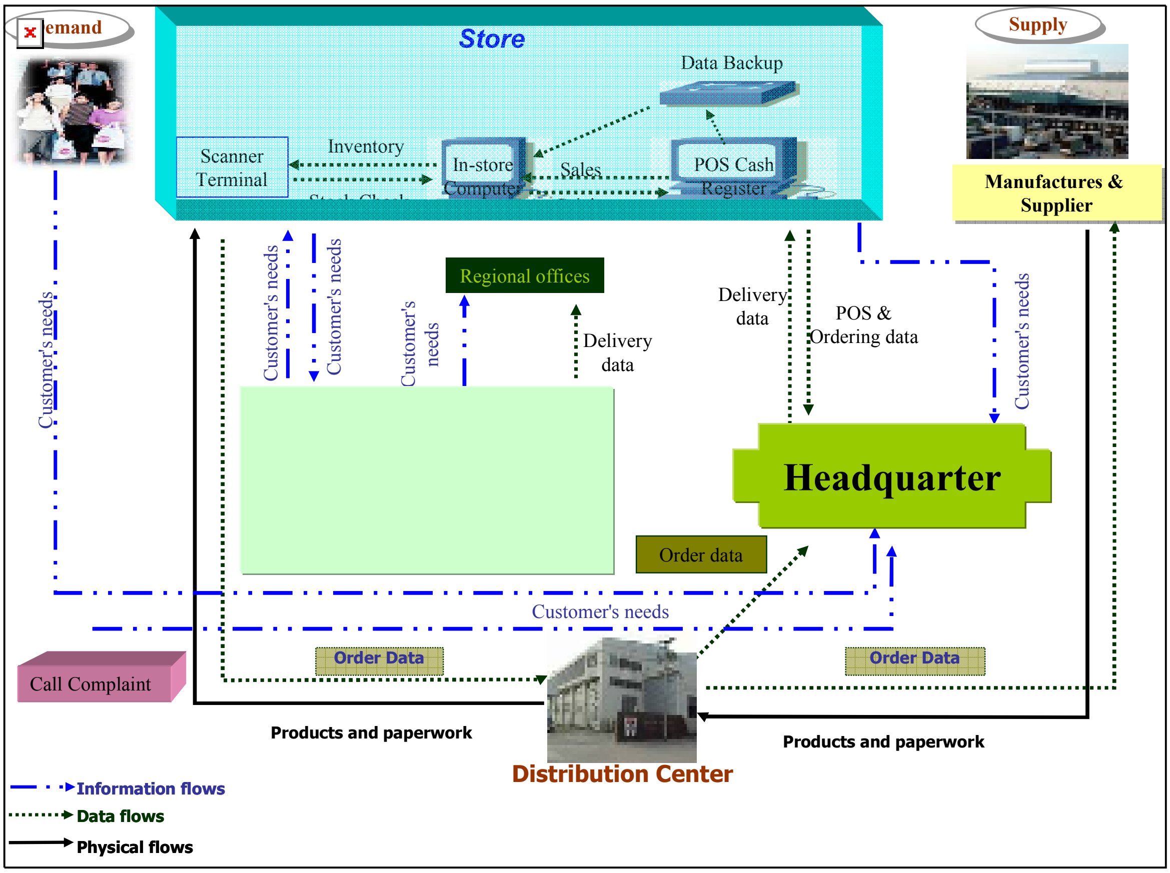

Figure 5.8 7-Eleven Thailand information, merchandise and customer needs exchange system, 2007

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