The Dynamics of Local Response

toward Agro-based Products of Retail Industry in Indones

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Introduction

The paper attempts to observethe dynamics of local response toward retail industry in Indonesia, especially on its agro-based products industry. The changing structure and behavior of players in the industry reasonably responded to its market, demand, consumer as well as policies applied by the Government of Indonesia. This particular is important considering the market is constantly getting bigger and the business environment is likely must adapt to the policies directed by the newly elected president's administration. This understanding, using literature study, leads to important challenging issues identified to be considered to as a direction of retail industry development in internationalization situation.

The nature of sizable market of agro-based products.

Indonesia is the 4th most populous nation in the world after China, India and the USA. The population number reached248.8 million people in the year of 2013 that had growth rate of 5.8% (BPS Indonesia, 2014). The nation consists of 14,000 islands in 34 provinces within area of 1,910,931.32 square kilometers.The five main cities in Indonesia are Jakarta, Bandung, Semarang, Surabaya which are all in Java island, and Medan in North Sumatera. Furthermore, the secondary cities are Makassar, Solo, Denpasar, Yogyakarta, Palembang, Pekanbaru and Samarinda in four big islands of Indonesia i.e. Java, Sumatera, Kalimantan (Borneo) and Sulawesi (Celebes).

As a tropical country, the people is heavily depending on agro-based products in their consumption, namely rice as an example of main staple carbohydrate source. The yearly demand of five basic food stuff, namely rice: 32 million ton, and 2.6 million ton of soybean, 570 thousand tons of beef, 5.7 tons of sugar, and 27 million tons of corn. The value is almost 400 trillion rupiah (40 billion US$) at its minimum prices in 2014 (Machfoedz, 2014). In 2011, food consumption was US$69.54 billion and it was predicted to rise reaching US$109.2 billion.

In 2012, GDP distribution at current prices showed that household consumption expenditures was 24.5 percent on food and 30.5 percent on non-food items whereas 2012 GDP was US$875 billion or IDR 8,241 trillion. One predicted that by 2015 the GDP per capita most likely reaching US$5,739, whereas in 2013 the GNI per capita reached US$3,580 according to World Bank (2014).Indonesian consumers market's value in total could be significant regardless its purchasing power in term of income per capita cannot be considered as high. Emerging middle class consumers as noted in USDA FAS (2013) are well educated and have a growing interest in imported goods, particularly for consumer products such as processed foods. A report by a major multinational bank indicates that Indonesia’s middle class was 1.6 million in 2004, 50 million in 2009, and was projected to reach 150 million by 2014.

Dynamics of the demand.

As cited in kaleidoscope of cultures and lifestyles, Indonesians are among the most optimistic citizens in the world with regard to their country's future, and with good reason. Having overcome a tumultuous political history, economic downturns in 1997 and 2008, as well as environmental disasters, including the devastating 2004 tsunami, Indonesia is now emerging as Southeast Asia's largest economy, under a new and strengthening democratic regime.

In recent years, food consumption patterns in Indonesia have begun to change, as populations shift away from starchy staples such as rice, and toward greater consumption of fruits, vegetables, and prepared food products. Indonesians are also showing a new interest in fortified and functional food products. Socio-demographic shifts, such as increased urbanization, coupled with economic development, are largely responsible for these important changes to the Indonesian diet. The retail landscape is also changing: significant investment is being made by large international retail players as consumers, increasingly wary of hygiene levels at local markets, turn to modern retailers, particularly mini-markets, for their grocery needs.

Consumer's demand is shaped by people's expenditure. According to BPS Indonesia (2014) the pattern of people's spending on food still took up big proportion of their monthly income, namely 45% and 59% for urban and rural people, respectively.Some 90 million Indonesians will join the consumer class by 2030—more than in any emerging nation save China and India. For consumer companies, that will mean an additional $1 trillion in annual spending by the nation’s optimistic and increasingly sophisticated consumers. Annual consumer spending in Indonesia will be rising at 5.2% growth rate projected to be US$194 billion in 2030; second to financial services (saving and investment) at US$565 billion that grows at the rate of 10.5%.

