Voluntary Chains of Retail Food Stores in Latin America

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[Methods of food retailing in many Latin American cities are disadvantageous to poor consumers, as illustrated by a survey in Cali, Colombia. Improvements could be attained by voluntary organizations of small shop owners which would provide bulk purchasing and other services for their members, but forming such organizations poses some serious problems.]

In Cali, the 1969 median family spent 66% of its income on food, and similarly high proportions are found in many developing countries. It is no wonder that food prices are a topic of great importance to populations of such countries and to their governments. When one is living close to a subsistence level a rise in food prices is felt acutely; conversely, a reduction in food prices can have a significant impact on improving the standard of life.

Diseconomies of Small-Scale Retailing

Within the last decade several studies have been made of food distribution systems in different cities of Latin America. One of the most relevant attributes of populations in these cities is access to personal transportation. Buyers can be divided into: a) those who can afford private cars or have incomes large enough to pay for transportation without difficulty; and b) those who do not, and must buy most or all of their food at stores located within walking distance of their homes. These "poor" must also buy food frequently, since people who cannot afford cars can seldom afford refrigerators or

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freezers. In Cali the "rich," who find it convenient to buy food anywhere in the community as long as roads and parking facilities are adequate, comprise about 15% of the population. The poor are served by small neighborhood stores, while the rich are served by large stores. Public markets, whose importance lies chiefly in retailing of fresh meat and produce, serve both strata; yet, as cities grow, the number of public markets does not usually increase as fast as population. [Note: For another description of the Cali food distribution system, see Development Digest, October 1970, pp. 71-79.]

**Pricing policies.** The "trading area" for the majority of consumers, i.e. the distance from which a neighborhood store can attract customers, is rather closely defined as the convenient walking distance. Competitors are the nearest similar stores, usually two to four in number. If the neighborhood store attempts to increase turnover through aggressive pricing policies, competitors will rapidly retaliate. Since foods are price-inelastic, and because lack of mobility means that additional outside customers will not be attracted into the relevant "trading area," the net result of a price decrease will be that sales in money terms will decline. The other option is to raise prices, relying on locational monopoly for protection. This strategy will drive most customers to the stores of nearby competitors. In short, the small storekeeper really has no pricing alternative but to accept the status quo. Because the stores of this type very often are extremely small, the status quo prices involve rather high margins. Although fixed costs are low, they have to be amortized over a small volume of sales.

For the store which sets out to attract customers from the rich, the "trading area" includes the entire city and thus the competition includes all large stores in the city. For meats, produce, and staples, these stores have to meet prices set in the public markets; the extra facilities and more agreeable shopping surroundings give them only a little leeway. Inter-store competition is confined largely to promotional sales of convenience and luxury foods. In Cali there was, in fact, little evidence of active competition of this type; the competitive strategy simply consists of finding a good location near a high-income neighborhood and making the store itself visible, either architecturally or through prominent signs.

The food purchases of the poor are confined almost entirely to basic foods. In contrast, the rich include in their food purchases a high proportion of luxury and convenience items, both "branded" foods and nonfoods. The term "branded" refers to goods that are highly elaborated and packaged, and that are marketed under a strategy that is based on distinctiveness of a company's product rather than price. The prices of these goods are set by manufacturers; margins, available to operators at various levels of
distribution, are generous. In contrast, prices of staple foods — such as rice, beans, and plantains — are set by an impersonal market at wholesale, and at retail level are regulated by the government. Consequently, large stores can trim down their margins on basic foods, making up the difference on branded foods, while neighborhood stores have to make their required gross margins on staples alone.

**Relations with wholesaling.** There are three principal types of wholesaler — the specialist wholesaler, the sales departments of the food processors (i.e. the distributors of branded foods), and the general wholesalers.

