

CRNM PRIVATE SECTOR TRADE BRIEF

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THE CARICOM AGRI-FOOD DISTRIBUTION SERVICES INDUSTRY

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IN THIS ISSUE: You get a peek into a research paper on the CARICOM agri-food distribution services industry. This research will probably be cited in years to come as a seminal piece, as it seeks to look at a forward linkage industry from agribusiness. We thank everyone who participated in this study. The research paper also provides useful negotiating recommendations for improving the industry's competitiveness. The following is an extract from the study. As always, we welcome your views.

Food Retail Sector

The CARICOM food retail sector is roughly estimated to have over 15,000 firms which together employ over 85,000 people and generate around US\$4,555 million in sales. The sector has experienced strong growth in the more developed CARICOM food retail markets where larger numbers of international brands and a growing number of national brands can be found. Similar but more delayed patterns are being experienced in CARICOM's less developed markets.

There are two international retailers in the region: Price Smart and Winn Dixie. PriceSmart is trading in services in three CARICOM states, while Winn Dixie recently sold its operations in the Bahamas. However, over the last five years, regional conglomerates with food retail operations, such as Neal & Massy, BS&T, and Goddard Enterprises, have been actively making equity investments across the region, either directly in supermarket firms or indirectly through their parent companies. Other distributors such as Grace from Jamaica, Laparkan from Guyana and Cirkel from Suriname have been exploring new markets across the region.

Industry members report that CARICOM retailers are exploring opportunities for mergers and acquisitions but there appears to be little interest among the food retailers in exporting retailing services outside the region at this time. However, local retailers are concerned that future investment by foreign competitors in CARICOM will have a significant impact on their operations and profitability. However, food service firms are going global; Barbados-headquartered Goddard's catering is in 21 countries in the Americas, and Jamaica's Island Grill wants to go hemispheric. Prestige (the KFC franchisees in Trinidad & Tobago) has rights for Central America and Rooprams Roti is already established in the European Union. Wolly's from Suriname is seeking to establish in Aruba and Holland, and the Coffee Mill (Jamaica) has established in China.

It is important to note that there are several leading international retail brands knocking on CARICOM's door steps. Carefour which is considered (by the Europeans) to be the leading international retailer, by virtue of the scope of their operations and the number of countries in which they operate, is in the Dominican Republic and Latin America. Wal-mart, which is by far the global leader, has recently become the market leader in Central America. So the real possibility exists that global retailers may eventually (in the short to medium term) target the Caribbean/CARICOM in spite of the region's relatively small size. Moreover, a very important point to support the above and which many regional retailers have dismissed, is that US-based PriceSmart is already in several other very small Caribbean states and this somehow challenges the perception that "we are too small for the big retailers to come into our markets".

Quick Service Restaurant (QSR) Sector

CARICOM's QSR sector is roughly estimated to have over 2,100 firms, employing over 27,000 people and generating over US\$1,000 million in sales. The sector too has experienced strong growth in the more developed CARICOM food retail markets where larger numbers of international brands and a growing number of national brands can be found. Similar but more delayed patterns are also being experienced in the region's less developed markets.

The top 35 firms, dominated by international brands, are estimated to have more than 550 stores employing over 16,750 people and accounting for over US\$380 million or 35 per cent of the sector's total estimated sales. The leading firms include mainly international and a few leading national brands. QSRs featuring chicken menus have, by far, the largest share of the market (38 per cent), reflecting the dominance (85 per cent) of poultry meat in the diets of CARICOM people. Several other segments, whose focus is on Chinese, Caribbean, burger and pizza/pasta menus, have between 11 per cent and 16 percent of the market. Restaurants with Chinese food have been growing rapidly as a result of the influx of Chinese immigrants across the region. Other segments are explored in the study such as sandwiches and seafood while lesser attention was paid to casual dining and snacks sub-sectors.

Larger members of the industry, which tend to be international chains with strong marketing, operations, technology and supply chain support, report moderate international competitiveness while smaller and more indigenous brands report greater sensitivity to competition. Most industry members report that new competition in the sector has stimulated consumer demand. Several more established industry members report that the industry has played a key role in creating new businesses in the supply chain and raising the standards to meet those of the international brands. In addition, several agri-food suppliers that have met these standards now qualify to export products to any other franchises in the international QSR chain.

Over the last five years, regional operators have been expanding their efforts to export their brands within the greater Caribbean. However, foreign QSRs, owned by expatriate Caribbean nationals, have begun to develop formats based on Caribbean cuisine in the USA and the UK, and seem to be benefiting from first mover advantage in these markets. Several CARICOM QSRs have also attempted to export services outside the region, but with little success, and others are planning to do so in the short to medium term. The regulatory environment for this sector in CARICOM has few restrictions, and these exist in only three countries, Barbados, Guyana and Suriname. Restrictions are also in place in the Bahamas, which is not part of the CARICOM Single Market and Economy (CSME).