As of about brand preferences, Indonesians attach more importance to brands than do the consumers of any nation at this stage of development, including China.Sixty percent of them prefer local brands, which are particularly strong across food and beverage categories. But consumers aren't strongly aware of brand ownership, so multinationals aren't at a disadvantage, provided they can develop a brand position that resonates with local buyers. The country's Honda motorcycle subsidiary, for instance, used the Bahasa Indonesian words satu hati, or "one heart," in a successful local advertising campaign.Successful companies will increasingly need to localize products and value propositions while crafting portfolios of local and global brands. That may sometimes require partnerships with local players. Consumer seems rely on web-based information to support their decision making to buy. This is true especially for high value products in terms of financially or non-finacial one. Web-based shopping forums are proliferating, and e-commerce is taking hold. Information flow through social media in the internet is getting more and more important. Some communities are developed through this soc-med, namely the healthy concern community for their organic vegetables and fruits locally produced.

Dynamics of the supply.

Franchising has been important in retail market. In mid 1990, a local retail player, Matahari chain (PT MAP) had been significant and franchised of many foreign brand such as Sogo, Mark & Spencer, and Starbuck among many stores opened that was more than 600 stores in Indonesia. Indonesia retail market was open for foreign investment in 1998. Jakarta as a capital city was always be the main destination for foreign retail investment, which its greater area called

Jabodetabek (Jakarta, Bogor, Depok, Tangerang and Bekasi) was populated by 18 million people.

The Indonesian retail sector began its rapid expansion in 1999, when a Presidential Decree allowed Carrefour, a French retailer, to increase its outlet numbers in Jakarta. As other foreign and local retailers followed, the Indonesian retail sector grew and consumers benefited from stronger competition between retailers. Modern retail businesses such as hypermarkets, supermarkets, and mini-markets are replacing more traditional retail outlets, including wet markets and independent small grocers. Growth of these retailers includes foreign retail giants such as Carrefour, Giant, Lotte (formerly Makro), and Lion Superindo (USDA FAS, 2010).

The importance of traditional market is confirmed by the fact that in average, traditional market's supply about 78%, and it is lower in higher income segment of buyer, but higher in lower income buyers. The figure of that average is predicted to be declining reaching 57% by 2018.

Slower economic growth in 2013 leads to stagnant retail value growth. In 2013, Indonesia witnessed a slowdown in economic growth, following the fuel hike in mid-2013 and the strong depreciation of Rupiah against the US Dollar. The increase in fuel price greatly affected the living cost as well as the price of goods in Indonesia, hence raising the inflation rate. As a result, Indonesia saw diminishing purchasing power, especially for the lower-income class. Such conditions dampened the strong growth of retailing, leading to stagnant retail value growth in 2013.

Aside from that, the improved and more affordable internet access greatly supports the growing popularity of internet retailing in Indonesia. Internet access in Indonesia saw much improvement in terms of penetration during review period, starting to reach smaller cities. Improved security in online transactions helped e-commerce to see vigorous growth over the review period, benefiting from increasing consumer trust. Modern retailers saw the golden opportunity of extending their service into this particular channel, hence started to offer online services.

Entering the year 2013, both grocery and non-grocery retailers enjoy double-digit growth. The growth within grocery retailers was strongly driven by the rapid expansion of convenience stores and hypermarkets, hence generating dynamic growth. Nonetheless, the robust growth was toned down by the weak performance of traditional grocery retailers, which presence was eroded by the growing popularity of modern retailers. The non-grocery retailers, on the other hand, recorded fast growth thanks to the impressive performance of particularly electronics and appliance specialist retailers, mixed retailers, as well as leisure and personal goods retailers.

Prominent companies within retailing continued to record dynamic growth in 2013, thanks to their wider market coverage. Leading retailers, such as Hypermart and Matahari Department Store, continued to expand to smaller cities across Indonesia, establishing first-mover advantages in untapped region. On the contrary, new global retailers which just entered Indonesia's market, namely H&M and Uniqlo, opened their first stores in Jakarta, where the affluent society resides.

Retailing is to see slower yet still positive sales growth over the forecast period. After witnessing economic slowdown as a result of fuel hikes, rising electricity costs and depreciation of the Rupiah, Indonesia's economy is expected to gradually recover over the forecast period. Nonetheless, over the short-term, the economic conditions remain uncertain, given the expected political instability following the upcoming presidential election in 2014. The growth of retailing is expected to be slower due to several uncertainties, such as strong depreciation of the Rupiah and the election. However, the growth is expected to remain positive thanks to increasing consumption, expanding presence of leading brands, and when the economy stabilises.

According to Trading Economic (2014), retail sales in Indonesia increased 18.60 percent in July of 2014 over the same month in the previous year. Retail sales YoY in Indonesia averaged 12.48 Percent from 2006 until 2014, reaching an all time high of 40.30 percent in January of 2010 and a record low of -26.30 Percent in November of 2008. Retail sales YoY in Indonesia is reported by the Central Bank Indonesia.