The specialist wholesaler typically handles one or two products, though he may also pick up the occasional truckload of different but related products "if the price is right." These specialist wholesalers work very efficiently as suppliers to stallholders in public markets. Yet, they are poorly adapted to needs of operators of small neighborhood stores because of the very narrow range of lines that each one offers, and because they will not break bulk below case or sack level. To the large stores these are not important disadvantages, but the neighborhood store operator usually has to patronize the general rather than specialist wholesalers.

The general wholesalers in Cali and Caracas were originally large traditional stores which began to be patronized by small retailers. In Caracas, general wholesalers sell almost entirely to retailers. Until 1970 the Cali central public market was also the center of food wholesaling; there, general wholesalers did about half of their trade at retail. None gave trade or volume discounts, so that retailer customers apparently paid about same prices as final consumers. The suppliers to the general wholesalers are specialist wholesalers and the sales departments of food processors or their distributors.

Almost all leading food manufacturing firms are multinationals. Their marketing strategies have been developed by long experience in North America and Europe. The most important characteristics of these strategies are that they permit volume discounts rather than trade or functional discounts, and that they involve large and active sales forces which deal with wholesalers and retailers impartially. They visit all large stores as well as a substantial proportion of neighborhood stores, preferentially selecting the larger members of this group.

Since the products manufactured by this sector are usually luxury items, they constitute only a small proportion of sales of the neighborhood stores, and of their suppliers, the general wholesalers. In Cali total sales of average large stores is approximately equal to those of average general wholesalers. Because branded goods make up a
higher proportion of sales of large stores than of the general wholesaler, large stores can buy branded goods at least as cheaply as the general wholesalers, and certainly much more cheaply than the neighborhood stores. Considering that branded goods are the high-margin items, it is evident why the poor pay higher prices for basic foods than do the rich. It is not that anyone is out to exploit the poor, nor is it part of a sinister plot to keep the poor down. It merely happens that the buying habits of the rich are such that they can be supplied with food more cheaply than the poor can.

How much more do the poor have to pay? Price data from Cali suggest that if the poor bought their food in the large stores they would save about 4% on their food bills. Such direct comparisons are open to question on the grounds of differences in quality and buying habits. Suppose a poor family in Cali suddenly became rich, started buying at supermarkets (large stores), and only changed its eating habits to the extent of consuming prime beef instead of third-quality beef. Taking into account the quality difference between the two grades of beef, food would become almost 9% cheaper, instead of the 4% quoted above.

Government Intervention in Food Distribution

With food prices in South America higher for the poor than for the rich, many governments have attempted to intervene on behalf of the poorer consumer. Typically, governments set maximum prices at which basic foodstuffs may be sold at retail. Naturally, these ceiling prices are set as low as possible "to protect the consumer." Under normal conditions of supply and demand, this provides the small retailer with only a very precarious existence.

When any commodities are in short supply, the small retailer is on the horns of a dilemma, because the wholesale price tends to approach or even to exceed the official retail price. The retailer can react in two ways. He can sell the goods at an "honest" price, which has to be higher than the regulated price; he is then guilty of "speculation" and may be fined accordingly. Or he can refuse to sell the goods, in which case he may be assumed to be guilty of "hoarding," an even more serious offense. What he cannot do is sell the goods at the regulated price, because he just does not have the financial resources to afford this. In contrast, the large stores, with their substantial sales of high-margin luxury items, can afford to sell basic goods at official prices; they will do so simply because they cannot afford the adverse publicity of being reported as having been fined for "speculating." All this further strengthens the contention that the world discriminates against the poor.
On top of all this is added the problem of chronic inflation and pressure to raise farm prices to slow down the rate of rural exodus to cities. Under these circumstances, there will be constant infringements of the price regulations, and perpetual harassment of small retailers who will be cast by the press and public relations media as the gougers and exploiters of the poor. Sooner or later the authorities will yield to the constant pressure to intervene more directly in food distribution. No matter what form it takes, the officials responsible for public food distribution are going to find their tasks frustrating and unrewarding. Dispirited and unhappy organizations rarely perform well. Consequently, the service received by the public will leave a lot to be desired.