Food Import Distribution Sector

There are several types of wholesalers, manufacturer distributors, importer distributors, importer retailers, and domestic wholesalers doing business within CARICOM. The more developed markets tend to import higher proportions of internationally branded products. In Belize and Guyana which produce more of their own food, domestic manufacturers and wholesalers play a greater role in distributing the bulk of food consumed locally. Importer distributors import on average more than 90 percent of their sales, of which 10–40 per cent emanate from within CARICOM. Only a small number of distributors operate in more than one country in the region. They find it difficult to achieve economies of scale because of the manner in which the maritime freight system operates in the Caribbean.

A growing problem which distributors have identified, is the growth of “parallel trading” in the region. This occurs when regional firms import from a wholesaler in an exporting country, rather than from the manufacturers which have distribution agreements. Generally, larger distributors considered themselves able to cope with new competition due to their investments in distribution assets, strong trade relationships, local market knowledge, and ability to deal with local public-sector agencies. CARICOM distributors have been developing several strategies to address growing competition. They include consolidating the distribution base (BS&T's SBI Distribution), rationalizing the portfolio of firms, brands and improving service levels (Geddes Grant Guyana and Jamaica), integrating backwards, developing retail brands (Grace-Kennedy's Grace brand, Goddard Enterprises' Eve brand), integrating forward (Goddard Enterprises' acquisitions in the food distribution sector in Grenada, St Vincent, Barbados, and a new joint venture in restaurants with Island Grill). Distributors were well acquainted with trade in goods issues, but were largely unaware that their sector might be the subject of international services negotiations.

Food Distribution Service Industry Supply Chains

There is some evidence that the food distribution services industry has had a positive effect on domestic supply chains. Larger QSRs, especially in countries where agricultural tariffs make domestic products more price-competitive, report that they procure most (60 – 80 per cent) of their major perishable and non-perishable food products locally. The major exceptions are cheese and French fries. There is also evidence that non-food product and supply chains have been strengthened in the process of meeting the standards of international brands. However, in some countries where tariffs are lower, and for smaller QSRs differentiating themselves by using “higher quality” imported products, this is not so. Leading supermarkets reported that local content was generally lower (5 - 30 per cent) than major QSRs (60 – 80 percent), with proportions varying significantly depending on the marketing strategy of the firm and the policy framework of the particular CARICOM state.

As competition in food distribution services increases across the region, firms have sought to differentiate their offers. The leading food retailers in each country have improved the quality and choice of their offer to consumers by expanding their fresh, chilled, frozen portfolios. This has led to increased imports in these categories which tend not to be produced locally. The entrance of PriceSmart into the region has led to the development of several discount formats which have also sought to improve their price offer to consumers by parallel trading, purchasing from diverters, and increasing their complement of secondary and tertiary international brands. Often, this is facilitated by tariff structures in CARICOM states that focus sensitive treatment on primary production rather than value-added production. As a result, competition has led to increased imports in these product categories.

There is evidence that trade in agri-food products can be facilitated by the development of trade in services as larger QSRs and supermarkets (PriceSmart) tend to source products from preferred certified suppliers within the region for distribution to their stores across the region. Tariff structures within the CSME may also explain, in part, this preference for intra-regional sourcing.

Improving Competitiveness in Food Distribution Services

Competitiveness assessment is difficult at this point in time largely because of the unavailability of relevant data in sufficient detail. Few regional companies are publicly listed. Also, in only a few instances was it possible to come up with information on supermarket and QSR profitability.

The study uncovered constraints to improved competitiveness and trade in services, which seem to have a disproportionate impact on small and medium-sized retailers and indigenous QSR operations. There is also a dearth of market intelligence on the food distribution service in domestic markets. However, the same situation does not apply in the case of export markets. Additionally, intra-regional air and sea freight, especially in the areas of refrigerated cargo and holding facilities on the ports, limits the trade in food distribution services particularly in the start-up phases. Port inefficiencies affect efficiency in food distribution. There is need to strengthen the backward linkages to agri-food and non-food supply chains to support export growth as suppliers in new markets tend to be underdeveloped and need to be supplied from domestic markets. Crime affects the profitability of distributors, particularly in the retail sector, by restricting options for service delivery and adding costs, e.g., for security and insurance. Insufficient use is being made of electronic commerce and information technology to improve marketing, productivity and general competitiveness. The industry also lacks targeted public sector and private sector programs to improve competitiveness, especially in the areas of marketing, productivity, standardization of operations to support franchising, and human resource development. There seems to be no clear best practice franchising models that smaller firms can adopt. Industry organization as a basis for developing domestic and trade policy is minimal but there is interest from the industry to dialogue with the public sector, and this requires institutional support.