The policy.

Several Indonesian regulations play an important role in modern retail expansion:

(1) Presidential Regulation No 111/2007 states that supermarkets smaller than 1,200 square meters and minimarkets below 400 square meters should be owned by Indonesian investors.

(2) Presidential Regulation No 112/2007 and Ministry of Trade Regulation (MOT) No. 53/2008 regulates the size, ownership and distance of new modern outlets from traditional markets. They also provide guidelines on listing fees, discounts and promotional costs.

(3) Franchise regulations on modern retail (MOT No 68/2012) limit the number of outlets owned by a retailer to 150. If a retailer already has more than 150 outlets, forty percent of the rest of the existing stores should be franchised to a third party within 5 years. The outlets are also required to sell a minimum of 80 percent of local products out of the total number of goods traded.

(4) The Empowerment and Protection of Farmer Law No. 19/2013 will limit the expansion of modern retail outlets that are not owned and or cooperate with Farmer Groups, Farmer Association, Cooperatives, and/or other Farmer Economic Institution in their Agricultural commodity production district.

Other than that, local government bodies have also limited permits for new convenience stores due to protests from traditional market retailers. They enforce zoning and operating hour rules on convenience store and minimarket franchises (Presidential Decree No 112/2007 regulates the operating hours from 10 am – 10 pm Monday to Friday and 10 am to 11 pm on Saturday and Sunday).

The latest regulation seems to put the retail investment into negative list for foreign investor. This will lead to more impottant role of local partner. Aside from that, in fact it is inevitable to admit that enforcement of food product regulations often lacks transparency and consistency. The lack of infrastructure, including, but not limited to poor port facilities, supply chain management, and cold chain facilities also creates a drag on the wider distribution of food products throughout Indonesia. This means there are rooms for engaging in retail industry and its supporting activities.

The determinants.

The near future determinant that must be considered is the changing administration in Indonesia following the success of general election in July 2014. Considering the importance of agriculture sector as a source of income generating activities in Indonesia, policy of the newly elected President gives an attention once more on issues of self-sufficiency and focuses on local products. Further elaboration of his economic agenda (Trading Economic, 2014) includes:

1. Cutting fuel subsidies to control the widening budget deficit which in 2013 accounted for 3.3 percent of GDP. In 2013, the energy subsidy cost around IDR 204 trillion (USD 17.5 billion) and according to revised budget for 2014, they are projected to reach IDR 247 trillion (USD 21 billion).

2. Infrastructure development. Jokowi pledged the construction of 2 thousand kilometers of roads nationwide, 10 new airports, 10 ports and 10 industrial estates.

3. New agricultural policies aiming at decreasing reliance on food imports and reducing poverty among farmers. Those include: improving the irrigation network, which will cover up to 3 million hectares of rice fields, 1 million hectares of it would be on outside Java and to seting up 5 thousand traditional markets as a way to support micro, small and medium business. New president also plans to set up a development and infrastructure bank to offer financing for farmers and the agricultural industry; limit plantation expansion and stop conversion of agricultural land into industry.
4. Encouraging foreign direct investment. Although, the ore export ban implemented in January of 2014, won't be removed; the new government proposes fiscal incentives for the oil and gas sector depending on the size of the project and the need of development. More importantly, President Jokowi administration intends to provide one-stop service point aiming at reducing waiting time for big business licenses from 45 to 15 days.
5. There are plans for building regional science and techno-parks, academies and vocational schools, and ban the sale of national banks to foreign investors and increase the tax to GDP ratio to 16 percent from current 12 percent.

In relation with retail industry, the latest regulation applied by the GoI as of in 2014 seems to be in line with that spirit, which oblige modern retail to absorp more local produce in their store up to 80% in addition to build strong partnership with local players. Moreover, local players in modern retail attempt to fulfill the growing segment of middle class reveals to be proliferated.

On the consumer side, issues of food quality, nutrition, and safety, especially halalness, in agro-based products of retail industry will continuesly rising in line with the emerging size of middle class in Indonesia. Despite the still favorable traditional retail market for consumers, the modern retail will take over significant proportion of the market with even faster rate of increase. Consumer preferences toward higher quality of fruits and vegetables leads to more room for premium quality imported ones. Consumer prefer local products only if the quality is satisfying.

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