There are several reasons for the poor results. First, administering the marketing of beans and rice is not the sort of activity which will appeal strongly to the most ambitious or best qualified civil servants. It is not professional, like the Treasury, the judiciary, or the health services, nor is it glamorous, like economic planning. The new Ministry or Directorate will have little influence at Cabinet level, and will find itself starved of both talent and funds. Second, the public takes its food supplies for granted; the officials will get little thanks for what they do right. But anything they do wrong — and they will inevitably commit their share of mistakes — will be very obvious to the public. There will be, for example, only one Director of Bean Supply: any mistakes he happens to make will result in beans either flooding the market or disappearing completely. There is a tendency to take no decisions unless the responsibility can be shifted on to someone else. Consequently, direct government intervention in urban food distribution should be avoided. Rather, governmental activities should be confined to preventing abuse of consumers and to encouraging structural improvements in marketing systems. Policing the purity of food and the honesty of weights and measures is usefully a matter for the civil authorities, and so is preventing the misuse of market power. If the private sector shows itself unable to do the job properly then, before leaping in itself, the government should first try to remove the barriers to effective performance.

The Role of Private Voluntary Chains

If the private sector wants to avoid direct government intervention in food distribution, it must vigorously try to remedy the main existing defect: the poor paying more for their food, because retailers only handle small sales volumes, buy dear, and have high operating costs per unit of sales.

The problem cannot be solved by locating large stores in poor areas, which do not have sufficient demand to support such stores. Calculations in Cali show that stores of the "superette" type, with
200 to 300 square meters of selling space, can obtain sales volumes from 8 to 18 times greater than those of even the larger existing neighborhood stores. But this sales volume will still not be great enough to permit the superettes to do advantageous buying. Some chain organization will be necessary in order to pool purchases, and to support essential advertising and promotional activities. Integrated corporate chains will not be practicable because of the difficulty of finding enough competent store managers. The alternative to integrated chains is the voluntary chain, i.e. the voluntary joining of retailers in an organization which can make bulk purchases for them and perform other functions.

Latin American precedent. In developing countries, voluntary chains can start with existing physical facilities. Therefore, relatively little capital is needed to get going. Furthermore, managerial skills and talent, which are scarce in developing countries, can be economized. At the middle management level the lack of trained branch managers can be compensated by the experience and direct financial interest of owners of retail outlets. Expertise in accounting and stock control can be readily provided by a small group of specialists at the "head office" of the voluntary chain. In short, the voluntary chain concept appears to be an excellent way of improving the performance of urban food distribution: wholesalers, retailers, and consumers all benefit, while still retaining a substantial degree of independence and flexibility.

So far, however, the considerable success that voluntary chains have enjoyed in developed countries has only sporadically been transferred to Latin America. In Costa Rica some five or six small chains are operating at a rather rudimentary level, and in Bogota, Colombia CORABASTOS is encouraging a scheme called PAN, which has some of the characteristics of a voluntary chain. Since SPAR, a major European voluntary chain, has many members in Spain and Portugal, the concept seems compatible with the Latin temperament. One can only conclude that the lack of Latin American interest in voluntary chains is due to historical accident.

