Executive Insights

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Foodservice Underserviced: Unlocking Growth Opportunities for Grocery Retailers in Southeast Asia

Khun Pimolpa runs a fusion Thai-Italian cuisine restaurant in the Sukhumvit district of Bangkok. Business has been good for her over the past decade, as she has been able to increase sales by 4-5% annually, an upward trend that has been benefiting the rest of the Thai food service industry. Despite the surge in income, Khun Pimolpa is tired — she starts the day at 5 a.m. and does not finish till 11 p.m. Aside from the everyday operation of her outlet, she also spends a significant amount of time and effort sourcing inputs — fresh meats and vegetables at the wet market, dry groceries at the Big C hypermarket — and purchasing emergency supplies from the 7-Eleven convenience store next door.

At the same time, the Big C hypermarket that she visits is also struggling. Like-for-like sales at Big C have been under pressure in the past few years due to intense competition from new stores and new variations of store formats, combined with a sluggish economy overall.

Khun Pimolpa's story is not the only one of its kind. Across Southeast Asia, similar stories can be heard in various parts of the region, where grocery retailers are experiencing slowing sales growth. However, a key customer segment — small and medium-sized foodservice operators — remains underserved.

Growth in the foodservice industry

Favorable trends such as rising income levels and urbanization are supporting the growth of "eating out" across Southeast Asia. In countries like Malaysia, Indonesia, the Philippines and Vietnam, growing populations and demographics (the young are more likely to dine out than older individuals) are further boosting demand. Consumer expenditure at foodservice outlets has grown by 8% annually in the six large Southeast Asian countries over the past decade, to close to US$ 120 billion today. It is estimated that 20,000 new food outlets open across the region every year.

Foodservice Underserviced: Unlocking Growth Opportunities for Grocery Retailers in Southeast Asia was written by **Manas Tamotia** and **Maria Steingoltz**, Managing Directors in L.E.K. Consulting's Singapore and Chicago offices respectively. They were supported by **Chandrakant Kanoria**, Consultant, and **Punda Sirivongse**, Associate, in Singapore also contributed to this article.

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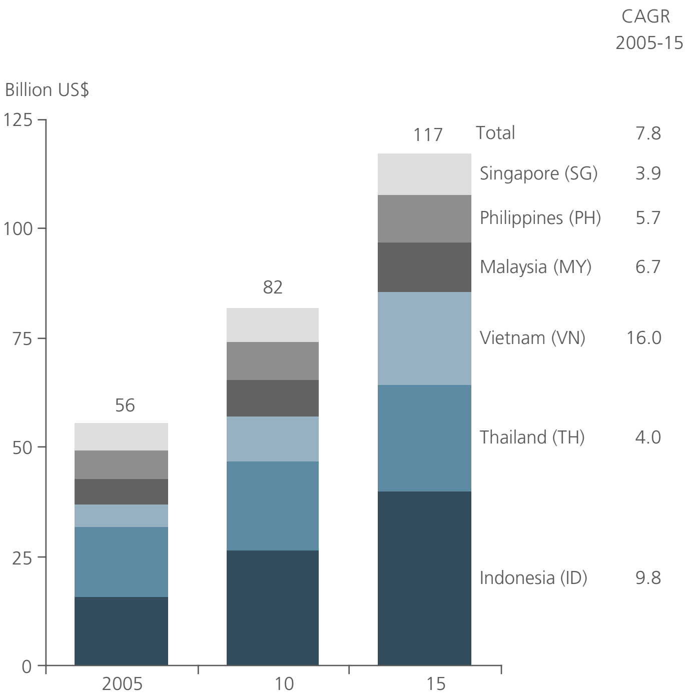
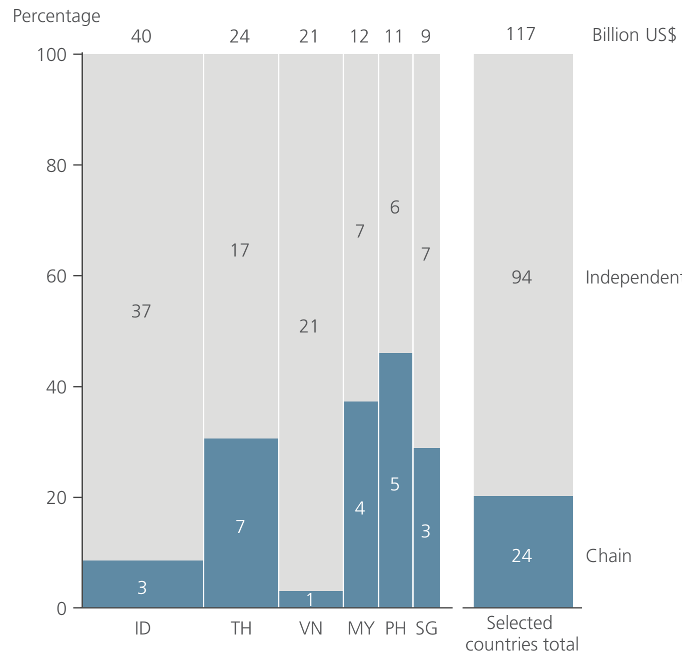
Figure 1
Consumer foodservice market value in selected Southeast Asian countries (2005-15)