There is evidence that firms recognize these constraints. The study proposes a series of programmes to address these constraints by way of training, incentive programmes, legislative development, improvements in national telecommunications infrastructure, and additional affordable e-commerce service offerings by financial institutions. Of particular importance will be the development of backward linkages to the agriculture sector and light manufacturing through special programmes to help small farmers and processors meet volume, quality, safety, and dependability levels demanded by larger supermarkets and QSRs. Other areas of training suggested include contract negotiation and agricultural extension services.

An industry policy for food distribution services is urgently required. The study has revealed significant economic activity and export potential. However, growth prospects will be affected by the existing lack of a coordinated policy framework that is applicable throughout the CSME. The elements mentioned above are not intended to be comprehensive and other observers will no doubt identify gaps. These areas, though, did arise in the consultations conducted during the course of the study as of some immediate concern to stakeholders in the sector. In some cases, the action must emanate from the sector players themselves. In all cases, a collaborative approach involving dialogue between the private and public sectors is indispensable. Resolving these issues will equip the sector to respond better to the challenges of the negotiations on international trade in services in which the region is involved.

Negotiating Options

Services negotiations can play a role in improving the efficiency of the food distribution sector by facilitating new competition and investment in strategic areas of that sector while, at the same time, providing time for well-coordinated industry policy to strengthen the competitiveness of more sensitive sectors of the industry. Participation by the region in international services negotiations on distribution services has been minimal, influenced by the determination of officials that the sector is sensitive and would be negatively affected by new foreign entrants. Businesses in the food distribution sector do not have a uniform opinion on this matter, but there is interest in exporting services particularly in the franchising sector and also in the food retailing sector. The regulatory environment is underdeveloped in comparison with more developed economies and this is a factor restraining new services commitments. However, relatively few areas of discriminatory measures have been identified.

CARICOM countries have no existing commitments in the sector at the World Trade Organization (WTO) in Distribution Services. Only Guyana made an offer in the sector in the current Doha Development Round (DDR) negotiations. A similar low level of commitment was envisioned in the stalled Free Trade Area of the Americas (FTAA) negotiations. In contrast to the lack of international binding, the countries of CARICOM operate relatively open, non-discriminatory environments for trade in food distribution services.

With respect to future trade negotiations, care should be taken in scheduling to avoid broad commitments that would inadvertently include the food distribution sector. The private sector should encourage their governments to consider using the approach of phasing. With respect to the various elements of the food distribution sector, raw product distribution might be less sensitive than processed products distribution. CARICOM countries will find it difficult to make commitments in retailing. In franchising, there are some export interests and important penetration of the region by international franchises. Policy makers should recognize that the industries' horizons and sensitivities are likely to change over time as they develop international experience and competitiveness. The ongoing exposure of CARICOM QSRs to international marketing, operations, and benchmarking systems may indeed be one reason why these firms view themselves as more competitive and less sensitive to competition. Programmes need to be put in place to establish similar benchmarking systems which might have similar impact on the food retailing sector.

The QSR sector is the most poised to export from the region, and exports of services across the greater Caribbean region are growing. Although indigenous brands are less able to export services because of the absence of the support systems similar to those provided by the international fast food chains, several indigenous CARICOM QSRs have been and continue to experiment with exports in services to the US, EU, and as far a field as China. The region's largest catering company is already operating in 21 countries in Latin America and the greater Caribbean. In addition, several Caribbean food QSR chains owned by Caribbean expatriates are developing in the US and may soon develop franchises in the region. Food retailers tend to be focusing on the CARICOM market for the time being, largely through equity transactions rather than trade in services. However, as they gain such experience in trade within the region, they are likely to develop extra-regional trade interests. Importer/distributors are present in several CARICOM markets and a few have expressed interest in Latin American markets.

Central America and the wider Caribbean tend to be of particular interest and should be the first focus of CARICOM export-seeking strategies in future negotiations. Multilaterally, Central America (with the exception of Panama) has not made commitments in the sector.

Regionally, though, Central America and the Dominican Republic have made liberalizing commitments to the United States with respect to their laws governing distribution of goods. This changes significantly the competitive environment in Central America to the disadvantage of potential CARICOM exporters of goods and services, and might be addressed in a negotiation with Central America.

Clearly, due to the sensitivity of the food distribution sector, defensive interests will be a priority and defensive impulses enhanced by the lack of extensive export interests. Requests made by the EU in the WTO negotiations are more likely to be addressed in the Economic Partnership Agreement (EPA) framework and must be accompanied by specific CARIFORUM requests related to, *inter alia*, improving Mode 4 access, removal of sector exclusions, removal of economic needs tests, and improved cross border supply commitments. While engaging in the negotiations with Europe, CARICOM must take into consideration future negotiations with Canada and the United States in framing its commitments.

Where you have questions or comments, we encourage you to read the full report and attend the planned sector consultations. As usual, we encourage you to email us any feedback at privatesector@crnm.org.