In Europe and North America the centrally organized chain stores made their appearance long before the large supermarket was invented. Their retail outlets were in all respects, except for the fact of chain organization, like the existing independent stores. Yet, their ability to buy advantageously in large volume made it possible for chain stores to consistently undersell independents. Independent retailers, and even more the independent wholesalers, could quite clearly see that the advantages of chains lay in their method of organization. They concluded that some of the advantages of the chain system would have to be reproduced if their operations were to survive. Thus, the voluntary chains — including retailer-owned cooperatives — were born as a survival technique.
In Latin America the situation was completely different: the supermarket was introduced before the chain concept had become adapted. Independent supermarkets, therefore, tended to attribute their success to size, a conclusion which diverted their attention from concentrating on methods of operation. Wholesalers did not perceive the supermarkets as a threat, because rapid urban growth was increasing demand enough to compensate for trade lost to supermarkets, who buy directly from manufacturers and who tend to locate in high income areas. In short, the entrance of supermarkets did not threaten survival of traditional wholesalers and retailers. Consequently, the main motivation to associate into chains for collective action has not yet existed. Furthermore, the possibility of increased profits is not a strong motivation, because the neighborhood retailer is basically a person who makes a bare living by selling food rather than an entrepreneur. Retailers have been reluctant to take the risky step of joining an untried chain that is barely starting up.

These considerations help to explain why so far there has been little interest in voluntary chains in Latin America. But they do not explain why the few chains that have been started so often failed. At least seven factors, singly or in combination, seem to have played important roles.

1. Slow Growth: A voluntary chain of the type needed will find it difficult to survive with less than about fifty member stores. It is likely that in some cases the innovators ran out of financial reserves before the operation could grow to viable size.

2. Overselling the Concept: Voluntary chains offer many advantages in food retailing, but are not a panacea for all ills. If they have been oversold, the retailers who join will become disappointed after a few months. Many will withdraw from the scheme.

3. Credit versus Cash: Prompt payment is of great importance to voluntary buying groups if they are to buy at best terms. Unfortunately, the small retailer appears to attach great importance to being able to work on credit. Failure to overcome this mental barrier may well have caused the collapse of several embryonic chains.

4. Management Failure: Food wholesaling leaves little room for slipshod management. If a wholesaler, trusting too much in the advantages of chain organization, ignores the basics of his business he will soon be bankrupt.

5. Suspicion and Distrust: The chain concept shows how savings can be made available to the constituent wholesalers and retailers. Yet, it says nothing about how the benefits are to be shared among participants. Any retailer who does not feel he is getting a "fair share" of the benefits will soon leave the chain.
6. Lack of Communication: Misunderstandings, especially on occasions when the wholesaler fails to get the best price available, will quickly wreck the morale of the participants.

7. Dishonesty: On some occasions "chains" have been promoted by individuals whose main objective was to run away with the initial subscriptions. Memories of these will be particularly difficult to eradicate. Equally serious in its long-term effect are the wholesalers who try to exploit retailers. Although it does not constitute dishonesty in the strict legal sense, it is a betrayal of the principles of voluntary chains, which emphasize cooperation and coordination rather than strictly arm's-length dealing.

Examination of the failures shows that previous ventures failed to identify those people already active in food distribution who would be likely candidates for membership in voluntary chains; and failed to prepare those people for membership by convincing them of the advantages of chain membership, indoctrinating them in the principles of voluntary associations, and making them aware of the rights and responsibilities of participants in a chain. The preparation stage will be rather prolonged, because it is important that the principles be not merely accepted but fully "internalized," i.e. the message must be received not only by the head but by the heart. For this reason, the second stage should not be rushed.

A good part of this preparation can be carried out in the form of classes, seminars, and group discussions. Two vital steps must take place in the field: identification of likely candidates, and arousing their interest in the idea. Once interested, they can easily be persuaded to obtain an adequate understanding of the voluntary chain concept. When a sufficient number of them have been properly prepared, the starting of the chain itself basically requires only some technical and financial assistance. A chain started in this way should have a very good chance of success. Furthermore, when one or two chains are operating successfully imitators will not take long to come upon the scene.

Field work to establish chains. In 1969 there were approximately 3,500 neighborhood retailers in Cali. From among them a few hundred would have to be selected as likely prospects, whose interest in voluntary chains is to be aroused. This promotional job would require a force of about 20 workers during at least 6 months once the confidence of retailers has been gained, a process which could take a good deal longer. It is expensive and administratively challenging to get together, train, and maintain a field group of this size for an indefinite period.