Note: Nominal values, fixed 2014 exchange rate
Source: Euromonitor

Figure 2
Consumer foodservice market value by outlet type in selected Southeast Asian countries (2015)



In these six countries, nearly 80% or US$ 90 billion is spent at independent outlets as opposed to fast food or restaurant chains. We estimate that independent foodservice operators in Southeast Asia spend approximately US$ 36 billion on inputs and food supplies every year.

Foodservice customers are underserved

Yet the foodservice industry suffers from insufficient coverage by suppliers, distributors and retailers alike. A significant proportion of operators, primarily the small independent outlets, rely on traditional markets to meet many of their needs, particularly in fresh food. Consistent with Khun Pimolpa's experience, they are forced to purchase from many different channels, making the process of running a business all the more difficult.

The high level of fragmentation is a key reason for the lack of service, where many independent outlets are too small to be served profitably by food distributors or retailers. Lack of infrastructure at these locations (e.g., appropriate cold storage facilities) makes more frequent deliveries important and further affects the cost to serve. Often, restaurants and cafés require customizations such as specific cuts of meat that are hard to meet for grocery chains that thrive on economies of scale.

Many restaurateurs also find fresh food at retailers not particularly "fresh" given their global sourcing and complex supply chains. More often than not, the process involves distribution centers and a significant time lag between when the food leaves the farm and when it arrives at the store.

Retail models to exploit the foodservice opportunity

Currently, we see the rise of new models emerging across Southeast Asia for grocery retailers to capture a greater share of foodservice expenditure. The level of changes to the business model, organization and capabilities required will differ based on the scale of the retailer's ambitions in this untapped market.

1. SME-focused cash-and-carry formats

Tweaking the current hypermarket model to develop a more cash-and-carry type of model would provide restaurants the opportunity to buy in bulk, thereby realizing per-unit cost savings. An additional need for small businesses is often working capital, and there may be a scope for retailers to offer some form of credit to customers. The cash-and-carry model is already seeing significant traction in the region, with Indonesian sales in cash-and-carry and wholesale clubs forecast to increase by 50% annually between 2015 and 2020.[1]

[1] Planet Retail, "Asian Regional Overview 2016", September 2016

Advantages:

- Requires minimal change to current business model and organization
- Leverages existing footprint, supply chain and brand assets

Disadvantages:

- Necessitates building new capabilities such as risk management of credit facilities
- Meets only a narrow section of the foodservice industry's unmet needs (e.g., continued lack of a credible fresh food offering)
- Potentially will require space reconfiguration and facilities to better cater to bulk purchasing

Example

Makro was first established in Thailand as a chain of cash-and-carry stores, targeting small and medium-sized enterprises. Makro operates 108 stores as of 2016 in Thailand, with THB 156 billion/US$ 4.4 billion in annual revenue.