The aim in forming voluntary chains is to make food available at lower prices to that part of the population which is at present being
served by food distributors who are not as efficient as they could be. Therefore, a public agency should be charged with the responsibility of encouraging formation of voluntary chains and carrying out the necessary activities related to this purpose. The obvious candidate — indeed, by law it may be the only possible candidate — will be the ministry in whose jurisdiction food distribution lies. But this agency might have been engaged for years in harassing, fining, and promoting schemes designed to eliminate small retailers. Any direct participation by personnel of this ministry in the field work would make the task extremely difficult. Therefore, participation will have to be indirect, and restricted primarily to such activities as financing, research, and coordination. The formal part of the preparatory work can be run under the auspices of suitable bodies, such as the local chambers of commerce or autonomous institutions, such as CORABASTOS in Colombia and the Instituto de Productividad (IN-PRO) in Venezuela.

The group in charge of the field work should have at least the following attributes: a) have working contacts with a substantial proportion of wholesalers and retailers in the community and, particularly, with progressive elements; b) possess enough experience in business matters to be able to recognize prospective candidates for voluntary chains; c) enjoy credibility with wholesalers and retailers; d) be sufficiently cohesive and compact to facilitate being assembled for training sessions; e) have association with successful well-managed organizations in food distribution, so that their recommendation of the voluntary chain concept would be listened to with some respect; and f) avoid direct financial interest in the proposed chains.

As it happens, the above list resembles the qualifications of the sales forces of the major food processors, and it is unlikely that any collection of similar talent could be readily duplicated within any country. Consequently, by far the most effective way of carrying out the field work would be by enlisting cooperation of sales forces of large manufacturers of products which are sold principally through food stores. But these companies are in the business of producing and selling processed food-stuffs. Why should they be concerned about voluntary chains?

The answer to the above question involves the fact that almost all the large food processors are subsidiaries of multinational companies. Since their firms are often subject to hostile scrutiny, they are under pressure to play a constructive role in activities of social importance. Cooperation with these firms would be eased by adhering to certain guidelines.

The direct costs of cooperation to the multinational firms should be small, and it would be possible to make good estimates of such costs. These costs should be reimbursed by the government, either directly or by remitting certain taxes. Therefore, out-of-pocket expense should not be a barrier to obtaining cooperation. A more difficult barrier to cooperation may come from sales managers, who will be reluctant to give up
any of their salesmen's time and who might well be distrustful of attempts to change the nature of their customers. It will take a convincing presentation of arguments in favor of cooperation to overcome this difficulty.

In the short run the existence of voluntary chains can be expected to substantially increase sales of products of the food processors. This is because reducing the prices of basic foodstuffs to people who spend about half their income on these goods creates a very large proportionate increase in discretionary income. A significant proportion of this added income will be spent on branded foods, which will then tend to become accessible luxuries. It is true that the amount spent by each family in this way will be small; but the number of families will be great. In addition to the increased plant efficiency made possible by these increased sales, significant savings will also result from the ability of the processors to deal with only a few central buying offices instead of selling to hundreds of small scattered retailers.

In the longer run, the growth of voluntary chains will dilute the concentrated market power of the principal integrated supermarket chains, which would also help the manufacturers. Due to their position as main suppliers of food to the rich, these supermarket chains now sell a far greater proportion of the total consumption of branded foods than would be suggested by their share of the total food market. In Caracas the food processors already complain that terms of sale are being dictated to them by the two or three principal supermarket chains. Since this concentration of buying power is likely to become greater, food manufacturers should be interested in helping to bring into existence other chains of food retailers before the existing ones become altogether dominant. In the long term it would surely be far better for food processors to deal with, say, 20 large items, than with 3 or 4 giants. A fundamental question remaining is whether the multinationals will have the vision to assist in the development of voluntary chains in those countries which are ready for them.