Twenty-three of its stores have been branded as Makro Foodservice outlets. The company recognized the growing revenue contribution from its hotel, restaurant and café (HORECA) customers and has introduced the new format, which continues to sell at bulk quantities on credit. However, improvements have been made to the product range to suit the needs of the HORECA customers. Unlike Makro's usual stores, Makro Foodservice outlets only sell food-related products with specialized services. Makro Foodservice stores offer extra services such as meat cutting and trimming, and quality screening for vegetables and fruit, in order to reduce the need for restaurant operators to buy from multiple suppliers. By streamlining the operation process, Makro manages to increase efficiency and productivity for restaurant owners.

2. Delivery services

Lack of delivery services is another critical pain point for foodservice customers. Delivery service could provide retailers with an opportunity to capture incremental share of wallet, by offering products that the business is purchasing either from a traditional market or from a nearby convenience store. Moreover, delivery encourages customer stickiness and lower price sensitivity due to the added convenience factor.

While delivery services are not core to the typical modern retailing format, modern retailers are being challenged with the development of e-commerce and mobile commerce, with several startups experimenting with local delivery services. For example, Hypermart, a leading Indonesian grocery chain, has launched an online store with delivery across the country, hereby directly addressing Indonesia's infrastructure problem, which can lead to difficulty in obtaining supplies. Additionally, new service providers such as grocery delivery startup Honestbee are working with retailers such as Carrefour Indonesia to offer same-day delivery in selected cities at minimal or no charge to the consumers. The development of delivery capabilities can be used to cultivate a potentially lucrative revenue stream.

Advantages:

- Addresses key customer pain point: delivery
- Increases customer stickiness and enables pricing power

Disadvantages:

- Costs and capabilities required to build delivery and customization infrastructure
- Certain foodservice customer needs (e.g., freshness of food) still unmet

3. Local sourcing

The third, and perhaps the most challenging, modification that a retailer could consider is to reimagine the way it manages its supply chain. Currently, most large and modern retailers with hypermarket, supermarket or convenience store networks adopt a central warehouse-focused distribution system. Under this model, all products converge at distribution centers before being sent out to local stores, which streamlines processes and lowers costs for the retailers. While the distribution warehouse-centric model works for most packaged food and general merchandise, it is suboptimal for fresh food. The lack of freshness is an important issue for foodservice outlets, as it directly affects the quality of their food.

To overcome the issue, retailers could consider sourcing fresh food from local suppliers.

Advantages:

- Fresher food that attracts restaurant owners
- Product offerings in line with local tastes
- The ability to clearly communicate food origin to consumers

Disadvantages:

- Higher costs of local rather than national/regional sourcing
- More limited product variety
- Less standardization of products across stores

Example

TF Valuemart is a Malaysian hypermarket chain operator with 20 stores as of December 2016 in Peninsula Malaysia. The company differentiates itself in a tough retailing environment by concentrating on smaller tier-two and tier-three cities where wet markets are often their key competitors, and by focusing on locally procured fresh food. It enjoys very high fresh food sales relative to other hypermarkets in the country and sees significantly higher margins. The fresh foods that are placed on offer also drive traffic into other dry grocery categories.

Ultimately, none of the above solutions would provide an end to roadblocks or issues for retailers, but they also are not mutually exclusive. A retailer that is serious about gaining share in an oft-neglected but sizeable market could adapt and innovate the existing format and product offering, and come up with variations of services to effectively integrate all of the models, borrowing from each one's advantageous points. The most important step of all, however, is for retailers to recognize and understand the depth of the untapped potential that lies within the independent foodservice operator industry.

About the Authors

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